MFG Core ESG Fund

(Managed Fund) (Ticker: MCSE)

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

Fund Update: 30 September 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

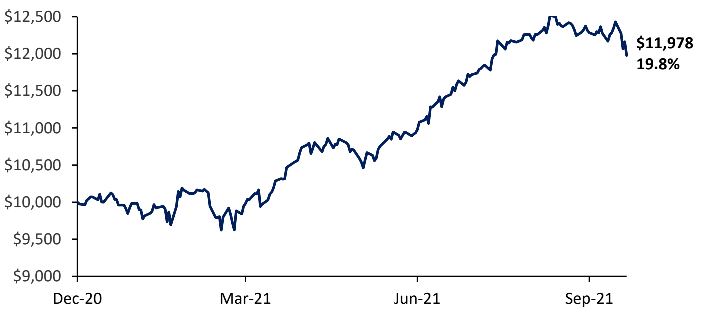
Fund Facts

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[1]	11 December 2020	
Management Fee[2]	0.50% per annum	
Buy/Sell Spread[2,3]	0.10%/0.10%	
Minimum Investment[3]	AUD$10,000	
Fund Size/NAV Price	AUD $14.3 million / $4.1166 per unit	
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 (CO_2t/US$1m revenues))	Fund: 30	Index**: 131

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

[1]The inception date represents the first date the fund was offered to retail investors;
[2]All fees are inclusive of the net effect of GST;
[3]Only applicable to investors who apply for units directly with the Responsible Entity. Certain information ©2021 MSCI ESG Research LLC. Reproduced by permission.

Performance Chart growth of AUD $10,000*



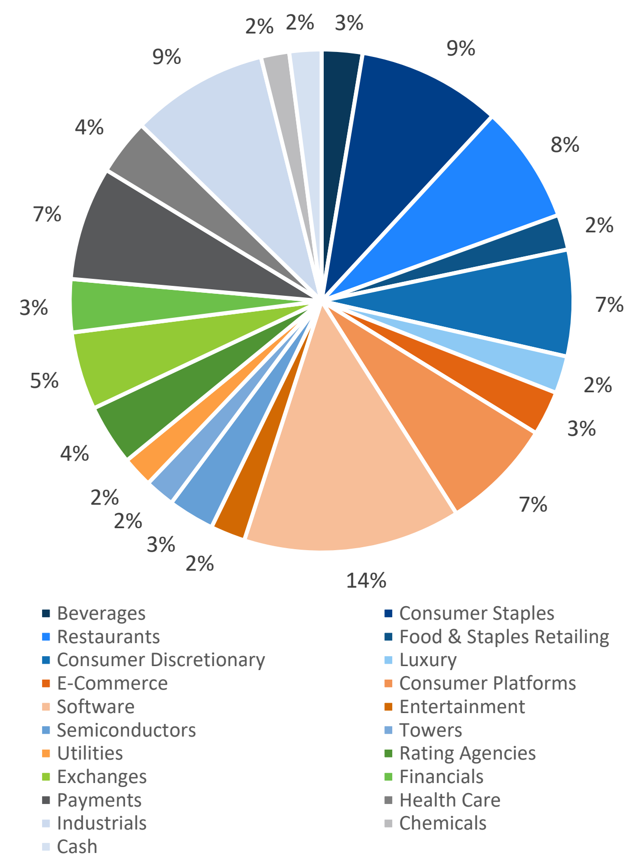
Performance*

	Fund (%)	Index (%)**	Excess (%)
1 Month	-3.5	-3.0	-0.5
3 Months	4.2	3.9	0.3
6 Months	16.1	13.6	2.5
Since Inception	19.8	20.4	-0.6

Top 10 Positions

Company	Sector#	%
CME Group Inc	Exchanges	2.3
Alphabet Inc	Consumer Platforms	2.1
Microsoft Corporation	Software	2.1
Starbucks Corporation	Restaurants	2.1
McDonald's Corporation	Restaurants	2.0
Visa Inc	Payments	2.0
SAP SE	Software	2.0
RELX PLC	Industrials	2.0
S&P Global Inc	Rating Agencies	2.0
Moody's Corporation	Rating Agencies	1.9
	TOTAL:	20.5

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 ended the September quarter almost unchanged, to end a run of nine rising quarters in 10. Stocks reached record highs over the first two months of the quarter after the Federal Reserve said it wouldn't overreact to higher inflation readings, US companies delivered better-than-expected earnings reports for the second quarter, and the eurozone and Japanese economies returned to growth. But these gains eroded in September after inflation concerns grew, rising interest rates reduced the premium on future profits, Congress failed to lift the US debt ceiling or pass more stimulus, worries emerged about China's economy, energy prices soared in Europe and covid-19 infections rose worldwide. During the quarter, seven of the 11 sectors fell in US-dollar terms. Materials (-5.0%) fell the most on China concerns while financials (+2.1%) rose most as higher interest rates helped bank margins. The Morgan Stanley Capital International World Index fell 0.01% in US dollars and 3.9% in Australian currency.

