



M&G Episode Growth Fund

a sub-fund of M&G Investment Funds (4)

Annual Short Report October 2018
For the year ended 31 October 2018

The Authorised Corporate Director (ACD) of M&G Investment Funds (4) presents its Annual Short Report for M&G Episode Growth Fund which contains a review of the fund's investment activities and investment performance during the period. The ACD's Annual Long Report and audited Financial Statements for M&G Investment Funds (4), incorporating all the sub-funds and a Glossary of terms is available free of charge either from our website at www.mandg.co.uk/reports or by calling M&G Customer Relations on 0800 390 390.

ACD

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(Authorised and regulated by the Financial Conduct Authority.
M&G Securities Limited is a member of the Investment Association
and of the Tax Incentivised Savings Association.)

Important information

On 28 September 2018 the Depositary changed from National Westminster Bank Plc to NatWest Trustee and Depositary Services Limited.

On 31 August 2018, the investment objectives, investment policies and investment approaches of the M&G Episode Growth Fund were amended.

Investment objective up to 30 August 2018

The fund's objective is to maximise total return (the combination of income and growth of capital).

Investment policy up to 30 August 2018

The fund manager adopts a flexible approach to the allocation of capital between asset classes in response to changes in economic conditions and the valuation of assets. Central to this approach is the identification of episodes, which are periods of time during which, in the fund manager's view, asset prices become over- or under-stated, relative to objective valuation measures, due to the emotional reaction of investors to events. These episodes can exist over both the short and medium term.

The fund invests in transferable securities, fixed income assets (including, but not limited to, corporate bonds and government and public securities), warrants, money market instruments, deposits, cash and near cash.

Exposure to these assets, and to property, may be gained via collective investment schemes and derivatives (including equity index futures, currency forwards, interest rate swaps and other liquid derivatives). The fund will invest a minimum of 50% in collective investment schemes. Derivatives may also be used for efficient portfolio management purposes.

Investment approach up to 30 August 2018

The fund managers believe the best approach for achieving the fund's objective lies in the flexible allocation of capital between asset classes, guided by a robust valuation framework. In particular, they seek to respond where asset prices move away from a reasonable sense of 'fair' value due to investors reacting emotionally to events. They believe such 'episodes' create opportunities because emotions should be less important than underlying fundamentals over the medium and long term.

The fund will typically invest 40-85% of its assets in company shares and 15-50% in fixed income securities (including cash). The fund can also invest up to 10% in other assets that can include indirect exposure to property and convertibles (fixed income investments that have the right to be converted into a predetermined number of company shares).

The fund managers will actively manage the fund's foreign currency exposure to seek to enhance returns with a minimum of 25% of the fund exposed to sterling and a minimum of 50% in developed market currencies. The fund's investment strategy may involve the use of financial instruments to take short positions, that is, positions that profit from a fall in the price of an asset.

Investment objective from 31 August 2018

The fund aims to deliver a higher total return (the combination of capital growth and income), net of the ongoing charge figure, than that of a composite index comprising two thirds global equities and one third global bonds*, over any five-year period.

* As measured by the MSCI ACWI and Bloomberg Barclays Global Aggregate Index respectively.

Investment policy from 31 August 2018

The fund is a multi-asset fund that invests across a range of asset classes, including equities, fixed income securities, convertibles, cash and near cash. Exposure to these assets may be gained either directly or indirectly via collective investment schemes or derivatives. The fund may also invest indirectly via collective investment schemes or derivatives in other asset classes such as property and gold.

The currency exposure of the fund will be actively managed, seeking to enhance returns, with a minimum of 25% of the fund exposed to sterling and a minimum of 50% in developed market currencies (including sterling).

Derivatives may be used for investment purposes, efficient portfolio management and hedging.

Investment approach from 31 August 2018

The fund managers have a flexible top-down approach to the allocation of capital between different types of assets in response to changes in economic conditions and asset values. This approach combines in-depth research to work out the value of assets over the medium to long term, with analysis of market reactions to events to identify investment opportunities. In particular, the managers seek to respond when asset prices move away from a reasonable sense of 'fair' long-term value due to market reactions to events.

