

**SHINING A LIGHT ON THE.....
M&G Optimal Income Fund**

AT A GLANCE

Investment Objective	
The fund aims to deliver income and capital growth by investing in a broad range of fixed income securities, wherever the manager sees the greatest opportunities. The manager may also hold up to 20% of the portfolio in company shares when he believes they offer better value than bonds. Exposure to these assets is gained through physical holdings and the use of derivatives. An in-house team of independent credit analysts assists the fund manager in the selection of individual bond issues.	

Inception Date	8 December 2006
Fund Factsheet Link	http://www.morningstar.co.uk/uk/funds/snapshot/snapshot.aspx?id=F0000000VZ

Management	
Manager Name	Start Date
Richard Woolnough	8 December 2016

Investment Style Details	
Equity Style	
Market Capitalisation	% of Equity
Giant	45.12%
Large	49.99%
Medium	3.23%
Small	0.00%
Micro	1.66%

Top 10 Holdings		
Total number of holdings	1028	
Assets in Top 10 Holdings	22.44%	
Name		% of Assets
US Treasury Note		4.59%
United Kingdom (Government Of) 1.75%		3.34%
1108738 Cds Usd RF 5.00000		2.29%
Germany (Federal Republic Of) 1.75%		2.11%
Germany (Federal Republic Of) 0.5%		1.94%
Verizon Comms 4.672%		1.86%
Verizon Comms 5.012%		1.86%
United Kingdom (Government Of) 1%		1.67%
Germany (Federal Republic Of)		1.41%
Germany (Federal Republic Of) 0.75%		1.37%

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Volatility Measurements	
3-Yr Std Dev (volatility)	3.76%
3-Yr Mean Return (average)	4.56%

FUND PERFORMANCE

Performance up to 31 August 2016

	2012	2013	2014	2015	2016
M&G Optimal Income Fund	13.75%	7.79%	5.26%	-0.86%	5.79%
50/50 iShares Core UK Gilts/Core £ Corporate Bond	7.59%	1.97%	13.41%	0.09%	17.86%

Performance over 1 year, 3 years, 5 years and since launch:

	1 year	3 years	5 years	Since launch
M&G Optimal Income Fund	5.85%	14.23%	40.15%	111.13%
50/50 iShares Core UK Gilts/Core £ Corporate Bond	18.78%	34.02%	50.80%	79.18%

You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. The total return reflects performance without sales charges or the effects of taxation, but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced.

UPDATE....

The fund is fast approaching its tenth anniversary. Richard set up the fund and continues to run it. Its track record over the long-term is excellent but in recent years it has slipped back. At the peak the fund had over £26 billion of assets, this has dropped to just over £15 billion.

He is a well-respected fund manager with over 30 years' experience and the fund was established to outperform other bond asset classes.

In this update with Richard we discussed macro views, credit views and positioning. Turning to the macro picture first, Richard believes that the US remains robust, the labour market is strong, wage growth is starting to come in and the economy is pretty much close to capacity. He believes interest rates should go up to reflect this but doesn't seem optimistic this will happen yet. One additional point was whether the US will drop into recession and he doesn't believe this is going to be the case, recessions since the 70s have followed a spike in oil prices and this just hasn't happened (yet).

His view is that although there remain challenges in Europe they are going in the right direction. But he feels government bonds are not an attractive investment at present.

As he explained with bunds on zero yield, you may know what yield you get at the end of a ten-year period, there could be extreme volatility over this period and he doesn't feel investors are being compensated for this. He added that if interest rates went down by 4% then the £1 starting price would go to £1.519; if they went up by 4% then the price would drop to £0.678. It gets worse if there

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is a negative yield because at maturity the end value will be less. It becomes more challenging when looking at 30 year bonds. The fund has therefore reduced its weighting to government bonds.

Turning to credit views. Richard feels that default rates are at their historic average and believes the area of value is with BBB bonds. However, he feels the UK is expensive and prefers US bonds. There is still risk with interest rates, but yields are higher and he feels that investors are still being rewarded in terms of return.

The fund moved out of equities during 2015 but has increased its weighting to 5% in recent weeks, reflecting better value opportunities in certain shares compared to bonds.

Turning to positioning the fund remains short duration; this is important because the higher the duration the more the security price will fall if interest rates rise. The opposite is true if interest rates fall. With interest rates at historic lows there is a strong argument that they are only likely to rise and therefore the manager needs to protect against this. Richard wasn't expecting rates to fall in August as his argument is that we are three years away from any economic crisis and there is no certainty of the outcome.

The reduction would have been needed if the economy was slowing and there is no indication this is happening. The potential is that things will improve whilst we wait to exit. The fund has around 15% in Government Bonds, 50% in Investment Grade, 30% in High Yield and the balance in equities.

In conclusion the main reason for investing in this type of fund is that the responsibility for deciding on where to invest within fixed interest (bonds) is left with the manager. With this fund you have a well-respected manager with an excellent long term track record. However, short term performance has been challenged and some may argue that the size of the fund has made it harder to achieve returns. The fund has shrunk and if this continues then it could reverse its performance. It is worth comparing this to smaller funds with regard to performance and positioning.

The source of information in this note has been provided by M&G and is correct as at September 2016. These are notes from meeting the fund manager or representative and should not be seen as a recommendation to purchase any fund mentioned. Any reference to shares is not a recommendation to buy or sell. Should you wish to make a decision based on these notes we cannot take responsibility for this and you should carry out your own research before making a decision. We would also recommend that you receive advice before following up on any decision.