M&G Global Macro Bond Fund
Sterling Class I – Accumulation shares

Quarterly Fund Review as at 30 September 2020

Fund manager(s) – Jim Leaviss

For investment professionals only

Highlights

- While COVID-19 concerns remained in focus, global bonds mostly delivered gains in the first two months of the quarter.
- However, performance was mixed in September as investors turned more risk-averse.
- We maintained a globally diverse bond fund, with themes that included a cautious approach to corporate credit exposure.

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.
High yield bonds usually carry greater risk that the bond issuers may not be able to pay interest or return the capital.
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.
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 may invest more than 35% in securities issued by any one or more of the governments listed in the fund prospectus. Such exposure may be combined with the use of derivatives in pursuit of the fund objective. It is currently envisaged that the fund's exposure to such securities may exceed 35% in the governments of Germany, Japan, UK, USA although these may vary subject only to those listed in the prospectus.
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	-1.5%	11.7%	6.8%	6.4%	8.0%
Sector	0.6%	4.9%	2.1%	3.6%	5.8%
Quartile ranking	4	1	1	1	1

Single year performance (5 years)

	2019	2018	2017	2016	2015
Sterling I Accumulation	4.4%	3.7%	-3.8%	25.3%	0.9%
Sector	5.6%	0.2%	1.9%	16.3%	-1.4%
Quartile ranking	3	1	4	1	1

Past performance is not a guide to future performance.

Sector= IA Global Bonds sector

The benchmark is a target which the fund seeks to outperform. The sector has been chosen as the fund's benchmark as the fund is a constituent of the sector. 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.

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.

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Asset breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
Government bonds	**57.0**	**0.0**	**0.0**	**57.0**
Investment grade corporate bonds	**24.0**	**-5.1**	**0.0**	**19.0**
Fixed rate	11.9	0.0	0.0	11.9
Floating rate	11.9	0.0	0.0	11.9
Index linked	0.2	0.0	0.0	0.2
Credit default swap indices	0.0	-5.1	0.0	-5.1
High yield corporate bonds	**1.3**	**-4.1**	**0.0**	**-2.8**
Fixed rate	1.3	0.0	0.0	1.3
Floating rate	0.1	0.0	0.0	0.1
Index linked	0.0	0.0	0.0	0.0
Credit default swap indices	0.0	-4.1	0.0	-4.1
Securitised	**1.8**	**0.0**	**0.0**	**1.8**
Emerging markets	**14.7**	**0.0**	**0.0**	**14.7**
Equities	**0.0**	**0.0**	**0.0**	**0.0**
Other	**0.0**	**0.0**	**0.0**	**0.0**
Cash	**1.0**	**0.0**	**0.0**	**10.2**

Credit rating breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
AAA	21.0	0.0	0.0	21.0
AA	43.4	0.0	0.0	43.4
A	10.5	0.0	0.0	10.5
BBB	19.1	-5.1	0.0	14.0
BB	3.1	0.0	0.0	3.1
B	1.5	-4.1	0.0	-2.6
CCC	0.3	0.0	0.0	0.3
CC	0.1	0.0	0.0	0.1
C	0.0	0.0	0.0	0.0
D	0.0	0.0	0.0	0.0
No rating	0.0	0.0	0.0	0.0
Cash	1.0	0.0	0.0	10.2

Country breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
US	46.1	0.0	0.0	46.1
UK	11.0	0.0	0.0	11.0
Germany	5.4	0.0	0.0	5.4
Japan	5.1	0.0	0.0	5.1
Netherlands	4.7	0.0	0.0	4.7
Australia	2.6	0.0	0.0	2.6
Canada	2.4	0.0	0.0	2.4
Mexico	2.1	0.0	0.0	2.1
Other	19.5	0.0	0.0	19.5
High Yield indices	0.0	-4.1	0.0	-4.1
Investment Grade indices	0.0	-5.1	0.0	-5.1
Cash	1.0	0.0	0.0	10.2

Largest issuers (%)

	Fund
US	36.0
Japan	4.9
Netherlands	3.8
Germany	3.5
UK	3.3
Australia	2.6
Indonesia	2.1
Mexico	1.9
Russia	1.8
Norway	1.5

Maturity breakdown (%)

	Physical
0 - 1 years	3.7
1 - 3 years	12.9
3 - 5 years	13.8
5 - 7 years	9.9
7 - 10 years	39.1
10 - 15 years	4.5
15+ years	15.0
Cash	1.0

