Professional Portfolio International

momentum

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Newsflash

A new month and the 138th issue of Viewpoint from **PPI Advisory**.

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Table of Contents

Market Commentary

While geopolitics dominated the headlines in April, it was economic factors that primarily drove markets during the month and underpinned the recovery in most risk assets after sharp falls in previous weeks. Developed market equities rose 1.1% while fixed income markets witnessed declines in credit spreads with gains in high yield bonds despite weakness in government bond markets. However, the most notable and important moves came in an acceleration in the recovery of the US Dollar and a rally in oil prices.

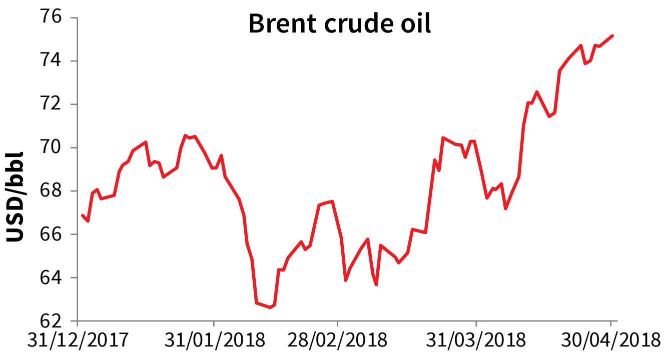
From its low point in mid-February, the US Dollar had already been recovering, but the trend accelerated in April with the Dollar rising by 2.1% on a trade weighted basis. The trend has been supported by continuing optimism around the US economy, despite a relatively subdued Q1 GDP growth reading of 2.3% and increasing evidence of an upturn in inflation. In response to the uptick in inflation, the Federal Reserve appeared mildly dovish in its April meeting, indicating it was prepared to tolerate a period of overshoot in inflation above its 2.0% target, however investors are anticipating a further rate increase in June and another before year end. This pushed the yield on two-year Treasuries to 2.49% by month end, its highest level since mid-2008.

Figure 1: Two year Treasuries climb to 10 year

Source: Bloomberg, Momentum GIM

In contrast, the economic momentum appeared to falter in Europe, with disappointing Q1 GDP growth readings in the Eurozone and UK and other data suggesting a slowdown from 2017 levels. This led to the European Central Bank (ECB) and the Bank of England adopting a more cautious tone to monetary tightening in the months ahead. Investors are now less certain about whether the ECB's quantitative easing programme will end later this year and about the timing of the next rate rise in the UK. Partly in response to this, the Euro and Sterling weakened, ending the month down 2.0% and 1.8% respectively versus the US Dollar. In addition, the Japanese Yen fell 2.8% versus the Dollar, in part due to a soft March inflation reading of 0.9%. Emerging markets particularly suffered from the US Dollar resurgence with emerging market equities and bonds declining 0.4% and 1.5% respectively.

Figure 2: From an intra-month low of USD 67.1/bbl, Brent crude rallied 12% to end the month at USD

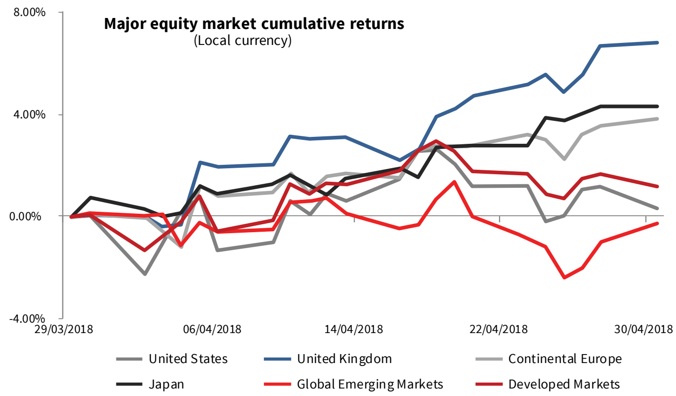


Source: Bloomberg, Momentum GIM

Commodities performed strongly during the month, rising 3.4%, partly driven by a 7.0% rise in Brent crude to USD 75.2/bbl, supported by demand strengthening in tandem with OPEC supply cuts, declines in Venezuelan output and geopolitical tensions between the US and Iran. US sanction tightening on Russia was a factor in pushing some metal markets sharply higher, with aluminium and nickel rising 13.7% and 2.6% respectively. Year-to-date commodities have been the best performing asset class, up 5.6%, while Brent crude has returned 12.4%, fuelling inflation concerns.

