TOP DOWN CHARTS

Chart driven macro insights for investors

Quarterly Strategy Pack – Q4 2022

1. **Introduction:** Background and reason for being.
2. **Research Process & Philosophy:** How I approach markets.
3. **Core Views:** Big picture macro/market outlook and asset allocation views.
4. **Interesting Ideas:** Some specific short and medium term directional views.
5. **Positioning:** Summary of views across asset classes.

1. Introduction

TOP DOWN CHARTS

Topdown Charts Limited is a New Zealand registered and headquartered company, founded on the 5th of September 2016. Topdown Charts is a 100% independent pure investment research firm.

The focus of the research is global economics and asset allocation. **The aim is to serve as a trusted and valued resource for portfolio managers and investment advisors.** This is achieved by delivering high quality insights, innovative and original research, and personalized service - with the perspective of a multi-asset portfolio manager front of mind.

Callum Thomas
Head of Research

Callum is founder and head of research at Topdown Charts. Prior to starting the business he worked in investment strategy at AMP Capital, AXA Global Investors, and the New Zealand Stock Exchange. Having spent his career in Australia and New Zealand he has by necessity developed a strong global focus, and sound capability in chart-driven top-down analysis for asset allocation.

Callum holds a Masters in Banking, Masters in Finance, and Bachelor's degree in Finance all earned at Massey University.

2. Research Process and Framework

TOP DOWN CHARTS

Research Process

Valuation

Valuation as a common anchor in the thesis
- Identify and develop valuation indicators
- Monitor for extremes (where the best opportunities are found)
- Explore the relative value case (no asset exists in a vacuum)

Cycle

Cycles are a constant across time and markets
- Identify the core cyclical/monetary drivers for the asset class
- Develop and monitor indicators and key data points
- Clarify how asset prices evolve across the cycle

Tactics

Round out the idea with tactical guidance
- Tactical indicators aid in idea generation + implementation
- Apply disciplined and sensible technical analysis techniques
- Look for extremes in sentiment, flows, and positioning

Key Beliefs

- Risk = owning an asset which is overvalued, overowned, overbought and out of time.
- Risk also = underexposed to assets which are undervalued, unloved, oversold, and turning around.
- See things as they are: minimize forecasting, be data-driven yet be unapologetically forward looking.
- Must define/frame key risks and drivers for a given asset class.
- Must know what indicators/charts to watch and monitor (and strive for constant innovation/improvement).
- Aim = put the odds in your favour.

2. Key Objectives and Scope of Research

TOP DOWN CHARTS

Really there are 3 key objectives that we aim to deliver: **risk management input** (investors tend to disproportionately punish permanent loss of capital vs rewarding exceptional performance), **idea generation** (but exceptional performance is still critical!), and help our clients **gain perspective** (which not only helps them in managing money, but also communicating with their clients and stakeholders).

Risk Management	Idea Generation	Gain Perspective
• Rule 1 of investing: don't lose money. • What do we need to be paying attention to?	• Engage multiple factors to find the best ideas. • Create unfair advantage for our clients through superior research.	• Stay focused on the signal, not the noise. • Inform our clients with cutting-edge studies.

Investment Universe

Equities
- ❑ Regions/Countries
- ❑ Sectors/Industries
- ❑ Styles/Factors

Alternatives
- ❑ Commodities
- ❑ Currencies
- ❑ REITs, MLPs

Fixed Income
- ❑ Government bonds
- ❑ Corporate credit
- ❑ Inflation linked

3. Core Views

TOP DOWN CHARTS

Big Picture Macro/Market/AA Outlook:

1. Act 2 of Policy Pivot: 2020 = global coordinated rate cuts vs 2022 = global coordinated rate hikes

2. Recession Watch: multiple leading indicators point to recession as heavyweight headwinds weigh-in

3. Inflation vs Stagflation vs Deflation: anticipate a shift in narrative as risks slowly but logically shift

4. Risk Radar: all about shocks and cycles, hopefully less shocks but a more shocking cycle!

5. Growth vs Defence: definitively defensive as the outlook for risk assets remains uninspiring

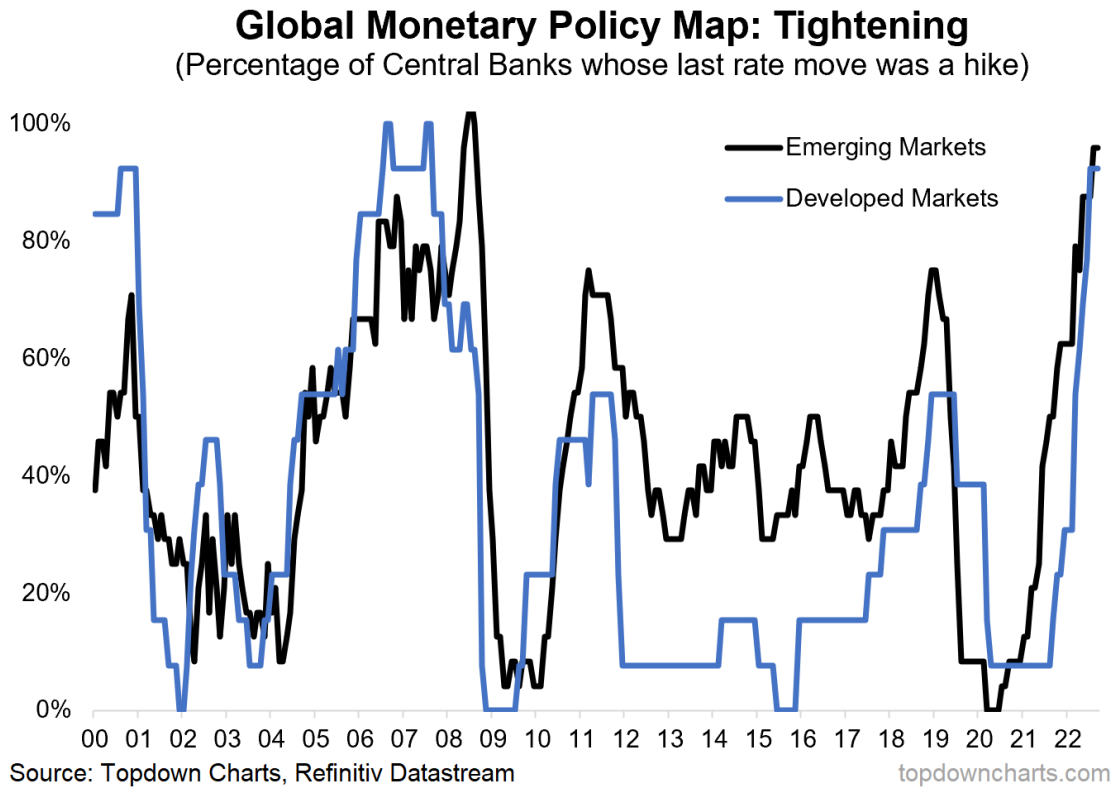
6. Global Equities: technicals say path of least resistance is lower, valuations improved (but…)

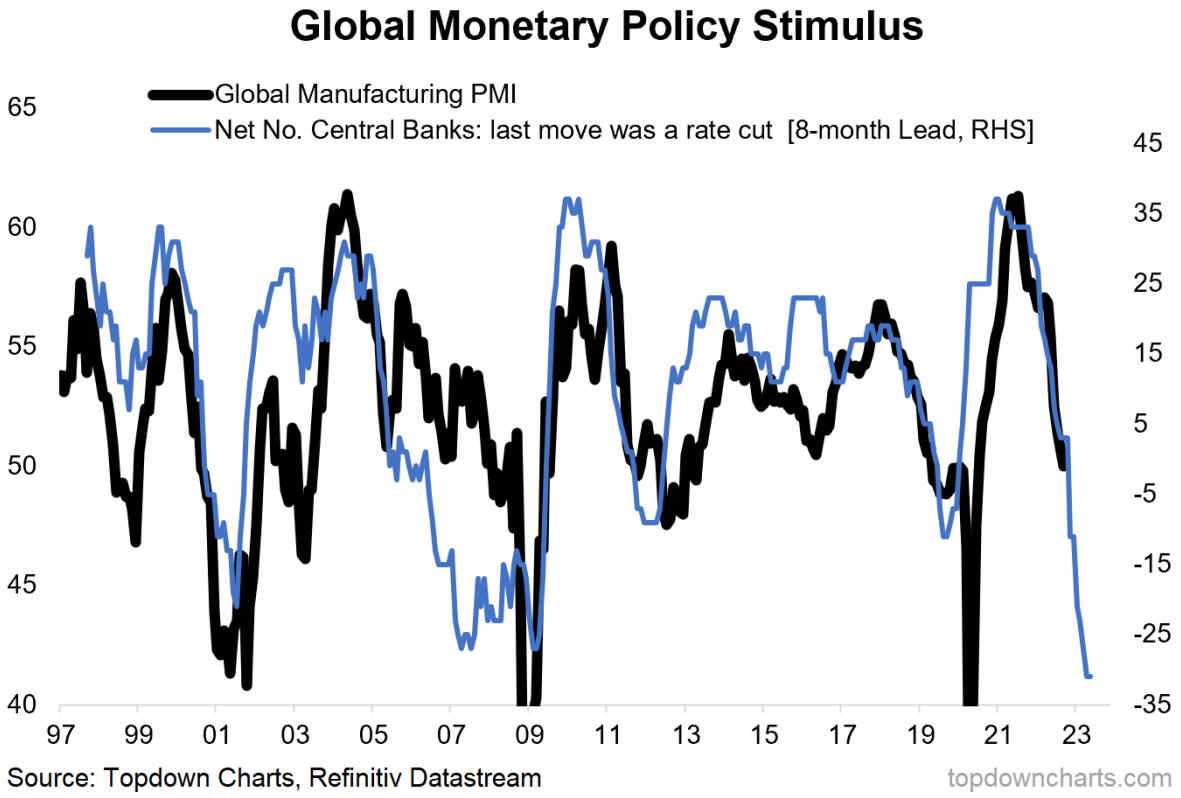
7. Commodities, EM, USD: strong dollar reinforcing weak outlook across EM and commodities

3. Core Views: Act 2 of Policy Pivot – Stimulus Exit

TOP DOWN CHARTS

From Panic rate-Cuts to Panic rate-Hikes: Last year I counted 123 rate hikes across 41 central banks… meanwhile so far in 2022 YTD I count 270+ rate hikes across 80+ central banks, with the majority of central banks globally now in rate hike mode. Along with rate hikes there is a steady stepping away from QE and towards QT. Fiscal policy has also turned the corner. So policy settings in general are coming full circle. This is all presenting increasing headwinds growth and risk assets.

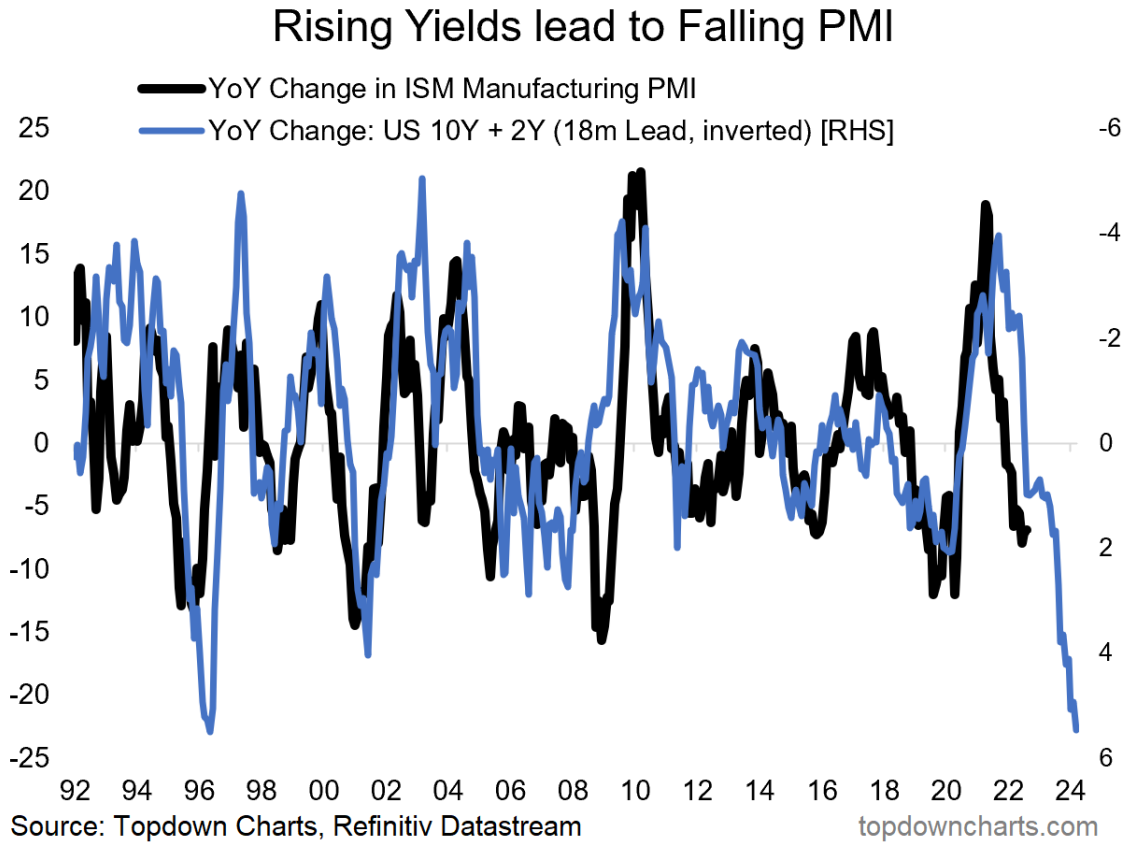




3. Core Views: Growth Headwinds

TOP DOWN CHARTS

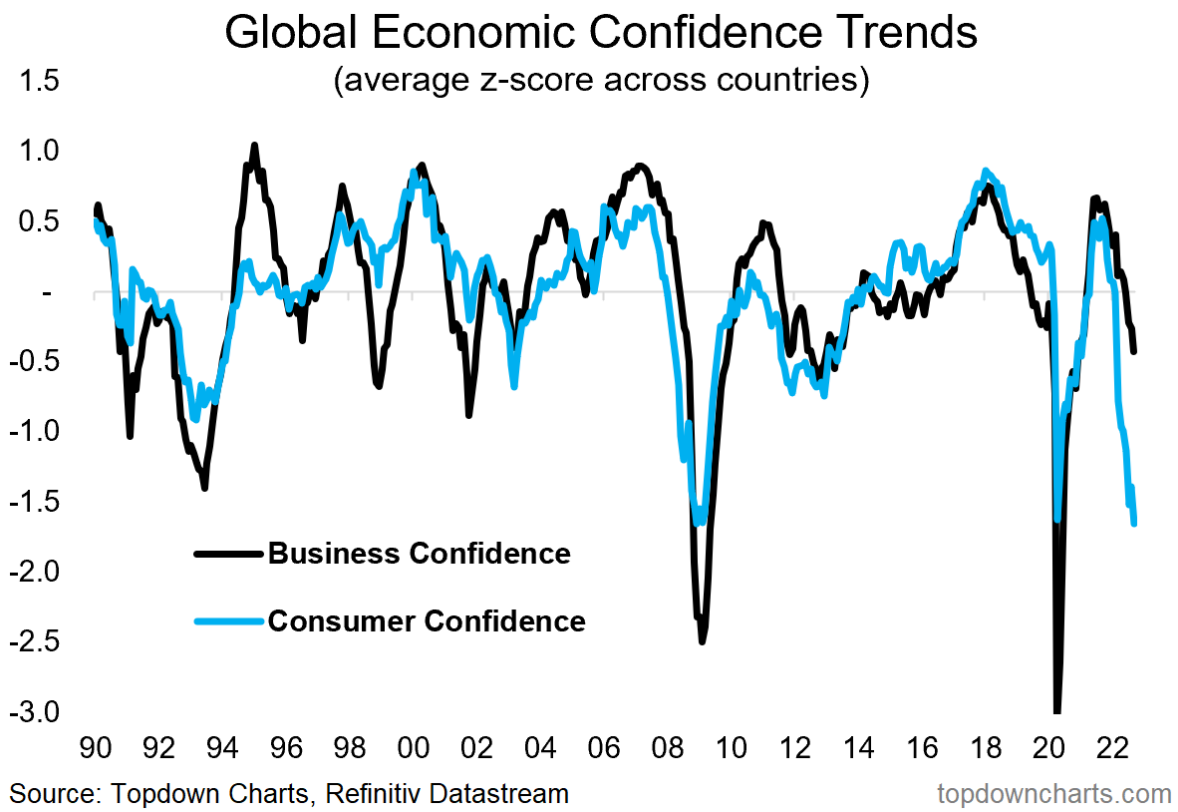
Borrowing Cost Burden: The sharp rise in bond yields and cash rates, along with generalized cost pressures (and in particular energy price shock) has put the squeeze on real incomes for consumers and profit margins for corporates. As such we have seen consumer and business confidence dropping sharply as the outlook takes on a distinctly dimmer hue.

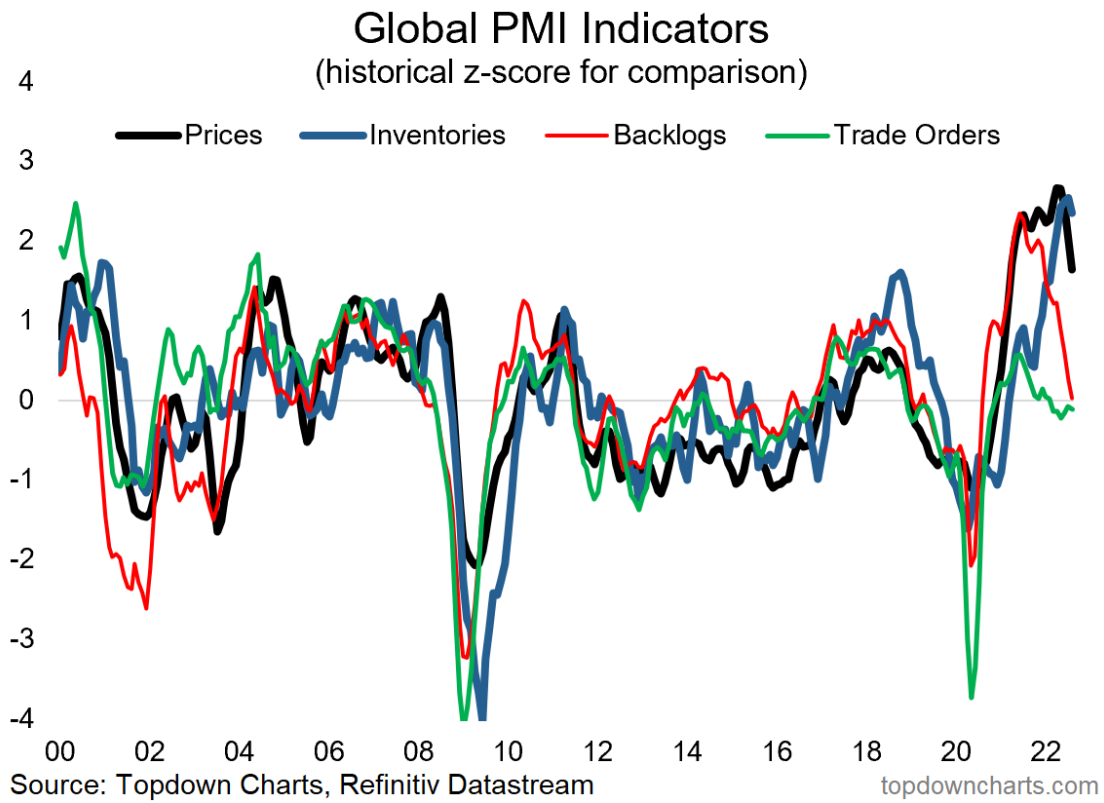


3. Core Views: Slowdown Signals

TOP DOWN CHARTS

Tell-tale Recession Signs Already Evident: Given severe negative wealth effects (and market volatility), inflation, and geopolitical shocks, globally consumer confidence has crashed and business confidence is catching down. Similarly the global PMI indicators show a transition from booming demand and backlogs (and price pressures) to rising inventories and softer demand (and likely easing price pressures soon…)

