Strategy Update: 30 June 2020

MFG Global Equity (USD)

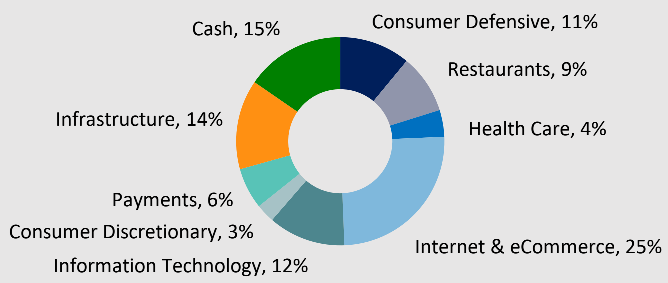
Portfolio Manager	Strategy Inception Date	Total Strategy Assets	Total Global Assets [1]
Hamish Douglass	1 July 2007	USD $38,086.3 million	USD $51,134.7 million

Objective	Approach
Capital preservation in adverse markets Pre-fee return of 10%p.a. through the economic cycle	High conviction (20-40 securities), high quality focus Dual-sleeve portfolio construction with dynamic allocation to cash (max 20%) Combined Risk Ratio cap of 0.8^

Strategy Fundamentals[2]	Strategy	Index
Number of Holdings	22	1,602
Return on Equity	25	12
P/E Ratio (1 year forward)	26.8	20.3
Interest Cover (EBIT/interest expense)	13	9
Debt/Equity Ratio	66	55
Active Share	81	n/a
Weighted Average Market Cap (USD million)	373,695	n/a

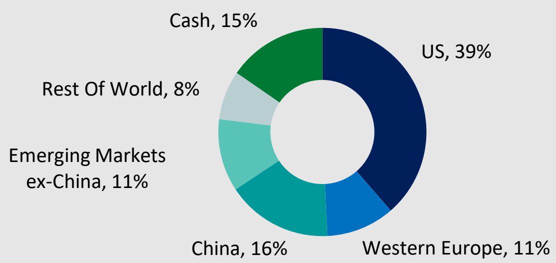
Top 10 Holdings[2]	Sector	%
Microsoft Corp	Information Technology	8.1
Tencent Holdings Ltd	Internet & eCommerce	6.7
Alibaba Group Holding Ltd	Internet & eCommerce	6.6
Alphabet Inc	Internet & eCommerce	6.0
Facebook Inc-A	Internet & eCommerce	5.7
Reckitt Benckiser Group	Consumer Defensive	4.7
Starbucks Corp	Restaurants	4.3
Novartis AG	Health Care	4.2
Crown Castle International	Communications	4.0
SAP SE	Information Technology	3.9
	TOTAL:	54.2

Sector Exposure[2]



Capital Preservation Measures[3]	3 Years	5 Years	7 Years	10 Years	Since Inception
Adverse Markets					
No of observations	10	18	21	30	47
Outperformance consistency	90%	94%	95%	97%	94%
Average return – Strategy	-3.9%	-3.1%	-2.4%	-1.9%	-3.9%
Average return – Benchmark	-7.2%	-6.1%	-5.4%	-5.8%	-8.2%
Down Market Capture	0.5	0.5	0.5	0.3	0.5
Drawdown					
Maximum Drawdown - Strategy	-15.3%	-15.3%	-15.3%	-15.3%	-36.0%
Maximum Drawdown - Index	-21.1%	-21.1%	-21.1%	-21.1%	-54.0%

Geographical Exposure[2]



Cumulative Performance[4]	3 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	7 Years (% p.a.)	10 Years (% p.a.)	Since Inception (% p.a.)
Composite (Gross)	15.1	8.3	12.8	11.2	11.4	15.3	11.9
Composite (Net)	14.8	7.5	11.9	10.4	10.6	14.3	11.0
MSCI World NTR Index	19.4	2.8	6.7	6.9	8.4	10.0	4.6
Excess (Gross)	-4.3	5.5	6.1	4.3	3.0	5.3	7.3
MSCI World Qual. Mix NTR	15.1	1.7	6.9	7.7	8.9	10.5	5.8
MSCI Min. Vol. NTR	9.8	-1.4	6.4	7.8	8.6	10.2	5.9

