# MFG Core ESG Fund

## (Managed Fund) (Ticker: MCSE)

A diversified portfolio of 70-90 high quality global equities with ESG risk integration

MFG CORE SERIES

Fund Update: 31 December 2021

ARSN: 645 514 110
APIR: MGE8722AU

## Fund Features

- A portfolio of high-quality securities that is actively constructed and rebalanced quarterly
- Integrated quality framework to identify companies with sustainable competitive advantages, and with a forward-looking view to the evolution in technology, consumer behaviour and other fundamental impacts to businesses
- Quarterly rebalanced, and continuously monitored, to ensure relevant and updated views on ESG, quality, value and risk
- Investors can buy or sell units on Chi-X like any other listed security or apply and redeem directly with the Responsible Entity

## ESG Philosophy and integration

- Integrated proprietary ESG risk assessment process and low carbon framework
- Companies with material exposures to operations considered detrimental to society or the environment are removed from the universe
- Companies are reviewed and scored for the materiality of their exposure to E, S and G issues. The assessment is a direct input into portfolio management
- We overlay our proprietary low carbon framework to deliver a portfolio with a much lower carbon risk exposure than world markets

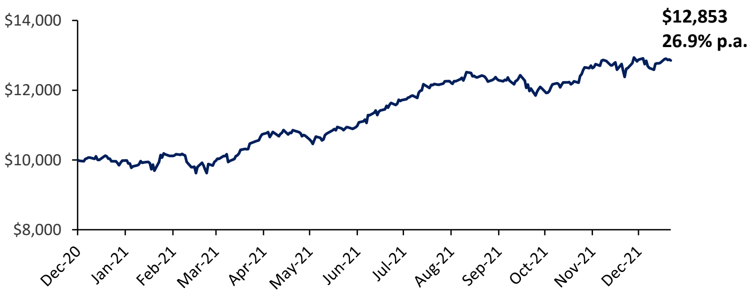
## Fund Facts

| | | |
|---|---|---|
| Portfolio Manager | Elisa Di Marco | |
| Structure | Global Equity Fund, A$ Unhedged | |
| Objective | Achieve attractive risk-adjusted returns over the medium to long term, through investment in a diversified portfolio of high-quality companies, whilst reducing ESG risk exposures. | |
| Inception Date | 11 December 2020 | |
| Management Fee[1] | 0.50% per annum | |
| Buy/Sell Spread[1,2] | 0.10%/0.10% | |
| Minimum Investment[2] | AUD$10,000 | |
| Fund Size/NAV Price[3] | AUD $15.7 million / $4.4174 per unit[3] | |
| Distribution Frequency | Semi-annually | |
| Chi-X Ticker | MCSE | |
| Tickers | Solactive iNAV | ICE iNAV |
| Bloomberg (MCSE AU Equity) | MCSEAIV | MCSEAUIV Index |
| Refinitive (MCSE.CHA) | MCSEAUDINAV=SOLA | MCSEAUiv.P |
| IRESS (MCSE.CXA) | MCSEAUDINAV | MCSE-AUINAV.NGIF |
| Carbon Intensity[4] ($CO_2$t/US$1m revenues) | Fund: 30 | Index**: 129 |

Visit www.mfgcoreseries.com.au for more information, including: fund performance, unit prices and iNAV, investment insights, PDS & forms

[1]All fees are inclusive of the net effect of GST; [2]Only applicable to investors who apply for units directly with the Responsible Entity; [3]NAV price is cum distribution and therefore includes the distribution of $0.07 per unit payable on 19 January 2022. [4]As at 31 December 2021, carbon intensity data available on a quarterly basis. Certain information ©2021 MSCI ESG Research LLC. Reproduced by permission.

