



M&G Strategic Corporate Bond Fund

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

The Authorised Corporate Director (ACD) of M&G Strategic Corporate 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 Strategic Corporate 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 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 fund invests mainly in investment grade bonds. The fund may invest in derivatives in pursuit of the fund objective and for the purposes of efficient portfolio management. The fund may also invest in other assets including collective investment schemes, other transferable securities and other debt instruments (including corporate, high yield and government debt, convertible and preference stocks), cash, and near cash, deposits, warrants and money market instruments.

Investment approach

The fund's investment approach is largely 'top-down': the fund manager's economic outlook will determine key investment decisions such as the portfolio's duration, and how the fund's assets are invested proportionally by asset class and corporate sector.

The fund manager uses proprietary research, rather than external research. M&G's in-house team of credit analysts provides bottom-up analysis of the corporate bond markets, which complements the fund manager's top-down views.

Risk profile

The fund invests in fixed income securities, or bonds, issued by UK companies. It is primarily subject to the price volatility of the UK 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.

The fund's focus is on high-quality corporate bonds, securities that are normally traded with relative ease. Up to 20% of the fund may be invested in other fixed income investments, such as government bonds, which are typically highly liquid assets, or high yield corporate bonds, which are 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 section of the Annual Long Report and audited Financial Statements for M&G Strategic Corporate Bond Fund.

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 3 September 2018, for the year ended 31 August 2018

Performance against objective

Between 1 September 2017 (the start of the review period) and 3 September 2018, the M&G Strategic Corporate Bond Fund delivered a small negative total return (the combination of income and growth of capital) across all its share classes*.

The M&G Strategic Corporate Bond Fund invests predominantly in high-quality, sterling-denominated corporate bonds, with the aim of providing income and capital growth.

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 Strategic Corporate Bond Fund.

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 ^[a]				
	One year 01.09.17 % ^[b]	Three years 03.09.15 % p.a.	Five years 03.09.13 % p.a.	Since launch % p.a.
Sterling ^[c]				
Class 'A'	-0.7	+3.7	+4.1	+6.0 ^[d]
Class 'I'	-0.2	+4.2	+4.5	+4.3 ^[e]

^[a] On 1 September 2009 the M&G Strategic Corporate Bond Fund de-merged from M&G Investment Funds (1) to become the M&G Strategic Corporate Bond Fund.

^[b] Absolute basis.

^[c] Price to price with income reinvested.

^[d] 20 February 2004, the launch date of the merging fund.

^[e] 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

In the latter stages of 2017, investors' attention had turned to the likelihood of central banks finally being able to move towards more 'normal' monetary policy and gradually withdraw the support they had been providing to financial markets since the global financial crisis. This took place against a backdrop of broadly positive economic data releases, indicating a healthy global economy.

The Federal Reserve increased US interest rates three times during the review period, in December 2017, March 2018 and June 2018, taking the total number times it has increased rates since the end of the financial crisis to seven.

The European Central Bank (ECB) announced in October 2017 that it would gradually reduce the amount of money it spends each month on its bond-buying programme, but would continue to support markets until at least September 2018. In June this year, the ECB announced it would halve its bond purchases in September and end them altogether in December.

Meanwhile, the Bank of England announced a small interest rate rise of a quarter of a percentage point in November 2017, taking rates back to their level immediately before 2016's Brexit referendum vote. It then increased interest rates by the same amount again in August 2018, taking them to 0.75%. However, with Brexit uncertainty still looming large over the outlook for the UK economy, any further rises are expected to be limited and gradual.

But after a broadly positive end to 2017 and a strong January 2018 for financial markets, many areas in the global bond market experienced a downturn, as investors reacted to the prospect of higher inflation and interest rates. By March, weakness in global stockmarkets, caused mainly by the prospect of a trade war between the US and China and the US imposition of sanctions on Russia, had started to spill over into corporate bond markets. While April proved somewhat calmer, Italian political turmoil, combined with ongoing trade tensions between the US and China, caused further volatility in May. Volatility returned once more in August, as concerns over Turkey's economy and government – which had been building for months – reached boiling point. The collapse of the Turkish lira had dramatic implications for other emerging markets, exacerbated by a rising US dollar and protracted trade wars.

The more challenging conditions from the start of 2018 led to muted returns across the bond market over the 12-month review period as a whole. Sterling-denominated corporate bonds generally delivered modestly negative returns over the period, as did US dollar corporate bonds, while the performance of European corporate bonds was roughly flat.

The fund's performance was driven by its sizeable exposure to investment grade corporate bonds denominated in sterling and US dollars, and to asset-backed securities (bonds whose income payments are derived from a specified group of underlying pooled assets).

Investment activities

During the review period, we undertook a number of relative value trades – for example, taking advantage of the difference in pricing between bonds from the same company issued in different currencies or different maturities – in names including AT&T, Microsoft and British American Tobacco (BAT).

We have been finding significant opportunities in the asset-backed securities market, especially those backed by residential and commercial mortgages. Such securities tend to be floating rate in nature, meaning they adjust periodically depending on the change in a reference interest rate, and should therefore perform well even when interest rates rise. We bought bonds from Land Securities and took part in a securitisation from Gatwick Airport during the review period.

We continue to think that UK government bonds (also known as gilts) look expensive and so we have little exposure to these assets. We do hold small positions in bonds from peripheral eurozone governments, such as Spain and Italy, as these have looked attractively priced compared to European corporate bonds with similar credit ratings. Our Spanish and Italian government bond holdings are denominated in sterling, and so held up relatively better than comparable euro-denominated bonds issued by these governments during the Italian political volatility in May.

