

Annual Short Report December 2013 For the year ended 31 October 2013

M&G Episode Balanced Fund

a sub-fund of M&G Investment Funds (4)

How to contact us



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* For security purposes and to improve the quality of our service, we may record and monitor telephone calls. You will require your M&G client reference. Failure to provide this will affect your ability to transact with us.

** Please remember to quote your name and M&G client reference and sign any written communication to M&G. Failure to provide this may affect your ability to transact with us.

† 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.

AUTHORISED CORPORATE DIRECTOR'S REPORT

Investment objective of the M&G Episode Balanced Fund

The Fund's objective is to maximise total return (the combination of income and growth of capital) through investment in a diversified range of asset types. Subject to this, the Fund aims to grow income in the long term.

Investment policy of the M&G Episode Balanced Fund

The fund manager adopts a flexible approach to the allocation of capital between asset classes in response to changes in economic conditions and the valuation of assets. Central to this approach is the identification of episodes, which are periods of time during which, in the fund manager's view, asset prices become over- or under-stated, relative to objective valuation measures, due to the emotional reaction of investors to events. These episodes can exist over both the short and medium term.

The Fund invests in transferable securities, fixed income assets (including, but not limited to, corporate bonds and government and public securities), warrants, money market instruments, deposits, cash and near cash. Exposure to these assets, and to property, may be gained via collective investment schemes and derivatives (including equity index futures, currency forwards, interest rate swaps and other liquid derivatives). The fund will invest no more than 60% of the portfolio in equities. Derivatives may also be used for efficient portfolio management purposes.

Investment approach

The fund seeks to outperform the IMA Mixed Investment 20-60% sector.

The fund managers believe the best approach for achieving this lies in the flexible allocation of capital between asset classes, guided by a robust valuation framework. In particular, they seek to respond where asset prices move away from a reasonable sense of 'fair' value due to investors reacting emotionally to events. They believe such episodes create opportunities because emotions should be less important than underlying fundamentals over the medium and long term.

The fund will typically hold between 20-60% in equity, 30-75% in fixed income (including cash), and up to 20% in other assets (primarily indirect exposure to commercial property). The fund managers will actively manage currency exposures to seek to enhance returns, with a minimum of 30% of the fund exposed to sterling and a minimum of 60% in established market currencies. The fund is likely to achieve its asset exposures through securities, collectives and derivative instruments.

Risk and reward profile*



- The above risk number is based on the rate at which the value of the Fund has moved up and down in the past.
- This risk number is based on historical data and may not be a reliable indicator of the future risk profile of the Fund.
- The risk number shown is not guaranteed and may change over time.
- The lowest risk number does not mean risk free.

The Fund has the above risk number because of the effect of the following risks:

- The value of stockmarket 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.
- Any investment in international companies means that currency exchange rate fluctuations will have an impact on the Fund.
- There is a risk that one or more countries will exit the Euro and re-establish their own currencies. In light of this uncertainty or in the event that this does occur, there is an increased risk of asset prices fluctuating or losing value. It may also be difficult to buy and sell securities and issuers may be unable to repay the debt. In addition, there is a risk that disruption in Eurozone markets could give rise to difficulties in valuing the assets of the Fund. In the event that it is not possible to carry out an accurate valuation of the Fund, dealing may be temporarily suspended.
- **Derivatives** – The Fund may use derivatives for the purposes of meeting the Fund’s objective, and protecting the capital value from risk. We anticipate that the use of derivatives will not materially alter the risk profile of the Fund or increase price fluctuations.

Some derivative transactions may be entered into directly with an eligible person or institution (a “counterparty”). There is a risk that the counterparty may not meet its obligations or becomes insolvent which could cause the Fund to incur a loss.

- **Fixed income securities** – Changes in the interest rate will affect the value and the interest earned from the fixed income securities held by the Fund. When interest rates rise, the capital value of the Fund is likely to fall and vice versa.

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). A default, expected default, or downgrading will make a fixed income security harder to sell as its value and income are likely to fall. 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.

