

# M&G (Lux) Optimal Income Fund

## Investment update and outlook 2022

Richard Woolnough, Fund Manager

January 2022



- 2021 was dominated by the COVID-19 pandemic, along with concerns around higher inflation; the global economy continued to recover – as did corporates' earnings and balance sheets.
- Credit spreads tightened while government bond yields rose, reflecting higher inflation and more hawkish central bank sentiment.
- The fund posted a positive return in 2021 – thanks to tighter credit spreads and a c5% exposure to equities.
- Despite rising rates, the fund didn't lose much from duration because of the portfolio's low interest-rate risk.
- We expect our flexible investment mandate to be in a strong position to explore arising opportunities in 2022.

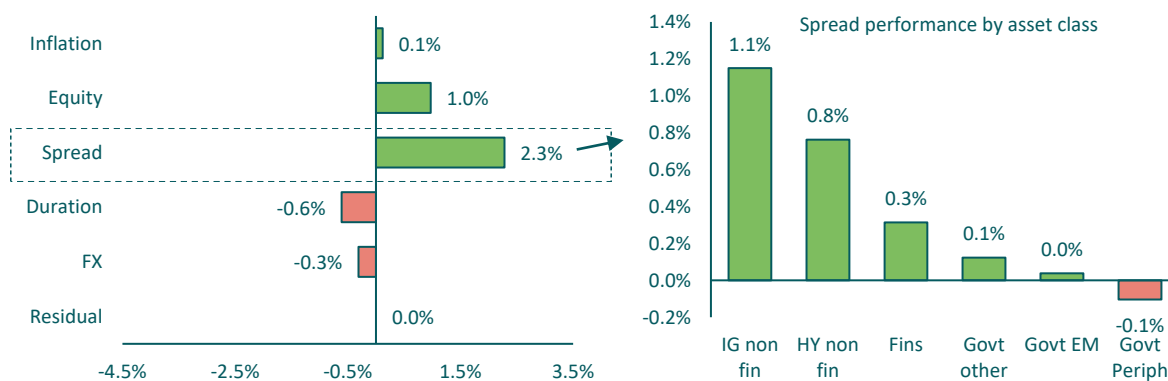
The value and income from the fund's assets will go down as well as up. This will cause the value of your investment to fall as well as rise and you may get back less than you originally invested. There is no guarantee that the fund will achieve its objective and you may get back less than you originally invested. Where any performance is mentioned, please note that past performance is not a guide to future performance.

### Performance review 2021

2021 was dominated once again by the COVID-19 pandemic, along with concerns around higher inflation. Economies, however, continued to recover and companies posted strong earnings while maintaining elevated profit margins. As a result, credit spreads tightened while government bond yields rose reflecting higher inflation and more hawkish sentiment from central banks. In this environment, the fund posted a positive return supported, in particular, by tightening spreads and by its exposure (c. 5%) to stocks. Within credit, most of the performance came from investment grade corporates, particularly US dollar long-dated names as spreads tightened significantly in this space. High yield bonds and emerging market bonds were also positive contributors to returns, while exposure to peripheral government bonds detracted as spreads rose towards the end of the year. Despite rising rates, the fund didn't lose much from duration as we maintained a very low interest-rate sensitivity in the portfolio (See Figure 1).

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.

Figure 1. Active return coming from spread and equities



Past performance is not a guide to future performance

Source: M&G, 31 December 2021. Please note, portfolio data is based on internal sources, is unaudited and may differ from information as shown in the Monthly Fund Review.

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

Figure 2. Fund performance over five calendar years (% pa)

	2021	2020	2019	2018	2017
Fund (EUR)	1.2	1.4	6.8	-4.0	4.3
BM* (EUR)	-0.9	4.9	7.8	N/A	N/A

Past performance is not a guide to future performance

\*The composite index – 1/3 Bloomberg Barclays Global Agg Corporate Index EUR Hedged; 1/3 Bloomberg Barclays Global High Yield Index EUR Hedged; 1/3 Bloomberg Barclays Global Treasury Index EUR Hedged – was introduced as the fund's benchmark on 7 September 2018.

The benchmark is a comparator against which the fund's performance can be measured. The composite 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.

Source: Morningstar, Inc., as at 31 December 2021, Euro A Acc share class, price to price, income reinvested.

