Quarterly Review

M&G Global Select Fund

Second quarter 2018

Fund manager – John William Olsen

FOR INVESTMENT PROFESSIONALS ONLY

Highlights

- Developed market equities delivered solid returns in sterling and euro terms, but US dollar returns were more muted, given the relative strengthening of the currency during the quarter.
- The fund outperformed the MSCI World Index, driven by stockpicking within healthcare, financials and energy, as well as the overweight in retailers, healthcare and software and services.
- There were no new holdings added during the quarter, except for Georgia Capital, spun out from Bank of Georgia. We closed the position in US tech giant IBM.

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.

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

The fund holds a relatively small number of investments and, as a result, may experience larger price rises and falls than a fund which holds a larger number of investments.

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.

Performance, attribution & positioning

Sterling Performance[1]	3 months %	YTD %
Fund	10.7	0.8
Index	8.3	3.2
Sector	7.8	2.7
Quartile	1	3

Euro Performance[2]	3 months %	YTD %
Fund	9.2	0.4
Index	7.4	3.6
Sector	6.2	2.1
Quartile	1	3

US dollar Performance[3]	3 months %	YTD %
Fund	3.2	-2.5
Index	1.9	0.8
Sector	0.8	-0.7

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

Single year performance (5 years ending 30 June 2018)

From To	01/07/2017 30/06/2018 %	01/07/2016 30/06/2017 %	01/07/2015 30/06/2016 %	01/07/2014 30/06/2015 %	01/07/2013 30/06/2014 %
Sterling I[1]	7.3	25.2	9.7	11.3	2.1
Euro A[2]	5.4	16.6	-6.5	24.1	8.2
USD A[3]	7.6	19.3	-6.8	1.7	13.1

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

[1] *Source: Morningstar, Inc., UK database as at 30 June 2018. Sterling I class shares, income reinvested, price-to-price basis. Index: MSCI World. Sector: IA Global*

[2] *Source: Morningstar, Inc., Pan European database as at 30 June 2018. Euro A class shares, net income reinvested, price-to-price basis. Index: MSCI World. Sector: Morningstar Global Large Cap Blend Equity*

[3] *Source: Morningstar, Inc., Pan European database as at 30 June 2018. USD A class shares, net income reinvested, price-to-price basis. Index: MSCI World. Sector: Morningstar Global Large Cap Blend Equity*

Past performance is not a guide to future performance

M&G INVESTMENTS

Largest positive contributors 3 months			
Stock	Relative weight %	Absolute return %	Contribution %
Tiffany & Co	2.6	43.8	0.9
UnitedHealth	4.8	22.2	0.6
Becton Dickinson	5.5	17.9	0.5

Largest positive contributors YTD			
Stock	Relative weight %	Absolute return %	Contribution %
Tiffany & Co	2.9	30.9	0.8
Becton Dickinson	5.4	15.5	0.7
UnitedHealth	4.6	14.8	0.6

Largest negative contributors 3 months			
Stock	Relative weight %	Absolute return %	Contribution %
Ball	4.0	-4.6	-0.5
ING Group	2.4	-6.4	-0.3
Novo Nordisk	4.3	0.4	-0.3

Largest negative contributors YTD			
Stock	Relative weight %	Absolute return %	Contribution %
WHSmith	6.2	-13.5	-1.0
L Brands	2.5	-35.3	-0.9
Novo Nordisk	4.5	-10.5	-0.6

Source: Xamin, investment returns (gross of fees) calculated in sterling, as at 30 June 2018, preliminary data. Performance contribution and weighting relative to MSCI World Index.

