L&G Mixed Investment Funds

MONTH IN FOCUS

THE HEADLINES

- **The weather was scorchio!…**
- **…heating up markets…**
- **…and attempting to mend many broken football dreams.**

MARKET OVERVIEW

Risk assets continued to recover in July, with equities trading higher, and credit spreads lower. The background noise around higher US tariffs on Chinese imports remained, except the market wasn't listening. Helping to support market sentiment was on-going policy support from Chinese authorities, a no-surprises stance from major central banks and a fairly supportive US earnings season.

Global equities pushed steadily higher during July. European ex UK equities and the US led the gains. Emerging market equities also appreciated in value over the period. However, political uncertainty in the wake of negative reaction to Prime Minister Theresa May's latest Brexit proposals saw UK equities underperform versus other regions. Japan also lagged global stocks amid mixed results from the domestic economy, with household spending data disappointing.

Technology companies caught the headlines as bumper profits from Amazon, Google's parent company, Alphabet, and Microsoft contrasted with disappointing trading updates from Twitter and Facebook.

Investment grade, high yield and emerging market debt all saw notable tightening in credit spreads through July. Developed market bond yields were generally higher. The pound slipped a cent lower against the US dollar.

FUND PERFORMANCE REVIEW

All of the Mixed Investment Funds delivered a positive return in July with the higher risk funds outperforming the lower risk funds.

Equities led the way, with European and US stocks the main contributors to the positive performance. Our mid risk assets also helped, generating positive returns from emerging market debt, infrastructure and high yield.

For the growth funds our overweight versus our strategic position to global inflation linked bonds detracted from performance slightly, but this was offset by our underweight in gilts.

July was a fairly quiet month for portfolio changes. We increased our exposure to the Japanese yen in the higher risk portfolios. We like Japanese yen from a risk perspective as it should be defensive in an equity downmarket. We also topped up our exposure to emerging market debt in the higher risk funds.

RECENT PORTFOLIO CHANGES

↑ JAPANESE YEN

↓ CASH

CHART OF THE MONTH – WE STILL LIKE TECH – NASDAQ RELATIVE TO THE S&P, BETA ADJUSTED

Source: LGIM, Bloomberg L.P.,

Legal & General
INVESTMENT MANAGEMENT

MARKET OUTLOOK

Two countervailing forces are keeping markets in something of a holding pattern recently: growth in the global economy and company earnings, versus the ascent of populist economic policies. We may be due to learn soon which one will gain the upper hand. Trade wars continue to occupy markets' attention. Although there has yet to be any major fall-out, our economists do anticipate some damage to growth from trade wars over the next year, and as such have slightly revised down our GDP forecasts for both the US and China.

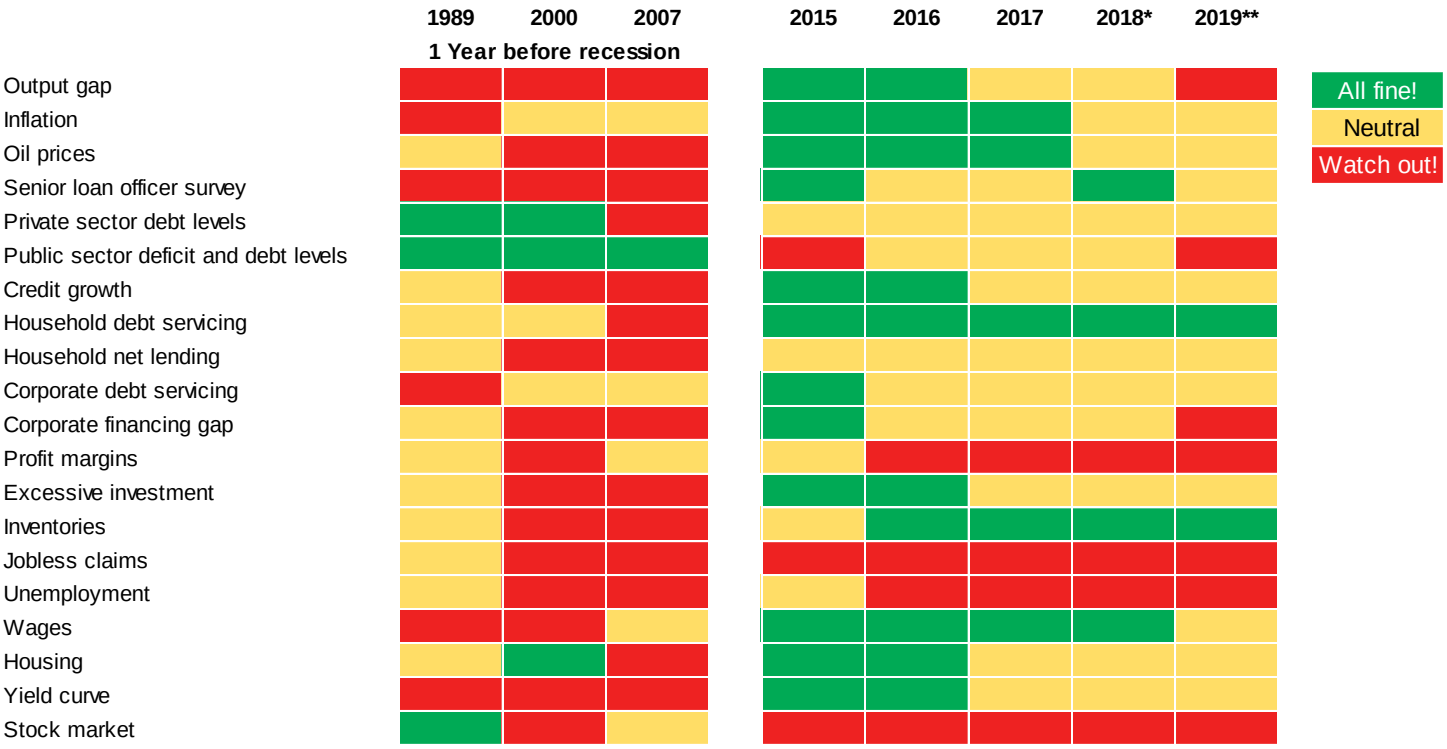
Given the backdrop of 'good growth and bad politics' and a mid-to-late cycle economy, we have kept our equities overweight versus our strategic allocation in the funds, but would look to reduce exposure if we saw recession pressures building. We also remain less positive on corporate bonds as credit spreads are still not attractive despite some recent widening. Lastly, we continue to look to protect the portfolios through taking more of our fixed income exposure via global inflation-linked bonds and being more selective within emerging market equities.

RECESSION RISK HAS BEEN PUSHED OUT

Given where we are in the economic cycle, we focus a lot of attention on measuring recession risk. Our Head of Economics, Tim Drayson, monitors the key indicators of a recession in the US, outlined below. The heat map shows, from left to right, how the indicators fared one year prior to the last three recessions, and then the evolution in recent years, including our forecast for next year. As you would probably expect, many of the indicators were flashing red before the last few recessions, so by the same measure the probability of recession this year looks low.

Recently we have upgraded some of the indicators by a notch, pushing out significant recession risk to 2020. Some of the indicators that have improved are; household debt servicing (still falling despite rising mortgage rates), household net lending (saving ratio revised up), corporate debt servicing (spreads and long-term interest rates lower than expected) and inventories (leaner than expected).

US RECESSION INDICATIOR HEAT MAP



*Aug 2018 **Expected start of 2019