## Performance Chart growth of AUD $10,000*



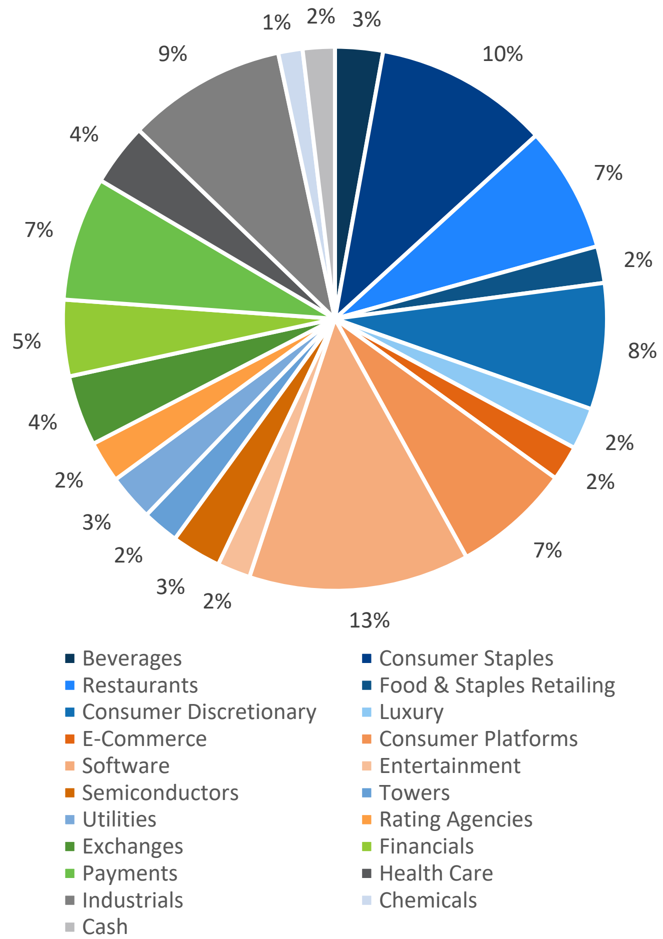

## Performance*

| | Fund (%) | Index (%)** | Excess (%) |
|---|---|---|---|
| 1 Month | 2.5 | 1.7 | 0.8 |
| 3 Months | 7.3 | 7.1 | 0.2 |
| 6 Months | 11.8 | 11.3 | 0.5 |
| 1 Year | 28.1 | 29.3 | -1.2 |
| Since Inception (p.a.) | 26.9 | 27.3 | -0.4 |

## Top 10 Positions

| Company | Sector# | % |
|---|---|---|
| Microsoft Corporation | Software | 2.4 |
| Amadeus IT Group SA | Software | 2.2 |
| Alphabet Inc | Consumer Platforms | 2.2 |
| Starbucks Corporation | Restaurants | 2.1 |
| McDonald's Corporation | Restaurants | 2.1 |
| RELX PLC | Industrials | 2.0 |
| MasterCard Inc | Payments | 2.0 |
| Autodesk Inc | Software | 2.0 |
| Visa Inc | Payments | 2.0 |
| Nestle SA | Consumer Staples | 2.0 |
| | TOTAL: | 21.0 |

## Portfolio Snapshot#




* Calculations are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). Fund Inception 11 December 2020. Returns denoted in AUD.
**MSCI World NTR Index (AUD).
# Sectors are internally defined. Exposures may not add to 100% due to rounding.

## Market Commentary

Global stocks surged to record highs in the December quarter as concerns abated about the economic damage of the new Omicron covid-19 variant, US companies posted stellar earnings reports, and US Congress postponed a debt-ceiling showdown and passed more stimulus. The rise occurred even though the Federal Reserve decided to reduce its asset purchases after US inflation reached a 39-year high and inflation accelerated worldwide. During the quarter, 10 of the 11 sectors rose in US-dollar terms. Information technology (+13.2%) rose the most while communication services (-1.7%) was the sector that fell. The Morgan Stanley Capital International World Index rallied 7.8% in US dollars, to be up 21.8% for 2021. In Australian dollars, the index gained 7.1% in the quarter and 29.3% over the year.

US stocks climbed as better jobless numbers and encouraging reports on earnings, especially from the banks and Big Tech, prompted investors to brush aside concerns that inflation is being entrenched. A report showed consumer prices climbed 6.8% in the 12 months to November, the most since 1982. In response, the Federal Reserve said it would accelerate its 'tapering' of monthly bond purchases. The central bank said it would prune its asset buying such that in January it would buy only US$60 billion of Treasuries and mortgage-backed securities compared with US$120 billion a month pre-tapering, while most Fed policymakers said they were prepared to raise the US cash rate three times in 2022. While reports showed an economy at full employment (the jobless rate fell to a pandemic low of 4.2% in November), the US economy expanded at a revised annualised rate of only 2.3% during the September quarter. In political news, the House of Representatives, over the unanimous opposition of Republicans, passed the US$2.2 trillion Build Back Better Act only for the centrepiece of President Joe Biden's domestic agenda to be blocked in the Democrat-controlled Senate. The House, with some Republican support, approved a US$1.2 trillion infrastructure package that had already passed the Senate. A proposal to raise the federal government's borrowing limit by US$2.5 trillion passed both chambers of Congress just before the December 15 deadline. The S&P 500 Index soared 10.6%, to up 26.9% for 2021.

