MFG Core ESG Fund
(Managed Fund) (Ticker: MCSE)

MFG CORE SERIES

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

Fund Update: 30 June 2022

ARSN: 645 514 110

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 Cboe 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

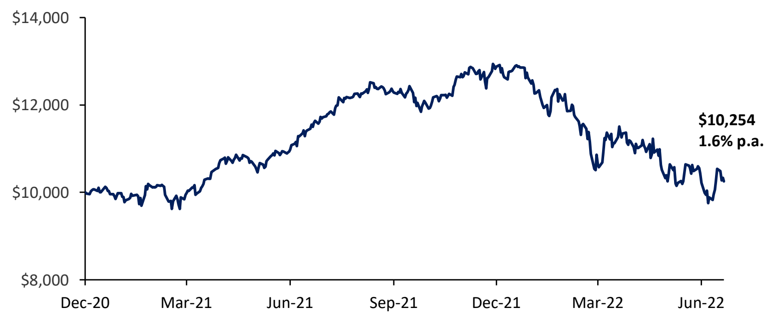
Fund Facts

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[2]	0.50% per annum	
Buy/Sell Spread[1,2]	0.10%/0.10%	
Minimum Investment[2]	AUD$10,000	
Fund Size/NAV Price[4]	AUD $12.4 million / $3.4683 per unit[4]	
Distribution Frequency	Semi-annually	
Cboe Ticker	MCSE	
Tickers	**Solactive iNAV**	**ICE iNAV**
Bloomberg (MCSE AU Equity)	MCSEAIV	MCSEAUIV Index
Refinitiv (MCSE.CHA)	MCSEAUDINAV=SOLA	MCSEAUiv.P
IRESS (MCSE.CXA)	MCSEAUDINAV	MCSE-AUINAV.NGIF
Carbon Intensity (CO_2t/US$1m revenues)[3]	Fund: 29	**Index****: 149

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] As at 30 June 2022. Carbon intensity data available on a quarterly basis. Certain information ©2021 MSCI ESG Research LLC. Reproduced by permission. [4] NAV price is cum distribution and therefore includes the distribution of $0.07 per unit payable on 21 July 2022.

Performance Chart growth of AUD $10,000*



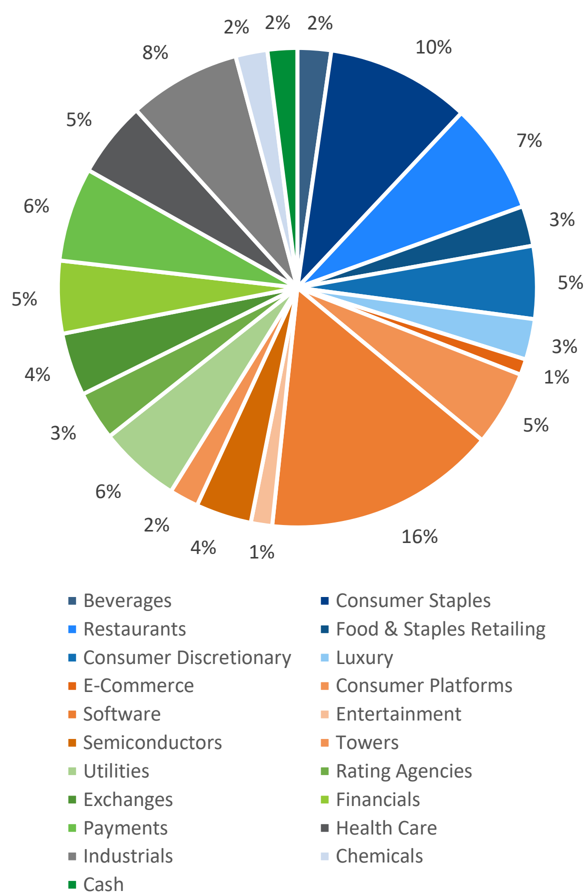
Performance*

	Fund (%)	Index (%)**	Excess (%)
1 Month	-2.9	-4.7	1.8
3 Months	-8.9	-8.5	-0.4
6 Months	-20.2	-16.0	-4.2
1 Year	-10.8	-6.5	-4.3
Since Inception (p.a.)	1.6	5.3	-3.7

Top 10 Positions

Company	Sector#	%
Microsoft Corporation	Software	2.6
American Water Works	Utilities	2.5
Alphabet Inc	Consumer Platforms	2.5
Adobe Inc	Software	2.4
Starbucks Corporation	Restaurants	2.3
Nestle SA	Consumer Staples	2.2
MSCI Inc	Financials	2.2
Autodesk Inc	Software	2.1
Yum! Brands Inc	Restaurants	2.1
CME Group Inc	Exchanges	2.1
	TOTAL:	23.0

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.

