

Fund Update

For the Prudential (ex M&G) Range of pension funds October 2011

› Six monthly investment report for the period 1 April 2011 to 30 September 2011

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Who is the report for?

This report is intended for customers who hold pension plans with Prudential. These plans were originally taken out with M&G and transferred to Scottish Amicable Life in December 2000 and Prudential in 2002.

What is this report for?

The purpose of this document is to provide an insight on investment markets and funds over the period, and is provided for information purposes only.

It should not be considered as financial advice.

Any change to your investment arrangements should be discussed with an adviser.

Important

Please remember that past performance is not a reliable indicator of future performance. The commentary in this report reflects the general views of the individual fund manager and should not be taken as a recommendation or advice as to how a specific market or fund is likely to perform.

The value of an investment may fluctuate and is not guaranteed. You may not get back the full amount of your original investment. What you get back will depend on the fund chosen and how it performs.

All information is shown as at 30 September 2011 unless otherwise stated.

It is our policy to review the aims and objective of the products we offer, on a continual basis, in light of prevailing market conditions.

We may at some point in the future close, amend or merge any of the funds currently available in order to satisfy our customers' investment needs.

If this happens and your plan is linked to one of these funds we will write to you to let you know what we propose to do.

➤ M&G's view of the market 5 April 2011 to 5 October 2011

Serious challenges for the global economy

Summer is traditionally a quiet time for financial markets. But as the dramatic events that took place this summer have shown, the past should not be relied on to predict the future.

The mood started to sour in late spring when data from all corners of the US economy – the jobs market, consumer spending and manufacturing – suggested that the recovery was falling apart. To make matters worse, these worrying signals coincided with the end of the Federal Reserve's (Fed's) second round of quantitative easing or bond purchases, the US policymaker's initiative to kickstart the economy. Fears of another recession were understandably inevitable.

Unlike the same period last year, the Fed ruled out another phase of quantitative easing but did acknowledge that the US economy was slowing. By this point, the effect of higher raw material costs had also become apparent, pushing up energy, food and clothes prices. Inflation has been a much greater problem though for the emerging economies where a larger slice of income is spent on basic goods. For example, the Chinese government has increased interest rates three times so far this year and raised the amount of money that banks must have in reserve in an effort to combat rising prices. Such tough action has not been free of consequences, occurring around

the same time as disappointing manufacturing data from China, which in turn aroused suspicions that the world's second largest economy was also stalling.

The list of problems threatening to destabilise the economy and therefore weighing on investor sentiment did not end there; US politicians had still not agreed on the government's spending budget for the next 12 months by late July. Although a consensus was eventually reached, the US paid the price for its indecision when Standard & Poor's withdrew the country's AAA credit rating for the first time in history.

Eurozone debt crisis

Talk of a 'double-dip' recession in the US, alongside such serious issues as politicians wrangling over the country's debt ceiling and scarily high inflation across the emerging world, would have been hard enough for investors to stomach. However, this potent cocktail of problems came shortly after the devastating earthquake in Japan and fears of a nuclear disaster. Around this time, questions about Greece's ability to avoid a default were being asked. Investors seemed convinced that a Greek default was now almost a certainty, with hopes fading fast that the government would get its finances under control – a prerequisite for further financial assistance from the European Union and the International Monetary Fund.

A further blow to the stability of the eurozone came when borrowing costs for the governments of Italy and Spain started to rise because of their debt piles. This alarming development was taken as confirmation that the eurozone crisis had now reached the region's larger countries. Standard & Poor's decision to downgrade Italy's credit rating in September also served as proof that the country's government was struggling to slash its borrowing levels. Worryingly, Europe's banks have fallen prey to this situation since financial institutions hold large stakes in bonds from the peripheral eurozone. As a result, banks have become cautious about lending to each other, and in early October the European Central Bank (ECB) was forced to take action to support the banking sector in order to avoid a repeat of 2008's financial crisis.

The ECB has also assisted individual countries, buying government bonds from Italy and Spain for example. Although this move was well received, investors criticised the policymaker for doing too little too late and faith that the crisis could be solved has been in short supply. Many market observers also questioned the ECB's decision to raise interest rates in April and again in July in a bid to cool inflation at a time of subdued economic activity in the peripheral eurozone.

Europe's economies lose momentum

Indeed, Europe has faced the double whammy of consumer spending cuts and tax rises at home as well as slower rates of growth in Asia and the US. Weaker growth from Germany in the second quarter showed that even such a robust economy with little government or consumer debt could not evade the global downturn. This shocked investors, especially since the German economy had been the one glimmer of hope in Europe, supported by its exports to the rest of the world. On the other hand, the southern European countries had already started to buckle under the strain of tax rises and tough government spending cuts, recording high rates of unemployment and modest growth.

The performance of the UK economy has also given cause for concern. The government's austerity plan has been blamed for hurting an economy still recovering from the previous recession. Unemployment remains a major headache for policymakers, while inflation – expected to fall early next year due to slower global growth and lower commodity prices – is still well above the Bank of England's (BoE's) target of 2.0%.

Fears of another recession have led to calls for a review of the government's spending cuts as well as pressure on the BoE to provide extra stimulus for the economy. This became a reality on 6 October when the BoE announced that it would pump a further £75 billion into the economy to stimulate growth.

Equities shunned by investors

The serious nature of the issues faced by the West and the degree of economic uncertainty they created meant that riskier assets were shunned by investors for much of the review period, and as a consequence global stockmarkets lost significant value. For example, the FTSE All World Index was down as much as 22% on 22 September in dollar terms from its May highs, falling through the 20% level, which signifies a 'bear' market.

Eager to reduce their exposure to riskier assets and preserve their capital, investors were indiscriminate in their selling, leaving no sector or region untouched. Those countries and companies with the greatest exposure to the eurozone debt crisis fell the furthest. For instance, European equities declined more than 20% in sterling terms during the six months and were the worst performers of the developed countries. Although US and UK equities outperformed their European peers, they too experienced substantial losses at the height of the stockmarket volatility in August and September.

