momentum

Momentum Global Balanced Fund Report

quarter ended 28 June 2019

Q2

global investment management

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1. Fund and index performance

Fund returns (USD)	3 months	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009
	Performance to 28 June 2019										
Momentum Global Balanced	2.4%	-8.5%	17.4%	4.7%	-3.4%	-0.5%	16.5%	12.7%	-4.9%	7.4%	23.9%
Composite benchmark[1]	3.6%	-6.0%	17.1%	5.6%	-2.5%	2.9%	12.3%	11.4%	-0.6%	8.5%	20.4%
Global equity[2]	3.6%	-3.8%	24.0%	7.9%	-2.4%	4.2%	22.8%	16.1%	-5.8%	11.4%	30.3%
ICE BofAML Global Broad Market TR	3.4%	-0.1%	7.4%	1.9%	-3.2%	0.8%	-2.0%	4.1%	7.0%	3.1%	5.8%

[1]60% MSCI AC World index, 40% Citigroup World Broad Investment Grade (BIG) index

[2]The equity component of the fund benchmark changed from the MSCI World index to the MSCI AC World index on 1 October 2011

[3]30% MSCI AC World Index ex UK, 35% Citigroup Sterling WorldBIG, 5% Citigroup WorldBIG and 30% FTSE All Share

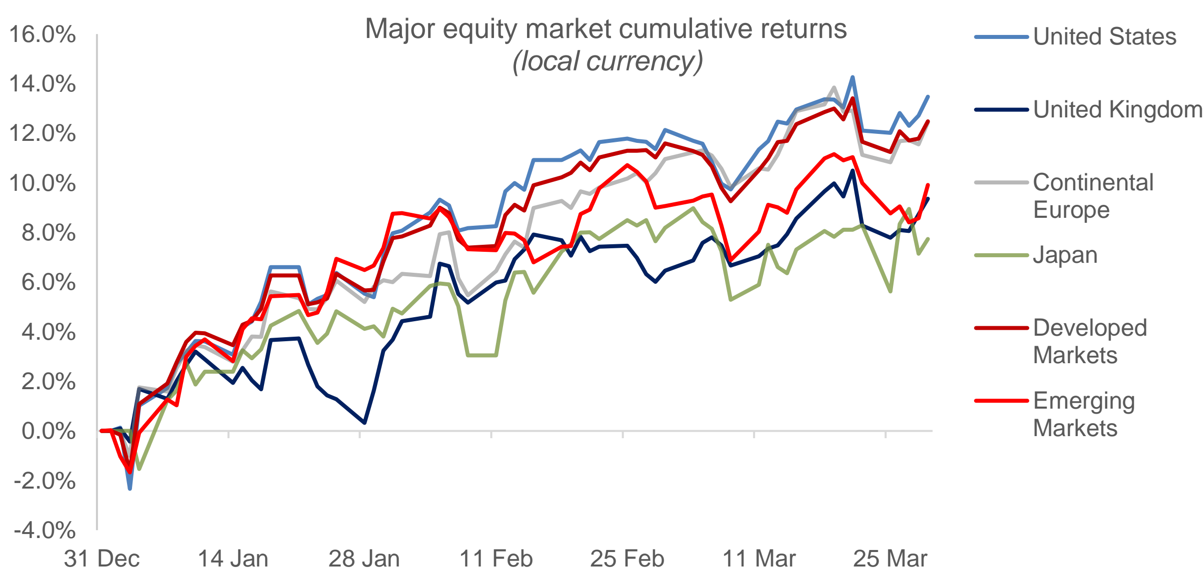
[4]The equity component of the fund benchmark changed from the MSCI AC World ex UK index to the MSCI AC World index on 1 April 2012

Source: Bloomberg; Morningstar, March 2019. ***Past performance is not indicative of future returns***

2. Market commentary

After the carnage of Q4 2018 came the recovery, with equities enjoying one of the strongest starts to a year in decades. Just as the market rout was triggered by the Fed's tightening, so the recovery was inspired by an about turn by the Fed, with an unexpected and sharp shift to easing. However, the surge in January, the strongest since 1987 (which those with a sufficiently long memory will recall was the year of Black Monday, October 19th, when the Dow suffered its biggest ever percentage point fall in a day, 23%….), faded and by the end of the quarter the prevailing mood was more cautious. Nevertheless, the return of 12% from global equities in Q1, led once again by the US, recovered much of the ground lost in Q4 2018 and left Wall Street within 3% of its all-time high.

