

M&G UK Inflation Linked Corporate Bond Fund

September 2010

The new M&G UK Inflation Linked Corporate Bond Fund is due to be launched on 16 September 2010. This innovative fund – one of the first of its kind in the UK – is designed to exceed inflation, as measured by the Consumer Prices Index (CPI) over the medium to long term. The fund will have at least 80% exposure to investment grade credit at all times. Jim Leaviss, head of M&G's Retail Fixed Interest team, and fund manager Ben Lord will run the fund jointly. Performance will be driven through a combination of top-down macroeconomic calls and bottom-up securities selection. In managing the fund, Jim will provide top-down macroeconomic analysis while Ben will draw on his experience in credit selection.

Range of inflation-linked assets

The fund can invest in a spread of fixed interest securities that should perform well when inflation is high or rising. These include:

- inflation-linked bonds issued by blue-chip companies and governments
- floating-rate notes (FRNs – short-maturity bonds with rates linked to money market rates)
- senior secured loans
- conventional bonds
- cash
- derivatives such as credit default swaps (CDS)

The fund managers may form assets out of a combination of government bonds and derivatives, whose returns behave in the same way as inflation-linked corporate bonds.

Ability to move negative duration

The fund has a duration limit of -3 years to +3 years. The ability to move negative duration goes further than conventional bond funds in that it enables the fund to perform even in an environment of rising yields, which is usually detrimental to bond fund returns.

Disinflationary outlook

Jim believes that the UK will continue to be in a disinflationary environment for some time and that interest rates will remain low.

Nonetheless, some investors are concerned about a potential resurgence of inflation. Also, no one yet fully understands the impact on inflation that quantitative easing many have. These concerns have prompted M&G to design the new fund, which affords investors exposure to credit while protecting performance should inflation return to the UK economy.

Jim Leaviss says: "Put simply, the new fund is the corporate bond equivalent of an index-linked gilt fund. It should protect the value of investors' income and capital over the medium to long term."

Please note that from 1 October 2010, Stefan Isaacs will take over the management of the M&G High Yield Corporate Bond Fund from Jim Leaviss to allow Jim to concentrate on the co-management of the new fund alongside Ben Lord. Jim will become the deputy fund manager on the M&G High Yield Corporate Bond Fund. Stefan has been managing the M&G European Corporate Bond Fund and M&G European High Yield Bond Fund since 2007.

