L&G Mixed Investment Funds

MONTH IN FOCUS

THE HEADLINES

- **Le Pen au chocolat vs. macaron in France**
- **Chocolate cake for Trump**
- **May seeks sweet victory in early election**

MARKET OVERVIEW

April was a month of geopolitical hopes and fears, albeit accompanied by generally small market moves, with hopes coming out on top for the time being.

One hope was that a market-friendly candidate would ultimately become French president, after the first round of voting set up a run-off between centrist Macron and the far-right Le Pen. With the risk of a far-right versus far-left vote in the second round off the table, European equity markets rallied 4% in one day on the basis that ex-investment banker Macron would sweep up the majority of the votes come the second round to be held in May.

President Trump struck a more conciliatory tone to China following an apparently successful meeting with President Xi where a 100-day plan to improve trade ties between the two superpowers was agreed. Fears around the US missile strike against the Syrian government (about which Trump informed the Chinese President over "the most beautiful" chocolate cake), US-Russia relations, and increasingly hostile rhetoric on North Korea had little effect on asset prices.

Theresa May hoped to strengthen her hand for Brexit negotiations by calling a snap early election just after Easter. The most obvious implication was for sterling which gained 3.2% against the US dollar as fears of a "hard" Brexit declined. This also had a knock-on effect for UK equity indices, with the large-cap and foreign-exposed FTSE 100 index declining 1.3%, while the more domestic mid-cap FTSE 250 index gained 3.8%.

Most other equity markets experienced small gains in local terms. Bond indices posted small positive returns as bond yields fell, helped in part by falling US inflation fears.

FUND PERFORMANCE REVIEW

Fund performance was mixed over the month. Despite positive returns from many assets in local terms, many were negative when translated back into sterling due to the currency moves over the month. This was a reversal (albeit on a smaller scale) of what we saw immediately after the Brexit referendum in June 2016, when the fall in sterling meant a boost to performance of overseas assets. The Mixed Investment Funds had been tactically positioned for a jump in the pound's value which helped to offset some of this effect. Lower risk funds, which have less overseas currency exposure, therefore delivered a small gain, while higher risk funds which have more overseas exposure posted a small loss.

Looking beyond the currency effects, equities were a small positive contributor, as were credits, especially high yield and emerging market hard currency debt.

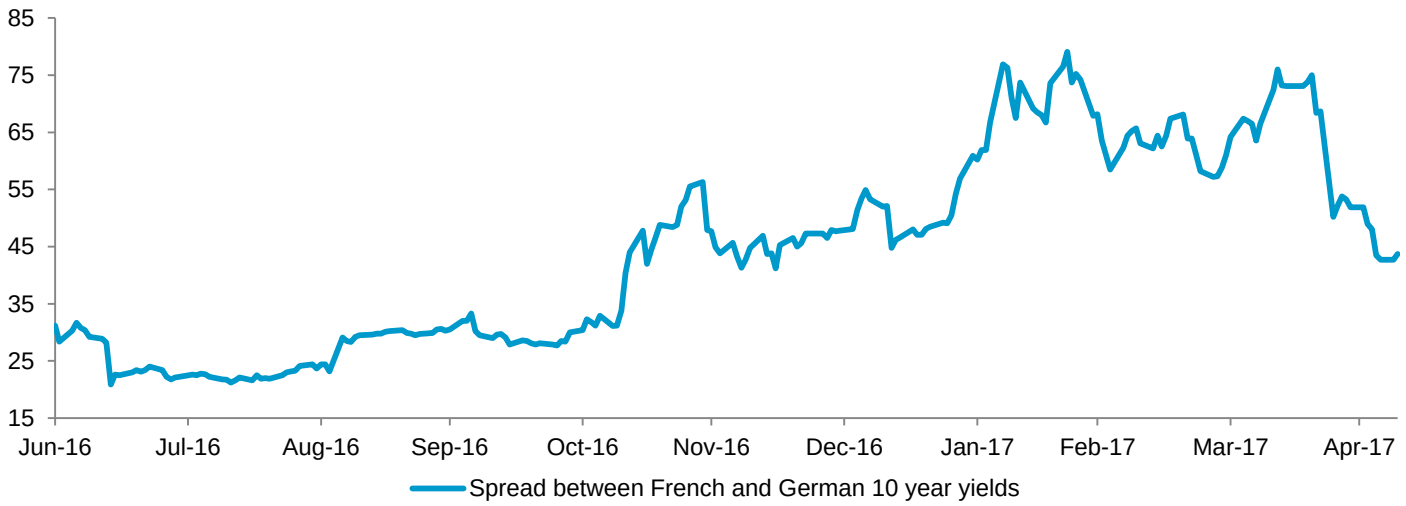
The funds had hedged some of their European related positions in advance of the French elections, in order to protect against the possibility of a negative result. Even though the negative event did not materialise, the move was prudent as the risks were building.

RECENT PORTFOLIO CHANGES

INFRASTRUCTURE & DEFENSIVE EQUITY
US ENERGY STOCKS

EUROPEAN EQUITIES
UK GILTS
EUROS

CHART OF THE MONTH – THE RISE AND FALL OF FRENCH BOND SPREADS OVER GERMAN BUNDS



Source: Bloomberg L.P. LGIM

Legal & General
INVESTMENT MANAGEMENT

MARKET OUTLOOK

We have a positive view on global growth and this typically should provide a tailwind to the performance of risk assets over the year ahead. However, we are wary that markets haven't fully considered the medium-term headwinds to growth, or to the risks. The market enthusiasm behind President Trump's proposed policies may run out of steam if he can't deliver, or indeed if he does deliver what the market believes to be the wrong policies. Furthermore, we have material political and economic risks to be wary of, including European politics in the medium term (even if the short-term risk in France has diminished) and Chinese debt levels over the longer term. We have therefore taken a more cautious view on certain asset classes whose recent performance has been exceptionally strong, in particular high yield debt and some of the more cyclical sectors. In our view, sectors which have lost favour amongst investors, such as energy and infrastructure, offer better opportunities.

THE LONG TERM VIEW – FTSE 250 FIGHTS BACK

The gap between the performance of the FTSE 100 and FTSE 250, which opened up after Brexit, has closed following recent strength in the pound, the weakness in the oil price, and the buoyancy of the UK economy post Brexit, relative to expectations.

We have spoken a lot in the past year about the differences between the FTSE 100 (large-cap stocks) and the FTSE 250 (mid-cap stocks), and why in certain circumstances the performance of these indices can be quite different. The 100 is more international, representing many global mega-cap firms, the 250 is more domestically focused. As a result, the 100 is more exposed to moves in sterling, benefiting from a weaker pound and losing when sterling strengthens. The 250 is more insulated from currency movements as less of the revenues of the mid-cap companies come from abroad. The FTSE 100 also contains more energy focused companies, swaying in value with the price of oil, much more so than the FTSE 250. Recent weakness in the oil price has therefore slowed performance of some of these large-caps firms.

Typically, active UK equity managers have a bias towards mid-cap stocks in their portfolios which explains both their underperformance in 2016 and their relative outperformance of the UK-All Share index (which combines large-, mid- and small-cap stocks) in 2017. In the Mixed Investment Funds, we hold a combination of both parts of the UK index to ensure we capture the full spectrum of UK equity returns.