L&G Mixed Investment Funds

MONTH IN FOCUS

THE HEADLINES

• US CPI inflation print the highest since 1990…
•…Omicron COVID-19 variant emerges and looks set to become the dominant variant…
•…Equities and energy assets struggle as new variant threatens reopening progress

MARKET OVERVIEW

Markets experienced volatility as we entered the final months of the year, with the return of concerns over COVID-19 as a result of the new Omicron variant, which led to enhanced social-distancing measures in certain countries and talks of renewed lockdowns.

Earlier in November, it was announced that year-on-year inflation in the US hit 6.2% the previous month, the highest since 1990. The increasing and broadening inflation around the world prompted market fears over potentially faster and higher rate rises by central banks than previously believed, only to be stifled by the new COVID-19 variant and its associated potential economic consequences.

Developed-market equities in local currency were generally negative given concerns over the Omicron variant, though US equities fared best as they were boosted by a surge in large tech stocks and other 'stay at home' names in the S&P 500 index.

Developed-market government bonds generally saw positive returns despite surging inflation, as virus concerns led investors to these perceived safe-haven assets. UK inflation-linked government bonds also had a good month of returns after the country's inflation print rose to 4.2% year-on-year, the highest since November 2011.

FUND PERFORMANCE REVIEW

The Mixed Investment Funds' performance was mostly negative in November. The funds with more exposure to bonds fared better than the funds with more equity exposure, given falling bond yields over the month.

We have been tactically managing our exposure to South African bonds given their recent volatility. We took the opportunity to take profits at the beginning of the month after strong performance. However, following a spike in yields and a rate hike, we once again see the level and steepness of South Africa's yield as attractive and have added them back into the portfolios.

We have removed our relatively small exposure to European telecommunication stocks across all funds. We had initially increased our allocation relative to broad European stocks since they had significantly underperformed going into the pandemic and had not recovered in the early months after the spring 2020 selloff. We expected structural forces such as increased pricing pressure to benefit the sector, but the investment case has not played out. Recently they have benefitted from some of the merger news in sector, so we saw this as a good time to close the position.

RECENT PORTFOLIO CHANGES

SOUTH AFRICAN BONDS

EUROPEAN TELECOMMUNICATION STOCKS, CASH

MARKET OUTLOOK

We remain positive on risk assets in the medium term, but retain a degree of caution. We still prefer equities to credit given current historically low credit spreads. However, given the lack of clarity over where we are in the economic cycle due to the unique nature of the pandemic, we have reduced our view on the economic cycle half a notch to marginally positive to express this higher level of uncertainty. Despite this, we want to maintain a slightly positive overall view on risk assets as we believe growth will remain above trend into the first half of 2022.

The latest COVID-19 news has made an already challenging forecasting environment even more difficult. We remain humble in our ability to predict the virus's path, but our base case is another bump in the road on a gradual and erratic path towards the world learning to live with the disease.

At the same time, inflation has come in even stronger than our above-consensus views. The latest virus developments have the potential to prolong the supply disruptions which were already proving more persistent than expected – a true dilemma for central banks. When this latest virus wave eventually passes, we continue to worry that central banks (especially the US Federal Reserve) will need to tighten policy faster and further to slow demand and control inflation in the medium term.

We will continue to look to buy the dip and increase our allocation to risk assets, but given some of the latest news flow on the virus and inflation, we will do so more cautiously than before.

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INVESTMENT MANAGEMENT

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