M&G Corporate Bond Fund

a sub-fund of M&G Investment Funds (3)

Interim Short Report December 2019
For the six months ended 31 December 2019

M&G INVESTMENTS

Fund information

The Authorised Corporate Director (ACD) of M&G Investment Funds (3) presents its Interim Short Report for M&G Corporate Bond Fund which contains a review of the fund's investment activities and investment performance during the period. The ACD's Interim Long Report and unaudited Financial Statements for M&G Investment Funds (3), incorporating all the sub-funds and a Glossary of terms is available free of charge either from our website at www.mandg.co.uk/reports or by calling M&G Customer Relations on 0800 390 390.

ACD

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(Authorised and regulated by the Financial Conduct Authority. M&G Securities Limited is a member of the Investment Association and of the Tax Incentivised Savings Association.)

Important information

As mentioned in the shareholder letter on 17 June 2019, we have made changes to the way we charge for M&G funds based in the UK, starting on Thursday 1 August 2019. The annual charge should be simpler to understand and easier to compare with other fund charges. We have combined all the charges that make up the current ongoing charge figure (OCF) into a single annual charge. Only exceptional items such as unforeseen legal and tax expenses, also known as extraordinary expenses, will be excluded from the annual charge. To find out the new annual charge and the OCF which are shown in the Key Investor Information Document (KIID) for the share class(es) you are invested in, visit our website www.mandg.co.uk

Investment objective

The fund aims to provide income and capital growth.

Investment policy

At least 70% of the fund is invested in sterling-denominated corporate debt instruments. The fund's exposure to corporate debt may be gained through the use of derivatives. Derivatives may also be used for efficient portfolio management. Any currency exposures within the fund may be managed by currency hedges into sterling. The fund may also invest in collective investment schemes, other transferable securities and other debt instruments (including corporate debt and government and public securities denominated in any currency), cash, near cash, other money market securities, warrants and other derivative instruments.

Investment approach

The fund's strategy is based on the principle that corporate bond market returns are driven by a combination of macroeconomic, asset, sector and stock-level factors. As different factors dominate returns at different stages of the economic cycle, the manager applies a dynamic investment approach, changing the blend of duration and credit exposure in the portfolio to weight them appropriately.

The fund manager has the investment freedom to take a high-conviction approach when selecting credits for the portfolio. Diversification – across individual issuers as well as industries – is an essential element of the fund's strategy to limit the potential for losses in the event of default.

The fund's investment style combines top-down and bottom-up analysis, and the fund manager is assisted in the selection of individual credits by a large team of independent sovereign and public credit analysts.

Benchmark

Benchmark: IA Sterling Corporate Bond sector.

The fund is actively managed. The benchmark is a comparator against which the fund's performance can be measured. The sector has been chosen as the fund's comparator benchmark as the fund is a constituent of the sector. The comparator benchmark does not constrain the fund's portfolio construction.

Risk profile

The fund invests mainly in sterling-denominated fixed income securities, or bonds, issued by UK companies. It is primarily subject to the price volatility of the UK bond market as well as the performance of individual issuers. It is also influenced by developments in the broader global bond market. In addition, the fund is subject to fluctuations in currency exchange rates.

The fund's focus is on high-quality corporate bonds, securities that are normally traded with relative ease. Up to 20% of the fund may be invested in other fixed income investments, such as government bonds, which are typically highly liquid assets, or high yield corporate bonds, which are higher risk assets that could potentially experience a degree of illiquidity in times of market distress.

The fund's exposure to debt securities may be gained through the use of derivatives. In association with the use of derivatives, including those instruments not traded through an exchange, collateral is deposited in order to mitigate the risk that a counterparty may default on its obligations or become insolvent.

Portfolio diversification is key in managing liquidity and default risks as well as reducing market risk. The fund's risks are measured and managed as an integral part of the investment process.

The following table shows the risk number associated with the fund and is based on Sterling Class 'A' shares.

The above number:

- is based on the rate at which the value of the fund has moved up and down in the past and is based on historical data so may not be a reliable indicator of the future risk profile of the fund.
- is not guaranteed and may change over time and the lowest risk number does not mean risk free.
- has not changed during this period.