The weaker Euro and Sterling helped boost European equity market returns with Continental European equities rising 3.8% in Euro terms, while UK equities significantly outperformed, rising 6.8%, rebounding from a 7.3% first quarter decline. Despite the improving returns in the month, developed market equities remain slightly down year-to-date at 0.1%, while emerging market equities are up 1.0%. With very strong corporate earnings in Q1, especially in the US, equity valuation multiples have declined somewhat from the elevated levels of last year.

Figure 3: After declining in March, developed market equities advanced in April, outperforming emerging markets



Source: Bloomberg, Momentum GIM

Once again geopolitics, in particular President Trump's rapid shifts of stance, left many observers unnerved. On the positive side there was a thawing in tensions between North and South Korea and huge anticipation ahead of a likely meeting between President Trump and Kim Jong-un. In addition there was progress on the renegotiation of the NAFTA agreement, as well as indications that a full blown trade war between the US and China could be avoided. On the negative side were tensions caused by the potential for the US to withdraw from the Iran Nuclear deal, raising fears of a broader confrontation across the Middle East and the possibility of a fall in Iranian oil exports. Since month end President Trump has indeed withdrawn the US from the Iran Nuclear deal and is preparing to impose sanctions.

Although geopolitics remain a threat to the stability of markets in the very short term, the direction of markets in the months ahead are far more likely to be determined by central bank policy action. While there is a risk President Trump's impositions of tariffs on China could lead to a trade war, the actions taken so far have been limited and negotiations are likely to result in an easing of initial plans. It appears the momentum of the global economy has eased so far this year, however economic growth has continued at a reasonable rate, supporting strong growth in corporate profits, albeit somewhat uneven across sectors and companies. It is possible the early evidence of a slowdown in growth could lengthen the upswing should central banks take on a more dovish approach to monetary policy. This is a key factor in the months ahead, with investors particularly focused on any signs of inflation acceleration in the US as this could trigger a more aggressive monetary tightening by the Federal Reserve.

The most likely outcome for the global economy in the near term is steady growth, modestly rising inflation and gradual monetary tightening. This is likely to keep bond markets under pressure with yields rising further. The combination of tightening monetary policy and heightened geopolitical uncertainty could make markets more vulnerable to setbacks and increased volatility, with the pattern of the sharp sentiment swings witnessed this year likely to continue. However, the underlying strength of the global economy remains largely intact and the pace of monetary stimulus withdrawal will likely be cautious with policy still remaining loose by historical standards. We therefore believe that this cycle has further to run. Equities remain our preferred asset class, while in fixed income we continue to believe shorter duration exposure is appropriate at this still early stage of the global monetary tightening cycle

Market Performance - Global (Local returns)

Asset Class/Region	Index	To 29 March 2018		
		Currency	1 Month	3 Month
Developed markets equities				
United States	S&P 500 NR	**USD**	0.4%*	-5.9%
United Kingdom	MSCI UK NR	**GBP**	6.8%	1.0%
Continental Europe	MSCI Europe ex UK NR	**EUR**	3.8%	-2.3%
Japan	Topix TR	**JPY**	3.6%*	-2.3%*
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	1.0%	-5.9%
Global	MSCI World NR	**USD**	1.1%	-5.2%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	**USD**	-4.7%	-11.8%
Emerging Asia	MSCI EM Asia NR	**USD**	0.1%	-6.6%
Emerging Latin America	MSCI EM Latin America NR	**USD**	-1.3%	-5.7%
BRICs	MSCI BRIC NR	**USD**	-0.5%	-8.7%
Global emerging markets	MSCI EM (Emerging Markets) NR	**USD**	-0.4%	-6.8%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	-0.8%	-0.7%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	**USD**	-0.1%	0.0%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	-0.9%	-2.3%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	0.6%	-0.8%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	**GBP**	-1.0%	1.3%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	**GBP**	0.0%*	-0.3%
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	-0.4%	1.4%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	0.0%	-0.1%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	**EUR**	0.6%	-0.3%
Japanese Government	JP Morgan Japan Government Bond Index TR	**JPY**	-0.1%	0.6%
Australian Government	JP Morgan Australia GBI TR	**AUD**	-0.6%	0.9%
Global Government Bonds	JP Morgan Global GBI	**USD**	-1.8%	-1.0%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**USD**	-1.5%	-1.4%
Global Convertible Bonds	UBS Global Focus Convertible Bond	**USD**	-0.6%	-2.4%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**USD**	-1.5%*	-3.1%

