M&G (Lux) Global Emerging Markets Fund

H1 update: finding value in turbulent markets

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- Despite a challenging backdrop, the fund delivered strong results relative to its benchmark and peer group in the year to the end of May 2022
- The team is ‘following the value’ towards quality areas of the market
- While broad based sentiment towards Chinese stocks continues to be weak, we see value on offer

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

War, inflation and recession fears

Global stockmarkets have fallen steeply in the first half of 2022 as worries about war, inflation and recession have driven a significant increase in market volatility.

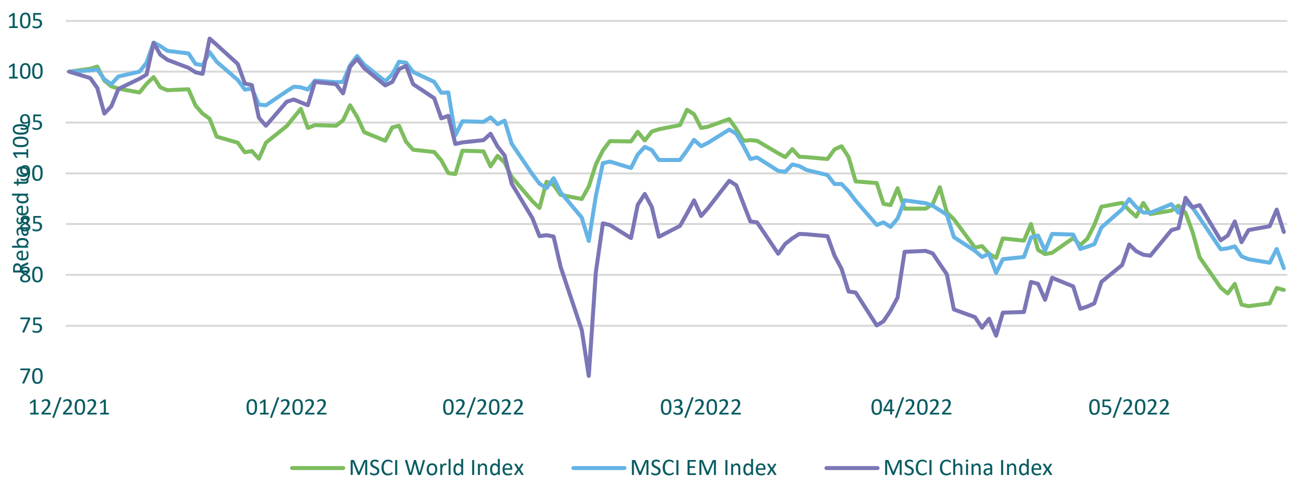
Russia’s invasion of Ukraine on 24 February was a major factor behind investors’ nervousness, with consequences that reverberated across the globe. The war and subsequent sanctions caused a surge in commodities prices, which exacerbated already high inflationary pressures. Central banks, notably the US Federal Reserve, responded by raising interest rates to curb soaring inflation. However, tighter monetary policy prompted fears of an economic slowdown.

Events in China also weighed on sentiment. Investors worried about the economic cost of the country’s zero-COVID strategy, which placed entire cities in lockdown and caused a slowdown in economic activity. This compounded concerns about the country’s property market and a regulatory crackdown.

Emerging market equities have been marginally more resilient so far this year than developed market stocks, largely as the S&P 500 Index of US stocks experienced a

Figure 1: Global stockmarkets have fallen in the 2022 amid worries about war, inflation and recession

Year-to-date performance: World, Emerging markets and China stockmarkets



Past performance is not a guide to future performance

UCITS HAVE NO GUARANTEED RETURN, AND PAST PERFORMANCE IS NOT A GUIDE TO FUTURE PERFORMANCE drop of 20% in the period, a fall that typically defines a 'bear' market (see Figure 1).

While stockmarkets in China, India, South Korea and Taiwan declined, it was a positive period for emerging markets sensitive to commodities. In Latin America, Brazil and Chile registered healthy gains. Oil-producing nations Kuwait, Qatar and the United Arab Emirates rose, while Indonesia also advanced.

Financials and utilities were among the best-performing sectors. In contrast, information technology and healthcare were the weakest areas. Energy declined despite higher oil prices, dragged down by Russian stocks, which were removed from the index. Investors are reminded that 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.

Robust relative performance

Against this challenging background, the fund's performance has held up very well and it is ahead of the benchmark index year to date (see Figure 2). The fund also ranks top quartile in the Morningstar Global Emerging Markets Equity sector over the same period.

Robust gains by Brazilian stocks, including utility firm Eletrobras, which has benefited from privatisation plans, and energy and financial holdings, have supported relative performance. They have helped make up for our Russian holdings, notably energy firm Lukoil and financial group Sberbank, which were all valued at zero after Russia invaded Ukraine. Investors are reminded that past performance is not a guide to future performance.