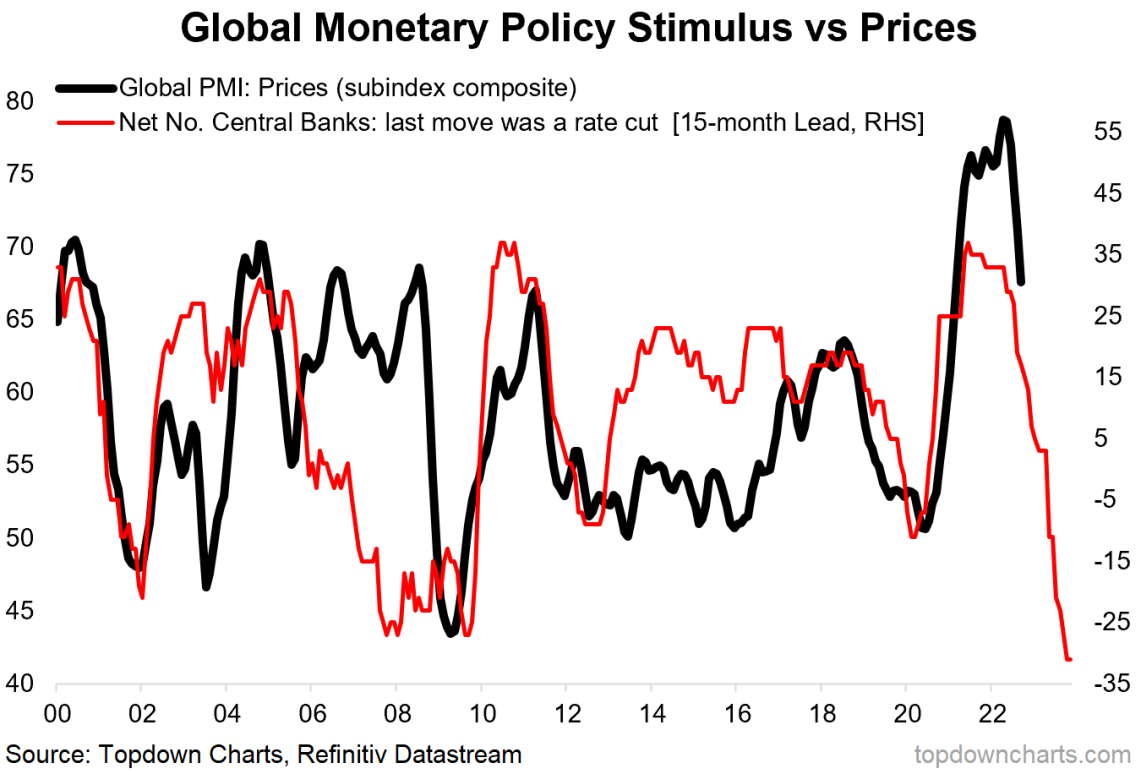


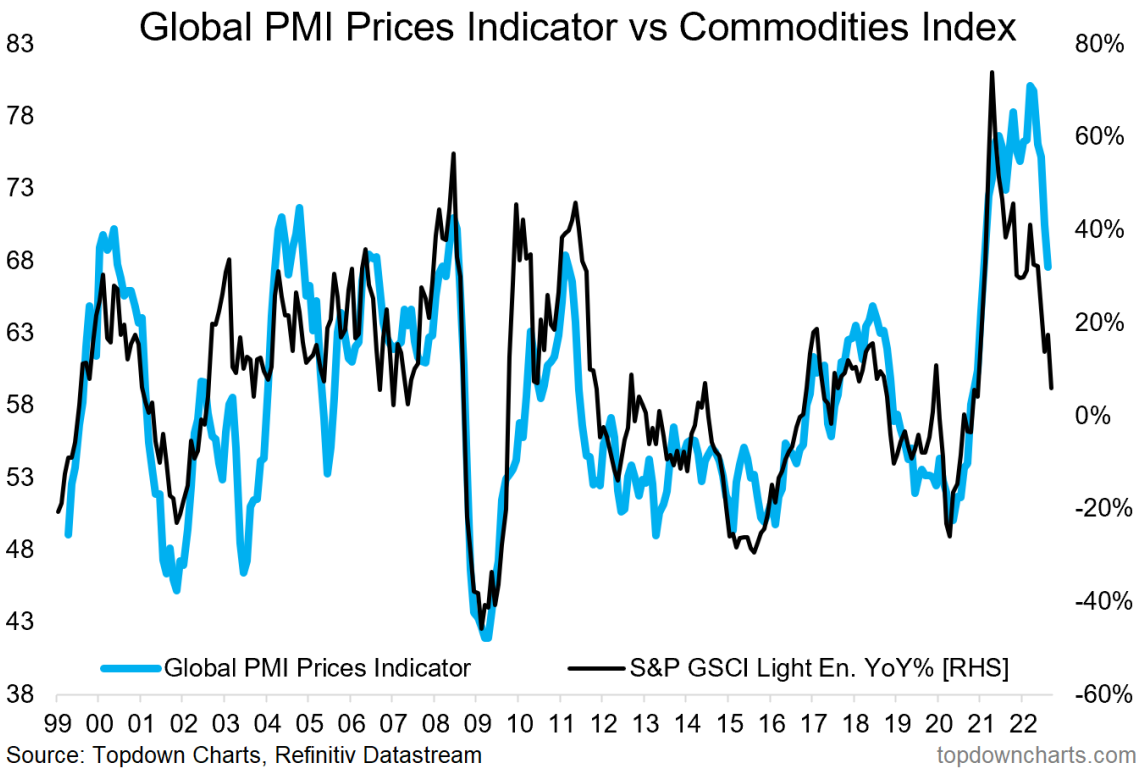


3. Core Views: (dis)Inflation Outlook

TOP DOWN CHARTS

Following on from the growth (demand) outlook, the inflation outlook looks set to logically follow a similar path. Various leading indicators of pricing pressures (2 of which are included below) point to a significant disinflationary impulse into 2023. There is even a chance the discussion might switch from inflation to deflation next year (but much of that depends on the recession severity and commodity price path).

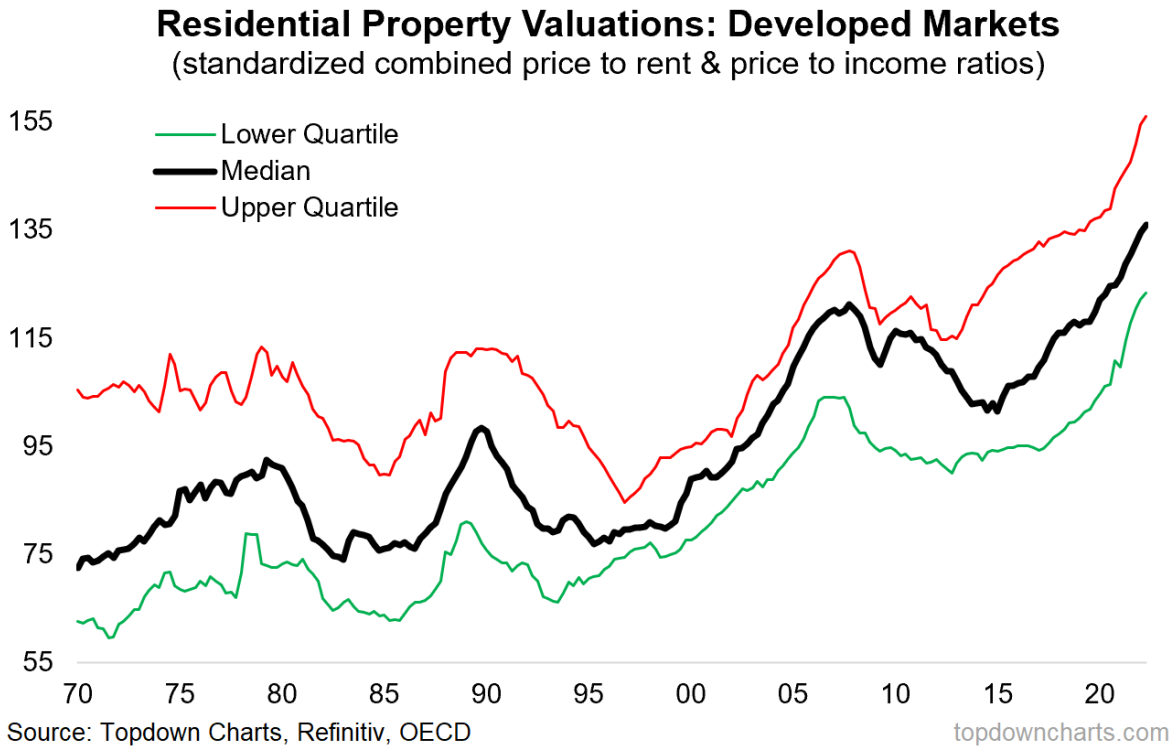


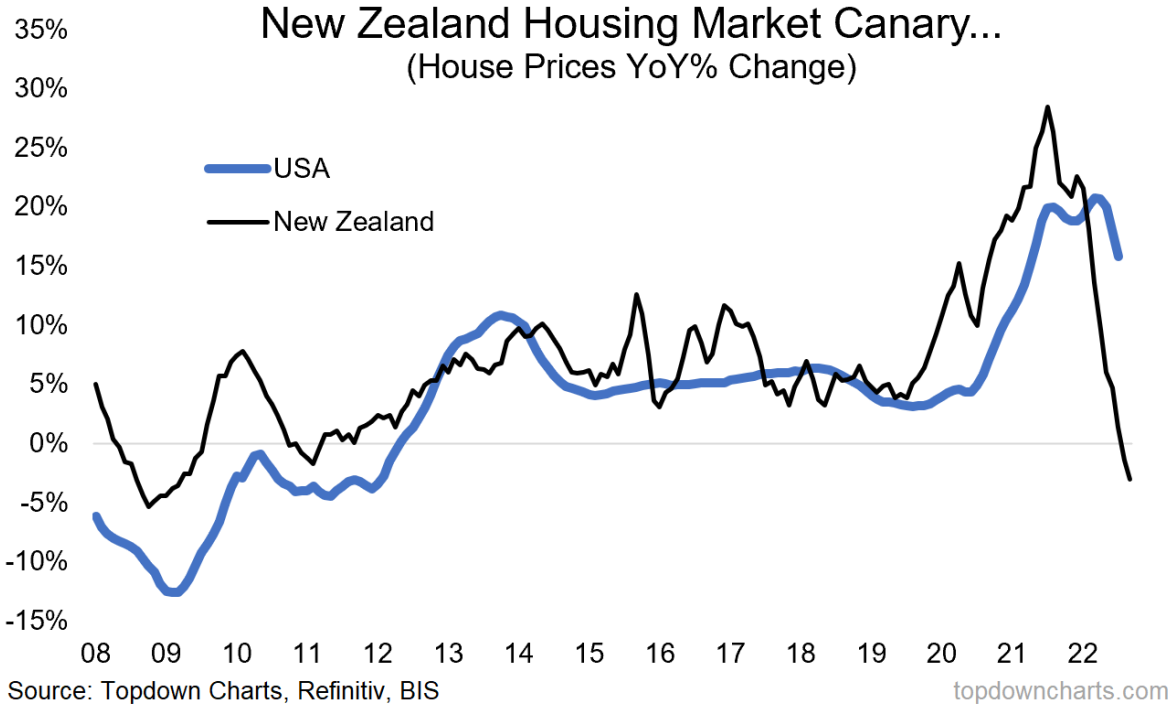


3. Core Views: Real Estate Rate Shock

TOP DOWN CHARTS

Richly Priced Real Estate + Rate Shock = Real Risk: Housing market valuations have far surpassed the heights reached during the subprime credit bubble. Real estate is extremely interest rate sensitive. Rates go up = real estate go down. Extreme expensive markets are particularly vulnerable in the face of a catalyst to repricing i.e. surging mortgage rates (more than doubled off the lows); which is also met with squeezing real incomes. NZ was among the first to start easing/reopening/hiking, so serves as a good case-study/leading indicator of things to come.

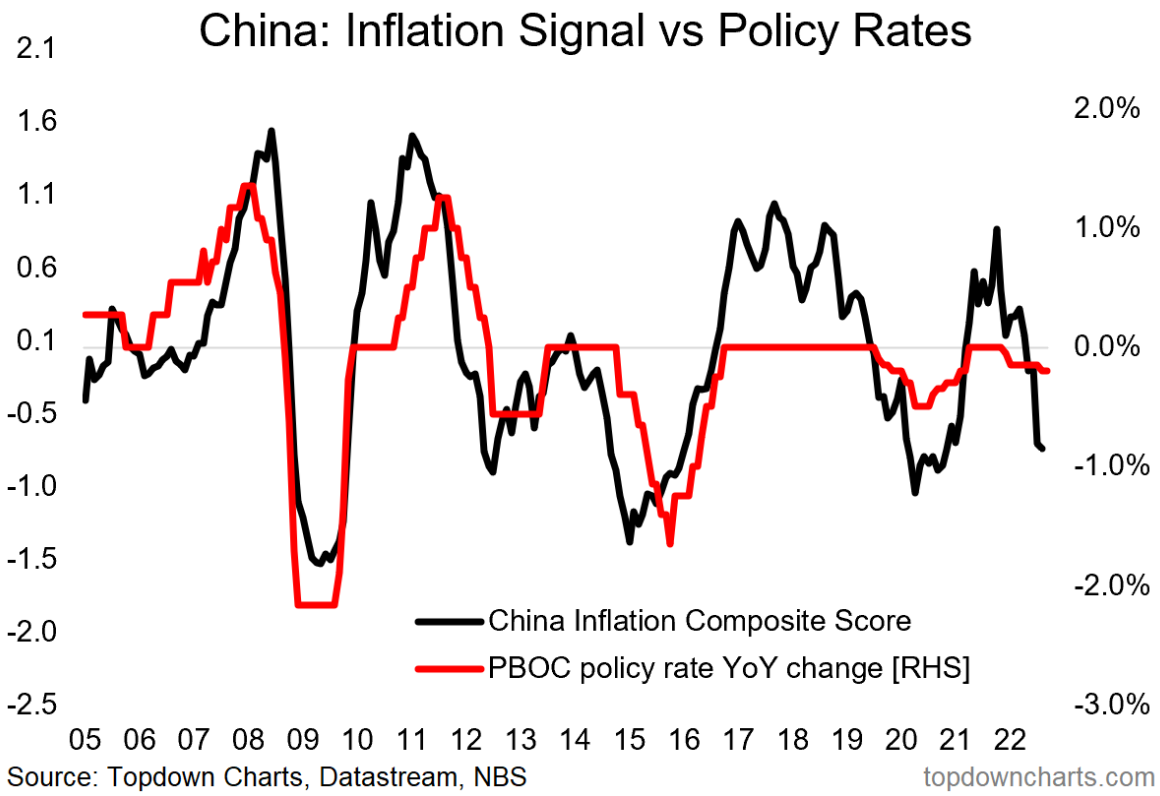


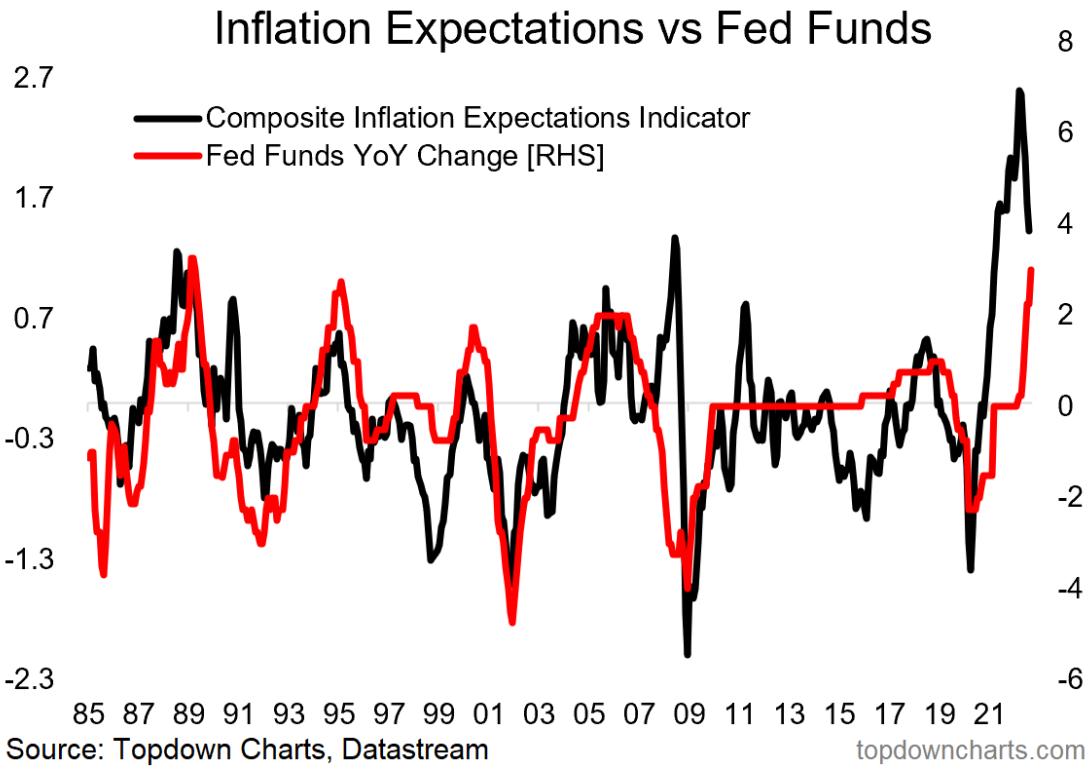


3. Core Views: China Macro – Zigging vs Zagging

TOP DOWN CHARTS

More of the Same Zigging while the Rest of the World is Zagging: Inflation continues to taper off in China amidst commodity price disinflation and macro downdrafts. Typically this along with the property market downturn would see the PBOC stepping in and easing monetary policy, but so far the response has been quite limited – a key reason is the Fed going hard in the opposite direction. FX devaluation risk has been a key constraint to traditional monetary easing in China.



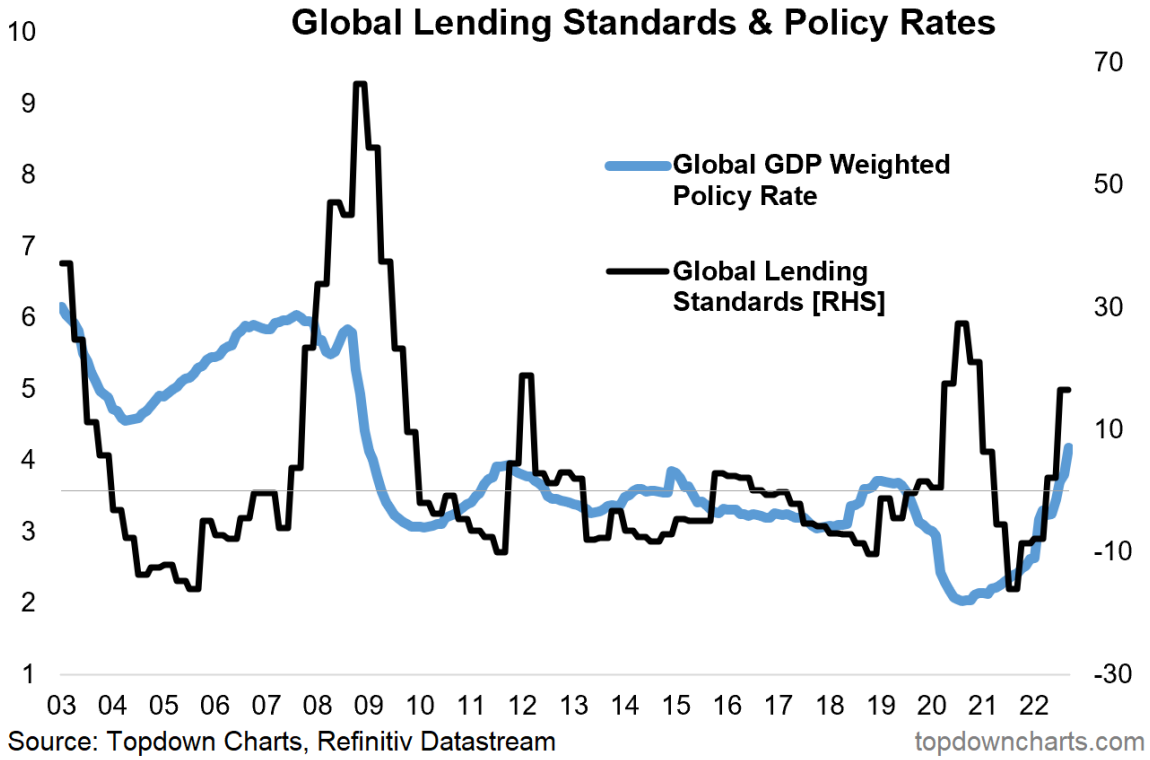


3. Core Views: Risk Radar

Political Geopol Economic Upside

TOP DOWN CHARTS

The geopolitical risk backdrop is about as worse as it gets, with very real and major downside risk on that front. But otherwise the main economic risk is tightening monetary policy and financial conditions. Recession looks near certain at this stage, and *deflation* risks are likely the next big thing.



