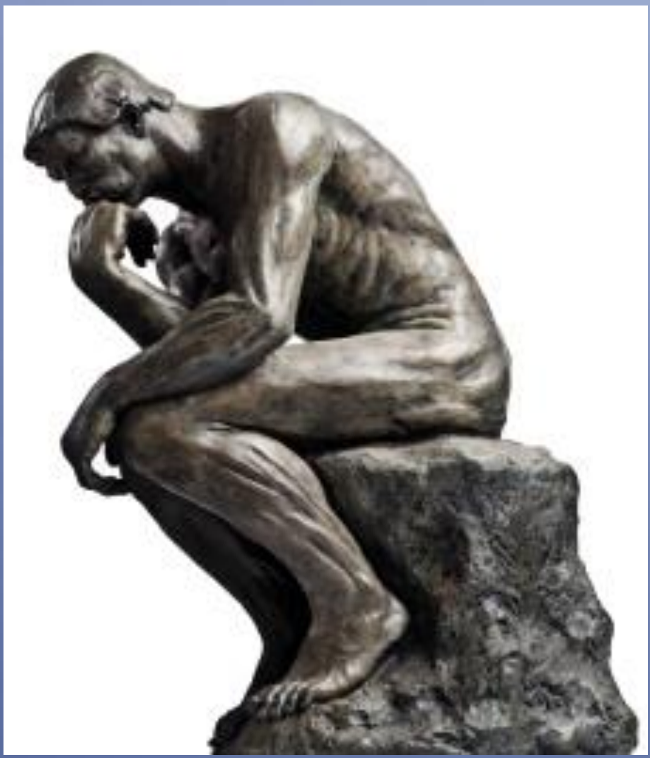

Fund Bites

M&G Optimal Income Fund

The M&G Optimal Income Fund has been part of the portfolios since 2009. This “fund bites” is a summary of the recent telephone update we had with the fund manager, Richard Woolnough.

Introduction

The M&G Optimal Income Fund is one of the most recognised strategic bond funds in the market. It enables the manager to choose where he invests from high yield bonds to equities to index linked gilts.

It has delivered stellar performance since its launch in 2006. However, with success come challenges. The fund has grown to over £14.5 billion in size which makes it like an oil tanker and difficult to control and steer. The manager was asked whether he saw this as a problem.

He responded by saying that it was down to the investor to decide. His argument is that the size of the market means that even at this size there are still plenty of opportunities. He has expanded the team to take advantage of these opportunities.

Unlike the M&G Recovery Fund we have not seen a decline in performance but we will continue to monitor this carefully.

The Fund

The fund was established in December 2006; Richard Woolnough has been the manager since its launch. He has over 28 years' experience in the fixed interest market so fully aware of what is happening.

He started by looking at the global market and in particular the US. What is happening in the US is that as the economy improves there will no longer be a need for QE. It is expected that housing will add 2% to GDP over the next year. For the reason the US are indicating to the market that interest rates won't stay low for ever.

In the UK the picture is different; there is still a large gap between where GDP should be and where it is now. For this reason although the US is a lot further down the road it is likely in the UK the rates will remain low for some time to go.

In Europe the problem is greater particularly in peripheral Europe, low interest rates and QE will not solve it quickly. The structural problems need to be resolved first.

On the fund positioning currently he has mainly short and neutral positions. On Financials he feels there has been a fundamental shift where bond holders had strong legal rights and now that has been taken away. He therefore continues to have a negative view on bank debt.

He has also reduced exposure to index inked bonds as they are no longer fair value. Richard sees opportunities in High Yield and has been adding to his exposure where he can see opportunities.

The fund also has its highest weighting to equities at 12.5%, it can go as high as 20%. This reflects the better returns that can be obtained through the equity compared to the bond. So effectively in Richard's view equities are cheap compared to debt. An example is Apple where the equity looks cheap compared to the debt, and in fact even the company management feel the same.

The fund currently holds nearly 30% in investment grade bonds, 25% in government bonds, just over 20% in high yield, around 15% in financials and 12% in equities.

Conclusion

Bond funds are never going to exciting funds to write about. A strategic approach enables the manager to choose across the spectrum. Clearly Richard has been successful in doing this but whether the fund size hinders him, well the jury is still out on that.

The source of information in this note has been provided by M&G and is correct as at 5 June. These are notes from meeting the fund manager or representative and should not be seen as a recommendation to purchase this fund. Any reference to shares is not a recommendation to buy or sell. Should you wish to make a decision based on these notes we cannot take responsibility for this and you should carry out your own research before making a decision. You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise.