HARMONY FUNDS
Multi Manager, Multi Asset Class Solutions

momentum

Harmony Portfolios
Quarterly Report

31 March 2014

Q1

Momentum Global Investment Management (Company Registration No. 3733094) has its registered office at 62 Queen Street, London, EC4R 1EB.

HARMONY FUNDS
Multi Manager, Multi Asset Class Solutions

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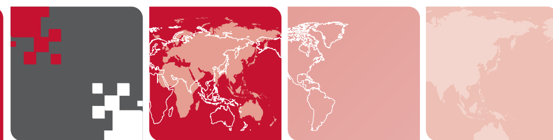
1. Portfolio objectives and overview

The eight Harmony Portfolios are offered via single priced Funds, providing a cutting edge solution for investors with efficient management, improved client administration and enhanced liquidity. The eight profiles are US Dollar Balanced, US Dollar Growth, Euro Balanced, Sterling Balanced, Sterling Growth, Asian Balanced, Asian Growth and Australian Dollar Growth. With eight bespoke Funds to choose from, the individual needs of each client can be provided for via a combination of one or more of these core solutions, together with selected satellite funds at a client level.

Each Harmony Fund offers a well-diversified solution, with exposure to seven key asset classes: cash, investment grade fixed income (bonds), alternative fixed income (emerging market debt and high yield bonds), equities (shares), alternatives (funds of hedge funds), commodities and property. The portfolios are diversified by asset class, currency, regional equity exposure, manager and style in order to provide sustainable returns and reduced volatility. Many of the managers are inaccessible to the retail market and all are appointed at a highly competitive fee level.

The portfolios are managed by a team of experienced investment professionals at Momentum Global Investment Management, authorised and regulated by the Financial Conduct Authority in the UK and is an authorised Financial Services Provider in South Africa in terms of the Financial Advisory and Intermediary Services Act 2002 (FAIS). Investors can be confident that their portfolios are being managed within a strictly regulated environment by a well qualified and experienced team with significant resources spent on manager research across the globe. Momentum Global Investment Management is wholly owned by MMI Holdings in South Africa.

The Harmony Investment Committee is in regular contact with the team in London and this ensures that the construction of the Harmony Funds is a two way process. Any comments from clients and advisers can therefore be fed through to the portfolios if deemed appropriate.



2. Portfolio commentary

The Harmony Fund range is designed to provide investors with a balance between the stability of bond returns and the potential for significant participation in equity market strength. The Funds have either a 'Balanced' or a 'Growth' profile, with the latter having a greater exposure to the equity market. On a through-the-cycle basis the Funds will have the majorioty of assets invested in their 'home' region with the balance invested in global assets. The particular weight will depend on the manager's view on relative valuation opportunities. These Funds will use asset allocation on a tactical basis to take advantage of valuation opportunities in the markets.

Year to date we have been active with the fixed income allocation of the Harmony Funds, electing to sell our high yield exposure. This is because we believe that this asset class has reached, and indeed exceeded, fair value. From today's valuation level the potential upside is limited and there is a risk of capital loss. This is a position that has been central to the Funds' fixed income allocation for a number of years post the global financial crisis. The trade has been a very profitable one for the range as prices of high yield debt were exceptionally cheap in the aftermath of the crisis. The proceeds of the sales have been used to augment our positions in emerging market debt and convertible bonds: areas of the fixed income market where we still see good value.

The Funds remains neutral to equity markets, with an overweight to emerging market stocks. Furthermore, the Funds remains underweight to local and global government paper. This is because on a long term view we do not see compelling valuations available in this area of the fixed income markets. Indeed, barring significant global shocks the upside from sovereign debt is expected to be muted, making the risk-return trade-off unattractive in anything but a significant 'double dip' scenario.

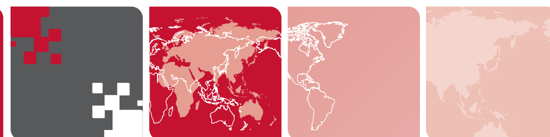
Going forward, while there is greater optimism around the outlook for growth in the developed world, this brings with it the increased chance of tightening credit conditions as these economies recover. This could have unintended consequences for investment markets and as a result we believe that investors should look to retain a prudent level of diversification in their portfolios. Overall, we believe that the Funds are well positioned to take advantage of future opportunities in the markets as they present themselves. Recent geopolitical events involving Russia and Ukraine serve as a salutary reminder that while we are constructive on the prospects for the market over the medium to long term, the Funds will be tested by unpredictable shocks from time to time. As a result, it is important to retain an appropriate level of diversification in the portfolio to help to mitigate the impact of these sorts of events.

