M&G Episode Allocation Fund
Sterling Class I – Accumulation shares

Quarterly Fund Review as at 30 June 2019

Fund manager – Tony Finding, Juan Nevado

For investment professionals only

Highlights

- Risk assets rallied on the prospect of looser monetary policy from major central banks, and hopes for a US-China trade truce.
- The fund delivered a positive return over the quarter, boosted by holdings in global equities and long-dated emerging market government bonds.
- Allocation to Western government bonds minimal at quarter end after the sale of a 5% holding in Italian government bonds.

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.

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 invests in other funds, which are subject to the risks associated with the type of assets held in those funds.

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 (%) p.a.
Sterling I Accumulation	1.6%	7.8%	1.5%	7.4%	5.2%	-
3-month GBP LIBOR +5.0%	1.4%	2.9%	5.9%	5.6%	5.6%	-

Single year performance (5 years)

	2018	2017	2016	2015	2014
Sterling I Accumulation	-8.0%	11.1%	12.9%	0.8%	7.8%
3-month GBP LIBOR +5.0%	5.7%	5.3%	5.6%	5.6%	5.6%

Past performance is not a guide to future performance.

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

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Portfolio construction (%)

	Net allocation range	Neutrality
Equity	20-60	40.0
Fixed income	30-75	50.0
Other	0-20	10.0
Currency	Min 30% sterling or sterling hedged	

Leverage and volatility

	Fund
Gross leverage	0.9x
Net leverage	0.9x
Volatility	6.8%

Largest exposures (excl. cash, %)

	Fund
Topix Index future	9.7
M&G Property Portfolio	7.3
M&G Recovery Fund	5.1
Mexican government 30Y	4.7
DAX Index future	4.1
FTSE 100 Index future	4.0
iShares Core MSCI World UCITS ETF	3.9
South African government 20Y	3.4
Kospi Index future	3.0
Hang Seng Index Future	2.8

Asset breakdown (%)

	Port. beginning weight 31/03/19	Port. ending weight 30/06/19
Convertible bonds	**0.8**	**0.9**
Corporate bonds	**7.8**	**7.8**
High yield	4.7	4.7
Investment grade	**3.1**	**3.2**
Equity	**58.6**	**58.5**
Asia Pacific- Ex Japan	**13.6**	**13.4**
Hong Kong	5.5	5.3
Indonesia	1.3	1.3
Singapore	3.8	3.8
South Korea	3.0	2.9
Europe	**17.9**	**18.1**
Germany	6.6	6.7
Greece	0.4	0.4
Ireland	4.6	4.6
Italy	3.4	3.4
Spain	3.0	3.0
Global Funds	**0.5**	**0.5**
UK	0.5	0.5
Japan	**9.5**	**9.5**
North America	**5.1**	**5.2**
Canada	0.7	0.6
USA	4.4	4.5
Other	**1.8**	**1.8**
Russia	0.4	0.5
Turkey	1.4	1.3
UK	**10.1**	**10.0**
Government bonds	**16.6**	**15.7**
Europe	**5.7**	**4.5**
Italy	5.7	4.5
Other	**10.9**	**11.2**
Argentina	0.8	0.8
Brazil	1.4	1.6
Mexico	4.4	4.5
South Africa	3.1	3.2
Turkey	**1.2**	**1.1**
Property	**7.4**	**7.3**
Currencies & Cash	**8.8**	**9.7**

Source: FactSet. Investment returns are absolute.

Contribution to fund performance (%)

	Port. contribution to return (local)
Convertible bonds	**0.1**
Corporate bonds	**1.9**
High yield	1.7
Investment grade	**0.2**
Equity	**0.3**
Asia Pacific- Ex Japan	**-0.5**
Hong Kong	-0.5
Indonesia	0.1
Singapore	-0.1
South Korea	0.0
Europe	**0.9**
Germany	0.5
Greece	0.1
Ireland	0.2
Italy	0.1
Spain	0.0
Global Funds	**0.0**
UK	0.0
Japan	**-0.4**
North America	**0.2**
Canada	-0.1
USA	0.3
Other	**0.2**
Russia	0.1
Turkey	0.1
UK	**0.0**
Government bonds	**1.4**
Europe	**0.4**
Italy	0.4
Other	**1.1**
Argentina	0.0
Brazil	0.1
Mexico	0.6
South Africa	0.3
Turkey	0.1
Property	**-0.1**
Currencies & Cash	**-0.4**

Source: FactSet. Investment returns are absolute.

