L&G Mixed Investment Funds

MONTH IN FOCUS

THE HEADLINES

- **Global equity markets rebounded…**
- **…with the help of dovish language from Powell …**
- **… while doubts increased about Theresa May's Brexit deal**

MARKET OVERVIEW

Following the sell-off seen last month, markets saw a change of tone in November, albeit still down from the September peaks. This was underpinned by optimism regarding a moderation in the pace of future US interest rate hikes, and rising hopes that the US-China trade dispute could be resolved through negotiation. In local currency terms, emerging market equities returned 3.0% over the month, reflecting investors' improved risk appetite. US and Japanese equities ended the month in positive territory: up 2.0% and 1.2% respectively. Having lost ground the previous month, REITs and listed infrastructure were the standout performers in November.

Soft economic data and political uncertainty dragged on Europe ex UK equities (-0.7%), while doubts over the plausibility of the government's Brexit proposals and mixed economic headlines hit UK equities (-1.6%). Credit spreads broadly widened last month, with UK investment grade credit (-1.4%) underperforming global investment grade credit (-0.2%). Global high yield bonds continued to perform poorly, losing a further 1.0%.

In the currency space, the US dollar extended its post-April gains, rising by +0.4% versus the euro during November. However the euro did appreciate against the pound, again on Brexit uncertainty.

FUND PERFORMANCE REVIEW

November saw some small negative returns from the lower risk and income funds while the higher risk growth funds managed to achieve a small positive return.

Equity markets rebounded somewhat after the October sell-off with emerging markets leading the way and positively contributing the most to the higher risk funds' performance.

Our overweight positions in mid-risk assets were also advantageous for all the funds' performance during the month, as REITs, infrastructure and emerging market debt (local currency) had strong months. UK investment grade credit and global high yield were the biggest detractors, in particular in the lower risk income funds that have a higher relative allocation.

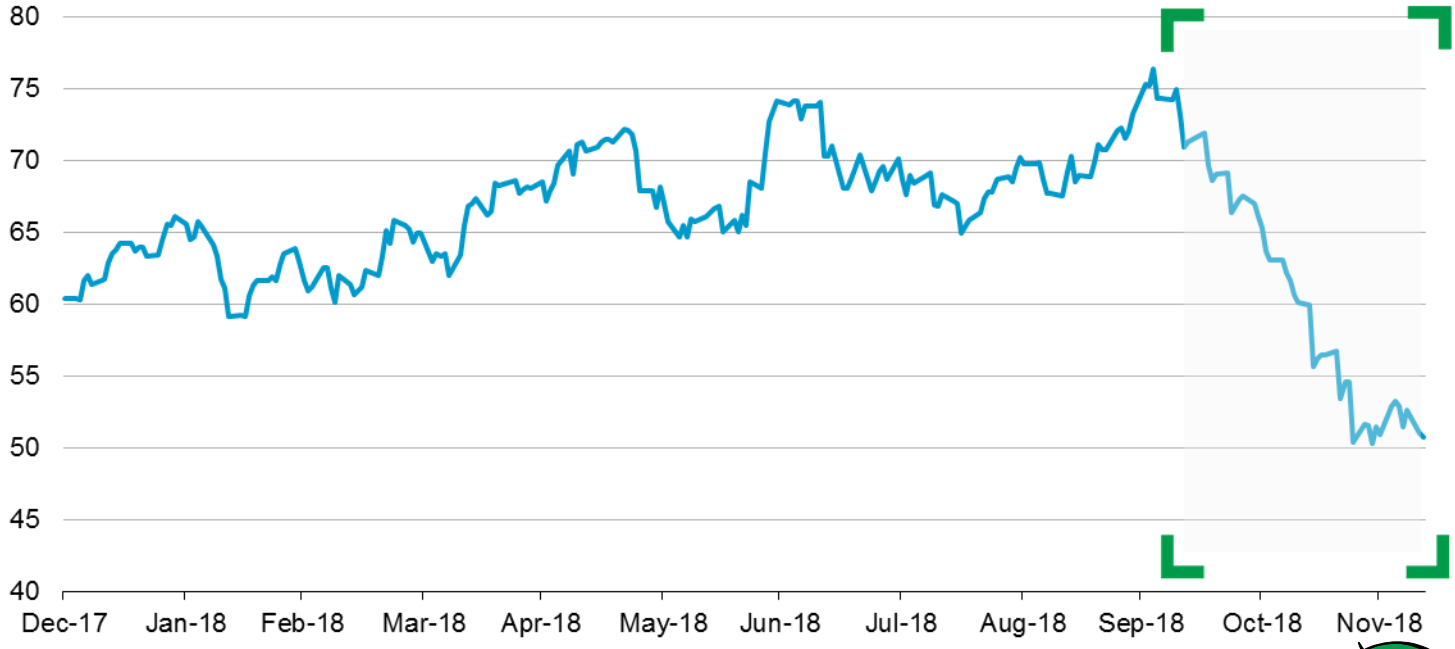
During November, we reintroduced US energy stocks into the some of the higher risk funds, as they have underperformed their normal relationship with the oil price. Additionally we expect oil price risks are more skewed to the upside after a sharp fall during November. While we increased GBP exposure and decreased Gilts in funds to reflect our view on Brexit implications (more detail on this below).

