

For investment professionals only



Thoughts on the market dichotomy

Dr Wolfgang Bauer, CFA, CAIA, Fund Manager

September 2018

M&G Absolute Return Bond Fund

Risks associated with this fund

The value of investments and the income from them will fluctuate. This will cause the fund price to fall as well as rise. These fluctuations may be more extreme in periods of market disruption and other exceptional events. There is no guarantee the fund objective will be achieved and you may not get back the original amount you invested.

The fund may take short positions through the use of derivatives. Short positions reflect an investment view that the price of the underlying asset is expected to fall in value. Accordingly, if this view is incorrect and the asset rises in value, the short position will cause the fund to incur a loss.

Currency exchange rate fluctuations will impact the value of your investment.

Derivatives may be used to generate exposure to investments exceeding the net asset value of the fund, thereby exposing the fund to a higher degree of risk. As a result of increased market exposure, the size of any positive or negative movement in markets will have a relatively larger effect on the net asset value of the fund. The additional exposure will however be limited to such an extent as to not materially increase the price fluctuations of the fund, in comparison to equivalent funds that do not use derivatives in this way.

The value of the fund will fall if the issuer of a fixed income security held is unable to pay income payments or repay its debt (known as a default). Fixed income securities that pay a higher level of income usually have a lower credit rating because of the increased risk of default. The higher the rating the less likely it is that the issuer will default, but ratings are subject to change.

In difficult market conditions the value of certain fund investments may be less predictable than normal and, in some cases, this may make such investments harder to sell at the last quoted market price, or at a price considered to be fair. Where market conditions make it hard to sell the fund's investments at a fair price In order to meet customers' sale requests, we may temporarily suspend dealing in the fund's shares.

The fund manager will place transactions (including derivative transactions), hold positions and place cash on deposit with a range of counterparties (institutions). There is a risk that counterparties may default on their obligations or become insolvent.

Wherever a reference or indication of past performance is shown, please note, past performance is not a guide to future performance.

It is also important to note that:

The Fund allows for the extensive use of derivatives. The fund may invest more than 35% in securities issued by any one or more of the governments listed in the fund prospectus. Such exposure may be combined with the use of derivatives in pursuit of the fund objective. It is currently envisaged that the fund's exposure to such securities may exceed 35% in the governments of Germany, Japan, UK, USA although these may vary subject only to those listed in the prospectus.

Fund facts

M&G Absolute Return Bond Fund

Fund name	M&G Absolute Return Bond Fund
Co-fund managers:	Jim Leaviss, Dr Wolfgang Bauer
Launch date (manager tenure):	December 2016 (since launch)
Fund size:	£35.7 million
Investment objective:	The Fund aims to achieve a total return (the combination of income and capital growth) of at least 2.5% per annum above the 3-month GBP LIBOR rate, before any charges are taken, in any market conditions and over any three year period. LIBOR is the rate at which banks borrow money from each other.
Distribution frequency	Semi-annual
Comparative sector:	3-month GBP LIBOR +2.5% pa over the medium term (3 years)
Valuation currency:	GBP
Fund structure:	UK OEIC – UCITS
Pricing/dealing frequency:	Daily

Past performance is not a guide to future performance

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

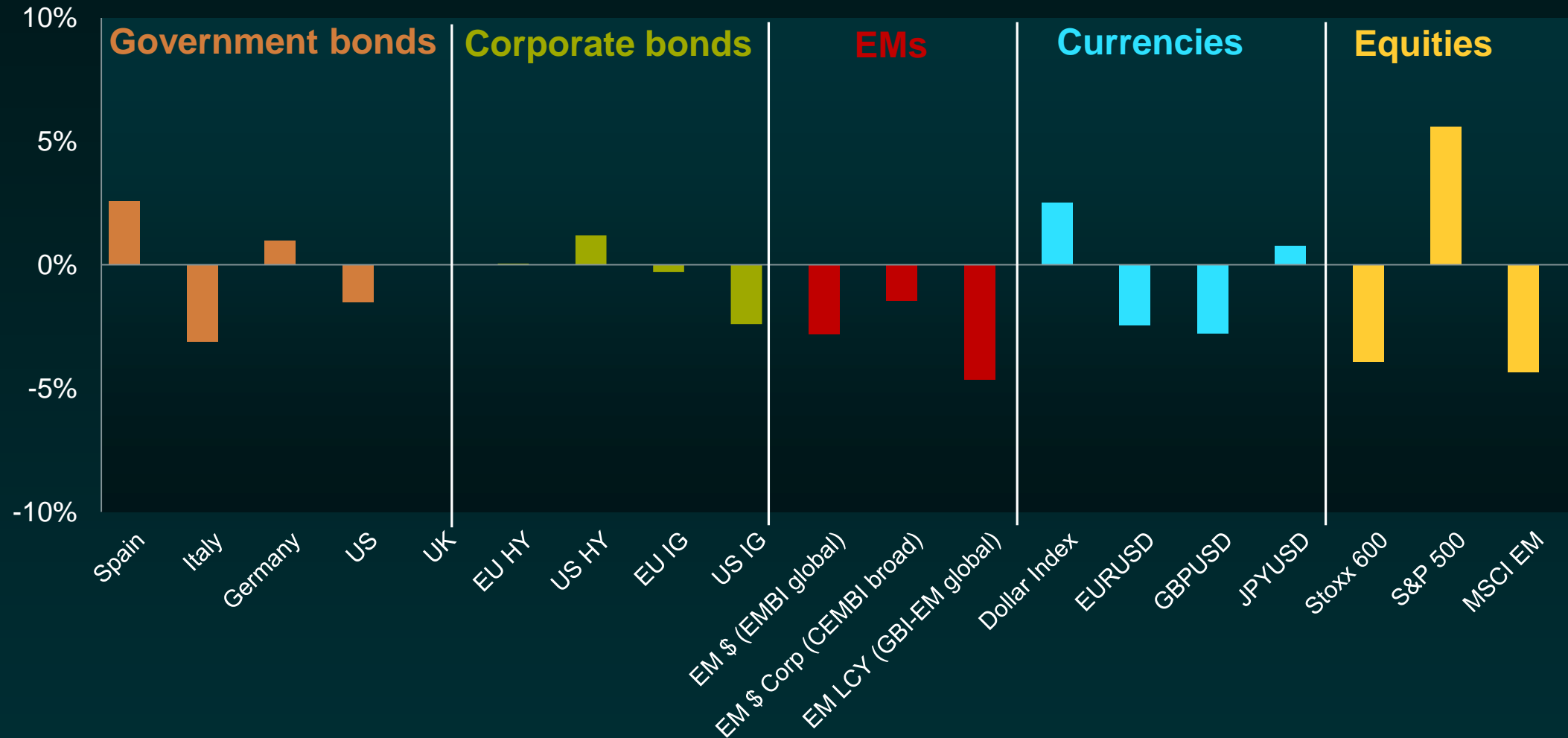
Agenda

Macro views

Fund positioning

YTD 2018 Performance

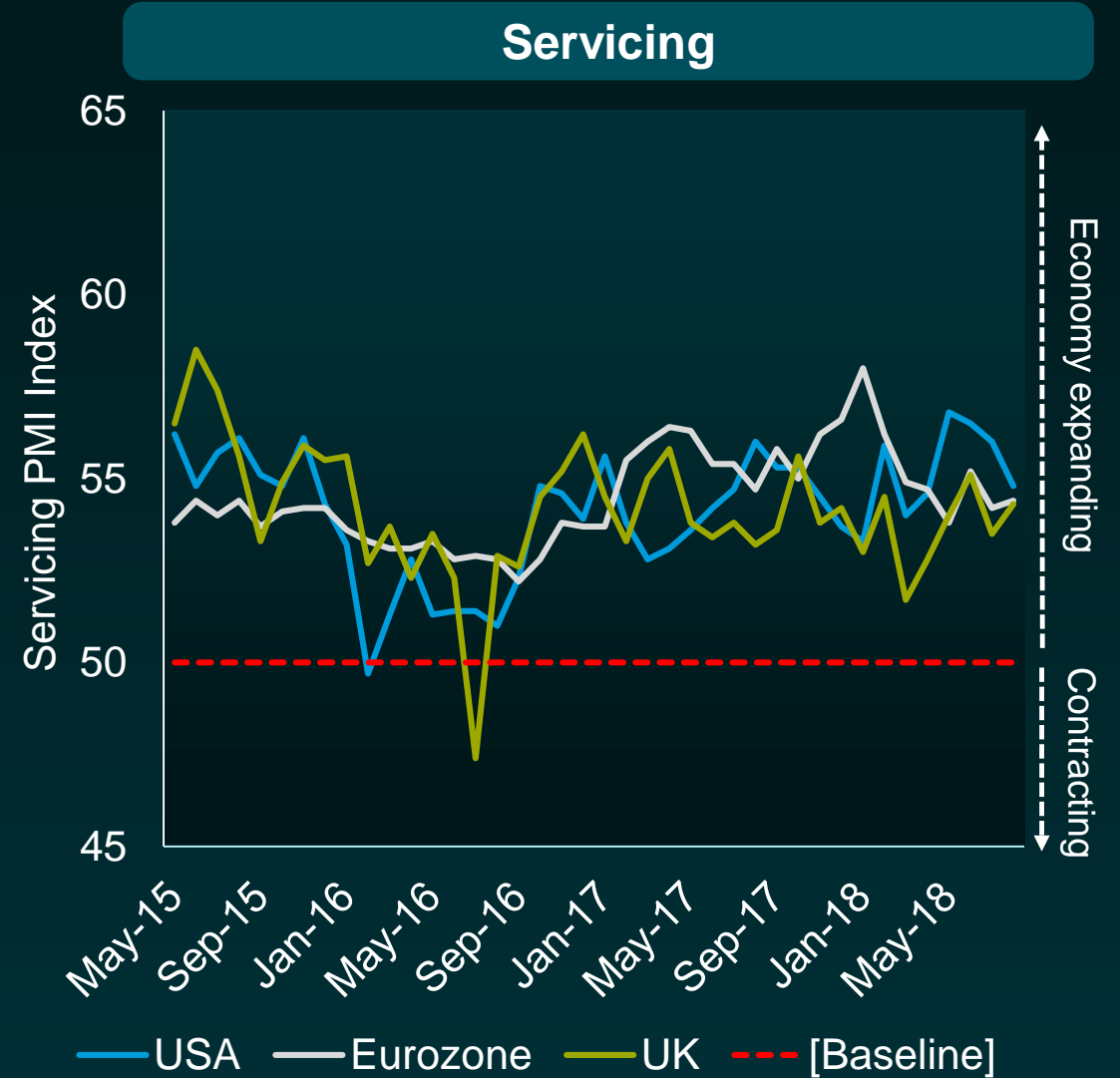
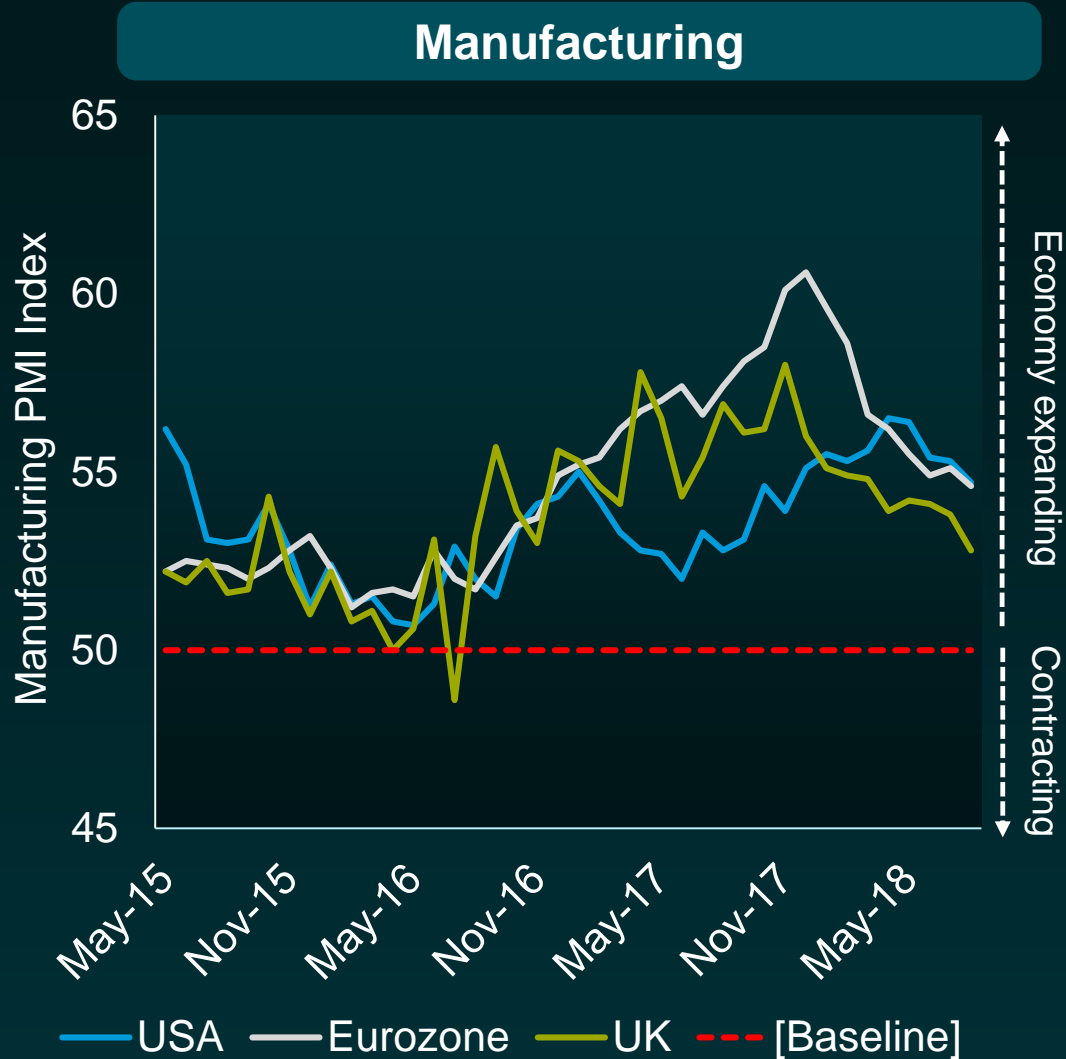
Risk on to risk off; markets have changed tack



