momentum

Harmony Portfolios
Quarterly Report

31 December 2014

Q4

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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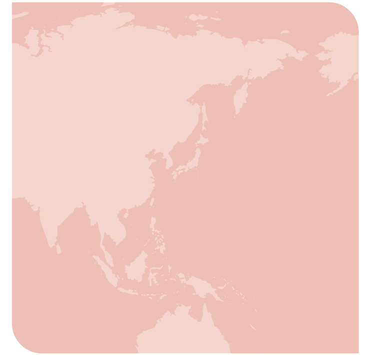

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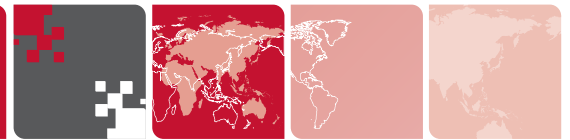
1. Portfolio objectives and overview

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”, “Diversified” or “Growth” profile, with each offering progressively greater exposure to the equity market. On a through-the-cycle basis, the funds will have the majority of their assets invested in a “home” region with the balance invested in global assets. The particular weighting to each region will depend on relative valuation opportunities. These funds will also use asset allocation on a tactical basis to take advantage of short term valuation opportunities.

Over twelve months all of the Harmony portfolios have delivered positive returns. Most of the funds also posted gains in the fourth quarter of 2014, with the exception of the Asian Balanced and Asian Growth funds which both fell by less than 1% in US dollar terms net of fees. Of the other six funds the US Dollar Balanced fund posted a modest gain of 1.4% while the other funds gained between 2.3% and 3.7% in their respective reporting currencies. Currency moves were a key factor in explaining these relative outcomes, with the US dollar in particular having a significant impact. This is discussed further below. Another factor was the mixed fortunes for equities across the main regions; the US market led the way with a gain of 4.6% whilst continental Europe and the UK delivered broadly flat returns and the Asia Pacific ex Japan region posted a decline of circa 1%. Meanwhile bond markets provided returns ranging from a 6% gain for UK gilts to a marginal decline for Asian bonds. Global property securities bolstered returns across all the Harmony funds, with the S&P Global Property index gaining 6.4% over the quarter.

The Harmony fund range delivered returns of between 0.7% and 6.0% net of fees in local currency terms in 2014. Growth risk profiles (which usually maintain a higher equity weighting) outperformed balanced risk profiles for the US Dollar, Sterling and Asian funds by circa 1 to -2%. Equity and bond returns were positive across most major geographies when measured in local currency terms. Standout performances came from the US equity market, and the UK and continental European bond markets.

As ever, last year’s performance should be considered in the context of strong longer term returns. Over three years the Harmony funds have delivered returns of between 4.2% and 11.6% annualised net of fees, with lower volatility and smaller drawdowns than their respective local equity markets.

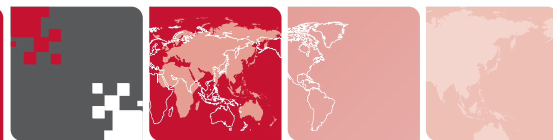
Considering the main performance contributors and detractors over the quarter, equity manager selection was generally a reasonable - if not sizeable - contributor to returns over the period, depending on the fund in question.