Risk List

- Global: Corporate tax hikes, fiscal policy
- US Mid-Term Elections

- Long Covid (lingering impacts e.g. in China)
- Geopolitics: Ukraine (nuclear war, spillover)
- Geopolitics: Iran/M.East, North Korea
- Geopolitics: China vs USA "Cold War 2.0"
- Food + energy price spikes triggering unrest

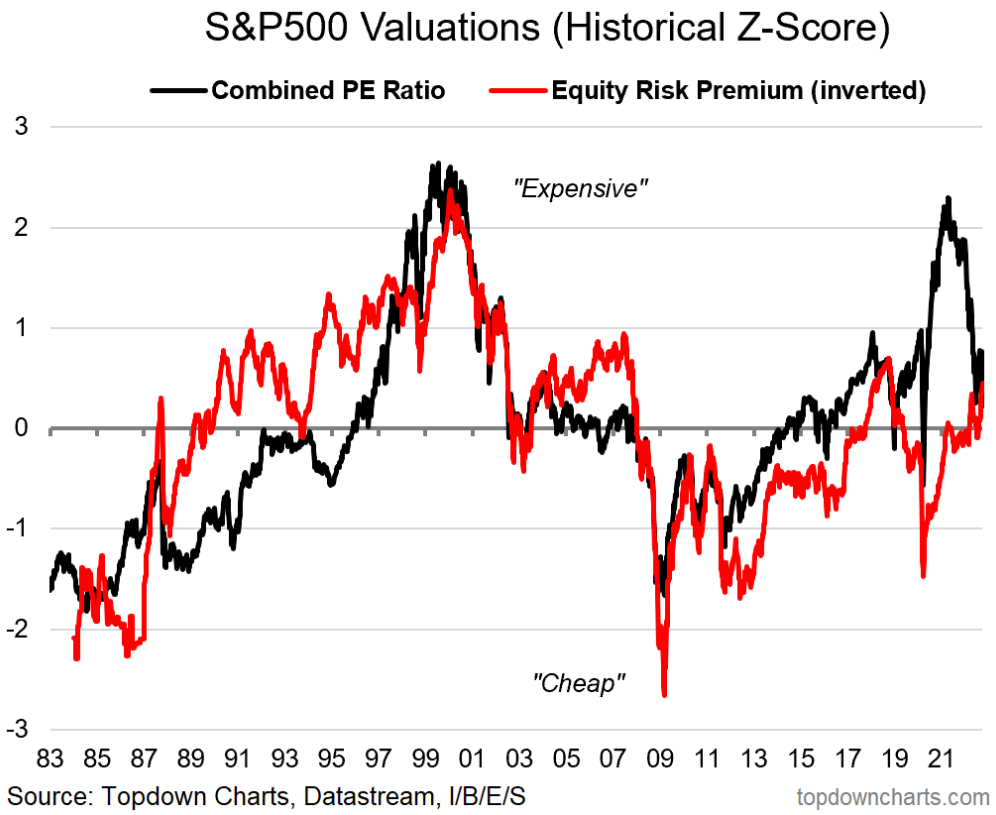
- Secondary crises (Emerging/Frontier Markets)
- Inflation prompts excessive tightening globally
- Post-stimulus growth scare/double-dip recession
- Inventory glut, weak demand: deflation risk

- Corporate capex rebound (commodities, capacity)
- Government capex (infrastructure + climate)
- Consumer relief rebound/pent-up demand boom
- Policy Divergence (e.g. China stimulus)

3. Core Views: Definitively Defensive

TOP DOWN CHARTS

Markets are a toxic combination of 1970's inflation and 2000 tech bubble deflation. The initial wave down in the global equity bear market was been driven by inflation shock and valuation re-rating. Looking forward, with heavy growth headwinds baked-in, it is likely the next wave down is driven by earnings downgrades, further valuation re-rating/mean-reversion, deflation risk, and rotation from stocks to bonds – as bonds likely break away from the joint pain of 2022 and start outperforming.

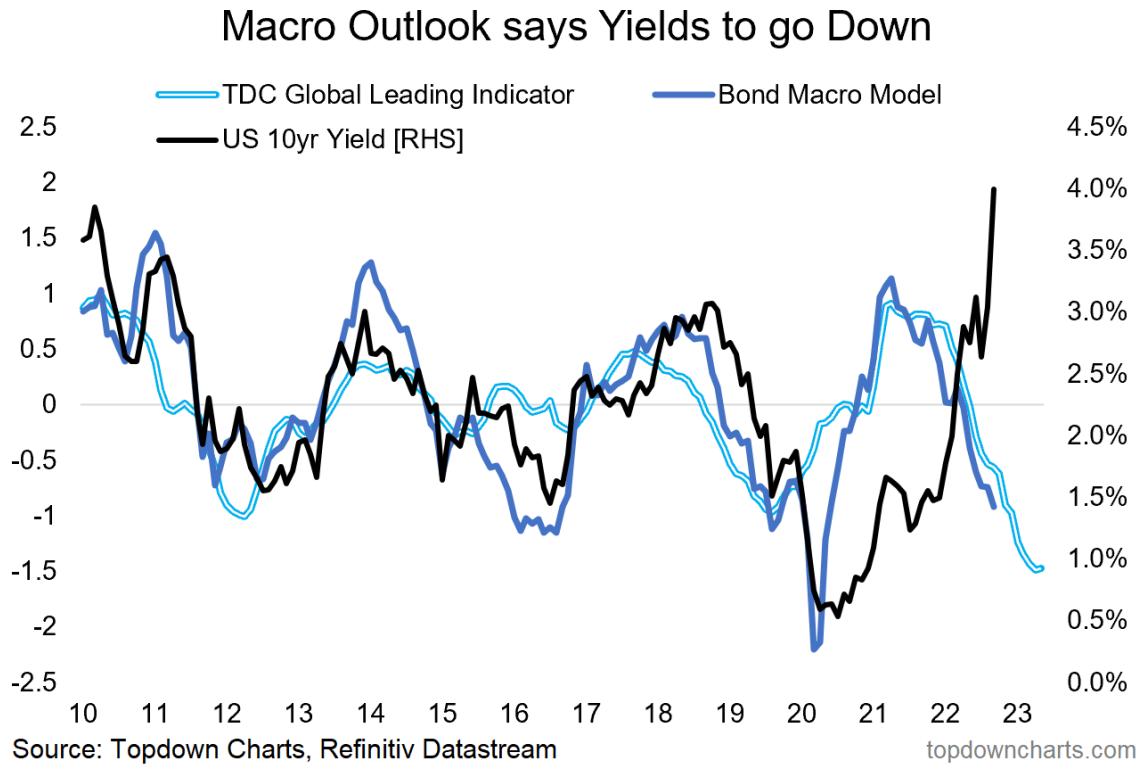


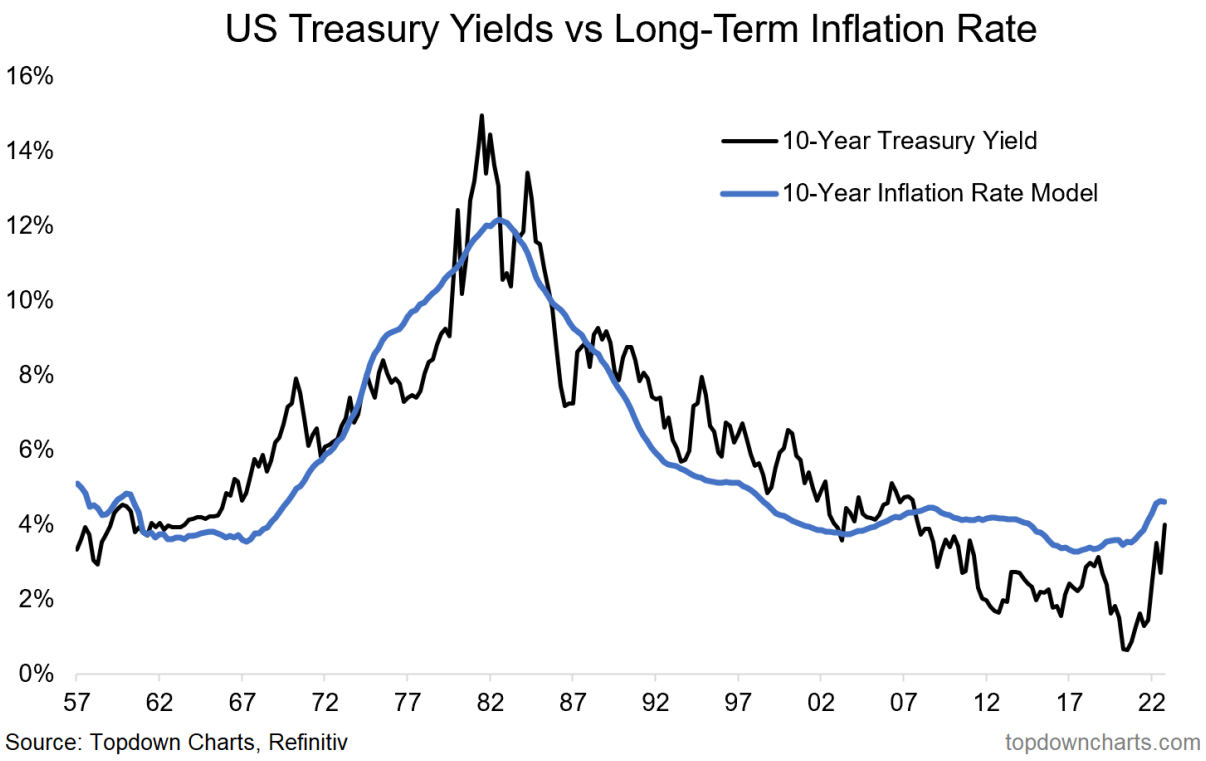
	Max Growth	Max Defence
Valuations	Cheap	Expensive
Monetary Policy	Easy/Easing	Tight/Tightening
Earnings/Econ (1)	So bad it's good	So good it's bad
Earnings/Econ (2)	Turning up	Turning down
Sentiment	Excess pessimism	Excess optimism
Positioning	Light/Excess Cash	Heavy/Min. Cash
Technicals (1)	Oversold	Overbought
Technicals (2)	Breakout	Breakdown
Technicals (3)	Uptrend	Downtrend

3. Core Views: Bullish Government Bonds

TOP DOWN CHARTS

The bond market is going through a chaotic stage where it is pushed and pulled by contrasting and conflicting trends, signals, and narratives. Inflation risk has been pushing government bond yields to multi-year highs globally, and yet the prospect of an economic downturn looms. These two charts sum it up well: inflation model says US 10-year goes above 4%, growth indicators say it drops below 1% into next year. This is the key macro tension at play: **inflation risk vs growth risk**.

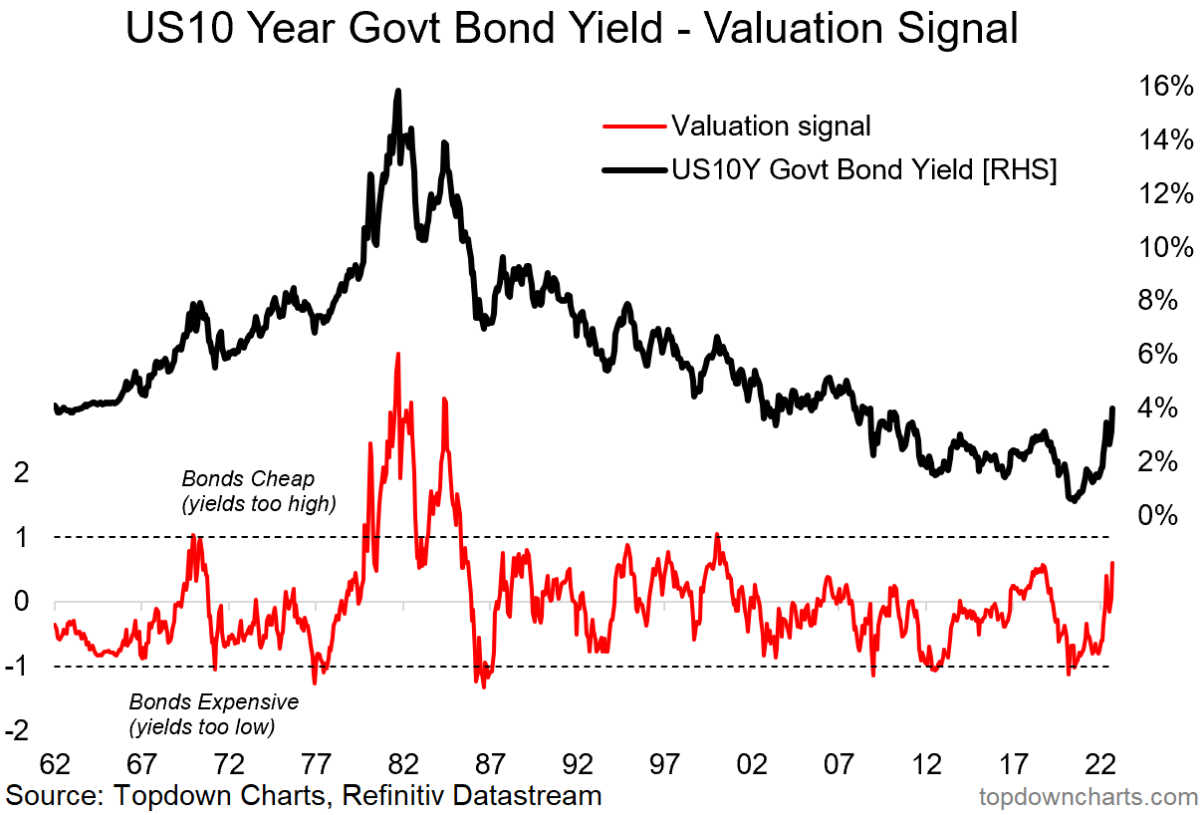


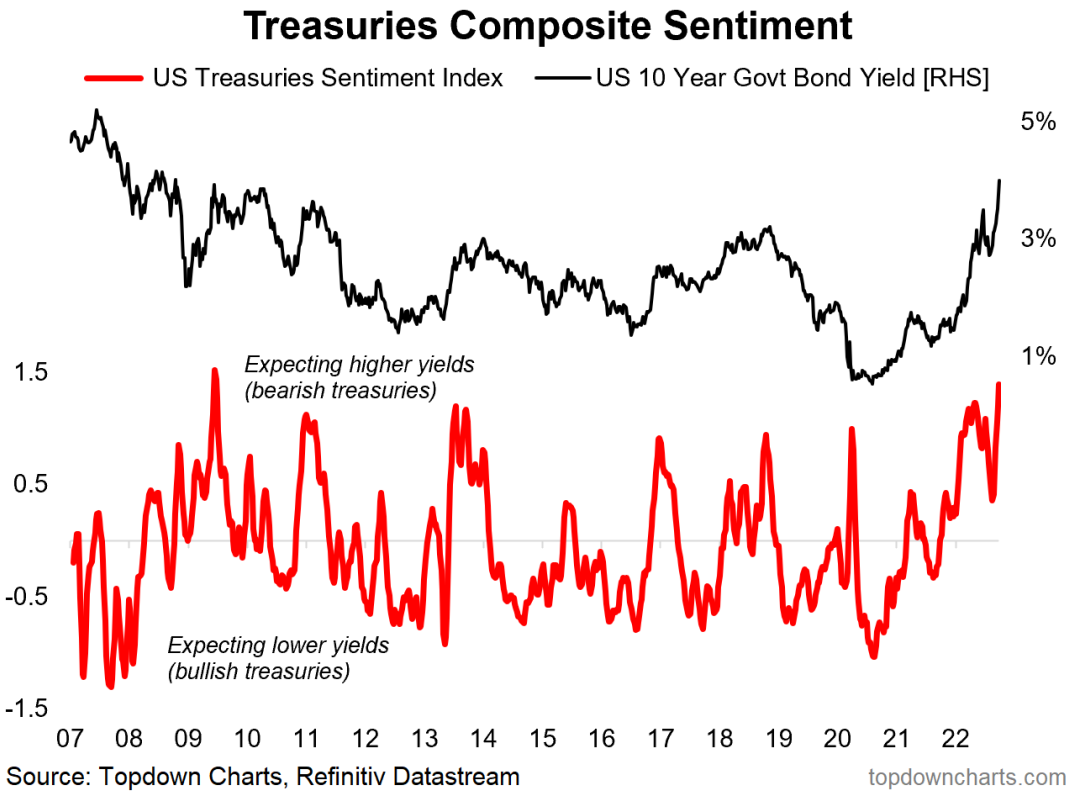


3. Core Views: Bullish Government Bonds

TOP DOWN CHARTS

Meanwhile, the background conditions for bonds are as good as they've been in a long while: valuations have improved to cheap (from extreme expensive not long ago), and sentiment + technical indicators are exhibiting extreme bearish/oversold conditions. When valuation and sentiment aligns you always want to pay attention, especially if the macro setup also lays out a clear and logical pathway to a turning point (e.g. peak inflation, recession). But timing is a factor…

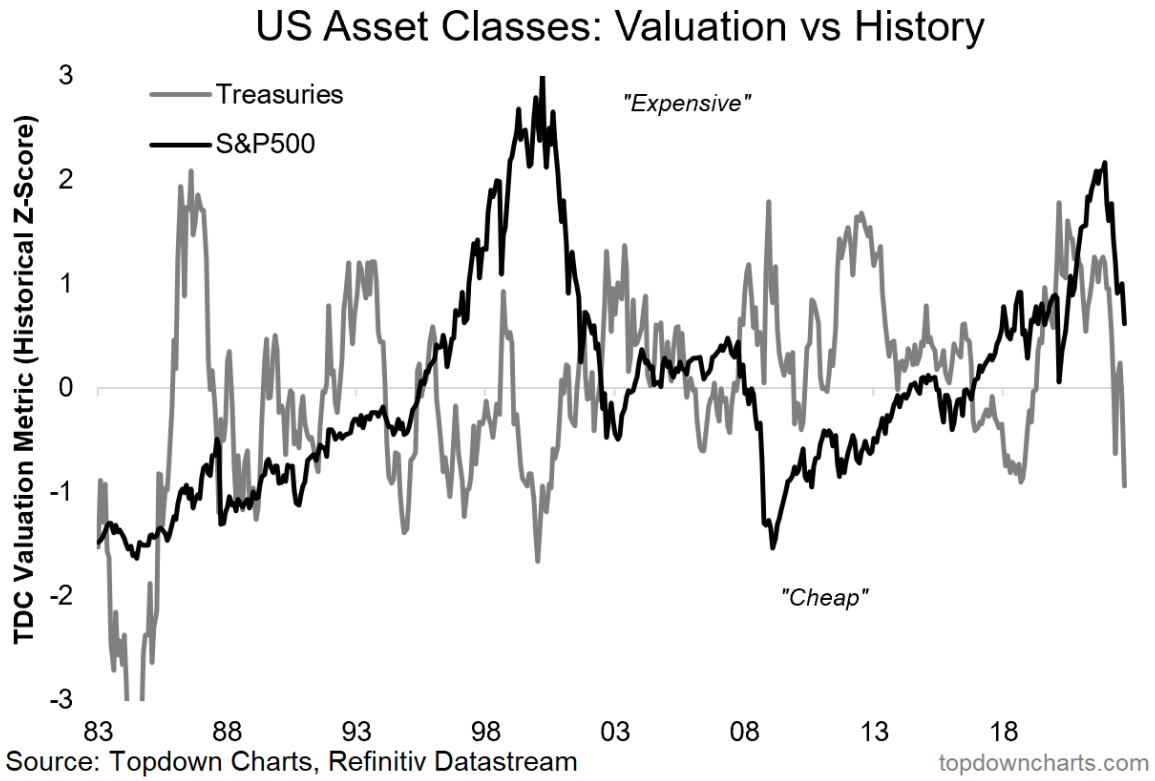


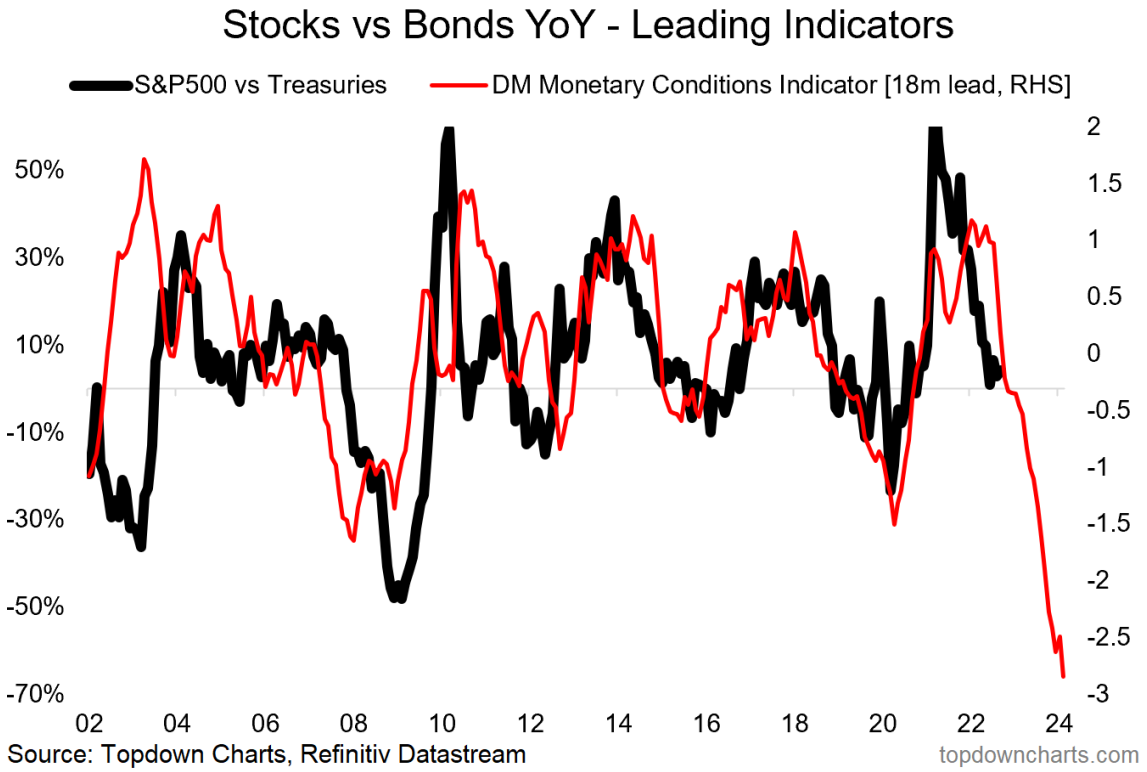


3. Core Views: Stocks vs Bonds

TOP DOWN CHARTS

With a potential global recession looming, stock valuations still elevated vs bond valuations increasingly cheap, the lead indicators point to equity returns losing ground vs bonds in the coming 6-18 months. 2022 has been a relatively unusual year with record losses in fixed income investments as well as equity investments. With stocks looking stretched vs bonds it is likely that the typical relationship is restored as an when inflation gives way to deflation.

