Quarterly Review

M&G Global Emerging Markets Fund

First quarter 2019

Fund manager – Michael Bourke

FOR INVESTMENT PROFESSIONALS ONLY

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Highlights

- Emerging market equities rebounded in the first quarter amid optimism about US-China trade talks and the Fed's patient interest rate policy. However, they trailed developed market stocks.
- The fund delivered positive returns ahead of the MSCI Emerging Markets Index, with stock selection in energy and information technology adding value. Stock selection in financials detracted.
- During the quarter, we added several new holdings from different sectors, including Indian financial group ICICI Bank, Mexican chemicals firm Mexichem and Russian retailer X5. Six stocks were sold.

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 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.

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

Things you should know:

The fund invests mainly in company shares and is therefore likely to experience larger price fluctuations than funds that invest in bonds and/or cash.

Quarterly, YTD and calendar year performance (5 years)

	3 months %	YTD %	2018 %	2017 %	2016 %	2015 %	2014 %
M&G Global Emerging Markets Fund	11.4	11.4	-11.8	17.6	40.3	-10.7	-2.8
MSCI Emerging Markets Index	7.5	7.5	-8.9	25.8	33.1	-9.7	4.3
IA Global Emerging Markets Sector	8.0	8.0	-11.5	24.8	31.9	-8.8	4.2

Past performance is not a guide to future performance.

Source: Morningstar, Inc., UK database as at 31 March 2019. Sterling I class shares, income reinvested, price-to-price basis.

Performance attribution and positioning

Largest positive contributors 3 months

Stock	Relative weight %	Absolute return %	Contribution %
Luxoft	N/A	84.9	1.0
Ctrip.com	2.6	57.8	0.9
Kosmos Energy	2.2	50.7	0.6

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Luxoft	N/A	84.9	1.0
Ctrip.com	2.6	57.8	0.9
Kosmos Energy	2.2	50.7	0.6

Largest negative contributors 3 months

Stock	Relative weight %	Absolute return %	Contribution %
Alibaba	-4.5	30.1	-0.8
Alfa	1.6	-10.8	-0.3
First Pacific	1.5	-7.7	-0.2

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Alibaba	-4.5	30.1	-0.8
Alfa	1.6	-10.8	-0.3
First Pacific	1.5	-7.7	-0.2

Source: Factset, investment returns calculated in sterling, as at 31 March 2019, preliminary data. Performance contribution includes both stocks held and not held and weighting relative to MSCI Emerging Markets Index.

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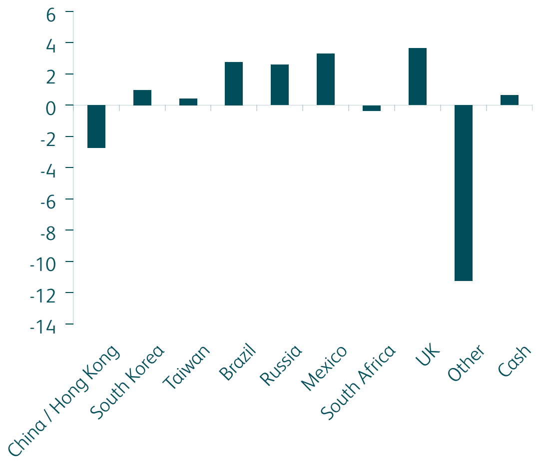
Largest overweights (%)	Fund	Index	Relative
Ctrip.com	3.2	0.3	2.8
Shinhan Financial	2.9	0.3	2.6
Kosmos Energy	2.3	0.0	2.3
Cosan	2.2	0.0	2.2
Hollysys	2.1	0.0	2.1
China Lesso	2.0	0.0	2.0
Delta Electronics	2.2	0.2	2.0
Far East Horizon	2.0	0.0	2.0
Xinyi Solar	2.0	0.0	2.0
Samsung Electronics	5.9	4.0	1.9

Largest underweights (%)	Fund	Index	Relative
Tencent	0.0	5.0	-5.0
Alibaba	0.0	4.5	-4.5
Myriad International	0.0	1.9	-1.9
China Mobile	0.0	1.2	-1.2
Ping An Insurance	0.0	1.1	-1.1
Reliance Industries	0.0	1.1	-1.1
Petrobras	0.0	1.0	-1.0
Industrial & Commercial Bank of China	0.0	1.0	-1.0
Housing Development Finance	0.0	0.9	-0.9
Itau Unibanco	0.0	0.8	-0.8

