momentum

Harmony Portfolios

Investment Overview

2017

At Momentum, we have a clear and resolute goal that drives us – to enhance the lifetime Financial Wellness™ of people, their businesses and their communities.

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1. Introduction

The Harmony Portfolio range

In this era of increased market volatility and investor uncertainty it is difficult for individuals to ensure that their specific risk and return requirements are met by their existing investment portfolios.

The Harmony Portfolios are a long established range of globally diversified, multi-asset funds designed specifically to provide a cornerstone investment. The Harmony range consists of eight portfolios, each risk profiled and with a specific geographical and currency focus, housed in a Luxembourg UCITS structure with daily pricing and daily liquidity.

The full range includes:

- Momentum Harmony Asian Balanced
- Momentum Harmony Asian Growth
- Momentum Harmony Australian Dollar Growth
- Momentum Harmony Europe Diversified
- Momentum Harmony Sterling Balanced
- Momentum Harmony Sterling Growth
- Momentum Harmony US Dollar Balanced
- Momentum Harmony US Dollar Growth

As at the end of January 2017, assets under management across the eight Harmony Portfolios totalled over USD 500 million.

The Harmony Portfolios investment philosophy is built on three core capabilities:

- Asset allocation
- Investment selection
- Portfolio construction

The asset allocation process is disciplined, robust and valuation driven, and builds portfolios with true diversification across a wide range of non-correlated assets. 'Best of breed' fund solutions are then used to construct each portfolio. We recognise that no investment house has a monopoly of skill in all disciplines: having an unconstrained choice allows us to choose the most appropriate investment managers for any particular asset class. We are objective and independent in our approach, with no incentive to utilise a specific provider in the underlying composition of the portfolios.

The Harmony Portfolios aim to create the best combination of investments to provide optimal returns relative to each of the eight mandates' tolerance for risk.

The Investment Manager

The Portfolios are managed in London by a team of experienced investment professionals at Momentum Global Investment Management (MGIM), which has been offering investment management and advisory services to institutional and retail investors since 1998. The fifteen-strong multi-asset investment team have been responsible for the investment strategy and management of the Portfolios since their inception in 2004. Senior members of the investment team have been working together throughout most of this period.

Investors can be confident that their investments are being managed within a strictly regulated environment, and by a highly qualified and experienced team with significant resources across the globe. MGIM is wholly owned by MMI Holdings in South Africa, a listed company with a market capitalisation of $3.3bn and a strong capital position with total assets of $54bn. MGIM is 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).

Key Benefits

- Strategic asset allocation
- Active tactical asset allocation
- Dynamic use of specialist third party funds
- Access to best in class active managers
- Unfettered, independent manager selection
- Strict risk controls
- Thorough investment due diligence process
- Independent operational due diligence
- Daily dealing
- Single priced, unitised UCITS fund structure
- Full transparency and liquidity of all underlying holdings
- Regular portfolio manager commentary and insight

2. A multi-asset approach

Asset allocation constitutes the most important step in constructing investment portfolios; it has been shown as accounting for more than 90% of the variability in portfolio performance over time.[1]

Asset classes such as equities, bonds and cash have different characteristics meaning that they respond differently to changing economic scenarios. These differences allow for the creation of multi-asset portfolios with complementary holdings that create optimised risk and return profiles.

Defining asset classes

Capital preservation assets

These are assets which provide protection during periods of market volatility, usually by virtue of their more predictable return streams and security of capital. Under normal circumstances, the stabilising influence of these assets comes at the opportunity cost of low relative returns. However they perform strongly relative to other assets in times of financial crisis or in deflationary conditions. Examples include cash and government bonds.

Income generation assets

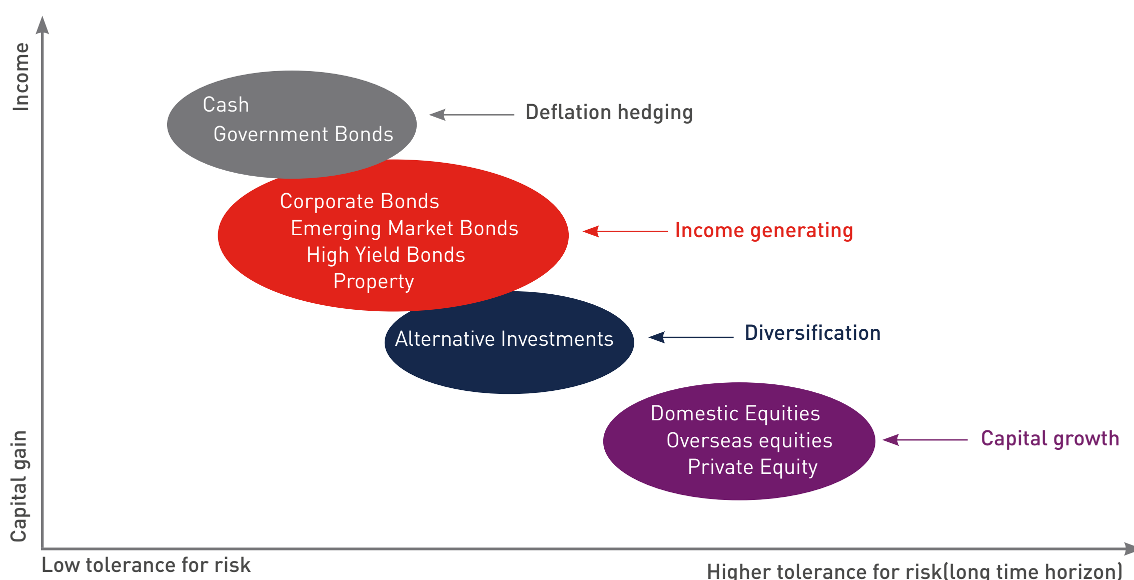
These assets generally deliver the majority of their returns through income payments. Typical assets include property, investment grade corporate bonds and high yield bonds. Under specific circumstances convertible bonds. Certain equities also provide a high dividend yield resulting in returns being driven more by this income element than by capital growth.