** Benchmark is the MSCI World NTR Index (AUD). All data 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.magellangroup.com.au/funds/benchmark-information/

Sectors are internally defined. Exposures may not add to 100% due to rounding.

Market Commentary

Global stocks fell for a second consecutive quarter in the three months to June after central banks tightened monetary policy to combat inflation, concerns grew that higher interest rates could pummel the US and global economies, doubts returned about the stability of the eurozone, and companies reported disappointing earnings and warned of pressure on margins. During the quarter, all of the 11 sectors fell in US-dollar terms. Consumer discretionaries (-24%) fell the most while energy (-5.1%) fell least. The Morgan Stanley Capital International World Index dived 16% in US dollars and lost 8.5% in Australian currency.

US stocks dropped as disappointing earnings (especially from retailers) added to pessimism that higher interest rates could send the US economy into recession. Inflation around 40-year highs prompted the Federal Reserve to deliver the first of two rate rises (that boosted the US cash rate by 1.25% to a range of 1.5% to 1.75%) in what is thought to be a series of rate increases that are expected to boost the key rate to above 3% by year end. As the University of Michigan consumer sentiment index slid to its lowest since the survey began in 1952 and mortgage rates surged to 14-year highs as the Fed commenced 'quantitative tightening' (asset selling), Fed chair Jerome Powell warned the country must accept a higher risk of recession to curb inflation. A report in June showed US inflation reached 8.6% in the 12 months to May, its fastest since 1981. Another 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%. The S&P 500 Index shed 16%.

European stocks slid as eurozone inflation set fresh record highs, the European Central Bank warned of tighter monetary policy and held an 'emergency meeting' to deal with the consequences, the European Commission downgraded growth forecasts and increased inflation predictions due to the energy crisis worsened by the Ukraine war, and the UK economic outlook crumbled. As a report showed eurozone inflation sped to 8.1% in the 12 months to May, ECB President Christine Lagarde warned the central bank's experiment with negative interest rates would end by September. 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. The Euro Stoxx 50 Index lost 12%.

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.

Fund Commentary

The portfolio recorded a negative return for the quarter. Among the biggest detractors, as a rise in government bond yields applied a greater discount to future profits, were the investments in Airbnb and Shopify. Another detractor was Rockwell Automation that underperformed due to earnings drag from supply constraints and demand uncertainty in the rising rate environment.

The biggest contributors, as defensives outperformed cyclicals, were the investments in Reckitt of the UK, Colgate-Palmolive and Dollar General. Reckitt gained after the consumer-goods company in the first quarter raised the prices of its goods by enough to protect margins from rising input prices. Colgate-Palmolive, despite a challenging cost environment, enjoyed a re-rate of its price-earnings ratio due to accelerating pricing initiatives and signs of improving execution in North America. Dollar General delivered strong operational performance that beat market expectations.

Outlook

In the past 12 months, inflation pressures have proven to be more persistent than expected, leading central banks to increase the size and pace of their monetary tightening's. While we believe that this is likely to result in a slow peak in inflation and a 'soft' landing, we see three risks to this outlook.

The first risk is that consumer expectations of inflation become unhinged, triggering a wage-price cycle. This would prompt central banks to conduct more rate increases, which would put more downward pressure on economic growth. The second risk is an unexpected supply- or demand-side shock that worsens the outlooks for growth and inflation. There might be, for instance, a disruption to energy supplies or a loosening or tightening in fiscal-policy settings. The third risk is that central banks are not nimble enough in adjusting monetary policy if growth slows more than expected and inflation takes longer than expected to return to more acceptable levels.

