

# Prudential Managed Defensive Fund

A sub-fund of Prudential Investment Funds (1)  
Interim short report for the six months ended 30 April 2010



# 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 profile

All stockmarket investments carry risk, the value of your investment and any income from it may fall as well as rise and you may not get back your original investment. Past performance is not a guide to future performance. The level of income is not fixed and may vary. A rising rate of inflation will have the effect of reducing the actual value of any gain by an equivalent amount. The current tax regime applicable to investors in this Collective Investment Scheme is not guaranteed and may change in the future.

Collective Investment Schemes invest in a range of assets, each with its individual risks. While the fund manager will exercise due skill and care in selecting such schemes for investment, he will not have any control over the management of these schemes or the fair pricing of their underlying securities. As such, there is no guarantee that fair value is at all times reflected in the reported net asset value.

The Fund can hold fixed interest investments, the value of the fixed interest securities held in the Fund will fall in the event of a default or perceived increased credit risk of an issuer. Yields of the fixed interest securities held may vary and the level of income may fluctuate. High-yielding bonds are generally issued by companies with lower credit ratings. They are more likely to default on their payments than traditional corporate bonds but offer a higher yield in return.

The Fund can hold investments in property funds. The following risk factors are applicable to the property asset class. It is anticipated that rental growth will take place for any property investments. Rent default could have an adverse impact on the performance of rental growth. The value of any property holding is generally determined by the opinion of a standing independent valuer and is therefore subjective. Property investments can be relatively illiquid compared to bonds and equities. Liquidity is a measure of how easily an investment can be traded.

The Fund may use derivatives for investment purposes as well as for efficient portfolio management. To the extent that derivatives are used for investment purposes, the net asset value of the Fund may at times be volatile. Although the fund manager will select the counterparties with which it enters into derivative transactions with due skill and care, there will be residual risk that the counterparty may default on its obligations or become insolvent.

## Investment activities over the report period

During the six month review period, the Prudential Managed Defensive Fund's total return (capital performance with net income reinvested) was 3.8%\*. This was behind the average return of 7.1%\* in the fund's peer group, the IMA Cautious Managed sector.

The fund is run with a more defensive bias than the IMA Cautious Managed sector. This stability helped it to outperform its peer group over the same period in the previous year. However, it meant that the fund lagged over the six months under review, during which time investors preferred riskier assets.

On the positive side, a combination of low interest rates, better-than-expected corporate results and a narrowing in credit spreads (the difference between the yield on a corporate bond and a government bond of a similar maturity) provided an encouraging backdrop for the holdings in the M&G European Corporate Bond Fund and the Prudential Corporate Bond Trust (the two largest positions in the portfolio). Indeed, these two funds provided the majority of the fund's gains during the review period. Given the scale of the rally in corporate bonds since March 2009, the fund manager decided to take some profits and reduce the targeted exposure to investment grade corporate bonds to 50% of the portfolio from 62% at the end of October 2009.

A position in the M&G Property Portfolio, a diversified fund invested in good quality bricks-and-mortar assets, also added value. Commercial property rebounded strongly during the review period as investors moved to take advantage of the high yields on offer, relative to equities and gilts. Higher-quality assets with good tenants on long leases that can provide reliable long-term income revenue were particularly favoured. In the fund manager's opinion, commercial property offers a better yield than equities and gilts at present, with the prospect of capital growth over the longer term. He therefore increased the fund's targeted position in the asset class to 9% from 7% at the start of 2010.

The equity rally that commenced in March 2009 continued throughout most of the review period, supported by investors' insatiable appetite for riskier assets. This was beneficial for the fund's relatively small equity holdings in the Prudential UK Growth Trust and the Prudential European Trust, which provided a modest return.

In contrast, holding UK government bonds (gilts) had a negative effect during a period in which the massive amount of government borrowing in southern Europe and Ireland put the spotlight on the UK's own precarious fiscal position. The government needs to issue a significant amount of debt in order to finance its huge budget deficit and the fund manager therefore expects gilt yields to rise in the future. With this in mind, he decided to sell out of gilts in April 2010.

The proceeds raised through the sale were used primarily to initiate a large position in the M&G High Interest Fund, which is designed to provide income with stability of capital through investing in a variety of debt instruments. The underlying fund has a large weighting in floating rate notes (FRNs), which have the potential to offer a better income return than cash, albeit with a possible risk to capital.

