M&G (Lux) Global Convertibles Fund
Euro Class A – Accumulation shares

Quarterly Fund Review as at 30 June 2019

Fund manager – Léonard Vinville

For investment professionals only

Highlights

- Despite a bout of panic selling in May, most financial assets rose during the second quarter, with investors encouraged by the increasingly dovish tone taken by the world's central banks. Convertibles reflected the rally in equities, albeit to a lesser extent.
- The fund improved and generated returns ahead of the comparative index. A weaker US dollar relative to the euro capped gains from US convertibles, although a stronger yen was beneficial.
- We bought several balanced convertibles from technology companies to make sure the fund's exposure to the sector remained in line with the universe.

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.

Convertibles are subject to the risks associated with both bonds and company shares, and to risks specific to the asset class. Their value may change significantly depending on economic and interest rate conditions, the creditworthiness of the issuer and the performance of the underlying company shares. In addition, issuers of convertibles may fail to meet payment obligations and their credit ratings may be downgraded. Convertibles may also be harder to sell than the underlying company shares.

The fund may use derivatives to profit from an expected rise or fall in the value of an asset. Should the asset's value vary in an unexpected way, the fund may lose as much as or more than the amount 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 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	1,2%	7,2%	1,4%	1,3%	3,7%	-
Thomson Reuters Global Focus Convertible EUR Index	0,1%	7,9%	5,0%	3,4%	4,9%	-
Morningstar Convertible Bond - Global Category	1,1%	7,1%	1,5%	2,6%	3,6%	-
Quartile ranking	2	2	3	4	2	-

Single year performance (5 years)

	2018	2017	2016	2015	2014
Euro A Accumulation	-5,6%	-4,9%	4,5%	10,8%	12,7%
Thomson Reuters Global Focus Convertible EUR Index	0,0%	-3,7%	3,2%	11,1%	12,7%
Morningstar Convertible Bond - Global Category	-4,2%	-0,3%	3,4%	9,0%	9,9%
Quartile ranking	3	4	2	2	2

Past performance is not a guide to future performance.

Performance prior to 9 November 2018 is that of the EUR Class A Accumulation of the M&G Global Convertibles 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 June 2019. Returns are calculated on a price to price basis with income reinvested.

190724114432 LU A1 GCEU EUR A EN PE 0004 0000

Largest positive contributors 3 months %

	Relative weight	Absolute return	Contribution
Sony	1,9	13,5	0,2
NIO	-0,4	-42,0	0,2
Abigrove	2,0	12,3	0,2

Largest positive contributors YTD %

	Relative weight	Absolute return	Contribution
Abigrove	1,8	23,3	0,3
Tesla Motors	-1,1	-14,6	0,3
NIO	-0,2	-45,0	0,2

Largest negative contributors 3 months %

	Relative weight	Absolute return	Contribution
Mercadolibre	-0,8	18,1	-0,2
CRRC	2,4	-3,3	-0,1
Sika	-1,3	10,5	-0,1

Largest negative contributors YTD %

	Relative weight	Absolute return	Contribution
Mercadolibre	-0,7	79,6	-0,5
SEA	-0,4	63,7	-0,2
Microchip Technology Incorporated	-1,8	-22,8	-0,2

Source: Aladdin, preliminary data. Performance contribution includes both stocks held and not held relative to the fund's comparative index.

Industry breakdown (%)

	Fund
Technology	22,9
Healthcare	17,8
Industrials	15,2
Financials	10,9
Consumer goods	8,4
Consumer services	7,6
Basic materials	6,5
Oil & gas	5,9
Telecommunications	0,6
Other	2,9
Cash	1,4

Country breakdown (%)

	Fund
US	36,9
Netherlands	11,0
France	7,7
Japan	6,4
Bermuda	5,6
Cayman Islands	4,8
Mexico	3,2
China	3,1
Other	19,9
Cash	1,4

Largest holdings (%)