The fund seeks to manage risk by investing globally across multiple asset classes, sectors, currencies and countries. The fund will typically invest 40-85% of its assets in equities and convertibles, 15-50% in fixed income securities and cash, and up to 10% in other assets. These allocations reflect the net exposure of the portfolio.

The fund will typically take investment positions at index or sector level, but it may also take positions in individual shares or bonds. The fund's investment strategy may involve the use of derivatives to take long or short positions.

Risk profile

The fund invests globally in a broad range of assets, including company shares (equities), fixed income securities (bonds), currencies and other assets such as property shares and convertible bonds. The fund is, therefore, subject to the price volatility of global financial and currency markets. Exposure to the different asset classes may be gained through the use of derivatives.

In association with the use of derivatives, including those instruments not traded through an exchange, collateral is deposited in order to mitigate the risk that a counterparty may default on its obligations or become insolvent.

The fund adopts a flexible approach to the allocation of capital between asset classes in response to changes in economic conditions and the valuation of assets, and the managers will seek to maximise portfolio diversity wherever possible. However, in cases where the managers believe that the opportunities are limited to a few areas, there may be a higher-than-usual concentration of asset or market exposure. Such strategies may result in higher volatility of the fund's short-term performance.

The blend of assets held in the fund is regularly adjusted depending on where the managers see the most value and to manage risks, including liquidity, credit, currency and market risks. The fund's risks are measured and managed as an integral part of the investment process.

Please note that the risk management policies are set out in full in the financial statements and notes sections of the Annual Long Report and audited Financial Statements of M&G Investment Funds (4).

The following table shows the risk number associated with the fund and is based on Sterling Class 'A' shares.



The above number:

- is based on the rate at which the value of the fund has moved up and down in the past and is based on historical data so may not be a reliable indicator of the future risk profile of the fund.
- is not guaranteed and may change over time and the lowest risk number does not mean risk free.
- has not changed during this period.

As at 1 November 2018, for the year ended 31 October 2018

Performance against objective

Between 1 November 2017 (the start of the review period) and 1 November 2018, the M&G Episode Growth Fund produced a negative total return (the combination of income and growth of capital) across all share class.* Over this period, the fund lagged its comparative index, which returned 2.2%. The comparative index, made up of two thirds global company shares (as measured by the MSCI ACWI Index) and one third global bonds (as measured by the Bloomberg Barclays Global Aggregate Index), introduced at the end of August 2018 when the fund's objective and policy was changed.

* For the performance of each share class, please refer to the 'Long-term performance by share class' table in the 'Fund performance' section of the Annual Long Report and audited Financial Statements for M&G Investment Funds (4).

To give an indication of the performance of the fund, the following table shows the compound rate of return, per annum, over the period for Sterling Class 'A' (Accumulation) shares and Sterling Class 'I' (Accumulation) shares. Calculated on a price to price basis with income reinvested.

Long-term performance				
	One year 01.11.17 % ^[a]	Three years 02.11.15 % p.a.	Five years 01.11.13 % p.a.	since launch % p.a.
Sterling^[b]				
Class 'A'	-7.0	+4.6	+4.3	+7.8 ^[c]
Class 'I'	-6.4	+5.4	+5.1	+7.4 ^[d]

^[a] Absolute basis.

^[b] Price to price with income reinvested.

^[c] 1 October 2002, the launch date of the share class.

^[d] 3 August 2012, the launch date of the share class.

Please note past performance is not a guide to future performance and the value of investments, and the income from them, will fluctuate. This will cause the fund price to fall as well as rise and you may not get back the original amount you invested.

Investment performance

The year under review was dominated by investor concerns about trade wars between the US and China, worries on the direction of the global economy – especially whether US economic growth had peaked – and general pessimism towards countries grappling with their own special problems, such as Turkey, Italy, Argentina and Brazil.

