momentum

# Harmony Portfolios

## Quarterly Report

**30 September 2014**

# Q3

*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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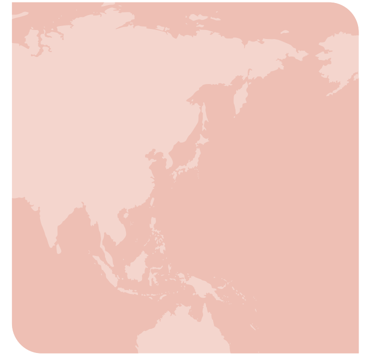

# Harmony Portfolios

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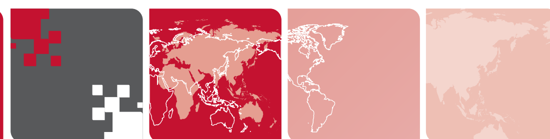
## 1. Portfolio objectives and overview

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 majority 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.

The Harmony portfolios mostly delivered negative returns in the third quarter of 2014, with the exception of the Euro Balanced and Australian Dollar Growth portfolios which posted small gains of 0.4% and 0.8% in their respective base currencies. The Asian and US Dollar portfolios proved the main laggards over the period with declines of around 2.0% in US dollar terms. Year to date and over twelve months all of the Harmony portfolios have delivered positive returns. Currency movements, particularly versus a resurgent US dollar, have had a significant bearing on the recently diverging returns of the various portfolios. The main driver of disappointing returns over the quarter was weak returns from equities and bonds across the main regions these portfolios invest in; only the Europe ex UK region saw positive returns from both bonds and equities while in other regions any positive returns were mostly small. Our asset allocation policy detracted from performance as areas where we were overweight (such as emerging market equity / bonds and convertible bonds) underperformed versus those areas we have chosen to have minimal exposure to (primarily government and investment grade bonds). Our manager selection was unable to offset these headwinds to performance over the period and indeed outcomes versus benchmark were mixed anyway, although performance of our selected Asian equity managers was particularly strong with positive returns across the board despite the benchmark index declining.

During the third quarter incremental changes were made to the asset allocation policy of the Harmony portfolios. Towards the end of September, following reasonably sharp declines in markets, we took the opportunity to increase our allocations to the equity and fixed income investments in emerging markets.

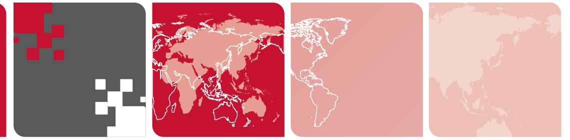
These changes were funded from a combination of developed market equity and strategic bond fund holdings. The increase in emerging market debt exposure was achieved both by adding to the existing position in the iShares $ JP Morgan Emerging Market Debt ETF as well as by adding a new holding in the Muzinich Short Duration Emerging Markets Credit position. This provides exposure to corporates in the emerging markets that have issued bonds in their respective local currency. As a result of the low duration, however, the position is not overly sensitive to changes in local interest rates. Muzinich are a specialist corporate credit manager with a well- resourced and highly experienced investment team that have expertise across the full spectrum of corporate credit. They adopt a conservative, bottom up investment process with a focus on capital preservation and delivering high risk adjusted returns.

We have also been active in the equity portion of the fund over the quarter. As the Japanese equity market sold off earlier in the year, it provided a relative valuation opportunity compared to the rest of the developed markets. We used this opportunity to add to our Japanese equity exposure (hedged to base currency) via James Salter's Japanese all cap strategy. The Polar Capital Japan fund is biased towards small and medium sized businesses, boasting strong balance sheets, low price-to-book multiples and a high degree of shareholder awareness. Furthermore, we have taken an initial position in the Heptagon Kopernik Global All Cap Equity fund. This holding is managed by a highly experienced and well-resourced team based in the US. The investment strategy is driven by Dave Iben, who founded Kopernik in 2013. He is supported by a team of eleven investment professionals, many of whom he has worked with in the past when managing the same strategy. Indeed he has been investing with an unconstrained deep value approach since the early 1990s. The composition of the portfolio is such that it is heavily exposed to areas that have historically been of a higher risk nature, therefore the manager maintains a highly diversified portfolio consisting of at least 50 stocks.