Largest overweights (%)	Fund	Index	Relative
Unitedhealth Group	6.4	0.6	5.8
Becton Dickinson	6.3	0.2	6.2
WH Smith	5.7	0.0	5.7
Microsoft	5.6	1.8	3.8
Novo Nordisk	4.8	0.2	4.6
Alphabet	4.5	1.7	2.8
Linde	3.9	0.1	3.8
Ball	3.8	0.0	3.8
Tokio Marine	3.8	0.1	3.7
Tiffany	3.5	0.0	3.5

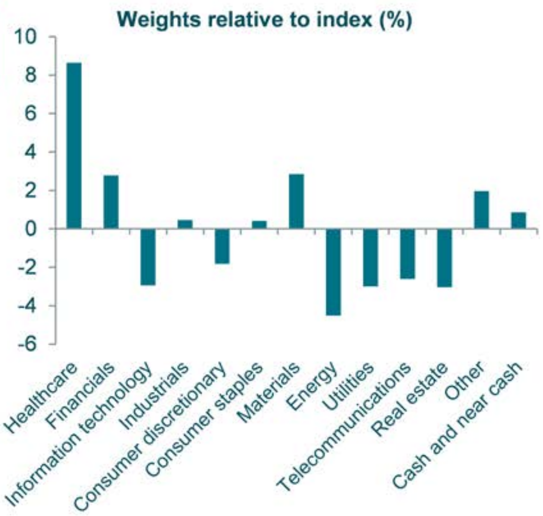
Source: M&G, as at 30 June 2018

Largest underweights (%)	Fund	Index	Relative
Apple	0.0	2.4	-2.4
Amazon	0.0	1.8	-1.8
Facebook	0.0	1.2	-1.2
JP Morgan	0.0	0.9	-0.9
Exxon Mobil	0.0	0.9	-0.9
Johnson & Johnson	0.0	0.8	-0.8
Royal Dutch Shell	0.0	0.7	-0.7
Bank of America	0.0	0.7	-0.7
Wells Fargo	0.0	0.6	-0.6
Chevron	0.0	0.6	-0.6

Source: M&G, as at 30 June 2018

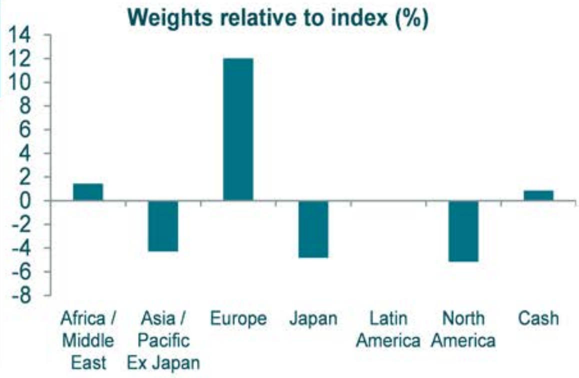
Industry breakdown (%)	Fund (start)	Fund (end)	Change	Index (end)	Relative
Healthcare	19.5	20.8	1.3	12.2	8.6
Financials	22.6	19.5	-3.1	16.8	2.8
Information technology	16.0	15.6	-0.4	18.5	-2.9
Industrials	11.0	11.6	0.6	11.2	0.5
Consumer discretionary	10.1	10.9	0.8	12.7	-1.8
Consumer staples	9.2	8.7	-0.5	8.3	0.4
Materials	7.4	7.7	0.3	4.9	2.9
Energy	1.8	2.3	0.4	6.8	-4.5
Utilities	0.0	0.0	0.0	3.0	-3.0
Telecommunications	0.0	0.0	0.0	2.6	-2.6
Real estate	0.0	0.0	0.0	3.0	-3.0
Other	0.0	2.0	2.0	0.0	2.0
Cash and near cash	2.3	0.9	-1.5	0.0	0.9

Source: M&G, as at 30 June 2018



Region breakdown (%)	Fund (start)	Fund (end)	Change	Index (end)	Relative
Africa / Middle East	1.1	1.6	0.5	0.2	1.4
Asia / Pacific Ex Japan	0.0	0.0	0.0	4.3	-4.3
Europe	35.2	34.6	-0.7	22.6	12.0
Japan	3.7	3.8	0.1	8.6	-4.8
Latin America	0.0	0.0	0.0	0.0	0.0
North America	57.7	59.2	1.5	64.3	-5.2
Cash	2.3	0.9	-1.5	0.0	0.9