Currency breakdown (%)

	Pre-hedge	Post-hedge
US dollar	49.1	45.0
Euro	14.3	17.4
Japanese yen	4.9	14.4
British pound	14.4	14.3
Indonesian rupiah	1.9	1.9
Mexican peso	1.6	1.6
Norwegian kroner	1.5	1.4
Malaysian ringgit	1.4	1.4
Peruvian nuevo sol	1.4	1.4
Other	9.5	1.2

Industry breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
Sovereign	67.8	0.0	0.0	67.8
Banking	7.5	0.0	0.0	7.5
Supranational	3.3	0.0	0.0	3.3
Foreign Sovereign	3.0	0.0	0.0	3.0
Covered Bonds	2.3	0.0	0.0	2.3
Technology & electronics	1.9	0.0	0.0	1.9
Government Guaranteed	1.7	0.0	0.0	1.7
Insurance	1.5	0.0	0.0	1.5
Capital goods	1.3	0.0	0.0	1.3
Healthcare	1.2	0.0	0.0	1.2
Retail	1.1	0.0	0.0	1.1
Mortgage backed	1.0	0.0	0.0	1.0
Telecommunications	1.0	0.0	0.0	1.0
Energy	0.9	0.0	0.0	0.9
Media	0.8	0.0	0.0	0.8
Asset backed	0.7	0.0	0.0	0.7
Consumer goods	0.4	0.0	0.0	0.4
Basic industry	0.4	0.0	0.0	0.4
Local-Authority	0.3	0.0	0.0	0.3
Services	0.2	0.0	0.0	0.2
Financial services	0.2	0.0	0.0	0.2
Transportation	0.1	0.0	0.0	0.1
Real Estate	0.1	0.0	0.0	0.1
Leisure	0.1	0.0	0.0	0.1
Automotive	0.0	0.0	0.0	0.0
Commercial Mortgage Backed	0.0	0.0	0.0	0.0
Investment Grade indices	0.0	-5.1	0.0	-5.1
High Yield indices	0.0	-4.1	0.0	-4.1
Cash	1.0	0.0	0.0	10.2

Duration by currency and asset class (years)

	Fund	Futures	Swaps	Net
Euro	0.8	-0.6	0.0	0.2
British pound	0.5	-0.2	0.0	0.2
US dollar	4.2	-0.7	-0.5	3.0
Other	2.0	0.0	0.0	2.0
Total	7.5	-1.5	-0.5	5.5

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 infections from the disease were still increasing. Despite the latter consideration, global bonds 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 virus cases 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 pandemic, political uncertainty around the outcome of the upcoming US presidential election was also a focal point among investors as the quarter drew to a close. This was further heightened when President Trump tested positive for the coronavirus. In Europe, attention focused once again on post-Brexit trade negotiations between the UK and European Union (EU), as the possibility of a no-deal seemed to increase when the talks appeared deadlocked.

Amid weaker performance in September, global bonds recorded mixed returns, with government debt outperforming corporate credit in the 'risk-off' environment. Core government bond yields mostly edged lower, while credit spreads generally widened in the month. However, investment grade and high yield corporate bonds, having performed well in July and August, registered positive returns for the quarter. Emerging market bonds also weakened in September, with negative returns recorded among hard and local currency debt. However, these assets delivered moderately positive returns for the third quarter after their gains in the previous two months.

In core currency markets, the US dollar depreciated against various key currencies in the quarter, including the euro and sterling. This outcome was recorded despite some strengthening by the US currency in the final month of the period.

The fund remained invested in a globally diversified bond portfolio. Through this positioning, the fund's performance was helped by its exposures to areas of the bond markets that produced gains. However, the marked depreciation of the US dollar against sterling was a factor that detracted from the returns of the fund's sterling unhedged share classes. This effect was felt from the fund's currency allocation to the US dollar.

Duration

Active management of the fund's duration, credit risk, and currency positioning remain its key drivers of performance. The fund's overall duration at the end of the second quarter stood at 6.3 years, although this lengthened to 7.5 years during July. This mainly resulted from some adjustments made to the fund's government bond position in the US, where we added longer-dated US Treasuries and sold Treasury Inflation Protected Securities (TIPS). In our opinion, valuations for TIPS became less attractive after they recently performed well. Among conventional US government bonds, we felt longer-dated securities offered better value than shorter-dated ones.