Past performance is not a guide to future performance

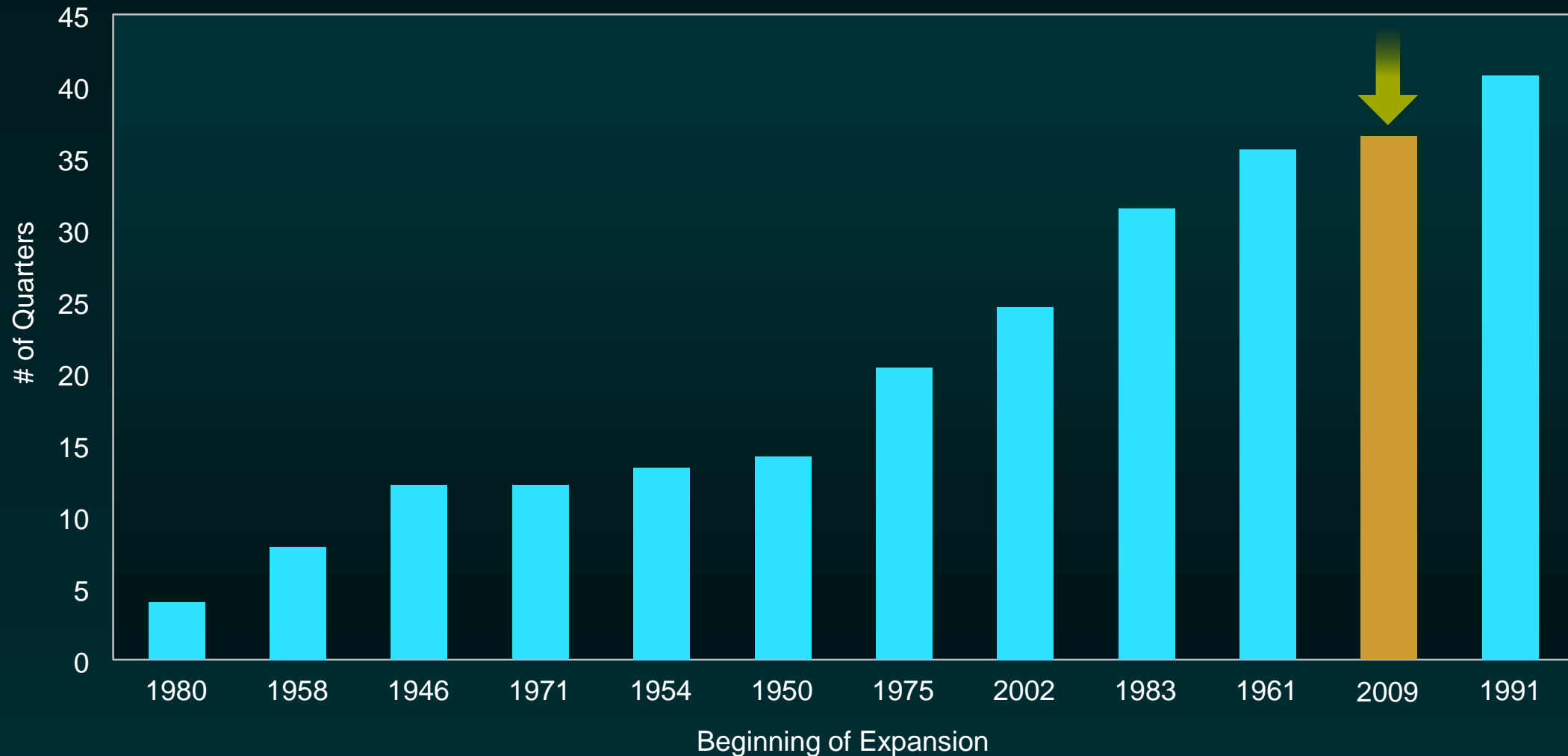
What is the data telling us?