An important factor in 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 moved the fund's duration slightly between 5.2 years and 5.6 years, keeping it roughly the same amount short (between 2.6 and 2.9 years short) of a comparable index, the iBoxx £ Corporate Index.

Outlook

From a macroeconomic perspective, we believe the global economic recovery remains on track. In the US, consumer confidence is at its highest level since the financial crisis, while a healthy labour market is expected to drive further wage growth over the coming months. Various key economic indicators look especially encouraging, with the recent surge in the number of people changing jobs strongly indicative of a future rise in wages.

Europe is also an improving economic story, in our view: its growth outlook has brightened and, while we saw significant market reaction to Italian political uncertainty in May, overall political risk has receded. As the ECB slowly continues to reduce the amount of support it provides to bond markets, this may have an impact on bond prices.

While the current period of economic growth may appear long compared to historic standards, we believe we are witnessing an unusually elongated economic cycle and so this slow and steady expansion is likely to persist. As a result, we want to retain a large exposure to corporate bonds, while maintaining the fund's relative lack of sensitivity to changes in interest rates.

We continue to monitor closely the possible impact on markets should the US Federal Reserve be forced to raise interest rates higher or faster than investors currently expect due to the rapid onset of inflation. The form of the UK's future relationship with the EU after its departure from the union is the other main potential challenge, as the clock ticks down towards the end of March 2019. This will have a major impact on whether we find ourselves in a more stable, or more challenging, political environment in the next few years. At the same time, political newsflow – from the US in particular – may cause further volatility, as we have seen during the escalating trade tensions between the US and China.

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.

Richard Woolnough

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	5.53	7.58
'AA' credit rated bonds	4.65	5.80
'A' credit rated bonds	15.35	16.62
'BBB' credit rated bonds	56.73	52.13
'BB' credit rated bonds	5.74	5.68
'B' credit rated bonds	0.00	0.14
Bonds with no credit rating	5.42	5.58
Debt derivatives		
Credit default swaps	0.00	(0.01)
Interest rate swaps	0.00	(0.06)
Interest rate futures	0.04	(0.06)
CURRENCY		
Forward currency contracts	(0.10)	(0.12)
CASH EQUIVALENTS		
'AAA' rated money market funds ^[a]	4.64	5.23

^[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 Strategic Corporate 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 Strategic Corporate 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

	2018	2017	2016
as at 31 August	£'000	£'000	£'000
Fund net asset value (NAV)	2,993,538	3,518,319	4,287,965

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.

Sterling Class 'A' Accumulation share performance

The share class was launched on 20 February 2004.

for the year to 31 August Change in NAV per share	2018 UK p	2017 UK p	2016 UK p
Opening NAV	117.09	114.64	104.21
Return before operating charges and after direct portfolio transaction costs	0.41	3.92	12.26
Operating charges	(1.36)	(1.32)	(1.24)
Return after operating charges	(0.95)	2.60	11.02
Distributions	(2.79)	(2.89)	(2.95)
Retained distributions	2.79	2.74	2.36
Closing NAV	116.14	117.09	114.64

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	1.16	1.16	1.16
Return after operating charges	-0.81	+2.27	+10.57
Distribution yield	2.50	2.31	2.40
Effect on yield of charges offset against capital	0.00	0.00	0.00

Other information

Closing NAV (£'000)	863,290	1,078,937	1,330,254
Closing NAV percentage of total fund NAV (%)	28.84	30.67	31.02
Number of shares	743,347,947	921,487,919	1,160,411,896
Highest share price (UK p)	119.06	117.28	114.65
Lowest share price (UK p)	115.14	110.15	102.80

Financial highlights

Fund performance

Sterling Class 'I' Accumulation share performance

The share class was launched on 3 August 2012.

for the year to 31 August	2018	2017	2016
Change in NAV per share	UK p	UK p	UK p
Opening NAV	1,296.26	1,263.12	1,143.66
Return before operating charges and after direct portfolio transaction costs	4.51	43.37	134.88
Operating charges	(8.60)	(8.30)	(7.77)
Return after operating charges	(4.09)	35.07	127.11
Distributions	(37.46)	(38.17)	(38.26)
Retained distributions	37.46	36.24	30.61
Closing NAV	1,292.17	1,296.26	1,263.12

Direct portfolio transaction costs	UK p	UK p	UK p
Costs before dilution adjustments	0.03	0.03	0.04
Dilution adjustments ^[a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.03	0.03	0.04

Performance and charges	%	%	%
Direct portfolio transaction costs ^[b]	0.00	0.00	0.00
Operating charges	0.66	0.66	0.66
Return after operating charges	-0.32	+2.78	+11.11
Distribution yield	3.01	2.81	2.90
Effect on yield of charges offset against capital	0.00	0.00	0.00

Other information

Closing NAV (£'000)	1,116,634	1,092,958	1,109,224
Closing NAV percentage of total fund NAV (%)	37.29	31.06	25.87
Number of shares	86,415,276	84,316,483	87,816,178
Highest share price (UK p)	1,320.24	1,298.32	1,263.23
Lowest share price (UK p)	1,280.08	1,214.80	1,130.25

^[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:

- **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 31 August	2018	2017	2016	Average ^[a]
Indirect portfolio transaction costs	%	%	%	%
Average portfolio dealing spread	0.80	0.73	0.93	0.82

^[a] Average of first three columns.

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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