Quarterly Review

M&G (Lux) Emerging Markets Bond Fund

First quarter 2019

Fund manager – Claudia Calich

FOR INVESTMENT PROFESSIONALS ONLY

Highlights

- Emerging market bonds registered gains in the first quarter of 2019.
- Hard currency emerging market government and corporate debt outperformed local currency sovereigns.
- We maintained a globally diversified portfolio of emerging market government bonds and corporate credit.

Main risks associated with this fund:

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

The value and income from the fund's assets will go down as well as up. This will cause the value of your investment to fall as well as rise. There is no guarantee that the fund will achieve its objective and you may get back less than you originally invested.

Investing in emerging markets involves a greater risk of loss due to greater political, tax, economic, foreign exchange, liquidity and regulatory risks, among other factors. There may be difficulties in buying, selling, safekeeping or valuing investments in such countries.

Investments in bonds are affected by interest rates, inflation and credit ratings. It is possible that bond issuers will not pay interest or return the capital. All of these events can reduce the value of bonds held by the fund.

The fund can be exposed to different currencies. Movements in currency exchange rates may adversely affect the value of your investment.

The fund may use derivatives to profit from an expected rise or fall in the value of an asset. Should the asset's value vary in an unexpected way, the fund will incur a loss. The fund's use of derivatives may be extensive and exceed the value of its assets (leverage). This has the effect of magnifying the size of losses and gains, resulting in greater fluctuations in the value of the fund.

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 allows for the extensive use of derivatives.

Important information:

On 7 December 2018 the non-sterling assets of the M&G Emerging Markets Bond Fund, a UK-authorised OEIC which launched on 15 October 1999, merged into the M&G (Lux) Emerging Markets Bond Fund, a Luxembourg-authorised SICAV, which launched on 17 September 2018. The SICAV is run by the same fund manager, applying the same investment strategy, as the UK-authorised OEIC.

Quarterly, YTD and calendar year performance (5 years)

	3 months %	YTD %	2018 %	2017 %	2016 %	2015 %	2014 %
Euro A[1]	8.7	8.7	-2.4	-0.5	13.7	10.4	19.1
Sector	7.6	7.6	-1.3	-3.3	13.0	8.2	16.5
USD A[2]	6.7	6.7	-6.8	13.0	10.3	-1.1	5.2
Sector	5.7	5.7	-6.1	10.1	9.8	-2.9	2.3

Past performance is not a guide to future performance.

1 Source: Morningstar, Inc., as at 31 March 2019. Euro A class shares, income reinvested, price-to-price basis.

Fund performance prior to 21 September 2018 is that of the Euro A class shares of the M&G Emerging Markets Bond Fund, a UK-authorised OEIC, which merged into this fund on 7 December 2018. Tax rates and charges may differ.

2 Source: Morningstar, Inc., as at 31 March 2019. USD A class shares, income reinvested, price-to-price basis.

Fund performance prior to 21 September 2018 is that of the USD A class shares of the M&G Emerging Markets Bond Fund, a UK-authorised OEIC, which merged into this fund on 7 December 2018. Tax rates and charges may differ.

Sector: Morningstar Global Emerging Markets Bond.

Performance and portfolio positioning

Several key themes continued to influence investors' sentiment in global bond markets during the first quarter. These included dovishness from the Federal Reserve, which resonated among other central banks amid slower economic growth. Importantly, the Fed dampened expectations of further rises in interest rates this year. In addition, financial markets remained encouraged by reduced trade tensions between the US and China.

In this environment, yields in core government bond markets declined. In the emerging debt markets, hard currency-denominated government and corporate bonds delivered solid returns as these assets rallied well, after underperforming in 2018. Local currency sovereigns delivered smaller gains, with declines experienced among a number of emerging currencies.

The underperformance of emerging currencies was more notable towards the end of the quarter. Only a few currencies saw positive returns against the US dollar in March. Renewed volatility was evident with the Argentine peso and Turkish lira. In Turkey, a larger-than-expected decline in central bank reserves pushed the lira down, prompting intervention by the central bank to try to support the currency. In Argentina, higher than expected inflation for the second month in a row led to the currency's decline, which was met with a rate increase by the central bank.

Turning to the performance of hard currency sovereign bonds, the JP Morgan Emerging Markets Bond (EMBI) Global Diversified Index increased by 7.0% in the first quarter. For emerging market corporate bonds, the JP Morgan Corporate EMBI (CEMBI) Broad Diversified Index gained 5.2%. The JP Morgan GBI-EM Global Diversified Index, which tracks local currency sovereigns, gained 2.9%. All returns are stated in US dollar terms.