Source: M&G, as at 30 June 2018



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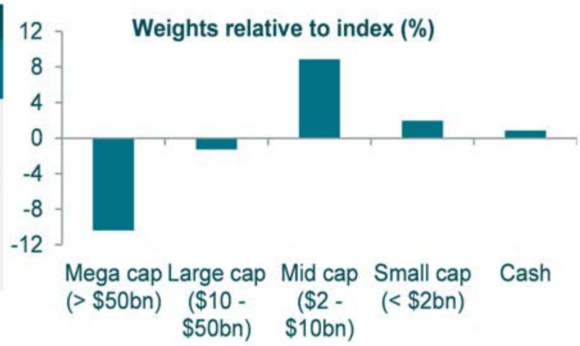
Capitalisation breakdown (%)

	Fund (start)	Fund (end)	Change	Index (end)	Relative
Mega cap (> $50bn)	47.6	44.6	-3.0	55.0	-10.4
Large cap ($10 - $50bn)	31.7	36.0	4.4	37.3	-1.3
Mid cap ($2 - $10bn)	16.4	16.5	0.1	7.6	8.9
Small cap (< $2bn)	2.0	2.0	0.0	0.0	2.0
Cash	2.3	0.9	-1.5	0.0	0.9

Source: M&G, as at 30 June 2018

Index: MSCI World



Performance and portfolio positioning

Developed market equities delivered solid returns in sterling and euro terms for the second quarter of 2018, while US dollar returns were more muted, given the relative strengthening of the currency during the period.

A number of factors contrived to sway investor sentiment during the quarter, largely resulting from the actions of US President Donald Trump. Fear that import tariffs announced by the US would precipitate an all-out trade war with China was an ongoing theme, as investors pondered the potential effects of this on global growth prospects. We also saw geopolitical concerns mount in the Middle East, fuelled by Trump's threat of missile strikes in Syria in retaliation for an alleged chemical attack on civilians. The potential ramifications for the wider region saw oil prices rise to four-year highs, rising yet further on Trump's decision to pull the US out of the Iran nuclear deal and reimpose sanctions on the country.

Meanwhile, the euro weakened as European Central Bank President Mario Draghi acknowledged that the pace of the eurozone recovery had moderated, while political turmoil in Spain and Italy hit sentiment, particularly in the banking sector. Sterling also fell, in light of disappointing first-quarter GDP estimates making a near-term interest rate rise less likely.

As the period came to a close, sentiment was supported by optimism over the US economic outlook – including a larger-than-expected rise in hourly earnings – while some of the European political tensions calmed. However, global trade war concerns once again unsettled investors, as Trump threatened another raft of tariffs on Chinese imports, as well as fresh tariffs on cars imported from the EU (the European automotive sector suffered as a result).

In this environment, amid a strengthening oil price, energy was the standout performer, helped by news that Saudi Arabia had struck a deal to allow Opec and its allies to increase oil production. Technology performed strongly as well, as investors set aside fears of increased regulation affecting the sector following revelations of the alleged misuse of user data held by Facebook and others. The consumer discretionary sector also performed well, driven by robust returns from the retailing sub-sector, an area that had been weak for some time. Conversely, financials, telecoms and industrials all lagged the wider market.

Against this background, the fund outperformed the MSCI World Index, driven by stockpicking within healthcare, financials and energy, as well as the overweight in retailers, healthcare and software and services within the information technology sector. Relative fund returns were also boosted by a timing difference between the pricing of the fund (at noon UK time) and the index (at market close). Conversely, the fund's underweight in energy and overweight in financials dragged on relative returns, as did stock selection within the consumer discretionary sector.

At a stock level, the fund's largest contributor was US-listed luxury jeweller **Tiffany**. Its shares rose sharply following the publication of robust results that beat expectations, reporting solid sales growth across most geographic regions and all product categories. It also published a better-than-expected full-year outlook, combined with a well-received share repurchase programme. Tiffany has been modernising its operations, including enhancing the customer experience, increasing the rate of new product introductions, optimising the store network, and improving business operations and processes.

Shares in diversified managed healthcare company **UnitedHealth Group** also rose strongly during the quarter. The company has delivered solid performance in both its insurance business, which added some 2.2 million customers in the first quarter of 2018, as well as its Optum segment, which has continued to see double-digit growth in earnings and revenue generation.

Optum provides pharmacy benefits management and technology services to insurers and medical providers, and also operates its own clinics under the OptumCare brand.

Other supportive holdings included US medical equipment manufacturer **Becton Dickinson** and industrial gases supplier **Linde**. In light of ongoing operational success, Becton published solid results, including good numbers from medical device company C.R. Bard, acquired by Becton at the end of 2017. Linde, meanwhile, also produced strong numbers, beating profit expectations and confirming its full-year outlook. This was in spite of currency headwinds leading to a decline in overall revenue. The positive mood in the company continued through the quarter, bolstered by reassurance to investors over its merger with rival Praxair, which was further confirmed as Brazil's antitrust regulator approved the US$80 billion merger, provided the companies go ahead with an undisclosed asset sale plan.

On the downside, the fund's largest detractor was metal packaging specialist **Ball Corp**, whose shares fell despite the company delivering strong overall operational performance, especially in Latin America. Part of the investor unease centred on well-publicised softness in the US market and measures taken by Ball Corp to remove capacity. While this has created a short-term headwind, we are happy with management's cost discipline and remain confident about the long-term prospects for the group.

Multinational pharma company **Novo Nordisk** dragged on relative returns as well, its shares drifting downward in the run-up to the company reporting results in May, before reversing course. While the company's shares delivered modestly positive returns for the quarter, they remained behind the wider market.

Other laggards included Dutch financial institution **ING**, which saw share price weakness following the general bank sell-off in light of the tumultuous political situation in Italy, and UK retailer **WH Smith**. The company reported a fall in pre-tax profit near the beginning of the quarter, amid a difficult UK retail environment. However, its travel division, including concessions in airports and train stations, posted solid sales growth, in line with our expectations of travel driving growth in the business.

Engagement activity

We maintain ongoing dialogue with our investee companies, as well as companies on our watchlist of stocks that we would like to own when the timing and price is right. Two engagements of note during the quarter involved consumer giant **Reckitt Benckiser** and jeweller **Tiffany**, mentioned above.

We participated in Reckitt's first meeting between the board of directors and shareholders. The event was an important step in increasing transparency and continuing the dialogue between both parties. The board acknowledged Reckitt's performance-driven culture being a key differentiator to its success, but also recognised how such a culture requires closer oversight and monitoring. We are optimistic about the company's RB 2.0 strategy, which prioritises broad-based organic growth across its extensive portfolio of highly successful consumer brands.

As for Tiffany, we engaged with both the company's management team and sustainability team during the quarter. Tiffany has been integrating sustainability into its brand for many years. For example, bringing the cutting and polishing of diamonds in-house has provided it with much better oversight into the operations of the supply chain. Its vertical integration and ownership of mines helps to ensure confidence in the mines' working conditions and environmental impact. Unfortunately, the company is conservative in the data and key performance indicators concerning this that it publishes – an area where we have encouraged, and will continue to encourage, it to increase transparency.

Portfolio changes

In line with our long-term, low-turnover approach, there were no new purchases during the quarter, although Georgian financial institution **Bank of Georgia** spun off its investment arm to form **Georgia Capital**, and we now hold both companies in the portfolio. We also added to our positions in **Novo Nordisk**, mentioned above, and Danish facilities management business **ISS**.

