M&G UK Inflation Linked Corporate Bond Fund

a sub-fund of M&G Investment Funds (10)

Annual Short Report March 2019
For the year ended 31 March 2019

M&G INVESTMENTS

Fund information

The Authorised Corporate Director (ACD) of M&G Investment Funds (10) presents its Annual Short Report for M&G UK Inflation Linked 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 (10), incorporating all the sub-funds and a Glossary of terms is available free of charge either from our website at www.mandg.co.uk/reports or by calling M&G Customer Relations on 0800 390 390.

ACD

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

Important information

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

Investment objective

The fund aims to protect the value of capital and income from inflation by generating a return consistent with or greater than UK inflation over a rolling three to five year period. There is no guarantee that the fund will achieve its objective over this, or any other, period. The income distributions and the value of your investment may rise and fall and investors may not recoup the original amount they invested.

Investment policy

The fund invests mainly in investment grade corporate bonds, including inflation-linked corporate bonds, floating rate notes (including asset backed securities) and other fixed income instruments (including bonds not linked to inflation). Derivatives may be used in pursuit of the fund objective and for efficient portfolio management purposes. Corporate bond exposure may be achieved either directly or by investing in a combination of assets, including government securities and credit derivatives. Inflation strategies may, at times, result in a return profile different to that of corporate bonds not linked to inflation. If deemed appropriate by the investment manager, the associated currency risks may be hedged.

The fund may also invest in other assets including collective investment schemes, other transferable securities and debt instruments (including high yield debt, convertible and preference stocks), cash and near cash, deposits, warrants and money market instruments.

Investment approach

The M&G UK Inflation Linked Corporate Bond Fund invests in a range of fixed interest securities that should perform well when inflation is high or rising. The fund will be mainly exposed to investment grade credit but can also invest in inflation-linked government bonds, floating rate notes (FRNs), senior secured loans, conventional corporate and government bonds, cash and derivatives such as credit default swaps (CDS). The fund manager may also form assets out of a combination of government bonds and derivatives, whose returns behave in a similar way to inflation-linked corporate bonds. The aim of the fund is to provide returns that are consistent with or exceed inflation, as measured by the Consumer Prices Index (CPI) over a rolling three- to five-year period.

Fund information

Risk profile

The fund invests in fixed interest assets that would be expected to perform well in an inflationary environment, such as inflation-linked bonds issued by companies and governments. It is therefore subject to the price volatility of the global bond market as well as the performance of individual issuers.

The fund's focus is on investment grade, or high-quality corporate bonds, which are securities that are normally traded with relative ease. The fund's exposure to index-linked bonds may be achieved either directly or by investing in a combination of assets, including government securities and credit 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 (10).

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 April 2019, for the year ended 31 March 2019

Performance against objective

Between 3 April 2018 (the start of the review period) and 1 April 2019, the M&G UK Inflation Linked Corporate Bond Fund delivered a small positive total return (the combination of income and growth of capital) across different share classes. However, returns in this period were behind the change in the UK Consumer Prices Index (CPI), which the fund seeks to match or exceed over a rolling three- to five-year period. Over three years, the fund's returns were ahead of the CPI, although slightly behind CPI over five years.*

* 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 (10).

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 03.04.18 % [a]	three years 01.04.16 % p.a.	five years 01.04.14 % p.a.	since launch % p.a.
Sterling [b]				
Class 'A'	+0.9	+2.5	+0.7	+2.1 [c]
Class 'I'	+1.4	+2.9	+1.2	+2.5 [c]

[a] Absolute basis.

[b] Price to price with income reinvested.

[c] 16 September 2010, the launch date of the fund.

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 review

Investment performance

The fund invests in a range of instruments that can help to mitigate the potentially damaging effects of inflation. It is mainly invested in inflation-linked bonds issued by high-quality companies, where both the value of the loan and the interest payments are adjusted in line with inflation until they mature. 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. Bonds issued by companies are referred to as 'corporate bonds', while those issued by governments are called 'government bonds'.

The 12-month period under review was a volatile period for corporate bond markets. A variety of factors weighed on sentiment throughout 2018, including concerns about the negative impact of rising US interest rates, escalating trade war tensions between the US and China, and political turmoil in Europe and several emerging markets.

The US Federal Reserve (Fed) raised interest rates in 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), contributing to periods of adverse sentiment towards UK corporate bonds. Investors in Europe became concerned in the latter stages of 2018 about Italian proposals to increase the country's budget deficit.

Investor sentiment towards corporate bonds 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 some weaker confidence in the outlook for corporate bonds and emerging markets.

