

**momentum**  
global investment management

**G** | globalmatters

# BONDS

**Global Matters | Quarterly**  
**Market Review**

September 2023

*With us, investing is personal*

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# Contents

# Global market review & outlook

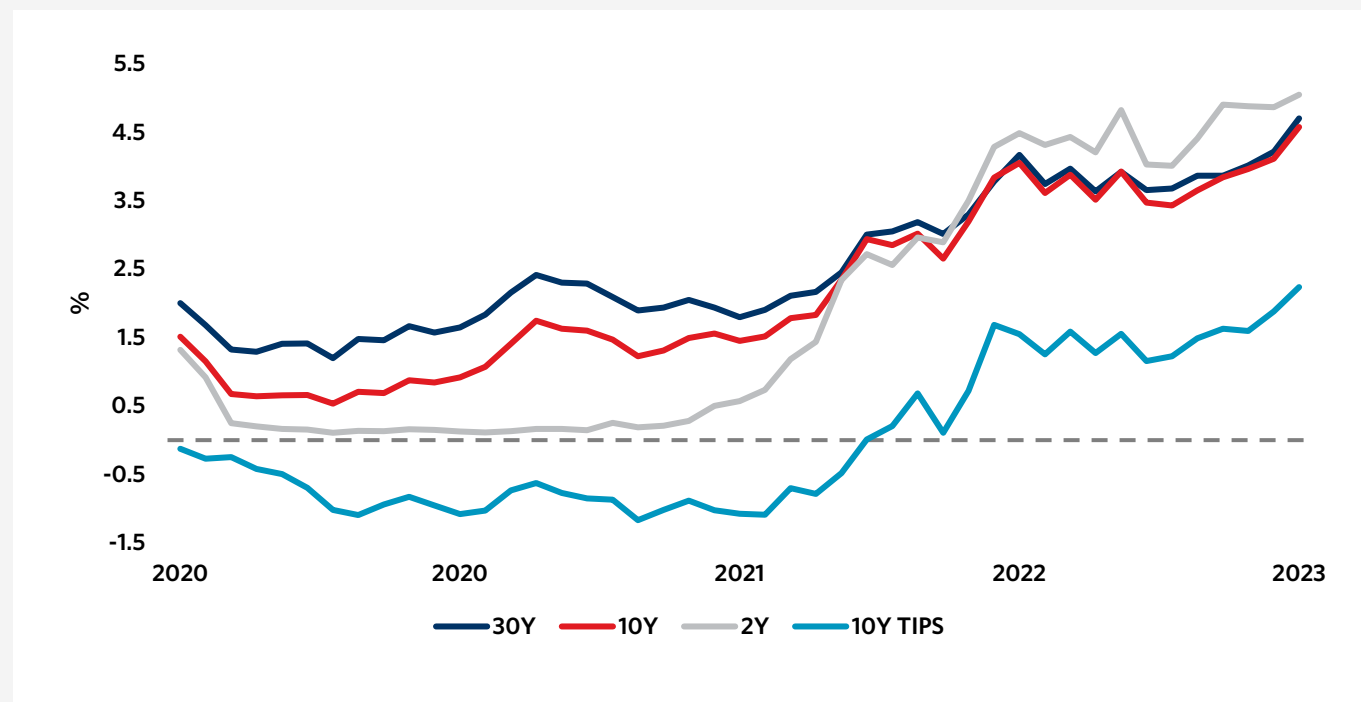
Eighteen months into one of the steepest monetary tightening cycles in history, financial markets in Q3 finally began to adjust to the Fed narrative of tighter for longer. Bond yields had already moved substantially higher as interest rates were pushed up relentlessly, starting in March 2022, but the biggest moves have been in short duration tenors, moving up broadly in line with the Fed Funds rate, while longer duration yields had risen by much less, leading to a steeply inverted yield curve. With interest rates now very close to the peak for this cycle, the focus has shifted to how long they will need to be kept at high levels to bring inflation sustainably back to the target of 2%. The message from the Fed and other developed world central banks has been increasingly hawkish in the face of the stickiness of inflation and resilience in economies, especially the key one, the US. Investor expectations for interest rate cuts have been pushed further out as the year progressed, and during Q3 the yields on longer duration bonds moved dramatically higher as the wait for lower rates has become more protracted and the cost of holding long duration versus cash and short duration bonds has become increasingly painful.

It meant another poor quarter of returns in bond markets, with US Treasuries -3.0% in Q3, and global government bonds -4.3%, as bond markets everywhere came under pressure and the dollar rose. The USD trade weighted index was up 3.2% in the quarter, and by over 6% from its low for the year in mid-July.

Few assets could hold up in this environment, with most equity markets down - the Japanese and UK markets were up in local currency terms in Q3, but weakness of their currencies resulted in negative returns in dollar terms. Credit markets generally followed the path of government bonds and weakened, although the additional yield on junk bonds helped them to produce a small positive return.

