momentum

Harmony Portfolios

Quarterly Report

30 September 2015

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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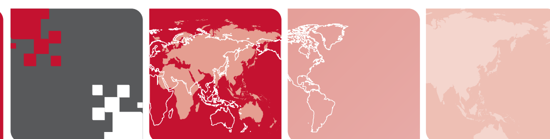
1. Portfolio objectives and overview

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, Europe Diversified, 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 third quarter of 2015 saw many asset classes posting sharp declines, most notably equities with many indices posting the largest quarterly falls since the European crisis four years ago. The bulk of the losses came in August, when the markets fears around China's economy and plummeting stock market, eventually fed risk-aversion across other global asset classes. Few investments made money over this period. Against this backdrop, the Harmony funds all delivered negative returns for the third quarter.

The Harmony Sterling and Australian Dollar funds fell the least over the quarter. Net of fees and in local currency terms, the Sterling Balanced and Sterling Growth returned -3.8% and -5.1% respectively, whilst the Australian Dollar Growth fund returned -4.3%. The Europe Diversified fund returned -7.1%, while the US Dollar Balanced and US Dollar Growth funds returned -7.2% and -9.2%. The Asian funds suffered the largest falls, down by 8.3% and 10.1% for the balanced and growth profiles respectively. Although returns for the quarter were disappointing, this follows a period of strong returns in the first half of the year when most of the funds delivered low single digit gains in their base currencies or in some cases much better gains. Also, the high level of diversification we maintain in all of the Harmony funds, across asset classes, investment styles, managers and currencies, meant that the funds suffered lower drawdowns than equity markets during this period.

Importantly, we have maintained our positions through this period of heightened volatility. Although this detracted from short term performance, we believe consistently implementing our valuation driven asset allocation approach should lead to strong long term performance. Having reduced risk in the funds earlier in the year, after valuations increased substantially in certain areas, we believe valuations for the asset classes we are invested in are much more compelling now, leaving us feeling optimistic about the future return potential for the funds. Indeed, so far we have seen a strong rebound in markets at the start of the fourth quarter, which the funds have captured well.

Key drivers of fund performance over the quarter included significant divergence across both regional equity market returns and fixed income asset classes, as well as the performance of our selected equity managers versus their benchmarks.

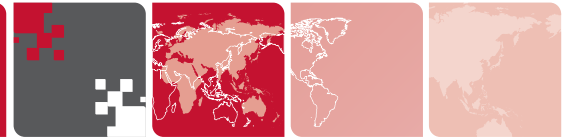
The performance of regional equity markets had a significant bearing on the variation in returns across the Harmony funds, as most of the funds have around two-thirds of their equity exposure invested in the 'home' region. The US, UK and Australian markets held up better than most other markets, despite all falling by roughly 6.5% in local currency terms, while continental Europe fell by over 8% and Japan by over 13%. Asia ex Japan and emerging market indices faired worst, plummeting by 17% to 18% in US dollar terms over the period. Most of the funds have roughly one third of their equity exposure in global markets which contributed to returns, for all but the US Dollar funds, given the outperformance of global equities versus the other home markets, part of which is attributable to the tailwind of US dollar currency appreciation. Given the large declines seen across all equity markets, the Harmony Growth risk profiles – which carry a higher equity weighting – underperformed the equivalent Harmony Balanced across each region.

Equity manager selection had a meaningful impact on performance for most of the funds over the quarter. The area where this contributed most significantly to performance in aggregate was in the Sterling and Asian portfolios. The most notable outcomes for individual holdings included Prusik in Asia, with outperformance of over 6%, and Lindsell Train and Evenlode in the UK, with both outperforming by approximately 4%. Sector selection was a key driver of these outcomes and others, with several holdings benefiting from having underweight allocations to the underperforming energy and materials sectors. The euro and Australian dollar portfolios also saw positive - but smaller - contributions from equity manager selection. However, the US dollar portfolios saw a negative contribution as our US active equity managers underperformed in aggregate. The most defensively positioned and quality orientated of our selected managers outperformed, but this was insufficient to offset the underperformance of our growth and value orientated manager holdings.

