M&G (Lux) Emerging Markets Bond Fund
Euro Class A – Accumulation shares

Quarterly Fund Review as at 30 September 2019

Fund manager – Claudia Calich

For investment professionals only

Highlights

- Emerging bond markets delivered mixed performance in the third quarter of 2019.
- Hard currency bonds produced modest gains, while local currency sovereigns declined.
- We maintained a globally diversified portfolio of emerging market government bonds and corporate credit.

The 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.

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.

Investments in bonds are affected by interest rates, inflation and credit ratings. It is possible that bond issuers will not pay interest or return the capital. All of these events can reduce the value of bonds held by the fund.

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 allows for the extensive use of derivatives.

Fund performance

	3 months (%)	YTD (%)	1 year (%)	3 years (%) p.a.	5 years (%) p.a.	Since launch (%)
Euro A Accumulation	4,5%	17,0%	17,2%	5,4%	7,7%	-
Morningstar Global Emerging Markets Bond Category	4,1%	13,9%	14,2%	3,9%	5,7%	-
Quartile ranking	2	2	2	1	1	-

Single year performance (5 years)

	2018	2017	2016	2015	2014
Euro A Accumulation	-2,4%	-0,5%	13,7%	10,4%	19,1%
Morningstar Global Emerging Markets Bond Category	-1,4%	-2,4%	12,7%	6,9%	14,2%
Quartile ranking	3	2	2	2	2

Past performance is not a guide to future performance.

Performance prior to 21 September 2018 is that of the EUR Class A Accumulation of the M&G Emerging Markets Bond Fund (a UK-authorised OEIC), which merged into this fund on 7 December 2018. Tax rates and charges may differ.

Source: Morningstar, Inc and M&G, as at 30 September 2019. Returns are calculated on a price to price basis with income reinvested.

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Asset breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
Government bonds - local currency	26,2	0,0	0,0	26,2
Government bonds - hard currency	42,0	0,0	0,0	42,0
Credit - local currency	4,4	0,0	0,0	4,4
Credit - hard currency	26,2	0,0	0,0	26,2
Other	0,0	0,0	0,0	0,0
Cash	1,1	0,0	0,0	1,1

Credit rating breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
AAA	0,8	0,0	0,0	0,8
AA	4,1	0,0	0,0	4,1
A	6,2	0,0	0,0	6,2
BBB	18,3	0,0	0,0	18,3
BB	23,8	0,0	0,0	23,8
B	37,2	0,0	0,0	37,2
CCC	4,7	0,0	0,0	4,7
CC	0,5	0,0	0,0	0,5
C	0,0	0,0	0,0	0,0
D	0,3	0,0	0,0	0,3
No rating	3,0	0,0	0,0	3,0
Cash	1,1	0,0	0,0	1,1

Country breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
Mexico	5,7	0,0	0,0	5,7
Brazil	4,7	0,0	0,0	4,7
Russia	4,3	0,0	0,0	4,3
Ukraine	3,7	0,0	0,0	3,7
US	3,0	0,0	0,0	3,0
India	2,9	0,0	0,0	2,9
Turkey	2,8	0,0	0,0	2,8
United Arab Emirates	2,7	0,0	0,0	2,7
Other	69,3	0,0	0,0	69,3
Cash	1,1	0,0	0,0	1,1

Largest issuers (%)

	Fund
Mexico	3,1
US	3,0
Egypt	2,5
Russia	2,4
Brazil	2,4
Ukraine	2,3
Dominican Republic	2,2
Turkey	2,1
Nigeria	2,1
Chile	1,9

Maturity breakdown (%)

	Physical
0 - 1 years	3,4
1 - 3 years	10,4
3 - 5 years	19,1
5 - 7 years	24,2
7 - 10 years	16,7
10 - 15 years	6,4
15+ years	18,7
Cash	1,1

Currency breakdown (%)

	Pre-hedge	Post-hedge
US dollar	60,5	69,1
Indonesian rupiah	2,6	2,5
Russian ruble	2,4	2,4
Brazilian real	2,4	2,4
Chilean peso	1,9	1,9
Colombian peso	1,6	1,6
Mexican peso	1,6	1,6
Indian rupee	1,5	1,5
Peruvian nuevo sol	1,5	1,5
Other	24,1	15,7

