Quarterly Review

M&G Global Select Fund

Third quarter 2018

Fund manager – John William Olsen

FOR INVESTMENT PROFESSIONALS ONLY

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Highlights

- Developed market equities delivered positive returns in the third quarter of 2018, despite persistent trade war concerns, political difficulties in Europe and ongoing Brexit anxiety.
- The fund did not keep up with the MSCI World Index, with underperformance primarily driven by stock selection within the healthcare sector.
- There were no new holdings during the quarter. We closed the position in US insurer AIG.

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 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	4.6	5.4
Index	6.4	9.8
Sector	3.9	6.6
Quartile	2	3

Euro performance[2]	3 months %	YTD %
Fund	4.1	4.5
Index	5.6	9.5
Sector	3.9	6.2
Quartile	3	3

US dollar performance[3]	3 months %	YTD %
Fund	3.5	1.0
Index	5.1	5.9
Sector	3.4	2.7

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

<u>Single year performance (5 years)</u>

	2017 %	2016 %	2015 %	2014 %	2013 %
Sterling I[1]	12.5	27.6	5.7	5.8	18.1
Euro A[2]	7.8	8.2	10.8	12.0	14.5
USD A[3]	22.3	4.9	-0.7	-1.1	19.6

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

[1] *Source: Morningstar, Inc., UK database as at 30 September 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 September 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 September 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

Largest positive contributors 3 months			
Stock	Relative weight %	Absolute return %	Contribution %
Ball	3.8	25.6	0.7
Microsoft	3.8	18.0	0.4
Manhattan Associates	2.8	17.6	0.3

Largest positive contributors YTD			
Stock	Relative weight %	Absolute return %	Contribution %
Microsoft	3.1	40.8	0.9
Becton Dickinson	5.4	27.7	0.9
UnitedHealth	4.6	26.5	0.8

Largest negative contributors 3 months			
Stock	Relative weight %	Absolute return %	Contribution %
Indivior	1.7	-51.9	-1.0
Apple	-2.4	23.9	-0.4
L Brands	1.7	-15.1	-0.3

Largest negative contributors YTD			
Stock	Relative weight %	Absolute return %	Contribution %
L Brands	2.5	-45.1	-1.3
WHSmith	6.2	-10.1	-1.1
Indivior	3.4	-55.0	-1.0

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

Largest overweights (%)			
	Fund	Index	Relative
Becton Dickinson	6.5	0.2	6.3
Unitedhealth Group	6.8	0.6	6.1
WH Smith	6.1	0.0	6.1
Ball	5.0	0.0	5.0
Novo Nordisk	5.2	0.2	4.9
Tokio Marine	4.2	0.1	4.1
Microsoft	6.1	2.0	4.1
Linde	4.1	0.1	4.0
Tiffany	3.4	0.0	3.3
Manhattan Associates	3.3	0.0	3.3

Source: M&G, as at 30 September 2018

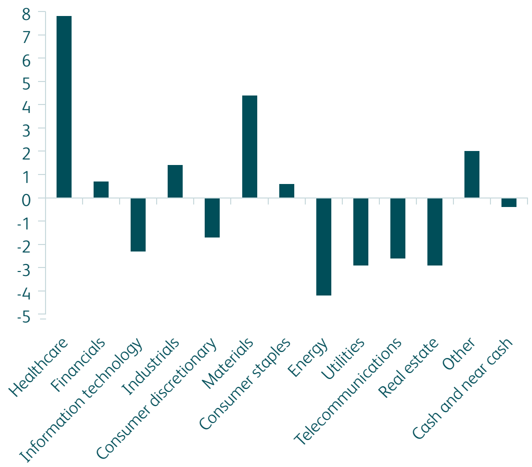
Largest underweights (%)			
	Fund	Index	Relative
Apple	0.0	2.7	-2.7
Amazon	0.0	2.0	-2.0
Facebook	0.0	0.9	-0.9
JP Morgan	0.0	0.9	-0.9
Johnson & Johnson	0.0	0.9	-0.9
Exxon Mobil	0.0	0.9	-0.9
Royal Dutch Shell	0.0	0.7	-0.7
Bank of America	0.0	0.7	-0.7
Berkshire Hathaway	0.0	0.7	-0.7
Visa	0.0	0.6	-0.6