Capital growth assets

These assets generate a large proportion of their returns through increases in prices (capital growth), but in some cases may also provide meaningful income as well. Typical assets include equities – both in developed and emerging markets.

Alternative assets

These are investments into assets which tend to exhibit a particularly low correlation of returns to other traditional asset classes. When combined in portfolios containing other assets they can sometimes provide an important diversification benefit and stability in periods of financial turmoil. Risk premia and arbitrage bond strategies would be included in this category, as well as precious metals and commodities.



G.P. Brinson, B.D. Singer, G.L. Beebower, "Determinants of Portfolio Performance II: An Update", in Financial Analyst Journal, May-June 1991

The graph below illustrates the difference in performance for a number of asset types across the last nine years, reinforcing the importance of the diversification that a multi asset portfolio can offer through a combination of strategic and tactical asset allocation.

2008	2009	2010	2011	2012	2013	2014	2015	2016
DM Bonds 7.08%	EM Equity 78.51%	Global Property 20.61%	EM Bonds 9.20%	Global Property 31.30%	US Equity 31.55%	Global Property 13.61%	EM Bonds 1.82%	US High Yield Bonds 17.49%
Global Cash 3.48%	US High Yield Bonds 58.10%	Commodities 19.01%	DM Bonds 5.64%	EM Equity 18.22%	DM Equity 26.68%	US Equity 12.99%	US Equity 0.75%	Commodities 13.34%
EM Bonds -9.70%	Global Property 41.21%	EM Equity 18.88%	US High Yield Bonds 4.37%	EM Bonds 18.04%	US High Yield Bonds 7.41%	EM Bonds 6.15%	Global Cash 0.28%	US Equity 11.23%
US High Yield Bonds -26.11%	DM Equity 29.99%	US High Yield Bonds 15.07%	US Equity 1.47%	DM Equity 15.83%	Global Property 3.75%	DM Equity 4.94%	Global Property 0.09%	EM Equity 11.19%
US Equity -37.45%	Commodities 26.23%	US Equity 14.37%	Global Cash 0.32%	US High Yield Bonds 15.55%	Global Cash 0.28%	US High Yield Bonds 2.51%	DM Equity -0.87%	EM Bonds 9.62%
DM Equity -40.71%	EM Bonds 25.95%	EM Bonds 11.83%	DM Equity -5.51%	US Equity 15.22%	DM Bonds -2.01%	DM Bonds 0.83%	DM Bonds -3.24%	DM Equity 7.51%
Commodities -41.35%	US Equity 25.55%	DM Equity 11.76%	Commodities -6.93%	DM Bonds 4.10%	EM Equity -2.60%	Global Cash 0.24%	US High Yield Bonds -4.61%	Global Property 4.93%
Global Property -48.85%	DM Bonds 5.78%	DM Bonds 4.38%	Global Property -7.44%	Commodities 2.03%	Commodities -4.49%	EM Equity -2.19%	EM Equity -14.92%	DM Bonds 1.95%
EM Equity -53.33%	Global Cash 0.80%	Global Cash 0.34%	EM Equity -18.42%	Global Cash 0.46%	EM Bonds -8.31%	Commodities -22.21%	Commodities -26.08%	Global Cash 0.71%

Source: Momentum Global Investment Management, Bloomberg. March 2017. Return in USD.

Equity and corporate bond markets were very weak in 2008 and 2011. With government bonds and cash out-performing equities, this provided a vivid illustration of the capital preservation qualities that these assets can provide to portfolios.

The other years mostly saw strong returns from assets such as equities and high yield bonds. Notably, US high yield bonds, which traditionally exhibit lower volatility than equities, has been one of the best performing asset classes over the full period. However, high yield bonds declined substantially in 2008 as well as in the latter part of 2014 and 2015 before rebounding strongly in both cases. This serves to highlight the value that can be added to multi asset portfolios through a valuation based tactical asset allocation approach that can take advantage of the opportunities that volatility often creates.

