M&G (Lux) Conservative Allocation Fund
Euro Class A – Accumulation shares

M&G Investments

Quarterly Fund Review as at 31 December 2020

Fund manager(s) – Craig Moran, Steven Andrew

For investment professionals only

Highlights

- Despite an uncertain start, the final quarter of a highly eventful year delivered further strength for risk assets, with many equity markets finishing 2020 close to multi-year or all-time record highs.
- The fund produced a strongly positive return for the quarter, largely from its allocation to global equities.
- The only changes to the portfolio were made in November, when, following some very strong performance, we reversed some of the tactical equity additions made in September.

The main risks associated with this fund

For any past performance shown, please note that past performance is not a guide to future performance.
The value and income from the fund's assets will go down as well as up. This will cause the value of your investment to fall as well as rise. There is no guarantee that the fund will achieve its objective and you may get back less than you originally invested.
Investments in bonds are affected by interest rates, inflation and credit ratings. It is possible that bond issuers will not pay interest or return the capital. All of these events can reduce the value of bonds held by the fund.
The fund may use derivatives to profit from an expected rise or fall in the value of an asset. Should the asset's value vary in an unexpected way, the fund will incur a loss. The fund's use of derivatives may be extensive and exceed the value of its assets (leverage). This has the effect of magnifying the size of losses and gains, resulting in greater fluctuations in the value of the fund.
The fund is exposed to different currencies. Derivatives are used to minimise, but may not always eliminate, the impact of movements in currency exchange rates.
Investing in emerging markets involves a greater risk of loss as there may be difficulties in buying, selling, safekeeping or valuing investments in such countries.
Further risk factors that apply to the fund can be found in the fund's Key Investor Information Document (KIID).

Things you should know

The fund allows for the extensive use of derivatives.
Performance is stated in the share class currency, which may differ from your domestic currency. As a result, the return may rise or fall due to currency movements.

Fund performance

	3 months (%)	YTD (%)	1 year (%)	3 years (%) p.a.	5 years (%) p.a.
Euro A Accumulation	5,8%	-1,6%	-1,6%	-0,8%	2,4%
Sector	3,2%	1,4%	1,4%	1,1%	1,4%
Quartile ranking	1	4	4	4	2

Single year performance (5 years)

	2020	2019	2018	2017	2016
Euro A Accumulation	-1,6%	7,5%	-7,7%	5,8%	9,2%
Sector	1,5%	7,5%	-4,9%	2,1%	1,9%
Quartile ranking	4	3	4	1	1

Past performance is not a guide to future performance.

Sector= Morningstar EUR Cautious Allocation - Global sector

The fund is actively managed and has no benchmark. Investors can assess the performance of the fund by its objective to provide a total return of 3-6% per annum over any three-year period.

Fund performance prior to 16 January 2018 is that of the M&G Prudent Allocation Fund (a UK-authorised OEIC) which merged into this fund on 16 March 2018. Tax rates and charges may differ. 'Since launch' refers to the launch date of the equivalent OEIC.

Source: Morningstar, Inc and M&G, as at 31 December 2020. Returns are calculated on a price to price basis with income reinvested.

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Portfolio construction (%)

	Net allocation range	Neutrality
Equity	0-35	20,0
Fixed income	0-100	70,0
Other	0-20	10,0
Currency	Min 60% euro (or hedged to euro)	

Leverage and volatility

	Fund
Gross leverage	0,9x
Net leverage	0,8x
Volatility	9,3%

VaR analysis (%)

	Fund
1 month 99% VaR	6,6

Largest exposures (excl. cash, %)

	Fund
US Government 30Y	20,3
Eurozone cdx	5,0
US equity	4,1
S&P500 emini index future	4,0
US fixed	3,4
UK equity	3,1
Topix index future	3,0
Greencoat UK Wind	2,2
M&G (Lux) Global Convertible Fund	2,2
UK swaps other	-4,9

Currency breakdown (%)

	Fund
Euro	88,6
Japanese yen	3,0
US dollar	2,6
British pound	2,6
Mexican peso	2,0
South African rand	1,6
Indonesian rupiah	1,5
Hong Kong dollar	1,0
Turkish lira	0,2
Other	-3,1