The mood then changed once again in early 2019, as investors took comfort from the Fed's statements that the central bank would moderate its strategy of raising interest rates. This resulted in a strong start to the year for corporate bonds, with these assets recovering some of their earlier declines.

In the UK, inflation initially picked up in the early part of the review period, with the CPI reaching 2.7% in August 2018. However, inflationary pressures eased from that point, with the CPI coming in at 1.9% in February 2019. Despite this, the market's expectation for UK inflation – based on the difference between index-linked gilt yields and conventional gilt yields – rose slightly over the period.

The fund delivered a modest positive return over the review period, helped by a rise in UK inflation expectations. While the fund maintained a low sensitivity to movements in interest rates, it nevertheless obtained some benefit from the significant fall in government bond yields in the second half of the review period. However, the overall weakness across corporate bond markets detracted from returns. (Yields refer to the income received from an investment. The yield is usually expressed annually as a percentage based on the investment's cost, its current market value or face value.)

Investment activities

Given ongoing uncertainty regarding Brexit, as well as potential changes to the Retail Prices Index (RPI) following a review by the House of Lords, we significantly reduced our UK index-linked bond exposure in the second half of the review period. We are particularly mindful that a smooth Brexit outcome could trigger a relief rally in sterling and a corresponding fall in UK inflation expectations. This in turn could have a negative impact on index-linked bond prices.

As a result, our index-linked gilt exposure is now focused on very short-dated instruments (such as those maturing in 2020 and 2022), where we think downside risks are limited. We also maintain modest positions in US Treasury Inflation Protected Securities (TIPS) and index-linked German bunds – these instruments provide exposure to global inflationary trends, but without being affected by Brexit noise and uncertainty over changes to the RPI.

Following the strong rally in corporate bond markets since the start of 2019, we have also recently reduced credit risk within the fund. For instance, we decreased our exposure to 'BBB' rated bonds, while increasing our allocation to more highly rated single 'A' rated bonds. We also trimmed our financial exposure, by selling or reducing several of our UK bank positions following strong performance.

The fund continues to be positioned with a low sensitivity to movements in interest rates, especially in terms of our UK interest rate risk where we have minimal exposure. This should help mitigate the negative impact of any future volatility in gilt markets amid ongoing political uncertainty.

Outlook

While we would not attempt to predict future political developments, we think it is fair to say that the UK currently faces unprecedented levels of political uncertainty. By focusing on index-linked bonds issued by highly rated companies that are due to be repaid in a relatively short period of time, we believe the fund is well placed to withstand any future rise in UK inflation because of sterling weakness. Furthermore, by keeping a low sensitivity to movements in interest rates, the fund should also be able to withstand any future turbulence in government bond markets.

While mindful of the recent slowdown in global growth, we maintain a broadly positive economic outlook. This is largely based on our positive assessment of the US economy, where a healthy labour market is expected to drive further wage growth over the coming months. The US is a service-based economy, and its reliance on people rather than goods means that it is unlikely to turn deflationary in the short to medium term. The market now expects the US Federal Reserve to keep interest rates on hold, or to even cut rates, but in our view the Fed may need to start increasing interest rates again sooner than expected.

Against this backdrop, we continue to favour corporate bonds over government bonds. That said, given the strong performance of corporate bonds since the start of the year, we think valuations are now closer to fair value. Until we have greater certainty over the eventual Brexit outcome, as well as the wider global economic outlook, we think a cautious stance is warranted.

Ben Lord
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 31 March	**2019**	**2018**
FIXED INCOME		
Debt securities		
'AAA' credit rated bonds	7.63	2.74
'AA' credit rated bonds	51.25	68.73
'A' credit rated bonds	12.18	9.67
'BBB' credit rated bonds	21.34	10.04
'BB' credit rated bonds	3.50	1.59
Bonds with no credit rating	2.61	5.42
Debt derivatives		
Credit default swaps	0.54	1.13
Interest rate swaps	(0.05)	0.02
Interest rate futures	(0.15)	(0.31)
CURRENCY		
Forward currency contracts	0.23	0.44
CASH EQUIVALENTS		
'AAA' rated money market funds [a]	0.68	0.26

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

The fund is available for investment in different share classes, each with varying levels of charges and minimum investments; please refer to the Prospectus for M&G Investment Funds (10), 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 (10), which is available free of charge either from our website at www.mandg.co.uk/reports or by calling M&G Customer Relations.

