M&G (Lux) Global Convertibles Fund USD Class CI-H – Accumulation shares

M&G Investments

Quarterly Fund Review as at 31 December 2021

Fund manager(s) – Léonard Vinville

For investment professionals only

Highlights

- Many stockmarkets generated healthy positive returns in the final quarter of 2021, despite the discovery of a new, potentially more dangerous variant of coronavirus. Bond markets were adversely affected by growing hawkishness of central banks. Convertibles reflected the strength in equity markets.
- The fund rose and outperformed its benchmark. US holdings added most value. The strong US dollar relative to the euro was a tailwind for the fund's unhedged share classes.
- While we added several new holdings to the portfolio, the main trading activity was to sell issues that no longer satisfied our selection criteria.

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.

Convertibles are subject to the risks associated with both bonds and company shares, and to risks specific to the asset class. Their value may change significantly depending on economic and interest rate conditions, the creditworthiness of the issuer and the performance of the underlying company shares. In addition, issuers of convertibles may fail to meet payment obligations and their credit ratings may be downgraded. Convertibles may also be harder to sell than the underlying company shares.

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 hedging process seeks to minimise, but cannot eliminate, the effect of movements in exchange rates on the performance of the hedged share class. Hedging also limits the ability to gain from favourable movements in exchange rates.

This promotion relates to the acquisition of units or shares in a fund and not in a given underlying asset such as property.

Further risk factors that apply to the fund can be found in the fund's Key Investor Information Document (KIID).

Fund performance

	3 months (%)	YTD (%)	1 year (%)	3 years (%) p.a.	5 years (%) p.a.
US Dollar CI-H Accumulation	0.6%	1.4%	1.4%	10.4%	-
Thomson Reuters Global Focus Convertible Hedged USD Index	-1.9%	-1.1%	-1.1%	11.2%	-
Sector	-0.4%	0.8%	0.8%	9.8%	-
Quartile ranking	1	2	2	2	-

Single year performance (5 years)

	2021	2020	2019	2018	2017
US Dollar CI-H Accumulation	1.4%	19.6%	11.0%	-	-
Thomson Reuters Global Focus Convertible Hedged USD Index	-1.1%	22.8%	13.1%	-	-
Sector	0.7%	18.2%	11.5%	-	-
Quartile ranking	2	2	3	-	-

Past performance is not a guide to future performance.

Benchmark= Thomson Reuters Global Focus Convertible Bond Hedged USD Index

Sector= Morningstar Convertible Bond - Global, USD Hedged sector

The benchmark is a comparator against which the fund's performance can be measured. The index has been chosen as the fund's benchmark as it best reflects the scope of the fund's investment policy. 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 investment manager has complete freedom in choosing which investments to buy, hold and sell in the fund. The fund's holdings may deviate significantly from the benchmark's constituents.

Fund performance prior to 9 November 2018 is that of the USD Class CI-H Accumulation of the M&G Global Convertibles Fund (a UK-authorised OEIC), which merged into this fund on 7 December 2018. Tax rates and charges may differ.

Source: Morningstar, Inc and M&G, as at 31 December 2021. Returns are calculated on a price to price basis with income reinvested. Benchmark returns stated in USD terms.

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Largest positive contributors 3 months (%) by issuer

	Rel. weight	Absolute return	Contribution
Silicon Laboratories Inc.	1.8	36.3	0.6
Palo Alto Networks	2.2	15.5	0.4
Nova	1.0	35.6	0.3

Largest positive contributors YTD (%) by issuer

	Rel. weight	Absolute return	Contribution
Palo Alto Networks	1.0	48.3	1.0
Silicon Laboratories Inc.	1.6	40.5	0.6
Etsy	1.0	9.6	0.5

Largest detractors 3 months (%) by issuer

	Rel. weight	Absolute return	Contribution
Ford Motor	-1.4	27.9	-0.4
Chegg	1.0	-15.8	-0.2
Yandex	1.5	-16.3	-0.2

Largest detractors YTD (%) by issuer

	Rel. weight	Absolute return	Contribution
Ford Motor	-0.9	36.8	-0.5
Chegg	1.3	-26.7	-0.4
Liberty Media	-1.8	21.5	-0.4

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

Industry breakdown (%)

	Fund
Technology	26.8
Consumer services	16.6
Health care	13.7
Industrials	12.1
Financials	11.4
Utilities	5.5
Telecommunications	5.1
Consumer goods	3.6
Basic materials	2.8
Oil & gas	0.2
Cash	2.2

Country breakdown (%)

	Fund
US	54.8
China	5.3
France	5.2
Italy	4.6
Japan	3.7
UK	3.2
Germany	2.7
Israel	2.6
Other	15.7
Cash	2.2

Largest holdings (%)