Another notable factor driving fund returns was the performance of our fixed income holdings. Having generally contributed strong performance earlier in the year, all of our holdings, across investment grade and high yield bonds, convertible bonds, emerging market sovereign and corporate bonds, delivered negative returns for the third quarter. In most cases they weren't down by more than a couple of per cent, but in the balanced risk profiles - where we hold greater fixed income allocations - this still represented a meaningful detractor from performance. Ultimately, volatility and risk aversion reached such high levels over the period, that we didn't receive the usual diversification benefit that we would expect from these investments. Only developed market government bonds provided some downside protection during this period, but we continue to view this as a very expensive asset class with low to negative return prospects over the next few years and so have virtually no direct exposure.

In addition to rebalancing as necessary to maintain our positioning after large market moves, we made a few other changes to the funds during the quarter. Some of these changes occurred because market volatility providing us with attractive entry points. Specifically, we increased our positions in core US high yield bond positions across all the funds and also added US investment grade bond holdings in the US Dollar and Sterling Balanced funds. In addition, we made a couple of new investments; in a UK commercial property portfolio and in a US deep value equity manager.

In the Sterling Funds, we invested in a London listed real estate investment trust, managed by Ediston Real Estate. We believe their focused UK commercial property portfolio has good return prospects and will provide a significant diversification benefit to the funds (indeed unlike most other investments it provided a positive return over the quarter). This investment decision follows numerous due diligence meetings with the management team over the last year as well as visits to some of the properties they own. Ediston Real Estate was founded in 2004 by Danny O'Neill, a former property fund manager at Standard Life Investments, and currently the team are responsible for over £450m of property assets across the UK. The portfolio we invested in targets income producing assets with a typical value of between £10-25 million, with initial yields in excess

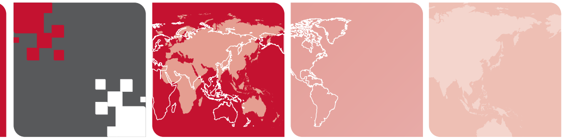


of 6.5%. The investment team are highly experienced at investing in assets which provide the opportunity to add value through a hands-on active management approach.

Meanwhile, in the US Dollar funds, we diversified our exposure to US value stocks, by switching some of the holding in the Harris equity strategy to a new holding in the Conventum Lyrical equity fund. The fund is managed by a small New York based team of highly experienced value investors. They have a simple but well thought-out approach to portfolio construction, which we believe reduces downside risk but also enables them to focus more attention on conducting in-depth fundamental research. Also, they manage just $4bn in US equities, which allows them to access mispriced opportunities amongst small and mid-caps as well as large caps, unlike many of their peers with greater assets under management. We believe the Lyrical fund can deliver meaningful outperformance versus the US market over the long run.

Going forward we expect a continued presence of volatility and stresses in markets, and sharp divergence of performance between countries, sectors and companies depending on fundamentals. On the positive side, these conditions will encourage continued loose monetary policy, and extend this long credit and market cycle. Moreover, valuations are materially lower than just a few months ago, with the re-pricing of the China risk, and slower global growth now to a large extent discounted, markets arguably offer the best opportunity for some time to add to the risk positions in portfolios. But in this dangerous world, prudent diversification and a focus on quality stocks, cash generation and strong balance sheets will continue to reward investors.

Source: Bloomberg / Morningstar. Returns in US dollars unless otherwise stated, September 2015. Past performance is not indicative of future returns.



3. Recent portfolio activity and positioning

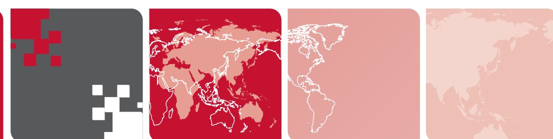
During the quarter the following changes were made to the funds:

Increased allocation	Decreased allocation
Jul'15: **UK Property**[1]	Jul'15: **Cash / Global Listed Real Estate**
Sep'15: **US High Yield Bonds**	Sep'15: **Cash**
Sep'15: **US Investment Grade Bonds**[2]	Sep'15: **European Crossover Credit**[2]

Manager changes during the quarter:

Holding initiated	Holding sold
Jul'15: **Ediston Property Investment Company (EPIC)**[1]	
Sep'15: **Westwood Strategic Convertibles**[2]	
Sep'15: **Sands Emerging Markets**[3]	

