Monthly Fund Review

28 February 2017

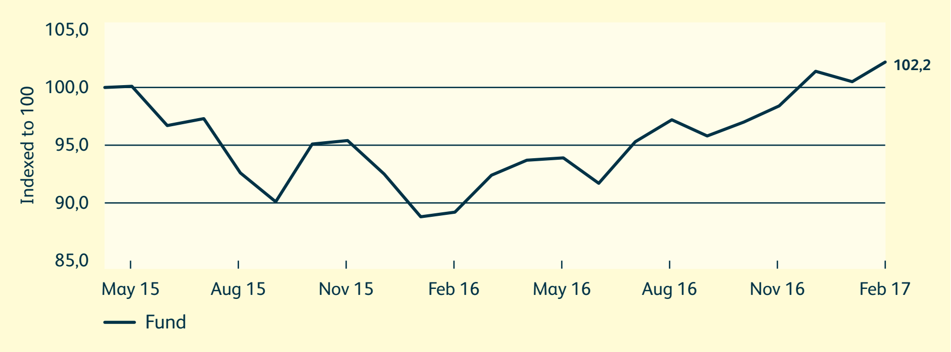
# M&G Income Allocation Fund

Euro Class A-Q

## Summary


- Financial markets generally moved in the same direction during February – upwards – with less divergence across and within asset classes than has been seen recently.
- The fund generated a positive return, with the largest contributors being some of the highest-conviction positions, namely US bank equities and Portuguese government bonds.
- A position in Taiwanese equities was established while the holding in US government bonds was increased.


## Performance since launch




## Fund performance

| | 1 month (%) | 3 months (%) | YTD (%) | 1 year (%) | 3 years (%) p.a. | 5 years (%) p.a. | Since tenure (%) p.a. | Since inception (%) p.a. |
|---|---|---|---|---|---|---|---|---|
| Fund | +1,7 | +3,9 | +0,8 | +14,6 | N/A | N/A | +1,2 | +1,2 |
| Index | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |
| Sector | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |

Past performance is not a guide to future performance.

The value of investments and the income from them will fluctuate. This will cause the fund price to fall as well as rise. There is no guarantee the fund objective will be achieved and you may not get back the original amount you invested.

The fund allows for the extensive use of derivatives.

## Key information

| | |
|---|---|
| **Fund manager** | Steven Andrew |
| **Fund manager tenure from** | 7 November 2013 |
| **Deputy fund manager** | Maria Municchi |
| **Launch date** | 7 November 2013 |
| **Launch of share class** | 8 May 2015 |
| **Fund size (millions)** | €893,28 |
| **Fund type** | OEIC, incorporated in the UK |
| **Comparative sector** | Morningstar EUR Moderate Allocation - Global sector |
| **Estimated yield (gross of tax)** | 4,00 % |
| **Historic yield (Inc)** | 3.36 % |
| **Duration of bond portion (years)** | 10,9 |
| **Average credit rating of fixed interest holdings** | BBB |
| **Share type** | Income |
| **Ongoing charge** | 1,68 % |

The 4 % is a gross estimated yield and represents the fund's total distribution over the next 12 months as a percentage of the current share price before tax. Please note that this estimated annual yield is not guaranteed and may be revised in the future. The ongoing charge is taken from investments held in the fund's portfolio and not from the income these investments produce.

The historic yield reflects distributions declared over the past 12 months as a percentage of the share price, as at the date shown. It does not include any preliminary charge and investors may be subject to tax on their distributions. The fund's charging policy has recently changed and, rather than being decided at fund level, certain charges are now deducted from income for accumulation share classes and from capital for income share classes. These charges include the annual management charge, administration fee and share class hedging fee (for hedged share classes). To ensure that yields quoted are representative of the fund's charging policy, for some share classes an estimated historic yield is shown. This is based on the historic yield, but adjusted for the impact of the new charging policy. This adjustment will be applied until distributions have been declared for a full year after the changes, from which time the historic yield will again be on the same basis as the distributions. For the fund's Euro Class A-Q income shares, the policy of deducting certain charges from capital has the effect of increasing distribution(s) for the year by 1,68 % and constraining capital performance to an equivalent extent.