After a period of cooling, data remains robust



The US expansion is now the second longest on record

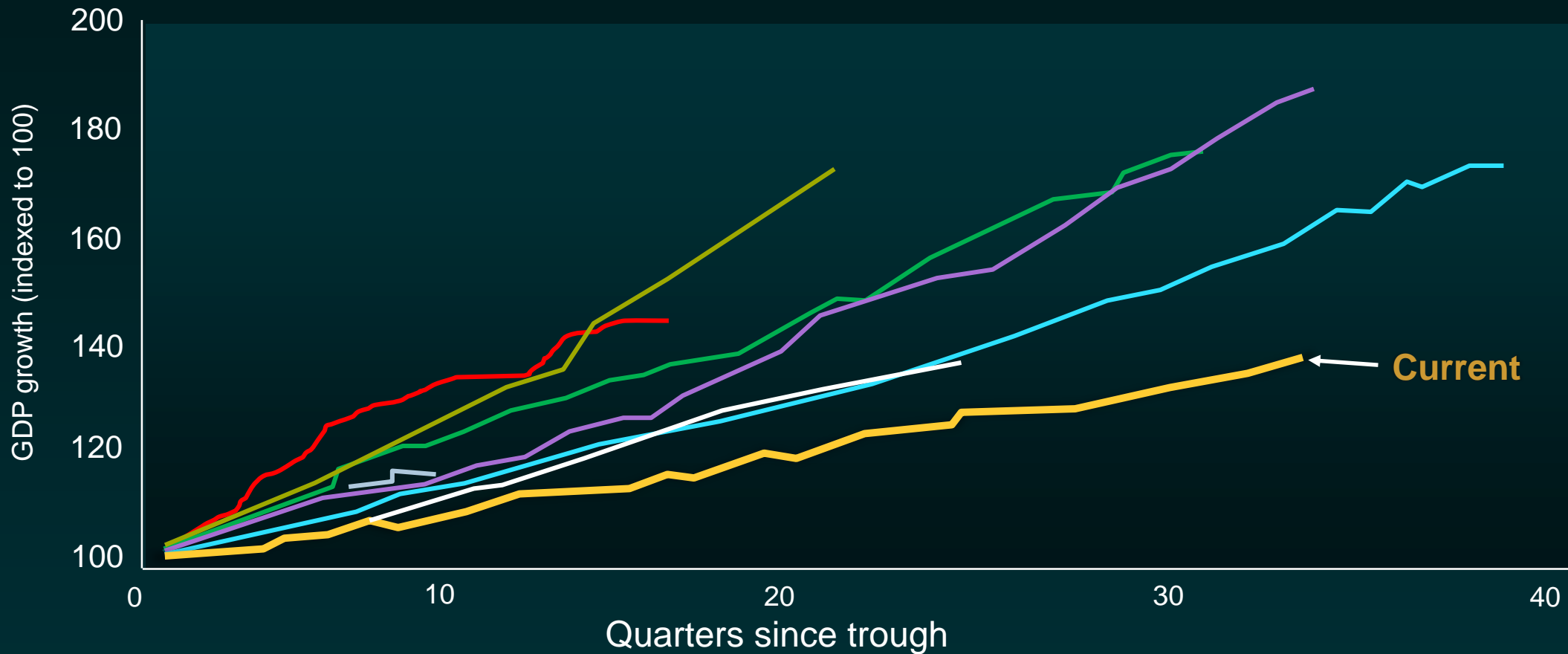
However, cycles don't die of old age



The upward trajectory of global growth has been slow

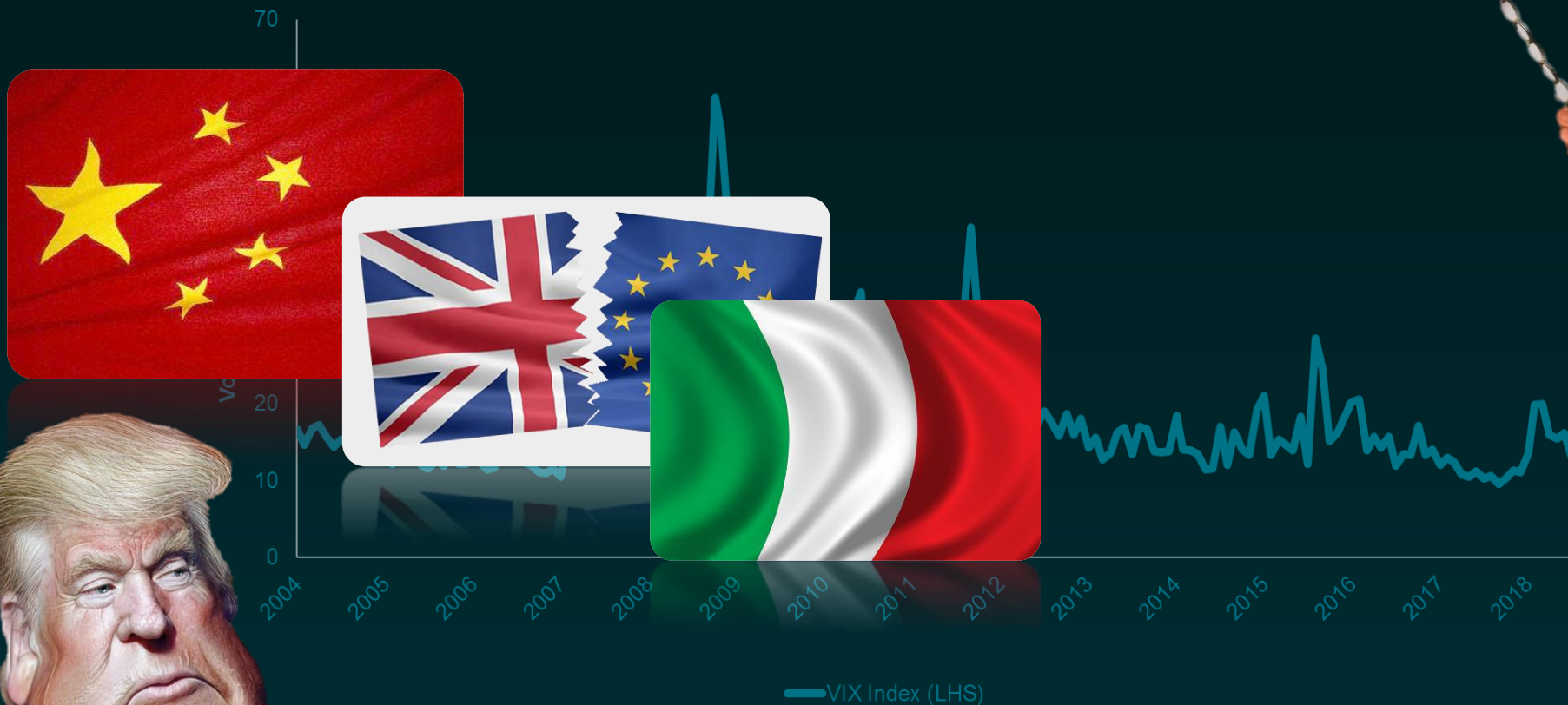
Are we due a recession?

Cumulative GDP growth post-recessions



What is the catalyst that could end the cycle?

2018 has been largely a risk off year with politics dominating markets



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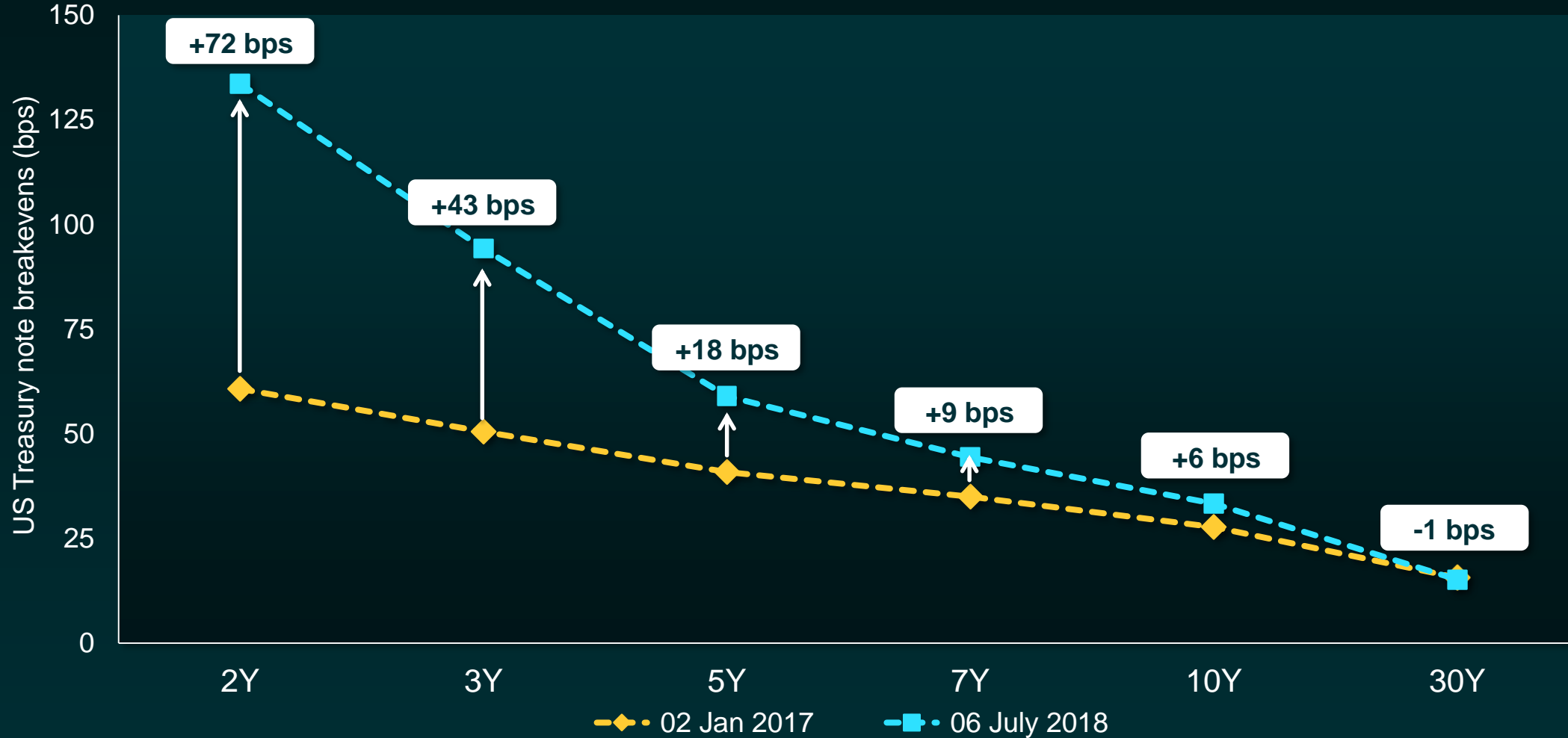
Markets have watched the US curve flatten