The only notable strength was in the oil market, up 27% in the quarter, supported by OPEC+ production cuts and resilience in economies. Saudi Arabia and Russia extended their production cuts of 1m and 0.3m bpd respectively to year end, and the IEA expects this to lead to a substantial market deficit in Q4. However, with the price of Brent crude at \$95 at end September, some price resistance is likely, especially if, as we expect, global growth slows. The rise will have an impact on headline inflation in the short term, but is unlikely to affect core price inflation materially.

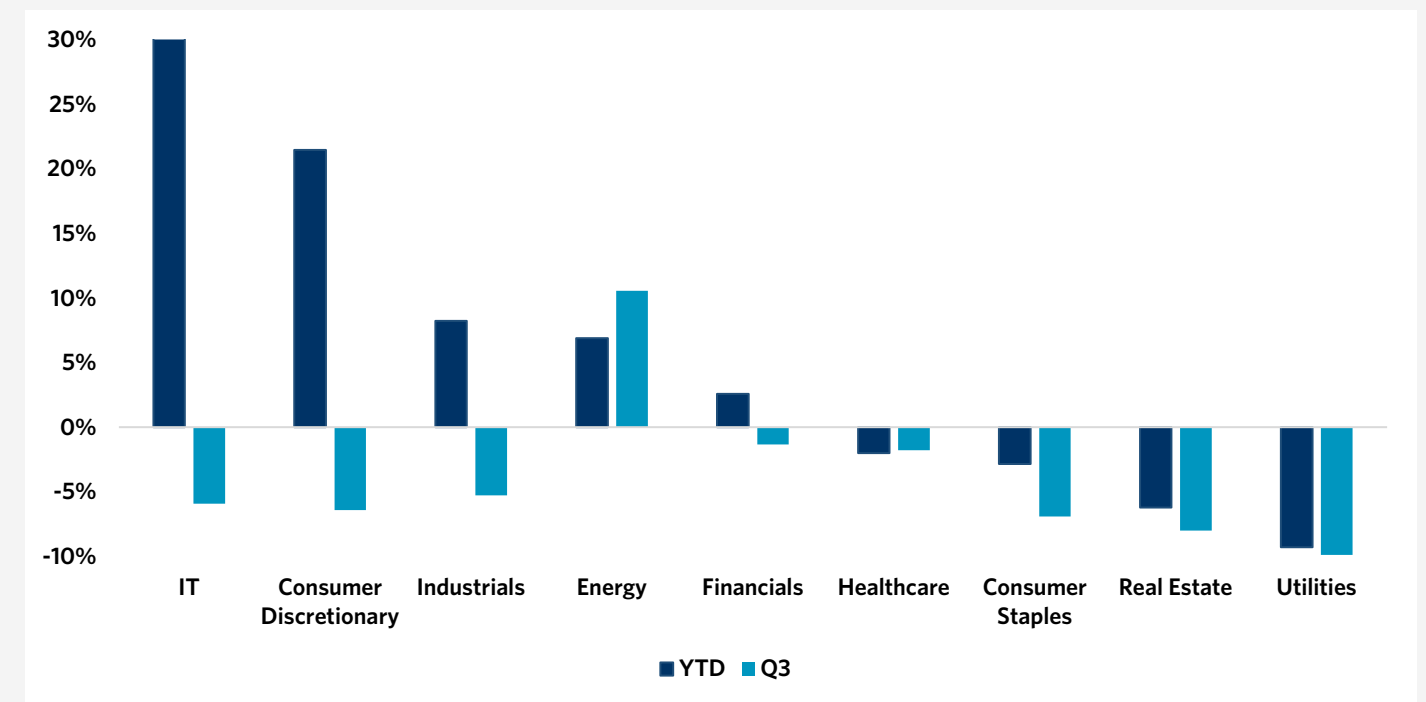
## Longer dated bond yields move sharply higher in Q3 - driven by real yields



Source: Bloomberg Finance L.P., Momentum Global Investment Management as at 29 September 2023

The yield on 10Y US Treasuries rose by 73bps in Q3 to 4.57% at end September, compared with only 3.3% in the aftermath of the mini-banking crisis in March, while 30Y yields rose by 84bps to 4.7%, the highest since the GFC. In contrast, 2Y yields rose by only 10bps to 5.0%, resulting in the yield curve flattening, albeit still well into inverted level. The importance of this sharp rise in long duration bond yields on what is, in effect, the world's discount rate, should not be under-estimated. Most of the rise came through higher real yields, up by over 60bps to 2.23%, taking them further into restrictive territory. It tightens financial conditions, reverberates globally by underpinning dollar strength and pushing financing costs up for USD borrowings, and puts pressure on other asset classes, both in terms of relative valuations and the negative impact on economic activity.

