# M&G (Lux) Dynamic Allocation Fund Euro Class A – Accumulation shares

Quarterly Fund Review as at 30 September 2019

Fund manager – Juan Nevado, Craig Moran

For investment professionals only

## Highlights

- Stockmarkets experienced mixed fortunes over the course of the third quarter, though generally recovered their August losses.
- The fund benefited from our preference for equities, but the short exposure to developed market government bonds detracted.
- We made tactical changes during the period but our broad macroeconomic view remains unchanged.

## 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 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 may lose as much as or more than the amount 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.

The fund is exposed to different currencies. Derivatives are used to minimise, but may not always eliminate, the impact of movements in currency exchange rates.

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. | Since launch (%) |
|---|---|---|---|---|---|---|
| Euro A Accumulation | 0,3% | 5,4% | -3,3% | 2,8% | 3,0% | - |
| Morningstar EUR Flexible Allocation - Global Category | 1,2% | 9,0% | 0,4% | 2,0% | 1,7% | - |
| Quartile ranking | 3 | 4 | 4 | 2 | 2 | - |

## Single year performance (5 years)

| | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| Euro A Accumulation | -10,8% | 8,3% | 8,8% | 2,0% | 9,8% |
| Morningstar EUR Flexible Allocation - Global Category | -8,6% | 5,1% | 2,2% | 2,1% | 5,3% |
| Quartile ranking | 4 | 1 | 1 | 2 | 1 |

**Past performance is not a guide to future performance.**

Past performance prior to 16 January 2018 is that of the M&G Dynamic Allocation Fund (a UK-authorised OEIC) which merged into this fund on 16 March 2018. Tax rates and charges may differ.

**Source: Morningstar, Inc and M&G, as at 30 September 2019.** Returns are calculated on a price to price basis with income reinvested.



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## Portfolio construction (%)

| | Net allocation range | Neutrality |
|---|---|---|
| Currency | Min 30% euro or euro hedged | |
| Equity | 20-60 | 40,0 |
| Fixed income | 0-80 | 50,0 |
| Other | 0-20 | 10,0 |

## VaR analysis (%)

| | Fund |
|---|---|
| 1 month 99% VaR | 5,6 |

## Largest exposures (excl. cash, %)

| | Fund |
|---|---|
| Us equity | 6,7 |
| Topix Index future | 6,3 |
| Mexico Government 10Y | 5,1 |
| Kospi Index future | 5,1 |
| Italy Government 5Y | 5,0 |
| US Government 30Y | 4,7 |
| UK Government 30Y | -5,4 |
| France Government | -7,3 |
| UK Government 10Y | -7,5 |
| Germany Government | -14,3 |

## Leverage and volatility

| | Fund |
|---|---|
| Gross leverage | 1,5x |
| Net leverage | 0,7x |
| Volatility | 7,9% |

## Asset breakdown (%)

| | Long exposure | Short exposure | Net exposure |
|---|---|---|---|
| **Equity** | **52,5** | **-3,2** | **49,3** |
| UK | 5,4 | 0,0 | 5,4 |
| Europe | 15,2 | 0,0 | 15,2 |
| US | 10,6 | -3,2 | 7,4 |
| Japan | 10,5 | 0,0 | 10,5 |
| Asia Pacific ex Japan | 7,7 | 0,0 | 7,7 |
| Global equity funds | 2,0 | 0,0 | 2,0 |
| Other | 1,2 | 0,0 | 1,2 |
| **Government bonds** | **27,0** | **-36,8** | **-9,8** |
| UK | 0,0 | -12,9 | -12,9 |
| Europe | 7,4 | -21,6 | -14,2 |
| US | 4,7 | 0,0 | 4,7 |
| Japan | 0,0 | -2,3 | -2,3 |
| Asia Pacific ex Japan | 3,8 | 0,0 | 3,8 |
| Other | 11,1 | 0,0 | 11,1 |
| **Corporate bonds** | **5,3** | **0,0** | **5,3** |
| Investment grade | 3,5 | 0,0 | 3,5 |
| High yield | 1,8 | 0,0 | 1,8 |
| **Global bond funds** | **5,0** | **0,0** | **5,0** |
| **Convertible bonds** | **2,0** | **0,0** | **2,0** |
| **Property funds** | **1,2** | **0,0** | **1,2** |
| Residual cash | 0,0 | 0,0 | 47,0 |

## Currency breakdown (%)

| | Fund |
|---|---|
| Euro | 85,9 |
| Mexican peso | 7,4 |
| Indonesian rupiah | 3,6 |
| Turkish lira | 3,6 |
| British pound | 2,9 |
| Japanese yen | 1,8 |
| Indian rupee | 1,7 |
| South African rand | 1,6 |
| Korean won | 1,5 |
| Other | -9,9 |

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# Commentary

## Fund Performance

The third quarter of the year was once again volatile, with stockmarkets retreating during August after a relatively tranquil July before generally recovering in September, against a backdrop of investor concern around slowing global growth. The fall in equity markets was caused by a combination of factors. These included the surprise resumption of the trade conflict between the US and China, ongoing unrest in Hong Kong and tension following a drone attack on a Saudi oil facility.

However, in September, markets regained much of the ground lost in previous months, despite a lack of corresponding changes at a fundamental level, amid enduring market pessimism. The manufacturing sector remained weak on the back of continued trade uncertainty, while unemployment and wage data held up. The outperformance of value versus growth strategies was a key theme for investors. Investors also managed to shrug off aggressive rhetoric between the US and Iran and, later in the month, increasing odds that President Trump could face impeachment. Central banks showed readiness to provide support, with the Federal Reserve cutting US interest rates again, the European Central Bank announcing a stimulus package and the Bank of England hinting that UK borrowing costs could be reduced in the event of a no-deal Brexit.