Annual Performance[4]	CYTD (%)	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010
Composite (Gross)	-0.7	29.7	0.4	25.2	4.7	4.2	6.6	30.8	21.6	11.9	18.3
Composite (Net)	-1.1	28.7	-0.4	24.2	3.9	3.4	5.7	29.8	20.7	11.0	17.4
MSCI World NTR Index	-5.8	27.7	-8.7	22.4	7.5	-0.9	4.9	26.7	15.8	-5.5	11.8
Excess (Gross)	5.1	2.0	9.1	2.8	-2.8	5.1	1.7	4.1	5.8	17.4	6.5
MSCI World Qual. Mix NTR	-7.1	27.7	-6.5	21.5	7.9	1.6	7.3	24.5	13.0	0.7	11.4
MSCI Min. Vol. NTR	-7.2	23.2	-2.0	17.3	7.5	5.2	11.4	18.6	8.1	7.3	12.0

Supplementary Statistical Measures 5	3 Years	5 Years	7 Years	10 Years	Since Inception
Turnover	23.5%	20.0%	18.5%	16.0%	13.9%
Beta	0.8	0.8	0.8	0.7	0.8
Tracking Error (% p.a.)	5.7%	5.2%	4.8%	5.6%	6.7%
Standard Deviation – Strategy	13.0%	11.9%	11.2%	11.2%	13.4%
Information Ratio	1.1	0.8	0.6	0.9	1.1

1 Comprised of all Global Strategies.
2 The data is based on a representative portfolio for the strategy. Sectors are internally defined. Geographical exposure is calculated on a look through basis based on underlying revenue exposure of individual companies held within the portfolio. Exposures may not sum to 100%/total due to rounding. The Index is the MSCI World NTR Index. Refer to the Important Notice below for further information.
3 Risk measures are calculated before fees and in USD. An adverse market is defined as a negative quarter, rolled monthly, for the MSCI World Net TR USD Index, whilst drawdown measures are measured monthly.
4 Returns are for the Global Equity Composite and denoted in USD. Performance would vary if returns were denominated in a currency other than USD. Refer to the GIPS Disclosure section below 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.
5 Supplementary Statistical Measures Beta, Tracking Error and Information Ratio are calculated in USD using the MSCI World NTR Index.
^ Combined risk ratio is a measure of relative beta and relative drawdown to MSCI World NTR USD Index. Please contact MFGAM should you wish for further details on the calculation.
* Returns are only for part year.

IMPORTANT NOTICE

The MSCI World Index (Net) is a free-float adjusted market capitalization weighted index that is designed to measure the equity performance of 24 developed markets. 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 brands 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 Equity composite is a concentrated global equity strategy investing in high quality companies (typically 20-40 stocks). High quality companies are those companies that have sustainable competitive advantages which translate into returns on capital materially in excess of their cost of capital for a sustained period of time. The investment objectives of the Global Equity strategy are to earn superior risk adjusted returns through the business cycle whilst minimising the risk of a permanent capital loss. The composite was created in December 2011.

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.

Market Commentary

Global stocks rose for the fifth quarter in six as they staged their best quarterly performance in 11 years in the three months to June after an ebbing in coronavirus infection rates in developed countries allowed governments to ease restrictions on everyday life and policymakers provided more stimulus to help their battered economies. During the quarter, all 11 sectors rose in US-dollar terms. Information technology rose most (+31%) as IT companies reported robust earnings while utilities rose least (+6.2%). The Morgan Stanley Capital International World Index surged 19% in US dollars, its best performance since the June quarter of 2009.

US stocks posted their biggest quarterly gain in more than 21 years as prospects for an economic recovery rose after state authorities relaxed restrictions and federal policymakers provided stimulus. Stocks rose even as the US death toll from the covid-19 illness exceeded 125,000, a second wave of infection broke out in some states easing restrictions (and some even reimposed them), riots broke out across the country after footage showed that a white policeman in Minneapolis suffocated an unarmed black detainee, and reports highlighted the toll of a virus on an economy now officially in recession. While one report showed the US economy shrank an annualised 5.0% during the March quarter when the restrictions had barely started, other indicators showed the worst might have passed. The number of new workers seeking jobless benefits held steady at about 1.5 million each week in June, well down on the peak of just below seven million in March but more than double the pre-pandemic record of 695,000 in 1982. The jobless rate fell to 13.3% in May compared with April's 14.7%, the highest since the series was compiled in 1948. Retail sales, which plunged 14.7% in April, soared 17.7% in May – the largest changes since records began in 1992. Over the quarter, congress took to four the number of stimulus packages it has passed since the crisis began. The Treasury said the US budget deficit soared to a record US$1.935 trillion in the 12 months ended April 30, almost double the US$1.037 trillion budget shortfall for the year ended March 31. The Federal Reserve said it had no plans to raise interest rates, which it cut in March to near zero, until the end of 2022, and said it would employ its "full range of tools" to bolster the economy. Displaying those tools, the Fed increased its balance sheet by nearly US$3 trillion to buy government and corporate bonds including low-quality issues, mortgage obligations, municipal bonds and exchange-traded funds and cooperated with the Treasury Department to get loans to small and medium-sized businesses. In political news, Joe Biden secured enough delegates in the Democratic nominating contest to clinch the party's presidential nomination, a symbolic victory as no other candidates were left in the primary. At quarter end, polls showed Biden would beat President Donald Trump in November's election. The S&P 500 Index rallied 20%, its biggest three-month gain since the last quarter of 1998.

