momentum
global investment management

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Global Matters | Quarterly

Market Review

March 2023

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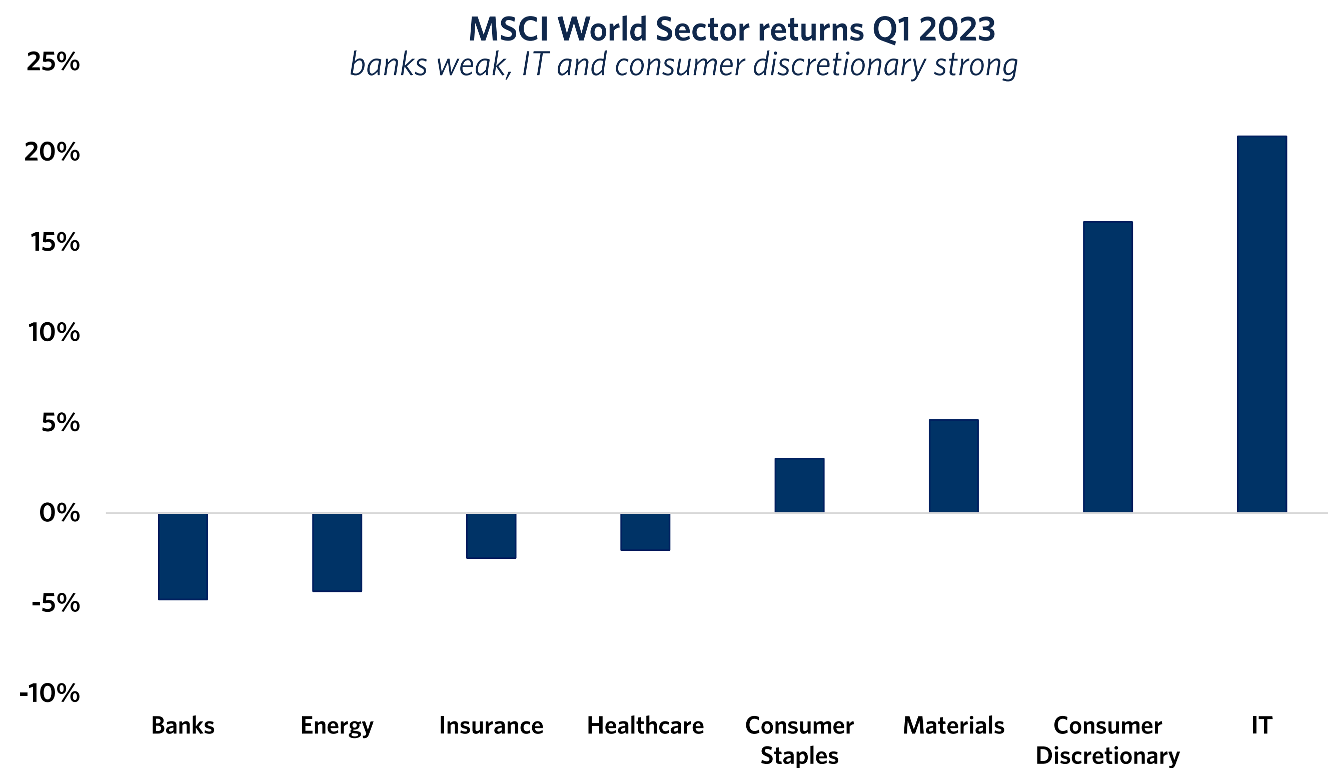
Contents

Global Market Review & Outlook

The spectre of a banking crisis returned to haunt markets in the first quarter of the year, overshadowing all else. Almost exactly one year on from the Fed's first increase in interest rates in what has become the steepest and fastest tightening cycle in over 40 years, something significant was broken, with the collapse in March of two mid-sized banks in the US and the fall of the much bigger Credit Suisse into the hands of its Swiss rival UBS, a transaction orchestrated by Swiss regulators. While there was no direct contagion between the two failed US regional banks, Silicon Valley Bank (SVB) and Signature, nor in the case of the globally systemically important Credit Suisse, there is no doubt that the dramatic shift from ultra-loose monetary policy to the highest policy rates since the Global Financial Crisis (GFC), tightened liquidity, rising bond yields and a steep inversion in the yield curve, played a significant part in each of the failures.