While it is uncomfortable at the time, volatility provides valuation opportunities for disciplined investors and our overweight to cash provides a ready source of liquidity which can be invested in opportunities as and when they arise.

From a manager selection perspective, RWC Asian Convertibles, which is held across the range, delivered a return of -0.3% in US dollar terms during March, to bring its first quarter return to 0.7%. This compares to Asian equities (as measured by the MSCI All Countries Asia ex Japan index) which returned 1.0% and -0.7% over these respective periods. Convertible bonds offer a reasonable degree of equity exposure, combined with the protection of a so-called 'bond-floor'. The asset class has performed well through the business cycles of the past decade, beating global equities and delivering returns similar to Asian equities but with much lower volatility. The strategy has performed very well over the past twelve months with a return of 6.6%, outperforming Asian equities by almost 4% with considerably lower volatility. The portfolio consists of around 60-80 holdings and is managed by a four-person investment team in London, led by Davide Basile. The objective of the strategy is to take advantage of the opportunities presented by corporates in Asia that issue convertible bonds. Asia's convertible bond market is growing both in absolute terms and as a proportion of the global market, creating further investment opportunities. Nonetheless, the manager is offering limited capacity in this strategy so that smaller issues can continue to have a meaningful impact on performance. We have increased exposure to this strategy in recent months, in part as an additional way to access the increasingly attractive valuations available in emerging market assets.

We began introducing American Century to the Funds in January. American Century is a multi-discipline, independently owned investment management business that offers a wide range of strategies run by specialist teams. American Century run a concentrated, unconstrained global growth strategy focusing on businesses displaying accelerating earnings growth. The strategy is managed by a New York-based investment team, consisting of two co-portfolio managers and supported by seven global sector analysts. They sit within a larger team in New York that consists of portfolio managers and analysts that focus on International strategies across various market cap segments. This gives the global team access to a wide range of ideas and insights. We believe this growth orientated strategy will deliver long term outperformance versus global equity indices, whilst also complementing our existing global equity holdings by improving style diversification.

Source: Bloomberg / Morningstar. Returns in US dollars unless otherwise stated, March 2014. Past performance is not indicative of future returns.



3. Recent portfolio activity and positioning

During the fourth quarter the following changes were made to the funds:

- Sold explicit high yield positions on valuation grounds.
- Continued to build our positions in the Pacific Assets Trust, at a price that represented a healthy discount to the underlying net asset value of the portfolio. Since July 2010 the Trust has been managed by the specialist Asian equity team at First State Stewart, with the lead manager, David Gait, based in Edinburgh and supported by a large team including analysts in Singapore and Hong Kong. As with all strategies managed by this team, they invest with a quality-value style, aiming to identify high quality businesses with sustainable and predictable growth and available to buy at attractive valuations.
- Increased exposure to Asian convertibles across the Harmony range.
- Divested from remaining 'lookthrough' high yield positions at the end of the quarter, by exiting Jupiter Dynamic Bond.
- Increased corporate bond exposure at the end of the quarter on valuation grounds.

Increased

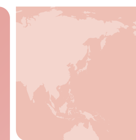
- Asian convertibles
- Corporate bonds
- Pacific Asset Trust in the Harmony Asian Funds

Decreased

- High yield
- Managers with a high sensitivity to high yield bonds

Manager changes during the quarter:

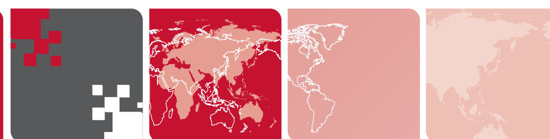
- Sold Muzinich Short Duration High Yield having previously moved to reduce the interest rate sensitivity of the Funds by holding shoter duration high yield debt.
- Vulcan was added to the Harmony US Dollar Funds during the quarter, to complement our existing manager blend. Vulcan Value Partners is a boutique investment management business, based in Birmingham, Alabama, running concentrated US equity strategies that adhere to one consistent investment philosophy. The highly experienced investment team invest with a disciplined, benchmark-agnostic approach. The businesses they invest in must have deep 'moats' that lead to high rates of free cash flow conversion and the ability to generate dependable cash flows over the next five years.
- Sold Jupiter Dynamic Bond on the basis of its continued high allocation to high yield debt.