The Sterling portfolios saw the biggest benefit from our manager selection, with all of our holdings outperforming, driven in part by their underweight exposure to the energy sector which posted a large decline: Lindsell Train outperformed by 8.1%, Schroder Recovery by 5.8%, Evenlode by 3.7% and RWC by 1.0%. The outperformance of the Schroder Recovery fund benefited all the Harmony funds given it was added as a small holding to the non-Sterling portfolios during the quarter. Although the magnitude of outperformance was slightly lower, our Europe ex UK, Australia and US equity managers also outperformed, with the exception of one of our five US managers who underperformed very marginally. Amongst other equity holdings, our three core global equity holdings all outperformed as did our listed real estate and listed infrastructure managers. These gains were offset by Kopernik, however, a smaller holding we recently added to the funds. Kopernik is a deep value manager with a strong bias towards areas that underperformed over the period, including emerging markets and the materials sector. Also our Asian equity managers mostly underperformed, although this comes at the end of a year in which they have added significantly to performance.
The Schroders Recovery fund was added to all of the non-Sterling portfolios, at around a 2% weighting. This allowed us to increase our equity exposure after a sharp sell-off in October, via a specialist manager operating in a market that appears relatively undervalued compared to other developed equity markets. The co-managers, Kevin Murphy and Nick Kirrage, invest with a contrarian value mind-set and offer high outperformance potential as a result of their disciplined, benchmark agnostic approach. Their portfolio will typically consist of 40 to 70 out of favoured companies that are compellingly cheap. Furthermore, we added the Axa US Short Duration High Yield fund, with an allocation between 2% and 5% depending on the fund, as valuations in this area became attractive enough for us to re-enter the asset class. Having been much narrower earlier in the year, spreads for lending to these sub-investment grade businesses have progressively widened since the summer and indeed since we last sold our holdings earlier in the year. We chose to invest in this specialist strategy as it offers the benefits of a large and experienced team of credit selection experts operating to a short duration mandate, which means the fund will be less susceptible to capital losses should medium or long term Treasury bond yields rise.

It is worth noting that 2014 was a difficult year for the majority of active equity managers across various geographies, particularly among global and US equity universes. Indeed, based on Morningstar peer groups, the average US equity manager underperformed by 3.0% in 2014, while even the 25th percentile of the peer group (representing the start of the top quartile) underperformed by 0.5%. There were a number of factors that likely contributed to so many active managers struggling, including small stocks underperforming their larger peers and the concentrated nature of the index performance, with the IT and healthcare sectors contributing over half of the index return despite accounting for a third of the index.

Asset allocation 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).

Emerging market assets mostly posted declines over the period which led to negative return contributions from our various small holdings in this area, including global emerging market equity, hard currency sovereign bonds, short duration corporate bonds and convertible bonds. Valuations for these various asset classes remain compelling in our opinion, however, and we are maintaining these holdings. Our new position in short duration US high yield that was added during the quarter also posted small declines



over the remainder of the quarter. Across all the Harmony funds, the opportunity cost we suffered from not having more interest rate exposure, during another quarter that saw strong returns for fixed income, was compounded by our holding in a strategic bond strategy managed by Old Mutual that was also expressing a bearish view on bond yields.

Like us, the manager incorrectly expected benchmark yields to rise over the year, particularly for US Treasuries, which would have led to muted or probably negative returns for government and investment grade bonds. The manager's positioning resulted in a return of -1.7% during the fourth quarter.

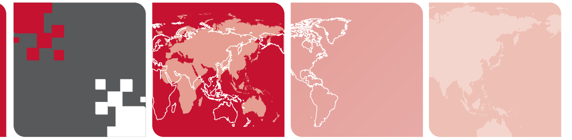
Two main changes were made to the asset allocation of the funds during the fourth quarter; a small increase in our equity weightings and an allocation to US high yield bonds. These were funded through a combination of reducing cash holdings and a slight reduction in both our listed real estate and listed infrastructure allocations, following strong outperformance during 2014.

All of the Harmony funds have a reasonable proportion invested in global assets, representing investments made outside of their base currency. During 2014 the US Dollar strengthened significantly versus all other major currencies, mostly during the second half of the year, and gained 12.2%, 8.5% and 5.9% versus the euro, Australian dollar and sterling respectively. These currency movements made a meaningful impact on the returns when translated into different base currencies. For instance, the MSCI AC World index returned 14.5% in AUD terms but only 4.2% in USD terms. Consequently, a key determinant of relative performance amongst the Harmony funds was actually the base reporting currency of the fund. This explains why the Harmony Euro Balanced and Harmony AUD Growth Funds delivered the strongest performance. Both funds returned 6.0% in their local currencies.