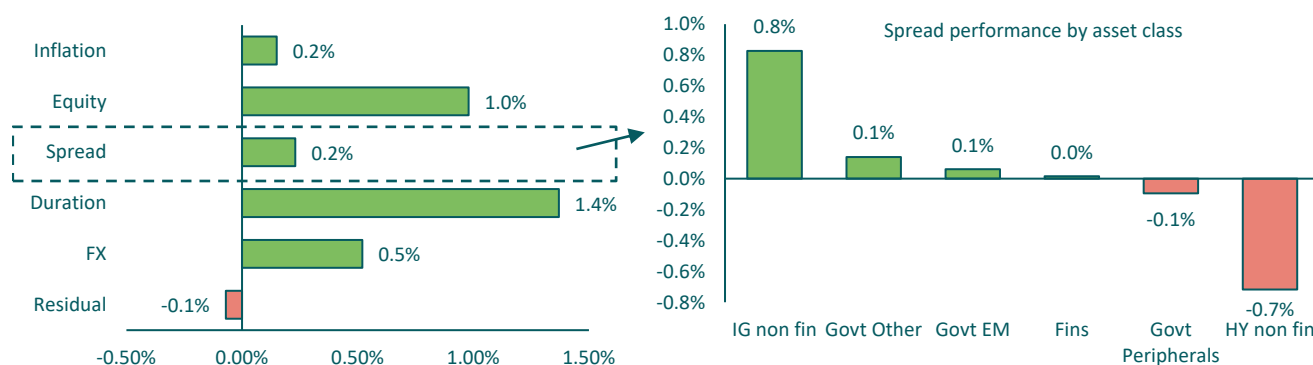
Fund performance prior to 7 September 2018 is that of M&G Optimal Income Fund (a UK-authorized OEIC), which merged into this fund on 8 March 2019. Tax rates and charges may differ.

Compared to the fund's reference benchmark (a composite index comprising: 1/3 Bloomberg Barclays Global Agg Corporate Index EUR Hedged; 1/3 Bloomberg Barclays Global High Yield Index EUR Hedged; 1/3 Bloomberg Barclays Global Treasury Index EUR Hedged), the fund posted a solid return (see Figure 2). It also outperformed (in gross terms) all three major fixed income asset classes included in the reference index: global investment grade, global high yield, and global government bonds. Most of this outperformance came from our long-standing underweight duration positioning, which helped as yields rose for the majority of 2021. Our exposure to equities, in mostly cyclical sectors and in companies with low price-to-earnings ratios, has also been a good source of returns. Finally, spreads contributed to relative returns with most of the outperformance coming from investment grade credit where we have been overweight throughout the year. On the other hand, our underweight exposure to high yield – holding fewer riskier credit names than the wider market – detracted (See Figure 3).

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.

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. 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.

Figure 3. Performance attribution vs. reference index\*



Past performance is not a guide to future performance

Source: M&G, 31 December 2021. Please note, portfolio data is based on internal sources, is unaudited and may differ from information as shown in the Monthly Fund Review. \*Reference index = 1/3 Bloomberg Barclays Global Treasuries, 1/3 Bloomberg Barclays Global Credit Corp, 1/3 Bloomberg Barclays Global High Yield

## Portfolio positioning in 2021

We were very active throughout 2021 in using the full flexibility of Optimal Income's wide-ranging investment capabilities.

### From USD IG into HY and EUR financials

As we entered 2021, the fund had an overweight exposure (relative to the benchmark) to US dollar investment grade credit, particularly long-dated issuance. This position was based on a pure credit view as opposed to a duration view. As a result, we were carefully managing our duration in order to capture the potential spread compression within these bonds. Boosted by central bank policy and a benign economic outlook, these instruments performed well and moved closer to what we would consider 'fair value', or in some cases even expensive. We therefore gradually shifted our exposure away from these long-dated US dollar corporate bonds mainly into both high yield bonds and into European investment grade financial bonds (see Figure 3). This is in line with our constructive view on the economy (which we feel should benefit financials) and our view that defaults will likely remain low (which should benefit high yield).

