L&G Mixed Investment Funds

MONTH IN FOCUS

THE HEADLINES

- **The shutdown, the slowdown, the showdown…**
- **…prompted the Federal Reserve to make a U-turn…**
- **…and caused markets to have an upturn.**

MARKET OVERVIEW

January proved to be one of the strongest months for performance since the credit crisis, with asset prices rising across the board. Markets focused on corporate earnings beating expectations, a more dovish US Federal Reserve, the restarting of US-China trade talks and the oil price rally. They were largely unaffected by the partial US government shutdown and disappointing economic data from China signalling a slowdown and continued political showdowns in Europe. Both risk assets and rates were up over the month. REITs and US equities led the way and were up over 7% and 5% respectively (in sterling terms). In addition, emerging market equities and emerging market debt (hard currency) were also standout performers.

In terms of other risk assets; high yield bonds, listed infrastructure and commodities all had a positive month. Commodities received a boost, as oil performed strongly on the back of an improving supply and demand picture. Credit also delivered positive returns, as did gilts, bunds and US treasuries. Nor was this confined to nominal debt as inflation-linked bonds also performed over the month.

FUND PERFORMANCE REVIEW

All of the Mixed Investment Funds delivered a positive return in January, as markets rallied after the December lows. The higher-risk funds outperformed the lower-risk funds.

A significant part of the positive performance can be attributed to equities, with developed market equities improving its performance the most after last quarter. Investment grade credit was also a large positive contributor, especially in the lower-risk funds. However, there were no materially negative contributors to performance in January.

During January, the most significant change to the portfolio positioning was increasing UK equities across most of the funds, taking advantage of more attractive valuations after experiencing large falls in December. This was beneficial for fund performance in January.

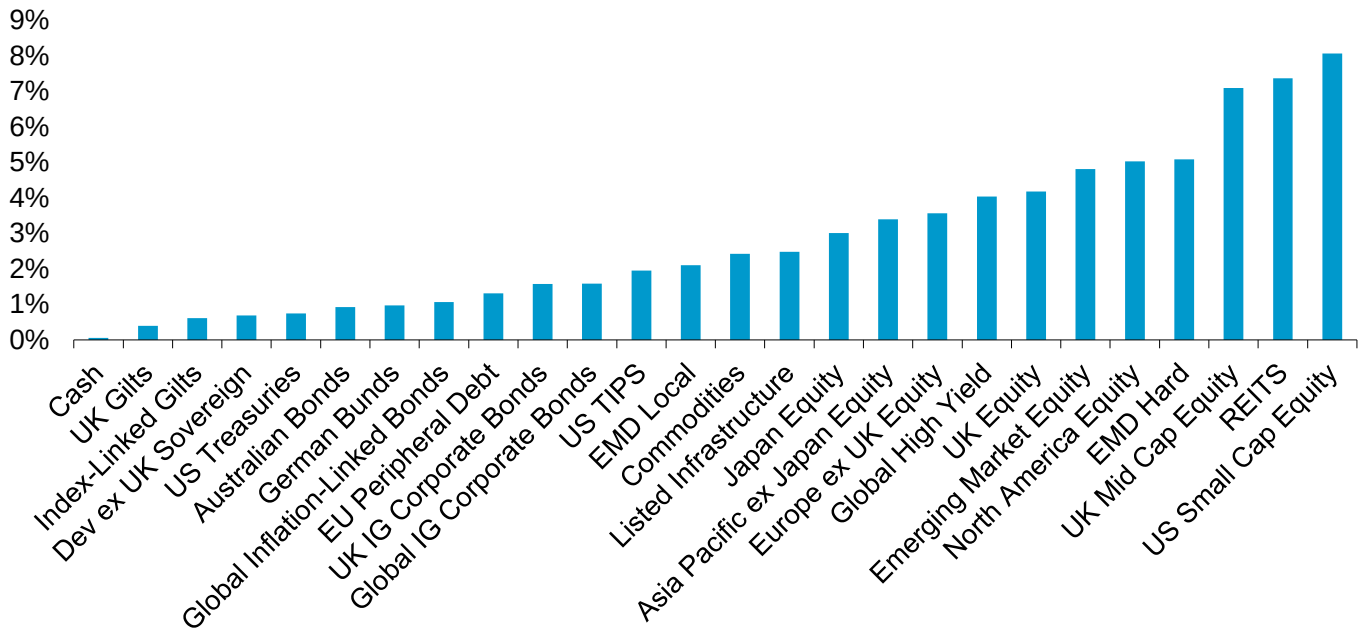
Meanwhile, we closed the European utilities position in the funds, after strong performance on an absolute and relative basis against European equities. Similarly, we closed the Australian sovereign bond position, partially replacing it with US treasuries.

RECENT PORTFOLIO CHANGES

↑ UK EQUITIES

↓ EUROPEAN UTILITIES, AUSTRALIAN SOVEREIGNS

CHART OF THE MONTH – SANTA CAME LATE THIS YEAR: JANUARY RETURNS



Source: LGIM, Bloomberg , showing asset class returns experienced by a GBP investor from 31/12/2018 – 31/01/2019.