European stocks climbed as countries reopened economies, the ECB boosted monetary stimulus and, on the fiscal side, France and Germany unveiled a 750-billion-euro bailout and debt-mutualisation package to help virus-hit EU economies though the incremental move towards fiscal union is still to be approved by the other 25 EU members.

The package followed a shock decision by Germany's constitutional court that the Bundesbank could not participate in the European Central Bank's quantitative easing unless it could show the asset buying was "proportionate", a task still incomplete at the end of June. The ECB increased its bond-buying program by 600 billion euros and extended it by six months to June 2021, to lift to 1.35 trillion euros the purchases promised by the ECB to help an economy ECB President Christine Lagarde said was suffering an "unprecedented contraction". Economic reports released during the quarter were grim. Eurozone output fell 3.6% in the first quarter, the biggest decline since the series began in 1995. The Euro Stoxx 50 Index added 16%.

Japan's Nikkei 225 Index rallied 18% on hopes virus infection rates had peaked even as reports showed Japan's economy contracted 3.4% annualised in the first quarter. China's CSI 300 Index rose 13% even as the country's leaders broke with precedent by abandoning their annual growth target for 2020, an outbreak of covid-19 occurred in Beijing and the US threatened Hong Kong's special trading status in response to the new security law. Australia's S&P/ASX 200 Accumulation Index surged 17% after authorities eased restrictions as infection rates dropped though outbreaks flared up again in Victoria in June. The MSCI Emerging Markets Index gained 19% in US dollars even as the virus took hold in Latin America, especially Brazil and Mexico, and India.

Strategy Commentary

The strategy recorded a positive return for the quarter. The biggest contributors were the investments in Microsoft, Facebook and Tencent Holdings. Microsoft gained after the software giant reported that its thriving cloud and server businesses had boosted margins over the March quarter when revenue rose 15% to US$35 billion and operating income climbed 25% to US$13 billion. Facebook advanced after the social-media company said revenue rose a higher-than-expected 17% to US$18 billion in the March quarter as the number of daily active users of its sites jumped 11%. Tencent rose over a quarter during which it announced it will invest US$70 billion in digital infrastructure over the next five years in alignment with the Chinese government's desire for a digital infrastructure investment push to restart the economy.

The only detractor was the investment in Heineken, which fell as restrictions on gatherings from March battered sales.

Index movements and stock contributors/detractors are based in local currency terms unless stated otherwise.

WeChat about China's Tencent

Chris Wheldon, Portfolio Manager, and Ryan Joyce, co-Head of Magellan's Technology team, explain why Tencent is a high-quality business, why the strategy invested in the company recently, what risks the investment poses and why Tencent performed well during the pandemic's initial stages.

Q: Tencent is one of the strategy's top five positions. Can you please tell us about the company?

A: Tencent was founded in 1998 as a Chinese instant-messaging service and web portal named QQ and subsequently built itself into a PC-based social network similar to today's Facebook. In 2011, Tencent launched the WeChat mobile app, now China's leading social network and communications platform and core to the company's success. WeChat's 1.2 billion users average nearly 100 minutes per day, every day, on the app.

In addition to generating significant advertising revenue from WeChat, in a similar manner to how Facebook monetises its app, over the past decade Tencent has successfully leveraged WeChat's user traffic to build leading positions in online gaming, digital payments and fintech, cloud computing and other areas including online video, music and news within China. Tencent, for example, has 112 million video subscribers in China compared with Netflix's 183 million subscribers globally.

Online gaming, which is wildly popular in China, was one of Tencent's earlier successes and a key source of profits that the company has reinvested internally to build out its suite of services. Tencent has also created significant value for shareholders by taking large positions in Chinese internet companies such as JD.com, Pinduoduo and Meituan Dianping and making them more successful by positioning them prominently on the WeChat ecosystem.

Q: Magellan invests in high-quality businesses with enduring characteristics. What are Tencent's?