Within the Harmony Sterling Balanced and Sterling Growth portfolios we initiated a small holding in the Evenlode Income Fund towards the end of the quarter. Evenlode is a small direct investment franchise within Wise Investments, which is predominantly a wealth management business. The parent company was established by Tony Yarrow in 1992 to manage investments for private individuals. They have a small team of investment professionals managing assets of approximately £275 million from their office in Oxfordshire. The Evenlode franchise was launched in October 2009 by the fund's co- managers; Hugh Yarrow and Ben Peters. The portfolio managers implement an all-cap, quality orientated investment approach. They combine a disciplined and repeatable process with detailed fundamental research and a long investment horizon, which results in a low-turnover and relatively concentrated portfolio of around 30 high quality businesses that offer attractive cash based valuations. The managers' strong preference is for asset-light companies with low reinvestment requirements, enabling the businesses to compound returns at a higher rate than the market average. Their holdings typically exhibit a high and sustainable return on invested capital and strong free cash flow generation.

Going forward, markets continue to face a number of challenges, including divergent growth paths both within the developed markets and between developed and emerging markets; differing monetary policy paths within the West; and uncertain geopolitics are all potential sources of portfolio shocks in the short term. The impact of these short term risks is best mitigated by diversification of return drivers in a portfolio. Today the portfolios have a broadly based asset allocation which resists the temptation to over- concentrate risks in any one asset class, style or sector. We remain of the view that global equity markets offer reasonable value over the medium to long term whereas government bonds do not and this view is reflected in the asset allocation of the Fund.

*Source: Bloomberg / Morningstar. Returns in US dollars unless otherwise stated, September 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:**

- Increased exposure to emerging market equity (Dimensional fund) and emerging market bonds (via new Muzinich fund as well as existing iShares holding) on valuation grounds
- Increased exposure to global deep value equity and the resources sector on valuation grounds via new holding in Kopernik fund.
- Extended exposure to Polar Japan equity fund from just the Asian and AUD Harmony funds to the entire Harmony range.
- Reduced strategic bond holdings (Old Mutual) following period of outperformance driven by rising government bond yields intra quarter.

**Increased**

- Emerging market equity
- Emerging market debt
- Japanese equity

**Decreased**

- Developed market equity
- Strategic bonds

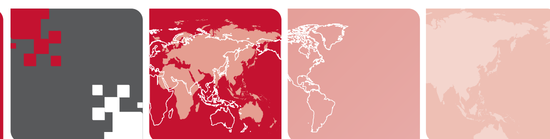
**Manager changes during the quarter:**

- Initiated holdings in Heptagon Kopernik Global All Cap Equity fund across the Harmony range.
- Initiated holdings in Muzinich Short Duration Emerging Markets Corporate Bond fund across the Harmony range.
- Initiated holdings in Evenlode UK Income fund in the Harmony GBP Balanced and Growth funds.
  Funded via small reduction in allocations to existing UK equity managers.

## 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%** |

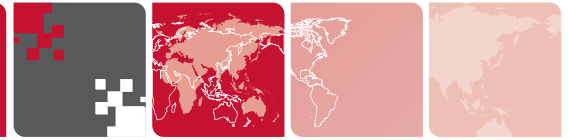
These target weights are correct as at the time this report is published and are indicative of the managers' medium term outlook for markets, which is driven principally by their assessment of relative valuation opportunities. The property exposure includes exposure to listed infrastructure.



