

Prudential Managed Defensive Fund

A sub-fund of Prudential Investment Funds (1)

Annual short report for the year ended 31 October 2013

Authorised Corporate Director's report

Investment objective of the Prudential Managed Defensive Fund

The Fund's objective is to deliver long term total return (the combination of income and growth of capital) with a bias towards income.

Policy for achieving the objective of the Prudential Managed Defensive Fund

The Fund aims to achieve its objective through asset allocation unconstrained by any benchmark. The Fund may invest globally either directly or via other collective investment schemes in assets including transferable securities, debt instruments, money market instruments, cash, near cash, deposits, derivatives, and indirectly in property.

Derivative instruments may be used for both investment purposes and efficient portfolio management. The Fund will invest no more than 35% of the portfolio in equities.

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 of, 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.
- › **Property** - Property investments can be harder to buy and sell when compared to investments in fixed income securities and shares.
- › There is a risk that a property held in the Fund's portfolio could default on its rental payments.
- › Property valuations are provided by an independent valuer and are therefore subjective.

* 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

Between 1 November 2012 (the start of the review period) and 31 October 2013, the Prudential Managed Defensive Fund's total return (capital performance with net income reinvested) was 8.5%*. This compares with an average total return of 6.4%* in the fund's peer group, the IMA Mixed Investment 0-35% Shares Sector. Past performance is no guide to potential returns in the future.

Risk assets were in favour with investors for much of the period under review although a number of issues served to dampen sentiment at times. A lack of political consensus about how to address the US's huge debt was a recurring theme during the year and the problem has yet to be addressed comprehensively. Meanwhile, sentiment was subdued in early summer 2013 due to concerns that the US Federal Reserve (Fed) was about to start scaling back its measures aimed at supporting economic growth. Overall, however, the mood was buoyant on the back of generally improving economic data around the globe. Investors were also encouraged by a continued willingness on behalf of many central banks, particularly the Fed, to bolster economic activity.

In the fund manager's opinion, the broad range of asset classes in the portfolio should provide access to those areas that perform well while also offering some protection against unexpected weakness. In his view, the fund has delivered favourable returns, while keeping an appropriate level of risk, as set out in the fund's mandate.

Against a broadly confident backdrop, the fund's portfolio of equities, or company shares, was beneficial for performance. Contributors to returns included the M&G Pan European Fund and the Prudential UK Growth QIS Fund. The fund manager feels that equities continue to represent good value and they should do well over the long term, although he believes they are vulnerable to short-term weakness. For this reason, he trimmed the presence in European equities by reducing the holding in the M&G Pan European Fund.

The fund manager is currently targeting an overall equity position of just over 20%, with slightly under 8% each allocated to the UK and Europe. He is targeting 3% for Asia and 2% to emerging markets.

Meanwhile, the fixed income portion of the portfolio comprises mainly corporate bonds, which are interest-bearing loans issued by companies. He is aiming for a 10% weighting in high yield corporate bonds in the portfolio. These refer to interest-bearing loans issued by

lower quality companies, which typically pay a greater level of income than their higher quality counterparts. He is also invested in investment grade, or higher rated, corporate bonds, where he is targeting a 43% weighting at present.

Contributors from the fixed income component of the portfolio included the M&G European Corporate Bond Fund, the M&G High Yield Corporate Bond Fund and the M&G Corporate Bond Fund.

Within the fixed income section of the portfolio, the fund manager increased the positions in the M&G Corporate Bond Fund, the M&G European Corporate Bond Fund and the M&G Short Dated Corporate Bond Fund. This fund typically invests in low-risk debt instruments such as variable rate securities and corporate bonds with a short time until their maturity date.

He also started a new position in the M&G Global Convertibles Bond Fund. Convertible bonds are a fixed interest security offered by companies that offer investors the right to convert the bond into a set number of shares, usually of the issuing company. Convertibles, therefore, have the characteristics of both shares and bonds; rising when stockmarkets are going up but providing downside protection in more difficult times.

The fund manager remains comfortable not holding government bonds (interest-bearing loans from governments), as he feels their rates of returns are excessively low. This strategy has been beneficial for returns, due to weakness in this area of the market.

The portfolio also has a presence in commercial property, where it is targeting a 9% position through a holding in the M&G Property Portfolio. The fund manager continues to feel that property is a solid asset that provides a useful diversification and contribution to returns.

Elsewhere in the portfolio, the fund manager started positions in a number of alternative investments, namely infrastructure vehicles Bilfinger Berger Global Infrastructure Fund and The Renewables Infrastructure Group.

Given the lack of sustained economic progress around the globe and the existence of political uncertainty, the fund manager prefers to remain relatively neutral and back a basket of assets rather than place a significant reliance on any major theme playing out correctly. Aside from the transactions already mentioned, other sales and purchases over the period under review mainly relate to cashflow management or steps taken to bring individual holdings back to their target weighting.

Economic growth in most major markets seems to be stabilising or picking up, although the pace of the recovery is disappointing. US expansion, and to a lesser extent that of the UK, appears to be fairly solid, but the picture in China is less certain. The socio-political situation too remains troublesome and there are pockets of unrest in the Middle East. Closer to home, the eurozone has come out of recession although structural reforms in the region have yet to be fully addressed. Likewise, US politicians have so far failed to find a meaningful way forward to tackling the debt crisis and the issue is expected to rear its head again early in the new year.

Despite these underlying concerns, the fund manager believes investors have already factored in some uncertainty and that many assets are favourably valued. In his view, the potential for short-term setbacks remains but longer term the picture is encouraging.

* Source: Morningstar, Inc.

Basis: Bid to bid with net income reinvested to 31 October 2013.

