

# Fixed Income Investing In PruFunds

(Information is as at 30 June 2022, updated in August 2022,  
next update will be as at 31 December 2022, updated in February 2023)

## Introduction

This update from the M&G Treasury & Investment Office (T&IO) provides an insight into the characteristics of the fixed income portfolios within the PruFund range of funds.

This update covers the standard rather than Planet versions of PruFund.

We hope to highlight the key differentiators and strengths including;

- The global exposure
- The ability to adapt modelling to include new asset classes in public and private markets
- Creating segregated pools of assets or internal funds to best capture opportunities
- Use of well-resourced and skilled asset managers to put money into markets

Detail is provided on exposure across different areas of fixed income markets and the building blocks that make up the overall allocation within PruFund Growth. Information is also provided on two key active managers that T&IO work with to create, manage and monitor the various building blocks.

## Characteristics of fixed income portfolios within the PruFund range of funds

- Globally diversified with new asset classes added as markets have evolved and our strategists have been able to adjust modelling and create new sleeves within the strategic asset allocation process
  - with relatively little exposure to developed market government bonds that currently offer negative real yields
  - reduced exposure to developed market corporate bonds over recent years although still the largest holding in % terms
  - exposure to higher yielding Asian and Emerging Market bonds has increased
  - exposure to Private Credit has increased leveraging the strength of specialist teams in M&G. Will continue to grow through new and future investments via M&G Catalyst
- Underlying mandates and funds are actively managed predominantly by well-resourced and experienced teams in M&G Investments and Eastspring Investments
- Fully hedged against movements in the major currencies
  - Sensible practice as currency movement can demonstrably affect risk adjusted returns in fixed income

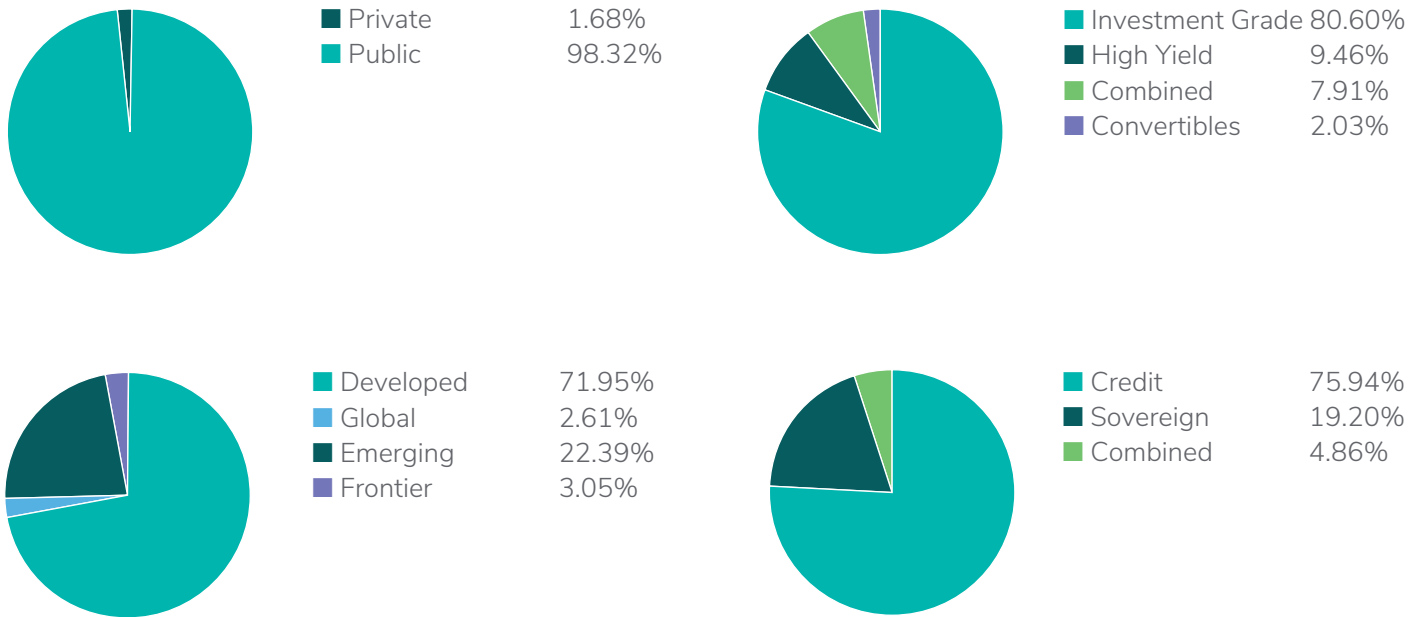
The value of any investment (and any income taken from it) can go down as well as up so your customer might not get back the amount they put in. The views expressed in this document should not be taken as advice or a recommendation.

