M&G (Lux) Sustainable Allocation Fund

ESG and Impact processes within the investment approach

FOR INVESTMENT PROFESSIONALS ONLY
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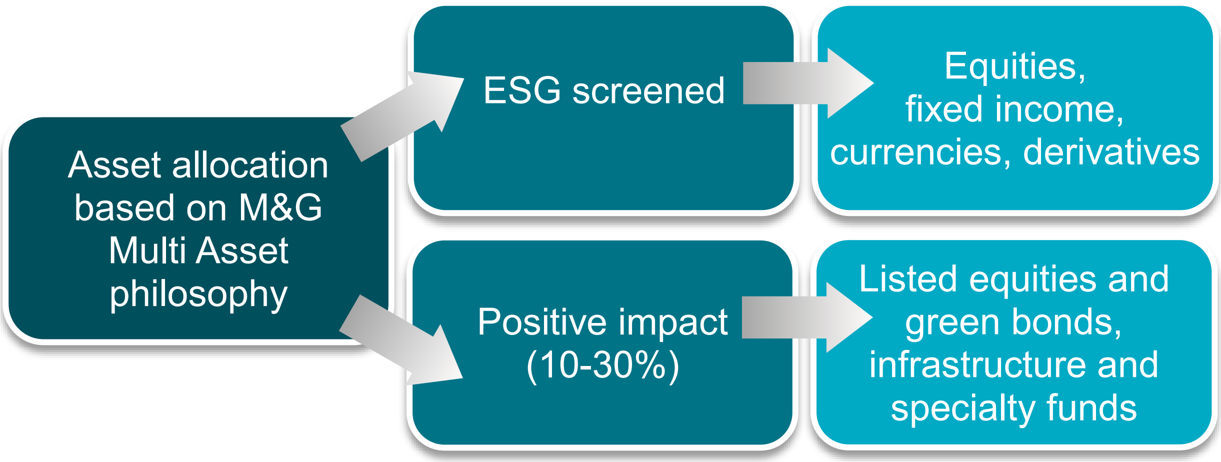
The M&G (Lux) Sustainable Allocation Fund employs a sustainable investment approach that looks to generate long-term returns. The returns are expected to consist of a combination of income and capital growth through flexible asset allocation, guided by a robust valuation framework, while investing in assets issued by companies or governments that uphold high standards of ESG behaviour. In addition, the fund aims to maintain a core holding of assets that are considered to have a positive societal impact through addressing the world's major social and environmental challenges.

Investment approach and policy

The M&G (Lux) Sustainable Allocation Fund aims to generate a total return (the combination of capital growth and income) of 4-8% per annum over any five-year period. The fund aims to provide this return while considering environmental, social and governance (ESG) factors. Please note, there is no guarantee the fund will achieve its objective over this or any other period, and you may not get back the amount you originally invested.

The main drivers of returns and volatility of the fund are the allocation to and selection of the different asset classes from around the world (including emerging markets). The portfolio's asset class-level exposures are determined through a top-down asset allocation approach. Potential holdings are then identified via an evaluation process that assesses the ESG factors of individual candidate securities that are considered to carry appropriate risk/return characteristics.

Allocation to asset classes



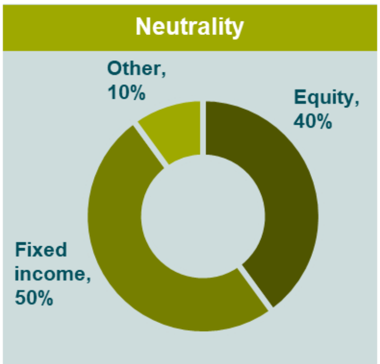
Source: M&G, as at 29 November 2018

The asset allocation decisions taken are expected to provide the key drivers to returns. These will be supplemented by selecting individual investments that the fund manager considers to be attractively valued and which meet our additional requirements for responsible or sustainable investment.

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. Changes in currency exchange rates will also affect the value of your investment.

The fund will invest in emerging markets which are generally more sensitive to economic and political factors, and where investments are less easily bought and sold. In exceptional circumstances, the fund may encounter difficulties when selling or collecting income from these investments, which could cause the fund to incur a loss. In extreme circumstances, it could lead to the temporary suspension of dealing in shares in the fund.

The manager starts from a neutral asset class position, of 40% equities, 50% fixed income and 10% in other securities. The investment in equities is expected to remain within the range 20%-60%.



Source: M&G, as at 29 November 2018

The fund will seek to hold a range of asset types which includes, but is not limited to, equities (company shares), fixed income (government bonds, investment grade corporate bonds and high yield corporate bonds), cash, currencies, infrastructure and specialty funds. These may be directly held or in the form of another fund or collective investment vehicle (subject to a maximum exposure of 10%). The fund may use derivatives to meet its investment objective, for hedging and for efficient portfolio management purposes. The fund may take synthetic short positions in equity or fixed income market indices, currencies, and other groups of securities. Index derivatives may be used to hedge physical exposures (using short positions) or to temporarily achieve exposure to equity or bond markets (using long positions) until a physical exposure can be implemented (with a maximum term of one month). The fund is not permitted to implement short positions on single stocks.