Meanwhile, there was a wide divergence in returns across the emerging markets. For example, China and South Korea paid the price for being exporters to the western world, while smaller countries, especially Indonesia and the Philippines, held up better.

At a sector level, banks, especially European financial institutions, were punished as investors questioned which ones had exposure to bonds from the

peripheral eurozone. Raw material stocks were not far behind banks in terms of losses suffered given the cyclical nature of their businesses and therefore reliance on a growing economy. Miners of commodities such as iron ore and copper started the review period well but lost their shine when signs of weakness in the Chinese economy came to light. The 'safe haven' status of gold meant that the precious metal was a rare exception to this trend. The price of gold set record after record, while the US dollar, another traditional 'safe haven' in uncertain times, gained in value against both sterling and the euro.

Those companies that depend less on a sound economy for their earnings growth, such as drug manufacturers and utilities groups, were also favoured. Investors opted for stability over excitement and paid a premium for those companies that they could be sure would continue to grow their profits even if another recession hits.

Emerging markets fight inflation

Inflation has been the main talking point across Asia and Latin America this year and investors have remained wary of many stockmarkets in these regions as a result. For example, Chinese and Indian equities – where governments have raised interest rates to get inflation under control and protect their economies from the negative effect of higher prices – have lagged most other Asian stockmarkets. Although the decline in commodity prices is bad news for those emerging countries with abundant raw

material reserves, such as Brazil, this development could not have come soon enough for the governments of China and India.

Slower rates of economic activity across Asia's two largest economies must be viewed in the context of much more muted growth elsewhere. Despite 12 interest rate rises in 18 months, the Indian economy is expected to expand between 7.5% and 8% in the fiscal year to April 2012, far higher than the rates of growth seen in the western world. What is more, most emerging countries have little government debt and plentiful savings and are therefore not restrained by public spending cuts.

Government bonds in pole position

Bonds issued by the governments of the UK, US and Germany outperformed equities during the review period. Regarded as less risky than shares and bonds issued by companies, they were a natural port of call for investors during those times when tensions over the eurozone crisis and the global recovery were running high. Even the loss of the US's AAA credit rating in early August did not deter investors from investing in the country's government bonds.

Government bonds maintained a clear lead over their corporate counterparts for much of the review period, securing better returns. Corporate bonds – especially high yield, which is debt issued by companies with low credit ratings – behave more like equities and investors

increasingly reduced their stakes in these bonds as fears over the economy and the situation in Europe intensified. Investors want a much greater yield (prospective rate of return) to own lower rated bonds compared with an average government bond because they believe the chance of a company with a poor credit rating going bust is now much greater in view of the challenging environment.

Outlook

Rather than dwelling on the sorry state of the economy or trying to predict the future of the eurozone, we as investors prefer to focus on the positive aspects of companies around the world. These could be pharmaceutical firms, cash machine manufacturers, advertising agencies or utility businesses. Our decision to invest in them is based on whether they are good quality companies with the potential to create value for their shareholders, not on market sentiment. In the same way, our fixed interest fund managers will invest in bonds from a company or a government if they think that they are being paid to do so.

And what is more, the corporate sector offers reason to be optimistic. The economy has an undeniable bearing on firms' prosperity, but they can still influence their own fate – whether that is by cutting costs, moving production to cheaper locations or focusing on more profitable products – and this is exactly what businesses have been doing for some time. As a result of such hard work, profits have recovered strongly, rising by 50% since the last economic downturn in 2009.

Investors can also take comfort from the fact that many companies are increasingly international in nature. For example, many companies listed on the London Stock Exchange derive their revenues and profits all over the world – they are simply global companies that happen to have a listing in the UK. Businesses have become more global and are able to offset lower rates of economic growth at home by tapping into the exciting developments taking place in Asia and Latin America. Consumers in these markets have not stopped wanting trainers or perfume simply because of the problems in the western world. On the contrary, the rise in consumer spending is a long-term phenomenon that will not be derailed by events in the US or Europe.

Finally, we also have to remember that financial markets are no stranger to similar bouts of turmoil; panic ensued after the earthquake in Japan in March and following the collapse of Lehman Brothers in 2008. We will therefore continue to focus on carefully selecting shares and bonds from good quality companies since we believe that this is the best way to achieve compelling long-term performance.

➤ Prudential range of pension funds (ex M&G)

The following is a list of existing funds covered in this report.

Below we have listed the current Annual Management Charge (AMC) and also the Total Charges for each fund. Please note that our charges may vary in the future and could be higher than they are now.

"Total Charges" are the sum of the Annual Management Charge plus "Other Charges"

"Other Charges" may consist of some or all the following:

- Expenses incurred in relation to any underlying Unit Trust/OEIC holdings (often termed "Unit Trust Expenses" or "UTE"s).
- Other Charges and Expenses incurred in relation to any underlying Unit Linked Fund holdings.
- Direct Custody Fees that the Unit Linked Fund bears (i.e. custodian fees relating to buying/selling assets and safe-keeping of asset records). Please note that the level of these fees are not set by Prudential and may change as and when the relevant body decides to do so.