## Energy sector the only winner in Q3 2023



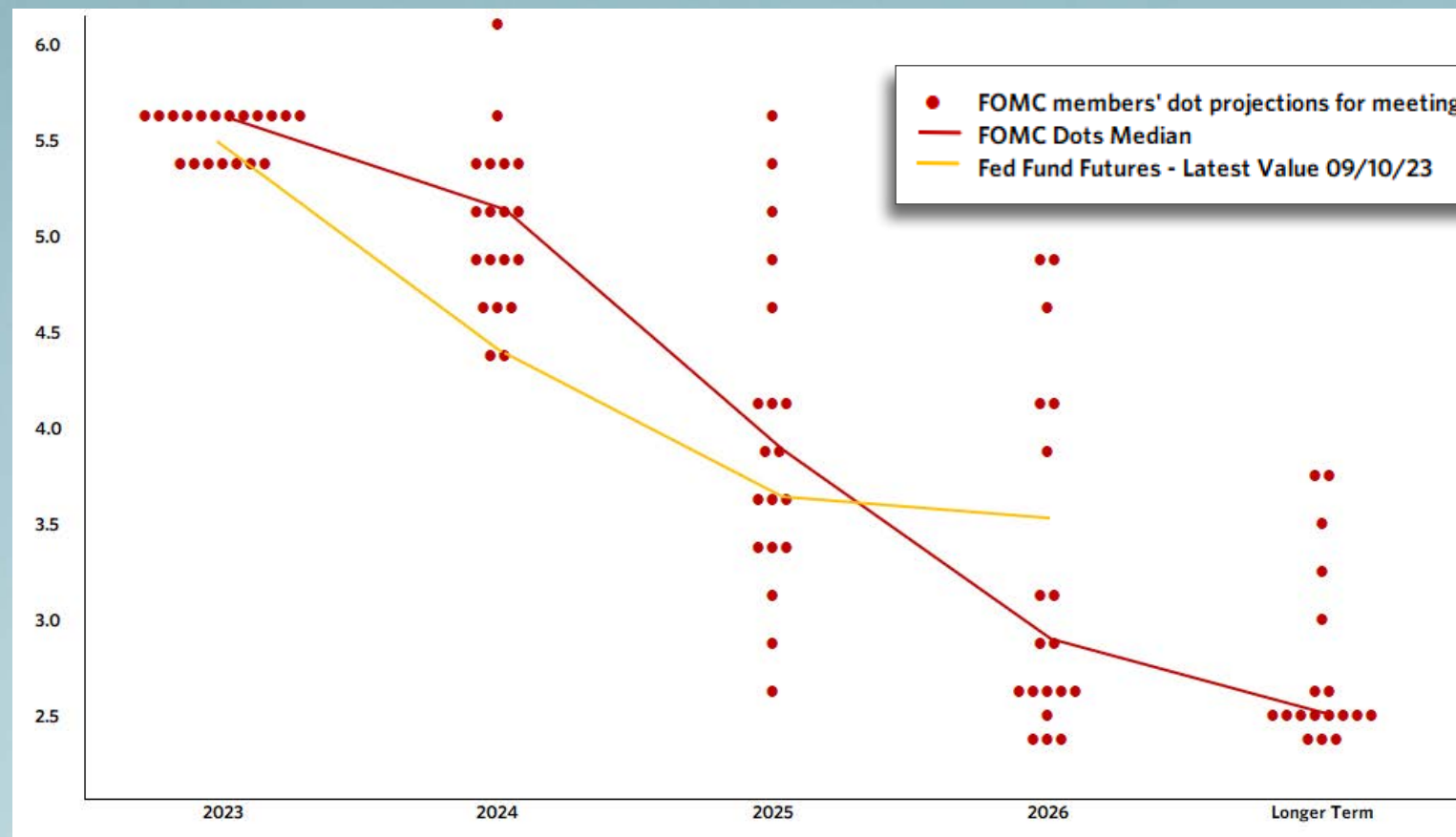
Source: Bloomberg Finance L.P., Momentum Global Investment Management as at 29 September 2023

It is the stickiness of core prices that led to all three of the big central banks increasing policy rates further in Q3, the Fed and Bank of England by 0.25% to 5.5% and 5.25% respectively, and the ECB by 0.50% to 4.0%. Although the Fed and Bank of England paused on rate hikes in their September policy meetings, and the ECB signalled that 4% was probably at peak levels, none closed the door to further rate rises, and all three committed to keeping rates high and restrictive for as long as necessary to bring inflation to target. Each will now be guided by economic data in determining policy, shifting from forward guidance and thereby heightening uncertainty for investors, with markets likely to be buffeted by data releases.



Data from the US economy has proved to be surprisingly strong this year, and the labour market remains tight, with wages rising at close to 6%, key factors in the Fed's continuing hawkishness. At its September policy meeting, the Fed's quarterly 'dot plot' of governors' expectations showed rate cuts were not expected before the second half of 2024, with Fed Funds still over 5% by the end of next year, with the median forecast 50bps higher than 3 months earlier.

