M&G (Lux) Global Dividend Fund

Highlights of 2021 and Outlook for 2022

Stuart Rhodes, Fund Manager

January 2022

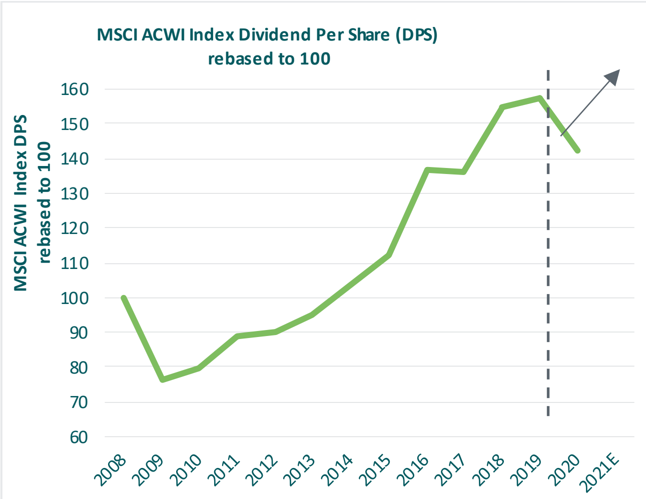
- Global dividends recovered from the worst dividend environment since the Second World War, with consensus forecasts of a 15% increase in 2021. Dividends are expected to rise again in 2022, by 5%, according to Bloomberg estimates.
- The fund generated a positive return in 2021 but underperformed the MSCI ACWI Net Return Index. Methanex led the detractors after the methanol producer gave back some of its gains from the value rally in the fourth quarter of 2020. Keyera added the most value in a standout energy sector.
- We made 15 new purchases and 11 complete sales – a level of turnover consistent with our typical time horizon of three to five years.
- We saw dividend growth across the portfolio, with the majority of holdings reporting increases in the typical 5-15% range, up from 0-5% in 2020. Lundin Mining was the most generous, with two dividend increases of 50% during the year. Methanex and Trinseo resumed dividend growth after reducing their payments in 2020.

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.

Dividends in 2021

Global dividends recovered from the worst dividend environment since the Second World War as corporate cashflows improved from the dark days of the pandemic. With interest rates at record lows and the injection of unprecedented levels of stimulus, cyclical companies, which follow the ups and downs of the economy and which bore the brunt of dividend cuts in 2020, were able to pay dividends again. Banks, energy and mining companies delivered strong dividend growth in 2021, albeit from depressed levels. Technology provided a source of reliable dividends as Apple and Microsoft extended their track record of continued growth. Defensive sectors whose performance does not depend so much on how the wider economy is doing, such as consumer staples and healthcare, remained resilient and continued to deliver steady dividend increases across economic cycles.

Figure 1. Dividends on the recovery path

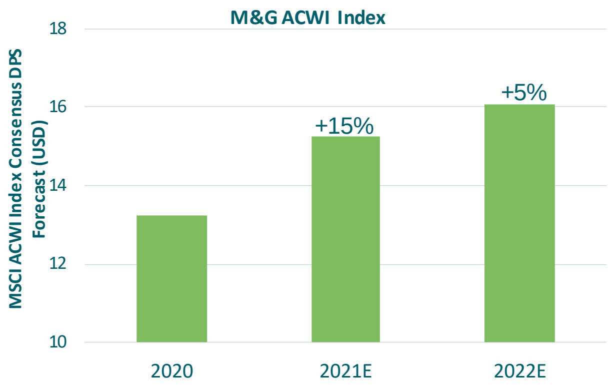


Source: Factset, 31 December 2021.

Past performance is not a guide to future performance.

Global dividends increased by 15% in 2021, according to consensus forecasts for the MSCI ACWI Index, and are set to rise by 5% in 2022 (Source: Bloomberg, 6 January 2022).

Figure 2. Consensus Dividend Per Share (DPS) forecast



Source: Bloomberg, 6 January 2022.