Source: M&G, as at 30 September 2018

Industry breakdown (%)					
	Fund (start)	Fund (end)	Change	Index (end)	Relative
Healthcare	20.8	20.7	-0.1	12.9	7.8
Financials	19.5	17.1	-2.5	16.3	0.7
Information technology	15.6	16.8	1.2	19.1	-2.3
Industrials	11.6	12.8	1.1	11.3	1.4
Consumer discretionary	10.9	10.9	0.0	12.6	-1.7
Materials	7.7	9.1	1.3	4.6	4.4
Consumer staples	8.7	8.6	-0.1	8.1	0.6
Energy	2.3	2.4	0.1	6.5	-4.2
Utilities	0.0	0.0	0.0	2.9	-2.9
Telecommunications	0.0	0.0	0.0	2.6	-2.6
Real estate	0.0	0.0	0.0	2.9	-2.9
Other	2.0	2.0	0.1	0.0	2.0
Cash and near cash	0.9	-0.4	-1.2	0.0	-0.4

Source: M&G, as at 30 September 2018

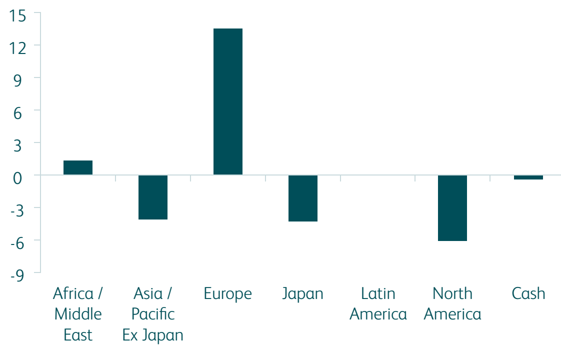
Weights relative to index (%)



Region breakdown (%)					
	Fund (start)	Fund (end)	Change	Index (end)	Relative
Africa / Middle East	1.6	1.5	-0.1	0.2	1.3
Asia / Pacific Ex Japan	0.0	0.0	0.0	4.1	-4.1
Europe	34.6	35.3	0.7	21.7	13.5
Japan	3.8	4.2	0.4	8.5	-4.3
Latin America	0.0	0.0	0.0	0.0	0.0
North America	59.2	59.4	0.2	65.5	-6.1
Cash	0.9	-0.4	-1.2	0.0	-0.4

Source: M&G, as at 30 September 2018

Weights relative to index(%)



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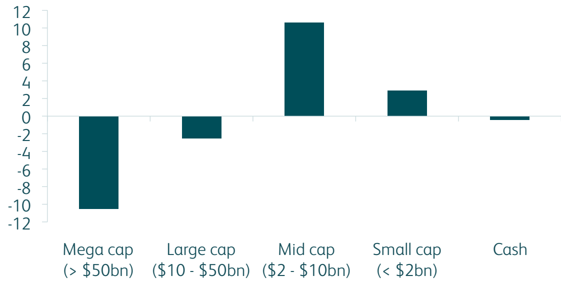
Capitalisation breakdown (%)	Fund (start)	Fund (end)	Change	Index (end)	Relative
Mega cap (> $50bn)	44.6	46.2	1.6	56.7	-10.5
Large cap ($10 - $50bn)	36.0	33.4	-2.7	35.9	-2.5
Mid cap ($2 - $10bn)	16.5	17.9	1.4	7.3	10.6
Small cap (< $2bn)	2.0	2.9	0.9	0.0	2.9
Cash	0.9	-0.4	-1.2	0.0	-0.4

Source: M&G, as at 30 September 2018

Index: MSCI World

Weights relative to index (%)



Performance and portfolio positioning

Developed market equities delivered positive returns in the third quarter of 2018, despite persistent trade war concerns, political difficulties in Europe – particularly within Italy and Turkey – and ongoing Brexit anxiety.

