M&G Global Government 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 Global Government 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

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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

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.

From 1 October 2018 the annual management charge (AMC) of the M&G Global Government Bond Fund was reduced by 0.15% across all share classes. The current and revised AMC rates are shown below.

Table of changes

M&G Global Government Bond Fund

Share class	Share type	Previous AMC	Revised AMC
Euro 'A'	Income & Accumulation	1.00%	0.85%
Euro 'C'	Income & Accumulation	0.50%	0.35%
Sterling 'A'	Income & Accumulation	1.00%	0.85%
Sterling 'I'	Income & Accumulation	0.50%	0.35%
Sterling 'R'	Income & Accumulation	0.75%	0.60%
Swiss franc 'A'	Income & Accumulation	1.00%	0.85%
Swiss franc 'C'	Income & Accumulation	0.50%	0.35%
US dollar 'A'	Income & Accumulation	1.00%	0.85%
US dollar 'C'	Income & Accumulation	0.50%	0.35%

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

Investment objective

The fund aims to maximise total return (the combination of income and growth of capital).

Investment policy

The portfolio will mainly consist of investment grade government debt securities, including government guaranteed debt securities, and will be invested on a global basis. The fund's exposure to investment grade government debt may be gained through the use of derivatives. The fund may also invest in other government and public securities, collective investment schemes, other transferable securities, other debt instruments, cash and near cash, deposits, warrants, money market instruments and other derivative instruments. The fund may use derivatives for Efficient Portfolio Management purposes.

Fund information

Investment approach

The M&G Global Government Bond Fund invests mainly in investment grade government bonds on a global basis. Its investment approach is driven primarily by the fund manager's views on macroeconomic factors such as economic growth, interest rates and inflation. This assessment determines the individual government bonds from different countries in which the manager believes the fund should invest in order to achieve its objective. It also influences the portfolio's mix of interest rate risk and currency exposure. These factors, along with the manager's selection of government bond holdings, drive the fund's long-term performance. With the active management of the fund's currency exposures being one of these drivers, its returns will include a higher degree of currency risk than domestic fixed income funds.

Risk profile

The fund invests mainly in investment grade government bonds, including government-guaranteed debt securities, in both developed and emerging markets on a global basis. It is, therefore, subject to the price volatility of the global bond market and the performance of individual issuers. It is also subject to fluctuations in currency exchange rates.

The fund's exposure to investment grade government debt 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.

Up to 30% of the fund's assets may be invested in non-investment grade government debt securities, which are higher risk assets that could potentially experience a degree of illiquidity in times of market distress.

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.

Investment review

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 Global Government Bond Fund recorded positive total returns (the combination of income and growth of capital) across its different share classes. Over the 12 months, mainstream government bond markets generally delivered positive returns, while emerging market government bonds also registered gains. For the fund's sterling and euro share classes, the increase in value of the US dollar (a currency in which the fund held a sizeable exposure) against sterling and the single currency was a factor that provided some further upside to returns.

The fund's objective is to maximise total returns, and it met its objective over three and five years and since launch.*

* 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).

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 02.07.18 % [a]	Three years 01.07.16 % p.a.	Five years 01.07.14 % p.a.	Since launch % p.a.
Sterling [b]				
Class 'A'	+10.7	+3.6	+8.6	+5.5 [c]
Class 'I'	+11.3	+4.1	+9.0	+4.3 [d]

[a] Absolute basis.

[b] Price to price with income reinvested.

[c] 4 October 1999, the end of the initial offer period of the predecessor unit trust.

[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

Several themes dampened investors' sentiment in global financial markets during the first half of the 12-month review period. These included signs that economic growth was slowing, while international trade tensions also remained a concern, especially between the US and China.

Much attention also stayed focused on the monetary policy of the US Federal Reserve (Fed). During 2018, the Fed continued its recent trend of raising interest rates as the US economy strengthened. Despite some weaker global economic signals, US interest rates were increased again in September and December, each time by a quarter of a percentage point.

Against this backdrop, areas of the global bond markets recorded subdued performance in the second half of 2018. This included segments of the corporate bond markets, as the performance of these assets can be more sensitive to a weaker economic outlook. In contrast, the performance of government bonds held up relatively well, as these assets are often supported in times of economic uncertainty.

Bonds are loans in the form of securities, usually issued by a government (sovereign bonds) or company (corporate bonds). They normally pay a fixed rate of interest (also known as a coupon) over a given time period, at the end of which the initial amount borrowed is repaid.

However, at the beginning of 2019, the Fed softened its rhetoric about further interest rate increases, largely in response to more moderate economic forecasts. Financial markets even began to consider the possibility that the Fed's next move on monetary policy might be a reduction in interest rates. This outlook also contributed to decisions by the Bank of England and European Central Bank (ECB) to hold interest rates unchanged at low levels.

In turn, this backdrop helped to generate a notable rally among most areas of the global bond markets in the opening months of 2019. Generally, the performance of government bonds in developed and emerging markets was helped in this environment. The performance of bonds, particularly government bonds, is influenced by expected or actual changes in interest rates. Bond prices move inversely to interest rates, so rising interest rates can reduce the returns of bonds, while falling rates tend to be helpful. Given the size and importance of the US market in a global context, the effects of higher or lower US interest rates can be felt internationally.

