



MFG ASSET
MANAGEMENT

Annual Investor Report 2019

MFG Core Infrastructure Strategy

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MFG CORE INFRASTRUCTURE STRATEGY



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The Core Strategy aims to provide investors with returns that are underpinned by our conservatively defined universe of listed infrastructure assets. This approach is intended to provide investment returns that have lower correlation to risks such as commodity prices, competition and the economic cycle. This provides investors with a more defensive exposure to the asset class. The Core Strategy typically holds between 80 and 100 stocks.

PERFORMANCE

Global stocks rose in the 12 months to June 2019 after companies posted higher-than-expected earnings, the US economy expanded briskly without generating inflation, the Federal Reserve indicated it would stop, and possibly reverse, its gradual tightening of US monetary policy, and the European Central Bank said it would “use all the instruments that are in the toolbox” to help the eurozone’s weak economy. Gains were capped by concerns global growth might slow, driven by China-US tensions and rising political uncertainty in Europe.

The strategy recorded a gross return of 15.4% for the 12 months in US dollars. The stocks that performed best included the investments in American Tower (+0.9% of the total strategy return), Transurban (+0.7%), Fortis of Canada (+0.7%), TC Energy of Canada (+0.7%) and Cellnex Telecom of Spain (+0.7%).

American Tower jumped after the owner of wireless communications towers raised guidance for fiscal 2018 and reported higher-than-expected earnings and sales figures. Transurban rose when investors turned to longer-duration assets as the Reserve Bank of Australia indicated it would cut the cash rate to help Australia’s slowing economy. Fortis rose after the electricity distributor raised its dividend by 6%, boosted its five-year capital plan by about C\$3 billion, reiterated that this plan was on track and said its funding plan would include asset sales expected to reap between C\$1 billion and C\$2 billion. TC Energy, formerly TransCanada, climbed after the company that pipes oil and gas reported profit and sales above expectations. Cellnex gained on the announcement that it is purchasing 10,700

telecommunication masts in three separate deals in France, Italy and Switzerland.

The stocks that detracted the most over the 12 months were Atlantia of Italy (-1.0%), PG&E of the US (-0.8%), ADP of France (-0.7%) and Edison International of the US (-0.2%).

Atlantia declined following the collapse of a bridge in Genoa that was a tolled section of the A10 motorway that was operated under a concession contract by Autostrade per l’Italia, an 88% owned subsidiary of Atlantia. PG&E and Edison struggled on concerns the electrical utilities might be liable for starting deadly bushfires in California. ADP fell after France’s constitutional court suspended the further sale of the government’s 50.6% stake in the operator of Paris’s airports ahead of a possible referendum on any sale proposed by political parties opposing the sale.

OUTLOOK

In our view, the likely time frame and trajectory of interest-rate movements has shifted to a ‘lower for longer’ scenario where we see the balance of probabilities in the near term for rates to stay low or indeed be cut further before rising in the medium term. We have previously focused on the risks posed by a significant increase in rates and we see a risk of inflation leading to a rise in interest rates. However, the probability of this risk has reduced.

Irrespective of the macro-economic outlook, we expect the underlying earnings of infrastructure and utility companies in our conservative universe to remain reliable and predictable. Ultimately, the

Performance as at 30 June 2019¹

Performance (USD) ¹	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	7 Years (% p.a.)	10 Years (% p.a.)	Since inception (% p.a.)
MFG Core Infrastructure Strategy (Gross)	15.4	8.1	8.1	11.2	-	11.6
MFG Core Infrastructure Strategy (Net)	14.6	7.4	7.3	10.5	-	10.8

¹ Returns are for the Global Core Infrastructure Composite and denoted in USD. Performance would vary if returns were denominated in a currency other than USD. Refer to the GIPS Disclosure section for further information. Composite (Net) returns are net of fees charged to clients and have been reduced by the amount of the highest fee charged to any client employing that strategy during the period under consideration. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. Fees are available upon request.

values of the companies in our strategy reflect the future cash flows they are expected to generate, and the risks associated with those revenue flows. Even allowing for the resilient nature of the stocks held in the strategy, if interest rates rise, we would expect to see volatility in equity markets. We are confident, however, that any increase in interest rates will fail to hamper the financial performance of the stocks in the strategy.