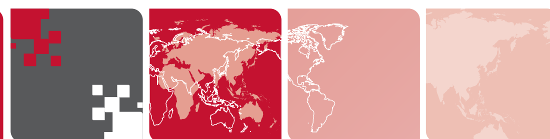
[1] Harmony Sterling Balanced and Harmony Sterling Growth only
[2] Harmony US Dollar Balanced and Harmony Sterling Balanced only
[3] Harmony US Dollar Balanced and Harmony US Dollar Growth only



4. Target portfolios

	Balanced	Diversified	Growth
Equities	45.0%	55.5%	70.0%
Fixed Income	38.0%	31.5%	17.0%
Property/Infrastructure	8.0%	8.0%	8.0%
Cash	9.0%	5.0%	5.0%
Total	**100.0%**	**100.0%**	**100.0%**

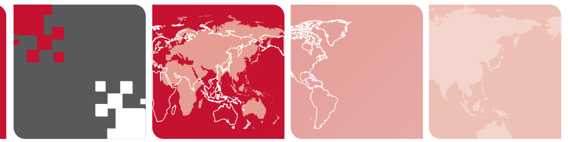
These target weights are correct as at the time this report is published and are indicative of the managers' medium term outlook for markets, which is driven principally by their assessment of relative valuation opportunities. The property exposure includes exposure to listed infrastructure.



5. Fund and peer group performance

Fund returns (local currency)	Performance to 30 September 2015				
	3 months	6 months	2014	2013	3 Years (annualised)
Asian Balanced (US dollars)	-8.3%	-7.7%	0.7%	2.5%	-0.3%
Peer group median	-6.6%	-7.4%	-4.5%	7.4%	-1.3%
Asian Growth (US dollars)	-10.1%	-9.4%	2.3%	6.2%	1.4%
Peer group median	-7.2%	-7.9%	-3.7%	7.4%	-0.8%
Global equities	-9.5%	-9.1%	4.2%	22.8%	7.0%
MSCI AC Asia Pacific ex Japan	-16.6%	-17.5%	2.8%	3.4%	-1.0%
AUD Growth	-4.3%	-6.3%	6.0%	17.1%	8.7%
Peer group median	0.9%	-1.2%	5.7%	17.3%	9.8%
Global equities	-0.8%	-0.9%	14.5%	43.2%	22.5%
ASX All Ordinaries	-5.8%	-11.7%	5.0%	19.7%	9.3%
Europe Diversified	-7.1%	-8.4%	6.0%	7.8%	5.8%
Peer group median	-3.9%	-6.4%	5.2%	4.8%	3.7%
Global equities	-9.6%	-12.6%	18.6%	17.5%	12.1%
MSCI Europe ex UK	-8.3%	-12.3%	6.4%	22.1%	12.8%
GBP Balanced	-3.8%	-6.0%	3.2%	10.6%	4.3%
Peer group median	-3.0%	-6.1%	3.1%	9.9%	3.9%
GBP Growth	-5.1%	-7.9%	4.1%	16.9%	6.5%
Peer group median	-3.2%	-6.3%	3.0%	10.3%	4.0%
Global equities	-6.0%	-11.0%	10.6%	20.5%	9.3%
MSCI UK	-6.6%	-9.2%	0.5%	18.5%	5.2%
USD Balanced	-7.2%	-6.9%	2.0%	10.6%	2.1%
Peer group median	-4.7%	-5.0%	0.7%	11.2%	2.5%
USD Growth	-9.2%	-9.1%	4.1%	17.6%	3.8%
Peer group median	-5.4%	-5.5%	0.9%	13.3%	3.1%
Global equities	-9.5%	-9.1%	4.2%	22.8%	7.0%
S&P 500	-6.4%	-6.2%	13.7%	32.4%	12.4%

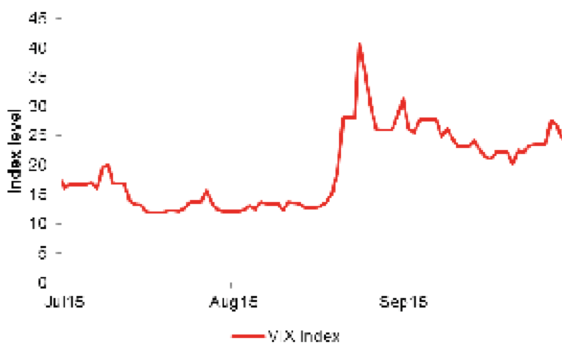
Source: Bloomberg, September 2015. Past performance is not indicative of future returns.



