M&G UK Select Fund

Annual Short Report May 2020
For the year ended 31 May 2020

M&G INVESTMENTS

M&G UK Select Fund

Fund information

The Authorised Corporate Director (ACD) of M&G Investment Funds (2) presents its Annual Short Report for M&G UK Select Fund which contains a review of the fund's investment activities and investment performance during the period. The ACD's Annual Long Report and audited Financial Statements for M&G Investment Funds (2), incorporating all the sub-funds and a Glossary of terms is available free of charge either from our website at www.mandg.co.uk/reports or by calling M&G Customer Relations on 0800 390 390.

We have published an annual value assessment delivered to investors in this fund, including an assessment of our charges and services, and how we compare to our competitors. This is available at https: // www.mandg.co.uk/ investor/fund-prices-performance/ annual value-assessment.

ACD

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(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)).

Important information

As per the shareholder letter issued 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 be easier to compare to 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 on the KIID for the share class(es) you are invested in, visit our website www.mandg.co.uk.

The World Health Organisation declared the COVID-19 outbreak a pandemic on 11 March 2020.

Global financial markets have been reacting to the outbreak. All markets have incurred increased volatility and uncertainty since the onset of the pandemic.

The ACD has also noted the operational risks that are posed to the Company and its service providers due to global and local movement restrictions that have been enacted by various governments.

The COVID-19 pandemic is an unprecedented event and the eventual impact on the global economy and markets will largely depend on the scale and duration of the outbreak. The ACD will continue to monitor this situation.

Investment objective

The fund aims to provide a higher total return (the combination of capital growth and income), net of the ongoing charge figure, than that of the FTSE All-Share Index over any five-year period.

Investment policy

At least 80% of the fund is invested directly in equity securities and equity-related securities of companies across any sectors and market capitalisations, that are incorporated, domiciled, listed or do most of their business in the United Kingdom.

The fund usually holds a concentrated portfolio of fewer than 50 companies.

The fund may also invest in other transferable securities directly and via collective investment schemes (including funds managed by M&G).

The fund may also hold cash and near cash for liquidity purposes.

Derivatives may be used for efficient portfolio management and hedging.

Investment approach

The fund employs a disciplined approach to investment which concentrates on the analysis and selection of individual companies.

The investment approach seeks to identify UK companies that have sustainable competitive advantages leading to high return on invested capital. Each company's strategy around capital allocation is central to the investment process.

M&G UK Select Fund

Fund information

Investment approach

The fund manager focuses on companies which recognise the importance of dividends, which in turn instils capital discipline and ensures that the highest returning growth projects are prioritised.

Rising cashflow, and over time, rising dividends, for the fund's holdings are expected to drive the long-term total return of the fund.

Benchmark up to 22 March 2020

Benchmark: FTSE All-Share Index

The fund is actively managed. The benchmark is a target which the fund seeks to outperform. The index has been chosen as the fund's target benchmark as it best reflects the scope of 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.

For unhedged Share Classes, the benchmark is shown in the Share Class currency.

Benchmark from 23 March 2020

Benchmark: FTSE All-Share Index

The benchmark is a target which the fund seeks to outperform. The index has been chosen as the fund's benchmark as it best reflects the scope of the fund's investment policy. The benchmark is used solely to measure the fund's performance and does not constrain the fund's portfolio construction.

The fund is actively managed.

The fund manager has complete freedom in choosing which investments to buy, hold and sell in the fund. The fund's holdings may deviate significantly from the benchmark's constituents.

For unhedged Share Classes, the benchmark is shown in the Share Class currency.

Risk profile

The fund invests in the shares of UK-listed companies and is, therefore, subject to the price volatility of the UK stockmarket and the performance of individual companies. The fund typically holds around 50 stocks and this relatively concentrated profile requires the fund manager to have strong conviction in each and every holding. However, the fund is mainly invested in the shares of large and medium-sized companies, which are normally traded with relative ease.

Diversification is key in managing liquidity risk and reducing market risk. 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 'A' shares.

