L&G Mixed Investment Funds

MONTH IN FOCUS

THE HEADLINES

- **The Italian government teeters…**
- **…much like in The Italian Job…**
- **…while other markets enjoy La Dolce Vita.**

MARKET OVERVIEW

After a few months of back and forth following inconclusive elections in March, it seemed Italy's politicians had come to a solution. The League party (formerly Northern League) and Five Star Movement agreed to form a populist coalition. However, this initiative collapsed at the first attempt after the Italian president vetoed an anti-euro politician as finance minister, raising the prospect of further elections and uncertainty. While a populist government was subsequently formed and risk aversion declined, it did bring back memories of the Eurozone crisis.

The Italian political situation cast a dark cloud over Italian bonds, some of which spread over to Spanish bonds and other peripheral debt. European equity investors were also gloomy as they delivered poor performance in the month.

On the flip side, the sun shone on assets that were less connected to Italy's political future with US equities, UK equities, global real estate investment trusts (REITs) and most core government bonds enjoying modest gains.

Both the euro and pound fell, the latter lifting the performance of unhedged foreign assets to UK investors. Within equities, it was tech and US small-cap that led the gains.

And finally, spreads continued to drift wider in May both for investment grade and high yield corporate bonds as well as for emerging market debt.

FUND PERFORMANCE REVIEW

All of the Mixed Investment Funds delivered a small positive return in May, with growth orientated funds outperforming income funds.

Equities led the way, with UK and US stocks the main contributors to the positive performance. REITs also helped, recovering some underperformance from earlier in the year.

Credit assets detracted from performance as spreads continued to widen, but we are underweight corporate credit so this limited the drag. The same could not be said of emerging market debt, where we hold an overweight and suffered from negative performance in May hindering our gains.

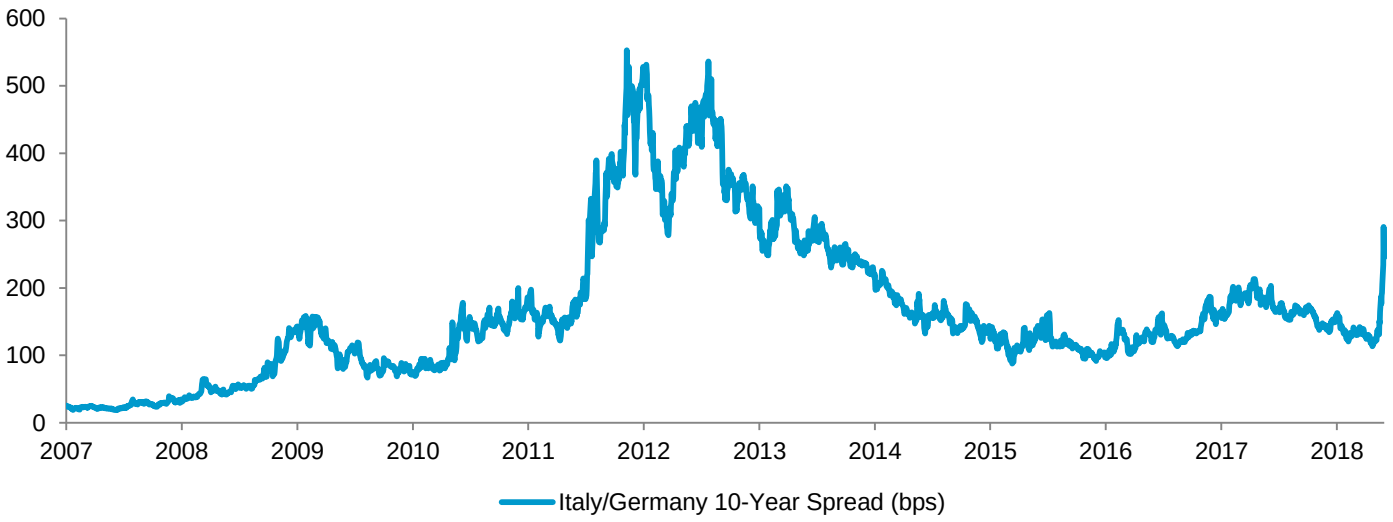
The changes in the funds over the month included reducing fixed income duration in the UK and Europe. We also removed our trade in US energy stocks altogether as oil prices trended higher, and reduced European utilities exposure in income orientated funds on the back of better performance.

RECENT PORTFOLIO CHANGES

US EQUITY
CASH

UK & EUROPEAN BONDS
ENERGY & UTILITIES STOCKS

CHART OF THE MONTH – ITALIAN BOND SPREAD BLOW OUT INVOKES MEMORIES OF EURO CRISIS



Source: LGIM, Bloomberg L.P.,

Legal & General
INVESTMENT MANAGEMENT

MARKET OUTLOOK

With US unemployment now below 4% and inflation back at target we assess the US economy has moved late cycle. This phase typically lasts between 1-4 years and will hinge on how quickly wages, inflation and rates rise, profits come under pressure and other imbalances develop. The fiscal stimulus should add to overheating pressure, but should keep the economy growing above trend into early 2019 even as the Fed continues to raise rates once a quarter. Recession risks are likely to build towards the end of 2019, especially if the fiscal stimulus starts to fade and rates have risen further.

Against that backdrop, we keep our overweight equity positioning in the funds, but would look to reduce exposure as those recession pressures build. On the flip side, we are underweight corporate bonds as spreads are still not attractive despite some recent widening.

WORLD CUP SPECIAL

With World Cup fever peaking, we have been playing out our own version – the Multi-Asset World Cup! Each country in our World Cup will compete on a number of economic and financial market criteria, the same type of criteria that we use in the Multi-asset team to decide what countries and markets might make good investments, but here with a little more fun. These included government debt as a percentage of GDP; the Gini coefficient, measuring income inequality and political risk scores. As we go through the tournament you can see who is economically excellent and who flunks at the final financial whistle.

In terms of footballing prowess, it was a surprise to see Brazil and Argentina drop out of our competition at the group stage, but given the economic misery endured by the former, especially over the past few years, the results didn't shock our more fiscally focused pundits. In the knock-out rounds (below) , England went past Japan and Sweden (thanks in no small part to a high dividend yield on UK equities) setting up a quarter final against Portugal. On the other side Germany meet hosts Russia. Log in to the newly revamped Primary Funds portal to see the results of the finals.

THE MULTI ASSET WORLD CUP 2018 – KNOCK OUT ROUNDS