M&G (Lux) Global Macro Bond Fund

In a changing world, flexibility is paramount

Jim Leaviss, Fund Manager

June 2021

- As a highly flexible, global bond strategy, we believe the M&G (Lux) Global Macro Bond Fund is well equipped to navigate the longer-term challenges that continue to face the global economy.
- In contrast with resilient performance during the pandemic-related sell-off in early 2020, this year rising bond yields and our defensive credit stance have created performance headwinds.
- The fund is tactically positioned for an expected return of inflation and growth scenario in 2021, with around a quarter of the fund currently held in inflation-linked bonds.

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.

A flexible, globally diversified approach

The M&G (Lux) Global Macro Bond Fund is a flexible, globally diversified bond fund seeking to drive long-term performance by the active management of its duration, credit risk and currency positioning. We seek to capture the best relative value in the global fixed income markets, with the freedom to invest across the full range of government and corporate bond markets in both developed and emerging market regions.

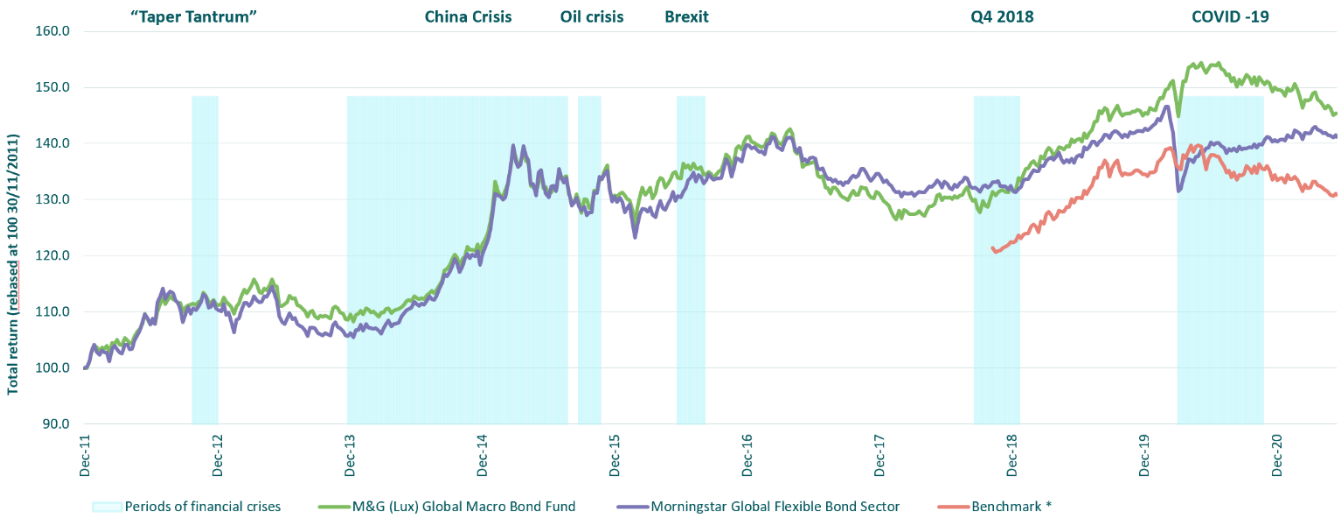
Diversification is a key part of the strategy and we typically look to have exposure to at least four to six uncorrelated macro themes across global bond and currency markets. Another distinctive feature of the fund is its ability to invest in currencies, not only as a an additional way to generate returns, but also to diversify risks.

The fund has established a long-term performance track record, with returns generated across multiple sources of alpha, including interest rates, credit, emerging markets and currencies. Historically, the fund has proved resilient during market downturns – most recently during the onset of the COVID-19 crisis in early 2020 – and we believe the strategy has the potential to provide good diversification from other risk assets.

Please note that 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. 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.

Figure 1. A fund that has been resilient to recent market downturns



Past performance is not a guide to future performance.

