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## **M&G Investment Funds (5)**

Annual Long Report and audited Financial Statements  
for the year ended 31 December 2019

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# M&G Investment Funds (5)

## Authorised Corporate Director's Report

The Authorised Corporate Director (ACD) of M&G Investment Funds (5) presents its Annual Long Report and audited Financial Statements for the year ended 31 December 2019.

The audited financial statements of M&G Investment Funds (5) and the investment report and audited financial statements and notes of the sub-fund are presented in their individual sections of this report as set out in the contents page.

Please note that we have included an explanation of key investment terminology in the 'Glossary' (at the back of this report).

### Company information

M&G Investment Funds (5) is an umbrella Open-Ended Investment Company (OEIC) and contains one sub-fund, hereinafter referred to as 'fund' in the rest of this report. The fund is a UCITS (Undertakings for Collective Investment in Transferable Securities) scheme as defined in the Collective Investment Schemes sourcebook, as issued (and amended) by the Financial Conduct Authority (FCA). This OEIC is an Investment Company with Variable Capital (ICVC) incorporated under the Open-Ended Investment Companies Regulations 2001. It is authorised and regulated by the FCA under the Financial Services and Markets Act 2000.

The Company was authorised on 24 December 2002 and the M&G Episode Macro Fund was launched on 3 June 2010.

The Company's principal activity is to carry on business as an OEIC. The Company is structured as an umbrella company, and different funds may be established by the ACD from time to time with the agreement of the Depositary and approval from the FCA.

A shareholder is not liable for the debts of the Company and will never be liable to make any further payment to the Company after paying the purchase price of the shares.

### Fund managers

The following fund managers are employed by M&G FA Limited (formerly M&G Limited) which is an associate of M&G Securities Limited.

#### **M&G Episode Macro Fund**

David Fishwick & Eric Lonergan

### ACD

M&G Securities Limited,  
10 Fenchurch Avenue, London EC3M 5AG, UK  
Telephone: 0800 390 390 (UK only)

(Authorised and regulated by the Financial Conduct Authority. M&G Securities Limited is a member of the Investment Association and of The Investing and Saving Alliance (formerly Tax Incentivised Savings Association))

### Directors of the ACD

M Ammon\*, G N Cotton\*\*, C Dobson (non executive director),  
N M Donnelly, P R Jelfs, M McGrade (non executive director),  
L J Mumford

\* Resigned 17 October 2019.

\*\* Resigned 27 September 2019.

### Investment manager

M&G Investment Management Limited,  
10 Fenchurch Avenue, London EC3M 5AG, UK  
Telephone: +44 (0)20 7626 4588

(Authorised and regulated by the Financial Conduct Authority)

### Registrar

DST Financial Services Europe Ltd,  
DST House, St. Nicholas Lane, Basildon, Essex SS15 5FS, UK  
(Authorised and regulated by the Financial Conduct Authority)

### Depositary

NatWest Trustee & Depositary Services Limited, Drummond House,  
1 Redheughs Avenue, Edinburgh EH12 9RH, UK  
(Authorised and regulated by the Financial Conduct Authority)

### Independent auditor

Ernst & Young LLP  
Atria One, 144 Morrison Street, Edinburgh EH3 8EX, UK

### Important information

The investment objective and policy were changed for the M&G Episode Macro Fund on 14 June 2019.

As mentioned in the shareholder letter on 17 June 2019, we have made changes to the way we charge for M&G funds based in the UK, starting on Thursday 1 August 2019. The annual charge should be simpler to understand and easier to compare with other fund charges. We have combined all the charges that make up the current ongoing charge figure (OCF) into a single annual charge. Only exceptional items such as unforeseen legal and tax expenses, also known as extraordinary expenses, will be excluded from the annual charge. To find out the new annual charge and the OCF which are shown in the Key Investor Information Document (KIID) for the share class(es) you are invested in, visit our website [www.mandg.co.uk](http://www.mandg.co.uk)

# M&G Investment Funds (5)

## Authorised Corporate Director's Report

### Investor information

The Prospectus, Instrument of Incorporation, Key Investor Information Documents, Costs and Charges illustration, the latest Annual or Interim Investment Report and Financial Statements as well as a list of purchases and sales are available free of charge on request from the following addresses. The Instrument of Incorporation can also be inspected at our offices or at the office of the Depositary.

#### Customer services and administration for UK clients:

M&G Securities Limited,  
PO Box 9039, Chelmsford CM99 2XG, UK

Please remember to quote your name and M&G client reference and sign any written communication to M&G. Failure to provide this will affect your ability to transact with us.

Telephone: 0800 390 390 (UK only)

For security purposes and to improve the quality of our service, we may record and monitor telephone calls. You will require your M&G client reference. Failure to provide this will affect your ability to transact with us.

#### Customer services and administration for non-UK clients:

M&G Securities Limited,  
c/o RBC I&TS, 14, Porte de France, L-4360 Esch-sur-Alzette,  
Grand Duchy of Luxembourg

Please remember to quote your name and M&G client reference and sign any written communication to M&G. Failure to provide this will affect your ability to transact with us.

Telephone: +352 2605 9944

Email: [csmandg@rbc.com](mailto:csmandg@rbc.com)

For security purposes and to improve the quality of our service, we may record and monitor telephone calls. You will require your M&G client reference. Failure to provide this will affect your ability to transact with us.

#### Austrian paying and information agent:

Société Générale, Vienna Branch,  
Prinz Eugen-Strasse 8-10/5/Top 11, 1040 Wien, Austria

#### Belgian financial agent:

ABN AMRO Bank N.V., Belgium branch  
Roderveldlaan 5 bus 4, 2600 Berchem Belgium

#### Danish representative agent:

Nordea Bank Danmark A/S,  
Client Relations DK, Investor Services & Solutions,  
Postbox 850, Reg.no.6428. HH. 6.1., 0900 København C, Denmark

#### French centralising agent:

RBC Investor Services, Bank France S.A.,  
105 rue Réaumur, 75002 Paris, France

#### German information agent:

M&G International Investments Limited,  
mainBuilding, Taunusanlage 19, 60325 Frankfurt am Main, Germany

#### Greek paying agents and distributors:

Alpha Bank A.E.,  
40 Stadiou Street, 10252 Athens, Greece  
Eurobank Ergasias S.A.,  
8 Othonos Street, 10557 Athens, Greece  
Piraeus Bank S.A  
4 Amerikis Street, 10564 Athens, Greece

#### Irish facilities agent:

Société Générale S.A., Dublin Branch,  
3rd Floor IFSC House – The IFSC, Dublin 1, Ireland

#### Italian paying agents:

Allfunds Bank, S.A.,  
Via Santa Margherita 7, 20121 Milano, Italy  
Banca Monte dei Paschi di Siena S.p.A.,  
Piazza Salimbeni 3, 53100 Siena, Italy  
Banca Sella Holding S.p.A.,  
Piazza Gaudenzio Sella 1, 13900 Biella, Italy  
BNP PARIBAS Securities Services,  
Piazza Lina Bo Bardi 3, 20124 Milano, Italy  
CACEIS Bank Luxembourg,  
Milan Branch, Piazza Cavour 2, 20121 Milano, Italy  
RBC Investor Services Bank S.A., Milan Branch  
Via Vittor Pisani 26, 20124 Milano, Italy  
State Street Bank S.p.A.,  
Via Ferrante Aporti 10, 20125 Milano, Italy  
Société Générale Securities Services S.A.,  
Via Benigno Crespi 19A - MAC 2, 20159 Milano, Italy

#### Portuguese distributor:

Best - Banco Electrónico de Serviço Total, S.A.,  
Praça Marquês de Pombal, no. 3 - 3º, 1250-161 Lisboa, Portugal

#### Spanish representative:

Allfunds Bank, S.A.,  
Calle Estafeta, No 6 Complejo Plaza de la Fuente,  
La Moraleja 28109, Alcobendas, Madrid, Spain

#### Swedish paying agent:

Nordea Bank AB (publ),  
Smålandsgatan 17, 105 71 Stockholm, Sweden

#### Swiss paying agent and representative:

Société Générale, Paris, Zurich Branch,  
Talacker 50, 8021 Zurich, Switzerland

# M&G Investment Funds (5)

## Authorised Corporate Director's Report

### Authorised Corporate Director's Responsibilities

The Authorised Corporate Director (ACD) is required to prepare annual and interim long reports for the Company. The ACD must ensure that the financial statements, contained in this report, for the fund are prepared in accordance with the Investment Association Statement of Recommended Practice for Financial Statements of UK Authorised Funds (SORP) and UK Financial Reporting Standards, and give a true and fair view of the net revenue or expenses and net capital gains or losses for the accounting period, and the financial position at the end of that period.

The ACD is required to keep proper accounting records, and to manage the Company in accordance with the Collective Investment Schemes sourcebook, as issued (and amended) by the FCA, the Instrument of Incorporation and the Prospectus, and to take reasonable steps for the prevention and detection of fraud or other irregularities.

### Directors' statement

This report has been prepared in accordance with the requirements of the Collective Investment Schemes sourcebook, as issued and amended by the Financial Conduct Authority.

M&G Securities Limited  
14 February 2020

# M&G Investment Funds (5)

## Depositary's Responsibilities and Report

### Statement of the Depositary's Responsibilities and Report of the Depositary to the Shareholders of M&G Investment Funds (5) ('the Company') for the period ended 31 December 2019

The Depositary must ensure that the Company is managed in accordance with the Financial Conduct Authority's Collective Investment Schemes sourcebook, the Open-Ended Investment Companies Regulations 2001 (SI2001/1228) (the OEIC Regulations), as amended, the Financial Services and Markets Act 2000, as amended, (together 'the Regulations'), the Company's Instrument of Incorporation and Prospectus (together 'the Scheme documents') as detailed below.

The Depositary must in the context of its role act honestly, fairly, professionally, independently and in the interests of the Company and its investors.

The Depositary is responsible for the safekeeping of all custodial assets and maintaining a record of all other assets of the Company in accordance with the Regulations.

The Depositary must ensure that:

- the Company's cashflows are properly monitored and that cash of the Company is booked into the cash accounts in accordance with the Regulations;
- the sale, issue, redemption and cancellation of shares are carried out in accordance with the Regulations;
- the value of shares in the Company is calculated in accordance with the Regulations;
- any consideration relating to transactions in the Company's assets is remitted to the Company within the usual time limits;
- the Company's income is applied in accordance with the Regulations; and
- the instructions of the Authorised Fund Manager ('the AFM') are carried out (unless they conflict with the Regulations).

The Depositary also has a duty to take reasonable care to ensure that the Company is managed in accordance with the Regulations and the Scheme documents in relation to the investment and borrowing powers applicable to the Company.

Having carried out such procedures as we consider necessary to discharge our responsibilities as Depositary of the Company, it is our opinion, based on the information available to us and the explanations provided, that in all material respects the Company, acting through the AFM:

- (i) has carried out the issue, sale, redemption and cancellation, and calculation of the price of the Company's shares and the application of the Company's income in accordance with the Regulations and the Scheme documents of the Company, and
- (ii) has observed the investment and borrowing powers and restrictions applicable to the Company.

Edinburgh  
14 February 2020

NatWest Trustee and  
Depositary Services Limited

# M&G Investment Funds (5)

## Independent Auditor's Report

### Independent Auditor's Report to the shareholders of M&G Investment Funds (5)

#### Opinion

We have audited the financial statements of M&G Investment Funds (5) ("the Company") for the year ended 31 December 2019 which comprise the Statement of Total Return and Statement of Change in Net Assets Attributable to Shareholders together with the Balance Sheet, the summary of significant accounting policies of the Company, the related notes and the Distribution Tables. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) including FRS 102 'The Financial Reporting Standard applicable to the UK and Republic of Ireland'.

In our opinion, the financial statements:

- give a true and fair view of the financial position of the Company as at 31 December 2019 and of the net revenue and the net capital gains on the scheme property of the Company for the year then ended; and
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'.

#### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the ACD's use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the ACD has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

#### Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The ACD is responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

#### Opinions on other matters prescribed by the rules of the Collective Investment Schemes sourcebook of the Financial Conduct Authority

In our opinion:

- the financial statements have been properly prepared in accordance with the Statement of Recommended Practice relating to Authorised Funds, the rules of the Collective Investment Schemes sourcebook of the Financial Conduct Authority and the Instrument of Incorporation;
- the information given in the ACD's report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- there is nothing to indicate that proper accounting records have not been kept or that the financial statements are not in agreement with those records.

#### Matters on which we are required to report by exception

We have nothing to report in respect of the following matter in relation to which the rules of the Collective Investment Schemes sourcebook of the Financial Conduct Authority require us to report to you if, in our opinion:

- we have not received all the information and explanations which, to the best of our knowledge and belief, are necessary for the purposes of our audit.

#### Responsibilities of the Authorised Corporate Director (ACD)

As explained more fully in the ACD's responsibilities statement set out on page 3, the ACD is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the ACD determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the ACD is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the ACD either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

# M&G Investment Funds (5)

## Independent Auditor's Report

### Independent Auditor's Report to the shareholders of M&G Investment Funds (5)

#### Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

#### Use of our report

This report is made solely to the Company's shareholders, as a body, pursuant to Paragraph 4.5.12 of the rules of the Collective Investment Schemes sourcebook of the Financial Conduct Authority. Our audit work has been undertaken so that we might state to the Company's shareholders those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the Company's shareholders as a body, for our audit work, for this report, or for the opinions we have formed.

Edinburgh  
14 February 2020

Ernst & Young LLP  
Statutory Auditor

1. The maintenance and integrity of the M&G website is the responsibility of the ACD; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.



# M&G Investment Funds (5)

## Financial statements and notes

The financial statements for M&G Investment Funds (5) comprise the individual financial statements for the fund and the notes below.

### Notes to the financial statements

#### 1 Statement of compliance

The financial statements of M&G Investment Funds (5) have been prepared in compliance with UK Financial Reporting Standard 102 (FRS 102) and in accordance with the Statement of Recommended Practice (SORP) for Authorised Funds issued by the Investment Association in May 2014 and amended in June 2017.

#### 2 Summary of significant accounting policies

##### a) Basis of preparation

The financial statements of M&G Investment Funds (5) are prepared on a going concern basis, under the historical cost convention as modified by the revaluation of certain financial assets and liabilities measured at fair value through profit or loss.

##### b) Functional and presentational currency

The functional and presentational currency of M&G Investment Funds (5) is US dollars.

##### c) Exchange rates

Transactions in currencies other than the fund's functional currency are translated at the rate of exchange ruling on the date of the transaction and where applicable assets and liabilities are translated into the fund's functional currency at the rate of exchange ruling as at 12 noon on 31 December 2019 being the last business day of the accounting period.

##### d) Investments - recognition and valuation

The provisions of both Section 11 and Section 12 of FRS 102 have been applied in full. All investments have been designated as fair value through profit and loss and recognised initially at fair value, which is normally the transaction price (excluding transaction costs and accrued interest).

At the end of the reporting period all investments have been measured at their fair value using the prices and the portfolio holdings determined at 12 noon on 31 December 2019, being the last valuation point of the accounting period, as this is not materially different from a valuation carried out at close of business on the balance sheet date.

Where separate bid and offer prices are available, the bid price is used for investment assets and the offer price for investment liabilities. Otherwise, the single price or most recent transaction price is used. Interest accrued is not included in the fair value. The methods of determining fair value for the principal classes of investment are:

- Equities and debt securities which are traded on an active market are included at the quoted price, which is normally the bid price, excluding any accrued interest in respect of bonds.
- Equities traded on the Alternative Investment Market (AIM), whose liquidity cannot be guaranteed, are included at their quoted bid price as this represents the most objective and appropriate method of valuation.

- Collective investment schemes operated by the ACD are included at either their cancellation price for dual priced funds or their single price for single priced funds.
  - Collective investment schemes operated by another manager are included at either their bid price for dual priced funds or their single price for single priced funds.
  - Other equities and debt securities which are unquoted or not actively traded on a quoted market are included at a value estimated by the ACD using an appropriate valuation technique, excluding any accrued interest in respect of bonds.
  - Exchange traded futures and options are included at the cost of closing out the contract at the balance sheet date.
  - Over the counter equity options, credit default swaps, interest rate swaps, asset swaps and inflation swaps are included at a value provided by Markit Valuations Limited, an independent credit derivative price provider. Their fair value excludes any accrued interest in respect of derivatives where the income is revenue in nature.
  - Forward currency contracts, for share class hedging and investment, are included at a value determined by reference to current forward exchange rates for contracts with similar maturity profiles.
- ##### e) Recognition of income and expenses
- Dividends, including ordinary stock dividends, from equity investments are recognised when the security is quoted ex-dividend.
  - Distributions from collective investment schemes are recognised when the scheme is priced ex-distribution.
  - Interest income, including coupons from debt securities and bank interest is recognised on an accruals basis.
  - Underwriting commission is recognised when the issue takes place.
  - Revenue from derivatives is recognised on an accruals basis.
  - Fee rebates from investing in other collective investment schemes are recognised on an accruals basis.
  - Expenses are recognised on an accruals basis.
- ##### f) Treatment of income and expenses
- Any increases or decreases in the fair value of investments and gains and losses realised on sales of investments are treated as capital and recognised in net capital gains / (losses).
  - Ordinary equity dividends, including ordinary stock dividends are treated as revenue.
  - Special dividends, share buy backs or additional share issues may be treated as revenue or capital depending on the facts of each particular case.
  - The value of any enhancement to a stock dividend is treated as capital.
  - Distributions from collective investment schemes are treated as revenue in nature, except for any element of equalisation, which represents the average amount of income included in the price paid for the collective investment scheme, which is treated as capital.

# M&G Investment Funds (5)

## Financial statements and notes

### Notes to the financial statements

#### 2 Summary of significant accounting policies (continued)

##### f) Treatment of income and expenses (continued)

- Debt security interest comprises the coupon interest and the difference between the purchase price and the expected maturity price spread over its expected remaining life. This is treated as revenue with the difference adjusting the cost of the shares and treated as capital.
- Other interest income, such as bank interest is treated as revenue.
- Underwriting commission is treated as revenue, except where the fund is required to take up all or some of the shares underwritten, in which case a proportion of the commission received is deducted from the cost of the shares and treated as capital.
- The treatment of the income on derivative contracts depends upon the nature of the transaction. Both motive and circumstances are used to determine whether the returns should be treated as capital or revenue. Where positions are undertaken to protect or enhance capital, and the circumstances support this, the returns are recognised in net capital gains; similarly where the motives and circumstances are to generate or protect revenue, and the circumstances support this, the returns are included within net revenue before taxation. Where positions generate total returns it will generally be appropriate to apportion such returns between capital and revenue to properly reflect the nature of the transaction.
- Expenses relating to the purchase and sale of investments are treated as capital; all other expenses are treated as revenue.
- Rebates of charges from holdings in collective investment schemes are treated as revenue or capital in accordance with the underlying scheme's distribution policy.

##### g) Tax

Dividends and similar income receivable are recognised at an amount that includes any withholding tax but excludes irrecoverable tax credits. Any withholding tax suffered is shown as part of the tax charge.

Tax is accounted for at the appropriate rate of corporation tax with relief for double taxation taken where appropriate. The tax accounting treatment follows the principal amounts involved.

Deferred tax is recognised in respect of temporary timing differences that have originated but not reversed by the balance sheet date. Deferred tax is measured on a non-discounted basis, at the average rate of tax expected to apply in the period in which it expects the deferred tax to be realised or settled. A deferred tax asset is only recognised to the extent that it is more likely than not that the asset will be recovered.

Marginal tax relief has not been taken into account in respect of expenses offset against capital.

##### h) Allocation of returns to share classes

The annual management charge, any share class hedging returns and associated share class hedging charge are directly attributable to individual share classes. All other returns are apportioned to the fund's share classes pro-rata to the value of

the net assets of the relevant share class on the day that the income or expenses are recognised.

All available net revenue accounted for in accordance with the above policies and adjusted where relevant by any specific distribution policies set out in the notes to that fund's financial statements, is distributed to holders of Income shares or retained and reinvested for holders of Accumulation shares. Should expenses and taxation together exceed revenue, there will be no distribution and the shortfall will be met from capital.

Distributions which have remained unclaimed by shareholders for more than six years are credited to the capital property of the fund.

#### 3 Risk management policies

The ACD is responsible for establishing, implementing and maintaining an adequate and documented risk management policy for identifying, measuring and managing all risks to which funds are or might be exposed.

The Company's investment activities expose it to various types of risk which are associated with the financial instruments and markets in which it invests; market risk, credit risk and liquidity risk.

These financial statements are designed to enable users to evaluate the nature and extent of those risks and how they are managed.

The following risk management policies are applicable to the fund, with specific risk disclosures set out in the notes to the financial statements of the fund.

##### Market risk

Market risk is the risk of loss resulting from fluctuations in the market value of positions in a fund's portfolio attributable to changes in market variables, such as interest rates, exchange rates, equity and commodity prices or an issuer's creditworthiness.

In relation to market risk, processes are applied that take account of the investment objective and policy of each fund. All funds are subject to an investment oversight process in accordance with the type and nature of the fund. In addition all funds are monitored for compliance within regulatory limits.

In measuring and monitoring market risk, the global exposure of a fund may be calculated using a 'commitment' approach or 'Value at Risk' (VaR) approach.

##### Commitment approach

The commitment approach is applied for funds investing only in traditional asset classes, namely equities, fixed income, money market instruments and collective investment schemes.

In addition, the approach is applied for funds which use or intend to use derivatives or instruments embedding derivatives, but only for efficient portfolio management purposes, or in a simple way not necessarily restricted to efficient portfolio management.

Under the commitment approach the global exposure of funds is measured and monitored using a commitment (adjusted notional) methodology.

Market risk is considered on a daily basis and forms the foundation of investment oversight analysis. This can include for each fund (but is not limited to) the analysis of factors such as fund concentration; style, geographical, industry and market capitalisation biases; active, systematic and specific risk measurements; active money; and beta characteristics.

# M&G Investment Funds (5)

## Financial statements and notes

### Notes to the financial statements

#### 3 Risk management policies (continued)

##### Value at Risk approach

The Value at Risk (VaR) approach is a methodology for estimating the maximum potential loss due to market risk based on historic market volatilities and correlations. More particularly, the VaR approach gives a broad indication of the maximum potential loss at a given confidence level (probability), over a specific time period under normal market conditions.

Instrument and portfolio modelling techniques are based on market accepted practices and are subject to regular review (back-testing). Market risk factors that are analysed include LIBOR / swap rates, government yield curves, equity prices, exchange rates, market volatility, credit spreads and credit default swap (CDS) spreads.

The VaR model is based on a Monte Carlo process with actual VaR being reported on the basis of a 99% confidence interval over a one month period (20 business days). Risk factor history used in the Monte Carlo process is based on 250 business days. From the variance / covariance matrices, a parametric Monte Carlo scenario set of 5,000 simulations is derived and applied to the fund.

VaR does have limitations in its ability to present valid levels of risk in extreme market conditions. Accordingly, the Risk Analysis team also carries out monthly stress testing and scenario based analysis. Stress testing allows for extreme sets of market circumstances which may not be reflected in historical data sets thereby enabling further assessment of combinations of market movements which may cause serious damage to portfolio values. The key element to the scenario based analysis is challenging the correlation assumptions implicit within statistical based models such as VaR.

The stress test and scenario based analysis is customised for each fund type and the VaR analysis is produced on a daily basis.

The table below shows funds using the 'commitment' approach and those using the 'Value at Risk (VaR)' approach:

Fund	Global exposure approach
M&G Episode Macro Fund	VaR

##### Liquidity risk

Liquidity risk is the risk that a fund's holdings cannot be sold, liquidated or closed out at limited cost in an adequately short time frame and that the ability of the scheme to comply at any time with its obligation to sell and redeem shares is thereby compromised.

The overall liquidity profile for each fund is reviewed and updated regularly. The liquidity profile takes into account investment, cashflow and market liquidity considerations.

Investment liquidity considerations include an assessment of asset class liquidity conditions, liquidity of underlying holdings, portfolio construction and concentration, the scale of individual stock ownership and the nature of the investment strategy.