## 5. Fund and peer group performance

| Fund returns (local currency) | Performance to 30 September 2014 | | | |
|---|---|---|---|---|
| | 3 months | 6 months | 2013 | 3 Years (annualised) |
| **Asian Balanced (US dollars)** | -1.9% | 1.4% | 2.5% | 4.8% |
| **Peer group median** | -4.9% | -2.3% | 7.4% | 5.3% |
| **Asian Growth (US dollars)** | -1.4% | 3.0% | 6.2% | 7.9% |
| **Peer group median** | -4.3% | -1.5% | 7.4% | 6.0% |
| **Global equities** | -2.3% | 2.6% | 22.8% | 16.6% |
| **MSCI AC Asia Pacific ex Japan** | -3.3% | 2.6% | 3.4% | 11.0% |
| **AUD Growth** | 0.8% | 2.2% | 17.1% | 10.6% |
| **Peer group median** | 1.0% | 2.2% | 17.3% | 9.3% |
| **Global equities** | 5.5% | 9.0% | 43.2% | 21.4% |
| **ASX All Ordinaries** | -0.3% | 0.2% | 19.7% | 14.0% |
| **EUR Balanced** | 0.4% | 2.2% | 7.8% | 8.7% |
| **Peer group median** | 0.7% | 2.8% | 4.8% | 6.2% |
| **Global equities** | 5.9% | 12.0% | 17.5% | 19.0% |
| **MSCI Europe ex UK** | 0.3% | 3.1% | 22.1% | 18.5% |
| **GBP Balanced** | -0.1% | 0.5% | 10.6% | 7.1% |
| **Peer group median** | 0.0% | 0.7% | 9.9% | 7.0% |
| **GBP Growth** | -0.3% | 0.4% | 16.9% | 10.1% |
| **Peer group median** | 0.0% | 0.7% | 10.3% | 7.2% |
| **Global equities** | 3.0% | 5.5% | 20.5% | 15.1% |
| **MSCIUK** | -0.9% | 2.5% | 18.5% | 13.0% |
| **USD Balanced** | -1.9% | 0.6% | 10.6% | 7.5% |
| **Peer group median** | -3.2% | -0.5% | 11.2% | 8.5% |
| **USD Growth** | -2.0% | 1.7% | 17.6% | 11.3% |
| **Peer group median** | -3.3% | -0.5% | 13.3% | 9.6% |
| **Global equities** | -2.3% | 2.6% | 22.8% | 16.6% |
| **S&P 500** | 1.1% | 6.4% | 32.4% | 23.0% |

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

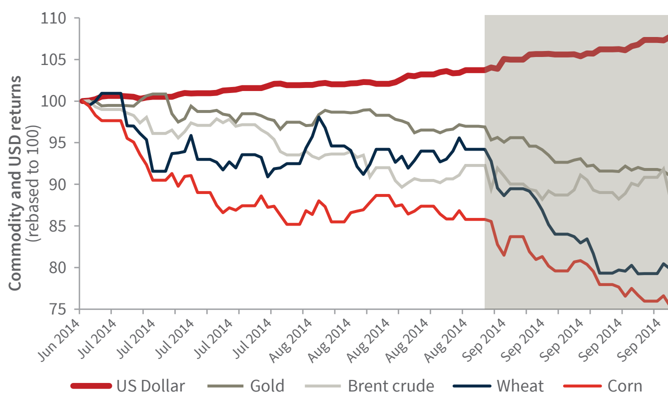


# 6. Market commentary

The third quarter of 2014 saw markets react to several interrelated themes; in particular, the growing divergence between the economic performance of developed markets. The slowdown underway in China and weakness in other Emerging Markets (EM) – together with low inflation and anaemic growth in Europe – continues to weigh on global demand. However, the US and UK have seen their economies strengthen, and their respective central banks are expected to start raising interest rates in the near future.