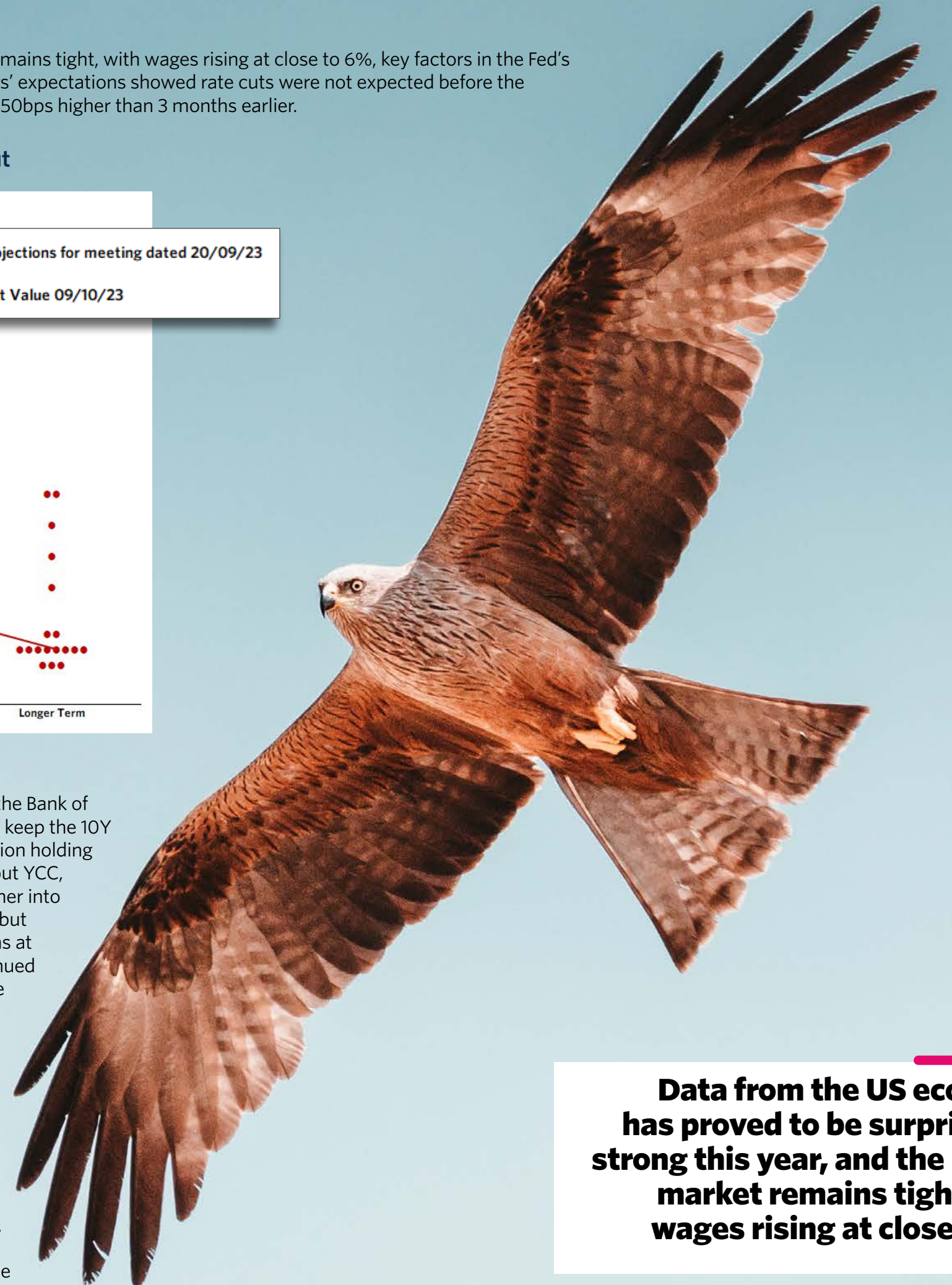
### Federal Reserve Dot Plot - rate cut expectations pushed further out



Source: Bloomberg Finance L.P., Momentum Global Investment Management as at 29 September 2023.

Similar messages were delivered by the ECB and Bank of England, the one outlier continuing to be the Bank of Japan (BoJ), which has maintained its negative policy rate and yield curve control (YCC), aiming to keep the 10Y government bond yield at zero, within tightly defined limits. However, with headline and core inflation holding above 3% throughout 2023, pressure has been building on the BoJ to tighten policy, and to phase out YCC, which as a policy tool perversely becomes more stimulative as inflation rises, taking real rates further into negative territory. The BoJ made a move in this direction in July, by keeping the target yield at zero but effectively increasing the upper limit to 1%. Although the yield almost doubled during Q3, it remains at only 0.75%, so that the interest rate differential between the yen and other major currencies continued to widen, putting pressure on the yen, down by 12.2% against the dollar this year to its lowest since 1990.

The potential inflationary impacts of the fall in the yen have raised concerns in government, with speculation growing that currency intervention will be used to stem the decline. We expect the BoJ to tighten policy before long by withdrawing YCC and raising rates into positive territory, although any moves are likely to be cautious to avoid undue volatility. The risks of sudden and substantial repatriation of funds to Japan cannot be ruled out, creating sharp moves in the yen and Japanese assets, with the potential for some imbalances and disruption in the short term, but they are very unlikely to be systemic in nature. The biggest loser of any rise in bond yields will be the dominant owner of them, the BoJ, which holds 53% of the JGB market following years of QE. We remain positive about Japanese equities, given their still attractive valuation and the improved shareholder returns from ongoing reforms in the corporate sector, and would see any setback in the market as a buying opportunity.



