L&G Mixed Investment Funds

MONTH IN FOCUS

THE HEADLINES

- **The new year brought us new highs in equities…**
- **… new lows in the US dollar…**
- **… and a new face in Davos.**

MARKET OVERVIEW

While January usually marks new beginnings, the markets rejected New Year's resolutions in favour of their old habits of 2017. Strong sentiment and confidence in global growth continued to support risk assets. US equities completed an impressive run of 15 consecutive positive monthly returns, driven by cyclical sectors including information technology (see Chart of the Month).

Bond yields increased but there was still sufficient faith in 'Goldilocks' that the weakness in fixed income did not affect broader equity markets. The only two laggards were European and UK equities, with the latter facing headwinds from the stronger domestic currency and its more defensive sector exposure. Investors shunned 'defensive' sectors, with consumer discretionary, technology and financials leading the charge higher. Global REITs and Infrastructure declined on a hedged basis.

While investment grade credit spreads continued to fall, softening the impact of higher yields, US dollar weakened against both the pound and the euro. Markets seem to hold onto the belief that strong global growth might signal the end of quantitative easing or very low rate environment in Europe and that may more than offset the prospect of further rate hikes in the US.

January also saw US President Trump visiting the World Economic Forum in Davos for the very first time. Although not a market-moving event in itself, his 'America First is not America Alone' speech brought back to the surface the growing concerns about the rise of protectionism, which could harm global trade in the future.

FUND PERFORMANCE REVIEW

January delivered modest negative returns for all of the mixed investment funds, mainly driven by weakness from interest rate sensitive equities such as infrastructure and real estate investment trusts and currency effects.

Although many overseas equity markets delivered strong positive gains, when translated back to pound sterling the gains were effectively cancelled out. For example, US equities gained over 5% in January, but US dollar fell by nearly 5% versus pound sterling and as such generated no return for the funds.

Elsewhere, corporate bonds also delivered a small negative contribution as spread tightening was not enough to keep up with rapidly rising yields on government bonds.

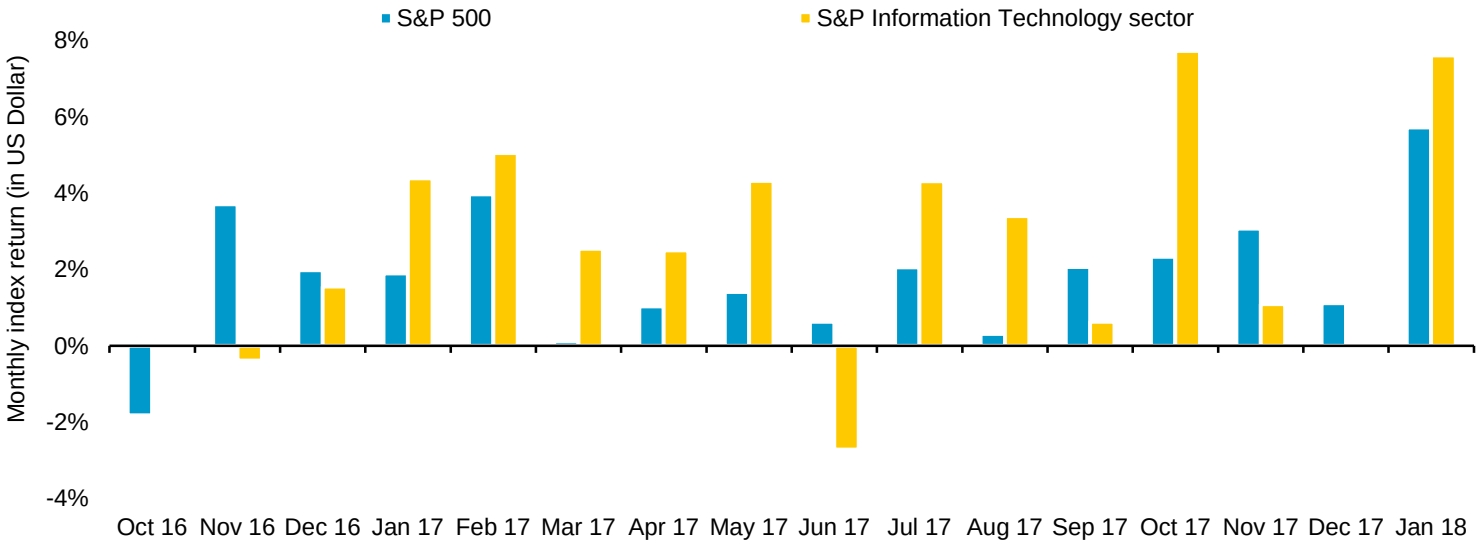
Over the month we increased our US Treasury exposure following the sharp rise in yields towards what we consider a fairer price. We also nudged higher our equity exposure, removing a tactical underweight that we had in place for the past month or so. We removed Japanese REITS and reduced our Japanese yen exposure.

