M&G Corporate Bond Fund

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

Interim Short Report December 2018
For the six months ended 31 December 2018

Fund information

The Authorised Corporate Director (ACD) of M&G Investment Funds (3) presents its Interim Short Report for M&G Corporate Bond Fund which contains a review of the fund's investment activities and investment performance during the period. The ACD's Interim Long Report and unaudited 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

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

Investment objective

The fund aims to provide income and capital growth.

Investment policy

At least 70% of the fund is invested in sterling-denominated corporate debt instruments. The fund's exposure to corporate debt may be gained through the use of derivatives. Derivatives may also be used for efficient portfolio management. Any currency exposures within the fund may be managed by currency hedges into sterling. The fund may also invest in collective investment schemes, other transferable securities and other debt instruments (including corporate debt and government and public securities denominated in any currency), cash, near cash, other money market securities, warrants and other derivative instruments.

Investment approach

The fund's strategy is based on the principle that corporate bond market returns are driven by a combination of macroeconomic, asset, sector and stock-level factors. As different factors dominate returns at different stages of the economic cycle, the manager applies a dynamic investment approach, changing the blend of duration and credit exposure in the portfolio to weight them appropriately.

The fund manager has the investment freedom to take a high-conviction approach when selecting credits for the portfolio. Diversification – across individual issuers as well as industries – is an essential element of the fund's strategy to limit the potential for losses in the event of default.

The fund's investment style combines top-down and bottom-up analysis, and the fund manager is assisted in the selection of individual credits by a large team of independent sovereign and public credit analysts.

Fund information

Risk profile

The fund invests mainly in sterling-denominated 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.

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 2 January 2019, for the six months ended 31 December 2018

Performance against objective

Between 2 July 2018 (the start of the review period) and 2 January 2019, the M&G Corporate Bond Fund delivered a small negative total return (the combination of income and growth of capital) in its sterling share classes, broadly in line with the average return of its peers. Returns for the fund's euro share classes were lower, the result of sterling weakness against the euro over the period*.

The M&G 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 Interim Long Report and unaudited Financial Statements for M&G Investment Funds (3).

Investment review

To give an indication of the performance of the fund, the following table shows the compound rate of return, per annum, over the period for Sterling Class 'A' (Accumulation) shares and Sterling Class 'I' (Accumulation) shares. Calculated on a price to price basis with income reinvested.

Long-term performance

	Six months 02.07.18 % [a]	Three years 04.01.16 % p.a.	Five years 02.01.14 % p.a.	Since launch % p.a.
Sterling [b]				
Class 'A'	-0.5	+3.3	+4.0	+6.0 [c]
Class 'I'	-0.2	+3.7	+4.4	+6.3 [d]

[a] Absolute basis.

[b] Price to price with income reinvested.

[c] 15 April 1994. All performance data prior to 11 March 2002 (the launch date of the share class) has been calculated by reference to a conversion factor due to a change of the nominated share class.

[d] 2 July 2007, the launch date of the share class.

Please note past performance is not a guide to future performance and the value of investments, and the income from them, will fluctuate. This will cause the fund price to fall as well as rise and you may not get back the original amount you invested.

Investment performance

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

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

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

These more challenging conditions led to losses across many parts of the bond market over the six-month period. Sterling and euro-denominated investment grade corporate bonds generally suffered more than US dollar-denominated corporate bonds, while high yield corporate bonds declined more notably.

The fund's performance was driven by its sizeable exposure to investment grade corporate bonds (fixed income securities issued by a company with a medium or high credit rating from a recognised credit rating agency, which are considered to be at lower risk from default than those issued by companies with lower credit ratings) and to asset-backed securities (bonds whose income payments are derived from a specified group of underlying pooled assets).

The fund's allocation (just over 20%) to US dollar-denominated corporate bonds was beneficial, as these generally performed better than their sterling equivalents over the six months, as was its relative lack of exposure to sterling-denominated bonds issued by financials versus a comparable index. However, the fund's relative lack of sensitivity to changes in interest rates (known as 'duration') constrained performance.

