M&G Positive Impact Fund

Five years on: what we've learned, and what's next

John William Olsen and Ben Constable-Maxwell

January 2024

Introduction

November 2023 marked the five-year anniversary of the launch of the M&G Positive Impact Fund. In this Q&A, John William Olsen (Fund Manager) and Ben Constable-Maxwell (Head of Impact & Sustainable Investing) reflect on the past five years and what's to come next. The pair discuss the biggest challenges and highlights since the fund launch, how their thinking has evolved, and why they believe the future is bright for impact investing.

The value of a 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. The views expressed in this document should not be taken as a recommendation, advice or forecast. Past performance is not a guide to future performance.

Setting the scene

Let's start at the beginning – what was the idea behind the fund?

JWO: This was new territory – there weren't many competitor funds at the time, as impact investing was typically only open to a small group of investors in private markets. Our aim for the fund was to open this up to ordinary investors and institutions alike. We wanted to drive positive change, but also create a fund that can compete with a more regular global equity proposition.

BCM: At the time, the Global Impact Investing Network (GIIN) was driving an expansion into public equity impact investing, with the aim of democratising impact investing. We have been members of the GIIN's Listed Equities Working Group, which aims to define best-practice for public equity impact investing, since its inception.

JWO: When setting up the fund, we also knew that it would be very different to its underlying benchmark. Our strict impact criteria means that big parts of the market are automatically excluded. But it was important to us that we ran an investment process focusing on good fundamental diversification, and we aim to keep fund volatility broadly similar to the benchmark, despite the very small overlap.

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Has the impact philosophy developed over time?

JWO: Our core impact philosophy – embodied by our 'Triple I' framework – hasn't changed materially since we launched the fund, as we believe it has effectively translated the core principles of impact investing into public markets. It continues to act as a framework for analysing the investment, intentionality and impact credentials of companies, helping us to identify those with quality business models, which should be capable of generating good long-term financial returns, while seeking to provide intentional, measurable solutions for the world's most pressing social and environmental challenges. We call this double compounding. Companies must be in a position to grow business returns while simultaneously growing the positive impact.

BCM: One area where our thinking has evolved is the concept of 'additionality'. We typically consider additionality with regards to our investee companies' activities. In other words, how the world would look if the company didn't exist, based on factors like its scale, and valuable aspects of the business model that are difficult to replicate.

Today, we also aim to demonstrate additionality as investors ourselves, often through our engagements with investee companies. We engage on a range of impact and sustainability topics, such as encouraging companies to set emission reduction targets, requesting greater information on how they are managing potential negative impacts, or encouraging them to improve their disclosure of impact data.

Moving on to performance – the fund delivered strong relative performance over the first couple of years, while the last few years have been more challenging. Why is this?

JWO: The fund performed very well in the earlier years because of some good stock picking, and because the political and economic backdrop was supportive. Some investor exuberance probably drove stock prices to quite

optimistic levels, which has since evaporated. 2022 was a tough year for impact and sustainable strategies for a few reasons. Commodities, energy companies and Western banks performed well – all of which the fund does not hold. The fund's bias to small and medium-sized companies was also a headwind. However, despite these relative headwinds, we actually held up well compared to the benchmark, and clearly outperformed a basket of like-for-like public equity impact fund peers, against which we compare our performance. We attribute this to our preference for quality companies, and our strong focus on fundamental diversification and risk management.

At the beginning of 2023, performance versus the benchmark suffered heavily as a result of not owning the 'Magnificent 7' stocks. These mega-cap technology stocks drove the wider market higher in the first half of the year, as positive sentiment around the potential of artificial intelligence (AI) skyrocketed, leaving the fund behind in relative terms.

BCM: At this point it's worth noting that we can't hold mega-cap technology names due to our strict impact requirements. These companies are held in many sustainability funds, and they do create some positive outcomes, such as Microsoft's cloud computing solutions, which help to reduce emissions. But these companies would not pass our 'materiality' and 'intentionality' assessments.