A: We think Tencent is a high-quality business. As mentioned, at the core of the company is its dominant WeChat social network and communications app that can be thought of as the portal through which Chinese citizens conduct their digital activities and access digital content. Critically, social networks by their nature tend to be advantaged and resilient businesses given that the more people use them, the more valuable they become. With 1.2 billion users, WeChat hosts nearly every Chinese citizen's social circle.

Shrewdly, by building WeChat into a super app that funnels users to owned and third-party services, Tencent has further entrenched itself into the digital lives of Chinese consumers. Tencent's apps now represent roughly 40% of total user time spent on mobile in China. Importantly, Tencent is expanding its suite of services; recent innovations include WeChat mini programs that have already exceeded 400 million daily active users and which position WeChat as more akin to an operating system.

While online gaming is a more 'hit' driven business, we consider Tencent's gaming business to be the largest and most advantaged globally and significantly more resilient than its peers given the benefits it gains from the integration with WeChat. This brings a significant distribution advantage and an unmatched ability to integrate social elements such as 'friend leader boards' and multi-player games. Tencent is also protected from western game developers that are reliant upon Chinese publishers to access the Chinese market.

Outside of social networks and online gaming, Tencent has the No. 1 or No. 2 positions in what we consider to be naturally oligopolistic industries such as digital payments, cloud computing, online music and online video where 'first mover' advantage, scale and the ability to invest upfront are critical. While competition within these industries can be fierce in their early stages, they offer significant long-term growth potential and we expect profitability to improve as the industries mature.

Q: Can you outline why we have invested in the company only recently?

A: Two key reasons have influenced our decision to invest in Tencent recently. The first is our assessment of Tencent's fair value relative to its share price. While Magellan has a focus on investing in high-quality businesses, we seek to be patient and to acquire positions when they are trading at a discount to a conservative estimate of fair value. Even for wonderful businesses, we believe valuation discipline is critical to earning desired returns for our clients. When we began looking at Tencent closely in 2017, we thought there was too much optimism factored into its share price, likely reflecting the expected growth of its online gaming business. We waited for a more attractive entry point that presented itself only recently.

The second reason is Tencent's increasingly diversified and higher-quality earnings mix. If we go back several years, Tencent's valuation was heavily reliant on its online gaming business. While we consider this business to be advantaged, it retains a hit-based profile and we had a lower degree of conviction in Tencent's ability to achieve hit after hit even with its distribution advantage. Fast forward to today and not only are we more confident in the durability of Tencent's online gaming business, but the company's earnings mix has shifted towards online advertising, digital payments and media subscriptions. Our confidence in Tencent's ability to generate strong earnings from its rapidly growing cloud business in the future has also increased markedly as it has emerged as a clear No. 2 player in China.

Q: Can you talk about the risks of investing in China?

A: With Tencent, the risk of greatest concern is regulatory risk across online gaming, social networks and payments. While regulatory risk is not unique to China – we see it with some of our US technology investments too – we are of the view that it is higher than in most developed countries due to the limited visibility and legal recourse. An example of this was the Chinese government's surprise decision in 2018 to halt new online game approvals for nine months due to concerns about content and addiction among minors. These restrictions had a meaningful drag on Tencent though it was only temporary as the business recovered once approvals restarted. This risk highlights the value of Tencent's more diverse earnings stream going forward.

Risks associated with investing in China rather than Tencent per se include the potential for Chinese government insistence that companies invest in uneconomic areas, and the need for foreigners to invest via 'variable interest entity' structures due to foreign-ownership restrictions. We consider the probability of either of these risks having a significant impact on the value of Tencent as low given the Chinese government's interest in attracting foreign investment and maintaining cordial global relationships. We also manage these risks via portfolio risk controls.

Q: Has the covid-19 crisis hampered Tencent?

A: Tencent performed well during the lockdown phase of the pandemic and is expected to derive long-term benefits from its impact. During the lockdown phase, the company's highly profitable online gaming business benefitted from a significant increase in user engagement. This has more than offset the temporary headwinds to its payments and cloud revenue. While much of the increase in time spent online is likely to prove temporary, some will be structural as Tencent has observed during prior virus outbreaks. This dynamic also provides defensiveness in the case of further outbreaks.

Benefits to Tencent from the pandemic that we expect to become more evident over time include opportunities related to the critical role it played in online healthcare and online education during the lockdown, accelerated merchant adoption of its mini programs for e-commerce, significant uptake of its enterprise collaboration tools WeChat Work and Tencent Meeting, and an acceleration in enterprise demand for cloud computing and digital upgrades. The critical role Tencent played in helping China manage the spread of covid-19, while also enabling workers to operate remotely and students to learn remotely during this period, is also likely to have improved the company's relationship with the government.