HARMONY FUNDS
Multi Manager, Multi Asset Class Solutions

momentum

Harmony Portfolios

Quarterly Report

30 June 2016

Q2

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

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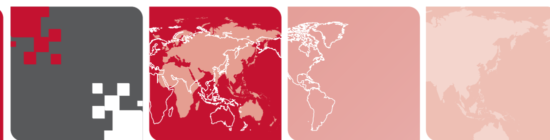
1. Portfolio Objectives and Overview

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

Global equities have returned 1.2% in local currency terms over the past three months. The performances of the major components of the MSCI World index varied significantly during the quarter: the UK and the US posted positive returns of 6.7% and 2.4%, whilst Continental Europe and Japan fell by -1.1% and -7.8% respectively. The MSCI Emerging Markets index gained 0.7% in US dollar terms. Meanwhile global bonds added 2.5%. Government and corporate bonds posted sizeable gains across most major regions. UK Gilts and hard currency emerging market bonds led the way with gains of 6.6% and 6.0% respectively. US high yield bonds gained 5.9% while European high yield bonds rose 2.0%. Currency movements made a meaningful impact to returns during the quarter, driven by volatility after the UK's EU referendum vote. Considering moves versus the US dollar the yen was very strong, gaining 9.6%, whilst the pound depreciated by 7.0%. Gold continued its strong run, up 6.8% over the quarter and 24.3% year to date in US dollar terms, whilst the broad commodities index gained 12.7% for the three month period.

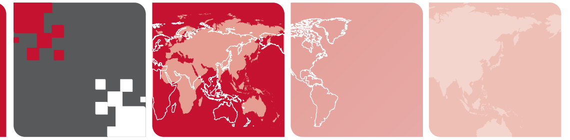
Against this backdrop the Harmony funds performed well over the quarter. The Asian Balanced and Asian Growth funds made modest gains of +0.4% to +0.3% in US dollar terms, whilst the Europe Diversified fund also gained 0.4% in euro terms. The US Dollar Balanced and US Dollar Growth funds returned 1.0% and 0.7% respectively in their base currency. The Australian Dollar Growth fund was up 3.6%. The Sterling funds were the best performers for the quarter despite the shock referendum result; Harmony Sterling Balanced was up 4.0% and Growth up 4.1% in sterling terms. The Sterling and Australian Dollar funds all benefited from weakness in their base currencies, which was a tailwind for performance of their overseas holdings and highlighted the benefits of this diversification. The UK market performed well post the sharp fall in the pound, reflecting the fact that the majority of sales for the largest index constituents are foreign currency denominated.

Considering performance drivers over the quarter, although the funds had no exposure to developed market government bonds (except for a small holding in the Australian Dollar Growth fund), holdings in other fixed income asset classes where we see better valuations performed almost as well. These include US high yield and hard currency emerging market debt, which represent meaningful positions across all the funds, as well as US and UK investment grade corporate bonds. The more interest rate sensitive areas of the equity markets also performed well, reflecting the fall in bond yields over the period, leading to strong performance contributions from listed infrastructure and real estate holdings across the funds. The rising gold price also supported our small holdings in the iShares Gold Producers ETF, which for the second quarter in a row was the best performing holding across the funds, gaining 35% in US dollar terms. The Kopernik Global Equity fund, which is held across all the Harmony funds, also benefited from the strong performance of gold producers, leading to outperformance of almost 20% versus the MSCI World index.

Equity manager selection detracted from performance across the funds with several of our holdings underperforming their benchmarks slightly over the quarter. However, such benchmark comparisons are misleading over this particular period as the performance of underlying holdings is underestimated. This is due to a very sharp rally in markets on the afternoon of the last day of the quarter, which was captured by market indices but not by most fund holdings as they typically calculate their prices earlier in the day. As a result the funds mostly performed well on the first day of July as the underlying pricing caught up with benchmark indices.