Legal & General INVESTMENT MANAGEMENT

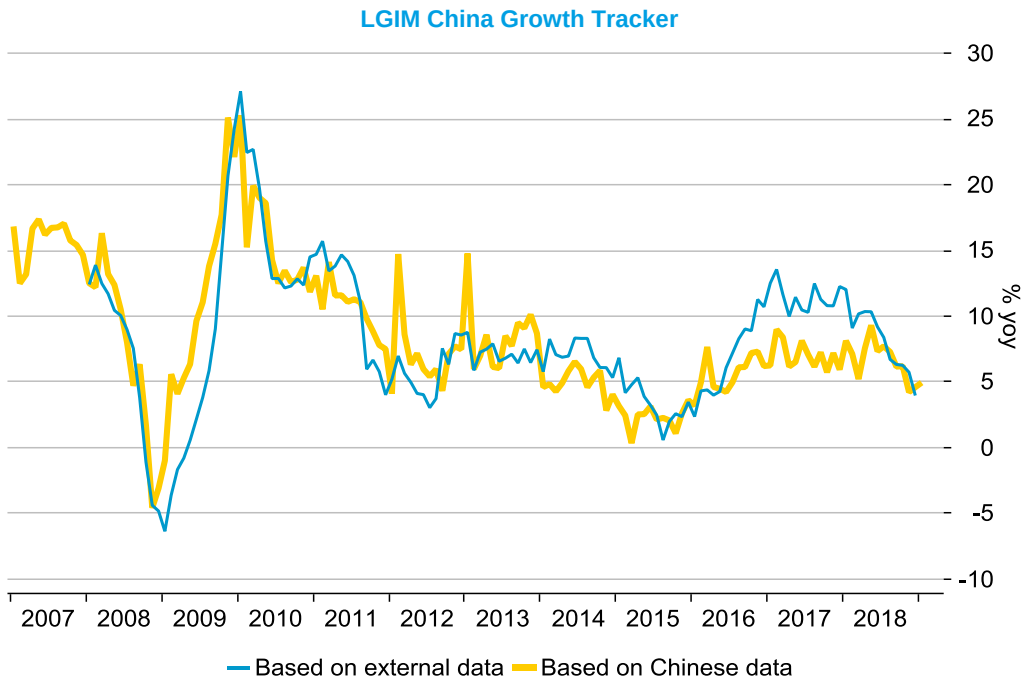
MARKET OUTLOOK

Our 2019 outlook[1] explains how we intend to balance caution with an appetite for growth. Our view is that US fundamentals remain solid, but also, we see this year as the start of the twilight zone between expansion and a downturn marking the end of the cycle. Our research suggests that equity bull markets tend to end with a bang and not a whimper, so de-risking a few months too early can be as problematic as a few months too late. However, those hoping for a return to tranquillity may be disappointed, and we believe this is an environment where a point forecast for equities at the end of the year is increasingly difficult to pin down. As such, at this stage we'll tend to lean against strong investor sentiment in either direction.

The recent dovish shift from the US Federal Reserve seems to have given equity markets the leg-up they needed, and in the broader setting it may mean we are further from the end of the economic cycle than we previously thought. In this context, we continue to hold our neutral position in risk assets, currently preferring European and Japanese to broad US stocks, while also favouring the technology and US energy sectors. We expect continued pressure on credit markets. However, consistent with our constructive outlook for emerging market fundamentals; emerging market debt (both hard and local currency) looks increasingly interesting.

One important concern is the potential for a persistent change in the relationship between equities and bonds. Bonds' shock-absorbing capacity could disappear when an inflationary mind-set takes hold. We also think we may continue to see pressure on the euro as Brexit negotiations go to the wire, and lacklustre growth appears to weaken further as Italy has tipped into recession.

WHEN WILL CHINA ACTIVITY BOTTOM?



Our proprietary growth trackers estimate Chinese growth by combining several indicators, for example the amount of imports into China, as reported by foreign trading partners and metal prices. The blue line shows the result using data sources that are external to China, while the yellow one uses Chinese data. We believe it is very important to look at these proprietary growth trackers, especially when analysing the Chinese economy. The official GDP data is notoriously unreliable, especially over shorter time periods. As you can see, the yellow line indicates that the Chinese economy has already bottomed out, and our emerging market economists believe that Chinese growth is close to bottoming out, due to several positive signals. For example, credit growth has already started to pick up, which is typically a leading indicator for economic growth. We think the authorities are happy with the shadow bank deleveraging and an increase in fiscal stimulus is on its way. Needless to say, China has become increasingly important for global investments, as the second largest economy in the world and a rising power against the US with on-going trade disputes. Hence why a sharp Chinese slowdown has been a key risk on our watch list for a while and one that we will continue to monitor closely.

Source: LGIM. [1] http://www.lgim.com/uk/ad/insights/our-thinking/market-insights/investing-in-the-twilight-zone.html