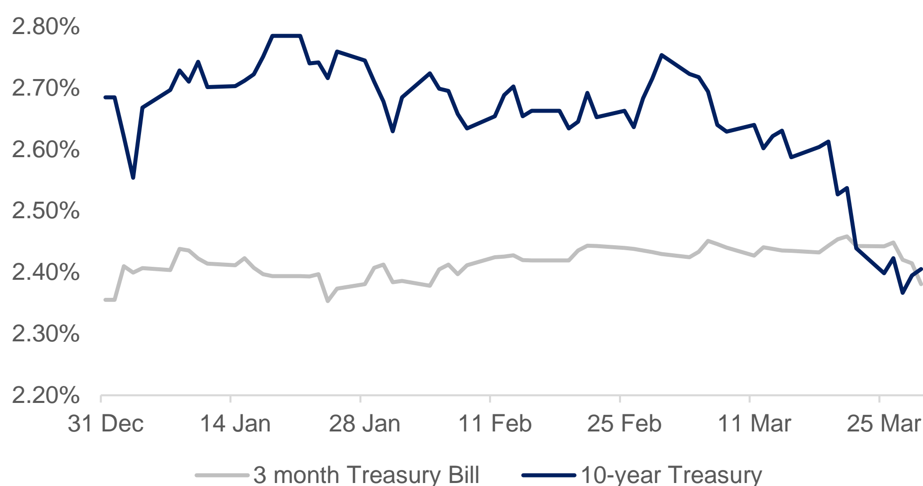
Figure 1.1: Global equity markets had a strong first quarter of 2019



Source: Bloomberg, Momentum GIM. Returns in local currency terms

As notable as the big move in equities, and perhaps of greater importance, was the move in bond yields, with sharp falls particularly in longer maturities and especially during March. The yield on the 10-year US Treasury fell by 28bps, taking it down to 2.4%, and producing a return of 2.2% in Treasuries for the quarter; since the cyclical peak in the yield in early November 2018 there has been a fall of some 83bps, an extraordinary move as we enter the 11th year of a global economic expansion. Bond markets around the world followed, with 10-year yields in Japan and Germany falling back into negative territory, while credit markets produced exceptional returns, 5% for US investment grade, 7% for High Yield and 6% for Emerging Markets. During March one of the closely watched lead indicators of a recession, the 3 month-10 year Treasury yield spread, inverted, yet US recessionary fears are not reflected in credit markets, where spreads narrowed in the past 3 months.

Figure 1.2: The 3-month Treasury Bill and 10-year Treasury yield curve inverted for the first time since 2007



Source: Bloomberg, Momentum GIM.

Despite the Fed's shift to an easier policy the US dollar strengthened over the quarter, largely because of weakness in the Euro, where the ECB also signalled a looser stance. Sterling was a notable outperformer, despite the Brexit saga, as the market interpreted the endless political machinations as likely to lead to a softer Brexit. In commodities, the notable move came in the oil price, up 27% and recovering about half the ground lost in the fourth quarter of 2018, taking it back to its levels of a year ago. Here supply constraints arising from the reimposition of US sanctions in Iran, the crash in production in Venezuela as its political crisis deepens, and the continuation of OPEC and Russian production cuts have outweighed the impact of softer demand and continuing growth of shale oil production in the US.

The key drivers of markets this year have been the increasing evidence of slower global growth, most prominent in China and Europe, and to a lesser extent in the US, and the response of central banks to this slowdown. Having pivoted to a more dovish, patient policy approach in December and January the Fed delivered a surprise to the market in March when in effect it called a halt to its tightening cycle. Reducing its growth and inflation forecasts for both 2019 and 2020, and pointing to growth slowing more than expected, less supportive financial conditions, persistent inflation undershoots and downside risks from Brexit and trade, the Fed removed expectations for interest rate rises this year, whereas previously it had anticipated two rises, and set out a timetable for ending its balance sheet run off programme by October 2019. This means that quantitative tightening, which has significantly reduced liquidity in markets, will be brought to an end earlier than previously anticipated.