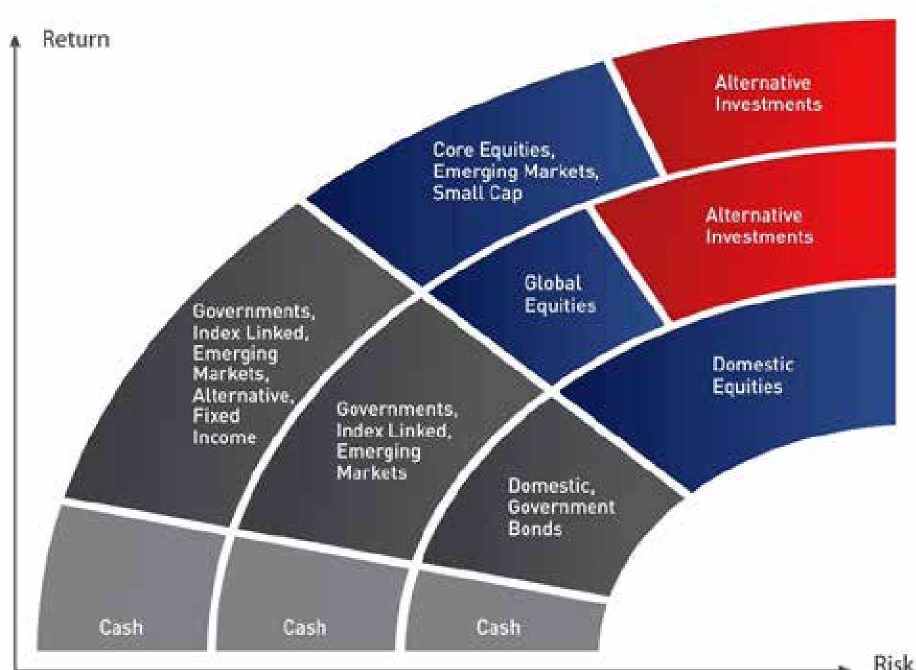
3. The Harmony Portfolios

Each Harmony Portfolio has a long term strategic asset allocation (SAA). This represents a combination of major asset classes which, held over the long run, should meet the return objectives of each portfolio whilst reducing volatility in order to smooth the investor's journey. The SAA should be used as a guide to the approximate levels of risk and return that these portfolio is designed to deliver and the investment team will target.

The SAA is the starting point, or neutral position, from which the portfolio is built. It is not treated as a benchmark because the focus is instead on generating strong risk-adjusted returns, on an absolute rather than relative basis. As such the investment team is free to deviate meaningfully from the strategic asset allocation based on the opportunity set and relative valuations. However, the aggregate level of risk will never vary substantially from the SAA, so as to provide a degree of certainty to investors that their portfolio remains appropriate for their circumstances.

Our approach to setting strategic asset allocations does not rely on historical returns of different asset classes, as these are not necessarily a good guide to future returns. Instead we place much greater emphasis on the historical volatility of asset classes and covariance with other asset classes. This enables us to define a robust strategic asset allocation of truly diverse asset classes, optimally combined to achieve the desired returns with as little risk as possible, whilst also minimising the probability of shortfall versus objectives. Our analysis uses decades of historical data reflecting our belief that long term historical asset class returns can be used to isolate the risk premia in asset classes; these differences in returns across asset classes will usually persist and drive future returns. One key output from this process is that 30% of the SAA is outside of the 'home' region / country, on a non-currency hedged basis, in order to increase portfolio diversification.

By combining assets that vary in response to the forces that drive markets, more efficient portfolios can be created. This is shown graphically below. Efficient portfolios are those that maximise return for a given level of risk or minimise risk for a particular return. This improves the robustness of investment results and reduces the variability of return outcomes.



Source: Momentum Global Investment Management, Bloomberg. March 2017.

4. Dynamic asset allocation

By tilting a portfolio's exposure between different asset classes at different times there is value to be earned, in the form of enhanced returns and/or reduced risk, which is the premise behind tactical asset allocation. This active method of portfolio management aims to add to or take from different asset classes within the portfolio depending on valuations and the outlook for a particular asset class at that point in time.

Many investors simply allocate among the asset classes popular at the time in proportions similar to those of other investors. While this usually creates uncontroversial portfolios, it often leads to substantial weightings in whatever the asset class of choice is at a particular point in time. Our approach avoids making allocations based on the fashion of the day.

Our active asset allocation decisions always begin with our five year expected returns framework. We dedicate significant resources to maintaining a wide range of long term expected returns across numerous regions and asset classes, each of which is updated monthly. Our aim is to focus portfolios towards asset classes that are undervalued relative to their long term return potential, where there is a 'margin of safety' that reduces the probability of losses. This framework is designed to distinguish, in a consistent and unemotional manner, between a good investment story - such as a strong economic backdrop in the US - and a bad investment opportunity - when all the good news is already discounted in prices and downside risk may be elevated. Macro and micro-economic conditions are constantly monitored, discussed and debated, but the foundation of any asset allocation decision we make is always the valuation. The investment team will adjust asset allocation as return expectations evolve and opportunities arise.

Appendix two shows our recent asset class return expectations.

5. Investment selection

The Harmony Portfolios mostly consist of a wide range of underlying fund holdings. Instead of researching individual companies and securities in order to implement asset allocation decisions, our investment team outsources the selection of these securities to a wide range of different specialist providers (managers). In this way the Harmony Portfolios are essentially being managed by many more investment professionals than Momentum's team alone. Furthermore, Momentum's large asset base provides strong buying power which leads to competitive fees.