JWO: Moving on to the second half of 2023, and issues at a number of renewables companies, including the two we hold in the fund, caused a ripple of negative sentiment through wider sustainable stocks. Our large overweight to healthcare has also dragged on relative performance. While we have seen some very strong individual performers, such as investee company Novo Nordisk, the wider sector has struggled for a number of reasons. Defensive, cash-generative healthcare companies have been competing with higher yields on long-dated bonds, while life sciences firms have suffered from destocking on the back of COVID-19. With more than a third of the fund invested in our 'Better health' impact area, this posed a significant challenge for us.

Past performance is not a guide to future performance.

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How has the fund performed from a non-financial or impact perspective?

BCM: Since inception, we have invested only in companies that meet our strict impact criteria, and which create positive societal impacts by providing solutions to the world's major social and environmental challenges, in line with the fund's non-financial objective.

We have also seen some encouraging improvements in the size and scale of impact delivered by many investee companies. For example, wind power company Ørsted most recently reported saving 18.2 million tonnes of CO_2 emissions via its clean energy generation, up from 8.1 million tonnes in 2018.

Aside from investing in impactful companies, we've also focused on other ways to drive greater impact. One example would be the work we did with genetic sequencing firm Oxford Nanopore. This company was held in M&G's Catalyst vehicle as a private company, and M&G supported it along the transition into public markets, after which we took out a position in our fund. During the process, we were able to encourage the company to improve its disclosure of impact data, and ensure the correct governance was in place to prevent a takeover that could dilute its impactful activities.

JWO: We also believe that we have promoted impact investing indirectly – by highlighting the value of a well-managed public equity fund, with robust risk management controls, in the impact sphere. By running the fund in this way, and actively talking to clients, the wider investment community, and initiatives such as the GIIN, we believe we are helping to promote public equity investing as a viable option for those looking to make a positive impact with their money.

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M&G Positive Impact Fund performance					
	2023	**2022**	**2021**	**2020**	**2019**
M&G Positive Impact Fund	0.89	-8.44	13.14	21.75	28.22
MSCI ACWI Index	15.88	-7.63	20.13	13.22	22.38

Past performance is not a guide to future performance.
Source: Morningstar, as at 31/12/2023. GBP Class A Acc shares, income reinvested, price-to-price basis. Benchmark returns stated in share class currency.

The benchmark is a target which the fund seeks to outperform. 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 fund 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.

Engagement is clearly an important part of the investment process. How has this evolved over the years?

BCM: Engagement is an effective way for us to create investor additionality, by encouraging positive outcomes at our investee companies. The fund's engagements initially focused on ESG and sustainability issues, and on 'net impact' – it is important to us that any positive impacts the company creates are not cancelled out by negatives in other areas. During the pandemic, we also wrote to all investee companies, encouraging them to stick to their impactful purpose in the extreme environment.

More recently, we have begun a programme of impact-specific engagements, focusing on improving impact measurability, developing KPIs directly related to the company's impact, and tying executive remuneration to these KPIs. As an example, we encouraged Ethiopian telecommunications company Safaricom to develop metrics that would help us better measure its impact – in other words, to quantify how its products lead to better life outcomes for customers. The company confirmed there were additional areas to explore, which had not yet been included in its own impact reporting. We encouraged Safaricom to look into annually updated social return figures, to which the company was receptive, and we will follow up in due course.

JWO: As engagement is such an integral part of our process, several years ago we hired a dedicated engagement specialist to work with our team. He has been busy – we logged 31 change-oriented company engagements in 2023, with many other calls and meetings with investees on top of this.

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Have there been other additions to the team over the five years?

JWO: Yes! As demand for impact investments has grown over the past five years, our team has doubled in size. Ben and I have been here since the beginning, and we have a team of embedded analysts around us, specialising in either social or environmental impact. Our research capabilities have grown, and that has also helped us to evolve our research process. We are able to discuss a company's impact or investment thesis as a team, working collaboratively to reach a consensus view.

BCM: We also have support from our wider impact committee. There are representatives from other areas of the business, such as emerging markets, multi-asset and client-facing teams. We must all be in agreement when deciding whether or not a company should pass the Triple I assessment.

JWO: As our team has grown, we have also launched a number of adjacent strategies, focusing on climate solutions, better health and well-being, and diversity and inclusion. With specialists in each of these areas, ideas can feed into the flagship impact fund (and vice versa).