	Fund
Vinci 0.375% 16-Feb-2022	3,1
Sony 0% 30-Sep-2022	3,1
Total 0.5% 02-Dec-2022	3,1
Priceline 0.9% 15-Sep-2021	3,0
Cemex 3.72% 15-Mar-2020	3,0
Jazz Investments I Ltd 1.875% 15-Aug-2021	2,7
NXP Semiconductors 1% 01-Dec-2019	2,6
Extra Space Storage LP 3.125% 05-Oct-2020	2,4
Supernus Pharmaceuticals Inc 0.625% 01-Apr-2023	2,3
JPMorgan Chase & Co 0.25% 01-May-2023	2,3

Currency breakdown (%)

	Fund
US dollar	69,4
Euro	12,5
Japanese yen	12,8
Hong Kong dollar	2,6
Singapore dollar	1,5
Canadian dollar	0,7
Mexican peso	0,3
South African rand	0,0
Swiss franc	0,2
British pound	0,0

Market review

The world's stockmarkets were volatile during the second quarter, though rose overall. The period began well, with investors encouraged by hopes of a trade deal between the US and China, decent corporate earnings and some better-than-expected economic data, all of which helped equities to rally. However, President Trump's threats to increase US tariffs on Chinese goods, and China's retaliation, then raised concerns about economic growth, while a ban on Chinese tech company Huawei selling its products into the US caused a sell-off in technology shares. The Federal Reserve's pledge to take appropriate action to support the economy, a move reflected by the European Central Bank, increased expectations of lower interest rates. The belief that interest rates were more likely to be cut than increased, and hopes that a trade deal might be agreed, sparked sustained buying of equities in June, with technology stocks leading the way.

The best-performing stockmarkets included the emerging markets of Greece and Russia, with developed markets delivering more modest gains, led by Germany, Brazil and the US. On the other hand, Asian markets lagged, unsettled by the tension between the US and China over trade.

The prospect of lower interest rates supported fixed income markets as well, with government bonds from emerging markets and peripheral Europe, as well as corporate bonds, outperforming mainstream government bonds. Convertibles improved, helped by the rallies in equity prices, although the weakness in May meant that they lagged other corporate bonds. The euro strengthened modestly against the US dollar, which reduced the returns from convertibles denominated in the US currency, although a stronger yen boosted the returns form Japanese convertibles.

Fund performance

The fund generated a positive return, ahead of the Thomson Reuters Global Focus Convertibles Index. The weaker US dollar relative to the euro meant that returns of the hedged share class were better than those of the unhedged share class, although the effect was reduced by the stronger yen.

On the whole, holdings from the US and Japan contributed the most to performance, with exposure to the consumer goods and technology sectors adding notable value. On the other hand, holdings in the healthcare sector detracted.

In terms of individual holdings, signs of a better environment for global commerce supported convertibles from Japanese consumer electronics giant Sony, German sportswear manufacturer Adidas and Russian steel producer Severstal. Hopes that a trade war could be averted, as well as the possible relaxation of sanctions on Huawei, also led to strength in the technology sector, and holdings of convertibles from Twitter, Akamai Technologies, Weibo, Xero Investments and RingCentral were all profitable.

Among the weaker performers, a stake in the shares of Teva Pharmaceutical, together with a convertible from the Israeli drug developer, declined on controversy about drug pricing and opioid supply. Stocks in the healthcare sector, including Teva, Supernus Pharmaceuticals and Jazz Pharma, weakened on the prospect of greater uncertainty if the 'Medicare for All' programme were to be implemented in the US.

Other convertibles that cost some value came from US data storage group Pure Storage, which reported a larger-than-expected loss, and Chinese train manufacturer CRRC.

Relative to the Thomson Reuters Global Focus Index, not owning convertibles from electric vehicle manufacturers Nio and Tesla, as well as nutrition group Herbalife, was beneficial although the avoidance of convertibles from Argentine e-commerce group Mercadolibre and Microchip Technology weighed on returns.

Portfolio activity

We were fairly active in terms of portfolio activity during the quarter, mainly through the purchase of convertibles that we felt provided exposure to interesting companies with an attractive risk/reward profile while reducing convertibles that had done well or whose equity sensitivity had fallen below the desired level.