4. Target portfolios

	Balanced	Growth
Equities	43.0%	68.0%
Fixed Income	32.0%	18.0%
Property	7.0%	7.0%
Cash	18.0%	7.0%
Total	**100.0%**	**100.0%**

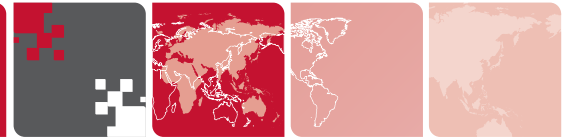
These target weights are correct as at the time this report is published and are indicative of the managers' medium term outlook for markets, which is driven principally by their assessment of relative valuation opportunities. The property exposure includes exposure to listed infrastructure.



5. Fund and peer group performance

	Performance to 31 March 2014			
Fund returns (local currency)	**3 months**	**6 months**	**2013**	**3 Years** (annualised)
Asian Balanced (US dollars)	0.2%	1.2%	2.5%	0.9%
Peer group median	0.4%	3.8%	7.4%	2.0%
Asian Growth (US dollars)	0.1%	1.8%	6.2%	2.6%
Peer group median	0.3%	3.5%	7.4%	1.8%
Global equities	1.1%	8.5%	22.8%	8.6%
MSCI AC Asia Pacific ex Japan	1.0%	3.3%	3.4%	1.9%
AUD Growth	0.0%	4.3%	17.1%	6.8%
Peer group median	-0.3%	4.1%	17.3%	6.3%
Global equities	-2.3%	9.7%	43.2%	13.1%
ASX All Ordinaries	2.2%	5.7%	19.7%	7.7%
EUR Balanced	0.9%	2.6%	7.8%	4.9%
Peer group median	1.4%	3.6%	4.8%	3.3%
Global equities	1.1%	6.5%	17.5%	9.6%
MSCI Europe ex UK	3.5%	9.9%	22.1%	9.1%
GBP Balanced	0.4%	2.5%	10.6%	4.9%
Peer group median	0.3%	2.9%	9.9%	3.9%
GBP Growth	0.5%	4.2%	16.9%	7.2%
Peer group median	0.2%	2.8%	10.3%	4.1%
Global equities	0.4%	5.4%	20.5%	7.2%
MSCI UK	-1.5%	3.5%	18.5%	7.6%
USD Balanced	0.0%	2.8%	10.6%	4.9%
Peer group median	1.4%	5.6%	11.2%	5.3%
USD Growth	-0.2%	4.1%	17.6%	7.7%
Peer group median	1.4%	6.2%	13.3%	5.8%
Global equities	1.1%	8.5%	22.8%	8.6%
S&P 500	1.8%	12.5%	32.4%	14.7%

Source: Bloomberg, March 2014. Past performance is not indicative of future returns.

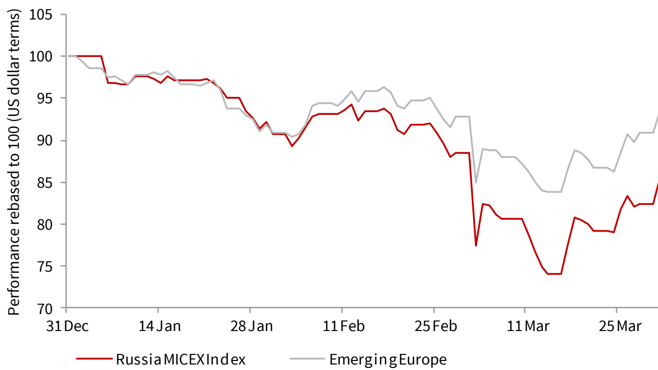


6. Market commentary

Global equities added 1.3% in the first quarter, led by Continental Europe with gains of 3.5% in euro terms. Japan was the main laggard, as the Topix index fell by 6.7% in yen terms, reversing a portion of 2013's significant outperformance prompted by the Bank of Japan's extraordinary monetary easing. In the US, the bellwether S&P 500 index returned 1.7% over the quarter (including reinvested dividends) having been down by as much as 5.7% at the end of January.