Cashflow liquidity is managed in each fund on a daily basis using reports that include subscription and redemption information as well as the impact of trading, derivative lifecycle events and corporate action activity. In addition to the daily reporting, the fund managers are provided with reporting that highlights the impact of reasonably predictable events in the portfolio, including an allowance for the potential future exposures that might result from derivative exposures.

Market (or distribution-related) considerations include an assessment of asset demand, fund growth, client concentration and the persistency of the client base. Supplementary to this, market liquidity stress tests are carried out on a monthly basis for all sophisticated funds.

##### Credit risk

For funds exposed to credit risk, the credit rating, yield and maturity of each interest bearing security is considered to determine if the yield fully reflects the risk. The capital value of interest-bearing securities within the funds will fall in the event of the default or perceived increased credit risk of an issuer.

The capital value of interest-bearing securities within a fund may also be affected by interest rate fluctuations such that when interest rates rise, the capital value of the interest-bearing securities is likely to fall and vice versa.

Funds investing in derivatives are exposed to counterparty risk. This is the risk that the other party to the transaction fails to fulfil their obligations, either by failing to pay or failing to deliver securities. To minimise this risk, carefully selected, financially strong and well-established counterparties are selected following a thorough due diligence review and collateral is posted daily (in the form of cash or high-quality government bonds). Derivative positions are valued on a mark-to-market basis (revalued to reflect prevailing market prices) daily and collateral moves from one counterparty to the other to reflect movements in the unrealised profit or loss. As a result, the maximum loss to the fund would be limited to that day's price movements in affected derivatives contracts.

For funds in which they are used, credit default swaps are bought and sold in response to detailed credit research to take advantage of anticipated movements in credit spreads on individual stocks and baskets of securities. When a fund buys a credit default swap the default risk associated with the underlying security transfers to the counterparty. When a fund sells a credit default swap the fund assumes the credit risk of the underlying security.

# M&G Investment Funds (5)

Financial statements and notes

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# M&G Episode Macro Fund

## Authorised Corporate Director's Report

### Investment objective up to 13 June 2019

The fund aims to deliver a higher total return, with lower volatility on average, than global equities over a rolling three to five year period. There is no guarantee that the fund will achieve a positive return over this, or any other, period and investors may not recoup the original amount they invested.

### Investment policy up to 13 June 2019

The fund manager adopts a flexible approach to the allocation of capital between asset classes in response to changes in economic conditions and the valuation of assets. Central to this approach is the identification of episodes, which are periods of time during which, in the fund manager's view, asset prices become over- or under-stated, relative to objective valuation measures, due to the emotional reaction of investors to events. These episodes can exist over both the short and medium term. The short term volatility of the fund may be high.

The fund will typically invest in a variety of equity index futures, currency forwards, interest rate swaps, and other highly-liquid derivatives. The portfolio may therefore comprise a high proportion of cash and near cash, the majority of which is likely to be held in cash deposits. In addition to derivatives, the fund may invest in a range of equities, fixed income and other assets, including collective investment schemes, other transferable securities, deposits, warrants and money market instruments.

Subject to rigorous risk management, the fund is likely to operate with a gross asset exposure in excess of net assets. This will be achieved through the use of derivative contracts, often with a view to increasing diversification.

### Investment approach up to 13 June 2019

The managers believe the best approach for achieving the fund objective lies in the flexible allocation of capital between asset classes, guided by a robust valuation framework. In particular, they seek to respond where asset prices move away from a reasonable sense of 'fair' value due to investors reacting emotionally to events. They believe such 'episodes' create opportunities because emotions should be less important than underlying fundamentals over the medium and long term.

The fund is fully flexible and is not bound by any sense of neutrality or benchmark. The fund's investment strategy is likely to involve the use of financial instruments to take short positions, that is, positions that profit from a fall in the price of an asset, or to generate modest amounts of leverage (gain exposure to greater investment than the net asset value of the fund).

### Investment objective from 14 June 2019

The fund aims to deliver a total return (the combination of capital growth and income) of at least 4-8% per annum above the 3-month LIBOR over any five-year period, after charges are taken.

There is no guarantee that the fund will achieve a positive return over five years, or any other period, and investors may not get back the original amount they invested.

### Investment policy from 14 June 2019

The fund typically uses derivatives to gain exposure to a range of asset classes including equities, fixed income securities, convertibles and currencies, from anywhere in the world. Exposure to these assets may also be gained directly, or indirectly via collective investment schemes (including funds managed by M&G). In addition, the fund may invest in cash and near cash.

The fund may use derivatives to operate with net long or net short exposure to any position or asset class, and at the overall fund level. Consequently, the fund can have net asset exposure in excess of the total net assets of the fund.

Derivatives may be used for investment, portfolio management and hedging purposes.

### Investment approach from 14 June 2019

The fund adopts a highly flexible investment approach. It is unconstrained in the allocation of capital in that there is no pre-set asset allocation limits or reference to industry benchmark.

The investment approach combines in-depth research to work out the value of assets over the medium to long term with analysis of market reactions to events to identify investment opportunities. In particular, the fund manager seeks to respond when asset prices move away from a reasonable sense of 'fair' long-term value due to market reactions to events.

The fund does not target a static level of volatility and short-term volatility can be high. The fund manager believes that this investment approach should lead, over five years, to a lower volatility than that of global equity markets (as represented by the MSCI ACWI Index).

### Benchmark

Benchmark: 3-month USD LIBOR + 4-8%.

The fund is actively managed. The benchmark is a target which the fund seeks to achieve. The rate has been chosen as the fund's target benchmark as it is an achievable performance target given the fund's investment policy. The target benchmark is used solely to measure the fund's performance and does not constrain the fund's portfolio construction.



# M&G Episode Macro Fund

## Authorised Corporate Director's Report

### Risk profile

The fund invests globally in a broad range of assets, including company shares (equities), fixed income securities (bonds), currencies and other assets such as property shares and convertible bonds. The fund is, therefore, subject to the price volatility of global financial and currency markets. Exposure to the different asset classes is typically gained through the use of derivatives.

In association with the use of derivatives, including those instruments not traded through an exchange, collateral is deposited, in order to mitigate the risk that a counterparty may default on its obligations or become insolvent.

The fund is fully flexible and is managed aggressively, although the managers will seek to maximise portfolio diversity wherever possible. However, in cases where the managers believe that the opportunities are limited to a few areas, there may be a higher-than-usual concentration of asset or market exposure. Such strategies may result in higher volatility of the fund's short-term performance.

The blend of assets held in the fund is regularly adjusted depending on where the managers see the most value and to manage risks, including liquidity, credit, currency and market risks. The fund's risks are measured and managed as an integral part of the investment process.

The following table shows the risk number associated with the fund and is based on Sterling Class 'S-H' shares.



The above number:

- is based on the rate at which the value of the fund has moved up and down in the past and is based on historical data so may not be a reliable indicator of the future risk profile of the fund.
- is not guaranteed and may change over time and the lowest risk number does not mean risk free.
- has not changed during this period.

### Investment review

**As at 2 January 2020, for the year ended 31 December 2019**

#### Performance against objective

Between 2 January 2019 (the start of the review period) and 2 January 2020, the M&G Episode Macro Fund's Sterling Class 'S-H' and Sterling Class 'T-H' shares delivered a positive total return (the combination of income and growth of capital) of around 14%.

The fund's objective changed on 14 June 2019, in order to provide a clearer explanation of what the fund sets out to do and how it is managed, and also to make it easier to determine whether it has achieved its aim. According to the new objective, the fund aims to deliver a total return of at least 4-8% per year above the 3-month LIBOR over any five-year period, after charges are taken.

Over the 12-month review period and over five years, the fund met its objective, delivering returns that were either above 3-month LIBOR plus 4-8%, or within the range, after charges are taken.\*

\* For the performance of each share class, please refer to the 'Long-term performance by share class' table in the 'Fund performance' section of this report.

#### Investment performance

The fund's positive returns in 2019 were primarily driven by its exposure to equities (company shares), with our decisions to increase positions at the end of 2018 and after the 'episode' in summer 2019 (which was a period of significant market weakness) proving beneficial. 'Episodes' are periods when asset prices rise or fall due to 'behavioural' influences such as panic or excitement, and which are often characterised by rapid price moves. Such episodes can represent opportunities for the fund as they reverse.

Having started the year with exposure to US government bonds (Treasuries) and adding positions in emerging market government bonds in the first quarter, the fund also partially benefited from the dramatic fall in global interest rates into the middle of the year. However, short positions (which benefit when prices fall) in UK government bonds (gilts) and German government bonds (bunds) delivered negative returns in this environment. In addition, there were modest gains from currency exposures, most notably to the Turkish lira.

After rising interest rates had driven negative returns in almost all assets in 2018, 2019 saw a reversal of this trend. The correlating influence of falling global interest rates – whereby both equities and bonds delivered positive returns – meant that our investment decisions were more about the scaling of equity and bond exposures over the course of the year, than the emergence of more distinctive episodes.

Indeed, the tactical element of our investment approach (that is, the ability to quickly and flexibly scale positions) proved extremely important. As we look back on calendar year returns, it is easy to forget that equity markets generally went sideways between April and October. By responding tactically, and increasing exposure in response to the 'episodic' opportunities that we identified in the fourth quarter of 2018 and in the summer of 2019, the fund was able to capture the key periods of positive return.

# M&G Episode Macro Fund

## Authorised Corporate Director's Report

### Investment review

#### Investment performance (continued)

Within equity exposures, notable gains came from a position in the US banking sector. We subsequently released profits, cutting exposure to 5% from 15%, as we believe valuations have become less attractive following the price increase.

There were also gains from exposure to a basket of emerging market government bonds, which we established in March 2019 and increased amidst the 'risk-off' behaviour that took hold in August (as investors took refuge in 'safe-haven' assets). This position, like the fund's exposures to high yielding currencies, also benefited from a lower rate environment.

Among the fund's currency positions, material gains were made via exposure to the Turkish lira: a 12% position that had been opened deep in the crisis of 2018, but which has now been reduced to 6% as market sentiment and valuations have become less extreme.

One of the biggest surprises of the year was the extent of yield (which moves inversely to bond price) declines on government bonds across the world. The capital gains seen in parts of the fixed income universe into the summer were staggering. While we had added duration (sensitivity to interest rate changes) via US Treasuries, and subsequently through emerging market government bonds, these were not enough to offset the losses from short positions in gilts and bunds.

#### Investment activities

The portfolio at the end of 2019 looks very different to the one that started the year, reflecting the dramatic shift in investor perceptions and the global interest rate dynamic.

Amidst the episodic fear that heralded the start of 2019, the fund's overall equity exposure was 74.5%. By the end of the year that figure stood at 27.5%, the lowest level since the post-US election rally in late 2016. This was a reflection of the shift in valuation signals and the unwinding of the behavioural episode that had taken hold before the start of the year. The fund now also has a large position in emerging market government bonds that was not in place a year ago, while the material position in the Turkish lira has been cut in half.

One area where the current portfolio resembles that of a year ago is in the exposure to US long-dated Treasuries. At the start of 2019 the weighting was at 15% of the fund, which provided an important offset to losses from short government bond positions as global bond yields fell sharply into the middle of the year. This position was closed in June, just prior to the sharpest – and most episodic – yield declines, but as these moves have unwound into the end of 2019, a 10% position was re-established in December.

### Outlook

Just as it felt emotionally uncomfortable adding to risk prior to the start of 2019, the end of the year offers just as much cause for anxiety. Are we about to see the 'melt up' in all assets as valuations properly adjust to very low rate expectations? Or are markets just as vulnerable to any sign that the global recession fears of only six months ago might have been justified?

Our experience suggests that phases of relative calm such as that which has been in place for the last couple of months are often forerunners to big moves, in either direction. Ultimately, however, our key observation is that the irrational behaviour by investors that periodically creates tactical opportunities for our strategy is less evident currently; rather, investors are 'rationally uncertain'. It is therefore appropriate to be in a more neutral position: backing our longer term value observations, but being in a position to respond to the episodic near-term volatility that will almost certainly emerge. Patient opportunism is key.

