



# M&G Gilt & Fixed Interest Income Fund

a sub-fund of M&G Investment Funds (2)

**Interim Short Report November 2017**  
For the six months ended 30 November 2017



The Authorised Corporate Director (ACD) of M&G Investment Funds (2) presents its Interim Short Report for M&G Gilt & Fixed Interest Income 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 (2), 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](http://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.)

### Investment objective

The fund aims to provide income and capital growth.

### Investment policy

At least 70% of the fund is invested in short, medium or long-dated gilts according to the fund manager's view at any given moment of the likely course of interest rates and trend of the gilt market. The fund's exposure to gilts may be gained through the use of derivatives. Derivatives may also be used for efficient portfolio management. The fund may also invest in collective investment schemes, other transferable securities, other debt instruments, cash, near cash, other money market securities, warrants and other derivative instruments.

### Investment approach

The fund manager's investment approach is driven primarily by macroeconomic factors such as views on interest rates, inflation and economic growth and tends not to be influenced by short-term changes in the economic or market environment.

### Risk profile

The fund invests in fixed income securities, or bonds, issued by the UK government. It is, therefore, subject to the price volatility of the UK government bond market. It is also influenced by developments in the broader global government bond market. UK government bonds are highly liquid securities, meaning they are normally traded with relative ease.

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.



1	2	3	4	5	6	7
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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 1 December 2017, for the six months ended 30 November 2017

### Performance against objective

Between 1 June 2017 (the start of the review period) and 1 December 2017, the M&G Gilt & Fixed Interest Income Fund's Sterling Class 'A' and 'I' shares delivered a total return (the combination of income and growth of capital) of -1.6% and -1.5%, respectively. This was slightly behind the average return from the fund's peer group, the IA UK Gilts sector, which was -1.4% over the same period.

In this reporting period, the fund has not met its objective of providing income and capital growth, although over three and five years and since launch it has.\*

\* 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 (2).

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 01.06.17 % <sup>[a]</sup>	Three years 01.12.14 % p.a.	Five years 03.12.12 % p.a.	Since launch % p.a.
<b>Sterling <sup>[b]</sup></b>				
Class 'A'	-1.6	+3.9	+3.3	+6.8 <sup>[c]</sup>
Class 'I'	-1.5	+4.1	+3.5	+3.1 <sup>[d]</sup>

<sup>[a]</sup> Absolute basis.

<sup>[b]</sup> Price to price with income reinvested.

<sup>[c]</sup> 9 December 1980, the end of the initial offer period of the predecessor unit trust.

<sup>[d]</sup> 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

The backdrop of strengthening global economic growth and the potential for higher inflation remained a key theme in financial markets during the six months under review. Consequently, market observers focused much attention on the prospect of higher interest rates, particularly as a number of central banks have implemented policy changes to constrain the firmer inflation trend. When consumer prices are rising quickly, central banks often increase interest rates. The US Federal Reserve increased interest rates three times in 2017 (March, June and December).

In the UK and eurozone, central banks have kept interest rates low as part of their attempts to stimulate economic activity, but investors increasingly expected this support to be reduced. In October, the European Central Bank announced plans to start scaling back some of its supportive measures.

Meanwhile, in the UK, the Bank of England (BoE) has been mindful of political uncertainty, which may impact economic activity. For example, there remains a lack of clarity about the government's aim for the nature of the post-Brexit UK and its trading relations with the European Union (EU) and the rest of the world. However, shortly after the end of the review period, an agreement was finally reached on stage one of the negotiations to leave the EU, allowing both parties to move on to discussions about the future, post Brexit, relationship. Meanwhile, the snap parliamentary elections that were held in June resulted in a hung parliament, which led to more uncertainty. Against this background, the annual inflation rate, as measured by the Consumer Prices Index (CPI), continued to increase, largely due to a weaker sterling following the referendum on EU membership; UK CPI inflation reached 3.0% in September and remained steady the following month before rising to 3.1% in November, the highest level in nearly six years. The BoE duly raised interest rates for the first time in 10 years.

In the bond markets, actual or anticipated rises in inflation or interest rates typically dampen sentiment towards government bonds. Given the importance of the US market, the effects of interest rate increases in the US are generally felt internationally. (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.)

In an environment of rising inflation and interest rates, government bond prices declined in the UK. Downward pressure on the asset class also came from the prospect of stronger growth in the US and the expected knock-on effect of higher oil prices filtering through into Europe and the UK. However, domestic political uncertainty supported government bonds to an extent.

Over the six months, UK government bonds (also known as gilts) with a shorter time until repayment generally outperformed those with a longer repayment period, although all government bonds declined. The performance of the fund over this period thus reflected this weaker tone in government bond markets.

## Investment activities

The fund's performance is affected by its 'duration', which refers to the ability to reduce or increase the portfolio's sensitivity to changes in bond yields. Bond yields refer to the interest received from a fixed income security, which is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value. Bond yields typically move in the opposite direction to bond prices.