The fund may take short positions through the use of derivatives which are not backed by equivalent physical assets. 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.

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.

ESG and Impact processes

Direct holdings in the fund are subject to exclusions. Companies are excluded from the investable universe if they are:

- Assessed to be in breach of the United Nations Global Compact principles on human rights, labour, environment and anti-corruption.
- Producers of the following:
  - Tobacco products,
  - Alcohol,
  - Adult entertainment,
  - Gambling,
  - Thermal coal,
  - Controversial weapons

ESG-screened allocation

Most of the portfolio is invested using an ESG-screening approach. An investable universe of screened direct securities is identified applying the following rules:

Minimum MSCI ESG ratings are applied in the following way:

- Equity and corporate bond issuers must be rated on an ESG score of at least BBB.
- Government bonds must be rated on an ESG score at least BB.

It is important to note that our positive impact exposure does not follow the same ESG-screened approach as the remainder of the portfolio, as the minimum ESG ratings are not applied. In fact, many of the companies within our corporate watchlist operate within specific niche markets, making the MSCI ESG broader sector-level comparison less efficient. However, any investment that forms part of the positive impact allocation is subject to detailed analysis, in order to understand the asset's ESG profile.

Positive Impact allocation (10-30%)

Positive Impact investing is a core feature of the fund. We aim to invest between 10% and 30% of the fund in positive impact assets at all time. We will aim to produce an annual report highlighting the impact that these holdings have provided. This will evolve through time as more accurate information becomes available.

Why 10-30%? – That range of exposure have been established considering two key factors:

- Liquidity of the eligible impact market, including less liquid asset classes like green bonds and infrastructure investment trusts
- Ability to flexibly allocate across asset classes to generate attractive risk-adjusted returns at the overall fund level

How do we choose positive impact assets?

We look to achieve positive impactful investment through listed equities, corporate bonds and convertible bonds, green corporate and government bonds, listed infrastructures and collective investment vehicles (eg other funds or ETFs, up to 10% of the total portfolio) and other securities. All securities in the positive impact section are assessed according to a "iii" framework.

iii Framework

Investment: we assess the quality and viability of the investment focusing on opportunities and threats (including the risk of default).

Intention: we aim to understand the intentionality behind the security / instrument issued by the company.

Impact: we seek to assess the material impact of the investment towards achieving one or more of the specific UN Sustainable Development Goals (SDGs).

Our positive impact exposure is diversified across the following asset classes. (This list may not be exhaustive)

Green, social and sustainable bonds, climate-aligned bonds

We identify new and existing issues using a screening tool, usually Bloomberg. The fund manager will also assess the likely impact the bonds will have, and the intentionality of the issuer. The credit quality of the issuer, and the valuation of the bond will also be assessed. Given the liquidity characteristics of these bonds, they are traded by a specialist dealer in our fixed income team, who would also notify the fund management team of new issuance in the market.

Supranationals

Bonds issued by supranational bodies, such as the European Investment Bank or the International Bank for Reconstruction and Development, may also considered as being impactful given the investment activity of those issuers. The intentionality of those investment and development banks is clearly aligned to several SDGs and the impact clearly demonstrated by the type of projects being financed.

Corporate Watchlist

Listed equities, corporate bonds and convertibles are sourced from those issued by companies in our positive impact corporate watchlist. This comprises about 100 companies operating worldwide and identified through M&G's "iii" framework.

Following an in-depth quantitative and qualitative analysis by dedicated analysts, the positive impact team (which includes fund manager, Maria Municchi) will vote on whether or not to include the company on the watchlist.

Infrastructure

The fund can gain access to the infrastructure market via specialised collective investment vehicles, or by investing directly in listed equities or bonds. Examples would include holdings in wind and solar farms infrastructure names and sustainable infrastructure real estate investment trusts (REITs).

Collective investments

For up to 10% of the fund value, specialist collective investment vehicles could be used to access specific parts of the market where the fund manager has assessed that the valuation and positive impact characteristics fulfil the fund's requirements in an efficient manner. This also provides the fund with the ability to invest in less liquid parts of the impact market.

Other securities

Other instruments, including, but not limited to, convertible bonds and derivatives such as futures and options, could be used to access more specific exposure with ESG characteristics.

What are the UN SDGs?

The United Nations Sustainable Development Goals are a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity. Its timeframes run to 2030.

The 17 Goals (with 169 key performance indicators - KPIs, or subgoals) build on the eight Millennium Development Goals established by the UN in 2000, while including new areas such as climate change, economic inequality, innovation and sustainable consumption among other priorities. The goals are interconnected – often the key to success on one will involve tackling issues more commonly associated with another.

This provides a framework to deliver sustainable outcomes and is increasingly being adopted by both investors and companies as a means of framing their sustainable, or impact, activities.

For more information visit **https://sustainabledevelopment.un.org/**

United Nations Sustainable Development Goals

The fund allows for extensive use of derivatives.