Inversion has historically signalled recession, but we are not there yet



But the flattening of the US Treasury curve provides a cushion

Front-end breakevens* have risen considerably

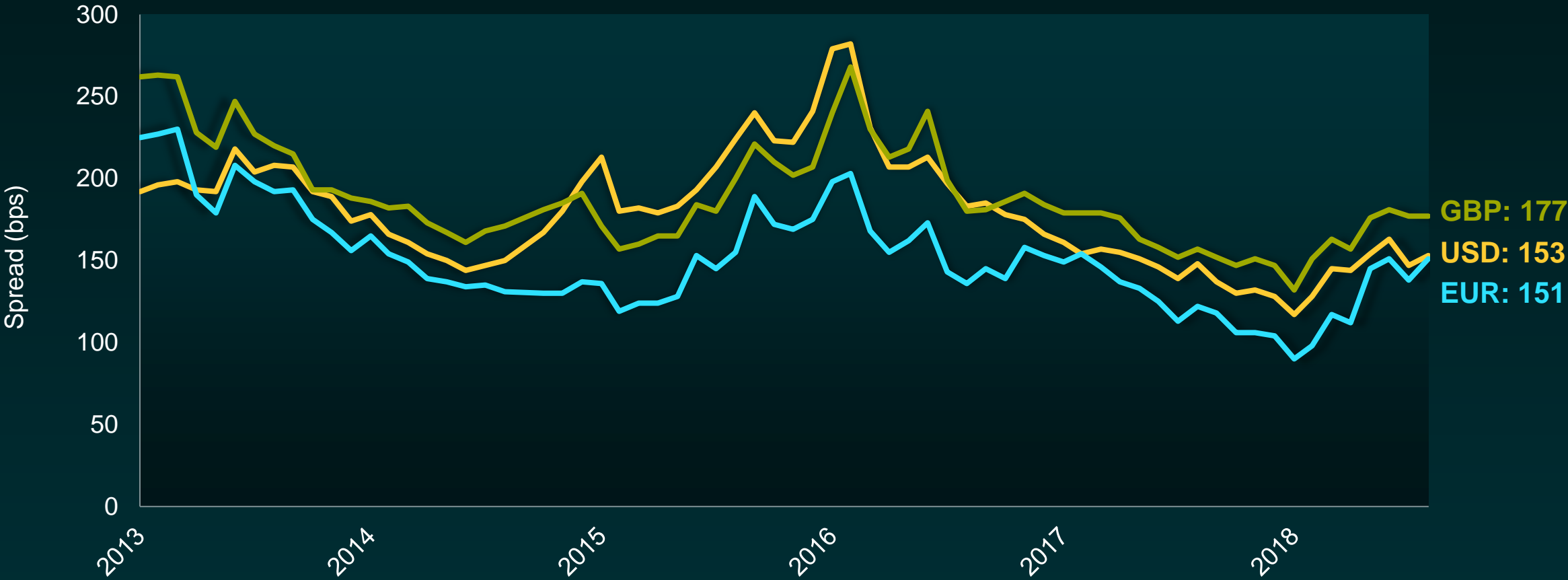


We are not being compensated for buying long dated US treasuries

Repricing gives us a better entry point than it has for some time

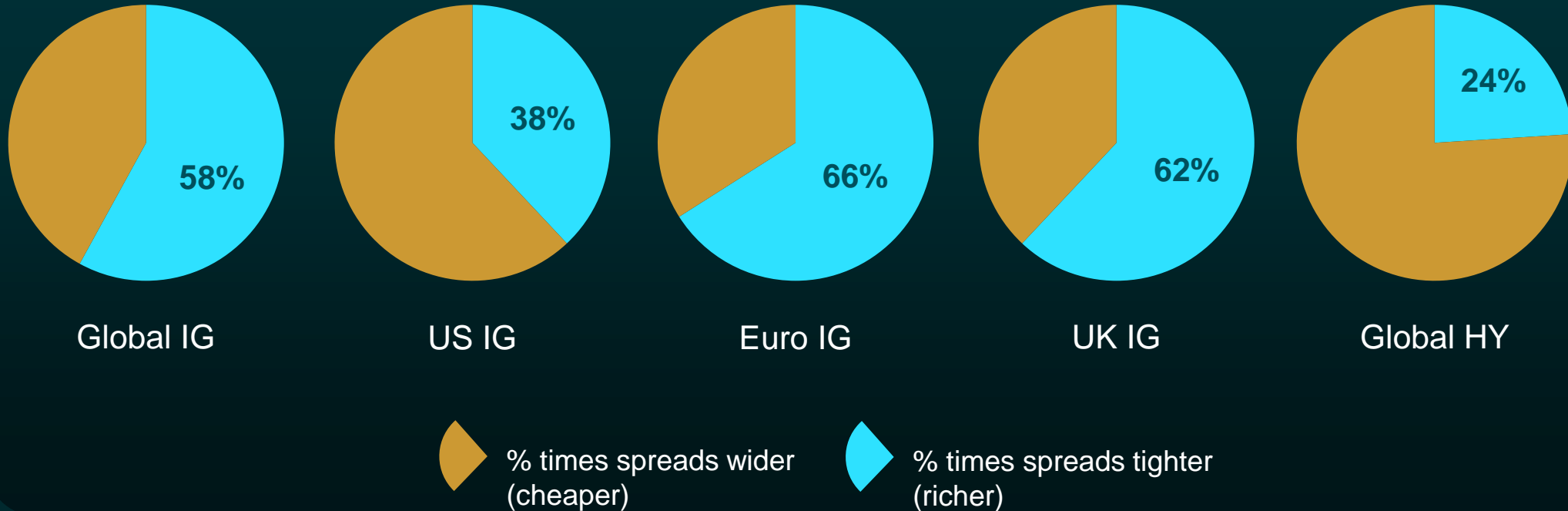
BBB corporate bonds

BBB corporate spreads over governments



Valuations look more attractive following some recent repricing

We believe spreads now offer a better entry point



Corporate IG indices have deteriorated in quality

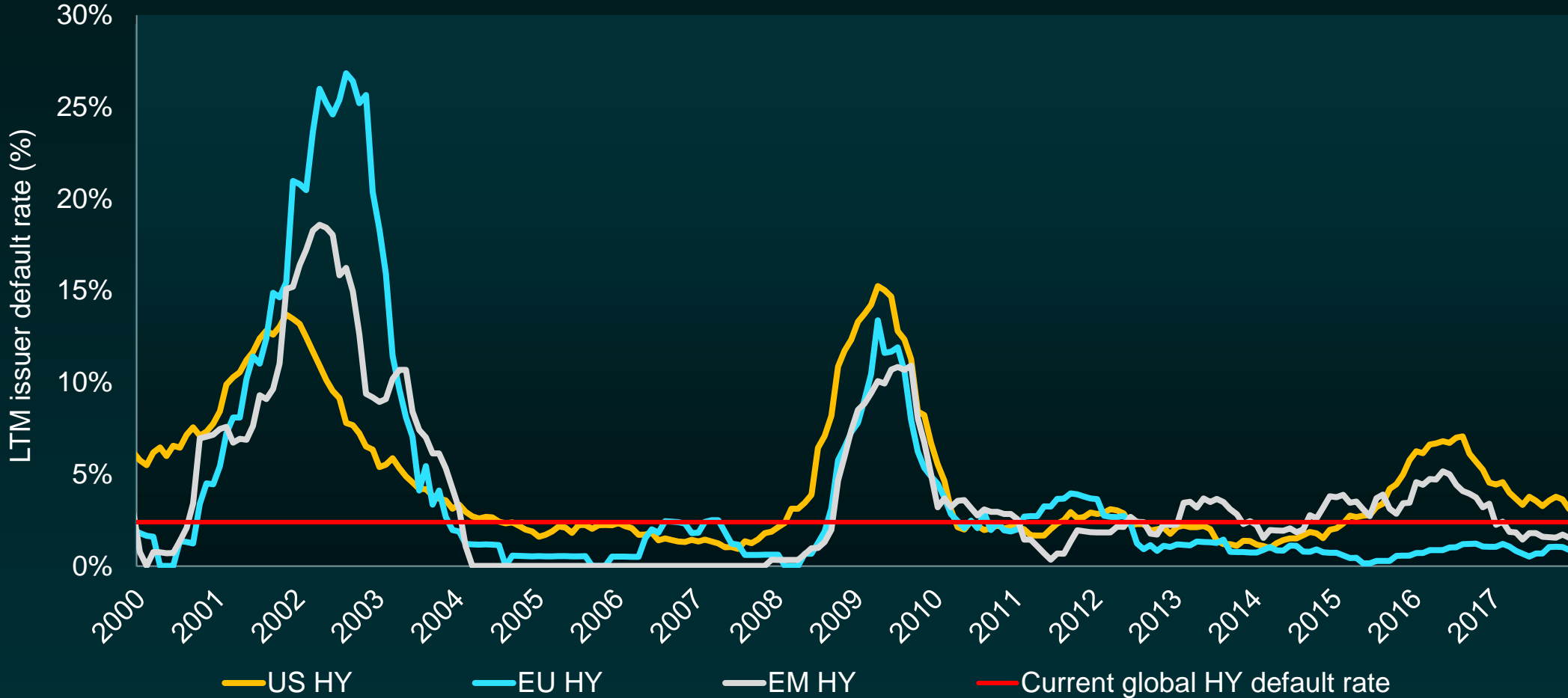
Percent of investment grade Index with BBB rated bonds