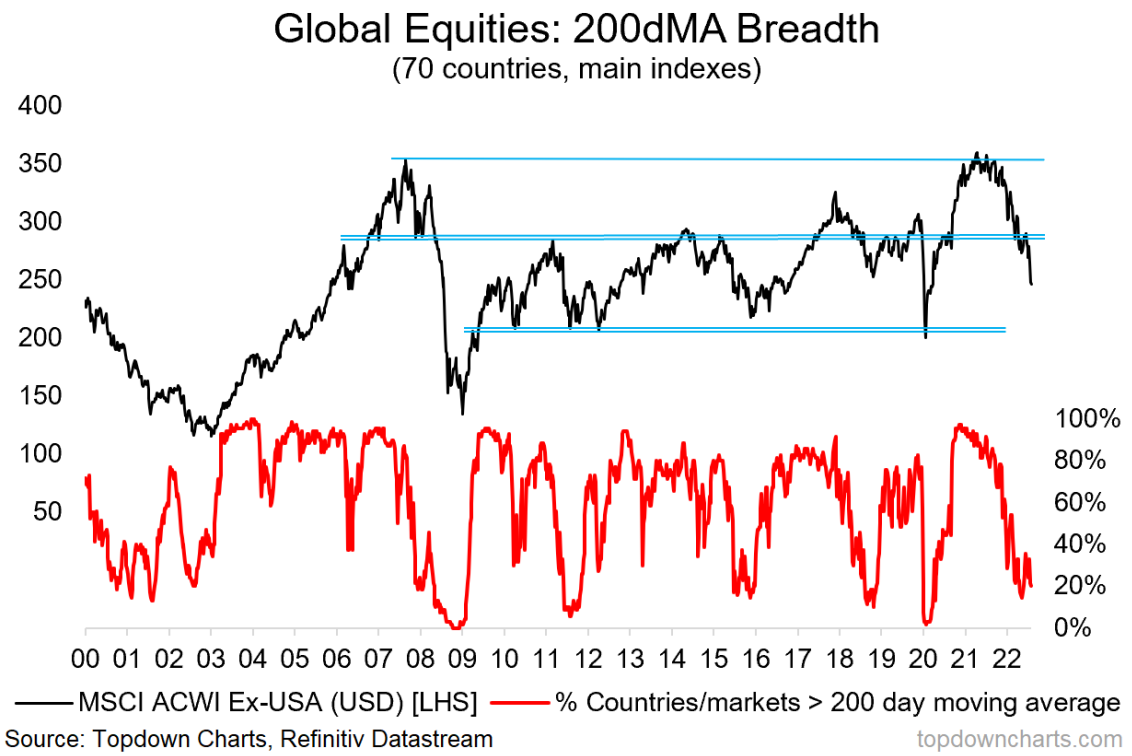


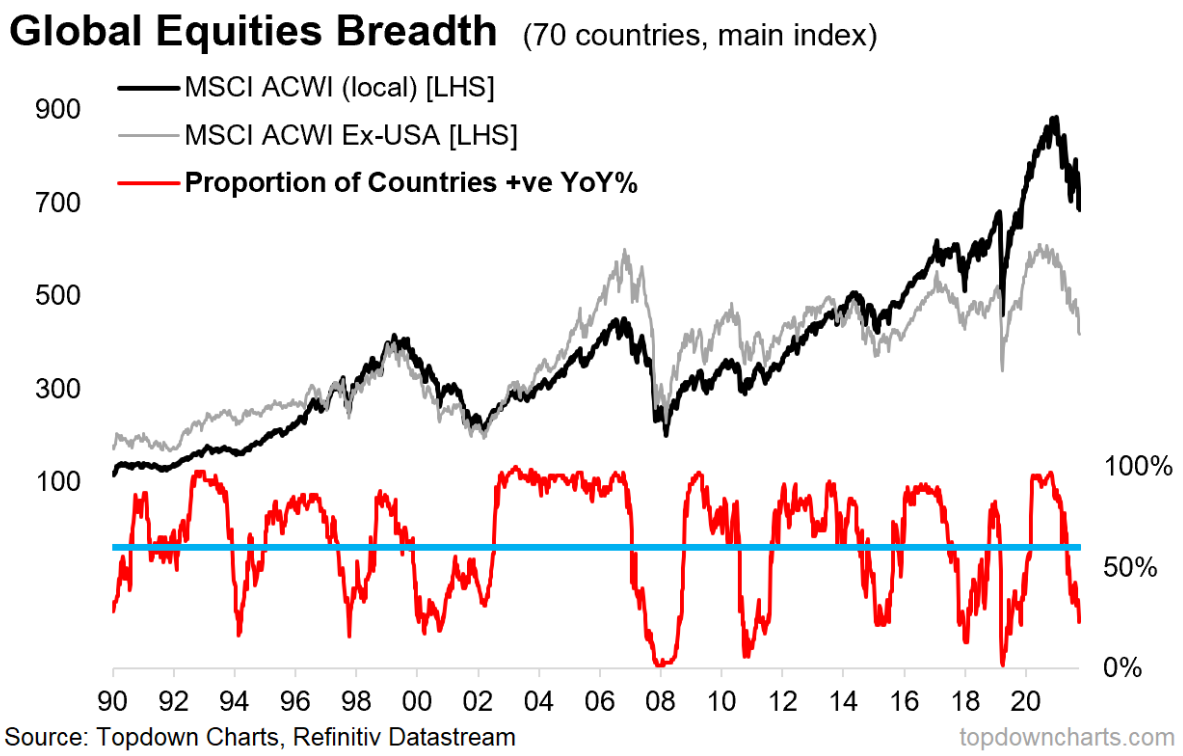


3. Core Views: Global Equities – Technical risk flags

TOP DOWN CHARTS

Speaking of equities, the technicals backdrop remains clearly bearish. The ACWI ex-US has broken down through a key support level after previously breaking down from the highs and that came after a period of steadily deteriorating breadth across countries, and as things stand breadth remains very weak. Again, sometimes you just have to listen to what price is saying.

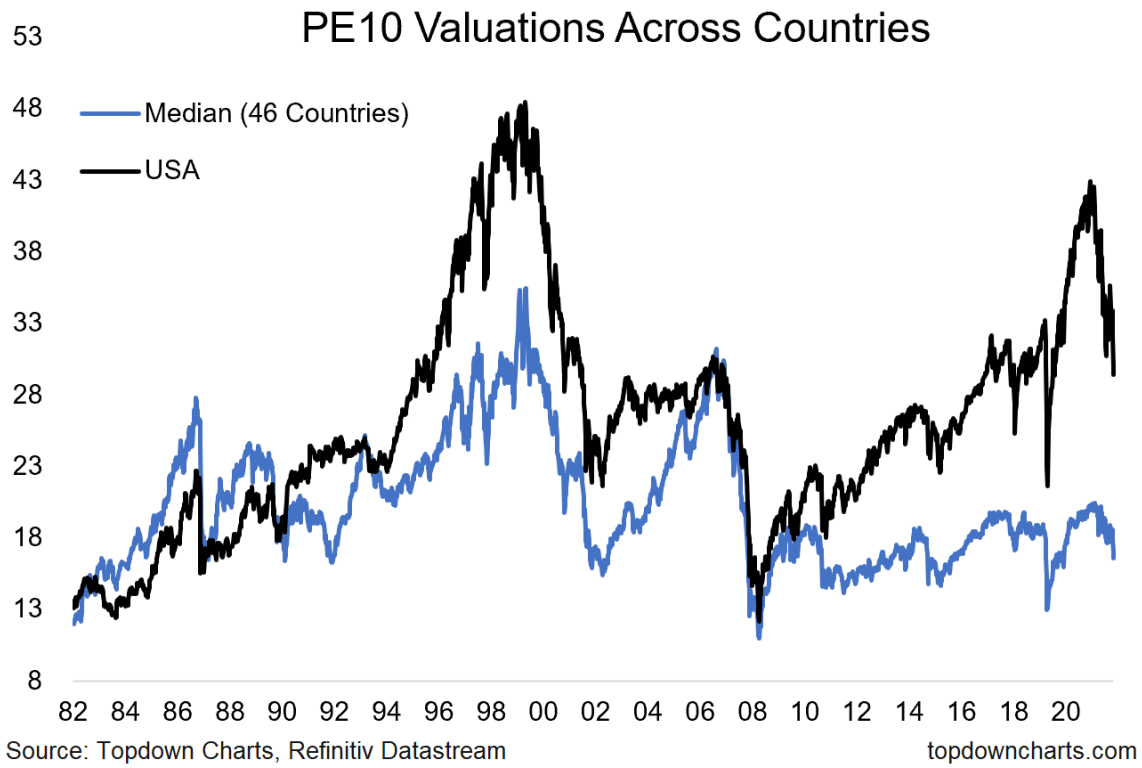


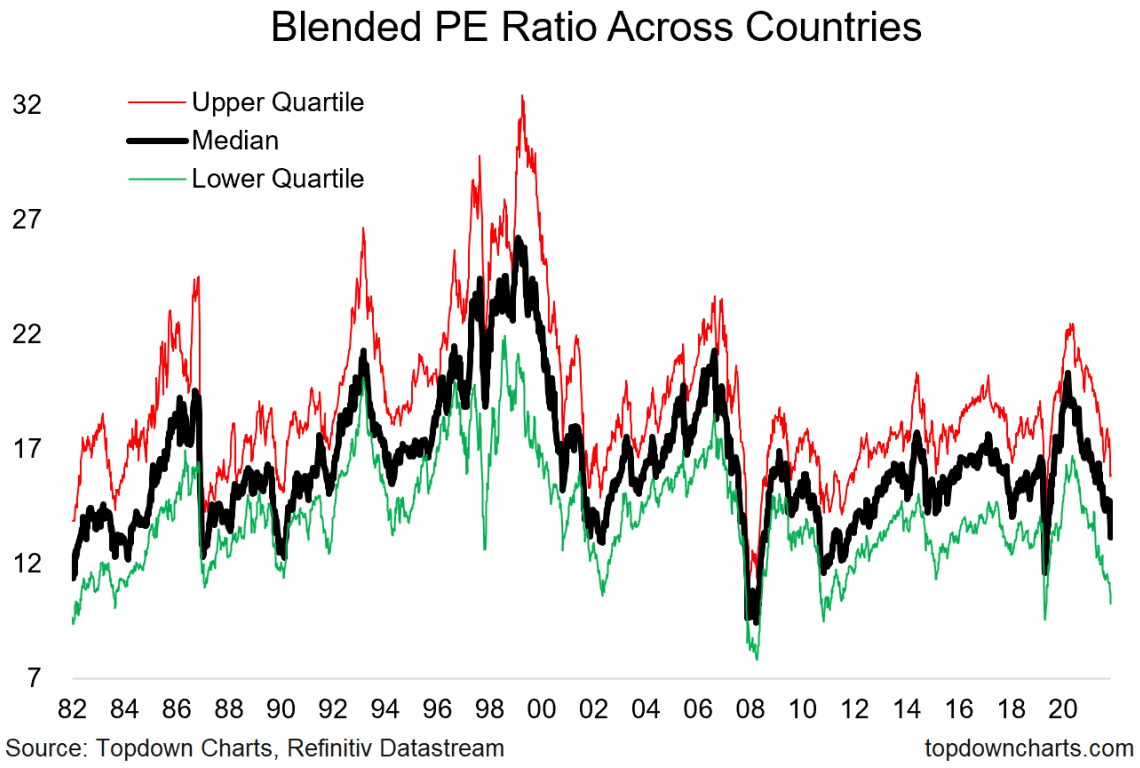


3. Core Views: Global Equities – Value yet?

TOP DOWN CHARTS

Back on that growth vs defence table, there ***will*** come a time to buy equities, and the story will start in valuations (and with policy pivots back to easing as key characters in that story). As things stand, we have seen a material reset in PE10 valuations, and a sharp drop in the blended PE. The problem with that second chart is that if we are right about recession then the E likely is a moving (down) target. So the short answer is that valuations are *not* cheap enough yet (but getting closer).

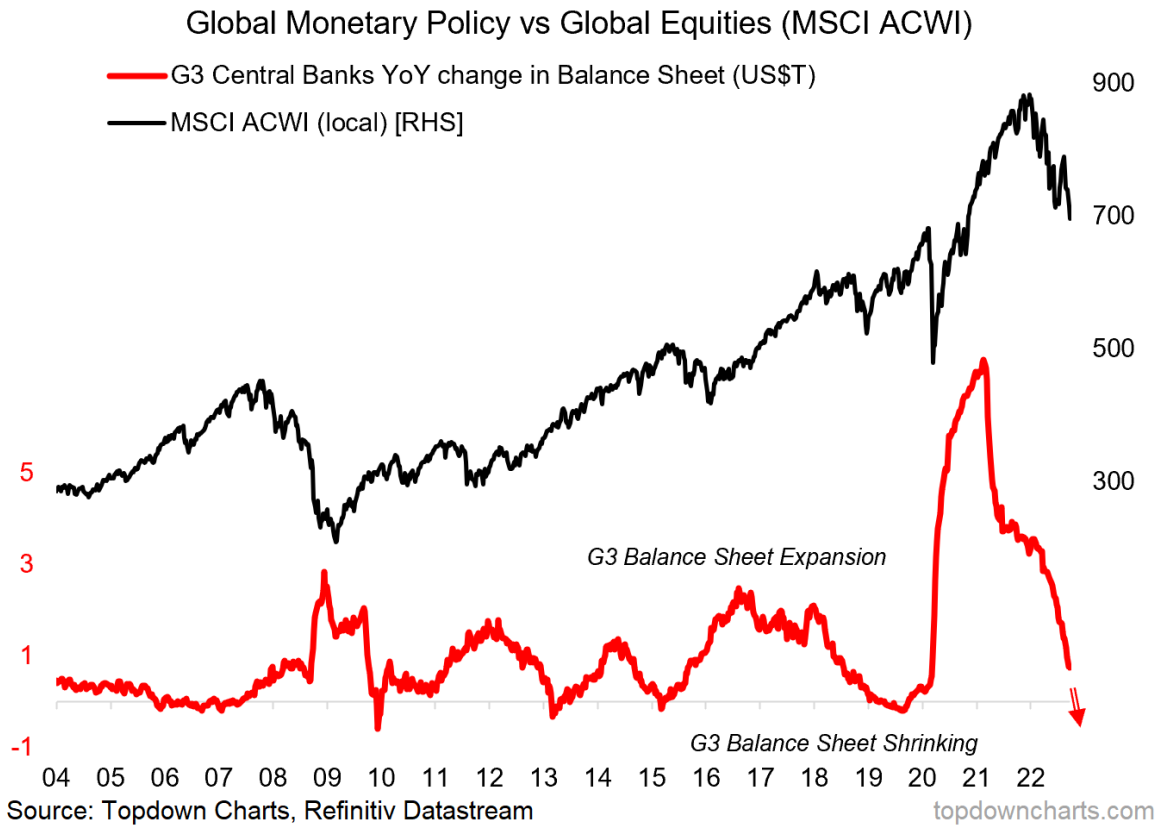


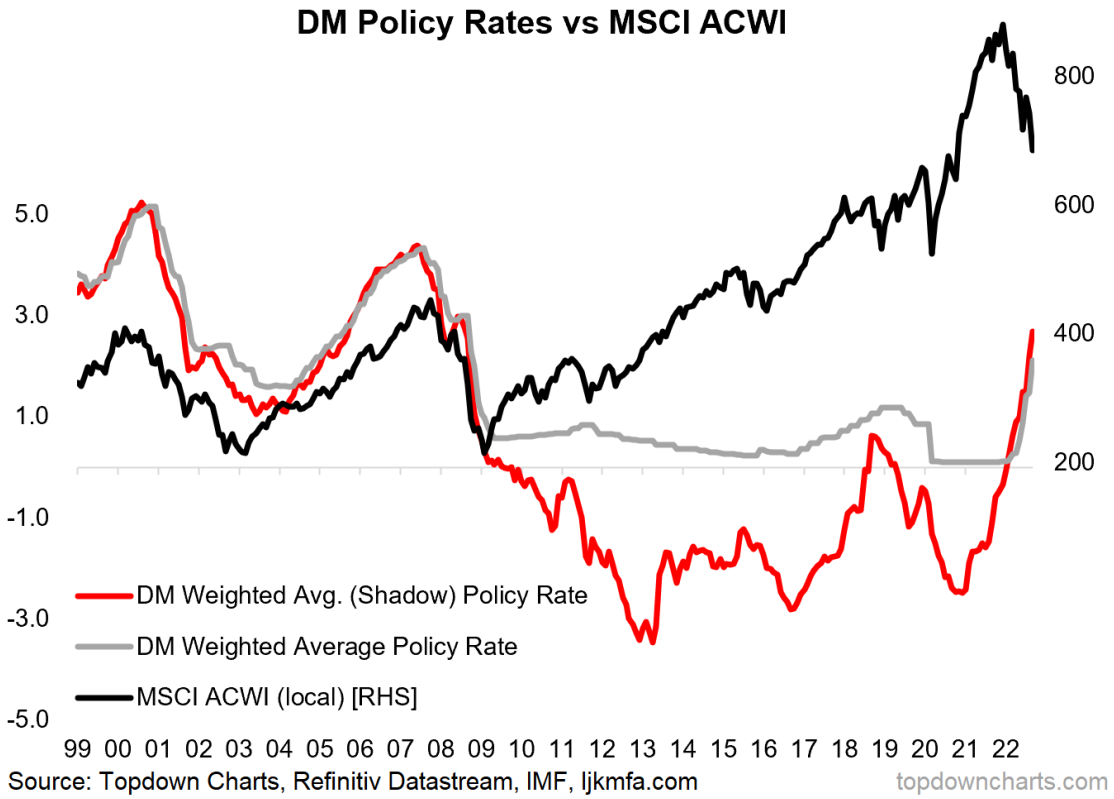


3. Core Views: Global Equities – Policy Puzzle

TOP DOWN CHARTS

Policy is the other side of the equation, and as things stand, despite the BoE action to step in against market stability, we are still far from a pivot to easing. That would require some combination of lower inflation and either max pain in markets or just plain old recession. One side note to ponder too is that as policy is tightened further, a pause may not cut it for a rally in risk assets, if the settings are too tight (i.e. compare and contrast: tight vs easy and tightening vs easing).

