

MFG GLOBAL SUSTAINABLE STRATEGY



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Our Global Sustainable Strategy considers environmental, social and governance factors and implements a proprietary low-carbon framework to invest in outstanding companies at attractive prices while exercising a deep understanding of the macroeconomic environment to manage investment risk. The strategy focuses on risk-adjusted returns rather than benchmark-relative returns. The investment process is designed to generate an unconstrained, concentrated portfolio of 20 to 50 high-quality companies.

PERFORMANCE

Global stocks over the 12 months to June 2020 were dominated by three key drivers, these being: 1) the supportive policy of central banks in the face of sluggish growth in 2019, 2) a de-escalation of trade tensions between the US and China towards the end of 2019 and 3) the impact of the SARS-Cov-2 pandemic.

The strategy's performance was modestly ahead of the market prior to the pandemic-induced market volatility of March 2020, notwithstanding a 15% holding in cash. At the beginning of 2020, the strategy was positioned to benefit from an expected improvement in economic growth supported by the conclusion of the 'Phase 1' trade agreement between the US and China. This positioning included exposures to financial and cyclical stocks that would likely have benefited from an uptick in business and consumer confidence. Unfortunately, these positions revealed themselves to be highly correlated in the pandemic-induced lockdowns across the world. Each of the five largest detractors from performance listed below was buffeted by the pandemic, whether from concerns on elevated leverage as fixed-income markets began to seize, or from expected large contractions in business volumes, or expected increases in loan losses. Nonetheless, the prevailing risk profile of the strategy in March along with subsequent de-risking of the strategy to the pandemic have helped the strategy's performance relative to markets.

The strategy recorded a gross return before fees of 3.8% in US dollars for the 12 months. The stocks that contributed the most to performance included the investments in Microsoft (+2.8% of the total strategy return), Alphabet (+1.9%), Chipotle Mexican Grill (+1.5%), Facebook (+1.3%) and Apple (+1.2%). Microsoft

surged to record highs after its cloud business helped the software giant beat earnings and revenue forecasts and held up relatively well during the pandemic lockdowns as it was judged a beneficiary from greater online activity. Alphabet and Facebook proved resilient as their financial results beat expectations, supported by increased consumer engagement during the lockdown and advertising revenues remaining robust, notwithstanding challenges faced by certain economic sectors such as travel and bricks-and-mortar retailers. Chipotle rose strongly as management noted its digital strategy had performed strongly during the lockdown and mused it expected sales and margins to rise with further digital penetration and rollout of Chipotlanes, its drive-through concept. Apple benefited from boosted sales forecasts, citing the popularity of the latest iPhone 11, new services such as Apple TV+ and wearables such as AirPods, and the easing of trade tensions between Washington and Beijing.

Stocks that detracted from performance included the investments in Yum! Brands (-1.7%), Anheuser-Busch InBev (-1.3%), Aena (-1.3%), American Express (-1.2%) and Capital One Financial Group (-0.8%). Yum! Brands and Anheuser-Busch InBev were hit by market concerns about their elevated levels of debt as well as the closure of their restaurants (in the case of Yum! Brands) and decreased on-premises consumption as bars and locales were ordered shut. Aena was hurt by the near-closure of its airports across the Iberian peninsula and expectations of lower travel. American Express and Capital One were hurt by expectations of higher loan losses caused by the recession, disruptions in fixed-income markets, and declining use of their products, particularly credit cards.

Performance as at 30 June 2020¹

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 Global Sustainable Strategy (Gross)	3.8	10.0	-	-	-	11.0
MFG Global Sustainable Strategy (Net)	3.0	9.1	-	-	-	10.2

¹ Returns are for the Global Sustainable 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. Inception date is 1 October 2016.

OUTLOOK

The outlooks for the economy and equity markets remain uncertain. Key will be the pace of economic reopening, policymaker responses, scientific advance in dealing with the pandemic, and consumer and business behaviours. We continue to see four scenarios.

The best scenario is a V-shaped recovery; a deep, but fleeting, recession. This would require a quick and successful reopening supported by policymakers, with most furloughed workers returning to their pre-pandemic hours. This scenario still appears relatively unlikely.

The worst scenario is a depression, where reopening is very slow and there is a policy error, hurting employment and output. This would be the worst outcome for markets but also appears relatively unlikely.

The two middle scenarios are a U-shaped recovery from a recession or a prolonged and deep recession. The downturn that occurred after the global financial recession lay between these two scenarios. It is still too early to form strong conviction on whether the current downturn will be more or less severe than the recession of 2008-2009.