But defaults remain low

Historic High Yield defaults by region

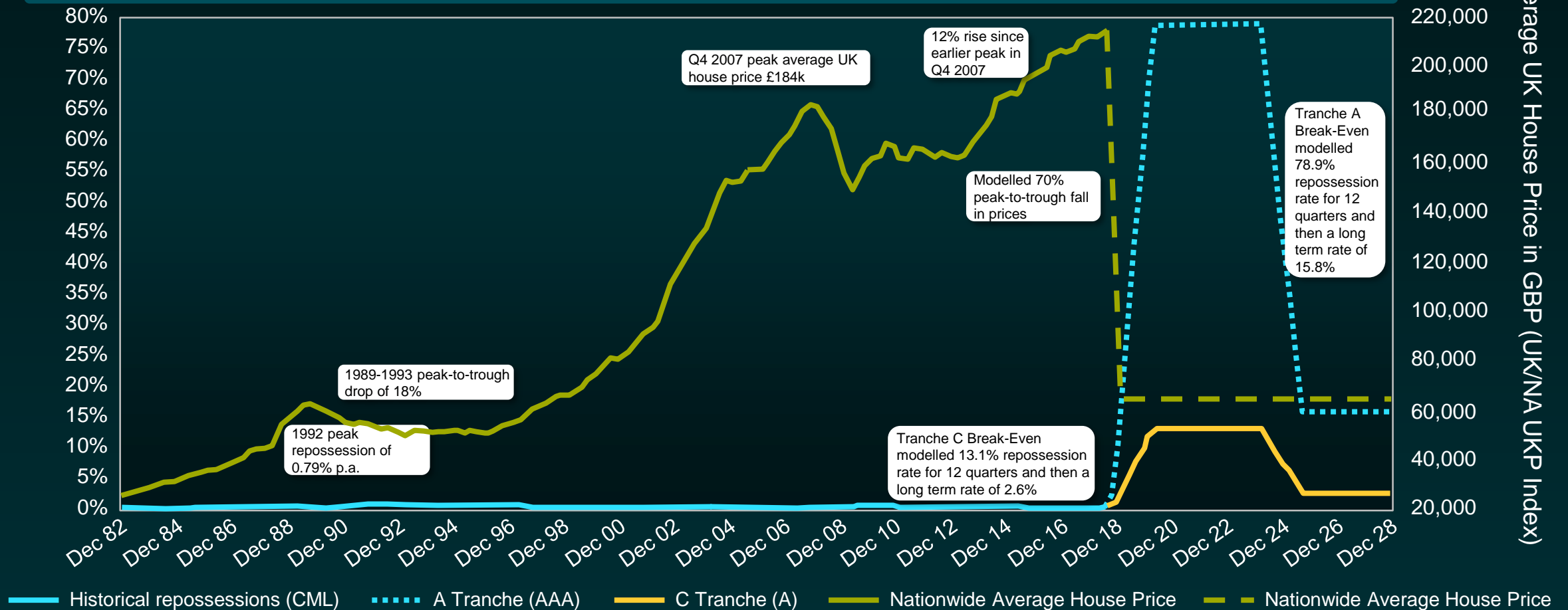
Issuer default rates by region



There are more defensive areas of credit

70% fall in UK house prices and 79% repossessions for class A's to take a loss

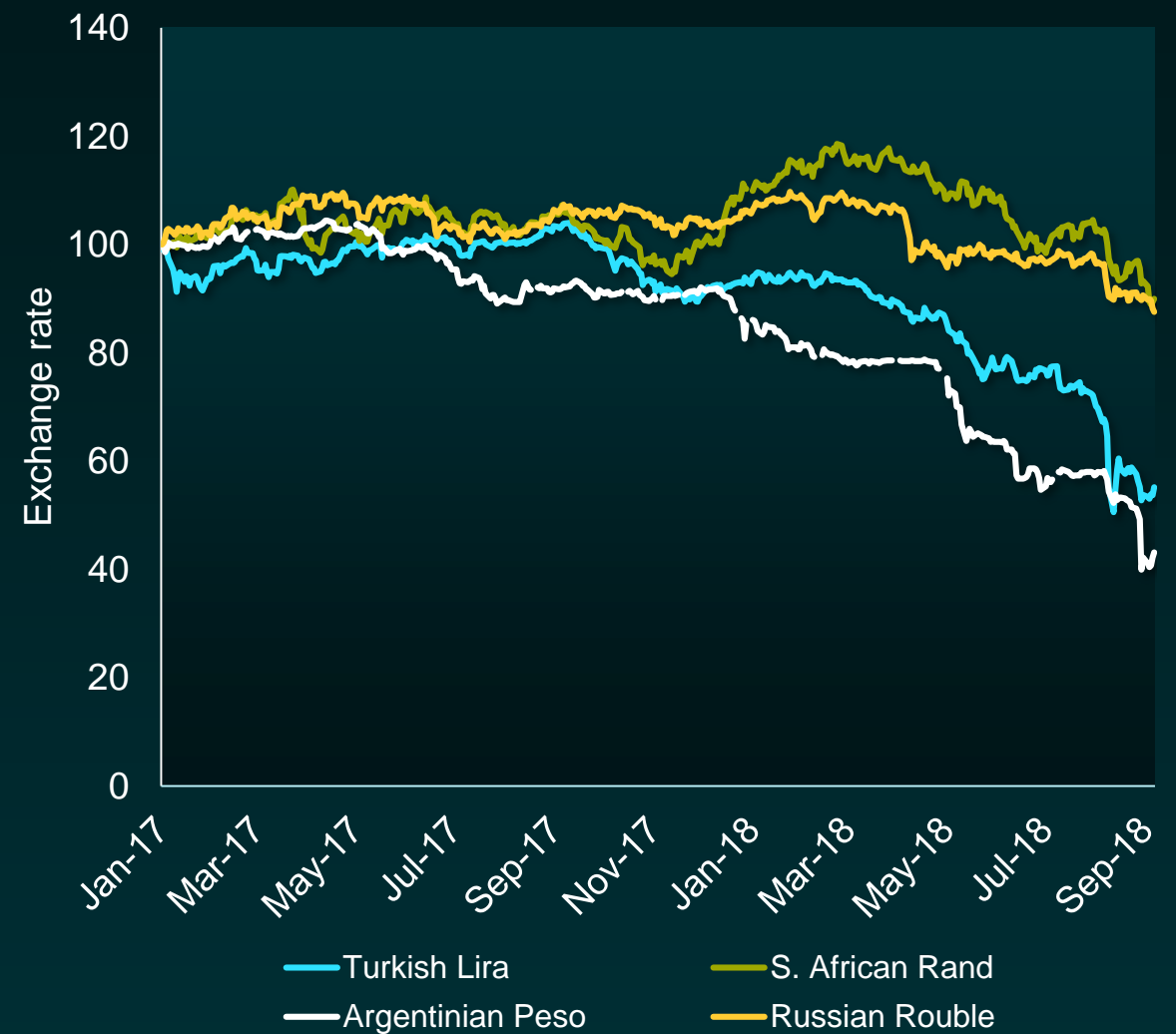
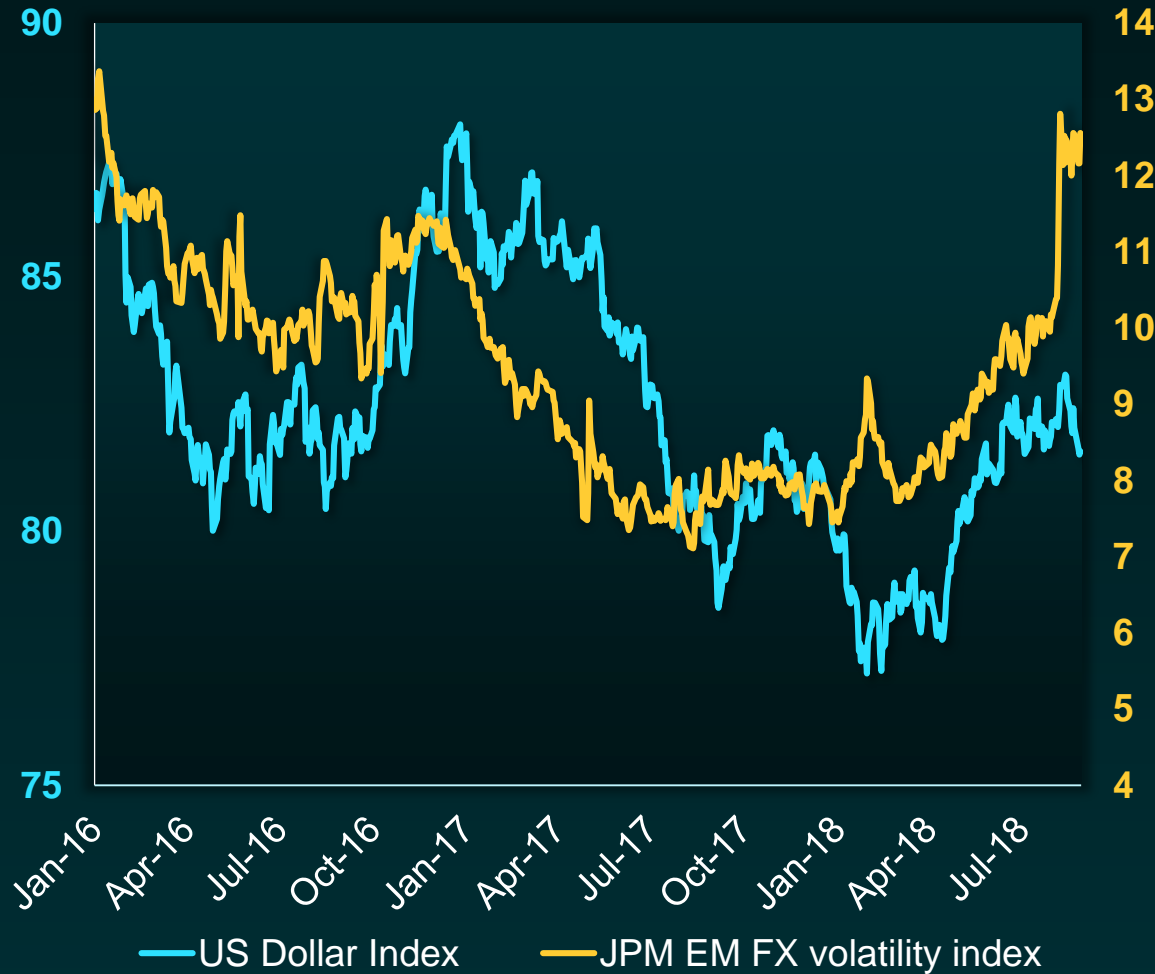
UK Residential Mortgage Backed Securities (SLT 1 A and SLT 1 C)



Source: M&G, ABSxChange & Nationwide, as at 28 August 2018. No representation is being made that any account, product, or strategy will or is likely to achieve profits, losses, or results similar to those shown. Not representative of specific strategy.

Is US Dollar strength the cause of EM weakness?

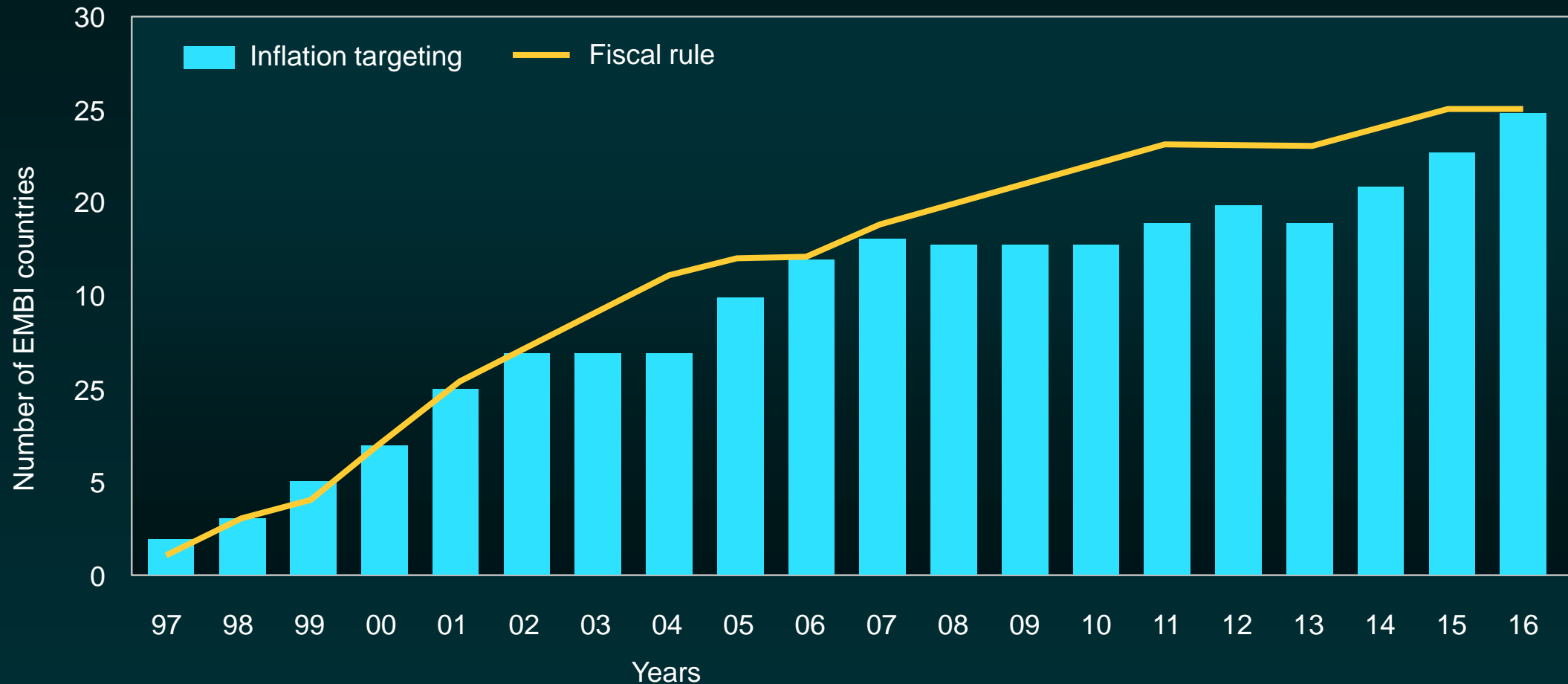
EM risks are contained to a few economies, at least for now



But at least Emerging Markets are now better prepared

Better policy framework

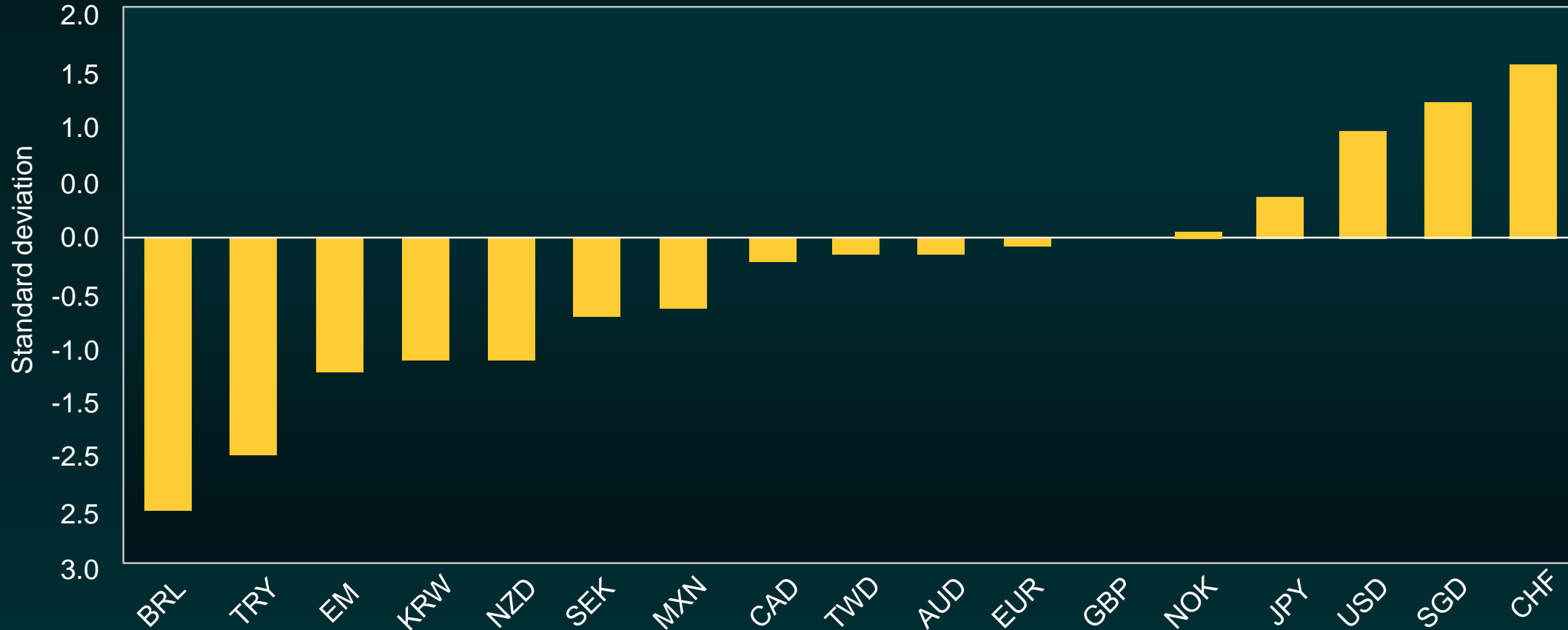
Adoption of IT and fiscal rules in EMBI countries. Cumulative number of EMBI countries within framework