The significance of this shift should not be under-estimated. Its impact on markets has been amplified by a similar pivot by the ECB, the world's second most important central bank. Having ended its QE programme at the end of last year, the ECB reacted to the alarming fall in growth in the Euro area, with economies in Italy and Germany either in or flirting with recession, others slowing sharply, and the spectre of deflation reappearing, by slashing its growth and inflation forecasts in March. The ECB pointed to risks to the downside and brought forward plans to provide banks with another round of cheap financing as well as pushing back its guidance on interest rate rises, which are now off the agenda completely for this year and probably most of 2020 too. Perhaps little wonder then that interest rates across the maturity curve fell sharply in government bond markets; but surprising that yields have fallen so rapidly back into negative territory in longer maturities in Europe. Now at -7 basis points, the yield on the 10-year German government bond is close to its Brexit induced lows of 2016 and is giving rise to comparisons with Japan, where interest rates were reduced to zero 20 years ago and have remained stuck around there ever since.

In China the well documented slowdown in growth, partly structural as the economy rebalances away from exports and investment towards consumption and services, partly due to deteriorating demographics and partly due to the debt overhang and the impact of the trade war with the US, produced a policy response from the authorities. Monetary policy has been progressively eased, with cuts in banks' reserve requirements, easier credit made available to SMEs and tax cuts announced from 1st April. After sharp falls in 2018 the Chinese stock market has been

he notable outperformer so far in 2019, up by 24%, reacting to the policy stimulus as well as the encouraging signs of progress in the trade talks with the US. China's growth rate will slow this year, with the official target set at 6-6.5%, continuing the gradual path to a lower level, but still contributing substantially to aggregate global growth.

While less important than events in the US and China, Brexit continues to dominate headlines and political discourse in the UK and Europe, as well as overhanging the UK economy and financial markets. As the original Brexit day has come and gone and the EU has cost yet another Conservative Party Prime Minister, the political morasse appears set to continue. With the PM's Withdrawal Agreement now seemingly dead, uncertainty is as intense as ever. It is impossible to forecast with any confidence the outcome of the latest turn of events, whether it be a long extension to the UK's exit, a 'no deal' exit, a general election, or conceivably some last-minute renegotiation of the Withdrawal Agreement enabling it to meet the approval of Parliament. The greatest fears of the market remain a disorderly Brexit and a general election giving rise to a Corbyn led government which would most likely put the shorter term disruption of a 'no deal' Brexit firmly in the shade. Sterling is likely to be the most sensitive market to the eventual outcome, whereas the UK stock market, undervalued and heavily dependent on revenues from outside the UK, could perform relatively well.

Investors are right to be worried about trade wars, Brexit and most importantly slowing global growth; leading indicators continue to point to weaker growth, especially in Europe. While returns from bond markets have been good in recent months the falls in yields point to structural as opposed to purely cyclical concerns, and mean that future returns will be lower from here. Furthermore, equities have recovered a substantial portion of the falls in the fourth quarter of 2018 and at current levels are not priced for further deceleration in growth or indeed a slide into recession.

However, there is no sign of inflation on the horizon, despite the length of this economic cycle and the low levels of unemployment, especially in the US. This provides considerable leeway to central banks and eases the fear of policy errors. With the Fed and ECB having turned dovish the liquidity tightening of last year is out of the way and financial conditions have improved substantially. Interest rate rises are a distant prospect across the developed world. Low rates improve debt sustainability for borrowers, and this has been reflected in tightening credit spreads and falling longer term bond yields. While trade wars and Brexit remain concerns, the progress of the US-China talks has been encouraging and both parties need to conclude a deal. The same could be said of the UK-EU negotiations but here political intransigence is holding back a satisfactory conclusion. Eventually a satisfactory conclusion will likely be reached, and the current intense uncertainty will be lifted, no doubt with more surprises on the way. Low interest rates and subdued inflation support growth, and the fiscal loosening in China will begin to have some positive impact, shoring up growth in the world's second largest economy. In the US the consumer, the driver of growth, is in good shape and should underpin growth this year, albeit at lower levels than last year when tax cuts provided a one-off boost.

While we recognise the risks, we do not share the concerns of some that the inversion of the yield curve (or at least parts of it) in the US points to the inevitability of a recession within the next 12-18 months. Global growth has weakened and is a concern but the usual triggers of a recession, either systemic financial problems and an ensuing liquidity crunch or excessive growth leading to capacity shortages, inflation and a sudden tightening of policy, are absent. Furthermore, ultra loose monetary policy has made it easier for yield curves to invert, suggesting that recession risks are being exaggerated.