As at 2 January 2020, for the six months ended 31 December 2019

Performance against objective

Between 1 July 2019 (the start of the review period) and 2 January 2020, the M&G Corporate Bond Fund delivered a positive total return (the combination of income and growth of capital) across both its sterling and euro share classes. Fund performance was either in line or ahead of the average return from fund's benchmark, the IA Sterling Corporate Bond sector, which was 3.0% and 8.5% in sterling and euro terms, respectively over the same period.

Over the review period and over five years, the fund met its objective, which is to provide income and capital growth.* For the five-year period, all of the fund's share classes recorded positive total returns that were higher than the return of its benchmark, which was 4.4% and 2.7% in sterling and euro terms, respectively.

* For the performance of each share class, please refer to the 'Long-term performance by share class' table in the 'Fund performance' section of the Interim Long Report and unaudited Financial Statements for M&G Investment Funds (3).

To give an indication of the performance of the fund, the following table shows the compound rate of return, per annum, over the period for Sterling Class 'A' (Accumulation) shares. Calculated on a price to price basis with income reinvested.

Long-term performance

	Six months 01.07.19 % [a]	Three years 03.01.17 % p.a.	Five years 02.01.15 % p.a.	Since launch % p.a.
Sterling [b]				
Class 'A'	+3.0	+3.9	+3.8	+6.1 [c]

[a] Absolute basis.

[b] Price to price with income reinvested.

[c] 15 April 1994. All performance data prior to 11 March 2002 (the launch date of the share class) has been calculated by reference to a conversion factor due to a change of the nominated share class.

Please note past performance is not a guide to future performance and the value of investments, and the income from them, will fluctuate. This will cause the fund price to fall as well as rise and you may not get back the original amount you invested.

Investment performance

Following a volatile and largely unpredictable period for financial markets throughout most of 2018, the months that followed to 31 December 2019 was, on balance, calmer in terms of investor behaviour and generally more beneficial for the performance of risk assets such as equities (company shares) and most corporate bonds.

Bonds are loans that are extended by an investor to an issuing entity – such as a company or government – in exchange for regular interest payments. The initial amount borrowed by the entity is usually repaid at the end of the loan's life. Bonds issued by companies are referred to as 'corporate bonds', while those issued by governments are called 'government bonds'. Investment grade corporate bonds refer to debt securities issued by a company with a medium or high credit rating from a recognised credit rating agency. They are considered to be at lower risk of non-repayment than those issued by companies with lower credit ratings (known as high yield bonds). The performance of investment grade corporate bond markets can be influenced by the performance of government bonds.

The drivers of volatility in 2018 centred on higher interest rates, or at least the prospect of higher interest rates, inflation, political uncertainty and global trade tensions. While the last two drivers were still evident during the period under review, especially negotiations over the UK's Brexit deal with the European Union (EU), the fact the Federal Reserve (Fed) paused its plans to raise US interest rates – and actually started to reduce them – certainly settled investor nerves.

But while investors took comfort from statements by the Fed that it would moderate its strategy around raising interest rates, by July and the start of the review period, the more optimistic mood was somewhat dampened. Renewed fears about the prospects for global trade, caused mainly by heightened tensions between the US and China over tariffs, saw investors once again preferring so-called 'safer' assets such as government bonds.

This increasing demand for core government bonds resurfaced in August, pushing bond yields lower – and prices higher – on UK gilts, US Treasuries, and German bunds. Against a backdrop of weaker economic data and inflation that was persistently below acceptable levels, major central banks issued statements in July that seemed to pave the way for fresh cuts to interest rates in the autumn months, and on 1 August the Fed cut rates for the first time since the global financial crisis.

In September, the outgoing European Central Bank (ECB) president Mario Draghi announced that the central bank would start buying eurozone government bonds again (a programme referred to as quantitative easing) in a bid to stimulate the flagging eurozone economy.

There was an increase in investors' appetite for risk assets in October and November, boosted by a potential resolution to US-China trade wars, Brexit nearing some type of agreed deal, and the Fed easing interest rates while announcing it would resume the purchases of bonds. The Fed signalled that this would likely be its last "mid-cycle insurance cut".