Emerging markets underperformed their developed counterparts for the fifth quarter in a row, after falling by 0.4%, although performance began to improve in the latter part of the quarter. Emerging Europe fell by 6.5%, after Russia fell by 9.0% in ruble terms. Emerging Latin American stocks managed to deliver modest positive returns of 0.3% in US dollar terms (-1.8% in local currency terms), led by Colombia (5.6% in peso terms).

Figure 1: Russian equities drag Emerging Europe down



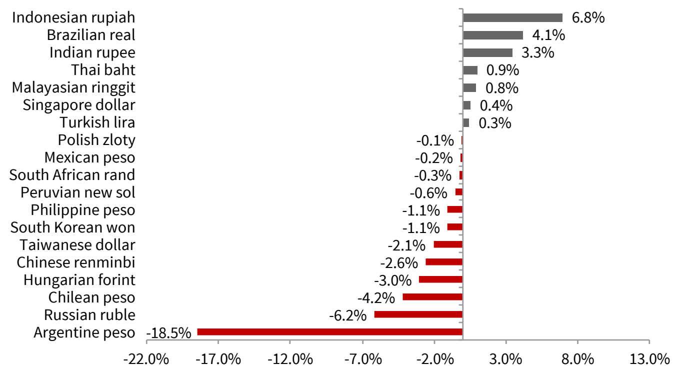
In fixed income markets, the majority of sectors produced positive returns in the first quarter, with global government bonds rallying by 2.7%; the first time government bonds have outperformed equities since Q2 2012. US Treasuries returned 1.6% as the US yield curve flattened, with yields on 10 year US Treasuries falling by 32 basis points to 2.7%. Corporate credit and high yield continued to rally on the back of strong demand from investors, with high yield bonds in the US returning 3.0%. European government bonds outperformed as yields moved in significantly, with Italian 10 year yields falling to nine year lows at 3.3%.

Elsewhere, global property securities added 3.5% after the MSCI US REIT index rallied by 9.7%. Commodities were also strong, with agricultural commodities rising by 12.3% in US dollar terms and by 7.2% in February alone. Finally, gold rebounded from 1,200 dollars per ounce to end the quarter at 1,284, despite high intra-period volatility.

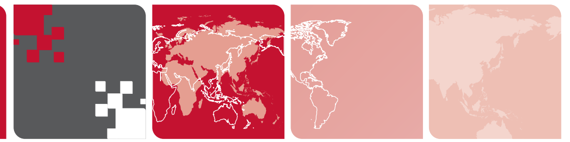
Uncertainty duly returned to markets at the start of 2014, with realised volatility (daily data, annualised) rising to 14.3% in the first quarter compared to 13.2% over the previous 12 months. Many pundits had entered the new year forecasting a continuation of the strong performance from developed market equities and poor performance from bonds. In reality, the reverse materialised. Equity markets suffered their worst start to a calendar year in five years, with the MSCI World index declining by 3.7% in
January and the MSCI Global Emerging Markets index down by 6.5% (with Latin America falling by almost 10%). As equities suffered, traditional safe haven government bonds instead rallied. 10 year Treasuries, which ended 2013 with yields of over 3%, saw yields fall back to 2.7%, despite the decision by the US Federal Reserve to continue tapering its asset purchase programme.

Emerging market currencies sold off in January, as investors reacted to the prospect of a reduction in dollar liquidity. The South African rand depreciated by 5.5% versus the US dollar (Turkish lira -4.8%; Russian rouble -6.5%), while in Argentina the central bank took the decision to devalue the currency by the biggest amount in 12 years, as its foreign exchange reserves continued to decline.