Issued by corporations, an FRN is a bond with coupon payments that vary in line with a reference interest rate, normally the London Interbank Offered Rate (LIBOR) – the rate of interest at which banks lend to each other. The coupon is reset at fixed periods, usually every three months, and depends on the level of LIBOR at that time. Although the risk of fluctuations in capital value due to changes in interest rates is limited with FRNs, they do have credit risk because there is a possibility that the company issuing the notes could default and therefore become unable to meet its interest payments.

Looking ahead, the fund manager will continue to adjust the portfolio to enhance returns in a cautious, risk-aware fashion, with a focus on protecting capital values, where possible. In the short term, the sovereign debt crisis in peripheral Europe remains a huge challenge that will take some time to overcome, despite the rescue package recently agreed by the European Union and the International Monetary Fund. This situation is expected to continue to affect the confidence of both equity and fixed income investors and further instability is therefore likely. Nonetheless, the fund manager believes that the portfolio is well positioned to provide a healthy return for investors with a relatively low level of volatility over the longer term.

\* Source: Morningstar, Inc.

Basis: Bid to bid with net income reinvested to 30 April 2010 (the nearest measurable period).

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

## Major holdings

The top ten holdings at the end of this period and the previous period end are shown below.

	% of sub-fund as at 30.04.10		% of sub-fund as at 31.10.09
Prudential Corporate Bond Trust Sterling Class 'C' (Income)	26.90	Prudential Corporate Bond Trust Sterling Class 'C' (Income)	34.96
M&G European Corporate Bond Fund Sterling Class 'A' (Accumulation)	23.09	M&G European Corporate Bond Fund Sterling Class 'A' (Accumulation)	28.69
M&G High Interest Fund Sterling Class 'A' (Income)	17.23	Treasury 5% 2025 (£)	9.96
M&G Property Portfolio Sterling Class 'S' (Income)	8.97	M&G Property Portfolio Sterling Class 'S' (Income)	7.26
Prudential European Trust Sterling Class 'C' (Income)	4.75	Prudential Maximum Income Trust Sterling Class 'A' (Income)	5.05
Prudential Maximum Income Trust Sterling Class 'A' (Income)	4.49	Prudential European Trust Sterling Class 'C' (Income)	4.91
Prudential UK Growth Trust Sterling Class 'C' (Income)	3.19	Prudential UK Growth Trust Sterling Class 'C' (Income)	3.08
M&G European Loan Fund Sterling Class 'A' (Income)	2.50	M&G European Loan Fund Sterling Class 'A' (Income)	2.55
International Public Partnerships	1.90	International Public Partnerships	1.88
iShares MSCI Emerging Markets Index Fund	1.09	iShares MSCI Emerging Markets Index Fund	0.97

## Classification of investments

The table below shows the percentage holding per sector.

	% of sub-fund as at 30.04.10	% of sub-fund as at 31.10.09
Equity portfolios		
Continental Europe	4.75	4.91
United Kingdom	3.19	3.08
Far East	0.00	0.00
Equity investment instruments	2.08	3.00
Non-equity investment instruments	1.09	0.97
Property portfolios	8.97	7.26
Bond portfolios	74.21	71.26
Bonds		
'AAA' credit rated bonds	0.00	9.96
Forward currency contracts	0.99	(0.58)

# Fund summary

Sterling Class 'C' shares are not generally available to all investors.

## Distribution dates and fund facts

Distribution type	xd	payment
Final	01.11.10	31.12.10

	Total Expense Ratio <sup>[a]</sup>	
	30.04.10	31.10.09
<b>Sterling</b>	%	%
<b>Class 'A'</b>	1.65	1.59
<b>Class 'C'</b>	0.30	0.26

The Portfolio Turnover Rate (PTR) for the 12 months ending 30 April 2010 was 74.70% compared with 111.03% for the year ending 31 October 2009. <sup>[b]</sup>

<sup>[a]</sup> The Total Expense Ratio (TER) shows the relevant annualised operating expenses of each share class from the most recent reporting period as a single percentage of the average net asset value for that share class over the same period.

<sup>[b]</sup> The Portfolio Turnover Rate (PTR) is a ratio that reflects the volume of trading within the fund over the course of a 12 month period. The PTR is calculated by taking the sum of all transactions in securities less the sum of all transactions in the fund's shares and is expressed as a percentage of the fund's average net asset value.