The big shift in monetary policy and the sharp falls in longer term interest rates provide strong support for valuations of risk assets. The policy backdrop will remain supportive through this year and we expect some of the major areas of uncertainty which have held back confidence and investment, notably US-China trade wars and possibly even Brexit, to begin to lift. We therefore expect further progress in markets during 2019. However, we also recognise the risks of an unfavourable outcome to some of these events and resulting extended uncertainty, as well as the longer term problem of excess debt in many countries, which contain the seeds of a more serious economic slowdown. These uncertainties are enough to keep investors nervous and to trigger bouts of volatility, especially following the sharp rise in markets this year. Some period of consolidation is therefore quite likely, but we view the medium term outlook as broadly positive and would use periods of weakness to accumulate risk assets.

Source: Bloomberg, March 2019. Returns in US dollars unless otherwise stated. **Past performance is not indicative of future returns**

3. Market performance

Asset class/region	Index	To 28 June 2019			
		Local currency	Quarter	Year-to-date	12 months
Developed markets equities					
United States	S&P 500 NR	USD	4.1%	18.2%	9.8%
United Kingdom	MSCI UK NR	GBP	3.3%	13.0%	1.6%
Continental Europe	MSCI Europe ex UK NR	EUR	4.3%	17.3%	6.0%
Japan	Topix TR	JPY	-2.4%	5.2%	-8.2%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	0.7%	12.2%	0.8%
Global	MSCI World NR	USD	4.0%	17.0%	6.3%
Emerging markets equities					
Emerging Europe	MSCI EM Europe NR	USD	11.7%	20.2%	15.6%
Emerging Asia	MSCI EM Asia NR	USD	-1.2%	9.7%	-2.3%
Emerging Latin America	MSCI EM Latin America NR	USD	4.4%	12.6%	18.4%
BRICs	MSCI BRIC NR	USD	-0.2%	13.7%	3.3%
Global emerging markets	MSCI Emerging Markets NR	USD	0.6%	10.6%	1.2%
Bonds					
US Treasuries	JP Morgan United States Government Bond TR	USD	3.1%	5.4%	7.5%
US Treasuries (inflation protected)	BBgBarc US Government Inflation Linked TR	USD	3.0%	6.4%	4.9%
US Corporate (investment grade)	BBgBarc US Corporate Investment Grade TR	USD	4.5%	9.9%	10.7%
US High Yield	BBgBarc US High Yield 2% Issuer Cap TR	USD	2.5%	9.9%	7.5%
UK Gilts	JP Morgan UK Government Bond TR	GBP	1.4%	5.0%	5.2%
UK Corporate (investment grade)	ICE BofAML Sterling Non-Gilt TR	GBP	2.0%	6.3%	6.0%
Euro Government Bonds	ICE BofAML Euro Government TR	EUR	3.4%	6.0%	6.5%
Euro Corporate (investment grade)	BBgBarc Euro Aggregate Corporate TR	EUR	2.2%	5.4%	4.8%
Euro High Yield	BBgBarc European High Yield 3% Constrained TR	EUR	2.4%	7.8%	5.6%
Japanese Government	JP Morgan Japan Government Bond TR	JPY	1.2%	2.9%	3.3%
Australian Government	JP Morgan Australia GBI TR	AUD	3.6%	7.8%	11.5%
Global Government Bonds	JP Morgan Global GBI	USD	3.5%	5.4%	5.7%
Global Bonds	ICE BofAML Global Broad Market	USD	3.4%	5.7%	6.0%
Global Convertible Bonds	ICE BofAML Global Convertibles	USD	3.2%	11.3%	4.4%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	4.4%	10.8%	11.7%

Source: Bloomberg. June 2019 **Past performance is not indicative of future returns.**

		To 28 June 2019			
Asset class/region	Index	Local currency	3 months	Year-to-date	12 months
Property					
US Property Securities	MSCI US REIT NR	USD	2.3%	-0.2%[e]	3.7%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	2.4%	16.7%	13.9%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-2.2%	12.7%	9.8%
Global Property Securities	S&P Global Property USD TR	USD	0.4%	15.0%	7.9%
Currencies					
Euro		USD	1.4%	-0.8%	-2.7%
UK Pound Sterling		USD	-2.6%	-0.5%	-3.9%
Japanese Yen		USD	2.7%	1.6%	2.6%
Australian Dollar		USD	-1.1%	-0.4%	-5.2%
South African Rand		USD	2.9%	2.0%	-2.6%
Commodities & Alternatives					
Commodities	RICI TR	USD	-1.3%	8.0%	-7.2%
Agricultural Commodities	RICI Agriculture TR	USD	1.0%	-0.8%	-6.1%
Oil	Brent Crude Oil	USD	-2.7%	23.7%	-16.2%
Gold	Gold Spot	USD	9.1%	9.9%	12.5%
Hedge funds	HFRX Global Hedge Fund	USD	1.4%	4.1%	-2.1%

Source: Bloomberg. June 2019.

