Pooled Pensions

M&G PP Total Return Credit Investment Fund

Fund Factsheet Q3 2024

All statistics from M&G internal sources as at 30.09.24, unless indicated otherwise.

Fund description

The investment strategy of the fund is to purchase units in the M&G Total Return Credit Investment Fund. That fund aims to maximise total return principally through prudent investment management. It aims to provide investors with attractive returns from capital and income from a diversified pool of debt and debt like assets, including but not limited to, debt instruments with a fixed, variable or floating rate coupon. The fund will identify opportunities at the market, sector, issuer or security level. There is no geographic limitation to the investment universe.

Key facts

Style	Active Multi-Asset Credit
Fund manager	Richard Ryan
Comparator	SONIA
Number of holdings	503
Fund size	£236.32m
Current bid/offer spread	0.07%
Offer Price	£14.69
AMC/OCE†	0.45%/0.01%

†AMC - annual management charges; OCE - other charges and expenses.

Performance

Percentage change in bid price since 1 January 2020, offer price prior to 1 January 2020 (net of fees).

12 months to end of September	2024	2023	2022	2021	2020
Fund	11.0	11.6	-4.7	6.8	3.8
SONIA	5.2	4.0	0.7	0.0	0.4

	Qtr	1 yr	3 yrs*	5 yrs*
Fund	2.2	11.0	5.7	5.5
SONIA	1.2	5.2	3.3	2.0

*Annualised

Fund launched on 16.06.15

Past performance is not a guide to future performance. The value and income from fund's assets will go down as well as up. This will cause the value of your investment to fall as well as rise. There is no guarantee that the fund will achieve its objective and you may get back less than you originally invested.

Performance and attribution

Within the span of 30 hours towards the end of July, three of the world's largest central banks – the Bank of Japan, US Federal Reserve, and the Bank of England – all announced their eagerly-awaited interest rate decisions. In Japan, officials lifted rates to 0.25%, whereas in the US, Chair Powell signalled that a cut was possible as soon as September, but only if current cooling trends continued. In the weeks that followed, markets were dominated by the US '25 or 50' basis point rate cut debate which was finally settled in September with the first US rate cut of 50bps after 14 months of keeping rates on hold. With US CPI printing at 3.0% in July, its lowest level in over three years, weak jobs report data and unemployment rising from its low of 3.4% in April 2023 to 4.2% in August 2024, Fed officials made it clear they weren't prepared to tolerate further economic weakening, and were keen to move rates back to less restrictive levels.

In the UK, the BoE began its easing cycle with a 'hawkish' 25bps cut at the start of August and kept rates steady at 5% at the 19 September meeting. Markets are currently pricing in a further 140bps of cuts over the following 12 months as at the end of September 2024.

In Europe, the ECB held rates at their mid-July meeting however the remainder of the month saw weak PMIs and inflation was a key theme throughout August with Germany's CPI falling to +2.0% (the lowest since March 2021). This resulted in the ECB cutting rates by 25bps at their September meeting and fuelled investor confidence that they will keep cutting rates over the next few months at every meeting, rather than every other meeting.

Looking ahead, despite hawkish communication from the Fed following the September cut (stressing this should not be seen as "the new pace" of easing), markets continue to price in a 35% chance of another 50bps reduction in November. The belief is that the Fed will be more aggressive, with c.70bps in cuts priced in by year-end and another 120bps priced in by the end of 2025. The '25 or 50' debate may not be over yet.

Overall, the shift in investors' expectations for interest rates saw government bonds perform strongly over the quarter, with US Treasuries, German Bunds and UK Gilts returning +4.8%, +3.2% and +2.5% and respectively.

Q3 24 also saw European, US and Sterling IG spreads marginally tighten by 1-4bps, with credit markets performing well as inflation softened and interest rates moved lower. Credit spreads tightened across most sectors, though the auto sector underperformed following various profit warnings which raised concerns over slowing growth. US, European and UK IG corporate spreads ended the quarter at 92bps, 116bps and 115bps respectively. Overall, Global IG returned 4.8%, with US corporates delivering 5.7%, European credit returning 3.3%, and Sterling corporates with a more modest 2.6% total return.

High Yield bonds were also supported by rate cuts and lower government bond yields, with Q3 seeing strong performance across High Yield markets. The Global HY index returned 4.9% over the quarter. Spreads tightened further, reaching historically low levels (US HY: 303bps, EU HY: 342bps), while CCC-rated distressed bonds posted solid gains. Gross issuance surged, particularly in the US, with $36.5bn raised. Market technicals remain supportive, driven by supply-demand imbalances and high carry. Year to date, Global HY has returned 8.42%, despite a year that began with concerns about recession risks.

