

M&G (Lux) Optimal Income Fund



H1 25 review – Duration is proving its worth

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- Modest outlook for growth/jobs – with inflation subdued - should mean rate cuts will accelerate
- Duration-bearing assets look attractive from a risk-reward basis
- We have added at the long-end of the yield curve in light of curve steepening
- The strategy favours long-dated government bonds, certain credits on a valuation basis – while being underweight more expensive high yield names
- Portfolio positioning: duration at **7.0/7.1 years**, spread duration at **4.0 years**
- The strategy currently offers a yield of 5.5% in GBP, 3.2% in EUR, and 5.3% in USD¹



Why we have a bias towards duration-bearing assets

We maintain that inflation is largely under control, and that growth may not be as robust as the market is pricing in. Moreover, if a recession were to occur (*not our base-case*), we anticipate interest rates would have to decline quite significantly. Governments today are generally overleveraged, which limits their capacity to stimulate the economy through fiscal measures, necessitating a stronger reliance on monetary policy, including more aggressive rate cuts.

In this regard, one of our well-known positions is an overweight in duration-bearing assets – investments that have the potential to perform as interest rates fall. A good example of these types of assets are high-quality government bonds with long maturity dates (eg 10-Year US Treasuries - see Figure 1, below). Currently, we believe there is an attractive asymmetry in the range of potential return outcomes. As the risk-reward features are strengthened, we have maintained a long position here with a tilt towards adding at the longer end of the yield curve (as it steepens).

Figure 1. The risk-reward in 10-year US Treasuries remains compelling in our view



Source: Bloomberg, 30 June 2025. The scenarios presented are an estimate of future performance based on evidence from the past on how the value of this investment varies, and/or current market conditions and are not an exact indicator.

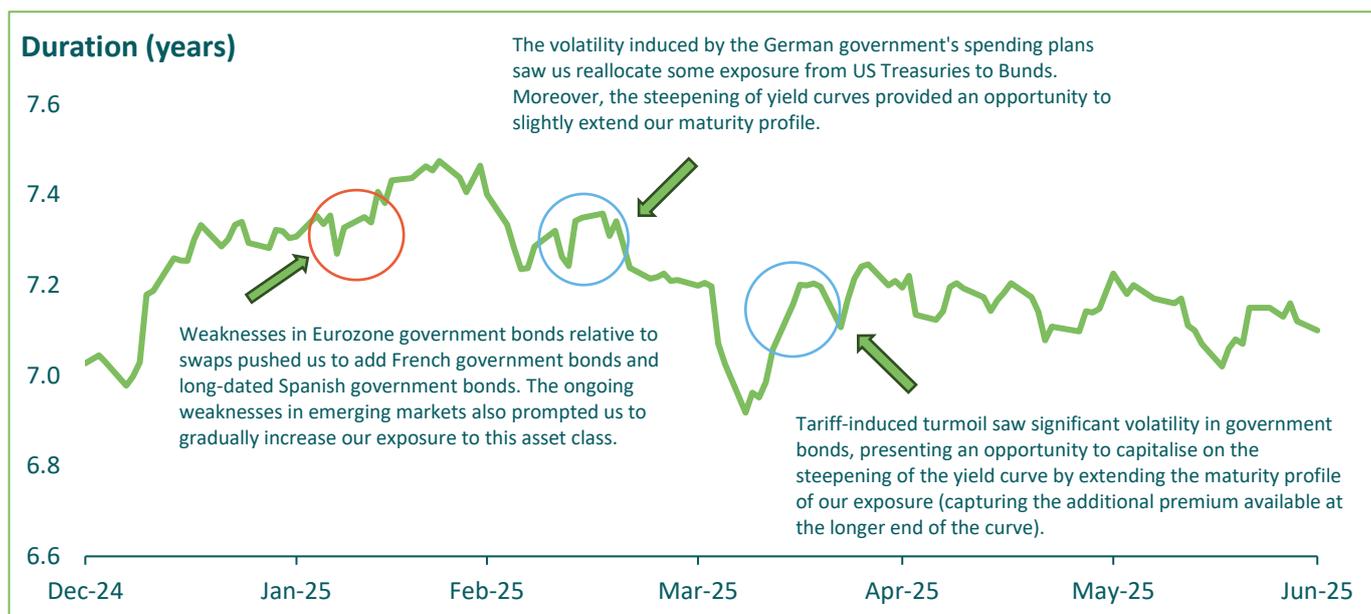
¹ Yield to maturity in base currency, as at 30/06/25. Data from M&G Investments.

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Duration positioning: first six months activity

We began 2025 with a portfolio of roughly 7.0 years of **duration risk** (mainly exposure to US Treasuries, with some UK gilts and Euro issuance across various maturities). Six months on, and while this long position remains at broadly **7.1 years**, we have been very active in the first half of this volatile period, as the chart below shows. Being proactive in our duration management saw us capitalising on the spike in rates to further extend the portfolio's duration, especially at the mid-quarter one stage. Various market events – with tariffs news being the standout one – presented us with some good opportunities to actively use our duration portfolio 'lever' (Figure 2).

