

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

# M&G Episode Growth 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 Growth Fund

The Fund's objective is to maximise total return (the combination of income and growth of capital).

## Policy for achieving the objective of the M&G Episode Growth 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 a minimum of 50% in collective investment schemes. Derivatives may also be used for efficient portfolio management purposes

## Investment approach

The fund seeks to outperform the IMA Mixed Investment 40-85% sector, with a lower volatility than company shares on average.

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 40-80% in equity, 15-50% in fixed income (including cash), and up to 10% 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 25% of the fund exposed to sterling and a minimum of 50% 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 'X' shares, the nominated share class. Please note that over the review period the risk number changed once. From 1 November 2012 to 30 July 2013 the risk number was 6.

## 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.

In our opinion, company shares, or equities, generally offered better value than bonds <sup>[a]</sup> over the period under review. Consequently we had a preference for selected global stockmarkets, namely the UK, US, Europe, Japan and parts of Asia.

The performance of different stockmarkets diverged markedly over the period under review and we actively recycled exposures as various markets became more or less attractively valued. The majority of these trading strategies were executed through derivatives <sup>[b]</sup>.

The presence in European equities was increased steadily throughout the year and exposure to the Italian and German stockmarkets was initiated based on the view that both assets were favourably valued. We believe Italian equities had been unfairly punished because of domestic political tensions.

Following some weakness, we increased our exposure to the South Korean stockmarket in February as we felt the price movement did not reflect any change in factual economic data, rendering it better value, although we cut it back in October after some positive performance.

Exposure to US technology stocks, including several good quality names, was initiated in May after a period of underperformance. However, we trimmed the overall exposure to the US stockmarket towards the end of the review period following strong gains.

Meanwhile, we had been cautious on government bonds issued by developed markets such as the US for some time as we felt their valuations were excessive. However, issues from the US sold off heavily in May 2013 due to concerns that the US Federal Reserve would scale back its stimulus measures sooner than expected. We subsequently took the opportunity to initiate exposure to more attractively valued US, German and Mexican government bonds with a long time to their maturity. Meanwhile, we sold some issues from Italy and Malaysia that had performed well.

## **Juan Nevado & Jenny Rodgers**

Co-fund managers

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

<sup>[a]</sup> 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.

<sup>[b]</sup> 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.

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

Sterling Class 'C' shares are not generally available to all investors.

## 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		Ongoing Charges Figure <sup>[b]</sup>	
	Inc 31.12.13 <sup>[a]</sup>	Acc 01.11.13 <sup>[a]</sup>	31.10.13	31.10.12
<b>Sterling</b>	<b>p</b>	<b>p</b>	<b>%</b>	<b>%</b>
Class 'A'	0.1789	0.2277	1.84	1.84
Class 'C'	0.0875	n/a	0.34	0.34
Class 'I'	3.8184	4.2615	1.03	1.00 <sup>[c]</sup>
Class 'R'	0.4168	0.4394	1.22	1.20 <sup>[c]</sup>
Class 'X'	0.1782	n/a	1.84	1.84

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

<sup>[b]</sup> 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.

<sup>[c]</sup> 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
<b>Sterling</b>	<b>p</b>	<b>p</b>	<b>p</b>	<b>p</b>	<b>%</b>	<b>%</b>
Class 'A'	50.18	64.23	43.29	54.38	+15.92	+18.11
Class 'C'	51.95	n/a	44.16	n/a	+17.64	n/a
Class 'I'	1,191.05	1,219.57	1,019.22	1,025.35	+16.86	+18.94
Class 'R'	118.89	121.77	101.94	102.51	+16.63	+18.79
Class 'X'	50.03	n/a	43.16	n/a	+15.92	n/a

## PRICES

	Calendar year	Income shares		Accumulation shares	
		Highest	Lowest	Highest	Lowest
<b>Sterling (net)</b>		<b>p</b>	<b>p</b>	<b>p</b>	<b>p</b>
Class 'A'	2008	45.72	29.93	51.12	34.33
	2009 <sup>[a]</sup>	40.78	30.04	47.91	34.62
	2010	45.45	38.22	54.70	45.68
	2011	45.84	38.32	55.78	46.94
	2012	44.78	40.69	56.19	50.44
	2013 <sup>[b]</sup>	50.58	45.00	64.51	56.51
Class 'C'	2011 <sup>[c]</sup>	45.99	38.63	n/a	n/a
	2012	45.72	41.29	n/a	n/a
	2013 <sup>[b]</sup>	52.26	46.00	n/a	n/a
Class 'I'	2012 <sup>[d]</sup>	1,054.81	994.12	1,060.53	995.68
	2013 <sup>[b]</sup>	1,200.08	1,061.09	1,224.88	1,066.83
Class 'R'	2012 <sup>[d]</sup>	105.47	99.40	106.01	99.55
	2013 <sup>[b]</sup>	119.83	106.09	122.32	106.64
Class 'X'	2008	45.59	29.84	n/a	n/a
	2009 <sup>[a]</sup>	40.65	29.95	n/a	n/a
	2010	45.31	38.11	n/a	n/a
	2011	45.70	38.20	n/a	n/a
	2012	44.64	40.57	n/a	n/a
	2013 <sup>[b]</sup>	50.43	44.87	n/a	n/a

<sup>[a]</sup> The M&G Balanced Portfolio merged into the M&G Episode Growth Fund (formerly known as the M&G Managed Fund) immediately after 13 March 2009.