As noted above, the tactical element of the approach played an important role that can be easily overlooked from the point of view of calendar year returns. However, with value signals from assets no longer so strong, it seems likely that this tactical element will not only continue to be significant, but also a clear differentiator.

#### David Fishwick & Eric Lonergan

Co-fund managers

Employees of M&G FA Limited (formerly M&G Limited) which is an associate of M&G Securities Limited.

Please note that the views expressed in this Report should not be taken as a recommendation or advice on how the fund or any holding mentioned in the Report is likely to perform. If you wish to obtain financial advice as to whether an investment is suitable for your needs, you should consult a Financial Adviser.

# M&G Episode Macro Fund

## Authorised Corporate Director's Report

### Investments

#### Portfolio statement

as at 31 December Holding	2019 \$'000	2019 %	2018 %
<b>EQUITIES</b>	<b>8,146</b>	<b>5.30</b>	<b>13.77</b>
<b>Banks</b>	<b>6,434</b>	<b>4.19</b>	<b>12.50</b>
37,248 Bank of America	1,309	0.85	
16,543 Citigroup	1,316	0.86	
9,287 JPMorgan Chase	1,288	0.84	
1,556,679 Lloyds Banking	1,285	0.84	
23,067 Wells Fargo	1,236	0.80	
<b>Finance &amp; credit services</b>	<b>1,292</b>	<b>0.84</b>	<b>2.58</b>
10,398 American Express	1,292	0.84	
<b>Equity derivatives</b>	<b>420</b>	<b>0.27</b>	<b>(1.31)</b>
<b>Equity futures contracts</b>	<b>420</b>	<b>0.27</b>	<b>(1.31)</b>
1,491 BIST 30 Feb 2020	81	0.05	
87 Euro Stoxx 50 Index Mar 2020	(10)	(0.01)	
28 FTSE MIB Index Mar 2020	(3)	0.00	
100 Hang Sei China Enterprise Index Jan 2020	79	0.05	
65 KOSPI 200 Index Mar 2020	280	0.18	
281 STOXX 600 Basic Resources Mar 2020	(7)	0.00	
24 TOPIX Index Mar 2020	0	0.00	
<b>FIXED INCOME</b>	<b>136,590</b>	<b>88.94</b>	<b>75.08</b>
<b>Debt securities</b>	<b>120,837</b>	<b>78.68</b>	<b>74.68</b>
<b>'AA' credit rated bonds</b>	<b>108,718</b>	<b>70.78</b>	<b>74.68</b>
\$13,010,300 US Treasury 0% 09/01/2020	13,006	8.47	
\$11,471,200 US Treasury 0% 06/02/2020	11,453	7.46	
\$12,480,800 US Treasury 0% 26/03/2020	12,435	8.10	
\$8,864,800 US Treasury 0% 09/04/2020	8,827	5.75	
\$13,010,700 US Treasury 0% 16/04/2020	12,952	8.43	
\$12,429,000 US Treasury 0% 23/04/2020	12,368	8.05	
\$7,353,600 US Treasury 0% 07/05/2020	7,314	4.76	
\$13,169,100 US Treasury 0% 14/05/2020	13,093	8.52	
\$7,095,800 US Treasury 0% 21/05/2020	7,053	4.59	
\$10,282,500 US Treasury 0% 28/05/2020	10,217	6.65	
<b>'A' credit rated bonds</b>	<b>3,044</b>	<b>1.98</b>	<b>0.00</b>
MXN55,380,000 Mexico (United Mexican States) 7.5% 03/06/2027	3,044	1.98	
<b>'BBB' credit rated bonds</b>	<b>3,098</b>	<b>2.02</b>	<b>0.00</b>
IDR39,814,000,000 Indonesia (Republic of) 8.25% 15/05/2029	3,098	2.02	
<b>'BB' credit rated bonds</b>	<b>5,977</b>	<b>3.90</b>	<b>0.00</b>
BRL6,500,000 Brazil (Federal Republic of) 0% 01/07/2021	1,505	0.98	
BRL5,000,000 Brazil (Federal Republic of) 10% 01/01/2029	1,500	0.98	
ZAR22,330,181 South Africa (Republic of) 8% 31/01/2030	1,483	0.97	
ZAR22,417,007 South Africa (Republic of) 8.875% 28/02/2035	1,489	0.97	
<b>Debt derivatives</b>	<b>1,101</b>	<b>0.72</b>	<b>0.40</b>
<b>Interest rate futures</b>	<b>1,101</b>	<b>0.72</b>	<b>0.40</b>
(224) Euro Bund Mar 2020	620	0.41	
(33) Euro Buxl Mar 2020	275	0.18	
(241) UK Long Gilt Bond Mar 2020	460	0.30	
81 US Ultra Long Treasury Bond Mar 2020	(254)	(0.17)	
<b>Fixed income portfolio</b>	<b>14,652</b>	<b>9.54</b>	<b>0.00</b>
236,020 iShares JP Morgan EM Local Government Bond	14,652	9.54	

#### Portfolio statement (continued)

as at 31 December Holding	2019 \$'000	2019 %	2018 %
<b>CURRENCY</b>	<b>(732)</b>	<b>(0.48)</b>	<b>1.09</b>
<b>Forward currency contracts</b>	<b>(732)</b>	<b>(0.48)</b>	<b>1.09</b>
AUD(6,433,132) Sold for \$4,402,930 (expires 21.02.20)	(115)	(0.07)	
€747,634 Bought for \$829,213 (expires 21.02.20)	13	0.01	
€(9,572,848) Sold for \$10,620,706 (expires 21.02.20)	(160)	(0.10)	
INR200,029,741 Bought for \$2,776,957 (expires 14.02.20)	14	0.01	
£2,079,373 Bought for \$2,776,060 (expires 21.02.20)	(26)	(0.02)	
£(7,375,744) Sold for \$9,505,231 (expires 21.02.20)	(251)	(0.16)	
RUB119,889,785 Bought for \$1,855,132 (expires 21.02.20)	63	0.04	
SGD\$(8,224,313) Sold for \$6,041,497 (expires 21.02.20)	(74)	(0.05)	
KRW5,003,890,243 Bought for \$4,261,620 (expires 21.02.20)	70	0.04	
CHF(4,269,883) Sold for \$4,348,063 (expires 21.02.20)	(83)	(0.05)	
TWD(245,986,864) Sold for \$8,183,740 (expires 21.02.20)	(41)	(0.03)	
TRY22,439,570 Bought for \$3,762,188 (expires 17.01.20)	(5)	0.00	
TRY14,436,038 Bought for €2,206,239 (expires 21.02.20)	(88)	(0.06)	
TRY35,201,477 Bought for \$5,962,966 (expires 06.03.20)	(141)	(0.09)	
TRY(21,314,755) Sold for \$3,641,481 (expires 17.01.20)	73	0.04	
TRY(5,636,450) Sold for \$954,789 (expires 21.02.20)	19	0.01	
<b>Portfolio of investments</b>	<b>144,004</b>	<b>93.76</b>	<b>89.94</b>
<b>SHARE CLASS HEDGING</b>	<b>529</b>	<b>0.34</b>	<b>(0.28)</b>
<b>Forward currency contracts for share class hedging</b>	<b>529</b>	<b>0.34</b>	<b>(0.28)</b>
£117,345,621 Bought for \$154,523,419 (expires 15.01.20)	532	0.34	
£(2,603,652) Sold for \$3,436,892 (expires 15.01.20)	(3)	0.00	
<b>Total portfolio (notes 2c &amp; 2d on page 7)</b>	<b>144,533</b>	<b>94.10</b>	<b>89.66</b>
<b>Net other assets / (liabilities)</b>	<b>9,056</b>	<b>5.90</b>	<b>10.34</b>
<b>Net assets attributable to shareholders</b>	<b>153,589</b>	<b>100.00</b>	<b>100.00</b>

All securities are on an official stock exchange listing except where referenced.



# M&G Episode Macro Fund

## Financial highlights

### Fund performance

Please note past performance is not a guide to future performance and the value of investments, and the income from them, will fluctuate. This will cause the fund price to fall as well as rise and you may not get back the original amount you invested.

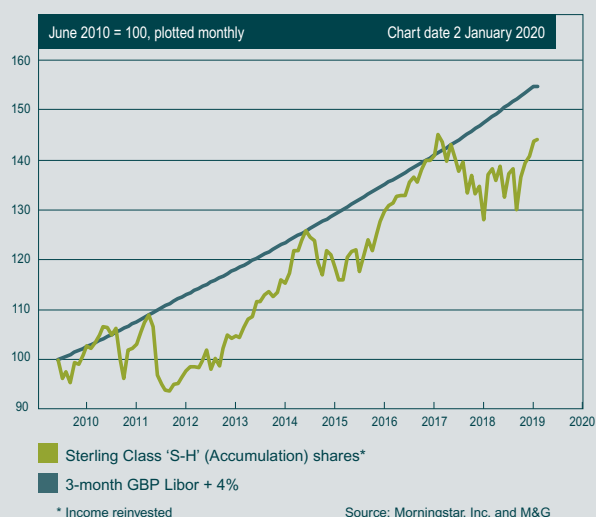
The following chart and tables reflect the key financial information of a representative share class, Sterling Class 'S-H' (Accumulation) shares. As different share classes have different attributes, for example charging structures and minimum investments, please be aware that their performance may be different. For more information on the different share classes in this fund please refer to the Prospectus for M&G Investment Funds (5), which is available free of charge either from our website at [www.mandg.co.uk/prospectuses](http://www.mandg.co.uk/prospectuses) or by calling M&G Customer Relations.

### Fund level performance

Fund net asset value			
as at 31 December	2019 \$'000	2018 \$'000	2017 \$'000
Fund net asset value (NAV)	153,589	140,472	397,405

### Performance since launch

To give an indication of how the fund has performed since launch, the chart below shows total return of Sterling Class 'S-H' (Accumulation) shares.



To give an indication of the performance of the fund, the following table shows the compound rate of return, per annum, over the period. Calculated on a price to price basis with income reinvested.

Long-term performance by share class				
	One year 02.01.19 % <sup>[a]</sup>	Three years 03.01.17 % p.a.	Five years 02.01.15 % p.a.	Since launch % p.a.
<b>Sterling<sup>[b]</sup></b>				
Class 'S-H'	+13.8	+3.4	+4.6	+3.9 <sup>[c]</sup>
Class 'T-H'	+14.1	+3.6	+4.6	+3.8 <sup>[c]</sup>

<sup>[a]</sup> Absolute basis.

<sup>[b]</sup> Price to price with income reinvested.

<sup>[c]</sup> 3 June 2010, the launch date of the fund.

## Operating charges, performance fees and portfolio transaction costs

We explain below the payments made to meet the ongoing costs of investing and managing the fund, comprising operating charges, performance fees and portfolio transaction costs.

### Operating charges

Operating charges include payments made to M&G and to providers independent of M&G:

- Annual charge:** Charge paid to M&G covering the annual cost of M&G managing and administering the fund and the costs of third parties providing services to the fund. From 1 August 2019, this charge rolls all costs that make up the operating charges into one annual charge.
 

For every £1 billion of a fund's net asset value, a discount of 0.02% will be applied to that fund's annual charge (up to a maximum of 0.12%).
- Extraordinary legal and tax expenses:** Costs that specifically relate to legal or tax claims that are both exceptional and unforeseeable. Such expenses are uncommon, and would not be expected in most years. Although they result in a short-term cost to the fund, generally they can deliver longer term benefits for investors.
- Investment management:** Charge paid to M&G for investment management of the fund. From 1 August 2019 this charge forms part of the annual charge.
- Administration:** Charge paid for administration services in addition to investment management – any surplus from this charge will be retained by M&G. From 1 August 2019 this charge is rolled into the annual charge.
- Share class hedging:** Charge paid to M&G for currency hedging services to minimise exchange rate risk for the share class. From 1 August 2019 this charge is rolled into the annual charge.