Fund Name	AMC	Total Charges
Pru Cash fund	1.00%	1.00%
Pru Equity fund	1.00%	1.00%
Pru European fund	1.00%	1.20%
Pru International fund	1.00%	1.20%
Pru Japan fund	1.00%	1.25%
Pru M&G American fund	1.00%	1.20%
Pru M&G Corporate Bond fund	1.00%	1.20%
Pru M&G Gilt & Fixed Interest Income fund	1.00%	1.15%
Pru M&G Global Basics fund	1.00%	1.30%
Pru M&G Global Leaders fund	1.00%	1.25%
Pru M&G High Yield Corporate Bond fund	1.00%	1.20%
Pru M&G Recovery fund	1.00%	1.25%
Pru M&G UK Growth fund	1.00%	1.20%
Pru M&G UK Select fund	1.00%	1.35%
Pru Managed fund	1.00%	1.10%
Pru Managed Income fund	1.50%	1.75%
Pru Personal Pension Equity fund	1.00%	1.10%
Pru PPP fund	1.00%	1.10%
Pru Property fund	1.00%	1.10%
Pru South East Asia fund	1.00%	1.25%
Pru UK Income fund	1.00%	1.20%

➤ Prudential range of pension funds (ex M&G)

Pru Cash fund	Fund manager review
<p>Investment strategy</p> <p>The investment strategy of the fund is to provide a return consistent with investing in interest bearing deposits and/or short-term UK government bonds.</p>	<p>The fund is invested wholly in short-term cash deposits and is therefore dependent on the London Interbank Offered Rate (LIBOR), the rate of interest that banks charge to lend money to each other. The Bank of England (BoE) has kept interest rates at an historic low of 0.5% since March 2009. This meant that, although LIBOR increased during the review period, the rate of interest available on cash deposits was still very modest.</p> <p>While inflation – as measured by the Consumer Price Index (CPI) – remains stubbornly above the BoE's target of 2%, price levels are expected to fall back in the medium term due to the lacklustre economic environment. According to figures from the Office for National Statistics (ONS), the UK economy grew by 0.5% in the third quarter of 2011, in line with expectations. The ONS acknowledged that underlying growth remained weak. This uncertain picture was confirmed by the Bank of England which during the same week stated that prospects for the UK economy had worsened and suggested that growth would not exceed 1% in either 2011 or 2012. Against this backdrop of subdued economic activity, interest rates are expected to remain low for some. When the BoE does begin to raise interest rates, returns for the fund should improve.</p>
<p>Investment strategy</p> <p>The investment strategy of the fund is to purchase units in the Prudential Unit Trust Limited UK Growth Qualified Investor Scheme Fund. That fund aims to achieve capital growth over the longer term from a range of mostly UK investments (up to 20% of the property of the Scheme may be invested overseas) including both equities and fixed interest securities. The Scheme's portfolio is broadly based and well balanced with a significant part invested in the shares of 'blue chip' companies.</p>	<p>The period under review proved to be an incredibly difficult time for stockmarket investors with fears over a potential nuclear disaster in Japan, the eurozone crisis and a slowing global economy causing concern. In this environment, risk appetite was extremely fragile and those sectors with the greatest exposure to the economic cycle, such as industrials and commodity-related industries, generally fared worst. For instance, mining and industrial metals companies lagged behind the overall market during the review period. Banks were also out of favour with investors, who were concerned about their potential exposure to the government debt of some European countries. Meanwhile, nervous investors turned their attention to 'defensive' industries that are generally more stable, regardless of the economy. For example, sectors that appealed to investors included tobacco, food producers, utilities and pharmaceuticals.</p> <p>The performance of the underlying fund was held back by the poor performance of a number of mining stocks, including First Quantum Minerals, Xstrata, Ferrexpo and Rio Tinto. More positively for Prudential UK Growth Trust, a holding in Shire Pharmaceuticals supported performance. The company raised its full-year sales forecast on the back of higher-than-expected revenue from its attention-deficit product Adderall XR and drugs for rare diseases. Shire also appealed to investors because of the defensive nature of its business. Meanwhile, food wholesaler Booker was rewarded by investors for its solid financial results.</p> <p>Investors have been shaken by the stockmarket turbulence of the past six months, while the UK economy continues to face serious challenges. Activity is lacklustre and unemployment levels remain high. Nevertheless, many companies are producing good results and increasing their dividend payments. Large UK companies often have a significant international presence, putting them in a favourable position to take advantage of robust demand from many developing countries such as China, India and Brazil. For these reasons, we are encouraged by prospects for UK company shares over the longer term, although stockmarket volatility is likely to continue in the immediate future.</p>

Pru European fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G European Fund. That fund aims to achieve long term capital growth by investing wholly or predominantly in a diversified portfolio of securities of European (excluding United Kingdom) issuers.

Fund manager review

Concerns over the global economy and the debt crisis in the eurozone meant that investors avoided riskier assets during the review period. As a result, European stocks declined considerably.

The fund was ahead of its comparative index, helped by holdings in consumer-related businesses, such as German luxury clothing retailer Hugo Boss and sportswear maker Adidas. Hugo Boss benefited from its ongoing expansion to Asia where the company boasts a well-recognised brand. A number of the portfolio's more defensive stocks also added value. For example, Anglo-Dutch food and household goods manufacturer Unilever and Swiss drugmaker Roche held up well.

Underlying fund managers Greg Aldridge and Charles Anniss took over the fund in January 2011 and have since introduced a fresh approach to managing the portfolio. Their investment philosophy rests on identifying growth companies with world-class scarce assets that are not easily replicable. By virtue of these assets, the firms can compete effectively on the world stage and generate sustainable returns.

The fund managers recently invested in German jet engine component maker MTU Aero Engines and Finnish sports equipment company Amer. Greg and Charles believe that MTU is well-placed in its field thanks to its good technological capabilities, which have led to a strong positioning in a variety of new engine programmes. Meanwhile, Amer's new management should be able to use the company's impressive brand portfolio, which includes Salomon and Wilson, to its benefit and thereby increase returns.

While Greg and Charles expect stockmarkets to remain volatile in the near term, they believe that a diversified portfolio containing high quality companies with strong growth potential should enable the fund to provide attractive performance for investors over a long-term horizon.

Pru International fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G Global Growth Fund. That fund aims to maximise long-term total return (the combination of capital growth and income) by investing mainly in a wide range of global equities. The fund will invest globally (including in the UK) in the equities of companies across a wide range of geographies, sectors and market capitalisations.

