M&G Strategic Corporate Bond Fund
Sterling Class I – Accumulation shares

Quarterly Fund Review as at 30 September 2020

Fund manager(s) – Richard Woolnough

For investment professionals only

Highlights

- Markets maintained their momentum, boosted by signs of a potential vaccine and lower-for-longer signals on interest rates from central banks.
- July and August were the stronger months; a second wave of COVID-19 in Europe, and US election/Brexit worries, cooled investor appetite for risky assets thereafter.
- Investment grade credit rallied, fuelled by central banks buying corporate bonds to support liquidity and a busier-than-usual summer for trading.
- We have reduced credit risk exposure during the period as valuations are rich against a backdrop of economic uncertainty.

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 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 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 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	2.9%	2.7%	4.2%	3.9%	4.8%
Sector	1.6%	4.3%	4.2%	4.4%	5.1%
Quartile ranking	1	4	2	3	3

Single year performance (5 years)

	2019	2018	2017	2016	2015
Sterling I Accumulation	11.2%	-3.6%	6.1%	7.7%	0.0%
Sector	9.5%	-2.2%	5.1%	9.0%	-0.4%
Quartile ranking	1	4	2	3	2

Past performance is not a guide to future performance.

Sector= IA Sterling Corporate Bond 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.

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Asset breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
Government bonds	**5.6**	**0.0**	**0.0**	**5.6**
Investment grade corporate bonds	**77.4**	**0.0**	**0.0**	**77.4**
Fixed rate	59.4	0.0	0.0	59.4
Floating rate	17.9	0.0	0.0	17.9
Index linked	0.1	0.0	0.0	0.1
Credit default swap indices	0.0	0.0	0.0	0.0
High yield corporate bonds	**6.0**	**0.0**	**0.0**	**6.0**
Fixed rate	4.4	0.0	0.0	4.4
Floating rate	1.5	0.0	0.0	1.5
Index linked	0.0	0.0	0.0	0.0
Credit default swap indices	0.0	0.0	0.0	0.0
Securitised	**5.7**	**0.0**	**0.0**	**5.7**
Equities	**0.0**	**0.0**	**0.0**	**0.0**
Other	**0.0**	**0.0**	**0.0**	**0.0**
Cash	**5.3**	**0.0**	**0.0**	**5.3**

Credit rating breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
AAA	9.5	0.0	0.0	9.5
AA	10.6	0.0	0.0	10.6
A	5.3	0.0	0.0	5.3
BBB	63.2	0.0	0.0	63.2
BB	5.9	0.0	0.0	5.9
B	0.3	0.0	0.0	0.3
CCC	0.0	0.0	0.0	0.0
CC	0.0	0.0	0.0	0.0
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	5.3	0.0	0.0	5.3

Country breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
UK	45.7	0.0	0.0	45.7
US	18.3	0.0	0.0	18.3
France	8.5	0.0	0.0	8.5
Germany	6.3	0.0	0.0	6.3
Netherlands	3.1	0.0	0.0	3.1
Italy	2.5	0.0	0.0	2.5
Canada	2.0	0.0	0.0	2.0
Belgium	1.9	0.0	0.0	1.9
Other	6.5	0.0	0.0	6.5
Cash	5.3	0.0	0.0	5.3

Largest issuers (excl. government bonds and CDS indices, %)

	Fund
Legal & General	2.7
AXA	2.5
Lloyds Banking Group	2.4
Thames Water	2.4
BAT International Finance	2.4
Aviva	2.3
European Investment Bank	2.1
Imperial Brands Finance	2.0
Anheuser Busch	1.9
KfW	1.8

Maturity breakdown (%)

	Physical
0 - 1 years	0.7
1 - 3 years	4.8
3 - 5 years	11.5
5 - 7 years	15.8
7 - 10 years	19.0
10 - 15 years	13.6
15+ years	29.4
Cash	5.3

Currency breakdown (%)

	Pre-hedge	Post-hedge
British pound	75.1	99.7
US dollar	21.6	0.3
Euro	3.2	0.0

Industry breakdown (%)

	Physical	Short (via CDS)	Long (via CDS)	Net
Consumer goods	10.2	0.0	0.0	10.2
Insurance	9.5	0.0	0.0	9.5
Asset backed	8.5	0.0	0.0	8.5
Banking	7.8	0.0	0.0	7.8
Telecommunications	7.3	0.0	0.0	7.3
Utility	6.5	0.0	0.0	6.5
Energy	4.5	0.0	0.0	4.5
Basic industry	4.5	0.0	0.0	4.5
Real Estate	3.7	0.0	0.0	3.7
Commercial Mortgage Backed	3.6	0.0	0.0	3.6
Covered Bonds	3.6	0.0	0.0	3.6
Automotive	3.4	0.0	0.0	3.4
Sovereign	3.0	0.0	0.0	3.0
Foreign Sovereign	2.6	0.0	0.0	2.6
Media	2.5	0.0	0.0	2.5
Supranational	2.1	0.0	0.0	2.1
Retail	1.9	0.0	0.0	1.9
Government Guaranteed	1.8	0.0	0.0	1.8
Technology & electronics	1.4	0.0	0.0	1.4
Financial services	1.3	0.0	0.0	1.3
Mortgage backed	1.3	0.0	0.0	1.3
Agency	1.3	0.0	0.0	1.3
Transportation	0.9	0.0	0.0	0.9
Healthcare	0.7	0.0	0.0	0.7
Leisure	0.5	0.0	0.0	0.5
Services	0.2	0.0	0.0	0.2
Capital goods	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Cash	5.3	0.0	0.0	5.3

