

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

Quarterly Fund Review as at 30 September 2020



Fund manager(s) – Garfield Kiff
For investment professionals only

Highlights

- The market continued to rise but at a more moderate pace than in the preceding quarter. In this environment, the fund was behind the Numis Smaller Companies ex Investment Companies Index and the IA UK Smaller Companies peer group over the third quarter. The fund outperformed the benchmark over one, three and five years, but lagged the peer group over these periods.
- The fund's performance was held back by stock selection, while asset allocation too cost some value. Stock selection in consumer services, technology and healthcare detracted, but stock selection in oil & gas was beneficial.
- We continue to focus on those businesses that are likely to be strengthened, or not hampered, by the coronavirus pandemic. We started new holdings in bike supplier and motor accessories Halfords, which is well placed as people turn away from public transport; food manufacturer Premier Foods, which is benefiting as people eat at home more; and Watches of Switzerland, due to its very resilient trading on the back of pent-up demand.

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 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	2.4%	-21.7%	-8.3%	-1.6%	4.7%
■ Numis Smaller Companies Index (excluding Investment Companies)	6.3%	-20.2%	-9.6%	-4.2%	2.8%
■ Sector	5.3%	-12.1%	0.0%	0.9%	6.8%
Quartile ranking	4	4	4	3	3

Single year performance (5 years)

	2019	2018	2017	2016	2015
■ Sterling I Accumulation	38.7%	-16.0%	28.5%	3.9%	17.2%
■ Numis Smaller Companies Index (excluding Investment Companies)	25.2%	-15.3%	19.5%	11.1%	10.6%
■ Sector	25.4%	-11.8%	27.1%	8.5%	14.9%
Quartile ranking	1	4	2	4	2

Past performance is not a guide to future performance.

Benchmark= Numis Smaller Companies Index (excluding Investment Companies)

Sector= IA UK Smaller Companies sector

Performance comparison: The fund is actively managed. The Numis index is a target benchmark which the fund seeks to outperform. The Numis index has been chosen as the fund's target benchmark as it best reflects the scope of the fund's investment policy. The Numis index, together with the FTSE All-Share Index and Alternative Investment Market, act as constraints on the fund's portfolio construction as they define the investment universe of 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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Largest positive contributors 3 months %

	Relative weight	Absolute return	Contribution
Computacenter	2.7	45.2	0.9
SDL	2.4	36.0	0.6
Future	1.0	52.2	0.4

Largest negative contributors 3 months %

	Relative weight	Absolute return	Contribution
William Hill	-1.0	144.3	-1.0
Pets At Home	-1.2	76.9	-0.8
S4 Capital	-1.5	45.6	-0.5

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

Largest overweights (%)

	Fund	Index	Relative weight
Computacenter	3.0	0.0	3.0
SDL	3.2	0.5	2.7
Emis Group	2.7	0.0	2.7
Dunelm Group	2.3	0.0	2.3
Londonmetric Property	2.3	0.0	2.3
Alpha Financial Markets Consulting	2.1	0.0	2.1
TT Electronics	2.3	0.3	2.1
Onesavings Bank	1.9	0.0	1.9
Countryside Properties	1.7	0.0	1.7
Tyman	2.1	0.4	1.7

Industry breakdown (%)

	Fund (Start)	Fund (End)	Change	Index	Relative weight
Industrials	33.9	34.8	0.9	22.3	12.5
Financials	17.5	16.9	-0.6	22.9	-5.9
Consumer services	13.2	12.9	-0.3	21.2	-8.4
Technology	14.7	12.8	-1.9	4.8	8.0
Consumer goods	7.2	9.5	2.3	8.5	1.0
Health care	3.5	3.3	-0.3	3.4	-0.1
Basic materials	2.3	2.6	0.3	8.1	-5.4
Oil & gas	2.3	2.3	0.0	3.6	-1.3
Telecommunications	1.5	1.4	-0.1	3.0	-1.6
Utilities	0.0	0.0	0.0	2.1	-2.1
Other	0.0	0.0	0.0	0.1	-0.1
Cash and near cash	3.8	3.5	-0.3	0.0	3.5

Largest positive contributors YTD %

	Relative weight	Absolute return	Contribution
Computacenter	2.2	34.4	1.0
Games Workshop	1.0	68.9	0.7
Dunelm	1.9	21.0	0.7

Largest negative contributors YTD %

	Relative weight	Absolute return	Contribution
Centamin	-1.6	68.0	-0.9
S4 Capital	-1.0	104.2	-0.8
Plus500	-1.1	95.8	-0.8

Largest underweights (%)