During August, however, our fund activity included taking steps to reduce duration in the US, partly based on a more pro-inflation stance by the Federal Reserve. Overall, the fund's duration shortened to around 5.5 years in the month, and stayed broadly stable at this level in September.

Throughout the quarter, the US dollar remained the largest contributor to the fund's duration by currency.

Asset allocation

Going into the third quarter, we continued to reduce the fund's overall credit allocation, having increased exposure to corporate bonds amid the significant sell-off in the asset class earlier in the year. Given the strength of the rebound in the performance of credit markets since then, our activity included taking profits from investment grade holdings. This included in the financial sector, an area where the fund's corporate allocation was highest, with sales from banking groups such as BNP, HSBC, Lloyds, and Wells Fargo.

At the same time, we continued to assess the market for buying opportunities on a selective basis. The fund's purchases included bonds from biotechnology company Amgen and food retailer Tesco, which we felt offered attractive valuations. In the high yield asset class, we kept a modest exposure within the fund's reduced credit allocation.

In September, we lowered investment grade exposure and spread duration via credit default swap (CDS) instruments. We also further reduced high yield exposure via activity in the CDS market, which took the fund's allocation to the asset class to a short position.

We maintained a selection of holdings in emerging debt markets, based on our view that long-term value can still be found in the area. However, in July we reduced overall hard currency exposure by closing a credit default swap (CDS) position. Among emerging market currencies, we sold Russian ruble exposure, but added to the Chilean peso and Malaysian ringgit.

In September, we reduced the fund's overall weighting to emerging markets, mainly via local currency sales. This was largely based on renewed weakness among local emerging market currencies amid a rally by the US dollar. Our activity included opening some short positions in the South African rand and Chinese renminbi.

Currency exposures

Our main themes included actively managing the fund's allocation to the euro within its overall currency positioning. We increased exposure to the euro earlier in the summer as the region appeared to be managing the virus better than other key areas such as the US. We also felt that the US dollar faced a weaker outlook due to factors such as the Fed's changes to monetary policy, including sizeable cuts to interest rates. Consequently, we held a reduced US dollar weighting earlier in the quarter.

However, during September we began to feel that the euro's appreciation against the US dollar had stretched its valuation levels versus the US currency. Based on this assessment, we switched some euro exposure back to the dollar. On the other hand, we switched some of the fund's sterling allocation into the euro. This largely reflected our view of the adverse implications for the UK of a possible no-deal outcome in its post-Brexit negotiations.

Outlook

Our preference remained to hold a diversified global bond fund as the third quarter ended. We kept a sizeable allocation to government debt and, despite the uncertainties regarding the outcome of the upcoming Presidential election, US Treasuries remained our largest position. In our view, the significant monetary stimulus launched in many countries, including interest rate reductions and quantitative easing, should continue to support low yields in government bond markets, adding to their appeal in 'risk-off' environments.

Elsewhere, our key positioning themes included a reduced allocation to corporate bonds, given the economic difficulties caused by the coronavirus pandemic and the marked tightening of spreads since the sell-off in credit markets in March and April.

We still hold a constructive long-term view on emerging market debt on a selective basis. In our assessment, the backdrop of low or negative yields in developed markets has helped to underline the attraction of higher yields that can still be found among emerging market bonds. While default rates in emerging markets may be expected to rise, we believe that opportunities can still be found that offer adequate compensation for default risk.

In addition, despite significant uncertainty, GDP growth in 2020 and beyond is still forecast to be higher in emerging markets compared to developed markets, according to recent projections from the International Monetary Fund. We would also note that debt-to-GDP ratios were lower on average in emerging markets versus developed countries before the COVID-19 crisis, and we do not expect this to change, especially given the record issuance seen recently in developed countries. Demographics also 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.

Overall, our approach remains to invest the fund where we have a favourable view across the full range of government and corporate bond markets in both developed and emerging market regions, while avoiding areas whose outlook we do not like.

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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 Global Macro Bond Fund is a stand alone OEIC.

Sector: Morningstar category averages represent the average return of funds within their category over time. The category averages are created by using the average daily total return index series, or TRI, as well as monthly, quarterly, and annual averages of return and non-return data. Morningstar applies a fractional weighting methodology whereby, on the last day of each month, the funds are equally weighted and the share classes within each fund are equally weighted. Fractional weighting ensures that funds with multiple share classes do not dominate and skew the returns of the average, thus presenting the peer group performance in a fair and consistent manner.

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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