Past performance is not indicative of future returns.

Momentum Global Balanced Fund

Despite a sell-off in May, with global equities falling 6% peak to trough, the quarter ended with Wall Street reaching new all-time highs, pulling the MSCI World index of developed markets to new highs as well.

The US and developed markets returned 4% over the quarter but the most dramatic moves were in bonds, where interest rate expectations repriced substantially lower in the face of weakening growth, falling inflation and rising deflationary fears.

Yields on 10 year US Treasuries fell by 40bps over the quarter to 2% and other government bond markets followed suit. In Germany 10 year yields are now -40bps, dropping below the ECB's deposit rate for the first time ever, with positive yields available only on maturities above 20 years. These are extraordinary moves given how low rates already were at the beginning of the year.

Against this backdrop the Momentum Global Balanced Fund returned 2.4% over the quarter. Our gold positions performed well, as gold prices rallied by 9%. The key detractor was manager selection within equities. Equity manager selection has been a detractor over 12 months, along with regional positioning within equity and our bias towards EMEA and away from the US stock market. We expect both of these themes to reverse and have not locked-in significant amounts of this underperformance through turning-over the portfolio unnecessarily.

While equity investment styles have dovetailed, with Value underperforming while Growth and Quality styles have outperformed, the extent of the underperformance of our Value managers has more than offset the positive contributions from our other managers. Key detractors amongst our Value managers include Contrarius, Hotchkis & Wiley and Paradice.

The Momentum Global Balanced Fund has returned +7.1% per annum over the past 3 years, net of all fees. For comparison, an investment in short term cash would have returned approximately 0.8%, depending on the reference currency, while global bonds have returned 1.6%. Hence 7.1% per annum is a reasonable outcome and places the fund in the first quartile relative to peers.

Global equity markets have performed strongly this year. Underlying company earnings have not kept pace with the result that valuations – for example oft used measures like the price-to-earnings ratio – have increased. However, the equity risk premium – what one stands to earn over and above cash and bonds – is still reasonable. As such we retain a reasonable allocation to global equities in the fund, with a bias towards EMEA, where pricing is less demanding currently.

Within equities we continue to like the profile of listed infrastructure and our preferred manager, Maple Brown Abbot has performed reasonably well thus far in 2019. We have a lower exposure to some of the technology names that have run the hardest and a higher exposure to some areas that have been under pressure, like retail (selectively chosen) and energy shares.

We remain underweight government bonds, where yields are unattractive. Where we do own government bonds we remain heavily biased to the US where there is scope for yields to move lower and thus drive the price of the bonds we own higher. We also have an allocation to inflation linked bonds, given that markets are currently disregarding the chance of any inflation for the foreseeable future: we think this outcome carries a low but nonetheless higher attendant probability than the rest of the market.

We think the opportunity in short duration high yield, short duration emerging market debt and loans remains attractive. We participated in the latest capital raise by Sequioa, a specialist funder of infrastructure projects predominantly in Europe and the US, during June.

We also retain an allocation to gold, which looks fair value in inflation-adjusted terms and relative to other asset prices, and offers a key hedge in these times of extraordinary monetary policy.

Despite the strong returns this year, and the powerful support to valuations from low inflation and exceptionally low interest rates, uncertainty remains high. Aside from the slowdown in growth, the unfolding trade wars and the negative impact on corporate earnings, other concerns – including a no deal Brexit, the Italian debt/budgetary issue and the US-Iran nuclear deal dispute – continue to worry investors.

Equity and bond markets have risen sharply this year, driven by the prospect of easier financial conditions, yet the economic backdrop has deteriorated and corporate earnings are under pressure, especially in sectors most exposed to manufacturing.

However, while trade and manufacturing have been weak, the key service sector has remained firm, employment has been strong and the consumer is generally in good shape. Furthermore, the extent of the falls in government bond yields provides a strong underpinning to equities and other risk assets.

While some consolidation is overdue we therefore believe that the cycle has further to run and any falls in markets will give rise to opportunities to add to risk assets, while at all times maintaining careful diversification in portfolios to provide protection during inevitable shorter term setbacks.