Our decision to increase equity allocations across the fund range at the start of February benefited performance significantly in recent months. Around the middle of April we decided to take some profits from our equity positions in response to the significant market rally we have witnessed since then. Equity allocations were reduced by roughly 4% across all the funds. We also reduced the US high yield allocation whilst rotating within the asset class away from core (full duration) bonds and towards the existing short duration US high yield holding, which should prove more defensive during market corrections. With many asset classes continuing to perform well through the remainder of the quarter, we took the opportunity to further reduce equity holdings by 3-4% just after the end of the quarter – with this round of reductions broadly spread across a number of holdings, including UK equity and listed infrastructure.

We still expect reasonable returns from equity markets over the medium term, as well as selected areas within fixed income markets - as such the majority of the funds remain invested within these areas. However, we are always keen to increase diversification within the portfolios, in order to reduce the volatility of returns whilst maintaining similar return potential. To this end we added a new holding in an absolute return strategy during May, the Goldman Sachs EFI Long Short Risk Premia fund which has been sized at a 2% position across all the funds. This strategy provides market neutral equity exposure to specific style factors; value, quality, low beta, size and momentum, all of which have been rigorously researched and proven to outperform over time. The portfolio is systematically constructed using a quantitative approach and is well diversified across around 800 stocks in order to minimise stock specific risk. The equity market exposure arising from these holdings is hedged away using futures so that fund returns are driven by the performance of these style factors relative to the MSCI World index. This results in a return stream that is uncorrelated with other holdings in the portfolio, thereby increasing diversification and the potential for downside protection when equity markets are falling.



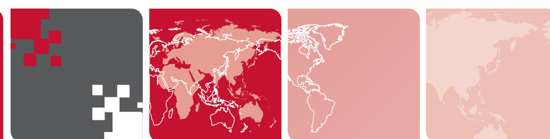
There was an additional change in the Asian Balanced and Asian Growth funds towards the end of the quarter, as we initiated a manager change within the local bond allocation, switching our holding from the Pictet Asia Local Currency fund into the Fullerton Asian Local Currency fund. Fullerton Asset Management is fully owned and supported by Temasek Holdings, a Singapore sovereign wealth fund, but has been operating as a separate entity since it was spun out in 2003. The firm focuses entirely on Asian investment strategies and as a local player benefits from extensive knowledge and experience in Asian markets. We have been impressed by the fixed income team which is highly experienced and has been very stable compared to most competitors. Fullerton will offer similar Asian rates and currency exposure to Pictet, but benefit from a broader investment opportunity set by also investing in corporate credit and up to 20% in dollar denominated bonds. The fund is run in a conservative way with a solid and repeatable investment process, managed within a relatively tight risk budget which will limit outperformance potential but should also reduce downside risks.

Given the high profile closures of several UK property funds during July, it is worth highlighting that the Harmony funds have no exposure to open ended funds investing in direct property because of the obvious liquidity mismatch risks they suffer. Instead we obtain property exposure via global portfolios of listed property securities (mostly REITs) and in the Sterling funds we also have a holding in the Ediston Property Investment Company, a London listed closed ended investment trust. Although the performance of the latter will suffer slightly as a result of expected weakness in the UK property market, we will not suffer any form of liquidity problem as all our holdings can be liquidated rapidly and with minimal price impact.

The UK referendum result last month was a shock, prompting large falls in sterling, global stock markets and a flight to safe haven assets such as government bonds and gold. As at the time of writing, global equities have recovered, but further falls cannot be ruled out. While essentially a political event, Brexit introduces extreme levels of uncertainty with inevitable consequences for investment and consumer confidence. Growth will almost certainly be lower in the UK over the period of exit negotiations, and the longer these take the greater the risks. Brexit also has profound implications for the EU and ultimately poses an existential risk for the project, with other anti EU parties across Europe buoyed by the result in the UK. However, Brexit is not a globally systemic event. The UK economy is less than 4% of global GDP, so even a very sharp fall in UK growth has no material impact globally. There is considerable uncertainty about the outcome of the lengthy exit negotiations to come but the most likely is that the UK and EU strike a unique arrangement, reflecting the importance and size of the UK.

Any change to the status quo invariably creates short term uncertainty which will elevate volatility in financial markets. We believe the chances are that the final outcome will be broadly market friendly and we are therefore looking for opportunities to accumulate assets on more attractive longer term valuations.

Source: Bloomberg / Morningstar. Returns in US dollars unless otherwise stated, June 2016. Past performance is not indicative of future returns.

