MFG ASSET MANAGEMENT

# MFG Global Plus (USD)

| Portfolio Managers | Strategy Inception Date | Total Strategy Assets | Total Global Assets[1] |
|---|---|---|---|
| Nikki Thomas, CFA and Arvid Streimann | 1 July 2013 | USD $1,012.3 million | USD $22,601.3 million |

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

| Strategy Fundamentals[2] | Strategy |
|---|---|
| Number of Holdings | 30 |
| Return on Equity | 36 |
| P/E Ratio (1 year forward) | 23 |
| Interest Cover | 16 |
| Debt/Equity Ratio | 89 |
| Weighted Average Market Cap (USD million) | 420,130 |

| Top 10 Holdings[2] | Sector[2] | % |
|---|---|---|
| Microsoft Corporation | Information Technology | 7.8 |
| Visa Inc | Payments | 6.0 |
| Alphabet Inc | Internet & eCommerce | 5.6 |
| MasterCard Inc | Payments | 5.1 |
| McDonald's Corporation | Restaurants | 4.5 |
| Yum! Brands Inc | Restaurants | 4.4 |
| Novartis AG | Health Care | 4.3 |
| Reckitt Benckiser Group | Consumer Defensive | 4.0 |
| Intercontinental Exchange Inc | Financials | 3.9 |
| Nestle SA | Consumer Defensive | 3.6 |
| | TOTAL: | 49.2 |

| 3 Year rolling returns (measured monthly) | 1 Year | 3 Years | 5 Years | Since Inception |
|---|---|---|---|---|
| **Against MSCI World NTR Index⁺** | | | | |
| No. of observations | 12 | 36 | 60 | 73 |
| Average excess return (% p.a.) (Gross) | -3.1 | 1.9 | 2.2 | 2.1 |
| Average excess return (% p.a.) (Net) | -4.0 | 1.0 | 1.3 | 1.2 |
| Outperformance consistency (Gross) | 8% | 69% | 82% | 85% |
| Outperformance consistency (Net) | 0% | 61% | 77% | 79% |

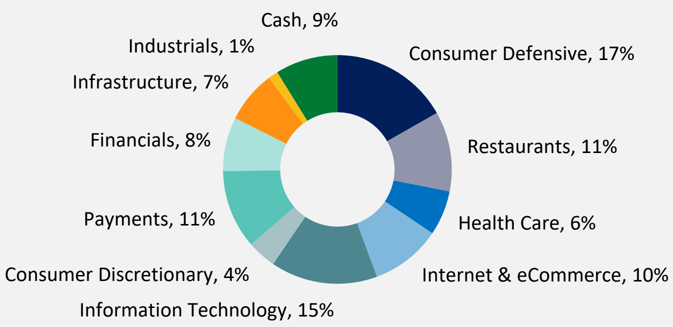
| Capital Preservation Measures[4] | 3 Years | 5 Years | Since Inception |
|---|---|---|---|
| **Adverse Markets** | | | |
| No. of observations | 12 | 19 | 30 |
| Outperformance consistency | 42% | 58% | 73% |
| Average return – Strategy | -6.3% | -4.8% | -3.4% |
| Average return – Index⁺ | -6.9% | -6.1% | -5.2% |
| Down Market Capture | 0.9 | 0.8 | 0.7 |
| **Drawdown** | | | |
| Maximum Drawdown - Strategy | -21.2% | -21.2% | -21.2% |
| Maximum Drawdown - Index⁺ | -21.1% | -21.1% | -21.1% |

| Performance[5] | 3 Months (%) | 1 Year (%) | 3 Years (% p.a.) | 5 Years (% p.a.) | Since Inception (% p.a.) |
|---|---|---|---|---|---|
| Composite (Gross) | -13.4 | -17.9 | 2.8 | 7.5 | 8.8 |
| Composite (Net) | -13.6 | -18.6 | 2.0 | 6.6 | 7.9 |
| MSCI World NTR Index⁺ | -16.2 | -14.3 | 7.0 | 7.7 | 8.5 |
| Excess (Gross) | 2.8 | -3.6 | -4.2 | -0.2 | 0.3 |
| MSCI World Factor Mix A-Series NTR Index⁺ | -13.1 | -10.3 | 6.8 | 7.9 | 9.0 |
| MSCI Min. Vol. NTR Index⁺ | -9.7 | -6.5 | 3.0 | 5.9 | 7.9 |