The fund remained invested in a globally diversified portfolio of emerging market government and corporate bonds. In the first-quarter market environment, the fund's allocations to hard currency bonds largely contributed to its delivery of a positive return. In addition, the fund's allocation to the US dollar provided further upside to its unhedged euro share class as the greenback appreciated against the single currency.

Fund management

Going into the first quarter, we felt that opportunities could be found in both the hard and local currency segments of the emerging bond markets after their underperformance in 2018. Our subsequent buying activity included adding holdings via the new issues market. In February, we participated in a debut issue of hard currency bonds from the Uzbekistan government. In our assessment, the US-dollar denominated securities were attractively priced, and the bond offering was notably oversubscribed.

In the final month of the quarter, we bought newly issued hard currency sovereign bonds in other smaller markets such as Benin, Ghana, and Sri Lanka. Elsewhere, Romania has been among our favoured allocations for some time, and we added exposure to the market via a new issue of euro-denominated government debt. In contrast, we reduced a government bond position in Ecuador after the country reached a deal with the International Monetary Fund and other creditors. The development helped to drive the bonds higher, which left the securities offering less upside potential, in our opinion.

Among corporate credit, we bought bonds from Credit Bank of Moscow in February on valuation grounds. We believe the macro backdrop is supportive in Russia, and would note that Moody's upgraded its sovereign credit rating in February to investment grade, a status already awarded by the other two major rating agencies (Standard & Poor's and Fitch). Elsewhere, we added a corporate holding in Latam Airlines but sold a position in Chilean telecommunications group VTR.

We also made some adjustments to the fund's corporate bond holdings in March. In China, we took profits on holdings in the real estate sector after good performance. Elsewhere, we switched some Mexican positions by selling building materials group Cemex and buying Banco Santander Mexico.

In the local currency space, our activity during the quarter included the purchase of naira-denominated Nigerian government bonds after President Buhari's re-election. The vote reduced the risk of an abrupt policy change, in our opinion. In Asia, we reduced exposure to the Thai baht, given our assessment that the currency offered a less compelling valuation after recent outperformance.

Outlook

The possibility of recession driven by a slowing global economy was an increasingly significant theme in the global outlook going into the second quarter. In the bond markets, investors even began to price in the prospect of a cut in interest rates, rather than a rise, as the next policy move by the Fed.

In the emerging bond markets, we continue to believe that with careful stock selection and management of the risks, decent relative value can be found on a long-term perspective. We base this view on factors such as an attractive pick-up in yields and low default rates. In terms of overall positioning, we continue to favour a higher exposure to hard currency emerging market bonds over local currency debt.

Among currency exposures, we remain comfortable to hold diverse allocations to local currencies on a selective basis.

At the end of the first quarter, the fund's larger positions continued to include the Indonesian rupiah (3.0%), Brazilian real (2.8%), Russian ruble (2.8%), Indian rupee (1.9%), and Malaysian ringgit (1.8%.

At the end of the period, the fund was invested around 42% in hard currency government bonds, 25% in local currency government bonds, and 26% in emerging market hard currency corporate bonds. The remainder of the fund was held in local currency corporate bonds and cash. The fund's exposure to the US dollar stood at 67.1%.

In our overall approach, we continue to believe that flexibility remains key for successfully investing in the emerging bond markets, with the freedom to hold those bonds and currencies that offer the best relative value and avoid countries or industries where the outlook is unfavourable.

Long-term performance

Euro A	1 year %	3 years % p.a.	5 years % p.a.	Since tenure %
M&G (Lux) Emerging Markets Bond Fund	9.1	6.4	9.0	8.8
Morningstar Global Emerging Markets Bond Sector	9.3	5.1	7.3	7.2

Source: Morningstar Inc., as at 31 March 2019, EUR A class shares, income reinvested, price-to-price basis.

Fund performance prior to 21 September 2018 is that of the EUR A class shares of the M&G Emerging Markets Bond Fund, a UK-authorised OEIC, which merged into this fund on 7 December 2018. Tax rates and charges may differ.

'Since tenure' includes the period when managing the M&G Emerging Markets Bond Fund, which was from 2 December 2013.

US dollar A	1 year %	3 years % p.a.	5 years % p.a.	Since tenure %
M&G (Lux) Emerging Markets Bond Fund	-0.5	5.9	4.6	4.9
Morningstar Global Emerging Markets Bond Sector	-0.2	4.6	3.0	3.4

Source: Morningstar Inc., as at 31 March 2019, USD A class shares, income reinvested, price-to-price basis.

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