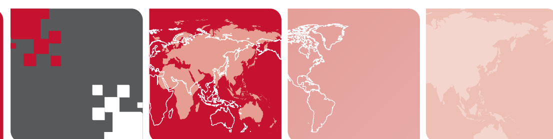


3. Recent Portfolio Activity and Positioning

The table below shows the portfolio activity throughout the quarter.

Date	Holding initiated/ Increased	Holding sold/ Decreased	Harmony funds
February	**Blackrock Global Real Estate** / First State Global Listed Infrastructure	Cash / **Muzinich Emerging Markets Corporate Bond**	All
February	Crux European Special Situations / Polar Japan / Schroder Recovery	Cash / **Muzinich Emerging Markets Corporate Bond**	All
February	**Blackrock USD / GBP IG Corporate Bond**	Cash	All
February	**Crux European Special Situations**	Cash	Asian
February	Pictet Asia Local Currency Bond	**Muzinich Emerging Markets Corporate Bond**	Asian
March	**Jennison Global Opportunities**	Wells US All Cap Growth	US Dollar
March	**Cadence Strategic Asia**	Prusik Asian Income	Asian
April	Cash / Muzinich Enhanced Yield	Global Developed / Emerging Market Equity	All
April	Cash / AXA IM US Short Duration High Yield	AXA IM US High Yield	All
May	**Goldman Sachs Long Short Risk Premia**	Cash	All
July	Cash / Muzinich Enhanced Yield	Global Developed / Emerging Market Equity / Listed Infrastructure	All
March	**Fullerton Asian Local Currency Bond**	**Pictet Asian Local Currency Debt**	Asian

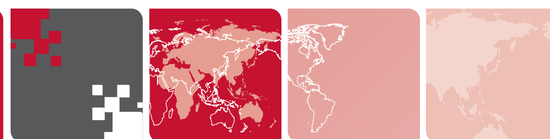
Asset Allocation
Manager Selection



4. Target Portfolios

	Balanced	Diversified	Growth
Equities	42.0%	54.5%	67.0%
Fixed Income	42.0%	31.5%	15.5%
Property/Infrastructure	10.0%	10.0%	10.0%
Cash	6.0%	4.0%	7.5%
Total	**100.0%**	**100.0%**	**100.0%**

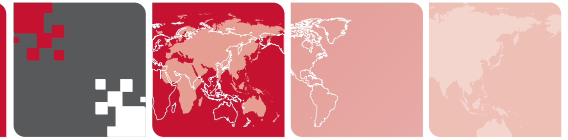
These target weights are correct as at the time this report is published and are indicative of the managers' medium term outlook for markets, which is driven principally by their assessment of relative valuation opportunities. The property exposure includes exposure to listed infrastructure.



5. Fund and Peer Group Performance

Fund returns (local currency)	Performance To 30 June 2016					
	3 months	6 months	2015	2014	2013	3 Years (annualised)
Asian Balanced (US dollars)	0.4%	2.6%	-4.3%	0.7%	2.5%	0.9%
Peer group median	-1.5%	0.8%	-9.1%	-4.5%	7.4%	-1.6%
Asian Growth (US dollars)	0.3%	1.8%	-4.5%	2.3%	6.2%	2.0%
Peer group median	-1.2%	0.8%	-8.3%	-3.7%	7.4%	-1.1%
Global equities	1.0%	1.2%	-2.4%	4.2%	22.8%	6.0%
MSCI AC Asia Pacific ex Japan	0.5%	2.4%	-9.4%	2.8%	3.4%	1.5%
AUD Growth	3.6%	1.4%	2.3%	6.0%	17.1%	6.3%
Peer group median	2.7%	1.6%	3.8%	5.7%	17.3%	6.6%
Global equities	4.5%	-0.8%	10.4%	14.5%	43.2%	14.2%
ASX All Ordinaries	-2.4%	4.1%	3.8%	5.0%	19.7%	5.6%
Europe Diversified	0.4%	-2.3%	5.8%	6.0%	7.8%	4.5%
Peer group median	-0.1%	-2.1%	2.4%	5.2%	4.8%	3.3%
Global equities	3.6%	-1.0%	8.8%	18.6%	17.5%	11.7%
MSCI Europe ex UK	-1.0%	-8.1%	10.7%	6.4%	22.1%	8.1%
GBP Balanced	4.0%	7.2%	0.2%	3.2%	10.6%	4.6%
Peer group median	3.3%	4.7%	-0.4%	3.1%	9.9%	3.9%
GBP Growth	4.1%	7.9%	0.0%	4.1%	16.9%	5.9%
Peer group median	3.3%	4.5%	-0.4%	3.0%	10.3%	3.8%
Global equities	8.6%	11.6%	3.3%	10.6%	20.5%	10.6%
MSCI UK	6.7%	6.9%	-2.2%	0.5%	18.5%	5.0%
USD Balanced	1.0%	2.6%	-4.6%	2.0%	10.6%	2.0%
Peer group median	0.6%	2.3%	-4.4%	0.7%	11.2%	2.4%
USD Growth	0.7%	1.5%	-6.2%	4.1%	17.6%	2.7%
Peer group median	0.5%	2.0%	-4.6%	0.9%	13.3%	2.6%
Global equities	1.0%	1.2%	-2.4%	4.2%	22.8%	6.0%
S&P 500	2.3%	3.5%	0.8%	13.7%	32.4%	11.0%

