M&G Emerging Markets Bond Fund Sterling Class I – Accumulation shares

Quarterly Fund Review as at 30 September 2020

Fund manager(s) – Claudia Calich

For investment professionals only

Highlights

- Emerging market bonds recorded gains in the quarter, despite weaker performance by the asset class in September.
- Hard currency bonds outperformed their local currency counterparts.
- The fund remained globally diversified across hard and local currency government and corporate bonds.

The main risks associated with this fund

For any past performance shown, please note that past performance is not a guide to future performance.

The value and income from the fund's assets will go down as well as up. This will cause the value of your investment to fall as well as rise. There is no guarantee that the fund will achieve its objective and you may get back less than you originally invested.

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.

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 can be exposed to different currencies. Movements in currency exchange rates may adversely affect the value of your investment.

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.

Further risk factors that apply to the fund can be found in the fund's Key Investor Information Document (KIID).

Things you should know

The fund allows for the extensive use of derivatives.

Fund performance

	3 months	YTD	1 year	3 years p.a.	5 years p.a.
Sterling I Accumulation	-2.5%	-0.1%	-3.6%	4.3%	9.9%
Benchmark	-2.6%	1.0%	-3.1%	4.1%	9.2%
Sector	-0.4%	-1.3%	-2.0%	1.6%	6.8%
Quartile ranking	3	2	3	1	1

Single year performance (5 years)

	2019	2018	2017	2016	2015
Sterling I Accumulation	12.1%	0.6%	3.5%	32.2%	3.6%
Benchmark	9.5%	2.0%	1.5%	31.3%	1.2%
Sector	10.2%	-3.7%	5.3%	23.3%	-5.8%
Quartile ranking	2	1	2	1	1

Past performance is not a guide to future performance.

Benchmark= 1/3 JPM EMBI Global Diversified Index 1/3 JPM CEMBI Broad Diversified Index 1/3 JPM GBI-EM Global Diversified Index

Sector= IA Global Emerging Markets Bond – Blended sector

The benchmark is a target which the fund seeks to outperform. The composite 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 assets to buy, hold and sell in the fund. The fund's holdings may deviate significantly from the benchmark's constituents.

Source: Morningstar, Inc and M&G, as at 30 September 2020. Returns are calculated on a price to price basis with income reinvested.

Benchmark returns stated in GBP terms.

201015215026 UK A1 EMBO GBP I EN UK 0004 0000

Asset breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
Government bonds - local currency	24.8	0.0	0.0	24.8
Government bonds - hard currency	41.0	0.0	0.0	41.0
Credit - local currency	4.3	0.0	0.0	4.3
Credit - hard currency	29.3	0.0	0.0	29.3
Other	**0.0**	**0.0**	**0.0**	**0.0**
Cash	**0.5**	**0.0**	**0.0**	**0.5**

Credit rating breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
AAA	4.1	0.0	0.0	4.1
AA	2.6	0.0	0.0	2.6
A	3.6	0.0	0.0	3.6
BBB	21.2	0.0	0.0	21.2
BB	28.6	0.0	0.0	28.6
B	30.0	0.0	0.0	30.0
CCC	3.3	0.0	0.0	3.3
CC	1.3	0.0	0.0	1.3
C	0.7	0.0	0.0	0.7
D	0.3	0.0	0.0	0.3
No rating	3.9	0.0	0.0	3.9
Cash	0.5	0.0	0.0	0.5

Country breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
Mexico	6.7	0.0	0.0	6.7
Russia	4.0	0.0	0.0	4.0
Brazil	3.8	0.0	0.0	3.8
Singapore	3.7	0.0	0.0	3.7
Ukraine	3.0	0.0	0.0	3.0
China	3.0	0.0	0.0	3.0
United Arab Emirates	3.0	0.0	0.0	3.0
Indonesia	3.0	0.0	0.0	3.0
Other	69.4	0.0	0.0	69.4
Cash	0.5	0.0	0.0	0.5

Largest issuers (%)

	Fund
Mexico	3.5
Singapore	3.1
Dominican Republic	2.4
Russia	2.3
Brazil	2.2
Indonesia	2.1
South Africa	2.0
Malaysia	1.9
Thailand Kingdom of	1.7
Czech Republic	1.6

Maturity breakdown (%)

	Physical
0 - 1 years	3.9
1 - 3 years	13.8
3 - 5 years	15.3
5 - 7 years	16.3
7 - 10 years	16.8
10 - 15 years	6.8
15+ years	26.6
Cash	0.5

Currency breakdown (%)