We believe that infrastructure assets, with their reliable earnings that are protected to a degree from inflation, are an attractive, long-term investment proposition. The predictable nature of their earnings compared with those offered by other asset classes means that infrastructure assets offer diversification benefits. In uncertain times, the reliable financial performance of infrastructure stocks makes them particularly attractive. An investment in listed infrastructure can be expected to reward patient investors.

STRATEGY POSITIONING

Top-10 holdings at 30 June 2019²

Security	Weight (%)
Enbridge	3.0
Aena	3.0
TC Energy	3.0
National Grid	3.0
Transurban	2.9
Groupe ADP	2.9
Fortis	2.8
Snam	2.8
Power Assets Holdings	2.6
Terna	2.2
Total	28.2

Our investment philosophy has not changed since we launched the strategy. We seek to build a strategy of outstanding infrastructure and utility companies that deliver reliable returns through the economic cycle.

The types of assets in which the strategy invests are generally natural monopolies that provide an essential service to the community. Infrastructure assets offer investors protection against inflation because their earnings generally have some direct linkage to inflation. Over time, the stable revenue or cash-flow streams derived from infrastructure assets are expected to deliver income and capital growth for investors.

Where our strategy is different is that we apply a stricter definition to what qualifies as infrastructure. We want to limit our investment universe to stocks that provide investors with predictable, through-the-cycle, inflation-protected returns. This means that we exclude infrastructure stocks whose earnings are exposed to competition, excessive sovereign risk and changes in commodity prices.

A key feature of the portfolio-construction process for our Core Infrastructure strategy is the application of what we call "the 75% rule". This relates to those companies whose assets are a mixture of assets that we classify as infrastructure and those assets that do not meet our strict requirements. In those circumstances, we require at least, and on a consistent basis, 75% of the company's earnings to be derived from the assets that meet our definitional requirement before it can be included in the Core strategy.

Application of this rule leads to a universe of infrastructure assets that we consider for the strategy mainly comprises two sectors; namely, regulated utilities, which includes energy and water utilities, and infrastructure, which includes airports, ports, railroads, toll roads, communications assets and energy infrastructure (oil and gas pipelines).

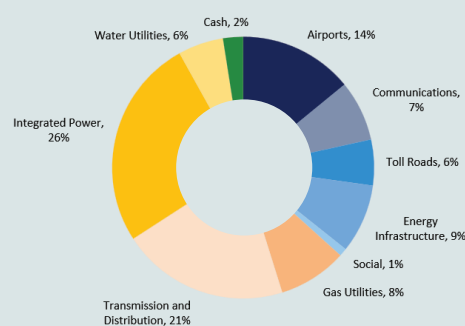
Utilities and infrastructure companies provide essential services while facing limited, if any, competition. Because the services are indispensable, the prices charged can be adjusted with limited impact on demand. As a consequence, earnings are more reliable than those for a typical industrial company and generally enjoy inherent protection against inflation. Consider it the triumph of cash flow.

The stability of earnings is influenced by the strength of the competitive positioning of the asset and the exposure of the asset to key risks.

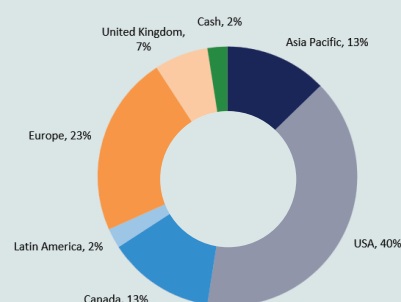
Key risks we consider are:

- Sovereign risk – We avoid countries where political decisions that undermine the contractual position or potential earnings of a company can be made easily. We invest only in countries where the judicial system and law are sound so that contractual positions can be enforced as required.
- Regulatory risk – We avoid regulatory jurisdictions where regulatory processes are opaque or applied inconsistently.
- Commodity-price risk – We seek to avoid businesses whose earnings are meaningfully exposed to the price of the product they transport. Many pipeline businesses in the US, for example, are excluded from our universe for this reason.
- Leverage risk – We avoid businesses with excessive debt or that might struggle to pay their interest bills.

