M&G European Corporate Bond Fund

a sub-fund of M&G Investment Funds (3)

Annual Short Report June 2019
For the year ended 30 June 2019

M&G INVESTMENTS

Fund information

The Authorised Corporate Director (ACD) of M&G Investment Funds (3) presents its Annual Short Report for M&G European Corporate Bond 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 (3), 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

M&G Securities Limited,
10 Fenchurch Avenue, London EC3M 5AG
Telephone: 0800 390 390
(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

Following successful extraordinary resolutions at shareholder meetings held on 4 October 2018, the mergers of the non-sterling share classes into sub-funds of M&G (Lux) Investment Funds 1 took place on various dates. The effective date of the non-sterling share class mergers for the M&G European Corporate Bond Fund was 9 November 2018. For further details of the mergers, please refer to www.mandg.com/brexitmergerdocumentation.

As mentioned in the shareholder letter on 17 June 2019, we are making changes to the way we charge for M&G funds based in the UK, starting on Thursday 1 August 2019. The annual charge should be simpler to understand and easier to compare with other fund charges. We are combining all the charges that make up the current ongoing charge figure (OCF) into a single annual charge. Only exceptional items such as unforeseen legal and tax expenses, also known as extraordinary expenses, will be excluded from the annual charge. To find out the new annual charge and the OCF which are shown in the Key Investor Information Document (KIID) for the share class(es) you are invested in, visit our website www.mandg.co.uk.

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

Investment objective

The fund aims to provide income and capital growth.

Investment policy

At least 70% of the fund is invested in investment grade corporate bonds denominated in any European currency. The fund may also invest in high yield corporate bonds, government and public securities denominated in any European currency. The fund's exposure to bonds, government and other public securities may be gained through the use of derivatives. Derivatives may also be used for efficient portfolio management. The fund may also invest in collective investment schemes, other transferable securities, cash, near cash, other money market instruments, warrants and other derivative instruments which may be denominated in any major global currency. More than 70% of the fund will be in euro or hedged back to euro.

Investment approach

The fund manager believes that bond returns are driven by a combination of macroeconomic, asset, sector, geography and stock-level factors. A dynamic investment approach is followed, allowing the fund manager to change the blend of duration and credit exposure based on the outlook. A high level of diversification, across individual issuers, sectors and geographies is an essential part of the investment process.

Risk profile

A minimum of 70% of the fund is invested in investment grade corporate bonds denominated in any European currency. It is primarily subject to the price volatility of the European bond market as well as the performance of individual issuers. It is also influenced by developments in the broader global bond market. In addition, the fund is subject to fluctuations in currency exchange rates.

Up to 30% of the fund may be invested in high yield corporate bonds, government and public securities denominated in any European currency. Some of these securities may be higher risk assets that could potentially experience a degree of illiquidity in times of market distress.

The fund's exposure to debt securities 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.

Portfolio diversification is key in managing liquidity and default risks as well as reducing market risk. 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 (3).

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

Low risk — High risk

Typically lower rewards — Typically higher rewards

1	2	3	**4**	5	6	7

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 July 2019, for the year ended 30 June 2019

Performance against objective

Between 2 July 2018 (the start of the review period) and 1 July 2019, the M&G European Corporate Bond Fund delivered a strong positive total return (the combination of income and growth of capital) across all of its sterling share classes.*

The fund's US dollar shares delivered a small positive return, but its euro and Swiss franc shares mostly posted very slightly negative returns between 2 July 2018 and 9 November 2018. On 9 November 2018, the fund's non-sterling share classes merged into the M&G (Lux) Euro Corporate Bond Fund, a Luxembourg-authorised SICAV which launched on that date.

The M&G European Corporate Bond Fund invests mainly in high-quality corporate bonds denominated in any European currency, with the aim to provide a higher total return (the combination of capital growth and income) than that of the European investment grade corporate bond market (as measured by the BofA Merrill Lynch Euro Corporate Index) over any five-year period.

Bonds are loans that are extended by an investor to an issuing entity – such as a company or government – in exchange for regular interest payments. The initial amount borrowed by the entity is usually repaid at the end of the loan's life. Bonds issued by companies are referred to as 'corporate bonds', while those issued by governments are called 'government bonds'. Investment grade corporate bonds refer to debt securities issued by a company with a medium or high credit rating from a recognised credit rating agency. They are considered to be at lower risk of non-repayment than those issued by companies with lower credit ratings (known as high yield bonds). The performance of investment grade corporate bond markets can be influenced by the performance of government bonds.

* 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 (3).

Investment review

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

	From 02.07.18 % [a]	From 01.07.16 % p.a.	From 01.07.14 % p.a.	Since launch % p.a.
Sterling [b]				
Class 'A'	+5.5	+4.5	+4.4	+5.3 [c]
Class 'I'	+6.0	+5.0	+4.9	+5.6 [d]

[a] Absolute basis.

[b] Price to price with income reinvested.

[c] 13 January 2003, the launch date of the fund.

[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

Volatility returned to financial markets in 2018, as a result of a range of factors that included higher interest rates and inflation, political uncertainty and global trade tensions.

