

Prudential Defensive Portfolio

A sub-fund of Prudential Investment Funds (1)

Annual short report for the year ended 31 October 2011



Authorised Corporate Director's report

Investment objective of the Prudential Defensive Portfolio

The Fund aims to achieve long-term total return (the combination of income and growth of capital) by investing mainly in collective investment schemes. No more than 30% of the Fund will be invested in schemes whose predominant exposure is to equities.

Policy for achieving the objective of the Prudential Defensive Portfolio

The Fund is an actively managed portfolio investing mainly in collective investment schemes in order to provide a well diversified exposure to global fixed income and variable rate assets, cash, near cash, equities and / or immovable property. Typically the Fund will have a high exposure to lower risk assets such as fixed income assets, cash and near cash. Scheme selection is made on the basis of in depth initial and ongoing qualitative assessment of the fund managers and quantitative analysis of the collective investment schemes.

The Fund may also invest directly in other assets including transferable securities, other collective investment schemes, cash and near cash, deposits, warrants and money market instruments. Derivative instruments may be held directly for the purposes of efficient portfolio management only.

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.

Investment activities over the report period

During the 12 months under review, the Prudential Defensive Portfolio produced a total return (capital performance with net income reinvested) of 1.0%*. This was ahead of the average total return of 0.7%* in the fund's peer group, the IMA Cautious Managed sector.

While the fund's combined equity and fixed interest holdings delivered positive returns overall, the review period offered a mixed bag of investor sentiment, volatility and risk aversion. The period began with the US Federal Reserve's plan to inject \$600 billion into the country's financial system to encourage growth, which contributed to the Dow Jones Index hitting two-year highs. The end of the 12-month period also saw European markets rallying strongly on expectations that policy initiatives would begin to provide some certainty to the continent's on-going sovereign debt crisis.

The period in between was not so clear-cut. As we moved through 2011, civil unrest across the Middle East and North Africa fuelled concerns about potential oil supply problems, and the devastating earthquake and tsunami which struck Japan on 11 March threw stockmarkets into chaos.

Going into the summer, global markets experienced a prolonged bout of risk aversion and extreme volatility, which intensified noticeably in August and again in September. Equities were sold indiscriminately across the world as investors worried about the ability of policymakers to solve the eurozone's debt problems. A reduction in global growth expectations in response to fiscal tightening in developed countries also dampened investor sentiment and appetite for riskier assets.

Given these conditions, the fund manager felt that risk assets, particularly equities, appeared attractively priced, but not inexpensive enough to justify the inherent risks in volatile markets. He reduced the portfolio's target allocation to equities from 20% to 15% in the run-up to the summer, but increased the allocation back to 21% when pricing appeared more favourable at the beginning of October.

In fluctuating markets, the exposure to global equities generally had a negative impact on the portfolio. While the First State Asia Pacific Leaders Fund and the Cazenove UK Growth and Income Fund both produced positive returns, the Henderson European Selected Opportunities Fund underperformed given difficult market conditions in Europe. Likewise, the Aberdeen Emerging Markets Fund and Fidelity South East Asia Fund both produced disappointing results.

In terms of fixed interest, the fund manager adjusted allocations broadly in line with equity holdings, increasing his target holdings from 69% to 74% of the overall portfolio through the middle of the review period, and settling back to 69% by the end. He remained very negative on government bonds throughout the review period, believing the asset class to be highly overvalued, and where possible he avoided holding them within the portfolio.

The fund manager was cautiously positive on corporate bonds, which he believed were offering much better value than their government counterparts, with credit spreads (the difference between the yield on a corporate bond and a government bond of a similar maturity) appearing attractive. He felt that there was still a good selection of well financed businesses offering shorter or medium-term bonds at attractive rates of interest, which more than compensated investors for the possibility that they might not be able to pay back their loans. Exposure to the M&G Strategic Corporate Bond Fund provided the largest boost to performance for the review period, while the Fidelity MoneyBuilder Income Fund and the Kames (formerly Aegon) Investment Grade Bond Fund both added value to the portfolio.

The fund manager closed the position in the Threadneedle American Fund in February, with the proceeds raised from the sale used to initiate a position in the M&G High Yield Corporate Bond Fund to take advantage of the higher rates of interest on offer in the high yield area of the fixed interest market. The portfolio also has exposure to the Kames High Yield Bond, which boosted performance, and the Ballie Gifford High Yield Bond, which underperformed. Overall he increased targeted exposure to high yield from 5% to 10% over the review period, subsequently reducing his targeted allocation to the M&G High Interest Fund from 19% to 14%.

The fund manager maintained his 9% target allocation to property. This was split between the M&G Property Portfolio and the Aviva Property Trust, both of which produced positive, though muted, returns over the period while providing an additional element of diversification.

The fund manager believes that, particularly concerning Europe, market risks still very much exist. Political will and strong policy decisions, including additional fiscal consolidation across the EU, will be necessary to help shore up the system, and it is unlikely to be a smooth road in the near term. As such, the fund manager believes that holding a balanced range of assets, including fixed interest, cash, equities and property, is the best way to provide a healthy risk-adjusted return for the fund's investors, without over-exposure to any single part of the market.

