

M&G Pan European Select Smaller Companies Fund Sterling Class I – Accumulation shares

Quarterly Fund Review as at 30 September 2020



Fund manager(s) – Michael Oliveros

For investment professionals only

Highlights

- The fund rose, outperforming its benchmark, the EMIX Smaller European Companies Index.
- Relative outperformance was driven by stockpicking, particularly within the healthcare and industrial sectors, while the underweight in financials and overweight in technology was also supportive.
- We added one new holding in the third quarter, SME billing and payments platform for UnifiedPost.

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.

The fund invests in shares of smaller companies which may be less liquid and more volatile in price than shares of larger companies.

The fund holds a small number of investments, and therefore a fall in the value of a single investment may have a greater impact than if it held a larger number of investments.

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

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 invests mainly in company shares and is therefore likely to experience larger price fluctuations than funds that invest in bonds and/or cash.

Fund performance

	3 months	YTD	1 year	3 years p.a.	5 years p.a.
■ Sterling I Accumulation	7.4%	-2.9%	4.0%	-3.9%	7.1%
■ EMIX Smaller European Companies Index	5.8%	-2.7%	3.9%	1.9%	10.1%

Single year performance (5 years)

	2019	2018	2017	2016	2015
■ Sterling I Accumulation	16.5%	-21.6%	21.6%	19.8%	20.2%
■ EMIX Smaller European Companies Index	22.1%	-13.1%	22.3%	19.1%	15.6%

Past performance is not a guide to future performance.

Benchmark= EMIX Smaller European Companies Index

Performance comparison: 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.

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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Largest positive contributors 3 months %

	Relative weight	Absolute return	Contribution
Medicover	3.0	38.7	0.9
Pets At Home	1.4	76.8	0.9
Vitec Software Group	2.8	40.5	0.8

Largest positive contributors YTD %

	Relative weight	Absolute return	Contribution
Flatex	2.9	85.9	1.7
Avanza	2.2	99.0	1.7
Remy Cointreau	2.8	49.8	1.5

Largest negative contributors 3 months %

	Relative weight	Absolute return	Contribution
Rubis	2.5	-22.4	-0.8
WHSmith	3.6	-13.2	-0.8
DCC	3.7	-10.7	-0.6

Largest negative contributors YTD %

	Relative weight	Absolute return	Contribution
WHSmith	4.5	-62.5	-4.1
Georgia Capital	1.4	-60.3	-1.2
On The Beach	1.6	-49.5	-1.1

Source: M&G and BlackRock Solutions®, preliminary data. Performance contribution includes both stocks held and not held relative to the fund's comparative index.

Country breakdown (%)

	Fund (Start)	Fund (End)	Change	Index	Relative weight
Sweden	18.4	19.9	1.5	12.4	7.5
UK	18.0	16.9	-1.1	24.1	-7.3
Germany	16.3	16.4	0.0	10.9	5.5
Denmark	9.6	10.8	1.1	2.6	8.2
France	10.6	10.4	-0.2	7.7	2.8
Ireland	7.7	6.7	-1.0	1.4	5.3
Switzerland	6.0	5.7	-0.2	9.7	-4.0
Spain	4.9	5.0	0.1	4.2	0.8
Other	7.8	8.7	0.9	27.0	-18.3
Cash	0.7	-0.5	-1.1	0.0	-0.5

Largest holdings (%)

	Fund
DSV	3.9
Medicover	3.6
CTS Eventim	3.6
Laboratorios Farmaceuticos Rovi	3.6
Remy Cointreau	3.6
Karnov Group AB (Publ)	3.6
ALK Abello	3.5
Fintech Group	3.4
Simcorp	3.4
WH Smith	3.3

Industry breakdown (%)

	Fund (Start)	Fund (End)	Change	Index	Relative weight
Industrials	29.0	26.5	-2.5	24.3	2.2
Technology	11.7	14.3	2.7	7.3	7.1
Health care	11.3	13.3	2.0	7.6	5.7
Consumer services	13.0	12.6	-0.3	11.7	1.0
Financials	12.1	11.5	-0.6	24.0	-12.5
Consumer goods	10.4	10.7	0.3	11.1	-0.4
Basic materials	5.6	5.4	-0.2	4.6	0.8
Oil & gas	4.6	3.4	-1.2	1.9	1.5
Telecommunications	1.8	1.6	-0.2	1.7	-0.1
Utilities	0.0	0.0	0.0	2.5	-2.5
Other	0.0	1.2	1.2	3.4	-2.2
Cash and near cash	0.7	-0.5	-1.1	0.0	-0.5

Capitalisation breakdown (%)

	Fund (Start)	Fund (End)	Change	Index	Relative weight
> €50 billion	0.0	0.0	0.0	0.0	0.0
€25 - €50 billion	3.3	3.9	0.6	0.0	3.9
€5 - €25 billion	14.4	12.4	-2.1	5.0	7.4
€2.5 - €5 billion	20.7	29.4	8.7	40.0	-10.5
< €2.5 billion	61.0	54.8	-6.1	55.0	-0.2
Cash and near cash	0.7	-0.5	-1.1	0.0	-0.5

Commentary

For the third quarter of 2020, European markets finished broadly flat in sterling and euro terms, and delivered positive returns in US dollars, lagging the wider global markets. Smaller European companies, however, outperformed the wider indices, at both a European and global level.