The financial markets have many different types of investment management companies and strategies. Major categories include active strategies, passive (index tracking) strategies, generalist managers and specialist managers.

We have the option to invest in passive index-tracking funds or exchange traded funds (ETFs) for most asset classes, but we generally invest with an active approach where we believe that managers are capable of delivering outperformance versus the benchmark. We recognise that the world-class, active managers we seek will not outperform every year, so rather we invest in them with a view to benefitting from outperformance over a full market cycle, or at least a three year horizon. However, in certain asset classes where it is harder to sustain an informational advantage relative to the rest of the market (e.g. government bonds), consistent outperformance is hard to achieve and in these cases we will tend to invest in passively managed vehicles instead.

Generalist managers are useful for providing a broad selection of funds in one location, but these funds may lack the specialisation and expertise compared to their more focused counterparts. Indeed, we believe that no single fund management house can create a monopoly of quality across the spectrum of products that they offer and our ability to invest with different specialists across the world is essential. Specialists create pockets of excellence in their key areas of focus. Our approach therefore enables clients to access a portfolio of investments that are allocated across leaders of the global investment industry.

Selecting specialist active managers requires extensive due diligence and significant resources, but this is expected to be justified by superior results. Momentum's dedicated investment professionals undertake detailed and extensive due diligence into all underlying managers. This creates great insight into the individual investment characteristics of any particular fund and allows us to blend best of breed managers from across the globe that we believe will complement each other to the benefit of the portfolio as a whole.

Further to our research into an investment manager's skills we also place much emphasis on the operational due diligence of the fund under analysis. The operational due diligence team has the right to veto a proposed investment if they identify operational risks.

After selecting an investment we continually monitor it to ensure that we have the best strategies for each asset class. For actively managed strategies this usually involves formal review meetings with the portfolio managers twice a year as well as regular desk based monitoring. Our view of what makes a great manager doesn't change, so we tend to be long term investors in the funds we choose, but the universe of managers usually grows. This provides us with upgrade opportunities. An upgrade could be a manager with a better expected risk/reward profile, or it could be a manager that better complements other holdings, improving the balance and diversification within the portfolio. Our aim is always to be invested with the managers that provide the greatest potential for strong future performance, rather than the manager with the best past performance.

The ability to access cherry-picked, thoroughly researched, pre-eminent investment managers within a single product at institutional fees is a highly attractive proposition. This is what the Harmony Portfolios offer.

6. Blending style factors

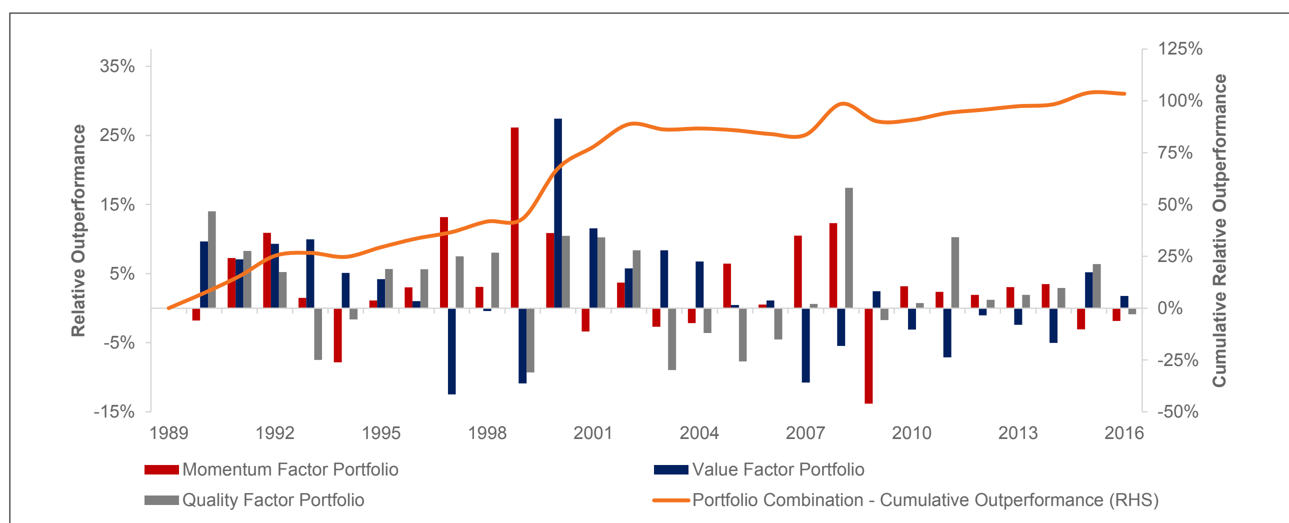
A key characteristic of the underlying active managers we invest with is that they all follow a well-defined and consistently applied investment philosophy, supported by proprietary fundamental research and analysis. In particular among equity strategies we focus on those that are managed with distinct investment styles that result in focused exposure to particular style factors such as value, quality or momentum. Portfolios that are consistently biased towards one of these factor groupings have been seen to outperform the market over the long run through capitalising on mispricing that results from the behavioural biases of other investors.