	Fund
JP Morgan	5.3
BOX	3.1
Booking Holdings	3.0
Citigroup Global Markets Funding Luxembourg SCA	3.0
Zalando	2.7
Akamai Technologies	2.5
Prysmian	2.4
Nextera Energy Partners LP	2.3
Electricite de France	2.2
Swiss RE	2.1

Currency breakdown (%)

	Fund
US dollar	63.3
Euro	23.2
Japanese yen	5.4
Hong Kong dollar	4.5
British pound	3.6
Singapore dollar	0.0
Australian dollar	0.0
China Offshore spot	0.0
Swiss franc	0.0
Taiwan dollar	0.0

Commentary

The biggest theme in financial markets in the final quarter of 2021 was probably the marked resilience of most equity markets despite the threat of the Omicron variant of the coronavirus. With investor sentiment having been positive for the first part of the period, bolstered by robust corporate earnings and relaxations of travel restrictions, the discovery of the new strain, feared to be more infectious and resistant to existing vaccines, caused a sharp sell-off. However, when it appeared that Omicron may not be as lethal as feared, investors' appetite for risk quickly returned and many stockmarkets finished the quarter with healthy gains.

The best returns came from the broad S&P 500 Index in the US, although France and Switzerland were not far behind. Other winners included the Nasdaq and Italy. The improvement was not universal, however, with Hong Kong and China declining as they felt the pressure of a regulatory crackdown on major technology firms, slowing economic growth and a debt crisis in the property sector. Japan declined in the quarter too, with its stockmarket being particularly badly affected by the rise of the Omicron strain.

In terms of sectors, technology continued to lead the way, followed by utilities and consumer goods. By contrast, the communications services sector declined.

Fixed income markets were fairly subdued during the quarter, under pressure from rising inflation and central banks becoming increasingly hawkish. Although bond prices rose when risk appetite disappeared in late November, it soon returned and, over the three months as a whole, most mainstream government bonds were little changed.

The convertibles market rose during the period, reflecting the moves in the equity market. It was helped by the tailwind of strength in the US dollar relative to the euro, which boosted the performance of dollar-denominated bonds to euro-based investors.

The fund's unhedged share classes rose during the review period, with gains principally coming from holdings in the US and in the technology and basic materials sectors. The hedged share classes did not do as well and finished the quarter flat, as they did not benefit from the strength of the US dollar. Both share classes were ahead of their benchmarks, which declined.

The recent earnings season had a big impact on the fund, with the holdings that added most value all issued by companies that announced robust results. For example, a convertible from semiconductor manufacturer Silicon Labs made the largest positive contribution, with the group's shares and convertible rallying after earning record revenues from its products aimed at the Internet of Things. Other US convertibles to have their performance boosted by good results included those from online security firm Palo Alto Networks, rare earth metal producer MP Materials, online marketplace Etsy and cloud-based content management platform Box. Metrology group Nova, based in Israel, was another to announce investor-pleasing results, causing its shares and convertible to rally.

Of course, not all of our positions did well in the quarter, with the largest detractor being Russian internet and ride-hailing form Yandex, which declined as the possibility of conflict between Russia and Ukraine makes it more likely that economic sanctions might be applied to Russian companies. Others to hinder performance included a convertible from US online learning provider Chegg, which lost ground when the group's CEO said that the online education industry was experiencing a slowdown. Luxembourg-based online fashion retailer Global Fashion Group fell back when commentators suggested such retailers may be at risk of lower earnings if consumers return to traditional buying channels as coronavirus restrictions ease.

Portfolio activity

The largest addition to the portfolio was a convertible from US online gaming
company Zynga. We bought a bond with shorter maturity since we felt it was more attractively valued than a longer-dated issue, which was sold. We also bought an existing convertible from Macom Technology Solutions, a US semiconductor manufacturer that supplies chips for telecoms, industry and defence and data centres applications. We also altered our exposure to Teladoc Health, buying a convertible originally issued by Livongo Health, another US digital health group that was acquired by Teladoc in October 2020, that now converts into Teladoc shares. The new purchase is a more balanced, equity-sensitive convertible than another Teladoc convertible already held in the fund, which was sold.

We also adjusted our exposure to Worldline, selling a high-premium convertible issued by the online payments group while adding to our position in an exchangeable issued by Atos that converts into Worldline. We are more confident in the credit quality of Atos following efforts to restructure the business.

We were more active in selling holdings that no longer satisfied our selection criteria. For example, we sold a convertible from Singapore Airlines, as in our view, the underlying equity had become expensive, and another from Morphosys, since we felt the potentially positive equity story would take too long to realise.

We disposed of a convertible from Etsy after good performance but, by contrast, sold convertibles from Itron, Oak Street Health and Umicore as their equity sensitivity had fallen below the desired range.

