

M&G (Lux) Optimal Income Fund - USD Class A-H

Monthly Fund Review as at 28 February 2019

For investment professionals only



Highlights

- Credit markets rallied again in February, with fears over the prospect of recession receding at least temporarily. Credit spreads tightened, and the fund rose.
- We remain close to our historically maximum short duration, and still prefer lending money to BBB rated companies.

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.

The fund may use derivatives with the aim of profiting from a rise or a fall in the value of an asset (for example, a company's bonds). However, if the asset's value varies in a different manner, the fund may incur a loss.

The fund may use derivatives to gain exposure to investments exceeding the value of the fund (leverage). This may cause greater changes in the fund's price and increase the risk of loss.

Changes in currency exchange rates will 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

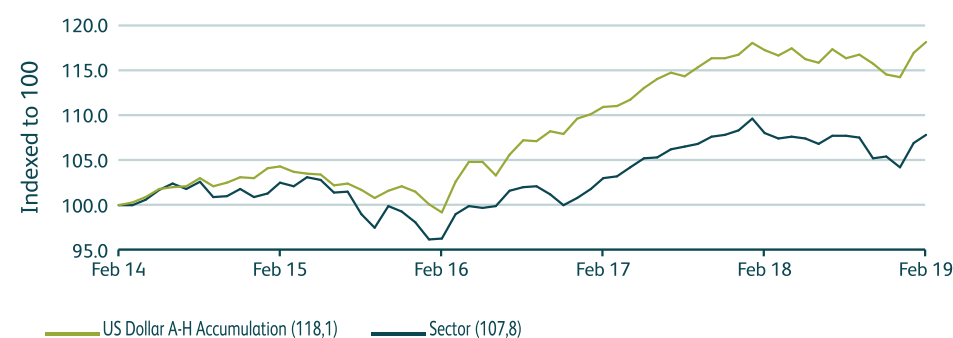
Following shareholder approval, the non-sterling assets of the M&G Optimal Income Fund, a UK-authorized OEIC, which launched on 8 December 2006, merged into the M&G (Lux) Optimal Income Fund on 8 March 2019. The SICAV is run by the same manager, applying the same investment strategy, as the OEIC. The **past performance**, **yield**, and **fund rating** information shown on this document is based on the OEIC and is for illustrative purposes only as OEIC and SICAV data will not be identical. Following the merger, all SICAV data will be made available at the next month end.

The fund allows for the extensive use of derivatives.

Single year performance (5 years)

	2018	2017	2016	2015	2014
USD A-H Acc	-2.1%	6.5%	7.9%	-1.4%	4.6%
Sector	-3.8%	7.2%	3.1%	-2.6%	1.9%

Performance over 5 years



Fund performance

	1 month (%)	3 months (%)	YTD (%)	1 year (%)	3 years (%) p.a.	5 years (%) p.a.	Manager tenure (%) p.a.	Since launch (%) p.a.
Fund	+1.0	+3.1	+3.4	+0.8	+6.0	+3.4	-	-
Sector	+0.8	+2.3	+3.4	-0.2	+3.8	+1.5	-	-

past performance is not a guide to future performance.

The past performance has been calculated using a different currency to your home currency. The returns shown here may increase or decrease due to currency fluctuations when compared to past performance returns calculated using your home currency.

Hedged share classes aim to mirror the performance of another share class. We cannot guarantee that the hedging objective will be achieved. The hedging strategy will limit holders of the hedged share class from benefiting if the hedged share class currency falls against the US Dollar. Please note that this fund comes with further risks that are explained in the Key Investor Information Document.

The past performance information shown here is based on the USD A-Hedged Acc Class shares of the UK-authorized OEIC which launched on 20 April 2007, and has been included for illustrative purposes only as OEIC and SICAV performance will not be identical. Once the merger has taken place, SICAV performance data will be made available. Comparative sector is the Morningstar USD Cautious Allocation sector.

