L&G Mixed Investment Funds

MONTH IN FOCUS

THE HEADLINES

- **Remember, remember the hike of November**
- **Jerome Powell wins musical Chairs**
- **Old bull trudges on**

MARKET OVERVIEW

Just two days into November, the Bank of England raised the official interest rate for the first time in more than a decade, from 0.25% to 0.5%. This reversed the cut implemented after the Brexit referendum. Whilst the hike was widely expected by the market, Carney's supporting address was slightly more dovish than anticipated. This caused gilt yields to fall slightly but as chatter about Brexit progress picked up through the month, this move was reversed to leave yields practically unchanged.

Across the pond, Jerome Powell was confirmed as Trump's choice as the new Chair of the Federal Reserve and we got an effective pre-announcement of the expected December rate hike by the Federal Reserve. Despite this, US dollar was still weaker in the month, and is now down about 8% year-to-date versus pound sterling and down 11% versus euro.

Global equities saw a positive return in November for the 13th month in a row, bringing us towards the longest ever bull-run for equities of over eight years. Performance by region was mixed though. North American equities were the strongest performer, driven by progress on the tax reform which is looking more likely to be signed off by Christmas. Like the last Ryder Cup, Europe had a much poorer showing with European and UK equities both down over 1% over the month, in part a result of strong euro and sterling performance.

FUND PERFORMANCE REVIEW

November saw flat returns for low risk funds with small negative performance for higher risk funds as many equity markets, including the UK, lost ground. The US still delivered a positive return despite a small tech sell off towards month end.

Pound sterling gained in November and although we are running a higher exposure to GBP in the funds than normal, it still means that overseas currency exposure delivered a negative contribution to fund performance in the month.

Real Estate Investment Trusts had another good month, following on from October, but the asset class is still playing catch-up for the year after a poor start. Nonetheless, this month it did help performance as we hold a positive view on the asset class. We did use this month's strong performance to trim down our position somewhat. But we remain overweight and like the defensive properties that this asset gives to our portfolios.

Australian and Eurozone bonds also added to performance while emerging market debt detracted.

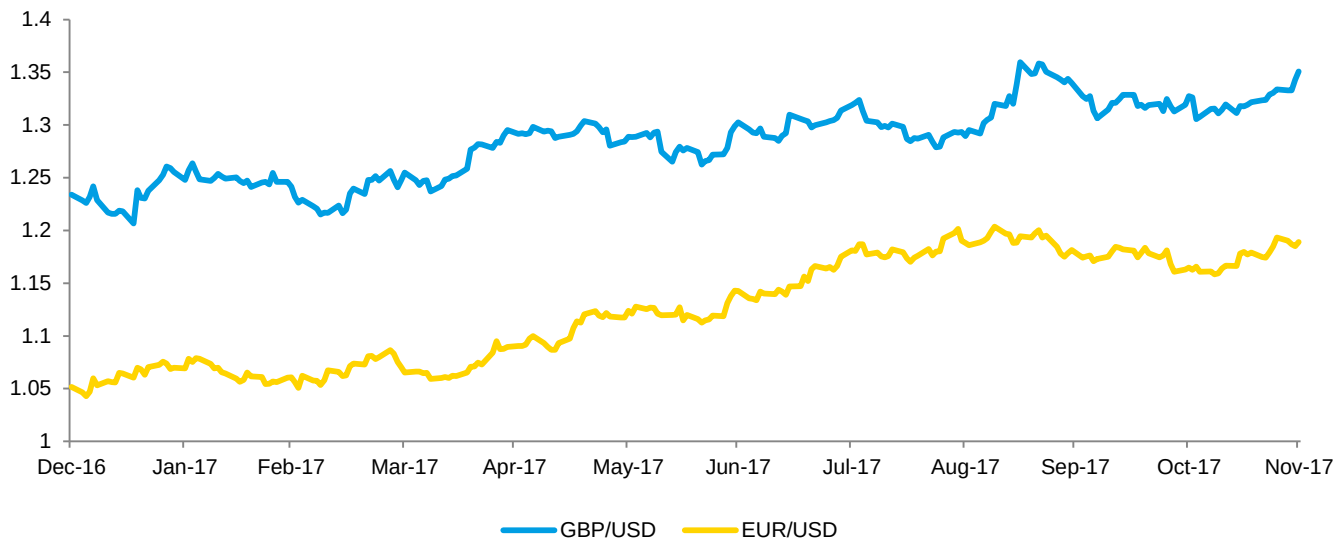
2017 year-to-date performance remains positive across the funds with high single digit returns.

RECENT PORTFOLIO CHANGES

↑ JAPANESE YEN

↓ REAL ESTATE INVESTMENT TRUSTS

CHART OF THE MONTH – DOLLAR WOES, STERLING GOES, EURO STRENGTH SHOWS



Source: LGIM

Legal & General
INVESTMENT MANAGEMENT

MARKET OUTLOOK

Equities have performed well in the last couple of years thanks to a synchronised economic recovery, but only subdued inflation. This is consistent with mid-economic cycle dynamics. Our economists do not see a recession in 2018, but we need to stay vigilant as we are clearly inching closer. As we start considering the year ahead, we see potential sources of downside risk in 2018 given low volatility, tightening labour markets, Fed rate hikes and the tightening of QE measures across the globe, combined with the long-standing views on structural headwinds for growth like debt and demographics. We are somewhat cautious on equities. Predicting the timing of any pullbacks is tough but timing is crucial for successful investment outcomes as market returns may stay strong until just before a correction. Therefore, as macro investors, we spend a lot of resources on analysing market risks and mapping them into our asset allocation.

