Balancing impact with investment quality

M&G (Lux) Positive Impact Fund

January 2023

Key points

- Impact equity investing involves finding impactful companies which contribute towards the world's most pressing challenges, while also seeking to generate an attractive financial return.
- This article covers how we aim to build portfolios of high-quality businesses, with the potential to deliver strong returns, in M&G's range of impact strategies.
- We also consider the drivers of performance for the M&G (Lux) Positive Impact Fund in 2022.

The value of a fund's assets will go down as well as up. This will cause the value of your investment to fall as well as rise and you may get back less than you originally invested. There is no guarantee that the fund will achieve its objective and you may get back less than you originally invested. The views expressed in this document should not be taken as a recommendation, advice or forecast.

Good impact isn't enough

It is important to emphasise from the outset that impact investing isn't philanthropy. While it is true that investee companies undergo rigorous assessment to ensure they make positive environmental or social impacts, they must also be high-quality businesses with the potential to deliver good financial returns. We analyse the investment case by reviewing companies in five areas:

- Business model
- Competitive position
- Capital allocation
- Business risk
- Liquidity

During this process we use a blend of field work, direct experience and internal sources, such as other fund managers and sector analysts, as well as external sources, including Credit Suisse HOLT, Morningstar, MSCI and external brokers. Potential investee companies are scored in each of the five areas, before being debated by the wider Positive Impact team. They must be approved unanimously to be added to the watchlist.

Is the price right?

It is equally important to not overpay for good companies. This is why the team conducts scenario-based valuation work, using change analysis to understand what is built into today's share price, and the sensitivity to change. The team looks at the potential upside and downside risks of holding the stock, placing probabilities on these different scenarios, and allowing them to determine what they believe to be a company's intrinsic value. The company can then be bought when there is a sufficient margin of safety between the current share price and the believed intrinsic value, compared to alternative opportunities and considering portfolio risks.

Aiming to hold resilient companies over the long term

In M&G's Impact strategies, we invest with a long time horizon, seeking companies that we would be happy to own for 10 years. These companies tend to have robust business models and strong pricing power. They are businesses which we would feel comfortable holding through economic cycles, providing resilience in challenging times and the potential for growth in rising markets.

By their nature, investee companies also often stand to benefit from multi-generational trends and opportunities. For example, the shift from fossil fuels to clean energy, and increasing demand for communications and financial services in developing communities.

Diversification is crucial

M&G's Impact strategies tend to be concentrated portfolios, usually holding fewer than 40 stocks. However, diversification remains an integral part of the investment process. Portfolio companies can be picked from across the globe, with no geographical restraints. They also operate across a variety of industries, from pharmaceuticals and renewables, to logistics and telecommunications.

Portfolio companies are split across three categories, based on how they make a positive impact. This provides additional diversification across different types and maturities of business model.

- **Pioneers**, whose products or services have a transformational effect on society or the environment.
- **Enablers**, which provide the tools for others to deliver positive social or environmental impact.
- **Leaders**, which spearhead the development of impact and sustainability in their industries.

M&G (Lux) Positive Impact Fund – recent performance

The M&G (Lux) Positive Impact Fund has shown resilience since the beginning of 2022, in what has been a challenging market for many impact funds. The below chart shows the fund's performance against 11 competitor public equity impact funds.

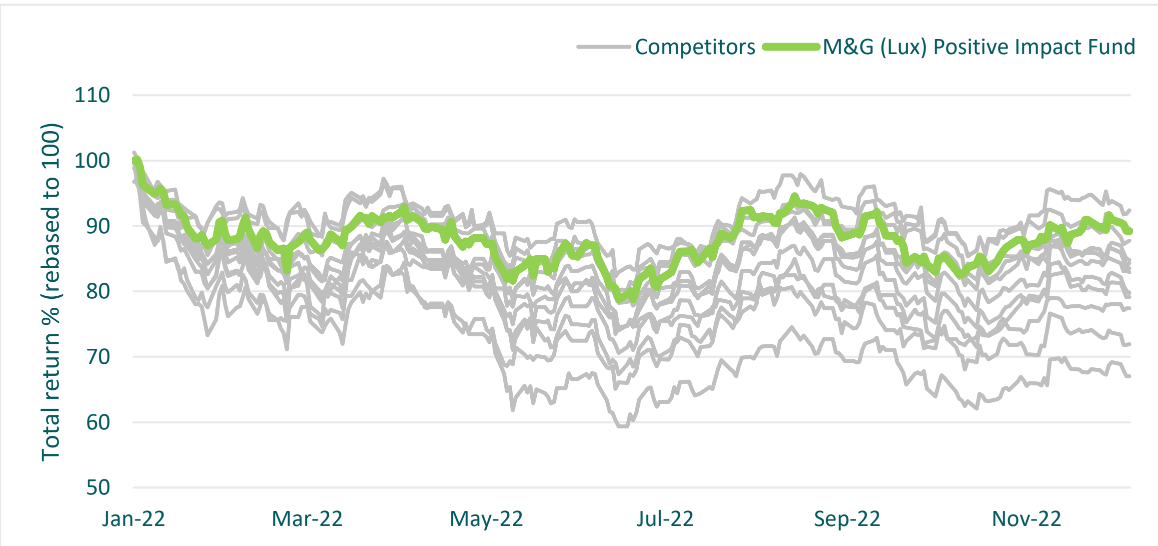
Early 2022 was a tough period for the fund, against a backdrop of high growth and inflation. In this market environment, commodities and energy companies tend to outperform, and the fund holds neither. Furthermore, the fund does not hold Western banks – which tend to respond well to higher interest rates – as they do not pass our strict impact criteria.