The US Federal Reserve (Fed) raised interest rates in September and December, making it a total of nine times US rates have risen since the great financial crisis about a decade ago. In the UK, much uncertainty remained about the eventual terms of the country's Brexit deal with the European Union (EU). This contributed to times of adverse sentiment towards UK bonds. Investors in Europe became concerned in the latter stages of 2018 about Italian proposals to increase the country's budget deficit. The plans, which met with opposition from the EU, were drafted after an anti-establishment party gained a strong presence in Italy's new coalition government.

Sentiment towards corporate bonds – and international stockmarkets – was increasingly affected by concerns of a trade war developing between the US and China. In addition, during the latter months of 2018, global economic growth forecasts began to moderate, which contributed to weaker confidence in the outlook for corporate bonds and emerging markets.

Sentiment then changed once again in early 2019, as investors took comfort from statements by the Fed that it would moderate its strategy around raising interest rates. Indeed, investors' mood changed so dramatically that markets now expect the next move by the Fed will be to cut, rather than raise, interest rates. However, the more optimistic mood was somewhat dampened in May, as renewed fears about the prospects for global trade, caused mainly by heightened tensions between the US and China over tariffs, caused investors to prefer safer assets once again. (On 31 July, subsequent to the end of the review period, the Fed announced that it would cut interest rates by 0.25%.)

While the second half of 2018 was challenging for corporate bonds, the strong start to 2019 helped them to deliver positive returns across the 12-month period as a whole. Corporate bonds denominated in US dollars generally outperformed those denominated in sterling and euros.

The biggest contribution to the fund's performance came from its holdings in corporate bonds issued by non-financial companies, while those issued by banks also contributed strongly. We have positioned the fund to be slightly less sensitive to changes in interest rates than many of its peers, and this acted as a slight lag on performance. The fund's exposure to asset-backed securities (ABS) also helped. ABS are bonds backed by assets including credit card receivables, car loans or mortgages, whose creditworthiness is based on the underlying assets, rather than on the company that issued the bonds. Most ABS holdings are floating-rate in nature and stand to benefit if interest rates rise as they have variable rate coupons.

Investment activities

One of the key drivers of a bond fund's performance is its ability to adjust the portfolio's sensitivity to changes in interest rates, known as 'duration'. Being shorter duration means that a fund is relatively less sensitive to changes in interest rates than longer duration funds. During the course of the reporting period, we held the fund's duration somewhat short of a comparable index, as we believe that core eurozone government bonds such as bunds (German bonds) appear very expensive.

We continue to like financials and have retained a significant exposure to this sector. In early 2019, we took our exposure to banks towards neutral, following strong performance by the sector. We sold some bonds from banks including Santander and Goldman Sachs.

We had begun the review period with a large underweight position in the auto sector. After bonds from car manufacturers came under significant pressure in late 2018 and early 2019, taking valuations back to more attractive levels, we started to add some bonds from companies including Ford, Daimler and BMW.

In the latter stages of the review period, we slightly reduced risk levels in the fund, selling some corporate bonds that had performed particularly well. We continue to prefer higher credit quality names to those with lower credit ratings.

In April, we added some Italian government bonds known as BTPs, which have been underperforming Italian corporate bonds and so look attractive in relative terms.

We remain nervous about prospects for the UK economy and the impact of Brexit uncertainty and did not add substantively to our UK holdings over the period.

Outlook

After a difficult 2018 for financial markets, the first half of 2019 has been largely constructive for global bond markets, with a return of risk appetite, as investors have been encouraged by signs that the US Federal Reserve would pause its interest rate rising cycle.

However, challenges remain. Eurozone inflation is likely to remain low in the foreseeable future, and the European Central Bank is sounding increasingly nervous, having revised growth and inflation expectations lower. Interest rates in Europe will remain low in the medium term.

We remain broadly positive on the outlook for the global economy and corporate bonds. While we have been partially reducing risk in the portfolio in the latter stages of the reporting period, we continue to find opportunities within corporate bond markets.

Regardless of how these situations develop, what we do as fund managers does not change. We look at where we are in the interest rate cycle and the economic cycle, and we look at where we can find the most attractive opportunities for the fund from different sectors and individual issuers at any given stage.

Stefan Isaacs
Fund manager

An employee 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 of investments

The table below shows the percentage holding per sector.

as at 30 June	% of fund 2019	% of fund 2018
FIXED INCOME		
Debt securities		
'AAA' credit rated bonds	12.03	16.19
'AA' credit rated bonds	12.15	10.23
'A' credit rated bonds	29.79	28.49
'BBB' credit rated bonds	32.77	30.34
'BB' credit rated bonds	4.99	6.78
'B' credit rated bonds	0.00	0.30
Bonds with no credit rating	6.06	6.68
Debt derivatives		
Credit default swaps	0.00	0.07
Interest rate futures	(0.16)	(0.08)
CURRENCY		
Forward currency contracts	0.08	0.01
CASH EQUIVALENTS		
'AAA' rated money market funds [a]	1.19	0.00
SHARE CLASS HEDGING		
Forward currency contracts for share class hedging	(0.05)	(0.03)

[a] 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 sterling share classes. Performance is shown after deduction of this charge. All UK 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 (3), 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 (3), which is available free of charge either from our website at www.mandg.co.uk/reports or by calling M&G Customer Relations.