Following the value to quality

There have been some significant share price moves in the volatile market conditions we have seen this year. Our response, as always, has been to focus on the long term and look for a potential dislocation between company fundamentals (operational and financial performance) and valuations. Where company share prices have fallen, we have assessed if there has been any actual deterioration to the company's underlying business and growth prospects or whether investors had reacted to macroeconomic or geopolitical uncertainty.

Figure 2: Performance in euros

	To end Q1 2022 %	2021 %	2020 %	2019 %	2018 %	2017 %	2016 %	2015 %	2014 %	2013 %	2012 %
M&G (Lux) Global Emerging Markets Fund	0.7	11.4	-5.2	25.1	-13.5	12.7	19.0	-6.4	3.0	-4.3	18.7
Benchmark*	-4.9	4.9	8.5	20.6	-10.0	21.0	14.9	-4.9	11.8	-6.5	16.8

	3 months %	YTD 2022 %	1 year %	3 years % pa	5 years % pa	Since launch 05 Feb 2009 % pa
M&G (Lux) Global Emerging Markets Fund	3.2	1.6	0.7	6.1	4.2	9.5
Benchmark*	-2.8	-6.3	-8.5	6.4	4.9	9.6
Morningstar Global Emerging Markets Equity sector average	-3.8	-9.4	-11.1	5.5	3.8	8.3
Quartile ranking	1	1	1	2	3	1

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* 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.

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.

Fund performance prior to 26 October 2018 is that of the equivalent UK authorised OEIC, which merged into this fund on 26 October 2018. Tax rates and charges may differ .

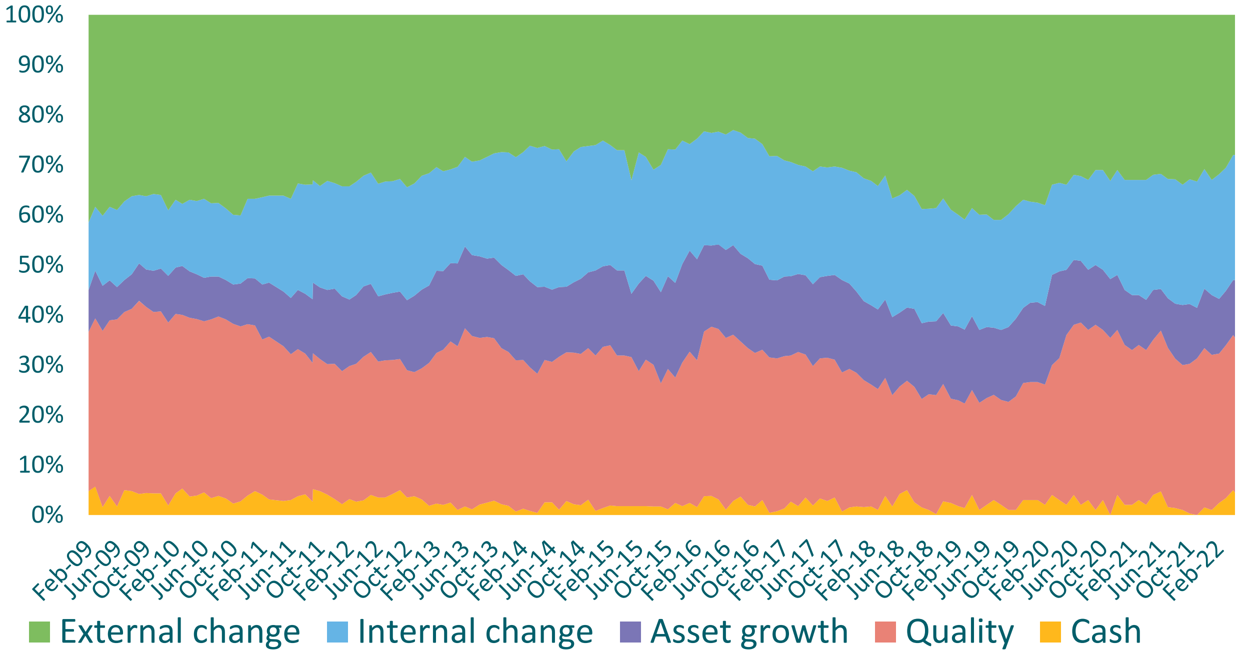
Since launch refers to the launch date of the equivalent OEIC.

*Benchmark is Gross Return prior to 26 October 2018 and Net Return after this date.

Source: Morningstar Inc., 31 May 2022. Morningstar Wider Universe, euro A class shares, income reinvested, price to price. Benchmark returns are stated in EUR terms.

Figure 3: Finding value in quality stocks

Breakdown of fund 'buckets'



Source: M&G, 31 May 2022

At least 80% of the fund is invested in the shares of companies domiciled, or conducting the major part of their economic activity, in emerging market countries. The fund may invest in China A-Shares via the Shanghai-Hong Kong Stock Connect and the Shenzhen-Hong Kong Stock Connect. Stock selection is driven by in-depth analysis of individual companies, with a specific focus on profits, corporate governance practices and valuation. Stocks are selected with distinct profitability profiles to build a fund that has the potential to cope in a variety of market conditions.