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## Portfolio construction (%)

| | Allocation range | Neutrality |
|---|---|---|
| Equity | 10-50 | 30 |
| Fixed income | 40-80 | 60 |
| Other | 0-20 | 10 |
| Currency | Min 70 % euro or euro hedged | |

Other: comprises real estate based securities and convertibles. Please note these guidelines are subject to change.

## Asset breakdown (%)

| | Fund |
|---|---|
| **Equity** | **47,7** |
| UK | 6,7 |
| Europe | 12,5 |
| US | 12,8 |
| Japan | 2,6 |
| Asia Pacific ex Japan | 8,4 |
| Global equity funds | 0,0 |
| Other | 4,7 |
| **Global bond funds** | **0,0** |
| **Government bonds** | **41,5** |
| UK | -0,6 |
| Europe | 18,4 |
| US | 12,4 |
| Japan | 0,0 |
| Asia Pacific ex Japan | 0,0 |
| Other | 11,3 |
| **Corporate bonds** | **8,8** |
| Investment grade | 2,9 |
| High yield | 5,8 |
| **Convertible bonds** | **0,0** |
| **Property funds** | **0,0** |
| **Cash** | **2,1** |

## Largest exposures (excluding cash, %)

| | Fund |
|---|---|
| US government 30Y | 12,4 |
| Portuguese government 30Y | 6,7 |
| Portuguese government 5Y | 3,6 |
| Italian government 30Y | 3,4 |
| South African government 20Y | 3,0 |
| Mexican government 20Y | 2,7 |
| Spanish government 10Y | 2,5 |
| Spanish government 30Y | 2,2 |
| Chilean government 5Y | 2,0 |
| Colombian government 10Y | 2,0 |

## Currency breakdown (%)

| | Fund |
|---|---|
| Euro | 72,6 |
| British pound | 5,1 |
| US dollar | 4,2 |
| South African rand | 3,0 |
| Canadian dollar | 2,8 |
| Mexican peso | 2,7 |
| Korean won | 2,1 |
| Chilean peso | 2,0 |
| Colombian peso | 2,0 |
| Other | 3,6 |

## Leverage and volatility

| | Fund |
|---|---|
| Leverage | 1,0x |
| Volatility | 6,78 % |

Leverage is the sum of all notional exposures, excluding cash, divided by NAV. Volatility is one-year annualised volatility calculated monthly, as at 28 February 2017, sourced from Morningstar.

## Performance review

Financial markets around the world generally moved in the same direction throughout February – upwards – with less divergence across and within asset classes than has been seen in previous months. Government bonds, credit and equity markets were all positive on the whole and emerging market currencies also performed well. Markets were, however, dominated by political headlines, election polls and policy action, rather than underlying economic data.

Although there was a lot of speculative newsflow focused on upcoming events, such as the French presidential election and the US Federal Reserve meeting in March, Fund Manager Steven Andrew prefers to consider the fundamental picture, which looks positive from his perspective. In his view, the continued improvements evident across trade data and global economic growth should have far more of an impact on asset pricing over the long term than the current headlines.

As he has for some time, Steven continues to back the equity risk premium. Mainstream government bond yields are still very low and it remains unclear to him why so many investors continue to flood into these ‘perceived’ safe haven assets. For example, 30-year German bund yields fell below 1 % in February, a level which Steven feels is deeply unattractive.

Although it may sometimes be frustrating when markets continue to be driven by non-fundamental factors, irrational market moves can provide exploitable valuation anomalies. From an overall portfolio construction perspective, Steven believes that the fund is appropriately positioned and adequately diversified to benefit from the pick-up in global growth, although there could be a ‘noisy’ period ahead. The fund’s flexible mandate, together with an open mind, convinces Steven that he has plenty of firepower to be able to identify and take advantage of opportunities as and when they arise.

