

Prudential Cautious Managed Growth Fund

A sub-fund of Prudential Investment Funds (1)
Annual short report for the year ended 31 October 2009



Authorised Corporate Director's report

Investment objective of the Prudential Cautious Managed Growth Fund

The Fund's objective is to deliver long-term total return (the combination of income and growth of capital).

Policy for achieving the objective of the Prudential Cautious Managed Growth 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 60% of the portfolio in equities.

Risk profile

The Fund may invest in a number of different asset types in various proportions. The risks associated with each asset type are shown below.

Derivatives

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 Investment 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.

Fixed Interest Securities

The value of the fixed interest securities held will fall in the event of a default or perceived increased credit risk of an issuer.

Yields of 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.

Property

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 holdings 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.

Investment activities over the report period

During the 12 months under review, the Prudential Cautious Managed Growth Fund's total return (capital performance with net income reinvested) was 26.8%*. This was well ahead of the average total return of 17.3%* in the fund's peer group, the IMA Cautious Managed sector.

The fund achieved a healthy profit for investors, despite the extraordinary level of volatility over the past 12 months. The defensive characteristics of the portfolio helped it to outperform its peer group during the first half of the review period, while the re-emergence of investors' appetite for risk from March 2009 onwards was also beneficial. The weakness of the British pound against the US dollar and the euro over the review period also enhanced returns to sterling-based investors.

Financial markets were in disarray near the end of 2008, following the collapse of US investment bank Lehman Brothers in September. Equity valuations were under intense pressure as investors reacted with extreme risk aversion, opting for assets they considered more secure, such as government bonds.

It took a massive intervention by policymakers worldwide from March 2009 onwards to boost investors' hopes of a rapid end to the downturn. Record low interest rates in the UK, US and the eurozone and the implementation of quantitative easing (the purchase of government and corporate bonds to increase the availability of money and lower the cost of lending) helped to transform market conditions. Moreover, the spectre of inflation did not appear, belying concerns about the amount of money being pumped into the economy.

Against such a volatile backdrop, the majority of the fund's gains came from the portfolio of equity holdings. Although performance was initially disappointing, having a significant exposure to equities was beneficial during the rally from March onwards. A holding in the Prudential European Trust, the second largest position in the fund, was beneficial, while in the UK, the M&G Recovery Fund did particularly well against its peer group, the IMA UK All Companies sector. Similarly, a small holding in Prudential Pacific Markets Trust rose in value, fuelled by the very strong performance of equities in the region.

The performance of the M&G European Corporate Bond Fund and the Prudential Corporate Bond Trust also provided excellent returns for the fund. By increasing the portfolio's exposure to investment grade corporate bonds throughout the review period, the fund manager was able to take advantage of a revival in investors' interest in company debt during the second half of the review period.

A small exposure to government bonds gave a modest positive return near the end of 2008, helped by investors' preference for lower-risk assets to shelter against stockmarket volatility. Indeed, conditions were ideal for government bonds at the time. Low interest rates and subsiding inflation on the back of slowing economic growth saw prices for government bonds increase and yields fall across all maturities. The scale of the rally was such that the fund manager temporarily closed the portfolio's holdings in the asset class at the start of 2009.

Overall, there was little that disappointed during the review period, although the remaining investment in UK commercial property had a negative effect. Nevertheless, the fund's holding in the M&G Property Portfolio was relatively modest, which reduced the impact of the decline. On a positive note, sentiment towards the asset class has improved in recent months and the fund manager is now seeking to increase the fund's exposure to this area of the market. Commercial property should play an important role in a balanced portfolio going forward.

While equity markets still offer value, they remain sensitive to sharp swings in investor confidence and further volatility is likely. To reflect this, the fund manager has reduced the fund's exposure to equities in recent months. The positions in the Prudential European Trust and the Prudential Pacific Markets Trust were cut back, while the exposure to UK equities was trimmed.

The proceeds raised from the sales were used to initiate a position in UK government bonds, as well as adding to existing holdings in the Prudential Corporate Bond Trust and the M&G Property Portfolio. The fund manager expects the holdings in corporate bonds and government bonds to provide some stability over the coming months.

Looking ahead, the fund manager will continue to focus on areas where he believes the best risk-adjusted opportunities lie, while preventing any over-exposure to any single asset class.

Investors have responded positively to government intervention and improving economic and corporate news. Nonetheless, confidence is fragile and it is important to remember that a sustained and stable recovery is likely to be a slow process.

* Source: Morningstar, Inc.

Basis: Bid to bid with net income reinvested to 30 October 2009.

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 year and the previous year end are shown below.