And currency can be used to reduce risk

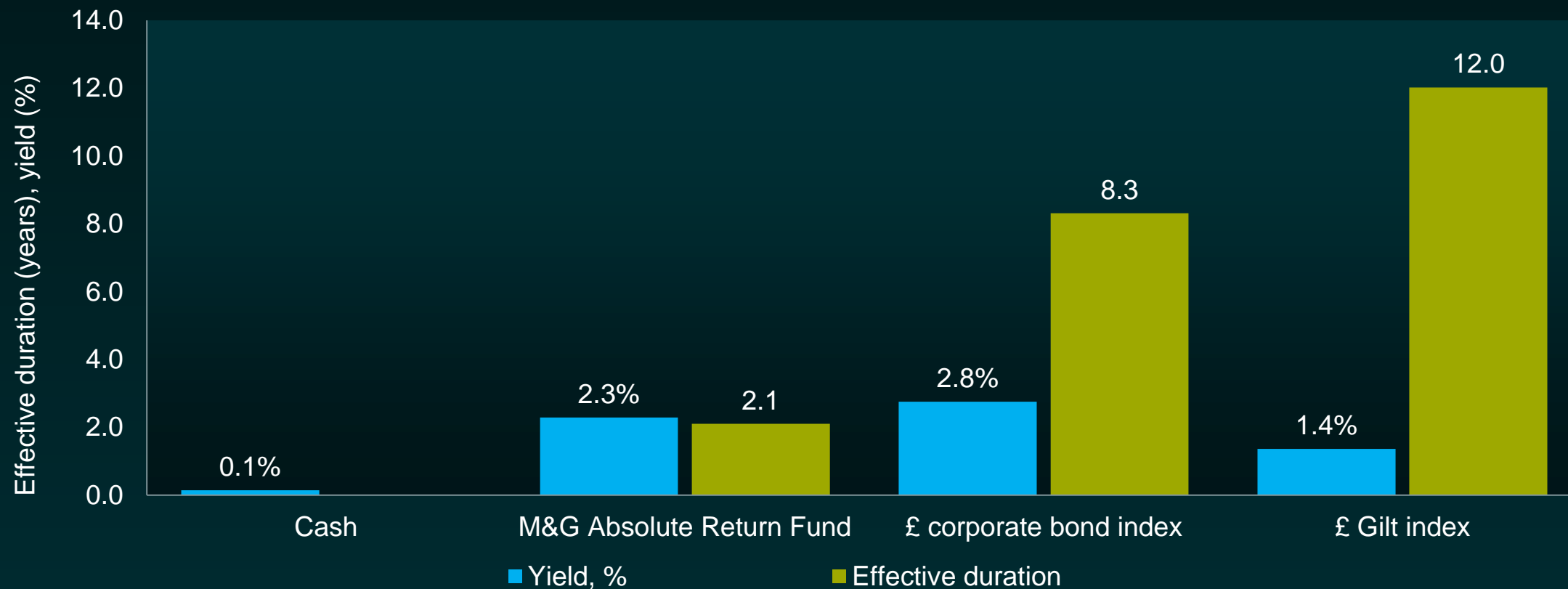
CHF, SGD and USD have historically been the best recessionary hedges

Average change in NEERs* around the last 5 recessions / standard deviation over those 5 episodes



It's not the time to be one-dimensional

Flexibility stands out in today's low rate environment



Interest rates are low, leaving investors at risk if interest rates rise

Past performance is not a guide to future performance

Source: M&G, Merrill Lynch indices, 31 August 2018. *LIBOR 3M GBP return. Please note, portfolio data is based on internal sources, is unaudited and may differ from information as shown in the Monthly Fund Review

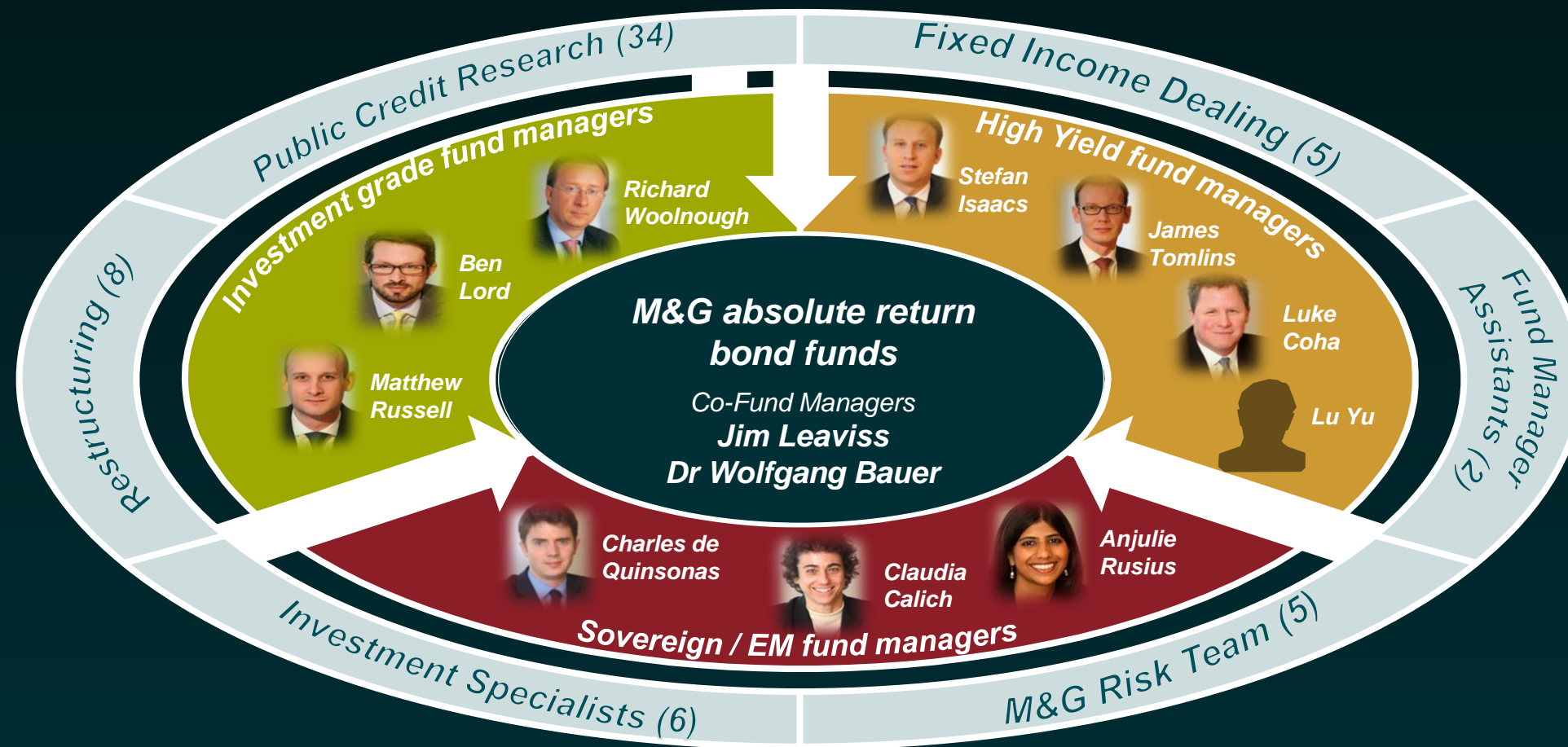
Agenda

Macro views

Fund positioning

Absolute return bond funds

Investment resources



Leveraging M&G's expertise in fixed income investing

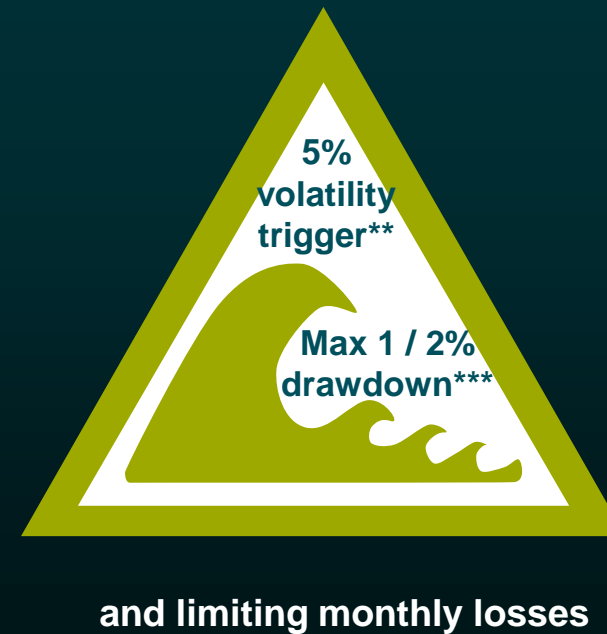
Proposition

M&G Absolute Return Bond Fund

Targeting a positive return



Managing volatility



There is no guarantee that the fund will achieve a positive return over three years, or any other period, and investors may not get back the original amount they invested.

Past performance is not a guide to future performance

*The combination of income and capital growth ** Maximum 1-month ex-post volatility of 5% (calculated daily and annualised) *** 1-month current drawdown of 1% / 2% maximum. M&G defines 1-month current drawdown as the percentage difference between the fund's current NAV and the maximum NAV achieved by the fund over the preceding 21 business days. This differs from other drawdown measures such as maximum drawdown. We use 1-month current drawdown as an input into our risk management process.