Outlook

Credit markets continue to perform strongly and spreads are approaching historically tight levels. Inflation will continue to be a key theme as we enter the last quarter of the year as major central banks are now expected to cut rates on a more regular basis, which will likely drive bond yields down. The potential for future unforeseen financial or geopolitical events still remains which could spark future bond market volatility or even a sharp turn in monetary policy. We believe that a patient and highly selective approach to fixed income investment is the best strategy to take advantage of opportunities in today’s market.

The Fund delivered a 1.02% return above its cash benchmark during Q3 2024. The primary contributors to performance were exposures to bonds in the industrial and financial sectors, whilst exposure to the securised sector contributed negatively. The largest individual positive contributors were CPI Property, Heimstaden Bostad and AroundTown. A notable detractors was Thames Water.

Strategy

During September, the Fund continued to marginally reduce risk into market strength. The Fund took profits on selective industrials (real estate hybrids) and financial bonds (tier 1 and tier 2 bonds), recycling proceeds into more liquid defensive assets. Opportunities were added on a selective basis via the primary and secondary markets, specifically through senior financial bonds, high yield industrials and ESG themed bonds issued by the utility sector. Overall, financial bonds continue to remain a source of value compared to other sectors (predominantly national champion European Banks) which continue to trade wide to industrials.

The manager reduced exposure into market strength, including Euro-denominated real estate hybrids issued by Castellum, Heimstaden Bostad and SBB, and senior bonds issued by Sagax. We also sold Euro and GBP-denominated tier 1 and 2 insurance paper issued by Hannover Re (EUR), NN Group (EUR) and Rothesay Life (GBP).

We remained active in the primary market, purchasing EUR-denominated Industrials issued by BMW, Paccar, Mercedes-Benz and Loomis. We also increased exposure to EUR-denominated financials issued by Mizuho financial (Self-Labeled Green Bond), Piraeus Bank and Triodos Bank (CBI Aligned Green bond), which all came to market with attractive new issue premia.

Due to limited spread movements over the quarter, opportunities in the secondary market were added on an idiosyncratic basis where spread dispersions within sectors remained. The fund purchased selective EUR-denominated financials issued by WorldLine, Hamburg Commercial Bank and Islandsbanki. We also purchased high yield industrials issued by AMS, Cable & Wireless, Eroski, IHO, Kohls, Mahle, Millicom, Mobico, Progroup, Spirit and Uniti Group.

Finally, several relative value transactions were executed throughout the quarter. The manager switched from Tier 2s into shorter dated senior bonds issued by Deutsche Bank, given a compression in spreads, and switched from longer dated bonds into shorter dated bonds issued by Prologis, following strong performance. Additionally, switched from longer dated bonds issued by Thames Water into short dated equivalents.

Fund positioning

Asset class*	%
Net Cash and Derivatives	32.3
Financial	22.6
Industrial	22.3
Securitized	7.5
Quasi & Foreign Government	4.9
Covered	4.6
Sovereign	3.6
Utility	2.3

* BofA Merrill Lynch Level 2 Industry sectors.

Rating*	%
Net Cash and Derivatives	32.3
AAA	15.1
AA	5.0
A	5.6
BBB	21.9
BB	13.8
B	4.6
CCC	1.0
CC	0.2
C	0.3
D	0.1

* Average of S&P, Moodys and Fitch or M&G internal rating.

Environmental Social Governance

M&G incorporates the evaluation of ESG factors into its investment process. Recent engagements include the following:

LONDON STOCK EXCHANGE GROUP PLC

M&G, as part of a collective engagement with the ShareAction Good Work investor coalition, which have now met the London Stock Exchange (LSE) three times, joined a call with representatives of the LSE to make our expectations of diversity and inclusion known. The first meeting took place in 2022 and, since then, the company has begun reporting ethnicity pay gap data, and have committed to including this data in their annual report.

On the call we encouraged the company to voluntarily disclose ethnicity pay gap data in line with the FCA-proposed methodology as part of its annual reporting. LSE confirmed that it already voluntarily reports ethnicity pay-gap data, and has chosen to use a different methodology to that suggested by the FCA. In its view, the FCA-proposed methodology is only relevant in the context of the UK. The company took the decision to follow global best practice as although it is UK listed, it operates in 60 countries worldwide. The company believes its approach helps them identify the differences in economic opportunity, and specifically what is contributing to the gap so it can address it and close it.

When asked how it would respond if the UK government legislated mandatory ethnicity pay gap reporting, the company confirmed that it will comply with the regulations however, the LSE maintains that its methodology is superior and in line with its global peers. On disaggregating the different elements of ethnicity, the company confirmed that it already monitors this data internally. While the company is keen to be as transparent as it can, there are no immediate plans to disclose this data externally.