In the UK, Prime Minister Boris Johnson called a general election for December 12, mainly to boost the government's chances of breaking the Brexit deadlock. The market generally interpreted this move as positive, and the price of sterling rose compared with the US dollar. The election result of December 13 would show a convincing victory for the ruling Conservative Party.

The second half of 2019 was broadly better for corporate bonds, particularly those issued by US and UK companies, and the asset class delivered positive returns across the six-month period as a whole. For a number of reasons, but mainly because of sluggish growth and jobs data, the picture was weaker for European corporate debt.

The fund's performance was driven by favouring investment grade corporate bonds denominated in sterling and US dollars. Allocation to sectors such as financials and telecoms, and asset-backed securities (bonds whose income payments are derived from a specified group of underlying pooled assets, such as mortgages or credit card payments) also added value.

The fund's duration positioning, however, held back its relative performance, mainly during the summer period when investors sought so-called safe-haven bond assets like UK and German government bonds. An important factor in a bond fund's performance is its ability to adjust the portfolio's sensitivity to changes in interest rates, known as 'duration'. Being shorter duration means that a fund is relatively less sensitive to changes in interest rates than longer duration funds. During the course of the reporting period, we moved the fund's duration slightly between 6.3 years and 6.6 years, keeping it roughly the same extent short (1.3 years short) of the iBoxx £ Corporate Index, a corporate bond index comprising liquid bonds developed by financial information provider Markit.

Investment activities

During the period under review, we took advantage of opportunities to add value through relative value trades – for example, taking advantage of the difference in pricing between bonds from the same company issued in different currencies or different maturities. The majority of these trades involved switching from an issuer's US dollar-denominated debt into its sterling debt, to harness the more attractive pricing. We were particularly active as relative value traders within the financials and telecoms sectors, and with a focus on BBB rated corporate bonds.

Overall, we have been reducing the level of credit risk in the fund by selling bonds we believe are overvalued, such as HSBC and JP Morgan. We disagree with the wider opinion of the market that financials are behaving more like 'safe-haven' bonds, and we think valuations are more compelling in consumer goods.

We continue to think that core government bonds look expensive, for example UK government bonds, and so we have little exposure to these bond assets. Within high yield bonds, we are equally careful not to commit too much cash to the riskier parts of fixed income, and allocation was around 4% of the fund by the end of the reporting period.

Outlook

After a difficult 2018 for financial markets, 2019 was largely constructive for global bond markets, with a return of risk appetite, as investors have generally been encouraged by signs that the US Federal Reserve would pause its interest rate rising cycle. However, we have long been of the view that the Fed will need to raise rates further, which is reflected in the fund's short duration positioning.

We remain broadly positive on the outlook for the global economy and corporate bonds, and do not believe that recession is imminent – this was certainly proven in 2019. Signs of resolutions in things like US-China trade disagreements, and of course Brexit, should help firm up market sentiment as we progress through 2020.

While we have been partially reducing risk in the portfolio in the latter stages of the reporting period, through holding fewer financial companies' bonds for example, we continue to find opportunities within corporate bond markets that are attractively priced and with high levels of credit quality.

Regardless of how these situations develop, what we do as fund managers does not change. We look at where we are in the interest rate cycle and the economic cycle, and we look at where we can find the most attractive opportunities for the fund from different sectors and individual issuers at any given stage.

Richard Woolnough & **Ben Lord**
Co-fund managers

Employees of M&G FA Limited (formerly M&G Limited) which is an associate of M&G Securities Limited. At the start of the review period Richard Woolnough was the sole fund manager.

Please note that the views expressed in this Report should not be taken as a recommendation or advice on how the fund or any holding mentioned in the Report is likely to perform. If you wish to obtain financial advice as to whether an investment is suitable for your needs, you should consult a Financial Adviser.

Classification spread of investments

The table below shows the percentage holding per sector.