6. Market commentary

The implications of China's profound economic problems finally spilled over into a full-scale global market rout in the third quarter. The ruling Communist Party marginally, but unexpectedly, devalued the yuan in August resulting in 'Black Monday' on August 24, when Chinese equities crashed by over 8% and global markets tumbled. September saw further jitters after the US Federal Reserve (Fed) decided to keep interest rates on hold, seemingly confirming investors' worst fears about the outlook for global growth. The VIX index of implied volatility, often referred to as the 'Wall Street Fear Gauge', spiked sharply higher in August and remained at elevated levels throughout September.

Figure 1: The VIX index of implied volatility – the 'Wall Street Fear Gauge'

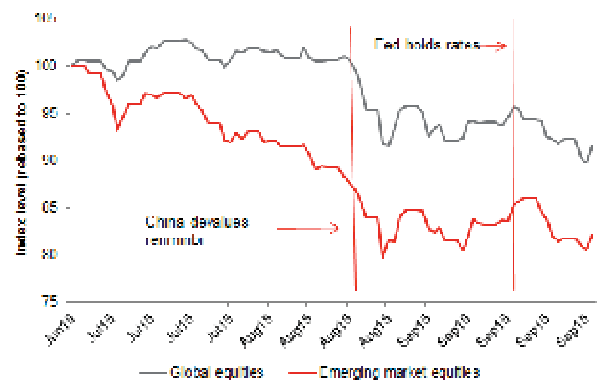


China's economy appears to be slowing more rapidly than the authorities would like, and investors focus has duly shifted to the global ramifications of this slowdown. Although the official Chinese GDP numbers showed growth at the targeted 7% in the second quarter, most indicators point to much slower growth, perhaps in the order of 4-5%. Beyond dispute is the fact that capital spending – for so long the great driver of the Chinese economy – is waning.

The slowdown in China and resulting collapse in commodity prices resulted in dramatic falls for emerging market (EM) equities, which fell by 17.9% over the quarter. EM stocks were hit by the perfect storm of China's slowdown, sluggish developed market growth, the challenges of reining in a credit boom, excessive dollar debt exacerbated by a strong greenback, inadequate structural reforms during the boom years, and domestic policy mistakes on a grand scale (notably in Brazil).

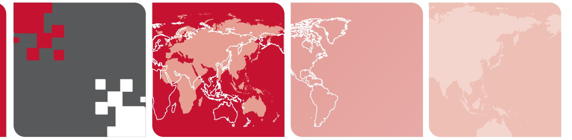
Recessionary fears have also returned to the developed world. While we are seeing a steady recovery in the US and UK, Europe and Japan are still fragile and global debt levels remain at historically high levels. Indeed, persistent headwinds from the crisis continue to constrain growth; low inflation has impaired policy transmission and low nominal growth of GDP has made reduction of debt more difficult. Productivity growth also remains anaemic.

Figure 2: Global and emerging market equity performance



During these sharp market falls there have been few safe-havens for investors. Gold disappointed, slipping by 5% over the quarter and many parts of the fixed income markets suffered from rising credit spreads as falling growth fears raised the spectre of defaults. However, government bonds across the developed world proved their worth as 'safe-haven assets' and – in the face of rising deflationary concerns – returned close to 1% in September and 2% over the quarter.

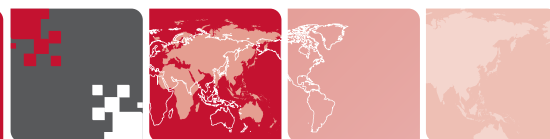
Figure 3: 'Safe-haven' asset class returns



It is important to keep these macroeconomic themes in perspective, however. China is on a path to structurally slower growth, but its consumer sector is strong and becoming more important both in China and globally. The economy is rebalancing rather than grinding to a halt and this will ultimately be a positive development which will create big opportunities for many countries and companies. The collapse in commodity markets causes some dislocation in the early stages of the down-cycle and cutbacks to capital spending in important parts of the global economy, but these negative effects should be offset by the positive impact of lower prices to users. A boost to real incomes and to spending will keep inflation at very low levels for some time ahead, which in turn enables central banks to maintain very loose monetary policy and continue with their stimulus efforts, without risking inflation. It is now unlikely that the Fed will raise rates this year, and it could be late into next year or even beyond before the first rate hike.