In the US, the economy remains on track for reasonable growth this year and next, and although there has been some recent evidence of a slowdown – for example, in construction data and manufacturing spend – the numbers still point to a steady increase in output. As a result, the Federal Reserve (Fed) is expected to end its asset purchase programme in October as planned. The Fed is also beginning to be more aggressive on its guidance regarding the pace of interest rate increases once they start, increasing its forecast rates for 2015 and 2016 by 0.25%, and introducing a new target of 3.75% by 2017. The US dollar has strengthened considerably on the back of this news, which has put pressure on commodity prices and commodity exporters, most notably Australia.

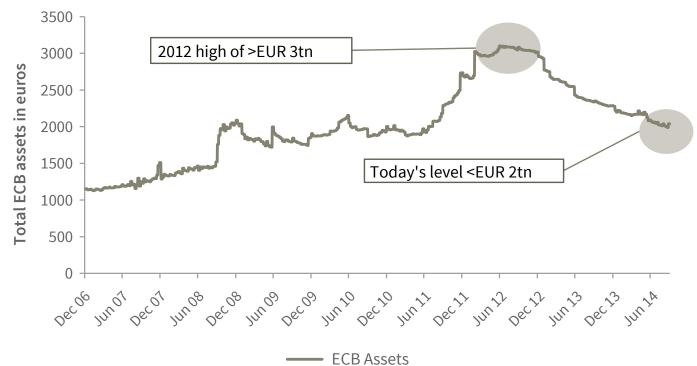
*Figure 1: US dollar strength and falling commodity prices*




In the UK, volatility increased in September, ahead of the Scottish referendum. Sterling depreciated in the run up to the vote, with the polls pointing to a close result and the potential break-up of the Union. In the event, voters chose to maintain the status quo. Aside from this brief period of uncertainty, the British economy has been on an upward trajectory in 2014.

Both the Fed and the Bank of England will likely raise interest rates at a slow pace, but even incremental increases puts them in stark opposition to the Bank of Japan and the European Central Bank (ECB), who are increasingly looking to add liquidity to their economies. Mario Draghi, President of the ECB, moved to a more aggressive easing programme in September, cutting the ECB's main refinancing rate by 0.10% to take it to -0.20%. It also announced a EUR 1 trillion target increase in the size of its balance sheet, which would take it back to its early 2012 levels of EUR 3 trillion. The ECB will start a "private" quantitative easing (QE) programme in October, lasting at least 2 years and buying at least EUR 400 billion of asset backed securities (ABS) and covered bonds. Mr Draghi noted that the bank stands "ready to adjust the size and composition" of its asset purchases if necessary, hinting at the possibility of government bond purchases. Euro government bonds rose as a result and remain the outstanding asset class year to date in 2014.

*Figure 2: Tracking total assets at the European Central Bank*




Emerging market equities enjoyed a strong start to the quarter, especially in Asia and Latin America, but the MSCI Global Emerging Markets index ended the period down (-3.5%) after stocks sold off by 7.4% in September. US dollar strength weighed on EM, as well as idiosyncratic factors such as the elections in Brazil, where the incumbent, Dilma Rousseff, looked to be gaining ground on more investor and business-friendly opposition candidate. Continued tension in Ukraine also resulted in increased sanctions imposed on Russia by the West, affecting emerging Europe in particular.

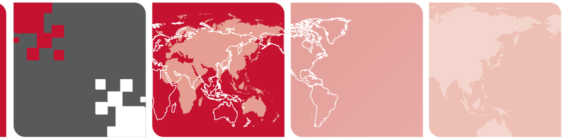
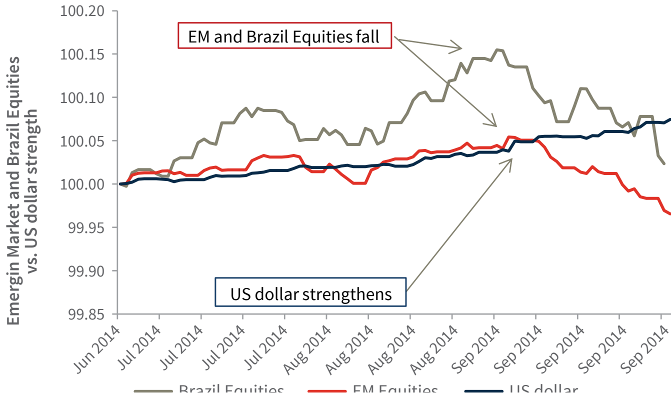


