M&G Episode Macro Fund - Euro Class T-H

Monthly Fund Review as at 31 May 2018

For investment professionals only

M&G INVESTMENTS

Highlights

- The fund generated a negative return in May, primarily driven by short government bond exposures.
- Overall long equity exposure was reduced during the month prior to market volatility towards month-end
- Ongoing developments in emerging markets and Italy could prompt 'episodic' opportunities

Risks associated with this fund

For any past performance shown, please note that past performance is not a guide to future performance.

The value of investments and the income from them will rise and fall. This will cause the fund price, as well as any income paid by the fund, to fall as well as rise. There is no guarantee the fund will achieve its objective, and you may not get back the amount you originally invested.

The fund may use derivatives with the aim of profiting from a rise or a fall in the value of an asset (for example, a company's bonds). However, if the asset's value varies in a different manner, the fund may incur a loss.

The fund may use derivatives to gain exposure to investments exceeding the value of the fund (leverage). This may cause greater changes in the fund's price and increase the risk of loss.

Changes in currency exchange rates will affect the value of your investment.

Further risk factors that apply to the fund can be found in the fund's Key Investor Information Document (KIID).

Single year performance (5 years)

	2017	2016	2015	2014	2013
Euro T-H Acc	7,0%	8,0%	2,1%	8,3%	6,7%

Performance over 5 years

M&G Episode Macro Fund monthly total returns in euro terms

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2010	-	-	-	-	-	-3,7	1,5	-2,2	4,2	-0,4	1,8	1,9	3,3
2011	-0,5	1,2	0,6	1,3	0,0	-1,0	1,0	-5,2	-3,6	5,6	0,3	0,6	-0,1
2012	2,0	1,3	1,2	-1,8	-8,9	-1,9	-1,2	-0,2	1,3	0,2	1,2	1,4	-5,9
2013	0,8	-0,1	-0,2	1,2	2,2	-3,7	2,1	-1,6	3,6	2,5	-0,5	0,4	6,7
2014	-1,1	2,1	1,2	0,4	2,2	0,0	1,0	0,5	-0,7	0,8	1,7	-0,4	8,3
2015	1,2	3,1	0,1	1,3	1,3	-0,8	-0,4	-2,9	-1,7	3,4	-0,5	-1,8	2,1
2016	-1,8	0,0	3,4	0,8	0,3	-2,8	2,1	2,1	-1,4	2,2	1,8	1,3	8,0
2017	0,6	0,3	0,8	0,1	0,1	1,6	0,6	-0,6	1,6	1,2	0,0	0,4	7,0
2018	2,4	-0,8	-2,5	2,1	-1,7	-	-	-	-	-	-	-	-0,6

We are unable to give financial advice. If you are unsure about the suitability of your investment, speak to your financial adviser.

Past performance is not a guide to future performance.

Hedged share classes aim to mirror the performance of another share class. We cannot guarantee that the hedging objective will be achieved. The hedging strategy will limit holders of the hedged share class from benefiting if the hedged share class currency falls against the Euro. Please note that this fund comes with further risks that are explained in the Key Investor Information Document.

Things you should know

The fund may invest more than 35% in securities issued by any one or more of the governments listed in the fund prospectus. Such exposure may be combined with the use of derivatives in pursuit of the fund objective. It is currently envisaged that the fund's exposure to such securities may exceed 35% in the governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, Netherlands, New Zealand, Singapore, Sweden, Switzerland, UK, USA although these may vary subject only to those listed in the prospectus.

The fund may be very concentrated at times which could result in greater fluctuations in the fund's short-term performance and sudden and large falls in value. As a result, you could lose the total value of your initial investment.

The fund allows for the extensive use of derivatives.

Key information

Fund managers	David Fishwick & Eric Lonergan
Fund manager tenure from	4 June 2010
Launch date	3 June 2010
Launch of share class	3 June 2010
Fund size (millions)	€457,98
Fund type	OEIC, incorporated in the UK
Average credit rating of fixed interest holdings	AA
Share type	Accumulation
Ongoing charge	0,94%
Performance fee*	20,00 %

* On all positive returns above the hurdle and above the high water mark (HWM). The HWM is the highest level that a fund's NAV (net asset value) has reached at the end of any 12-month accounting period. In this context, a hurdle is a value to surpass before the performance fee can be levied. Each day, the hurdle will increase (or decrease) by the hurdle rate (three-month LIBOR for the currency in which the relevant share class is denominated).

Performance fees - The investment manager is entitled to receive a performance fee. Performance fees may be considered to create an incentive for the investment manager that may increase the risk profile of the fund. Please note that this fund comes with further risks that are explained in the Key Investor Information Document.

VaR analysis (%)

	Fund
1 month 99% VaR	3,17

Asset breakdown (%)

	Long exposure	Short exposure	Net exposure
Equity	**40,3**	**0,0**	**40,3**
UK	2,1	0,0	2,1
Europe	8,9	0,0	8,9
US	12,8	0,0	12,8
Japan	4,1	0,0	4,1
Asia Pacific ex Japan	12,4	0,0	12,4
Global equity funds	0,0	0,0	0,0
Other	0,0	0,0	0,0
Global bond funds	**0,0**	**0,0**	**0,0**
Government bonds	**0,0**	**-73,2**	**-73,2**
UK	0,0	-27,4	-27,4
Europe	0,0	-31,7	-31,7
US	0,0	-14,2	-14,2
Japan	0,0	0,0	0,0
Asia Pacific ex Japan	0,0	0,0	0,0
Other	0,0	0,0	0,0
Corporate bonds	**0,0**	**0,0**	**0,0**
Investment grade	0,0	0,0	0,0
High yield	0,0	0,0	0,0
Convertible bonds	**0,0**	**0,0**	**0,0**
Property funds	**0,0**	**0,0**	**0,0**

The fund will comprise a high proportion of cash and near cash, as the fund will typically achieve exposures through derivative strategies. As a result, cash and near cash have been excluded from the asset breakdown table to provide a more accurate indication of the fund's actual investment exposure.