There are clearly significant imbalances across the world and a high level of uncertainty, not least around the ultimate end-game of this long period of extraordinary monetary policy. Volatility is expected to remain higher, but for long term investors this creates opportunities to add to investments at attractive levels and we have been using the falls in recent weeks to add to our risk positions in portfolios. As we enter the final quarter of the year there are attractive opportunities across many markets, now at much improved valuations. Indeed, in the first week of October we have seen a sharp reversal of the trends of the past few months.

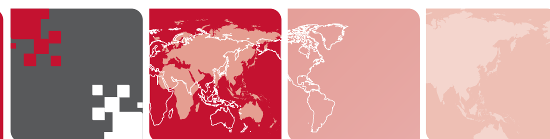
Source: Bloomberg / Morningstar. Returns in US dollars unless otherwise stated, June 2015. Past performance is not indicative of future returns.



7. Market Summary

Asset Class/Region	Index	Currency	Quarter	12 Months
		To 30 September 2015		
Developed markets equities				
United States	S&P 500 NR	USD	-6.6%	-1.2%
United Kingdom	MSCI UK NR	GBP	-6.6%	-5.9%
Continental Europe	MSCI Europe ex UK NR	EUR	-8.3%	4.1%
Japan	Topix TR	JPY	-12.8%	8.4%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-16.6%	-14.5%
Global	MSCI World NR	USD	-8.4%	-5.1%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	USD	-15.4%	-28.3%
Emerging Asia	MSCI EM Asia NR	USD	-17.0%	-13.1%
Emerging Latin America	MSCI EM Latin America NR	USD	-24.3%	-38.7%
BRICs	MSCI BRIC NR	USD	-21.1%	-18.1%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	-17.9%	-19.3%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	1.9%	4.2%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	-1.2%	-0.8%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	0.8%	1.7%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	-4.8%	-3.4%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	3.3%	8.8%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	1.0%	4.6%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	2.5%	4.0%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	-0.3%	-0.3%
Euro High Yield	Barclays European HY 3% Issuer Constraint Total Return Index Value	EUR	-1.7%	0.4%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	0.9%	2.6%
Australian Government	JP Morgan Australia GBI TR	AUD	2.7%	8.1%
Global Government Bonds	JP Morgan Global GBI	USD	2.0%	-2.4%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	1.3%	-3.0%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	-3.5%	-2.6%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	-0.9%	-0.9%

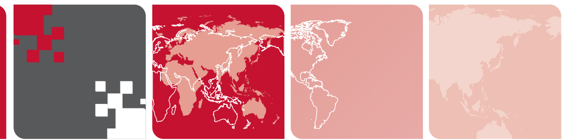
Source: Bloomberg, December 2014.



Asset Class/Region	Index	To 30 September 2015 Currency	Quarter	12 Months
Property				
US Property Securities	MSCI US REIT NR	**USD**	1.8%	8.2%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	**AUD**	0.2%	14.6%
Asia Property Securities	S&P Asia Property 40 Index NR	**USD**	-10.9%	-0.4%
Global Property Securities	S&P Global Property USD TR	**USD**	-3.8%	1.6%
Currencies				
Euro		**USD**	0.3%	-11.5%
UK Pound Sterling		**USD**	-3.7%	-6.7%
Japanese Yen		**USD**	2.2%	-8.3%
Australian Dollar		**USD**	-9.0%	-19.8%
South African Rand		**USD**	-12.2%	-18.5%
Commodities & Alternatives				
Commodities	RICI TR	**USD**	-16.0%	-30.2%
Agricultural Commodities	RICI Agriculture TR	**USD**	-12.2%	-7.7%
Oil	ICE Crude Oil CR	**USD**	-23.9%	-48.9%
Gold	Gold Spot	**USD**	-4.9%	-7.7%
Hedge funds	HFRX Global Hedge Fund	**USD**	-4.3%	-4.7%
Hedge funds	Dow Jones Credit Suisse Hedge Fund USD	**USD**	-1.6%	1.5%

** Estimate*

Source: Bloomberg, December 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 The Rex Building, 62 Queen Street, London, EC4R 1EB.

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