M&G Global Macro Bond Fund

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

M&G INVESTMENTS

Fund information

The Authorised Corporate Director (ACD) of M&G Global Macro Bond Fund presents its Annual Short Report 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 Global Macro Bond Fund, incorporating 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 4 May 2018, Sterling Class 'J' (Income) and 'J-H' (Income) share classes were launched.

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

As a result of the Extraordinary General Meetings of Shareholders held on 4 October 2018, the non-sterling share classes of the M&G Global Macro Bond Fund were merged into corresponding share classes of the M&G (Lux) Global Macro Bond Fund, a sub-fund of M&G (Lux) Investment Funds 1. The effective date of the merger was 26 October 2018. For further details of the Merger, please refer to www.mandg.com/brexitmergerdocumentation.

Investment objective

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

Investment policy

The fund invests mainly in debt instruments on a global basis which include, but are not limited to, variable rate securities, fixed interest securities, sovereign debt and corporate debt. The fund's exposure to debt instruments may be gained through the use of derivatives. The fund may also invest in other assets including collective investment schemes, money market instruments, cash and near cash, deposits, other transferable securities and derivatives.

Investment approach

The M&G Global Macro Bond Fund is a flexible global bond fund. 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 asset classes in which he believes the fund should invest in order to achieve its objective. It also influences the portfolio's mix of interest rate risk, credit risk and currency exposure, as well as the subsequent holdings. These factors 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.

Fund information

Risk profile

The fund is a flexible bond fund which invests in a range of fixed income securities from anywhere in the world and in any currency. The fund is therefore subject to the price volatility of global bond markets and fluctuations in currency exchange rates.

There are no restrictions on the amount of government bonds, investment grade bonds or high yield bonds that can be held within the portfolio. While government and investment grade bonds are generally highly liquid assets that are normally traded with relative ease, high yield corporate bonds are higher risk assets that could potentially experience a degree of illiquidity in times of market distress.

The fund's exposure to fixed income 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 section of the Annual Long Report and audited Financial Statements for M&G Global Macro Bond Fund.

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 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 performance of global bond markets was challenged by some key investment themes. In the period, the M&G Global Macro Bond Fund delivered varied performance across the different share classes. The returns of the fund's sterling unhedged share classes held up relatively well, helped by a moderately large increase in the value of the US dollar against sterling. This benefit resulted as the fund maintained a sizeable exposure to the US currency and a relatively small exposure to sterling. However, the fund's sterling hedged share classes are designed to reduce the effect on the fund's performance of currency movements between sterling and the US dollar. Consequently, amid the subdued performance in global bond markets, the fund's hedged share classes did not experience the same upside from the US dollar's gains versus sterling that benefited the unhedged share classes.

The fund's non-sterling share classes were transferred to a new Luxembourg-authorised SICAV on 26 October 2018. Between 1 November 2017 and 26 October 2018, these non-sterling share classes delivered negative returns. This outcome largely resulted from the fund's exposures to areas of the global bond markets that declined during the period.

Over five years or since launch of the share class (if less than five years old), the fund has achieved its objective of maximising long-term total return*.

* 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 Global Macro Bond Fund.

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 to 1 November 2018 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 [a]

	One year 01.11.17 % [b]	Three years 02.11.15 % p.a.	Five years 01.11.13 % p.a.	Since launch % p.a.
Sterling [c]				
Class 'A'	-0.3	+7.1	+4.2	+5.3 [d]
Class 'I'	+0.4	+7.7	+4.7	+5.1 [e]

[a] On 1 May 2009 the M&G Global Macro Bond Fund de-merged from M&G Investment Funds (4) to become the M&G Global Macro Bond Fund.

[b] Absolute basis.

[c] Price to price with income reinvested.

[d] 15 October 1999, the end of the initial offer period of the predecessor unit trust.

