M&G (Lux) Positive Impact Fund

Positioned for resilience

FOR INVESTMENT PROFESSIONALS ONLY
March 2020

While the spread of Covid-19 continues to cause unprecedented disruption and uncertainty in equity markets, we outline the reasons why we strongly believe the M&G (Lux) Positive Impact Fund should be able to weather the current market rout.

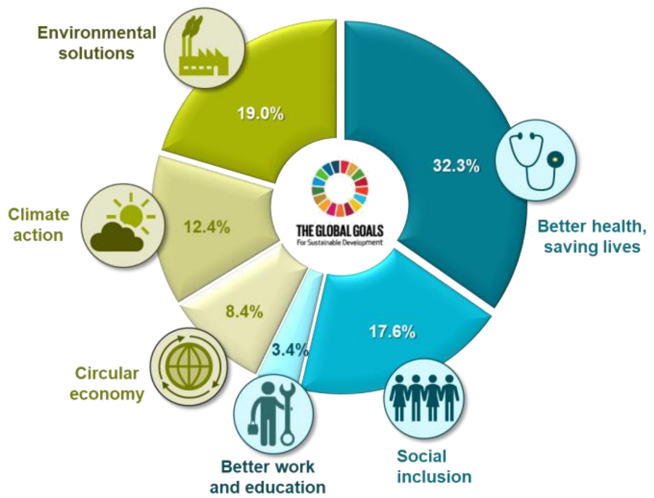
The value and income from the fund's assets will go down as well as up. This will cause the value of your investment to fall as well as rise. There is no guarantee that the fund will achieve its objective and you may get back less than you originally invested.

The fund holds a small number of investments, and therefore a fall in the value of a single investment may have a greater impact than if it held a larger number of investments.

While impact investing through listed equities is a nascent discipline, and the M&G (Lux) Positive Impact Fund is only 16 months old, its lead manager John William Olsen is not new to the kind of drawdown currently affecting equity markets. Through his 24-year career, he has had to contend with the Asian Crisis, the tech bubble burst, the global financial crisis, the European debt crisis, the Chinese stock market crash and Brexit. In fact, despite its youth, the fund has already experienced its own share of market turbulence even before the Covid-19 coronavirus; its launch coincided with a 9% market drawdown amid persistent worries over global trade and slowing economic growth.

In John William's view, the economic impact of the 'black swan' event that is coronavirus will largely depend on the scale of the emergency measures deployed by governments and the areas prioritised for help. We believe it is pointless to try to make predictions at this stage. Instead, the sensible course of action, in our view, is to ensure that the companies in which the fund invests are not running too much financial risk. It is likely that a degree of fiscal stimulus will be directed towards some of the social areas targeted by the fund. This should provide the necessary oxygen companies need to function until their cash flows return to normal, potentially a year or two away from now.

Figure 1. Impact area breakdown % (excluding cash)



Source: M&G, 29 February 2020

Diversification is paramount

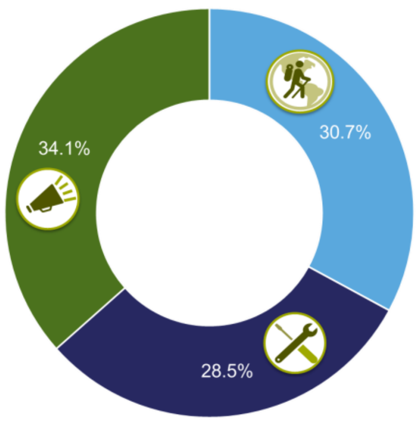
Consistent with John William's tried and tested investment approach, the fund entered the current crisis in a balanced state.

The portfolio is purposefully invested across six different impact areas, targeting not just the environment but a broad spectrum of social issues as well (see Figure 1). Until recently, investors' attention had focused predominantly on the fund's three environmental areas, namely 'climate action', 'environmental solutions' and 'circular economy'. However, the fund's exposure to three social areas, 'better health, saving lives', in particular, has provided attractive defensive characteristics during the recent market sell-off.

Another source of diversification comes from the fund's investment in three different categories of companies: pioneers, enablers and leaders. This means we are investing in companies with different cash profiles and different end-market exposures (see Figure 2).