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Currency breakdown (%)

	Net exposure
US dollar	95,1
Korean won	2,9
Turkish lira	2,2
Russian ruble	2,1
Indian rupee	2,0
South African rand	2,0
Swiss franc	-2,0
Euro	-2,8
Taiwan dollar	-3,0
Other	1,5

The fund's neutral currency positioning is 100% in US dollars. Deviations from this figure, therefore, represent long/short exposure.

Leverage and volatility

	Fund
Net leverage	-0,3x
Gross leverage	1,1x
Volatility	5,75%

Net leverage is the sum of all net notional exposures, excluding cash, divided by NAV. Gross leverage is the sum of all gross notional exposure, excluding cash, divided by NAV. Volatility is three-year annualised volatility calculated monthly, as at 31 May 2018, sourced from Morningstar.

Performance highlights

The fund's negative return in May was primarily driven by the market reaction sparked by fears over Italian politics at the end of the month. Against this background, short government bond exposures were the major detractors, particularly as yields on UK gilts and German bunds fell sharply during the period. Long equity exposures also cost some performance, although the decision to reduce net exposure from 57.5% to 40.5% in the first half of the month left the fund less exposed to some of this weakness. The fund's currency basket also delivered a negative return overall, although losses from long exposures to some emerging market currencies were partly offset by short exposure to the euro.

Worries about political instability in Italy prompted relatively sharp price movements across global assets, particularly in Europe. Yields on developed market government bonds generally fell, and prices rose, and the fund's short positions on UK gilts and German bunds were the largest detractors. These positions had been increased at the end of March, while at the same time a short position in 10-year US Treasuries was re-opened. There were no changes to these positions in May and the fund retains a 30% short position in 10-year UK gilts, a 30% short in 10-year German bunds, a 5% short in 30-year German bunds, and a 15% short position in 10-year US Treasuries.

Tactical exposure to equity markets, which had also been increased in response to episodic volatility at the end of March, was removed in the second week of May after some strong performance. This took net equity exposure from 57.0% to 40.3%, and as part of this, total exposure to European equities was taken from 19% to 9% (with Italy reduced from 5% to 2.5%). The largest losses in May came from portfolio's largest positions: Korea (10% equity exposure) and the US banking sector (13% equity exposure), while this was partly offset by a position in the European basic resources sector.

Within the portfolio's currency basket, the much-discussed pressure on emerging market currencies had a detrimental effect, particularly related to exposures to the Turkish lira, Brazilian real and Mexican peso. However, the extent of losses was limited by gains from the fund's short exposure to the euro. While trends in the US dollar have periodically acted as a correlated driver of weakness across emerging markets, there have also been distinct phases where idiosyncratic behaviour in these currencies has been evident, suggesting some discretion on the part of market participants rather than a generic episodic sell-off.

Outlook

The main issues attracting investors' attentions today are emerging markets and events in Italy. In each case it is very easy to picture extreme negative outcomes, and there is a potential for genuine fundamental problems. Investors are challenged when events that were previously considered tail risks but which have potentially catastrophic outcomes such as balance of payments crises, or Italy leaving the eurozone, become a more salient part of the probability distribution.

Often, market reactions in these phases can represent investment opportunities, since humans tend to overweight the likelihood of such risks. However, scaling and timing decisions become crucial since valuation anchors can become very loose for prolonged periods. This is particularly true of currencies and in cases where movements in asset prices themselves can have a reflexive impact on fundamentals.

Therefore, while the predisposition of the approach is to add exposures to both selected emerging markets and European assets (in face of apparently episodic price movements) it is important to be conscious of the different risk characteristics that these positions could exhibit. Importantly, observing the nature of short-term price behaviour is essential to establishing the degree to which moves represent an episodic opportunity, how extended such moves can become, and how positions may interact with other exposures in an investment portfolio.

We believe it is also critical not to lose sight of the broader key issues with regards to the prevailing environment. The ongoing impact of increases in US interest rates is material for all assets, not just in the emerging world and is a crucial consideration for the portfolio's preference for selected global equities over cash and many developed market government bonds. Global macro and corporate profit data remain strong in an absolute sense but weaker than expectations, while the inflation backdrop is supportive across most of the world. These factors are likely to be even more important than near-term issues of the day in driving the fund's returns.

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Fund codes and charges

Share class	ISIN	Bloomberg	Annual management charge	Ongoing charge	Minimum initial investment	Minimum top up investment
Euro B-H Acc	GB00B4RGN439	MGMEBHE LN	2,25%	2,44%	€1000	€75
Euro S-H Acc	GB00B5LHB564	MGMESHE LN	1,75%	1,94%	€1.000	€75
Euro T-H Acc	GB00B5LHW198	MGMETHE LN	0,75%	0,94%	€500.000	€50.000

The ongoing charge figures disclosed above include direct costs to the fund, such as the annual management charge (AMC), administration charge and custodian charge, but does not include portfolio transaction costs. They are based on expenses for the period ending 31 December 2017.

Please note that not all of the share classes listed above might be available in your country.

Important information

The fund's physical holdings include a significant proportion of cash or cash equivalents, which are used as backing for the derivatives positions.

Source of performance data: Morningstar, Inc., as at 31 May 2018, Euro Class T-H shares, net income reinvested, price to price basis. Past performance is not a guide to future performance. All other statistics from M&G internal sources, as at 31 May 2018 unless indicated otherwise.

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