In addition, investors in Europe became increasingly focused on the possibility of renewed economic stimulus measures by the ECB towards the end of the review period. This resulted from some weak economic data in the eurozone area. The prospect of new ECB stimulus also supported the performance of government bonds in the region, as the central bank's strategy should include measures designed to keep interest rates low.

In the UK, a major theme for investors remained the uncertainty about the terms and timing of its departure from the European Union (EU). While a withdrawal deal was agreed with the EU, the agreement failed to win approval in the UK parliament. Subsequently, the deadline for Brexit was pushed back and Prime Minister Theresa May resigned. As a result, a contest began within the governing Conservative Party to select a replacement. Despite Brexit-related concerns, UK government bonds, helped by their perceived 'safe-haven' status among investors, performed well in the review period.

In the fund, we maintained a globally diversified portfolio of government bonds with holdings across the developed and emerging markets. Through this positioning, the fund generated positive returns. For the fund's sterling and euro share classes, some further upside to performance was provided by factors such as the US dollar's increase in value versus sterling and euro, respectively. This stemmed from the fund's exposure to the US dollar, which was maintained at considerably higher levels than its allocations to sterling and the euro.

Investment activities

The active management of the fund's allocations to individual countries, as well as its currency positioning, continue to be key drivers of its long-term returns. During the period, we kept exposures to a number of industrialised nations, while also favouring government bonds in emerging markets on a selective basis. In our view, appealing long-term value could still be found in the latter area of the market for taking on additional degrees of risk. We maintained this opinion despite concerns about the US/China trade dispute and slowing global economic growth.

Our largest country position remained the US, and we moderately increased this exposure during the period. We took this stance given that at times, against the backdrop of rising US interest rates in 2018, US government bonds experienced some marked price declines. In our view, these price falls were often overdone and left the valuations of these assets looking more attractive.

Among other industrialised nations, the fund's largest allocations continued to include Japan and the UK. We slightly increased these exposures and, at the end of the review period, they ranked as the fund's second and third largest country positions, respectively. Elsewhere, we held a relatively small exposure to the German government bond market, which largely reflected our view that very low yields among mainstream eurozone countries lacked relative value. (Bond yields refer to the interest received from a fixed interest security, which is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value).

In the emerging markets, our selected holdings included government bonds denominated in 'hard' currencies such as the US dollar and euro, as well as those issued by governments in their local currencies. We also maintained globally diversified holdings across the main emerging market regions of Latin America, Asia, emerging Europe, and Africa.

Our fund activity included adding positions via newly issued bonds that we felt were attractively priced. Within this theme, we participated in the first ever international bond offering from the government of Uzbekhistan. The US dollar-denominated offer proved heavily oversubscribed among investors. In emerging Europe, we added to the fund's allocation to Romania by buying newly issued euro-denominated government bonds. We selected Romania given its recent solid economic growth track record, while Montenegro and Albania were among our other preferred investments in the region. Elsewhere, we added to exposure in Latin America via purchases of government bonds in Peru and Paraguay. In contrast, an allocation to Sri Lanka was closed as we assessed this smaller market offered less upside potential.

Outlook

In addition to our chosen country allocations, the fund's flexible investment approach allows us to position the portfolio so that its performance should be less sensitive to the prospect of rising interest rates – a strategy known as holding short duration. Duration measures the sensitivity of a bond's price to a change in interest rates; it is an estimate of the number of years it takes an investor to recover the price of a bond if interest rates change. Generally, the longer the duration, the more sensitive the bond's price is to changes in interest rates.

Investment review

Earlier in the review period, we kept a short duration positioning in the fund against the backdrop of actual, or expected, increases in interest rates. However, we adjusted this stance towards the end of 2018 to be less pronounced, given factors such as the slower economic growth outlook. In our opinion, this prospect warrants more moderate expectations regarding the extent of upward moves in interest rates. Consequently, we broadly maintained this adjusted duration stance going into 2019 and for the remainder of the review period.

Among other investment themes, we maintained a globally diversified portfolio of government bonds, not only from large developed nations such as the US, Japan, and the UK, but also from select emerging economies. Despite periods of underperformance from emerging market bonds in 2018, we consider that long-term value can still be found in this area when comparing their valuations to government bonds in developed countries. Relevantly, emerging market bonds offer higher yields relative to developed markets for taking on a higher degree of risk. We also continue to believe that sentiment towards emerging market bonds should be supported by improvements made to their creditworthiness – a measure of a borrower's ability and willingness to repay its debt.

As always, however, the relevant risks need to be monitored closely, including moves to introduce international trade tariffs, as well as mixed signals on the performance of China's economy. Overall, we continue to manage the fund by seeking the most attractive value in the global government bond markets amid the prevailing economic conditions, while avoiding those countries where we believe the outlook is less favourable.

Claudia Calich
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.