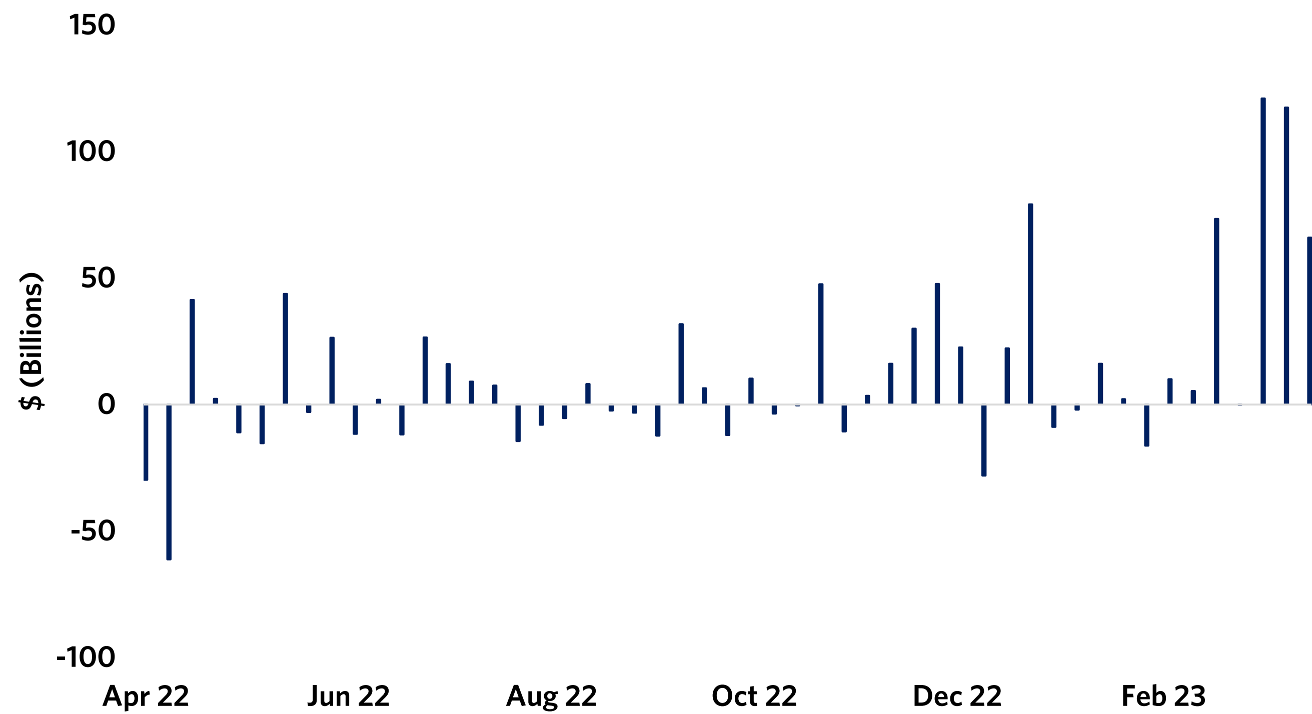
Source Bloomberg Finance L.P as at 29 March 2023.

When sizeable banks fail investors are rightly nervous, and this was immediately reflected in markets. Within a few days of the collapse of SVB, US equities had sold off by close to 5% and in Europe by 7%, arguably a more muted reaction than might have been expected, although shares of banks inevitably suffered much larger falls, with the MSCI World Banks index down by 16%, wiping out all of the sector's earlier gains this year when banks had performed well, seen as beneficiaries of higher interest rates.

"When sizeable banks fail investors are rightly nervous, and this was immediately reflected in markets"

The biggest moves however were in bond markets as fears of recession rose and investors priced in early cuts in the Fed's and other central banks' policy rates. In early March the US Treasury 10Y bond yield was around 4%, but within a few days had fallen to 3.4%, while the drop in the 2Y yield was even sharper, from 5.1% to 3.8%. Most of the move in longer term bond yields was driven by falling real yields; the 10Y inflation breakeven rate is little changed between the end of December 2022 and end March at around 2.3%, whereas 10Y real rates have fallen by over 40bps to 1.16%. The sharp drop in nominal and real yields provided some support for equities, and underpinned a big recovery in growth stocks, led by the IT sector, up by 21% in Q1. The flight to safe havens triggered a 10% rise in the gold price, while the fear of other bank failures led to a deposit flight from mid-sized banks, with a surge in inflows to money market funds, intensifying the competition for deposits.