While returns were stronger for those funds where the relevant reporting currency weakened versus other major currencies, the flip side of this was that funds with a US dollar reporting currency faced a substantial headwind. For instance regions including the UK, continental Europe, Japan and global emerging markets all delivered negative returns of between -2.2% and -6.5% when translated into US dollar terms. These declines contributed to a negative US dollar return for the MSCI World ex USA index of -4.3%. Also, despite a strong year for government bonds with yields declining across most major geographies, the JP Morgan Global Government Bond index returned a meagre 0.7% in US dollar terms.

The currency moves during the year are a key factor in explaining the relatively modest returns delivered by the Harmony US Dollar Balanced and Growth Funds in 2014. On average around 29% of the Balanced funds and 48% of the Growth funds were invested in our five selected US equity managers. Additionally, around 10% and 20% respectively was invested in non-US equities. This latter exposure made a negative contribution given the currency translation effects explained above.
We do not expect currency effects such as this to have such a detrimental impact over longer time periods. Various factors contributed to the strong US dollar in 2014, including divergence in both central bank policy and economic growth expectations between the US and most of the rest of the world. The US dollar could potentially strengthen further in 2015 but we remain committed to investing a portion of each of the Harmony portfolios outside of their base currency, in order to: improve diversification; increase the investable universe to capture more asset classes and managers; and to reduce volatility of returns over time. Nonetheless, it is important to point out that all of the Harmony funds will have at least two thirds exposure to their base currency or "home" region at all times.

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

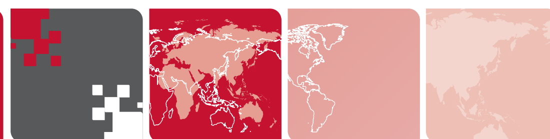
- UK equity
- US High Yield (short duration)

Decreased

- Listed real estate
- Listed infrastructure
- Cash

Manager changes during the quarter:

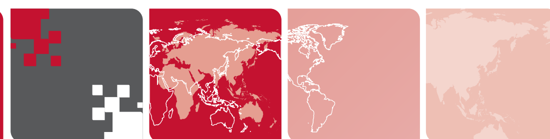
- Initiated holdings in Schroder Recovery fund in all non-Sterling portfolios (already a core holding in Sterling portfolios).
- Initiated holdings in Axa US Short Duration High Yield across the Harmony range.



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%**

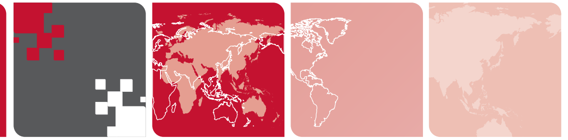
These target weights are correct as at the time this report is published and are indicative of the managers' medium term outlook for markets, which is driven principally by their assessment of relative valuation opportunities. The property exposure includes exposure to listed infrastructure.



5. Fund and peer group performance

Fund returns (local currency)	Performance to 31 December 2014			
	3 months	6 months	2013	3 Years (annualised)
Asian Balanced (US dollars)	-0.9%	-2.8%	2.5%	4.3%
Peer group median	-2.6%	-7.3%	7.4%	4.5%
Asian Growth (US dollars)	-0.7%	-2.1%	6.2%	7.2%
Peer group median	-2.5%	-6.7%	7.4%	5.0%
Global equities	0.4%	-1.9%	22.8%	14.1%
MSCI AC Asia Pacific ex Japan	-0.8%	-4.0%	3.4%	9.1%
AUD Growth	3.7%	4.5%	17.1%	11.6%
Peer group median	3.7%	4.8%	17.3%	10.9%
Global equities	7.5%	13.4%	43.2%	23.7%
ASX All Ordinaries	2.6%	2.3%	19.7%	14.3%
EUR Balanced	2.7%	3.1%	7.8%	8.2%
Peer group median	0.9%	1.6%	4.8%	5.8%
Global equities	4.8%	11.0%	17.5%	16.8%
MSCI Europe ex UK	-0.2%	0.1%	22.1%	15.8%
GBP Balanced	2.3%	2.2%	10.6%	6.7%
Peer group median	2.1%	2.1%	9.9%	6.9%
GBP Growth	3.2%	2.8%	16.9%	9.8%
Peer group median	2.0%	2.0%	10.3%	7.1%
Global equities	4.4%	7.6%	20.5%	14.0%
MSCIUK	-0.4%	-1.4%	18.5%	9.5%
USD Balanced	1.4%	-0.6%	10.6%	6.7%
Peer group median	-0.1%	-3.3%	11.2%	7.2%
USD Growth	2.6%	0.6%	17.6%	10.3%
Peer group median	0.0%	-3.2%	13.3%	8.2%
Global equities	0.4%	-1.9%	22.8%	14.1%
S&P 500	4.9%	6.1%	32.4%	20.4%