**Data from the US economy has proved to be surprisingly strong this year, and the labour market remains tight, with wages rising at close to 6%**

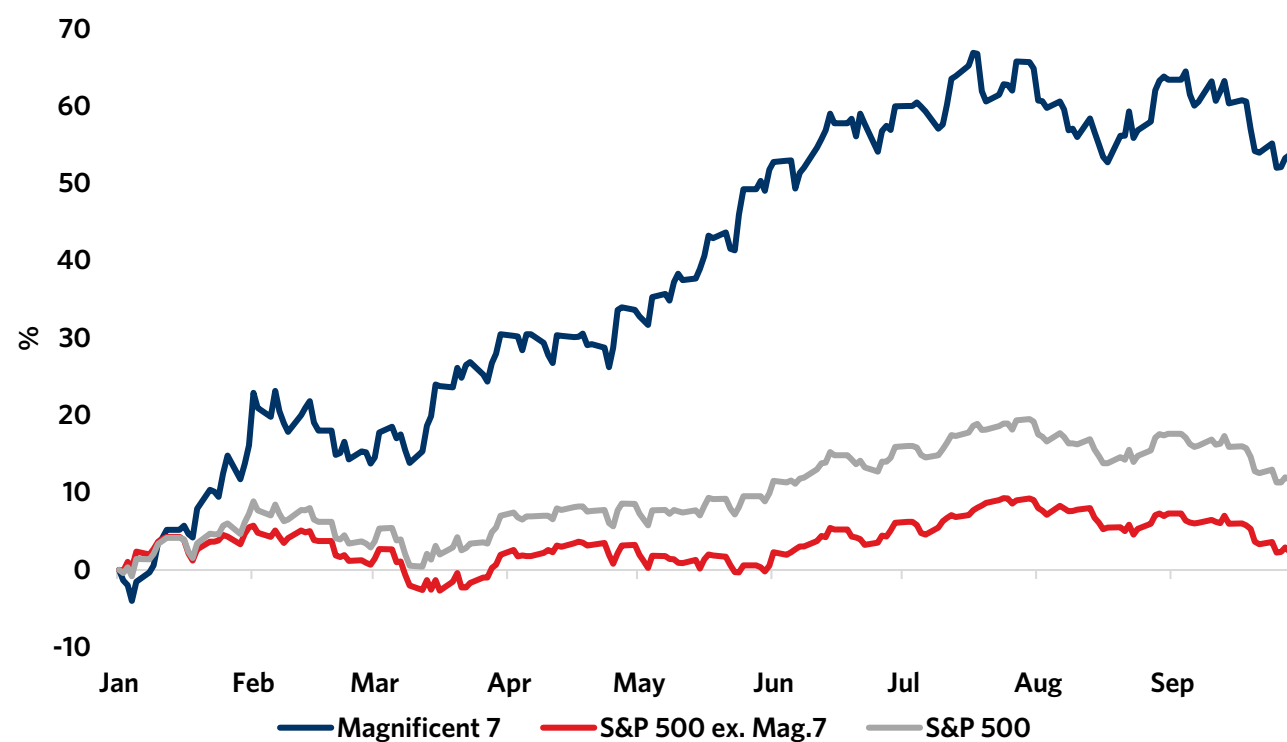


Problems in China continued to mount, although the equity market was relatively stable, down only 2% in Q3, after steep falls earlier in the year. The slowdown in the economy continued, leading indicators remained soft, retail sales weak, exports and imports have been falling year-on-year, and inflation has been stuck around zero for 6 months. Deepening problems in the highly leveraged property development industry added to the woes, with 2 of the biggest developers, Country Garden and Evergrande, struggling to avoid debt defaults, and facing restructuring. Equity and bond prices in the sector sold off heavily, and contagion risks remain a concern, especially among local governments and their funding arms, local government financing vehicles, created to finance infrastructure and real estate developments. China is also grappling with the impact of US-imposed constraints on technology imports, de-globalisation and re-shoring of supply chains, with evidence mounting of the damage to activity and investment. China's authorities have responded to the weakness with stimulus measures, although the scale has been modest, limited by already high debt levels. The People's Bank of China has cut interest rates in small increments and injected liquidity while measures have been taken to encourage bank lending and stock market investing.

The scale of China's cyclical and structural problems is considerable, but is increasingly being recognised in the equity market, down by some 50% from the peak. The debt problem is not likely to be systemic, with very limited contagion risks globally, and China has the wherewithal to work through its problems. Its growth rate will inevitably continue to slow, but opportunities both for recovery and longer-term growth are opening up for investors.

The dominance of US mega cap tech stocks faded in Q3. The Bloomberg Magnificent 7 index fell by 1.4%, slightly better than the S&P 500 -3.4%, and has traded broadly sideways since mid-June. That still leaves the 'magnificent 7' US stocks up by over 80% YTD using the Bloomberg equally weighted index, leaving the rest of the market largely unchanged. Some pause after a rise of this magnitude is warranted, and it is perhaps surprising that stocks which are highly valued based on earnings far into the future, have held up so well at a time when the longer term bond yields used to discount those earnings have soared.

