



M&G Global Government Bond Fund

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

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

The Authorised Corporate Director (ACD) of M&G Investment Funds (3) presents its Interim Short Report for M&G Global Government 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 maximise total return (the combination of income and growth of capital).

Investment policy

The portfolio will mainly consist of investment grade government debt securities, including government guaranteed debt securities, and will be invested on a global basis. The fund's exposure to investment grade government debt may be gained through the use of derivatives. The fund may also invest in other government and public securities, collective investment schemes, other transferable securities, other debt instruments, cash and near cash, deposits, warrants, money market instruments and other derivative instruments. The fund may use derivatives for Efficient Portfolio Management purposes.

Investment approach

The M&G Global Government Bond Fund invests mainly in investment grade government bonds on a global basis. Its investment approach is driven primarily by the fund manager's views on macroeconomic factors such as economic growth, interest rates and inflation. This assessment determines the individual government bonds from different countries in which the manager believes the fund should invest in order to achieve its objective. It also influences the portfolio's mix of interest rate risk and currency exposure. These factors, along with the manager's selection of government bond holdings, drive the fund's long-term performance. With the active management of the fund's currency exposures being one of these drivers, its returns will include a higher degree of currency risk than domestic fixed income funds.

Risk profile

The fund invests mainly in investment grade government bonds, including government-guaranteed debt securities, on a global basis. It is, therefore, subject to the price volatility of the global bond market and the performance of individual issuers. It is also subject to fluctuations in currency exchange rates.

The fund's exposure to investment grade government debt 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.

Up to 30% of the fund's assets may be invested in non-investment grade government debt securities, which are higher risk assets that could potentially experience a degree of illiquidity in times of market distress.

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.



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 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 Global Government Bond Fund recorded positive total returns (the combination of income and growth of capital) across its different share classes, with the exception of its Swiss franc share classes. Over the six months, a variety of global investment themes remained in focus in government bond markets, including expected (and confirmed) rises in interest rates. However, most segments of the mainstream government bond markets registered modestly positive returns and emerging market government bonds delivered marginal gains. For the fund's Swiss franc share classes, the decrease in value of the US dollar (a currency in which the fund held a sizeable exposure) against the Swiss franc was a main factor that detracted from returns.

The fund's objective is to maximise total returns, and while it had mixed results due to the Swiss franc share class during the period under review, it met its objective over three and five years and since launch.*

* 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).

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'	+4.2	+9.4	+6.9	+5.3 ^[c]
Class 'I'	+4.5	+9.9	+7.3	+3.6 ^[d]

^[a] Absolute basis.

^[b] Price to price with income reinvested.

^[c] 4 October 1999, the end of the initial offer period of the predecessor unit trust.

^[d] 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

A number of key themes continued to influence sentiment in global financial markets during the six months to 31 December 2018. These included actual and anticipated interest rate rises in the important US economy, as well as heightened trade tensions between the US and China. The latter factor became an increasing concern as the period progressed, and began to contribute to some lower forecasts of global economic growth.

Despite this backdrop, the US economy continued to perform well in many key areas, including a robust labour market. As widely expected among investors, the Federal Reserve confirmed two further interest rate increases of 0.25 percentage points each. The moves added to the gradual steps taken by the US central bank in recent years to raise rates amid a strengthening economy with firmer inflation.

Elsewhere, attention focused on the prospect that the European Central Bank (ECB) would soon scale back its significant economic stimulus policies, which were in operation during recent years. Known

as quantitative easing (QE), these policies include the ECB's own purchases of government and corporate bonds in the region, with the main aims of encouraging lending and keeping interest rates low. (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 December, the ECB confirmed that it would be ceasing its QE programme, although the central bank did not change interest rates during the review period.

In the UK, the annual inflation rate, as measured by the Consumer Prices Index (CPI), stayed above the 2% target set by the Bank of England (BoE). To counter rising consumer prices, central banks often raise interest rates. However, the BoE's Monetary Policy Committee also had to continue assessing Brexit-related uncertainty in the UK outlook. Amid this environment, the central bank left interest rates unchanged, a stance that also seemed driven by signs of weaker economic growth data in the UK as 2018 drew to a close.

Actual or potential rises in interest rates typically dampen economic growth expectations – as well as the performance of bond markets. Given the size and relevance of the US market in a global context, the effects of US interest rate moves can be felt internationally. In addition, the theme of trade protectionism remained a focal point as President Trump's administration imposed new tariffs on an expanded range of imported goods from China. This prompted retaliatory moves by the government in Beijing. Such anti-free trade measures are generally viewed as harmful for the export revenues of governments and corporations. Later in the review period, these factors contributed to reduced forecasts for global economic growth by financial institutions such as the International Monetary Fund.