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

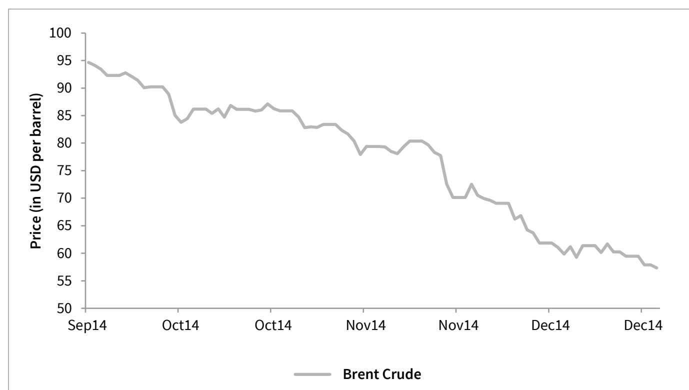


6. Market commentary

In the final quarter of 2014, central banks continued to play a major role in markets. In the US, the Federal Reserve (Fed) ended its programme of Quantitative Easing (QE). The prospect of this extraordinary monetary policy coming to an end had disconcerted investors, but the event had been well flagged, and by October, market prices had adjusted to reflect QE ending. Furthermore, the Fed committed for the foreseeable future to keep interest rates at historically low levels. The Bank of Japan surprised investors by announcing that it will increase the scale of its Quantitative Easing programme from its current level of JPY 60-70 trillion a year to JPY 80 trillion (circa USD 710 billion). The announcement came hours after the USD 1.2 trillion Japanese Government Pension Investment Fund announced that it will double its holdings of domestic equities to take the total equity exposure of the fund to 50% (split evenly between Japanese and international holdings). Both measures should, on balance, provide impetus to Japan's equity market. In Europe, expectations for full-scale quantitative easing (that includes sovereign bond buying) by the European Central Bank (ECB) continued to heighten.

Oil remained an important theme in the market, falling by 39.4% over the quarter. At time of writing, Brent crude has dipped below USD 50 a barrel, almost a third of its 2008 peak of USD 139.8 a barrel. Looking at the demand dynamics behind this fall, it is clear that activity is slowing, or at risk of slowing, in a number of key economic areas, while supply continues to increase; the US is producing oil at its highest levels for decades while OPEC has recently declined to cut production despite price falls.