We are cautious about the outlook for equity market returns over the next 18 or so months. As economies slow, we expect equity returns to be increasingly driven by a softening in earnings expectations rather than higher interest rates. Until the peak in interest rates and the likely path of growth become clearer, uncertainty will weigh on equity valuations. We view the exposure to defensives and quality companies with sustainable earnings will be important holdings over this period.

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

Stock Story: McDonald's

McDonald's opened its first restaurant in 1948 and has since become one of the most recognisable brands in the world. The iconic golden arches were designed to draw attention to the company's pioneering 'Speedee Service System' that allowed McDonald's to serve its customers at speed, at lower cost and with consistent quality. It is this 'Quick Service Restaurant' design that enabled McDonald's to franchise. The company's reach has expanded to 39,000 restaurants in more than 100 countries that serve 65 million customers every day.

Given its size and industry positioning, McDonald's is exposed to numerous environmental, social and governance risks and opportunities, particularly in relation to the supply chain and labour management. It is important that these ESG risks are managed, to limit any threat to the company's cash flows and valuation. Communication of risks and how the company is mitigating them is crucial because transparency enables investors to better understand these risks. Magellan views that the key ESG risks and opportunities for McDonald's include:

- Labour. McDonald's is one of the largest employers in the US. Staff are vital as customer service is essential to operations. Consideration for diversity, equity and inclusion are important to culture, business continuity and brand.
- Health and wellness. McDonald's needs to ensure the items on its menu meet the changing demands of customers including their quest for healthy eating.
- Climate change. According to the UN Intergovernmental Panel on Climate Change, the global food system is responsible for 21% to 37% of global greenhouse gas emissions. Cattle are the largest contributors due to the methane they give off and land clearing for grazing. Investing in sustainable farming techniques is an important step to reducing emissions and lowering vulnerability to climate change for McDonald's.
- Raw material sourcing (including animal welfare). Improving the sustainability of sourcing reduces the environmental damage from operations. Importantly too is that this is the ethical path.
- The 'circular economy'. The term, which extends to natural resources, refers to the long-term sustainability of society, where there is less waste and more recycling of waste. Given the reliance of McDonald's on natural resources for packaging and food, it is important that management implement strategies to reduce waste and increase recyclability.
- Governance. It is important for all companies to operate ethically and in the best interests of shareholders.

As the world's largest restaurant chain, McDonald's attracts much attention from the media and investors. The McDonald's annual general meeting this year was no exception. Prominent activist investor Carl Icahn contested some of the proposals subject to shareholder voting at the meeting held in May. A contested ballot is uncommon. Less than 1% of Magellan's investments were subject to a contested ballot in fiscal 2022.[1]

At this year's annual meeting, Icahn called for McDonald's management to focus more on sustainability. In the context of the material ESG risks we monitor, Icahn's campaign was focused on a relatively narrow issue within McDonald's pork supply chain (sow gestation stalls – animal-rights activists say they are too small for pregnant pigs). To drive change, he submitted a shareholder proposal requesting a report from management on the issue and asked for two seats on the board to monitor compliance. Icahn had a tiny holding (just 200 shares) yet wanted director representation vastly greater than this ownership stake and out of proportion relative to McDonald's risks.

Contested ballots can be a distraction to management, but they can be a reminder that communication is critical to risk management. Ahead of the meeting, McDonald's management improved disclosure, providing much greater transparency relating to the activist investor's shareholder proposal on sow stalls. McDonald's outlined its collaboration with industry, its targets related to sow stalls, supply challenges due to covid 19 and progress to date. Although Icahn's proposal was voted down, it resulted in improved transparency, which is a good outcome for the industry.

The episode highlights that ESG risk management is important to asset owners. It is a reminder to asset owners that their vote matters and that asset owners can influence management. At Magellan, we value our right to vote. In this example, we reviewed the proposals, discussed the evidence, engaged with management and encouraged better communication. We concluded that McDonald's is managing the risk and as a result there would be limited impact on its valuation.[2]

Sources: Company filings

[1] A contested ballot or proxy contest is when a shareholder or group of shareholders attempt to drive change at a company. The activist investors typically seek a presence on the board with a view that the greatest change can be achieved from within.

[2] Magellan's ESG Philosophy is to consider all ESG risks with respect to materiality to cash flow and valuation.