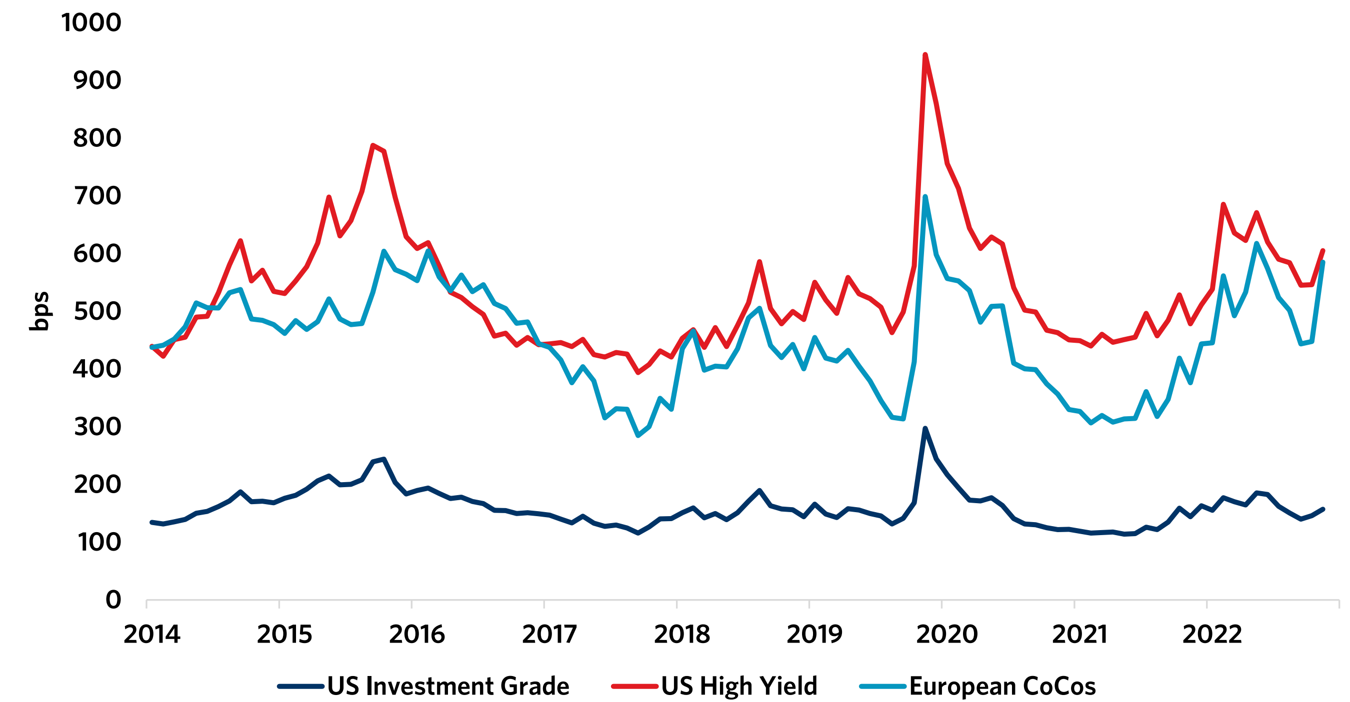
Surge in inflows to money market funds in March – weekly flows



Source Bloomberg Finance L.P as at 29 March 2023.

Credit spreads widened as perceived default risks rose, but the biggest casualty in fixed income was debt issued by banks following the shock decision by the Swiss regulator to wipe out Credit Suisse's CHF16bn worth of Additional Tier 1 (AT1) contingent convertible bonds while attaching value to the equity. The AT1 market is relatively new, having been established post-GFC by European regulators to provide banks with an additional loss-absorbing capital buffer, converting into equity or potentially being wiped out if Common Equity Tier 1 (CET1) falls below certain triggers. The established hierarchy of corporate stakeholder seniority, with AT1 impacted only when CET1 is wiped out, appeared to be thrown into doubt by the Credit Suisse experience, leading to an immediate 20-25% fall in the $270bn AT1 market. This stabilised only when the European Central Bank (ECB) and Bank of England issued unambiguous statements confirming the hierarchy of creditors under their jurisdictions, with shareholders bearing losses ahead of AT1 bonds, leaving the Swiss as an outlier.