*Figure 3: Emerging Markets sell off in September*



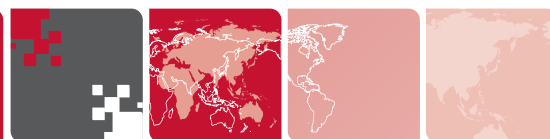

In fixed income markets, the third quarter (Q3) saw significant outflows out of high yield bond funds, with US High yield bonds returning -1.9%. Globally, government bonds fell by 3.3%, US treasuries added 0.4%, whilst UK Gilts rallied by 3.9% in sterling terms.

Geopolitical risk continues to weigh on markets, but remains – in our opinion – a subplot compared to the evolving macro-economic landscape. The instability in the Middle East is certainly a concern, with Islamic State (IS) militants attempting to push south towards Iraq's oil fields. A powerful alliance of nations led by the US, and including Muslim states, has now begun a campaign of airstrikes against IS in Iraq (with the US also engaging IS in Syria) in an effort to halt the militant group.

Markets are correcting as they adjust to reduced growth expectations, an increasingly difficult environment for earnings growth and the challenge of the first increase in US interest rates since June 2006. This weakness is likely to continue in the short term. However, markets will be supported by investors" search for yield and the prospect of very loose monetary policy for a long time ahead. While valuations of some markets are a cause for some concern, equities in our view are still reasonably supported by the fundamentals.

All returns in USD terms, unless stated otherwise.

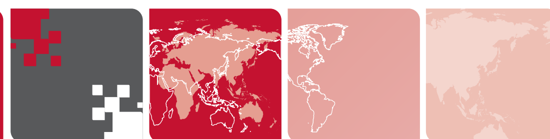
*Source: Bloomberg, September 2014. Returns in US dollars unless otherwise stated.*



## 7. Market Summary

| Asset Class/Region | Index | To 30 September 2014 | | |
|---|---|---|---|---|
| | | Currency | Quarter | 12 Months |
| **Developed markets equities** | | | | |
| **United States** | S&P 500 NR | **USD** | 1.0% | 19.0% |
| **United Kingdom** | MSCI UK NR | **GBP** | -0.9% | 6.0% |
| **Continental Europe** | MSCI Europe ex UK NR | **EUR** | 0.3% | 13.3% |
| **Japan** | Topix TR | **JPY** | 5.8% | 13.3% |
| **Asia Pacific (ex Japan)** | MSCI AC Asia Pacific ex Japan NR | **USD** | -3.3% | 6.0% |
| **Global** | MSCI World NR | **USD** | -2.2% | 12.2% |
| **Emerging Market Equities** | | | | |
| **Emerging Europe** | MSCI EM Europe NR | **USD** | -12.4% | -13.5% |
| **Emerging Asia** | MSCI EM Asia NR | **USD** | -1.6% | 9.0% |
| **Emerging Latin America** | MSCI EM Latin America NR | **USD** | -5.5% | -1.0% |
| **BRICs** | MSCI BRIC NR | **USD** | -3.3% | 3.0% |
| **Global emerging markets** | MSCI EM (Emerging Markets) NR | **USD** | -3.5% | 4.3% |
| **Bonds** | | | | |
| **US Treasuries** | JP Morgan United States Government Bond Index TR | **USD** | 0.4% | 2.7% |
| **US Treasuries (inflation protected)** | Barclays Capital U.S. Government Inflation Linked TR | **USD** | -2.1% | 1.9% |
| **US Corporate (investment grade)** | Barclays Capital U.S. Corporate Investment Grade TR | **USD** | -0.1% | 6.8% |
| **US High Yield** | Barclays Capital U.S. High Yield 2% Issuer Cap TR | **USD** | -1.9% | 7.2% |
| **UK Gilts** | JP Morgan United Kingdom Government Bond Index TR | **GBP** | 3.9% | 5.9% |
| **UK Corporate (investment grade)** | BofA Merrill Lynch Sterling Non Gilts TR | **GBP** | 2.9% | 7.6% |
| **Euro Government Bonds** | Citigroup EMU GBI TR | **EUR** | 2.9% | 11.4% |
| **Euro Corporate (investment grade)** | Barclays Capital Euro Aggregate Corporate TR | **EUR** | 1.8% | 7.8% |
| **Euro High Yield** | BofA Merrill Lynch Euro High Yield Constrained TR | **EUR** | -8.4% | 1.4% |
| **Japanese Government** | JP Morgan Japan Government Bond Index TR | **JPY** | 0.6% | 2.4% |
| **Australian Government** | JP Morgan Australia GBI TR | **AUD** | 1.0% | 5.7% |
| **Global Government Bonds** | JP Morgan Global GBI | **USD** | -3.3% | 0.3% |
| **Global Bonds** | Citigroup World Broad Investment Grade (WBIG) TR | **USD** | -3.0% | 1.4% |
| **Global Convertible Bonds** | UBS Global Focus Convertible Bond | **USD** | -5.7% | 2.3% |
| **Emerging Market Bonds** | JP Morgan EMBI+ | **USD** | -2.1% | 7.8% |