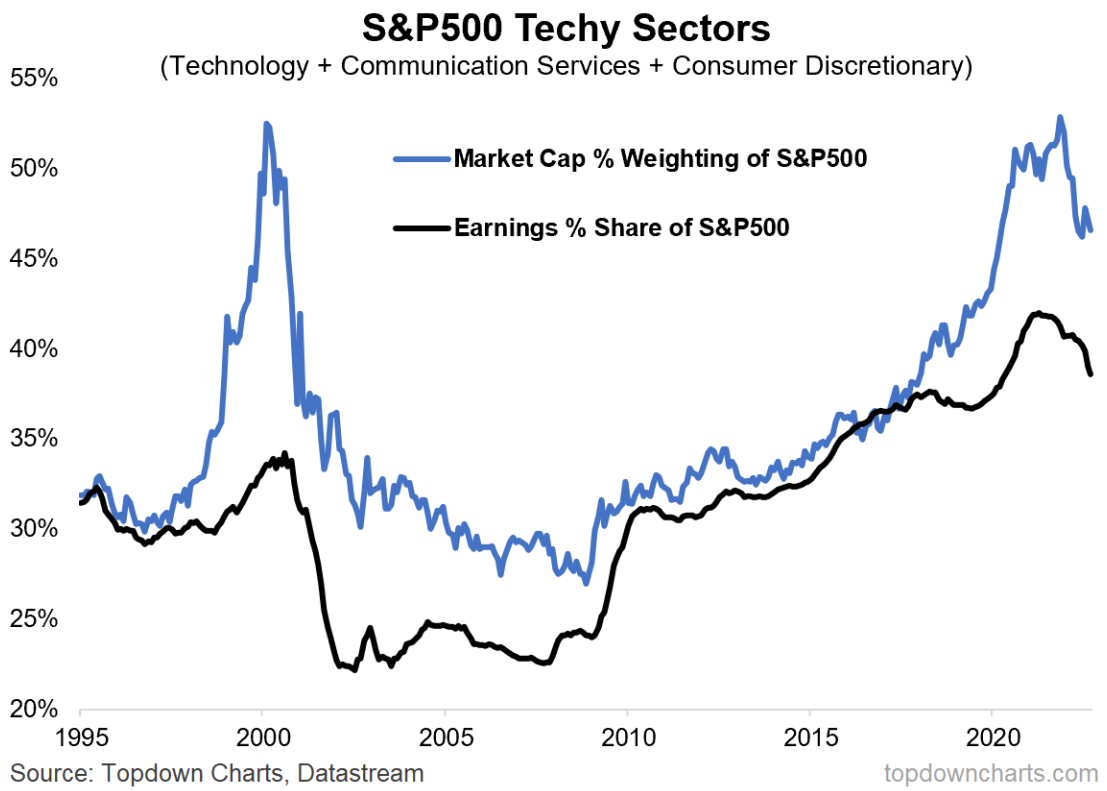


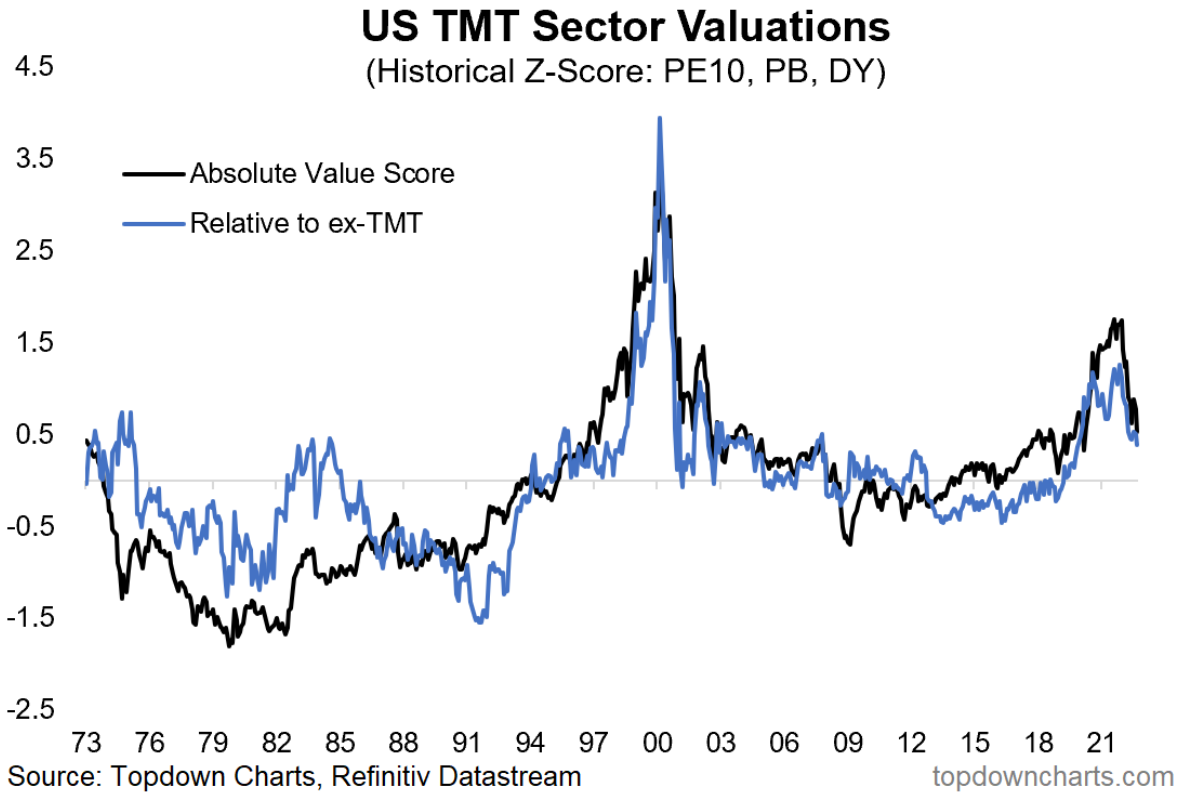


3. Core Views: Equities – Tech Wreck Check

TOP DOWN CHARTS

Also, looking at what you might call the epicentre of the bear market, the tech unwind is also very much still a work in progress. It is different this time in many respects, but while last time price was way disconnected from earnings, this time we might have some questions around whether earnings are disconnected from trend. In other words, tech boasted big multiples on big earnings promises, and hence remains vulnerable to expectations dissonance. No value set up here yet either.

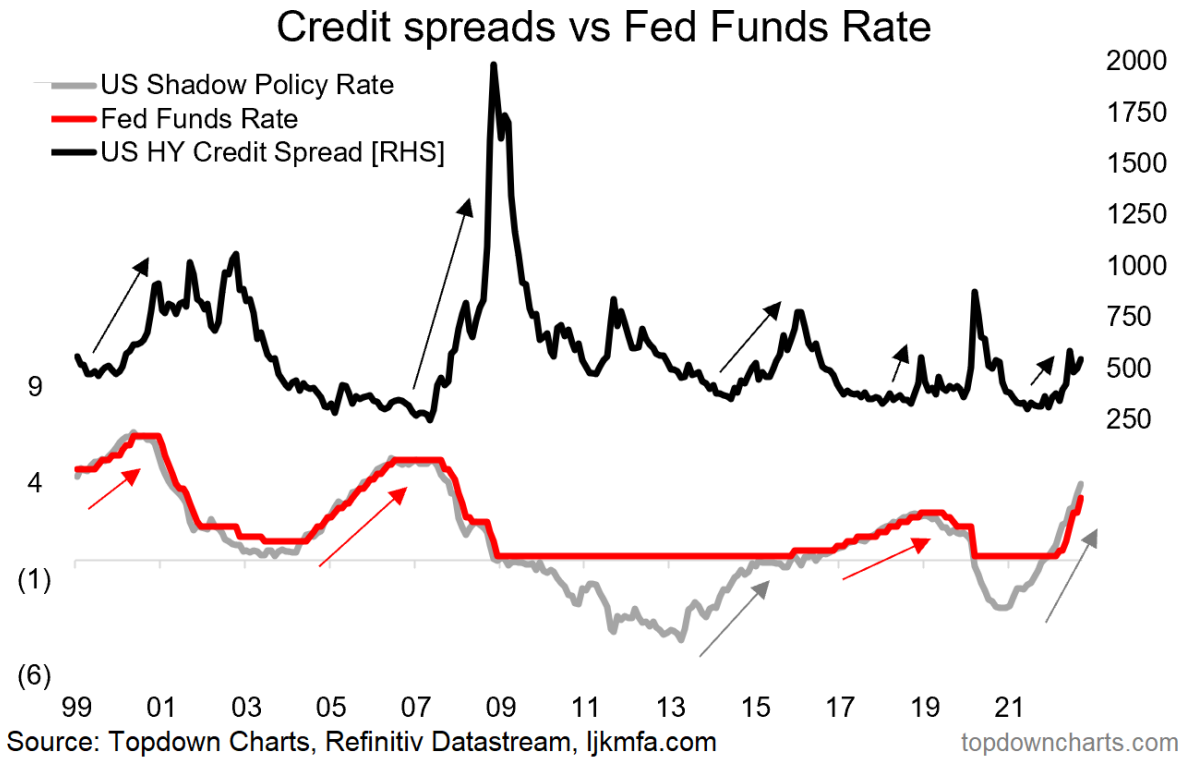


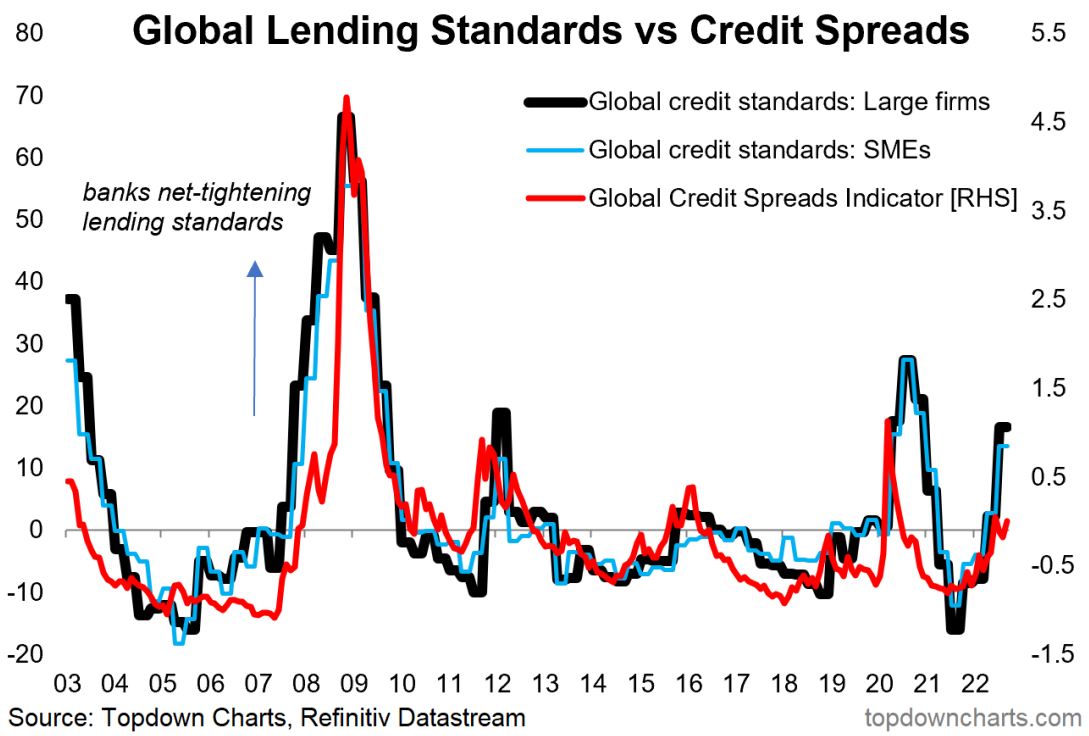


3. Core Views: Credit on Borrowed Time

TOP DOWN CHARTS

Credit has been smashed this year, especially the typically longer-duration IG side of things, but mostly just because of the bond-quake (rates shock). The concern now is that spreads are the next shoe to drop in this space as tightening financial conditions (higher bond yields, less appetite to lend, lower availability of funding) put pressure on borrowers just as the economy starts to wobble. If you want to own bonds, stay out of credit and focus on duration in the first instance.



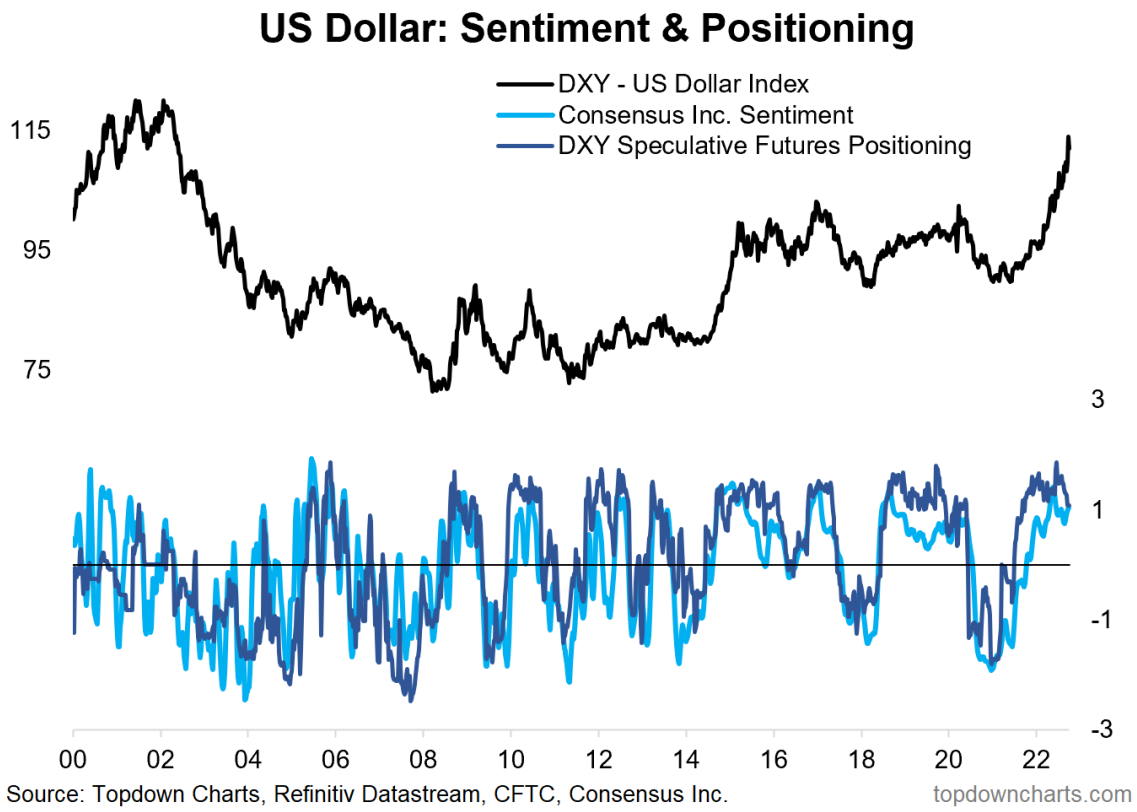


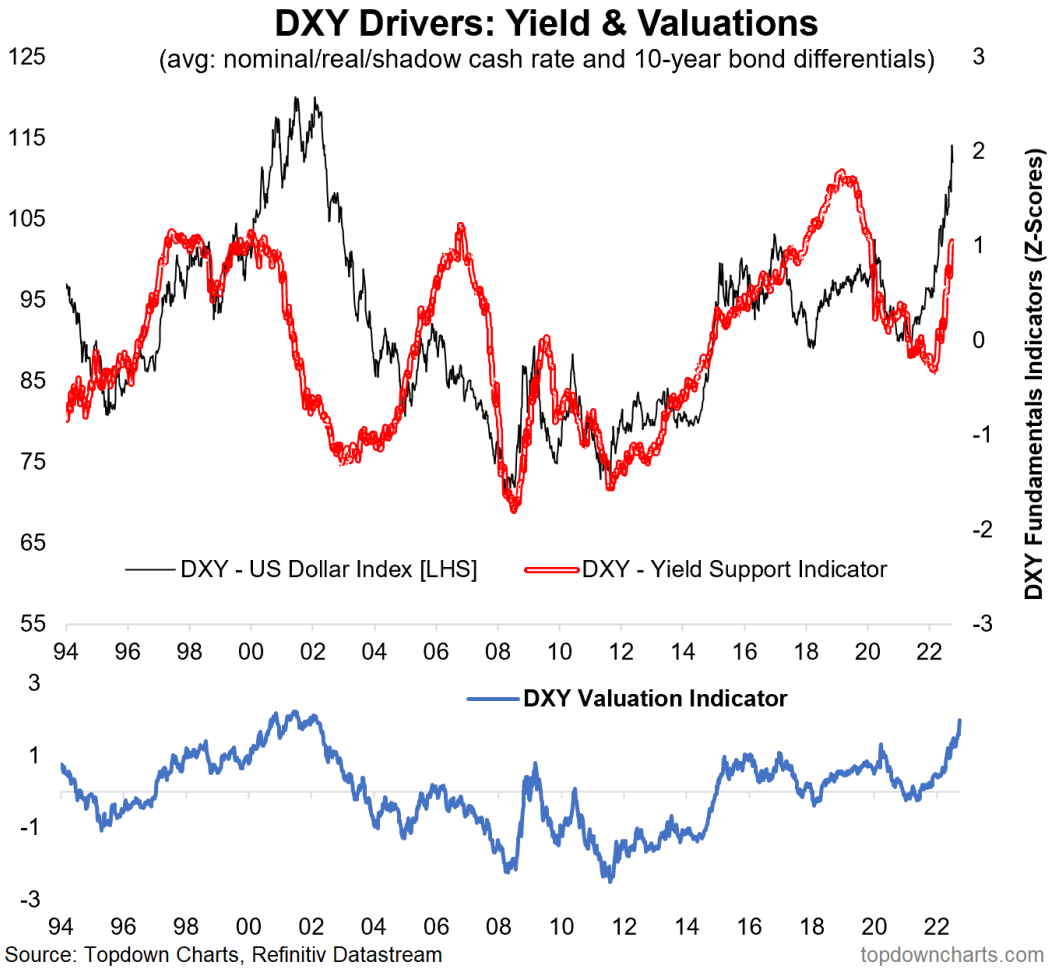
3. Core Views: US Dollar

TOP DOWN CHARTS

For the US dollar it is a tension between very crowded/consensus bullishness and expensive valuations on the one hand vs policy divergence/yield support and defensive flows on the other hand. If Fed blinks on hiking, DXY will be the first to let you know.

Meantime, momentum is upwards facing.

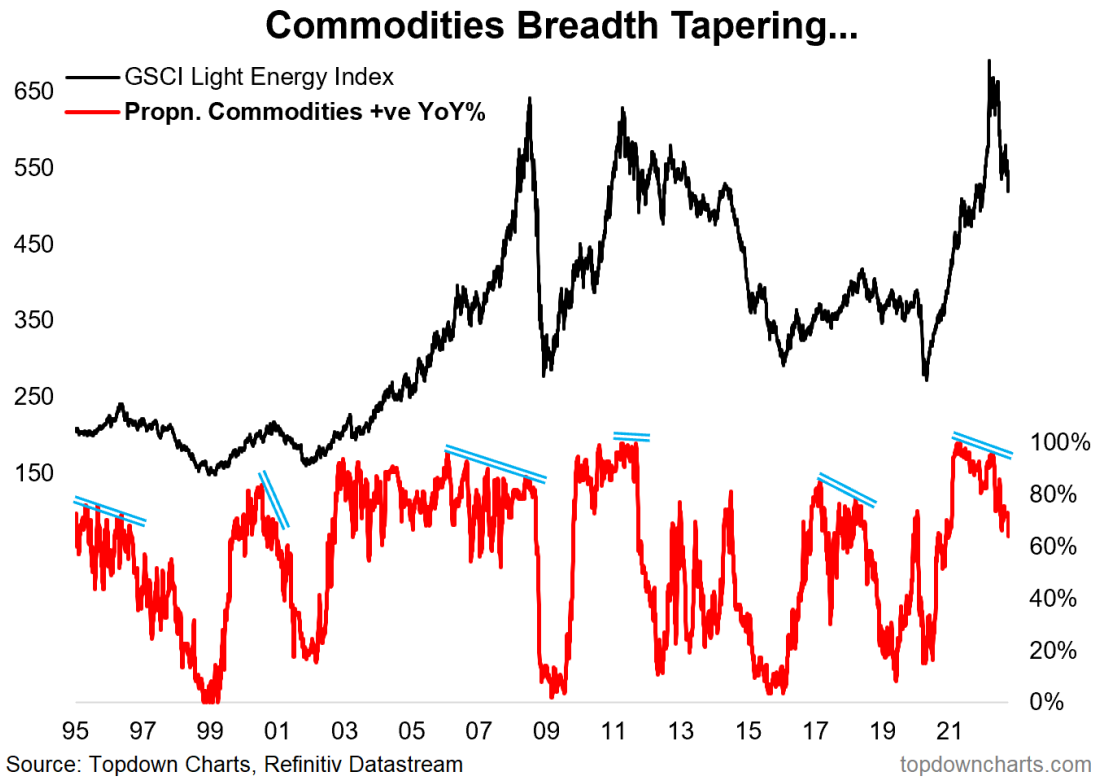


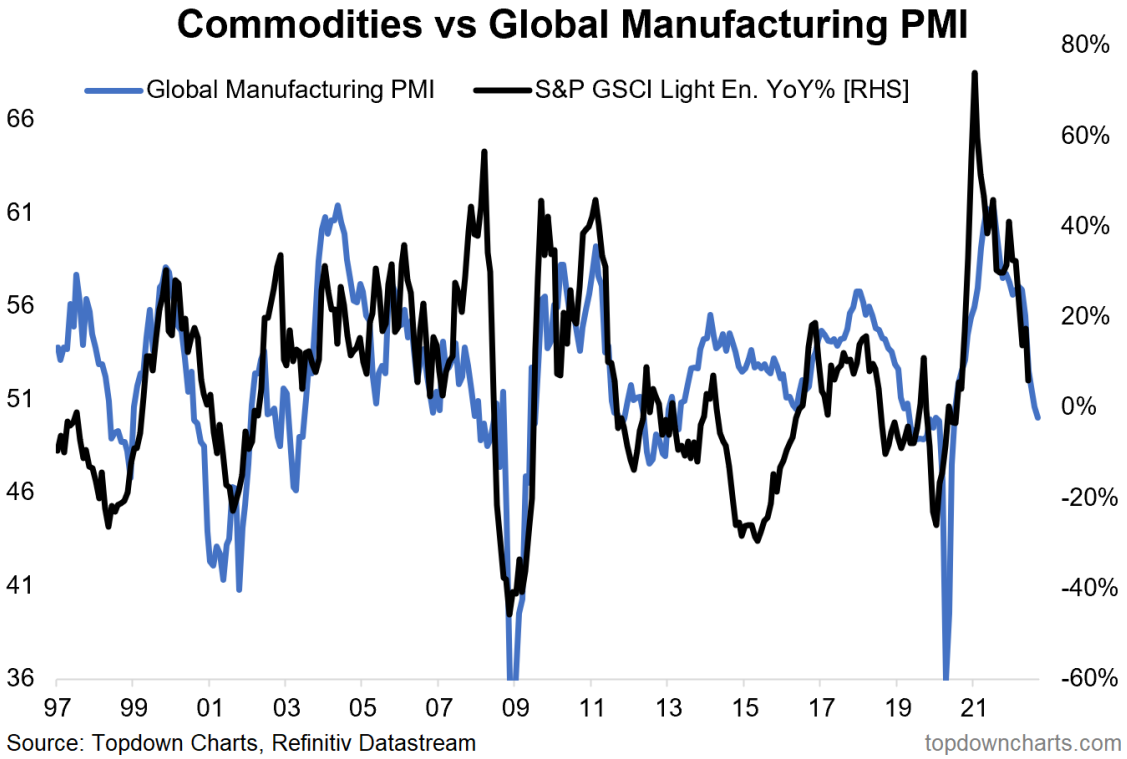


3. Core Views: Bearish Commodities

TOP DOWN CHARTS

Multiple tactical indicators (intermarkets, technicals/breadth, macro, positioning, sentiment, flows) point to ongoing downside risk for commodities. A key example is the longer-term technicals chart which is exhibiting a reliably bearish turning point setup. The companion chart is also informative in that it shows how the growth pulse matters for commodities. The post-pandemic demand shock is now at risk of giving way to a reverse demand shock as headwinds pile-up.