There were periods when investor appetite improved, and our basket of diversified global equities (company shares, which offer ownership stakes to investors) did well as a result. But the overall pattern during the 12 months under review was usually a sharp pullback in risk-taking (and flight to so-called ‘safe-haven’ assets, which are generally assets that investors believe would protect them from the impact of a big fall in asset prices) immediately following a positive month in the markets. September and October were good examples of this. In fact, October was a notably bleak month for virtually all assets, including US stocks and, untypically, the US technology sector (Amazon, Google parent Alphabet and the like).

This aversion to risk assets and pessimistic view of the path of the global economy – which we think is without justification given the underlying facts – weighed on fund performance in the period. On the other hand, it did lead to some attractive valuations in the likes of US equities, Asian equities and, selectively, in risk assets out of undervalued Italy and Turkey.

Holdings of European stockmarkets, notably Spanish and Italian banks, detracted as these assets suffered from being seen as having strong links to struggling peripheral European countries like Turkey. The fund’s exposure to the European smaller companies market, via the M&G Pan European Select Smaller Companies Fund, weighed on performance as well.

Exposure to Asian equity markets also detracted in the period. South Korean equities fell on trade threats for its key export industries. Chinese stocks wobbled for similar reasons – although in this regard we continue to be constructive on Chinese monetary policy, which bodes well for the domestic economy.

On the other hand, North American equities, especially US financial companies and technology companies, added to returns in the period. In the first nine months of 2018, the S&P 500 Index continued its steady climb, supported by strong company earnings and a broadly upbeat outlook for the domestic economy.

Within bonds, contributions to performance were mixed, particularly within emerging market issuers. (Bonds are loans that are extended by an investor to an issuer – such as a company or government – usually in exchange for regular interest payments. Bonds issued by companies are referred to as ‘corporate bonds’, while those issued by governments are called ‘government bonds’.)

Bonds issued by Brazil added to performance in the period, investors seeing its October general election outcome as market friendly. Conversely, exposure to Mexico government bonds detracted, while peripheral European government bonds – mainly Turkey – weighed on performance. These markets generally suffered from various bouts of risk aversion in the period, as investors grew concerned on fiscal and monetary policy uncertainty.

Holdings in a corporate bonds delivered a flat performance in the period. A holding in the M&G Property Portfolio, a UK commercial property fund, boosted returns as investors generally shrugged off Brexit fears and warmed to a better outlook for the market in 2018.

Investment activities

Following sharp falls in the price of equities during the early part of 2018 and in a number of subsequent months, valuations became ever more attractive. As a result, we steadily increased equity exposure and therefore the level of risk in the fund. For example, around February and March, following a market sell-off, we added to the basket of banking stocks and US technology and biotech companies in order to try to capitalise on what we saw as a temporary fall in stock prices. Similarly, we increased Italian equities in June, because we believed they were attractively valued compared to the fundamentals (like fairly strong earnings). We also added to Turkish equities around the same time as part of our emerging markets equity bucket. In our view, the price moves we saw in the spring had been extreme, and represented an attractive investment opportunity for the fund.

Towards the end of the period under review, we increased exposure to Korean equities, from 2% to 4.5%, as their valuations became more attractive. We also increased our US technology basket, from 2.25% to 4%, following October’s price weakness in companies like Amazon and Alphabet.

In terms of changes to our fixed income holdings, we focused on looking for attractively-priced bonds with the potential to provide diversification in an environment of interest rate hikes. For example, we bought 10-year US government bonds in February (selling out in April) on the view these securities were offering good value following the recent sell-off.

Within riskier bonds, we added a 5% holding in Italian government bonds in May, funded out of cash. The rationale behind the addition was that we believed the price of the bond was attractive relative to other government bonds with similar credit risk profiles.

Finally, we added government bonds from Brazil, Turkey and Indonesia, switching from US dollar assets (the fund does not have a long US dollar position anymore), to provide the fund with diversification and return potential at good valuations.

Towards the end of the period, we closed the position in corporate bonds, which continued to disappoint in an environment of rising interest rates. We also closed our small position in the M&G Property Portfolio following strong performance (compared to equities), and this allowed us to raise cash to fund the equity purchases mentioned earlier – Korea and US technology companies.