For much of this year, we have held a short duration position in the fund, making the portfolio less sensitive to the prospect of rising interest rates, as we believe that gilt yields may rise (and prices fall) going forward. Generally, government bonds with a short time till repayment tend to be less sensitive to interest rate movements than bonds with longer maturity dates. In the near term, we remain comfortable with maintaining a short duration positioning.

Concerns over geopolitical tension between the US and North Korea raised demand for government bonds, perceived to be safe havens, thus leading to price gains. In our view, investors' reaction was excessive and we briefly reduced duration in August, although we increased it again by the end of the month.

During the period, we sold our remaining holdings in Treasury Inflation-Protected Securities (TIPS), following a strong performance. TIPS are US inflation-linked bonds where both the value of the loan and the interest payments are adjusted in line with inflation over the life of the security. We reinvested the proceeds into conventional UK government bonds of a similar duration.

The fund can also invest a small proportion of the portfolio in high-quality non-government bonds. We had exposure to European Investment Bank over the period that was due to mature in August. We switched into a bond from the same issuer that matures in 2022,

lengthening the term of the investment. Finally, the bonds issued by Transport for London that we had held matured towards the end of the review period, so we added some high-quality and government-backed corporate bonds to replace these.

## Outlook

The economic impact of the UK's decision to leave the EU is likely to be unclear for the time being, or at least until there is greater clarity about the trading relations of the UK post Brexit. While Prime Minister Theresa May's hand has been weakened following the election result, recently the Brexit negotiations have moved to the next stage.

While the UK economy was remarkably resilient in the immediate aftermath of the referendum, data has been less impressive during 2017. As a result, we expect that domestic economic activity will be slower than initially expected for 2017 and 2018.

Gilts and index-linked gilts tend to perform well during uncertain economic times as investors increase their demand for assets that are perceived to be low risk. Given the current uncertain environment, in both the economic and political spheres, we believe demand for gilts will be sustained, which is expected to support UK government bond prices.

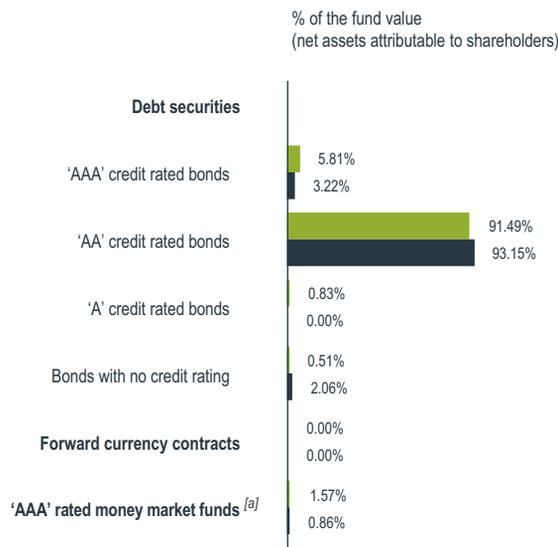
### Matthew Russell

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



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

■ 30 November 2017  
■ 31 May 2017

Source: M&G

## Portfolio transactions

for the six months to 30 November	2017	2016
Portfolio transactions	£'000	£'000
Total purchases	299,521	615,863
Total sales	323,681	642,235

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

# 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.

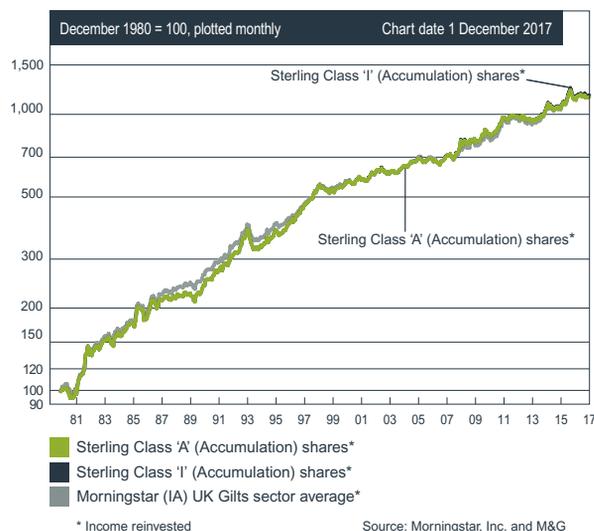
The fund is available for investment in different share classes, each with varying levels of charges and minimum investments; please refer to the Prospectus for M&G Investment Funds (2), which is available free of charge either from our website at [www.mandg.co.uk/prospectuses](http://www.mandg.co.uk/prospectuses) 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 (2), which is available free of charge either from our website at [www.mandg.co.uk/reports](http://www.mandg.co.uk/reports) or by calling M&G Customer Relations.