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- A large percentage of assets held in segregated mandates/internal vehicles\* which has several benefits;
    - Underlying fund managers work solely with T&IO as no other retail or institutional investors
    - T&IO can work with the managers to set investment objectives and appropriate risk controls like stock and sector limits
    - An underlying fund manager is unlikely to be a forced seller of assets
    - Close and collaborative working relationships are formed with fund managers which provides market insights and new investment ideas
    - The ability to create appropriate benchmarks and weights can help avoid a structural overweight to certain markets and help ensure money is allocated efficiently over time in less liquid markets
    - Mandates can be adjusted as markets change and new ones evolve or if the broader macro environment changes such that overall portfolio duration can be adjusted, for example
    - T&IO will seek to ensure that ongoing fund management costs are competitive
  - Geographic diversification and alternative sources of credit premium, different risk/return profiles and duration includes areas like;
    - **Asian bonds** – access to investment grade and sovereign debt with a higher potential yield
    - **Bridge loans** – generally investment grade, short duration bonds sourced in private markets that offer a higher return than an equivalent publicly traded bond
    - **Private credit** – now with a greater focus now on driving 'Impact and positive change in the global economy through investment innovation' through 'M&G Catalyst'
    - **High yield bonds** – positive credit spreads and often shorter duration
    - **Emerging markets debt** – higher yields and exposure to a diversified set of monetary and fiscal regimes
- These more specialist asset classes now make up a meaningful part of PruFund portfolios as shown on the next page;
- \* Some pooled vehicles are used – Eastspring Asian Bonds and M&G Emerging Market Debt for example

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### Portfolio breakdown of PruFund Growth (source: T&IO, 30 June 2022)



\* Please note that these weightings are based on the predominate exposures of each underlying fund. The actual allocations can differ slightly from what is shown above due to the underlying managers having some mandate flexibility

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## Underlying building blocks of the PruFund Growth fixed income portfolio\*

To provide greater insight into PruFund portfolios the table below provides a breakdown of each sub asset class, the underlying vehicles and the asset manager.