# M&G Episode Macro Fund

## Financial highlights

### Fund performance

## Operating charges, performance fees and portfolio transaction costs

### Operating charges (continued)

- **Oversight and other independent services:** Charges paid to providers independent of M&G for services which include depositary, custody and audit. From 1 August 2019 these charges will be paid by M&G and rolled into the annual charge.
- **Ongoing charges from underlying funds:** Ongoing charges on holdings in underlying funds that are not rebated. From 1 August 2019 charges from underlying funds (excluding Investment Trust Companies and Real Estate Investment Trusts) will be rebated.

### Performance fees

Performance fee paid to M&G based on fund performance.

The operating charges and performance fees paid by each share class of the fund are shown in the following performance tables. These charges do not include portfolio transaction costs or any entry and exit charges (also known as initial and redemption charges). The charging structures of share classes may differ, and therefore the operating charges and performance fees may differ.

Once the annual charge has been operational for twelve months, operating charges will be in line with the ongoing charges shown in the Key Investor Information Document, other than where there have been extraordinary legal or tax expenses, or an estimate has been used for the ongoing charge because a material change has made the operating charges unreliable as an estimate of future charges.

### Portfolio transaction costs

Portfolio transaction costs are incurred by funds when buying and selling investments. These costs vary depending on the types of investment, their market capitalisation, country of exchange and method of execution. They are made up of direct and indirect portfolio transaction costs:

- **Direct portfolio transaction costs:** Broker execution commission and taxes.
- **Indirect portfolio transaction costs:** 'Dealing spread' – the difference between the buying and selling prices of the fund's investments; some types of investment, such as fixed interest securities, have no direct transaction costs and only the dealing spread is paid.

Investments are bought or sold by a fund when changes are made to the investment portfolio and in response to net flows of money into or out of the fund from investors buying and selling shares in the fund.

To protect existing investors, portfolio transaction costs incurred as a result of investors buying and selling shares in the fund are recovered from those investors through a 'dilution adjustment' to the price they pay or receive. The table below shows direct portfolio transaction costs paid by the fund before and after that part of the dilution adjustment relating to direct portfolio transaction costs. To give an indication of the indirect portfolio dealing costs the table also shows the average portfolio dealing spread.

Further information on this process is in the Prospectus, which is available free of charge on request either from our website at [www.mandg.co.uk/prospectuses](http://www.mandg.co.uk/prospectuses) or by calling M&G Customer Relations.

Portfolio transaction costs				
for the year to 31 December	2019	2018	2017	Average <sup>[a]</sup>
Direct portfolio transaction costs <sup>[b]</sup>	%	%	%	%
Broker commission	0.11	0.02	0.03	0.05
Taxes	0.03	0.02	0.01	0.02
Costs before dilution adjustments	0.14	0.04	0.04	0.07
Dilution adjustments <sup>[c]</sup>	(0.01)	(0.01)	(0.01)	(0.01)
Total direct portfolio transaction costs	0.13	0.03	0.03	0.06
as at 31 December	2019	2018	2017	Average <sup>[a]</sup>
Indirect portfolio transaction costs	%	%	%	%
Average portfolio dealing spread	0.07	0.00	0.00	0.02

<sup>[a]</sup> Average of first three columns.

<sup>[b]</sup> As a percentage of average net asset value.

<sup>[c]</sup> In respect of direct portfolio transaction costs. Please see the section above this table for an explanation of dilution adjustments.

# M&G Episode Macro Fund

## Financial highlights

### Specific share class performance

The following tables show the performance of each share class. All 'Performance and charges' percentages represent an annual rate except for the 'Return after operating charges' which is calculated as a percentage of the opening net asset value per share (NAV). 'Dilution adjustments' are only in respect of direct portfolio transaction costs.

Historic yields for the current year are calculated as at 10 January 2020.

#### Sterling Class 'S-H' Accumulation share performance

The share class was launched on 3 June 2010.

for the year to 31 December Change in NAV per share	2019 UK p	2018 UK p	2017 UK p
Opening NAV	128.34	141.01	129.90
Return before operating charges and after direct portfolio transaction costs	18.06	(9.97)	13.73
Operating charges	(2.70)	(2.70)	(2.62)
Return after operating charges	15.36	(12.67)	11.11
Distributions	(0.92)	0.00	0.00
Retained distributions	0.92	0.00	0.00
Closing NAV	143.70	128.34	141.01
<b>Direct portfolio transaction costs</b>	<b>UK p</b>	<b>UK p</b>	<b>UK p</b>
Costs before dilution adjustments	0.19	0.06	0.05
Dilution adjustments <sup>[a]</sup>	(0.01)	(0.01)	(0.01)
Total direct portfolio transaction costs	0.18	0.05	0.04
<b>Performance and charges</b>	<b>%</b>	<b>%</b>	<b>%</b>
Direct portfolio transaction costs <sup>[b]</sup>	0.13	0.03	0.03
Operating charges <sup>[c]</sup>	1.97	1.93	1.94
Return after operating charges	+11.97	-8.99	+8.55
Historic yield	0.64	0.00	0.00
Effect on yield of charges offset against capital	0.00	0.00	0.00
<b>Other information</b>			
Closing NAV (\$'000)	146,821	124,154	154,127
Closing NAV percentage of total fund NAV (%)	95.59	88.38	38.78
Number of shares	77,352,145	75,765,045	80,893,353
Highest share price (UK p)	144.02	145.85	141.34
Lowest share price (UK p)	126.75	126.99	129.91

#### Sterling Class 'T-H' Accumulation share performance

The share class was launched on 3 June 2010.

for the year to 31 December Change in NAV per share	2019 UK p	2018 UK p	2017 UK p
Opening NAV	126.72	138.08	128.05
Return before operating charges and after direct portfolio transaction costs	17.56	(10.09)	13.64
Operating charges	(1.32)	(1.26)	(1.25)
Performance fee	(0.58)	(0.01)	(2.36)
Return after operating charges	15.66	(11.36)	10.03
Distributions	(1.55)	(0.34)	0.00
Retained distributions	1.55	0.34	0.00
Closing NAV	142.38	126.72	138.08
<b>Direct portfolio transaction costs</b>	<b>UK p</b>	<b>UK p</b>	<b>UK p</b>
Costs before dilution adjustments	0.19	0.06	0.05
Dilution adjustments <sup>[a]</sup>	(0.01)	(0.01)	(0.01)
Total direct portfolio transaction costs	0.18	0.05	0.04
<b>Performance and charges</b>	<b>%</b>	<b>%</b>	<b>%</b>
Direct portfolio transaction costs <sup>[b]</sup>	0.13	0.03	0.03
Operating charges <sup>[c]</sup>	0.97	0.93	0.94
Performance fee	0.43	0.01	1.75
Return after operating charges	+12.36	-8.23	+7.83
Historic yield	1.09	0.26	0.00
Effect on yield of charges offset against capital	0.00	0.00	0.00
<b>Other information</b>			
Closing NAV (\$'000)	6,768	16,318	12,430
Closing NAV percentage of total fund NAV (%)	4.41	11.62	3.13
Number of shares	3,598,660	10,086,228	6,662,807
Highest share price (UK p)	142.66	141.95	138.33
Lowest share price (UK p)	125.15	125.36	128.13

<sup>[a]</sup> In respect of direct portfolio transaction costs.

<sup>[b]</sup> As a percentage of average net asset value.

<sup>[c]</sup> Following the change in charging structure, you may see variances between the comparative and current year figures.

# M&G Episode Macro Fund

## Financial statements and notes

### Financial statements

#### Statement of total return

for the year to 31 December	Note	2019		2018	
		\$'000	\$'000	\$'000	\$'000
<b>Income</b>					
Net capital gains / (losses)	2		19,879		(71,014)
Revenue	4	4,060		6,027	
Expenses	5	(2,772)		(8,032)	
Net revenue / (expense) before taxation		1,288		(2,005)	
Taxation	6	(110)		(313)	
Net revenue / (expense) after taxation			1,178		(2,318)
<b>Total return before distributions</b>			<b>21,057</b>		<b>(73,332)</b>
Distributions	7		(1,178)		(210)
<b>Change in net assets attributable to shareholders from investment activities</b>			<b>19,879</b>		<b>(73,542)</b>

#### Statement of change in net assets attributable to shareholders

for the year to 31 December		2019		2018	
		\$'000	\$'000	\$'000	\$'000
<b>Opening net assets attributable to shareholders</b>			<b>140,472</b>		<b>397,405</b>
Amounts received on issue of shares		32,370		295,740	
Amounts paid on cancellation of shares		(40,178)		(195,602)	
Transferred to M&G (Lux) Episode Macro Fund		0		(283,689)	
			(7,808)		(183,551)
Dilution adjustments			29		61
Change in net assets attributable to shareholders from investment activities (see above)			19,879		(73,542)
Retained distributions on Accumulation shares			1,017		99
<b>Closing net assets attributable to shareholders</b>			<b>153,589</b>		<b>140,472</b>

#### Balance sheet

as at 31 December	Note	2019		2018	
		\$'000	\$'000	\$'000	\$'000
<b>Assets</b>					
<b>Fixed assets</b>					
Investments			145,794		129,391
<b>Current assets</b>					
Debtors	8	200		0	
Cash and bank balances	9	15,131		17,008	
<b>Total assets</b>			<b>161,125</b>		<b>146,399</b>
<b>Liabilities</b>					
Investment liabilities			(1,261)		(3,442)
<b>Creditors</b>					
Bank overdrafts			0		(2)
Overdrawn positions at futures clearing houses and collateral manager			(6,098)		(2,272)
Other creditors	10		(177)		(211)
<b>Total liabilities</b>			<b>(7,536)</b>		<b>(5,927)</b>
<b>Net assets attributable to shareholders</b>			<b>153,589</b>		<b>140,472</b>

### Notes to the financial statements

#### 1 Accounting policies

The financial statements have been prepared in accordance with the 'Summary of significant accounting policies' set out on pages 7 and 8.

#### 2 Net capital gains / (losses)

for the year to 31 December	2019	2018
	\$'000	\$'000
Non-derivative securities	7,864	(10,081)
Derivative contracts	12,293	(57,803)
Currency gains / (losses)	(274)	(3,118)
Transaction charges	(4)	(12)
<b>Net capital gains / (losses)</b>	<b>19,879</b>	<b>(71,014)</b>

#### 3 Portfolio transactions and associated costs

The following tables show portfolio transactions and their associated transaction costs. For more information about the nature of the costs please see the section on 'Operating charges, performance fees and portfolio transaction costs' on pages 15 and 16.

for the year to 31 December	2019	% of	2018	% of
	\$'000	transaction	\$'000	transaction
<b>a) Purchases</b>				
<b>Equities</b>				
Equities before transaction costs	11,045		57,811	
Commissions	5	0.04	20	0.03
Taxes	5	0.04	45	0.08
<b>Equities after transaction costs</b>	<b>11,055</b>		<b>57,876</b>	
<b>Debt securities after transaction costs <sup>[a]</sup></b>				
	<b>368,529</b>		<b>1,441,151</b>	
<b>Collective investment schemes</b>				
Collective investment schemes before transaction costs	16,728		0	
Commissions	5	0.03	0	0.00
<b>Collective investment schemes after transaction costs</b>	<b>16,733</b>		<b>0</b>	
<b>Total purchases after transaction costs</b>	<b>396,317</b>		<b>1,499,027</b>	
<b>b) Sales</b>				
<b>Equities</b>				
Equities before transaction costs	30,822		42,239	
Commissions	(15)	0.05	(17)	0.04
Taxes	(10)	0.03	(1)	0.00
<b>Equities after transaction costs</b>	<b>30,797</b>		<b>42,221</b>	
<b>Debt securities after transaction costs <sup>[a]</sup></b>				
	<b>355,647</b>		<b>1,411,916</b>	
<b>Collective investment schemes</b>				
Collective investment schemes before transaction costs	2,724		0	
Commissions	(1)	0.03	0	0.00
<b>Collective investment schemes after transaction costs</b>	<b>2,723</b>		<b>0</b>	
<b>Total sales after transaction costs</b>	<b>389,167</b>		<b>1,454,137</b>	

# M&G Episode Macro Fund

## Financial statements and notes

### Notes to the financial statements

#### 3 Portfolio transactions and associated costs (continued)

	2019 \$'000	% of average NAV	2018 \$'000	% of average NAV
<b>c) Direct portfolio transaction costs</b>				
<b>Commissions paid</b>				
Equities	20	0.01	37	0.01
Collective investment schemes	6	0.01	0	0.00
Derivatives	132	0.09	85	0.01
<b>Total commissions paid</b>	<b>158</b>	<b>0.11</b>	<b>122</b>	<b>0.02</b>
<b>Taxes paid</b>				
Equities	15	0.01	46	0.01
Derivatives	34	0.02	49	0.01
<b>Total taxes paid</b>	<b>49</b>	<b>0.03</b>	<b>95</b>	<b>0.02</b>
<b>Total direct portfolio transaction costs [b]</b>	<b>207</b>	<b>0.14</b>	<b>217</b>	<b>0.04</b>
<b>d) Indirect portfolio transaction costs</b>		%		%
Portfolio dealing spread [c]		0.07		0.00

[a] These transaction types do not attract direct portfolio transaction costs.