The quarter started on a cautious note, as worries over global trade hurt sentiment, with the EU warning that US President Donald Trump's threat to hit European car imports with tariffs risked fuelling global retaliation against up to £300 billion worth of US goods. The potential for an all-out trade war saw, for example, the oil price experience its biggest one-day drop in two years, reflecting the potential knock to demand that a trade war would inflict. This became a recurring theme, with various regions and sectors falling under President Trump's tariff spotlight, causing wide fluctuations in sentiment depending on the perception of how positively, or not, trade talks were progressing.

Elsewhere in Europe, the political situation in Germany, which threatened Angela Merkel's nascent coalition government, also soured the mood. Eventually some of these concerns eased and markets rose, supported by good economic data out of the US, a well-received batch of corporate earnings and Chinese plans for tax cuts and increased infrastructure spending. Trump reported that he had secured concessions from the EU to avoid a trade war (European auto stocks rallied from their lows) while it was also reported that Washington and Beijing were making efforts to restart talks.

As we moved into August, markets overall remained buoyant, but this was largely supported by good performance out of the US. This helped to counterbalance declining European markets, where investor sentiment suffered from concerns over Brexit, a difficult political situation in Italy and currency chaos in Turkey, the latter of which drove a wave of risk aversion, hitting banks particularly hard. Ongoing trade war news also continued to affect the investor mood, and as we moved through the month the potential for positive talks between the US and China, as well as a well-received trade deal between the US and Mexico, enlivened investors, helping to drive US markets to record highs.

September saw more muted performance as continued global trade uncertainty, concerns over emerging markets and the ongoing political difficulties in Europe weighed on investor sentiment. While a sense of malaise was prominent in the first half of the month, the mood eventually improved and markets recovered lost ground. This was helped by strong performance from Japan, where markets were supported by a weaker yen and solid corporate earnings. For the quarter as a whole, though, the US led the pack among larger market constituents.

Against this background, the best-performing sector for the period was healthcare, while the information technology, industrials and communication sectors all delivered solid returns. Conversely, real estate, materials and energy all lagged the wider market.

In this environment the fund did not keep up with the MSCI World Index, with underperformance primarily driven by stock selection within the healthcare sector, while selection among industrials and consumer discretionary also weighed on relative returns. On the upside, stockpicking within materials, information technology and consumer staples was supportive.

At a stock level, the fund's largest detractor was addiction cessation drug maker Indivior. The company's shares fell sharply on news that Indian generic drug maker Dr Reddy's had launched its own version of Indivior's flagship product, Suboxone Film, in the US (launched 'at risk'), which would severely hit Indivior's market share and earnings. Indivior subsequently blocked Dr Reddy's, with US courts granting a temporary restraining order on the company. Its shares then continued to decline over the summer, dropping further in September following Indivior downgrading sales estimates by some 80% for its new injectable treatment, due to lower take up than expected from patients in light of difficulties in the distribution chain. Meanwhile, the courts are scheduled to come to an ultimate decision over Dr Reddy's in November.

While the journey since June has been painful, we have maintained our faith in the long-term value of the company. In the shorter term, its injectable has better efficacy as a treatment than Suboxone and the company is working through its distribution, while the Suboxone Film patent has a good chance of being upheld in the courts. We will continue to monitor the situation closely.

Also within healthcare, Israeli pharmaceutical company Teva weighed on performance as well. Teva's shares fell in August after the company reported a decline in revenue due to continued price erosion in its US generics business, generic competition to its multiple sclerosis drug Copaxone and loss of revenue following the divestment of certain products. The company also reported that the US Food and Drug Administration (FDA) had not made a decision on its potential blockbuster migraine drug Ajovy, expected months previously, due to FDA concerns over its manufacturing process. The regulator finally approved the drug in September – and Teva's shares rallied. Two weeks later, however, the FDA also approved a new preventative migraine drug from rival Eli Lilly, and Teva's shares fell.

Other detractors included Dutch financial institution ING, which declined along with many European banks in light of the difficulties in Turkey and Italy, and US retail operator L Brands. Owner of Victoria's Secret, PINK and Bath and Body works, the company's shares fell sharply after it announced weak June sales at Victoria's Secret, with a disappointing turnout at its semi-annual sale. L Brands has had a tough time amid increased competition and a generally difficult retail environment in the US.