Due to our cautious economic outlook and the risks confronting equities, the cash position was increased from 15% to 17% over the 12 months.

PORTFOLIO POSITIONING²

Top-10 holdings at 30 June 2020

Security	Weight (%)
Alphabet Inc	7.3
Microsoft Corp	7.1
Alibaba Group Holding Ltd	6.3
Facebook Inc-A	5.4
Tencent Holdings Ltd	5.1
Reckitt Benckiser Group	4.7
Novartis AG	4.2
SAP SE	3.9
Unilever NV	3.8
Nestle SA	3.6
Total	51.4

Notwithstanding our cautious outlook, we believe our portfolio of 24 high-quality businesses will generate a satisfactory return over the medium to long term.

We have positioned our portfolio cautiously by holding a substantial amount of cash and by investing in businesses that should be largely resilient, or even beneficiaries, in the current environment.

Over the long term, we believe that investing in a portfolio of high-quality defensive and growth businesses bought at reasonable prices will generate attractive returns and prove resilient in times of economic uncertainty. The inherently stable nature of high quality defensive businesses should be expected to protect capital through the economic cycle whilst high-quality growth businesses are less reliant on the underlying strength of the economy as their growth is driven by innovation and market share gains. We seek businesses that have a high likelihood of success for decades to come. As always, we evaluate prospective returns in relation to the type and degree of risk we are taking.

The core investment themes in our portfolio at 30 June 2020 were:

- A range of highly resilient businesses that represented 31% of the portfolio. These businesses are largely unaffected by measures that have been enacted to combat the pandemic as their services are either essential or in increasing demand. More importantly, these characteristics give these stocks a high degree of resiliency in a weak economy. In the current environment, we do not know the ultimate effect the coronavirus will have on society and the economy. These investments offer attractive risk-adjusted returns under a wide range of potential economic outcomes. They comprise:
 - Consumer staples and a mass-market retailer at 21% of the portfolio (Danone, Mondelez International, Nestlé, PepsiCo, Reckitt Benckiser, Unilever and Walmart).
 - Three regulated utilities in the US, Italy and Spain at 6% of the portfolio (Eversource Energy, Red Electrica and Terna).
 - A pharmaceutical business, Novartis of Switzerland, at 4% of the portfolio.
- The Chinese-consumer-related stocks (technology-platform companies Alibaba and Tencent Holdings and coffee chain Starbucks) that comprised 14% of the portfolio. The Chinese middle class is forecast to double in size over the next five to 10 years with the high-end cohort growing even faster. Alibaba and Tencent are structural winners in the Chinese economy as they own the leading ecommerce platforms and gaming/social media respectively. They are also the leading cloud-computing and digital-payment businesses in China. Starbucks is the leading coffee chain in China and is rapidly growing its store footprint as the Chinese consumer grows to appreciate Starbucks' products.
- Advertising technology-platform companies (Alphabet, the owner of Google, and Facebook) that represented 13% of the portfolio. These companies benefit from the shift in marketing expenditure from traditional media properties to digital platforms.
- Enterprise-software companies (SAP of Germany and Microsoft) that comprised 11% of the portfolio. These companies are integrated within the operations of their business customers, which lowers the risk these customers will switch software vendors. They are benefiting from the transformational growth in cloud computing, which is likely to become even more popular in the coming years.
- Payment-platform companies (Mastercard and Visa) that represented 5% of the portfolio. These are classic 'network effect' business models that connect millions of merchants with billions of cardholders. They provide the 'rails' upon which global electronic payment systems run.
- An investment in two quick-service restaurants (Chipotle Mexican Grill and Yum! Brands) that represented 5% of the portfolio. These businesses have faced some short-term challenges due to restrictions to slow the spread of the virus. Over the longer term, the strength of their brands and resiliency to a weak economy are attractive.
- A 17% holding in cash (the bulk held in US dollars).



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² Portfolio positioning based on a representative portfolio for the strategy, may not sum to 100% due to rounding.

IMPORTANT INFORMATION

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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 portfolios managed by MFG Asset Management, excluding assets managed by brands operating as distinct business entities.

The US Sustainable composite is a concentrated global equity strategy investing in high quality companies (typically 20-50 stocks), domiciled in the United States, with an integrated low carbon overlay. 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 US Sustainable strategy are to earn superior risk adjusted returns through the business cycle whilst minimising the risk of a permanent capital loss with an integrated ESG strategy with meaningfully lower carbon intensity than broader equity markets. The composite was created in January 2017. Prior to May 29, 2018 the composite was named the US Low Carbon Composite.

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.