- **Emerging markets** – The Fund can invest in emerging markets which tend to have larger price fluctuations than more developed countries. The Fund may encounter difficulties when buying and selling these investments or converting the proceeds of a sale or any income earned back into the base currency of the Fund.
 - The Fund invests mainly in other funds and there is a risk that the fair value of the assets held is not at all times reflected in the Fund’s reported value. The fund manager will not have control over the management of these funds or the fair pricing of the assets held in their portfolios.
- * Please note that this ‘Risk and reward profile’ section is based on Sterling Class ‘A’ shares, the nominated share class.

INVESTMENT ACTIVITIES OVER THE REPORT PERIOD

As at 1 November 2013, for the year ended 31 October 2013

Our approach involves the flexible allocation of capital between global asset classes. We aim to look objectively at underlying economic conditions and asset valuations, seeking to find assets where investors’ sentiment is overly negative or positive. The fund can invest in assets such as equities (company shares) and bonds ^[a] either directly or via derivatives ^[b].

In our opinion, equities generally offered better value than bonds over the period under review. Consequently we had a preference for selected global stockmarkets, namely the UK, US, Europe, Japan and other parts of Asia.

Meanwhile, we had been cautious on government bonds issued by developed markets such as the US for some time as we felt they were overvalued. However, after these assets sold off heavily over May and June 2013, we took the opportunity to increase holdings in US government bonds with a long time to go until repayment at more attractive valuation levels. Also in government bonds, we added new holdings in Portuguese and South African issues. In addition, we switched our Mexican government bond holdings maturing in three years into holdings with a longer time to go until maturity.

Elsewhere, throughout the review period, we reduced the fund's UK equity exposure after some strong performance. The proceeds were used at various points to initiate positions in Italian, Indian and Turkish equity, and stocks in the US technology sector, all of which we believe to be undervalued for sentiment-driven, rather than factual, reasons. Towards the end of the 12 months, we also slightly pared back the fund's US equity exposure, as this market has rallied significantly. Following some weakness, we increased our exposure to the South Korean stockmarket in February.

Finally, we recycled some of our exposure to US high yield corporate bonds ^[c] into European high yield issues.

Juan Nevado & Tony Finding

Co-fund managers

Juan Nevado and Tony Finding are employees of M&G Limited which is an associate of M&G Securities Limited.

^[a] A type of security, usually issued by a government (government bonds) or company (corporate bonds or debt), which normally pays a fixed rate of interest over a given time period, at the end of which the loan is repaid.

^[b] Derivatives are financial instruments rather than physical holdings. Their value is dependent on one or more underlying assets. Derivatives can be used to gain exposure to, or to help protect against, changes in the value of the underlying investments. We believe the use of derivatives allows for more efficient and low cost executions of our investment ideas.

^[c] These are interest-bearing loans issued by companies with a low credit rating from a recognised credit rating agency, which typically provide a high level of income or interest to compensate investors for the higher risk of non-repayment.

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.

FUND SUMMARY

DISTRIBUTION DATES AND FUND FACTS

Distribution type	xd	payment
First interim	03.02.14	31.03.14
Second interim	01.05.14	30.06.14
Third interim	01.08.14	30.09.14
Final	03.11.14	31.12.14

	Final distribution Inc 31.12.13 ^[a]	Acc 01.11.13 ^[a]	Ongoing Charges Figure ^[b] 31.10.13	31.10.12
Sterling	p	p	%	%
Class 'A'	0.6148	0.7203	1.67	1.67
Class 'I'	5.6191	5.7517	0.98	0.97 ^[c]
Class 'R'	0.5609	0.5743	1.18	1.17 ^[c]
Class 'X'	0.6152	0.7208	1.67	1.67

^[a] The date on which the final distribution will be paid to Income shareholders and credited to Accumulation shareholders.

^[b] The Ongoing Charges Figure is the ratio of the relevant annualised total disclosable costs of each share class from the most recent reporting period to the average net asset value for that share class over the same period.