The apparent drawback of these strategies is that the returns are usually lumpy with long periods of underperformance being followed by rapid outperformance when the style is in favour. However, because these styles each result in significant variation in the underlying portfolio composition, they tend to do well and badly at different times. This allows us to create a diversified basket of style specific strategies that should preserve their various inherent tailwinds while reducing the volatility of the returns series to create a more efficient returns profile. This is illustrated in the graphic below using a simple equally weighted combination of the three main style categories; the volatility of returns around a global equity benchmark is vastly reduced this way while outperformance in maintained.

Having this clear vision of the types of managers we want to invest with enables us to effectively filter the sizeable universe of strategies down to a subset of strategies that have the greatest future performance potential. It is then up to us to identify which strategies will be successful, and we have an advantage in this regard because we have managed portfolios consistently in this way for over ten years.

Performance statistics (January 1990-September 2016)

	Momentum Style	Value Style	Quality Style	Combination
Tracking error	7.8%	6.8%	5.6%	**3.8%**
Max drawdown	-19.9%	-33.8%	-24.9%	**-6.4%**
Excess return (ann.)	3.4%	1.4%	2.8%	**2.7%**
Information ratio	0.44	0.21	0.50	**0.71**



Source: FactSet, Figures as at 30 September 2016, for illustrative purposes only. Past performance is not indicative of future returns

7. Portfolio construction

Portfolio construction is the next step in the investment management process. This is where we blend together asset allocation and manager selection decisions to form a coherent investment proposition. Target allocations will evolve as and when necessary. Although volatility can be uncomfortable for investors, especially when it leads to short term drawdowns in portfolio valuations, it can provide us with more opportunities for attractive investments. This is a key aspect of portfolio construction - maintaining a well-diversified portfolio reduces the impact of volatility on a portfolio and puts us in a stronger position to make the most of market dislocations.

Another key aspect of the portfolio management process is monitoring and managing risk exposures, which we do continually and systematically through proprietary tools and analysis. Our aim is to ensure that the portfolio is well diversified and can prove robust through different environments. Future events, opportunities and downside risks are inherently difficult to predict, so we try to ensure that the portfolio is not held hostage to one particular outcome in markets, but rather aim to maximise the probability of meeting investor goals across a range of scenarios.

The intention is for the Harmony Portfolios always to be well diversified by asset class, currency, geography, investment style and across several managers, in order to provide sustainable returns and reduced volatility. No single fund holding will represent more than 20% of the portfolio and each underlying fund is obliged to maintain a high level of diversification across different securities.

8. Summary

In this document we have explained our approach to maximising our chances of meeting investor goals whilst smoothing the journey as far as possible. The Harmony Portfolios aim to provide an 'all-in' cornerstone solution for clients that effectively takes responsibility for the significant research burden of investment and manager selection combined with specialist active asset allocation, portfolio construction and risk management activities.

The portfolios provide a single means through which investors can access a globally diversified multi-asset portfolio of world class investment talent, via a highly liquid and daily dealing UCITS investment vehicle that provides the highest level of security for their investments.

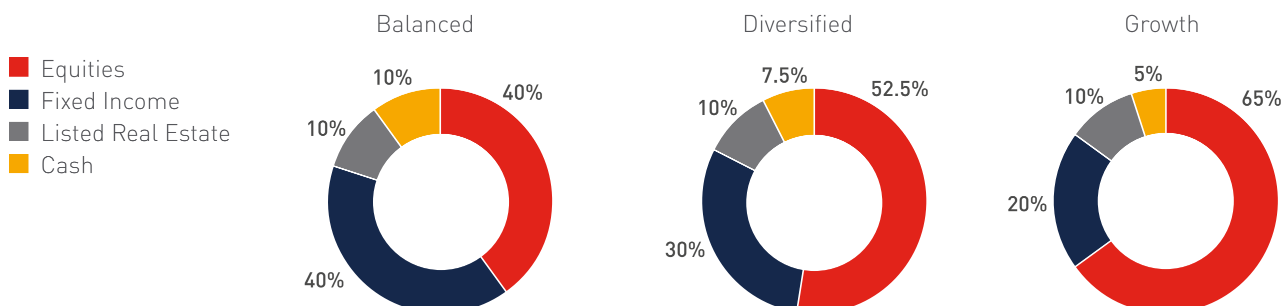
Appendix 1:
Harmony Portfolios strategic asset allocation

The table below shows the strategic asset allocation for each of the Harmony Portfolios along with the corresponding expected risk and return parameters.

Investment Mandates

	Developed Markets						Emerging Markets	
	USD Balanced	GBP Balanced	Europe Diversified	USD Growth	GBP Growth	AUD Growth	Asia Balanced	Asia Growth
Return target over cash (net p.a.)	3.0%	3.0%	3.5%	4.0%	4.0%	4.0%	4.0%	5.0%
Expected volatility	7-10%	7-10%	8-11%	9-12%	9-12%	9-12%	10-13%	12-15%
Recommended holding period	3-4 years			4-5 years			5+ years	
Base Currency	USD	GBP	EUR	USD	GBP	AUD	USD	USD
Regional focus	US	UK	Europe ex UK	US	UK	Australia	Asia Pac ex Japan	

Strategic Asset Allocation



The targeted outcomes for the Harmony Portfolios are net of fees and should be considered in the context of asset class returns over the very long run (see table below). For example, the Harmony Sterling Growth Portfolio targets a net of fees return that is equal to or higher than UK Cash +4% p.a., which compares to UK equities and UK bonds which have outperformed UK Cash by 4.2% p.a. and 0.5% p.a. respectively.