Industry breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
Foreign Sovereign	38,7	0,0	0,0	38,7
Sovereign	28,4	0,0	0,0	28,4
Energy	5,6	0,0	0,0	5,6
Transportation	3,3	0,0	0,0	3,3
Banking	3,1	0,0	0,0	3,1
Agency	3,1	0,0	0,0	3,1
Basic industry	2,7	0,0	0,0	2,7
Real Estate	2,0	0,0	0,0	2,0
Consumer goods	1,7	0,0	0,0	1,7
Healthcare	1,6	0,0	0,0	1,6
Local-Authority	1,5	0,0	0,0	1,5
Financial services	1,3	0,0	0,0	1,3
Utility	1,2	0,0	0,0	1,2
Supranational	0,8	0,0	0,0	0,8
Services	0,8	0,0	0,0	0,8
Capital goods	0,6	0,0	0,0	0,6
Government Guaranteed	0,6	0,0	0,0	0,6
Telecommunications	0,6	0,0	0,0	0,6
Leisure	0,2	0,0	0,0	0,2
Other	1,1	0,0	0,0	1,1
Cash	1,1	0,0	0,0	1,1

Duration by currency and asset class

	Fund	Futures	Swaps	Net
Euro	0,5	0,0	0,0	0,5
British pound	0,1	0,0	0,0	0,1
US dollar	3,8	0,0	0,0	3,8
Other	1,4	0,0	0,0	1,4
Total	5,7	0,0	0,0	5,7

Commentary

Several key themes continued to influence investors' sentiment in emerging bond markets during the third quarter, including slower global economic growth and ongoing international trade tensions between China and the US. There was also some renewed volatility in emerging currency markets, most notably during August after Argentina's President Macri was beaten in primary voting in the country's elections. The Argentine peso sold off sharply, and the local currency sovereign sub-asset class recorded negative returns in the quarter.

Attention also remained focused on renewed economic stimulus activities among central banks, which provided some support towards the performance of risk assets, including emerging market debt. In the US, as widely expected, the Federal Reserve reduced interest rates in July and September, each time by 0.25 percentage points. The European Central Bank, also as expected, confirmed renewed stimulus measures in the final month of the quarter. These included an interest rate cut and a quantitative easing programme in response to weaker economic performance in the region.

Despite the central banks' moves, yields rose in the US Treasury market in September, which weighed on the performance of hard currency government bonds in emerging markets. However, local currency sovereigns produced small positive returns in the final month of the quarter, reversing some of their recent underperformance. Among other themes, geopolitical tensions escalated in the Middle East after a drone attack significantly disrupted the oil production of Saudi Aramco. Oil prices rose markedly in September in the immediate aftermath, but went back down as Aramco subsequently reassured markets that its production was restored. The fund held no exposure to Saudi sovereign bonds or Aramco.

The JP Morgan Emerging Markets Bond (EMBI) Global Diversified Index, which represents hard currency government bonds, gained 1.5% in the third quarter. The JP Morgan Corporate EMBI (CEMBI) Broad Diversified Index, which measures hard currency corporate issues, increased by 1.7%. For local-currency sovereign debt, the JP Morgan GBI-EM Global Diversified Index declined by 0.8%. All returns are stated in US dollar terms.

The fund remained globally diversified across emerging market hard and local currency government and corporate bonds. Through this positioning, the fund's performance was helped by its allocations to the hard currency sub-asset classes, although this was partly countered by exposures to local currencies.

Portfolio activity

Within our overall investment strategy, we continued to believe that investing in the right mix of local and hard currency government and corporate bonds is key to delivering performance in the fund. Going into the third quarter, the portfolio was invested around 43.6% in hard currency government bonds, 26.4% in local currency government bonds, and 24.8% in emerging market hard currency corporate bonds. The remainder of the fund was held in local currency corporate bonds and cash.