	% of fund	
as at 30 June	**2019**	**2018**
FIXED INCOME		
Debt securities		
'AAA' credit rated bonds	9.22	7.89
'AA' credit rated bonds	28.38	24.48
'A' credit rated bonds	17.52	23.80
'BBB' credit rated bonds	19.80	22.34
'BB' credit rated bonds	10.13	8.30
'B' credit rated bonds	9.72	5.65
Bonds with no credit rating	2.49	2.95
CURRENCY		
Forward currency contracts	0.00	0.02
CASH EQUIVALENTS		
'AAA' rated money market fund [a]	0.87	3.07

[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.

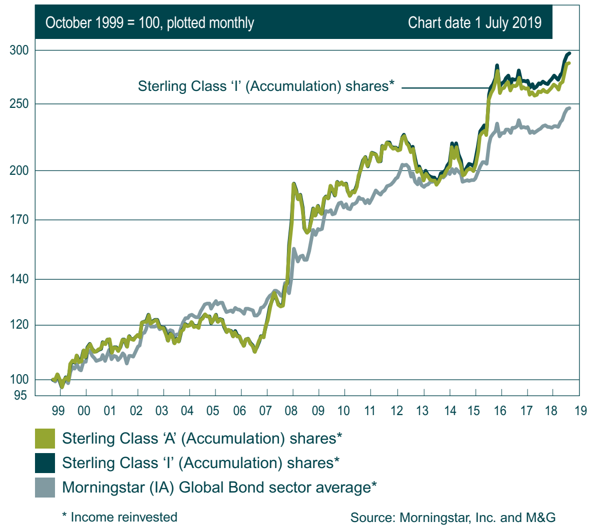
Fund level performance

Fund net asset value

as at 30 June	2019 $'000	2018 $'000	2017 $'000
Fund net asset value (NAV)	175,095	87,020	76,013

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 4 October 1999.

for the year to 30 June Change in NAV per share	2019 UK p	2018 UK p	2017 UK p
Opening NAV	130.10	132.84	126.77
Return before operating charges and after direct portfolio transaction costs	14.30	(1.15)	7.96
Operating charges	(1.45)	(1.59)	(1.62)
Return after operating charges	12.85	(2.74)	6.34
Distributions	(3.44)	(3.19)	(2.95)
Retained distributions	3.44	3.19	2.68
Closing NAV	142.95	130.10	132.84
Direct portfolio transaction costs	**UK p**	**UK p**	**UK p**
Costs before dilution adjustments	0.08	0.00	0.00
Dilution adjustments [a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.08	0.00	0.00
Performance and charges	**%**	**%**	**%**
Direct portfolio transaction costs [b]	0.06	0.00	0.00
Operating charges [c]	1.09	1.21	1.21
Return after operating charges	+9.88	-2.06	+5.00
Distribution yield	2.65	2.70	2.51
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV ($'000)	11,409	7,931	9,228
Closing NAV percentage of total fund NAV (%)	6.52	9.11	12.14
Number of shares	6,290,218	4,639,906	5,352,374
Highest share price (UK p)	143.46	137.39	140.69
Lowest share price (UK p)	128.23	126.85	127.07

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	1,199.22	1,218.46	1,157.67
Return before operating charges and after direct portfolio transaction costs	132.22	(10.64)	72.55
Operating charges	(7.06)	(8.60)	(8.71)
Return after operating charges	125.16	(19.24)	63.84
Distributions	(38.08)	(35.40)	(33.10)
Retained distributions	38.08	35.40	30.05
Closing NAV	1,324.38	1,199.22	1,218.46
Direct portfolio transaction costs	**UK p**	**UK p**	**UK p**
Costs before dilution adjustments	0.70	0.00	0.00
Dilution adjustments [a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.70	0.00	0.00
Performance and charges	**%**	**%**	**%**
Direct portfolio transaction costs [b]	0.06	0.00	0.00
Operating charges [c]	0.57	0.71	0.71
Return after operating charges	+10.44	-1.58	+5.51
Distribution yield	3.14	3.20	3.00
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV ($'000)	116,146	36,857	35,205
Closing NAV percentage of total fund NAV (%)	66.34	42.35	46.31
Number of shares	6,912,196	2,339,042	2,226,239
Highest share price (UK p)	1,329.09	1,261.12	1,286.17
Lowest share price (UK p)	1,183.83	1,168.21	1,162.28

[a] In respect of direct portfolio transaction costs.

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

[c] The annual management charge has been discounted, please see the table of changes in the 'Important information' section of this report on page 2 for more details.

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 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. 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 30 June Direct portfolio transaction costs [b]	2019 %	2018 %	2017 %	Average [a] %
Taxes	0.06	0.00	0.00	0.02
Costs before dilution adjustments	0.06	0.00	0.00	0.02
Dilution adjustments [c]	0.00	0.00	0.00	0.00
Total direct portfolio transaction costs	0.06	0.00	0.00	0.02
as at 30 June Indirect portfolio transaction costs	**2019 %**	**2018 %**	**2017 %**	**Average [a] %**
Average portfolio dealing spread	0.36	0.35	0.37	0.36

[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.

Notes

Contact

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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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