Low risk ← → High risk

Typically lower rewards — Typically higher rewards

1	2	3	4	**5**	6	7

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.

M&G UK Select Fund

Investment review

As at 1 June 2020, for the year ended 31 May 2020

Performance against objective

Between 3 June 2019 (the start of the review period) and 1 June 2020, the fund delivered a negative total return (the combination of income and growth of capital) across all share classes but outperformed the benchmark FTSE All-Share Index, which fell by -10.0% in sterling, and -10.6% in euros.*

On 1 March 2019 the fund's objective changed to aiming to provide a higher total return (the combination of capital growth and income), net of the Ongoing Charge Figure, than that of the FTSE All-Share Index over any five-year period. The fund's performance against its new objective over five years was mixed. Fund returns were broadly in line with the FTSE All-Share Index which returned 1.7% p.a. in sterling and -2.7% p.a. in euros.*

* For the performance of each share class, please refer to the 'Long-term performance by share class' table in the 'Financial highlights' section of the Annual Long Report and audited Financial Statements for M&G Investment Funds (2).

To give an indication of the performance of the fund, the following table shows the compound rate of return, per annum, over the period for Sterling Class 'A' (Accumulation) shares. Calculated on a price to price basis with income reinvested.

Long-term performance

	One year 03.06.19 % [a]	Three years 01.06.17 % p.a.	Five years 01.06.15 % p.a.	Since launch % p.a.
Sterling [b]				
Class 'A'	-3.0	-0.6	+1.2	+9.2 [c]

[a] Absolute basis.

[b] Price to price with income reinvested.

[c] 17 December 1968, the end of the initial offer period of the predecessor unit trust.

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.

Investment performance

The year to June 2020 has been one of the most extreme and volatile in financial market history. Ultimately, the net return for the FTSE All Share over the 12 months was -10%. However, behind the headline number were a couple of significant events.

The first of these was Boris Johnson's landslide victory in the UK election. Ever since the 2016 referendum, a deep fog of uncertainty has evolved around Brexit, causing the FTSE All-Share to materially underperform its global counterparts. As the prime minister first secured his exit deal with the European Union (EU), and then went on to dominate the election, sentiment inflected rapidly towards a more positive outlook. The markets' response was unequivocal, with the dramatic bounce of both sterling and the FTSE All-Share demonstrating the constrained power that can be unleashed when uncertainty unwinds. From 3 June 2019 to the calendar year end, the FTSE All-Share had returned a positive 9.4%.

We entered 2020 with many global equity indices nearing or hitting all-time records. However, the market can't price what it cannot see, and it was blissfully unaware of the impending coronavirus pandemic. As cases rapidly spread globally, most notably in Italy and South Korea, it became evident that a systematic shutting down of the global economy would be required to bring the pandemic under control. Over a matter of weeks, the FTSE All-Share would fall 35% from its January highs. In response, central banks and governments unleashed a tsunami of measures such as unlimited quantitative easing – purchases of financial assets from the markets – interest rates slashed to near-zero, and trillions of US dollars in stimulus and support packages. Never before have we witnessed such a threat to a globalised society and world order, and not since WWII have we seen such radical countermeasures.

Incredibly, despite a troubling macroeconomic picture, equity markets experienced somewhat of a resurgence after the March nadir, with the FTSE All-Share up 25% by 1 June 2020. The combination of massive stimulus and emerging green shoots of economic optimism as countries eased their respective lockdowns re-energised financial markets.

M&G UK Select Fund

Investment review

Investment performance

Of course, we never like to see negative returns for investors; however, compared to the market as a whole, in our view the M&G UK Select Fund has been a relative bastion of safety during the market volatility. Although the extreme volatility has often felt indiscriminate, it is abundantly clear that high-quality companies with less indebtedness and robust business models have been rewarded.

Two of the top contributors to the fund's performance were the subject of takeover approaches in the second half of 2019, when the combination of a weak pound and relatively cheap valuations of UK equities attracted international buyers to the market. Last year, bids for cyber security firm Sophos, which succeeded, and the London Stock Exchange, which ultimately failed, boosted their share prices considerably.