**Dominance of Magnificent 7 fades in Q3**



Source: Bloomberg Finance L.P., Momentum Global Investment Management as at 29 September 2023.

We are arguably entering the most dangerous part of this long monetary cycle. The battle to control inflation is well underway, progress has been made, but the easiest part of that job is over, with the more challenging and uncertain part ahead. Resilience of economies, especially that of the US, and of labour markets, is making core inflation more persistent than anticipated and tougher to control. Policy rates are now at or very close to the peak, but the big uncertainty is for how long they will need to be kept at restrictive levels to bring core inflation down to target. The huge moves in long term bond yields in recent weeks is a reflection of this uncertainty, with investors demanding higher nominal and real yields to offset the risks. The danger is that the longer rates stay in the firmly restrictive territory in which they are now, the greater is the risk of a financial accident and of tipping the economy into recession. Anyone taking out a new 30-year mortgage in the US today will be paying an interest rate of around 7.5%, up by 80 bps in the past 3 months to the highest level since 2000. As companies seek to refinance debt, especially those with weaker balance sheets, it will be increasingly difficult and costly, while government debt piles will become a much bigger burden. There is no hiding place under these circumstances, and at the moment, no end in sight.

The risk of policy error is rising, and at this stage those risks seem to be firmly tilted towards staying too tight for too long, after the too easy for too long error in the upswing. Central banks seem prepared to risk a sharp slowdown, rather than easing too early, then having to pay an even heavier price in the event of inflation picking up again.

This challenging and uncertain environment calls for caution in equity markets in the short term, a caution amplified by the big valuation shift in the past few weeks in favour of bonds, especially those with longer maturity. Yields of US Treasury bonds with maturities of 10 years or more are at their highest levels in almost 15 years, and offer real yields of well over 2%. As nominal yields head close to 5%, we believe they are firmly in attractive valuation territory, and would be the biggest beneficiaries of a recession or financial mishap. We see a slowdown as inevitable, with Europe and the UK more vulnerable than the US to recession, and while we do not see systemic risks, with balance sheets of households, companies and, critically, banks, generally in good shape and resilient, accidents are rarely forewarned. We have been increasing exposure to safe-haven government bonds in short maturities in recent months but are now looking for opportunities to extend duration as we enter the latter stages of the cycle, taking advantage of high risk-free yields and the prospect of capital gains as economies slow and rate cuts come into view.

## The dominance of US mega cap tech stocks faded in Q3



# Market performance - Global (local returns) as at 29 September 2023

Asset Class / Region	Index	Ccy	1 month	3 months	YTD	12 months
<b>Developed Markets Equities</b>						
United States	S&P 500 NR	USD	-4.8%	-3.4%	12.7%	21.0%
United Kingdom	MSCI UK NR	GBP	2.9%	2.6%	5.8%	13.9%
Continental Europe	MSCI Europe ex UK NR	EUR	-2.5%	-3.1%	9.2%	20.4%
Japan	Topix TR	JPY	0.5%	2.5%	25.7%	29.8%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-2.7%	-3.4%	-0.4%	11.6%
Global	MSCI World NR	USD	-4.3%	-3.5%	11.1%	22.0%
<b>Emerging Markets Equities</b>						
Emerging Europe	MSCI EM Europe NR	USD	-5.7%	1.8%	15.0%	64.6%
Emerging Asia	MSCI EM Asia NR	USD	-2.6%	-2.9%	1.0%	11.9%
Emerging Latin America	MSCI EM Latin America NR	USD	-2.3%	-4.7%	12.9%	19.4%
China	MSCI EM China NR	USD	-1.1%	-0.8%	-1.1%	7.7%
BRICs	MSCI BRIC NR	USD	-2.8%	-1.9%	-7.3%	5.2%
Global emerging markets	MSCI Emerging Markets NR	USD	-2.6%	-2.9%	1.8%	11.7%
<b>Bonds</b>						
US Treasuries	JP Morgan United States Government Bond TR	USD	-2.2%	-3.0%	-1.5%	-0.7%
US Treasuries (inflation protected)	BBgBarc US Government Inflation Linked TR	USD	-1.9%	-2.8%	-0.9%	1.2%
US Corporate (investment grade)	BBgBarc US Corporate Investment Grade TR	USD	-2.7%	-3.1%	0.0%	3.6%
US High Yield	BBgBarc US High Yield 2% Issuer Cap TR	USD	-1.2%	0.5%	5.9%	10.3%
UK Gilts	JP Morgan UK Government Bond TR	GBP	-1.0%	-0.7%	-4.3%	-2.6%
UK Corporate (investment grade)	ICE BofAML Sterling Non-Gilt TR	GBP	0.1%	2.2%	1.2%	7.4%
Euro Government Bonds	ICE BofAML Euro Government TR	EUR	-2.7%	-2.5%	-0.4%	-2.2%
Euro Corporate (investment grade)	BBgBarc Euro Aggregate Corporate TR	EUR	-0.9%	0.3%	2.5%	3.6%
Euro High Yield	BBgBarc European HY 3% Constrained TR	EUR	0.3%	1.8%	6.3%	11.3%
Japanese Government	JP Morgan Japan Government Bond TR	JPY	-0.7%	-3.2%	-0.5%	-2.4%
Australian Government	JP Morgan Australia GBI TR	AUD	-1.9%	-0.8%	0.4%	0.7%
Global Government Bonds	JP Morgan Global GBI	USD	-3.1%	-4.3%	-3.5%	0.2%
Global Bonds	ICE BofAML Global Broad Market	USD	-3.1%	-3.9%	-2.4%	1.8%
Global Convertible Bonds	ICE BofAML Global Convertibles	USD	-2.7%	-2.7%	4.6%	9.0%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	-3.7%	-3.4%	-0.2%	8.5%