Investment activities

One of the key drivers of a bond fund's performance is its ability to adjust the portfolio's sensitivity to changes in interest rates, known as 'duration'. Being shorter duration means that a fund is relatively less sensitive to changes in interest rates than longer duration funds. During the course of the reporting period, we held the fund's duration close to its maximum permitted short position versus a comparable index, the iBoxx £ Corporate Index.

We once again took advantage of opportunities to add value through 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 – during the review period. In August, for example, we switched a position in Aviva to a slightly longer dated sterling denominated bond from the same issuer. In October, we switched some US dollar-denominated positions into equivalent sterling ones, primarily in the telecoms sector.

Investment review

After a significant sell-off in corporate bond markets towards the end of 2018 caused prices to fall, we have been happy to add some credit risk back into the portfolio. In December, for example, we sold some good-quality names that had performed well, for example Goldman Sachs and Apple, in order to buy into selected good value credits such as Sky and WPP Group.

We continue to think that UK government bonds (also known as gilts) look expensive and so we have little exposure to these assets.

Outlook

In our view, monetary policy pursued by the core central banks over the past decade has worked and the world has normalised. Interest rates are the only part not to have yet returned to 'normal', although rates in the US are not too far off.

Monetary policy works with a lag. We can see this in the labour market, where wages were high in 2007-2008 off the back of a strong global economy in 2005-2006. There are clear signs that the US labour market is now overheating, which will drive pay higher. Both the US and UK are services-dominated economies and as a result, when wages rise, so does inflation.

While the UK is at a different stage in the cycle to the US from a monetary policy perspective due to Brexit, the two are in a similar place from an economic standpoint.

Our main concern at present is less about an imminent US recession. Rather, we worry that if the financial system is truly different since the great financial crisis – as many have argued – when central banks do eventually need to put on the brakes, they may need to put them on harder than before. At the same time, we remain vigilant about any further escalation in global trade tensions.

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 31.12.18	30.06.18
FIXED INCOME		
Debt securities		
'AAA' credit rated bonds	7.39	10.26
'AA' credit rated bonds	6.96	9.07
'A' credit rated bonds	20.37	19.26
'BBB' credit rated bonds	49.02	46.60
'BB' credit rated bonds	3.71	3.73
Bonds with no credit rating	7.16	7.58
Debt derivatives		
Interest rate futures	(0.34)	(0.08)
Interest rate swaps	0.00	0.01
CURRENCY		
Forward currency contracts	(0.21)	(0.36)
CASH EQUIVALENTS		
'AAA' rated money market funds [a]	4.09	2.14

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

Portfolio transactions

for the six months to 31 December Portfolio transactions	2018 £'000	2017 £'000
Total purchases	519,845	376,338
Total sales	595,324	579,343

Purchases and sales exclude the cost and proceeds of 'AAA' rated money market funds.

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 Interim Long Report and unaudited 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.

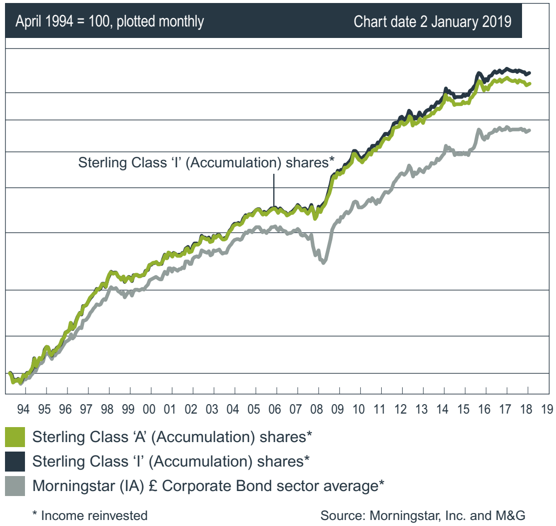
Fund level performance

Fund net asset value

as at	31.12.18 £'000	30.06.18 £'000	30.06.17 £'000
Fund net asset value (NAV)	3,617,578	3,696,143	4,127,165

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 2 July 2007. 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 15 April 1994.