Finally, a convertible from Vinci left the portfolio as the end of the conversion period was approaching. We sold rather than convert into equity so as to avoid having the risk of holding equity in these uncertain markets.

Technical characteristics

The average equity sensitivity of the portfolio fell to 0.58 from 0.59 at the end of September, although the average distance above the bond floor increased to 23.1% from 20.6%. If the fund's underlying equities were to increase by 30%, the portfolio would increase by 16% on average, all else being equal. However, if the equities were to fall by 30%, the portfolio should decline by just under 13%. At quarter-end, the portfolio yield (a combination of yield-to-maturity and current yield) was approximately 0.3%.

Credit rating breakdown (%)

	Fund (Start)	Fund (End)	Change
Investment grade	16.2	16.4	0.3
High yield	4.0	6.3	2.3
No rating	79.8	77.2	-2.6

Outlook

There are many factors that may prompt the return of volatility to what seems to be a relatively sanguine market environment, such as new variants of coronavirus, geopolitical tension, higher inflation and rising interest rates, a rising cost of living and elections in various countries. In our opinion, having exposure to the convertibles market could be a worthwhile way of lowering investment risk while retaining exposure to any potential further gains in equity markets.

We remain firmly of the view that the asymmetric return profile of convertibles – participating more when equity markets are rising than when they are falling – should make them a worthwhile constituent of an investor's portfolio. Convertibles tend to perform well when equity prices experience high levels of volatility, and if volatility does rise for any reason, we are hopeful that convertibles would continue to be a relatively safe haven.

The largest risk to the continued good performance of the convertibles market seems to be a significant switch out of technology companies, which traditionally make up a high proportion of this market. Rotation out of highly valued growth stocks might also act as a headwind to the asset class. However, the universe as a whole currently seems more balanced than it has previously, with the valuations of technology stocks no longer as elevated as they were.

Given the lack of clarity in the investment outlook, we have tried not to position the fund aiming for one particular scenario, but to construct a portfolio that should be able to navigate all possible scenarios, remaining agile should the background change significantly one way or the other. At all times, however, we aim to benefit as much as possible from the unique risk characteristics of the asset class by focusing on balanced convertibles, often by buying new issues. We have reduced exposure to both highly equity-sensitive convertibles that could be vulnerable to equity price falls and to bond-like convertibles that would not share in further equity appreciation if it were to occur.

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We have tried to avoid the highest equity valuations in, for example, the 'stay-at-home' theme, but want to stay invested in the segment by having exposure to more balanced convertibles. We have also invested in potential recovery stories, such as the travel and leisure sector, where we own online booking companies, hotels and airlines. However, we always try to focus on better-quality, cash-generative businesses, with good credit ratings that should give their convertibles robust bond floors, as opposed to the fastest-growth plays or the cheapest cyclical and value stocks with poor balance sheets. We believe this approach has the potential to deliver healthy returns to investors over time.

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.

Climate metrics

	Weighted Average Carbon Intensity	Coverage by portfolio weight (%)
US Dollar CI-H Accumulation	121.79	96.85%
Benchmark	165.34	93.44%

Source: MSCI

Explanation of our climate metrics

The Weighted Average Carbon Intensity (WACI) is the metric used to report our funds' carbon emissions. It is a measure of how much CO2 is being emitted per US$ million of sales by each company that the fund invests in. This can be used to determine the likely effect a company is having on the environment. It can also help to compare the impact different companies have on the environment, and to compare companies against the broad market or the financial benchmark for the fund. However, this metric does not take into account the difference in carbon characteristics among sectors.
The WACI metric is one of many greenhouse gas emissions data points, each offering a different aspect of analysis on climate impact. M&G have selected this metric as it is applicable to multi-asset, equity and fixed income funds and it is aligned to the recommendations from the Taskforce for Climate Related Financial Disclosures (TCFD). It has also been chosen to align with M&G's groupwide target of transparency when it comes to the disclosure of climate emissions.
At M&G we currently use MSCI as our main third-party data provider for carbon intensity data as we consider its coverage to be the broadest of the current providers. As with any mass data collection, there are methodology limitations; this also applies to MSCI. We make every effort to check its data and are currently building our own tools which will use a variety of data sources to gather and map the carbon emissions of our funds.
For the avoidance of doubt, this fund is not managed to a carbon emission objective and, the benchmark WACI (should funds have a benchmark) has been included for information purposes only.

Important information

On 9 November 2018, the non-sterling assets of the M&G Global Convertibles Fund, a UK-authorised OEIC, merged into the M&G (Lux) Global Convertibles Fund, a Luxembourg-authorised SICAV, which launched on 9 November 2018. The SICAV is run by the same fund manager, applying the same investment strategy, as the UK-authorised OEIC.

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

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