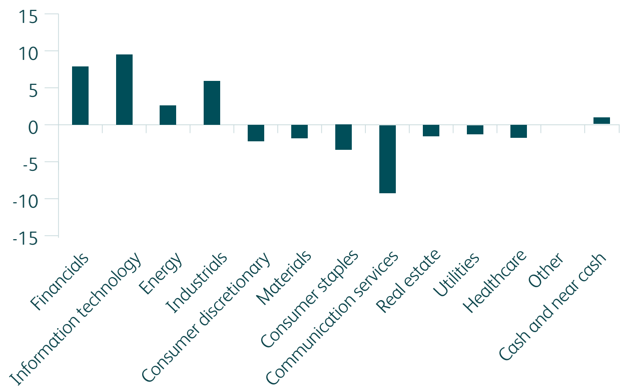
Country breakdown (%)	Fund (start)	Fund (end)	Change	Index (end)	Relative
China / Hong Kong	29.3	30.2	0.9	32.6	-2.4
South Korea	15.1	14.1	-1.0	13.0	1.0
Taiwan	12.9	11.7	-1.2	11.3	0.3
Brazil	10.2	9.9	-0.3	7.2	2.7
Russia	5.8	6.2	0.4	3.8	2.5
Mexico	4.9	5.9	1.0	2.7	3.2
South Africa	6.1	5.4	-0.7	5.7	-0.3
UK	3.9	3.7	-0.2	0.1	3.7
Other	10.1	12.0	1.9	23.3	-11.3
Cash	1.7	0.9	-0.8	0.0	0.9

Weights relative to index (%)



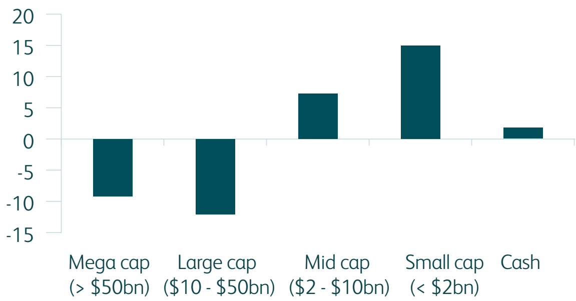
Industry breakdown (%)	Fund (start)	Fund (end)	Change	Index (end)	Relative
Financials	34.9	31.9	-3.0	24.2	7.7
Information technology	25.3	24.0	-1.3	14.5	9.5
Energy	8.3	10.6	2.4	8.1	2.5
Industrials	10.4	10.5	0.1	5.3	5.3
Consumer discretionary	8.2	10.2	2.0	13.3	-3.1
Materials	2.5	3.0	0.5	7.3	-4.3
Consumer staples	2.3	2.8	0.5	6.4	-3.6
Communication services	2.7	2.6	-0.1	12.3	-9.7
Real estate	1.9	2.0	0.0	3.2	-1.2
Utilities	1.1	1.6	0.4	2.5	-1.0
Healthcare	0.0	0.0	0.0	2.6	-2.6
Other	0.7	0.0	-0.7	0.0	0.0
Cash and near cash	1.7	0.9	-0.8	0.0	0.9

Weights relative to index (%)



Capitalisation breakdown (%)	Fund (start)	Fund (end)	Change	Index (end)	Relative
Mega cap (> $50bn)	23.6	21.6	-2.0	30.6	-8.9
Large cap ($10 - $50bn)	21.4	23.2	1.8	35.1	-11.9
Mid cap ($2 - $10bn)	34.9	39.3	4.4	33.0	6.3
Small cap (< $2bn)	18.4	15.0	-3.4	1.1	13.9
Cash	1.7	0.9	-0.8	0.0	0.9

Weights relative to index (%)



Source of all portfolio data: M&G, as at 31 March 2019.
Index: MSCI Emerging Markets Index.

Fund commentary

Emerging market equities rebounded from recent declines in the first quarter. However, they lagged developed market stocks.

The improvement in risk appetite was driven by hopes of a resolution to the trade dispute between the US and China and the Federal Reserve's (Fed) more patient approach to interest rate rises. After four rate hikes last year, investors welcomed the Fed's suggestion that there would be no more rate rises this year.

Worries about the outlook for the global economy were not completely banished though. Towards the end of the period, developments in the US bond market knocked investor confidence. The yield on 10-year government bonds fell below rates on the three-month Treasury bill – this 'inversion' is regarded as a sign of a coming economic recession.

China was one of the best-performing markets, supported by optimism about progress in US-China trade negotiations and expectations of government stimulus measures. In recent months, Chinese policymakers have announced plans for infrastructure spending and tax cuts to support the economy. Russia's stockmarket rose as oil prices rallied more than 30% – oil is a key export for Russia. Peru and Colombia also outperformed.

In contrast, Turkey was a notable laggard, hurt by currency volatility ahead of local elections. South Africa and South Korea also underperformed. The smaller Southeast Asian markets of Indonesia and Malaysia lagged too.

At the sector level, consumer discretionary led the way. Energy and information technology also performed well. Given the 'risk-on' environment, 'defensive' areas were out of favour: consumer staples, healthcare and utilities were among the laggards.

In this buoyant environment, the fund delivered positive returns ahead of the MSCI Emerging Markets Index, with stock selection in energy and information technology adding value.