Sector Exposure³



Geographic Exposure³



Gerald Stack

² Holdings based on a representative portfolio for the strategy.

³ Magellan defined sectors, Geographical exposures are by domicile of listing. Exposures may not sum to 100% due to rounding.

IMPORTANT INFORMATION:

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The investment program of the Strategy presented herein is speculative and may involve a high degree of risk. The Strategy is not intended as a complete investment program and is suitable only for sophisticated investors who can bear the risk of loss. The Strategy may lack diversification, which can increase the risk of loss to investors. The Strategy's performance may be volatile. The past performance of the Strategy is not necessarily indicative of future results and no person guarantees the performance of the Strategy or the amount or timing of any return from it. There can be no assurance that the Strategy will achieve any targeted returns, that asset allocations will be met or that the Strategy will be able to implement its investment Strategy or achieve its investment objective. The management fees, incentive fees and allocation and other expenses of the Strategy will reduce trading profits, if any, or increase losses. The Strategy will have limited liquidity, no secondary market for interests in the Strategy is expected to develop and there are restrictions on an investor's ability to withdraw and transfer interests in the Strategy. In making an investment decision, you must rely on your own examination of any offering documents relating to the Strategy.

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The Global Infrastructure Benchmark is comprised of the following: from inception to 31 December 2014 the benchmark is UBS Developed Infrastructure & Utilities Net Total Return Index and from 1 January 2015 the benchmark is S&P Global Infrastructure Net Total Return Index. The benchmark changed because UBS discontinued their index series.

The UBS Developed Infrastructure & Utilities Net Total Return Index is a market capitalisation weighted index that is designed to measure the equity performance of listed Infrastructure and Utility stocks. Index results assume the reinvestment of all distributions of capital gain and net investment income using a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties.

The S&P Global Infrastructure Net Total Return Index is a market capitalisation weighted index that is designed to track 75 companies from around the world diversified across three infrastructure sectors energy, transportation and utilities. Index results assume the reinvestment of all distributions of capital gain and net investment income using a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties.

GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS®) DISCLOSURE

Magellan Asset Management Limited, doing business as MFG Asset Management in jurisdictions outside Australia and New Zealand, (MFG Asset Management) claims compliance with the Global Investment Performance Standards (GIPS®).

For the purpose of complying with GIPS, the Firm is defined as all discretionary portfolios managed by MFG Asset Management, excluding portfolios managed by subsidiaries operating as distinct business entities. MFG Asset Management is a wholly-owned subsidiary of the publicly listed company Magellan Financial Group Limited. MFG Asset Management is based in Sydney, Australia. Total Firm assets is defined as all assets managed by MFG Asset Management, excluding assets managed by subsidiaries operating as distinct business entities.

The Global Core Infrastructure composite is a global strategy investing in strictly defined or "pure" infrastructure companies (typically 80-100). The filtered investment universe is comprised of stocks that 1. generate reliable income streams, 2. benefit from inflation protection and have an appropriate capital structure. The investment objective of the strategy is to minimise the risk of permanent capital loss; and achieve superior risk adjusted investment returns over the medium to long-term. The composite was created in February 2012.

To achieve investment objectives, the composite may also use derivative financial instruments including, but not limited to, options, swaps, futures and forwards. Derivatives are subject to the risk of changes in the market price of the underlying securities instruments, and the risk of the loss due to changes in interest rates. The use of certain derivatives may have a leveraging effect, which may increase the volatility of the composite and may reduce its returns.

A copy of the composite's GIPS compliant presentation and/or the firm's list of composite descriptions are available upon request by emailing client.reporting@magellangroup.com.au

The representative portfolio is an account in the composite that closely reflects the portfolio management style of the strategy. Performance is not a consideration in the selection of the representative portfolio. The characteristics of the representative portfolio may differ from those of the composite and of the other accounts in the composite. Information regarding the representative portfolio and the other accounts in the composite is available upon request.

USD is the currency used to calculate performance.