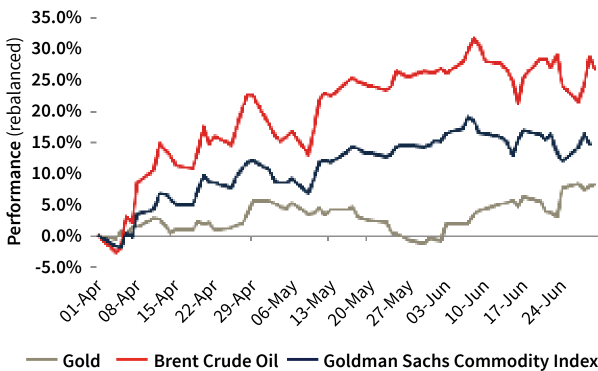
Source: Bloomberg, June 2015. Past performance is not indicative of future returns.



6. Market Commentary

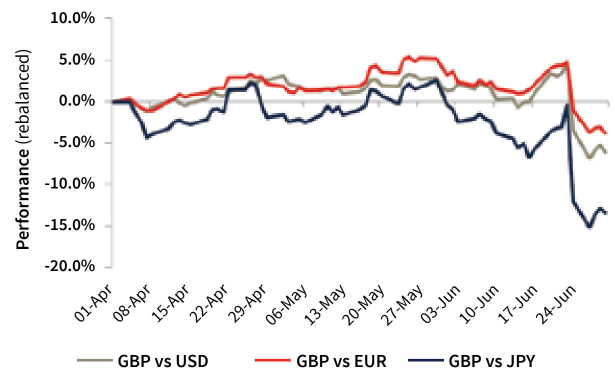
Broadly speaking, throughout the majority of the second quarter markets globally showed positive signs in comparison to the sharp falls throughout January and February; resulting in the MSCI World Index gaining 1.0% for the quarter, compared to a 2.8% fall for the last twelve months. Improving labour market conditions in developed countries saw unemployment rates in the US and UK fall to 4.9% and 5% respectively, both at their lowest monthly levels since the global financial crisis. US equities gained 2.4% from April through June, and the Personal Consumption Expenditure (PCE) inflation index, the Fed's preferred inflation measure, averaged 1.6% throughout the period, initially giving rise to expectations of impending interest rate cuts from the Federal Reserve. Meanwhile Emerging market equities gained 0.7% in local currency and US dollar terms, whilst Brent crude oil continued its recovery with a 20.6% rise for the quarter, climbing back up to USD 49.68 per barrel.