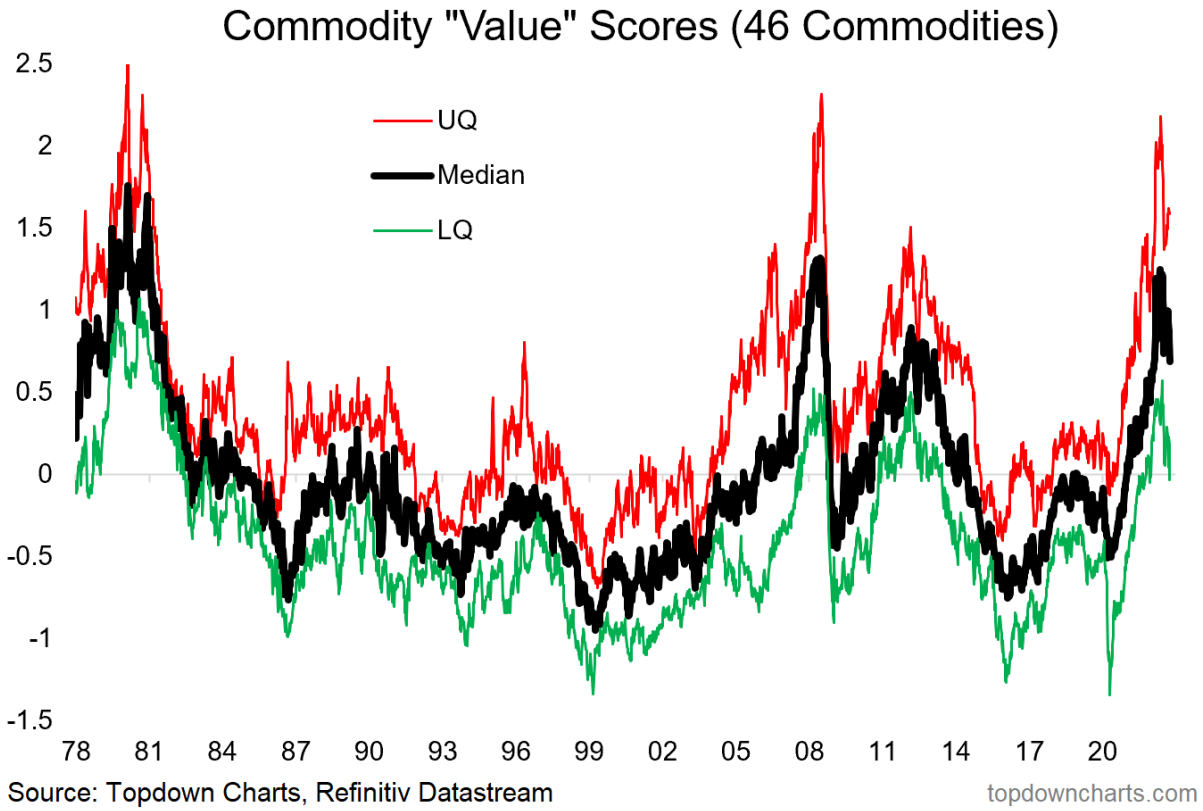


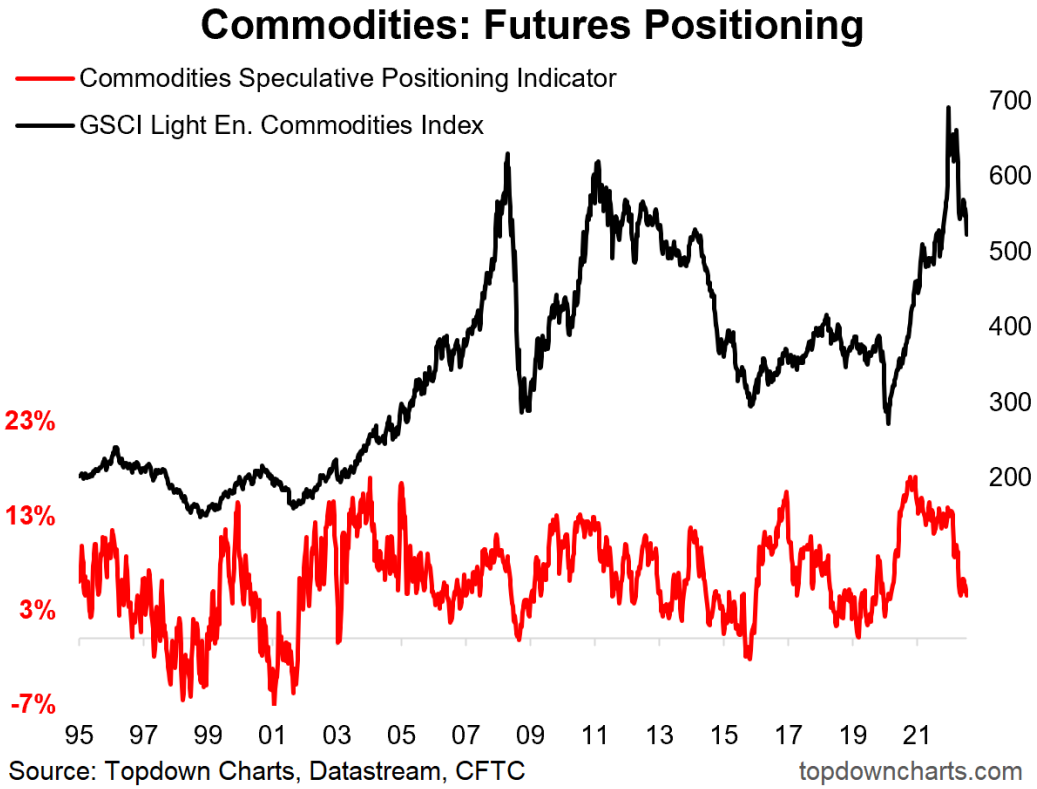


3. Core Views: (correcting) Commodities

TOP DOWN CHARTS

All this is set against the backdrop of expensive valuations across commodities. We have seen some initial reset, but prices remain elevated, and it's typical at tops to see this type of movement in valuation indicators. Meanwhile investors and traders are steadily migrating out of previously exuberant positioning in commodities, and thus the momentum is bearish here too.

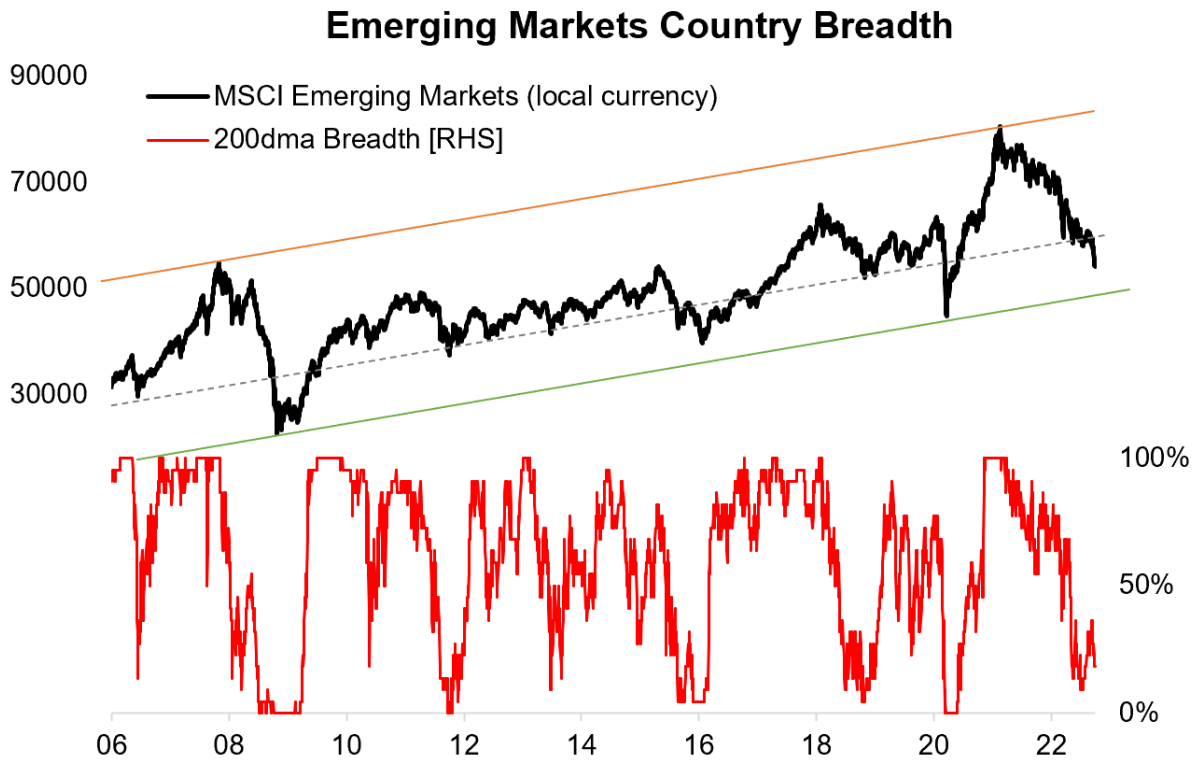


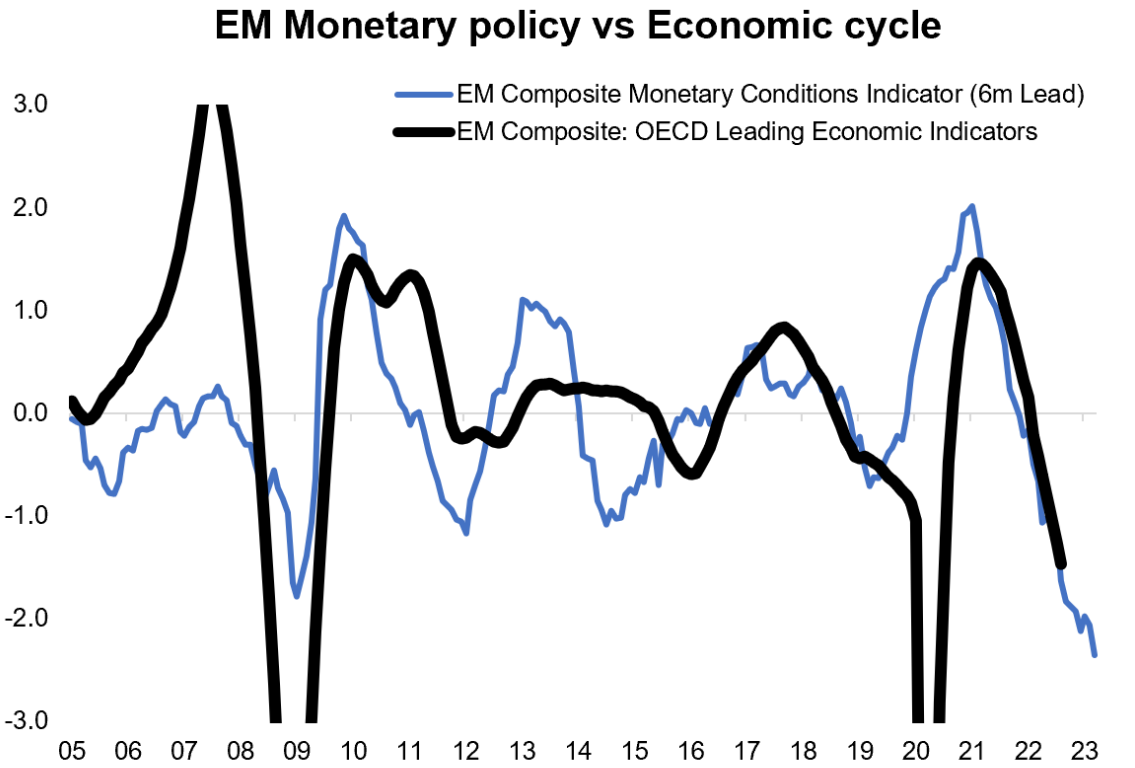


3. Core Views: Emerging (bear) Markets

TOP DOWN CHARTS

Emerging market equities, much like the rest of the world, remain entrenched in bear market mode. EM central banks were first off the mark to get into rate hikes, and hefty tightening of monetary conditions across EM have locked-in a downturn: reinforcing the bearish price action. Basically the price momentum and the economic momentum are squarely headed in one direction.

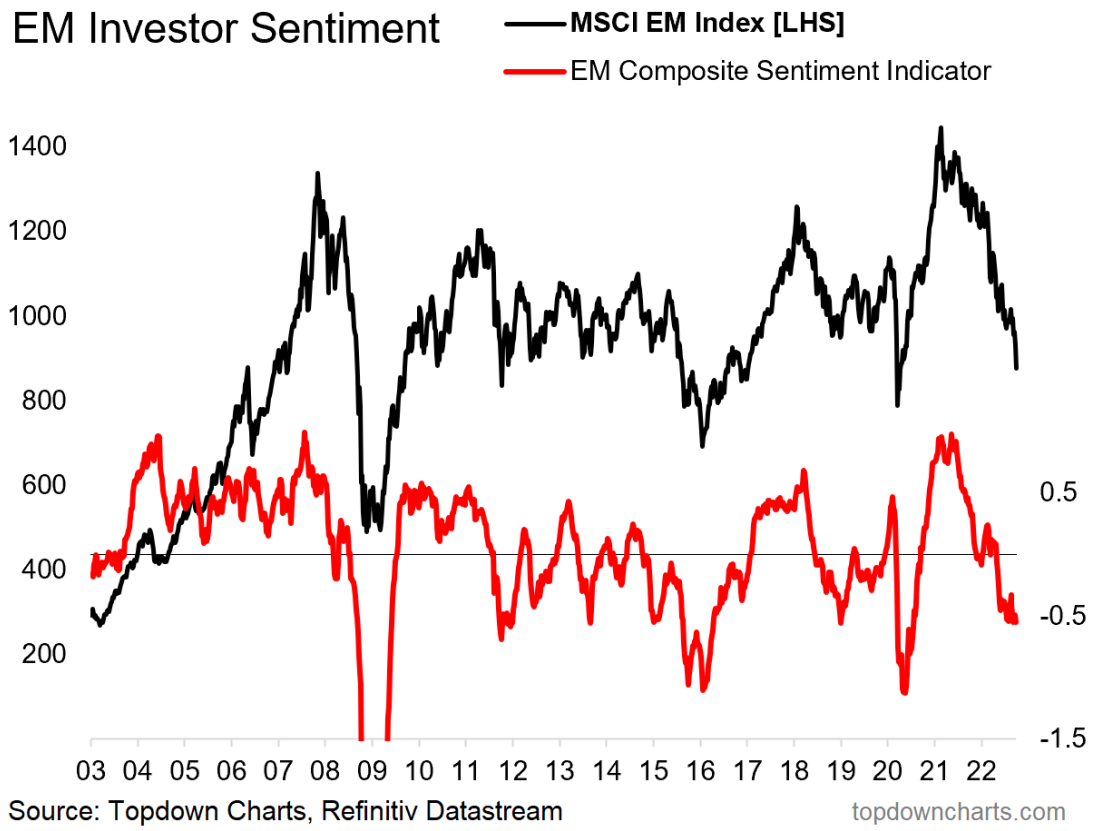


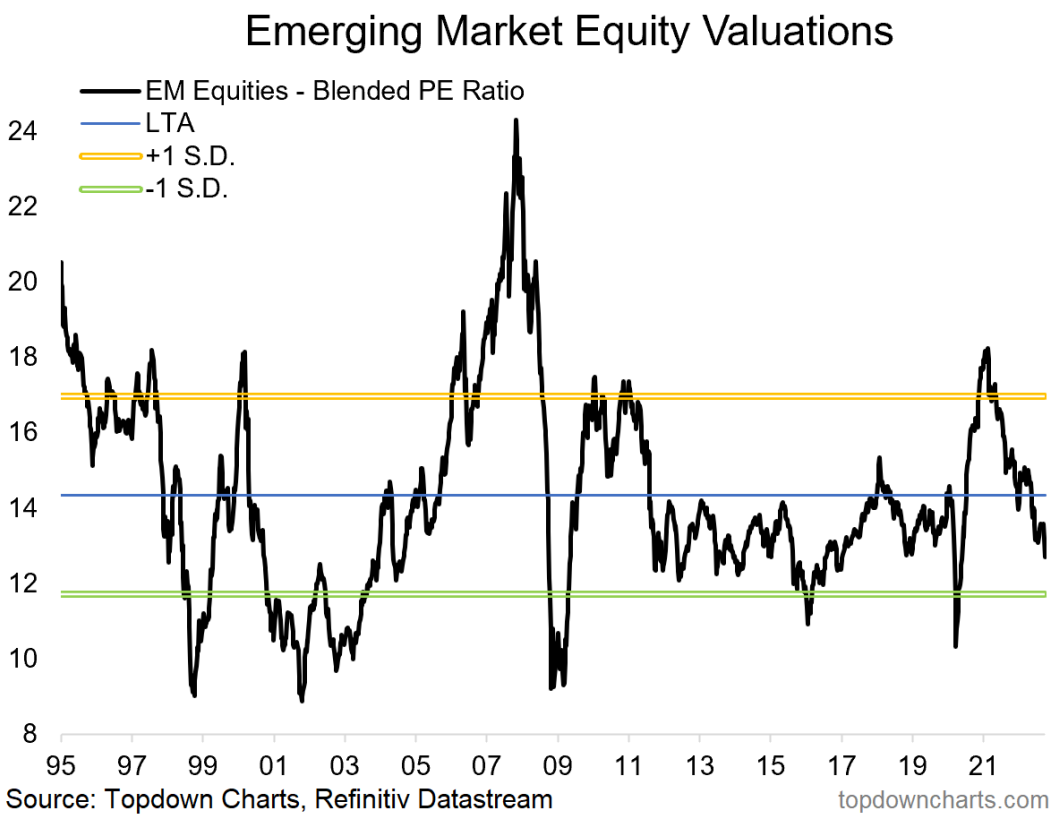


3. Core Views: Emerging Markets

TOP DOWN CHARTS

Sentiment & Valuation signals have however materially reset from expensive to slightly cheap and increasing pessimism, but as noted the significant tightening of monetary conditions across emerging markets mean there are real headwinds to overcome. Yes EM equities have corrected (clearly established bear market), but it is still not yet the "obvious" buy that it was in March 2020.