Source: Bloomberg | ***Past performance is not indicative of future returns.*** | **) denotes estimate*

Market Performance - Global (Local returns)

Asset Class/Region	Index	To 29 March 2018		
		Currency	1 Month	3 Months
Property				
US Property Securities	MSCI US REIT NR	**USD**	1.4%	-3.0%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	**AUD**	4.5%*	0.2%
Asia Property Securities	S&P Asia Property 40 Index NR	**USD**	2.2%	-4.4%
Global Property Securities	S&P Global Property USD TR	**USD**	1.6%	-3.1%
Currencies				
Euro		**USD**	-2.0%	-2.7%
UK Pound Sterling		**USD**	-1.8%	-3.0%
Japanese Yen		**USD**	-2.8%	-0.1%
Australian Dollar		**USD**	-2.0%	-6.5%
South African Rand		**USD**	-5.0%	-5.0%
Commodities & Alternatives				
Commodities	RICI TR	**USD**	3.4%*	2.2%
Agricultural Commodities	RICI Agriculture TR	**USD**	2.0%*	2.8%
Oil	Brent Crude Oil	**USD**	7.0%*	8.9%
Gold	Gold Spot	**USD**	-0.7%	-2.2%
Hedge funds	HFRX Global Hedge Fund	**USD**	0.1%*	-3.3%
Interest rates				
United States			1.75%	
United Kingdom			0.50%	
Eurozone			0.00%	
Japan			0.10%	
Australia			1.50%	
South Africa			6.50%	

Source: Bloomberg | ***Past performance is not indicative of future returns.*** | ** denotes estimate*

Market Performance - UK (All returns in GBP)

Asset Class/Region	Index	To 29 March 2018		
		Currency	1 Month	3 Months
Developed markets equities				
UK - All Cap	MSCI UK NR	**GBP**	6.8%	1.0%
UK - Large Cap	MSCI UK Large Cap NR	**GBP**	6.9%	1.0%
UK - Mid Cap	MSCI UK Mid Cap NR	**GBP**	5.5%	-0.3%
UK - Small Cap	MSCI Small Cap NR	**GBP**	5.5%	1.7%
United States	S&P 500 NR	**USD**	2.2%*	-3.0%
Continental Europe	MSCI Europe ex UK NR	**EUR**	3.9%	-1.9%
Japan	Topix TR	**JPY**	2.7%*	0.8%*
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	**USD**	3.0%	-3.0%
Global developed markets	MSCI World NR	**GBP**	3.1%	-2.3%
Global emerging markets	MSCI EM (Emerging Markets) NR	**GBP**	1.5%	-4.0%
Bonds				
Gilts - All	BofA Merrill Lynch Gilts TR	**GBP**	-1.0%*	1.3%
Gilts - Under 5 years	BofA Merrill Lynch Gilts TR under 5 years	**GBP**	0.2%*	0.2%
Gilts - 5 to 15 years	BofA Merrill Lynch Gilts TR 5 to 15 years	**GBP**	-0.4%*	0.7%
Gilts - Over 15 years	BofA Merrill Lynch Gilts TR over 15 years	**GBP**	-2.1%*	2.4%
Index Linked Gilts - All	BofA Merrill Lynch Inflation-Linked Gilts TR	**GBP**	-2.6%*	0.1%
Index Linked Gilts - 5 to 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR 5 to 15 years	**GBP**	-0.3%*	0.3%
Index Linked Gilts - Over 15 years	BofA Merrill Lynch Inflation-Linked Gilts TR over 15 years	**GBP**	-3.7%*	0.0%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	**GBP**	0.0%*	-0.3%
US Treasuries	JP Morgan United States Government Bond Index TR	**USD**	1.1%	2.4%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	**USD**	1.0%	0.7%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	**USD**	2.6%	2.2%
Euro Government Bonds	Citigroup EMU GBI TR	**EUR**	-0.3%	1.9%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	**EUR**	0.1%	0.4%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	**EUR**	0.7%	0.2%
Global Government Bonds	JP Morgan Global GBI	**GBP**	0.1%	2.0%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	**GBP**	0.4%	1.6%
Global Convertible Bonds	UBS Global Focus Convertible Bond	**GBP**	1.4%	0.6%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	**GBP**	0.3%*	-0.1%