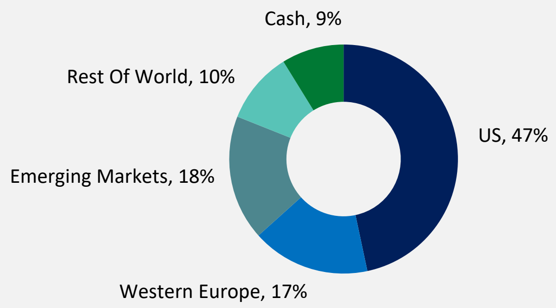
| Annual Performance[5] | CYTD (%) | 2021 (%) | 2020 (%) | 2019 (%) | 2018 (%) | 2017 (%) | 2016 (%) | 2015 (%) | 2014 (%) | 2013* (%) |
|---|---|---|---|---|---|---|---|---|---|---|
| Composite (Gross) | -21.2 | 13.8 | 11.1 | 29.7 | 0.3 | 25.6 | 4.3 | 3.9 | 6.6 | 13.4 |
| Composite (Net) | -21.6 | 12.9 | 10.2 | 28.6 | -0.5 | 24.6 | 3.4 | 3.0 | 5.8 | 12.9 |
| MSCI World NTR Index⁺ | -20.5 | 21.8 | 15.9 | 27.7 | -8.7 | 22.4 | 7.5 | -0.9 | 4.9 | 16.8 |
| Excess (Gross) | -0.7 | -8.0 | -4.8 | 2.0 | 9.0 | 3.2 | -3.2 | 4.8 | 1.7 | -3.4 |
| MSCI World Factor Mix A-Series NTR Index⁺ | -16.6 | 21.4 | 10.0 | 27.7 | -6.5 | 21.5 | 7.9 | 1.6 | 7.3 | 14.3 |
| MSCI Min. Vol. NTR Index⁺ | -12.3 | 14.3 | 2.6 | 23.2 | -2.0 | 17.3 | 7.5 | 5.2 | 11.4 | 7.9 |

| Supplementary Statistical Measures 6 | 3 Years | 5 Years | 7 Years | Since Inception |
|---|---|---|---|---|
| Beta | 0.7 | 0.7 | 0.8 | 0.8 |
| Tracking Error (% p.a.) | 7.8% | 6.9% | 6.3% | 5.8% |
| Standard Deviation – Strategy | 14.4% | 13.3% | 12.5% | 11.9% |
| Information Ratio | -0.5 | 0.0 | 0.1 | 0.0 |

## Sector Exposure[2]




## Geographical Exposure[2]




[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% due to rounding. Refer to the Important Notice below for further information.
[3] Rolling 3-year returns are calculated and rolled monthly for the duration of each period shown. The average excess return is then calculated for each period, with the outperformance consistency indicating the percentage of positive excess returns. Strategy inception is 1 July 2013.
[4] Capital preservation measures are calculated before fees and in USD. An adverse market is defined as a negative 3-month return for the MSCI World NTR Index+ (USD), rolled monthly, whilst drawdown is based on rolling monthly returns. Strategy inception is 1 July 2013.
[5] Returns are for the Global Plus 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 July 2013. 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.
[6] Supplementary Statistical Measures Beta, Tracking Error and Information Ratio are calculated in USD against 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.
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* Returns are only for part year.

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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.

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The Global Plus 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 Plus strategy are to earn superior risk adjusted returns through the business cycle whilst minimising the risk of a permanent capital loss. The minimum market capitalisation for a stock to be included is US$25 billion. The composite was created in July 2013.

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 fell for a second consecutive quarter in the three months to 30 June as the anticipation of tightening of monetary policy in the face of 40-year highs in inflation squeezed financial conditions. The issues confronting economies and markets remained widespread, from the Ukraine conflict and its ramifications for commodities to eurozone stability and zero-covid policy in China leading to strict lockdowns. While companies typically reported strong results during March and April, a few revealed margin hits from rapid cost increases. During the quarter, all the 11 GICS sectors fell in US-dollar terms. Consumer discretionary (-24%) fell the most while energy (-5.1%) fell least. The Morgan Stanley Capital International World Index overall fell 16% in US dollars and lost 8.5% in Australian currency.

