Quarterly Review

M&G Global Recovery Fund

First quarter 2019

Fund manager – David Williams

FOR INVESTMENT PROFESSIONALS ONLY

Highlights

- Global stockmarkets recorded a strong start to 2019, recovering from their disappointing performance at the end of last year; the MSCI ACWI Index recorded its best quarter since 2010, with the US driving the gains, led by the technology sector.
- The M&G Global Recovery Fund ended the first quarter broadly in line with the MSCI ACWI, assisted by a positive price swing, as the fund's strategy detracted slightly. This was due in part to an underweight exposure to technology companies, where there is a lack of suitable candidates that fit the recovery criteria, as well as stock selection in the materials and consumer discretionary sectors. However, significant value was added by the fund's holdings in the healthcare sector.
- In the first quarter, we introduced one new stock in the early stages of the recovery cycle into the fund, Vermilion Energy, an oil & gas producer with operations in North America, Europe and Australia, taking advantage of a weak oil price at the start of the year to pick up the stock on a high yield. Two holdings exited the portfolio: upmarket global hotel group Belmond after being bought by LVMH, and Prudential was sold, having reached the end of stage 3 (recovering well) of the recovery cycle.

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.

The fund can be exposed to different currencies. Movements in currency exchange rates may adversely 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).

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 %
Sterling I[1]	10.0	10.0	-16.8	13.9	32.0	3.7	5.9
Index[1]	9.8	9.8	-3.3	13.8	29.4	3.8	11.2
Sector[1]	9.8	9.8	-5.6	14.3	23.9	4.1	8.6
Quartile[1]	2	2	4	2	1	3	4
Euro A[2]	14.9	14.9	-18.5	9.1	11.9	9.5	12.7
Index[2]	14.4	14.4	-4.3	9.5	11.7	9.3	19.2
Sector[2]	14.0	14.0	-6.3	7.9	7.0	10.2	16.8
Quartile[2]	2	2	4	2	1	3	4
USD A[3]	12.7	12.7	-22.1	23.9	8.5	-2.6	-1.0
Index[3]	12.3	12.3	-8.9	24.6	8.5	-1.8	4.7
Sector[3]	11.9	11.9	-10.8	22.9	3.9	-1.0	2.6

Please note, not all share classes are necessarily available in all jurisdictions.

Past performance is not a guide to future performance.

[1] *Source: Source: Morningstar, Inc., UK database as at 31 March 2019. Sterling I class shares, income reinvested, price-to-price basis. Index: MSCI ACWI. Sector: IA Global*

[2] *Source: Morningstar, Inc., Pan European database as at 31 March 2019. Euro A class shares, income reinvested, price-to-price basis. Index: MSCI ACWI. Sector: Morningstar Global Large-Cap Blend Equity.*

[3] *Source: Morningstar, Inc., Pan European database as at 31 March 2019. USD A class shares, income reinvested, price-to-price basis. Index: MSCI ACWI. Sector: Morningstar Global Large-Cap Blend Equity.*

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Performance attribution and positioning

Largest positive contributors 3 months			
Stock	Relative weight %	Absolute return %	Contribution %
GW Pharmaceuticals	2.7	69.2	1.1
Hutchison China MediTech	3.9	32.4	0.6
Afterpay Touch Group	1.5	66.6	0.5

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Afterpay Touch Group	1.5	66.6	0.5

Largest negative contributors 3 months			
Stock	Relative weight %	Absolute return %	Contribution %
St. Barbara	1.2	-28.6	-0.7
Midas Gold	1.9	-12.6	-0.5
China Financial Services Holdings	1.9	-11.1	-0.4

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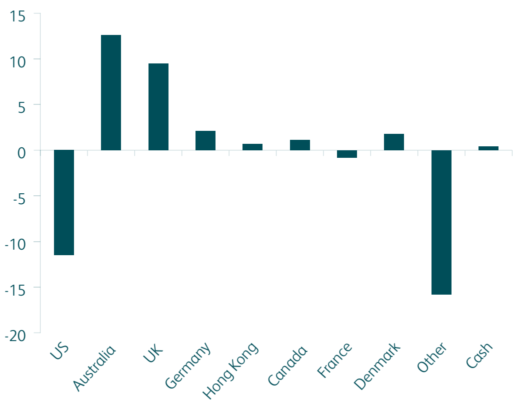
Source: Factset, investment returns (gross of fees) calculated in sterling, as at 31 March 2019, preliminary data. Performance contribution includes both stocks held and not held, and weighting shown is relative to MSCI AWCI Index.