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
Final	03.11.14	31.12.14

	Final distribution		Ongoing Charges Figure ^[b]	
	Inc 31.12.13 ^[a]	Acc 01.11.13 ^[a]	31.10.13	31.10.12
Sterling	p	p	%	%
Class 'A'	2.0296	2.2804	1.65	1.64
Class 'C'	3.3504	n/a	0.31	0.29
Class 'R'	n/a	2.2008	1.14	1.18 ^[c]

- ^[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.

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'	123.57	142.27	115.98	131.36	+6.54	+8.31
Class 'C'	123.71	n/a	116.06	n/a	+6.59	n/a
Class 'R'	n/a	111.47	n/a	102.51	n/a	+8.74

Past performance is not a guide to future performance.

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

Fund summary

Prices

		Income shares		Accumulation shares	
Calendar year		Highest	Lowest	Highest	Lowest
Sterling Class 'A'		p	p	p	p
	2008	101.92	90.11	103.50	92.43
	2009	109.05	91.20	113.88	94.92
	2010	113.61	106.14	121.57	113.51
	2011	114.87	107.13	125.16	117.77
	2012	119.15	110.13	134.72	122.68
	2013 ^[a]	126.39	118.83	143.16	134.58
Class 'C'	2008	102.15	90.03	n/a	n/a
	2009	110.13	91.46	n/a	n/a
	2010	114.91	106.38	n/a	n/a
	2011	115.79	107.27	n/a	n/a
	2012	120.49	110.41	n/a	n/a
	2013 ^[a]	127.83	119.13	n/a	n/a
Class 'R'	2012 ^[b]	n/a	n/a	105.23	100.00
	2013 ^[a]	n/a	n/a	112.16	105.10

^[a] Up to 1 November 2013.

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

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Fund summary

Income

Interest income per share		Distributed	Reinvested
	Calendar year		
Sterling (net)		p	p
Class 'A'	2008	2.2424	2.2772
	2009	2.8796	2.9973
	2010	2.1208	2.2681
	2011	2.2980	2.4860
	2012	2.0948	2.3376
	2013 ^[a]	2.0296	2.2804
Class 'C'	2008	3.3752	n/a
	2009	3.9780	n/a
	2010	3.3232	n/a
	2011	3.4952	n/a
	2012	3.3576	n/a
	2013 ^[a]	3.3504	n/a
Class 'R'	2012	n/a	0.5440
	2013 ^[a]	n/a	2.2008

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

Fund summary

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
M&G Corporate Bond Fund Sterling Class 'I' (Income)	22.02	M&G European Corporate Bond Fund Sterling Class 'A'	23.55
M&G European Corporate Bond Fund Sterling Class 'A'	21.97	M&G Corporate Bond Fund Sterling Class 'I' (Income)	23.05
M&G Short Dated Corporate Bond Fund (formerly M&G High Interest Fund) Sterling Class 'A' (Income)	10.06	M&G High Interest Fund Sterling Class 'A' (Income)	10.82
M&G Property Portfolio Sterling Class 'I' (Income)	8.79	M&G Pan European Fund Sterling Class 'A' (Income)	8.91
Prudential UK Growth QIS Fund Sterling Class 'C'	8.38	M&G Property Portfolio Sterling Class 'S' (Income)	8.57
M&G Pan European Fund Sterling Class 'A' (Income)	7.83	Prudential UK Growth QIS Fund Sterling Class 'C' (Income)	8.10
M&G High Yield Corporate Bond Fund Sterling Class 'X'	7.68	M&G High Yield Corporate Bond Fund Sterling Class 'X'	7.69
Prudential Pacific Markets Trust Sterling Class 'C'	2.95	Prudential Pacific Markets Trust Sterling Class 'C' (Income)	2.87
M&G European Loan Fund Sterling Class 'A' (Income)	2.53	M&G European Loan Fund Sterling Class 'A' (Income)	2.34
iShares MSCI Emerging Markets Index Fund	2.00	International Public Partnerships	1.74

[a] All holdings are in Accumulation shares / units unless otherwise stated.

Classification of investments

The table below shows the percentage holding per sector.

	% of sub-fund as at 31.10.13	% of sub-fund as at 31.10.12
Equity portfolios		
Continental Europe	7.83	8.91
United Kingdom	8.38	8.10
Far East	2.95	2.87
Emerging markets	2.00	1.52
Equity investment instruments	4.28	3.43
Property portfolios	8.79	8.57
Bond portfolios	66.22	67.45

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 Services Authority. This Short Report does not contain the Financial Statements of the Prudential Managed Defensive Fund, and it is unaudited.

Report and accounts

A copy of the Authorised Corporate Director's (ACD) Annual Investment Report and Financial Statements for Prudential Investment Funds (1), which incorporates all the sub-fund annual investment reports and audited financial statements is available free of charge on request from our website at www.pru.co.uk/managersreports or by calling Customer Relations on 0845 783 5500. All literature provided will be in English.

Other information

The information in this report is designed to enable shareholders to make an informed judgement on the activities of the fund during the [year](#) it covers and the results of those activities at the end of the [year](#). For more information about the activities and performance of the fund during this and the previous [year](#), please contact the Authorised Corporate Director.

Authorised Corporate Director (ACD)

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General information

If you would like further details about any aspects of your investment please contact Customer Relations, PO Box 10866, Chelmsford, Essex CM99 2BX. Please remember to quote your name, customer number and sign any written communication to Prudential. Failure to provide this may affect your ability to transact with us. Alternatively, you can telephone us on 0845 783 5500. For security purposes and to improve the quality of our service, we may record and monitor telephone calls. You will require your customer number. Failure to provide this will affect your ability to transact with us.

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