US stocks dropped, with the S&P 500 Index down 16% over the quarter, as the prospect increased that higher interest rates and quantitative tightening by the Federal Reserve to fight inflation could send the US economy into recession. Inflation had reached 40-year highs at 8.6% in the 12 months to May, prompting the Federal Reserve to deliver the first of two rate rises so far, boosting the US cash rate by 1.25% to a range of 1.5% to 1.75%. The market is pricing a series of further rate increases to 3% or higher by year end. Surging inflation has seen US consumer sentiment, as measured by the University of Michigan, slide to its lowest since the survey began in 1952 while mortgage interest rates have risen from low levels to 14-year highs. Fed chair Jerome Powell warned the country must accept a higher risk of recession to curb inflation. A report showed the US economy unexpectedly shrank at an annualised pace of 1.6% in the first quarter, whereas investors had expected a gain of 1.1%.

European stocks slid, with the Euro Stoxx 50 Index down 12% in the quarter, as eurozone inflation set fresh record highs and the European Central Bank warned of tighter monetary policy and held an 'emergency meeting' to deal with the consequences. The European Commission downgraded its growth forecasts and increased inflation predictions due mainly to the energy crisis worsened by the Ukraine war. The UK economic outlook also deteriorated rapidly. As a report showed eurozone inflation at 8.1% in the 12 months to May, ECB President Christine Lagarde said they expect negative interest rates to end by September 2022. The ECB held an unscheduled meeting to alleviate concerns that higher borrowing costs for indebted countries could destabilise the eurozone – the ECB said it would come up with a plan to control sovereign yields. On June 30, indebted Italy sold government 10-year bonds at 3.47%, the highest yields since 2014. The EC reduced its growth forecasts for the EU and euro area for 2022 to 2.7% from 4% previously and said inflation would exceed 6% over the year. A report showed the eurozone economy grew 0.6% in the first quarter. In the UK, the Bank of England raised its key rate for a fifth consecutive month by 0.25%, to boost the key rate to 1.25%, and warned the economy would contract. In political news, Emmanuel Macron in April defeated Marine Le Pen in the French presidential elections, to make Macron the first head of state to be re-elected since Jacques Chirac in 2002. But in June France was said to have become 'ungovernable' when Macron's centrist Ensemble (Together) alliance lost its parliamentary majority in general elections that saw the far left and far right thrive, the first such defeat for a president in the fifth republic that began in 1958.

Japan's Nikkei 225 Index shed 5.1% as a report showed the Omicron variant caused growth to contract at an annualised rate of 1% in the first quarter and an energy crisis loomed. Australia's S&P/ASX 200 Accumulation Index dived 12% after iron ore prices slid and the Reserve Bank of Australia raised its key rate by 0.75% in two steps to combat inflation running at 5.1%, as the Australian Labor Party in national elections secured government after nine years in opposition. China's CSI 300 Index jumped 6.2% as Beijing implemented monetary and fiscal stimulus and large cities reopened after lockdowns enforced under a zero-covid policy. The MSCI Emerging Markets Index tumbled 12% in US dollars as the higher US dollar put pressure on countries with large debts denominated in the US currency and a global economic slowdown loomed.

## Strategy Commentary

The strategy recorded a negative return for the quarter. Among the biggest detractors were the investments in Alphabet, Microsoft and Intercontinental Exchange. Alphabet, the parent of Google, dropped after first-quarter revenue growth of 20% disappointed high expectations due to poorer-than-expected ad sales in Europe and on YouTube. Microsoft slid on news the EU is probing allegations the software giant has too much market power in the cloud-computing-services market. Intercontinental Exchange fell after it announced it agreed to acquire Black Knight, a software, data and analytics company that serves the mortgage industry, for US$13.1 billion in cash and stock. While the deal will likely take over a year to receive regulatory approval, in our view, it will be a positive transaction for the group as it digitalises the mortgage market.

The biggest contributors were our investments in Reckitt Benckiser, McDonald's and WEC Energy. The three are defensive and resilient businesses in the deteriorating economic outlook we face. All reported excellent results for the first quarter, beating market expectations and benefiting from strong pricing power and thus pass-through of cost inflation. McDonald's is also benefiting from the reopening of economies post the peak of covid-19 as patronage returns to its restaurants. WEC Energy, a US utility that supplies electricity and gas to Midwestern states, operates in a supportive regulatory environment and benefited from strong demand for gas during the US winter and growth in its 'rate base'.