Other notable contributions included Fevertree, the premium alcoholic mixer producer, which rebounded strongly from its oversold March levels. As expected, two of our most defensive healthcare companies, AstraZeneca and ConvaTec, proved their worth as stable performers during the market volatility. Meanwhile, pork and poultry producer Cranswick benefited enormously from the shift to off-trade consumption during lockdown as well as from surging Chinese demand for pork due to the African Swine Flu that has crippled their domestic herd.

The main negative contributors at the stock level were Burford Capital, an AIM (Alternative Investment Market)-listed company providing specialised finance to the legal world, IQE, a Welsh-based manufacturer of innovative compound semiconductors that go into high-end technology applications, On the Beach, an online travel agent, WH Smith, the high street and transport hub retailer, and Standard Chartered, the emerging market-focused banking group.

Burford was subject to an attack by a specialist US short-seller, Muddy Waters. We used the drastic share price reaction to increase the fund's position. IQE suffered from end-market weakness in smartphones, as well as the US-China trade spats; however, we believe that these will pass at some point. On the Beach and WH Smith were affected by the collapse in travel and the high street shutdown. Meanwhile, Standard Chartered was under pressure from low interest rates and cancelled dividends, as well as rising tensions over China's plans to curtail Hong Kong's autonomy.

Investment activities

Although we like to invest in high-quality businesses that tend to trade at a premium to the market, we are big believers in quality and intrinsic value being mutually inclusive. Market volatility often provides us the opening to marry the two. Over the past 12 months we have made 11 new investments.

Through 2019 this was orientated towards UK domestic cyclicals that had underperformed whilst the market was punishing UK equities. FDM, Close Brothers and Watkin Jones were all bought at what we thought were unfairly discounted valuations. We also used the noise surrounding the US/China trade dispute to start a position in AIA, the Hong Kong listed life insurer.

Coming into 2020, the fund had been carrying a healthy level of cash. This proved invaluable as the market rapidly deteriorated throughout the first quarter, with some investments that we had long idolised coming into our valuation cross-hairs. As a consequence we initiated positions in Ashtead, Games Workshop, Coats, Fevertree, Asos, UDG and Total. We felt at the time, and still do now, that the collapse in share prices provided a once-in-a-decade opportunity to significantly enhance the portfolio by adding positions that will fuel the next 5-10 years of performance.

Coats is a market leader in manufacturing fabrics into numerous end-markets, the most significant of which is the apparel and footwear industry. This industry has long been characterised by commoditisation and a race to the bottom on price. However, technology, material innovations and the push to sustainable supply is causing the whole value chain to professionalise. Coats is pioneering that trend. We think it is greatly under-appreciated for its quality attributes and long-term potential. Coats was an early victim of coronavirus due to its Asian manufacturing footprint. This gave us a unique chance to step in and buy the shares.

Fevertree is a well-known brand among premium G&T drinkers. Fevertree's savvy founders created a whole new category of premium mixers for alcoholic drinks. These premium mixers then provided the catalyst for a gin revolution. Fevertree went from zero to nearly 45% of the tonic category, whilst gin consumption doubled. 2019, however, proved to be a bit of a hangover year. Gin consumption started to peak and Fevertree's share gain matured. Furthermore, excitement over their US business deflated when

Investment activities

they announced a price cut to stimulate the market. The shares fell from £40 to £10 in just over a year. We felt that £10 offered exceptional value and used the opportunity to build a position.

Over the last decade or so, Asos has created an unassailable position as the online department store for fashion-conscious 15 to 35-year olds. In order to build out their distribution leadership in the UK, Europe and the US, Asos has spent an incredible amount of capital (capex) on automated distribution centres. We believe the company is now through its capex peak, and although that proved a hard pill to swallow, we think it extends their competitive position beyond comprehension. As the high street continues its slow death, Asos' profitability and cash generation should, in our view, skyrocket. Coronavirus will only perpetuate that trend.