<sup>[b]</sup> To 1 November 2013.

<sup>[c]</sup> From 17 June 2011 (the launch date of the share class).

<sup>[d]</sup> 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	Interim	Total	Reinvested
Sterling (net)		p	p	p	p	p
Class 'A'	2008	0.5000	0.5280	nil	1.0280	1.1566
	2009	0.5000	0.4330	0.0380	0.9710	1.1222
	2010	0.7750	0.0776	0.0260	0.8786	1.0460
	2011	0.7780	0.0620	0.0770	0.9170	1.1154
	2012	0.8160	0.1050	n/a	0.9210	1.1414
	2013 <sup>[a]</sup>	0.7337	0.1789	n/a	0.9126	1.1529
Class 'C'	2011	0.2949	0.0610	0.0760	0.4319	n/a
	2012	0.8300	0.1070	n/a	0.9370	n/a
	2013 <sup>[a]</sup>	0.7296	0.0875	n/a	0.8171	n/a
Class 'I'	2012	3.4220	2.6540	n/a	6.0760	6.0840
	2013 <sup>[a]</sup>	16.8651	3.8184	n/a	20.6835	21.2794
Class 'R'	2012	0.3380	0.2690	n/a	0.6070	0.6082
	2013 <sup>[a]</sup>	1.6857	0.4168	n/a	2.1025	2.2932
Class 'X'	2008	0.5000	0.5270	nil	1.0270	n/a
	2009	0.5000	0.4310	0.0370	0.9680	n/a
	2010	0.7730	0.0777	0.0250	0.8757	n/a
	2011	0.7770	0.0610	0.0770	0.9150	n/a
	2012	0.8130	0.1050	n/a	0.9180	n/a
	2013 <sup>[a]</sup>	0.7313	0.1782	n/a	0.9095	n/a

<sup>[a]</sup> 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. <sup>[a]</sup>

	% of sub-fund as at 31.10.13		% of sub-fund as at 31.10.12
Northern Trust Global Fund - Sterling <sup>[b]</sup>	15.57	Northern Trust Global Fund - Sterling <sup>[b]</sup>	13.51
US Treasury 0% 2025 (\$)	8.82	iShares FTSE 100	9.38
iShares FTSE 100	6.84	US Treasury 0% 2012 (\$)	7.56
US Treasury 2.875% 2043 (\$)	5.91	iShares S&P 500	6.39
M&G Smaller Companies Fund Sterling Class 'A'	5.80	M&G Smaller Companies Fund	4.95
iShares MSCI Korea	5.52	M&G Recovery Fund Sterling Class 'C' (Accumulation)	4.30
M&G Recovery Fund Sterling Class 'C'	4.61	M&G UK Growth Fund	3.41
iShares S&P 500 Index Fund	4.58	M&G High Yield Corporate Bond Fund Sterling Class 'X' (Accumulation)	3.34
Treasury 0% 2013 (£)	3.90	GLG Japan CoreAlpha Fund (Accumulation)	3.22
M&G High Yield Corporate Bond Fund Sterling Class 'X'	3.37	iShares MSCI Korea	3.20

<sup>[a]</sup> All holdings in M&G Collective Investment Schemes are in Sterling Class 'A' (Income) shares / units unless otherwise stated.

<sup>[b]</sup> 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		
Continental Europe	2.76	6.68
United Kingdom	8.99	13.22
Far East	2.77	2.64
Global	7.34	10.05
Japan	0.00	3.22
Equities		
Eire	0.06	0.18
Norway	0.00	0.08
United Kingdom	1.11	0.72
Australia	0.24	0.12
Canada	0.23	0.40
United States	2.12	1.12
Non-equity investments		
United Kingdom	6.84	9.38
North America	6.62	6.39
Far East	5.52	3.20
Emerging Markets	3.09	1.02
Property portfolios	4.65	5.19
Bond portfolios	5.46	5.33
Bonds		
'AAA' credit rated bonds	7.89	2.89
'AA' credit rated bonds	14.73	7.56
'A' credit rated bonds	3.85	3.22
'BBB' credit rated bonds	0.00	1.05
'BB' credit rated bonds	0.00	1.78
Bonds with no credit rating	0.00	0.00
Credit default swaps	0.00	(0.05)
Forward currency contracts	0.08	0.05
Equity index futures contracts	1.17	(0.07)
'AAA' rated money market funds <sup>[a]</sup>	15.57	13.51

<sup>[a]</sup> 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 Growth 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](http://www.mandg.co.uk/reports) or by calling M&G Customer Relations on 0800 390 390.

### **Authorised Corporate Director**

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### **Fund manager**

Juan Nevado & Jenny Rodgers (employees of M&G Limited  
which is an associate of M&G Securities Limited)

### **Registrar**

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### **Independent Auditors**

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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  
and provides investment products. The company's registered office is Laurence  
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