

LGIM Asset Allocation Views.

Markets entered the year with a fresh bout of volatility, sparked once again by concerns around the Chinese currency, emerging market outflows, default rates in US high yield markets and the perceived slowing of global economic growth. Falling oil prices continue to put pressure on energy company equities and corporate bonds, while the divergence in interest rate policy between the US and other major economies saw the US dollar strengthen. In this complex environment, hints of further easing by the European Central Bank, soothing statements from the Fed and a surprise rate cut to negative rates by the Bank of Japan, helped to stem the losses towards the end of the month. The 'risk off' environment saw government bonds bounce strongly to erase their December losses.



RISKS

- Increase in risks, particularly in emerging markets and China
- Global debt remains a concern in medium term
- Normalising monetary policy could prove disruptive

OPPORTUNITIES

- Investor nervousness and volatility may present opportunities to add risk at attractive levels
- Oil price declines driven by oversupply may present opportunities to add risk on the back of overly bearish market concerns
- A weakening of the pound in anticipation of "Brexit" fever building

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

Rebalancing equities, remaining overweight

We took advantage of volatility in January to increase our equity position, which brings our portfolios in line with our positive medium-term view. Our base case for remaining overweight in equities in the medium term remains unchanged, although we clearly need to remain on high alert (as always) for emerging signs of an end-of-cycle dynamic. With turmoil in corporate bond markets, we will be watching for any sign that banks are set to withdraw credit from the market, which could be a key litmus test for understanding whether a material weakening in the economy lies around the corner.

Sun not yet rising on the yen

Following the surprise move by the Bank of Japan (BoJ) to cut interest rates, we've tweaked our exposure to the Japanese yen. We feel that our base case in favour of Japanese equities in the near term remains, but we have been cautious of the yen. This has led us to scale back some of our short yen exposure and hedges. This move by the BoJ has put more pressure on global yields directly as Japanese investors are incentivised to look overseas for positive-yielding bonds, and indirectly as other markets are forced to consider their plausibility.

Struggling to take off

The US economy is definitely not firing on all cylinders, but neither is it obviously rolling over. While acute weakness in the energy sector has spilt over into manufacturing, it accounts for less than 10% of US employment; instead the service sector is much more important. Service sector growth has been sustained by strong household real income growth and we look for this to continue.

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

CONTACT US

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IMPORTANT INFORMATION

Legal & General Investment Management Limited (Company Number: 02091894) is registered in England and Wales and has its registered office at One Coleman Street, London, EC2R 5AA ("LGIM").

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