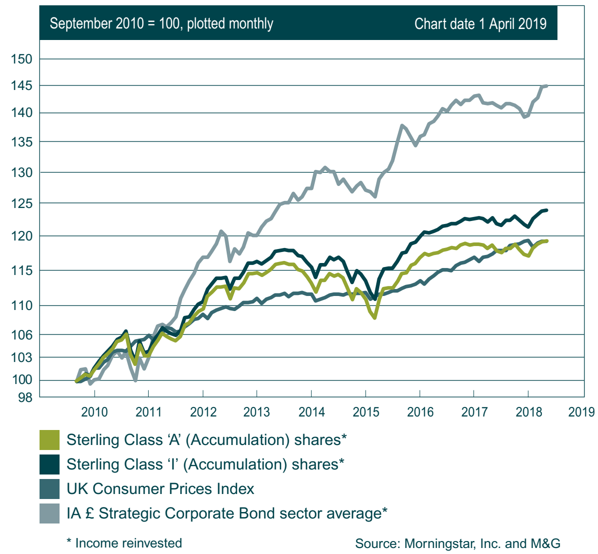
Fund level performance

Fund net asset value

as at 31 March	2019 £'000	2018 £'000	2017 £'000
Fund net asset value (NAV)	1,080,651	1,192,190	1,085,121

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.



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 16 September 2010.

for the year to 31 March Change in NAV per share	2019 UK p	2018 UK p	2017 UK p
Opening NAV	118.14	117.06	110.82
Return before operating charges and after direct portfolio transaction costs	2.41	2.44	7.67
Operating charges	(1.37)	(1.36)	(1.33)
Return after operating charges	1.04	1.08	6.34
Distributions	(0.12)	0.00	(0.57)
Retained distributions	0.12	0.00	0.47
Closing NAV	119.18	118.14	117.06
Direct portfolio transaction costs	**UK p**	**UK p**	**UK p**
Costs before dilution adjustments	0.00	0.00	0.01
Dilution adjustments [a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.00	0.00	0.01
Performance and charges	**%**	**%**	**%**
Direct portfolio transaction costs [b]	0.00	0.00	0.01
Operating charges	1.16	1.16	1.16
Return after operating charges	+0.88	+0.92	+5.72
Distribution yield	0.00	0.00	0.00
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV (£'000)	30,318	48,328	53,420
Closing NAV percentage of total fund NAV (%)	2.81	4.05	4.92
Number of shares	25,438,455	40,906,802	45,636,252
Highest share price (UK p)	119.23	119.16	117.47
Lowest share price (UK p)	116.96	117.00	110.91

Sterling Class 'I' Accumulation share performance

The share class was launched on 16 September 2010.

for the year to 31 March Change in NAV per share	2019 UK p	2018 UK p	2017 UK p
Opening NAV	122.15	120.43	113.51
Return before operating charges and after direct portfolio transaction costs	2.50	2.52	7.86
Operating charges	(0.81)	(0.80)	(0.78)
Return after operating charges	1.69	1.72	7.08
Distributions	(0.74)	0.00	(1.17)
Retained distributions	0.74	0.00	1.01
Closing NAV	123.84	122.15	120.43
Direct portfolio transaction costs	**UK p**	**UK p**	**UK p**
Costs before dilution adjustments	0.00	0.00	0.01
Dilution adjustments [a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.00	0.00	0.01
Performance and charges	**%**	**%**	**%**
Direct portfolio transaction costs [b]	0.00	0.00	0.01
Operating charges	0.66	0.66	0.66
Return after operating charges	+1.38	+1.43	+6.23
Distribution yield	0.17	0.00	0.26
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV (£'000)	442,333	457,560	444,839
Closing NAV percentage of total fund NAV (%)	40.93	38.39	40.99
Number of shares	357,173,836	374,593,898	369,378,412
Highest share price (UK p)	123.89	123.01	120.83
Lowest share price (UK p)	121.39	120.41	113.61

[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 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 31 March Direct portfolio transaction costs [b]	2019 %	2018 %	2017 %	Average [a] %
Broker commission	0.00	0.00	0.01	0.00
Taxes	0.00	0.00	0.00	0.00
Costs before dilution adjustments	0.00	0.00	0.01	0.00
Dilution adjustments [c]	0.00	0.00	0.00	0.00
Total direct portfolio transaction costs	0.00	0.00	0.01	0.00
as at 31 March Indirect portfolio transaction costs	**2019 %**	**2018 %**	**2017 %**	**Average [a] %**
Average portfolio dealing spread	0.22	0.12	0.28	0.21

[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.

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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