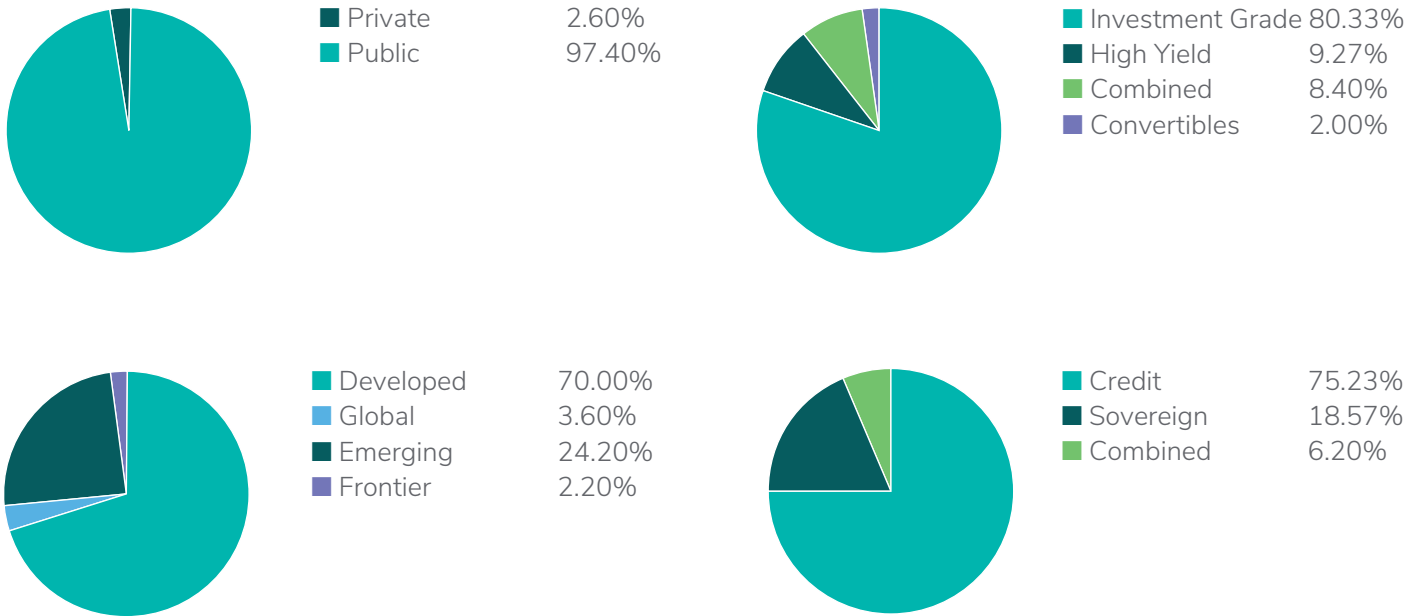
Asset class	Strategic Asset Allocation		Fund Name	Investment Style	Internally or Externally managed
UK (Investment Grade)	5.00	4 x segregated mandates 1 x bespoke mandate	M&G UK Investment Grade Mandate	Active	Internal
Europe (Investment Grade)	1.95		M&G European Investment Grade Mandate	Active	Internal
			M&G Collateral Fixed Income Mandate	Active	Internal
UK & Euro (High Yield)	0.46		M&G European/UK High Yield Mandate	Active	Internal
			M&G European Leveraged Loans Mandate	Active	Internal
US (IG & HY)	5.51	3 x segregated mandates	M&G US Total Return Fixed Income Mandate	Active	Internal
US Treasury	0.75		M&G US Short Dated Fixed Income Mandate	Active	Internal
			M&G US Treasuries Mandate	Active	Internal
Asian Fixed Income	3.60	4 x pooled funds	ESI Local Currency Asian Bond Fund	Active	External
			ESI Hard Currency Asian Bond Fund	Active	External
			ESI High Yield Asian Bond Fund	Active	External
			ESI China Bond Fund	Active	External
Convertibles	0.39	1 x segregated mandate	M&G Global Convertibles Fund	Active	Internal
Lower Risk Private Credit	0.34	1 x bespoke mandate 1 x segregated mandate	M&G Catalyst – Lower Risk M&G Private Asset Fund (PAF)	Active Active	Internal Internal
Global High Yield	0.19	1 x pooled fund	M&G Global High Yield Fund	Active	Internal
African Debt	0.54	1 x pooled fund	M&G South Africa Pan-African Bond Fund	Active	Internal
Emerging Market Debt	0.91	1 x pooled fund	M&G Emerging Market Debt Fund	Active	Internal

Source: T&IO as at 30.06.2022

\* the same building blocks are used across the entire PruFund range

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### Portfolio breakdown of PruFund Cautious (source: T&IO, 30 June 2022)



\* Please note that these weightings are based on the predominate exposures of each underlying fund. The actual allocations can differ slightly from what is shown above due to the underlying managers having some mandate flexibility.

## Underlying building blocks of the PruFund Cautious fixed income portfolio\*

To provide greater insight into PruFund portfolios the table below provides a breakdown of each sub asset class, the underlying vehicles and the asset manager.

Asset class	Strategic Asset Allocation	Fund Name	Investment Style	Internally or Externally managed
UK (Investment Grade)	4.94	M&G UK Investment Grade Mandate	Active	Internal
Europe (Investment Grade)	12.96	M&G European Investment Grade Mandate	Active	Internal
		M&G Collateral Fixed Income Mandate	Active	Internal
		M&G European/UK High Yield Mandate	Active	Internal
UK & Euro (High Yield)	2.42	M&G European Leveraged Loans Mandate	Active	Internal
US (IG & HY)	10.85	M&G US Total Return Fixed Income Mandate	Active	Internal
US Treasury	1.09	M&G US Short Dated Fixed Income Mandate	Active	Internal
		M&G US Treasuries Mandate	Active	Internal
Asian Fixed Income	0.67	ESI Local Currency Asian Bond Fund	Active	External
		ESI Hard Currency Asian Bond Fund	Active	External
		ESI High Yield Asian Bond Fund	Active	External
		ESI China Bond Fund	Active	External
Convertibles	0.47	M&G Global Convertibles Fund	Active	Internal
Lower Risk Private Credit	2.77	M&G Catalyst – Lower Risk	Active	Internal
		M&G Private Asset Fund (PAF)	Active	Internal
Global High Yield	3.00	M&G Global High Yield Fund	Active	Internal
African Debt	0.95	M&G South Africa Pan-African Bond Fund	Active	Internal
Emerging Market Debt	1.44	M&G Emerging Market Debt Fund	Active	Internal

\*Source: T&IO as at 30.06.2022

## Underlying Fixed Income managers for PruFund

T&IO is responsible for the strategic asset allocation of the PruFund range of funds as well as the selection and ongoing monitoring of the various investment managers. The underlying stock selection decisions are carried out by these investment managers who are selected by T&IO following a thorough due diligence process.

The following provides an insight into the two key fixed income managers.

### M&G Investments

T&IO work very closely with M&G Investments who run most of the fixed income assets for PruFunds.

They are one of Europe's largest fixed interest investors and have a large established team of investment professionals that aim to deliver performance over the long-term across global government bonds, investment grade and high yield corporate debt.

As well as huge experience in public markets the institutional team also has a long heritage in private markets.

- M&G Investments continues to be an important player in the UK and European credit markets
  - One of the largest and most experienced teams
  - They cover a diverse set of sub-asset classes within fixed income and across public and private markets
  - There is no reliance on external ratings agencies or their ratings
- Many of their credit analysts have been covering their sectors for decades
- Credit analysts cover all names in their sector including investment grade, high yield and unrated bonds
- The team assess the fundamental credit risk of borrowers to identify attractive relative and absolute value opportunities where risk and pricing are misaligned
- Their focus on long-term performance allows them to exercise conviction, whilst maintaining a considered approach to risk-management
- Considering material ESG factors is also an integral part of their investment approach

### M&G Investments and integrating ESG

Within fixed income, M&G Investments are continually innovating their approach to ESG risks and opportunities. In 2021 they saw a continued acceleration of ESG integration within fixed income, including widening the scope of quarterly ESG reviews of their portfolios, expanded coverage of their proprietary ESG scorecards, and the ongoing development of analytical tools to provide an enhanced ESG overview within credit analysis.

Analysis of ESG risks within fixed income tends to focus on the impact such factors might have on the issuer being to able to repay the debt in line with its contracted obligations.

Engagement with issuers is usually undertaken by M&G's credit analysis teams, with support when needed from the Stewardship and Sustainability (S&S) team, since the analysts have a clear and detailed understanding of the ESG issues affecting the credit quality of the issuers that they cover

Although bond holders normally have less influence than equity holders when engaging with companies, M&G considers it still important to engage with fixed income issuers regarding material ESG issues to encourage improved ESG practices.

### Eastspring Investments (Eastspring)

Eastspring manage the Asian fixed income funds within PruFunds. They are a global asset manager with Asia at its core and have built unparalleled on-the-ground presence in 11 Asian markets as well as distribution offices in North America and Europe. They manage a total of USD 258bn\* across equity, fixed income, multi asset, quantitative and alternative strategies on behalf of institutional and individual investors globally.

- Fixed income teams based in Singapore, Indonesia, Korea, Malaysia, Taiwan and Vietnam. They also have fixed income teams in China, India and Thailand through joint ventures.
- In-depth knowledge of Asian bonds and proximity to local markets help Eastspring to identify value opportunities and generate potential long-term returns for their clients

- Eastspring seek to capture market opportunities at cyclical turning points when interest rates or credit spreads are at their extremes
- Their fundamental, valuation and technical analysis helps uncover opportunities such as when shifts in risk perceptions cause assets to be mispriced relative to their fundamentals

\* Source Eastspring at 31.12.2021

## Summary

Within the fixed income exposure of the PruFund range of funds, Developed market corporate bonds remain the largest holdings but in recent months and years T&IO have continued a two-pronged shift away from them in order to capture more differentiated sources of return that they believe will benefit portfolios in the future;

- By investing in more emerging market debt with higher yields and exposure to a diversified set of monetary and fiscal regimes, with more room to stimulate their economies,
- Accessing the credit and illiquidity premia available within private credit

- Have a globally diversified portfolio that offers multiple asset types with different characteristics, duration and risk/return profiles
- Utilise well-resourced and skilled active fixed income managers
- Source new and differentiated sub-asset classes
- Take a long-term view and see market downturns as an opportunity to acquire assets at compelling valuations

It has been a very tough year for corporate bond markets across the globe, and PruFund portfolios have not been immune to this. However, T&IO continue to believe the fixed income allocations within PruFunds are well-diversified and are continually evolving. They also feel that the fundamental, valuation and technical analysis carried out across the whole of M&G from both a top-down perspective and bottom-up stock level will continue to help capture market opportunities across a long-term investment horizon.