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

Quarterly Fund Review as at 30 September 2020

Fund manager(s) – Craig Moran, Steven Andrew

For investment professionals only

Highlights

- Investors favoured risk assets as sentiment continued to improve in the third quarter, although expectations were dampened towards the end of the period.
- The fund produced a positive return, with equity and fixed income allocations contributing roughly equally.
- For the first two months of the quarter, we maintained a balanced portfolio, with the equity allocation at the fund's neutral weighting, before increasing the target equity weighting in September.

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.

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

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 allows for the extensive use of derivatives.

Performance is stated in the share class currency, which may differ from your domestic currency. As a result, the return may rise or fall due to currency movements.

Fund performance

	3 months (%)	YTD (%)	1 year (%)	3 years (%) p.a.	5 years (%) p.a.
Euro A Accumulation	0,0%	-7,0%	-2,8%	-2,5%	1,5%
Sector	1,3%	-1,8%	-0,9%	0,3%	1,1%
Quartile ranking	4	4	4	4	2

Single year performance (5 years)

	2019	2018	2017	2016	2015
Euro A Accumulation	7,5%	-7,7%	5,8%	9,2%	-
Sector	7,5%	-4,9%	2,1%	1,9%	-
Quartile ranking	3	4	1	1	-

Past performance is not a guide to future performance.

Sector= Morningstar EUR Cautious Allocation - Global sector

The fund is actively managed and has no benchmark. Investors can assess the performance of the fund by its objective to provide a total return of 3-6% per annum over any three-year period.

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

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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Portfolio construction (%)

	Net allocation range	Neutrality
Equity	0-35	20,0
Fixed income	0-100	70,0
Other	0-20	10,0
Currency	Min 60% euro (or hedged to euro)	

Leverage and volatility

	Fund
Gross leverage	1,0x
Net leverage	0,9x
Volatility	8,7%

VaR analysis (%)

	Fund
1 month 99% VaR	8,9

Largest exposures (excl. cash, %)

	Fund
US Government 30Y	17,7
Eurozone cdx	7,4
S&p500 emini index future	5,0
Us equity	4,4
Uk equity	3,5
Topix index future	3,2
Us fixed	3,2
Mexico Government 20Y	2,1
Australia Government 10Y	2,1
Uk swaps other	-4,7

Currency breakdown (%)

	Fund
Euro	88,6
Japanese yen	3,0
Mexican peso	2,9
Indonesian rupiah	2,8
British pound	2,7
South African rand	2,6
Hong Kong dollar	1,3
Korean won	1,1
Turkish lira	0,2
Other	-5,1

Asset breakdown (%)

	Long exposure	Short exposure	Net exposure
Equity	**25,9**	**0,0**	**25,9**
UK	3,7	0,0	3,7
Europe	5,1	0,0	5,1
North America	9,9	0,0	9,9
Japan	3,2	0,0	3,2
Asia Pacific ex Japan	4,0	0,0	4,0
Global	0,0	0,0	0,0
Emerging markets	0,0	0,0	0,0
Government	34,7	-4,7	30,0
UK	0,0	-4,7	-4,7
Europe	0,0	0,0	0,0
North America	17,7	0,0	17,7
Japan	0,0	0,0	0,0
Other Developed Markets	5,5	0,0	5,5
Emerging markets	11,4	0,0	11,4
Corporate	18,6	0,0	18,6
Investment grade	13,0	0,0	13,0
High yield	5,7	0,0	5,7
Convertible bonds	**2,1**	**0,0**	**2,1**
Infrastructure	6,9	0,0	6,9
Property	0,0	0,0	0,0
Other	0,0	0,0	0,0
Residual cash	0,0	0,0	16,5

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Commentary

Investors favoured risk assets as sentiment continued to improve in the third quarter, owing to upbeat macroeconomic data, raising hopes of a quicker global recovery than previously anticipated. Ongoing fiscal and monetary support around the world also helped, as did further steps towards a vaccine for the virus. Against this backdrop, risk assets gained ground, particularly US equities. Shares of global technology companies were once again some of the best performers over the period, reflecting the world's growing reliance on their products and services during the pandemic. Conversely, mainstream government bonds, particularly gilts, sold off, with yields peaking towards the end of August.