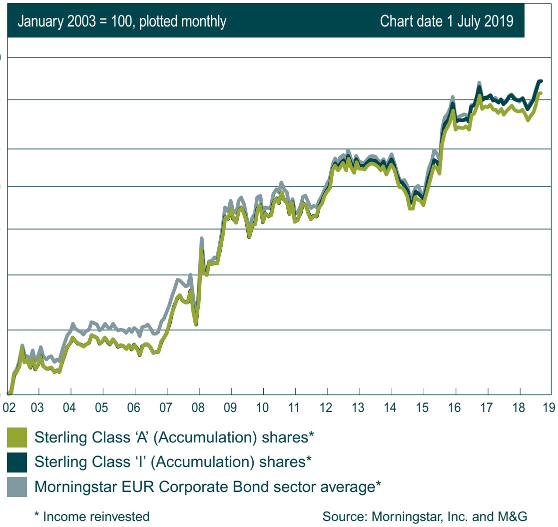
Fund level performance

Fund net asset value

as at 30 June	2019 €'000	2018 €'000	2017 €'000
Fund net asset value (NAV)	184,337	1,697,355	1,947,876

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.

Financial highlights
Fund performance

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.

Sterling Class 'A' Accumulation share performance

The share class was launched on 13 January 2003.

for the year to 30 June Change in NAV per share	2019 UK p	2018 UK p	2017 UK p
Opening NAV	111.60	110.24	100.94
Return before operating charges and after direct portfolio transaction costs	6.55	2.67	10.68
Operating charges	(1.31)	(1.31)	(1.24)
Return after operating charges	5.24	1.36	9.44
Distributions	(0.98)	(1.09)	(1.30)
Retained distributions	0.98	1.09	1.16
Closing NAV	116.84	111.60	110.24
Direct portfolio transaction costs	**UK p**	**UK p**	**UK p**
Costs before dilution adjustments	0.00	0.00	0.00
Dilution adjustments [a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.00	0.00	0.00
Performance and charges	**%**	**%**	**%**
Direct portfolio transaction costs [b]	0.00	0.00	0.00
Operating charges	1.17	1.16	1.16
Return after operating charges	+4.70	+1.23	+9.35
Distribution yield	0.37	0.92	1.00
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV (€'000)	40,203	51,650	51,566
Closing NAV percentage of total fund NAV (%)	21.81	3.04	2.65
Number of shares	30,869,258	41,001,496	41,102,044
Highest share price (UK p)	117.39	118.35	112.64
Lowest share price (UK p)	108.43	109.79	102.94

Sterling Class 'I' Accumulation share performance

The share class was launched on 3 August 2012.

for the year to 30 June Change in NAV per share	2019 UK p	2018 UK p	2017 UK p
Opening NAV	1,378.24	1,354.69	1,234.89
Return before operating charges and after direct portfolio transaction costs	81.17	32.70	130.84
Operating charges	(9.26)	(9.15)	(8.68)
Return after operating charges	71.91	23.55	122.16
Distributions	(19.12)	(20.39)	(22.51)
Retained distributions	19.12	20.39	20.15
Closing NAV	1,450.15	1,378.24	1,354.69
Direct portfolio transaction costs	**UK p**	**UK p**	**UK p**
Costs before dilution adjustments	0.01	0.02	0.03
Dilution adjustments [a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.01	0.02	0.03
Performance and charges	**%**	**%**	**%**
Direct portfolio transaction costs [b]	0.00	0.00	0.00
Operating charges	0.67	0.66	0.66
Return after operating charges	+5.22	+1.74	+9.89
Distribution yield	0.87	1.42	1.49
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV (€'000)	30,308	26,325	16,011
Closing NAV percentage of total fund NAV (%)	16.44	1.55	0.82
Number of shares	1,875,040	1,692,136	1,038,578
Highest share price (UK p)	1,456.99	1,455.52	1,379.48
Lowest share price (UK p)	1,343.59	1,354.42	1,261.56

[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.
- **Share class hedging:** Charge paid to M&G for currency hedging services to minimise exchange rate risk for the share class.
- **Oversight and other independent services:** Charges paid to providers independent of M&G for services which include depositary, 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:

- **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. As the fund invests mainly in fixed interest securities, the direct transaction costs paid on other investments are too small to be reflected in the table below. To give an indication of the indirect portfolio dealing costs the table below 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

as at 30 June Indirect portfolio transaction costs	2019 %	2018 %	2017 %	Average [a] %
Average portfolio dealing spread	0.48	0.45	0.49	0.47

[a] Average of first three columns.

Contact

Customer Relations*

0800 390 390

Write to us at:**

M&G Securities Limited
PO Box 9039
Chelmsford
CM99 2XG

Our website:

www.mandg.co.uk

Email us with queries:†

info@mandg.co.uk

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** Please remember to quote your name and M&G client reference and sign any written communication to M&G. Failure to provide this may affect your ability to transact with us.

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