Asset breakdown (%)

	Long exposure	Short exposure	Net exposure
Equity	**22,0**	**0,0**	**22,0**
UK	2,9	0,0	2,9
Europe	4,2	0,0	4,2
North America	8,5	0,0	8,5
Japan	3,0	0,0	3,0
Asia Pacific ex Japan	3,3	0,0	3,3
Global	0,0	0,0	0,0
Emerging markets	0,0	0,0	0,0
Government bonds	**33,5**	**-4,9**	**28,6**
UK	0,0	-4,9	-4,9
Europe	0,0	0,0	0,0
North America	20,3	0,0	20,3
Japan	0,0	0,0	0,0
Other Developed Markets	5,0	0,0	5,0
Emerging markets	8,2	0,0	8,2
Corporate bonds	**15,9**	**0,0**	**15,9**
Investment grade bonds	10,4	0,0	10,4
High yield bonds	5,4	0,0	5,4
Convertible bonds	**2,2**	**0,0**	**2,2**
Infrastructure	7,6	0,0	7,6
Property	0,0	0,0	0,0
Other	0,0	0,0	0,0
Residual cash	0,0	0,0	23,8

Commentary

Despite an uncertain start, the final quarter of a highly eventful year delivered further strength for risk assets, with many equity markets finishing 2020 close to multi-year or all-time record highs.

Initially, a resurgence in the number of COVID-19 infections, which caused the re-imposition of restrictions on travel and social gatherings in various countries, weighed on equity markets, with investors upset by the likely negative impact on economic activity. However, the discovery of effective vaccines to protect against the disease was seen as a game changer, raising hopes that a return to more normal behaviour might be possible. Investors rushed to buy equities and many stockmarkets experienced record breaking rallies.

Other encouraging news during the quarter included a better-than-feared corporate results season, a seemingly definitive result in the US election, the agreement of a trade deal between the UK and the European Union and the eventual passage of a financial support plan in the US. All these combined to overcome another worrying rise in new infections, together with the consequent lockdowns, plus the discovery of new, more infectious, strains of the disease.

The surge in share prices in the quarter was led by European banks, emerging markets, the UK mid-cap index, Spain and Japan. Fixed income markets reflected the greater appetite for risk, with emerging market bonds and high yield credit outperforming investment grade corporate bonds and government debt. US government bonds were one of the few assets to decline in the period.

In the currency markets, the US dollar declined relative to most major currencies, with sterling and the euro being particularly strong. Most emerging markets' currencies strengthened as well. Finally, hopes of economic recovery supported commodity prices, especially oil, though gold lagged.

The fund produced a positive return for the quarter, largely from its allocation to global equities. The largest contributors to returns were the 'basket' of banking stocks, followed by exposure to Europe and Asia ex Japan, although all equity positions contributed.

Government bond holdings also added to gains overall, with a positive contribution coming from non-mainstream government bonds, particularly Mexico and South Africa, both of which saw yields fall during the quarter. However, the allocation to long-dated US government bonds detracted. Corporate bond holdings were positive, led by the allocation to BBB bonds and credit funds; the allocation to emerging market bond funds also contributed. The alternatives portion of the portfolio was a significant contributor to performance, with by far the largest share coming from the Unibail Rodamco holding. The convertibles holding also contributed. Currency movements were positive for performance.

Portfolio activity

The only changes to the portfolio during the quarter were made in November, when, following some very strong performance, we reversed some of the tactical equity additions made in September, reducing the total target equity weighting from 25% to 21%. We reduced the weighting to the S&P 500, Euro Stoxx and Kospi indices, and sector exposures to UK miners and US banks. We remain broadly diversified geographically, while being tilted towards cyclical sectors that have lagged the recovery (banks and mining stocks) as we believe that they offer attractive medium to long-term value. For similar reasons, we reduced our allocations to emerging market government bonds and currencies. In aggregate, the portfolio's equity positions remain more geographically diversified than the MSCI World Index. Consequently, we are generally less exposed than our peers to the US market and technology sectors.