BASF

M&G, in collaboration with the Climate Action 100+ (CA100+) co-leads, conducted a meeting with BASF's Investor Relations (IR) team. The primary objective was to maintain pressure on the German chemical company, BASF, to publish a comprehensive Scope 3 emissions target. This includes seeking an update on BASF's Science Based Targets initiative (SBTi) application, discussing the latest CA100+ benchmark, and planning the next engagement with the new BASF CEO in the fourth quarter.

During the meeting, since BASF is a member of SBTi chemical advisory group, we were informed that the company can provide direct input on the proposed methodology and therefore, BASF has been advocating for a simplified version of the guidelines for Scope 3 emissions. The company has expressed concerns regarding the linear pathway, the reduced budget for chemical industry emissions, and the exclusion of product circularity. A final version of the guidelines is not anticipated until the end of 2024.

Going forward, BASF has scheduled a capital markets day in September, during which any updates are expected to be announced. Regarding the CA100+ benchmark, BASF believes it is making progress and has provided feedback. Additionally, we have scheduled a meeting with the new CEO, which has been arranged for November.

Close Brothers plc

The primary objective of this engagement was to request that Close Brothers, the UK banking group, monitor the risk of windfall gains under the proposed remuneration policy. To address this, M&G conducted a call with the chair of the remuneration committee.

Close Brothers is currently consulting on a new remuneration policy. In light of the Financial Conduct Authority (FCA) investigation into car financing, the remuneration committee is considering some interim changes to the remuneration policy, which M&G found acceptable. However, given the recent decline in the share price and the structure of the interim changes to the share incentives, M&G expressed concerns about the potential for windfall gains. These concerns were communicated during the call, and M&G is now awaiting feedback on the consultation.

CAPITAL ONE FINANCIAL CORPORATION

M&G met with the Capital One's Head of Climate and a member of the Investor Relations team, to discuss the company's net zero commitments and climate transition plans, as well as the Discover Financial Services acquisition, which is a provider of credit cards, student loans, and banking services.

As part of our due diligence process for the acquisition, we aimed to ensure that Capital One's sustainability credentials matched Discover's. Specifically, we requested that Capital One set a Scope 2 emissions reduction target, as it currently only has targets for Scope 1 and Scope 3 emissions. Additionally, we asked the company to publish its Scope 3 category 15 emissions and to incorporate these into its overall Scope 3 target.

Capital One currently reports 100% renewable energy use, primarily through Renewable Energy Certificates (RECs) with some degree of onsite generation. Consequently, the company felt that setting a Scope 2 target was unnecessary. However, based on our discussions with the Science Based Targets initiative, which informed us that "maintenance targets" could be set in such circumstances, we suggested that Capital One publish such a target to ensure continued focus on renewable sourcing. The company was not previously aware of maintenance targets and indicated that this suggestion would be considered.

Regarding category 15 'financed emissions,' Capital One informed us that it is currently in the second generation of estimating these emissions and plans to publish the data once it is confident in the calculations. In terms of target setting, Capital One, primarily a consumer finance business, noted that reductions are dependent on consumer preferences. The company has made estimates related to credit card use, while auto financing is largely influenced by the transition to electric vehicles (EVs). Although the commercial business is relatively small, Capital One has begun making estimates for this segment as well, despite the variability in disclosure from middle-market, often private, companies. Additional target setting will be considered, and we will follow up once the acquisition is completed.

YARA INTERNATIONAL ASA

M&G, along with its NZEI co-leads, met with Yara's Head of Responsible Investment and Head of Investor Relations. The purpose of the meeting was to request that the global chemical company establish metrics and milestones to measure progress against its 2025 and 2030 targets on specific abatement levers. Additionally, we sought an update on Yara's Science Based Targets initiative (SBTi) application process, inquired about Yara's stance on Just Transition, and discussed Yara's policy advocacy mapping exercise.

In terms of the metrics and milestones for abatement levers, Yara is concentrating on preparing for the Corporate Sustainability Reporting Directive (CSRD) and waiting for projects to mature before giving granular information. There will be a transition plan later this year which will explain actions that may take place.

Yara may become more active in portfolio management moving forward and is currently determining how to provide guidance on capital expenditures (capex) while maintaining confidentiality. The capex budget is approximately $200-300 million, but Yara is not specifically disclosing green actions within this budget. Policy makers can significantly influence strategy, as seen with the Inflation Reduction Act (IRA) in the USA.

For downstream Scope 3 emissions, the biggest challenge is obtaining primary data as farmers are not currently incentivised to provide this information. However, if their customers request data, there is a possibility that farmers will collaborate with Yara. Currently, Yara analyses soil data and climatic factors, such as precipitation, to estimate emissions. The company maps emission hotspots and then plans mitigation strategies accordingly.