On the upside, the fund's largest contributor was US tech giant Microsoft, which has continued to benefit from strong growth in its cloud services. Revenue for the company's cloud computing service Azure grew some 89% year-over-year, helping to generate overall annual revenue that exceeded $100 billion for the first time. Microsoft has become a strong second to Amazon Web Services in the cloud computing market – and the threat of Amazon to retailers could work in Microsoft's favour, as e-commerce companies seek a cloud computing platform that is not run by a competitor. Microsoft also reported strong growth from other areas of its business, including social networking, gaming, and hardware.

Other supportive holdings included metal packaging specialist Ball Corp and medical equipment maker Becton Dickinson, both US companies. For Ball Corp, investors reacted positively to strong quarterly earnings (on the back of excellent operational performance and solid global demand for environmentally-friendly aluminium packaging) and the announcement of an $800 million minimum share buyback and special dividends. Sentiment in Becton, meanwhile, remained strong after the company reported solid results in the second quarter, including good numbers from medical device company C.R. Bard, acquired by Becton at the end of 2017. Becton has a history of successfully integrating acquisitions, including medical technology firm CareFusion bought in 2015.

Engagement activity

This quarter we are highlighting discussions we had with two companies, where privacy and data security poses a threat. Discover Financial is a credit card issuer, where data is at the heart of its competitive advantage. Ansys is the global leader in creating software simulation environments, which customers use to test the characteristics of products in their pipeline.

Generally, data security is an area in which companies purposely provide poor transparency and disclosure. This makes sense as companies, naturally, do not want to provide a blueprint of their security defences for hackers and other bad agents. However, we often get the opportunity to discuss matters with management teams and data security analysts within a company. While such discussions will never eliminate the possibility of a data breach, they do provide us with a basis to rate a company's approach to such threats and better understand risks.

Both Ansys and Discover follow basic but important protocols, such as clear lines of responsibility of data security matters, documented escalation processes and the requirement for staff to complete annual testing and attestation on data security matters.

Discover has more personal and financial data, and as such employ an industry-leading protection mechanism, known as tokenisation. They also hire external hacking teams – known as white hat hackers – who are solely compensated on locating system and data security vulnerabilities. Based on our conversation with the companies, we are comfortable with the measures they are taking to secure data.

Portfolio changes

In line with our long-term, low turnover approach, there were no new purchases during the quarter. We closed the position in US insurer AIG, as our investment thesis had not developed as expected. We originally invested in the company as we believed it was going through a period of positive change, but we do not think the restructuring benefits have come through, and we do not anticipate them doing so in the foreseeable future.

Outlook

Our outlook has not changed materially from the previous quarter. We think there is some uncertainty around the US mid-term elections, and while US valuations are generally looking stretched, we still see pockets that look attractive. Europe is currently looking very attractive, as the earnings recovery is coming through while valuations remain supportive.

We look for companies that can generate persistent cashflows, and given the climate for much of last year, this may be considered boring compared to rapidly growing tech companies or deep value stocks. Facilities management business ISS, for example, one of our new holdings from 2018, 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.

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 idiosyncratic risk, which actually lends itself to diversification. This ties in with keeping the fund balanced.

In terms of the current fund, 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	13.5	17.2	11.7	13.6
Comparative Index	15.1	19.8	14.1	14.6
IA Global sector average	11.7	17.6	12.1	12.7
Fund quartile ranking in sector	2	3	3	2

Source: Morningstar, Inc., UK database as at 30 September 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	11.7	9.1	9.3	9.7
Comparative Index	13.8	12.5	12.6	11.7
Morningstar Global Large-Cap Blend Equity sector average	10.0	9.8	10.4	9.7
Fund quartile ranking in sector	2	3	3	3

Source: Morningstar, Inc., Pan-European database as at 30 September 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	9.5	10.2	6.0	5.6
Comparative Index	11.8	14.0	9.2	7.5
Morningstar Global Large-Cap Blend Equity sector average	8.0	11.2	7.1	5.5

Source: Morningstar, Inc., Pan-European database as at 30 September 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 October 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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