Figure 2. Active positioning within the Optimal Income portfolio in the last six months – Duration / years



Source: M&G, 30 June 2025. Portfolio interest rate risk, measured in duration/years for the first six months of 2025

Within the context of fund performance drivers, year to date, our long duration view has accounted for roughly two-thirds of performance, both relative and absolute. Here we benefitted not only by being active during tariff-induced turmoil, but also by engaging across different markets and leveraging the increased volatility at the longer end of different curves such as UK sterling and US dollar. Overall, government bonds have accounted for over a half of strategy assets during the first six months of the year, leaving allocation at c54% at the halfway stage.

Credit positioning: Cautious across Investment Grade, tactical in high yield

In contrast to our positive view of duration-bearing assets, we are more conservative on credit risk. At the beginning of the year, we held around 3.6 years of **spread duration risk**, which has ticked up slightly to around 4.0 years. However, we continue to believe the extra compensation for holding credit remains historically low and does not adequately reflect some of the negative economic dynamics. Simply put, we are not being paid for taking too much portfolio risk across key areas of the credit bucket. Overall, the credit portion of the portfolio has remained about a third of strategy assets, including investment grade corporate bonds (26-27%) and high yield (7-8%), as at June 30 2025.

However this hasn't meant we have stood still this year. We continue to be very flexible in tactical asset allocation, whether in pinpointing relative value trades or taking advantage of market volatility. A good example of this is within our high yield view (see Figure 3, overleaf). Although we are very underweight on a historical basis, we have made some key bets (mainly via the derivatives route) during the last six months – trying to take advantage of increasing volatility because of trade tariff noise.

Figure 3. Active positioning within the Optimal Income portfolio in the last six months – high yield (%)

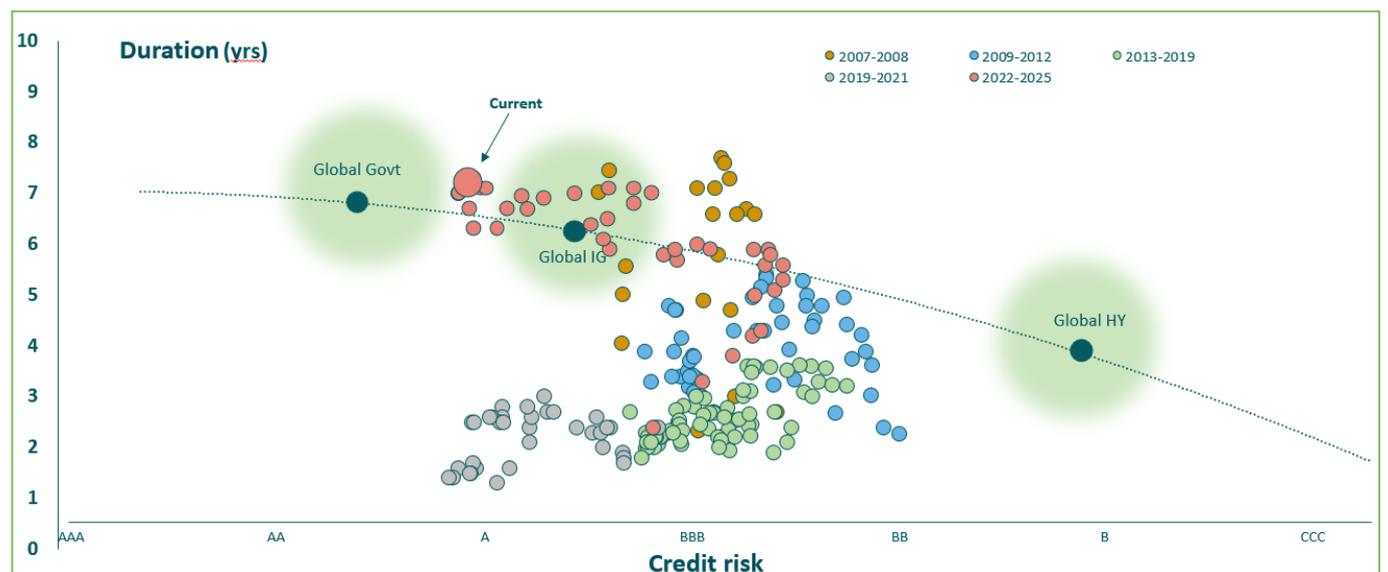


Source: M&G, 30 June 2025. High yield bond exposure over the first six months 2025 (our neutral weighting is 33%)

A flexible remit

We believe that the fund has an interesting, forward-thinking, and flexible remit across what can be an exciting asset class to own. Figure 4, below, shows how we have actively rotated across the three core bond assets (the green ‘orbits’ of global government, investment grade, high yield in the chart). Today, we are somewhere between a government bond fund, because of our duration view) and global investment grade fund in terms of credit quality. For most of the strategy’s nearly-two decade lifetime, we have been more within the high yield world, against a backdrop of lower rates/wider credit spreads. Figure 5, overleaf, shows our current investment thinking compared to the end of 2024 – the broad themes continue.