US stocks edged up as investors baked in expectations that monetary policy would stay loose for a while yet. In a key speech in August, Fed chairman Jerome Powell emphasised that rate increases were a long way off and the central bank was conscious of the economic hit stemming from surging delta cases. In September, however, Powell said inflation might last longer than thought and that while the central bank is unlikely to hike rates anytime soon it might announce plans to taper "soon". On the fiscal side, the House of Representatives failed to pass President Joe Biden's US$4.5 trillion agenda as Democrats squabbled though Congress passed a measure that kept the US government funded until December 3. Republicans in the Senate blocked moves to raise the US debt ceiling and thus kept alive the possibility the US could default, insisting Democrats had the numbers to lift the ceiling through the budget-reconciliation process. A boost for stocks was that almost 90% of companies beat expectations for the second quarter, the highest percentage of 'beats' since Refinitiv began keeping such records in 1994. Backing the Fed's view, investors regarded reports that showed consumer prices rising at a pace of about 5.3% in the 12 months to August as most likely driven by temporary supply constraints. The S&P 500 Index added 0.2%.

European stocks fell as German inflation notched a 29-year high when it reached 4.1% in the 12 months to September (while eurozone inflation stood at 3.0% in the 12 months to August), business confidence dropped and a fresh wave of covid-19 infections threatened. In better economic news, a report showed the euro area's economy expanded a revised 2.2% in the June quarter, after shrinking 0.3% in the previous three months. In political news, Germany's left-leaning Social Democrats won the greatest voting share in the general election and looked to be in the stronger position to form a coalition government with party leader Olaf Scholz as chancellor. The Euro Stoxx 50 Index eased 0.4%.

Japan's Nikkei 225 Index added 2.3% after the economy expanded a faster-than-expected 0.5% in the second quarter, after contracting in the previous three months, as Fumio Kishida became prime minister after Yoshihide Suga quit unexpectedly. China's CSI 300 Index slumped 6.8% as property developer Evergrande threatened to default, the delta variant spread, key indicators showed the economy is slowing, producer prices reached their highest since 2008, and regulators homed in on technology companies. Australia's S&P/ASX 200 Accumulation Index rose 1.7% as companies reported healthy earnings for the period to June 30 and an end loomed for the Melbourne and Sydney lockdowns. The MSCI Emerging Markets Index dived 8.8% in US dollars as China's economy slowed and Brazil's central bank raised the key rate to 6.25% from 2% at the start of the year and signalled another increase of 100 basis points in October to slow surging inflation.

Index movements are in local currency terms.

Fund Commentary

The portfolio recorded a positive return for the quarter. The biggest contributors were the investments in MSCI, Alphabet and Verisk Analytics. MSCI rallied on a strong quarterly result where resilient markets, strong inflows and margin expansion were the highlights. Alphabet surged after the parent of Google posted a higher-than-expected profit of US$21.7 billion in the June quarter after online advertising rebounded. Verisk rose after the US analytics company’s quarterly results exceeded expectations and management offered upbeat commentary on the long-term growth outlook.

The biggest detractors were the investments in Alibaba Group, Kering and Tencent Holdings. Alibaba dropped after Chinese authorities cracked down on tech with a focus on antitrust and security issues. Kering of France that owns Gucci and other luxury labels slid as doubts about China’s economy undermined luxury-goods companies dependent on China’s expanding middle and upper classes for sales. Tencent slumped amid the crackdown that restricts gaming by children, antitrust authorities fined Tencent for unfair practices and ordered the company to end exclusive music-licensing deals.

Stock contributors/detractors are based in local currency terms unless stated otherwise.

Stock Story: RELX Group

Big data is essential for operating a successful business. From helping insurers to predict risk, scientists develop new medical breakthroughs, and businesses target consumer groups and prevent online malfeasance, the use of data and analytics coupled with improved technological capabilities is a differentiating factor to success.

The UK-based RELX Group fulfils this need. The company renamed from Reed Elsevier is a leading provider of academic journals and platforms (Elsevier, which has over 2,650 titles on its ScienceDirect platform including *The Lancet*), database tools (Reaxys, which supports early-stage drug development), insurance decision tools, fraud analytics and leading legal electronic reference and decision tools (LexisNexis).

RELX, which describes its purpose as enabling its customers to make better decisions, get better results and be more productive, has customers in more than 180 countries in the education, medical, insurance, financial services and legal industries.