### Active in inflation markets, both as a buy and sell

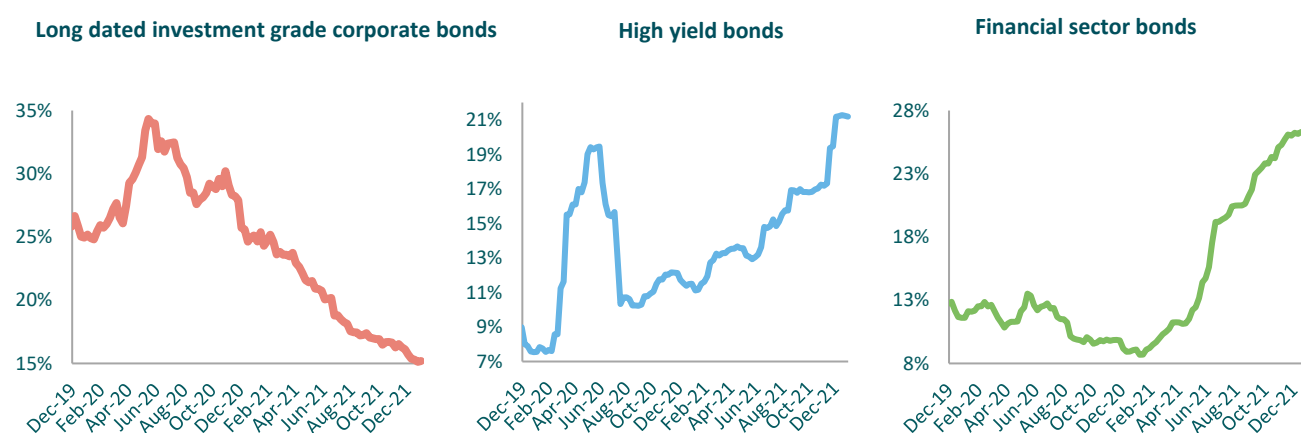
We also have been active in inflation markets, trading inflation-linked bonds ('linkers') and also inflation swaps. The linkers we bought were mainly Eurozone and Japanese, as we were finding breakeven rates (indicating inflation expectations) attractive. On the other hand, we used long-dated inflation swaps to take a short position on inflation expectations in the UK after they rose significantly as investors priced-in inflation above 4% over the long term. Notwithstanding the build-up of prices in recent months, that sort of level is a stretch in our view.

Throughout the year we also looked for opportunities within equities and particularly within value stocks and in cyclical sectors. Our current exposure to equities is around 5% (versus a portfolio maximum of 20%) and this allocation has been steady for some time.

### We are underweight duration as we see rates rising in 2022

Finally, our overall duration exposure remains unchanged: we remain close to 2.5 years, which is roughly 4 years lower than our reference benchmark index. However, during the year we have been active in shifting its composition around, both within currencies and across the yield curve. Within the former, we gradually rotated duration away from euro assets into US dollar and UK sterling assets where the market started to expect more interest rate hikes. Across yield curves, we added some duration at the short-dated end, while we reduced duration at the longer-dated end as yield curves flattened, a market movement that is in contrast with our constructive view on the economy.

Figure 4. Changes in fund exposure to long-dated investment grade corporate bonds, high yield bonds, and financials



Source: M&G, 31 December 2021. Please note, portfolio data is based on internal sources, is unaudited and may differ from information as shown in the Monthly Fund Review.

## Outlook

We think central banks need to raise interest rates sooner rather than later (and the Bank of England's is already doing this with a December 2021 hike). But to avoid braking too hard on the economic recovery, we believe the pace of rate rises will be more measured, even if this means allowing some level of inflation to circulate. Given the economy is strong, the consumer is in a good position – more than the market has realised, in our view – and inflation is back, we also argue that yield curves should be steepening from their current levels, as the market at the long-end grapples with rising inflation expectations. This should be good for financials and especially banks and a key theme for the fund's credit exposure as we enter 2022.

Going into 2022, we remain constructive on the economy and think credit will remain supported by solid growth and low defaults, as discussed above. However, as central banks start to remove their stimulus and inflation continues to remain above target, we would expect some more dispersion in returns, which in turn can be a positive for active investors. And we want to own credit risk and not duration risk as a consequence.

## Aligning the fund to SFDR Article 8

Since 29 October 2021, the M&G (Lux) Optimal Income Fund has become Article 8 classified under the new Sustainable Finance Disclosure Regulation (SFDR) introduced by the European Commission in March 2021. This is part of M&G's commitment to evolve as many strategies as possible towards environmental, social and governance (ESG), sustainable or impact outcomes. SFDR dictates various disclosure-related requirements for financial markets, aiming to provide more transparency on sustainability in a standardised way.

### **M&G**

#### **January 2022**

The fund allows for the extensive use of derivatives.