Market review

Global equities rallied in 2021 as the recovery from the pandemic gathered pace. The US led the markets higher, with the major indices – the S&P 500 Index, the Dow Jones Industrial Average and the Nasdaq Composite Index – reaching record highs. Europe delivered solid gains but fell short of the MSCI ACWI Net Return Index. Asia and emerging markets lagged further behind.

Energy was the standout sector in a mixed year for cyclicals: financials outperformed, helped by the strength of banks, but industrials and materials struggled to keep up with the rising market.

Technology enjoyed another good year as semiconductor stocks surged. Consumer discretionary underperformed owing to the weakness in Alibaba and Amazon.com.

Defensive sectors remained out of favour as rising bond yields took their toll on sentiment. Utilities, consumer staples and healthcare underperformed.

5-year fund performance (%pa) and performance since launch (%pa)

Product return in euro	2021	2020	2019	2018	2017
M&G (Lux) Global Dividend Euro A	20.9	3.7	24.1	-8.7	8.4
MSCI ACWI Net Return Index	27.5	6.7	28.9	-4.5	9.5

Past performance is not a guide to future performance.

Product return in euro	1 year	3 years	5 years	10 years	Since launch
M&G (Lux) Global Dividend Euro A	20.9	15.9	9.0	10.4	10.0
MSCI ACWI Net Return Index	27.5	20.6	12.9	13.8	11.4
Morningstar Global Equity Income sector average	26.1	14.7	8.1	10.0	8.4
Quartile	4	2	2	2	1

Source: Morningstar, Pan European universe, 31 December 2021.

Past performance is not a guide to future performance.

The fund generated a positive return in 2021 but underperformed the MSCI ACWI Net Return Index. Methanex provided the biggest drag on performance after the shares gave back some of their gains from the final quarter of 2020, when the stock price almost doubled. To us, the long-term investment case for the methanol producer remains unchanged. We are optimistic about the prospects for cash generation in the current operating environment and the stock remains a core holding.

Trinseo was another laggard in the materials sector despite making progress in corporate strategy. The chemicals company is transforming itself to become a higher value-added, more sustainable business and we are supportive of the management team and its strategic direction.

Abrdn, formerly Standard Life Aberdeen, was another notable laggard among our holdings in extreme value. The asset manager's valuation remains distressed and does not reflect the value attached to the company's quoted stake in India's HDFC Life, in our view.

Takeda Pharmaceutical and Novartis underperformed in healthcare as rising bond yields provided a difficult backdrop for defensive stocks. Both stocks remain attractively valued, in our view.

Not owning Apple, which rose more than 30%, and NVIDIA, which doubled, also held back performance relative to the MSCI ACWI Net Return Index. We have been monitoring Apple throughout 2021 as the technology bellwether underperformed during the first nine months of the year, but the valuation remains a challenge. NVIDIA is another potential investment candidate because the semiconductor company pays a dividend, but we see cyclical businesses that we think are much more attractively valued elsewhere.

Turning to the positive contributors, Keyera added the most value in a buoyant energy sector. The midstream company, which owns and operates pipelines, storage terminals and processing facilities, offers attractive long-term prospects, in our view, driven by its exposure to some of the most prolific basins in North America; the stock also offers compelling value with a dividend yield of 6%, which we believe is secure.

KLA Corp (semiconductors) and Microsoft (software) gained more than 50% in technology. Both companies benefited from strong operating results throughout the year.

Lowe's, the US home improvement retailer, rose to an all-time high, backed by robust fundamentals. St. James's Place, the UK wealth manager, and Anthem, the US managed care organization, performed in a similar vein for similar reasons.

Sector allocation added value, helped by the overweight in energy. Country allocation benefited from a zero weighting in China and an underweight in Japan.

Portfolio activity

We made 15 new purchases and 11 complete sales during the year – a level of turnover consistent with our typical time horizon of three to five years. The number of holdings increased to 45, compared to our historic range of 40-50.