Duration by currency and asset class (years)

	Fund	Futures	Swaps	Net
Euro	0.5	-0.3	0.0	0.2
British pound	5.5	-0.3	-0.7	4.6
US dollar	2.6	-2.4	0.0	0.2
Other	0.0	0.0	0.0	0.0
Total	8.7	-3.0	-0.7	5.0

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Commentary

With economies bolstered by massive government and central bank support, risky assets broadly matched the gains of the second quarter. However, the momentum seemed to fade as the summer ended. Political uncertainty in the form of a stormy US presidential election campaign and lack of progress in the Brexit negotiations combined with a second wave of coronavirus infections hitting Europe to put the brakes on investor demand for the full range of risk assets.

Prior to this, the majority of risk assets outperformed, especially emerging market equities, US technology stocks, and commodities. Silver and copper bounced higher on renewed signs of economic activity as lockdown restrictions were eased worldwide. Continued central bank support, a series of fiscal boosts – including an agreement on the European Recovery Fund – and most crucially, signs of progress in finding a vaccine against the virus, were also viewed favourably by investors.

Bond markets also recorded fairly solid returns in the period. Within credit, US and European high yield outperformed investment grade, mirroring the robust demand for riskier areas of fixed income. The performance of government bonds was generally flat as investors rotated out of UK gilts, US Treasuries and German bunds for either credit or European peripheral markets. Italian governments bonds (BTPs) and Spanish government bonds had decent quarters, boosted by progress on the European Recovery Fund.

In foreign exchange markets, the euro was the period's standout performer, strengthening against both the yen and US dollar. In fact, the US currency had a poor summer on a combination of a subdued outlook for the domestic economy, price correction – some believe it was overvalued from the start – and finally uncertainty on the outcome of November's presidential election.

Performance, portfolio activity and positioning

The fund produced a positive return in the quarter as corporate bond prices rose across most sectors we favour. UK corporate bonds rated BBB, long-dated US dollar bonds, and some non-index (iBoxx Sterling Corporate Index) financial bonds helped us deliver positive returns, particularly at the beginning of the quarter.

Laggards came in the form of our historical below-index weighting in strong-performing bonds such as insurers, and being short of interest rate risk as yields fell and prices rose in core government bonds over the month. In August, the fund lost money in below-index exposure, such as utilities, healthcare, consumer services, and retail. Not having enough exposure to better-performing automobiles and oil & gas also cost some performance.

September was a 'risk-off' month, so the fund was helped by having less exposure to UK financials. Many banks and insurers had a torrid month and this was not just because of low interest rates dampening profits. HSBC was also hit by media reports of links to alleged suspicious transfers and the price of its equity and bonds suffered.
Meanwhile, the poor performance of high yield bonds was a detractor, despite fund exposure being fairly modest.

We have reduced credit risk in the portfolio, as valuations continue to rise against a backdrop of simmering doubts on a second peak of COVID-19 and the global economy generally. By the end of the quarter, our credit spread duration was around 8.7 years – roughly 0.4 years overweight the iBoxx Sterling Corporate Index – and this benefited the fund when the price of corporate bonds rose.

In terms of exposure to interest rate risk during the third quarter, duration was unchanged, standing at about 5.0 years, or -2.9 years underweight the iBoxx Sterling Corporate Index. We did move some US dollar duration into euro duration, although this move was minimal and involved non-index exposure.

Turning to credit selection, where we believe we have the best opportunity to deliver absolute returns for the fund, we have scaled back some risk in the period. This meant sales of names we bought during the corporate funding 'binge' of March and April, including US dollars issued by GE and also taking profits on telecom bonds. We rotated into 'plain vanilla' credits such as covered bonds rated AAA issued by KfW, the German state-owned development bank, and UK gilts.

One sector we are concerned about is banks because of the poor outlook for interest rate rises in coming months. By contrast, we are running risk in carmakers and cyclical sectors, where risk premiums remain more attractive, in our opinion.

Outlook

Given the marginally wider credit spreads towards the end of the period, we had considered adding some names on a case-by-case basis. However, for now, we are content with having a comfortable level of risk-free assets (government bonds and cash), while boosting covered bonds exposure and reducing financials once again. We believe the current economic outlook and low interest rates environment could make for a rough period ahead for both banks and insurers.

For the remainder of 2020, we believe credit selection and using the full resources of M&G's in-house expertise remain crucial for our ability to potentially deliver returns above those of the fund's benchmark, the IA Sterling Corporate Bond Sector. In this regard, while we continue to favour the investment opportunity provided by holding good-quality corporate bonds, we are aware that valuations are rising all the time.

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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 Strategic Corporate 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.