	% of fund as at 31.12.19	30.06.19
FIXED INCOME		
Debt securities		
'AAA' credit rated bonds	8.65	7.13
'AA' credit rated bonds	7.60	5.65
'A' credit rated bonds	18.23	21.79
'BBB' credit rated bonds	47.58	49.72
'BB' credit rated bonds	1.48	3.68
Bonds with no credit rating	8.22	6.75
Debt derivatives		
Credit default swaps	0.00	0.00
Interest rate futures	0.24	(0.30)
CURRENCY		
Forward currency contracts	0.15	(0.32)
CASH EQUIVALENTS		
'AAA' rated money market funds [a]	7.01	4.56

[a] Uncommitted surplus cash is placed into 'AAA' rated money market funds with the aim of reducing counterparty risk.

Portfolio transactions

for the six months to 31 December Portfolio transactions	2019 £'000	2018 £'000
Total purchases	378,829	519,845
Total sales	616,107	595,324

Purchases and sales exclude the cost and proceeds of 'AAA' rated money market funds.

Financial highlights
Fund performance

Please note past performance is not a guide to future performance and the value of investments, and the income from them, will fluctuate. This will cause the fund price to fall as well as rise and you may not get back the original amount you invested.

The following chart and tables reflect the key financial information of a representative share class, Sterling Class 'A' (Accumulation) shares. As different share classes have different attributes, for example charging structures and minimum investments, please be aware that their performance may be different. For more information on the different share classes in this fund please refer to the Prospectus for M&G Investment Funds (3), which is available free of charge either from our website at www.mandg.co.uk/prospectuses or by calling M&G Customer Relations.

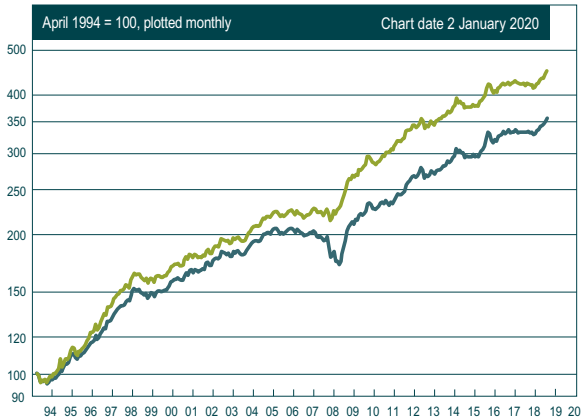
Fund level performance

Fund net asset value

as at	31.12.19 £'000	30.06.19 £'000	30.06.18 £'000
Fund net asset value (NAV)	3,414,631	3,505,536	3,696,143

Performance since launch

To give an indication of how the fund has performed since launch, the chart below shows total return of Sterling Class 'A' (Accumulation) shares.



* Income reinvested

Source: Morningstar, Inc. and M&G

To give an indication of how the fund has performed during the period the table below shows the performance of Sterling Class 'A' (Accumulation) shares.

All 'Performance and charges' percentages represent an annual rate except for the 'Return after operating charges' which is calculated as a percentage of the opening net asset value per share (NAV). 'Dilution adjustments' are only in respect of direct portfolio transaction costs.

Sterling Class 'A' Accumulation share performance

The share class was launched on 15 April 1994.

Change in NAV per share	Six months to 31.12.19 UK p	Year to 30.06.19 UK p	Year to 30.06.18 UK p
Opening NAV	73.04	69.17	69.24
Return before operating charges and after direct portfolio transaction costs	2.70	4.68	0.74
Operating charges	(0.42)	(0.81)	(0.81)
Return after operating charges	2.28	3.87	(0.07)
Distributions	(0.85)	(1.76)	(1.72)
Retained distributions	0.85	1.76	1.72
Closing NAV	75.32	73.04	69.17
Direct portfolio transaction costs	**UK p**	**UK p**	**UK p**
Costs before dilution adjustments	0.00	0.00	0.00
Dilution adjustments [a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.00	0.00	0.00
Performance and charges	**%**	**%**	**%**
Direct portfolio transaction costs [b]	0.00	0.00	0.00
Operating charges [c]	1.10	1.16	1.16
Return after operating charges	+3.12	+5.59	-0.10
Distribution yield	2.15	2.39	2.44
Effect on yield of charges offset against capital	0.00	0.00	0.00
Other information			
Closing NAV (£'000)	299,495	309,130	367,913
Closing NAV percentage of total fund NAV (%)	8.77	8.82	9.95
Number of shares	397,622,406	423,211,540	531,917,115
Highest share price (UK p)	76.26	73.11	70.75
Lowest share price (UK p)	73.17	68.16	68.85

[a] In respect of direct portfolio transaction costs.