UDG is an outsourcer to the pharmaceutical industry. Its Ashfield business acts as a PR, communications and sales agency to big pharma. Its Sharp division is a very well regarded contract manufacturer of pharma products. The healthcare end-market is one we particularly like due to ever-increasing healthcare needs from ageing populations and shift towards big-pharma outsourcing. This company should be able to provide robust and long-term sustainable growth, solid cash generation and healthy returns on capital. Besides, its dividend discipline dates back to 1987.

Games Workshop is a branded manufacturer of small fantasy figurines, known most widely for its Warhammer brand. It is often wrongly characterised as a pure retailer, whilst we think it should be considered more for its enormous unlocked brand value. In recent years it has done a great job internationalising the business, using wholesale and online channels to sell products, and also exploring monetising the brand through TV, film and games partnerships. We still think the company is in the foothills of the journey to unleash the Warhammer brand potential. A glance toward Lego, Marvel, DC Comics, Star Wars etc, shows what can be done with popular and enduring brand franchises.

Ashtead is a leading rental equipment company with a significant exposure to the US market. The rental industry has historically struggled in difficult economic conditions as players slashed prices and sold equipment to raise cash. Since the financial crisis of 2008/9, the industry has consolidated considerably. Technology and scale are becoming ever more important, squeezing out the tail of 'mom & pop' operators. We believe that irrational pricing pressure in this crisis will be far less extreme. We don't think the market understands the structural improvement in the industry, and therefore Ashtead's ability to create value across the economic cycle.

The energy market has been under enormous pressure amidst the coronavirus pandemic due to capitulating demand and excess supply, a problem exacerbated by disagreements between the OPEC+ members. Longer term, we remain deeply sceptical about how the oil majors will cope with the energy transition towards 'net zero' emissions. However, the collapse in share prices across the sector was disproportionate to the medium-term outlook, as demand recovers and underinvestment in new production begins to taper supply. Given this backdrop, we felt it was the right thing to do to diversify our exposure in the sector by adding Total and reducing our positions in BP and Royal Dutch Shell.

As part of the continued portfolio transition under the new fund manager, a number of positions were exited during the 12-month period. These included Hiscox, Sage, Next Fifteen Communications, Methanex, DS Smith, Essentra, Burberry, Dechra, Liontrust, Lloyds Banking Group, Prudential and AG Barr.

Outlook

The big question on everyone's mind is whether the recent resurgence in equity markets is the start of something sustainable or a bear market rally.

Bulls will point towards near-unlimited quantitative easing flooding financial markets with investable liquidity, green shoots of economic activity as lockdowns ease and the potential for a vaccine to be discovered. On the flip side, we are still being held in an artificially benign economic comatose state, with unfettered government funding providing the life support. Only when that life support is removed will we see the true long-term damage caused and the underlying level of bankruptcies, debt defaults and unemployment. In a socially distanced world, great swathes of industries and companies will struggle to operate profitably when capacity utilisation is forcibly limited. There also exists the distinct risk of a second wave of infections leading to subsequent restrictions.

Specific to the UK market, Brexit narrative will return to the forefront of people's attention. The Conservative government remains committed to avoiding an extension in negotiating the future trade deal. Negotiations have begun on rocky grounds, with massive distance between both sides on the subjects of ongoing governance, sovereignty and a level playing field

Outlook

on goods and services. Expect the rhetoric from each side to sour as both the UK and EU stubbornly hold firm. No doubt this will again go down to the wire. Whatever deal gets struck will likely be quite bare bones, whilst the risk of no deal is a material possibility. As in 2019, the closer we get to a resolution, the more likely the UK's valuation discount to other markets will start to unwind, but the process of getting there could be painful.

Ultimately, we still think the overall outlook remains clouded with uncertainty despite the rebound in equity markets suggesting a V-shaped recovery is the consensus. In light of this, looking ahead, to survive this potentially extended period of limited economic activity it is obvious that businesses with more resilient balance sheets and revenue models have a better chance of surviving and then thriving. When the coronavirus clouds part, companies that come out the other side relatively unscathed will be in an even more advantageous position versus the competition. We should be clear in saying that not every one of the M&G UK Select Fund's holdings has avoided or will avoid seeking governmental aid, cutting dividends or issuing new equity. However, we believe that as a collective, the portfolio should endure any turbulent economic conditions more comfortably than the market as a whole.