Key information

Fund manager	Richard Woolnough
Deputy fund manager	Stefan Isaacs
Launch date	5 September 2018
Launch of share class	7 September 2018
Fund size (millions)	\$2,965.01
Fund type	Luxembourg SICAV
Comparative sector	Morningstar USD Cautious Allocation sector
Number of issuers	229
Distribution yield (Acc)	1.90%
Distribution yield (Inc)	3.35%
Underlying yield (Acc)	1.90%
Underlying yield (Inc)	1.90%
Yield to expected maturity*	1.46%
Modified duration (years)	1.84
Spread duration (years)	6.82
Average coupon	3.42
Share type	Acc & Dist
Ongoing charge	1.43%

The key information shown above is for the M&G (Lux) Optimal Income Fund, except for the **yields**, which are based on the USD A-Hedged Share class of the M&G Optimal Income Fund, a UK-authorized OEIC, which will merge into this Luxembourg-authorized SICAV on 8 March 2019.

The distribution yield reflects the amounts that may be expected to be distributed over the next 12 months as a percentage of the share price, as at the date shown. It is based on a snapshot of the portfolio on that day. It does not include any preliminary charge and investors may be subject to tax on distributions. It is the fund's policy to offset certain charges against income for accumulation share classes and to offset certain charges against capital for income share classes. These charges include the annual management charge, administration fee and share class hedging fee (where applicable). As a result, yield figures for income and accumulation share classes may differ significantly. The underlying yield reflects the annualised income net of expenses of the fund (calculated in accordance with relevant accounting standards) as a percentage of the mid-market price of the fund as at the date shown. It is based on a snapshot of the portfolio on that day. It does not include any preliminary charge and investors may be subject to tax on distributions. For the fund's income share classes, the distribution yield is higher than the underlying yield only because a portion of the fund's expenses are charged to capital. This has the effect of increasing distribution(s) for the year and constraining the fund's capital performance to an equivalent extent.

* The yield to expected maturity is calculated gross of fund expenses and includes effects from derivative instruments and currency forwards. It is calculated at fund level in the valuation currency of the fund. A fund may hold callable bonds whose yields are calculated on the basis of expected maturity.

Fund ratings

Overall Morningstar rating	★★★★★
Morningstar Analyst rating	Silver

Source of Morningstar ratings: Morningstar, as at 28 February 2019

Ratings should not be taken as a recommendation.

The following portfolio information is that of the M&G (Lux) Optimal Income Fund.

Asset breakdown (%)

	Physical	CDS short	CDS long	Net
Government bonds	22,1	0,0	0,0	22,1
Investment grade corporate bonds	53,3	0,0	9,9	63,3
Fixed rate	52,7	0,0	0,0	52,7
Floating rate	0,6	0,0	0,0	0,6
Index linked	0,0	0,0	0,0	0,0
Credit default swap indices	0,0	0,0	9,9	9,9
High yield corporate bonds	10,2	0,0	3,1	13,3
Fixed rate	9,9	0,0	0,0	9,9
Floating rate	0,3	0,0	0,0	0,3
Index linked	0,0	0,0	0,0	0,0
Credit default swap indices	0,0	0,0	3,1	3,1
Securitised	3,2	0,0	0,0	3,2
Equities	3,3	0,0	0,0	3,3
Cash	7,9	0,0	0,0	7,9

CDS short: bought protection (short credit exposure);
CDS long: sold protection (long credit exposure)

Credit rating breakdown (%)

	Physical	CDS short	CDS long	Net
AAA	19,3	0,0	0,0	19,3
AA	6,7	0,0	0,0	6,7
A	5,5	0,0	0,0	5,5
BBB	45,9	0,0	9,9	55,8
BB	9,7	0,0	0,0	9,7
B	1,7	0,0	2,4	4,1
CCC	0,0	0,0	0,0	0,0
CC	0,0	0,0	0,0	0,0
C	0,0	0,0	0,0	0,0
D	0,0	0,0	0,0	0,0
No rating	3,3	0,0	0,7	4,0
Cash	7,9	0,0	0,0	7,9

CDS short: bought protection (short credit exposure);
CDS long: sold protection (long credit exposure)

Unrated may include equities.

Where a security has not been rated by Standard & Poor's, Fitch or Moody's, we may use M&G's internal credit rating. Based on a comparison of all available ratings for each security, the most conservative rating (S&P, Fitch, Moody's or M&G's internal rating) is taken into consideration. The ratings so identified are then expressed or converted into M&G's ratings format to obtain uniform information for all securities in the portfolio.