As we entered the quarter, investors were presented with mixed signals. Sentiment was supported by significant economic stimulus programmes by many central banks – including the agreement of a €750 billion Recovery Fund by the EU, aimed at those economies hardest hit by the pandemic – together with some indications that economic activity was rebounding. However, the mood was dampened by more concerning news, including a resurgence in the number of COVID-19 cases around the world, particularly in the US, UK and Australia, and a return of tension between the US and China.

As we moved through the period, many markets fully recovered from March's downturn to reach record highs. Sentiment was supported by good quarterly results, particularly within the tech sector, and some positive economic data, as well as by hopes for further stimulus measures and the potential for a COVID-19 vaccine. In saying that, sources of investor strife remained, as heightened tension between the US and China soured the mood. Beijing sanctioned a number of US citizens in response to similar measures from Washington, while US President Trump put Chinese tech groups in the crosshairs. European stocks suffered amid the introduction of tighter travel restrictions, particularly from the UK, as this added to concerns that a rise in coronavirus cases across Europe could stifle economic recovery if further widespread lockdowns became necessary. This had a particularly negative impact on the travel sector.

As we passed into September, the momentum that global equities more generally had enjoyed from earlier in the period stalled. European equities, which fell to a three-month low during the month, were particularly hard hit, with sentiment most deeply affected by a resurgence of COVID-19 infections across the region sparking worries about the economic recovery, while uncertainty over the agreement of a Brexit trade deal also dampened the mood. Elsewhere, worries included growing uncertainty about the US Presidential election, a lack of agreement on further economic support in light of the pandemic and the high valuations of some technology companies.

In this environment, the worst performing sector in the smaller companies universe was financials, dragged down by concerns about low interest rates and the economic outlook. Oil & gas also underperformed, given ongoing weakness in the oil price and uncertainty over demand, while consumer services and industrials also lagged the wider market. On the upside, consumer goods, technology and basic materials all outperformed.

Against this background the fund rose, outperforming its benchmark, the EMIX Smaller European Companies Index. Relative outperformance was driven by stockpicking, particularly within the healthcare and industrial sectors, while the underweight in financials and overweight in technology was also supportive.

At a stock level, the fund's largest contributor for the period was Swedish private healthcare provider Medcover. Medcover provides both private healthcare and diagnostic services, focusing primarily on Central and Eastern Europe and Germany, but with operations elsewhere, including India. The company's shares were supported by expectations of robust recovery in its operations, underpinned by COVID-19 testing and care provision during the quarter. This was particularly the case in India, where some 3,100 COVID-19 patients were discharged from Medcover's Indian hospitals since the start of the crisis.

UK retailer Pets at Home boosted returns as well. In a trading statement the company reported expectations that annual profits would beat market consensus, despite the risk of a second coronavirus lockdown, with the second quarter delivering double-digit like-for-like growth in customer sales across both its retail and veterinary operations.

Other supportive holdings included Nordic vertical software integrator Vitec Software, Danish transport and logistics company DSV Panalpina and French cognac producer Remy Cointreau.

On the downside, the fund's largest detractor was another UK retailer, WH Smith. The company was hit hard by pandemic-related lockdowns and travel restrictions in both its high street and travel operations, and since March its share price has been volatile. Having been one of the worst performer in July, and subsequently one of the best performers in August amid news of cost-saving initiatives, its shares once again fell sharply in September, as news of new COVID-19 outbreaks led to concerns over further lock-down measures.

Other detractors included French petrochemical storage and distribution firm Rubis, Irish diversified business services and distribution firm DCC and German biotech specialist Magforce.

Portfolio activity

Having added four new holdings while closing six positions in the second quarter, we added one new holding in the third quarter, Europe's largest billing and payments platform for SMEs, UnifiedPost. The company operates a monthly fee-tiered service – a basic service provides electronic invoicing, identity verification and payments, while an advanced service offers analytics, financing and process automation. The company's competitive advantage is its scale and referral networks, as the customer base is very fragmented, with relatively low customer revenues, so a very efficient way to attract client volumes is key. The company has been expanding into new countries, including in Eastern Europe and the UK, while also expanding into payments, and we think should benefit from the new Payment Services Directive (PSD2), which opens direct banking transfers to non-bank players. We participated in the IPO.

Outlook

Events like the extreme market reaction to the COVID-19 outbreak are difficult to predict, and while from an investment viewpoint such events can be painful in the short term, they can also create opportunities for long-term investors. We believe that investing in quality companies when they are being undervalued can help to deliver long-term benefits for our customers, as markets return to more normal levels.

In the current environment, we have seen a high level of investor 'clustering' around companies that have moved through the COVID-19 crisis and thrived. As these areas of the market have attracted increasing numbers of investors, we believe there are signs of market exuberance. We think there is now an elevated risk of disappointment in cyclical stocks that have high levels of debt, and growth stocks that have become very highly valued, particularly given the extraordinarily uncertain macroeconomic environment.

We continue to search for opportunities for the fund in quality, sustainable companies with protected business models, while remaining firm in the face of extreme short-term market volatility. That volatility is what allows us to buy these companies when their valuations become more attractive, as investors abandon fundamentals in the face of extreme risk aversion. This was certainly the case in light of the COVID-19-induced market sell-off, where we believe we were able to take advantage of bargain valuations to invest in good companies.

In terms of the current portfolio, we remain confident in the quality of our holdings, and firmly believe that they will generate long-term value for the fund. As long-term investors, this is our focus, and we continue to be optimistic about their prospects.

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

The M&G Pan European Select Smaller Companies Fund is a sub-fund of M&G Investment Funds (1).

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