Figure 1: Strong quarter for commodities

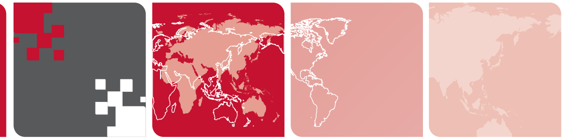


However, the most notable economic events and global market movements were broadly defined in the tail end of the period which was dominated by the build-up to and fallout from the UK's EU referendum vote on the 23rd June. Following the result (52% leave vs 48% remain), sterling and the euro depreciated dramatically against the dollar and yen, while investors crowded into safe haven assets in the form of sovereign bonds and gold. Sterling's depreciation of 10.5% against the greenback post-referendum left the currency down 7.3% for the quarter and 15.3% over the last twelve months. Conversely the Japanese yen, following continued central bank stimulus, gained 9.1% against the dollar for April through June and is 18.7% over the last year. In terms of 10-year bond yields throughout the quarter: US Treasury yields fell 0.64 percentage points to 1.5%, UK gilts fell 0.63 percentage points to 0.9% and Japanese and German 10-year government bonds made history by ending June in record negative yield territory (-0.2% and -0.1% respectively). In local currency terms UK equities outperformed with a 6.7% rise, but sterling's depreciation translated this into a 0.7% fall in dollar terms. The opposite was true of Japan's equities with the strength of the yen: up 1.0% in dollar terms, down 7.8% in local currency terms. Finally gold was a major beneficiary of the referendum result, despite losing 6.0% throughout May it posted 8.8% gains throughout June to end 6.8% up over three months.

Figure 2: Sterling vs major currencies Q2 2016

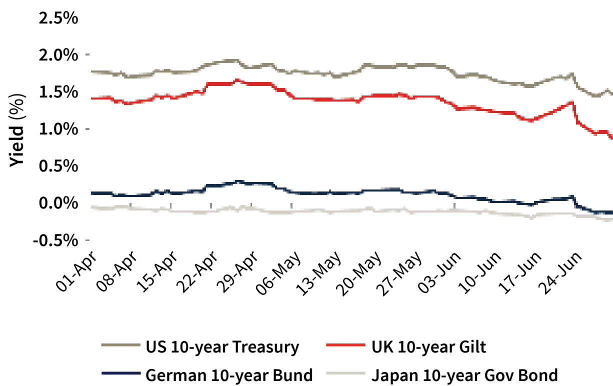


It now seems that investors and economists will look back not just on this quarter but on 2016 as the year the UK voted to leave the EU. The exit process will undoubtedly introduce significant short-term uncertainty with consequences for investment and consumer confidence; UK growth forecasts have been cut by at least 1% per annum over the next two years. The impact on EU growth is likely to be smaller but still significant, at a time when the union still faces a long period of weak growth post financial crisis. Meanwhile its banking system, notably in Italy, remains substantially undercapitalised. There are also potential existential risks, with anti-EU parties across Europe buoyed by the result in the UK.



Even so, Brexit is not a globally systemic event. The UK economy is less than 4% of global GDP such that a fall in UK growth has little material impact on global markets. In the meantime, the Bank of England has backed up its intentions to support growth by reducing capital requirements for banks, freeing up lending by GBP 150 billion. UK interest rates will also likely be reduced and kept close to zero for a prolonged period. Consensus expectations also predict further monetary easing from the European Central Bank, and expectations throughout the quarter for a Federal Reserve rate cut this year have reversed, and the market has now pushed back its expectations of a further rate cut all the way to 2018.

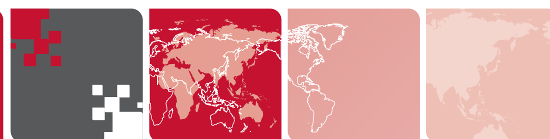
Figure 3: Major sovereign bond yields Q2 2016



The key question now is what form Brexit will take. It is neither in the interests of the UK nor the EU for Britain to lose access to the single market. The UK's total trade with the EU represents 53% of UK imports and 44% of exports. Exports to the EU are worth 12% of UK GDP. Meanwhile exports from the EU to the UK account for 3% of EU GDP, and the EU runs a substantial GBP 70 billion trade surplus with the UK, which it will be reluctant to lose.