Currency breakdown (%)

	Fund
British pound	85.8
Mexican peso	4.7
Turkish lira	4.1
South African rand	3.4
US dollar	3.2
Korean won	1.6
Brazilian real	1.5
Swiss franc	-1.8
Euro	-2.4
Other	-0.1

Market review and fund commentary

Risk assets continued their strong performance in the quarter as investors took their cue from a change in the rhetoric of the US Federal Reserve (Fed) – and central banks elsewhere – on future interest rate increases. Certainly, increasing talk of cuts in the US and Europe, and actual monetary policy changes by central banks in Australia and India, was the catalyst for robust demand for global equities, particularly in April and June. The downturn in financial markets in May was largely fuelled by softer economic data and an escalation in the US/China trade war, but by the end of the quarter, sentiment had recovered. The fund's exposure to diversified global equities was a source of positive performance in the period. European markets appeared to rally in the aftermath of the European Central Bank's suggestion of possible asset purchases in the future. The performance of Asian and Japanese equities was more mixed, as investors worried about how higher tariffs on Chinese goods imposed by the US would affect key exporters. Stockmarkets in Korea, Hong Kong and Taiwan felt the impact of investor anxiety the most. The change in tone from the Fed and others on monetary policy also supported emerging market assets, and the fund benefited from rising demand for Russian and Turkish securities in the period. Within sectors, positions in US banks largely added value although lower bond yields – a signal of lower profits in the future – meant that the sector lagged the broader market. Similarly, the fund's holding in Methanex detracted within our North America basket as the methanol producer was affected by a lower oil price. In fixed income, contributions came from the fund's basket of emerging market government bonds, especially long-dated Mexican bonds which rallied on hopes of a US rate cut. These bonds tend to perform better when expectations of US rate hikes lessen and this also supported strong demand for South African, and to a lesser extent, Brazilian government bonds in the quarter. While Italian government bonds were a source of weakness in the first quarter, there was a turnaround in performance this time as investors cited a more favourable fiscal footing as being supportive of these assets.

Fund management

As in the previous quarter, the portfolio is currently weighted towards a basket of diversified global equities and selected emerging market government bonds with long duration. The fund's maximum net exposure to equities is 60%, and as at 30 June, it was 59.0%, demonstrating where we see the strongest source of return for a multi-asset portfolio in current conditions.

While we chose to back the valuation signal and keep trading activity modest for most of the period, late in the quarter we sought to de-risk the portfolio in light of higher asset prices. In this regard, a 5% position in 10-year Italian government bonds (BTPs) initiated last summer was closed out, with the proceeds invested in cash. (Cash is now around 13% of the portfolio.) The rationale behind selling the fund's entire BTP exposure was based on yields falling (and the price of these bonds rising) materially over recent months. We believe the political 'episode' from May 2018, which was a main driver of asset prices, has fully unwound. As such, Italian government bonds are no longer as tactically attractive as they were for a multi-asset portfolio. As a result, the fund's Western government bond exposure is negligible at quarter-end.

Outlook

We believe the relative appeal of equities versus bonds has not changed, despite the strongly correlated performance of these two asset types recently. This means we continue to believe it is a good environment to be invested in a basket of global equities and selected emerging market bonds. We think the positive tailwind on account of a recent softening in interest rate expectations supports this view, with valuations in most equity markets looking attractive and priced to hopefully provide the expected level of return given their risk properties.

Important information

The M&G Episode Allocation Fund is a sub-fund of M&G Investment Funds (4).

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