Strategy Update: 30 September 2018

MFG Global Equity (USD)

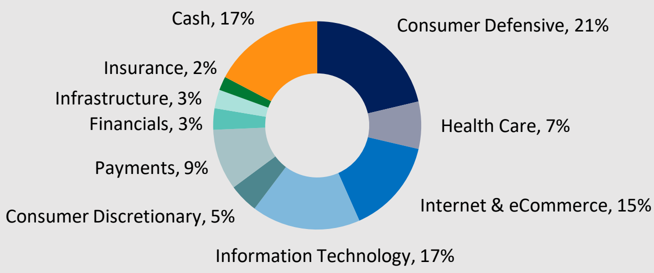
Portfolio Manager	Strategy Inception Date	Total Strategy Assets	Total Global Assets [1]
Hamish Douglass	1 July 2007	USD $32,732.1 million	USD $41,159.2 million

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	23	1,640
Return on Equity	27	17
P/E Ratio (1 year forward)	19.6	15.6
Interest Cover	14	11
Debt/Equity Ratio	44	49
Active Share	87	n/a
Weighted Average Market Cap (USD million)	277,654	n/a

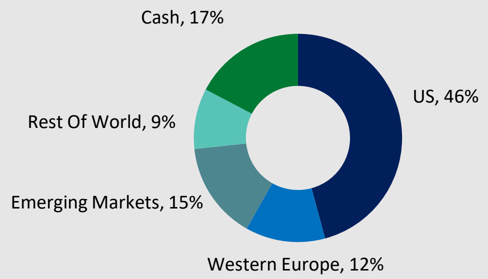
Top 10 Holdings[2]	Sector[2]	%
Alphabet Inc	Internet & eCommerce	6.8
Facebook Inc-A	Internet & eCommerce	6.0
Apple Inc	Information Technology	5.8
Visa Inc	Payments	5.5
Starbucks Corp	Consumer Defensive	5.3
Lowe's Co Inc	Consumer Discretionary	4.6
Kraft Heinz Co	Consumer Defensive	4.4
HCA Healthcare Inc	Health Care	4.3
Microsoft Corp	Information Technology	4.0
MasterCard Inc	Payments	4.0
	TOTAL:	50.7

Sector Exposure[2]



Capital Preservation Measures[4]	3 Years	5 Years	7 Years	10 Years	Since Inception
Adverse Markets					
No of observations	8	14	19	32	40
Outperformance consistency	88%	93%	95%	97%	93%
Average return – Strategy	-2.4%	-1.3%	-0.7%	-3.8%	-3.8%
Average return – Benchmark	-3.5%	-3.4%	-3.8%	-7.8%	-8.0%
Down Market Capture	0.7	0.4	0.2	0.5	0.5
Drawdown					
Maximum Drawdown - Strategy	-6.2%	-7.3%	-7.3%	-28.6%	-36.0%
Maximum Drawdown - Index	-8.8%	-12.0%	-12.0%	-35.9%	-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)	7.3	17.7	14.8	11.9	16.3	14.6	12.3
Composite (Net)	7.0	16.8	13.9	11.0	15.4	13.7	11.4
MSCI World NTR Index	5.0	11.2	13.5	9.3	12.5	8.6	4.9
Excess (Gross)	2.3	6.5	1.3	2.6	3.8	6.0	7.4
MSCI World Qual. Mix NTR	5.7	11.6	13.5	10.1	12.4	9.5	6.3
MSCI Min. Vol. NTR	6.0	10.3	12.1	10.2	11.3	8.8	6.3

Annual Performance[3]	CYTD (%)	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Composite (Gross)	10.5	25.2	4.7	4.2	6.6	30.8	21.6	11.9	18.3	39.4	-21.6
Composite (Net)	9.8	24.2	3.9	3.4	5.7	29.8	20.7	11.0	17.4	38.3	-22.3
MSCI World NTR Index	5.4	22.4	7.5	-0.9	4.9	26.7	15.8	-5.5	11.8	30.0	-40.7
Excess (Gross)	5.1	2.8	-2.8	5.1	1.7	4.1	5.8	17.4	6.5	9.4	19.1
MSCI World Qual. Mix NTR	5.5	21.5	7.9	1.6	7.3	24.5	13.0	0.7	11.4	27.7	-35.4
MSCI Min. Vol. NTR	5.7	17.3	7.5	5.2	11.4	18.6	8.1	7.3	12.0	16.4	-29.7

Supplementary Statistical Measures [5]	3 Years	5 Years	7 Years	Since Inception
Turnover	22.3%	21.0%	18.8%	14.7%
Beta	0.9	0.9	0.8	0.8
Tracking Error (% p.a.)	4.1%	4.0%	5.0%	6.7%
Standard Deviation – Strategy	8.6%	9.3%	9.5%	13.0%
Information Ratio	0.3	0.7	0.8	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 Important Notice below 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 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.