European stocks advanced on encouraging earnings results and improved economic news. A report showed the eurozone economy expanded 2.2% in the September quarter after pandemic restrictions eased, the same speed it grew in the June quarter. A report that showed eurozone inflation reached 4.9% in the 12 months to November proved no dampener after the European Central Bank indicated it would not overreact to rising prices. The Euro Stoxx 50 Index added 6.2% over the quarter and 21% over 2021.

Japan's Nikkei 225 Index lost 2.2% in the quarter, reducing 2021's gain to 4.9%, as the new covid-19 variant prompted authorities to close the national border to foreigners and a report showed the economy shrank a larger-than-expected 0.9% in the September quarter, a contraction that prompted the re-elected Liberal Democrat government to promise US$350 billion in fresh fiscal stimulus. Australia's S&P/ASX 200 Accumulation Index rose 2.1% over the quarter (and 17.2% over 2021) as iron ore prices recovered and governments eased pandemic restrictions.

China's CSI 300 Index edged up 1.5% over the quarter (to be down 5.2% for 2021) on talk the regulatory crackdown on tech stocks has peaked. A report showed the pandemic had slowed economic growth to a 12-month rate of 4.9% in the September quarter. The MSCI Emerging Markets Index shed 1.7% in US dollars over the quarter and 4.6% over the year as emerging countries were hit harder by the new variant.

*Index movements are in local currency terms unless stated otherwise.*

## Fund Commentary

The portfolio recorded a positive return in the quarter. The biggest contributors included the investments in CME Group, Microsoft and Compagnie Financière Richemont of Switzerland. CME gained as trading volumes benefited from higher expectations of interest rate changes and greater volatility in energy markets. Microsoft surged on a 22% jump in revenue for the third quarter as its cloud business benefited from the global shift to remote work. Richemont reported very strong half-year results, beating market expectations. Exceptional growth in jewellery, in Asia and online sales were the highlights.

The biggest detractors were the investments in Alibaba Group, PayPal Holdings and Medtronic. Alibaba dropped after the Chinese tech company announced sales figures that disappointed for a second straight quarter and lowered its fiscal outlook for 2022, which fanned concerns about slowing consumer spending in China. Still, Alibaba announced a 29% rise in revenue for the September quarter and forecast 20% to 23% growth in fiscal 2022 revenue, rather than the 27% analysts were expecting. PayPal traded down in the quarter after reaching all-time highs earlier in the year amid concerns about disruption and weaker guidance than expected. Medtronic underperformed due to delays in several key pipeline products.

*Stock contributors/detractors are based in local currency terms.*

## Stock story: MSCI

Capital International, now Morgan Stanley Capital International (MSCI), published its first global equity index in 1968. Since then, MSCI has become a global index behemoth. More than US$16 trillion in assets is benchmarked to MSCI products, including the well-known MSCI World Index. Most of the world's leading asset managers use MSCI products to build portfolios and to benchmark investment performance.

MSCI, as the publisher of more than 250,000 daily indices, plays a core role in global capital markets. The index teams at MSCI set standards for investors by deciding which stocks and markets are worthy of inclusion in the closely followed indices. These decisions move stock prices and send billions of dollars of capital across international borders.

MSCI's index business has expanded extensively on the back of two key drivers, with more room to grow. The first driver, the growing popularity of global investing, expanded MSCI's client base. As asset owners looked to diversify holdings away from single domestic markets, the MSCI World Index, and its counterparts such as the MSCI Emerging Markets Index, served an expanding client need. Investors used the indices to define investable universes, monitor and manage portfolio risk, and benchmark investment performance.

The second driver, growth in passive investing, has widened the reach of MSCI index decisions. Passive investment strategies replicate an underlying index, delegating stock selection to the index publisher such as MSCI. MSCI indices are replicated by passive ETF assets that hold over US$1.3 trillion in assets. The outlook remains rosy given the relatively low penetration of global passive products.

But, MSCI is more than an index publisher. Motivated to "help clients build better portfolios for a better world," MSCI leverages its core position in the index industry to build tools for investors to assess and manage portfolio risk. No risk appears more front of mind for investors than ESG and climate change, and here MSCI excels.

MSCI has earned itself a pivotal role in the ESG (environmental, social and corporate governance) investing revolution. Its product set includes one of the broadest sets of ESG ratings (covering more than 14,000 issuers), leading climate risk-assessment tools, and ESG and climate risk-adjusted versions of the popular MSCI global indices. No fewer than 48 of the top 50 asset managers (of almost 2,000 clients) subscribe to MSCI ESG Research ratings, and MSCI is the number one provider of ESG indices used in passive strategies. Just as MSCI World Index decisions influence capital flows, MSCI's ESG ratings are starting to do the same. In a rapidly growing market, MSCI is becoming entrenched in investor flows much like in its index business.

