PRU Global Basics Fund

Teleconference

PRU Global Basics Fund is organised as a feeder fund, which feeds into Sterling Class A shares of the M&G Investment Funds (1) – M&G Global Basics Fund ("M&G Global Basics Fund"), domiciled in the United Kingdom. The investment manager of the M&G Global Basics Fund is the UK domiciled M&G Investment Management Limited ("M&G").

A teleconference was held on 28 October 2008 to update investors on developments in the management of the M&G Global Basics Fund. Speaking was fund manager Graham French, who has managed the fund since launch in 2000. He discussed his investment approach and developments in the fund's positioning in light of recent market conditions.

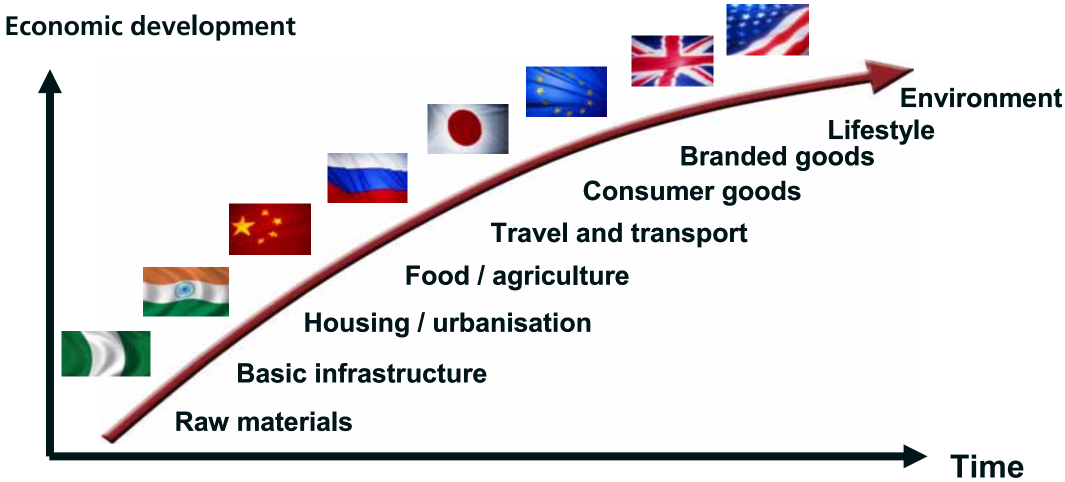
Devaluation of the paper asset

Let me start by saying that in my 20-year career, I've never seen anything close to what investors have experienced during the past three months. It has been a tough time. In 2000 we predicted that this decade would be the decade of the physical asset, whereas the previous decade was the decade of the paper asset. Those words are becoming profoundly true. No one could have predicted quite how bad the devaluation of the paper asset would be. What we saw over the first eight years of the decade was that physical assets and physical asset companies did rather well – and that continued up until about 10 weeks ago, when the ripple effect of those paper assets being destroyed started to hit the real economy for the first time. The M&G Global Basics Fund reflects the real economy. In my opinion, what's occurring is the unwinding of hedge funds, which we predicted eight years ago would occur at some point.

It's very sad to see it happening because so many investors are being let down by those hedge funds and those pieces of paper. The hedge funds don't really know what they own, or the value of those assets. And even though this fund is suffering, along with every equity fund in the world, we do know what we have: we know what physical assets the companies we invest in produce. We know the management. We have no derivatives exposure. We have no hedging. We have virtually no exposure to financials or emerging markets. We have nothing exotic in this fund and hopefully that should reassure investors in these turbulent times. Investors do not need to be worried about something nasty coming out of the M&G Global Basics Fund.

To go back to what I've been saying consistently for eight years, this growth up the curve (shown below), this move as three billion people have emerged into the world economy, continues. It is important to step back and look at what actually is happening in the real world. At the moment every TV programme, every newspaper is full of talk of a global recession. Yet the IMF last week predicted that the world economy would still grow by 3% next year. That growth is concentrated in China, India, the Middle East, Latin America and so on. And even today we're seeing that China's economy is still growing at 8% even though it has slowed from 11%. And 8% growth on its current economic base is, of course, far greater in impact than an 11% growth rate eight years ago when the economy was smaller.

The curve of global economic development



What we've seen in the past two months is that business is slowing down for some companies, not because of demand collapsing – not because three billion emerging consumers have stopped buying toothpaste or shampoo – but because finance is not available. The financial malaise has become so acute that there is no liquidity left to provide normal business finance. So if you look at resource companies, demand for iron ore is still strong and mines are still producing. The problem is simply that the producers cannot load their iron ore onto ships because there's no finance available for the letter of credit needed to do that. When confidence finally returns, investors will realise that the world continues to grow.

Significant steps to protect investors

One of the things we have done on this fund this year, rather successfully, is to move away from raw materials and commodities and up the curve (see chart above) towards more food and personal goods companies, which have outperformed in this market. At the end of May this year about 40% of the fund was invested in basic materials; by mid-October, this was down to 25%. This move has negated some of the falls in commodity stocks that have seen some funds fall 70% or 80%. We are proud we took these steps and they should illustrate to investors that we were taking measures to protect them in this period of turmoil.

