M&G (Lux) Absolute Return Bond Fund

Fourth quarter 2018

Co-fund managers – Jim Leaviss & Wolfgang Bauer

FOR INVESTMENT PROFESSIONALS ONLY

- *The final quarter of 2018 was a challenging period for risk assets, as concerns over slowing global growth and trade war tensions contributed to weakness across equity and credit markets.*
- *The fund's bias towards credit weighed on investment performance this quarter as spreads widened across the fixed income market.*
- *We continued to see attractive opportunities in the primary corporate bond market, adding a variety of new issues during the quarter.*

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.

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

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 Germany, Japan, UK, USA although these may vary subject only to those listed in the prospectus.

The fund allows for the extensive use of derivatives.

A highly flexible bond fund targeting steady, positive returns

The final quarter of 2018 was a challenging period for risk assets, as concerns over slowing global growth and trade war tensions contributed to weakness across equity and credit markets. In contrast, core government bonds benefited from their perceived safe-haven qualities, with yields declining in the US, Europe and the UK.

The fund declined during the quarter. A bias towards credit weighed on investment performance as spreads widened across the fixed income market. Losses were partly offset by our core government bond positions and the fund's tactical credit hedge, which we implement by buying protection on credit default swaps (CDS) indices.

The fund's one-month rolling peak-to-current drawdown reached 178 basis points (bps) during the quarter, although this had fallen to 12 bps by the end of December. Ex-post one-month volatility remains comfortably below its 5% trigger level, at 1.83% at the end of December.

We maintain our bias towards credit, where we are now seeing the emergence of some attractive value. However, we continue to be cautiously positioned from an interest rate perspective, with duration held at around 2.0 years.

We continue to see attractive opportunities in the primary corporate bond market, adding a variety of new issues over the quarter, including deeply discounted new issues from Japanese pharmaceutical company Takeda and German automaker Volkswagen.

In currencies, we maintain a 'barbell' approach, consisting on the one hand of defensive 'safe-haven' positions - such as the Japanese yen, Swiss franc and US dollar – and, on the other hand, much smaller opportunistic positions, such as the Russian ruble and Colombian peso.

Fund facts	
Modified duration (years)	2.0
Spread duration (years)	4.2
Fund size (€, million)	43.5

Source: M&G, as at 31 December 2018

Fund performance

	Total returns (%)						
	3-mth	2018	2017	2016	2015	2014	Since launch (pa)*
Fund (Net of OCF)	-1.9	-3.2	1.8	N/A	N/A	N/A	-0.7
Fund (Gross of OCF)	-1.5	-2.0	3.1	N/A	N/A	N/A	0.6
3-month EURIBOR + 2.5%	0.5	2.2	2.2	2.3	2.5	2.8	2.2

*Source: Morningstar Inc., as at 31 December 2018. Euro A Acc class shares, income reinvested, price-to-price basis. *The fund was launched on 21 December 2016. The fund targets combined income and capital growth of at least 3-month EURIBOR plus 2.5% per year over any three-year period, before any charges and in any market condition. There is no guarantee that the fund will achieve a positive return over any period and investors may not get back the original amount they invest. Fund performance data shows both gross returns (before the Ongoing Charge Figure is taken), which is in line with the fund's objective, and net returns (after the Ongoing Charge Figure is taken) to illustrate how charges affect performance. Investors should note that the net return figure is what they would receive and is therefore the more relevant figure.*

Figure 1. Strategic asset allocation

Strategy	Net (%)
High-conviction credit (single name or theme)	46.0
'Risk-free', duration and currencies	33.0
Short-dated investment grade credit	19.4
Asset-backed and mortgage-backed securities	14.0
Fixed coupon high yield	6.9
Long-dated investment grade credit	6.0
Inflation strategy	3.1
High yield floating rate notes	1.9
Tactical credit hedges	-30.3

Source: M&G, as at 31 December 2018

***Asset-backed securities:** Bonds whose income is derived from a pool of underlying assets, such as mortgages.*

***Fixed coupon high yield credit:** Bonds issued by companies with a low credit rating from a recognised credit rating agency.*

***High-conviction credit (single name or thematic):** Encompassing the fund managers' key convictions across developed and emerging market corporate bond markets.*

***High yield floating rate notes:** Bonds issued by companies with a low credit rating from a recognised credit rating agency, which pay a variable level of income and have a very low sensitivity to movements in interest rates.*

***Inflation strategy:** Strategy to identify opportunities across global inflation-linked bond markets, which are bonds where both the interest payments and face value are adjusted in line with inflation.*

***Long-dated investment grade credit:** Bonds issued by companies with a high credit rating from a recognised credit rating agency, which are due to mature in more than 5 years.*

***'Risk-free', duration, and currencies:** Strategy to identify opportunities across global government bond and currency markets including the fund's 'risk-free' exposure, typically consisting of bonds issued by highly rated governments (such as the UK, the US or Germany).*

***Short-dated investment grade credit:** Bonds issued by companies with a high credit rating from a recognised credit rating agency, which are due to mature within five years.*

***Tactical credit hedges:** Strategy to adjust the fund's overall credit exposure, typically implemented through the use of the derivatives.*

M&G
January 2018

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