Ultimately, we strongly believe that the UK will thrive and prosper in the long term whether in or out of the EU. Financial market volatility will increase until there is some degree of clarity on how Brexit will unfold, but we believe the likely outcome will be broadly market friendly. We are therefore seeking to use periods of weakness to accumulate assets on more attractive longer term valuations; being patient in this way should help reduce fund drawdowns and ultimately boost returns over time. We note that for overseas investors, UK assets are considerably cheaper today than two weeks ago, following sterling's depreciation, and we expect to see increased foreign investment interest in due course. Furthermore, with global policymakers likely to lean towards more monetary and fiscal accommodation in response to the renewed global growth risks, there should be ongoing support for financial assets going forward.

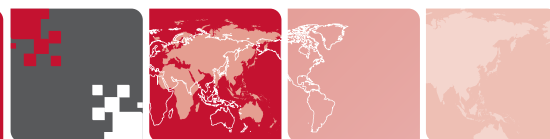
Source: Bloomberg, March 2016. Returns in US dollars unless otherwise stated.



7. Market Performance

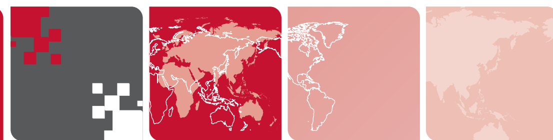
Asset Class/Region	Index	Currency	Quarter (To 30 June 2016)	12 Months (To 30 June 2016)
Developed markets equities				
United States	S&P 500 NR	**USD**	2.3%	3.3%
United Kingdom	MSCI UK NR	**GBP**	6.7%	3.4%
Continental Europe	MSCI Europe ex UK NR	**EUR**	-1.0%	-10.5%
Japan	Topix TR	**JPY**	-7.4%	-22.0%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	0.5%	-10.3%
Global	MSCI World NR	**USD**	1.0%	-2.8%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	**USD**	-3.9%	-11.9%
Emerging Asia	MSCI EM Asia NR	**USD**	0.3%	-12.2%
Emerging Latin America	MSCI EM Latin America NR	**USD**	5.3%	-7.6%
BRICs	MSCI BRIC NR	**USD**	3.1%	-16.5%
Global Emerging Markets	MSCI EM (Emerging Markets) NR	**USD**	0.7%	-12.1%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	2.3%	6.8%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	**USD**	1.8%	4.6%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	3.6%	7.9%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	5.5%	1.7%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	**GBP**	6.6%	14.4%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	**GBP**	4.1%	8.9%
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	2.2%	8.9%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	1.6%	5.2%
Euro High Yield	Barclays European HY 3% Issuer Constraint Total Return Index Value	**EUR**	1.6%	3.3%
Japanese Government	JP Morgan Japan Government Bond Index TR	**JPY**	3.0%	10.0%
Australian Government	JP Morgan Australia GBI TR	**AUD**	3.5%	8.4%
Global Government Bonds	JP Morgan Global GBI	**USD**	3.6%	11.5%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**USD**	2.4%	8.6%
Global Convertible Bonds	UBS Global Focus Convertible Bond	**USD**	-0.5%	-2.3%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**USD**	6.0%	13.2%

Source: Bloomberg, December 2014.



Asset Class/Region	Index	Currency	Quarter (To 30 June 2016)	12 Months (To 30 June 2016)
Property				
US Property Securities	MSCI US REIT NR	**USD**	6.5%	22.4%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	**AUD**	7.7%	18.8%
Asia Property Securities	S&P Asia Property 40 Index NR	**USD**	2.2%	-5.1%
Global Property Securities	S&P Global Property USD TR	**USD**	3.6%	9.8%
Currencies				
Euro		**USD**	-2.4%	-0.4%
UK Pound Sterling		**USD**	-7.3%	-15.3%
Japanese Yen		**USD**	9.1%	18.7%
Australian Dollar		**USD**	-2.7%	-3.3%
South African Rand		**USD**	0.3%	-17.4%
Commodities & Alternatives				
Commodities	RICI TR	**USD**	11.9%	-17.3%
Agricultural Commodities	RICI Agriculture TR	**USD**	5.4%	-9.4%
Oil	ICE Crude Oil CR	**USD**	25.5%	-21.9%
Gold	Gold Spot	**USD**	7.3%	12.8%
Hedge funds	HFRX Global Hedge Fund	**USD**	-2.0%	-7.4%

Source: Bloomberg, December 2014.



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