	Real Return p.a.
US Equities 1901 - 2015	6.3%
UK Equities 1899 - 2015	5.0%
US High Yield Bonds 1983 - 2015	6.0%
UK Commercial Property 1983 - 2015	5.5%
US Corporate Investment Grade 1926 - 2015	2.9%
US Government Bond 1926 - 2015	2.6%

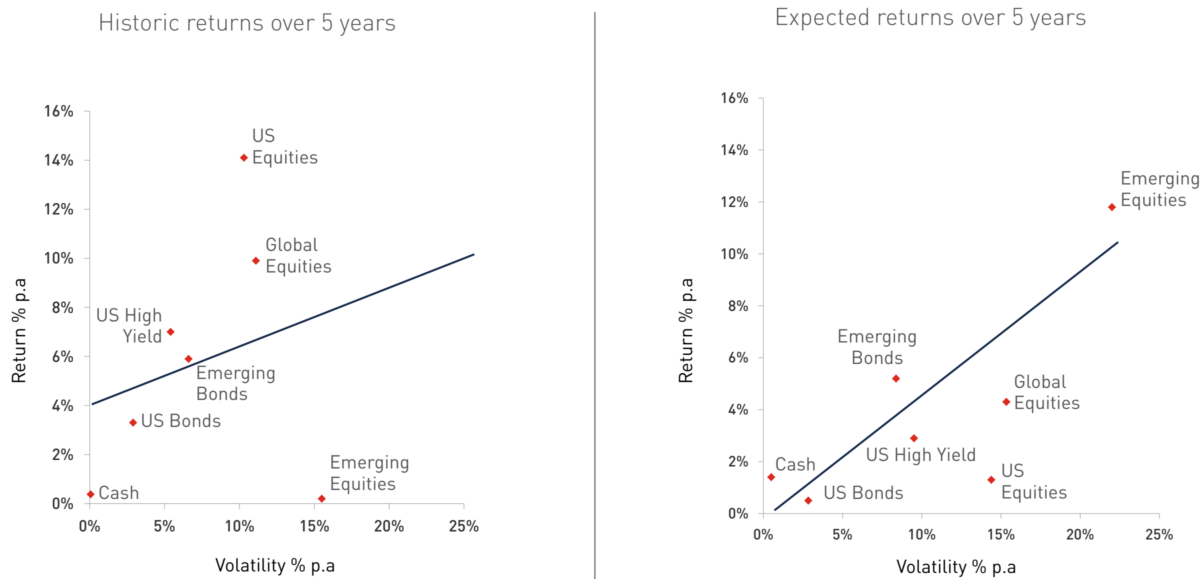
	Real Return p.a.
UK Gilts 1899 - 2015	1.3%
UK Cash 1899 - 2015	0.8%
US Cash 1926 - 2015	0.5%
Gold 1921 - 2015	1.5%
Oil 1871 - 2015	-0.4%
Agricultural Crop Prices 1913 - 2015	-1.4%

Source: Barclays Equity Gilt Study 2015

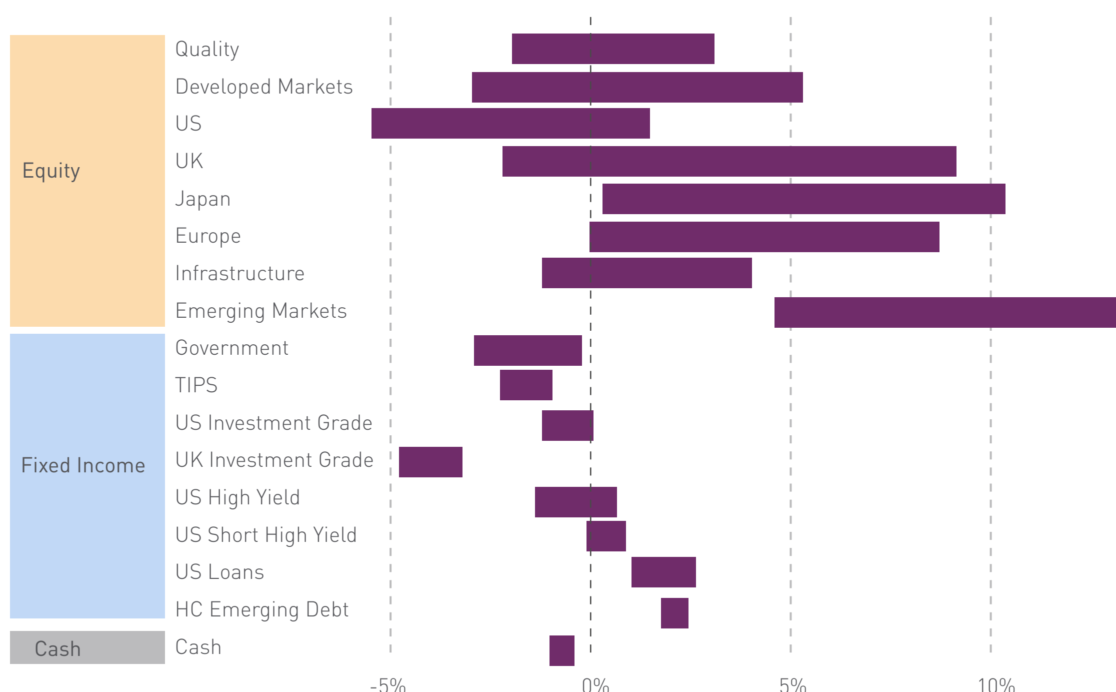
One could reasonably argue that some investors should simply hold all their investments in the equity market over the long term for the marginally better return experience. However, this would expose the investor to significantly higher volatility and drawdowns, which increases the chance of that investor reducing exposure at low points in the markets when levels of fear are elevated, thereby potentially missing out on the subsequent recovery and impairing long term returns. The Harmony Portfolios aim to smooth the return experience for investors in order to reduce the probability of selling out of the market at the wrong time. Although the end return may be slightly lower, the volatility and drawdowns will be significantly lower, which translates into much better risk-adjusted returns.