[b] Costs before dilution adjustments. Please refer to the 'Financial highlights' section for the effect of dilution adjustments.

[c] Average portfolio dealing spread at the balance sheet date.

#### 4 Revenue

	2019 \$'000	2018 \$'000
<b>for the year to 31 December</b>		
Bank interest	59	180
Derivative revenue	144	(2,062)
Distributions from collective investment schemes: taxable	380	0
Dividends from equity investments: non-taxable	725	1,625
Dividends from equity investments: taxable	38	82
Interest on debt securities	2,636	6,034
Rebate of ongoing charges from underlying funds	28	0
Share class hedging revenue	50	168
<b>Total revenue</b>	<b>4,060</b>	<b>6,027</b>

#### 5 Expenses

	2019 \$'000	2018 \$'000
<b>for the year to 31 December</b>		
<b>Payable to the ACD or associate</b>		
Annual charge	1,097	0
Annual management charge [a]	1,457	7,151
Administration charge [a]	131	661
Performance fee	47	79
Share class hedging charge [a]	16	76
	2,748	7,967
<b>Payable to the Depositary or associate</b>		
Depositary's charge (including VAT) [a]	8	32
<b>Other expenses</b>		
Audit fee (including VAT) [a] [b]	9	16
Interest payable	0	10
Legal fees	1	0
Safe custody charge [a]	6	7
	16	33
<b>Total expenses</b>	<b>2,772</b>	<b>8,032</b>

[a] The segregated charges shown above for annual management, administration, depositary, audit, share class hedging and safe custody are those paid by the fund up to and including 31 July 2019. As of 1 August 2019 these charges have been replaced by the single annual charge.

[b] Audit fees for the financial year ending 2019 were \$16,000.

#### 6 Taxation

	2019 \$'000	2018 \$'000
<b>for the year to 31 December</b>		
<b>a) Analysis of charge in the year</b>		
Corporation tax	0	0
Withholding tax	110	313
Deferred tax (note 6c)	0	0
<b>Total taxation</b>	<b>110</b>	<b>313</b>
<b>b) Factors affecting taxation charge for the year</b>		
Net revenue / (expense) before taxation	1,288	(2,005)
Corporation tax at 20%	258	(401)
Effects of:		
Dividends from equity investments: non-taxable	(145)	(325)
Current year expenses not utilised	(110)	726
Withholding tax	110	313
Withholding tax expensed	(3)	0
<b>Total tax charge (note 6a)</b>	<b>110</b>	<b>313</b>
<b>c) Provision for deferred taxation</b>		
Provision at the start of the year	0	0
Deferred tax in profit and loss account (note 6a)	0	0
<b>Provision at the end of the year</b>	<b>0</b>	<b>0</b>

The fund has not recognised a deferred tax asset of \$3,366,000 (2018: \$3,476,000) arising as a result of having excess management expenses. We do not expect this asset to be utilised in the foreseeable future.

#### 7 Distributions

	2019		2018	
	Inc [a]	Acc [b]	Inc [a]	Acc [b]
<b>for the year to 31 December</b>	\$'000	\$'000	\$'000	\$'000
<b>Dividend distributions</b>				
Final	n/a	1,017	n/a	99
<b>Total net distributions</b>		1,017		99
Income deducted on cancellation of shares		289		(606)
Income received on issue of shares		(128)		717
<b>Distributions</b>		<b>1,178</b>		<b>210</b>
Net revenue / (expense) per statement of total return		1,178		(2,318)
Income deficit transferred to capital		0		2,528
<b>Distributions</b>		<b>1,178</b>		<b>210</b>

[a] Distributions payable on Income shares.

[b] Retained distributions on Accumulation shares.

#### 8 Debtors

	2019 \$'000	2018 \$'000
<b>as at 31 December</b>		
Debt security interest receivable	197	0
Rebate of ongoing charges from underlying funds	3	0
<b>Total debtors</b>	<b>200</b>	<b>0</b>

#### 9 Cash and bank balances

	2019 \$'000	2018 \$'000
<b>as at 31 December</b>		
Amounts held at futures clearing houses and collateral manager	9,861	13,141
Cash held as bank balances	5,270	3,867
<b>Total cash and bank balances</b>	<b>15,131</b>	<b>17,008</b>

# M&G Episode Macro Fund

## Financial statements and notes

### Notes to the financial statements

#### 10 Other creditors

as at 31 December	2019 \$'000	2018 \$'000
ACD's annual management charge payable	0	88
Administration charge payable	0	8
Annual charge payable	118	0
Derivative expense payable	3	17
Expenses payable	9	18
Performance fee payable	47	79
Share class hedging charge payable	0	1
<b>Total other creditors</b>	<b>177</b>	<b>211</b>

#### 11 Contingent assets, liabilities and outstanding commitments

There were no contingent assets, liabilities or outstanding commitments at the balance sheet date (2018: same).

#### 12 Shares in issue

The following table shows each class of share in issue during the year. Each share class has the same rights on winding up however they may have different charging structures as set out in note 13.

Share class	Opening 01.01.19	Movements Issued Cancelled	Closing 31.12.19
<b>Sterling</b>			
Class 'S-H' Accumulation	75,765,045	17,843,908 (16,256,808)	77,352,145
Class 'T-H' Accumulation	10,086,228	634,254 (7,121,822)	3,598,660

#### 13 Charging structure

The table below sets out the charging structure for each class of share in existence as at the balance sheet date. The charging structure is the same for both Income and Accumulation shares of each class.

Share class	Entry charge %	Exit charge %	Annual charge <sup>[a]</sup> %	Performance fee %
<b>Sterling</b>				
Class 'S-H'	n/a	n/a	1.93	n/a
Class 'T-H'	n/a	n/a	0.93	<sup>[b]</sup>

<sup>[a]</sup> The amounts shown are the maximum annual charge. M&G will apply a discount of 0.02% for every £1 billion of a fund's net asset value. This is assessed quarterly and implemented on a forward basis no later than 13 business days after quarter end.

<sup>[b]</sup> Fee based on fund performance. For more information, please refer to the Prospectus for M&G Investment Funds (5).

#### 14 Related parties

M&G Securities Limited, as Authorised Corporate Director (ACD), is a related party and acts as principal on all the transactions of shares in the fund except with in specie transactions, where M&G Securities Limited acts as an agent. The aggregate monies received through issues, and paid on cancellations, are disclosed in the 'Statement of change in net assets attributable to shareholders' and note 7. Amounts due to / from M&G Securities Limited in respect of share transactions at the year end are disclosed in notes 8 and 10 where applicable.

Amounts paid to M&G Securities Limited in respect of the annual charge, ACD's annual management charge, administration charge, performance fee and share class hedging charge are disclosed in note 5. Amounts due at the year end from the annual charge are disclosed in note 10.

At the balance sheet date, shareholders from within M&G plc, of which M&G Securities Limited is a wholly owned subsidiary, have holdings totalling 80.92% (2018: 74.91%) of the fund's shares.

#### 15 Events after the balance sheet date

There were no events after the balance sheet date to disclose.

#### 16 Fair value analysis

Financial instruments have been measured at their fair value and have been classified below using a hierarchy that reflects the significance of the inputs used in measuring their fair value:

##### Level 1: Unadjusted quoted price in an active market for an identical instrument

This includes instruments such as publicly traded equities, highly liquid bonds (e.g. Government bonds) and exchange traded derivatives (e.g. futures) for which quoted prices are readily and regularly available.

##### Level 2: Valuation technique using observable market data

This includes instruments such as over-the-counter (OTC) derivatives, debt securities, convertible bonds, mortgage-backed securities, asset-backed securities and open-ended funds which have been valued using models with observable market data inputs.

##### Level 3: Valuation technique using unobservable inputs

This refers to instruments which have been valued using models with unobservable data inputs. This includes single broker-priced instruments, suspended/unquoted securities, private equity, unlisted closed-ended funds and open-ended funds with restrictions on redemption rights. However no such financial instruments were held.

as at 31 December	Assets 2019 \$'000	Liabilities 2019 \$'000	Assets 2018 \$'000	Liabilities 2018 \$'000
<b>Basis of valuation</b>				
Level 1	132,891	(274)	127,326	(2,522)
Level 2	12,903	(987)	2,065	(920)
Level 3	0	0	0	0
	<b>145,794</b>	<b>(1,261)</b>	<b>129,391</b>	<b>(3,442)</b>

In accordance with FRS 102 (22.4a) the shares in issue for each class meet the definition of a puttable instrument as the shareholders have the right to sell the shares back to the issuer. The shares in the fund may be issued and redeemed on any business day at the quoted price. These shares are not traded on an exchange. However, the price is observable and transactions within the fund take place regularly at that price. The shares in issue as detailed in note 12 meet the definition of a level 2 financial instrument 'Valuation techniques using observable market data'.



# M&G Episode Macro Fund

## Financial statements and notes

### Notes to the financial statements

#### 17 Risk management policies

The general risk management policies for the fund are set out in note 3 to the financial statements on pages 8 and 9.

#### 18 Market risk sensitivity and exposure

VaR is the risk measurement methodology used to assess the fund's leverage and market risk volatility. When VaR is calculated as a percentage of the net asset value it may not be greater than the VaR limit set for the fund.

The VaR limit set during the financial year to 31 December 2019 was 15% (2018: 15%).

The lowest, highest and average VaR, as well as utilisation of VaR with reference to the limit above, are calculated during the financial years ended 31 December 2019 and 31 December 2018.

for the year to 31 December	2019 % of VaR	2019 Utilisation of VaR <sup>[a]</sup>		2018 Utilisation of VaR <sup>[a]</sup>	
		15%	% of VaR	15%	% of VaR
Lowest	3.87	25.80	2.50	16.69	
Highest	9.30	62.00	8.50	56.68	
Average	6.42	42.80	4.29	28.58	

<sup>[a]</sup> The VaR on the fund has been divided by its maximum limit.

#### 19 Credit risk

The fund is exposed to credit risk both through the credit quality of the investments it holds and through the derivative positions with counterparties. The table below shows the credit quality of the investments held in the portfolio.

as at 31 December	2019 \$'000	2018 \$'000
Investment grade securities	114,860	104,910
Below investment grade securities	5,977	0
Other investments	23,696	21,039
<b>Total</b>	<b>144,533</b>	<b>125,949</b>

The tables below show the exposure to counterparties. Collateral is posted daily, in the form of cash or high-quality government bonds, to minimise this exposure.

as at 31 December 2019	Forward currency contracts \$'000	Futures \$'000
Bank of America Merrill Lynch	(5)	1,521
BNP Paribas	(51)	0
Citigroup	111	0
HSBC	(393)	0
JPMorgan	(8)	0
National Australia Bank	(147)	0
State Street Bank	455	0
UBS	(165)	0
<b>Total</b>	<b>(203)</b>	<b>1,521</b>

as at 31 December 2018	Forward currency contracts \$'000	Futures \$'000
Bank of America Merrill Lynch	(1)	(1,286)
BNP Paribas	1,582	0
Citigroup	27	0
Deutsche Bank	18	0
HSBC	55	0
JPMorgan	(197)	0
State Street Bank	(370)	0
UBS	31	0
<b>Total</b>	<b>1,145</b>	<b>(1,286)</b>

Net exposure represents the mark-to-market value of derivative contracts less any cash collateral held. Positive exposure represents the fund's exposure to that counterparty. Negative amounts are not an exposure to the fund.