^[c] The comparative Ongoing Charges Figure shown here is an estimate of the charges, as the share class had not been in existence for a full financial year.

Income accrued from interest-bearing securities is distributed on an effective yield basis.

FUND PERFORMANCE

Performance of share classes						
	Net asset value per share as at 31.10.13		Net asset value per share as at 31.10.12		Net asset value % change	
	Inc	Acc	Inc	Acc	Inc	Acc
Sterling	p	p	p	p	%	%
Class 'A'	122.11	143.82	110.68	127.52	+10.33	+12.78
Class 'I'	1,116.98	1,149.35	1,006.67	1,013.70	+10.96	+13.38
Class 'R'	111.47	114.81	100.62	101.33	+10.78	+13.30
Class 'X'	122.18	143.93	110.74	127.61	+10.33	+12.79

PRICES

	Calendar year	Income shares		Accumulation shares	
		Highest	Lowest	Highest	Lowest
Sterling (net)		p	p	p	p
Class 'A'	2008	100.13	79.29	102.03	82.73
	2009 ^[a]	105.33	84.07	113.82	89.11
	2010	113.25	102.16	125.01	110.93
	2011	113.33	102.00	125.39	114.23
	2012	113.93	105.30	131.28	119.89
	2013 ^[b]	125.06	113.53	145.69	131.92
Class 'I'	2012 ^[c]	1,037.22	992.33	1,043.90	992.33
	2013 ^[b]	1,141.03	1,036.33	1,161.42	1,049.13
Class 'R'	2012 ^[c]	103.66	99.22	104.32	99.22
	2013 ^[b]	113.96	103.49	116.09	104.84
Class 'X'	2008	100.21	79.35	102.11	82.80
	2009 ^[a]	105.40	84.13	113.88	89.18
	2010	113.32	102.22	125.09	110.99
	2011	113.40	102.06	125.47	114.31
	2012 ^[c]	114.00	105.36	131.36	119.97
	2013 ^[b]	125.13	113.59	145.80	132.01

^[a] The M&G Cautious Managed Portfolio merged into the M&G Episode Balanced Fund (formerly known as the M&G Cautious Multi Asset Fund) immediately after 13 March 2009.

^[b] To 1 November 2013.

^[c] From 3 August 2012 (the launch date of the share class).

Past performance is no indication of current or future performance and the performance data does not take account of the commissions and costs incurred on the issue and redemption of shares.

The price of shares and the income from them may go down as well as up, and you may get back less than you invested.

INCOME

Dividend income per share

	Calendar year	Interims	Distributed Final	Total	Reinvested
Sterling (net)		p	p	p	p
Class 'A'	2008	2.2190	0.6830	2.9020	2.9912
	2009	1.9533	0.5360	2.4893	2.6321
	2010	1.8320	0.4290	2.2610	2.4904
	2011	1.6160	0.7440	2.3600	2.6262
	2012	1.6930	0.6720	2.3650	2.6902
	2013 ^[a]	2.0302	0.6148	2.6450	3.0698
Class 'I'	2012	n/a	7.0300	7.0300	7.0300
	2013 ^[a]	18.7338	5.6191	24.3529	24.7197
Class 'R'	2012	n/a	0.7020	0.7020	0.7030
	2013 ^[a]	1.8589	0.5609	2.4198	2.4577
Class 'X'	2008	2.2210	0.6830	2.9040	2.9932
	2009	1.9332	0.5340	2.4672	2.6388
	2010	1.8320	0.4300	2.2620	2.4871
	2011	1.6180	0.7440	2.3620	2.6280
	2012	1.6920	0.6830	2.3750	2.7079
	2013 ^[a]	2.0303	0.6152	2.6455	3.0733

^[a] Up to final: ex-distribution date 1 November 2013;
payment date 31 December 2013.