[e] 16 December 2011, 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

A number of global factors remained in focus in financial markets during the 12 months under review, including higher interest rates and inflation. In the important US economy, the Federal Reserve increased interest rates by a total of 1% in gradual stages, while the Bank of England (BoE) announced two increases of 0.25% each. These moves took the BoE's base interest rate up to 0.75%.

Investors also continued to assess the prospect of central banks in Europe and Japan reducing their significant economic stimulus measures. A main purpose of these measures includes keeping interest rates low. However, interest rate policies were left unchanged in these regions during the period.

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, as well as generally weak performance by sterling. (Bonds are loans in the form of a security, usually issued by a government – government bonds – or company – corporate bonds – which normally pay a fixed rate of interest over a given time period, at the end of which the initial amount borrowed is repaid.)

Elsewhere, investors in Europe became concerned towards the end of the period with 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.

In bond markets, actual or expected rises in inflation or interest rates typically dampen sentiment towards government bonds. The effects of US interest rate moves can even be felt internationally, given the size and influence of the US market within a global context. Political uncertainty, such as Brexit-related concerns and Italy's changing outlook, can add to investors' caution.

Against this backdrop, US government bonds (also known as Treasuries) generally declined in the review period and returns were mixed among eurozone government bonds. In Germany, while most segments of the government bond market produced modest gains, short-dated securities fell. Italian government bonds notably underperformed, although we avoided exposure to this market given the wariness caused by politics in the country.

The performance of corporate bonds also varied. High-quality corporate bonds in the US and eurozone declined, while their counterparts in the UK produced small increases or marginally negative/flat returns.

Sentiment towards corporate bonds – and international stockmarkets – became increasingly affected by concerns of a trade war developing between the US and China. This factor also weighed on the performance of emerging market bonds, as export revenues are important for many emerging economies. In addition, during the latter months of the review period, global economic growth forecasts began to moderate, which contributed to some weaker confidence in the outlook for corporate bonds and emerging markets.

At the same time, investors continued to weigh up the implications of higher interest rates and inflation. Central banks often respond to above-target inflation with interest rate rises and, against this backdrop, we continued to prefer a cautious stance in terms of the fund's overall positioning. This partly involved maintaining a sizeable allocation to bonds that are less sensitive to interest rate movements – a strategy known as holding low or short duration.

Our short duration positioning provided some support to the portfolio amid the challenging performance backdrop for global bonds. For example, this stance helped the relative performance of the fund's allocation to the US Treasury market. However, the fund's exposure to underperforming areas of the corporate bond markets, as well as emerging market bonds, detracted from its returns. In the fund's currency positioning, we maintained a sizeable exposure to the US dollar, which benefited the performance of the fund's sterling unhedged share classes as the US currency increased in value against sterling. This factor helped the performance of the fund's sterling unhedged share classes to hold up relatively well. The fund's non-sterling share classes, on the other hand, delivered negative returns.

Investment activities

Amid the performance headwinds faced by global bonds, we looked to assess whether potentially attractive buying opportunities could be found where price declines may have been overdone. During the period, for example, we thought that US government bonds began to offer better value, after their prices generally fell since the start of 2018. In March and April, we began to increase the fund's allocation to US Treasuries with shorter term maturity dates, believing that the environment of rising US interest rates was more appropriately priced in to their valuation levels.

We also maintained an exposure to the US market via holdings of index-linked government bonds, given the strengthening inflation data in the country. (These are bonds where both the value of the loan and the interest payments are adjusted in line with inflation over the life of the security.) Known as US Treasury Inflation-Protected Securities (TIPS), these assets performed well relative to conventional US government bonds. In turn, we took some profits from the fund's allocation to TIPS in July, and mainly switched the proceeds into additional holdings of conventional Treasuries.

Our investment strategy also continued to include a cautious approach to the fund's exposure to corporate bonds. In our assessment, valuations in areas of the corporate bond markets looked less attractive after a period of solid performance. Our approach remained to keep an allocation to corporate bond issuers with high credit ratings, while we restricted our exposure to companies whose creditworthiness is lower rated.