## Fund level performance

Fund net asset value			
as at	30.11.17 £'000	31.05.17 £'000	31.05.16 £'000
Fund net asset value (NAV)	599,453	648,310	674,624

## Performance since launch

To give an indication of how the fund has performed since launch, the chart below shows total return of Sterling Class 'A' (Accumulation) shares and Sterling Class 'I' (Accumulation) shares.



The fund's Sterling Class 'I' (Accumulation) shares were launched on 3 August 2012. Performance data shown prior to this date is that of the fund's Sterling Class 'A' (Accumulation) shares.

# Financial highlights

## Fund performance

To give an indication of how the fund has performed during the period the tables below show the performance of Sterling Class 'A' (Accumulation) shares and Sterling Class 'I' (Accumulation) shares.

All 'Performance and charges' percentages represent an annual rate except for the 'Return after operating charges' which is calculated as a percentage of the opening net asset value per share (NAV). 'Dilution adjustments' are only in respect of direct portfolio transaction costs.

### Sterling Class 'A' Accumulation share performance

The share class was launched on 9 December 1980.

	Six months to 30.11.17 UK p	Year to 31.05.17 UK p	Year to 31.05.16 UK p
<b>Change in NAV per share</b>			
Opening NAV	562.03	524.72	504.34
Return before operating charges and after direct portfolio transaction costs	(12.78)	42.64	26.00
Operating charges	(2.53)	(5.04)	(4.62)
Return after operating charges	(15.31)	37.60	21.38
Distributions	(0.86)	(2.62)	(4.99)
Retained distributions	0.86	2.33	3.99
Closing NAV	546.72	562.03	524.72

<b>Direct portfolio transaction costs</b>	<b>UK p</b>	<b>UK p</b>	<b>UK p</b>
Costs before dilution adjustments	0.00	0.00	0.00
Dilution adjustments <sup>[a]</sup>	0.00	0.00	0.00
Total direct portfolio transaction costs	0.00	0.00	0.00

<b>Performance and charges</b>	<b>%</b>	<b>%</b>	<b>%</b>
Direct portfolio transaction costs <sup>[b]</sup>	0.00	0.00	0.00
Operating charges	0.91	0.91	0.91
Return after operating charges	-2.72	+7.17	+4.24
Distribution yield	0.29	0.27	0.81
Effect on yield of charges offset against capital	0.00	0.00	0.00

#### Other information

Closing NAV (£'000)	325,178	351,649	335,616
Closing NAV percentage of total fund NAV (%)	54.25	54.24	49.75
Number of shares	59,478,126	62,567,997	63,961,600
Highest share price (UK p)	564.05	585.09	533.28
Lowest share price (UK p)	543.69	528.62	487.87

### Sterling Class 'I' Accumulation share performance

The share class was launched on 3 August 2012.

	Six months to 30.11.17 UK p	Year to 31.05.17 UK p	Year to 31.05.16 UK p
<b>Change in NAV per share</b>			
Opening NAV	1,197.44	1,115.43	1,069.97
Return before operating charges and after direct portfolio transaction costs	(27.25)	90.68	55.26
Operating charges	(3.91)	(7.77)	(7.14)
Return after operating charges	(31.16)	82.91	48.12
Distributions	(3.30)	(8.51)	(13.30)
Retained distributions	3.30	7.61	10.64
Closing NAV	1,166.28	1,197.44	1,115.43

<b>Direct portfolio transaction costs</b>	<b>UK p</b>	<b>UK p</b>	<b>UK p</b>
Costs before dilution adjustments	0.00	0.00	0.00
Dilution adjustments <sup>[a]</sup>	0.00	0.00	0.00
Total direct portfolio transaction costs	0.00	0.00	0.00

<b>Performance and charges</b>	<b>%</b>	<b>%</b>	<b>%</b>
Direct portfolio transaction costs <sup>[b]</sup>	0.00	0.00	0.00
Operating charges	0.66	0.66	0.66
Return after operating charges	-2.60	+7.43	+4.50
Distribution yield	0.54	0.51	1.06
Effect on yield of charges offset against capital	0.00	0.00	0.00

#### Other information

Closing NAV (£'000)	158,262	170,815	200,800
Closing NAV percentage of total fund NAV (%)	26.40	26.35	29.76
Number of shares	13,569,759	14,265,003	18,001,958
Highest share price (UK p)	1,202.56	1,244.42	1,132.94
Lowest share price (UK p)	1,159.33	1,123.71	1,035.27

<sup>[a]</sup> In respect of direct portfolio transaction costs.

<sup>[b]</sup> 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. 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](http://www.mandg.co.uk/prospectuses) or by calling M&G Customer Relations.

Portfolio transaction costs				
	Six months to 30.11.17	Year to 31.05.17	Year to 31.05.16	Average <sup>[a]</sup>
Indirect portfolio transaction costs	%	%	%	%
Average portfolio dealing spread	0.07	0.07	0.08	0.07

<sup>[a]</sup> 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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