Source: Bloomberg | ***Past performance is not indicative of future returns.*** | ** denotes estimate*

Market Performance - UK (All returns in GBP)

Asset Class/Region	Index	To 29 March 2018		
		Currency	1 Month	3 Months
Property				
Global Property Securities	S&P Global Property USD TR	**GBP**	3.6%	-0.1%
Currencies				
Euro		**GBP**	-0.2%	0.3%
US Dollar		**GBP**	1.8%	3.1%
Japanese Yen		**GBP**	-1.0%	3.0%
Commodities & Alternatives				
Commodities	RICI TR	**GBP**	5.3%*	5.3%
Agricultural Commodities	RICI Agriculture TR	**GBP**	3.8%*	5.9%
Oil	Brent Crude Oil	**GBP**	8.9%*	12.2%
Gold	Gold Spot	**GBP**	1.2%	0.8%
Interest rates				
United Kingdom			0.50%	
United States			1.75%	
Eurozone			0.00%	
Japan			0.10%	

Source: Bloomberg | ***Past performance is not indicative of future returns.*** | ** denotes estimate*

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Asset Allocation Dashboard

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Asset class	View
Equities	
Developed equities	» We retain a neutral allocation to global equities today. Valuations vary across regions and sectors and whilst in aggregate they are not cheap, they do offer the prospect of reasonable returns, both in absolute terms and relative to other classes. Low bond yields can support this for now, although we recognise the direction is likely upward from here » CB policy and politics will remain central to risk pricing, and volatility is likely to remain more elevated than last year's levels, which we'd say is appropriate + The global macro backdrop remains favourable for global equities, albeit with a pick in volatility more recently + Equities are better placed than most asset classes to perform in a moderately pro inflationary environment – Valuations remain selectively expensive at current levels – Continued talk around and implementation of trade tariffs is not constructive for global equities
UK equities (relative to developed)	» UK equities remain reasonably priced today but caution is warranted given UK's evolving Brexit negotiations. The market has rallied hard in recent weeks but this is mostly a function of weaker Sterling. Any continued weakness -which is quite possible as the Dollar finds near term support - will boost UK stocks further, and that contributes to maintaining the neutral view » While the larger cap market constituents are more globally focused than they are UK, and have earnings shielded in large part from FX swings, the more domestically oriented names may face bigger challenges, not least with traditional high street retailers remaining under pressure » The UK market remains sensitive to commodity prices + The UK market remains exposed to global markets and factors and as such is somewhat insulated from the headline Brexit concerns, benefiting from any associated Sterling weakness – Today the chief worries lie with the ongoing Brexit negotiations, and perhaps an overconfidence in the outcome is creeping in
European equities (relative to developed)	» European equity valuations remain favourable when viewed against corporate and sovereign European bond markets. From a more cyclical point of view Europe continues to recover from its post crisis lows, though we recognise that data has disappointed significantly in recent weeks. Technically, this is likely to reverse and could land European equities some near support » CB policy and politics will remain central to risk pricing, and volatility is likely to be more elevated + European earnings have scope to recover meaningfully from their lows. – European assets, including equities, may come under pressure should the ECB's bond programme reduction accelerate, or the Euro strengthens further.
US equities (relative to developed)	» The US remains the most expensive of the major developed markets, even when adjusted for the strong tech sector performance. The US economy is in rude health but equity returns face a valuation headwind today, and prices already discount strong earnings growth ahead. With the benchmark index having declined again through March the valuation has improved slightly and we lift our assessment marginally, still preferring ex US but lifting off our lowest rating ahead of the Q1 earnings season which is expected to show buoyant earnings growth » Monetary policy remains crucial to keeping markets in check and volatility under control. To date the Fed has managed this well but there is always a risk of policy error, or an outside risk of higher inflation leaving the Fed little alternative to raising rates more quickly than rates markets are pricing + The economy is strong and leading indicators positive. Tax repatriation could spur investment and share buyback programmes + Returns on equity are comfortably the best of the DM regional markets – Valuations remain somewhat extended despite the recent market volatility, and rising yields may prove an obstacle to staying or extending from current levels
Japan equities (relative to developed)	» Japanese equities remain reasonably attractive and we acknowledge the government's policies to improve working practices and governance. However, after posting strong returns in the final quarter (and full year) the valuation is more in line with other ex US markets today. Latest earnings are strong with most companies having reported and 14% growth recorded. » Japanese assets should remain well buoyed by BoJ policy which remains aggressive when compared to the other main DM central banks. + Yen weakness will likely boost equities if the Fed moves in line with their stated intentions and the BoJ maintains their yield curve policy. – In a protracted risk off scenario Yen strength would hit Japanese equities, as recently seen
Emerging market equities	» Valuations remain reasonably attractive today and we continue to favour EM assets more generally over DM as relative growth dynamics looks favourable, which coupled with low inflation and accommodative policy should support EM equities. EM assets have come under pressure recently as the Dollar has found favour and idiosyncratic factors have come into play, but as the region has lagged so it appears more attractive on a relative basis » More elevated volatility should be expected going forward, with CB policy and politics remaining central to risk pricing + EM currencies have weakened recently and this provides additional support over the longer term to what already look somewhat cheap currencies in aggregate – Emerging markets remain prone to bouts of volatility and flow reversal at times of heightened perceived risk – Recent Dollar strength bears witness to this. A sustained reversal will see EM assets remain under pressure