Figure 2: EM currencies under pressure at the start of 2014(returns versus USD)



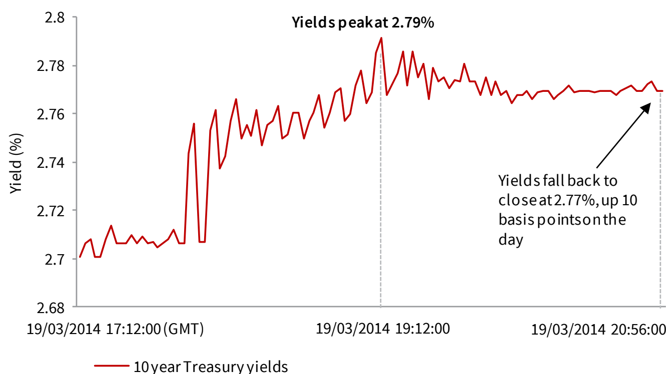
Equity markets subsequently regained January's lost ground at the start of February, with the S&P 500 closing at record highs on consecutive days. Events at the end of the month served to halt the recovery, however, as the political situation in Ukraine deteriorated. The overthrow of Ukraine's President and emergence of a new caretaker, pro-west government, led to an immediate and powerful response from Russia, with troops moving into the Crimea region. Crimea is of large strategic significance to Russia, providing it with one of only two warm water, year-round ports as well as access to oceans otherwise a long way from Russia's Arctic ports.



Russia moved swiftly to annex Crimea in the early part of March. So far the West has been unwilling to take action, beyond imposing sanctions upon key Russian individuals. As March progressed the crisis began to ease and investors shrugged off their earlier fears. Equity markets overcame a nervous start to the month to finish in positive territory: MSCI World +0.1%, the US +0.8% and Pacific ex Japan +1.8%. Arguably the biggest surprise was the outperformance of emerging markets (EM), with the MSCI Emerging Markets index adding 3.1% in US dollar terms as EM markets and currencies rallied (+1.9% in local currency terms).

Janet Yellen's first FOMC meeting as Chair saw the central bank continue to trim its quantitative easing programme in line with market expectations. What was not expected, however, was an upward shift in committee members' interest rate expectations and an implied earlier start date to the first interest rate rise. In her first press conference as Chair, Yellen failed to allay investor fears about the outlook for monetary policy, suggesting that the first rate rise could come as soon as six months after asset purchases end, ahead of consensus expectations. Markets reacted by pushing yields on longer dated government bonds higher, although subsequent remarks from various members of the FOMC served to play down these fears.

Figure 3: US Treasury yields spike upwards in response to the FOMC's statement



In China, the country's authorities are wrestling with the challenge of reining in an unsustainable credit expansion without triggering a credit crisis. They have also begun to liberalise interest rate and currency markets; a process likely to take several years. During March, Beijing elected to increase the daily trading band of the currency to 2% from 1% previously. In practice this is now sufficiently wide to ensure that, if the authorities permit it, the currency can be determined predominantly by market forces at least on a daily basis. China's authorities also chose to allow the first ever onshore corporate bond default by a Chinese borrower during March. While small at USD 160 million, it was the message conveyed and not the size of the default that mattered and further defaults can now be expected.

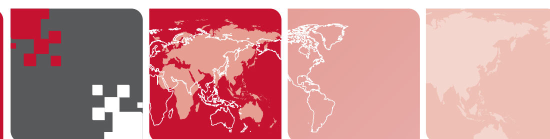
This attempt to simultaneously (i) rein-in credit; (ii) liberalise key markets; (iii) maintain growth at 7.5%, gives rise to the potential for a policy misstep. Forward indicators suggest that growth in China will be relatively sluggish (relative to the country's recent history), although this may prompt the administration to do more to stimulate the economy.

Gauging the health of the US economy was difficult over the first quarter due to the recent, prolonged bout of extreme cold weather. In Europe, the European Central Bank kept interest rates on hold having cut the Main Refinancing Rate to 0.25% back in November, while suggesting that both inflation and the appreciation of the euro are causes for concern, opening the door up to further unorthodox measures. Low levels of inflation globally are giving central banks room to maintain a very loose monetary policy for a considerable time without the fear of triggering an inflationary surge.

Japan's setback at the start of 2014 appears to be a function of fears over the rise in the sales tax rate and some disappointment with the third leg of Prime Minister Abe's reforms. Corporate profit growth, however, remains healthy and Japanese valuations offer room for a rerating versus the rest of the world.

Against this mixed background, markets have begun the year in cautious fashion, although early signs of improving sentiment towards EM assets offer cause for optimism. Given the apparent risks on the horizon – notably the impact of tapering in the US and the dangers of a policy misstep in China – a degree of caution remains appropriate at the start of the second quarter.