Three broad categories of investment strategies

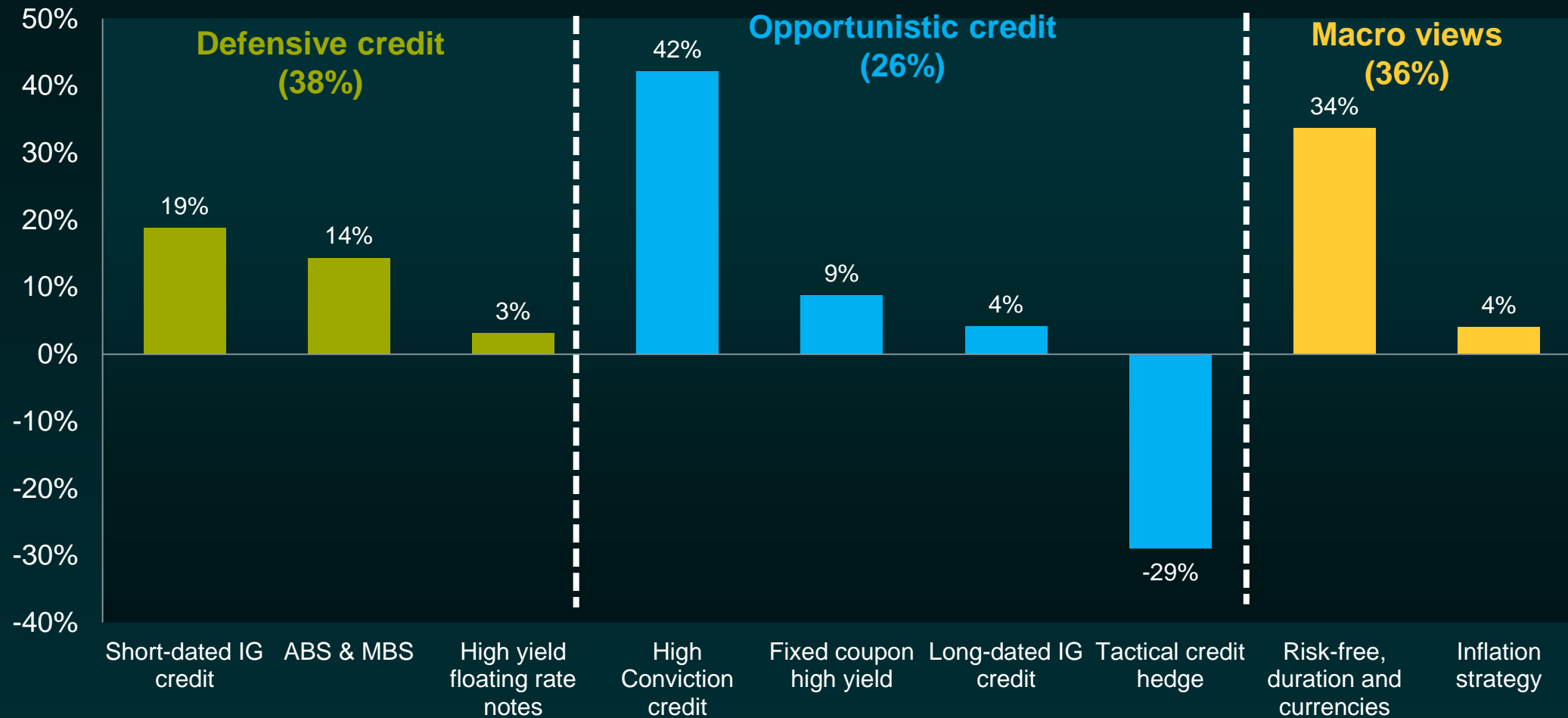
Credit 'beta', credit 'alpha', and macro views



Three broad categories comprising 9 different fixed income strategies

Asset allocation by investment strategy

M&G Absolute Return Bond Fund

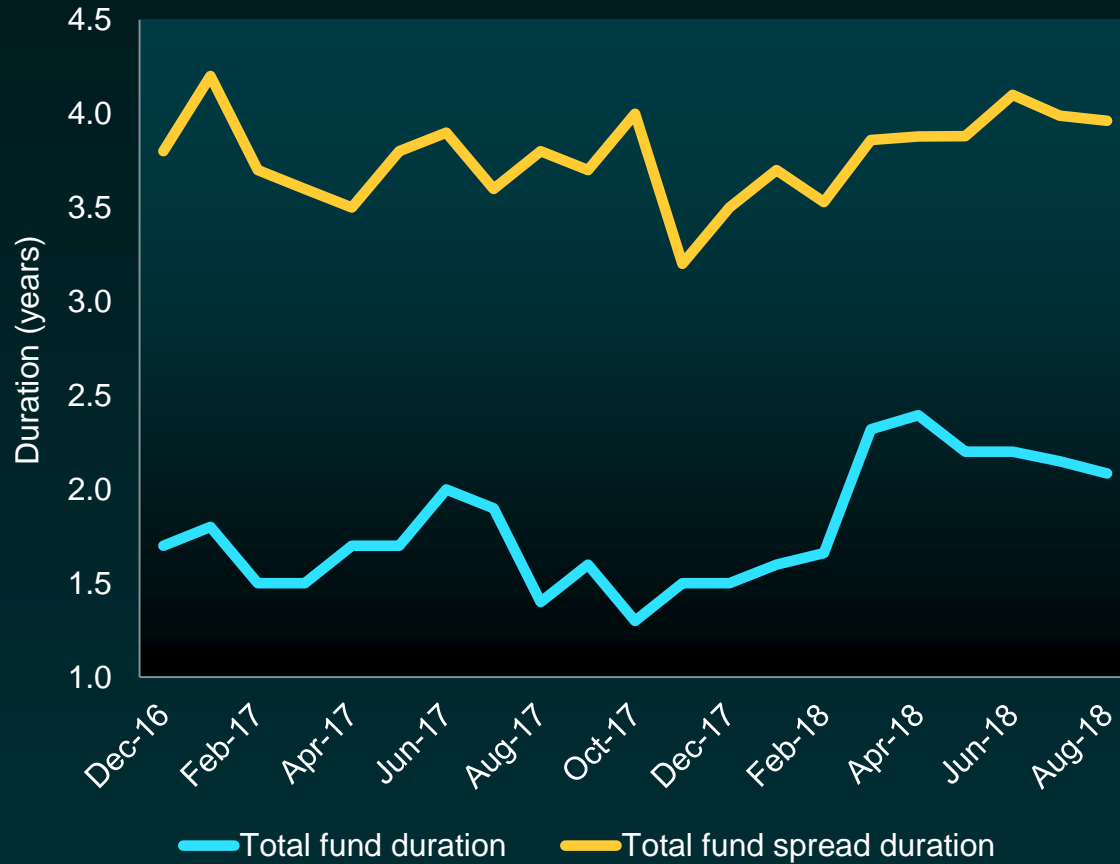


Past performance is not a guide to future performance

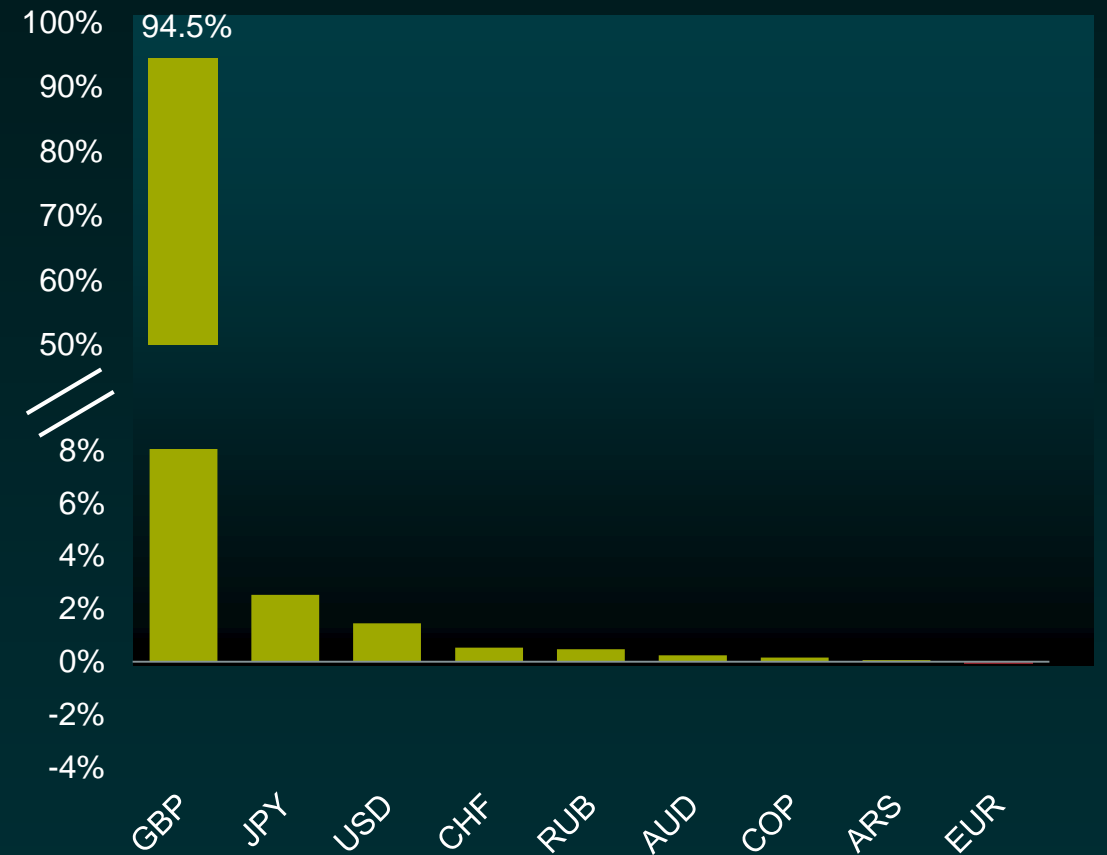
Asset allocation over time

M&G Absolute Return Bond Fund

Duration movements since inception



Active currency positioning (%)



Calendar year performance in Sterling

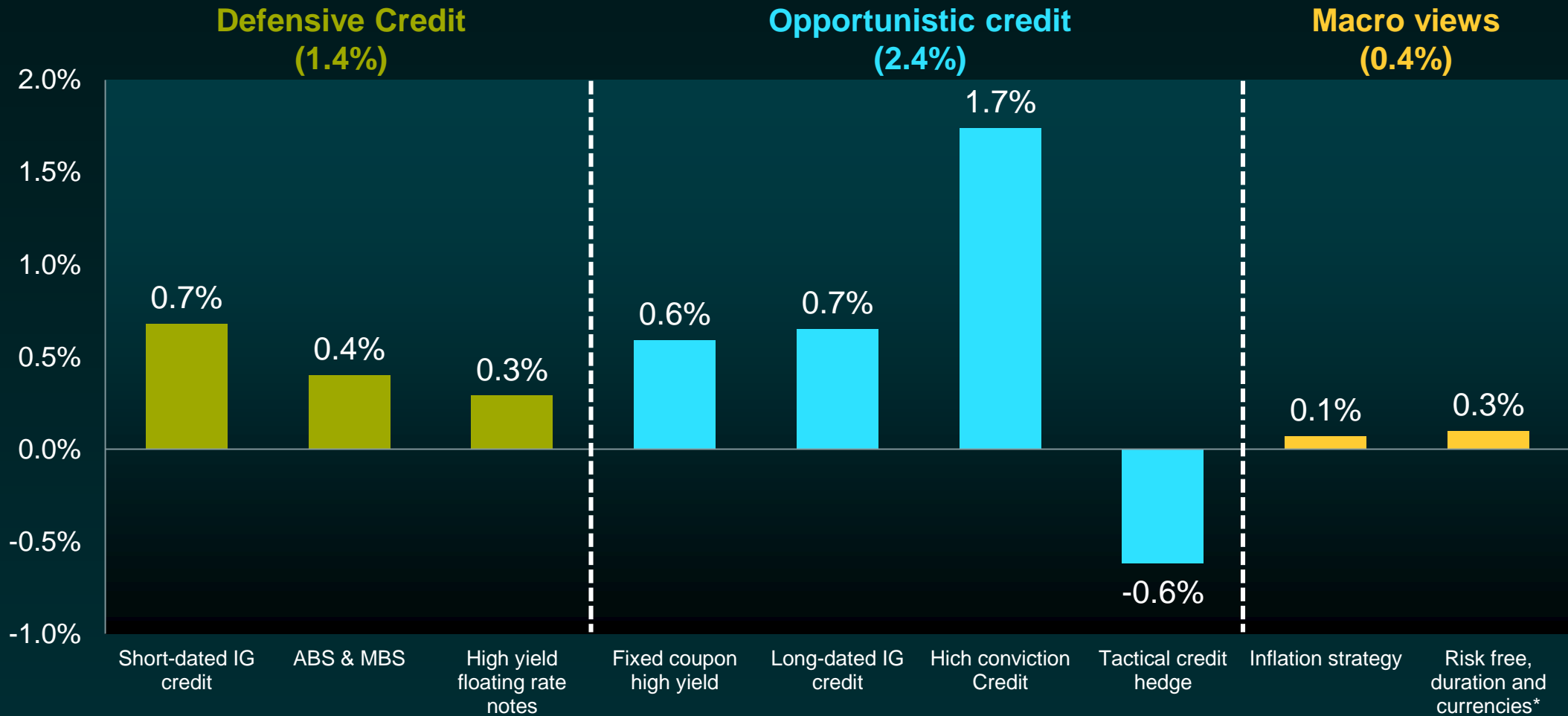
M&G Absolute Return Bond Fund

	Year to date %	2017 %	2016 %	2015 %	2014 %	2013 %
M&G Absolute Return Bond Fund	-0.3	3.0	N/A	N/A	N/A	N/A
3-month GBP LIBOR +2.5%	2.1	2.9	3.0	3.1	3.1	3.0

Past performance is not a guide to future performance.