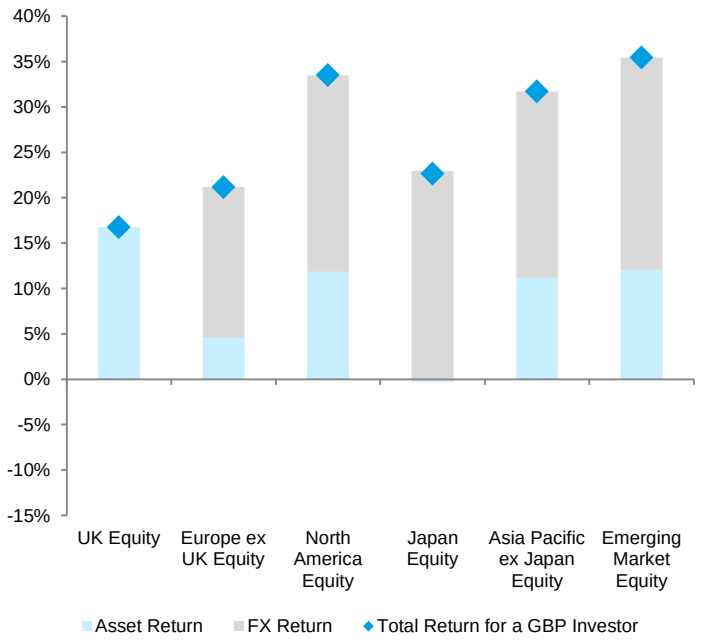
While there is little visibility on what would be the next catalyst for a large asset price correction, we stay prudent in our investment strategy. If markets and economic data progresses as we expect, we would gradually reduce the equity exposure as we go deeper into 2018. But if inflation stays subdued and other risks do not build, we will be more inclined to stay closer to neutral positioning. In addition, we also hold some specific hedges in the portfolio. Namely, US inflation-linked bonds amongst our diversified fixed income assets, a larger allocation to the long the US dollar and, more recently, a higher Japanese yen positions.

THE LONG-TERM VIEW – HOW CURRENCY MOVES INFLUENCE RETURNS

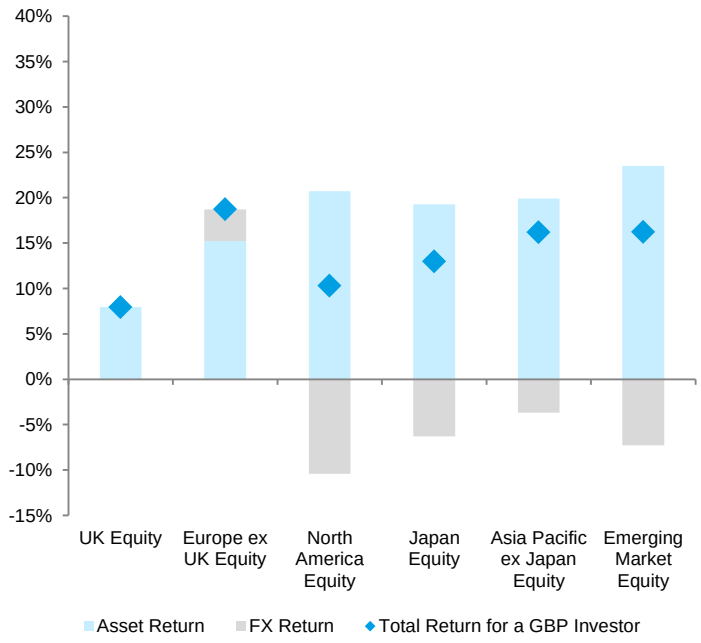
The Mixed Investment Funds generally invest in equities on an unhedged basis. This means that when the funds invest in US equities, for example, the return received not only reflects how well the American stock market has performed, but also how well US dollar performed versus pound sterling. In 2016, American equities delivered a sound 12% return locally, but because pound sterling was so weak after the Brexit referendum, the resulting return experienced by a GBP-based investor was over 30%. This was the same across other equity markets which made 2016 seem like a very strong year for overseas equity investments. This year, the picture is a little different; equity markets, locally have actually been stronger, with returns over 20% in some markets, but as sterling has recovered somewhat, the return experienced by UK investors is lower.

We also have the ability to hedge currency risk in the funds, so if we want to access only the equity return but were concerned about the currency impact, we could hedge that risk out. The funds currently have some euro risk hedged as we are worried about the future performance of the currency, but for other major currencies our equity exposure comes with the currency exposure as well.

Unhedged equities - 2016 returns



Unhedged equities - 2017 YTD returns



Source: Bloomberg L.P. LGIM