Asset Class / Region	Index	Ccy	1 month	3 months	YTD	12 months
<b>Property</b>						
US Property Securities	MSCI US REIT NR	USD	-7.0%	-7.3%	-2.9%	1.9%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	-8.7%	-3.6%	-2.1%	7.4%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	-2.2%	-3.1%	-9.8%	-1.8%
Global Property Securities	S&P Global Property USD TR	USD	-5.4%	-4.6%	-3.6%	3.6%
<b>Currencies</b>						
Euro		USD	-2.5%	-3.1%	-1.2%	7.9%
UK Pound Sterling		USD	-3.7%	-4.0%	1.0%	9.2%
Japanese Yen		USD	-2.6%	-3.4%	-12.2%	-3.1%
Australian Dollar		USD	-0.8%	-3.4%	-5.5%	0.5%
South African Rand		USD	-0.2%	-0.4%	-10.0%	-4.4%
<b>Commodities &amp; Alternatives</b>						
Commodities	RICI TR	USD	0.9%	9.1%	1.3%	6.0%
Agricultural Commodities	RICI Agriculture TR	USD	-2.9%	0.3%	0.8%	2.6%
Oil	Brent Crude Oil	USD	9.7%	27.2%	10.9%	8.4%
Gold	Gold Spot	USD	-4.7%	-3.7%	1.3%	11.3%
Hedge funds	Bloomberg All Hedge Fund Index	USD	-0.3%	0.3%	3.6%	6.0%
<b>Interest Rates</b>						
						<b>Current Rate</b>
United States						5.50%
United Kingdom						5.25%
Eurozone						4.50%
Japan						-0.10%
Australia						4.10%
South Africa						8.25%

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

# Market performance - UK (all returns GBP) as at 29 September 2023

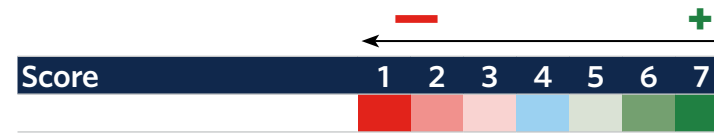
Asset Class / Region	Index	Local Ccy	1 month	3 months	YTD	12 months
<b>Equities</b>						
UK - All Cap	MSCI UK NR	GBP	2.9%	2.6%	5.8%	13.9%
UK - Large Cap	MSCI UK Large Cap NR	GBP	4.0%	3.0%	4.2%	12.6%
UK - Mid Cap	MSCI UK Mid Cap NR	GBP	-2.2%	-0.3%	7.8%	19.4%
UK - Small Cap	MSCI Small Cap NR	GBP	-1.1%	1.0%	1.2%	11.6%
United States	S&P 500 NR	USD	-1.2%	0.7%	11.7%	10.3%
Continental Europe	MSCI Europe ex UK NR	EUR	-1.3%	-2.2%	6.9%	18.6%
Japan	Topix TR	JPY	1.5%	3.1%	9.2%	14.6%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	0.9%	0.7%	-1.3%	1.8%
Global developed markets	MSCI World NR	USD	-0.7%	0.6%	10.1%	11.2%
Global emerging markets	MSCI Emerging Markets NR	USD	1.0%	1.1%	0.9%	1.9%
<b>Bonds</b>						
Gilts - All	ICE BofAML UK Gilt TR	GBP	-1.1%	-0.8%	-4.6%	-3.0%
Gilts - Under 5 years	ICE BofAML UK Gilt TR 0-5 years	GBP	0.7%	2.5%	1.1%	3.8%
Gilts - 5 to 15 years	ICE BofAML UK Gilt TR 5-15 years	GBP	0.0%	1.3%	-2.1%	2.3%
Gilts - Over 15 years	ICE BofAML UK Gilt TR 15+ years	GBP	-3.8%	-5.7%	-11.1%	-12.8%
Index Linked Gilts - All	ICE BofAML UK Gilt Inflation-Linked TR	GBP	-3.5%	-5.2%	-8.0%	-13.5%
Index Linked Gilts - 5 to 15 years	ICE BofAML UK Gilt Inflation-Linked TR 5-15 years	GBP	-0.4%	0.2%	0.9%	2.6%
Index Linked Gilts - Over 15 years	ICE BofAML UK Gilt Inflation-Linked TR 15+ years	GBP	-6.8%	-10.6%	-15.8%	-26.4%
UK Corporate (investment grade)	ICE BofAML Sterling Non-Gilt TR	GBP	0.1%	2.2%	1.2%	7.4%
US Treasuries	JP Morgan US Government Bond TR	USD	1.6%	1.0%	-2.9%	-9.2%
US Corporate (investment grade)	BBgBarc US Corporate Investment Grade TR	USD	1.0%	0.9%	-1.4%	-5.2%
US High Yield	BBgBarc US High Yield 2% Issuer Cap TR	USD	-1.2%	0.5%	5.9%	10.3%
Euro Government Bonds	ICE BofAML Euro Government TR	EUR	-2.7%	-2.5%	-0.4%	-2.2%
Euro Corporate (investment grade)	BBgBarc Euro Aggregate Corporate TR	EUR	-0.9%	0.3%	2.5%	3.6%
Euro High Yield	BBgBarc European High Yield 3% Constrained TR	EUR	0.3%	1.8%	6.3%	11.3%
Global Government Bonds	JP Morgan Global GBI	GBP	0.5%	-0.3%	-4.4%	-8.6%
Global Bonds	ICE BofAML Global Broad Market	GBP	-3.1%	-3.9%	-2.4%	1.8%
Global Convertible Bonds	ICE BofAML Global Convertibles	GBP	-2.7%	-2.7%	4.6%	9.0%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	GBP	-0.1%	0.6%	-1.1%	-1.1%