In technology, software development company Luxoft soared following a takeover bid at a significant premium. Our holding in Totvs, a Brazilian software company, also added value. The stock has benefited from the positive market environment in Brazil following the election of a new president.

Chinese PC maker Lenovo also maintained its recent positive momentum, climbing 30% over the quarter. Investors have been encouraged that its turnaround strategy is starting to deliver results.

Another Chinese holding, Ctrip.com, was a leading contributor. The online travel agent's shares have rebounded this year after steep falls in 2018 on hopes of a resolution to the trade war and robust results.

Meanwhile, in energy, as oil prices rallied more than 30% following output cuts by leading oil-producing nations, Russian energy firm Lukoil and oil & gas exploration companies Kosmos Energy and Tullow Oil were notable contributors.

In contrast, stock selection in financials detracted. In South Africa, our holdings in financial group Absa, formerly Barclays Africa, and insurer Sanlam were leading detractors as concerns about the country's economy and the crisis at the state-owned energy provider Eskom weighed on share prices. South Korean banks Hana Financial and Shinhan Financial were notable detractors too.

Our holdings in Alfa, a conglomerate from Mexico, and First Pacific, a Hong Kong-listed conglomerate, also cost some performance as they failed to participate in the stockmarket rally.

First Pacific has several businesses across Asia involved in consumer foods, infrastructure and telecoms. In our view, the group trades at a discount to the value of its underlying businesses.

In addition, not holding any shares in Chinese internet companies Alibaba and Tencent hurt relative performance as the two large-index weights recovered from declines last year.

Strategy and positioning

During the quarter we identified several new opportunities in a range of different industries. We invested in Russian food retailer X5, which we believe is a well-managed business that is strategically positioned to benefit from long-term trends in the sector. X5 replaced Russian supermarket chain O'Key. Despite this purchase, we remain underweight consumer staples as we think valuations in this area are generally expensive.

In technology, we started a position in Silicon Motion Technology, a leading developer of controllers for NAND memory used in smartphones and PCs. The stock sold off on concerns about slowing smartphone sales, but we believe the share price decline is excessive. Silicon Motion replaced Russian software company Luxoft which left the portfolio after being taken over.

Technology remains the fund's largest overweight position, although our holdings are concentrated in technology hardware and equipment stocks, which we consider to be more attractively valued than software and internet companies.

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In India, we sold our stake in Axis Bank, which has struggled with bad debts, and replaced it with ICICI Bank, which has a new chief executive who is driving a change in strategy. We believe the lender's return on equity should rise as asset quality issues improve. We still have a large underweight in India, which is one of the most expensive emerging markets.

In contrast, Mexico is a relatively large position. During the quarter, we bought a stake in Mexichem, a Mexican chemicals firm. After a period of expansion, the company is focusing on capital allocation and improving returns on capital.

The final newcomer was Dubai-based ports operator DP World. The market is concerned about a potential decline in container shipping volumes, but in our view, the company is a quality operator and recent acquisitions should contribute to revenue growth.

These purchases were funded by selling small holdings where we feel the risk/reward balance is no longer attractive. These included Brazilian electricity distributor EDP Energias do Brasil and Taiwanese financial services firm Cathay Financial. Meanwhile, oil company Ophir Energy left the portfolio following a takeover bid.

Outlook

We are optimistic about the opportunities in emerging markets today. We believe emerging market stocks are attractively valued, relative to developed market companies, and we think companies' earnings are robust.

In our view, worries about the macroeconomic outlook (slowing global economic growth) and geopolitics (trade wars) have weighed on the share prices of emerging market stocks. In contrast, we believe that investors have largely ignored the operational performance, or fundamentals, of companies. As a result, we believe there are opportunities to invest in companies whose valuations have been marked down for reasons unrelated to their underlying performance.

We think that the corporate activity we have seen this quarter is confirmation of the considerable value that we believe can be found in the market. In recent years, investors have favoured more expensive 'growth' stocks and overlooked cheaper companies. If investors ignore this situation, we believe it is likely that cash-rich corporates will take advantage of these value opportunities and make acquisitions. And this is precisely what has started to happen this year, with larger companies buying out some of the cheaper holdings in the portfolio.

As long-term value-oriented investors, we will continue to look for opportunities in areas that we think are being overlooked by other market participants. As we have done over the past few months, we will apply our selective stockpicking approach and seek to take advantage of any stocks that become mispriced as a result of fears about the external environment.

Long-term performance

Sterling I	1 year %	3 years % pa	5 years % pa	Since launch (5 Feb 2009) %
M&G Global Emerging Markets Fund	2.6	13.8	7.5	11.8
MSCI Emerging Markets Index	0.1	14.8	9.3	11.1
IA Global Emerging Markets sector average	-1.7	13.4	8.8	10.8
Fund quartile ranking in sector	1	2	4	1

Source: Morningstar, Inc., UK database as at 31 March 2019. Sterling I class shares, income reinvested, price-to-price basis.

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