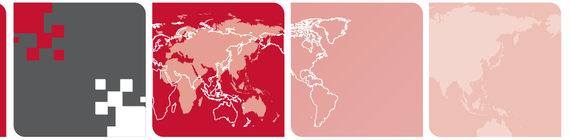
*Source: Bloomberg, March 2014.*



| Asset Class/Region | Index | To 30 September 2014 Currency | Quarter | 12 Months |
|---|---|---|---|---|
| **Property** | | | | |
| **US Property Securities** | MSCI US REIT NR | **USD** | -3.4% | 11.9% |
| **Australian Property Securities** | S&P/ASX 200 A-REIT Index TR | **AUD** | 1.0% | 6.0% |
| **Asia Property Securities** | S&P Asia Property 40 Index NR | **USD** | -3.7% | -3.7% |
| **Global Property Securities** | S&P Global Property USD TR | **USD** | -4.1% | 5.9% |
| **Currencies** | | | | |
| **Euro** | | **USD** | -7.7% | -6.6% |
| **UK Pound Sterling** | | **USD** | -5.2% | 0.2% |
| **Japanese Yen** | | **USD** | -7.6% | -10.4% |
| **Australian Dollar** | | **USD** | -7.3% | -6.1% |
| **South African Rand** | | **USD** | -5.7% | -11.2% |
| **Commodities & Alternatives** | | | | |
| **Commodities** | RICI TR | **USD** | -12.2% | -8.6% |
| **Agricultural Commodities** | RICI Agriculture TR | **USD** | -15.2% | -15.2% |
| **Oil** | ICE Crude Oil CR | **USD** | -15.0% | -11.4% |
| **Gold** | Gold Spot | **USD** | -9.0% | -9.1% |
| **Hedge funds** | HFRX Global Hedge Fund | **USD** | -0.6% | 3.5% |
| **Funds of hedge funds** | Dow Jones Credit Suisse Hedge Fund USD | **USD** | 0.60%* | 7.70%* |

** Estimate*

*Source: Bloomberg, March 2014.*



# Important Notes

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The value of investments in discretionary accounts, and the income derived, may fluctuate and it is possible that an investor may incur losses, including a loss of the principal invested. Past performance is not generally indicative of future performance. Investors whose reference currency differs from that in which the underlying assets are invested may be subject to exchange rate movements that alter the value of their investments.

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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