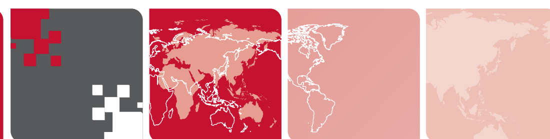
Source: Bloomberg, March 2014. Returns in US dollars unless otherwise stated.



7. Market Summary

Asset Class/Region	Index	To 31 March 2014		
		Currency	Quarter	12 Months
Developed markets equities				
United States	S&P 500 NR	**USD**	1.7%	21.1%*
United Kingdom	MSCI UK NR	**GBP**	-1.5%	6.4%
Continental Europe	MSCI Europe ex UK NR	**EUR**	3.5%	19.7%
Japan	Topix TR	**JPY**	-6.7%*	18.6%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	1.0%	2.4%
Global	MSCI World NR	**USD**	1.3%	19.1%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	**USD**	-6.5%	-8.3%
Emerging Asia	MSCI EM Asia NR	**USD**	-0.3%	3.1%
Emerging Latin America	MSCI EM Latin America NR	**USD**	0.3%	-13.8%
BRICs	MSCI BRIC NR	**USD**	-2.9%	-3.5%
Global emerging markets	MSCI EM (Emerging Markets) NR	**USD**	-0.4%	-1.4%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	1.6%	-1.6%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	**USD**	2.2%	-6.8%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	2.9%	1.5%*
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	3.0%	7.5%*
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	**GBP**	2.4%	-2.6%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	**GBP**	2.5%	1.6%*
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	3.8%	5.7%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	2.4%	4.2%*
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	**EUR**	3.0%	19.9%*
Japanese Government	JP Morgan Japan Government Bond Index TR	**JPY**	0.8%	0.5%
Australian Government	JP Morgan Australia GBI TR	**AUD**	1.2%	1.3%
Global Government Bonds	JP Morgan Global GBI	**USD**	2.7%	0.9%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**USD**	2.5%	2.4%
Global Convertible Bonds	UBS Global Focus Convertible Bond	**USD**	3.7%	14.9%
Emerging Market Bonds	JP Morgan EMBI+	**USD**	3.5%	-1.9%*

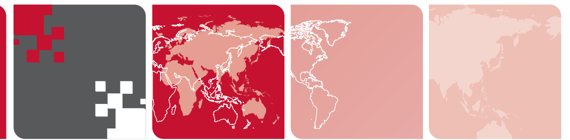
Source: Bloomberg, March 2014.



Asset Class/Region	Index	To 31 March 2014		
		Currency	Quarter	12 Months
Property				
US Property Securities	MSCI US REIT NR	**USD**	9.7%	3.0%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	**AUD**	2.1%	-0.8%*
Asia Property Securities	S&P Asia Property 40 Index NR	**USD**	-6.2%	-5.4%
Global Property Securities	S&P Global Property USD TR	**USD**	3.5%	0.8%
Currencies				
Euro		**USD**	0.2%	7.4%
UK Pound Sterling		**USD**	0.6%	9.6%
Japanese Yen		**USD**	2.0%	-8.7%
Australian Dollar		**USD**	3.9%	-11.1%
South African Rand		**USD**	-0.3%	-12.3%
Commodities & Alternatives				
Commodities	RICI TR	**USD**	4.9%	0.0%*
Agricultural Commodities	RICI Agriculture TR	**USD**	12.3%	1.4%*
Oil	ICE Crude Oil CR	**USD**	-3.2%	-1.4%*
Gold	Gold Spot	**USD**	6.5%	-19.7%
Hedge funds	HFRX Global Hedge Fund	**USD**	1.1%	4.6%*
Funds of hedge funds	Dow Jones Credit Suisse Hedge Fund USD	**USD**	0.9%	7.0%

** Estimate*

Source: Bloomberg, March 2014.



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Under our multi-management arrangements, we selectively appoint underlying sub-investment managers and funds to actively manage underlying asset holdings in the pursuit of achieving mandated performance objectives. Annual investment management fees are payable both to the multimanager and the manager of the underlying assets at rates contained in the offering documents of the relevant portfolios (and may involve performance fees where expressly indicated therein).

Momentum Global Investment Management (Company Registration No. 3733094) has its registered office at 62 Queen Street, London, EC4R 1EB.

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