*Bloomberg Barclays Global Aggregate Index.

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.

Source: Morningstar Inc., Wider universe database, 31 May 2021, euro A share class, gross income reinvested price-to-price basis. Fund performance prior to 26 October 2018 is that of the euro A share class of the M&G Global Macro Bond Fund, a UK-authorised OEIC, which merged into this fund on 26 October 2018. Tax rates and charges may differ. The Bloomberg Barclays Global Aggregate Index was introduced as the fund's benchmark on 26 October 2018; it is shown starting from that date.

Figure 2. Fund performance year to date (%) and five calendar years (% pa)

	YTD	2020	2019	2018	2017	2016
Fund (EUR A)	-2.6	3.0	9.8	1.8	-7.5	7.1
BM*	-2.3	0.2	8.8	N/A	N/A	N/A

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2020 recap – demonstrating resilience

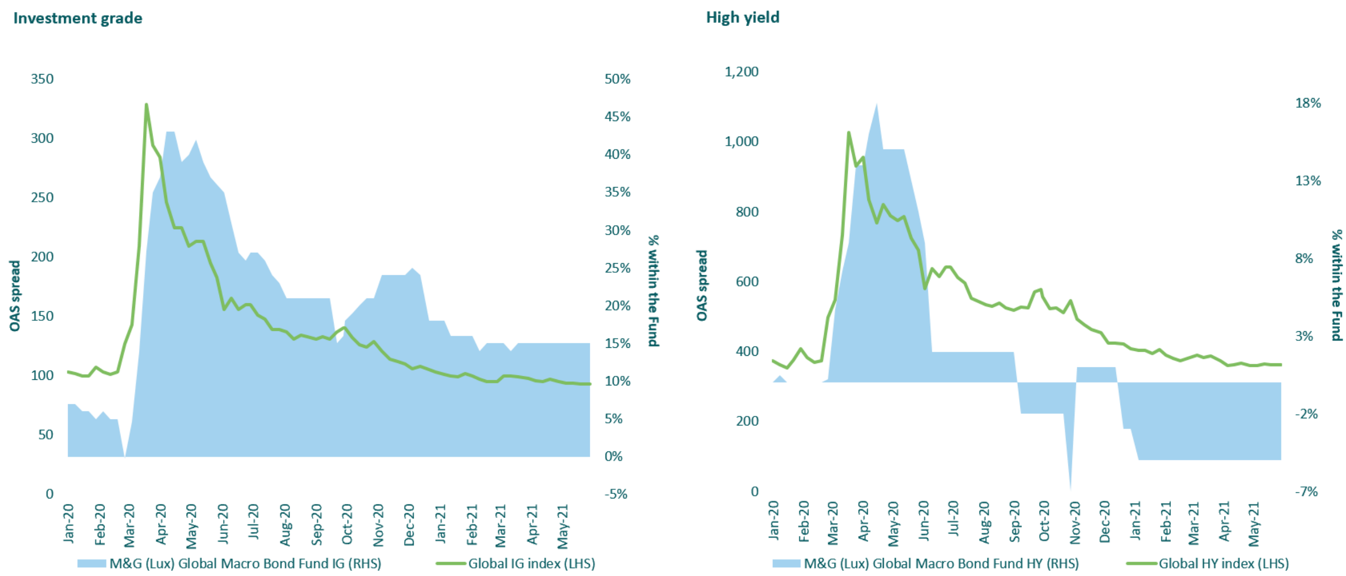
We made use of our flexibility to deliver robust returns in 2020. A key return driver was our decision to significantly reduce credit risk and increase duration before the onset of the crisis. While we did not foresee the full impact of the crisis, we did think markets had become too complacent regarding the outlook for the global economy, leaving credit valuations with little margin for error.

At the start of 2020 we increased duration from around 3 years to more than 7 years, as we thought the elevated level of government bond yields at that time looked at odds with the uncertain economic outlook. This stance allowed us to benefit from the subsequent collapse in government bond yields as the crisis intensified in February and March.