Figure 1: The falling price of oil in Q4 2014

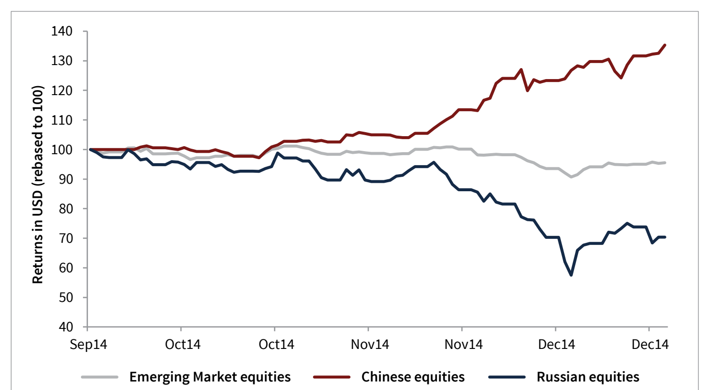


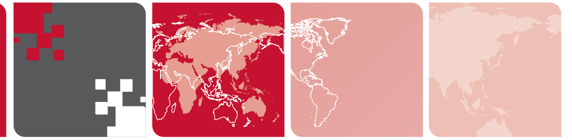
In Greece, current polls suggest that the leftist, antiausterity Syriza party will win the upcoming general election, which is scheduled for 25 January. The snap-election, a result of the current Greek parliament failing to elect a new president in December, could lead to a confrontation between Greek policy makers and the EU, as the Syriza party looks to renegotiate the Greek bailout conditions. Baring this in mind, the possibility of Greece leaving the euro in a so called 'Grexit' became an increasing concern, although Syriza's latest manifesto suggests they have moved away from earlier threats to do so. Geopolitical concerns surrounding Russia, Ukraine and the Islamic State movement in Iraq and Syria also disconcerted markets.

The S&P 500 index added 4.8% despite the energy stocks struggling over the quarter. Japan returned 6.3% in yen terms, but the fall of the currency against the USD led to a negative return of -2.5% in dollar terms. European equities fell by -0.2% and the UK returned -0.4%, in local currency terms. The strength of the greenback, however, meant that this translated into larger loses when translated into USD (-4.4% for both regions).

A combination of geopolitical risk, energy shocks and underwhelming economic prospects weighed on emerging markets (EM) stocks over the period: the MSCI EM index returned -4.5% over the quarter. Most notably the Russian index fell by 29.7% in US dollar terms, thanks in large part to the weakness of the rouble. Bucking the EM trend, Chinese equities enjoyed a stellar second half of the year to bring their 2014 return to +36.9% in yuan terms. It is interesting to observe these significant gains against a deteriorating economic background, illustrating the importance of investing for valuations rather than macro-economic trends.

Figure 2: Divergent returns in the emerging world

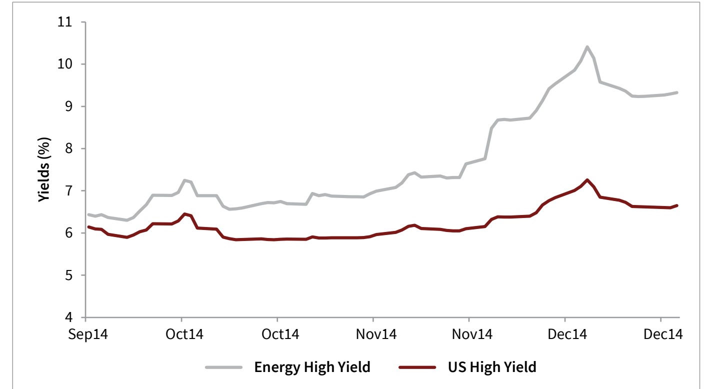




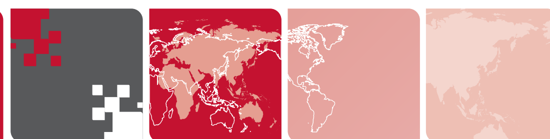
Global bond markets enjoyed a strong quarter. US Treasuries gained 2.3% over the period while UK Gilts gained 6.1% in sterling terms. European government bonds added 2.8% in euro terms. From these levels the upside is limited and the ability of bonds to provide a meaningful diversification to the equity market had lessened. Emerging market bonds fell by 0.9%. The quarter saw good returns for property securities, with global property markets returning +6.4% and US property securities returning +14.0%. Gold drifted off by 1.9%.

US high yield bonds returned -1.0% as the energy sector weighed on the asset class, while the higher quality investment grade index added 1.8%. In Europe, high yield saw modest returns (+0.8%) and corporates added 1.6%. Despite global government bonds outperforming both investment grade and high yield bonds in major economies, their overall performance when translated into USD dollars was -0.8% (due again to the strength of the greenback).