#### 20 Leverage risk

Funds using VaR approaches are required to disclose the level of leverage employed during the financial reporting period.

Derivatives can be used by the fund to generate market exposure to investments exceeding the net asset value. As a result of this exposure, the size of any positive or negative movement in markets may have a more significant effect on the net asset value of the fund.

The lowest, highest and average level of leverage employed and utilisation of the leverage level calculated during the financial years ended 31 December 2019 and 31 December 2018 are disclosed in the table below.

for the year to 31 December	2019 \$'000	2019 <sup>[a]</sup> % <sup>[b]</sup>	2018 \$'000	2018 <sup>[a]</sup> % <sup>[b]</sup>
Lowest	234,667	146	266,073	108
Highest	783,122	534	1,243,119	422
Average	400,061	280	663,803	158

<sup>[a]</sup> Leverage has been calculated using the Gross Sum of Notional Approach for derivative positions only (including forward currency contracts) and excludes all physical holdings.

<sup>[b]</sup> Expressed as a percentage over net assets.

#### 21 Exchange rate risk for hedged share classes

This fund contains hedged share classes. These share classes operate currency hedges designed to reduce the impact of exchange rates in certain circumstances. As a result, profit and loss on the currency hedges may impact the liquidity of the overall fund. On a day to day basis this is monitored using reporting from the outsourced provider of the hedged share class service. On an ongoing basis the size of the hedged share classes is monitored to ensure that unforeseen exchange rate volatility can be adequately managed without significantly impacting all shareholders. The exposure to forward currency contracts for share class hedging at the year-end accounting date is disclosed in the portfolio statement on page 14.

# M&G Episode Macro Fund

## Financial statements and notes

### Notes to the financial statements

#### 22 Dividend distribution tables

This fund pays annual ordinary distributions and the following table sets out the distribution period.

Annual distribution period				
	Start	End	Xd	Payment
Final	01.01.19	31.12.19	02.01.20	29.02.20

The following tables set out for each distribution the rates per share for both Group 1 and Group 2 shares.

Group 1 shares are those purchased prior to a distribution period and therefore their income rate is the same as the distribution rate.

Group 2 shares are those purchased during a distribution period and therefore their distribution rate is made up of income and equalisation. Equalisation is the average amount of income included in the purchase price of all Group 2 shares and is refunded to the holders of these shares as a return of capital. Being capital it is not liable to Income Tax. Instead, it must be deducted from the cost of shares for Capital Gains Tax purposes. The tables below show the split of the Group 2 rates into the income and equalisation components.

Sterling Class 'S-H' Accumulation shares				
Ordinary distributions for the year to 31 December	Group 2		Group 1 & 2 Distribution	
	Income 2019	Equalisation 2019	2019	2018
	p	p	p	p
Final	0.4157	0.5078	0.9235	0.0000

Sterling Class 'T-H' Accumulation shares				
Ordinary distributions for the year to 31 December	Group 2		Group 1 & 2 Distribution	
	Income 2019	Equalisation 2019	2019	2018
	p	p	p	p
Final	0.2083	1.3414	1.5497	0.3388



# M&G Investment Funds (5)

## Other regulatory disclosures

### Assessment of value

From June 2020, we will be publishing an annual assessment of the value delivered to investors in this fund. The assessment will cover, amongst other things, an assessment of our charges, the quality of our services, and how we compare to our competitors. This will be available at [www.mandg.co.uk](http://www.mandg.co.uk)

### Remuneration

In line with the requirements of the Undertakings for Collective Investment in Transferable Securities (UCITS) V, the UCITS Manager is subject to a remuneration policy which is consistent with the principles outlined in SYSC19E of the FCA Handbook (UCITS Remuneration Code).

The remuneration policies are designed to ensure that any relevant conflicts of interest can be managed appropriately at all times and that the remuneration of its staff is in line with the risk policies and objectives of the UCITS funds it manages. Further details of the remuneration policy can be found here: <https://www.mandg.com/about-us/policies-and-business-principles>. M&G's remuneration policy and its implementation is reviewed on an annual basis, or more frequently where required, and approved by the M&G Remuneration Committee. The latest review found that the remuneration policy continued to align to all local regulatory requirements and continued to operate as intended.

The UCITS management company is required under UCITS to make quantitative disclosures of remuneration. These disclosures are made in line with M&G's interpretation of currently available guidance on quantitative remuneration disclosures. As market or regulatory guidance evolves, M&G may consider it appropriate to make changes to the way in which quantitative disclosures are calculated. Members of staff and senior management typically provide both UCITS and non-UCITS related services and have a number of areas of responsibility. Therefore, only the portion of remuneration for those individuals' services which may be attributable to UCITS is included in the remuneration figures disclosed. Accordingly the figures are not representative of any individual's actual remuneration.

M&G Securities Limited does not directly employ any staff members. However, for the financial year ended 31 December 2018, aggregate remuneration of £47,703,371 (£7,395,780 in respect of fixed remuneration and £40,307,591 in respect of variable remuneration) was paid to individuals whose actions may have a material impact on the risk profile of the UCITS Manager, of which £3,523,355 related to senior management.

### Swiss investor information

For funds registered in Switzerland we are required by FINMA to disclose the Total Expense Ratio (TER).

For this fund the TERs are the same as the operating charges disclosed in the fund's financial highlights section under 'Performance and charges'.

# Glossary

**Accumulation shares:** A type of share where distributions are automatically reinvested and reflected in the value of the shares.

**Accumulation units:** A type of unit where distributions are automatically reinvested and reflected in the value of the units.

**Asset:** Anything having commercial or exchange value that is owned by a business, institution or individual.

**Asset allocation:** Apportioning a portfolio's assets according to risk tolerance and investment goals.

**Asset class:** Category of assets, such as cash, company shares, fixed income securities and their sub-categories, as well as tangible assets such as real estate.

**Bond:** A loan in the form of a security, usually issued by a government or company, which normally pays a fixed rate of interest over a given time period, at the end of which the initial amount borrowed is repaid.

**Bond issue:** A set of fixed income securities offered for sale to the public by a company or government. If the bonds are sold for the first time, it is called a 'new issue'.

**Bottom-up selection:** Selecting stocks based on the attractiveness of a company.

**Bunds:** Fixed income securities issued by the German government.

**Capital:** Refers to the financial assets, or resources, that a company has to fund its business operations.

**Capital growth:** Occurs when the current value of an investment is greater than the initial amount invested.

**Capital return:** The term for the gain or loss derived from an investment over a particular period. Capital return includes capital gain or loss only and excludes income (in the form of interest or dividend payments).

**Cash equivalents:** Deposits or investments with similar characteristics to cash.

**Comparative sector:** A group of funds with similar investment objectives and/or types of investment, as classified by bodies such as the Investment Association (IA) or Morningstar™. Sector definitions are mostly based on the main assets a fund should invest in, and may also have a geographic focus. Sectors can be the basis for comparing the different characteristics of similar funds, such as their performance or charging structure.

**Consumer Prices Index (CPI):** An index used to measure inflation, which is the rate of change in prices for a basket of goods and services. The contents of the basket are meant to be representative of products and services we typically spend our money on.

**Convertible bonds:** Fixed income securities that can be exchanged for predetermined amounts of company shares at certain times during their life.

**Corporate bonds:** Fixed income securities issued by a company. They are also known as bonds and can offer higher interest payments than bonds issued by governments as they are often considered more risky.

**Coupon:** The interest paid by the government or company that has raised a loan by selling bonds.

**Credit:** The borrowing capacity of an individual, company or government. More narrowly, the term is often used as a synonym for fixed income securities issued by companies.

**Credit default swaps (CDS):** Are a type of derivative, namely financial instruments whose value, and price, are dependent on one or more underlying assets. CDS are insurance-like contracts that allow investors to transfer the risk of a fixed income security defaulting to another investor.

**Credit rating:** An independent assessment of a borrower's ability to repay its debts. A high rating indicates that the credit rating agency considers the issuer to be at low risk of default; likewise, a low rating indicates high risk of default. Standard & Poor's, Fitch and Moody's are the three most prominent credit rating agencies. Default means that a company or government is unable to meet interest payments or repay the initial investment amount at the end of a security's life.

**Credit rating agency:** A company that analyses the financial strength of issuers of fixed income securities and attaches a rating to their debt. Examples include Standard & Poor's and Moody's.

**Credit risk:** Risk that a financial obligation will not be paid and a loss will result for the lender.

**Credit selection:** The process of evaluating a fixed income security, also called a bond, in order to ascertain the ability of the borrower to meet its debt obligations. This research seeks to identify the appropriate level of default risk associated with investing in that particular bond.

**Credit spread:** The difference between the yield of a corporate bond, a fixed income security issued by a company, and a government bond of the same life span. Yield refers to the income received from an investment and is expressed as a percentage of the investment's current market value.

**Default:** When a borrower does not maintain interest payments or repay the amount borrowed when due.

**Defaulted bond:** When a bond issuer does not maintain interest payments or repay the amount borrowed when due.

**Default risk:** Risk that a debtholder will not receive interest and full repayment of the loan when due.

**Derivatives:** Financial instruments whose value, and price, are dependent on one or more underlying assets. Derivatives can be used to gain exposure to, or to help protect against, expected changes in the value of the underlying investments. Derivatives may be traded on a regulated exchange or traded over the counter.

**Developed economy/market:** Well-established economies with a high degree of industrialisation, standard of living and security.

**Dilution adjustments:** The dilution adjustment is used to protect ongoing investors against the transaction charges incurred in investing or divesting in respect of creations and cancellations. The dilution adjustment is made up of the direct and indirect transaction charges. In the financial statements the direct transaction charges as a percentage of average NAV will be disclosed. This percentage will take account of those direct transaction charges that have been recovered through the dilution adjustment leaving a percentage that just represents the costs incurred in portfolio management.

**Distribution:** Distributions represent a share in the income of the fund and are paid out to Income shareholders or reinvested for Accumulation shareholders at set times of the year (monthly, quarterly, half-yearly or annually). They may either be in the form of interest distributions or dividend distributions.

**Distribution yield:** Expresses the amount that is expected to be distributed by the fund over the next 12 months as a percentage of the share price as at a certain date. It is based on the expected gross income less the ongoing charges.

# Glossary

**Diversification:** The practice of investing in a variety of assets. This is a risk management technique where, in a well-diversified portfolio, any loss from an individual holding should be offset by gains in other holdings, thereby lessening the impact on the overall portfolio.

**Dividend:** Dividends represent a share in the profits of a company and are paid out to the company's shareholders at set times of the year.

**Duration:** A measure of the sensitivity of a fixed income security, also called a bond, or bond fund to changes in interest rates. The longer a bond or bond fund's duration, the more sensitive it is to interest rate movements.

**Duration risk:** The longer a fixed income security, also called a bond, or bond fund's duration, the more sensitive and therefore at risk it is to changes in interest rates.

**Emerging economy or market:** Economies in the process of rapid growth and increasing industrialisation. Investments in emerging markets are generally considered to be riskier than those in developed markets.

**Equities:** Shares of ownership in a company.

**Exchange traded:** Usually refers to investments traded on an exchange, such as company shares on a stock exchange.

**Ex-dividend, ex-distribution or XD date:** The date on which declared distributions officially belong to underlying investors.

**Exposure:** The proportion of a fund invested in a particular share/fixed income security, sector/region, usually expressed as a percentage of the overall portfolio.

**Fixed income security:** A loan in the form of a security, usually issued by a government or company, which normally pays a fixed rate of interest over a given time period, at the end of which the initial amount borrowed is repaid. Also referred to as a bond.

**Floating rate notes (FRNs):** Securities whose interest (income) payments are periodically adjusted depending on the change in a reference interest rate.

**Foreign exchange:** The exchange of one currency for another, or the conversion of one currency into another currency. Foreign exchange also refers to the global market where currencies are traded virtually around the clock. The term foreign exchange is usually abbreviated as 'forex' and occasionally as 'FX'.

**Foreign exchange (FX) strategy:** Currencies can be an asset class in its own right, along with company shares, fixed income securities, property and cash. Foreign exchange strategy can therefore be a source of investment returns.