	Pre-hedge	Post-hedge
US dollar	60.9	68.5
Singapore dollar	3.1	3.1
Mexican peso	3.1	3.1
Indonesian rupiah	2.4	2.4
Russian ruble	2.3	2.3
Brazilian real	2.2	2.2
Malaysian ringgit	1.9	1.9
Indian rupee	1.8	1.8
Thai baht	1.7	1.7
Other	20.7	13.2

Industry breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
Foreign Sovereign	38.8	0.0	0.0	38.8
Sovereign	27.1	0.0	0.0	27.1
Banking	5.0	0.0	0.0	5.0
Energy	4.8	0.0	0.0	4.8
Transportation	3.2	0.0	0.0	3.2
Financial services	2.8	0.0	0.0	2.8
Real Estate	2.6	0.0	0.0	2.6
Basic industry	2.5	0.0	0.0	2.5
Agency	2.4	0.0	0.0	2.4
Telecommunications	1.5	0.0	0.0	1.5
Consumer goods	1.5	0.0	0.0	1.5
Utility	1.4	0.0	0.0	1.4
Healthcare	1.2	0.0	0.0	1.2
Supranational	1.0	0.0	0.0	1.0
Local-Authority	0.9	0.0	0.0	0.9
Technology & electronics	0.7	0.0	0.0	0.7
Retail	0.6	0.0	0.0	0.6
Capital goods	0.5	0.0	0.0	0.5
Government Guaranteed	0.5	0.0	0.0	0.5
Services	0.4	0.0	0.0	0.4
Media	0.3	0.0	0.0	0.3
Automotive	0.0	0.0	0.0	0.0
Insurance	0.0	0.0	0.0	0.0
Leisure	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Cash	0.5	0.0	0.0	0.5

Duration by currency and asset class (years)

	Fund	Futures	Swaps	Net
Euro	0.5	0.0	0.0	0.5
British pound	0.1	0.0	0.0	0.1
US dollar	4.0	0.0	0.0	4.0
Other	1.6	0.0	0.0	1.6
Total	6.2	0.0	0.0	6.2

Commentary

The coronavirus pandemic and the huge economic stimulus measures from central banks around the world remained the key themes in global financial markets in the third quarter. Going into the period, while investors' sentiment was helped by some continued reopening of economies around the world, concerns remained that Covid-19 infections were still increasing. Despite the latter consideration, global bonds and emerging market debt mostly delivered gains in July and August. This performance was supported by factors such as optimism over progress towards a vaccine against the virus, as well as the significant stimulus programmes of many governments and central banks in developed and emerging countries.

However, investors' sentiment turned risk-averse globally in September, largely as the virus infection rates accelerated in various regions, notably in Europe. In turn, this renewed concerns that lockdowns might be reintroduced in a number of countries. In addition to the ongoing theme of the global pandemic, political uncertainty around the outcome of the upcoming US presidential election was also a focal point in financial markets as the quarter drew to a close. This was further heightened when President Trump tested positive for the coronavirus.

Despite weaker performance in September, each sub-asset class of the emerging bond markets delivered positive returns for the third quarter. Hard currency debt produced the best results, as renewed volatility was experienced in the local currency space. This was most evident during the final month of the quarter, when the US dollar produced a rally after its recent weakness, and local currency emerging market sovereign bonds declined more than hard currency denominated government debt.

The JP Morgan Emerging Markets Bond (EMBI) Global Diversified Index, which measures the performance of hard currency government bonds, gained 2.3% in the third quarter. Emerging market hard currency corporate bonds, as represented by the JP Morgan Corporate EMBI (CEMBI) Broad Diversified Index, returned 2.7%. The JP Morgan GBI-EM Global Diversified Index, which tracks the performance of emerging market local currency sovereign debt, increased by 0.6% in the period. All returns are stated in US dollar terms.

In the fund, we kept a globally diversified portfolio invested across emerging market hard and local currency government and corporate bonds. This positioning supported the fund's performance in the quarter as each of these areas delivered gains. However, the US dollar depreciated markedly against sterling during the period, which detracted from the returns of the fund's unhedged sterling share classes as we maintained a sizeable exposure to the greenback

Portfolio activity

The fund's overall asset allocation and currency positioning remained broadly stable in the quarter. Within this stance, we stayed fully invested, with a moderately lower allocation to local currencies relative to the fund's benchmark.

In terms of fund activity, we continued to monitor the new issues markets for potential opportunities to add holdings. During July, we participated in some sovereign offerings that had to be priced cheaply because of their challenging fundamentals, but where we felt we were being adequately compensated for the risks. This included newly issued debt in El Salvador and Jordan.

