MFG Global Sustainable (USD)

MFG ASSET MANAGEMENT

AS AT 31 DECEMBER 2023

PORTFOLIO MANAGER	ALAN PULLEN

INVESTMENT PHILOSOPHY

To invest in outstanding companies at attractive prices, while exercising a deep understanding of the macroeconomic environment to manage investment risk.

OBJECTIVES

Seek to achieve attractive risk-adjusted returns over the medium to long term while reducing the risk of permanent capital loss.

Am to deliver carbon intensity less than 1/3 of MSCI World Index.

PORTFOLIO CONSTRUCTION

High conviction (20 - 50 securities), high quality focus.

Portfolio construction with dynamic allocation to cash (typical exposure between 0% - 20%).

Combined Risk Ratio cap of 0.8^.

Integrated ESG with proprietary, multidimensional carbon emissions management.

MAGELLAN GLOBAL SUSTAINABLE (USD)

TOTAL STRATEGY ASSETS	TOTAL GLOBAL SUSTAINABLE ASSETS[1]	INCEPTION DATE
USD $312.4 million	USD $312.4 million	1 October 2016

USD PERFORMANCE[2]

	3 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	7 Years (% p.a.)	Since Inception (% p.a.)	OUTPERFORMANCE CONSISTENCY*
Composite (Gross)	14.2	32.5	6.5	11.1	10.7	10.3	33%
Composite (Net)	13.9	31.5	5.7	10.2	9.8	9.4	33%
MSCI World NTR Index+	11.4	23.8	7.3	12.8	10.7	10.6	-
Excess (Gross)	2.8	8.7	-0.8	-1.7	-0.1	-0.3	-
MSCI World Low Carbon NTR Index+	11.6	23.7	6.9	12.8	10.7	10.5	-

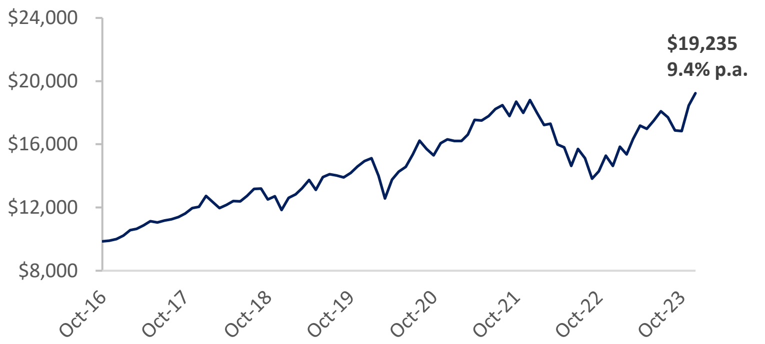
CALENDAR YEAR RETURNS[2]	2023 (%)	2022 (%)	2021 (%)	2020 (%)	2019 (%)	2018 (%)	2017 (%)	2016 (%)**
Composite (Gross)	32.5	-21.6	16.3	10.1	27.2	-1.0	21.4	0.3
Composite (Net)	31.5	-22.2	15.3	9.2	26.2	-1.8	20.4	0.1
MSCI World NTR Index+	23.8	-18.1	21.8	15.9	27.7	-8.7	22.4	1.9
Excess (Gross)	8.7	-3.5	-5.5	-5.8	-0.5	7.7	-1.0	-1.6
MSCI World Low Carbon NTR Index+	23.7	-18.8	21.5	16.5	28.5	-8.9	22.2	1.4

Past performance does not predict future returns.

STRATEGY FUNDAMENTALS[3]

Number of Holdings	26
Carbon Intensity (CO_2t/US$1m revenues)	Strategy: 28 Index+: 106
Return on Equity (%) (Trailing 1 year)	30
P/E Ratio (1 year forward)	23
Interest Cover (EBIT/interest expense)	16
Weighted Average Market Cap (USD million)	615,396

PERFORMANCE CHART GROWTH OF USD $10,000 (NET)[2]



Past performance does not predict future returns.

[1] Comprised of all Global Sustainable strategies.

[2] 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. Strategy inception is 1 October 2016. 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.

[3] Strategy Fundamentals are based on a representative portfolio in the strategy. Certain information ©2023 MSCI ESG Research LLC. Reproduced by permission. The Fund's carbon intensity score is calculated using MSCI data. In a limited number of circumstances, where data is not available or Magellan deems it appropriate, manual adjustments are made to the MSCI carbon intensity score for certain investments held by the fund.

^ Combined risk ratio is a measure of relative beta and relative drawdown to MSCI World NTR USD Index. Please contact MFG Asset Management should you wish for further details on the calculation.

+ All MSCI data used is the property of MSCI. No use or distribution without written consent. Data provided "as is" without any warranties. MSCI and its affiliates assume no liability for or in connection with the data. Please see complete disclaimer in www.mfgam.com.au/funds/benchmark-information/

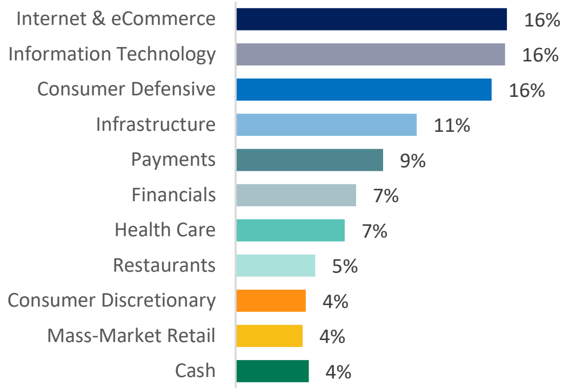
* Outperformance consistency indicates the percentage of positive excess returns for rolling 3 year returns since inception.

**Part year return.

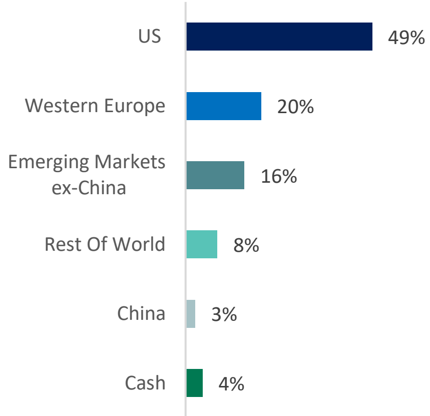
TOP 10 HOLDINGS[4]

STOCK	SECTOR	%
Microsoft Corporation	Information Technology	7.4
Alphabet Inc	Internet & eCommerce	7.2
Nestlé SA	Consumer Defensive	7.0
Meta Platforms Inc	Internet & eCommerce	4.7
Amazon.com Inc	Internet & eCommerce	4.6
Intercontinental Exchange Inc	Financials	4.3
Booking Holdings Inc	Consumer Discretionary	4.3
Dollar General Corporation	Mass-Market Retail	4.1
Eversource Energy	Infrastructure	4.0
American Tower Corporation	Infrastructure	4.0
	TOTAL:	51.6

SECTOR EXPOSURE BY SOURCE OF REVENUE[4]



GEOGRAPHICAL EXPOSURE BY SOURCE OF REVENUE[4]



[4] The data is based on a representative portfolio in the strategy. Sectors are internally defined. Geographical exposure is calculated on a look through basis on underlying revenue exposure of individual companies held within the portfolio. Exposures may not sum to 100% due to rounding.

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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 brands 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 Sustainable composite is a concentrated global equity strategy investing in high quality companies (typically 20-50 stocks) with an integrated ESG risk assessment process, including a low carbon overlay and specific ESG exclusions on societal grounds related to either material manufacturing or retail exposures to Tobacco, Alcohol, Gambling, Controversial Weapons, Civilian Firearms, Adult Entertainment and other activities that Magellan may specify from time to time. 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 Sustainable strategy are to earn superior risk adjusted returns through the business cycle whilst minimising the risk of a permanent capital loss with specific ESG exclusions and a meaningfully lower carbon intensity than broader equity markets. The composite name was changed from Global ESG to Global Sustainable on 1 November 2020 following the restructure of our Global Sustainable product offerings into two distinct strategies, one with additional ESG exclusions and one without. The Global Sustainable strategy does apply additional ESG exclusions.

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.

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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. The representative portfolio for the Global Sustainable strategy changed on 1 November 2020 following the removal of the additional ESG exclusions from the previous representative portfolio.

USD is the currency used to calculate performance.

Market Commentary

The December quarter saw strong global equities returns with the MSCI World Index rising 11.4% in USD terms, driven by lower bond yields. The Information Technology sector led these gains (up 16.9%), followed by Industrials (11.4%) and Financials (11.2%), with these sectors sensitive to interest rate movements and the economic outlook. The Energy sector declined 5.5% as oil prices fell in the quarter. The S&P 500 rose 11.2%, MSCI Emerging Markets Index (7.4%) and Euro Stoxx 600 (6.4%). In contrast, China's CSI 300 Index fell 7.0%.

The main driver of equity returns in the quarter was a large fall in bond yields. US 10-year Treasury yields fell 70bp to 3.9%, German 10-year Bunds declined 80bp to 2.0% and Japanese 10-year JGBs declined 10bp to 0.6%. These were a response to easing inflationary pressures, with annualised US inflation in the three months to November running at 2% compared with 5.5% just six months earlier. Notably, this development led the Federal Reserve to suggest in December that its policy rate may be "at or near its peak". The tailwind to equity returns from lower interest rates was reinforced by a slightly improved profit outlook, with the gradual slowdown in global growth not hurting profit growth as much as many had feared earlier in the year.

The Chinese growth outlook remains challenged as the country digests its real estate bubble. Poor consumer, business and investor confidence are stiff headwinds to growth and will take time to improve in the absence of economic stimulus. While the Chinese government appears so far to be more focussed on internal security rather than growth, there have been some signs of minor pro-growth policies. These growth headwinds are reducing geopolitical risk in East Asia as the Chinese government focuses more on domestic issues.

Strategy Commentary

The strategy delivered strong returns over the quarter, both in absolute terms and relative to the MSCI World Index. Key contributors to performance included American Tower, Microsoft and US Bancorp. American Tower performed strongly on a solid 3Q23 result and as yields on long-dated US government debt moderated as inflation concerns eased. Microsoft delivered a strong quarterly result driven by commercial cloud momentum, unexpected Windows growth in a stabilising PC environment, gross margin expansion, and operating leverage. Azure performance provided encouraging early evidence of Microsoft's ability to monetise the AI opportunity despite cloud spending headwinds. US Bancorp benefited from the improved outlook for the US economy, which eased fears of significant credit losses. In addition, lower long-term interest rates should reduce losses on the bank's securities holdings, benefiting their balance sheet.

Detractors for the quarter included Nestlé, Novartis and Reckitt. Nestlé reported a disappointing third-quarter result owing to an IT integration issue in its vitamins, minerals and supplements division. The issue is expected to be resolved in early 2024, causing six months of earnings impact. Sector rotation into higher beta stocks also caused the staples index as a whole to underperform. Novartis underperformed due to sector rotation towards more economically sensitive stocks. There is no change to our investment thesis, and we remain positive on Novartis's drug pipeline potential post the company's recent investor day. Reckitt's third-quarter volume performance disappointed investors and increased risk that volume growth will be delayed and FY24 organic growth might be lower than expectations. The stock's attractive valuation adequately reflects near-term headwinds.

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

Developments in Sustainability

The annual United Nations conference on climate change, COP28, reignited pivotal discussions on global climate strategy. While we saw nearly every country agree to a 'transition away from fossil fuels', there was no agreement on timing or approach. The lack of global unity, however, has not deterred some nations from driving climate action at the national level. For example, the French government has implemented strict rules that force and incentivise households to address emissions. Overall, the mixed global stage regarding policy makes our commitment to the Net Zero Asset Manager Initiative and ongoing engagement with companies exposed to the transition critical to ensuring companies are resilient and working towards their own net zero targets aligned with limiting warming to 1.5C. We outline our climate strategy and our stewardship efforts more broadly in our 2023 Stewardship - Proxy and Engagement Review.

During the quarter, the United Nations Principles for Responsible Investment (UNPRI), the global organisation responsible for spurring and driving best practice in Responsible Investment including ESG integration, released the 2023 survey results. Happily, Magellan scored above peers in ESG integration, policy governance and oversight. We are pleased with this result, a reflection of our continued focus to enhance ESG risk management and investment opportunities.

Outlook

Following the rally in late 2023, markets enter 2024 relatively fully valued. The market continues to price in a Goldilocks scenario, with central banks tapping the brakes sufficiently to bring inflation under control, but not so much as to trigger a deep recession. The credibility of this position has been aided by the Federal Reserve's recent comments suggesting that US interest rate rises are complete. However, economic forecasting is notoriously error prone, and while we view the base case of a soft landing as reasonable, we are mindful that a more adverse outcome is certainly possible. At current market valuations there is little room for such an error, and consequently we continue to position the portfolio conservatively.

With market returns unlikely to benefit materially from higher valuations given current above-average levels, we anticipate returns are more likely to be driven by earnings growth. Our companies remain well placed to deliver solid earnings growth in the years ahead, reflecting their high quality, strong free cash flow generation, and the benefit of long-term structural tailwinds such as AI adoption.

Stock Story: Yum!

(Emma Henderson – Investment Analyst)

Behind the success of the world's most famous quick-service chicken restaurant, the world's second-largest pizza chain and the US's leading Mexican-style franchise sits Yum! Brands. With over 55,000 restaurants across more than 155 countries and territories, Yum! Brands is the world's largest restaurant company by number of restaurants and second only to McDonald's in total restaurant sales.

The iconic KFC, Pizza Hut and Taco Bell brands were originally brought together under consumer goods giant PepsiCo in the 1970s and 1980s as part of a series of acquisitions to diversify its business away from beverages. In 1997, PepsiCo announced it would be narrowing its focus back to its core beverages and snacks businesses and its fast-food unit would be spun off into an independent public company, ultimately named Yum! Brands.

Over the last 25 years, Yum! Brands has grown its global restaurant base by over 25,000 restaurants and has transformed from a US-centric company to a truly global business. It has also shifted its business model from owning and operating a portion of its restaurants to running an almost entirely franchised model, driving dual benefits of reduced risk and accelerated growth for shareholders.

Today, over 98% of KFC, Pizza Hut and Taco Bell outlets are operated by franchisee and licensee partners who deploy their own capital to open and operate restaurant outlets. These partners in turn pay Yum! Brands a royalty fee of approximately 5% of restaurant sales. In 2022, KFC, Pizza Hut and Taco Bell stores around the world generated US$60 billion in total system sales, resulting in US$3 billion in franchise revenue for Yum! Brands and contributing 90% of the company's earnings. Franchise fee revenue is a high-margin, capital-light earnings stream that is insulated from labour and commodity costs increases. The accessible price point and strong value-for-money nature of fast food add to the predictability of this attractive earnings stream throughout economic cycles.

By geography, approximately half of Yum! Brands' franchise revenue is now generated in international markets, including approximately 30% in fast-growing emerging markets like China, India, Southeast Asia and Latin America. While we have seen various misses from Yum! Brands and peers when trying to export US brands internationally, both KFC and Pizza Hut concepts have proven to have strong global appeal, with chicken and pizza products easily customised for local market tastes and preferences. Mexican-style Taco Bell, which is an outstanding business in its home US market, has proven harder to replicate internationally but is beginning to make inroads in markets like Spain, India, the UK, and China.

Despite significant growth and value creation delivered over the past few decades, there remains an exciting growth runway ahead for Yum! Brands, particularly in emerging markets where penetration of its brands remains low, consumer incomes are rising, and the existing restaurant landscape is highly fragmented and unsophisticated. Yum! Brands is targeting global system sales growth of 7% p.a. underpinned by new store growth of approximately 5% p.a. and modest growth in existing store sales through menu and marketing initiatives. The company has been running ahead of this net new store growth target, with over 100 countries contributing to global store growth of closer to 6% in recent years. Highly attractive payback periods on new stores and a more sophisticated and better-capitalised franchisee base relative to peers should prove key advantages to sustaining development in a higher interest rate environment.

Yum! Brands' growth will also be increasingly powered by digital and technology. The company has spent the last few years investing heavily in areas like customer analytics, digital ordering, loyalty programs and back-of-house restaurant technologies, which will be shared across its global system to drive better customer experiences, sales performance and franchisee profitability. One of many examples is the company's acquisition of Dragontail Systems in 2021 for approximately US$70 million. Dragontail is an AI-based technology that automates and optimises multiple Pizza Hut processes, from preparing the pizzas to dispatching product to delivery drivers and enabling customer tracking. In an increasingly digital world, we expect economies of scale on largely fixed-cost technology investments, as well as consumer data advantages from operating over 55,000 restaurants, to become increasingly important competitive differentiators relative to smaller restaurant players in the highly fragmented US$900 billion limited services restaurants industry.

Yum! Brands has a strong track record of ensuring its brands remain culturally relevant and loved. However, to ensure its brands can continue to grow sustainably, it will be important to manage food quality and nutrition risks as consumer preferences evolve, social risks as a large global employer and environmental risks as a large procurer of global agricultural and packaging products.

Yum! Brands remains a cornerstone of the Magellan Global portfolios, generating sustainable and defensive cash flows for investors.