Change in NAV per share	Six months to 31.12.18 UK p	Year to 30.06.18 UK p	Year to 30.06.17 UK p
Opening NAV	69.17	69.24	65.67
Return before operating charges and after direct portfolio transaction costs	(0.25)	0.74	4.54
Operating charges	(0.41)	(0.81)	(0.79)
Return after operating charges	(0.66)	(0.07)	3.75
Distributions	(0.87)	(1.72)	(1.84)
Retained distributions	0.87	1.72	1.66
Closing NAV	68.51	69.17	69.24
Direct portfolio transaction costs	**UK p**	**UK p**	**UK p**
Costs before dilution adjustments	0.00	0.00	0.00
Dilution adjustments [a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.00	0.00	0.00
Performance and charges	**%**	**%**	**%**
Direct portfolio transaction costs [b]	0.00	0.00	0.00
Operating charges	1.16	1.16	1.16
Return after operating charges	-0.95	-0.10	+5.71
Distribution yield	2.59	2.44	2.52
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV (£'000)	318,333	367,913	459,881
Closing NAV percentage of total fund NAV (%)	8.80	9.95	11.14
Number of shares	464,645,477	531,917,115	664,216,712
Highest share price (UK p)	70.25	70.75	70.07
Lowest share price (UK p)	68.16	68.85	66.07

Sterling Class 'I' Accumulation share performance

The share class was launched on 2 July 2007.

Change in NAV per share	Six months to 31.12.18 UK p	Year to 30.06.18 UK p	Year to 30.06.17 UK p
Opening NAV	72.40	72.12	68.09
Return before operating charges and after direct portfolio transaction costs	(0.26)	0.76	4.73
Operating charges	(0.24)	(0.48)	(0.47)
Return after operating charges	(0.50)	0.28	4.26
Distributions	(1.09)	(2.16)	(2.27)
Retained distributions	1.09	2.16	2.04
Closing NAV	71.90	72.40	72.12
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	0.66	0.66	0.66
Return after operating charges	-0.69	+0.39	+6.26
Distribution yield	3.09	2.94	3.02
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV (£'000)	544,069	573,803	618,336
Closing NAV percentage of total fund NAV (%)	15.04	15.52	14.98
Number of shares	756,727,838	792,512,099	857,427,451
Highest share price (UK p)	73.58	73.89	72.98
Lowest share price (UK p)	71.50	71.87	68.62

[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.
- **Oversight and other independent services:** Charges paid to providers independent of M&G for services which include depositary, custody and audit.
- **Ongoing charges from underlying funds:** Ongoing charges on holdings in underlying funds that are not rebated.

Operating charges do not include portfolio transaction costs or any entry and exit charges (also known as initial and redemption charges). The charging structures of share classes may differ, and therefore the operating charges may differ.

Operating charges are the same as the ongoing charges shown in the Key Investor Information Document, other than where an estimate has been used for the ongoing charge because a material change has made the operating charges unreliable as an estimate of future charges.

For this fund there is no difference between operating charges and ongoing charges figures, unless disclosed under the specific share class performance table.

Portfolio transaction costs

Portfolio transaction costs are incurred by funds when buying and selling investments. These costs vary depending on the types of investment, their market capitalisation, country of exchange and method of execution. They are made up of direct and indirect portfolio transaction costs:

- **Direct portfolio transaction costs:** Broker execution commission and taxes.
- **Indirect portfolio transaction costs:** 'Dealing spread' – the difference between the buying and selling prices of the fund's investments; some types of investment, such as fixed interest securities, have no direct transaction costs and only the dealing spread is paid.

Investments are bought or sold by a fund when changes are made to the investment portfolio and in response to net flows of money into or out of the fund from investors buying and selling shares in the fund.

To protect existing investors, portfolio transaction costs incurred as a result of investors buying and selling shares in the fund are recovered from those investors through a 'dilution adjustment' to the price they pay or receive. As the fund invests mainly in fixed interest securities, the direct transaction costs paid on other investments are too small to be reflected in the table below. To give an indication of the indirect portfolio dealing costs the table below shows the average portfolio dealing spread.

Further information on this process is in the Prospectus, which is available free of charge on request either from our website at www.mandg.co.uk/prospectuses or by calling M&G Customer Relations.

Portfolio transaction costs

as at Indirect portfolio transaction costs	31.12.18 %	30.06.18 %	30.06.17 %	Average [a] %
Average portfolio dealing spread	0.85	0.72	0.70	0.76

[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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