Over the past six months, we identified several companies that we felt had become attractively valued in the market turbulence. One area where valuations became more attractive, in our view, was higher quality stocks and this led us to add to our existing positions in technology firms Samsung Electronics and TSMC and start a position in Indian financial group HDFC. Although this had the effect of increasing the weighting of the 'quality' bucket in the portfolio (see Figure 3), it was not a strategic shift to quality but rather a result of following the value signals.

We can illustrate this point with the case of Taiwanese semiconductor firm TSMC. At the start of 2022, TSMC was a large underweight position (-5.9%), relative to the benchmark index. (It is one of the largest stocks in the MSCI EM Index). We had previously reduced the holding as the shares had performed well and moved well beyond our assessment of fair value, and we reallocated the proceeds to stocks that we considered more attractive opportunities such as Chinese e-commerce firm Alibaba.

TSMC's shares have fallen in value since their peak in early January 2022 and have moved back into a sensible valuation territory, in our opinion. We believe the company's long-term fundamentals remain positive but the market is concerned about a slowdown in logic chip pricing as supply catches up with demand and inventory builds in the supply chain. While we are unlikely to go overweight at this valuation, we have used the stock's weakness to pare back our underweight to -2.7% at the end of May.

We are committed to our philosophy of sizing positions, when we have confidence in the long-term fundamentals of the companies we invest in, at the right valuation. In our view, TSMC remains a best-in-class operator but there is a price for quality and when we move within or outside our valuation tolerance, we will add to or reduce a holding accordingly.

In relation to Samsung, the South Korean consumer electronics and memory chip company looks very lowly valued to us. It has a huge amount of cash on the balance sheet which we believe will either be distributed as an extra dividend or used for mergers and acquisitions. If the firm opts for the latter, it would have to be meaningful and we are unsure how the market would take this.

In our view, the stock currently offers an attractive dividend yield, and we think the company's capital allocation is sensible. Despite a perceived slowdown in the memory space, we believe the company is sufficiently diversified elsewhere.

While we have been adding reasonably priced growth stocks to the portfolio, we have taken profits from some of our more cyclical holdings following healthy gains. Most notably we reduced our positions US-listed oil and gas explorer Kosmos Energy and Canada-listed copper miner First Quantum Minerals which rallied on higher commodities price. We also sold some shares in Brazilian lender Banco Bradesco and South African lender Absa. As discussed above, we scale our position sizes according to what we consider is the attractiveness of the valuation and we could therefore increase these positions again if the valuations become more attractive to us.

Contrarian approach to China

As value-oriented investors, we are often drawn to out-of-favour, unloved parts of the market. China has certainly been shunned by many investors this year but our contrarian instincts led us to look beyond the negative headlines about COVID-19 restriction and a slowing economy to search for promising investments there.

In our view, China's stockmarket had become extremely lowly valued and by combining a rigorous fundamental approach with a consideration of valuations, we found some attractive opportunities. We added to our position in Alibaba, which has been hurt by concerns about weaker consumer spending and increasing competition. We also bought more shares in online vehicle sales firm Autohome and in the healthcare sector, we added to our holdings in drugmakers Beigene and Zai Laboratory.

These purchases continue the recent trend of returning to China. The fund has been underweight to China, relative to the benchmark, for many years, but this has been narrowed as we have found more opportunities there while other investors have been more pessimistic about developments in the country.

Our confidence in this contrarian approach has been bolstered by a rebound in China's stockmarket towards the end of period (see Figure 1). The reversal was driven by signs that China was easing some of its strict COVID restrictions, the announcement of stimulus measures to support the economy and a softening stance towards technology regulation. The latter was beneficial for our holding in Alibaba, which climbed in June and recouped most of its losses from earlier in the year.

China's recent stockmarket reversal has been very narrowly led by large internet stocks such as Alibaba and has yet to broaden out to the wider market. This prompts the question whether it is a tech rally rather than a China rally. If investor sentiment towards the outlook for China continues to improve, we believe that some of our other Chinese holdings such as financials Ping An and Far East Horizon and online vehicle sales firm Autohome could potentially benefit too.

One area that we are thinking about currently is the potential increase in consumer demand once the economy reopens and the impact on the overall growth picture. There is a great deal of pessimism about China at the moment but in our view, there are reasons to be optimistic as the country gradually opens up once again.

Outlook

Worries about the macroeconomic and geopolitical outlook are likely to weigh on investors' minds for some time. In this uncertain environment, we believe it is important to stick to our process and remain focused on finding well managed companies whose long-term prospects are being underappreciated. Our disciplined valuation approach is currently leading us to find opportunities in out of favour areas such as China. By taking the long view and focusing on fundamentals, we believe that we are able to identify promising investments created by market turbulence.

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.

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.

The views expressed in this document should not be taken as a recommendation, advice or forecast.

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

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