Credit spreads widen – especially for bank debt

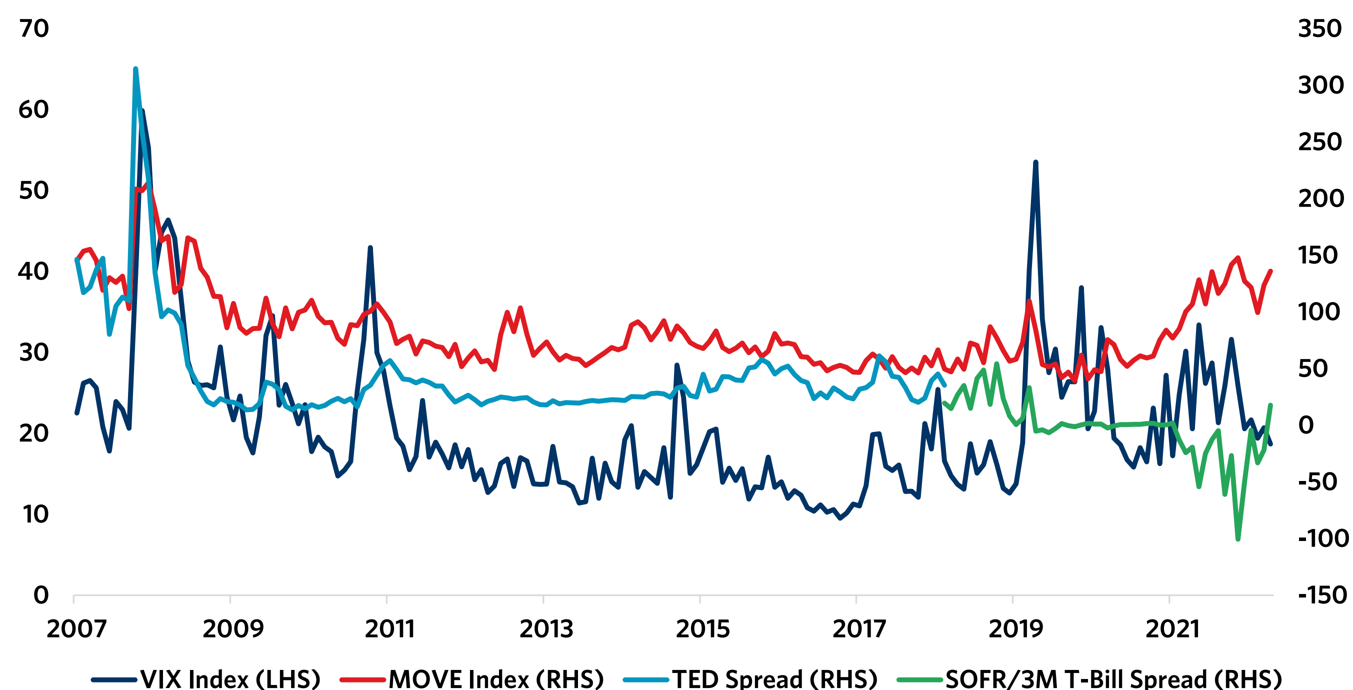


Source: Bloomberg Finance L.P. as at 31 March 2023. European CoCos are Additional Tier 1 bonds issued by banks.

"The flight to safe havens triggered a 10% rise in the gold price"

While volatility increased, especially in bond markets, nothing suggested acute distress across the banking sector or among investors generally. Each of the bank failures was idiosyncratic in nature, SVB and Signature Banks suffering from concentrated client exposures respectively in early-stage growth companies and crypto, leading to a run on deposits, while Credit Suisse paid the price for seemingly endless problems and poor management over a long period with weak profitability and falling assets. Regulators in the US and Europe responded rapidly and forcefully to arrest contagion risks, and the Fed, along with the FDIC and the Treasury, provided full protection to depositors of the failed US banks, as well as making substantial liquidity available to US banks through a new term lending facility. Following the Credit Suisse failure, other central banks joined the Fed in co-ordinated action to ensure sufficient liquidity in US dollars globally.

Volatility rises, risk appetite falls
reflected in bonds and overnight lending (TED/SOFR spreads)



Source: Bloomberg Finance L.P. Data for the LIBOR/3M T-Bill 'TED Spread' ends at 31/01/2019. From that date forward the spread between the US Secured Overnight Financing Rate (SOFR) and 3M T-Bills are used instead. The VIX and MOVE indexes measure volatility in equity and bond markets respectively, data as at 31 March 2023.

While further casualties of the increasingly tight monetary policy cycle are possible, and probably inevitable, we see no parallels with the banking crash which led to the GFC. There are no systemic risks arising from the collapsed banks, and the prompt action by central banks and regulators has minimised contagion risks. The GFC was a solvency issue for banks as the value of their (mostly mortgage related) loans collapsed, while the problem with today's failures was liquidity; in contrast to today, in 2008 banks were lightly regulated and under-capitalised and faced massive counterparty risks and funding shortages. The tightening of regulations post the GFC and more conservative risk management of banks has resulted in much stronger balance sheets, bigger capital buffers and greater resilience, and although the mark-to-market value of so called 'held to maturity' bonds would crystallise some trading losses were they sold, the impact to bank capital in aggregate would be limited and non-systemic.

After the initial shock, markets settled down and by the end of March equities had mostly regained the ground lost in the immediate sell-off, leaving US equities up 3.6% in March and 7.4% for Q1, MSCI World similarly +3.1% and +7.7% respectively and global emerging markets +3.0% and +4.0%. The more telling moves came in bond markets, with yields backing up somewhat after the initial sharp falls but remaining well below levels prevailing before the bank crisis. The failure of large banks damages confidence, increases risk aversion, raises the cost of capital as banks tighten lending standards, and tightens financial conditions, all of which increase the chances of a hard landing. The market immediately priced in lower expectations for the Federal Funds rate with the peak policy rate now expected earlier, during the second quarter of the year, and only a 50% chance of a further rise in the policy rate, whereas in early March the peak in rates was expected to be significantly higher at around 5.75%.