Against this backdrop, mainstream government bond markets, which are generally perceived as being lower risk assets in times of economic uncertainty, found support from investors towards the end of the period. This helped most segments of government bond markets in countries such as the US, Germany and the UK to deliver small positive returns. In emerging markets, government bonds also registered slightly positive returns. This outcome was recorded despite emerging market bonds experiencing some notable declines in the opening months of the period amid rising US interest rates and the US – China trade dispute.

The fund remained globally diversified in government bonds across developing and emerging markets. Through this positioning, the fund generated modestly positive returns, with the exception of its Swiss franc share classes. For the fund's sterling and euro share classes, some further upside to performance was provided by factors such as the US dollar's increase in value versus sterling and the euro, respectively. This stemmed from the fund's exposure to the US dollar, which was maintained at much higher levels than its allocations to sterling and the euro. For the fund's Swiss franc share class, however, the US dollar's decline in value against the Swiss currency was the main factor that detracted from returns.

Investment activities

The key drivers of the fund's long-term returns continue to include the active management of its allocations to individual countries, as well as its currency positioning. Our largest country position remained the US and we took steps to increase this exposure. In our view, the backdrop of rising interest rates by the Fed, which caused some marked price declines among US government bonds earlier in 2018, left the valuations of these assets looking more attractive.

We also maintained allocations to a number of other industrialised nations. These included Japan, where the fund's position remained broadly stable, as well as the German government bond market. In the latter, while we had reduced the fund's allocation prior to the review period, we added back exposure towards the end of 2018. At the end of the period, Japan and Germany ranked as the fund's second and third largest country exposures, respectively.

In addition to the fund's holdings in major industrialised nations, we continued to favour exposures to government bonds in emerging markets on a selective basis. In our view, appealing long-term value could still be found in this area of the market, despite concerns about higher US interest rates, international trade tensions, and the prospect of slower global economic growth.

In this environment, our preference was to reduce positions in emerging markets earlier in the review period, although we subsequently reinvested money into these assets. Our transactions included selling South African government bonds as we believed the country faced weaker economic prospects. Elsewhere, our investment assessment improved towards government bonds in Turkey, given

factors such as the significant decline of the Turkish market amid renewed economic challenges in the country. We added US-dollar denominated government bonds in Turkey, which were later switched into euro-denominated government securities that we felt were attractively priced. In the final month of the period, we added to the fund's emerging markets exposure via purchases that included government bonds in the smaller markets of Israel, Senegal and Albania.

Outlook

In addition to our chosen country allocations, the fund's flexible investment approach allows us to position the portfolio so that its performance should be less sensitive to the prospect of rising interest rates – a strategy known as holding short duration. Duration measures the sensitivity of a bond's price to a change in interest rates; it is an estimate of the number of years it takes an investor to recover the price of a bond if interest rates change. Generally, the longer the duration, the more sensitive the bond's price is to changes in interest rates. During the review period, we kept a short duration positioning in the fund against the backdrop of actual, or expected, increases in interest rates. However, we adjusted this stance towards the end of the period to be less pronounced, given factors such as the slower economic growth outlook. In our opinion, this prospect should lead to more moderate expectations regarding the extent of upward moves in interest rates.

Among other investment themes, we maintained a globally diversified portfolio of government bonds, not only from large developed nations such as the US, Japan, and the UK, but also from select emerging economies. Despite some recent periods of marked underperformance from emerging market bonds, we believe long-term value can still be found in this area when comparing their valuations to government bonds in developed countries. Relevantly, emerging market bonds offer higher yields relative to developed markets for taking on a higher degree of risk. (Bond yields refer to the interest received from a fixed interest security, which is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.) We also believe that sentiment towards emerging market bonds should be supported by improvements made to their creditworthiness – a measure of a borrower's ability and willingness to repay its debt.

At the same time, the relevant risks need to be monitored closely, including the increase in anti-free trade policies, as well as signals that China's economy was decelerating at the start of 2019.

Overall, we continue to determine the fund's investment strategy by seeking the most attractive value in the global government bond markets amid the prevailing economic conditions, while avoiding those countries where we believe the outlook is less favourable.