We bought positions in several convertibles from US technology companies to ensure that the fund's weighting in the software sector remained in line with the convertibles universe. The importance of the industry to the convertibles market has increased over recent months due to new issuance and robust performance and it was crucial that the fund reflected the change. We added balanced convertibles from Coupa Software, Vonage and DocuSign, which we believe are strongly positioned companies in fast-growing segments of the market. We also initiated a position in a convertible from Five9, another developer of cloud-based communications, to replace our exposure to RingCentral, which operates in a similar area and whose convertible we are trimming after good performance. Other technology groups to join the portfolio included Interdigital in the US and Bilibili and Momo from China.

We also initiated a position in a bond issued by JPMorgan that converts into German engineering conglomerate Siemens, which gave us an opportunity to extend the term of our exposure to a company that we think has good upside potential. We already own a Siemens convertible that expires later this year, and hence we reduced that holding.

Among other convertibles added were bonds from medical devices company Nuvasive and online education platform Chegg in the US, Danish hearing-aid developer GN Store Nord, and Link REIT in Hong Kong. Conversely, we sold the shorter-dated of our two convertibles from Mitsubishi Chemicals, along with others into the shares of Swiss duty free retailer Dufry, US oil services provider Oil States International and Finnish steel manufacturer Outokumpu, as they had had little equity sensitivity. We also disposed of a convertible from US industrial group Fortive as the underlying equity had become expensive and exercised an option to have a convertible from Johnson Electric in Hong Kong repaid.

We trimmed exposure to convertibles from RingCentral, Western Digital and ON Semiconductor after good performance increased their equity sensitivity to above the desired range.

Sector breakdown

Despite adding several convertibles in the technology sector, the fund's weighting declined slightly as we reduced exposure to some of the better performers. Technology remains the industry with the highest weighting, however, followed by healthcare, which was boosted by the addition of convertibles from Nuvasive and GN Store Nord. The sale of convertibles from Outokumpu, Fortive, Siemens and Mitsubishi Chemicals reduced the holdings in the industrial and basic materials sectors.

It is worth reiterating that the sector breakdown does not reflect a top-down view of the relative merits of the different sectors, but simply that we have, or have not, been able to find convertibles in those industries that satisfy our fundamental and technical requirements for inclusion in the portfolio.

Country breakdown

The proportion of the fund invested in the US increased once again during the quarter as we added several positions and increased exposure to certain existing holdings. Meanwhile, the weighting of the fund held in convertibles listed in the Netherlands fell following the trimming of exposure to convertibles from Siemens and NXP Semiconductor. Similarly, the sale of a Mitsubishi Chemicals bond reduced the weighting of Japan. There are more than 20 countries represented in the fund's holdings.

Currency breakdown

The fund's currency distribution simply depends on the securities selected. Being the most common currency for convertible bond issues, the US dollar represented the largest proportion of the fund's holdings, accounting for more than half. The euro and the yen were the next largest currencies of denomination, with the proportion of the fund's holdings held in the yen declining due to disposals. Since the fund's exposure to the US dollar is meaningfully higher than the weighting of the US dollar in the convertibles universe, and exposure to Japanese yen lower, we retain a currency hedge to increase the yen currency exposure and reduce the US dollar exposure. This brings the fund's currency holdings more in line with the TR Global Focus Convertibles Index and should reduce the unintended risk that the position represents.

Credit breakdown

As with the broader convertibles market, a large proportion of the fund consisted of non-rated convertibles. We believe these bonds can create opportunities, given our bottom-up stockpicking approach, as a deep understanding of the credit profile of these companies could lead to participation of any re-rating of credit.

Risk

Upward moves in equity prices were reflected in higher convertible prices, although the changes made to the portfolio, together with the falls in May, reduced the overall effect. The average equity sensitivity of the portfolio rose slightly, to 0.45 at the end of June from 0.44 at the end of March. Conversely, the average distance to the bond floor contracted a little, to 9.8% from 10.2%. This means that, if the fund's underlying equities were to increase by 30%, the portfolio would increase by 13.0% on average, all else being equal. However, if the equities were to fall by 30%, the portfolio should decline by 7.7%. At quarter-end, the portfolio yield (a combination of yield to maturity and current yield) was approximately 1.2%.