RECENT PORTFOLIO CHANGES

↑ US ENERGY

↓ UK GOVERNMENT BONDS

CHART OF THE MONTH – OIL DOWN TO NEAR $50 PER BARREL



Source: LGIM, Bloomberg chart shows WTI Crude price per barrel

Legal & General INVESTMENT MANAGEMENT

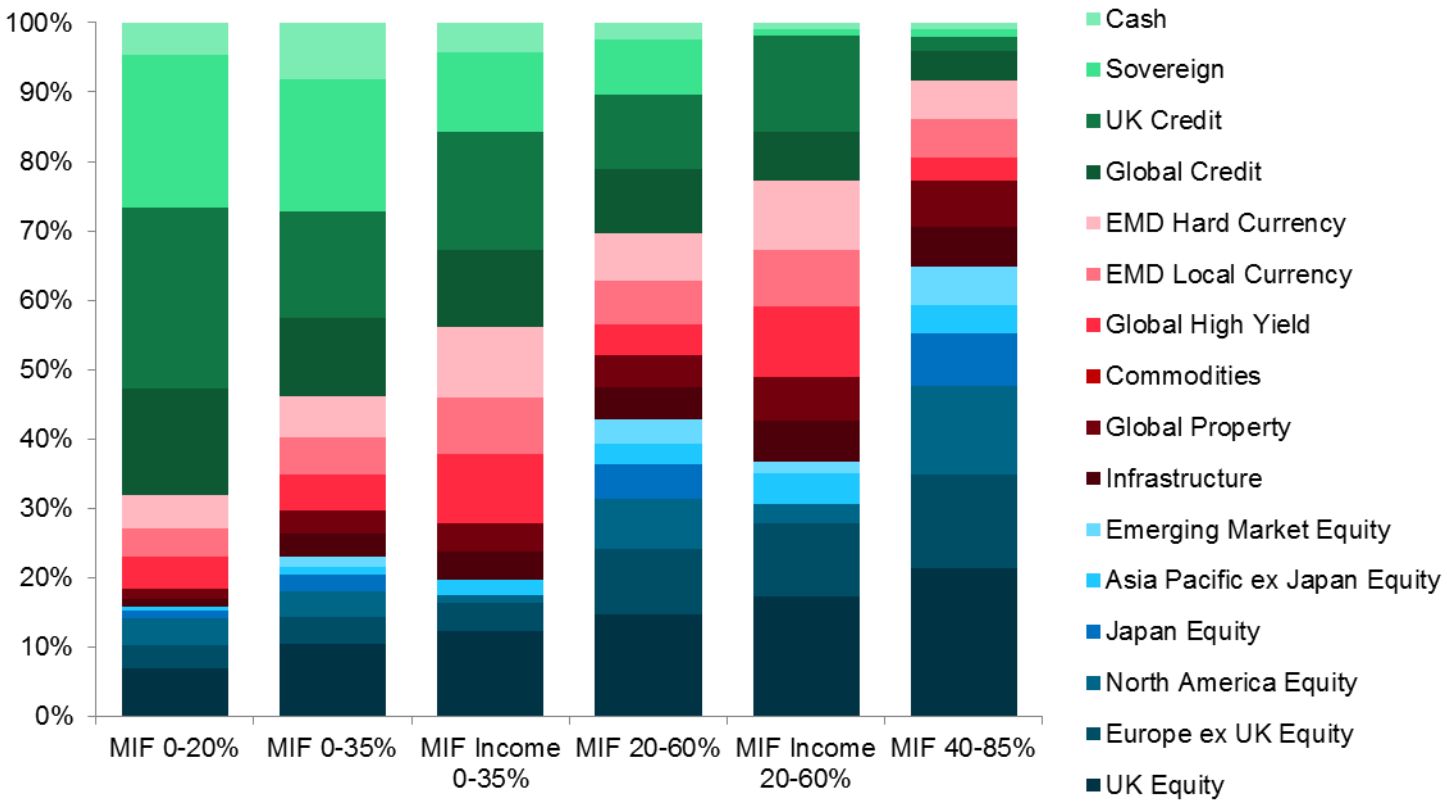
MARKET OUTLOOK

The recent volatility experienced by stock markets is consistent with the 'bumpy journey' our Chief Investment Officer Anton Eser identified in his last outlook*, which anticipated that the removal of central bank largesse would stoke market volatility. But it's difficult to identify a single convincing catalyst for the recent weakness, despite a long list of culprits cited by market participants. One thing, in our opinion, that does ring true, is that the declines were at least helped by investors being overly optimistic on US equities. We had anticipated that this optimism would increase the risk that smaller catalysts would trigger more market corrections like the ones seen recently. We think ongoing volatility, rather than a sharp bull or bear market, is the likely regime for 2019 as well. Whilst investor confidence has undoubtedly been shaken, it is important try to look at the bigger picture and not get caught up in the day-to-day noise.

Lofty valuations in some markets have started to normalise; we feel that equities do not look expensive, especially when compared to other asset classes such as government bonds. Although the global economy looks to be in good shape, with a combination of solid growth and low recession risk, in 2019 we anticipate a slowdown in global growth, a rise in core inflation in developed countries and further interest rate hikes from the Federal Reserve. We retain our neutral view of equities in the funds, but will look to reduce exposure when we do see recession pressures building. We still have a negative view of corporate bonds, as they look expensive relative to other bonds, i.e. credit spreads do not appear attractive considering the risks. Lastly, given that we expected increased inflation, coupled with heightened protectionism (i.e. tariffs), which is also likely to be inflationary; we aim to protect the portfolios through taking more of our fixed income exposure via global inflation-linked bonds.

TARGET ASSET ALLOCATION (AS OF 30/11/2018)

Portfolio diversification is one of our key investment principles underpinning the LGIM Asset Allocation team's investment philosophy, and we believe having a well diversified portfolio is ever more important for managing risk during challenging markets, like those we have been experiencing this year. Below you can see the current asset allocation of the Mixed Investment Funds, illustrating how well diversified the range is. We not only target diversification across broad asset classes, but within each asset class we are well diversified globally. We have a healthy allocation to alternatives, in addition to actively managing currency exposure.



Source: LGIM