The ongoing uncertainty provided a boost to government bond markets in July and August as investors sought out 'safe haven' assets, with developed market bond yields falling to unprecedented depths. However, renewed appetite for risk in September saw the asset class sell off towards the end of the quarter.

In this environment, the fund produced a modestly positive return in the quarter. Of equity positions, holdings in Japan and US banking stocks contributed to performance. Exposure to the mining and oil sectors, and to a lesser extent Asia ex Japan, detracted on political concerns. The main detractor during the quarter was the short exposure to some European government bonds, owing to pronounced bouts of investor risk aversion. These losses were offset to a certain extent by exposure to emerging markets, particularly Mexico and Indonesia, as well as Italy and the US. The fund's alternative investment (a new holding in European REIT Unibail Rodamco) provided another boost to performance. However, currency movements provided a headwind to performance.

## Fund Management

The main change during the quarter was a tactical addition to the fund's equity weighting in August during what we believed was an unwarranted bout of investor risk aversion. We increased the target equity weighting by 5.5 percentage points in direct response to the material selloff in equities and widening in spreads. This was partly achieved by reducing the short on the S&P 500 index. We've observed that often the S&P 500 has been the most effective way to exploit short-term price episodes, rather than taking on specific markets, which may have larger price moves but also a less robust fundamental backdrop. We removed the positions in September following the unwinding of the episodic price action.

In July, we closed the 3% position in US 30-year bonds. With yields having fallen considerably since the inception of the position, we considered that these bonds no longer offered compelling value, nor the same levels of portfolio diversification as previously. Similarly, the following month we increased our short position in UK long-dated gilts, as we believed that, with renewed low yields, they had become yet more vulnerable to a change in market sentiment as well as offering a very asymmetric return profile.

We also sold our remaining exposure to Argentinian US dollar bonds, which had rallied materially in the previous two months. We used the proceeds to open a 1% position in the new M&G (Lux) Emerging Markets Corporate ESG Bond Fund, as we consider emerging market corporate bonds to be attractively valued, as well as adding diversification to the fund.

We removed the high yield credit protection on the fund in August after credit spreads widened, as we believed that the sell-off was unduly rapid, especially against a backdrop of highly accommodative monetary policy and fixed income-friendly rhetoric. Also, from a portfolio construction perspective, credit assets offer the potential for steady returns should the environment of modest growth and low inflation persist, as well as portfolio diversification.

In September, we removed the 2% position in three-year Italian government bonds we opened in June following an abrupt fall in yield. This change, from around 100 basis points at the point when we entered the trade to -10 basis points when we removed them at the end of September, demonstrates how quickly the market can change its mind over the riskiness of an asset.

# Outlook

In terms of medium-term valuations, we continue to believe that equities offer the most compelling returns, while emerging market bonds and currencies offer attractive levels of yield and scope for more significant rate cuts if necessary. Conversely, Western government bonds offer very asymmetric return profiles from such low prevailing levels of yield.

As ever, we don't know what will happen next in the macroeconomy, or in the ever-changing arena of geopolitics. Therefore, rather than trying to make predictions, we will continue to analyse the facts of the global economy and where the odds look favourable. However, as we have outlined previously, we do consider plausible economic outcomes and how they might affect the fund. Our current base scenario would be ongoing modest growth and inflation – in which case our very cheap equities and emerging market bonds would deliver reasonable gains via income and modest capital gains.

The bullish scenario – which absolutely no one is talking about – is acceleration of growth and cyclical improvement. This could lead to very strong equity performance, modest gains from emerging markets and potentially a material selloff in Western government bonds as negativity dissipates and markets begin to consider rate rises again. The final scenario, global recession, would likely see losses coming from equities positions should profits fall materially and widening of credit spreads. However, we believe that this would be offset by gains in emerging market bonds, which have significant scope to cut rates in this environment. Given the unprecedented lows in yields, developed market bonds are already largely pricing in the latter scenario. We believe that were we truly to enter a negative phase for the global economy, central banks would be supportive – and this might ultimately put upward pressure on long-dated bonds. We have seen increasing acknowledgement from the markets that the effectiveness of monetary policy and ever-lower rates is approaching its limits, and that it is more important than ever that there is a fiscal response to further weakening economic conditions.

With a number of significant events on the horizon in terms of trade discussions and Brexit negotiations, this is likely to be an interesting phase in markets that could lead to significant volatility. We continue to observe some very extreme valuations, representing potential opportunities. Given the recent scaling back of capital, we feel we are well-positioned to take advantage of any such opportunities. We therefore believe that this environment should be a good one for our strategy.

## Important information

**On 16 March 2018, the M&G Dynamic Allocation Fund, a UK-authorised OEIC, which launched on 3 December 2009, merged into the M&G (Lux) Dynamic Allocation Fund, a Luxembourg-authorised SICAV, which launched on 16 January 2018. The SICAV is run by the same fund managers, applying the same investment strategy, as the UK-authorised OEIC.**
**The fund's neutral currency positioning is 100% in euros. Deviations from this figure, therefore, represent long/short exposure.**

**Past performance prior to 16 January 2018 is that of the M&G Dynamic Allocation Fund (a UK-authorised OEIC) which merged into this fund on 16 March 2018. Tax rates and charges may differ.**

The M&G (Lux) Dynamic Allocation Fund is a sub-fund of M&G (Lux) Investment Funds 1.

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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