At the same time, our defensive credit positioning helped mitigate the sharp sell-off in credit markets. In addition, the fund's increased risk-free allocation meant we were well-placed to add credit at what we considered to be extremely attractive levels at the height of the sell-off, including a variety of new issues in the primary corporate bond market.

We steadily reduced credit exposure in the second half of 2020 as spreads tightened significantly. This more cautious stance slightly weighed on relative performance in the latter stages of the year, as it meant the fund did not fully capture the continued rally in credit markets.

Figure 3. Investment grade and high yield allocation



Source: Bloomberg, M&G, 31 May 2021.

2021 YTD – a more challenging market backdrop

The fund has faced a more challenging market backdrop in 2021, with returns held back by government bonds yields. The key performance drivers in 2021 can be summarised as follows:

1 Rising government bond yields

Another headwind has been the significant rise in core government bond yields since the start of 2021, as a pick-up in growth and inflation expectations has seen investors bring forward their expectations of an increase in interest rates. 10-year US Treasury yields have increased from 0.9% at the end December 2020 to 1.6% at the end of May 2021, with similar moves across other core government bond markets. While the fund has been cautiously positioned from a duration perspective (with duration currently standing at around 5 years), rising yields have nevertheless acted as a drag on overall returns.

2 Limited credit risk

Our defensive credit stance has also weighed on relative performance in 2021 as corporate bond spreads have continued to tighten. Spreads in most areas of the market are now back to pre-crisis levels, which we do not think can be justified given that the longer-term economic outlook is far less certain than it was before the pandemic. We follow a disciplined approach and do not take risk when we feel we are not being paid for it. While this may lead to some short-term underperformance if risk assets continue to rally, we think it leaves us well-positioned to withstand any renewed market turbulence, as well as to take advantage of any opportunities that present themselves, such as we saw in early 2020.

3 Inflation-linked exposure

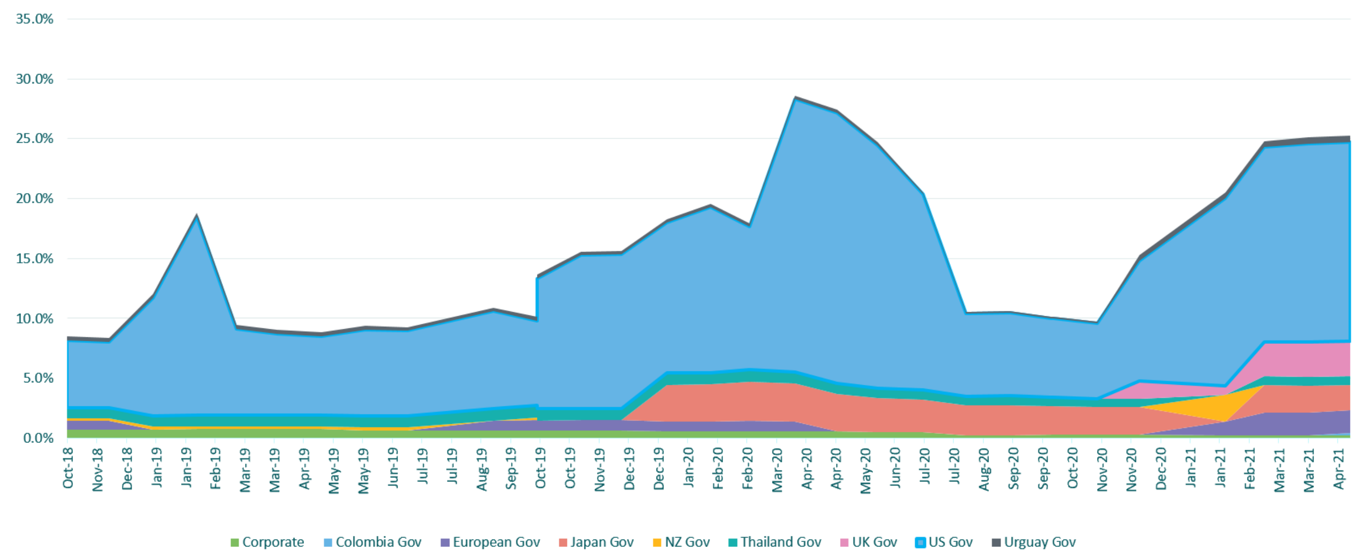
These detractors have been partly offset by resilient performance across the fund's inflation-linked bond positions and certain inflation-correlated currencies. Driven by the improved economic backdrop and the unprecedented stimulus measures taken by governments and central bank around the world, our inflation-linked exposure has benefited from a sharp increase in inflation expectations since the start of 2021, as markets have started to price in faster price rises.