Credit rating breakdown (%)

	Fund (Start)	Fund (End)	Change
Investment grade	30,2	27,2	-3,0
High yield	20,1	19,7	-0,4
No rating	49,8	53,1	3,3

Outlook

We remain positive on the outlook for the convertibles market. Although the first half of 2019 has proved positive for global stockmarkets, we saw in May, how quickly investors sentiment can change. There are all manner of events that could lead to falls in equity prices, from unexpectedly poor or even, as in more recent times, good economic data, as well as adverse signals on trade or an unexpected geopolitical development, with Iran the most likely current flashpoint Typically, convertibles benefit as volatility increases in the markets, with their debt characteristics providing some support when share prices are falling. We think that the asymmetric risk/reward profile of convertibles, participating when share prices rise but receiving some protection when shares fall, should be attractive to investors if the rest of 2019 proves to be as turbulent as parts of the second quarter. The potential good performance of convertibles has already been demonstrated so far in 2019, with the asset class beating government bonds and investment grade credit, in line with high yield credit and lagging only equities.

Primary issuance has continued to be steady, with around US$18 billion being raised in the market during the second quarter, according to BofA Merrill Lynch Global Research. However, the likely reduction in interest rates in the US could act as a headwind in future as companies might opt to launch traditional corporate bonds rather than convertibles.

The vast majority of issuance came from the US, with issuance in Europe slow, although Asia was fairly active. However, there were very few new deals from Japan. Uncertainty about the future direction of financial markets, due to worries about trade and the economy, have helped shift new deal terms in favour of investors, with higher coupons (in the US at least) and lower conversion premiums. We have been able to identify plenty of attractively valued new convertibles, particularly in the US technology sector and from Asia.

The second quarter of 2019 was encouraging, both for the fund and for the broader convertibles market and we are hopeful that this can be maintained. We believe the convertibles universe offers compelling opportunities for stockpicking that should enable us to gain exposure to under-researched companies in a wide variety of countries and sectors. We will continue to search for those convertibles that offer the best balance of risk and reward by focusing on the basic characteristics of the issuing companies and by developing a deep understanding of the underlying business. We also rigorously analyse the technical qualities of each potential investment. We believe this approach has the potential to deliver healthy returns to investors over time.

Important information

On 9 November 2018, the non-sterling assets of the M&G Global Convertibles Fund, a UK-authorised OEIC, merged into the M&G (Lux) Global Convertibles Fund, a Luxembourg-authorised SICAV, which launched on 9 November 2018. The SICAV is run by the same fund manager, applying the same investment strategy, as the UK-authorised OEIC.

Performance prior to 9 November 2018 is that of the EUR Class A Accumulation of the M&G Global Convertibles Fund (a UK-authorised OEIC), which merged into this fund on 7 December 2018. Tax rates and charges may differ.

The M&G (Lux) Global Convertibles Fund is a sub-fund of M&G (Lux) Investment Funds 1.

For Investment Professionals only. Not for onward distribution. No other persons should rely on any information contained within.

This information is not an offer or solicitation of an offer for the purchase of investment shares in one of the Funds referred to herein. Purchases of a Fund should be based on the current Prospectus. The Instrument of Incorporation, Prospectus, Key Investor Information Document, annual or interim Investment Report and Financial Statements, are available free of charge from the Luxembourg paying agent: Société Générale Bank & Trust SA, Centre operational 28-32, place de la Gare L-1616 Luxembourg.

Before subscribing investors should read the Prospectus, which includes a description of the investment risks relating to these funds.

This financial promotion is issued by M&G International Investments S.A. Registered Office: 16, Boulevard Royal, L-2449, Luxembourg.

190724114432 LU A1 GCEU EUR A EN PE 0004 0000