MAJOR HOLDINGS

The top ten holdings at the end of this year and the previous year end are shown below. ^[a]

	% of sub-fund as at 31.10.13		% of sub-fund as at 31.10.12
Northern Trust Global Fund - Sterling ^[b]	14.67	iShares FTSE 100	13.69
US Treasury 0% 2025 (\$)	11.80	US Treasury 0% 2012 (\$)	12.47
US Treasury 2.875% 2043 (\$)	6.48	Northern Trust Global Fund - Sterling ^[b]	11.85
M&G Property Portfolio Sterling Class 'I'	5.90	M&G Property Portfolio Sterling Class 'S' (Income)	6.26
M&G Recovery Fund Sterling Class 'C' (Accumulation)	5.82	M&G Recovery Fund Sterling Class 'C' (Accumulation)	5.26
M&G High Yield Corporate Bond Fund Sterling Class 'X' (Accumulation)	4.82	M&G Global Leaders Fund	5.25
iShares MSCI Korea	4.56	M&G High Yield Corporate Bond Fund Sterling Class 'X' (Accumulation)	4.69
iShares FTSE 100	4.36	iShares MSCI Korea	3.98
South Africa (Republic of) 13.5% 2015 (ZAR)	3.55	Treasury 4.25% 2039 (£)	3.94
Treasury 4.25% 2039 (€)	3.53	iShares S&P 500	3.76

^[a] All holdings in M&G collective investment schemes are in Sterling Class 'A' (Income) shares/units unless otherwise stated.

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

CLASSIFICATION OF INVESTMENTS

The table below shows the percentage holding per sector.

	% of sub-fund as at	
	31.10.13	31.10.12
Equity portfolios	10.60	14.43
Emerging markets	0.00	0.00
Global	10.60	12.55
Japan	0.00	1.88
Equities	3.28	3.32
Eire	0.09	0.25
Norway	0.00	0.12
United Kingdom	1.00	0.93
Australia	0.39	0.20
Canada	0.34	0.54
United States	1.46	1.28
Non-equity investments	19.83	23.52
United Kingdom	4.36	13.69
Continental Europe	1.27	1.05
North America	4.17	3.76
Far East	6.95	3.98
Emerging markets	3.08	1.04
Property portfolios	5.90	6.26
Bond portfolios	8.06	10.44
Bonds	34.97	28.97
'AAA' credit rated bonds	3.53	3.94
'AA' credit rated bonds	18.28	12.47
'A' credit rated bonds	8.35	7.57
'BBB' credit rated bonds	2.45	2.70
'BB' credit rated bonds	2.36	0.00
Credit default swaps	0.42	(0.07)
Forward currency contracts	0.04	0.16
Equity index futures contracts	1.01	(0.07)
'AAA' rated money market funds ^[a]	14.67	11.85

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

Past performance is no indication of current or future performance and the performance data does not take account of the commissions and costs incurred on the issue and redemption of shares.

The price of shares and the income from them may go down as well as up, and you may get back less than you invested.

OTHER INFORMATION

The information in this report is designed to enable shareholders to make an informed judgment on the activities of the sub-fund during the period covered by the report and the results of those activities at the end of the period. For more information about the activities and performance of the sub-fund during this and the previous period, please contact the Authorised Corporate Director (ACD).

Short Reports

This Short Report is issued in accordance with the requirements of the Collective Investment Schemes sourcebook as issued (and amended) by the Financial Conduct Authority. This Short Report does not contain the Financial Statements of the M&G Episode Balanced Fund, and it is unaudited.

Investment Report and Financial Statements

A copy of the ACD's Annual Investment Report and Financial Statements for M&G Investment Funds (4), which incorporates all the sub-fund's annual investment reports and audited financial statements is available free of charge on request from our website at www.mandg.co.uk/reports or by calling M&G Customer Relations on 0800 390 390.

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M&G is a member of the Investment Management Association and of
the Tax Incentivised Savings Association.

The Instrument of Incorporation can be inspected at our offices or at
the office of the Depositary.

M&G Securities Limited is authorised and regulated by the Financial Conduct Authority
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