L&G Multi-Index Funds

MONTH IN FOCUS

THE HEADLINES

- **Warming up in Korea**
- **Bunkering down in Guam**
- **Emerging markets the hottest**

MARKET OVERVIEW

What a summer holiday that was. During August, Theresa May went walking in Italy, Trump played golf, Putin enjoyed manly pursuits in Siberia, and North Korea's Kim Jung Un launched missiles and threatened to target Guam. Only the latter had any impact on markets, albeit briefly. The other focus of concern in the month was the risk of a US government shutdown over the debt ceiling, though the need to respond to Hurricane Harvey's impact seems to have lowered the chance of a shutdown for the time being.

Most developed equity markets were close to flat in the month, FTSE World index gained 0.5% in local terms while UK equities gained 1.4%. Emerging markets did relatively well, with FTSE Emerging gaining 2.5%. Weakness in the pound, particularly against the euro, added to unhedged returns on overseas equities. In case you were wondering, Korean equities fell 1.6% in local terms.

Global bond yields declined over the month on ongoing signs of subdued inflation and nervousness about geopolitical risks, Gilt yields fell 0.2% to around 1%.

Credit and high yield spreads bucked the trend of the last few months and widened over August. Similar to the buoyancy in equities, both hard and local emerging market debt performed well over August.

FUND PERFORMANCE REVIEW

All funds recorded positive returns in August, bringing year-to-date returns from mid- to high-single digits for all funds. Funds with greater equity exposure (in particular emerging markets) outperformed those targeting a lower risk profile.

Our preference for mid-risk assets was rewarded in August with higher returns as emerging market debt (both dollar denominated and in local currency), global REITs and infrastructure performed strongly. Our decision earlier this summer to reduce exposure to high yield bonds meant that we were less affected by the widening of spreads of speculative grade bonds in August.

After months of underperformance, US small-cap stocks recovered some of their losses towards the end of the month and the funds benefited as we introduced a position in the asset class.

While not changed during the month, we have kept our hedge against the Korean won and our underweight position in emerging market. These are not in place due to concerns about North Korea risks, however we would expect them to act as decent hedges if tensions rise further.

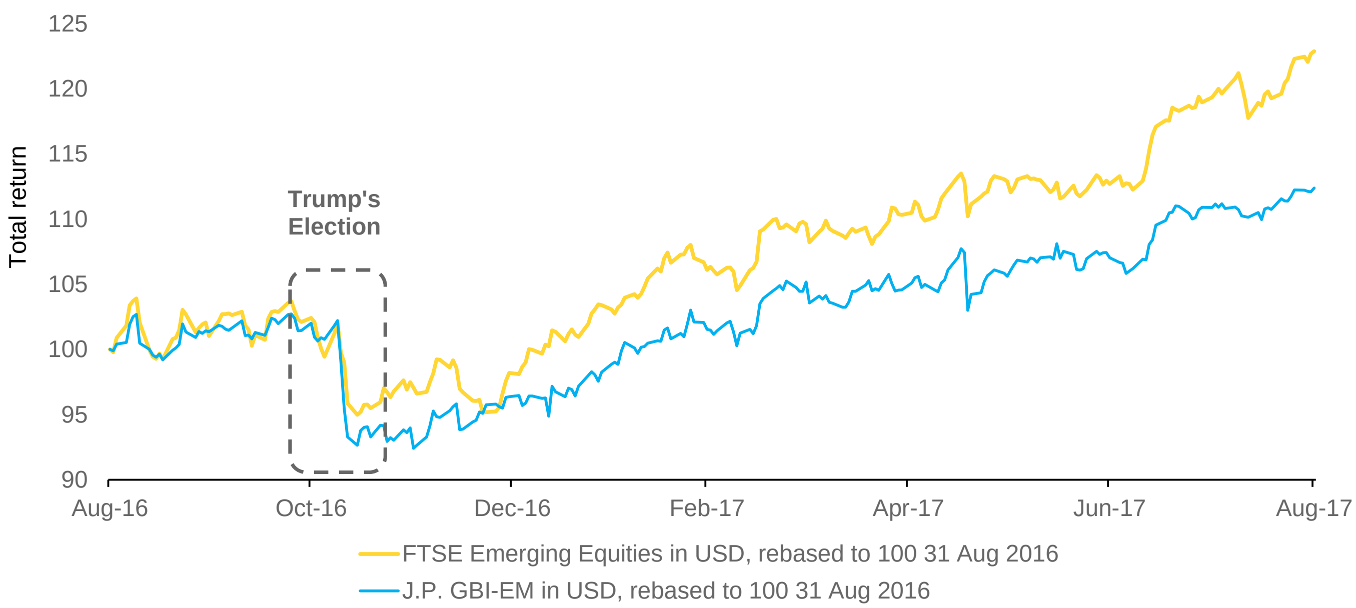
We now also tilt our European government bond allocation to the European periphery (Portugal for example).

RECENT PORTFOLIO CHANGES

EUROPEAN 'PERIPHERY' BONDS

EUROPEAN 'CORE' BONDS

CHART OF THE MONTH – EMERGING MARKET EQUITIES & LOCAL DEBT (IN US DOLLARS)



Source: Bloomberg L.P. LGIM

Legal & General
INVESTMENT MANAGEMENT

MARKET OUTLOOK

Our economic outlook remains one of mid-cycle expansion for the global economy, which is typically consistent with steady but unspectacular returns on risk assets such as equities. However, there remain systemic risks, in particular North Korea and China's large build-up of debt. We therefore prefer assets that do well in such unspectacular conditions (typically high yielding such as emerging market debt, listed infrastructure, listed REITs).