Past performance is not indicative of future returns.

Fixed Income	
Government	» Despite on-going supportive policy actions, on a medium term outlook the majority of DM government bonds look unattractive today » Treasuries offer improved value today as yields oscillate around the 3% level but aggregate global government bond yields remain low + Quality government bonds remain one of the best diversifiers in a multi asset portfolio, and at current yields treasuries are starting to look somewhat attractive again – 2018 is likely to mark the year that net central bank bond purchases turns negative. That provides a headwind for all rate sensitive debt
Index-linked (relative to government)	» Index linked bonds offer some selective value today but, like their nominal counterparts, they are expensive today with US breakevens starting to look somewhat full » UK linkers remain one of the more expensive DM markets + Index linked bonds are one of the few ways to meaningfully protect against inflation risk – Inflationary forces are at best nascent today and on any renewed concerns over global growth they would almost certainly underperform nominal bonds
Investment grade (relative to government)	» Investment grade bonds provide some diversification benefit in a multi asset portfolio but valuations remain somewhat stretched today. Marginally preferred to sovereigns today » Fundamentals remain reasonable but we would advocate owning more shorter dated credit at today's levels as rate sensitivity remains near highs + A reasonable alternative to owning sovereign bonds with diversifying qualities and some spread – It is difficult to see spreads tightening much further, and with central bank buying slowing the risks are asymmetric.
High yield	» Spreads remain quite tight in leveraged credit markets, and whilst fundamentals remain robust, all in valuations are somewhat expensive » We favour owning shorter duration credit where the risk return looks more favourable today, and loans where permissible + In the absence of a systemic market shock high yield returns will likely trump most of other fixed income – Issuance terms are increasingly favouring the issuer, and valuations look somewhat expensive
Emerging market debt	» Emerging market bonds have come under pressure recently following a period of renewed Dollar strength, notably so local bonds. However this doesn't change the fact that EM bonds still rank as one of the better real return opportunities in fixed income over the longer term. With the sector remaining under pressure we prefer hard currency bonds today » We think a short duration strategy has a better risk return today and would look to re-enter core duration strategies at higher spreads + EM bonds continue to offer some of the best return opportunities in core bond markets today – A resurgent dollar is likely to cause some temporary repricing in EM assets, and local bonds would likely bear the brunt of that, as we are currently witnessing
Convertible bonds	» Convertible bonds are pricing rich to their constituent parts today. Whilst this is driven by loftier US valuations we favour an allocation to this asset class in a multi asset portfolio for the convexity it brings, which remains valuable at a time of elevated valuations, as we are today » Some caution is warranted given the concentration to the US market and technology names + The natural convexity provided by convertibles should continue to provide reasonable protection against any protracted equity correction – The call optionality embedded into convertibles only really has any value if markets move higher, and the US, the largest constituent is well valued today – If volatility reverts again to the recent multi year lows then the optionality holds limited value