Claudia Calich

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	11.97	7.89
'AA' credit rated bonds	34.31	24.48
'A' credit rated bonds	18.88	23.80
'BBB' credit rated bonds	18.73	22.34
'BB' credit rated bonds	6.21	8.30
'B' credit rated bonds	5.32	5.65
Bonds with no credit rating	2.44	2.95
CURRENCY		
Forward currency contracts	0.01	0.02
CASH EQUIVALENTS		
'AAA' rated money market funds ^[a]	0.59	3.07

^[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	2018	2017
Portfolio transactions	\$'000	\$'000
Total purchases	65,719	21,001
Total sales	36,834	8,597

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

	31.12.18	30.06.18	30.06.17
as at	\$'000	\$'000	\$'000
Fund net asset value (NAV)	113,281	87,020	76,013

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 4 October 1999.

	Six months to 31.12.18 UK p	Year to 30.06.18 UK p	Year to 30.06.17 UK p
Change in NAV per share			
Opening NAV	130.10	132.84	126.77
Return before operating charges and after direct portfolio transaction costs	4.47	(1.15)	7.96
Operating charges	(0.76)	(1.59)	(1.62)
Return after operating charges	3.71	(2.74)	6.34
Distributions	(1.62)	(3.19)	(2.95)
Retained distributions	1.62	3.19	2.68
Closing NAV	133.81	130.10	132.84
Direct portfolio transaction costs	UK p	UK p	UK p
Costs before dilution adjustments	0.04	0.00	0.00
Dilution adjustments ^[a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.04	0.00	0.00
Performance and charges	%	%	%
Direct portfolio transaction costs ^[b]	0.07	0.00	0.00
Operating charges	1.14*	1.21	1.21
Return after operating charges	+2.85	-2.06	+5.00
Distribution yield	2.64	2.70	2.51
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV (\$'000)	9,772	7,931	9,228
Closing NAV percentage of total fund NAV (%)	8.63	9.11	12.14
Number of shares	5,719,448	4,639,906	5,352,374
Highest share price (UK p)	134.94	137.39	140.69
Lowest share price (UK p)	128.23	126.85	127.07

* As the annual management charge has been discounted during the period, 1.04% is a more reliable estimate of the operating charges for the period to 31.12.18.

Financial highlights

Fund performance

Sterling Class 'I' Accumulation share performance

The share class was launched on 3 August 2012.

	Six months to 31.12.18 UK p	Year to 30.06.18 UK p	Year to 30.06.17 UK p
Change in NAV per share			
Opening NAV	1,199.22	1,218.46	1,157.67
Return before operating charges and after direct portfolio transaction costs	41.23	(10.64)	72.55
Operating charges	(3.87)	(8.60)	(8.71)
Return after operating charges	37.36	(19.24)	63.84
Distributions	(17.98)	(35.40)	(33.10)
Retained distributions	17.98	35.40	30.05
Closing NAV	1,236.58	1,199.22	1,218.46
Direct portfolio transaction costs	UK p	UK p	UK p
Costs before dilution adjustments	0.40	0.00	0.00
Dilution adjustments ^[a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.40	0.00	0.00
Performance and charges	%	%	%
Direct portfolio transaction costs ^[b]	0.07	0.00	0.00
Operating charges	0.63*	0.71	0.71
Return after operating charges	+3.12	-1.58	+5.51
Distribution yield	3.13	3.20	3.00
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV (\$'000)	50,634	36,857	35,205
Closing NAV percentage of total fund NAV (%)	44.69	42.35	46.31
Number of shares	3,207,032	2,339,042	2,226,239
Highest share price (UK p)	1,247.02	1,261.12	1,286.17
Lowest share price (UK p)	1,183.83	1,168.21	1,162.28

* As the annual management charge has been discounted during the period, 0.54% is a more reliable estimate of the operating charges for the period to 31.12.18.

^[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

	Six months to 31.12.18	Year to 30.06.18	Year to 30.06.17	Average ^[a]
Direct portfolio transaction costs ^[b]	%	%	%	%
Taxes	0.07	0.00	0.00	0.02
Costs before dilution adjustments	0.07	0.00	0.00	0.02
Dilution adjustments ^[c]	0.00	0.00	0.00	0.00
Total direct portfolio transaction costs	0.07	0.00	0.00	0.02
as at	31.12.18	30.06.18	30.06.17	Average ^[a]
Indirect portfolio transaction costs	%	%	%	%
Average portfolio dealing spread	0.30	0.35	0.37	0.34

^[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.

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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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