We also added to our holding of 30-year US Treasuries, as in our view a moderate sell-off at the long end of the US yield curve offered a good opportunity to buy long-dated US government bonds. We continue to view these as a useful counterbalance, in risk terms, to our equity positions within the portfolio. We believe that a benign inflation environment and central banks' desire to anchor rates lower should help moderate further pressure on rates moving up. At the same time, we closed our 2% position in 30-year US TIPS.

We also took the opportunity presented by US dollar weakness to open a 2% target position in the currency, having hedged our exposure for some time. This reintroduction is in line with our general reluctance to take bets on major currency pairs to avoid non-episodic currency movements becoming a dominant source of returns.

These changes aimed to make the shape of the fund more balanced and with a greater capital preservation focus, whilst still allowing it to participate in the ongoing recovery.

Outlook

As we enter 2021, we remain focused, as ever, on the relationship between current expectations, valuations and prices, as we aim to discern where we believe the market might be making a 'mistake'. We believe that this is especially likely where there is a strong consensus; in terms of the outlook for the year, we observe that most investors expect a 'cyclical' recovery in the second half of the year, fuelled by successful vaccine rollouts. A rotation into 'value' segments of the market, which are expected to benefit from a gradual re-opening of economies, is another common theme. It is also possible that, after a year spent grappling with the pandemic and its policy responses, markets may be more vulnerable to surprises from other sources. We are therefore mindful of the potential for surprise market outcomes, and remain positioned accordingly.

Clearly, the prospect of mass vaccination is very encouraging, although much uncertainty remains over the short term, especially the impact on the economy of the severe restrictions being imposed to combat the rising number of virus cases and new, more infectious, strains of the disease being identified.

Depending on the timing and efficiency of the immunisation strategy, which could eventually lead to a resolution of the pandemic crisis, we would hope to see a normalisation of corporate earnings in the next 12 to 18 months. If that were to happen, we might expect, in our view, those companies and sectors that have lagged behind the price recovery since March, including banks, consumer services and 'value' stocks in general, to recover at least some of the ground lost. This is just the sort of price action we saw in the vaccine-induced 'risk on' rally in November.

Approach to responsible investment

	Yes	No	N/A
ESG integration		✓	
Additional ESG specifications		✓	
Exclusions	✓		
Cluster munitions & anti personnel landmines	✓		
Other exclusions or restrictions		✓	
Voting			✓
Engagement			✓

Please see glossary for further explanation of these terms.

ESG Standard Glossary

Additional ESG specifications: In the context of M&G, these are funds managed with an explicit ESG objective, outcome or in accordance with specific ESG criteria, and will have a number of minimum exclusions in place.

Engagement: Interaction with company management on various financial and non-financial, including ESG, issues. Engagement allows investors to better understand how a company is undertaking its operations and how it is interacting with its stakeholders, as well as advising on and influencing company behaviour and disclosures where appropriate.

ESG integration: Describes the explicit and systematic inclusion of Environmental, Social and Governance factors in investment analysis and investment decisions. It underpins a responsible investment approach, and allows investors to better manage risk and generate sustainable, long-term returns.

Exclusions: The exclusion or restriction of investments based on the sector in which they operate, the products or services they provide or for other specific criteria, i.e. they are deemed to be in breach of the United Nations Global Compact principles on human rights, labour the environment and anti-corruption.

Voting: As the partial owners of a company, shareholders have the right to vote on resolutions put forward at a company's annual general meeting. These resolutions include the re-election of directors, executive remuneration and business strategy, among others, and may include resolutions put forward by shareholders.

Important information

On 16 March 2018, the M&G Prudent Allocation Fund, a UK-authorised OEIC, which launched on 23 April 2015, merged into the M&G (Lux) Conservative Allocation Fund, a Luxembourg-authorised SICAV, which launched on 16 January 2018. The SICAV is run by the same fund managers, applying the same investment strategy, as the UK-authorised OEIC.

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

Where a security has not been rated by Standard & Poor's, Fitch or Moody's, we may use M&G's internal credit rating. Based on a comparison of all available ratings for each security, the most conservative rating (S&P, Fitch, Moody's or M&G's internal rating) is taken into consideration. The ratings so identified are then expressed or converted into M&G's ratings format to obtain uniform information for all securities in the portfolio.

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