**Forward contract:** A contract between two parties to buy or sell a particular commodity or financial instrument at a pre-determined price at a future date. Examples include forward currency contracts.

**Fundamentals (company):** A basic principle, rule, law, or the like, that serves as the groundwork of a system. A company's fundamentals pertain specifically to that company, and are factors such as its business model, earnings, balance sheet and debt.

**Fundamentals (economic):** A basic principle, rule, law, or the like, that serves as the groundwork of a system. Economic fundamentals are factors such as inflation, employment, economic growth.

**Futures:** A futures contract is a contract between two parties to buy or sell a particular commodity or financial instrument at a pre-determined price at a future date. Futures are traded on a regulated exchange.

**Gilts:** Fixed income securities issued by the UK government.

**Government bonds:** Fixed income securities issued by governments, that normally pay a fixed rate of interest over a given time period, at the end of which the initial investment is repaid.

**Hedging:** A method of reducing unnecessary or unintended risk.

**High water mark (HWM):** The highest level that a fund's NAV (net asset value) has reached at the end of any 12-month accounting period.

**High yield bonds:** Fixed income securities issued by companies with a low credit rating from a recognised credit rating agency. They are considered to be at higher risk of default than better quality, ie higher-rated fixed income securities but have the potential for higher rewards. Default means that a company or government is unable to meet interest payments or repay the initial investment amount at the end of a security's life.

**Historic yield:** The historic yield reflects distributions declared over the past 12 months as a percentage of the share price, as at the date shown.

**Income yield:** Refers to the income received from an investment and is usually expressed annually as a percentage based on the investment's cost, its current market value or face value.

**Index:** An index represents a particular market or a portion of it, serving as a performance indicator for that market.

**Income shares:** A type of share where distributions are paid out as cash on the payment date.

**Income units:** A type of unit where distributions are paid out as cash on the payment date.

**Index tracking:** A fund management strategy that aims to match the returns from a particular index.

**Index-linked bonds:** Fixed income securities where both the value of the loan and the interest payments are adjusted in line with inflation over the life of the security. Also referred to as inflation-linked bonds.

**Inflation:** The rate of increase in the cost of living. Inflation is usually quoted as an annual percentage, comparing the average price this month with the same month a year earlier.

**Inflation risk:** The risk that inflation will reduce the return of an investment in real terms.

**Initial public offering (IPO):** The first sale of shares by a private company to the public.

**Interest rate risk:** The risk that a fixed income investment will lose value if interest rates rise.

**Interest rate swap:** An agreement between two parties to swap a fixed interest payment with a variable interest payment over a specified period of time.

**Investment Association (IA):** The UK trade body that represents fund managers. It works with investment managers, liaising with government on matters of taxation and regulation, and also aims to help investors understand the industry and the investment options available to them.

**Issuer:** An entity that sells securities, such as fixed income securities and company shares.

**Investment grade bonds:** Fixed income securities issued by a company with a medium or high credit rating from a recognised credit rating agency. They are considered to be at lower risk from default than those issued by companies with lower credit ratings. Default means that a company or government is unable to meet interest payments or repay the initial investment amount at the end of a security's life.

**Issuer:** An entity that sells securities, such as fixed income securities and company shares.

**Leverage:** When referring to a company, leverage is the level of a company's debt in relation to its assets. A company with significantly more debt than capital is considered to be leveraged. It can also refer to a fund that borrows money or uses derivatives to magnify an investment position.

**Liquidity:** A company is considered highly liquid if it has plenty of cash at its disposal. A company's shares are considered highly liquid if they can be easily bought or sold since large amounts are regularly traded.

**Long position:** Refers to ownership of a security held in the expectation that the security will rise in value.

**Macroeconomic:** Refers to the performance and behaviour of an economy at the regional or national level. Macroeconomic factors such as economic output, unemployment, inflation and investment are key indicators of economic performance. Sometimes abbreviated to 'macro'.

**Maturity:** The length of time until the initial investment amount of a fixed income security is due to be repaid to the holder of the security.

**Modified duration:** A measure of the sensitivity of a fixed income security, called a bond, or bond fund to changes in interest rates. The longer a bond or bond fund's duration, the more sensitive it is to interest rate movements.

**Monetary easing:** When central banks lower interest rates or buy securities on the open market to increase the money in circulation.

**Monetary policy:** A central bank's regulation of money in circulation and interest rates.

**Monetary tightening:** When central banks raise interest rates or sell securities on the open market to decrease the money in circulation.

**Morningstar™:** A provider of independent investment research, including performance statistics and independent fund ratings.

**Near cash:** Deposits or investments with similar characteristics to cash.

**Net asset value (NAV):** A fund's net asset value is calculated by taking the current value of the fund's assets and subtracting its liabilities.

**Ongoing Charge Figure:** The Ongoing Charge figure represents the operating costs you can reasonably expect to pay under normal circumstances.

**Open-ended investment company (OEIC):** A type of managed fund, whose value is directly linked to the value of the fund's underlying investments.

**Options:** Financial contracts that offer the right, but not the obligation, to buy or sell an asset at a given price on or before a given date in the future.

**Over-the-counter (OTC):** Whereby financial assets are traded directly between two parties. This is in contrast to exchange trading, which is carried out through exchanges set up specifically for the purpose of trading. OTC is also known as off-exchange trading.

**Overweight:** If a fund is 'overweight' a stock, it holds a larger proportion of that stock than the comparable index or sector.

**Payment date:** The date on which distributions will be paid by the fund to investors, usually the last business day of the month.

**Physical assets:** An item of value that has tangible existence, for example, cash, equipment, inventory or real estate. Physical assets can also refer to securities, such as company shares or fixed income securities.

**Portfolio transaction cost:** The cost of trading, such as brokerage, clearing, exchange fees and bid-offer spread as well as taxes such as stamp duty.

**Preference shares:** Preference shares are a loan to a company that may be traded in the same way as ordinary shares, but generally have a higher yield and pay dividends on fixed dates. Preference shares have varying characteristics as to the treatment of the principal and the dividend payment, which includes ranking them above ordinary shares when it comes to dividend payments.

**Principal:** The face value of a fixed income security, which is the amount due back to the investor by the borrower when the security reaches the end of its life.

**Private placement:** An offer of sale of securities to a relatively small number of investors selected by the company, generally investment banks, mutual funds, insurance companies or pension funds.

**Property Expense Ratio (PER):** Property expenses are the operating expenses that relate to the management of the property assets in the portfolio. These include: insurance and rates, rent review and lease renewal costs and maintenance and repairs, but not improvements. They depend on the level of activity taking place within the fund. The Property Expense Ratio is the ratio of property expenses to the fund's net asset value.

**Real yield:** The return of an investment, adjusted for changes in prices in an economy.

**Retail Prices Index (RPI):** A UK inflation index that measures the rate of change in prices for a basket of goods and services in the UK, including mortgage payments and council tax.

**Risk:** The chance that an investment's return will be different to what is expected. Risk includes the possibility of losing some or all of the original investment.

**Risk management:** The term used to describe the activities the fund manager undertakes to limit the risk of a loss in a fund.

**Risk premium:** The difference between the return from a risk-free asset, such as a high-quality government bond or cash, and the return from an investment in any other asset. The risk premium can be considered the 'price' or 'pay-off' for taking on increased risk. A higher risk premium implies higher risk.

**Risk-free asset:** An asset that notionally carries no risk of non-payment by the borrower such as a high-quality fixed income security issued by a government or cash.

**Risk/reward ratio:** A ratio comparing the expected returns of an investment with the amount of risk undertaken.



# Glossary

**Safe-haven assets:** Refers to assets that investors perceive to be relatively safe from suffering a loss in times of market turmoil.

**Security:** Financial term for a paper asset – usually a share in a company or a fixed income security also known as a bond.

**Share class:** Each M&G fund has different share classes, such as A, R and I. Each has a different level of charges and minimum investment. Details on charges and minimum investments can be found in the Key Investor Information Documents.

**Share class hedging:** Activities undertaken in respect of hedged shares to mitigate the impact on performance of exchange rate movements between the fund's currency exposure and the investor's chosen currency.

**Short position:** A way for a fund manager to express his or her view that the market might fall in value.

**Short selling:** This often refers to the practice whereby an investor sells an asset they do not own. The investor borrows the asset from someone who does own it and pays a fee. The investor must eventually return the borrowed asset by buying it in the open market. If the asset has fallen in price, the investor buys it for less than they sold it for, thus making a profit. The contrary may also occur.

**Short-dated corporate bonds:** Fixed income securities issued by companies and repaid over relatively short periods.

**Short-dated government bonds:** Fixed income securities issued by governments and repaid over relatively short periods.

**Sovereign debt:** Debt of a government. Also referred to as government bonds.

**Sub-investment grade bonds:** Fixed income securities issued by a company with a low rating from a recognised credit rating agency. They are considered to be at higher risk from default than those issued by companies with higher credit ratings. Default means that a company or government is unable to meet interest payments or repay the initial investment amount at the end of a security's life.

**Suspended:** Temporarily halting the trading of a listed security on the stock exchange. It can be voluntary (requested by the issuing company) or imposed by regulators. Typically, trading suspensions are introduced ahead of important news announcements, following technical glitches, or due to regulatory concerns.

**Top-down investing:** An investment approach that analyses economic factors, ie surveys the 'big picture', before selecting which companies to invest in. The top-down investor will look at which industries are likely to generate the best returns in certain economic conditions and limit the search to that area.

**Total return:** The term for the gain or loss derived from an investment over a particular period. Total return includes income (in the form of interest or dividend payments) and capital gains.

**Treasuries:** Fixed income securities issued by the US government.

**Triple A or AAA rated:** The highest possible rating a fixed income security, also called a bond, can be assigned by credit rating agencies. Bonds that are rated AAA are perceived to have the lowest risk of default. Default means that a company or government is unable to meet interest payments or repay the initial investment amount at the end of a security's life.

**UCITS:** Stands for Undertakings for Collective Investment in Transferable Securities. This is the European regulatory framework for an investment vehicle that can be marketed across the European Union and is designed to enhance the single market in financial assets while maintaining high levels of investor protection.

**Unconstrained:** The term used to describe the mandate of a fund whereby the manager has the freedom to invest according to his or her own strategy, not being obliged to allocate capital according to the weightings of any index, for example.

**Underlying value:** The fundamental value of a company, reflecting both tangible and intangible assets, rather than the current market value.

**Underlying yield:** Refers to the income received by a managed fund, and is usually expressed annually as a percentage based on the fund's current value.

**Underweight:** If a portfolio is 'underweight' a stock, it holds a smaller proportion of that stock than the comparable index or sector.

**Unit trust:** A type of managed fund, whose value is directly linked to the value of the fund's underlying investments.

**Unit/share type:** Type of units/shares held by investors in a trust or fund (unit/share types differ by features such as whether income is to be paid out as cash or reinvested on the payment date).

**Unlisted/unquoted stocks:** Shares of ownership in companies that are not listed on a public exchange, known as private companies.

**Valuation:** The worth of an asset or company based on its current price.

**Volatile:** When the value of a particular share, market or sector swings up and down fairly frequently and/or significantly, it is considered volatile.

**Volatility:** The degree to which a given security, fund, or index rapidly changes. It is calculated as the degree of deviation from the norm for that type of investment over a given time period. The higher the volatility, the riskier the security tends to be.

**Warrant:** A security issued by a company that gives the holder the right to buy shares in that company at a specified price and within a certain timeframe.

**Yield:** This refers to either the interest received from a fixed income security or to the dividends received from a share. It is usually expressed as a percentage based on the investment's costs, its current market value or its face value. Dividends represent a share in the profits of the company and are paid out to a company's shareholders at set times of the year.

**Yield (equity):** Refers to the dividends received by a holder of company shares and is usually expressed annually as a percentage based on the investment's cost, its current market value or face value. Dividends represent a share in the profits of the company and are paid out to a company's shareholders at set times of the year.

**Yield (bonds):** This refers to the interest received from a fixed income security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

**Yield (income):** Refers to the income received from an investment and is usually expressed annually as a percentage based on the investment's cost, its current market value or face value.

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