L&G Mixed Investment Funds

MONTH IN FOCUS

THE HEADLINES

- **Focus on potential for second waves of COVID-19**
- **…US dollar weakened significantly over the month…**
- **…gold reached new highs as US real yields plummeted**

MARKET OVERVIEW

July was another largely strong month for risk assets, with most asset classes generating positive returns. However, investor sentiment is not quite as favourable as it was in the previous two months with signs of a pickup in COVID-19 cases in several countries that previously appeared to have controlled the outbreak. In the US, we have seen hospitalisations growing in 80% of states and have started to see the number of deaths rising too.

US equities performed well again in July, returning 5.8% on a local currency basis. European ex-UK and Japanese equities returned -0.3% and -3.9%, respectively, over the month after an increase in COVID-19 cases saw an introduction of tougher social-distancing measures. UK equities fell 3.6%, in part weighed down by a stronger pound versus the dollar.

We saw global investment-grade credit and global high-yield credit return 2% and 3.3% respectively with the continuation of post-COVID spread tightening and yield compression inspired by sustained central bank and government intervention. Additionally, against a backdrop of improving European economic data and long-dated US yields falling to historic lows, we have continued to see a weak US dollar throughout July, also boosting gold prices to new highs.

FUND PERFORMANCE REVIEW

The Mixed Investment Funds' performance ranged from small positive to small negative returns in July as markets weighed up signs of second waves in COVID-19 virus infections. The funds with higher bond exposure fared better than funds with more equities, as some equity markets weakened in July.

In terms of positioning, our medium-term risk dial remained at neutral in July. In all funds, we reduced exposure to inflation-linked bonds given real yields are currently so low, and increased exposure to nominal US government bonds given the deteriorating economic trajectory could cause long-term yields to fall.

In all but the lowest-risk fund, we added a small position in South African government bonds, hedging the foreign currency exposure back to sterling. Given their particularly steep yield curve, there is potential to earn a premium above hedging costs. We also added a position in the European telecommunication sector, which appears relatively under-valued compared with broader European shares.

RECENT PORTFOLIO CHANGES

US GOVERNMENT BONDS, SOUTH AFRICAN GOVERNMENT BONDS, AUSTRALIAN GOVERNMENT BONDS, EUROPEAN TELECOMS

GLOBAL INFLATION LINKED BONDS, BROAD EUROPEAN EQUITIES

MARKET OUTLOOK

Since the end of March, risk assets have pulled back from the brink of collapse, as policymakers calmed down markets with stimulus measures and investors turned from pessimists to optimists.

We remain concerned about the risk of second waves of COVID-19 and that the development and roll-out of a vaccine is still a fair way off, although signs are promising. Over the next six months, we may see mounting evidence of 'economic scarring', due to corporate defaults, layoffs and cuts to capital expenditure. Real evidence of progress on a vaccine could mean markets look through this and prompt further gains in risk assets, though. At the present juncture, our overall strategy remains broadly neutral after considering both of these risks. We continue to track global progress on the virus, and its impact on economic activity, to inform our scenario-based risk analysis.

In terms of duration, over the medium term, we still believe we're in a lower-for-longer environment, but do expect yields to rise modestly as the world returns closer to 'normality'. We expect central banks to keep a lid on yields as they seek to prop up economies. We maintain our neutral medium-term view on investment grade-credit after central-bank support has seen significant spread tightening, meaning we have moved back to more normal valuations. This follows our positive view on the asset class in the immediate months after the end of the March market turmoil.

Legal & General
INVESTMENT MANAGEMENT