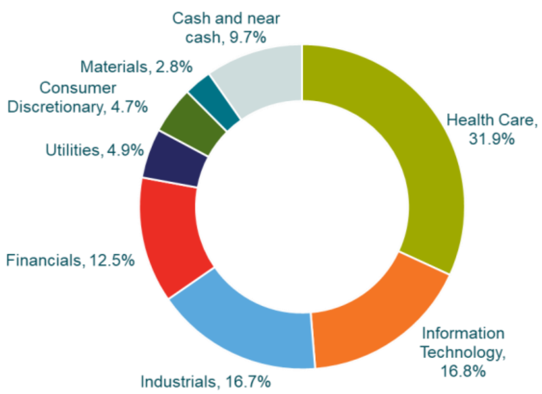
- **Pioneers** whose products or services have a transformational effect on society or the environment.
- **Enablers** which provide the tools for others to deliver positive social or environmental impact.
- **Leaders** which spearhead and mainstream sustainability and impact in their industries.

Figure 2. Company type breakdown % (excl cash)



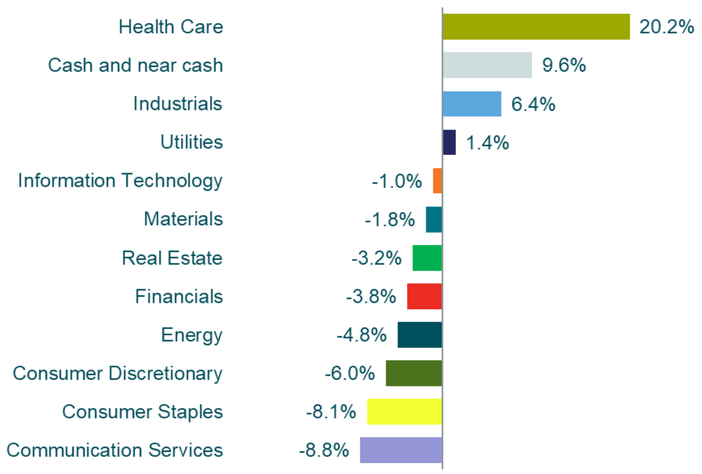
Source: M&G, 29 February 2020

Figure 3. Absolute fund sector weighting %



Source: M&G, 31 January 2020

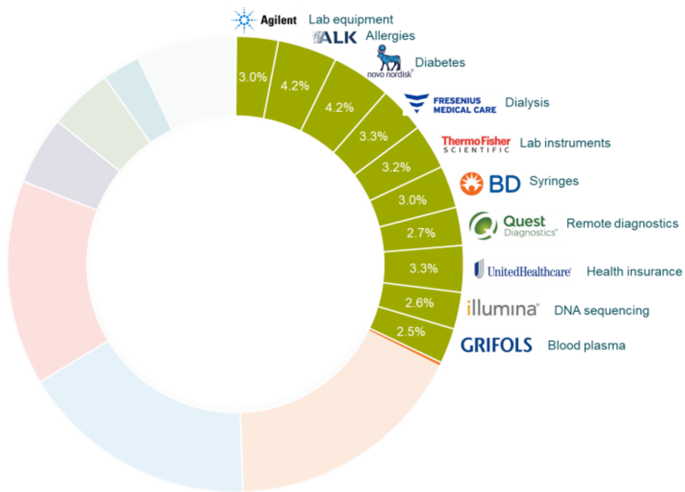
Figure 4. Sector weighting relative to MSCI ACWI Index %



Source: M&G, 31 January 2020

Looking at a traditional sector breakdown, the fund's 32% weighting in healthcare works as a stability ballast, and makes up for its lack of exposure to consumer staples (see Figures 3 and 4). This simply reflects the fact that most listed consumer companies do not currently have a positive impact profile, and so do not qualify for inclusion in the fund. Importantly, the fund's holdings in healthcare are themselves very diversified and not exposed to broad pharmaceuticals risks (see Figure 5). They cover idiosyncratic activities such as lab equipment, diagnostic tools, diabetic care, dialysis treatment and genetic sequencing equipment, which, we believe, should be resilient in the face of the current crisis. A few may even help contribute to solving that crisis. Thermo Fisher Scientific, for example, specialises in

Figure 5. Diversified pharmaceuticals exposure



Source: M&G, 29 February 2020

sophisticated lab equipment used to facilitate and accelerate research for vaccines. The company is therefore ideally placed to provide labs with the equipment they need to develop a vaccine against Covid-19.