Further risks associated with the fund can be found in the fund's Key Investor Information Document.

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



**For Investment Professionals, Institutional Investors, Accredited Investors and Professional Investors only. Not for onward distribution. No other persons should rely on any information contained within. Distribution of this document in or from Switzerland is not permissible with the exception of the distribution to Qualified Investors according to the Swiss Collective Investment Schemes Act, the Swiss Collective Investment Schemes Ordinance and the respective Circular issued by the Swiss supervisory authority ("Qualified Investors"). Supplied for the use by the initial recipient (provided it is a Qualified Investor) only.** In Spain the M&G Investment Funds are registered for public distribution under Art. 15 of Act 35/2003 on Collective Investment Schemes as follows: M&G (Lux) Investment Funds 1 reg. no 1551. The collective investment schemes referred to in this document (the "Schemes") are open-ended investment companies with variable capital incorporated in Luxembourg. In the Netherlands, all funds referred to are UCITS and registered with the Dutch regulator, the AFM. M&G Luxembourg S.A. is the manager of the UCITS referred to in this document. Registered Office: 16, boulevard Royal, L-2449, Luxembourg. For Hong Kong only: The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the offer of any funds mentioned in it. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice. Shares, units or other interests in the funds mentioned in this document may only be offered or sold in Hong Kong to persons who are "professional investors" as defined in the Securities and Futures Ordinance ("Ordinance") and any rules made under the Ordinance – or in circumstances which are permitted under the Companies (Winding Up and Miscellaneous Provisions) Ordinance. In addition, distribution of this document in Hong Kong is restricted. It may not be issued or possessed for the purposes of issue, whether in Hong Kong or elsewhere, and shares, units or other interests in the funds mentioned may not be disposed of to any person unless such person is a "professional investor" as defined in the Ordinance and any rules made under the Ordinance or as otherwise may be permitted under Hong Kong law. For Singapore only: For "accredited investors" and "institutional investors" as defined under the Securities and Futures Act (Cap. 289) of Singapore ("SFA") only. This document forms part of, and should be read in conjunction with, the Information Memorandum of the Fund and other communications permitted for offers made in reliance of prospectus exemptions under the SFA. All forms of investments carry risks. Such investments may not be suitable for everyone. M&G Investments (Hong Kong) Limited, M&G Investments (Singapore) Pte. Ltd. (Co. Reg. No. 201131425R), and M&G International Investments S.A. and the funds referred to in this document may not be authorised, recognised or regulated by the local regulator in your jurisdiction. This information is not an offer or solicitation of an offer for the purchase or sale of investment shares in one of the funds referred to herein. Purchases of a fund should be based on the current Prospectus. The Instrument of Incorporation Prospectus, Key Investor Information Document, the annual or interim Investment Report and Financial Statements, are available free of charge in English or your local language (unless specified below) from [www.mandg.com/investments/](http://www.mandg.com/investments/) or in paper form from one of the following: the Luxembourg paying agent: Société Générale Bank & Trust SA, Centre operational 28-32, place de la Gare L-1616 Luxembourg; the Danish paying agent: Nordea Danmark, Filial af Nordea Bank Abp, Finland, Issuer Services, Postbox 850, Reg.no. 5528, DK-0900 Copenhagen C; Allfunds Bank, Calle Estafeta, No 6 Complejo Plaza de la Fuente, La Moraleja, 28109, Alcobendas, Madrid, Spain; M&G International Investments S.A. or its French branch; from the French centralising agent of the fund: RBC Investors Services Bank France; or from the Swedish paying agent: Nordea Bank AB (publ), Smålandsgatan 17, 105 71 Stockholm, Sweden. For Switzerland, please refer to M&G International Investments Switzerland AG, Talstrasse 66, 8001 Zurich. For Italy, they can also be obtained on the website: [www.mandgitalia.it](http://www.mandgitalia.it). For the Netherlands, they are available online at [www.mandg.com/investments/nl](http://www.mandg.com/investments/nl) and for more information concerning the Key Investor Information Document, please refer to [www.afm.nl/ebi](http://www.afm.nl/ebi). For Ireland, they are available in English language and can also be obtained from the Irish facilities agent, Société Générale SA, Dublin Branch, 3rd Floor IFSC House – The IFSC Dublin 1, Ireland. For Greece, they are available in English, except the Key Investor Information Document/s which is available in Greek, from the Greek Representative: Eurobank Ergasias S.A. 8, Othonos Street, 10557 Athens. For Taiwan only: The financial product(s) offered herein has not been reviewed or approved by the competent authorities and is not subject to any filing or reporting requirement. The financial product(s) offered herein is only permitted to be recommended or introduced to or purchased by customers of an offshore banking unit of a bank ("OBU")/offshore securities unit of a securities firm ("OSU") which customers reside outside the R.O.C. Customers of an OBU/OSU are not eligible to use the financial consumer dispute resolution mechanism under the Financial Consumer Protection Law. This product(s) may be made available for purchase by Taiwan OBUs/OSUs acting on behalf of non-Taiwan customers of such units but may not otherwise be offered or sold in Taiwan. **Before subscribing investors should read the Prospectus and Key Investor Information Document**, which includes a description of the investment risks relating to these funds. The value of the assets managed by the funds may greatly fluctuate as a result of the investment policy. M&G International Investments S.A. may terminate arrangements for marketing under the new Cross-Border Distribution Directive denotification process. The information contained herein is not a substitute for independent investment advice. Complaints handling information is available in English or your local language from the following websites:

Luxembourg: [www.mandg.com/investments/professional-investor/en-lu/complaints-dealing-process](http://www.mandg.com/investments/professional-investor/en-lu/complaints-dealing-process)

Ireland: [www.mandg.com/investments/professional-investor/en-ie/complaints-dealing-process](http://www.mandg.com/investments/professional-investor/en-ie/complaints-dealing-process)

Belgium: [www.mandg.com/investments/professional-investor/en-be/complaints-dealing-process](http://www.mandg.com/investments/professional-investor/en-be/complaints-dealing-process)

Denmark: [www.mandg.com/investments/professional-investor/en-dk/complaints-dealing-process](http://www.mandg.com/investments/professional-investor/en-dk/complaints-dealing-process)

Norway: [www.mandg.com/investments/professional-investor/en-no/complaints-dealing-process](http://www.mandg.com/investments/professional-investor/en-no/complaints-dealing-process)

Netherlands: [www.mandg.com/investments/professional-investor/en-nl/complaints-dealing-process](http://www.mandg.com/investments/professional-investor/en-nl/complaints-dealing-process)

Sweden: [www.mandg.com/investments/professional-investor/en-se/complaints-dealing-process](http://www.mandg.com/investments/professional-investor/en-se/complaints-dealing-process)

Finland: [www.mandg.com/investments/professional-investor/en-fi/complaints-dealing-process](http://www.mandg.com/investments/professional-investor/en-fi/complaints-dealing-process)

Greece: [www.mandg.com/investments/private-investor/en-gr/complaints-dealing-process](http://www.mandg.com/investments/private-investor/en-gr/complaints-dealing-process)

Spain: [www.mandg.com/investments/professional-investor/es-es/complaints-dealing-process](http://www.mandg.com/investments/professional-investor/es-es/complaints-dealing-process)

Italy: [www.mandg.com/investments/professional-investor/it-it/complaints-dealing-process](http://www.mandg.com/investments/professional-investor/it-it/complaints-dealing-process)

Portugal: [www.mandg.com/investments/private-investor/pt-pt/complaints-dealing-process](http://www.mandg.com/investments/private-investor/pt-pt/complaints-dealing-process)

France: [www.mandg.com/investments/professional-investor/fr-fr/complaints-dealing-process](http://www.mandg.com/investments/professional-investor/fr-fr/complaints-dealing-process)

In Hong Kong, this financial promotion is issued by M&G Investments (Hong Kong) Limited, Office: Unit 1002, LHT Tower, 31 Queen's Road Central, Hong Kong;

In Singapore, this document is issued by M&G Investments (Singapore) Pte. Ltd. (Co. Reg. No. 201131425R), regulated by the Monetary Authority of Singapore;

and, elsewhere, by M&G International Investments S.A. Registered Office: 16, boulevard Royal, L-2449, Luxembourg. The Portuguese Securities Market Commission (Comissão do Mercado de Valores Mobiliários, the "CMVM") has received a passporting notification under Directive 2009/65/EC of the European Parliament and of the Council and the Commission Regulation (EU) 584/2010 enabling the fund to be distributed to the public in Portugal.

669801\_SICAV\_PE\_ex-DE\_AT\_SG\_HK\_TWN