RECENT PORTFOLIO CHANGES

US TREASURIES
EQUITIES

JAPANESE YEN
JAPANESE REITS

CHART OF THE MONTH – S&P 500 HAS A (BULL) RUN OF ITS LIFE, WITH US TECHNOLOGY STOCKS SOARING ABOVE



Source: LGIM

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INVESTMENT MANAGEMENT

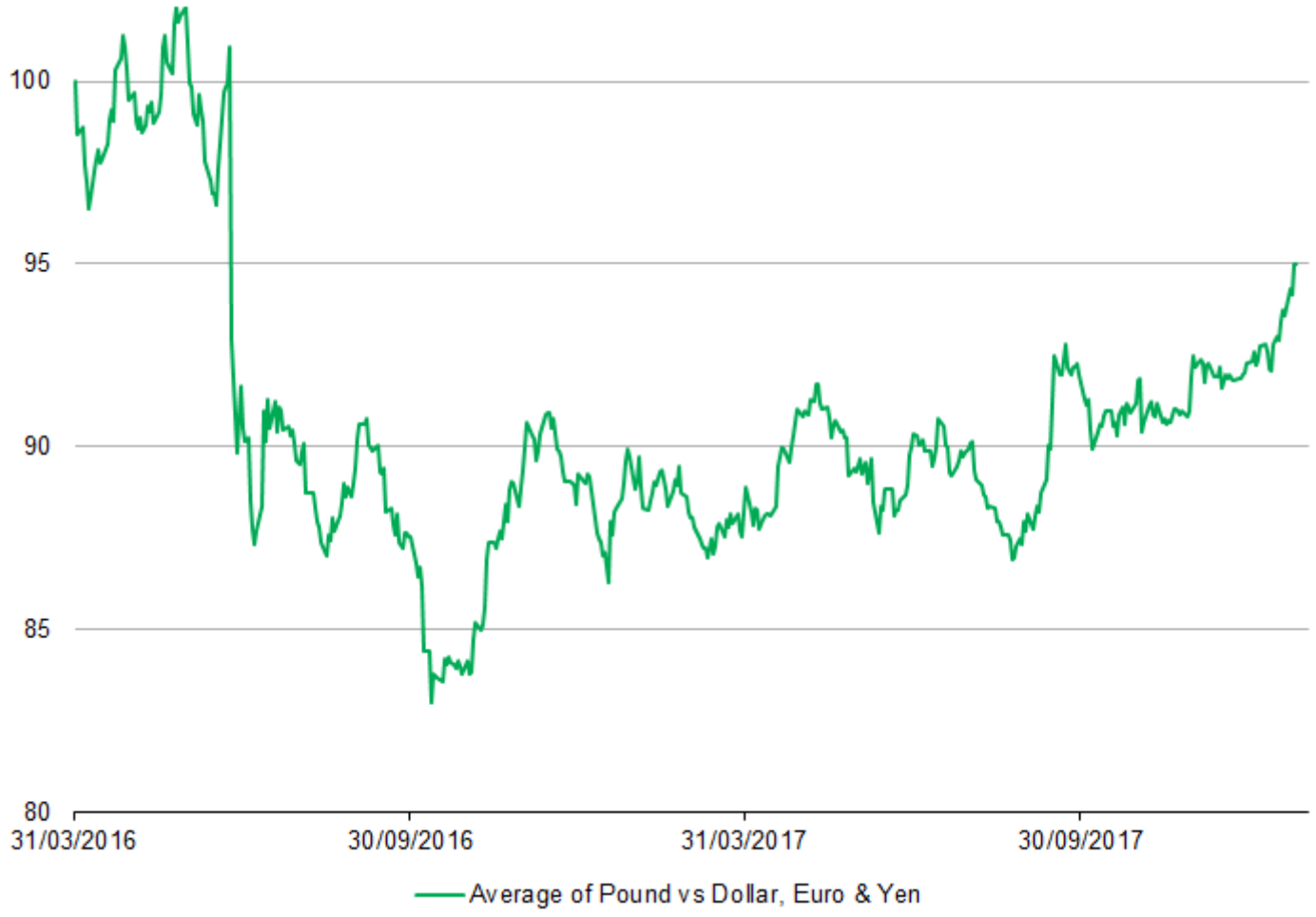
MARKET OUTLOOK

The pace of equity market gains has come as a bit of a surprise in January, continuing a long positive streak for equities thanks to a synchronised economic recovery but only subdued inflation. While this is consistent with mid-economic cycle dynamics, rising inflation would start to push us towards late cycle. While our economists do not see a recession as imminent, we remain vigilant as we inch closer. The economic scenario playing out is one of lower unemployment, President Trump's tax plan and protectionism stoking inflationary pressures, while global growth remains strong. The recent US Employment Report supported the case that inflation could be heading higher.

While there is little visibility on what would be the next catalyst for a large asset price correction, we remain prudent in our investment strategy. If markets and economic data progress 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 a larger allocation to the US dollar as well as US inflation linked bonds amongst our diversified fixed income assets.

BREXIT AND THE POUND

The pound sterling has proved to be the financial market most clearly linked to sentiment about Brexit. Against an average of the US dollar, the euro and the Japanese yen, the pound is now back to levels last seen very early on the morning of 24 June 2016, in contrast to those seen at the peak of fear in October 2016.



Source: Bloomberg L.P. LGIM