Outlook

The fund is positioned pro-risk in what we view as a pro-growth world, with a preference for global equities compared to fixed income assets based on an observation of the relative attractiveness in valuations. That said, we acknowledge that recent growth forecasts have edged lower on trade tariff concerns and worries about a slowing Chinese economy.

We have more conviction that some of the fund's risk exposures – across Turkey, Italy and emerging markets more generally – are starting to behave independently of each other. In the summer, the opposite was largely true; Italian banks lost 20% of their value on investors' belief that the much-maligned sector's fortunes were strongly linked to the fate of the Turkish economy.

There are still concerns on the valuation of developed government bonds, and we continue to view the risk properties of the likes of UK and German government bonds as unfavourable for multi-asset portfolios.

As volatility has picked up this year, valuations have improved in many equity markets, and we believe this bodes well for the fund's investment approach. With all the noise, we believe it is important to remain focused on areas such as underlying earnings expectations, which continue to move higher. This is encouraging at a time when inflation is remarkable in its stability.

Eric Lonergan & Jenny Rodgers

Co-fund managers

Employees of M&G Limited which is an associate of M&G Securities Limited.

Please note that the views expressed in this Report should not be taken as a recommendation or advice on how the fund or any holding mentioned in the Report is likely to perform. If you wish to obtain financial advice as to whether an investment is suitable for your needs, you should consult a Financial Adviser.

Classification spread of investments

The table below shows the percentage holding per sector.

	% of fund as at	
	2018	2017 ^[a]
EQUITY PORTFOLIOS ^[b]		
United Kingdom	23.33	25.16
France	3.00	3.09
Ireland	2.26	0.00
Luxembourg	1.62	1.64
United States	1.14	3.09
Japan	8.31	8.13
China	7.32	1.22
India	0.00	2.16
South Korea	4.52	2.11
Turkey	2.56	1.07
EQUITIES		
United Kingdom	1.63	2.77
Ireland	1.04	0.67
Italy	4.18	2.36
Spain	1.09	1.08
United States	11.53	11.49
Japan	3.08	2.74
Australia	0.79	0.84
Russia	3.33	1.73
Equity futures contracts	(0.29)	0.04
Equity options	0.00	0.07
DEBT SECURITIES		
Italy	5.00	0.00
Ireland	0.00	4.65
Luxembourg	1.13	1.00
Mexico	4.13	3.94
Indonesia	2.03	0.00
Turkey	1.74	0.00
DEBT DERIVATIVES		
Interest rate swaps	0.00	(0.04)
Interest rate futures	0.00	(0.19)
CURRENCY		
Forward currency contracts	(0.47)	0.53
CASH EQUIVALENTS		
'AAA' rated money market funds ^[c]	3.77	18.10

^[a] The portfolio has been reclassified to more appropriately reflect how the fund is managed. 2017 comparatives have been restated to reflect this.

^[b] All holdings in M&G collective investment schemes are in Sterling Class 'A' (Income) shares unless otherwise stated.

^[c] Uncommitted surplus cash is placed into 'AAA' rated money market funds with the aim of reducing counterparty risk.

Please note past performance is not a guide to future performance and the value of investments, and the income from them, will fluctuate. This will cause the fund price to fall as well as rise and you may not get back the original amount you invested.

The following chart and tables show the performance for two of the fund's share classes – Sterling Class 'A' (Accumulation) shares and Sterling Class 'I' (Accumulation) shares.

We show performance for these two share classes because:

- The performance of the Sterling Class 'A' (Accumulation) share is what most individuals investing directly with M&G have received. It has the highest ongoing charge of all the share classes. Performance is shown after deduction of this charge. All investors in the fund therefore received this performance or better.
- The performance of the Sterling Class 'I' (Accumulation) share is the most appropriate to compare with the average performance of the fund's comparative sector. It is the share class used by the Investment Association in the calculation of the comparative sector's average performance. This share class is available for direct investment with M&G subject to minimum investment criteria, or via third parties who may charge additional fees. The performance shown takes the deduction of the ongoing charge for this share class into account but it does not take account of charges applied by any other party through which you may have invested.