Conversely, we closed the position in US tech giant **IBM**, having lost faith in management's ability to carry out the company's transformation towards the 'cloud'. We also reduced a number of positions, including addiction cessation drug maker **Indivior**, US insurer **AIG**, and global food and beverage company **Nestlé**.

Outlook

We look for companies that can generate persistent cashflows. Given the climate for much of last year, this may be considered boring compared to rapidly growing tech companies or deep value stocks. ISS, mentioned above, is probably as boring as you can get, but has the ability to deliver long-term compounding returns and create wealth, sustainably, for our investors.

We believe that it is not worth being too aggressive on risk when everyone else is. It can sometimes feel like you are missing out when you see investors making massive returns speculating on Bitcoin, or when already expensive tech stocks keep going up. However, that is when you need to be the most disciplined. And the good thing about momentum is that you can scale out of it. In some cases, we have scaled back positions by more than our original holding in a company, just through investment gains.

We have recently bought shares in some special cases – in particular Bank of Georgia at the end of 2017. We have taken on risk by doing so, but this is not market or momentum-driven; it is stock-specific risk, which actually lends itself to diversification. This ties in with keeping the fund balanced.

The portfolio is currently broken down 57% 'Stable Growth' and 43% 'Opportunities'. This reflects the recent pullback of cyclicals in response to softer economic indicators in Europe, and the correction of financials in the wake of the Italian crisis (both cyclicals and financials are held in the Opportunities bucket). We welcome the fact that this creates room for upside, with world markets ex-US now trading on an attractive real earnings yield of around 7.8% (as at 2nd July 2018). The US earnings yield of 6.1% is lower, but still reasonably high in absolute terms. The US market offers the advantage of relatively safer earning growth this year, benefiting from tax reforms and more exposure to growth, against a backdrop of rising volatility world-wide.

We remain confident in the quality of the stocks within the portfolio. As long-term investors, our focus is on the ability of our holdings to generate long-term value for the fund and for our investors, and we continue to be optimistic about their prospects.

Long-term performance

Sterling I	1 year %	3 years % pa	5 years % pa	Since tenure* %
M&G Global Select Fund	7.3	13.8	10.9	13.2
Comparative Index	9.9	15.1	12.9	13.8
IA Global sector average	9.4	13.6	11.8	12.4
Fund quartile ranking in sector	3	2	3	2

Source: Morningstar, Inc., UK database as at 30 June 2018. Sterling I class shares, income reinvested, price-to-price basis. The fund's sterling I class shares launched on 03/08/2012. Performance data shown prior to this date is that of the fund's sterling A share class.

Euro A	1 year %	3 years % pa	5 years % pa	Since tenure* %
M&G Global Select Fund	5.4	4.7	9.1	9.3
Comparative Index	9.1	6.9	12.2	11.0
Morningstar Global Large-Cap Blend Equity sector average	6.6	5.0	10.3	9.2
Fund quartile ranking in sector	3	3	3	3

Source: Morningstar, Inc., Pan-European database as at 30 June 2018. Euro A class shares, net income reinvested, price-to-price basis.

US dollar A	1 year %	3 years % pa	5 years % pa	Since tenure* %
M&G Global Select Fund	7.6	6.2	6.6	5.0
Comparative Index	11.7	8.5	9.8	6.7
Morningstar Global Large-Cap Blend Equity sector average	9.2	6.6	7.9	4.9

Source: Morningstar, Inc., Pan-European database as at 30 June 2018. USD A class shares, net income reinvested, price-to-price basis.

**John William Olsen took over management of the fund on 01 July 2014. On 01 January 2016, the fund's performance comparative index changed. Past performance shown from 01 July 2013 to 31 December 2015 is the MSCI All Country World Index. Past performance shown from 01 January 2016 is the MSCI World Index.*

Past performance is not a guide to future performance

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