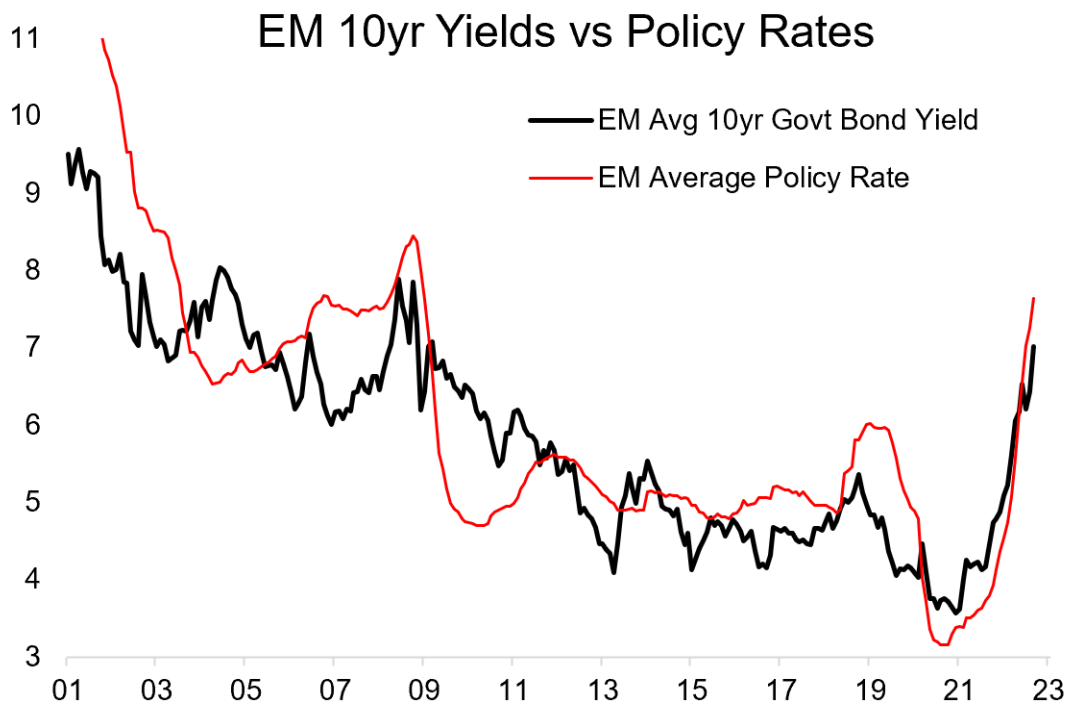




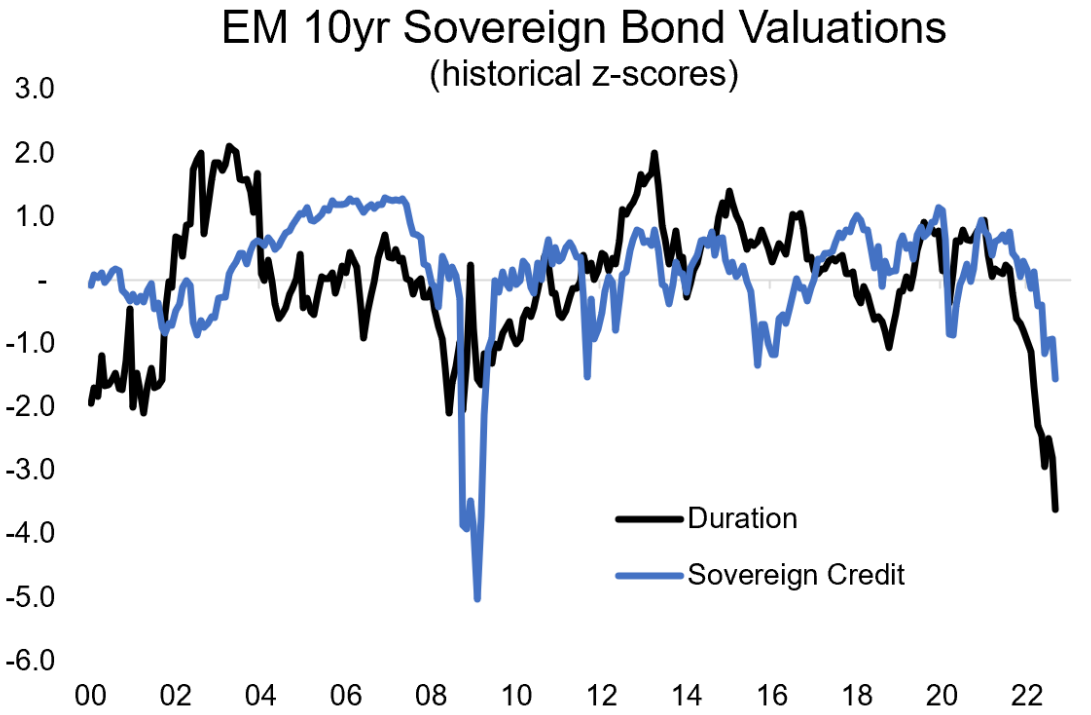
4. Interesting Ideas: Value in EM Fixed Income

TOP DOWN CHARTS

EM sovereign bonds on the other hand are showing up as extreme cheap in terms of duration, and sovereign credit risk pricing is also increasingly lining up (albeit perhaps more of a sentiment signal). But the key catalyst for EM sovereign bonds to start performing would be a peak in EM policy rates. No signs of that just yet – but again, EM were first to start hiking, and hiked big, so may well be first to ease too.



Source: Topdown Charts, Refinitiv Datastream, IMF topdowncharts.com

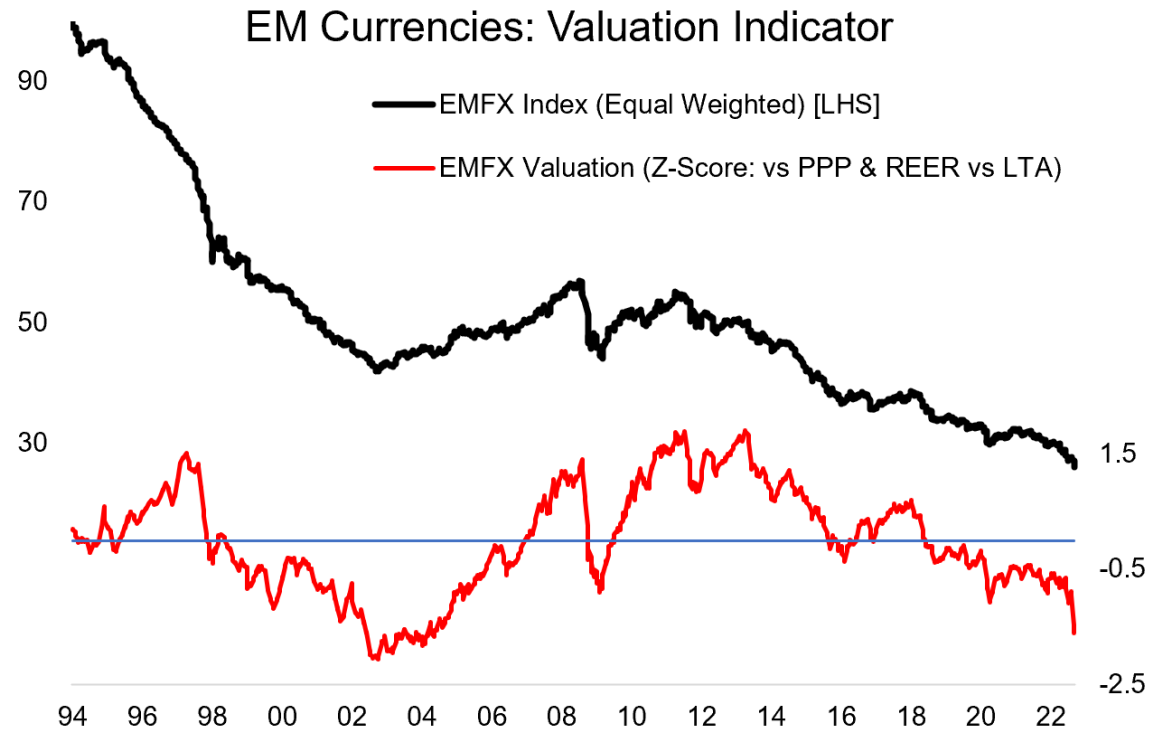


Source: Topdown Charts, Refinitiv Datastream topdowncharts.com

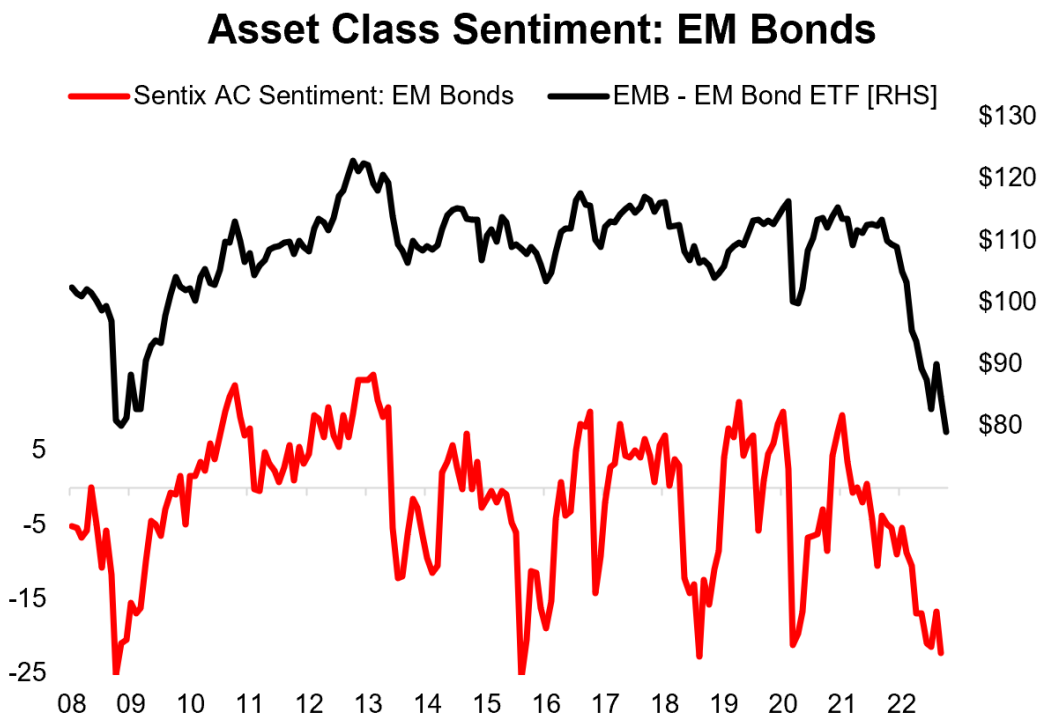
4. Interesting Ideas: Value in EM Fixed Income

TOP DOWN CHARTS

Also of note is that EMFX looks fairly cheap, but I would add the caution that for now we are still in an entrenched long-term bear market for EMFX overall vs USD, so while there is the extra value in EMFX and hence local EM govt bonds (making them more attractive on an overall valuation basis)– hard dollar might be the safer bet (and most hard dollar EM bond ETFs tend to be longer duration). Also of note is that sentiment has dropped to extreme bearish levels (a contrarian bullish signal).



Source: Topdown Charts, Thomson Reuters, BIS, IMF topdowncharts.com

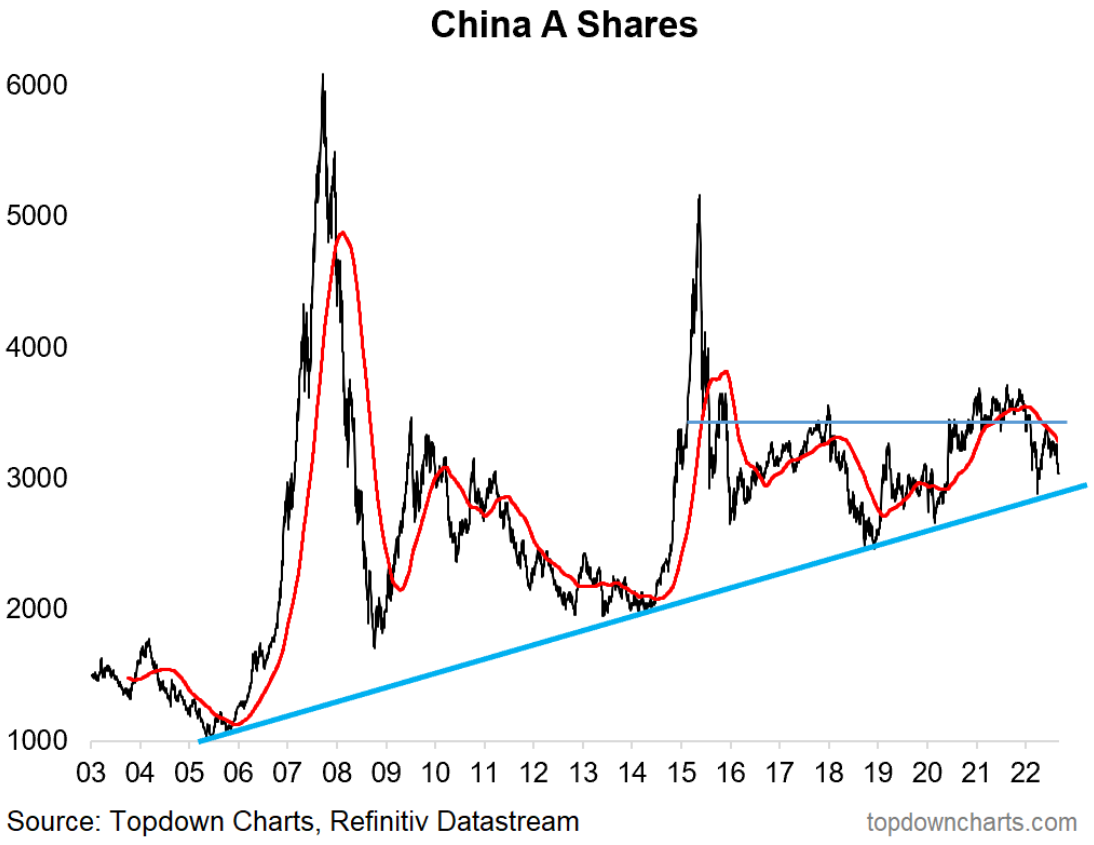


Source: Topdown Charts, Refinitiv Datastream, Sentix topdowncharts.com

4. Interesting Ideas: Chinese Equities

TOP DOWN CHARTS

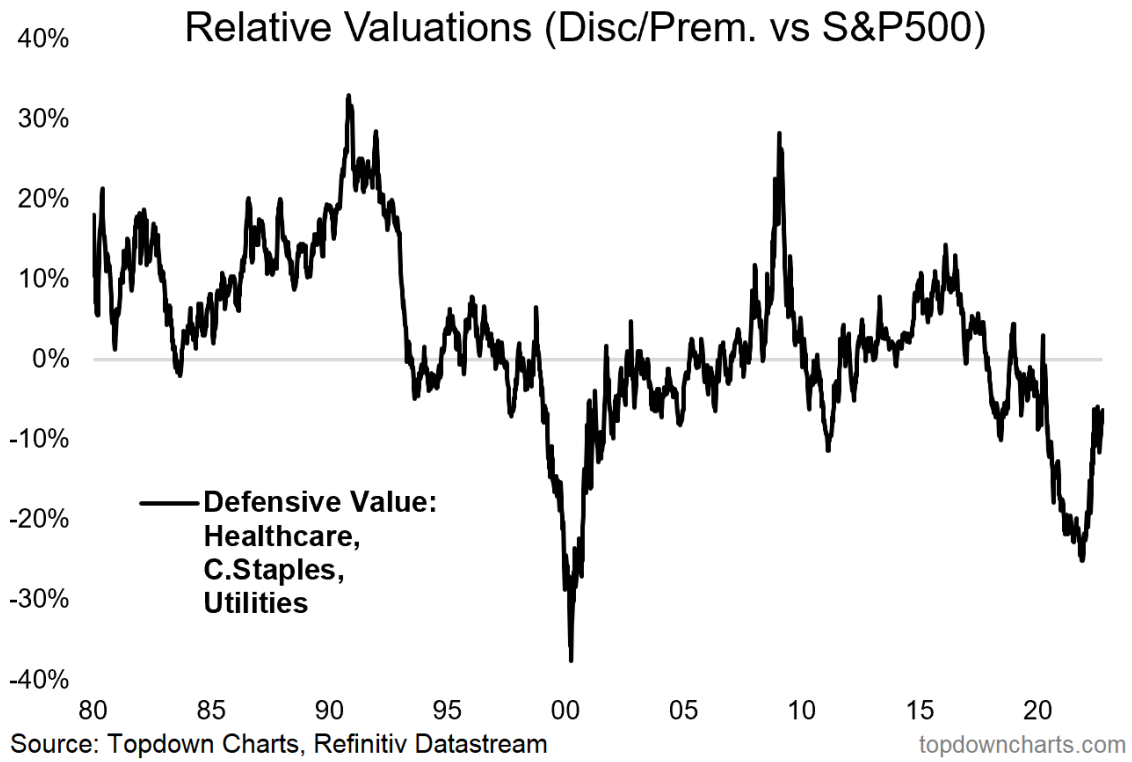
Meanwhile in China, things are looking interesting on the equity front. The previous policy tightening, regulatory tightening, and then more recently: covid tightening, all weighed heavily on Chinese equities – taking them back to cheap and also back to test the uptrend line. But as at the time of writing China A-shares look set to retest that uptrend line, and still waiting on stimulus.

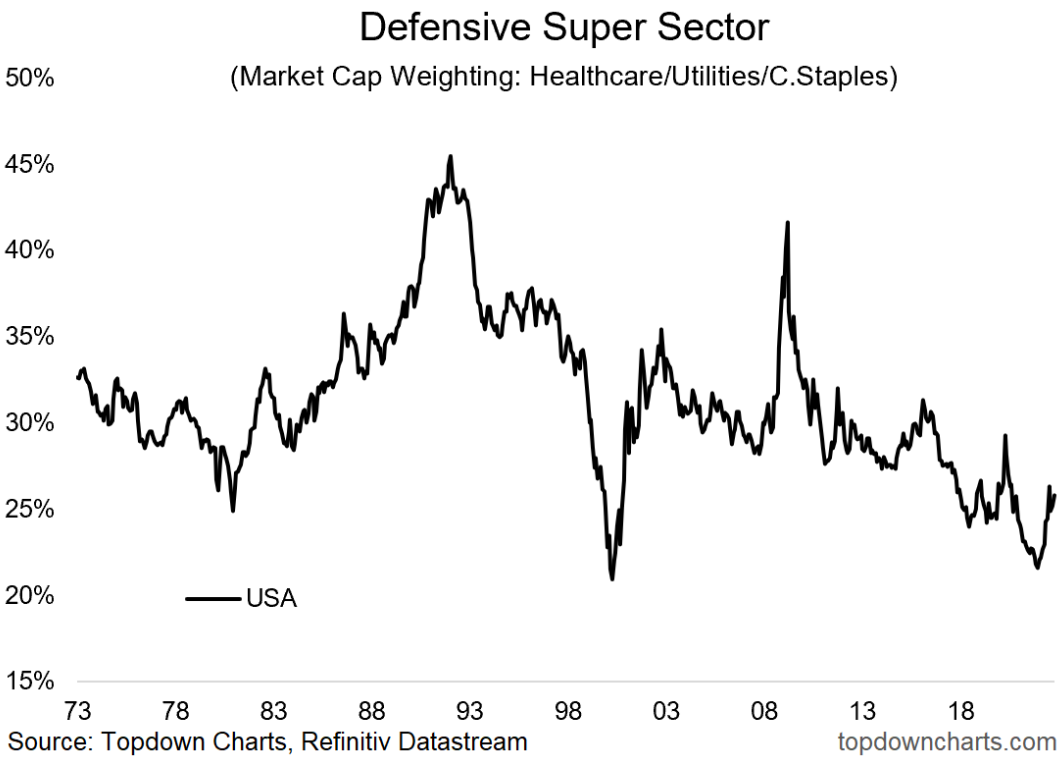


4. Interesting Ideas: Defensive Value

TOP DOWN CHARTS

The "defensive value" basket (Healthcare, Consumer Staples, Utilities) has performed true to label this year in terms of outperforming the rest of the market during bear markets/major corrections. The uptick in relative performance has diminished some of the original thesis here e.g. relative value has rebounded – but it still remains cheap on a relative basis, and the equity bear still looks like a ways to run just yet. Thing to watch for next stage is contra signals from this space e.g. 2009.

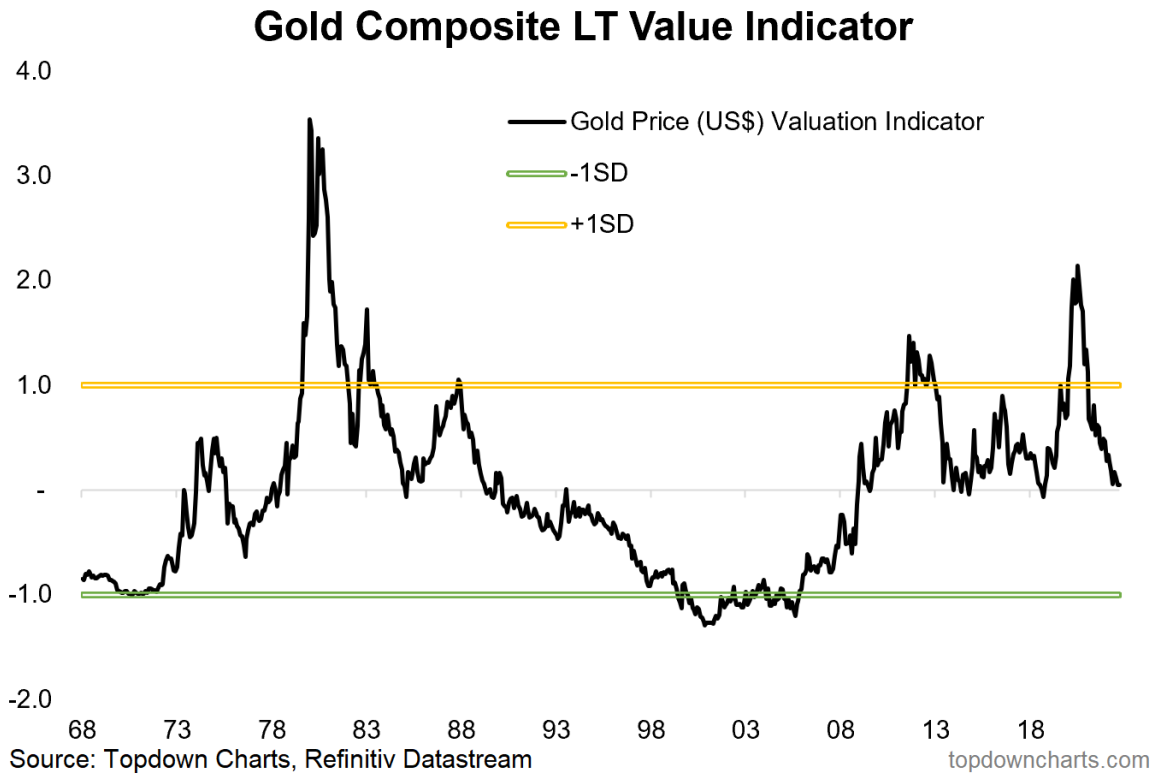


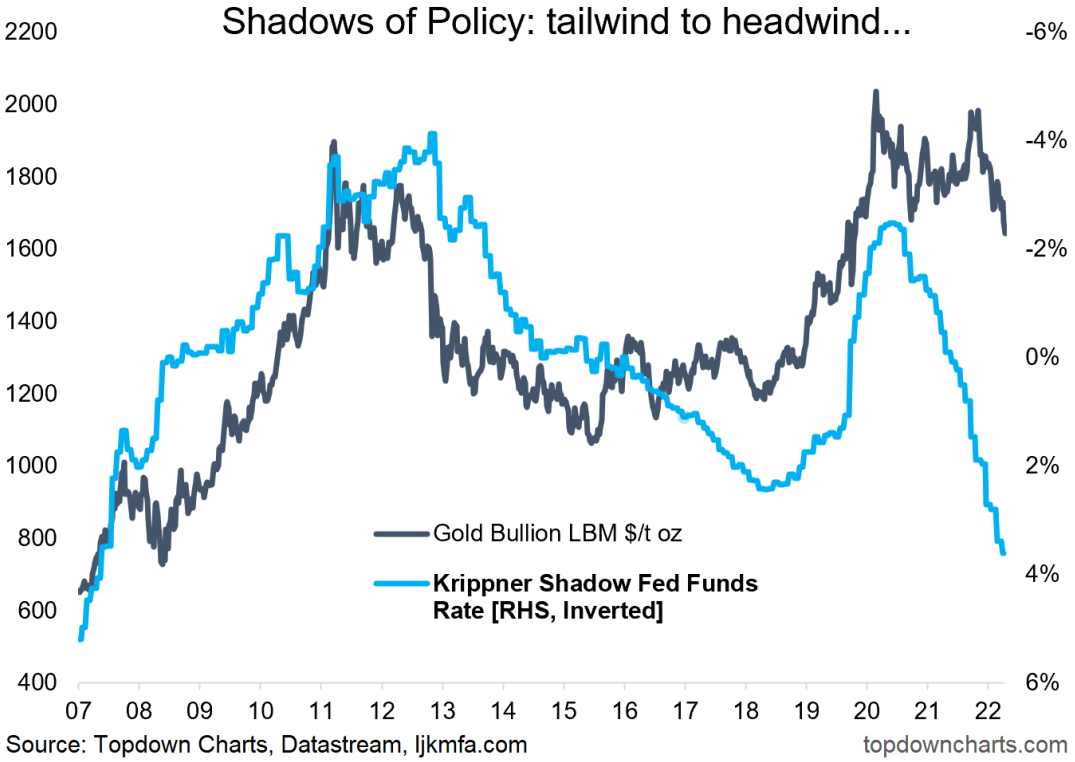


4. (un)interesting Ideas: Gold

TOP DOWN CHARTS

Starting to breakdown: at risk. A few things have changed here, the value indicator has dropped to neutral and positioning/sentiment/flows have turned down. But there are a few indicators pointing to major downside risk for gold prices e.g. real yields, policy headwinds, USD. Perhaps we can say that there is a big geopolitical risk premium implied in the price at these levels. So it is a bit of a conundrum: gold likely rallies if bonds rally and/or if central banks pivot to easing.