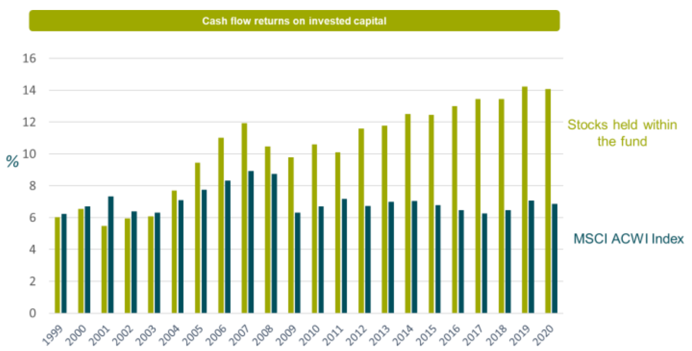
Quality is key

As critical as diversification is the robustness of the fund's investment framework. This 'triple i' framework (Investment, Intention, Impact) screens for companies that are not only intentionally impactful, but also have quality, sustainable business models.

We use this framework to help us avoid one of the potential pitfalls of impact investing, which is to focus unduly on impact to the detriment of financial returns. The III framework has been designed specifically to side step this and identify quality companies capable of delivering both profits and impact in equal measure.

High cashflow returns on invested capital over long periods is one of the key financial metrics we look for to determine a company's quality. This is among other features, such as strong brands, superior scale or network effects. The stocks currently held in the portfolio have a proven track record of producing high cashflow returns considerably above that of the benchmark (see Figure 6). This also gives us confidence that they should prove resilient to overcome what is probably already a global recession.

Figure 6. Cashflow return profile of portfolio stocks since 1999



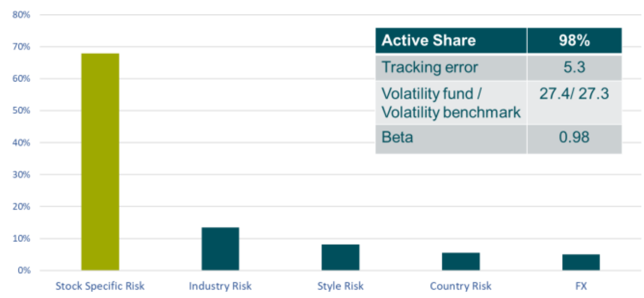
Source: Credit Suisse, Holt , 16 March 2020. © 2020 Credit Suisse and its subsidiaries and affiliates. used by permission. All rights reserved. CFROI® is a registered trademark of Credit Suisse or its affiliates in the United States and other countries.

Past performance is not a guide to future performance.

Stock-specific risk

The portfolio is built consciously to minimise factor risks, such as those related to foreign exchange, country and industry, that we have no influence over. Currently 68% of the portfolio risk is stock-specific (see Figure 7). This high level, in our view, is confirmation that our efforts to diversify are working and that the fund's performance is not overly influenced by unintended factor biases.

Figure 7. Drivers of portfolio risk



Source: Aladdin, 19 March 2020

The fund can be exposed to different currencies. Movements in currency exchange rates may adversely affect the value of your investment.

Activity

John William has been deploying around half of the fund's 9% cash position over the last month. Not only has he been adding to existing positions on weakness, but he took advantage of the sharp fall in markets to build a new position in Kenyan telecommunications company Safaricom. The company does not just have strong net cash on the balance sheet and a 65% national market share, but it is also impactful, being the main communications backbone of the country. Its mobile network should help families to stay in contact in periods of self-isolation and its mobile payment system should allow small and medium-sized businesses to access government relief.

Outlook

With the severity of the coronavirus crisis becoming more obvious, investors' focus has moved from the income statement to the balance sheet. It is inevitable that some companies will go bankrupt and that governments will need to decide which companies they want to save. A credit crunch situation is not outside the realms of possibility, but politicians and central banks are urgently aware of this and will desperately try to avoid it.

This downturn is different because it is so sharp, but we still believe this is less systemic than the previous one. At this point, our focus is on avoiding permanent damage to balance sheets. Our belief is that companies with little risk of financial stress should get at least back to where they were when we come out on the other side of this pandemic. This makes us comfortable with the fund's current balance and positioning. We remain optimistic in the portfolio's companies' ability to weather the storm and in their long-term ability to make our world safer, fairer and more sustainable.

M&G
March 2020

Further details of the risks that apply to the fund can be found in the fund's Prospectus on our website.

M&G INVESTMENTS