L&G Multi-Index Income Funds

MONTH IN FOCUS

THE HEADLINES

- **The new year brought new highs in equities…**
- **… new lows in the US dollar…**
- **… and a new face in Davos.**

MARKET OVERVIEW

While January typically marks new beginnings, markets rejected New Year's resolutions in favour of their old habits of 2017. Strong sentiment and confidence in global growth continued to support risk assets. US equities completed an impressive run of 15 consecutive positive monthly returns driven by cyclical sectors, including information technology (see Chart of the Month).

Bond yields increased, but there was sufficient faith in 'Goldilocks' that the weakness in fixed income did not affect broader equity markets. The only two laggards were European and UK equities, with the latter facing headwinds from the stronger domestic currency and its more defensive sector exposure. Investors shunned 'defensive' sectors, with consumer discretionary, technology and financials leading the charge higher. Global REITs and infrastructure declined on a hedged basis.

While investment grade credit spreads continued to fall, softening the impact of higher yields, US dollar weakened against both the pound and the euro. Markets seem to hold onto the belief that strong global growth might signal the end of quantitative easing or very low rate environment in Europe and that may more than offset the prospect of further rate hikes in the US.
January also saw US President Trump visiting the World Economic Forum in Davos for the very first time. Although not a market-moving event in itself, his 'America First is not America Alone' speech brought back to the surface growing concerns about the rise of protectionism, which could harm global trade in the future.

FUND PERFORMANCE REVIEW

January saw negative performance of c. 50-70 basis points across the three funds. This was partly due to negative performance in some fixed income assets affected by the rising bond yields across the developed world. Our holdings in UK credit, global credit and global linkers all detracted from the overall fund performance. Australian bonds and emerging market debt were largely flat.

Within equities, our position in UK equities was the main detractor, but this was somewhat offset by good performance in emerging market and European equities.

January saw mixed performance among alternative assets. It was another positive month for a direct UK property, but global REITs and our infrastructure proxies were held back, partly due to their higher sensitivity to rising interest rates.

Pound sterling strengthened in January and we used that opportunity once again to trim our exposure in line with our long-term strategic target.

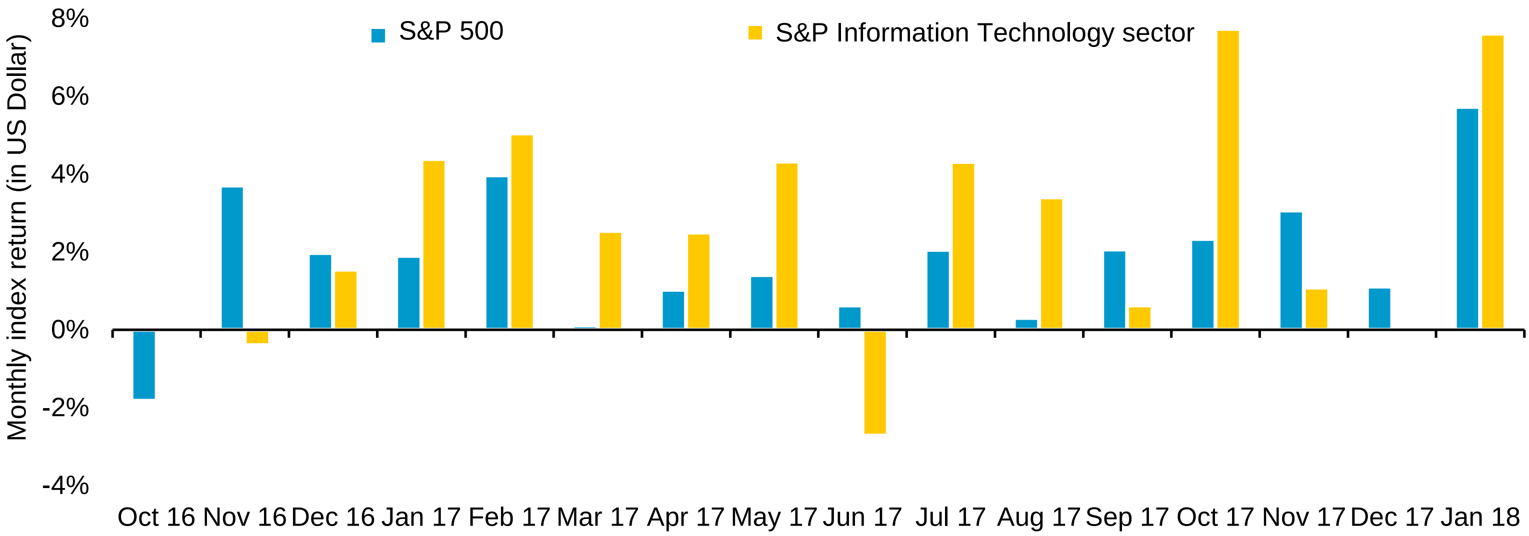
As spreads on our direct bonds narrowed, we took the opportunity to sell our holding in Croatian and Turkish euro-denominated bonds in favour of the broad index of hard currency emerging market debt.