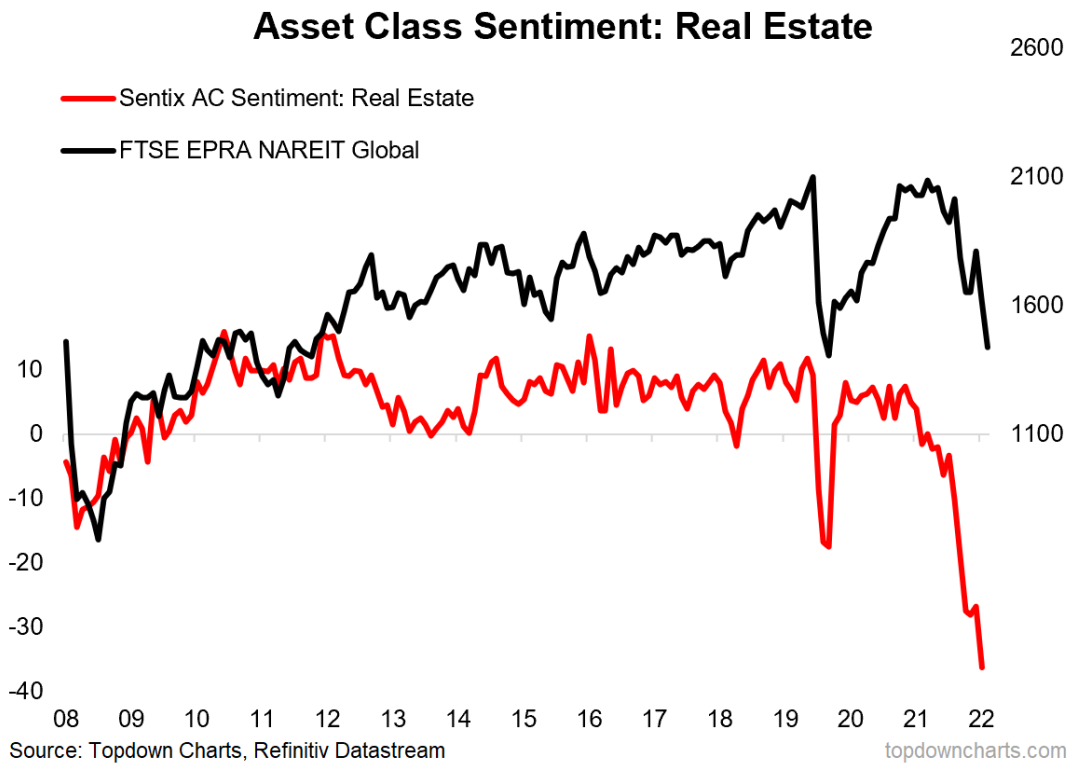


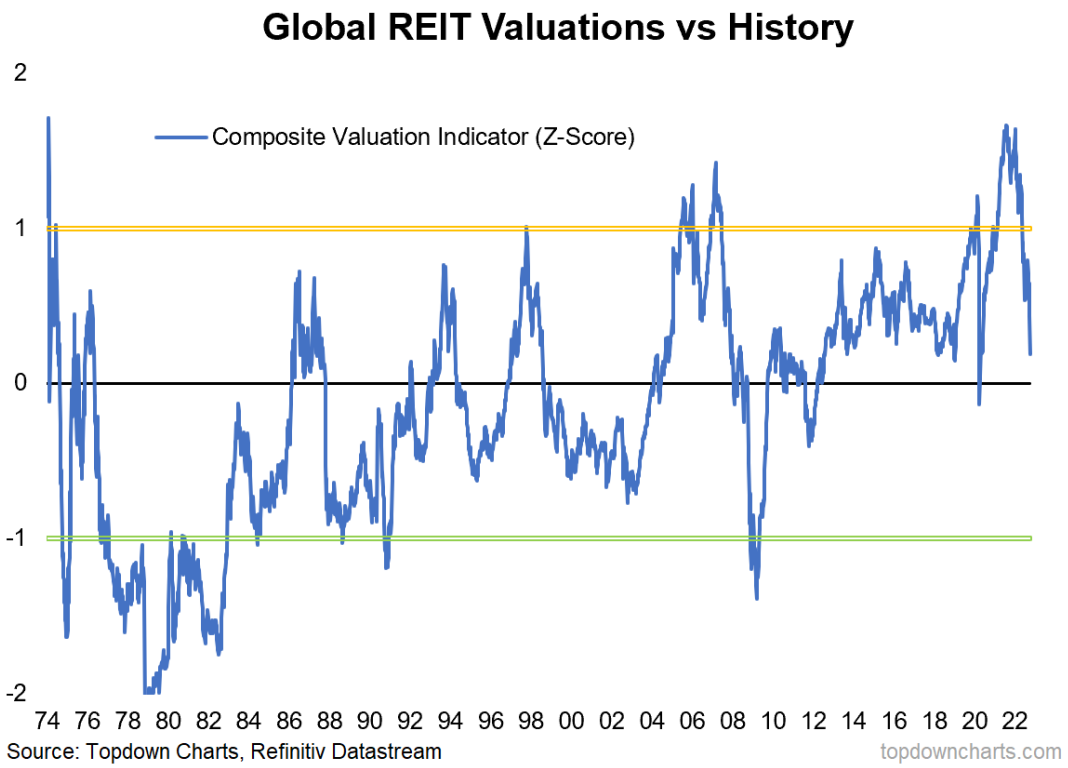


4. (un)interesting Ideas: REITs

TOP DOWN CHARTS

As noted earlier, Real Estate is particularly sensitive to rates, and so the rate shock has heavily dented sentiment on commercial real estate, and REITs have seen a material reset in valuations. Still treat with some scepticism as yield spreads have been squeezed, post-pandemic uncertainty still lingers, recession risk looms, and in the face of all that: insufficient valuation cushion to compensate.



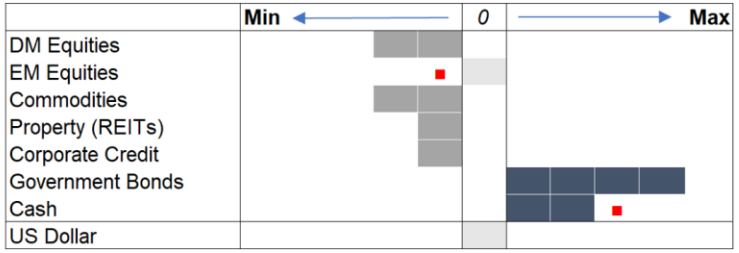


5. Positioning/Summary

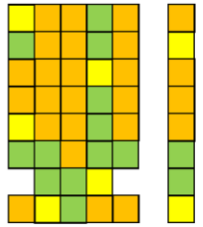
Summary view across asset classes (global unless otherwise noted)

Asset Class	Short-Term View	Medium-Longer Term View
DM Equities	Sentiment extreme bearish, but clear bearish momentum. Likely to remain extremely volatile in either direction given sentiment vs trend.	Favour DM ex-US on relative value over a longer view. In the immediate term US valuations remain somewhat elevated, cycle turning down, monetary headwinds.
EM Equities	Sentiment increasingly bearish, but technicals remain weak, USD strength, monetary tightening, geopolitics present ongoing headwinds.	Relative value vs DM (US) and reasonable absolute valuations a positive. EM looks attractive longer term. But value not yet enough offset monetary/growth concerns.
Commodities	Technicals and sentiment still show bearish momentum; growth risks in focus, geopolitics = 2-way risks.	Supply tailwinds (weak capex) may provide partial offset to growth slowdown. Valuations somewhat expensive.
Property	Sentiment extreme bearish, technicals weakened for listed property, monetary headwinds a concern, valuations still somewhat elevated in absolute terms.	Elevated absolute valuations and reliance on low yields is an issue, some uncertainty on longer term effects of the pandemic (changes in behaviour, tenant stress).
Corp. Credit	Previous complacency disrupted, technicals softer, macro-outlook mostly bearish, warrants caution on credit.	Credit spreads far from cheap levels, duration an offset(?), monitoring for weak spots as policy tightens, economy falters.
Govt Bonds	Sentiment/positioning very one-sided. Valuations have reset to cheap, main tension is growth risk vs inflation risk. Technicals mixed, volatility very high.	Real yields remain low vs history. Expect bonds to better prove their value as a diversifying asset in event of genuine recession, esp. vs equities.
Cash	Low cash rates = expect negative real returns. Yet short-term: cash remains a reliable means of capital preservation.	Cash rates globally on the rise. Short-term rates being bid up across geographies as central banks push on with rate hikes.
US Dollar	Technicals look overbought, sentiment and positioning stretched bullish, Fed rate hikes increasingly priced-in already, risks somewhat balanced.	Lean bearish on a medium/longer term basis as longer-term cycles play out, but neutral for now given macro/policy divergences, resilient technicals.

TAA Positioning Indication - Main

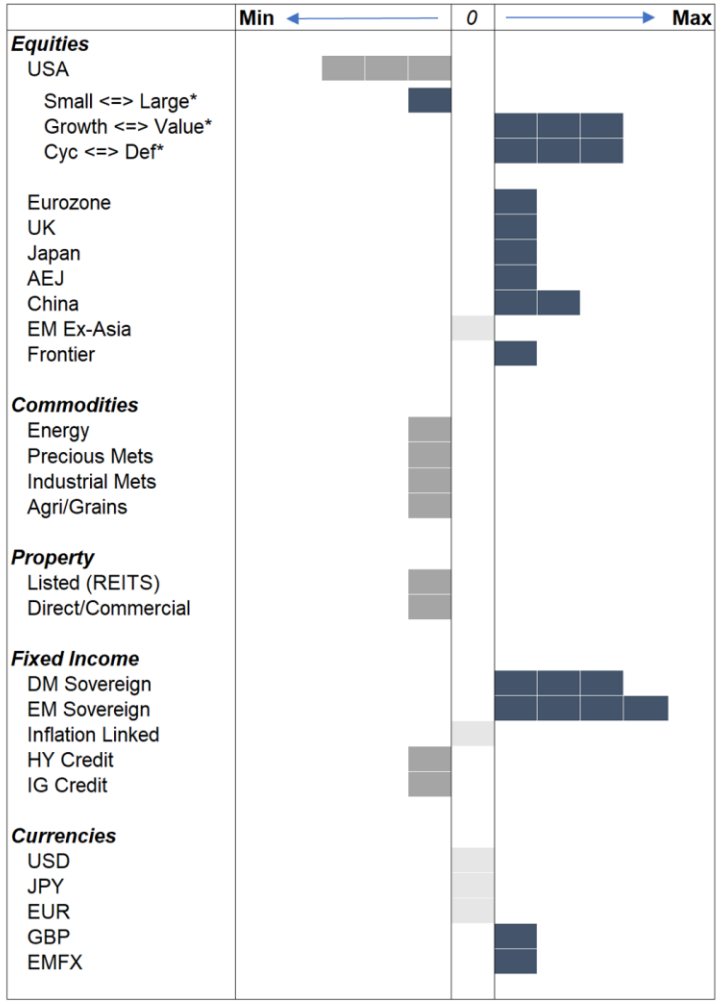


Asset Class Ratings



TOP DOWN CHARTS

TAA Positioning Indication - Extended



■ = **Short Term View**
(i.e. less than 1yr)
(only if strong ST view)

■ = **Medium Term View**
(i.e. more than 1yr)

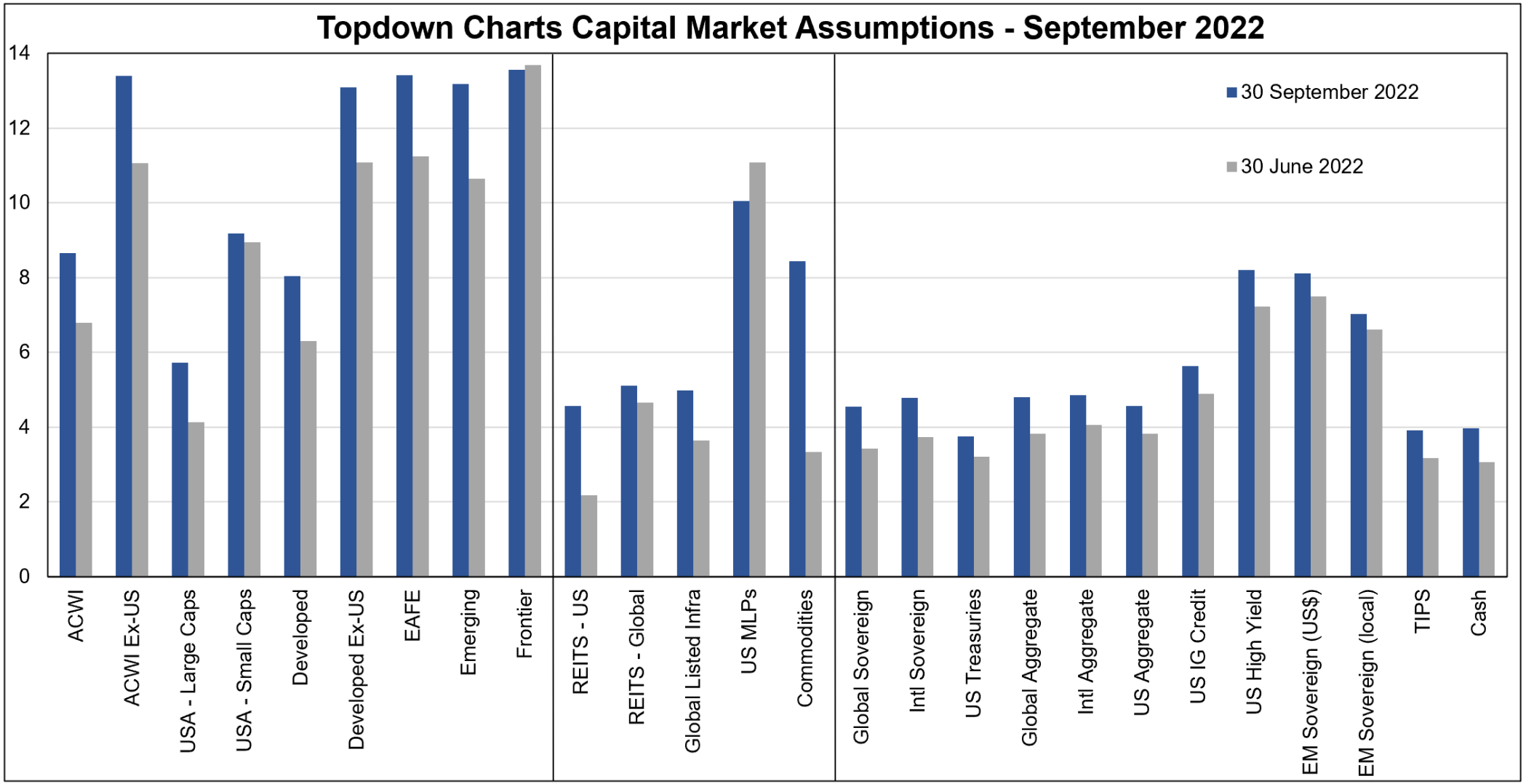
Asset Class Ratings:
V = Valuation
C = Cycle
M = Monetary policy
S = Sentiment/positioning
T = Technicals

Max/Min: Qualitative ratings. Refers to overall view on that asset with 5 squares representing the highest possible conviction in either the Max (long/OW) or Min (short/UW) direction.

***XXX vs XXX:** Relative views, e.g. small vs large, interchange "min" with first mentioned e.g. for small vs large a maximum bullish view on small caps vs large caps would show as 5 boxes on the left side.

5. Capital Market Assumptions

TOP DOWN CHARTS



Source: Topdown Charts

Projections as 30 September 2022, based on expected trend earnings growth, dividend yield, valuation mean-reversion adjustment, hedging and FX changes, yield to maturity, trend nominal GDP. Over a 5-10yr Projn. Period.

Figures are subject to change and are not a guarantee of performance or offer of securities. Full details on methodology available on request.

www.topdowncharts.com

Potential Sources and Scenarios of Upside Risk (for Equities/Risk Assets/Growth)

TOP DOWN CHARTS

Upside Risk	Comments/Notes	Impact	Prob. %	Time
China Stimulus	Large (significant/material) scale monetary easing and/or fiscal stimulus by China	**High**	30%	Med.
US Fiscal+	Risk case is that it has a larger and faster +ve impact on growth (e.g. infln redn Act)	Med.	20%	Long
COL Stimulus	Further energy crisis/cost-of-living stimulus payments, shores up consumer, avoid recession	Low	30%	Short
No Tax Hikes	Planned tax hikes in a number of jurisdictions get cancelled, fiscal setting marginally +ve	Low	15%	Med.
Policy Pause	Central banks globally begin to pause in their tightening efforts, but do NOT flag/do easing.	Low	30%	Short
Policy Pivot	Central banks pivot to outright easing (likely in the face of recession and/or crises)	**High**	15%	Med.
US$ Collapse	USD weakens substantially, eases global financial conditions, supports EM (allows easing)	Med.	35%	Med.
Comdty Crash	Commodity prices fall due to supply surprises (+/sentiment), inflation falls, bond yields fall.	Med.	20%	Short
Disinflation	(US) inflation data peaks, starts showing clear and persistent signs of disinflation	Med.	35%	Short
Consumer Cash	High cash balances make US consumer more resilient, prevents retail recession	Low	20%	Med.
Capex Boom	Large scale investment: infrastructure, energy transition/climate, pandemic supply reponse	Med.	40%	Long
Earnings	Corporate EPS growth holds up (due to high *nominal* growth), surprises vs recession exp.	Med.	25%	Short
Global Trade	Global trade growth remains reslient: helps make recession shallower than expected (or avoid).	Med.	30%	Med.
Ukraine Peace	War ends (sustainably), confidence effects reverse, commodities/inflation fall, Europe rallies	**High**	10%	Med.
China Covid	China drops covid-zero policy (e.g. achieves breakthrough, contains), full reopening	Med.	35%	Med.
Reopening+	Remaining restrictions dropped globally, travel/tourism boom, retail/restaurant/resort rebound	Med.	50%	Med.
Alt. Energy+	Breakthrough in alternative energy reduces reliance on fossil fuels: lower infln, capex boom	Med.	5%	Long
Catharsis	Markets have a final cathartic crash lower, valuations get x-cheap, Cbanks forced to stimulate	**High**	40%	Short

Source: Topdown Charts

topdowncharts.com

For more information about Topdown Charts, the service, or indeed any questions about this pack please get in contact.

Please do not distribute this pack without permission.

Best regards,

Callum Thomas
Head of Research
Topdown Charts Limited

info@topdowncharts.com
www.topdowncharts.com

+64 22 378 1552

Disclaimer