Figure 4. Duration risk versus credit risk in the Optimal Income strategy through the years



Source: M&G Investments; portfolio positioning between 31 December 2006 and 31 May 2024
 On 8 March 2019, the non-sterling assets of the M&G Optimal Income Fund, a UK-authorized OEIC which launched on 8 December 2006, merged in the M&G (Lux) Optimal Income Fund, a Luxembourg authorised SICAV, which launched on 5 September 2018. Data prior to 8 March 2019 refers to the OEIC.
 Note: Equity is considered with a CCC rating. Information is subject to change and is not a guarantee of future results.

Figure 5. Key changes in fund portfolio positioning over the first six months of 2025

ALLOCATION:	WEIGHT:	31.12.24:	30.06.25:	Tactical view
Duration	Long	7.0 years	7.0 years	We're rotating within regions, currencies and across maturities to find the best value
IG credit	Neutral*	27%	26.3%	Actively involved in identifying opportunities, but spreads very tight
High yield bonds	Underweight*	7.6%	8.0%	Staying cautious with a low weight – have been active via derivatives route to capture price volatility eg April trades
Government bonds	Overweight*	56.7%	54%	Attractive risk-reward on many bonds – trades include US Treasuries, UK gilts, Bunds, some EM

Source: M&G. Portfolio positioning for the M&G (Lux) Optimal Income Fund at 31 December 2024 vs 30 June 2025. *Vs portfolio neutral weight of 33%

Figure 6. Performance: YTD, YTQ (%) and calendar-year performance (pa%)

Past performance is not a guide to future performance

	2025 YTD	YTQ	2024	2023	2022	2021
Fund (EUR)	3.3	3.3	-0.4	10.2	-12.3	1.2
BM* (EUR)	2.6	2.6	4.0	7.3	-14.1	-0.9
Fund (USD)	4.4	4.4	1.2	12.7	-10.2	2.0
BM* (USD)	3.6	3.6	5.8	9.8	-12.0	0.0
	2020	2019	2018	2017	2016	2015
Fund (EUR)	1.4	4.4	-4.0	4.3	7.0	-1.6
BM* (EUR)	5.0	3.6	n/a	n/a	n/a	n/a
Fund (USD)	3.1	9.9	-1.2	6.5	7.9	-1.2
BM* (USD)	6.5	11.0	n/a	n/a	n/a	n/a

YTQ = year to most recent quarter.

*Benchmark: 1/3 Bloomberg Global Aggregate Corporate Index EUR Hedged, 1/3 Bloomberg Global High Yield Index EUR Hedged, 1/3 Bloomberg Global Treasury Index EUR Hedged. The composite index was introduced as the fund's benchmark on 7 September 2018. Fund performance prior to 7 September 2018 is that of the equivalent UK-authorized OEIC, which merged into this fund on 8 March 2019. Tax rates and charges may differ.

The benchmark is a comparator used solely to measure the fund's performance and reflects the scope of the fund's investment policy but does not constrain portfolio construction. The fund is actively managed. 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.

Source: Morningstar, Inc., as at 30 June 2025, Euro Class A Acc shares and USD Class A-Hedged shares, price to price, income reinvested, net of fees. Performance data do not take account of the commissions and costs that may incur on the issue and redemption of units. Not all share classes are registered for sale in all countries. Details in Prospectus.

Performance analysis

Strategy performance has been both consistent and robust, in absolute terms and against the wider market, year to date (Figure 6, previous). We believe a steady performance can also be viewed favourably within the context of what has been a volatile investment environment for most risk assets this year. As mentioned, an overweight position in **duration** has been an important driver of positive returns for a majority of months to June 30, 2025, with trades in long-dated US and UK government bonds a good example of beneficial duration-bearing assets.

Credit, where we continue to be conservative within selection based on what we see as an unfavourable risk-reward, has also made a positive contribution to return, year to date. Our active calls during tariff-related market volatility has been a boost, including relative value positioning within financials.

Fund description

The fund aims to provide a combination of capital growth and income to deliver a return based on exposure to optimal income streams in investment markets, while applying environmental, social and governance (ESG) criteria. It seeks to make these investments using an exclusionary approach, as described in the prospectus. Typically, at least 50% of the portfolio is invested in a broad range of fixed income securities of any credit quality and from any country, including emerging markets, and denominated in any currency. The fund manager selects investments wherever he sees the greatest opportunities, based on his assessment of a combination of macroeconomic, asset, sector and stock-level factors. The manager may also hold up to 20% of the portfolio in company shares when he believes they offer better value than bonds. The fund's recommended holding period is five years. In normal market conditions, the fund's expected average leverage – how much it can increase its investment position by borrowing money or using derivatives – is 200% of its net asset value.

Main risks associated with the fund

- 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.
- 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 is exposed to different currencies. Derivatives are used to minimise, but may not always eliminate, the impact of movements in currency exchange rates.
- Investing in this fund means acquiring units or shares in a fund, and not in a given underlying asset such as building or shares of a company, as these are only the underlying assets owned by the fund.

Further risk factors that apply to the fund can be found in the fund's Prospectus. The Fund's sustainability information is available to investors on the Fund page of the M&G website.

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

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