Our preferred sectors in the corporate bond market included financial companies and banks with high credit rankings, with bonds known as floating rate notes (FRNs) being among our selected holdings. We believe the attraction of FRNs is helped by the way these bonds pay a variable interest that is adjusted in line with movements in a reference interest rate. This not only minimises the impact of rising rates on investors, but also potentially allows them to benefit from higher rates.

The fund's flexible investment approach also allows us to allocate assets in the emerging bond markets. While we kept an exposure to this area on a selective basis, we reduced the fund's overall position in emerging bond markets. This partly reflected our consideration of the adverse implications of new trade tariffs between the US and China, a factor that contributed to increased volatility in emerging markets during 2018. Our steps to reduce the fund's allocation to emerging markets included the sale of bonds in Turkey, South Africa and Mexico.

Outlook

Higher US interest rates, firmer inflation trends, and ongoing international trade tensions, remained key considerations in bond markets as the review period ended. These factors also appeared to contribute to some trimming of global economic growth forecasts. In early October, for example, the International Monetary Fund (IMF) confirmed a reduction in its global forecast, to 3.7% from 3.9%.

In the fund, our main positioning themes continue to include holding bonds that are less sensitive to interest rate rises, while also maintaining caution towards corporate bond exposure. However, we still favour holding corporate securities as useful contributors to returns when valuations are appealing. Given this approach, we retain corporate bond positions that we feel offer attractive performance potential and, as always, will monitor all areas of the market for better buying opportunities.

Elsewhere, we are comfortable maintaining a selective approach to holding emerging market bonds, although we reduced this overall allocation in recent months. While emerging market bonds experienced increased volatility during 2018, we continue to believe that with careful selection these assets can offer diversification opportunities and the potential for a higher return for taking on higher degrees of risk. At the end of the review period, we held modest government bond positions in markets such as Brazil and Indonesia.

Overall, however, our largest allocation was to government securities in mainstream markets, with US government bonds ranking as our largest position. We added exposure to this area during 2018 as we felt some areas of the US market offered better value after prices declined. In terms of the fund's overall currency positioning, its largest exposures at the end of the period were to the US dollar and Japanese yen, while its smaller exposures included to the euro, Swiss franc, sterling, and Australian dollar.

Looking ahead, we will continue to seek what we believe is the best relative value among global bonds amid the prevailing economic conditions, while avoiding areas where we believe the outlook is less favourable.

Jim Leaviss
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 2018	2017
FIXED INCOME		
Debt securities		
'AAA' credit rated bonds	16.22	14.93
'AA' credit rated bonds	38.07	49.22
'A' credit rated bonds	11.89	7.96
'BBB' credit rated bonds	21.51	20.55
'BB' credit rated bonds	6.82	3.64
'B' credit rated bonds	4.05	2.08
Bonds with no credit rating	1.06	1.08
Debt derivatives		
Credit default swaps	(0.44)	(0.88)
Interest rate swaps	0.00	0.19
Interest rate futures	0.02	0.00
CURRENCY		
Forward currency contracts	(0.31)	(0.14)
CASH EQUIVALENTS		
'AAA' rated money market funds [a]	0.00	0.25
SHARE CLASS HEDGING		
Forward currency contracts for share class hedging	0.00	(0.24)

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

Financial highlights
Fund performance

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 sterling share classes, each with varying levels of charges and minimum investments; please refer to the Prospectus for M&G Global Macro Bond Fund, 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 Global Macro Bond Fund, which is available free of charge either from our website at www.mandg.co.uk/reports or by calling M&G Customer Relations.