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

## Stock Story: Diageo

DIAGEO

In the mid-2010s, UK-based distiller Diageo invested in proprietary technology tools to uncover growth opportunities and improve returns on marketing spending. The analysis revealed the US was a ripe market for premium tequila, an alcoholic brew made from the blue agave plant that flourishes around the town of Tequila in the western Mexican state of Jalisco. Tequila volumes in the US doubled from 2003 to 2015, as Hispanic influence took hold and millennials-come-mixologists began making margaritas or sipping the liquid straight.

Diageo's key step in its campaign to penetrate the high-end US tequila market came in 2017 when the company spent US$1 billion (including a US$300-million 'earn-out' based on sales) to acquire Casamigos tequila, a company founded four years earlier by US actor George Clooney and two others. Casamigos, which translates to 'house of friends' in Spanish, was the fastest-growing (40%+) 'super premium' tequila in the US. With the purchase, Diageo added Casamigos, which Clooney still promotes, to its tequila portfolio that includes complementary brands such as Don Julio.

By 2021, the campaign's success was obvious. Diageo's 'organic net sales' of tequila in fiscal 2021 had soared 79% from the previous year, numbers that meant tequila sales comprised 8% of the company's organic net sales. (This sales measurement excludes the effects of currency translation and takeovers and divestments.) The company subsequently announced it would spend US$500 million to expand production in Jalisco where it has two tequila plants.

Thanks to strategic portfolio adjustments such as this, Diageo has outperformed peers in the US, which accounts for nearly 60% of group operating profit. Globally, the owner of Baileys Irish Cream liqueur, Captain Morgan rum, Johnnie Walker whisky, Tanqueray gin and Smirnoff vodka posted sales of 12.7 billion pounds in fiscal 2021, an increase of 12% from the year earlier.

Diageo, whose spirits hold the No. 1 spot in six of the nine biggest spirit categories, extends beyond spirits. The company brews beer including Guinness, makes wine and offers ready-to-drink (pre-mixed) options. All up, the company boasts more than 200 global, local, and luxury brands that are sold in more than 180 countries. Through a 34% stake in LVMH's Moët Hennessy, Diageo stretches into the high-end cognac and champagne categories.

Spirits represent about 80% of Diageo's revenue – scotch generates 25% of Diageo sales, while vodka accounts for 10%. Beer brings in about 15% of sales while other categories such as ready-to-drink products and wine generate the remainder. In terms of locations, the company sources about 40% of sales in North America, 20% in Europe (including Turkey) and another 20% in Asia Pacific.

The modern history of Diageo, which can trace its start to 1759 when Arthur Guinness leased a brewery in Ireland, began in 1997 when Guinness and GrandMet merged. This union and subsequent bolt-on acquisitions have created a company with three key competitive advantages.

The first is that Diageo owns brands for which consumers are prepared to pay a premium. Spirits variants are distinguishable in terms of flavour, production process, provenance, and vintage. Such points of differentiation allow distillers to charge higher prices for luxury categories. Johnnie Walker's 18-years-to-produce Black Label scotch, for instance, sells at 3.7 times the price of Johnnie Walker Red Label whisky.

Diageo's second competitive advantage is that it has secured superior access to distribution channels. Bars, bottle shops, pubs, restaurants and supermarkets have finite space to display drinks. They favour brands that sell quickly and deliver higher margins. They want brands that can be supplied and restocked by a reputable and reliable company such as Diageo.

The third advantage is Diageo has the turnover to achieve economies of scale in advertising, data analytics, distribution, manufacturing, research and development and procurement of ingredients. Lower average costs mean competitive pricing and higher margins.

Because of these three key advantages we believe that the company is likely to generate superior returns for the foreseeable future, the attribute that stocks must possess to enter the Magellan global portfolio.

To be sure, Diageo faces challenges. Hot categories such as tequila inevitably attract competition. Celebrities Dwayne Johnson (the Rock) and Kendall Jenner have launched tequila brands in recent years that they promote via their widely followed Instagram accounts. There is a risk that this could dent category returns, as new brands take market share and prompt existing players to increase their marketing spending. The counterargument to this point is that new celebrity-backed brands generate buzz for the category, and they typically compete based on product differentiation rather than unhealthy price competition. Diageo must be quick to adapt to fresh competitive threats and new industry trends, as the company did when it stormed the top end of the tequila category in the US in 2017.

*Sources: Dunn & Bradstreet, company filings and Bloomberg.*