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 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 over the September quarter, to mark their ninth gain in the past 10 quarters, after companies posted higher-than-expected earnings, the US economy expanded briskly, the Federal Reserve reaffirmed that monetary policy would only be tightened gradually and Japan's economy rebounded. Gains were capped when the US escalated its trade war with China, US bond yields rose on inflationary pressures, a higher US dollar buffeted emerging markets and investors fretted about the impasse over the UK's departure from the EU.

US stocks reached unprecedented heights in September as companies reported strong earnings growth and the economy hummed. Financial research and data company FactSet said that 80% of S&P 500 companies announced earnings per share for the second quarter that beat estimates – a 'beat rate' that is the highest since FactSet began tracking this measure in 2008. In September, the Fed raised the US cash rate by a quarter point to between 2% and 2.25% and, as expected, signalled another five rate increases into 2020. The Fed made its eighth post-crisis rate increases on signs that the US economy was growing at close to capacity. Over the three months, reports showed the US economy completed nine years of consecutive growth (June 2009 to June 2018) when it expanded an annualised 4.2% in the June quarter, its fastest pace in four years. The US jobless rate stayed close to the 18-year low of 3.8% set in May and consumer confidence hit an 18-year high in September (as measured by the Conference Board). Gains were capped when the US and China tit-for-tat tariff enactments widened to about half their traded goods and 10-year US government bond yields rose 21 basis points over the three months to 3.06% on inflation concerns.

European stocks rose after European companies posted higher-than-expected earnings, US and European trade tensions eased and Sweden's mainstream parties held off populists in elections. In July, US President Donald Trump and EC President Jean-Claude Juncker met and agreed to "work together toward zero tariffs, zero non-tariff barriers, and zero subsidies on non-auto industrial goods", a statement that boosted hopes the US and EU would avoid a trade war. Sweden's centrist parties did better than expected in the country's election to prevent the populist Sweden Democrats from holding a pivotal, rather than nuisance, position in negotiations to form a government, even though the mainstream parties failed to win enough support to immediately mould a coalition. Gains were capped when the EU rejected the latest withdrawal agreement offered by the UK and Italy's new populist government said it was aiming for a budget deficit of 2.4% in 2019, three times the shortfall of the previous government and in breach of EU budget requirements for indebted governments. Reports showed the eurozone and EU economies expanded 0.4% in the second quarter, the same rate as for the first quarter.

Japanese stocks rose as the economy bounced back to expand 1.9% in the June quarter, after contracting in the previous quarter, and pro-stimulus Prime Minister Shinzō Abe overcame a corruption scandal to win a third term as leader of the Liberal Democratic Party, which allows him to stay in office for three more years. In China, stocks struggled amid concerns about the trade war with the US and as signs emerged the economy is cooling. Emerging markets fell as the collapse in Argentina's and Turkey's currencies presaged financial crises in these countries and Brazil's presidential election in October created uncertainty.

Strategy Commentary

The strategy recorded a positive return for quarter. The stocks that performed best included the investments in HCA Healthcare, Apple and Lowe's. HCA rallied after the US hospital chain reported higher-than-expected profits and revenue for the second quarter and raised guidance for the full year due to higher patient numbers and an increase in higher-paying procedures. Apple surged (to become the first US company with a market value in excess of US$1 trillion) after the consumer-technology company recorded higher-than-expected earnings for the third quarter and boosted its sales forecast for the fourth quarter due to the high demand for iPhones and other services. Lowe's climbed after the retailer's new CEO told a conference of his plans to simplify the company's operations, lift store productivity, improve service levels and boost longer-term returns.

Stocks that lagged included the investments in Facebook, Kraft Heinz and eBay. Facebook slid after management said slower revenue growth and higher costs would reduce profit margins from about 45% to about 35%, the Instagram founders left and the company revealed that 50 million accounts had been hacked. Kraft Heinz fell after issuing lower earnings guidance for fiscal 2018 even though management indicated renewed focus on improving the business's organic growth. Online auction site owner eBay dropped after the company trimmed its forecast for full-year revenue amid lower-than-expected growth in its Marketplace and StubHub (online ticket exchange) businesses and slower-than-expected progress in the company's 'structured data' initiative, which is an attempt to standardise data related to product display.

Key Stock in Focus – Reckitt Benckiser

Reckitt Benckiser: The consumer-goods multi-national thinks health brands will help in a disruptive world.

Reckitt Benckiser, a UK-based consumer-goods giant now called RB that as recently as 2015 achieved comparable annual sales growth of 6%, could well symbolise how tough conditions are for Big Brands in the age of rising ecommerce and private label penetration.

The company that boasts Clearasil acne treatment, Dettol antiseptic products, Finish washing detergent and Nurofen painkillers among its brands posted zero sales growth in 2017, its worst annual performance since it was formed in a merger in 1999. That result included RB's first-ever declines in comparable quarterly sales; they dropped 2% and 1% in the second and third quarters last year respectively.