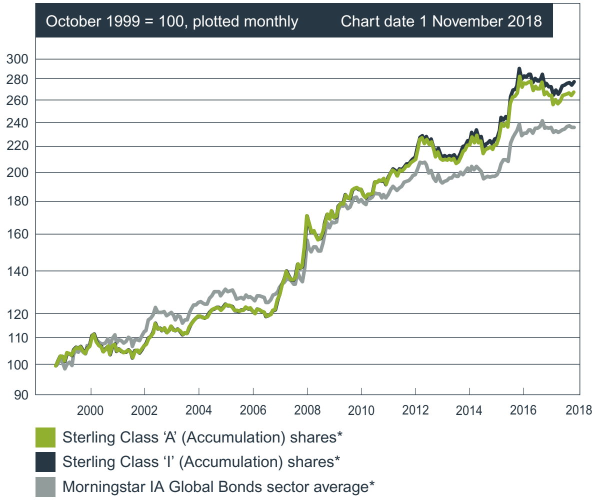
Fund level performance

Fund net asset value

as at 31 October	2018 $'000	2017 $'000	2016 $'000
Fund net asset value (NAV)	1,138,569	2,335,573	1,882,678

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.



* Income reinvested

Source: Morningstar, Inc. and M&G

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.

The non-sterling share classes were merged on 26 October 2018.

Sterling Class 'A' Accumulation share performance

The share class was launched on 15 October 1999.

for the year to 31 October Change in NAV per share	2018 UK p	2017 UK p	2016 UK p
Opening NAV	129.16	136.70	105.24
Return before operating charges and after direct portfolio transaction costs	1.90	(5.60)	33.47
Operating charges	(1.81)	(1.87)	(1.67)
Return after operating charges	0.09	(7.47)	31.80
Distributions	(2.15)	(1.28)	(1.70)
Retained distributions	2.15	1.21	1.36
Closing NAV	129.25	129.16	136.70
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	1.42	1.41	1.42
Return after operating charges	+0.07	-5.46	+30.22
Distribution yield	1.99	0.74	1.12
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV ($'000)	28,217	39,031	43,499
Closing NAV percentage of total fund NAV (%)	2.48	1.67	2.32
Number of shares	17,091,540	22,860,213	26,142,132
Highest share price (UK p)	131.60	136.95	137.45
Lowest share price (UK p)	121.68	127.24	104.24

Sterling Class 'I' Accumulation share performance

The share class was launched on 16 December 2011.

for the year to 31 October Change in NAV per share	2018 UK p	2017 UK p	2016 UK p
Opening NAV	141.01	148.41	113.70
Return before operating charges and after direct portfolio transaction costs	2.08	(6.11)	36.28
Operating charges	(1.14)	(1.17)	(1.04)
Return after operating charges	0.94	(7.28)	35.24
Distributions	(3.19)	(2.24)	(2.62)
Retained distributions	3.19	2.12	2.09
Closing NAV	141.95	141.01	148.41
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	0.82	0.81	0.81
Return after operating charges	+0.67	-4.91	+30.99
Distribution yield	2.60	1.34	1.72
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV ($'000)	506,096	569,644	424,479
Closing NAV percentage of total fund NAV (%)	44.45	24.39	22.55
Number of shares	279,096,179	305,597,282	234,991,502
Highest share price (UK p)	144.36	148.81	149.22
Lowest share price (UK p)	133.21	138.82	112.69

[a] In respect of direct portfolio transaction costs.

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

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 wholly in fixed interest securities no direct portfolio transaction costs are applicable. 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 31 October Indirect portfolio transaction costs	2018 %	2017 %	2016 %	Average [a] %
Average portfolio dealing spread	0.26	0.21	0.32	0.26

[a] Average of first three columns.

Notes

Contact

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* For security purposes and to improve the quality of our service, we may record and monitor telephone calls. You will require your M&G client reference. Failure to provide this will affect your ability to transact with us.

** 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.

† Please note that information contained within an email cannot be guaranteed as secure. We advise that you do not include any sensitive information when corresponding with M&G in this way.

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