M&G (Lux) Global Emerging Markets Fund

Relative success against tough backdrop for risk assets

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- We seek to identify emerging market companies that can capture profitably the opportunities created by the powerful long-term trends underway in these markets.
- Against the challenging 2022 market backdrop the fund has bounced back strongly, outperforming for two consecutive years.

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.

2023: All eyes on China and the US Federal Reserve

Emerging Markets (EM) equities had their worst year since the Global Financial Crisis (GFC) in 2022. The MSCI Emerging Markets Index finished down around 20% in US dollar terms – the sixth year of negative absolute returns over the past decade.

In 2023, while economic growth is likely to slow, equity returns may improve as investors digest the impact of China re-opening and the diminished shock of higher US rates as we approach the peak of the Fed cycle. Inflation is not a concern for EM in our view, as the central banks dealt with it sooner and, we believe, more decisively than in developed markets. Slower growth, disinflation and a Federal Reserve reaching the peak of its tightening cycle may tempt EM central banks to cut rates, although the market will remain wary of premature moves. India, Indonesia, Brazil and South Africa don't have monetary headroom, whereas Korea and Taiwan will be torn between the opposing forces of China's recovery and a slowing global economy.

China, in our opinion, looks poised to perform especially well, given the combination of low valuations and a recovering economy. The long-awaited China re-opening play may face short-term headwinds given large COVID-19 infection rates, but we feel the market will begin to look through these as we approach the early Chinese New Year celebrations. In tandem, China re-opening should boost demand for commodities, which we think can feed positively into other EMs. With many investors still trying to appraise whether or not Beijing's 'common prosperity' policy extends to shareholders, or if re-opening and greater concern for economic outcomes post-COVID are favourable for companies, we see an attractive entry point.

Korea also looks very attractive and we believe will itself benefit from China's re-opening and stabilisation, as well as a turn in the global tech cycle, especially semiconductors. In addition, there are a number of attractively-valued names in Brazil, as the country continues to benefit from global commodity price inflation and supply-chain disruption. For now, investors remain understandably nervous about the return of Lula da Silva as president and the economic and fiscal policies to be adopted by his administration.

Conversely, there is much debate in EM investor circles as to whether or not India has run too far, with long-run valuations several standard deviations higher than history. Corporates have benefited from the monetary and fiscal largesse adopted during the pandemic, which has also boosted market valuations. While the economic stimulus is reduced, investors will likely find other EMs offering more attractive risk/reward, especially with China re-opening. Valuations in India are at absolute highs and their most expensive relative to the rest of the emerging markets. We remain underweight India.

MENA (ex-North Africa) had a very strong 2022, due to high energy prices delivering resilience from global woes. Regional index weights reached record highs. That resilience may continue, spurring the growth diversification story in, for example, Saudi Arabia which saw fresh Initial Public Offerings (IPOs) broadening the equity opportunity set. Saudi Arabia is now the MSCI EM Index's sixth largest country weight at 4%, approaching that of Brazil at 5%, as at 31 December 2022.

Performance across sectors and regions was very differentiated in 2022. We may see a further rise in stock dispersion in 2023, as investors drill down beyond macro considerations to focus on individual stock opportunities. As US rates peak, emerging market currencies should benefit, especially if EM central banks are slow to cut rates. We believe the environment, as such, is almost perfect for active managers, like ourselves, to thrive.

The fund can be exposed to different currencies. Movements in currency exchange rates may adversely affect the value of your investment.

Overall, EM is much cheaper on most simple valuation metrics than developed markets. In our view, with earnings starting to stabilise (while yet to meaningfully fall in the US) we could potentially see overdue outperformance from the asset class.

Despite the short-term soap opera of the news flow, the long-term EM drivers are still intact, in our opinion. Near-shoring will benefit Mexico and ASEAN. India and Indonesia remain structural growth winners, albeit stocks are trading at more expensive multiples. The likes of Korea and Taiwan still have very strong competitive advantages, and strength in MENA gives a new depth to the asset class.

Markets, as ever, will continue to price in the changing macroeconomic circumstances in China and elsewhere well ahead of time. Amidst the uncertain backdrop, we maintain our bottom-up ethos, and remain poised to take advantage of company-specific stock opportunities.

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.

Fund performance

Against the 2022 market background the fund has bounced back strongly, outperforming for two consecutive years. The fund's returns are now ahead of the benchmark over three and five years. Relative performance was supported by stock selection in a number of areas, notably consumer discretionary, financials and information technology. From a country perspective, the above-index allocation to Brazil was helpful given the country's stockmarket outperformed. Another positive contribution came from stock selection in China.

US-listed oil & gas explorer Kosmos Energy was a leading contributor for the second consecutive year. The stock rallied as energy prices soared after Russia's invasion of Ukraine – with Russian gas under sanctions, investors looked especially favourably on the company's gas assets.