However, these gains were partially offset by a reversal during September, when the environment became more positive for mainstream government bonds, with yields in some markets falling to historic lows. A number of factors caused investors to become more cautious. These included the potential for a second lockdown in some countries as the number of COVID-19 cases again began to rise sharply, and an increase in unemployment as government support schemes started to come to an end. Political uncertainty also played a part, relating to slow progress in Brexit negotiations, and the upcoming US general election. Within corporate credit, high yield bonds typically outperformed their investment grade counterparts, while amid mixed returns in emerging markets, hard currency debt generally outperformed local currency bonds.

The fund produced a positive return over the quarter, with equity and fixed income allocations contributing roughly equally. Currency movements proved a headwind to performance. Of the fund's equity positions, the largest contributions came from the US, followed by Asia ex Japan. The main detractor was the 'basket' of banking stocks, where the sector came under pressure in September. European equities was the other main detractor.

For fixed income, within government bonds, the largest contributors were the short exposure to UK gilts and long position in US Treasuries. Non-mainstream government bonds detracted due to weakness in Indonesia and South Africa. Corporate bonds also cost some performance.

The fund's alternatives exposure detracted significantly, largely owing to headwinds for real estate holding Unibail Rodamco and wind farm Greencoat UK. On the other hand, convertibles were a positive contributor as the asset class benefited from its domination by growth sectors, which rallied over the quarter.

Portfolio activity

For the first two months of the quarter, we maintained our equity allocation at the fund's neutral weighting, but with a restructured equity mix to make it more balanced and diversified. This stance was based on our belief that valuations were not cheap, fundamentals remained uncertain and earnings were beating (very depressed) consensus expectations. The degree of protection afforded by the portfolio duration added in previous months allowed us to hold a higher allocation to equities than we might otherwise have done. These changes represented a new caution in terms of the fund's overall risk balance whereby it was diversified across equities, credit and government bonds rather than being more heavily concentrated in equities.

In September, following a meaningful fall in equity prices, we tilted the portfolio towards equities, from a balanced allocation, increasing the target equity weighting from 20% to 25%, in our efforts to participate in a potential improvement in investor confidence. Our equity additions are split between those assets we would consider to have fallen in an 'episodic' way, such as US equities and mining companies, and cyclical exposures that lagged over the course of the summer, such as European equities and US banks. This was funded by reducing exposure to short-dated Italian government bonds and 30-year US Treasury Inflation-Protected Securities, which we now believe offer less good value.

Outlook

In terms of concrete facts concerning the future paths of profits and economies, it is very difficult to say that the situation has deteriorated in recent months. In fact, if anything, our sense is that the macroeconomic data has broadly positively surprised compared with expectations in the spring. The policy response has continued to be very supportive and politicians have generally reaffirmed desires to avoid the economically damaging measures that were taken earlier in the year.

The recent changes reflect our commitment to shifting tactical positioning in an effort to generate performance while managing the return profile of the fund. Equally, we would be willing to remove these tactical shifts should a significant rally occur. We feel we remain in a position to respond to further short-term weakness. As ever, we believe the outlook is unknowable, and alongside known risks, the marketplace could easily be surprised by any number of issues. As asset allocators, our preference is to look for opportunities where we feel we are being well compensated for the risks we are taking. We therefore retain our focus on diversified equities, credit and emerging market bonds, whilst maintaining portfolio balance, particularly with long-dated government bonds.

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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

On 16 March 2018, the M&G Prudent Allocation Fund, a UK-authorised OEIC, which launched on 23 April 2015, merged into the M&G (Lux) Conservative 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 M&G (Lux) Conservative Allocation Fund is a sub-fund of M&G (Lux) Investment Funds 1.

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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