L&G Mixed Investment Funds

MONTH IN FOCUS

THE HEADLINES

- **Bond yields spike as investors bring growth expectations forwards…**
- **…Former President of the European Central Bank, Mario Draghi, appointed Prime Minister of Italy…**
- **…Previous losers from the pandemic (e.g. travel & leisure stocks) outperform previous winners (e.g. tech).**

MARKET OVERVIEW

In February, markets began to price in the effects of a stronger than expected economic recovery. This led to a rise in bond yields as investors brought forwards their expectations for central-bank interest-rate increases. In Europe, Mario Draghi was appointed Prime Minister of Italy and will be looking to lead the nation through the pandemic and unify its politics. In the US, negotiations over Joe Biden's proposed $1.9 trillion fiscal relief bill stalled, meaning it looks likely the bill will be approved through the reconciliation process.

Global equities continued to show strong performance over February as the COVID-19 vaccination rollout continued apace, before stocks were curtailed by concerns over sharp increases in bond yields towards the end of the month. US small-cap equities were once again a standout, boosted by the ever-increasing likelihood of a large US fiscal stimulus. UK large-cap equities were also positive over the month; however, they were bettered by UK mid-cap equities given the negative impact of a stronger pound on the foreign earnings of the larger multinationals. Sovereign bonds weakened significantly over the month as a result of the aforementioned rise in global bond yields. We saw a boost to commodity prices given the anticipated surge in consumer demand during the recovery.

FUND PERFORMANCE REVIEW

The Mixed Investment Funds' returns were mostly negative in February as we saw weakness across bond markets, with investors bringing forward global rate-rise expectations. The funds with more exposure to bonds fared worse than the funds with more equity exposure.

Over the month, we increased exposure to UK government bonds, again across all funds, off the back of an increase in yields. This followed comments from the Bank of England's Monetary Policy Committee, which reduced the likelihood of negative interest rates and – if anything – slightly brought forward expectations for rate rises.

This revelation also saw us increase our conviction in our 'UK pound sterling versus euro' trade, in the higher-risk funds.

RECENT PORTFOLIO CHANGES

↑ UK BONDS, STERLING

↓ EURO

MARKET OUTLOOK

We believe we are in the early stages of the economic cycle, coming out of a deep recession. This has historically been the most supportive time in the economic cycle for risk assets, and is therefore the main driver for our positive medium-term view on risk assets – equities in particular, which we favour over credit. There is continued positive news flow on the rollout of COVID-19 vaccines, with the US and UK vaccinating a significant proportion of their populations and the EU picking up steam. Hospitalisations and deaths have fallen sharply and are expected to fall to very low levels despite some new cases in younger unvaccinated cohorts.

We now expect the US to pass a further $1.9 trillion fiscal relief bill. This, in addition to the continued ample support from monetary stimulus, should boost the recovery. Forecasters' attention will now turn to the months ahead and to the question of just how strong the recovery will be. Due to the year-on-year nature of inflation measures, we expect a pickup in the coming weeks as a result of the drop in consumer demand last spring. We also expect a potential boost as a result of supply constraints in a rapid reopening scenario. Policymakers should be able to look through this, but we will remain on the lookout for signs of overheating which could prompt rate rises.

From a virus perspective, our main worry is the emergence of a mutation for which existing vaccines are ineffective. Any recalibration of vaccines (including production and distribution) is expected to take six months and would delay the full reopening of economies. In geopolitics, we remain concerned about the tensions associated with the rise of China; however, the new US administration promises a welcome return to a rules-based foreign policy and a different tone from the previous administration. In Europe, we believe the EU's Recovery Fund is the long-awaited first step in the direction of a fiscal union.

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INVESTMENT MANAGEMENT

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