In Brazil, electricity utility Eletrobras added value as investors welcomed the company's privatisation. Financial group Banco Bradesco made a positive contribution too, as investors became more optimistic about the Brazilian economy amid higher commodities prices.

Elsewhere, Turkish conglomerate Sabanci and Mexican real estate firm Fibra Uno were notable contributors. Mexico is expected to benefit from US-China tensions and "near-shoring" of manufacturing activities from Asia to North America.

In contrast, our Russian holdings held back the fund's performance relative to the benchmark. Prior to the attack on Ukraine, we held positions in energy firms Lukoil and Novatek, financial group Sberbank and retailer X5. Given the uncertainty around the ability of foreign investors to trade Russian stocks, following the introduction of sanctions, the decision was taken to write down the value of all our Russian equity holdings to zero.

Meanwhile, worries about the global economic outlook and weaker demand for consumer electronics and semiconductors weighed on our shares in South Korean technology firms Samsung Electronics and SK Hynix.

Performance

5-year fund performance (%, pa)

	Q4 2022	H2 2022	YTQ and 1Y	3yr pa	5yr pa
EUR A	3.2	-2.9	-5.5	-0.1	1.6
Benchmark (EUR)*	0.7	-5.0	-14.9	-1.0	1.0
USD A	12.8	-0.3	-10.8	-1.7	-0.8
Benchmark** (USD)	9.7	-3.0	-20.1	-2.7	-1.3

Past performance is not a guide to future performance.

Source: Morningstar Inc., 31 December 2022. EUR A and USD A share classes, income reinvested, price to price.

* **Benchmark (EUR)** = MSCI Emerging Markets Net Return Index

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Prior to 26 October 2018 the benchmark was the MSCI Emerging Markets Index (Gross Return). Thereafter it is the MSCI Emerging Markets Net Return Index. Net Return indices include dividends after the deduction of withholding taxes. Prior to 26 October 2018 the benchmark was the MSCI Emerging Markets Index (Gross Return). Thereafter it is the MSCI Emerging Markets Net Return Index. Net Return indices include dividends after the deduction of withholding taxes.

The fund's benchmark is the MSCI Emerging Markets Net Return Index.

The benchmark is a comparator against which the fund's performance can be measured. It is a net return index which includes dividends after the deduction of withholding taxes. 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. The benchmark is not an ESG benchmark and is not consistent with the ESG Criteria.

YTQ = year to most recent quarter

Discrete-year performance, 10 years (pa, %)

	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Fund (EUR)	-5.5	11.4	-5.2	25.1	-13.5	12.7	18.9	-6.4	3.0	-4.3
Bmark (EUR)	-14.9	4.9	8.5	20.6	-10.0	21.0	14.9	-4.9	11.8	-6.5
Fund (USD)	-10.8	2.7	3.6	22.7	-17.3	27.9	15.3	-16.1	-9.1	0.0
Bmark (USD)	-20.1	-2.5	18.3	18.4	-14.3	37.8	11.6	-14.6	-1.8	-2.3

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Source: Morningstar Inc., 31 December 2022, EUR A and USD A share classes, income reinvested, price to price.

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A distinctive investment approach

Our strategy seeks to identify emerging market companies that can capture profitably the opportunities created by the powerful long-term trends underway in these markets.

Our approach is centred on the belief that shareholder value creation (companies generating returns on capital above their cost of capital) ultimately drives company share prices. As patient, value-oriented investors, we look for companies whose future returns on capital are, in our view, being underappreciated by other investors.

We employ a consistent bottom-up stockpicking process that incorporates three core tenets: return on capital, valuations and shareholder alignment.

To begin with, we undertake rigorous analysis to understand the level of returns a company might generate in the future – we look for two specific types of companies: 'change' businesses that can improve their returns over time and firms that already have high and sustainable returns.

Our strict valuation focus helps us identify opportunities where we believe the market is undervaluing the company's prospects. We are searching for companies where the market's expectations for a firm's future returns differ to our assessment.

The final part of the process is alignment. We want to be sure that we will share in the company's success: we seek well-managed companies that are run for the benefit of all their shareholders.

We aim to construct a balanced portfolio with four distinct types of companies (internal change, external change, quality and asset growth) that have different return on capital profiles. This approach is designed to help the strategy perform in a variety of market conditions.

The strategy is managed by our London-based Emerging Markets Equities team. The fund manager, Michael Bourke, is supported by a deputy manager and dedicated analysts. He can also draw on M&G's extensive investment capabilities including the Asia Pacific Equity team, experienced equity fund managers and expert global equity analysts.

The fund may invest in China A shares. Investments in assets from China are subject to changeable political, regulatory and economic conditions, which may cause difficulties when selling or collecting income from these investments. In addition, such investment is made via the Stock Connect system, which may be more susceptible to clearing, settlement and counterparty risk. These factors could cause the fund to incur a loss.

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.

Further risks associated with the fund can be found in the fund's Prospectus.