Largest overweights (%)			
	Fund	Index	Relative
Hutchison China Meditech	6.9	0.0	6.9
Medical Developments International	3.0	0.0	3.0
Citigroup	3.3	0.3	3.0
IPH	2.9	0.0	2.9
GW Pharmaceuticals	2.7	0.0	2.7
Pandora	2.3	0.0	2.3
Airasia	2.2	0.0	2.2
Volkswagen	2.2	0.1	2.1
BP	2.4	0.3	2.0
China Financial Services	1.9	0.0	1.9

Largest underweights (%)			
	Fund	Index	Relative
Apple	0.0	2.0	-2.0
Amazon	0.0	1.6	-1.6
Alphabet	0.0	1.6	-1.6
Facebook	0.0	0.9	-0.9
Johnson & Johnson	0.0	0.8	-0.8
Exxon Mobil	0.0	0.8	-0.8
JP Morgan	0.0	0.7	-0.7
Nestle	0.0	0.6	-0.6
Visa	0.0	0.6	-0.6
Tencent	0.0	0.6	-0.6

Region breakdown (%)					
	Fund (start)	Fund (end)	Change	Index (end)	Relative
US	42.7	43.9	1.2	55.3	-11.5
Australia	13.9	14.6	0.8	2.1	12.6
UK	14.3	14.6	0.3	5.2	9.5
Germany	5.3	4.7	-0.5	2.6	2.1
Hong Kong	5.3	4.6	-0.7	3.9	0.7
Canada	4.0	4.2	0.2	3.0	1.1
France	2.4	2.5	0.1	3.3	-0.8
Denmark	-	2.3	2.3	0.5	1.8
Other	11.4	8.1	-3.3	23.9	-15.8
Cash	0.8	0.4	-0.5	0.0	0.4

Weights relative to index (%)



Industry breakdown (%)					
	Fund (start)	Fund (end)	Change	Index (end)	Relative
Healthcare	19.3	21.5	2.2	11.7	9.8
Consumer discretionary	20.7	19.2	-1.5	10.7	8.5
Industrials	13.4	13.9	0.6	10.4	3.5
Financials	12.9	11.8	-1.1	16.6	-4.8
Information technology	10.1	11.1	1.0	15.7	-4.6
Materials	11.6	10.0	-1.6	4.8	5.2
Energy	7.1	7.7	0.6	6.3	1.5
Utilities	1.7	1.7	0.0	3.3	-1.6
Real estate	1.1	1.2	0.1	3.3	-2.0
Communication services	0.9	0.8	-0.1	8.7	-7.9
Consumer staples	0.4	0.6	0.2	8.4	-7.8
Cash and near cash	0.8	0.4	-0.4	0.0	0.4

Weights relative to index (%)

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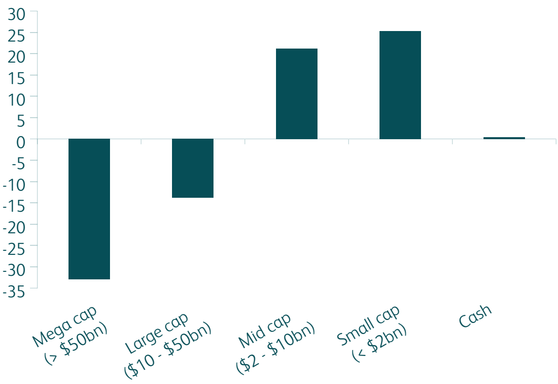
Capitalisation breakdown (%)					
	Fund (start)	Fund (end)	Change	Index (end)	Relative
Mega cap (> $50bn)	19.6	19.3	-0.3	52.3	-33.0
Large cap ($10 - $50bn)	23.7	22.9	-0.8	36.7	-13.8
Mid cap ($2 - $10bn)	23.2	31.9	8.7	10.8	21.2
Small cap (< $2bn)	32.7	25.5	-7.2	0.1	25.3
Cash	0.8	0.4	-0.5	0.0	0.4

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

Weights relative to index (%)



Fund manager commentary

Global stockmarkets recorded a strong start to the year, recovering from their disappointing performance at the end of 2018, as the MSCI ACWI Index recorded its best quarter since 2010, with the US driving the gains. The bulk of the markets' progress was recorded in the first two months of the year, with January particularly strong. A combination of relief that company earnings for the final quarter of 2018 were better than expected and the dovish comments by many central banks drove sentiment.

At a sector level, technology led the markets higher. Energy and industrials also outperformed as cyclicals were back in favour, although financials, particularly banks, struggled in the face of an inverting yield curve. Defensive areas such as healthcare and utilities trailed the rising market.

In fixed income markets, government bond yields fell as the interest rate outlook improved, and a greater risk appetite resulted in corporate bond spreads narrowing. In currencies, sterling strengthened as fears of a no-deal Brexit receded. In commodities, the oil price had a particularly good quarter.

Fund performance

The fund delivered a solid performance, finishing a strong first quarter broadly in line with the MSCI ACWI.

Performance was assisted by a positive price swing, while the fund's strategy detracted slightly. In particular, this was due in part to an underweight exposure to the technology sector, where there is a lack of suitable companies that fit the recovery criteria, as well as stock selection in the materials and consumer discretionary sectors.