The fund is available for investment in different share classes, each with varying levels of charges and minimum investments; please refer to the Prospectus for M&G Investment Funds (4), which is available free of charge either from our website at www.mandg.co.uk/prospectuses or by calling M&G Customer Relations. For the specific performance tables of all share classes, please refer to the Annual Long Report and audited Financial Statements for M&G Investment Funds (4), which is available free of charge either from our website at or by calling M&G Customer Relations.

Fund level performance

Fund net asset value

	2018	2017	2016
as at 31 October	£'000	£'000	£'000
Fund net asset value (NAV)	854,877	969,437	876,639

Financial highlights

Fund performance

Performance since launch

To give an indication of how the fund has performed since launch, the chart below shows total return of Sterling Class 'A' (Accumulation) shares and Sterling Class 'I' (Accumulation) shares.



The fund's Sterling Class 'I' (Accumulation) shares were launched on 3 August 2012. Performance data shown prior to this date is that of the fund's Sterling Class 'A' (Accumulation) shares.

To give an indication of how the fund has performed during the period the tables below show the performance of Sterling Class 'A' (Accumulation) shares and Sterling Class 'I' (Accumulation) shares.

All 'Performance and charges' percentages represent an annual rate except for the 'Return after operating charges' which is calculated as a percentage of the opening net asset value per share (NAV). 'Dilution adjustments' are only in respect of direct portfolio transaction costs.

Historic yields for the current year are calculated as at 9 November 2018.

Sterling Class 'A' Accumulation share performance

The share class was launched on 1 October 2002.

for the year to 31 October	2018	2017	2016
Change in NAV per share	UK p	UK p	UK p
Opening NAV	84.86	71.79	69.41
Return before operating charges and after direct portfolio transaction costs	(4.71)	14.49	3.59
Operating charges	(1.52)	(1.42)	(1.21)
Return after operating charges	(6.23)	13.07	2.38
Distributions	(0.87)	(0.67)	(1.85)
Retained distributions	0.87	0.67	1.85
Closing NAV	78.63	84.86	71.79

Direct portfolio transaction costs	UK p	UK p	UK p
Costs before dilution adjustments	0.02	0.05	0.05
Dilution adjustments ^[a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.02	0.05	0.05

Performance and charges	%	%	%
Direct portfolio transaction costs ^[b]	0.03	0.06	0.08
Operating charges	1.81	1.79	1.80
Return after operating charges	-7.34	+18.21	+3.43
Historic yield	1.10	0.79	2.56
Effect on yield of charges offset against capital	0.01	0.01	1.50

Other information

Closing NAV (£'000)	42,404	44,001	42,035
Closing NAV percentage of total fund NAV (%)	4.96	4.54	4.79
Number of shares	53,929,963	51,849,542	58,549,086
Highest share price (UK p)	88.57	84.86	71.91
Lowest share price (UK p)	77.23	69.95	58.08

Financial highlights

Fund performance

Sterling Class 'I' Accumulation share performance

The share class was launched on 3 August 2012.

for the year to 31 October	2018	2017	2016
Change in NAV per share	UK p	UK p	UK p
Opening NAV	1,663.67	1,397.43	1,340.09
Return before operating charges and after direct portfolio transaction costs	(95.04)	280.93	69.61
Operating charges	(15.69)	(14.69)	(12.27)
Return after operating charges	(110.73)	266.24	57.34
Distributions	(30.44)	(25.08)	(35.40)
Retained distributions	30.44	25.08	35.40
Closing NAV	1,552.94	1,663.67	1,397.43
Direct portfolio transaction costs	UK p	UK p	UK p
Costs before dilution adjustments	0.48	0.92	1.02
Dilution adjustments ^[a]	(0.08)	(0.05)	(0.06)
Total direct portfolio transaction costs	0.40	0.87	0.96
Performance and charges	%	%	%
Direct portfolio transaction costs ^[b]	0.03	0.06	0.08
Operating charges	0.96	0.94	0.94
Return after operating charges	-6.66	+19.05	+4.28
Historic yield	1.94	1.56	2.52
Effect on yield of charges offset against capital	0.01	0.01	0.65
Other information			
Closing NAV (£'000)	55,169	46,664	33,196
Closing NAV percentage of total fund NAV (%)	6.45	4.81	3.79
Number of shares	3,552,534	2,804,861	2,375,523
Highest share price (UK p)	1,739.91	1,664.34	1,399.95
Lowest share price (UK p)	1,525.23	1,361.88	1,123.93