Nitrate emissions are treated as Scope 1 emissions by Yara, while urea emissions are considered Scope 3 emissions, as this is from farmers. The Science Based Targets initiative (SBTi) aims for these emissions to be mitigated, although no specific standards for mitigation have been established however, the options for reducing emissions from ammonia production include enhancing production efficiency, implementing carbon capture, changing feedstock, and closing plants. SBTi expects a 70% reduction by 2050, with a 12% reduction aligned with the 1.5°C pathway. Yara believes a 12% reduction is achievable but not 70% therefore, the company has encouraged experts to engage with SBTi and advocates for CO_2 and nitrous oxide to be treated separately.

Yara submitted its 2030 emission targets in 2022 and plans to publish its Transition Plan before the Annual General Meeting (AGM) in the spring of 2025. Although Scope 3 data has been prepared, it has not yet been disclosed. Yara aims to address upstream emissions but currently lacks comprehensive data on third-party produced ammonia. The company has considered setting a new target for 2035 but requires a framework to measure success.

In terms of the Just Transition, Yara adheres to the OECD guidelines but does not have additional formal principles. For advocacy, including direct advocacy, Yara has mapped 140 different organisations and has identified no red flags. The company will explore the feasibility of updating this mapping to ensure continued alignment with its advocacy goals.

Risk rating

Minimal	Lower	Lower to Medium	Medium	Medium to Higher	Higher

What type of funds are in this risk category? These funds may invest in assets, combinations of assets or defensive strategies, where the chances of values falling or rising are likely to lie between those of funds investing in money market instruments and funds investing solely in corporate bonds.

M&G Investment Pooled Pensions

M&G Investments Pooled Pensions manage a full range of funds on both an active and passive basis for defined benefit and defined contribution clients. We believe that the quality of client service is an important part of our overall pooled fund service. Our team of Directors is responsible for all aspects of our relationships with individual clients, including regular attendance at trustee meetings to present performance and investment strategy.

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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.

For scheme members

If you require further information about your pension please talk to your sponsoring employer. For all general enquiries and administration please contact The Bank of New York Mellon Asset Servicing - Customer Services Desk on 0344 892 1812.

Regulatory and technical information

Usage

- This factsheet is intended for trustees, sponsors, advisers and 'defined contribution' members of occupational pension schemes and personal pensions invested in M&G Pooled Pensions fund range.
- The commentary in this factsheet reflects the general views of M&G and should not be taken as a recommendation or advice as to how a specific market or fund is likely to perform.
- You should also consider discussing your decision and the appropriateness of a fund's risk rating with an adviser.

Advice

- This factsheet is intended for trustees, sponsors, advisers and 'defined contribution' members of occupational pension schemes and personal pensions invested in M&G Pooled Pensions fund range.

Performance

- Performance is measured on a bid price to bid price basis since 1 Jan 2020, offer price to offer price prior to 1 Jan 2020 (net of fees).
- The annual management charges are deducted before the unit prices are set and hence before the net performance figures shown here are calculated.
- To obtain unit price information for all funds in M&G. Pooled Pensions fund range, Pension Schemes can log on to www.mandg.com/investments/institutional/en-gb/funds

How are fund prices calculated?

- M&G Pooled Pensions funds operate on a 'single swinging' price basis. Although we create both bid and offer prices for each dealing day, the basis on which units in the fund are transacted is dependent upon the cash flow into/out of the fund on any day. If the fund has net positive cash flow on the day then it will be priced on an offer basis. If the fund has net negative cash flow on the day then it will be priced on a bid basis.
- The annual management charges are deducted from the fund before the unit prices are calculated.
- M&G Pooled Pensions funds are 'forward' priced, which means that the unit price is set after money is invested. Money is invested on a 'T+0' dealing cycle, which means that money received before 12.00 will be invested by close of business that day and the unit price applicable for that 'valuation date' would be published by 12.00 on the following day.

What is the risk rating?

- Risk ratings have been developed by Prudential to help provide an indication of a fund's potential level of risk and reward based on the type of assets which may be held by the fund. Other companies may use different descriptions and as such these risk ratings should not be considered as generic across the fund management industry.
- We regularly review our fund risk ratings, so they may change in the future. If, in our view, there is a material change in the fund's level of risk, for example due to a significant change to the assets held by the fund or in the way the fund is managed, we will provide information on the new risk rating. We recommend that you make sure you understand the risk rating of any fund before you invest.
- You should also consider discussing your decision and the appropriateness of a fund's risk rating with an adviser.

Glossary

For definitions of the investment terminology used within this document please see the glossary at: www.mandg.com/investments/private-investor/en-gb/help-centre/glossary

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