In contrast, we reduced some holdings where we assessed fundamentals and/or valuations were less appealing. Within this activity, we sold out of a position in Namibia. Among corporate holdings, we reduced exposure to some high yield issues on valuations, particularly in sectors that we felt may still be vulnerable to a second wave of virus infections. Within this theme, we sold bonds from Car Inc, the large car rental group in China.

During August, our activity included increasing exposure to the Indian rupee, based on our favourable view on the currency. In our assessment, supportive factors for the rupee include the country's ongoing current account surplus and the prospect that the Reserve Bank of India may leave interest rates unchanged in the near term, given recent higher-than-expected inflation data.

Despite increasing exposure to the rupee, we kept a slightly lower overall allocation to local currencies relative to the fund's benchmark index. However, we remained comfortable to hold an exposure to these assets on a selective basis determined by where we assessed relative value could still be found. While the fund's overall local currency positioning stayed broadly stable in September, our portfolio activity included slightly increasing exposures to the Kazakhstani tenge, Philippine peso, and Thai baht.

We also participated again in a variety of new issues in both the sovereign and corporate segments, which we considered were attractively priced. Across emerging markets, the supply of newly issued debt picked up later in the quarter after a relatively quiet August. We bought newly issued government bonds in Dubai, Dominican Republic, Panama, Morocco, and Mongolia. Among selling activity, we exited a position in Abu Dhabi at the end of September.

In the corporate space, we bought newly issued securities from Commercial Bank in Qatar, Bangkok Bank, and African energy provider Vivo. The fund's purchases during September in both the sovereign and corporate markets were largely funded by recent investors' inflows. Among countries whose outlook we do not like, the fund continued to have a zero position in Belarus, given its ongoing troubled political situation.

Outlook

While the coronavirus pandemic continues to weigh on the global economic outlook, sentiment towards emerging market debt was supported by a variety of key factors in the third quarter. These included the significant economic stimulus programmes launched in many countries, which provided assistance against the uncertainties created by Covid-19 crisis. In some cases, these measures included interest rate cuts and renewed bond-buying activity by central banks. Indeed, quantitative easing (QE) programmes went global, with emerging countries joining those in developed markets to activate such central bank stimulus for the first time.

In this environment, government bond yields in developed markets, including US Treasuries, declined to historic lows during the quarter. In other core markets, such as in parts of Europe and Japan, yields in many segments of the curve remained in negative territory as the quarter ended. We believe this backdrop helped to underline the attraction of higher yields that can still be found among emerging market bonds. In our opinion, while default rates in emerging markets may be expected to rise, we believe that opportunities that offer adequate compensation for default risk can still be found.

In our assessment, it was also relevant that the impact of the coronavirus was felt across the globe, in both advanced and developing economies, without one area being obviously more affected than the other. Hence, many of the long-term trends that were evident before the crisis remain in place. For example, despite significant uncertainty, gross domestic product (GDP) growth in 2020 and beyond is still projected to be higher in emerging markets compared to developed markets, according to recent projections from the International Monetary Fund (IMF).

We would also note that debt-to-GDP ratios were lower on average in emerging markets versus developed countries before the crisis, and we do not expect this to change, especially given the record issuance seen recently in developed countries. In addition, demographics remain favourable to emerging markets, given factors such as their significantly younger populations, which we believe should also support the economic growth differential in the long run.

As always within our flexible approach, we seek to hold bonds and currencies that we believe offer the best relative value, and avoid countries or industries where we consider the outlook is unfavourable. Going into the fourth quarter, we maintained a preference for holding a globally diverse portfolio, which was invested in 138 issuers from approximately 80 countries at the end of September.

In terms of overall asset allocation, the fund was invested around 41% in hard currency government bonds, 29% in emerging market hard currency corporate bonds, 25% in local currency government bonds, and 4% in local currency corporate bonds. Our selected local currency exposures were diversified across the emerging markets via positions that included the Mexican peso, Singapore dollar, Indonesian rupiah, Russian ruble, Brazilian real, Malaysian ringgit, Indian rupee, and Thai baht.

ESG Integrated funds

Funds that integrate financially material ESG data into the risk management and decision-making process, as well as our company-wide exclusions (cluster munitions and anti-personnel mines). Some strategies may have some additional ESG exclusions.

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

Cash may be held on deposit and/or in the Northern Trust Cash Funds, a range of collective investment schemes.

The M&G Emerging Markets Bond Fund is a sub-fund of M&G Investment Funds (3).

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.