RECENT PORTFOLIO CHANGES

EMERGING MARKET HARD CURRENCY BOND INDEX

CROATIA AND TURKEY BONDS (EUR)

CHART OF THE MONTH – S&P 500 HAS A (BULL) RUN OF ITS LIFE, WITH US TECHNOLOGY STOCKS SOARING ABOVE



Source: LGIM

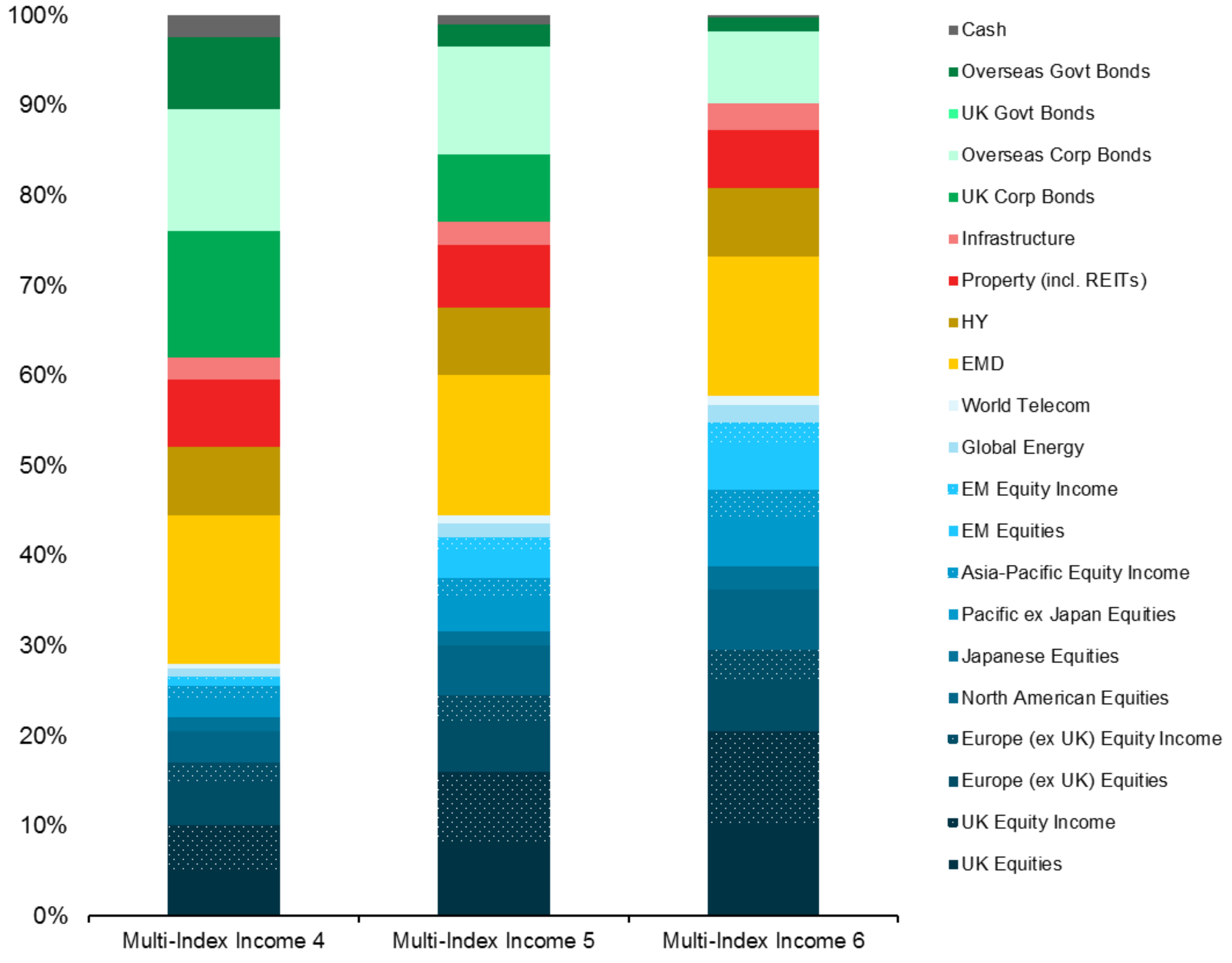
Legal & General INVESTMENT MANAGEMENT

MARKET OUTLOOK

The pace of equity market gains has come as a bit of a surprise in January, continuing a long positive streak for equities thanks to a synchronised economic recovery but only subdued inflation. While this is consistent with mid-economic cycle dynamics, rising inflation would start to push us towards late cycle. While our economists do not see a recession as imminent, we remain vigilant as we inch closer. The economic scenario playing out is one of lower unemployment, President's Trump's tax plan and protectionism collectively stoking inflationary pressures, while global growth remains strong. The recent US Employment Report supported the case that inflation could be heading higher.

While there is little visibility on what would be the next catalyst for a large asset price correction, we remain prudent in our investment strategy. If markets and economic data progress as we expect, we will gradually reduce equity exposure as we go deeper into 2018; but if inflation stays subdued and other risks do not build up, we will be more inclined to stay closer to neutral positioning. In addition, we hold some specific hedges in the portfolio, namely a larger allocation to the US dollar as well as US inflation linked bonds amongst our diversified fixed income assets.

TARGET ASSET ALLOCATION (AS OF 31/01/2018)



Source: LGIM

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