LGIM Asset Allocation Views.

The calm after the storm

Following the chaotic post-Brexit fallout, markets regained their poise in July. Investors weighed up the various scenarios for each asset class once the panic subsided and started to pick winners and losers in the UK, with the result being that most markets progressed nicely. With Brexit out of the way, global investor attention turned once again to central bank rumours, speculation, action and lack of it. A stronger dollar and lower oil prices failed to hold back markets as risk assets moved higher throughout the month. Markets see no reason yet to doubt a goldilocks scenario with reasonable growth, ok earnings and accommodative central banks boosting valuations of risk assets to further elevated levels.

RISKS

- Increase in political risks across most Western countries (Brexit, Trump, Italian referendum)
- Global debt a concern in the medium term (notably in emerging markets)
- Difficulties in normalising monetary policy

OPPORTUNITIES

- Investor nervousness and volatility may present recurrent opportunity to add risk at attractive levels
- Asset purchases by central banks to keep asset prices supported for an extended period

Overview	Views
Equities	◆
Govt. bonds	◆
Credit	◆
Real estate	◆
Commodities	◆

Equities	Views
US	◆
UK	◆
Europe	◆
Japan	◆
Emerging markets	◆

Fixed Income	Views
Nominal govt. bonds	◆
Inflation-linked	◆
Investment grade	◆
High yield	◆
Emerging market debt	◆

Outlook

In the eye of the storm
We believe the tranquillity in markets will prove to be temporary. The relief over the UK's swift transfer of power to strong leadership is likely to fade and markets could refocus on risks to the Chinese economy, Italian banks, the strong US dollar and the potential for a Trump presidency. These risks combine to support our decision to maintain our underweight to risk assets.

The Game of Yields stampedes to emerging market debt
Yields ground lower almost everywhere over the month, with a decent chunk of high quality government bonds now offering negative yields. This has strengthened the flow into hard currency emerging market debt, benefiting our long position there. But is it now too expensive? We don't yet think valuations are stretched, nor have credit risks increased. For now, we are sticking with the position.

Complacency over Chinese currency risk offers opportunities
Chinese currency weakness has largely gone unnoticed during the Brexit bust-up as official data readings seem to be suggesting that China has capital flight under control. We don't believe it. Outflows continue, obscured by technical currency flows out of state banks and the authorities ceasing to publish banks' currency positions. If we account for these hidden flows, Chinese reserves would be lower by $200bn. We think the risks to the Chinese currency are heavily under-priced, leading us to being long the US dollar versus the yuan and proxies such as the Korean won and the Singaporean and Australian dollars.

Tables reflect tactical views at time of publication.
Medium-term views/biases may be different.

Legal & General INVESTMENT MANAGEMENT

CONTACT US

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IMPORTANT INFORMATION