Fund manager review

During a highly challenging period for the world's major stockmarkets, a wide range of holdings suffered as investors fled anything they considered risky. In the portfolio, firms benefiting from sustained demand for their products in both developed and emerging markets held up relatively well. This included companies like dental care products manufacturer Colgate-Palmolive and clothing retailer VF, both listed in the US. Conversely, French nickel miner Eramet was hit by falling commodity prices as fears grew that a new recession could dampen future demand for raw materials.

Underlying fund manager Greg Aldridge looks for more than just higher sales or economic growth when assessing suitable investment opportunities for the fund. He seeks out quality businesses generating sustainably high returns with a decent track record of sensible reinvestment. In Greg's opinion, if a company does not have access to a scarce resource, then it will struggle to grow. This can be tangible, like a mine or inventory, or intangible, such as a particular technology, a great brand, or the right culture.

Newcomer to the portfolio Google is a good example of the kind of business that Greg favours. The US company already generates significant revenues through its position as the world's leading internet search engine provider. However, Greg believes that Google can expand its presence beyond the UK and US, its core markets, while also profitably developing operating systems, browsers and applications, used primarily in mobile phones.

By investing in companies like Google, with rare or unique strengths or assets that are difficult for potential rivals to replicate, Greg believes that the fund will be able to produce a competitive return to its investors over the longer term and in varying market conditions.

Pru Japan fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G Japan Fund. That fund aims to achieve long-term capital growth by investing in a wide range of securities of Japanese issuers, covering most aspects of the economy. Income is not a consideration when investments are selected.

Fund manager review

During the review period, Japanese equities performed relatively well, recovering from the depressed levels reached in the immediate aftermath of the earthquake and tsunami in March. On the domestic front, economic data, including industrial production figures, surprised on the upside but this was partly offset by negative global newsflow about lacklustre growth in the US and the ongoing eurozone debt crisis.

The fund's performance was helped by its holdings in domestically focused companies which benefited from improved expectations for Japan's economy. Shares in KDDI rebounded from low valuations after the telecommunications business released strong full-year results achieved partly on the back of new smartphone packages. A holding in specialised information services provider Sumisho Computer Systems also added value as investors welcomed the company's takeover of rival IT business CSK, which is expected to result in a bigger customer base.

Conversely, the portfolio's stake in motorcycle maker Yamaha Motor was harmful, as investors sold companies exposed to the global economic cycle. Underlying fund manager Dean Cashman believes that this underperformance is temporary and he continues to support Yamaha Motor as its shares remain attractively priced.

In Dean's view, Japan currently offers compelling opportunities for investors looking for appealingly valued stocks that are trading well below fair value compared with their longer term earnings potential. In this environment, Dean initiated a position in Ricoh, a manufacturer of multifunction printers and copier machines. Ricoh is undergoing a substantial restructuring process, which should be positive for the company's performance over time. Dean took advantage of the weakness in the share price, which is close to historical lows, to build the position at a compelling valuation.

Pru M&G American fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G American Fund. That fund aims to achieve long-term capital growth through investment wholly or mainly in securities of North American (including Canadian) issuers. When not wholly invested as above, it may only invest in companies which are listed, registered or trading within North America.

Fund manager review

Investors were anxious about prospects for economic growth over the six months, avoiding company shares in general. Where they did venture into the stockmarket, they chose to invest in higher quality companies, which they believed would deliver solid earnings in the short term.

In this environment, investors shunned some of the fund's 'internal change' holdings and this was a significant negative factor. These are typically lower quality companies undergoing restructuring measures and there is usually less certainty regarding their future earnings. However, their quality generally improves with time because of the positive steps their management teams are taking.

Underlying fund manager Aled Smith remains confident about the longer term prospects for many of these internal change holdings. However, he is mindful of the current challenging economic circumstances and he has reduced the size of the holdings while investors remain wary.

When times are tough, investors often turn to stocks in areas like consumer staples and healthcare. These 'defensive' types of industries tend to be relatively stable, regardless of the overall economic picture. This is why many of the good quality defensive stocks in the portfolio supported performance during the past six months. Examples include household names like food producer Kellogg and soft drinks company Coca-Cola.

The situation is unsettled for investors in company shares and there may well be further downturns in the short term. Aled therefore increased the fund's exposure to good quality businesses in the spring, namely food giant Heinz and diversified healthcare company UnitedHealth. As a result, he feels the fund is sufficiently resilient to withstand difficult market conditions. Importantly, this is balanced against the fund's holdings in companies undergoing change that he feels should do well when the environment does improve.

Pru M&G Corporate Bond fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G Corporate Bond Fund. That fund aims to achieve a higher total return (the combination of income and growth of capital) from investment than would be obtainable in UK government fixed interest securities (ie gilts) of similar maturities. The fund invests mainly in sterling denominated corporate debt instruments. Any currency exposures within the fund may be managed by currency hedges into sterling.

Fund manager review

The six months under review was a very favourable period for higher rated fixed income assets as investors' risk aversion increased considerably on the back of negative economic news. Figures showed that the global economy might enter another recession while European policymakers failed to adequately address the debt crisis afflicting the eurozone. Against this background, investors preferred assets that they perceived to be safer.

In this environment, the fund's significant outperformance of its comparative sector was driven by its large weighting in higher rated corporate bonds from stable non-financial companies, such as UK retailer Tesco and US telecommunications group AT&T. Underlying fund manager Richard Woolnough's decision to increase the fund's weighting in good quality government bonds from the UK, the US and Germany also turned out to be well-timed as these assets benefited from their 'safe haven' status.

In addition, the portfolio's small weighting in bank bonds was beneficial. Richard remains wary of many bank bonds partly due to the ongoing problems in the weaker eurozone economies and the large exposure that some financial institutions have to debt from these countries. He believes that any potential restructuring of eurozone government debt could have severe implications for a number of fragile banks. During the review period, Richard further reduced the fund's holdings within the banking sector.