* Source: Morningstar, Inc.

Basis: Bid to bid with net income reinvested to 31 October 2011.

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

Classification of investments

The table below shows the percentage holding per sector.

	% of sub-fund as at	
	31.10.11	31.10.10
Equity portfolios		
Continental Europe	8.42	5.23
United Kingdom	8.30	4.80
Far East	3.05	2.69
United States	0.00	5.05
Emerging markets	2.09	1.91
Property portfolios	8.71	8.83
Bond portfolios	68.58	69.35

Major holdings

The top ten holdings at the end of this year and the previous period end are shown below. ^[a]

	% of sub-fund as at 31.10.11		% of sub-fund as at 31.10.10
M&G High Interest Fund Sterling Class 'A' (Income)	13.86	M&G High Interest Fund Sterling Class 'A' (Income)	19.23
Kames Investment Grade Bond Fund (formerly Aegon Investment Grade Bond Fund) Sterling Class 'A'	9.12	Invesco Perpetual Corporate Bond Fund	8.58
Investec Strategic Bond Fund Sterling Class 'A'	8.98	Fidelity MoneyBuilder Income Fund	8.44
M&G Strategic Corporate Bond Fund Sterling Class 'A'	8.94	M&G Strategic Corporate Bond Fund Sterling Class 'A'	8.41
Fidelity MoneyBuilder Income Fund	8.90	Old Mutual Corporate Bond Fund Sterling Class 'A'	6.77
Invesco Perpetual Corporate Bond Fund	8.64	Aegon Investment Grade Bond Fund Sterling Class 'A'	6.61
Henderson European Selected Opportunities Fund (formerly Gartmore European Selected Opportunities Fund) Retail	8.42	M&G Property Portfolio Sterling Class 'S' (Income)	6.57
Cazenove UK Growth & Income Fund Sterling Class 'B'	8.30	Investec Strategic Bond Fund Sterling Class 'A'	6.23
Aviva Investors Property Trust	4.58	Gartmore European Selected Opportunities Fund Retail	5.23
M&G Property Portfolio Sterling Class 'S' (Income)	4.13	Threadneedle American Fund Retail	5.05

[a] All holdings are in Accumulation shares / units unless otherwise stated.

Fund summary

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

Distribution dates and fund facts

Distribution type	xd	payment
Final	01.11.12	31.12.12

	Final distribution		Total Expense Ratio ^[b]	
	Inc 31.12.11 ^[a]	Acc 01.11.11 ^[a]	31.10.11	31.10.10
Sterling	p	p	%	%
Class 'A'	1.3476	1.3532	2.79	2.18
Class 'C'	2.4020	n/a	1.20	1.25

^[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.

Fund performance

Performance of share classes

	Net asset value per share as at 31.10.11		Net asset value per share as at 31.10.10		Net asset value % change	
	Inc	Acc	Inc	Acc	Inc	Acc
Sterling	p	p	p	p	%	%
Class 'A'	105.42	107.26	105.64	106.12	-0.21	+1.07
Class 'C'	105.46	n/a	105.67	n/a	-0.20	n/a

Fund summary

Prices

	Calendar year	Income shares Highest	Lowest	Accumulation shares Highest	Lowest
Sterling		p	p	p	p
Class 'A'	2010 ^[a]	107.57	98.97	107.57	98.97
	2011 ^[b]	109.39	102.73	109.90	103.21
Class 'C'	2010 ^[a]	108.44	99.04	n/a	n/a
	2011 ^[b]	110.11	103.71	n/a	n/a

^[a] From 22 January 2010 (the launch date of the sub-fund) to 31 December 2010.

^[b] To 1 November 2011.

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
Sterling (net)		p	p
Class 'A'	2010	0.4920	0.4920
	2011 ^[a]	1.3476	1.3532
Class 'C'	2010	1.3232	n/a
	2011 ^[a]	2.4020	n/a

^[a] Up to final: ex-distribution date 1 November 2011;
payment date 31 December 2011.

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 Defensive Portfolio, 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. All literature provided will be in English.

Other information

Mr Mark Thompson resigned as a Director of Prudential Unit Trusts Limited on 10 December 2010.

Mr John Warburton was appointed as a Director of Prudential Unit Trusts Limited on 28 June 2011.

Please note that, effective from 3 October 2011, State Street Bank and Trust Company has been assisting the Trustee in the performance of its function as Custodian of the Scheme Property.

The Royal Bank of Scotland (RBS), the Trustee of the trust has transferred its Trustee and Depositary Services business to National Westminster Bank, which took effect on 28 October 2011.

As Trustee, the National Westminster Bank Plc has the same duties and responsibilities as RBS and this change of Trustee will have no impact on the way the trust is operated.

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)

With effect from 28 October 2011,
National Westminster Bank Plc, Trustee & Depository Services,
The Broadstone, 50 South Gyle Crescent, Edinburgh EH12 9LD
(Authorised and regulated by the Financial Services Authority)

Independent auditors

PricewaterhouseCoopers LLP,
7 More London Riverside, London SE1 2RT

General information

If you would like further details about any aspects of your investment please contact Customer Relations, PO Box 10866, Chelmsford, Essex CM99 2BX. 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.