Alternatives	
Commodities	» Commodity prices are primarily supply and demand driven, and idiosyncratic factors will drive commodity prices as much or more so than the global economic cycle. Commodities remain sensitive to negative news on global growth » Commodities are susceptible to the increasing trade tariff newsflow and geopolitical factors which may lead to volatile pricing » The US pulling out of the Iran deal has lifted oil prices recently + With the US Dollar coming down from cyclical highs, and growth reasonably strong globally, commodities have scope to generate positive returns. + Gold remains a good hedge against risk off outcomes – Should the Dollar's decline come to a halt or reverse, commodities would likely come under pressure. However, recent dollar strength has been accompanied by a rising commodity index. The negative relationship is likely to reassert at some point
Property (UK)	» Property remains an attractive asset class for investors requiring yield. » Total returns will come mostly from income with limited scope for capital growth, although on a global basis REITS have recently come under pressure from rising bond yields and look somewhat more attractive today » When viewed against high quality longer duration Sterling assets and inflation linked bonds, UK property has appeal + Reasonable valuations and yields should continue to attract capital, more so into UK property on Sterling weakness – As a long duration asset class property remains susceptible to any repricing in long term bond yields – UK property remains sensitive to eventual Brexit terms
Infrastructure	» Infrastructure stocks trade at reasonable valuations today - broadly in line with global equities today having underperformed of late. Their income generating potential should continue to support the sector and attract buyers of quality infrastructure assets » Within the sector, the higher beta stocks and the ones most sensitive to economic growth such railroads, ports or airports have out-performed while more rate sensitive stocks like utilities have struggled + In a multi asset portfolio the relatively defensive nature of the asset class and a degree of inflation protection make the asset class appealing – As a long duration asset class infrastructure remains susceptible to any repricing in long term bond yields – Regulation can work both for and against the underlying investments
Liquid Alternatives	» We define this section as less/non-directional, absolute return type strategies that seek to capture long term risk premia or market mispricings, and includes hedge fund alternatives in predominantly UCITS vehicles » We favour an allocation to a basket of liquid strategies today to provide additional diversification as high quality bonds remain expensive + These strategies provide additional diversification with reasonable return potential – The sector is relatively young and growing. It remains somewhat untested through a protracted risk off period so thorough due diligence is vital, and blend is recommended
Currencies	
GBP	» Sterling has fallen sharply in recent weeks as the economic backdrop has softened and expectations over the higher path of policy rates has receded » In real terms the currency remains at the lower end of valuations and has room to appreciate over the medium to long term, but politics and rate policy is likely to dominate its nearer term path, and remains a source of volatility » With the Dollar having rallied in recent weeks at the same time as UK short rates have repriced lower, the currency may find support around these levels but positioning remains extended (long) and the stronger Dollar trend may persist as rate differentials exert. Valuation would support a structural long position but there may be a better opportunity to take this
Euro	» The Euro has declined of late in the face of the stronger Dollar. Whilst any change in explicit rate policy still remains some way off, the reducing quantum of bonds the ECB is now buying exerts some marginal upside to rates, » In real terms the common currency looks about fair value today but positioning remains extended today and a slew of disappointing data provides limited support to the currency.
Yen	» Rate differentials continue to offer little reason to buy the Yen as the Bank of Japan's yield curve policy means short rates will offer no real value for some time. However, in real terms the Yen remains cheap today. » With some of the excess now taken out of the currency following a periods of weakness (Dollar strength), the currency looks more attractive today. What sets the Yen apart from Sterling and the Euro is the currency's diversifying qualities and as such we lift our view to neutral, preferring not to retain a short bias following a period of market stabilisation

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