With the M&G UK Select Fund, we try to build a concentrated portfolio of compelling investments without taking macroeconomic views. We like our companies to do the talking, buying what we believe to be good-quality businesses that can generate shareholder value over the long term. We leave tactical short-termism to the traders and focus our attention on finding great investment opportunities no matter the noise coming from the macroeconomic backdrop.

Rory Alexander
Fund manager

An employee 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 UK Select Fund

Investment review

Classification of investments

The table below shows the percentage holding per sector.

	% of fund	
as at 31 May	**2020**	**2019** [a]
EQUITIES		
Software & computer services	1.89	5.30
Technology hardware & equipment	1.06	0.40
Medical equipment & services	5.71	3.53
Pharmaceuticals & biotechnology	10.15	6.11
Banks	4.75	9.07
Finance & credit services	2.82	4.31
Investment banking & brokerage services	7.70	8.44
Life insurance	2.76	4.37
Non-life insurance	0.00	2.31
Household goods & home construction	7.58	5.66
Leisure goods	2.51	0.00
Personal goods	4.63	6.83
Media	4.00	4.33
Retailers	3.63	3.76
Travel & leisure	1.02	1.85
Beverages	2.54	0.82
Food producers	2.57	3.02
Tobacco	3.89	3.07
Construction & materials	1.73	0.40
General industrials	3.61	3.39
Industrial engineering	3.25	4.38
Industrial support services	7.11	4.65
Industrial transportation	1.80	0.48
Chemicals	1.51	3.03
Non-renewable energy	5.87	6.93
Unquoted / unlisted	0.00	0.00
CASH EQUIVALENTS		
'AAA' rated money market funds [b]	6.52	7.75

[a] The comparative sector weightings have been re-analysed to reflect changes to the sector classifications.

[b] Uncommitted surplus cash is placed into 'AAA' rated money market funds with the aim of reducing counterparty risk.

Top ten portfolio transactions

for the year to 31 May	
Largest purchases	**£'000**
Royal Dutch Shell	29,648
Hutchison China MediTech ADR	14,197
Polypipe	11,983
Coats	11,538
Burford Capital	11,245
Watkin Jones	11,161
Total	10,522
IQE	9,898
Clarkson	9,698
Prudential	9,446
Other purchases	116,821
Total purchases	**246,157**

Largest sales	**£'000**
Lloyds Banking	19,568
BP	18,665
London Stock Exchange	18,019
Prudential	17,545
Sophos	17,368
Unilever	13,533
Hiscox	12,332
ConvaTec	10,661
St. James's Place	10,381
WH Smith	10,055
Other sales	129,705
Total sales	**277,832**

Purchases and sales exclude the cost and proceeds of 'AAA' rated money market funds.

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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 charts and tables reflect the key financial information of a representative share class, Sterling Class 'A' (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 (2), which is available free of charge either from our website at www.mandg.co.uk/prospectuses or by calling M&G Customer Relations.

Fund level performance

Fund net asset value

as at 31 May	2020 £'000	2019 £'000	2018 £'000
Fund net asset value (NAV)	535,323	581,167	601,265

