

Politics continues to be a threat for the euro as we head into 2019, with Brexit negotiations going to the wire, and the risk that the confrontation between the Italian government and the European Commission heads into the 11th hour.

One important twilight concern is the potential for a persistent change in the relationship between equities and bonds. In principle, the shock-absorbing capacity of bonds could disappear as an inflationary mindset takes hold. Instead of reducing portfolio risk, bonds could move with equities and exacerbate the problem. There's limited evidence of this so far, but it's a key risk to monitor in order to avert darkness descending upon multi-asset funds.

We expect the pressure on credit markets to continue. The large weight of relatively low quality issuers are vulnerable as uncertainty over future cashflows builds. However, the significant repricing seen in 2018 now provides a more sensible cushion against deteriorating fundamentals. Consistent with our constructive outlook for emerging market fundamentals, emerging market debt (both hard and local currency) looks increasingly interesting as we approach the end of the US tightening cycle.

Watch out for: Italy. It's the cheapest BBB rated sovereign credit, but has the greatest chance of creating a systemic crisis

Left-field risks: An unprecedented cyber-attack with possible geopolitical consequences

The key dynamic in late cycle is that changes in investors' recession probabilities become more likely. That can be very negative if short-term concerns about proximity to the cliff-edge spike higher. But anything which pushes out expectations for the next recession beyond 2020 would be a hugely positive market catalyst.

Twilight is *typically* the precursor to darkness, but not always. During a Scottish summer, for example, dusk runs straight into dawn the next day. The key to thriving in the twilight zone is to watch out for stumbling blocks and try not to jump at shadows. Both will be important in 2019.

[Click to subscribe to the latest multi-asset views from the Asset Allocation team.](#)



Important Notice

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").

LGIM is authorised and regulated by the Financial Conduct Authority. The value of investments and any income from them may fall as well as rise and investors may get back less than they invest. Past performance is not a guide to future returns

This document is designed for our corporate clients and for the use of professional advisers and agents of Legal & General. The views expressed within this document are those of Legal & General Investment Management, who may or may not have acted upon them. The information contained in this brochure is not intended to be, nor should be construed as investment advice nor deemed suitable to meet the needs of the investor. Nothing contained herein constitutes investment, legal, tax or other advice nor is it to be solely relied on in making an investment or other decision. This document, and any information it contains, has been produced for use by professional investors and their advisors only. It should not be distributed without the permission of Legal & General Investment Management Limited. This document may not be used for the purposes of an offer or solicitation to anyone in any jurisdiction in which such offer or solicitation is not authorised or to any person to whom it is unlawful to make such offer or solicitation.

As required under applicable laws Legal & General will record all telephone and electronic communications and conversations with you that result or may result in the undertaking of transactions in financial instruments on your behalf. Such records will be kept for a period of five years (or up to seven years upon request from the Financial Conduct Authority (or such successor from time to time)) and will be provided to you upon request.