Strategy Update: 30 September 2017

MFG Global Equity (USD)

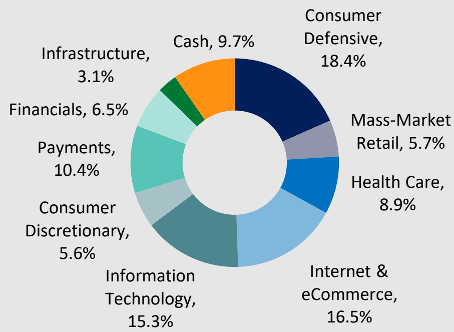
Portfolio Manager	Strategy Inception Date	Total Strategy Assets	Total Global Assets[1]
Hamish Douglass	1 July 2007	USD $28,355.4 million	USD $33,692.4 million

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	24	1,652
Return on Equity	24	14
P/E Ratio (1 year forward)	18.9	16.8
Interest Cover	13	10
Debt/Equity Ratio	40	52
Active Share	89	n/a
Weighted Average Market Cap (USD million)	236,438	n/a

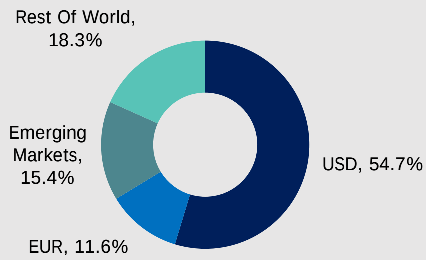
Top 10 Holdings[2]	Sector	%
Apple Inc	Information Technology	7.3
Alphabet Inc	Internet & eCommerce	6.5
Facebook Inc-A	Internet & eCommerce	5.9
Lowe's Co Inc	Consumer Discretionary	5.6
Visa Inc	Payments	5.5
Starbucks Corp	Consumer Defensive	4.3
Microsoft Corp	Information Technology	4.2
eBay Inc	Internet & eCommerce	4.2
Wells Fargo & Co	Financials	3.9
Kraft Heinz Co	Consumer Defensive	3.8
	TOTAL:	51.2

Sector Exposure[2]



Capital Preservation Measures[4]	3 Years	5 Years	7 Years	Since Inception
Adverse Markets				
No of observations	10	11	19	37
Outperformance consistency	100%	100%	100%	95%
Average return – Strategy	-1.1%	-1.1%	-0.8%	-3.9%
Average return – Benchmark	-3.8%	-3.7%	-5.1%	-8.5%
Down Market Capture	0.3	0.3	0.1	0.5
Drawdown				
Maximum Drawdown - Strategy	-7.3%	-7.3%	-7.3%	-36.0%
Maximum Drawdown - Index	-12.0%	-12.0%	-19.6%	-54.0%

Geographical Exposure[2]



Cumulative Performance[3]	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)	**4.2**	**18.3**	**10.4**	**12.9**	**15.1**	**11.8**	**11.8**
Composite (Net)	4.0	17.4	9.5	12.0	14.1	10.9	10.9
MSCI World NTR Index	4.8	18.2	7.7	11.0	10.1	4.2	4.3
Excess (Gross)	-0.6	0.1	2.7	1.9	5.0	7.6	7.5
MSCI World Qual. Mix NTR	4.3	15.6	8.8	11.2	10.8	5.6	5.8
MSCI Min. Vol. NTR	2.9	9.3	10.0	10.5	10.7	5.8	5.9

Annual Performance[3]	CYTD (%)	2016 (%)	2015 (%)	2014 (%)	2013 (%)	2012 (%)	2011 (%)	2010 (%)	2009 (%)	2008 (%)	2007 (%)*
Composite (Gross)	**17.5**	**4.7**	**4.2**	**6.6**	**30.8**	**21.6**	**11.9**	**18.3**	**39.4**	**-21.6**	**0.0**
Composite (Net)	16.8	3.9	3.4	5.7	29.8	20.7	11.0	17.4	38.3	-22.3	-0.4
MSCI World NTR Index	16.0	7.5	-0.9	4.9	26.7	15.8	-5.5	11.8	30.0	-40.7	-0.1
Excess (Gross)	1.5	-2.8	5.1	1.7	4.1	5.8	17.4	6.5	9.4	19.1	0.1
MSCI World Qual. Mix NTR	14.9	7.9	1.6	7.3	24.5	13.0	0.7	11.4	27.7	-35.4	1.0
MSCI Min. Vol. NTR	12.3	7.5	5.2	11.4	18.6	8.1	7.3	12.0	16.4	-29.7	1.0

Supplementary Statistical Measures [5]	3 Years	5 Years	7 Years	Since Inception
Turnover	25.9%	21.5%	18.4%	15.1%
Beta	0.9	0.9	0.7	0.7
Tracking Error (% p.a.)	4.2%	4.1%	5.7%	6.9%
Standard Deviation – Strategy	9.6%	9.2%	9.8%	13.3%
Information Ratio	0.6	0.5	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. The Index is the MSCI World NTR Index. Refer to the end of the document for further information.
3 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.
4 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.
5 Supplementary Statistical Measures Beta, Tracking Error and Information Ratio are calculated 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.

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.

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 list of composites and descriptions, as well as policies for valuing investments, calculating performance, and preparing compliant presentations are available upon request by emailing data@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.

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Market Commentary

Global stocks set record highs as they rose for a sixth straight quarter in the September quarter after US companies posted better-than-expected earnings for the second quarter, reports showed the world's major economies were growing in unison for the first time in a decade, the Federal Reserve reiterated that monetary policy would likely only be tightened gradually and Angela Merkel won a fourth term as chancellor of Germany.

In the US, 73% of S&P 500 companies reported 'positive' earnings-per-share surprises for the second quarter while 'blended earnings growth' reached 10.3%, according to FactSet, as the tech giants shone. In news on the economy, the third reading on second-quarter GDP showed the US economy expanded at an annualised rate of 3.1% over the three months to June, the fastest pace in two years, while the jobless rate stayed around 16-year lows.

In Europe, stocks rose on Merkel's victory and upbeat economic reports such as the one showing the eurozone economy expanded 0.6% in the second quarter, to be 2.3% higher than 12 months earlier.

In other news, Japan's economy grew 1% in the second quarter, its sixth consecutive quarterly expansion, and Prime Minister Shinzō Abe in September called a snap election for October that polls show him winning. In China, the latest readings on industrial production, retail sales and investment disappointed though its economy expanded at a faster-than-expected pace of 6.9% in the 12 months to June.

Ten of the 11 industry classifications within the MSCI World rose in US-dollar terms over the quarter. Energy and materials were the best performers while consumer staples fell.

Strategy Commentary

The portfolio recorded a positive return in the quarter. At a stock level, the best performers included investments in PayPal, Visa and Mastercard. PayPal gained after better-than-expected earnings, which delivered 26% growth in total payments volumes including 50% in mobile transactions. Visa rose after its earnings topped analyst expectations for the third straight quarter, aided by outperformance of Visa Europe relative to the expectations held at the time of the acquisition. Mastercard rallied after second-quarter revenue hit a record as volumes and transactions on its network rose.

Stocks that lagged included investments in Kraft Heinz, Starbucks and HCA. Kraft Heinz slid after second-quarter revenue fell more than expected though cost-cutting boosted profit beyond analyst estimates. Starbucks fell amid cautious market commentary as to the outlook for growth in retail traffic and store footprint and the company slightly reduced its annual profit forecast. HCA fell amid uncertainty as to whether or not the ACA repeal bill would be passed given expiration of the budget reconciliation in the month of September.

Key Stock in Focus – Kraft Heinz

KraftHeinz

Kraft Heinz – A leaner consumer brands giant looking to expand

3G Capital is a Brazilian-based private-equity firm with an almost-unparalleled record of improving businesses. The company is now a major shareholder of Kraft Heinz, which it manages. It is intent on making the world's fifth-largest food and beverage group more efficient and even bigger.

3G's owners first built their reputations for enhancing household-name businesses largely through improving and expanding brewing companies. They started with ownership of the Brazilian brewer Brahma in 1989 and by 2016 had formed the world's biggest brewer in Anheuser-Busch InBev, which sells about one in three beers worldwide through brands such as Budweiser, Corona and Stella Artois.

In recent times, 3G expanded into the consumer-packaged-goods industry. In 2013, 3G joined with Berkshire Hathaway to buy HJ Heinz for US$23 billion, which it took private and ran more efficiently. Two years later came an even bigger creation: 3G and Berkshire Hathaway spent US$50 billion to purchase the listed Kraft Foods and merge it with the more-profitable Heinz. 3G owns 24% and Berkshire Hathaway 27% of the group that recorded US$26.5 billion in sales in 2016.

The core strategy of Kraft Heinz is to expand profit margins on its global brands while using the cash generated from these businesses to expand its presence in the consumer-packaged-goods sector, an industry ripe for consolidation.

This dual strategy – improving the profitability of existing lines while looking to expand through takeovers – means that Kraft Heinz is partially insulated from the angst plaguing consumer brands in the age of e-commerce and healthier lifestyles. If the Amazons of the world and better diets reduce the demand for competing brands, these companies may become more attractive takeover targets for Kraft Heinz. As such, Kraft Heinz appears to be entering a future where its products will become more profitable and where it will add more profitable lines. The company's outlook, in short, is for higher earnings in coming years.

Even with 3G in charge, Kraft Heinz has challenges. One problem is that 3G's reputation for using cost-cutting to improve businesses often stokes opposition to its bids, especially from the targets as was shown with Kraft Heinz's failed bid for Unilever this year. The US$143 billion bid for the Anglo-Dutch food and personal care company was abandoned at launch because Unilever painted it as unfriendly.

Another challenge for Kraft Heinz is boosting sales when the consumer-packaged-goods industry's revenue is susceptible to being substituted for private labels and to being overlooked by people who prefer natural and organic foods. Even considering these risks, though, the 3G-led drive to improve profitability and its expansion ambitions make Kraft Heinz an attractive risk-reward proposition for investors.

Long history

HJ Heinz's history goes back to 1869 when Henry John Heinz started selling homegrown horseradish in Pennsylvania. By the time 3G took control of Heinz in 2013, the company was one of the world's most recognised brands. But Heinz was struggling to grow sales.

Kraft's history starts with the entangled story of three US entrepreneurs – James Kraft who started a cheese business in Chicago in 1903, Charles Post who founded a cereal company in Michigan in 1895, and Oscar Mayer who began a meat business in Detroit in 1883. By 2015, Kraft boasted more than 70 major consumer brands including Kool-Aid and Lifesavers and its products were found in nearly all US homes. It too faced challenges at the time.

The merger brought together a company that has eight brands, including Maxwell House, Philadelphia cheese and Planters nuts and the Kraft and Heinz brands, that earn more than US$1 billion in revenue each year.

3G boasts that it is a "strong meritocracy" in that employees must perform or they are out – others would describe the investment firm as a "ruthless meritocracy". Whatever description is more apt, since assembling Kraft Heinz two years ago, 3G has reduced the company's workforce by about 13,000 down to 42,000 workers and closed several plants including iconic ones. On a pro forma basis (assuming Kraft and Heinz were combined from the start of 2014), sales have declined by 9% but operating profits have increased 40% over the past two years, because profit margins have expanded by half to about 28%, well above industry averages of about 16%.

It's this 3G ability to improve the businesses it takes control of plus the potential for takeovers within the consumer-packaged-goods industry that make Kraft Heinz a stock to watch.