Since Russia's invasion of Ukraine, macroeconomic conditions have deteriorated significantly due to inflationary pressures and geopolitical uncertainties. The fund remained relatively resilient in this tough period, which we attribute to our focus on quality companies. We look for investee companies with strong pricing power and structural growth drivers, which we believe tend to be more resilient in challenging markets.

The fund's performance has also benefited from our more balanced approach. With a focus on diversification across end markets, industries and maturities of business model, the fund has less of a bias towards high-growth companies and smaller companies, both of which have struggled in 2022.

At least 80% of the fund is invested in the shares of companies, across any sector and of any size, from anywhere in the world, including emerging markets. The fund usually holds shares in fewer than 40 companies. The fund invests in securities that meet its ESG Criteria and Impact Criteria. Norms-, sector- and/or values-based exclusions apply to investments. All companies are assessed on their investment credentials and ability to deliver positive social and/or environmental impact. At least 80% of the fund will be invested in sustainable investments: at 30% in sustainable investments with a social objective and at 30% in those with an environmental objective.

M&G (Lux) Positive Impact Fund performance versus peers in 2022



Past performance is not a guide to future performance.
Source: Refinitiv Eikon Datastream, 08/12/2022, total return. Rebased to 100 at 01/01/2022. Please note: Comparisons are with funds on a like-for-like basis.

M&G (Lux) Positive Impact Fund performance											
	YTD and YTQ	**2021**	**2020**	**2019**	**2018**	**2017**	**2016**	**2015**	**2014**	**2013**	**2012**
M&G (Lux) Positive Impact Fund	-14.0	20.2	11.9	34.6	N/A	N/A	N/A	N/A	N/A	N/A	N/A
MSCI ACWI Net Return Index	-13.0	27.5	6.7	28.9	-4.9	8.9	11.1	8.8	18.6	17.5	14.4

Past performance is not a guide to future performance.

YTQ = year to most recent quarter end.
Source: Morningstar, as at 31/12/2022. EUR Class A Acc shares, income reinvested, price-to-price basis. Benchmark returns stated in share class currency.

The benchmark is a comparator used solely to measure the fund's performance and does not constrain portfolio construction. The benchmark has been chosen as it best reflects the fund's financial objective. The fund is actively managed. The fund 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. The benchmark is not an ESG benchmark and is not consistent with the ESG Criteria and Impact Criteria.

The main risks that could affect the fund's 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 holds a small number of investments, and therefore a fall in the value of a single investment may have a greater impact than if it held a larger number of investments.
- The fund can be exposed to different currencies. Movements in currency exchange rates may adversely affect the value of your investment.
- Investing in emerging markets involves a greater risk of loss due to greater political, tax, economic, foreign exchange, liquidity and regulatory risks, among other factors. There may be difficulties in buying, selling, safekeeping or valuing investments in such countries.
- In exceptional circumstances where assets cannot be fairly valued, or have to be sold at a large discount to raise cash, we may temporarily suspend the fund in the best interest of all investors.
- The fund could lose money if a counterparty with which it does business becomes unwilling or unable to repay money owed to the fund.
- Operational risks arising from errors in transactions, valuation, accounting, and financial reporting, among other things, may also affect the value of your investments.
- ESG information from third-party data providers may be incomplete, inaccurate or unavailable. There is a risk that the investment manager may incorrectly assess a security or issuer, resulting in the incorrect inclusion or exclusion of a security in the portfolio of the fund.

Further details of the risks that apply to the fund can be found in the fund's Prospectus.

Other important information:

- 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.
- Investing in this fund means acquiring units or shares in a fund, and not in a given underlying asset such as a building or shares of a company, as these are only the underlying assets owned by the fund.

UCITS HAVE NO GUARANTEED RETURNS, AND PAST PERFORMANCE IS NOT A GUIDE TO FUTURE PERFORMANCE

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