The flexibility to navigate the challenges that lie ahead

In an environment of tight valuations, we believe our highly flexible approach helps us to seek to take full advantage of opportunities across developed markets, emerging markets and currencies. The fund is not benchmark-constrained and can freely invest according to where we see the best value.

This flexibility has allowed us to position the fund tactically for an expected reflation scenario – with inflation rising on the back of a strong economic recovery – in 2021 as the global economy re-opens. We think inflation could overshoot in the near term as the huge levels of pent-up demand and excess saving are released. Around one quarter of the fund is held in inflation-linked bonds, and we also have exposure to a number of currencies that tend to be positively correlated to inflation or commodities such as the Australian dollar, Norwegian krone and Canadian dollar.

Figure 4. Percentage holdings of inflation-linked securities – government and corporate



Source: M&G, 31 May 2021.

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

Another area where we see attractive medium-term value is in emerging markets. The asset class continues to offer elevated real yields, while many emerging market countries compare favourably to developed nations in regards to their longer-term economic growth prospects and debt-to-GDP ratios. The asset class shows significant dispersion, both in terms of valuations and growth trajectories of individual countries, giving ample opportunities for active managers to uncover value. When investing in this asset class, we are able to draw on the wider expertise of M&G's Emerging Markets Debt team, which is led by Claudia Calich.

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.

From a currency perspective, we have increased the fund's US dollar exposure in recent months, with this allocation now back in line with its typical exposure range of just above 50%. Having been somewhat cautious on the greenback throughout 2020, we are now more constructive as we think the currency should benefit from the improved economic outlook and the good progress of the vaccine rollout in the US. Latest data indicates that the US is experiencing a strong recovery, with ISM surveys recently touching their highest levels for more than 20 years. We also see ample scope for a further strengthening of the US labour market, with the employment population ratio still well behind pre-crisis levels but normalising rapidly. Inflationary pressures also continue to build, with increasing evidence that the rise in US inflation could become more permanent. All of this should create upward pressure on US rates and we believe be positive for the US dollar.

While the relatively benign conditions in financial markets may suggest otherwise, we believe the global economy continues to face significant challenges and uncertainties over the coming years. At this stage we do not know the longer-term economic impact of the pandemic, such as whether we could see structurally higher levels of unemployment in the future. A sharper-than-expected rise in inflation is another key risk, while central banks face the difficult task of deciding when to tighten policy without jeopardising the economic recovery. Geopolitical issues also remain very much in the foreground, with the US and China trade situation an ongoing source of tension. The fund has historically proven resilient during market downturns and we believe our flexible and globally diversified approach leaves us well equipped to navigate the challenges that lie ahead.

M&G

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The fund allows for the extensive use of derivatives.

The fund may invest more than 35% in securities issued by any one or more of the governments listed in the fund prospectus. Such exposure may be combined with the use of derivatives in pursuit of the fund objective. It is currently envisaged that the fund’s exposure to such securities may exceed 35% in the governments of Germany, Japan, UK and the US, although these may vary subject only to those listed in the prospectus.

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

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