Hedge funds' unwinding affecting real economy

Over the last two years what we've realised is that most hedge funds – and bear in mind these are unregulated bodies involving an estimated US$1.8 trillion in assets – were all largely employing the same strategy. And that was to fervently buy commodities and oil shares. Because hedge funds are unregulated, we had little information on what they were doing and it's only now that we are seeing that so many of them were playing a long commodities/short financials game. As they have unwound – and they've been forced to unwind by their relationship with Wall Street banks – they have forcibly sold everything on their books. Because a lot of that has been in commodities, we have seen a near-halving of commodity shares as well as a halving of emerging-market stocks. But, interestingly, consumer goods stocks, which rely on the demand of those three billion new consumers, have held up remarkably well. And it's interesting that, in the third quarter, McDonald's, Procter & Gamble and Coca-Cola, for example, all reported international sales in the region of, or in excess of, 10%.

These are good companies producing simple products in the middle region of the curve (on previous page) and all are showing global growth. So in reality, the sell-off has occurred because of the unwinding in the financial markets – the biggest unwinding that anyone has ever seen, by a huge magnitude.

'Safer' sectors

The fund's biggest relative position is in food producers (see Table 1), and although this hasn't been like holding cash, it has been one of the safer options. The third-largest overweight, personal goods, is again a very 'safe' sector. We are heavily underweight towards oil & gas, which has been the right decision as the oil price has halved more because of the unwinding of hedge funds than due to supply and demand factors. The economy of China seems to be still growing strongly – but the market of China believes otherwise. At some point we'll have to address the sectors we have avoided over the last three or four months because they are now offering tremendous value. You can buy commodity shares on just four to five times cashflow, which leaves a big amount of potential upside given that the life of a mine for a number of companies is greater than 25 years.

Table 1: Top five relative overweight positions

Sector	Relative weight (%)
Food Producers	8.7
Mining	6.6
Personal Goods	6.1
Health Care Equipment & Services	5.5
Industrial Metals	4.0

Table 2: Top five relative underweight positions

Sector	Relative weight (%)
Gas, water & multi utilities	-3.8
Automobile & parts	-4.2
Electricity	-5.6
General retailers	-6.3
Oil & gas producers	-8.9

Source: M&G Investment Management Limited, as at 10 Oct 2008

Sales and purchases

Table 3 depicts the significant sales by the fund in 2008. Selling a stock such as K&S when it's a popular 'glamour' stock is a very hard thing to do, but that decision has been vindicated: its share price is down around 65% from its peak. We reduced our position in Eramet when the shares were above €600 a share. The share price has since collapsed. The share prices of Statoil, Centennial Coal, Hess, Consol, Aracruz, Norsk Hydro and FMC have all fallen dramatically since we sold them.

Table 3 shows the significant purchases made this year. In the case of Colgate-Palmolive, we believe there are not likely to be any problems with toothpaste consumption in the world. The rural poor in India who are using toothpaste for the first time aren't really concerned about what's happening on Wall Street. For a company such as Unilever, the same applies – emerging consumers who for the first time are using washing powder to clean their clothes are not concerned about the greed of hedge funds. Yum! Brands, the company that owns KFC and Pizza Hut (now re-branded as Pasta Hut), met with us just last week and said that China was still showing strong growth (see below). And frankly, once again the problems on Wall Street, the greed of hedge funds and the incompetence of the regulatory authorities isn't really affecting people's desire to eat pizza for the first time in their lives.

At the bottom of table 3 is Kerry Group, an Irish food and ingredients company that has held up remarkably well through the recent turmoil. We saw them last week and they confirmed the fact that, despite the slowdown, there is still a need for bread and basic foodstuffs in the world. Again, we are really proud of having made that switch in the fund but at some point during the next 12 to 18 months we may have to consider moving back into the areas where we sold stocks to save investors from losing money.

Table 3: Significant sales and purchases

Significant sales	Significant purchases
Total	Acuity Brands
K&S	Colgate-Palmolive
Eramet	AMMB Holdings
Cooper Cos	Futuris
Yamaha Motor	Unilever
StatoilHydro	Kansas City Southern
Centennial Coal	Imerys
Bio-Treat Tech	Johnson Matthey
Tele Atlas (takeover)	Constellation Brands
Patriot Coal	Noble Group
Hess	Agrana Beteiligungs
Consol Energy	LVMH
Aracruz	Yum! Brands
Norsk Hydro	Foster's
FMC	Starbucks
Linde	Kerry Group