The fund generated a positive return in February and, encouragingly, the largest contributors to performance were some of the highest-conviction positions, namely US bank equities and Portuguese government bonds. US equities delivered the best returns, driven mainly by the banks, but also by a small basket of technology stocks. Although US banks have already made significant gains, Steven thinks they remain attractively valued and so is comfortable retaining exposure. On the other hand, the rally in technology stocks prompted him to trim the size of the positions.

European government bonds were not far behind US equities in terms of contribution, with Portuguese government bonds adding good value as they recovered well from the weakness experienced in January. Some people appear to have identified Portugal as the next Greece, a view Steven does not share. To him, a yield of 5 % on Portuguese government debt seems too high, both in absolute terms and in relation to the yield on German bonds, and appears enough to compensate for what he sees as the limited risk of the eurozone breaking up.

Other successful holdings, albeit to a lesser extent, included Asian and UK equities and government bonds from the US, Italy and Mexico. Performance was also helped by currency movements, particularly the strength of the US dollar, Mexican peso and South African rand relative to the euro.

## Key changes

In terms of portfolio activity, Steven added to the holding of long-dated US government bonds, taking the position up to about 12.5 % of the portfolio. Now that the yield on 30-year Treasuries is around 3 %, the diversification properties of the bonds should be more valuable in the event of equity markets or emerging market government bonds falling in price.

At the same time, he increased the equity allocation by establishing a position in Taiwanese shares. Companies in Taiwan currently offer a high real earnings yield while exhibiting earnings growth. They should be supported by the expansion in global trade and economic growth signalled by the most recent data. These purchases were funded by a decrease in the fund’s cash position and a reduction in the size of stakes in US technology companies.

Finally, credit exposure was adjusted. Some of the positions in Europe, where spreads have narrowed, were reduced, while in the UK, where yields are higher, holdings were increased. Steven initiated an interest rate swap so as to hedge the duration of the sterling corporate bonds and give some protection against falls in the gilt market, where the fund has no direct exposure.

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## Fund codes and charges

| Share class | ISIN | Bloomberg | Annual management charge | Ongoing charge | Minimum initial investment | Minimum top up investment |
|---|---|---|---|---|---|---|
| Euro A Acc | GB00BBCR3283 | MGIAEAA LN | 1,50 % | 1,69 % | €1.000 | €75 |
| Euro A Inc | GB00BBCR3390 | MGIAEAI LN | 1,50 % | 1,69 % | €1.000 | €75 |
| Euro A Q Inc | GB00BVYJ1B75 | MGIEAQI LN | 1,50 % | 1,68 % | €1.000 | €75 |
| Euro B Q Acc | GB00BYQRBZ43 | MGIAEBA LN | 2,00 % | 2,19 % | € 1.000 | € 75 |
| Euro B Q Inc | GB00BYQRC069 | MGIAEBI LN | 2,00 % | 2,19 % | € 1.000 | € 75 |
| Euro C Acc | GB00BBCR3408 | MGIAECA LN | 0,65 % | 0,83 % | €500.000 | €50.000 |
| Euro C Inc | GB00BBCR3515 | MGIAECI LN | 0,65 % | 0,83 % | €500.000 | €50.000 |
| Euro C Q Inc | GB00BVYJ1C82 | MGIECQI LN | 0,65 % | 0,82 % | €500.000 | €50.000 |

The ongoing charge figures disclosed above include direct costs to the fund, such as the annual management charge (AMC), administration charge and custodian charge, but does not include portfolio transaction costs (including research costs). They are based on expenses for the period ending 31 October 2016.

Please note that not all of the share classes listed above might be available in your country.

## Important information

Cash may be held on deposit and/or in the Northern Trust Cash Funds, a range of collective investment schemes.

Source of performance data: Morningstar, Inc., as at 28 February 2017, Euro Class A-Q shares, net income reinvested, price to price basis. Past performance is not a guide to future performance. All other statistics from M&G internal sources, as at 28 February 2017 unless indicated otherwise.

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