However, significant value was added by the fund's holdings in the healthcare sector, where it benefited from a pick-up in some of its biotech companies such as **GW Pharmaceuticals**, **Mesoblast** and **Hutchison China Meditech**. In particular, the former is making considerable progress in the US commercialising Epidiolex, its ground-breaking treatment for severe epilepsy in children. Elsewhere, in the resources sectors, **Tullow Oil** and **First Quantum Minerals** were lifted by rising commodity prices, GPS watch manufacturer **Garmin** produced a strong set of results, and a recent position in **Coty**, a global cosmetics business based in the US, was boosted when a consumer goods firm, JAB Holding Company, raised its stake from 40% to 60%. In addition, investors responded positively to the news that financial technology firm **Afterpay Touch** had made an encouraging start in the US in terms of the take-up of its buy-now-pay-later payment system. This offers an alternative method of purchasing goods without resorting to credit cards and is popular with millennials.

The main detractors included gold miners **St Barbara** and **Midas Gold**, reflecting a fall in the gold price as risk appetite improved (furthermore, the former disappointed the market with new operational plans); also, low-cost carrier **AirAsia** succumbed to rising fuel prices, and shares in brick-laying robot manufacturer **FBR** (formerly Fastbrick Robotics) were diluted by a placing to fund the commercialisation of the product. Meanwhile, **Volkswagen** was affected by a slowing German economy and concerns about falling demand for their cars in China; similarly, port operator **DP World** suffered from concerns about moderating global growth.

Portfolio changes

Vermilion Energy, an oil & gas producer with operations in North America, Europe and Australia, was the one new holding established in the first quarter, taking advantage of a weak oil price at the start of the year to pick up the stock on a high yield. The company has good assets and capital allocation policies, plus a strong management team.

Elsewhere, we continued to build up some of the fund's existing holdings in stage 1 (unloved) and stage 2 (stabilising) of the recovery cycle. In particular, in stage 1 these included branded apparel manufacturer **Global Brands**, **FBR**, **Mesoblast**, plus clothing and shoe business **Cherokee**. Companies in stage 2 increased included luxury accessories group **Tapestry** (formerly Coach), **American Airlines** and jewellery retailer **Pandora**.

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Two holdings exited the portfolio: upmarket global hotel group **Belmond**, a stage 1 company, after being bought by LVMH, and **Prudential** was sold, having reached the end of stage 3 (recovering well) of the recovery cycle.

In other activity, we trimmed some more of the fund's stage 3 holdings that had outperformed. These included **GW Pharmaceuticals**, **Garmin**, **IPH –** an Australian-listed intellectual property services (patent law) firm – **PayPal**, the payments company, and oil major **BP**.

Outlook

Although there are lingering concerns around China, tariffs, Brexit and global growth, there has been little fundamental change in the macroeconomic backdrop. The global economy remains in expansionary mode, while corporate earnings and dividend growth are broadly supportive for global equity markets. Furthermore, the cost of borrowing is still very low, monetary policy stimulative at current levels and inflationary pressure subdued.

In the M&G Global Recovery Fund, we take a long-term approach to investment and allow the management teams of companies that we back sufficient time to take the action required to return their businesses to health. We take profits as companies transition through their recovery cycle, which means the companies we get right materially enhance performance, while those that lag should not hurt us too much. Over time, most of the fund's performance is likely to be driven by the stocks transitioning from stage 2 (stabilising) to stage 3 (recovering well) of their recovery cycle. This is where the improvements the companies are making are more tangible and can be recognised by the market and rewarded by increases in share prices. That said, companies in other stages of the recovery cycle can also contribute significantly – each case is unique.

The fund has a compelling proposition, with differentiated positioning relative to its peers and the benchmark.

The increase in volatility last year has added to the mixed performance from the fund. But as results start to come through, we remain confident that a strong valuation discipline applied to restructuring businesses will be rewarded by the markets.

Long-term performance

Sterling I	1 year %	3 years % pa	5 years % pa	Since launch* % pa
M&G Global Recovery Fund	-0.1	9.5	8.3	8.4
MSCI ACWI	11.1	15.0	12.4	12.1
IA Global Sector average	8.7	12.8	10.4	10.7
Fund quartile ranking in sector	4	4	4	4

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

Euro A	1 year %	3 years % pa	5 years % pa	Since launch* % pa
M&G Global Recovery Fund	1.2	5.5	6.8	7.2
MSCI ACWI	13.0	11.8	11.5	11.6
Morningstar Global Large-Cap Blend Equity Sector	10.9	9.0	9.2	9.8
Fund quartile ranking in sector	4	4	4	4

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

US dollar A	1 year %	3 years % pa	5 years % pa	Since launch* % pa
M&G Global Recovery Fund	-7.8	5.0	2.2	4.7
MSCI ACWI	3.2	11.3	7.0	9.1
Morningstar Global Large-Cap Blend Equity Sector	1.3	8.5	4.8	7.4

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

* Fund was launched on 17 February 2012.

Past performance is not a guide to future performance.

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