[b] As a percentage of average net asset value.

[c] Following the change in charging structure, you may see variances between the comparative and current year figures.

We explain below the payments made to meet the ongoing costs of investing and managing the fund, comprising operating charges and portfolio transaction costs.

Operating charges

Operating charges include payments made to M&G and to providers independent of M&G:

- **Annual charge:** Charge paid to M&G covering the annual cost of M&G managing and administering the fund and the costs of third parties providing services to the fund. From 1 August 2019, this charge rolls all costs that make up the operating charges into one annual charge.

  For every £1 billion of a fund's net asset value, a discount of 0.02% will be applied to that fund's annual charge (up to a maximum of 0.12%).

- **Extraordinary legal and tax expenses:** Costs that specifically relate to legal or tax claims that are both exceptional and unforeseeable. Such expenses are uncommon, and would not be expected in most years. Although they result in a short-term cost to the fund, generally they can deliver longer term benefits for investors.

- **Investment management:** Charge paid to M&G for investment management of the fund. From 1 August 2019 this charge forms part of the annual charge.

- **Administration:** Charge paid for administration services in addition to investment management – any surplus from this charge will be retained by M&G. From 1 August 2019 this charge is rolled into the annual charge.

- **Oversight and other independent services:** Charges paid to providers independent of M&G for services which include depositary, custody and audit. From 1 August 2019 these charges will be paid by M&G and rolled into the annual charge.

- **Ongoing charges from underlying funds:** Ongoing charges on holdings in underlying funds that are not rebated. From 1 August 2019 charges from underlying funds (excluding Investment Trust Companies and Real Estate Investment Trusts) will be rebated.

These charges do not include portfolio transaction costs or any entry and exit charges (also known as initial and redemption charges). The charging structures of share classes may differ, and therefore the operating charges may differ.

Once the annual charge has been operational for twelve months, operating charges will be in line with the ongoing charges shown in the Key Investor Information Document, other than where there have been extraordinary legal or tax expenses, or an estimate has been used for the ongoing charge because a material change has made the operating charges unreliable as an estimate of future charges.

Portfolio transaction costs

Portfolio transaction costs are incurred by funds when buying and selling investments. These costs vary depending on the types of investment, their market capitalisation, country of exchange and method of execution. They are made up of direct and indirect portfolio transaction costs:

- **Direct portfolio transaction costs:** Broker execution commission and taxes.

- **Indirect portfolio transaction costs:** 'Dealing spread' – the difference between the buying and selling prices of the fund's investments; some types of investment, such as fixed interest securities, have no direct transaction costs and only the dealing spread is paid.

Investments are bought or sold by a fund when changes are made to the investment portfolio and in response to net flows of money into or out of the fund from investors buying and selling shares in the fund.

Financial highlights

Operating charges and portfolio transaction costs

To protect existing investors, portfolio transaction costs incurred as a result of investors buying and selling shares in the fund are recovered from those investors through a 'dilution adjustment' to the price they pay or receive. As the fund invests mainly in fixed interest securities, the direct transaction costs paid on other investments are too small to be reflected in the table below. To give an indication of the indirect portfolio dealing costs the table below shows the average portfolio dealing spread.

Further information on this process is in the Prospectus, which is available free of charge on request either from our website at www.mandg.co.uk/prospectuses or by calling M&G Customer Relations.

Portfolio transaction costs

as at Indirect portfolio transaction costs	31.12.19 %	30.06.19 %	30.06.18 %	Average [a] %
Average portfolio dealing spread	0.76	0.80	0.72	0.76

[a] Average of first three columns.

Contact

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* For security purposes and to improve the quality of our service, we may record and monitor telephone calls. Please have your M&G client reference to hand.

** Please remember to quote your name and M&G client reference and sign any written communication to M&G.

† Please note that information contained within an email cannot be guaranteed as secure. We advise that you do not include any sensitive information when corresponding with M&G in this way.

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