Contributions to total returns – since inception

M&G Absolute Return Bond Fund



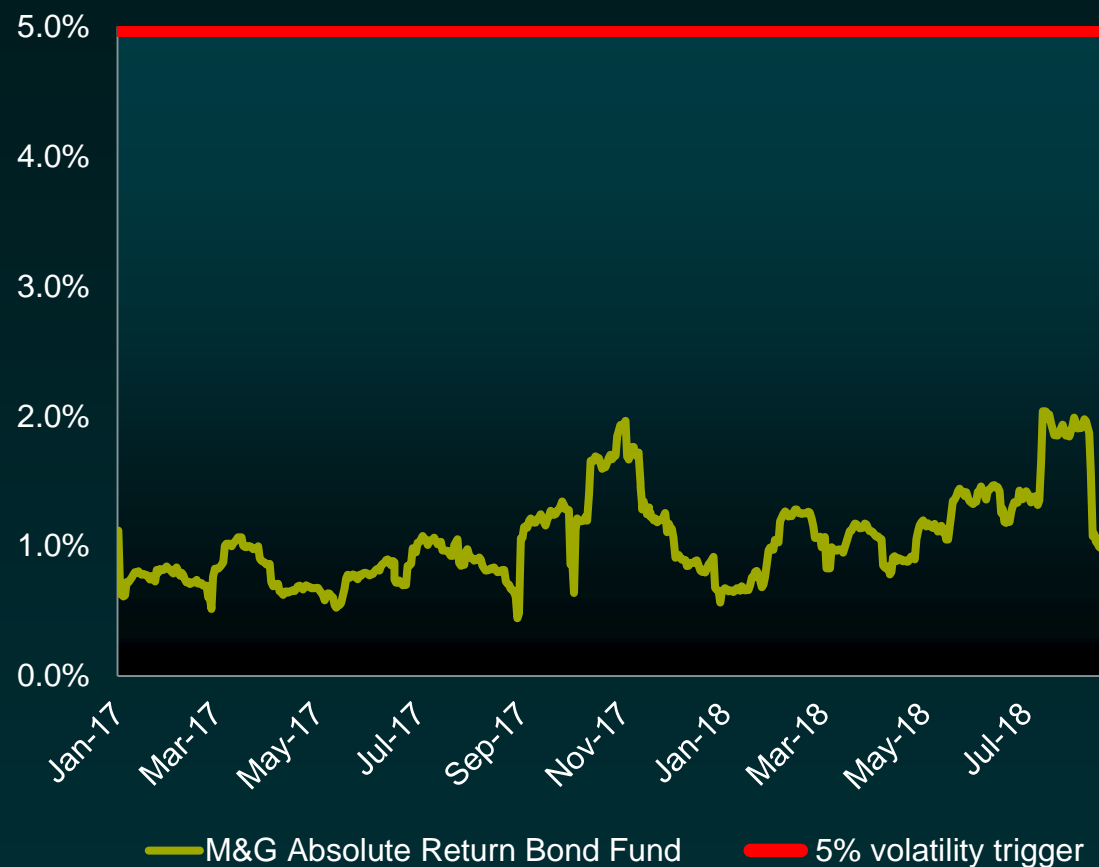
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*Includes effect of currency hedges. Returns are gross of fees and from internal system

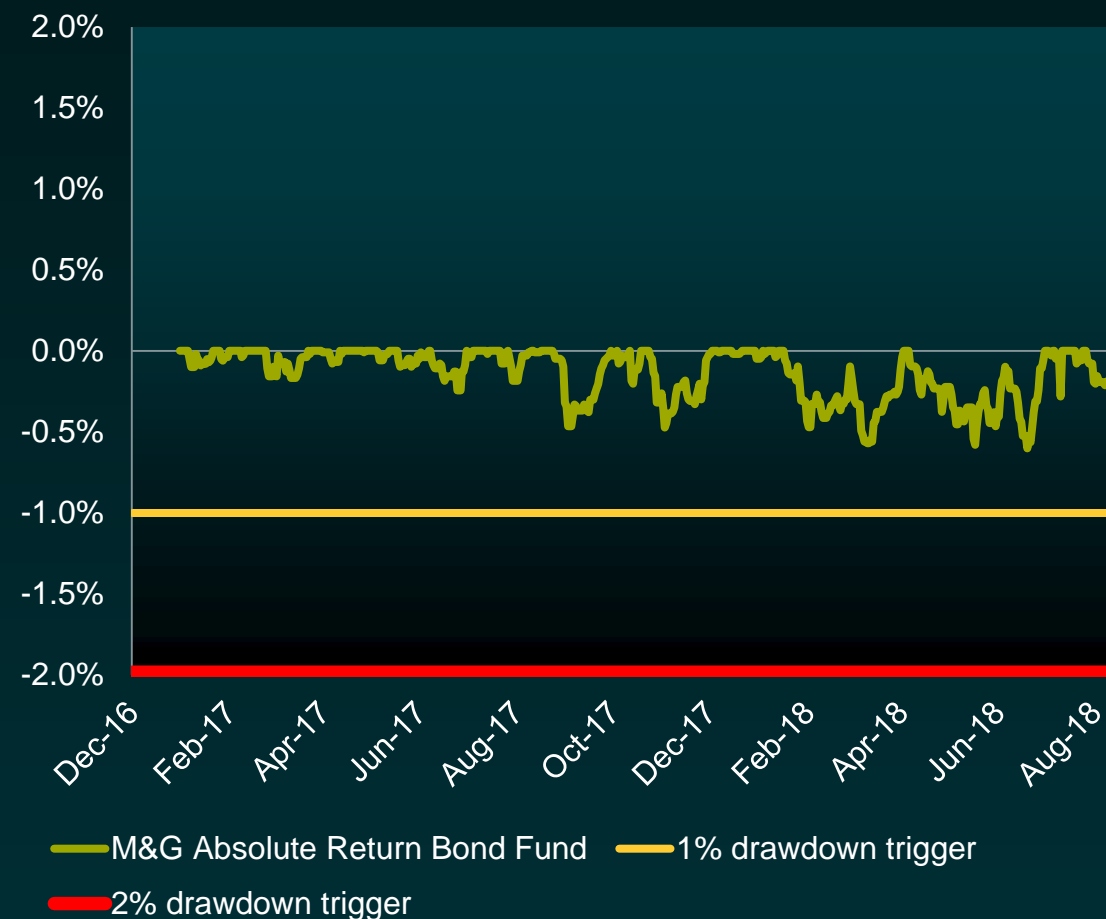
Rolling 1 month volatility and current drawdowns

M&G Absolute Return Bond Fund

1 month rolling volatility (annualised)



Current 1 month drawdown



Past performance is not a guide to future performance

Source: M&G, Bloomberg, 31 August 2018. GBP I Acc share class. *M&G defines 1-month current drawdown as the percentage difference between the fund's current NAV and the maximum NAV achieved by the fund over the preceding 21 business days. This differs from other drawdown measures such as maximum drawdown. We use 1-month current drawdown as an input into our risk management process.





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Competition: win one of 20 copies of The Sterling Bonds and Fixed Income Handbook

Posted on [15 March 2013](#) by [Jim Leaviss](#)

Mark Glowrey has written an excellent guide to the UK's bond markets, covering everything from gilts, linkers, corporate bonds and high yield, to dealing, settlement, tax and covenants. There's also some great bond market history and anecdote – I like the story of the two brothers who worked as bond brokers at the London Stock Exchange. Both had been awarded the Military Cross in World War 2, but the second brother had been awarded the Military Cross and bar. The nickname of the first brother was 'The Coward'.

We have 20 copies of the book to give away. You can win one by tweeting us (we're [@bondvigilantes](#)) the answer to this question. Add the hashtag #BVbook to help us find your entry in our inbox please.

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[See here for terms and conditions.](#) Tweet your entries by midday on Friday 22nd March. The 20 winners will be contacted shortly afterwards.

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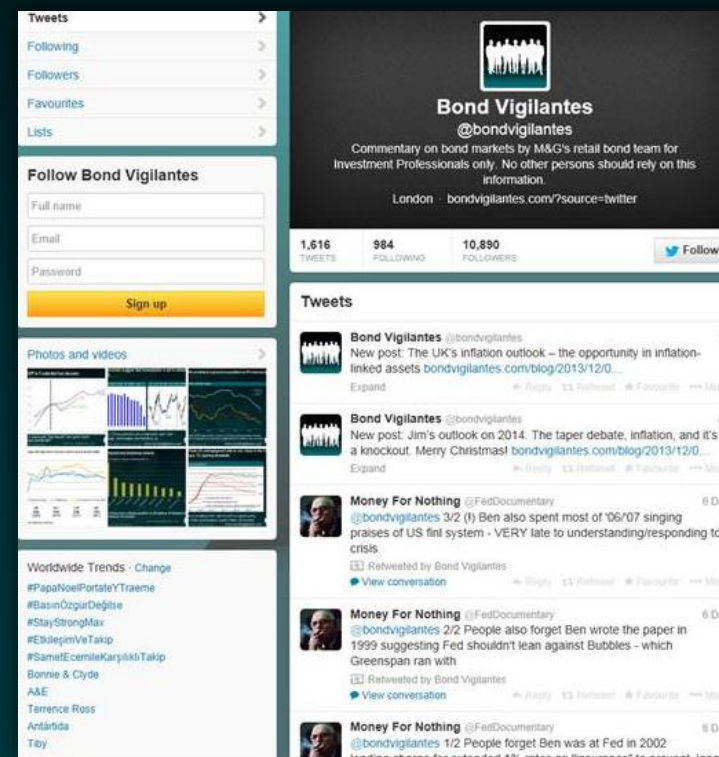
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Q&A

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