	Fund	Index	Relative weight
Centamin	0.0	2.0	-2.0
Pets AT Home Group	0.0	1.8	-1.8
William Hill	0.4	2.1	-1.7
Integratfin Holdings	0.0	1.5	-1.5
Plus500	0.0	1.5	-1.5
Hastings Group Holdings	0.0	1.5	-1.5
Dominos Pizza Group	0.0	1.4	-1.4
Helios Towers	0.0	1.3	-1.3
Gamesys Group	0.0	1.2	-1.2
Contourglobal	0.0	1.1	-1.1

Capitalisation breakdown (%)

	Fund (Start)	Fund (End)	Change	Index	Relative weight
Large	0.0	0.0	0.0	0.0	0.0
Medium	56.0	59.0	3.0	66.5	-7.5
Small	19.7	17.2	-2.5	25.9	-8.7
AIM	20.4	20.2	-0.2	0.0	20.2
Non-FTSE All-Share	0.0	0.0	0.0	7.5	-7.5
Cash and near cash	3.8	3.5	-0.3	0.0	3.5

Commentary

The UK lagged the major regional equity markets in the third quarter as confidence at home was mainly undermined by concerns about Brexit, the withdrawal of £38 billion of dividends in the first half of the year and a resurgence of Covid-19. A smaller technology sector than its global peers, especially the US, acted as a further drag. However, sterling strength against the US dollar through July and August, plus government measures to support the economy, helped medium-sized and smaller companies outperform larger companies in the UK over the quarter. The former were led by more economically sensitive sectors including industrials, retailers and travel & leisure. Meanwhile, aside from dividend cuts, larger companies succumbed to a combination of an adverse currency trend, the impact of low oil prices on the energy sector, a poor performance from banks under pressure from a low interest rate environment, and disappointing returns from more defensive sectors such as telecoms and utilities. However, the mining behemoths notably benefited from rising commodity prices.

The fund finished behind the Numis Smaller Companies ex Investment Companies Index and the IA UK Smaller Companies peer group over the quarter. Longer term, the fund outperformed the benchmark over one, three and five years, although it lagged the peer group over these periods.

During the third quarter of 2020, the fund's performance was held back by stock selection, particularly in consumer services, technology and healthcare. Stock selection in oil & gas, however, was beneficial. Asset allocation in consumer services and industrials cost some performance, although it was helpful in oil & gas and technology.

Individual detractors included public services provider Serco Group and office service supplier Restore. Shares in Serco drifted lower following strong performance in the previous quarter. The company's leisure and transportation businesses also came under pressure due to the pandemic. Meanwhile, Restore's shares struggled as many office workers continue to work from home, affecting the company's archiving and paper recycling activities. A small, underweight position in bookmaker William Hill also cost some relative performance as the company's shares gained following a takeover bid.

Contributors to performance included IT support firm Computacenter, which is benefiting from an increased need for workers to access technology from home. Also adding value was Future, a magazine publisher with a strong online presence. In particular, Future's electronics and gaming publications have proved popular as people spend more time at home. Both firms have benefited from solid trading figures. Language translation and content management firm SDL was a further contributor after receiving a bid approach from RWS Holdings.

Portfolio activity

We continue to focus on investing in businesses whose prospects are likely to be strengthened, or not hampered, by the pandemic. For example, we started a new holding in bike supplier Halfords, which also has a motor accessories business. Halfords stands to benefit as people spend more time at home and shy away from public transport. Shares in the company remain attractively valued.

Another new holding, food manufacturer Premier Foods, is benefiting as consumers eat at home more, leading to stronger trading and the ability to reduce debt more quickly. Elsewhere, luxury watches retailer Watches of Switzerland was another entrant to the portfolio. The company is seeing very resilient trading on the back of pent-up demand.

In terms of disposals, we sold holdings in recruitment consultant PageGroup, whose shares have been fairly resilient, and pub company Wetherspoons. Prospects for PageGroup are difficult, given the challenging outlook for the economy and employment. Similarly, the outlook for Wetherspoons has deteriorated and we feel there are better ways to access the consumer market.

In other activity, we supported a fund raising by Countryside Properties, which we feel is a structurally advantaged housebuilder with strong growth prospects in its social-housing business. We continued to add to existing holdings such as insurer underwriter Lancashire Holdings and Tyman, a supplier of engineered components to the door and window industry. Finally, we took profits in Softcat, a value-added reseller of software products, and Blue Prism, a manufacturer of robotic process automation software, with both firms having benefited from the increased appeal of technology stocks.

Outlook

Economic prospects for the near to medium-term remain very uncertain and are dependent on a number of factors, notably the course of the coronavirus pandemic, with the possibility of further restrictions should any meaningful increase in cases of the virus occur; and Brexit-related developments, with the end of year deadline looming. In this extremely uncertain environment, we are taking a cautious approach to new investments and will await to see how events unfold.

Our investment focus remains on identifying good value opportunities in quality companies with stronger balance sheets than their immediate competitors and that look better placed to survive the current crisis.

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 Smaller Companies Fund is a sub-fund of M&G Investment Funds (3).

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