Source: Bloomberg /Morningstar. Returns in US dollars unless otherwise stated, June 2019. **Past performance is not indicative of future returns.**

5. Top ten holdings

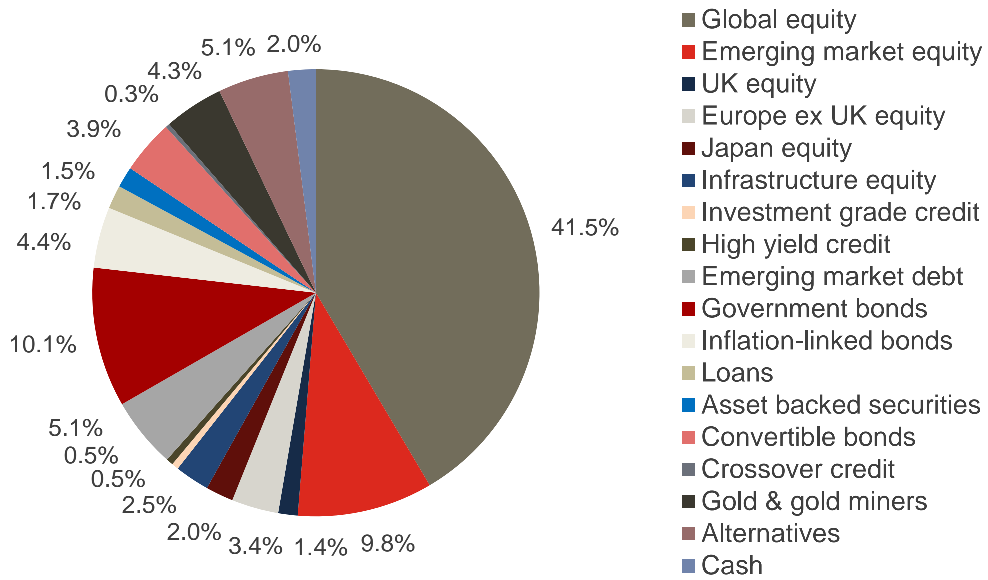
Global Balanced positions March 2019		
Security	Asset class	Weight
[1] US Treasury Bonds	Fixed Income	5.5%
[1] Robeco Global Value	Equity	5.3%
[2] iShares $ Treasury Bond 7-10yr	Fixed Income	4.6%
[1] iShares $ TIPS	Fixed Income	4.4%
[2] Jennison	Equity	4.0%
[2] Robeco Global Enhanced Index	Equity	3.8%
[2] Robeco Global Conservative	Equity	3.8%
[1] Momentum IF Global Emerging Markets	Equity	3.6%
[1] iShares MSCI Emerging Markets	Equity	3.3%
[2] Morgan Stanley Global Brands	Equity	3.2%
Total		**41.4%**

[1] Direct holding

[2] Indirectly held in the Momentum IF Global Equity Fund

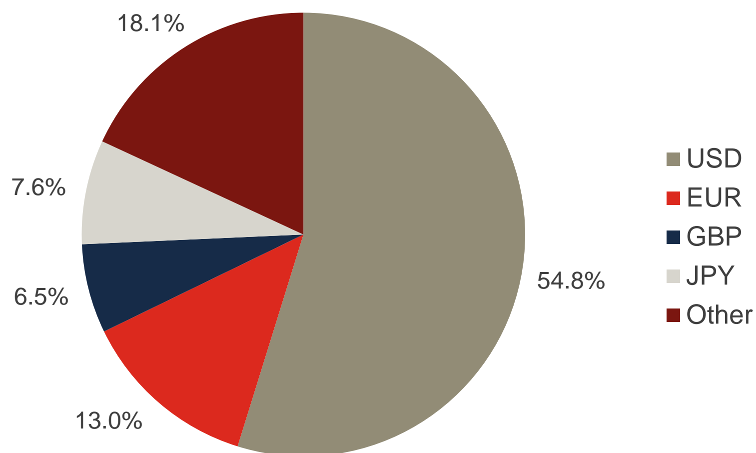
Source: Momentum Global Investment Management, March 2019. ***Past performance is not indicative of future returns.***

Asset Allocation



Source: Momentum Global Investment Management, June 2019.
Past performance is not indicative of future returns.

Currency Allocation



Source: Momentum Global Investment Management, June 2019.
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For more information, please contact:

Anastasiya Volodina
Distribution Services
anastasiya.volodina@momentum.co.uk
Tel: +44 (0)207 618 1806

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