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.

We were most active during the first quarter when we made six new purchases and four complete sales. We made a conscious effort to diversify the fund's exposure to the cyclical 'assets' bucket with the addition of Siemens (industrials) and Lundin Mining (materials). We also bought Blackrock and S&P Global in financials. The negative sentiment triggered by rising bond yields provided an attractive entry point for NextEra Energy (utilities) and Walmart (consumer staples). Ørsted (renewables), Tokyo Electron (semiconductors) and Martin Marietta (materials) provided a source of cash after strong performance. We also sold Danone (consumer staples) after we lost conviction in the management team.

Portfolio turnover returned to more normal levels during the second quarter, when we initiated four new holdings and exited two positions. The purchase of Analog Devices (semiconductors), Intact Financial (insurance) and AstraZeneca (healthcare) were driven by a desire to look beyond the economic reopening and identify companies benefiting from internal developments to deliver growth. We also bought Adidas (consumer discretionary) to gain exposure to a long-term growth industry. Cisco Systems (technology) and Arthur J Gallagher (insurance) were sold after both stocks benefited from a significant re-rating. Their valuations were no longer compelling.

The third quarter saw one new purchase and two sales. We bought VF Corp (consumer discretionary) in the belief that the company's strategic focus on key brands will generate profitable growth over the long term. We sold UnitedHealth and Roche in healthcare to back our conviction in Anthem and Novartis, where we have greater conviction.

We made four new purchases and three complete sales during the fourth quarter. We sought to take advantage of the abrupt market downturn in November by adding three new holdings: Marsh McLennan and Charles Schwab in financials, as well as Mastercard in digital payments. Broadcom, a semiconductor company, was the final purchase during the year. We sold Enel and NextEra Energy in utilities as a source of cash. We also disposed of St. James's Place in financials after a strong run.

Fund positioning

The fund's exposure to 'quality' declined from 42% at the end of 2020 to 39%. The defensive part of the portfolio remained below the historic range of 40-60% for most of the year. The exposure to 'assets' was higher at 47%, up from 43%. The weighting remained above our historic range of 20-35%, reflecting the value we see in a variety of cyclicals. The fund's exposure to 'rapid growth' fell from 12% to 10% following the sale of Enel, NextEra Energy and St. James's Place during the final quarter. The premium growth segment usually accounts for 10-20% of the portfolio.

Looking at sectors, materials and energy remained meaningful overweight positions although the absolute weightings were lower at the end of the year in both cases. The fund remained underweight in industrials and financials among the cyclical sectors, although the industrials exposure increased with the new purchase of Siemens and the higher weighting in ABB.

Consumer staples and healthcare remained the largest overweight positions among the defensive sectors. Utilities dropped to zero after we sold Enel and NextEra Energy. The fund continues to have zero exposure to the bond proxies in telecommunication services and real estate.

The technology weighting increased as we added Analog Devices and Broadcom to our semiconductor holdings. That said, the fund remained underweight in the sector overall due to the limited exposure in software and the zero weighting in hardware following the sale of Cisco. The fund remains overweight in semiconductors.

Regional weightings saw North America increase from 58% to 63% as 12 of the 15 new purchases originated from the US and Canada. Europe ex UK fell from 16% to 11% as Ørsted, Danone, Roche and Enel exited the portfolio. The UK declined from 14% to 12% with the sale of St. James's Place. Japan was lower after we sold Tokyo Electron. The exposure to Asia Pacific ex Japan and emerging markets rose above 10%.

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.

Company engagement

The assessment of environmental, social and governance (ESG) issues is an increasingly important consideration in the stock selection process and we remain committed to our longstanding practice of engaging companies on crucial aspects of corporate responsibility. We are keen to ensure that the companies in which we are invested adopt best practice to the benefit of all stakeholders, including employees, customers, shareholders and broader society.

In this respect, we are pleased with the continued recognition of our efforts to improve the ESG standard across the portfolio: the fund remains AAA rated by MSCI ESG.