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Let's move on to the future. Looking forward, how do you feel about the fund's prospects over the next few years?

JWO: Despite the recent underperformance, or maybe even because of it, I am more excited about the one-year and multi-year prospects for the fund than I have been before. I believe there is a lot of intrinsic value held in the fund, which is waiting to come out when the market conditions are right.

We don't make investment decisions based on macroeconomic outlooks – we focus on trying to generate good returns over the next decade, with a high level of fundamental diversification. However, there are factors in place at the moment that may give the fund a relative tailwind over the next year or two.

First, a recession still seems probable over the next 12 months. In this situation, the fund would be well set up, and we could see a relative rebound in performance. We invest in quality companies with strong pricing power, which we believe have the capability to compound their economic growth and positive impact over the coming decade. We believe pricing power is key in times of downturn, so would expect our investee companies to fare better in relative terms during a recession.

Furthermore, energy utilities are typically very defensive by nature. If inflation and rates come down, companies like wind power specialist Ørsted should be in good position, as earnings are solid and it is sensitive to both falling input costs and discount rates. We would also be optimistic about healthcare in a recession, as this is an inexpensive part of the market with solid underlying fundamentals, displaying defensive characteristics.

Another factor that may impact the fund's relative performance is the fortunes of big technology companies. As we are unable to hold these, their continued outperformance would deliver a relative headwind for the fund, whereas any short-term cracks in the AI adaptation story could be positive in relative terms.

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And how do you feel about the longer term prospects?

JWO: We are confident in the massive investment opportunities surrounding the long-term trends linked to our impact areas. These include the need to decarbonise the global economy, and increased demand for health and well-being solutions, as the global population ages and lifestyle diseases become increasingly prevalent. Of course, there will be bumps in the road as markets and the economic environment shifts, but with the combination of structural tailwinds and a focus on quality companies, we remain excited for the opportunity to deliver compounding positive impacts and financial returns for long-term investors.

BCM: Furthermore, the challenges that the fund is trying to tackle aren't going anywhere soon. Let's consider the UN's Sustainable Development Goals* (SDGs) – these are a call to action to tackle the world's major sustainability and development challenges. There are 17 goals and 169 underlying targets, spanning areas from social inclusion to biodiversity. The SDGs form an important part of our impact framework – we assign at least one SDG to every investee company, and use KPIs to measure its contribution towards achieving the goal.

The deadline for achieving the goals is 2030, and while there has been progress in some areas, we are currently far behind schedule – the world's ambition isn't being met by its actions. According to the OECD, today there is an estimated annual SDG financing gap of $3.9 trillion in developing countries – investors can play an integral role by directing capital towards overcoming these issues. Fortunately, there is no shortage of quality companies providing impactful solutions geared towards the SDGs, and we will continue working tirelessly to identify and support them.

*While we support the UN SDGs, we are not associated with the UN and our funds are not endorsed by them.

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Fund description

The fund has two aims: to provide combined capital growth and income, net of the Ongoing Charge Figure, that is higher than the MSCI ACWI Index over any five-year period; and to invest in companies having a positive social impact. The fund usually holds shares in fewer than 40 companies. The fund invests over the long term in companies that make a positive social and/or environmental impact alongside a financial return. Sustainability and impact considerations are fundamental in the stock selection process.

Benchmark

The fund's benchmark is the MSCI ACWI Index. The benchmark is a target which the fund seeks to outperform. 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 fund 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. For unhedged and hedged share classes, the benchmark is shown in the share class currency.

Key fund risks

The main risks that could affect the fund's performance:

- 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 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.
- 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.
- In exceptional circumstances where assets cannot be fairly valued, or have to be sold at a large discount to raise cash, we may temporarily suspend the fund in the best interest of all investors.
- The fund could lose money if a counterparty with which it does business becomes unwilling or unable to repay money owed to the fund.
- Operational risks arising from errors in transactions, valuation, accounting, and financial reporting, among other things, may also affect the value of your investments.

Further details of the risks that apply to the fund can be found in the fund's Prospectus.

Other important information:

- 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.
- Any reference to specific companies should not be considered a recommendation to purchase or sell any particular security.

The value of investments will fluctuate, which will cause fund prices to fall as well as rise and investors may not get back the original amount invested.

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