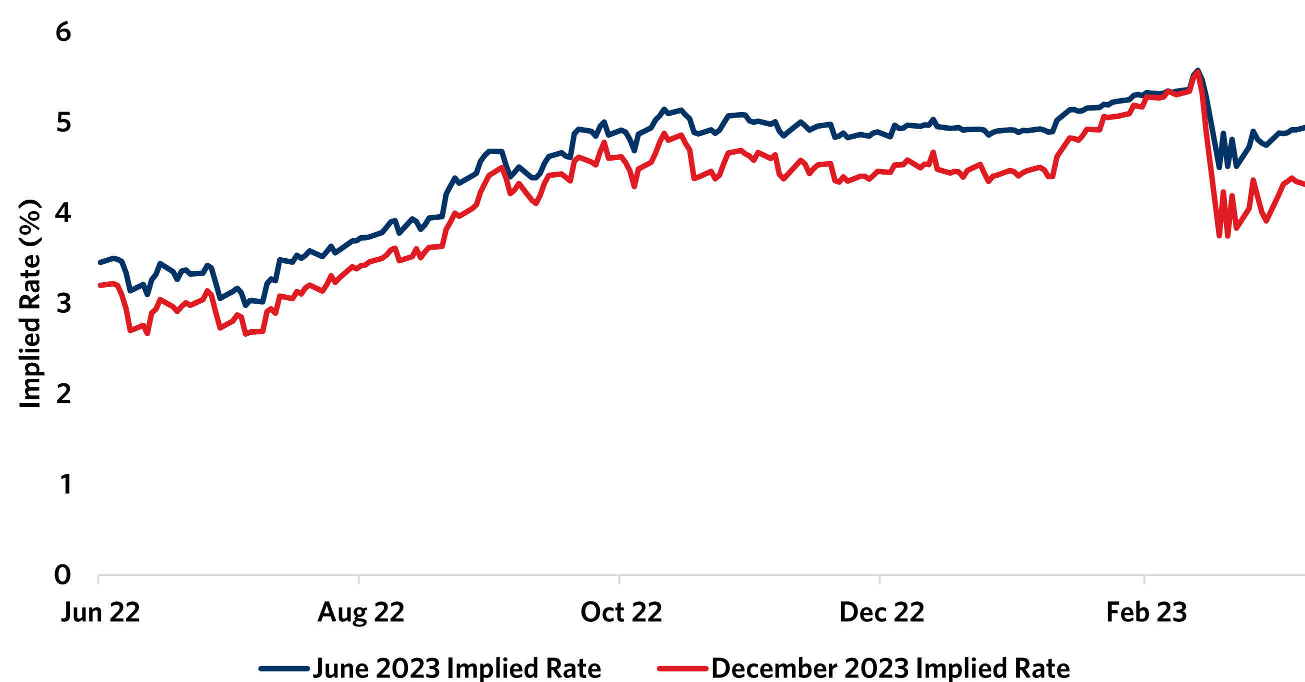
The big falls in yields resulted in a strong performance for government bonds in March, with US Treasuries returning 2.9%, ahead of high yield bonds, +1.1% and emerging market bonds, +1.8%. In an unusually volatile period for bonds, over the quarter global government bonds returned 3.1%, with corporate investment grade and high yield bonds generally performing slightly ahead of safe haven governments bonds.

Prior to the banking troubles in March, hopes had been rising for a softer landing as the US economy proved to be resilient while Europe appeared to have avoided a recession through the winter as gas prices collapsed, and China's post-Covid re-opening boosted growth. As in earlier months, leading indicators for most countries were above expectations in March, especially in the services sector, and pointed to continuing growth. But just as growth was better than expected, the labour market remained very tight, and inflation proved to be much stickier than forecast. Markets had to adjust to an increasingly hawkish Fed, matched by most other major central banks, all of which continued to prioritise the fight against inflation over financial stability risks, which, following the bank collapses, central banks handled through liquidity injections and rapid and forceful regulatory moves to prevent contagion.

"Prior to the banking troubles in March, hopes had been rising for a softer landing as the US economy proved to be resilient"

The resolve to bring inflation firmly under control was reflected in further rises in policy rates after the banking problems erupted; the Fed pushed rates up by 0.25% to 5%, the ECB by 50bps to 3%, the Bank of England by 0.25% to 4.25% and the Swiss National Bank by 50bps to 1.5%. The notable and continued outlier remains the Bank of Japan, where policy rates remain negative, but with outgoing Governor Kuroda passing the baton to the non-establishment academic Kazuo Ueda, expectations are growing that a regime shift away from the largely exhausted yield curve control (YCC) will ultimately yield higher rates in the land of the rising sun. In the US, the impact of the banking difficulties led to a more cautious stance about further tightening, with the Fed noting that 'recent developments are likely to result in tighter credit conditions....and weigh on economic activity, hiring and inflation' the effect of which Powell suggested could be equivalent to an interest rate rise of 0.25% or more. The Fed sees growth risks to the downside, and gave a clear signal, both from a softer statement and its quarterly forecasts of the policy committee's members (the 'Dot Plot'), that only one more rate rise is now anticipated this year, before rate cuts through 2024. The market's view of where rates will be at year end changed much more dramatically, with Fed Funds futures now pointing to a rate of 4.3% by end 2023, whereas on March 8th, just before the collapse of SVB, the end year expectation was 5.6%.

Market expectations for Fed Funds rate fall sharply in March*



Source: Bloomberg Finance L.P. as at 4 April 2023. *The chart shows Fed Funds rate futures for June 2023 and December 2023 over past 9 months.

Much depends on the continuing stability of the financial system after the March crisis, and the path of inflation and growth. So far, the banking system has weathered the immediate storm extremely well, and remains financially very strong and resilient. There are areas of concern, notably the exposure of mid-sized banks to commercial real estate loans, although these are on a much smaller scale than troubled loans in the GFC, and seem manageable. Markets have reacted reasonably calmly, and pockets of stress are limited. However, the probability of recession has increased and monetary policy, which acts with lags, remains very tight. The full consequences of that tightening, both in the financial system and the real economy, are yet to play out. Central banks have a difficult balancing act, reining in inflation while maintaining financial stability and avoiding recession. Events in March have made that task that much more difficult; policy overkill is an increasing risk.