Given the solid performance of emerging market debt in the first half of the year, our portfolio adjustments as the third quarter got under way included locking in some gains in the fund on a selective basis. In July, this activity included reducing some euro-denominated sovereign holdings whose spreads were trading tighter than their US dollar-denominated counterparts. Positions were lowered in Egypt, Senegal and Serbia, while we exited a euro-denominated sovereign position in Cyprus.

In the US dollar-denominated sovereign space, we reduced an allocation to Oman to an underweight after the bonds performed well. Among purchases, we added newly issued government bonds in El Salvador as we felt the outlook for the country appeared to be stabilising. In contrast, however, we trimmed the fund's sovereign holding in Tajikistan as we assessed that its fundamentals had weakened.

In the corporate bond markets, we invested in Naftogaz, the Ukrainian state-owned oil and gas group. The position increased the fund's existing exposure to Ukraine, a country that we think has offered an appealing risk/reward profile for some time, having emerged from a crisis at the end of 2015. Fundamentals have improved, and the latest political developments in the country remain supportive, in our view, with continued cooperation with the IMF and potential for reforms. We also bought bonds from global cosmetics group Oriflame, which is headquartered in Europe but generates significant revenues in emerging countries.

During August, our fund activity included reducing an underweight stance in China after the country's underperformance amid its trade war with the US. We purchased Dalwan high yield real estate bonds in China, and topped up exposure to Mongolia. The latter is heavily exposed to Chinese economic growth and commodity prices, and has also recently underperformed.

In the emerging Europe region, we assessed that the positive yields in some markets started to look relatively expensive after a solid rally by core eurozone government bonds. Consequently, we sold an allocation to Montenegro on valuation grounds, but purchased sovereign bonds in Albania given our favourable view on its outlook. We continued to adjust holdings in the region in September via the sale of a euro-denominated sovereign position in Macedonia.

Elsewhere, we added some exposure in Africa during the final month of the quarter. This included opening a position in Namibia via US dollar-denominated sovereign debt, based on our favourable assessment of valuations in the country. We also participated in a new issue of corporate bonds from IHS Towers, the Nigeria-based multinational telecommunications infrastructure provider. As the offer was heavily oversubscribed, our allocation was significantly scaled down and, after the bonds performed well, we took profits on the relatively small holding.

At the end of September, we kept the fund's largest weighting to the emerging market sub-asset classes in hard currency government debt. We also remained comfortable holding diverse exposures to local currency sovereigns and emerging market corporate bonds on a selective basis.

Outlook

Throughout the year-to-date period, we held broadly neutral weightings to both the hard and local currency sub-asset classes, reflecting our belief that opportunities may still be found in both segments of the market. We also maintained this opinion and fund positioning stance as the third quarter ended.

In our assessment, despite some elevation of risks from international trade and economic concerns, other factors should favour the longer term outlook for emerging bond markets. These include emerging economies' sizeable portion of global gross domestic product (GDP), as well as their demographic advantages and lower debt levels compared to developed markets. The current very low interest rate environment should also help sentiment towards the asset class, which provides a pick-up in yields in both hard and local currencies.

For emerging market corporate bonds, prevailing low borrowing costs should assist the more leveraged credits to improve their balance sheets. In our view, emerging market corporates display attractive and stable fundamentals, while default rates are low relative to historical levels. While the economic outlook has weakened – and idiosyncratic risks remain in emerging markets such as Argentina and Turkey – global growth remains positive, and we believe the differential in growth rates between developed and emerging economies should remain supportive for emerging market bonds.

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Important information

On 7 December 2018 the non-sterling assets of the M&G Emerging Markets Bond Fund, a UK-authorised OEIC which launched on 15 October 1999, merged into the M&G (Lux) Emerging Markets Bond Fund, a Luxembourg-authorised SICAV, which launched on 17 September 2018. The SICAV is run by the same fund manager, applying the same investment strategy, as the UK-authorised OEIC.

Performance prior to 21 September 2018 is that of the EUR Class A Accumulation of the M&G Emerging Markets Bond Fund (a UK-authorised OEIC), which merged into this fund on 7 December 2018. Tax rates and charges may differ.

The M&G (Lux) Emerging Markets Bond Fund is a sub-fund of M&G (Lux) Investment Funds 1.

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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