Our journey to higher ESG quality took another step forward with the sale of Martin Marietta. Investment decisions are never determined by ESG considerations alone, but ESG had a clear influence in this instance. The US buildings materials company was one of the higher carbon emitters in the portfolio and sub-standard in terms of climate disclosure. Martin Marietta is rated BBB by MSCI ESG, which is average by MSCI's standards, but ranked bottom 10 among the fund's holdings. It was clear that the fund would be better placed from an ESG perspective without its inclusion. The primary reason for the sale was strong share price performance, as a result of which a cyclical stock was valued more like a growth stock, but unresolved ESG issues played their part.

ESG analysis is often associated with negative screening, but we are also keen to embrace its positive aspects and its ongoing development to create a more sustainable world. With this objective in mind, we are delighted that Gibson Energy, where we have been a cornerstone shareholder for many years, continued to make progress on its sustainability strategy by announcing measurable ESG targets, including a 15% reduction in overall greenhouse gas (GHG) intensity by 2025, rising to 20% by 2030. This development prompted MSCI to upgrade Gibson Energy's ESG rating to AAA. The midstream business becomes only the third company in its peer group to win this accolade and the only North American company in the industry to receive a top ranking.

Gibson Energy's progress did not end there. The news of the MSCI upgrade was accompanied by the announcement of an even more ambitious target: net zero Scope 1 and 2 emissions by 2050. (Scope 1 emissions are those resulting from sources that the company controls, such as furnaces, vehicles etc. Scope 2 emissions are indirect, as they are associated with such actions as the purchase of electricity, heating or cooling, etc. for the company's needs.) We have been proactive in encouraging Gibson Energy to develop a sustainability strategy and we are pleased that senior management have been quick to embrace best practice and set new standards. It also highlights what can be achieved with constructive dialogue. We continue to engage with Gibson Energy on a variety of issues and have similar conversations with representatives of other holdings in the portfolio.

We are also pleased that our engagement with Methanex has been productive. As Methanex's largest shareholder, we wrote to the Board of Directors to express our support for recent initiatives including the strategic update in July, the share buyback programme announced in September, the restart of the Geismar 3 project and the plans for debt reduction. We believe that the company has made considerable progress as a result of our discussions and is now on the right path to create significant value for shareholders.

Dividend announcements

We saw dividend growth across the portfolio, with the majority of holdings reporting increases in the typical 5-15% range, compared to 0-5% in 2020. Procter & Gamble (consumer staples), Bristol Myers Squibb (healthcare), Blackrock (financials) and Siemens (industrials) were among the holdings that raised their dividends by 5-15% in 2021.

The technology sector provided a source of robust growth, with many of our holdings accelerating their pace of dividend growth. In semiconductors, KLA Corp accompanied a strong set of results with a 17% dividend increase, up from last year's 6%. Broadcom, Analog Devices and Taiwan Semiconductor Manufacturing Company (TSMC) also reported double-digit increases in the same industry.

In software, Automatic Data Processing (ADP) extended its long sequence of dividend growth with a 12% dividend increase, up from last year's 2%, while Microsoft accompanied its 11% dividend increase with a $60 billion share buyback programme. Visa and Mastercard raised their dividends by 17% and 11%, respectively, in digital payments.

Figure 4. Dividend announcements in 2021

15%		5-15%		<5%		Dividend cut
Trinseo	300%	S&P Global	15%	Travelers	4%	Abrdn
Methanex	233%	Blackrock	14%	Cisco Systems[2]	3%	
Lundin Mining[1]	125%	Siemens	14%	Gibson Energy	3%	
Lowe's	33%	Broadcom	14%	Novartis	2%	
Anthem	19%	ADP	12%	Coca-Cola	2%	
KLA Corp	17%	Analog Devices	11%	Colgate-Palmolive	2%	
Visa	17%	Microsoft	11%	Walmart	2%	
UnitedHealth[2]	16%	Mastercard	11%	Amcor	2%	
		NextEra Energy[2]	10%	VF Corp	2%	
		Procter & Gamble	10%	Roche[2]	1%	
		TSMC	10%	Imperial Brands	1%	
		Intact Financial	10%	ABB	Flat	
		Bristol Myers Squibb	10%	Takeda Pharmaceutical	Flat	
		Novo Nordisk	9%			
		Enel[2]	9%			
		Medtronic	9%			
		Arthur J Gallagher[2]	7%			
		AIA	7%			
		PepsiCo	5%			