Country breakdown (%)

	Physical	CDS short	CDS long	Net
US	31,6	0,0	0,0	31,6
Germany	22,0	0,0	0,0	22,0
UK	16,8	0,0	0,0	16,8
France	7,8	0,0	0,0	7,8
Italy	3,8	0,0	0,0	3,8
Belgium	2,0	0,0	0,0	2,0
Spain	1,9	0,0	0,0	1,9
Mexico	1,5	0,0	0,0	1,5
Netherlands	1,4	0,0	0,0	1,4
Switzerland	1,2	0,0	0,0	1,2
Other	2,1	0,0	0,0	2,1
Investment grade indices	0,0	0,0	9,9	9,9
High yield indices	0,0	0,0	3,2	3,2
Cash	7,9	0,0	0,0	7,9

CDS short: bought protection (short credit exposure);
CDS long: sold protection (long credit exposure)

Industry breakdown (%)

	Physical	CDS short	CDS long	Net
Banking	20,1	0,0	0,0	20,1
Sovereign	20,0	0,0	0,0	20,0
Telecommunications	12,5	0,0	0,0	12,5
Consumer Goods	4,7	0,0	0,0	4,7
Technology & Electronics	3,9	0,0	0,0	3,9
Insurance	3,2	0,0	0,0	3,2
Media	2,8	0,0	0,0	2,8
Basic Industry	2,2	0,0	0,0	2,2
Healthcare	2,2	0,0	0,0	2,2
Energy	2,2	0,0	0,0	2,2
Automotive	2,2	0,0	0,0	2,2
Foreign Sovereign	2,1	0,0	0,0	2,1
Utility	2,0	0,0	0,0	2,0
Asset Backed	1,8	0,0	0,0	1,8
Commercial				
Mortgage Backed	1,4	0,0	0,0	1,4
Real Estate	1,3	0,0	0,0	1,3
Retail	1,1	0,0	0,0	1,1
Covered Bonds	0,7	0,0	0,0	0,7
Supranational	0,5	0,0	0,0	0,5
Transportation	0,4	0,0	0,0	0,4
Financial Services	0,4	0,0	0,0	0,4
Capital Goods	0,3	0,0	0,0	0,3
Agency	0,3	0,0	0,0	0,3
Leisure	0,2	0,0	0,0	0,2
Services	0,2	0,0	0,0	0,2
Local-Authority	0,2	0,0	0,0	0,2
Government Guaranteed	0,1	0,0	0,0	0,1
Mortgage Backed	0,1	0,0	0,0	0,1
Investment grade indices	0,0	0,0	9,9	9,9
High yield indices	0,0	0,0	3,2	3,2
Other	3,3	0,0	0,0	3,3
Cash	7,9	0,0	0,0	7,9

CDS short: bought protection (short credit exposure);
CDS long: sold protection (long credit exposure)

Currency breakdown (%)

	Pre-hedge	Post-hedge
Euro	44,1	99,4
US dollar	32,6	0,4
British pound	23,2	0,1
Swiss franc	0,1	0,0
Singapore dollar	0,0	0,0

Maturity breakdown (%)

	Physical
0 - 1 years	3,7
1 - 3 years	8,0
3 - 5 years	11,5
5 - 7 years	15,4
7 - 10 years	19,5
10 - 15 years	8,7
15+ years	25,2
Cash	7,9

Duration breakdown by currency and asset class

	Physical	Futures	Swaps	Net
Euro	1,4	-1,3	0,0	0,0
British pound	1,9	-0,9	0,0	1,1
US dollar	3,1	-2,4	0,0	0,7
Other	0,0	0,0	0,0	0,0
Total	6,4	-4,6	0,0	1,8

Largest issuers (excluding government bonds and CDS indices, %)

	Fund
Verizon Communications	3,8
AT&T	3,6
Microsoft	3,0
Bank of America	2,3
HSBC	2,2
JP Morgan	1,9
Citigroup	1,6
Lloyds Banking Group	1,6
Morgan Stanley	1,5
Anheuser-Busch	1,4

Commentary

The strong start to the year for global bond markets continued throughout February, with the effect of the Federal Reserve's more dovish stance retaining its momentum for the time being. The market seems to think this pause in the hiking cycle will last forever, with implied expectations pricing a significantly greater chance of rate cuts than hikes over the coming years.

