L&G Mixed Investment Funds

MONTH IN FOCUS

THE HEADLINES

- **US tech market shows signs of stress as investors continue to rotate into "reopening stocks"…**
- **…US dollar weakens…**
- **…large losses experienced in cryptocurrencies – no relevance to our portfolios, but interesting all the same.**

MARKET OVERVIEW

May was a reasonably strong month for most risk assets in local currency terms; however, a weak US dollar will have eaten into the returns of non-US investors' unhedged exposures. In the US, inflation readings came in higher than the already elevated expectations. This followed a US nonfarm payrolls data print which was far below market expectations. These developments left investors perplexed as they are contradicting signals for growth and inflation. At least in part as a result, there was much volatility in equity and bond markets over the month. For instance, May was another difficult month for US tech, with a 10% correction at one stage for the NASDAQ index versus the S&P 500 index since its peak in early February, its biggest relative fall of the past decade.

Japanese and Europe ex-UK equities gained in May, with Europe stepping up the pace of vaccinations and Japanese equities unwinding some previous weak performance. Inflation-linked assets also experienced strong returns in May. UK index-linked bonds led the way, and US Treasury inflation-protected securities (TIPS) also performed well. This was likely due to the aforementioned inflation data. Perhaps surprisingly, nominal government bond prices also crept higher in May, suggesting that investors are already positioned for a potential rise in nominal yields.

FUND PERFORMANCE REVIEW

The Mixed Investment Funds experienced positive returns in May. The funds with more exposure to equities fared better than the funds with more bond exposure, as economies continuing to reopen was a key driver of strong equity returns.

We rebalanced our allocation to artificial intelligence stocks after witnessing the recent selloff in the sector versus the broad US market. We understand the main reason for the selloff to be investors rotating into previously unloved sectors such as financials and automobiles as the economic recovery progresses. However, we believe the selloff was somewhat excessive. The earnings outlook is still strong for tech, and if anything has strengthened recently, so we have taken the opportunity to add exposure.

We increased our exposure to Japanese equities in some of the higher-risk funds while reducing exposure to US and European (ex-UK) equities. We already had a favourable view on Japanese equities on a medium-term basis, and our conviction has increased in the short term after some recent market weakness.

RECENT PORTFOLIO CHANGES

JAPANESE EQUITIES, ARTIFICIAL INTELLIGENCE STOCKS

US BONDS, EUROPEAN & US EQUITIES, CASH

MARKET OUTLOOK

We believe that we have now moved from the early to the mid stage of the economic cycle. This is far quicker than a typical cycle and can be put down to the unconventional nature of the pandemic-induced recession. However, we maintain our slightly positive medium-term view on overall risk, while updating our subcomponent views, as set out below.

Mid-cycle is not as supportive for risk assets as early cycle, which in our view warrants a downgrade to our economic view. Nevertheless, monetary and fiscal policy are expected to remain supportive for now and we continue to expect rapid growth over the next 12 months. We have therefore only downgraded our economic view one notch, from positive to slightly positive.

We believe equity valuations are slightly elevated on an absolute basis, particularly in the US, but relative to bonds, equities still appear reasonable. We also expect earnings to beat expectations over the coming months, which should be supportive. We therefore maintain our neutral view on valuations.

When it comes to systemic risk (where we consider political and credit risk), tensions between superpowers are still present, but we do not see as immediate a risk of tit-for-tat tariff measures between the US and China flaring as previously. Additionally, each of the three major economic blocs (the EU, US and China) have shown impressive institutional resilience in the past year. We have therefore upgraded our risk view from slightly negative to neutral.

We will continue to update you as our outlook evolves with the changing investment landscape.

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INVESTMENT MANAGEMENT

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