L&G Mixed Investment Funds

MONTH IN FOCUS

THE HEADLINES

- **In one of the broker surveys which we look at, fears over new COVID-19 variants overtook inflation worries as the largest risk to markets in July…**
- **…limited market reaction to another strong US inflation print…**
- **…more than three billion COVID-19 vaccines now administered globally.**

MARKET OVERVIEW

The second half of the year began with a reasonably strong start for markets, with most asset classes in positive territory during July. The month saw China's stock market rocked by government intervention in both the tech sector and the after-school tutoring industry in the space of a few weeks. We also saw the Delta variant of the COVID-19 virus continue to spread around the world, particularly affecting countries with lower vaccination rates. Meanwhile, there was another large increase in US inflation over the month.

Emerging-market equities in local-currency terms were the weakest performers over the month, with the spill-over from the fall in the Chinese stock market and the spread of the Delta variant affecting the wider East Asia region. Generally, developed-market equities continued to grind higher over the month. In fixed income, index-linked gilts had a very strong month amid rising inflation expectations and a willingness from the Bank of England to adopt a cautious approach to rolling back monetary support. Developed-market government bonds more widely performed well, with market participants extending their expectations for interest-rate hikes. Elsewhere, mid-risk assets such as global high-yield bonds and global real estate investment trusts (REITs) produced mildly positive to fairly strong returns.

FUND PERFORMANCE REVIEW

The Mixed Investment Funds experienced positive returns in July. The funds with more exposure to bonds fared slightly better than the funds with more equity exposure, given the supportive performance from fixed-income assets.

We reduced exposure to Australian government bonds in most of the funds. The recent Delta-driven lockdowns in Sydney and Melbourne undermine the idea that the country could return rapidly to normal without extensive vaccinations. Australian bonds outperformed other markets as a result, so in our view no longer offered compelling value.

In currencies, we reduced our exposure to UK sterling while increasing exposure to the euro in the higher-risk funds, reversing a position which we had held for almost a year. We have seen sterling appreciate against the euro over the period and, given the planned roll-off of support measures in the UK, we are now more cautious on the nation's currency.

RECENT PORTFOLIO CHANGES

EURO, CASH

AUSTRALIAN BONDS, POUND STERLING

MARKET OUTLOOK

We expect the economic recovery to continue, with the near-term range of outcomes narrowing as the vaccine rollout continues apace worldwide. We expect to see equity markets grind higher but, given the risks associated with the spread of the Delta variant in China, we moved our view on risk down half a notch to marginally positive (in early August).

While developed markets, led by the US, are at the forefront of the rebound, we believe emerging markets' macro fundamentals remain solid, despite the waves of COVID-19. However, countries that are major tourist destinations are likely to remain relative losers due to ongoing border restrictions. And even though headline inflation, boosted by commodity prices and supply bottlenecks, remains elevated, we see little impact on our growth forecasts at current levels and expect inflationary pressures to be transitory.

Against this backdrop, we expect the US Federal Reserve to begin tapering its asset purchases by the year's end.

We continue to monitor:
- The UK's reopening as a possible blueprint for other countries;
- The potential for a more sustained economic boom from pent-up savings;
- The danger of new, vaccine-resistant COVID-19 strains;
- The next round of US fiscal stimulus, in particular its timing and revenue-raising components.

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