It now seems that the peak in the tightening cycle has either been reached or is very close, and the peak in the market's expectations of the Fed Funds rate has almost certainly been passed. That is an important turning point in the cycle and is a support for valuations of assets. The peak in the inflation cycle has also been reached, and inflation will fall sharply through 2023 as base effects fall away, the energy price falls in recent months feed through, and supply chain improvements continue to ease pricing pressures. Uncertainties remain about the pace of the slowdown in core inflation, but the seeming inevitability of tighter and more expensive credit ahead, and resultant fall in growth, increases the probability of a more balanced labour market and a sustained fall in inflation.

Markets face a difficult conundrum; on the one hand, interest rates are at or very close to a cyclical peak and bond yields have fallen sharply in recent weeks, supporting valuations of other asset classes; on the other, the risks of a recession in coming months have increased materially, with the inevitable consequences of credit contraction, earnings weakness and higher default risks. While less attractive than a month ago, there are still valuation opportunities in government bonds, as well as other parts of the fixed income sector, and for the first time in years cash is a viable instrument to achieve target returns and manage risk in multi-asset portfolios. Equities also offer some valuation opportunities but are overhung by the risk of recession and earnings weakness. They have generally held up well through the challenges of March, and some consolidation is now likely. Recovery lies ahead and we are optimistic for markets over the next twelve months, but believe it is prudent to temper that optimism in the short term given the heightened risks of recession. We are therefore taking opportunities to add to defensive assets in real (inflation linked) and nominal bonds while biding our time before adding to risk assets.

Market Performance - *Global (local returns) as at 31 March 2023*

Asset Class / Region	Index	Ccy	1 month	3 months	YTD	12 months
Developed Markets Equities						
United States	S&P 500 NR	USD	3.6%	7.4%	7.4%	-8.2%
United Kingdom	MSCI UK NR	GBP	-2.6%	4.0%	4.0%	5.5%
Continental Europe	MSCI Europe ex UK NR	EUR	0.8%	9.9%	9.9%	4.5%
Japan	Topix TR	JPY	1.7%	7.2%	7.2%	5.8%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	2.8%	4.1%	4.1%	-8.9%
Global	MSCI World NR	USD	3.1%	7.7%	7.7%	-7.0%
Emerging Markets Equities						
Emerging Europe	MSCI EM Europe NR	USD	-4.2%	1.5%	1.5%	1.0%
Emerging Asia	MSCI EM Asia NR	USD	3.6%	4.8%	4.8%	-9.4%
Emerging Latin America	MSCI EM Latin America NR	USD	0.8%	3.9%	3.9%	-11.1%
China	MSCI EM China NR	USD	3.2%	0.8%	0.8%	-8.3%
BRICs	MSCI BRIC NR	USD	4.5%	4.7%	4.7%	-4.7%
Global emerging markets	MSCI Emerging Markets NR	USD	3.0%	4.0%	4.0%	-10.7%
Bonds						
US Treasuries	JP Morgan United States Government Bond TR	USD	2.9%	2.9%	2.9%	-4.4%
US Treasuries (inflation protected)	BBgBarc US Government Inflation Linked TR	USD	2.9%	3.4%	3.4%	-6.5%
US Corporate (investment grade)	BBgBarc US Corporate Investment Grade TR	USD	2.8%	3.5%	3.5%	-5.6%
US High Yield	BBgBarc US High Yield 2% Issuer Cap TR	USD	1.1%	3.6%	3.6%	-3.4%
UK Gilts	JP Morgan UK Government Bond TR	GBP	3.0%	2.2%	2.2%	-16.7%
UK Corporate (investment grade)	ICE BofAML Sterling Non-Gilt TR	GBP	1.1%	2.4%	2.4%	-10.3%
Euro Government Bonds	ICE BofAML Euro Government TR	EUR	2.3%	2.0%	2.0%	-11.9%
Euro Corporate (investment grade)	BBgBarc Euro Aggregate Corporate TR	EUR	1.0%	1.8%	1.8%	-7.5%
Euro High Yield	BBgBarc European High Yield 3% Constrained TR	EUR	-0.3%	2.7%	2.7%	-4.2%
Japanese Government	JP Morgan Japan Government Bond TR	JPY	1.5%	2.4%	2.4%	-1.8%
Australian Government	JP Morgan Australia GBI TR	AUD	3.7%	5.1%	5.1%	0.4%
Global Government Bonds	JP Morgan Global GBI	USD	3.6%	3.1%	3.1%	-9.0%
Global Bonds	ICE BofAML Global Broad Market	USD	3.2%	3.0%	3.0%	-8.4%
Global Convertible Bonds	ICE BofAML Global Convertibles	USD	0.3%	4.5%	4.5%	-8.3%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	1.8%	1.9%	1.9%	-8.4%