^[a] In respect of direct portfolio transaction costs.

^[b] As a percentage of average net asset value.

Financial highlights

Operating charges and portfolio transaction costs

We explain below the payments made to meet the ongoing costs of investing and managing the fund, comprising operating charges and portfolio transaction costs.

Operating charges

Operating charges include payments made to M&G and to providers independent of M&G:

- **Investment management:** Charge paid to M&G for investment management of the fund (also known as Annual Management Charge).
- **Administration:** Charge paid to M&G for administration services in addition to investment management – any surplus from this charge will be retained by M&G.
- **Oversight and other independent services:** Charges paid to providers independent of M&G for services which include depository, custody and audit.
- **Ongoing charges from underlying funds:** Ongoing charges on holdings in underlying funds that are not rebated.

Operating charges do not include portfolio transaction costs or any entry and exit charges (also known as initial and redemption charges). The charging structures of share classes may differ, and therefore the operating charges may differ.

Operating charges are the same as the ongoing charges shown in the Key Investor Information Document, other than where an estimate has been used for the ongoing charge because a material change has made the operating charges unreliable as an estimate of future charges.

For this fund there is no difference between operating charges and ongoing charges figures, unless disclosed under the specific share class performance table.

Portfolio transaction costs

Portfolio transaction costs are incurred by funds when buying and selling investments. These costs vary depending on the types of investment, their market capitalisation, country of exchange and method of execution. They are made up of direct and indirect portfolio transaction costs:

Financial highlights

Operating charges and portfolio transaction costs

- **Direct portfolio transaction costs:** Broker execution commission and taxes.
- **Indirect portfolio transaction costs:** 'Dealing spread' – the difference between the buying and selling prices of the fund's investments; some types of investment, such as fixed interest securities, have no direct transaction costs and only the dealing spread is paid.

Investments are bought or sold by a fund when changes are made to the investment portfolio and in response to net flows of money into or out of the fund from investors buying and selling shares in the fund.

To protect existing investors, portfolio transaction costs incurred as a result of investors buying and selling shares in the fund are recovered from those investors through a 'dilution adjustment' to the price they pay or receive. The table below shows direct portfolio transaction costs paid by the fund before and after that part of the dilution adjustment relating to direct portfolio transaction costs. To give an indication of the indirect portfolio dealing costs the table also shows the average portfolio dealing spread.

Further information on this process is in the Prospectus, which is available free of charge on request either from our website at www.mandg.co.uk/prospectuses or by calling M&G Customer Relations.

Portfolio transaction costs				
for the year to 31 October	2018	2017	2016	Average ^[a]
Direct portfolio transaction costs ^[b]	%	%	%	%
Broker commission	0.02	0.05	0.06	0.05
Taxes	0.01	0.01	0.02	0.01
Costs before dilution adjustments	0.03	0.06	0.08	0.06
Dilution adjustments ^[c]	0.00	0.00	0.00	0.00
Total direct portfolio transaction costs	0.03	0.06	0.08	0.06
as at 31 October	2018	2017	2016	Average ^[a]
Indirect portfolio transaction costs	%	%	%	%
Average portfolio dealing spread	0.12	0.11	0.15	0.13

^[a] Average of first three columns.

^[b] As a percentage of average net asset value.

^[c] In respect of direct portfolio transaction costs. Please see the section above this table for an explanation of dilution adjustments.

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