Income accrued from interest-bearing securities is distributed on an effective yield basis.

## Fund performance

Performance of share classes

	Net asset value per share as at 30.04.10		Net asset value per share as at 31.10.09		Net asset value % change	
	Inc	Acc	Inc	Acc	Inc	Acc
<b>Sterling</b>	p	p	p	p	%	%
<b>Class 'A'</b>	108.52	116.06	104.67	111.94	+3.68	+3.68
<b>Class 'C'</b>	109.17	n/a	104.69	n/a	+4.28	n/a

# Fund summary

## Prices

	Calendar year	Income shares		Accumulation shares	
		Highest	Lowest	Highest	Lowest
<b>Sterling</b>		<b>p</b>	<b>p</b>	<b>p</b>	<b>p</b>
<b>Class 'A'</b>	2007 <sup>[a]</sup>	102.55	98.91	103.53	98.91
	2008	101.92	90.11	103.50	92.43
	2009	109.05	91.20	113.88	94.92
	2010 <sup>[b]</sup>	109.27	106.14	116.86	113.51
<b>Class 'C'</b>	2007 <sup>[a]</sup>	103.28	99.23	n/a	n/a
	2008	102.15	90.03	n/a	n/a
	2009	110.13	91.46	n/a	n/a
	2010 <sup>[b]</sup>	109.83	106.38	n/a	n/a

<sup>[a]</sup> From 16 February 2007 (the launch date of the sub-fund) to 31 December 2007.

<sup>[b]</sup> Up to 4 May 2010.

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.

## Income

### Interest income per share

	Calendar year	Distributed	Reinvested
		p	p
<b>Sterling (net)</b>			
<b>Class 'A'</b>	2007	1.5532	1.5532
	2008	2.2424	2.2772
	2009	2.8796	2.9973
	2010 <sup>[a]</sup>	-	-
<b>Class 'C'</b>	2007	2.2580	n/a
	2008	3.3752	n/a
	2009	3.9780	n/a
	2010 <sup>[a]</sup>	-	n/a

<sup>[a]</sup> The Prudential Managed Defensive Fund distributes annually, therefore there is no interim distribution.

### **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) Interim Report (which incorporates the unaudited financial statements) for the Prudential Managed Defensive Fund is available free of charge on request from the ACD. Copies of the ACD's Annual Report (which incorporates the audited financial statements) for the Prudential Investment Funds (1) are also available free of charge on request from the ACD. Alternatively please visit our website at [www.pru.co.uk/managersreports](http://www.pru.co.uk/managersreports) where the financial statements can be viewed online.

## **Other information**

The annual management charge is paid fortnightly in arrears from the fund's Scheme Property. It was previously paid fortnightly in advance from the fund's Scheme Property.

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

### **Authorised Corporate Director (ACD)**

Prudential Unit Trusts Limited, Laurence Pountney Hill,  
London EC4R 0HH Telephone: 0845 783 5500  
(Authorised and regulated by the Financial Services Authority)

### **Investment manager**

M&G Investment Management Limited,  
Laurence Pountney Hill, London EC4R 0HH  
(Authorised and regulated by the Financial Services Authority)

### **Registrar**

International Financial Data Services (UK) Limited,  
IFDS House, St. Nicholas Lane, Basildon, Essex SS15 5FS  
(Authorised and regulated by the Financial Services Authority)

### **Depository**

The Royal Bank of Scotland plc,  
Trustee & Depository Services, The Broadstone,  
50 South Gyle Crescent, Edinburgh EH12 9UZ  
(Authorised and regulated by the Financial Services Authority)

### **Independent auditors**

PricewaterhouseCoopers LLP,  
Hay's Galleria, 1 Hay's Lane, London SE1 2RD

### **General information**

If you would like further details about any aspects of your investment please contact Customer Relations, PO Box 9022, Chelmsford, Essex CM99 2WA. 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.

'Prudential' is a trading name of Prudential Unit Trusts Limited and Prudential Personal Equity Plans Limited. This name is also used by other companies within the Prudential Group, which between them provide a range of financial products including life assurance, pensions, savings and investment products. Prudential Unit Trusts Limited and Prudential Personal Equity Plans Limited are registered in England and Wales under numbers 1796126 and 2059989 respectively. Registered Office at Laurence Pountney Hill, London EC4R 0HH. Authorised and regulated by the Financial Services Authority.