Asset Class / Region	Index	Ccy	1 month	3 months	YTD	12 months
Property						
US Property Securities	MSCI US REIT NR	USD	-2.7%	2.4%	2.4%	-20.2%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	-6.9%	-0.2%	-0.2%	-17.8%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-0.1%	-3.2%	-3.2%	-11.8%
Global Property Securities	S&P Global Property USD TR	USD	-2.8%	0.3%	0.3%	-20.5%
Currencies						
Euro		USD	2.5%	1.3%	1.3%	-2.1%
UK Pound Sterling		USD	2.6%	2.1%	2.1%	-6.1%
Japanese Yen		USD	2.5%	-1.3%	-1.3%	-8.4%
Australian Dollar		USD	-0.7%	-1.9%	-1.9%	-10.7%
South African Rand		USD	3.2%	-4.3%	-4.3%	-17.9%
Commodities & Alternatives						
Commodities	RICI TR	USD	-0.7%	-4.7%	-4.7%	-10.0%
Agricultural Commodities	RICI Agriculture TR	USD	0.8%	-0.4%	-0.4%	-8.1%
Oil	Brent Crude Oil	USD	-4.9%	-7.1%	-7.1%	-26.1%
Gold	Gold Spot	USD	7.8%	8.0%	8.0%	1.6%
Hedge funds	HFRX Global Hedge Fund	USD	-1.4%*	-0.2%*	-0.2%*	-3.3%*

Interest Rates	Current Rate
United States	5.00%
United Kingdom	4.25%
Eurozone	3.50%
Japan	-0.10%
Australia	3.60%
South Africa	7.75%

Source: Bloomberg Finance L.P. , Momentum Global Investment Management. Past performance is not indicative of future returns. *estimate.

Market Performance - *UK (all returns GBP) as at 31 March 2023*

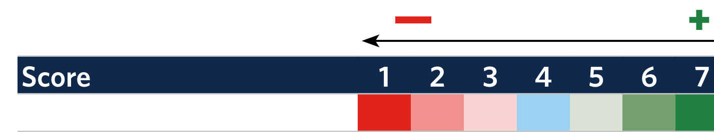
Asset Class / Region	Index	Local Ccy	1 month	3 months	YTD	12 months
Equities						
UK - All Cap	MSCI UK NR	GBP	-2.6%	4.0%	4.0%	5.5%
UK - Large Cap	MSCI UK Large Cap NR	GBP	-3.1%	1.8%	1.8%	7.0%
UK - Mid Cap	MSCI UK Mid Cap NR	GBP	-1.2%	10.0%	10.0%	-3.8%
UK - Small Cap	MSCI Small Cap NR	GBP	-5.2%	1.7%	1.7%	-10.5%
United States	S&P 500 NR	USD	1.5%	5.2%	5.2%	-2.3%
Continental Europe	MSCI Europe ex UK NR	EUR	1.2%	9.3%	9.3%	9.0%
Japan	Topix TR	JPY	1.9%	3.6%	3.6%	3.1%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	0.7%	2.0%	2.0%	-3.1%
Global developed markets	MSCI World NR	USD	1.0%	5.5%	5.5%	-1.1%
Global emerging markets	MSCI Emerging Markets NR	USD	1.0%	1.9%	1.9%	-5.0%
Bonds						
Gilts - All	ICE BofAML UK Gilt TR	GBP	3.0%	2.3%	2.3%	-17.2%
Gilts - Under 5 years	ICE BofAML UK Gilt TR 0-5 years	GBP	0.8%	0.9%	0.9%	-2.3%
Gilts - 5 to 15 years	ICE BofAML UK Gilt TR 5-15 years	GBP	2.7%	2.8%	2.8%	-10.9%
Gilts - Over 15 years	ICE BofAML UK Gilt TR 15+ years	GBP	5.2%	2.8%	2.8%	-29.8%
Index Linked Gilts - All	ICE BofAML UK Gilt Inflation-Linked TR	GBP	6.1%	4.3%	4.3%	-27.5%
Index Linked Gilts - 5 to 15 years	ICE BofAML UK Gilt Inflation-Linked TR 5-15 years	GBP	4.4%	5.1%	5.1%	-10.5%
Index Linked Gilts - Over 15 years	ICE BofAML UK Gilt Inflation-Linked TR 15+ years	GBP	8.9%	4.9%	4.9%	-38.9%
UK Corporate (investment grade)	ICE BofAML Sterling Non-Gilt TR	GBP	1.1%	2.4%	2.4%	-10.3%
US Treasuries	JP Morgan US Government Bond TR	USD	0.7%	0.1%	0.1%	1.8%
US Corporate (investment grade)	BBgBarc US Corporate Investment Grade TR	USD	0.6%	0.7%	0.7%	0.6%
US High Yield	BBgBarc US High Yield 2% Issuer Cap TR	USD	1.1%	3.6%	3.6%	-3.4%
Euro Government Bonds	ICE BofAML Euro Government TR	EUR	2.3%	2.0%	2.0%	-11.9%
Euro Corporate (investment grade)	BBgBarc Euro Aggregate Corporate TR	EUR	1.0%	1.8%	1.8%	-7.5%
Euro High Yield	BBgBarc European High Yield 3% Constrained TR	EUR	-0.3%	2.7%	2.7%	-4.2%
Global Government Bonds	JP Morgan Global GBI	GBP	1.5%	1.0%	1.0%	-3.2%
Global Bonds	ICE BofAML Global Broad Market	GBP	3.2%	3.0%	3.0%	-8.4%
Global Convertible Bonds	ICE BofAML Global Convertibles	GBP	0.3%	4.5%	4.5%	-8.3%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	GBP	-0.3%	-0.2%	-0.2%	-2.6%

