



Legal & General Distribution Funds – a market outlook for 2009

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The Distribution Funds range:

- Life Distribution Fund
- Life Distribution (Growth) Fund
- Life Distribution (Rising Income) Fund
- International Distribution Fund
- Pension Distribution Fund
- Distribution Trust

Our view of the economy

It is going to be an interesting and challenging year as rising investor risk appetite is buffeted by a steep decline in economic momentum. We do not expect any relief from a tide of bad news from the economy as a whole and companies individually, until the third quarter. Fourth quarter 2008 was a shocker in terms of economic activity and it was no surprise to see governments resort to extraordinary measures. As the year plays out we feel household disposable income will rise strongly. Zero interest rates and falling inflation of energy prices will enrich consumers. The flies in the ointment are obviously rising unemployment and job insecurity as well as falling asset prices.

At the heart of the problem remains the critical issue of bank solvency. The taxpayers are now shouldering the burden of restoring confidence in the financial system. As bank capital takes an increasing strain from the downturn, governments will have to increasingly step in. The market capitalisation of banks continues to shrink, having a negative impact on market returns generally. This is no comfort to holders of shares in banks, as nationalisation is a total wipeout.

In the credit markets the ice is melting for some borrowers, if not all. Investment grade credit spreads are tightening for larger, better quality borrowers. Issuers are rushing to the market, as although spreads are wide, absolute rates are competitive. Investor demand is extremely strong for the right name. However, not all are equally loved. The cyclical borrowers are unloved. There is no quick fix for many of the damaged balance sheets.

The pain of the credit crunch is being socialised. The taxpayer is prefunding the re-inflation of the economy. The short-term effect is most acute in currency markets. The UK has benefited from the fall in the value of Sterling. One of the main supports for the FTSE 100 Index is the proportion of foreign earnings against Sterling costs for a huge swathe of companies in the index. Away from that, the distinction between sovereign and corporate credit risk is blurring. We see the extremely low interest rates of governments threatened by direct supply and the guarantees handed out seemingly at the drop of a hat by politicians groping for solutions.

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Our asset allocation strategy

Our allocation strategy strongly favours corporate bonds over company shares and property. We have had strong short-term performance from our credit positions at last. We hold these for relative valuation as well as income purposes, as we are concerned about the dividend prospects in the second half of the year. We are quietly confident that the oil majors and HSBC will distribute in the first half but are less confident of the future, given the current oil price and capital issues. We see the second half of the year as offering better returns from the equity market as a recovery is priced in. Our year end target for the FTSE 100 Index is 4,800 – a gain of 8% year on year which is a strong rally albeit from lower levels.

We are reducing exposure to Sterling based assets and investing in our absolute return fund, as well as UK equities (especially FTSE 100 stocks). We are long in credit, underweight in property and running adequate cash. Overall, we hope for strong single digit returns in 2009.

Past performance is not a guide to future performance. The value of investments and any income from them is not guaranteed and will fluctuate. Investors could get back less than they invest.

Investment in fixed rate securities with lower credit ratings may potentially have a greater risk of default with adverse consequences for the funds. Investment overseas involves exposure to currencies other than sterling and exchange rate variations can cause the overseas investments to increase or decrease.

The views expressed are those of Legal & General Investment Management Limited.

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Investment management of all funds is carried out by Legal & General Investment Management.

All the companies are authorised and regulated by the Financial Services Authority.

Investors should refer to the separate product literature for a full description of the risks and charges that affect the investment and the individual funds referred to.

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Q22002 01/09 H99003