Richard maintains a relatively pessimistic view on the UK economy and believes that interest rates will remain low for some time. However, many companies have cut costs and reduced their debts, leaving them in better financial health than before the crisis of 2008. In Richard's opinion, this positive development is not fully reflected in the corporate bond market where valuations are pricing in a relatively high level of company defaults. He therefore remains supportive of corporate bonds.

Pru M&G Gilt & Fixed Interest Income fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G Gilt & Fixed Interest Income Fund. That fund aims to provide a secure income with stability of capital consistent with investment in gilts. The fund invests mainly in short, medium or long-dated gilts according to M&G's view at any given moment of the likely course of interest rates and trend of the gilt-edged market.

Fund manager review

UK government bonds (gilts) rallied during the review period, benefiting from the ongoing low interest rate environment and investors' preference for assets that they perceived to be safe. The increased risk aversion was driven by heightened fears over a government debt default in the eurozone and tepid economic data from the US, the UK and Europe. As a result, gilt prices rose and their yields (prospective rate of return) fell considerably over the six months.

The fund performed strongly but it was slightly behind its comparable sector. Performance was hurt by the fund's relative short duration positioning. Duration measures the portfolio's sensitivity to yield changes and long-dated bonds tend to benefit the most from falling yields. Therefore, the portfolio's comparatively small exposure to the longest-dated bonds hampered performance somewhat.

Underlying fund manager Jim Leaviss believes that the environment for investors will remain volatile due to the current economic uncertainty and higher inflation. On the one hand, the UK economy has barely grown this year, the unemployment remains high and the housing market continues to show weakness. On the other hand, inflation is still relatively high, caused by the rise in fuel and food prices and an increase in value added tax (VAT) in January.

Jim maintains the view that inflation should moderate in 2012 as the effects of higher taxes and energy prices taper off. In light of the ongoing volatility, Jim continues to prefer 'safe haven' assets when looking for further value in the portfolio. At the end of the review period, more than 90% of the portfolio was invested in gilts and German government bonds, with the remainder held in government-guaranteed bonds issued by a range of good quality UK companies.

Pru M&G Global Basics fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G Global Basics Fund. That fund aims to achieve long-term capital growth. The fund is a global equity fund which invests wholly or mainly in companies operating in basic industries ("primary" and "secondary" industries) and also in companies that service these industries. The fund may also invest in other global equities.

Fund manager review

Underlying fund manager Graham French takes a clear and transparent approach when selecting companies for the fund. He invests in quality businesses that are supplying the raw materials, goods and services that are increasingly in demand in a developing and industrialising world. These can range from basic needs, such as energy, food and shelter, to the branded goods and lifestyle products that people in places like China, India and elsewhere increasingly want to own as their economic situation improves.

It was the fund's exposure to good quality, highly cash-generative consumer staples producers and defensive services businesses that helped it to show relative resilience in the testing stockmarket conditions which prevailed during much of the review period. Companies like US toothpaste manufacturer Colgate-Palmolive and global security company G4S benefited from consistent demand for their goods and services.

However, things were much more challenging in the raw materials sector, where investors feared that the debt crisis in Europe and the US might push the world economy back into recession. In this climate, few commodity producers were able to perform well. One exception was Australian mineral sands miner Iluka Resources, which was able to raise its prices thanks to growing demand for its products, used primarily in the manufacture of ceramics and paint, at a time when supplies are limited.

In spite of a cautious shorter-term outlook, Graham strongly believes that his philosophy for the fund is as true today as it was a decade ago. In his opinion, by investing with conviction in the right western companies producing the goods and services that are needed across Asia, Africa and Latin America, the fund can produce attractive returns for its investors over the long term and across a range of market environments.

Pru M&G Global Leaders fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G Global Leaders Fund. That fund aims to maximise long-term total return (the combination of income and growth of capital) by investing in a wide range of global equities that the fund manager considers to be leading in their field.

Fund manager review

The six months under review was a turbulent time for global equities as investors became more risk-averse following negative economic developments. Above all, concerns over the health of the US economy and the ability of the weaker European countries to repay their government debt led to considerable volatility in the stockmarkets.

In this uncertain environment, the fund underperformed the comparable index. During the market turmoil, investors preferred higher quality, 'safer' companies at the expense of riskier, lower quality stocks. Consequently, underlying fund manager Aled Smith's focus on improving, but lower returning businesses was disadvantageous.

Stakes in Canadian oil explorer Talisman Energy and Swiss asset manager GAM disappointed in particular. Talisman's earnings were partly hurt by the UK government's decision to hike taxes on oil production in the North Sea while GAM suffered due to downbeat sentiment towards the financial industry in general. Aled believes that Talisman's renewed focus on its valuable shale gas resources should generate higher returns in the long run. Similarly, Aled continues to back GAM as the company is transforming into a diversified asset manager with a number of attractive products.

While remaining supportive of the above stocks, Aled has been rebalancing risk in the portfolio by closing holdings in businesses where, in his view, the increased risk to earnings was no longer reflected in their valuations. Examples of this were US information technology group Hewlett-Packard and Korean electronics maker Samsung, which both left the portfolio.

Conversely, Aled re-assessed the fund's more defensive holdings and started new positions in Swiss drugmaker Novartis and its French competitor Sanofi. Aled believes that shifting the portfolio towards higher quality stocks should help protect the fund against market volatility, which he expects to continue in the near term.

Pru M&G High Yield Corporate Bond fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G High Yield Corporate Bond Fund. That fund aims to maximise total return (the combination of income and growth of capital) while generating a high level of income. The fund invests predominantly in higher yielding corporate debt instruments which may be denominated in sterling, European currencies and other major global currencies, should the investment managers deem them to be appropriate investments.