Within sovereign bonds, we have increased European and Australian exposure. In the US, the bond market has priced out most interest rate hikes for 2018. With unemployment down to 16 year lows, there is a risk that wages and inflation start to pick up going forward so where we have US bonds we prefer those which have inflation protection embedded. We see investment grade credit and high yield as less attractive as spreads have reduced in an environment of low interest rates and subdued perceptions of risk.

THE LONG TERM VIEW – ASSET CLASS PATCHWORK QUILT

The table below shows a ranking of major asset class returns year-by-year over the last ten years. We show just ten asset classes to keep it relatively simple. It's been an eventful ten years, most notably with the financial crisis of 2008, but since then relatively good returns on most asset classes. Sometimes there are patterns; emerging market assets had a tough trot 2013-2015, US equities did well in 2013-2016 for example.

At the bottom we show the return on an equally-weighted (monthly rebalanced) portfolio of these ten asset classes, it provides a simple demonstration of a multi-asset portfolio in action. In each year, the equally-weighted portfolio of these assets typically performs just above the middle. You won't get the best performance, but you will also avoid the worst performance. When you look over longer periods of time, something special happens. The equally weighted portfolio over the last ten years (December 2007 to August 2017) is only out-performed by three asset classes, seven asset classes under-perform it. This isn't just luck, a diversified portfolio will tend to have lower risk and higher returns than the sum of its parts over longer periods of time.

A diversified portfolio, provides the starting point of our Multi-Index fund range. On top of this, our dynamic approach to asset allocation benefits from the expertise of our economists, strategists and the wider Asset Allocation team to navigate this dynamic landscape, with the aim to further improve outcomes for end investors.

RANKED ASSET CLASS PERFORMANCE

Rank	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017 ytd	Dec 2007 - August 2017
1st	Emerging Debt (29%)	Emerging Equity (63%)	Global REITs (24%)	Gilts (17%)	Global REITs (23%)	US Equity (30%)	Global REITs (23%)	Japanese Equity (18%)	Emerging Equity (35%)	Emerging Equity (20%)	US Equity (13%)
2nd	Gilts (13%)	Global High Yield Bonds (57%)	Emerging Equity (24%)	UK Corporate Bonds (7%)	Global High Yield Bonds (19%)	European Equity (26%)	US Equity (20%)	US Equity (7%)	US Equity (33%)	European Equity (18%)	Global REITs (9%)
3rd	Japanese Equity (-1%)	UK Equity (30%)	Japanese Equity (19%)	Global High Yield Bonds (3%)	European Equity (17%)	Japanese Equity (25%)	Gilts (15%)	European Equity (6%)	Emerging Debt (33%)	Emerging Debt (12%)	Global High Yield Bonds (8%)
4th	UK Corporate Bonds (-10%)	Global REITs (23%)	US Equity (19%)	US Equity (2%)	UK Corporate Bonds (16%)	UK Equity (21%)	UK Corporate Bonds (13%)	Global REITs (6%)	Global REITs (25%)	Japanese Equity (8%)	Emerging Debt (7%)
5th	US Equity (-12%)	European Equity (20%)	Emerging Debt (17%)	UK Equity (-3%)	Emerging Debt (15%)	Global High Yield Bonds (7%)	Emerging Equity (8%)	UK Equity (1%)	Japanese Equity (23%)	UK Equity (8%)	Japanese Equity (7%)
6th	European Equity (-24%)	UK Corporate Bonds (15%)	Global High Yield Bonds (16%)	Global REITs (-5%)	Emerging Equity (13%)	Global REITs (2%)	Global High Yield Bonds (3%)	UK Corporate Bonds (1%)	European Equity (20%)	US Equity (8%)	UK Corporate Bonds (7%)
7th	Global High Yield Bonds (-27%)	US Equity (13%)	UK Equity (15%)	Emerging Debt (-6%)	UK Equity (12%)	UK Corporate Bonds (2%)	Japanese Equity (3%)	Gilts (0%)	UK Equity (17%)	Global High Yield Bonds (6%)	European Equity (6%)
8th	Global REITs (-28%)	Emerging Debt (4%)	UK Corporate Bonds (9%)	Japanese Equity (-13%)	US Equity (11%)	Gilts (-4%)	UK Equity (1%)	Global High Yield Bonds (-1%)	Global High Yield Bonds (15%)	UK Corporate Bonds (5%)	Gilts (6%)
9th	UK Equity (-30%)	Gilts (-1%)	Gilts (8%)	European Equity (-14%)	Japanese Equity (3%)	Emerging Equity (-5%)	European Equity (0%)	Emerging Equity (-10%)	UK Corporate Bonds (12%)	Global REITs (3%)	Emerging Equity (6%)
10th	Emerging Equity (-35%)	Japanese Equity (-6%)	European Equity (6%)	Emerging Equity (-18%)	Gilts (3%)	Emerging Debt (-7%)	Emerging Debt (0%)	Emerging Debt (-13%)	Gilts (11%)	Gilts (3%)	UK Equity (6%)
Equal Weighted Portfolio	-13.6%	20.9%	15.8%	-3.1%	13.3%	9.1%	8.4%	1.4%	22.6%	9.0%	8.1%

Equal Weighted Portfolio

Source: Bloomberg L.P. LGIM