Citing "muted" inflation pressures and the fact that "growth has slowed in some major foreign economies, particularly China and Europe", Fed Chair Powell repeated that "our policy decisions will be data dependent [and that] we're in no rush to make a judgement about changes in policy". Despite slower growth and continuing uncertainty in Europe, for now at least, global sentiment remains 'risk-on'. Credit spreads tightened, while government bonds traded within a tight range until the latter stages of the month, when yields moved higher.

In these circumstances, the fund rose, thanks to its short duration, long credit spread duration positioning, while its equity exposure also contributed strongly.

Key changes

Within investment grade credit, we remain focused on opportunities within the BBB rated area of the market. This part of the market is currently exhibiting some of the largest dislocations, having been adversely affected by supply, and is unloved by many investors due to its proximity to high yield. We are happy lending to those willing and capable of retaining their investment grade status.

Towards the end of the month, we took a little risk off the table, mainly focused in high yield, where higher beta credit has performed particularly well recently, and also selling down some US senior bank exposure that has been similarly strong.

Within high yield, we sold some credits trading very tightly and some short-dated contingent convertibles (CoCos), where we also own the equity. We sold some shares in Ford in favour of buying its bonds, as we believe the latter now look more attractive in relative terms.

There was little activity of note within the government bond portion of the portfolio. We marginally reduced US Treasury exposure by selling some US inflation-linked bonds that had performed particularly well.

In the absence of any significant moves in interest rates, we kept overall duration around 1.8 years.

Fund codes and charges

Share class	ISIN	Distribution	Annual management charge	Ongoing charge	Minimum initial investment	Minimum top up investment
USD share class A-H Inc	LU1670725420	Semi-Annually	1.25%	1.43% *	\$ 1,000	\$ 75
USD share class A-H Acc	LU1670725347	Semi-Annually	1.25%	1.43% *	\$ 1,000	\$ 75
USD share class A-H M Inc	LU1670725693	Monthly	1.25%	1.43% *	\$ 1,000	\$ 75

* The ongoing charge figure shown here is an estimate. The fund's annual report for each financial year will include details of the exact charges made. Please note that not all of the share classes listed above might be available in your country.

Important information

Please note: The comparative sector is indicated as n/a due to a change in Morningstar's sector categorisation of the M&G Optimal Income Fund's hedged share classes. This was done effective from 28 April 2017 and as a result, the fund's currency hedged share classes now sit in the "Other Allocation" sector – a sector that does not allow for quartile rankings, due to the very broad variety of funds classified within. On this basis, M&G believes that it is not an appropriate sector for comparison. The reclassification of the fund's hedged share classes is in no way a reflection of the fund, but simply a change in Morningstar's methodology.

Cash may be held on deposit and/or in the Northern Trust Cash Funds, a range of collective investment schemes.

Currency breakdown - Hedged to relevant share class currency.

It is policy to offset certain charges against income for accumulation share classes and to offset certain charges against capital for income share classes. These charges include the annual management charge, administration fee and share class hedging fee (where applicable). As a result, yield figures for income and accumulation share classes may differ significantly.

For income share classes, the distribution yield is higher than the underlying yield only because a portion of the fund's expenses are charged to capital. This has the effect of increasing distribution(s) for the year and constraining the fund's capital performance to an equivalent extent. The M&G (Lux) Optimal Income Fund is a Luxembourg-authorized SICAV.

Sector: Morningstar category averages represent the average return of funds within their category over time. The category averages are created by using the average daily total return index series, or TRI, as well as monthly, quarterly, and annual averages of return and non-return data. Morningstar applies a fractional weighting methodology whereby, on the last day of each month, the funds are equally weighted and the share classes within each fund are equally weighted. Fractional weighting ensures that funds with multiple share classes do not dominate and skew the returns of the average, thus presenting the peer group performance in a fair and consistent manner.

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