Past performance is not a guide to future performance.
Source: M&G, 31 December 2021.

[1] Two dividend increases of 50% plus a special dividend.
[2] No longer held.

Lundin Mining was even more generous with its dividend commitments. The company raised its regular dividend by 50% on two occasions during the year and announced a special dividend tied to operating performance. We believe that Lundin is well placed for the long term due to its focus on copper, which as an efficient conductor of heat and electricity, is a potential beneficiary of the structural growth in renewable energy.

Lowe's (consumer discretionary) and Anthem (healthcare) also reported dividend growth of more than 15%.

It was also encouraging to see some of the dividend cutters in 2020 reinstate dividends or resume dividend growth in 2021.

Methanex, which reduced its dividend to retain financial flexibility in the wake of the pandemic, raised its dividend more than threefold, reflecting a positive outlook for the methanol industry. Trinseo, which lowered its dividend to prioritise debt reduction following an acquisition, increased the payment by a multiple of four. The balance sheet was deemed sufficiently strong to accommodate higher cash returns to shareholders. Imperial Brands also reported a higher dividend in line with its progressive dividend policy.

Pandora, which took the decision before the pandemic to suspend dividends and focus on share buybacks, paid special dividends given the company's strong operational performance and ample liquidity. The Danish company also announced a new share buyback programme, equivalent to about 6% of market cap.

However, it was not all good news. Abrdn reduced its dividend by a third in light of tough operating conditions. A dividend cut should never be taken lightly, but we remain supportive as the company remains committed to long-term dividend growth from the rebased level. The stock remains attractively valued in our view, on a dividend yield of 6% and a significant discount to its sum of the parts.

The dividend cut was the exception rather than the rule in a portfolio where many holdings delivered solid, and in some cases impressive, dividend increases. That said, we remain vigilant about the dividend outlook. Being selective will be paramount. Balance sheet strength is a key consideration in our company research to ensure that dividends are sustainable in the current climate. We take comfort from the fact that many of our holdings are carrying net cash.

We continue to believe that the majority of our holdings can sustain dividend growth in the core 5-15% range over the long term, and that the fund is well placed to deliver on its income growth objective.

Outlook

The emergence of the Omicron variant of the new coronavirus has provided a stark reminder that the global health crisis is far from over. But the renewed uncertainty about COVID has done little to alter the view of policymakers that the global economy is in the midst of a strong recovery and interest rates need to rise to keep inflation in check.

It has been our view from the early days of the pandemic that the economy will rebound quickly in response to unprecedented levels of stimulus, that rates will have to rise from record lows and that the normalisation of rates will lead to a reappraisal of how financial assets are priced – particularly in the stockmarket where valuations are polarised: expensive growth at one end and extreme value at the other.

We continue to believe that the demanding multiples attached to some 'new economy' stocks are unsustainable; we are also convinced that the attractive valuations in less fashionable areas of the market present the best opportunities for long-term returns. We remain unapologetically optimistic about the investment opportunities available to us.

That being said, we are increasingly looking beyond the reopening for new ideas. We continue to see dramatic swings in the market's attitude to growth and value, but valuation remains a key discipline in our fundamental analysis. It is important that we do not overpay for the growth we seek. We remain poised to take advantage of buying opportunities when they arise. Capitalising on these opportunities will ultimately determine fund performance in the years ahead and we remain confident about the future.

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.

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