MSCI's index business (about 80% of earnings) has strong network effects. Asset allocators and asset managers benefit from using the same standards, much like two people speaking the same language. Asset allocators familiar with MSCI indices would likely prefer to benchmark an asset manager's investment performance against an MSCI index than an alternative they hadn't heard of. Similarly, asset managers would prefer to use the MSCI index, which they too are familiar with, over one they weren't familiar with. Once entrenched, neither the asset allocator nor the asset manager is likely to switch. As allocators and asset managers grow familiar with MSCI's ESG standards, the same effect is occurring, building a stable recurring revenue stream for MSCI to allocate to new products. Given this network effect, for established relationships and benchmarks, there is little competition.

MSCI management has long followed this approach, using stable and growing cash flows from the core index business to build new business lines. ESG and climate tools are only one of two future new growth areas for MSCI. The second is a longer-term opportunity to build what MSCI describes as the "holy grail," an index of all investible assets. Combining listed and unlisted markets across equity and fixed income into one index methodology, MSCI hopes to become a one-stop shop for all investors globally. While there is greater competition in the development of new benchmarks, if MSCI's history is a guide, the company is well placed to play a leading role in these longer-term opportunities.

Overall, MSCI is a high-quality business that has a unique growth profile and risk exposure to financial markets. MSCI stands to benefit from the long-term growth of passive and ESG investing while displaying defensive characteristics, given the high level of subscription revenues.

## Stock story: Alphabet

# Alphabet

Alphabet is best known for its ubiquitous online search service, Google Search, which commands more than 80% of the global search market outside China. The company also owns YouTube, the largest global online ad-supported video platform on which more than two billion users watch more than one billion hours of content per day. It owns Android, and the Play Store for developers to distribute Android apps, which collectively support over two billion devices globally.

Alphabet has five other online services with more than one billion users – Google Maps, Chrome, Gmail, Google Photos, and Google Drive. It also owns the Google Cloud Platform, the third-largest hyperscale cloud vendor globally after Amazon's AWS and Microsoft's Azure. Finally, the company's 'Other Bets' segment houses a number of early-stage 'moonshot' projects; most notably, autonomous driving company, Waymo, which is arguably the technology leader in the nascent industry.

Of the more than US$250 billion in sales that Alphabet is expected to have generated in 2021, more than 80% is from advertising, and the majority of this is from Search advertising. Market dominance is a self-perpetuating pillar of the wide moat of the search business. Having the most users is a key competitive advantage as more users generate more revenue to cover the high fixed operating and capital costs, more users generate greater usage data to feed back into the service to improve it, more users drive advertisers to spend more time optimising their ads for your platform, and more direct traffic results in less revenue shared with distribution partners. In addition, Google is a highly customer-centric company, focused on improving the utility of the service, and ensuring that ad load does not hurt the user experience. Consequently, users generally like Google Search, and because it is free to use, it is difficult for new entrants to attract enough users to become viable.

Google Search's share of the global advertising market is more than 20% and growing because it is able to deliver users with greater commercial intent than offline media, generating measurably higher returns for advertisers. The search business's primary competitive risk is from the growth of vertical search competitors, Amazon in particular, but Google's business is broader than e-commerce and has grown strongly despite Amazon's steady rise. It also faces a risk from the rise of new computing interfaces such as digital assistants (e.g. Alexa). Alphabet has overcome the rise of new interfaces before. Apple is the prime example. Alphabet pays Apple well over US$10 billion p.a. for providing default search services on its devices (primarily the iPhone).

The greatest risk to Alphabet's outlook is antitrust regulation. The company is facing dozens of lawsuits globally. It has been fined more than US$10 billion in total by the European Commission for antitrust abuses across Google Shopping, Android, and its online advertising tools. Notably, none of these cases, or the resultant behavioural changes, appear to have impeded the company. US governments have opened similar cases and US Congress appears focused on legislating on these issues though laws that restrict self-preferencing (e.g. not being able to preference Google Maps in Google Search results) could be damaging to Alphabet in its largest market.

From an environmental, social and corporate governance perspective, Google is exposed to privacy concerns as it collects and analyses the data generated by its users to better target advertising at them. However, Search is less exposed to reductions in targeting ability than YouTube, because of the critical importance of the search input text to show relevant ads. Separately, despite the high energy use of its global data centres, Alphabet has been carbon neutral since 2007 and intends to run entirely on renewable power by 2030.

Overall, Alphabet is a high-quality business that stands to benefit from the continued shift to digital life.