	% of sub-fund as at 31.10.09		% of sub-fund as at 31.10.08
Prudential Corporate Bond Trust Sterling Class 'C' (Income)	19.73	Prudential European Trust Sterling Class 'C' (Income)	18.42
Prudential European Trust Sterling Class 'C' (Income)	12.10	Prudential Corporate Bond Trust Sterling Class 'C' (Income)	12.47
M&G European Corporate Bond Fund Sterling Class 'A' (Accumulation)	10.89	Prudential Pacific Markets Trust Sterling Class 'C' (Income)	9.77
M&G Property Portfolio Sterling Class 'S' (Income)	7.23	M&G Property Portfolio Sterling Class 'S' (Income)	7.64
M&G UK Growth Fund Sterling Class 'A' (Accumulation)	4.67	M&G European Corporate Bond Fund Sterling Class 'A' (Accumulation)	7.40
Treasury 5% 2025 (£)	4.67	M&G UK Growth Fund Sterling Class 'A' (Accumulation)	6.20
Prudential Japanese Trust Sterling Class 'C' (Income)	4.62	Prudential North American Trust Sterling Class 'C' (Income)	5.65
Prudential Pacific Markets Trust Sterling Class 'C' (Income)	4.15	Prudential Japanese Trust Sterling Class 'C' (Income)	5.35
Prudential North American Trust Sterling Class 'C' (Income)	3.95	iShares MSCI Emerging Markets	5.35
iShares MSCI Emerging Markets	3.89	Prudential Equity Income Trust Sterling Class 'C' (Income)	4.89

Classification of investments

The table below shows the percentage holding per sector.

	% of sub-fund as at 31.10.09	% of sub-fund as at 31.10.08
Equity portfolios	37.29	56.64
Continental Europe	12.10	18.42
United Kingdom	12.47	17.45
Far East	4.15	9.77
Japan	4.62	5.35
United States	3.95	5.65
Equity investment instruments	3.79	4.20
Non-equity investment instruments	3.89	5.35
Property portfolios	7.23	7.64
Bond portfolios	37.99	24.34
Bonds		
'AAA' credit rated bonds	4.67	3.60
Forward currency contracts	(0.19)	0.20

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

	Final distribution		Total Expense Ratio ^[b]	
	Inc 31.12.09 ^[a]	Acc 02.11.09 ^[a]	31.10.09	31.10.08
Sterling	p	p	%	%
Class 'A'	2.0040	2.0705	1.73	1.63
Class 'C'	2.9190	n/a	0.39	0.33

The Portfolio Turnover Rate (PTR) for the 12 months ending 31 October 2009 was 57.10% compared with 56.12% for the year ending 31 October 2008. ^[c]

^[a] The date on which the final distribution will be paid to Income shareholders and credited to Accumulation shareholders.

^[b] 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.

^[c] 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 units 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 31.10.09		Net asset value per share as at 31.10.08		Net asset value % change	
	Inc	Acc	Inc	Acc	Inc	Acc
Sterling	p	p	p	p	%	%
Class 'A'	94.18	99.38	75.70	78.21	+24.41	+27.07
Class 'C'	94.10	n/a	75.47	n/a	+24.69	n/a

Fund summary

Prices

	Calendar year	Income shares Highest	Lowest	Accumulation shares Highest	Lowest
Sterling Class 'A'	2007 ^[a]	p 104.75	p 97.39	p 104.75	p 97.39
	2008	102.46	73.16	103.28	74.28
	2009 ^[b]	98.94	72.56	102.22	74.97
Class 'C'	2007 ^[a]	105.41	97.79	n/a	n/a
	2008	102.75	73.05	n/a	n/a
	2009 ^[b]	99.74	72.68	n/a	n/a

^[a] From 16 February 2007 (the launch date of the fund) to 31 December 2007.

^[b] Up to 2 November 2009.

Income

Income per share

	Calendar year	Distributed	Reinvested
Sterling (net) Class 'A'	2007	p 0.8230	p 0.8230
	2008	1.9430	1.9585
	2009 ^[a]	2.0040	2.0705
Class 'C'	2007	1.5030	n/a
	2008	2.9650	n/a
	2009 ^[a]	2.9190	n/a

^[a] Up to final: ex-distribution date 2 November 2009;
payment date 31 December 2009.

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.

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 Cautious Managed Growth Fund, and it is unaudited.

Report and accounts

A copy of the Authorised Corporate Director's (ACD) Annual Investment Report and Financial Statements for Prudential Investment Funds (1), which incorporates all the sub-fund annual investment reports and audited financial statements is available free of charge on request from our website at www.pru.co.uk/managersreports or by calling Customer Relations on 0845 783 5500.

Other information

Mr Trevor Cheal was appointed as a Director of Prudential Unit Trusts Limited on 4 February 2009.

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