Figure 3: Yields on US high yield bonds and its energy subcomponent.



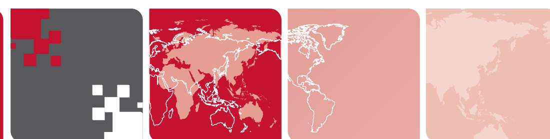
Source: Bloomberg, December 2014. Returns in US dollars unless otherwise stated.



7. Market Summary

Asset Class/Region	Index	To 31 December 2014 Currency	Quarter	12 Months
Developed markets equities				
United States	S&P 500 NR	**USD**	4.8%	13.0%
United Kingdom	MSCI UK NR	**GBP**	-0.4%	0.5%
Continental Europe	MSCI Europe ex UK NR	**EUR**	-0.2%	6.4%
Japan	Topix TR	**JPY**	6.3%	10.3%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	-0.7%	2.8%
Global	MSCI World NR	**USD**	1.0%	4.9%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	**USD**	-20.3%	-30.0%
Emerging Asia	MSCI EM Asia NR	**USD**	-0.3%	4.9%
Emerging Latin America	MSCI EM Latin America NR	**USD**	-13.4%	-12.3%
BRICs	MSCI BRIC NR	**USD**	-4.1%	-2.9%
Global emerging markets	MSCI EM (Emerging Markets) NR	**USD**	-4.5%	-2.2%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	2.3%	6.1%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	**USD**	0.2%	4.4%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	1.8%	7.5%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	-1.0%	2.5%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	**GBP**	6.1%	14.1%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	**GBP**	4.3%	12.3%
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	2.8%	13.2%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	1.6%	8.4%
Euro High Yield	Barclays European HY 3% Issuer Constraint Total Return Index Value	**EUR**	0.8%	5.7%
Japanese Government	JP Morgan Japan Government Bond Index TR	**JPY**	2.5%	4.8%
Australian Government	JP Morgan Australia GBI TR	**AUD**	4.9%	11.3%
Global Government Bonds	JP Morgan Global GBI	**USD**	-0.9%	0.7%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**USD**	-0.8%	0.8%
Global Convertible Bonds	UBS Global Focus Convertible Bond	**USD**	-0.5%	-1.1%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**USD**	-0.9%	6.2%

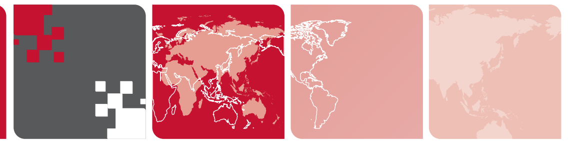
Source: Bloomberg, December 2014.



Asset Class/Region	Index	To 31 December 2014		
		Currency	Quarter	12 Months
Property				
US Property Securities	MSCI US REIT NR	**USD**	14.0%	28.8%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	**AUD**	9.8%	20.4%
Asia Property Securities	S&P Asia Property 40 Index NR	**USD**	1.4%	-0.5%
Global Property Securities	S&P Global Property USD TR	**USD**	6.4%	13.6%
Currencies				
Euro		**USD**	-4.2%	-12.0%
UK Pound Sterling		**USD**	-3.9%	-5.9%
Japanese Yen		**USD**	-8.8%	-12.6%
Australian Dollar		**USD**	-6.6%	-8.4%
South African Rand		**USD**	-2.5%	-9.3%
Commodities & Alternatives				
Commodities	RICI TR	**USD**	-16.1%	-22.2%
Agricultural Commodities	RICI Agriculture TR	**USD**	6.1%	-6.9%
Oil	ICE Crude Oil CR	**USD**	-39.4%	-48.3%
Gold	Gold Spot	**USD**	-1.9%	-1.7%
Hedge funds	HFRX Global Hedge Fund	**USD**	-1.8%	-0.6%
Hedge funds	Dow Jones Credit Suisse Hedge Fund USD	**USD**	-0.8%	2.6%

** 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).

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