Source: M&G Investment Management Limited, as at 10 Oct 2008

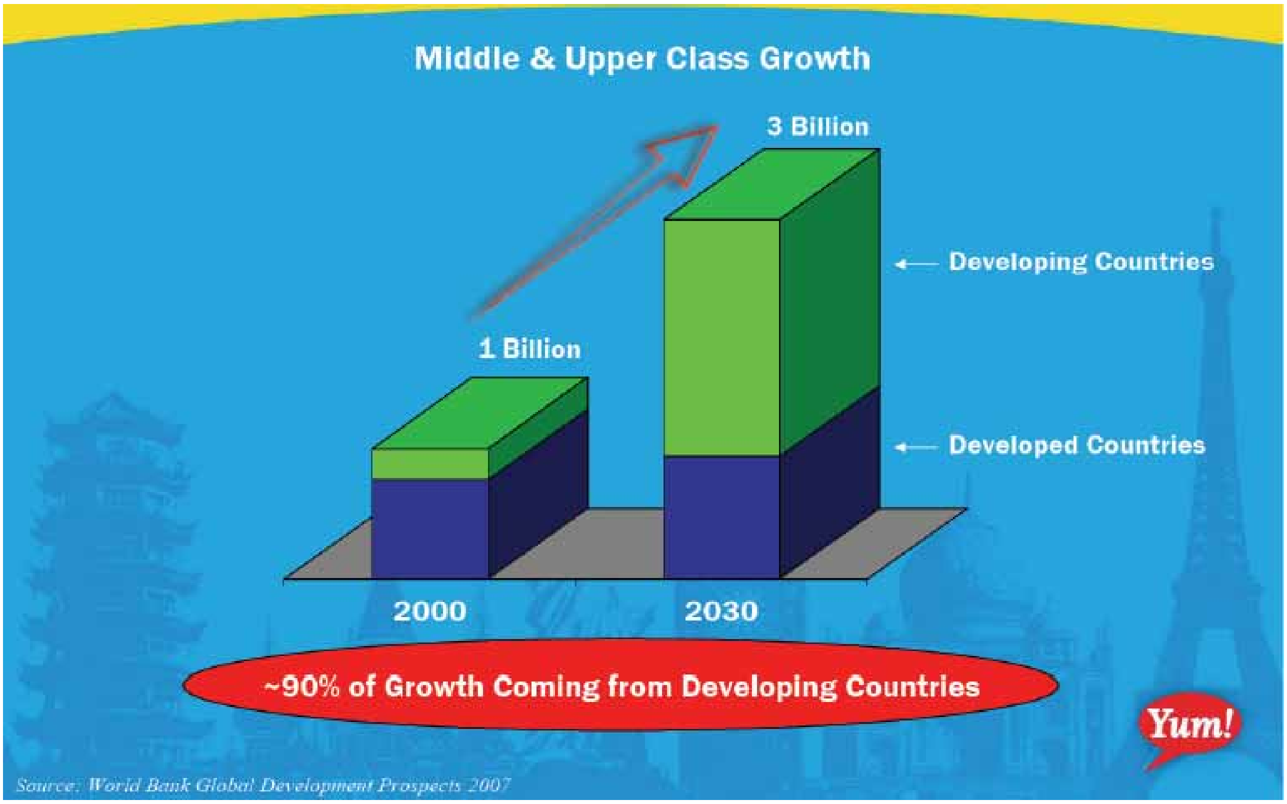
Please note that the securities mentioned above are included for illustration purposes only. It should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any security discussed herein will remain in the portfolio of the fund at the time you receive this material or that securities sold have not been repurchased. The securities discussed do not represent the funds' entire portfolio and in the aggregate may represent only a small percentage of the fund's portfolio holdings.

Decoupling

As I have been saying for eight or nine years now, the predominance of the US in world economic affairs is going to lessen. What we have seen in this malaise is the dominance of America declining. The biggest creditor nation of the world is China. Countries such as China, Indonesia, Singapore, Dubai and Qatar are the ones who are essentially bailing out the greed and stupidity on Wall Street. The thesis of the world economy decoupling from the west is indeed occurring, of having to have more exposure to the growth of the markets of China, India and so on is happening.

However, in this fund we do not invest directly in those markets, so the fund has minimal direct exposure in China, Russia and Latin America. This is important because direct investments in emerging markets have been terrible for investors. We invest in companies in the developed world that are providing the goods and services to those emerging economies.

Retail sales in China grew 23% in September (source: National Bureau of Statistics of China, November 2008). I didn't see a single headline about that news – all I saw were stories about the world going into recession. To return to Yum! Brands, they believe that in the next 20 years, an extra two billion people are going to emerge as their customers – in other words, the middle-class consumers of Pizza Hut, KFC, etc. (See the diagram below for an indication of the growth Yum! Brands expect to come from developed and developing consumers in future years.)



Source: Yum! Brands investor presentation, September 2008

We are seeing something of a decoupling between stock markets and the real economy, in other words stock markets are telling us we are going to have a depression; stock markets are telling us that the world has stopped, but these examples should prove the world hasn't stopped. When we finally get to the end of the hedge funds' forced selling and we stop seeing the acute panic that has characterised the past 10 weeks, we can return to the fact that we have growth in those parts of the world, and if you are in the right equities that supply the goods and services that emerging consumers want, you'll be able to sit back and enjoy potential good returns.

Source: M & G Investment Management Limited, as at November 2008.

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