The problems for a company that earned 11.5 billion euros in revenue in fiscal 2017 from brands stocked in more than 180 countries, were many over a year during which it divided itself into two businesses – health, which provides 50.5% of sales, and hygiene home, a split the company dubbed 'RB 2.0'. RB, which changed its name from Reckitt Benckiser in 2014, was hit by the 'NotPetya' ransomware cyberattack that hurt production and distribution for up to six months. The Scholl Amope foot care product launch flopped. A boycott in South

Korea over deaths from a noxious humidifier sanitiser lingered. A new goods and services tax in India slowed consumer spending there. RB shares fell 11% over the last six months of 2017 as the company cut forecasts for sales growth.

While like-for-like revenue has risen so far in fiscal 2018 – it gained 2% and 4% in the first and second quarters respectively – and RB shares rose 3.2% over the first nine months of 2018, the company faces a challenge to regain the trust of long-term investors and RB is well primed to do just that. The company in recent years has turned to health because it is a high-growth segment due to favourable demographics and one that provides opportunities for consolidation due to its fragmentation. A benefit of the move to acquire health brands is that it helps insulate RB against the ecommerce and private-label threats harming many 'Big Brand' companies. RB's bet on health brands is that they will maintain their higher margins, are harder to disrupt, promise faster growth, offer greater scope for innovation and are ripe for consolidation.

With the shift to health, the well-managed RB is among the most-disruption proof of Big Brand companies because nearly two-thirds of revenue (net of what suppliers get) comes from brands that are number one or number two in their categories and RB's goods are popular in fast-growing emerging markets, especially China. We invested in RB early in 2018 because we judged the stock to be attractively priced, especially when considering that many of the growth impediments in 2017 were one-offs.

RB, to be sure, has challenges. There is no escaping that all Big Brand household-good companies are losing pricing power as retailers consolidate and shoppers move online, though those brands outside the top two leading positions are most vulnerable. Another risk is that RB, which is always eyeing takeovers, might pay too much to expand. So far so good; management this year pulled out of a bid for Pfizer's consumer health arm due to concerns about overpaying and taking on too much. Emerging economies, which provide nearly half of revenue, are also higher-risk markets on which to depend. RB's management team under Rakesh Kapoor since 2011, which is regarded among the best in the industry on operations and strategy, is managing these risks. Such a team overseeing stellar health Big Brands is likely to keep RB investors happy enough for the foreseeable future.

Well insulated

In 1819, Isaac and Thomas Reckitt built a mill in the UK. In 1823, Johann Benckiser founded an industrial chemicals business in Germany. After nearly 200 years of business and innovation, which included the invention of Mortein fly spray in 1880, Lysol disinfectant in 1899 and Disprin in 1948, the surnames were joined atop one company 19 years ago when Reckitt & Colman merged with the, by then, Netherlands-based Benckiser.

The consumer giant that emerged from this union largely sold 'home products' such as laundry detergent, bar soap and insecticides. In the next two decades, RB expanded into health via takeovers, asset sales, a spin-off and organic growth.

The pivotal takeovers started in 2005, when only 5% of the company's sales were derived from health. In that year, RB bought Boots, and that came with Nurofen and Strepsils. In 2008, the company purchased Adams Respiratory Therapeutics, which owned Mucinex. In 2010, RB acquired SSL International, which came with Durex and Scholl. In 2012, it purchased Schiff Nutrition to branch into vitamins and supplements. The last big swoop was on Mead Johnson in 2017 that signalled the entry into baby formula. Amid these takeovers, RB spun off the pharmaceutical business Indivior in 2014 and sold its food brands to McCormick in 2017.

The strategy RB has for its two business units is clear. Within the best categories, the company aims to offer innovative market-leading products and market these products at prices significantly above the competition. RB calculates that, even though it charges higher prices, it can boost volumes by applying to pharmaceuticals the marketing techniques it honed to sell 'fast-moving consumer goods'.

What sets RB above competitors is how well the company is managed. RB has pursued categories that allow it to achieve the highest margins of all its counterparts. With a culture of controlling costs, streamlining supply networks, developing staff and robust management performance targets (that led to Kapoor having his pay package reduced in 2016 and 2017 due to the company's disappointing results), we expect RB to provide decent returns in coming years.

RB's revenue is diversified from a geographic point of view. About 47% of RB's revenue is derived from fast-growing emerging markets; mainly from China (13%), Brazil (5%) and India (4%, a number that should grow as India builds 110 million toilets as part of a five-year 'Clean India' campaign). About 32% of RB's sales come from the US and 22% from Western Europe.

About 44% of RB's global sales are in categories that we consider to be at moderate or high risk of being replaced by private labels. About 40% of global sales face moderate risk of migrating online. These products include baby food and vitamins.

Given such product positioning and management's nous and strategy, we expect RB to achieve a 3% to 4% p.a. annual revenue growth rates in coming years while modestly improving its profit margin from about 27%. While the growth rates would be half or a third below what RB achieved only three years ago, such results would rank as feats in the disrupted world of Big Brands.

Sources: Company filings and website.