Fund manager review

High yield corporate bonds are loans issued by companies that pay relatively high rates of interest to compensate investors for the risk that they might be unable to repay the money borrowed, or 'default'.

Conditions were favourable for high yield corporate bonds at the start of the review period. Many investors were attracted by the additional income offered by the asset class at a time when the return on cash and government bond investments was very low. However, growing fears about the health of the global economy prompted investors to sell high yield bonds as the period progressed.

Things came to a head in August, when the high yield sector endured its worst monthly performance since October 2008, with losses most pronounced at the lower quality end of the spectrum. Fears that the global economy might be slipping back into recession were reinforced after the US had its credit rating downgraded and signs emerged that the government debt crisis in the eurozone was spreading.

In this climate, underlying fund manager Stefan Isaacs's preference for better quality high yield bonds added some stability. The portfolio's small weighting in bonds issued by banks was beneficial as well. Stefan has been wary about the potential exposure that some financial institutions have to government debt issued by peripheral eurozone countries.

Despite the economic uncertainty, Stefan believes that many high yield bonds offer good value, with investors being very well paid for holding the asset class. In his opinion, even bonds issued by good quality companies have been heavily sold and are now very attractively priced. Furthermore, given how difficult it can be for businesses to secure lending from banks at present, Stefan expects to see a number of interesting investment opportunities to emerge over the short term.

Pru M&G Recovery fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G Recovery Fund. That fund aims to achieve capital growth by investing predominantly in a diversified range of securities issued by companies which are out of favour, in difficulty or whose future prospects are not fully recognised by the market.

Fund manager review

Anxious about the eurozone crisis and the economy, investors have indiscriminately avoided those companies most exposed to these issues over the past six months. This has been the case for serviced office provider Regus, one of the biggest holdings in the fund, whose shares lost value during the review period.

Underlying fund manager Tom Dobell is no stranger to ups and downs in company share prices since many of the firms he invests in have been or still are 'unloved' businesses that have suffered their fair share of problems. He believes that Regus is continuing to recover well and has the potential to create shareholder value over the medium to long term.

Tom's patience and willingness to invest in a company for as long as it takes until the value of that business is recognised by investors is demonstrated by oil and gas exploration group Tullow Oil. Held in the portfolio for more than a decade, Tullow fared well during the review period and has generally been a consistent performer since 2000. On the other hand, Tom has been concerned about the UK banking sector for a long time and the fund has relatively little money in financials. This positioning served the fund well during the six months.

While Tom is not concerned with economic matters beyond his control, he focuses instead on the increasing international nature of many UK businesses. He is encouraged by the fact that many UK companies derive a growing portion of their earnings overseas and are therefore not as sensitive to the local economy as they once were. Tom will continue to do what he has done well throughout his 11 years as fund manager of the fund; invest in companies that he believes have something special which can – with support – turn themselves around and create value for their shareholders.

Pru M&G UK Growth fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G UK Growth Fund. That fund aims to achieve capital growth by investing principally in the equities of UK companies with high growth potential.

Fund manager review

In common with the world's other stockmarkets, UK shares suffered major falls in August 2011. Investor sentiment was badly affected by surprisingly poor economic data in the UK and elsewhere, a perceived reduction in the credit quality of the US government and the inability of Europe's politicians to solve their debt problems.

During this time, underlying fund manager Garfield Kiff followed his proven strategy of selecting companies that should be able to improve their earnings consistently over the medium to long term. He bases his decisions on rigorous analysis and regular meetings with the management of the companies he invests in.

As investors sold the shares of companies that depend on growing economic activity, the fund's holdings of 'defensive' businesses, whose earnings are less reliant on increasing commercial activity, were beneficial. Among the best performers were drug developer GlaxoSmithKline and cigarette maker BAT. However, stakes in recruitment companies Hays and SThree suffered on concern that temporary and permanent staff appointments might be in short supply.

As well as identifying firms that should perform well, Garfield also aims to ensure that the portfolio is not exposed to groups that might be vulnerable to falling profits. For example, he has been cautious on the prospects for the banking sector for some time. This stance proved beneficial when growing concerns about fading economic activity and potential losses from holdings of European government bonds caused further weakness in banks' share prices. Having little exposure to Barclays (a stake that was subsequently reduced to zero) and no exposure to Lloyds Banking or Royal Bank of Scotland proved valuable.

Pru M&G UK Select fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G UK Select Fund. That fund aims to maximise total return (the combination of income and growth of capital) by investing in a range of UK equities.

Fund manager review

In common with the world's other stockmarkets, UK shares suffered major falls in August 2011. Investor sentiment was badly affected by surprisingly poor economic data in the UK and elsewhere, a perceived reduction in the credit quality of the US government and the inability of Europe's politicians to solve their debt problems.

During this time, the fund manager followed the proven strategy of selecting companies that should be able to improve their earnings consistently over the medium to long term. He bases his decisions on rigorous analysis and regular meetings with the management of the companies he invests in.

As investors sold the shares of companies that depend on growing economic activity, the fund's holdings of 'defensive' businesses, whose earnings are less reliant on increasing commercial activity, were beneficial. Among the best performers were cigarette maker Imperial Tobacco and drug developer GlaxoSmithKline. However, stakes in miners Anglo American and Rio Tinto suffered on concern that demand for metals might fall.

As well as identifying firms that should perform well, underlying fund manager Mike Felton also aims to ensure that the portfolio is not exposed to groups that might be vulnerable to falling profits. For example, he has been cautious on the prospects for the banking sector for some time. This stance proved beneficial when growing concerns about fading economic activity and potential losses from holdings of European government debt caused further weakness in banks' share prices. Having little exposure to Barclays (a stake that was subsequently reduced to zero) and no exposure to Lloyds Banking or Royal Bank of Scotland proved valuable.

Pru Managed fund

Investment strategy

The investment strategy of the fund is to achieve steady capital growth through a broadly based investment portfolio, the emphasis being on UK equities but also including exposure to fixed interest securities.