Asset Class / Region	Index	Local Ccy	1 month	3 months	YTD	12 months
<b>Property</b>						
Global Property Securities	S&P Global Property TR	GBP	-1.9%	-0.6%	-4.4%	-5.6%
<b>Currencies</b>						
Euro		GBP	1.3%	0.9%	-2.1%	-1.2%
US Dollar		GBP	3.9%	4.1%	-1.0%	-8.4%
Japanese Yen		GBP	1.2%	0.5%	-13.0%	-11.3%
<b>Commodities &amp; Alternatives</b>						
Commodities	Rogers International Commodity (RICI) TR	GBP	4.7%	13.6%	0.4%	-3.3%
Agricultural Commodities	Rogers International Commodity (RICI) Agriculture TR	GBP	0.8%	4.5%	-0.1%	-6.5%
Oil	Brent Crude Oil	GBP	13.8%	32.6%	10.0%	-1.2%
Gold	Gold Spot	GBP	-1.2%	0.3%	0.5%	1.5%
<b>Interest Rates</b>						
						<b>Current Rate</b>
United Kingdom						5.25%

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



# Asset allocation views



**With the recent rise in global rates, bonds now provide a more attractive opportunity**

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

## Our Overall View

The lack of depth in this year's market rally is a cause for concern with fears of a recession still high and lead indicators suggesting slower growth ahead. Our fixed income view remains broadly neutral as rates continue to edge higher, and although the threat of a recession requires an element of caution with certain fixed income assets, good opportunities can be found. Alternative assets remain a good diversifier of returns, especially favourable should market volatility increase. Cash is an attractive lure today but won't preserve real wealth long term.

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

We temper our positive view on Japanese equities, taking some profit after the strong year to date performance. Last year's aggressive rate hikes continue to show signs of pushing developed economies towards recession and there is a risk of complacency taking hold in risk markets. US equities in particular have shown a worrying lack of breadth in this year's rally, but the opportunity set for active managers is appealing. European equities look reasonably attractive, but the most compelling markets remain the UK and Japan which trade at a discount to global peers and offer healthy dividends.

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

Rates have recently started to edge higher, and momentum has been against fixed income. Despite offering alluring all-in yields, we think the spreads offered today on investment grade and riskier high yield corporate bonds do not compensate investors adequately for the underlying fundamental credit risk. The possibility of a recession and rising default rates suggest that an element of caution is necessary. We continue to prefer shorter duration bonds in both developed and emerging markets. Improving real yields and weak growth expectations have recently improved the appeal of inflation linked bonds.

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

Commodity prices are likely to be challenged against a slowdown in global growth. With expectations of a more turbulent period ahead in markets, alternatives continue to offer diversification benefits at attractive valuations after a period of poor investor sentiment. Discounts in NAVs in private equity continue to appear overly pessimistic while secular trends in infrastructure and specialist financials have boosted our outlook for both asset classes. Our liquid alternatives continue to offer attractive diversification benefits especially during periods of market uncertainty.

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

Against long term valuation metrics, Sterling and Yen continue to remain cheap relative to the Dollar. The Bank of Japan's ongoing policy of yield curve control policy holds the Yen back, for now. Recession expectations in the US and inflation in Europe could mean divergent rate expectations in support of the Euro, but the Fed's higher for longer narrative keeps the common currency in check for now. Gold's status as a haven asset means it remains a useful diversifier, although somewhat expensive versus real rates today.

The asset allocation views are updated at the end of each quarter unless otherwise stated.





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