Appendix 2:
Expected asset allocation

The graphs below shows the extent to which our expectations of future returns and volatility for certain key asset classes vary from the recent experience.

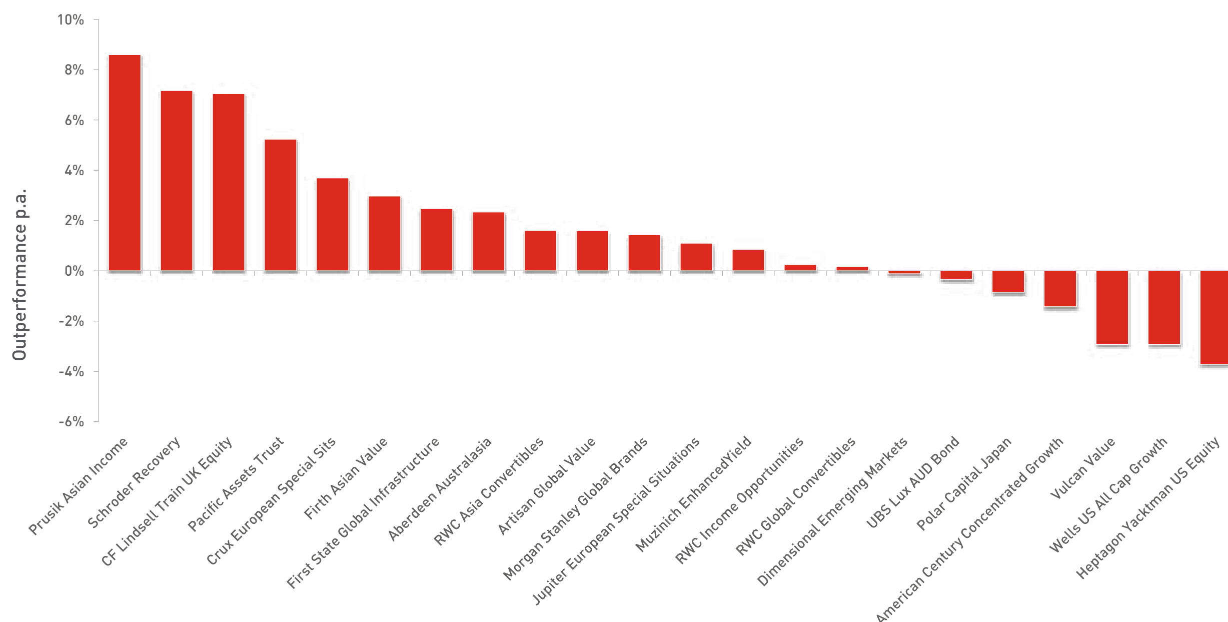


We consider a range of scenarios when estimating our expected asset class returns. The chart above represents our base case estimates but we also pay attention to potential returns in bull and bear scenarios. This leads to a wider range of expected returns which is valuable at the portfolio construction stage; for example we aim to avoid creating portfolios of asset classes that are all vulnerable to losses under one particular scenario. The chart below shows the widest estimated ranges between 'Bull' and 'Bear' scenarios and serves to highlight the value of fixed income securities alongside equity holdings, given much less uncertainty around the range of potential outcomes across different scenarios.



Source: Momentum Global Investment Management, Bloomberg, FactSet - Feb 2017

Appendix 3:
Performance of active managers held in Harmony Portfolios



Source: Bloomberg, Momentum. Data as at 31 January 2017. Past performance is not indicative of future returns

The chart above provides evidence of our success at selecting active strategies. It shows the annualised rate of outperformance for all actively managed strategies that are currently held in one or more of the Harmony Portfolios, from the date of first investment across the Harmony Portfolio range to 31st January 2017. It does not include passive index tracking strategies or those strategies that we have invested in for less than three years (because anything less is an inappropriately short period to judge an actively managed holding). Returns are shown net of the manager's fees.