Investments may be held either directly or through other M&G Pension Funds or authorised Collective Investment Schemes.

Fund manager review

The period under review proved to be an incredibly difficult time for stockmarket investors with fears over a potential nuclear disaster in Japan, the eurozone crisis and a slowing global economy causing great concern. In this environment, risk appetite was extremely fragile and those sectors with the greatest exposure to the economic cycle, such as industrials and commodity-related industries, generally fared worst. Banks were also out of favour with investors, who were concerned about their potential exposure to the government debt of some European countries. Meanwhile, nervous investors turned their attention to 'defensive' industries that are generally more stable, regardless of economic circumstances. For example, sectors that appealed included tobacco, food producers, utilities and pharmaceuticals.

The portfolio's relatively large weighting in global equities had a negative effect on performance during the review period. Exposure to European equities via a holding in the M&G European Fund was particularly detrimental as investors significantly reduced their stakes in the region's stockmarket amid concerns over the eurozone crisis. The sharp decline in investor sentiment also meant that Asian equities struggled and a holding in the M&G Asian Fund consequently had a negative effect on returns. A holding in the Prudential UK Growth Trust, which invests in UK equities, also detracted value. The performance of this fund was held back by the poor performance of a number of mining stocks, including First Quantum Minerals, Xstrata, Ferrexpo and Rio Tinto.

Meanwhile, the fund's bond portion – which comprises exposure to good quality international government bonds via the M&G International Sovereign Bond Fund – contributed positively to performance. Good quality government bonds benefited from their 'safe haven' status during the review period with yields falling to record lows as tensions over the eurozone crisis mounted. Investors remain extremely cautious since the debt problems in Europe have yet to be resolved and the outlook for the economy is still unclear. We believe that holding a diversified portfolio of liquid assets should help to reduce risk by ensuring investments are spread across a wide range of asset types and geographic regions.

Pru Managed Income fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G Managed Fund. That fund aims to maximise total return (the combination of income and growth of capital) by investing mainly in securities, fixed income assets, warrants, money market instruments, deposits, cash, near cash and property mainly via collective investment schemes, but, with the exception of property, may invest directly in these assets.

Fund manager review

Investors were preoccupied by a number of concerns over the six months, ranging from prospects for the global economy to the worryingly high levels of government debt of some eurozone countries. In this uncertain environment, nervous investors generally avoided company shares, or equities, as these tend to be seen as a relatively high risk investment. Instead, they sought out bonds issued by stable governments, which they perceive to be a safer place for their money in troubled times.

As sentiment was negative for much of the six months, the fund's performance was inevitably hurt by its equity holdings. However, no more than 85% of the fund can be invested in equities, as set out in the IMA Balanced Sector restrictions, while its comparative index, the FTSE World Index, only represents equities. Therefore, during periods when stockmarkets are falling, as was the case over the six months under review, the fund is protected to an extent from these declines.

In addition to equities, the portfolio holds government bonds, corporate bonds – namely bonds issued by companies – and property. This diversification means that the effect of weakness in individual areas may be reduced because of healthier performances elsewhere in the portfolio. For example, the fund's presence in good quality government bonds supported performance during the review period.

Although there are undoubtedly risks to global economic growth, such as high unemployment in various countries and significant debt levels across the west, companies' financial results have been broadly positive. Underlying fund managers Juan Nevado and Jenny Rodgers believe that selected stockmarkets offer good value for investors over the long term, with UK and Asian equities proving particularly attractive. However, as has been seen in recent months, the potential for short-term upsets remains clear.

Pru Personal Pension Equity fund

Investment strategy

The investment strategy of the fund is to achieve long-term capital growth (the combination of income and growth of capital) by investing mainly in UK and International companies, predominantly through collectives managed by Prudential Group companies.

Fund manager review

The period under review proved to be an incredibly difficult time for stockmarket investors with fears over a potential nuclear disaster in Japan, the eurozone crisis and a slowing global economy causing great concern. In this environment, risk appetite was extremely fragile and those sectors with the greatest exposure to the economic cycle, such as industrials and commodity-related industries, generally fared worst. For instance, mining and industrial metals companies lagged behind the overall market during the review period. Banks were also out of favour with investors, who were concerned about their potential exposure to the government debt of some European countries. Meanwhile, nervous investors turned their attention to 'defensive' industries that are generally more stable, regardless of the economy. For example, sectors that appealed to investors included tobacco, food producers, utilities and pharmaceuticals.

The performance of the Prudential UK Growth Trust was held back by the poor performance of a number of mining stocks, including First Quantum Minerals, Xstrata, Ferrexpo and Rio Tinto. More positively for Prudential UK Growth Trust, a holding in Shire Pharmaceuticals supported performance. The company raised its full-year sales forecast on the back of higher-than-expected revenue from its attention-deficit product Adderall XR and drugs for rare diseases. Shire also appealed to investors because of the defensive nature of its business. Meanwhile, food wholesaler Booker was rewarded by investors for its solid financial results.

Investors have been shaken by the stockmarket turbulence of the past six months, while the UK economy continues to face serious challenges. Activity is lacklustre and unemployment levels remain high. Nevertheless, many companies are producing good results and increasing their dividend payments. Large UK companies often have a significant international presence, putting them in a favourable position to take advantage of robust demand from many developing countries such as China, India and Brazil. For these reasons, we are encouraged by prospects for UK company shares over the longer term, although stockmarket volatility is likely to continue in the immediate future.

Pru PPP fund

Investment strategy

The investment strategy of the fund is to achieve long-term capital growth (the combination of income and growth of capital) by investing mainly in UK and International companies, predominantly through collectives managed by Prudential Group companies.