Asset Class / Region	Index	Local Ccy	1 month	3 months	YTD	12 months
Property						
Global Property Securities	S&P Global Property TR	GBP	-4.8%	-1.7%	-1.7%	-15.4%
Currencies						
Euro		GBP	-0.1%	-0.7%	-0.7%	4.3%
US Dollar		GBP	-2.5%	-2.1%	-2.1%	6.5%
Japanese Yen		GBP	0.0%	-3.1%	-3.1%	-2.3%
Commodities & Alternatives						
Commodities	Rogers International Commodity (RICI) TR	GBP	-2.7%	-6.6%	-6.6%	-4.3%
Agricultural Commodities	Rogers International Commodity (RICI) Agriculture TR	GBP	-1.2%	-2.4%	-2.4%	-2.2%
Oil	Brent Crude Oil	GBP	-6.8%	-9.0%	-9.0%	-21.3%
Gold	Gold Spot	GBP	5.6%	5.8%	5.8%	8.2%

Interest Rates	Current Rate
United Kingdom	4.25%

Source: Bloomberg Finance L.P. , Momentum Global Investment Management. Past performance is not indicative of future returns. *estimate.

Asset Allocation Views



Score	Change	1	2	3	4	5	6	7
MAIN ASSET CLASSES	▲/▼/—							
Equities	—				■			
Fixed Income	—				■			
Alternatives	—					■		
Cash	—				■			

Our Overall View

We have not deemed it necessary to make any significant changes to our overall asset class weightings. The improving equity valuations seen last year have stalled as markets have staged a recovery in 2023. Having previously been upgraded to neutral due to higher rates, the threat of a recession presents risks to certain fixed income assets but good opportunities are still prevalent. The diversifying quality of our alternative assets remains especially favourable during this current period of uncertainty.

Score	Change	1	2	3	4	5	6	7
EQUITIES	▲/▼/—							
Developed Equities	—				■			
UK Equities	—						■	
European Equities	—				■			
US Equities	—			■				
Japanese Equities	—						■	
Emerging Market Equities	—					■		

The recovery in equity markets that began in Q4 of last year continued into 2023 until stronger than expected inflation and labour market data raised expectations for tighter credit conditions. Fears of a recession continue to put pressure on global equity markets. US equities remain unattractive; despite rerating heavily in 2022 they are still expensive and the declines have not continued this year. The fundamental risks facing European equities have eased slightly but valuations still have space to improve. The most compelling opportunities remain in the UK and Japan with last year's cheap valuations having not yet changed materially.

Score	Change	1	2	3	4	5	6	7
FIXED INCOME	▲/▼/—							
Government	▲				■			
Index-Linked	▲				■			
Investment Grade Corporate	▼				■			
High Yield Corporate	▼			■				
Emerging Market Debt	—					■		
Convertible Bonds	—			■				

With the recent rise in global rates, bonds now provide a more attractive opportunity. However, with a possible recession looming and with it a higher probability of defaults, we do not believe that spreads on investment grade and riskier high yield corporate bonds offer a suitable risk premium over sovereign bonds and as such we prefer shorter duration credit in both developed and emerging markets twinned with safer government debt. Improving real yields and weak growth expectations have also improved the appeal of inflation linked bonds. Convertible bonds remain out of favour with equities and credit both currently presenting more compelling opportunities.

Score	Change	1	2	3	4	5	6	7
SPECIALIST ASSETS/ALTERNATIVES	▲/▼/—							
Commodities	—				■			
Property	—				■			
Infrastructure	—				■			
Liquid Alternatives	—				■			
Private Equity	—						■	
Specialist Financial	—					■		

Following a strong performance in 2022, commodities are likely to struggle against a slowdown of global growth. Private Equity, which has struggled recently due to investor scepticism over NAVs, now offers compelling discounts. Infrastructure also suffered due to poor investor sentiment, but we believe the asset class will continue to be driven by structural tailwinds. Our liquid alternatives continue to offer excellent diversification benefits especially during periods of market uncertainty.

Score	Change	1	2	3	4	5	6	7
CURRENCIES vs. USD	▲/▼/—							
GBP	—					■		
EUR	—				■			
JPY	—					■		
Gold	▼			■				

Against long term valuation metrics, Sterling and Yen continue to remain cheap relative to the Dollar. The Yen has suffered due to the Bank of Japan's strict yield curve control but recent changes to the policy have supported the Yen which historically has acted as a good diversifier. Recession expectations in the US and high inflation in Europe could mean changing rate expectations in support of the Euro but economic and political headwinds remain for the currency. Gold's status as a safe haven asset is likely to be beneficial in the face of continuing market uncertainty.

The Asset Allocation views are as of March 2023 and are updated quarterly unless otherwise stated.

For more information, please contact:
Distribution Services

E: distributionservices@momentum.co.uk
T: +44 (0)207 618 1803

Important Notes

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