Performance since launch

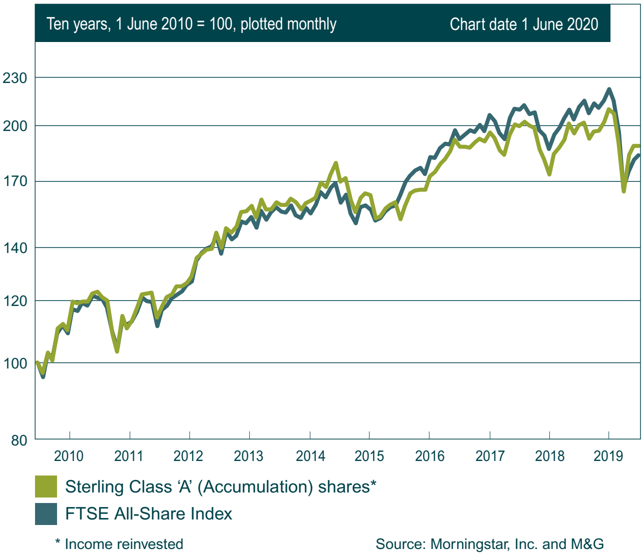
To give an indication of how the fund has performed since launch, the chart below shows total return of Sterling Class 'A' (Accumulation) shares.

M&G UK Select Fund

Financial highlights

Ten-year performance

Please note that comparative data is not available from fund launch. Therefore a ten-year comparable performance chart is shown below.



To give an indication of how the fund has performed during the period the table on the following page shows the performance of Sterling Class 'A' (Accumulation) shares.

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 5 June 2020.

Sterling Class 'A' Accumulation share performance

The share class was launched on 17 December 1968.			
for the year to 31 May	2020	2019	2018
Change in NAV per share	**UK p**	**UK p**	**UK p**
Opening NAV	4,652.54	4,809.42	4,598.26
Return before operating charges and after direct portfolio transaction costs	(87.60)	(80.52)	286.79
Operating charges	(59.01)	(76.36)	(75.63)
Return after operating charges	(146.61)	(156.88)	211.16
Distributions	(52.74)	(73.22)	(52.09)
Retained distributions	52.74	73.22	52.09
Closing NAV	4,505.93	4,652.54	4,809.42
Direct portfolio transaction costs	**UK p**	**UK p**	**UK p**
Costs before dilution adjustments	8.61	11.87	7.84
Dilution adjustments [a]	(0.62)	(1.67)	(0.26)
Total direct portfolio transaction costs	7.99	10.20	7.58
Performance and charges	**%**	**%**	**%**
Direct portfolio transaction costs [b]	0.18	0.22	0.16
Operating charges [c]	1.28	1.66	1.66
Return after operating charges	-3.15	-3.26	+4.59
Historic yield	1.13	1.56	1.08
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV (£'000)	163,588	180,828	203,795
Closing NAV percentage of total fund NAV (%)	30.56	31.11	33.89
Number of shares	3,630,503	3,886,649	4,237,421
Highest share price UK p	5,094.93	4,884.05	4,872.93
Lowest share price UK p	3,444.47	4,081.30	4,306.59

[a] In respect of direct portfolio transaction costs.

[b] As a percentage of average net asset value.

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

Operating charges and portfolio transaction costs

We explain below the payments made to meet the ongoing costs of investing and managing the fund, comprising operating charges 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 of 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.
- **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.

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 classesmay differ, and therefore the operating charges 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. As the fund invests mainly in fixed interest securities, the direct transaction costs paid on other investments are too small to be reflected in the table below. To give an indication of the indirect portfolio dealing costs the table 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 or by calling M&G Customer Relations.

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Financial highlights

Portfolio transaction costs

Portfolio transaction costs

for the year to 31 May Direct portfolio transaction costs [b]	2020 %	2019 %	2018 %	Average [a] %
Broker commission	0.04	0.04	0.03	0.04
Taxes	0.15	0.22	0.14	0.17
Costs before dilution adjustments	0.19	0.26	0.17	0.21
Dilution adjustments [c]	(0.01)	(0.04)	(0.01)	(0.02)
Total direct portfolio transaction costs	0.18	0.22	0.16	0.19

as at 31 May Indirect portfolio transaction costs	2020 %	2019 %	2018 %	Average [a] %
Average portfolio dealing spread	0.13	0.12	0.09	0.11

[a] Average of first three columns.

[b] As a percentage of average net asset value.

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

Contact

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** Please remember to quote your name and M&G client reference and sign any written communication to M&G.

† Please note that information contained within an email cannot be guaranteed as secure. We advise that you do not include any sensitive information when corresponding with M&G in this way.

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