Fund manager review

The period under review proved to be an incredibly difficult time for stockmarket investors with fears over a potential nuclear disaster in Japan, the eurozone crisis and a slowing global economy causing great concern. In this environment, risk appetite was extremely fragile and those sectors with the greatest exposure to the economic cycle, such as industrials and commodity-related industries, generally fared worst. For instance, mining and industrial metals companies lagged behind the overall market during the review period. Banks were also out of favour with investors, who were concerned about their potential exposure to the government debt of some European countries. Meanwhile, nervous investors turned their attention to 'defensive' industries that are generally more stable, regardless of the economy. For example, sectors that appealed to investors included tobacco, food producers, utilities and pharmaceuticals.

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<p>Pru Property fund</p>	<p>Fund manager review</p>
<p>Investment strategy</p> <p>The investment strategy of the fund is to purchase units in the M&G Property Portfolio. That portfolio aims to maximise long-term total return (the combination of income and growth of capital) through investment in commercial property. The portfolio invests in a diversified portfolio of property mainly in the UK and may also invest in other property related assets, including collective investment schemes, securities, derivatives and debt instruments, as well as government debt, money market instruments and cash.</p>	<p>The fund manager completed the acquisition of several assets over this period. Among these was a large supermarket in Dover, Kent, which is let to Tesco on a long lease, and comes with the added security of inflation-linked rent reviews. Another acquisition was a sizeable retail warehouse, let on a long lease to a national retailer in Sheffield, Yorkshire. These assets should provide a large and stable source of rental income over the long term.</p> <p>Optimisation of the fund's properties through active asset management is a key strategy in our management of commercial property, to enhance the performance of the portfolio. Successes in this area include the completion of a 10-year lease extension with an existing tenant at a large retail park in Berkshire. The new lease, which will expire in 2024, was agreed in return for a short, rent-free period, plus some refurbishment costs. Furthermore, it should help to maintain the value and lengthen the average unexpired lease term of the park.</p> <p>While yields on the best quality properties remain stable at levels the fund manager considers to be sustainable, weaker assets are still vulnerable to further capital erosion. Due to the current level of economic uncertainty, the outlook for short-term rental growth is muted. However, rents have been picking up in specific prime locations, such as Central London, where there is limited available space. Furthermore, a shortage of new properties and a lack of available financing for development work should be beneficial for rental values over the medium term as and when the economic cycle turns more positive.</p> <p>The fund provides investors with the benefit of a differentiated portfolio and access to market sectors which are difficult to hold directly. We believe that the fund is defensively positioned for the challenging economic climate due to its focus on prime and good secondary assets, an exceptionally low vacancy rate, long leases and good quality tenants.</p>
<p>Pru South East Asia fund</p>	<p>Fund manager review</p>
<p>Investment strategy</p> <p>The investment strategy of the fund is to purchase units in the M&G Asian Fund. That fund's sole aim is long-term capital growth. It invests wholly or mainly in a range of Asian (including Australasian) securities. When not wholly invested as above, the fund may also invest in global securities with the exception of Japanese securities.</p>	<p>As investors became increasingly worried that the world's economy was slowing and developed countries struggled to solve their debt problems, global stockmarkets experienced major falls. These were particularly acute in August 2011. In Asia, South Korea and China suffered the most during the six months under review while some smaller countries, such as Indonesia and the Philippines, proved more resilient.</p> <p>Against this volatile background, underlying fund managers Matthew Vaight and Michael Godfrey maintain their view that investment is a long-term process and that recent large moves in share prices provide buying opportunities for long-term investors. In their opinion, improvements in the way Asian companies are run should boost earnings and benefit shareholders over the coming years.</p> <p>Among the best performers in the portfolio were two mobile telecommunications providers, Idea Cellular in India and China Unicom, whose returns are improving thanks to astute management decisions. Both businesses delivered solid gains for the fund during the review period as they benefited from efficient investment over recent years and consequent technological advances. Idea and China Unicom have expanded their third generation (3G) mobile phone coverage in an effort to attract more subscribers and improve profitability.</p> <p>From a negative perspective, two holdings in Australia – sportswear manufacturer Billabong International and steelmaker Bluescope Steel – suffered from the strength of the Australian dollar, which makes exporting their products more difficult. The businesses are also exposed to weakness in the global economy. Matthew and Michael are encouraged that the companies' management teams are taking sensible steps to reduce their reliance on exports and are confident that the positions will prove valuable over the long term.</p>

Pru UK Income fund

Investment strategy

The investment strategy of the fund is to purchase units in the M&G Extra Income Fund. That fund aims to achieve a high income stream which also increases over time, by investing mainly in a range of UK equities. The target yield is 50% higher than that of the FTSE All-Share Index but this may vary in the shorter term.

Fund manager review

Over a volatile six-month review period, the fund's bond investments (which comprised debt issued by governments and companies) proved a source of stability and positive return. Slightly more than three quarters of the portfolio is invested in UK shares, the majority of which fell in value over the six months along with other global equity markets.

In the circumstances, investors opted for the relative safety of better quality bond investments which meant that this asset delivered healthy returns for the fund. Although share prices fell, the fund benefited from its focus on higher dividend-paying stocks issued by healthcare providers, telecommunications firms, as well as tobacco and utility companies. These businesses tend to be less affected by swings in economic activity.

Being less exposed to lower dividend-paying companies in the mining and banking sectors also assisted performance, as their performance was highly volatile over the period.

Given the fund's high income objective, much of the trading activity was carried out with income as a primary consideration, and although the stockmarket setback posed many challenges, it presented pockets of buying opportunities too. Accordingly, of note among the new positions established during the period were fund management group Henderson, South African life assurer Old Mutual and software consultancy Logica.

Dividend growth proved to be resilient, apart from BP, which had a negative impact. Overall, the distribution was little changed from the previous year.

Within the fixed income segment of the fund, the focus was on adding to the portfolio's exposure to UK government bonds in view of their strength in the uncertain economic and stockmarket conditions.

› Further information

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