When selecting active strategies, we would hope to achieve a high success rate (more outperforming than not over the long run) and a positive skew towards the left (good investments outperforming by more than bad investments underperform). This chart stacks up well on both metrics; the success rate here is very high and the best performing investments have generally outperformed by twice as much as the worst have underperformed. Results are even better when one considers that:

- The best performing holdings have been held longer on average, meaning the cumulative outperformance is larger. For example, Prusik Asian Income, the best performing holding, has been held since December 2012 and has outperformed by a cumulative 55% since then.

- This does not fully capture the performance contribution, which depends on the weighting and how widely the strategy is held across the Portfolios. Many of the best performing holdings have been held at large weights (e.g. Lindsell Train or Prusik Asian Income) or across all portfolios (e.g. Artisan Global Value).

- An additional benefit of active management can come from volatility reduction; the RWC Income Opportunities fund has only outperformed slightly since we invested, but has experienced much lower drawdowns and less volatility than the UK market, thus contributing to a smoother investment journey.

Appendix 4:
Harmony Portfolios performance

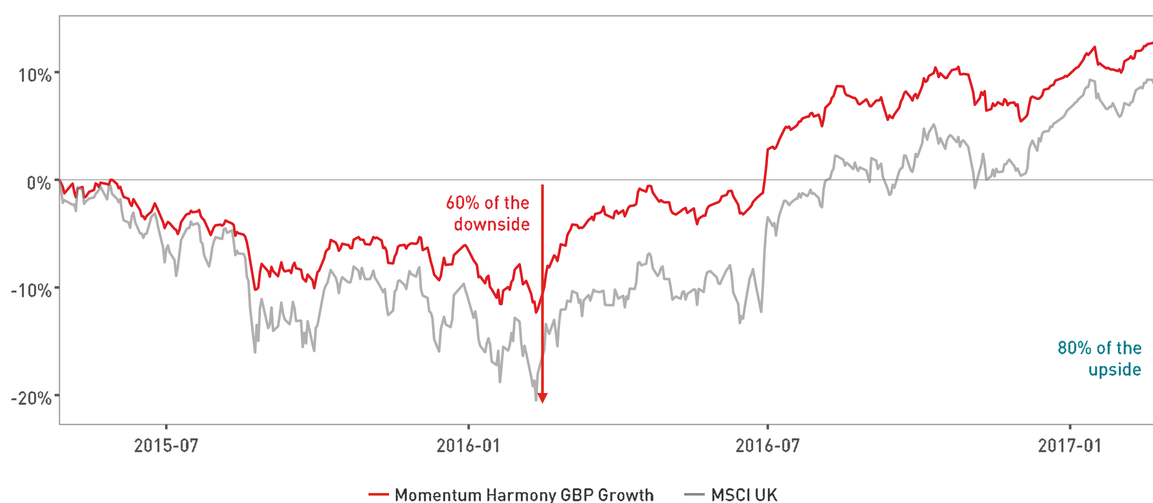
The realised returns for the Harmony Portfolios are shown below (net of fees). Most of the funds have met or exceeded their return targets over five years, without suffering significant drawdowns over any calendar year. Only the Asian funds have fallen short of our expectations over five years, reflecting a prolonged period of subdued returns for Asian and emerging market assets (particularly in USD terms) that followed a decade long bull market.

	Reporting currency	YTD	2016	2015	2014	2013	2012	5 years annualised
Asian Balanced	USD	5.1%	2.9%	-4.3%	0.7%	2.5%	9.7%	1.6%
Asian Growth	USD	6.3%	3.8%	-4.5%	2.3%	6.2%	13.4%	3.2%
AUD Growth	AUD	1.3%	6.9%	2.3%	5.9%	17.1%	11.9%	8.2%
Europe Diversified	EUR	3.4%	3.1%	5.8%	6.0%	7.8%	11.0%	6.3%
GBP Balanced	GBP	2.6%	14.1%	0.2%	3.2%	10.6%	6.4%	6.6%
GBP Growth	GBP	3.0%	16.9%	0.0%	4.1%	16.9%	8.6%	8.7%
USD Balanced	USD	4.1%	5.2%	-4.6%	2.0%	10.6%	7.6%	3.8%
USD Growth	USD	5.2%	5.5%	-6.2%	4.1%	17.6%	9.6%	5.5%

Source: Momentum GIM. Performance shown net of fees for A share class to 28 February 2017. Past performance is not indicative of future returns.

The graph below highlights the return and risk benefits that the funds have provided over shorter periods of elevated market volatility. Over the approximately two year period below, the Harmony Sterling Growth Portfolio provided significant downside protection relative to the large peak to trough decline in the UK market, then participated in a far higher proportion of the gains from that point onwards as the equity market recovered. This reflected contributions from all aspects of our investment process: asset allocation, investment selection and portfolio construction.

Momentum Harmony GBP Growth (A) vs. MSCI UK



Source: Momentum Global Investment Management, Bloomberg.

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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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