RELX's global reach can hide how competitive is the data and analytics industry. The barriers to entry are lower today compared with a decade ago, given improvements in technology. What hasn't changed, however, is the value of unique and rich data sets. In fact, one could say that when these data sets are combined with talented data scientists, technology advancements (natural language processing and machine learning) and strong product reach, the value is enhanced for customers and providers alike.

RELX combines these capabilities in providing customers with digestible data and analytics as well as tools to improve productivity and business outcomes. RELX's LexisAdvance online legal research tool, for example, allows users to enter a natural language question. The tool curates and delivers relevant answers, which results in faster answers and fewer searches of the 16 million case law legal decisions and 91 million statutes, regulations, and legislative documents in the US. This assists lawyers to develop their cases more efficiently while tapping into a comprehensive vein of relevant data.

RELX's larger divisions (Scientific, Technical and Medical; Risk and Business Analytics; and Legal) are the key drivers of business quality. These divisions are network businesses that have resulted in an oligopolistic industry structure for key division products. The divisions have elevated switching costs, economies of scale, deep customer and supplier relationships and trusted brands.

What does this look like, say, for RELX's largest division, Scientific, Technical and Medical?

RELX has a leading position in its primary research business in terms of journal title quality, title awareness and distribution. That is, RELX owns numerous journal titles, including *The Lancet* and *Cell* in which researchers strive to be published. The primary research business is a network business, as authors and readers benefit from improved circulation and the quality of the publication. The virtuous cycle is intensified by the academic need to publish. (Universities require professors to publish to retain tenure. Being published in higher-quality publications can lead to improved salaries and greater funding.) Furthermore, in medical research, publication is a key method to progress new techniques. It is difficult to replicate the brand awareness and distribution that RELX has created.

RELX operates in largely established industries such as education and insurance. The company's industry positioning and history of innovation have been critical to offsetting disruptive forces to date. RELX, for example, has successfully transitioned from a print business of magazines and journals to a business that generates 87% of revenue from electronic means and with a user base highly reliant on its written and quantitative data sets. RELX is always navigating disruptive threats including the risk of reduced government and corporate spending on research, uncertainty in primary research pricing structures, increased use and acceptance of non-peer-reviewed publications, and improved technology that provides competing analytical tools. These threats aren't new, and we view that RELX are well positioned to withstand them.

The materiality of ESG risks and opportunities differs by sub-industry. ESG risks are typically lower, for example, in the data and analytics industry. Data security is a typical key risk for the industry. Because RELX has less-sensitive data (highly sensitive data includes personal identifiable data), it's less likely to be targeted. RELX, however, doesn't ignore the risk. It prioritises cyber security and data privacy, as such steps are critical to business continuity and brand. Labour management is another key industry risk. Maintaining talent can be challenging in technology-focused roles, given the high demand. RELX prioritises culture, diversity, and inclusion, which we view as key facets for successful team management.

Overall, RELX is a high-quality business that has a unique growth and risk profile. RELX stands to benefit from the long-term growth in R&D by governments, academic institutions and companies while displaying defensive characteristics, given the high level of subscription revenues and the research-focused clients who rely upon the service and are less sensitive to economic circumstances.

Stock Story: Microsoft

Microsoft is known by households and businesses for its enterprise software (eg. Office, Windows, Azure) and hardware that help their productivity. What Microsoft may not be known for are its efforts to positively affect society via its leading sustainability and ESG initiatives.

The focus on sustainability is a priority and is ingrained in Microsoft's culture. Microsoft uses its influential innovative technology culture to drive change in the areas in which it can 'do good'. However, like all companies, Microsoft faces many challenges and risks related to sustainability.

Environment

Microsoft has made one of the most striking environmental commitments to its shareholders and society – the commitment to become carbon negative by 2030, and by 2050 to remove the carbon Microsoft has emitted since it was founded in 1975. Microsoft is going beyond the UN Paris Agreement, which seeks to limit global warming by countries and companies being net zero carbon emitters by 2050. The company intends to remove more carbon than it emits by

2030 and invest in technology that will benefit society more broadly in reducing emissions. These commitments are not simple tasks.

So how does a company not only reduce emissions but remove emissions?

Category	Definition	Microsoft example
Direct usage (Scope 1 emissions)	Direct carbon emissions occur from a company's operations; for example, the exhaust from vehicles on Microsoft's campus.	Microsoft expect to reduce Scope 1 and Scope 2 emissions to near zero by the middle of the decade. The company is achieving this through investment in energy efficiency – zero carbon transport, improving the operational efficiency of buildings, and implementing an internal carbon tax.
Indirect usage (Scope 2 emissions)	Indirect emissions occur from a company's consumption of energy.	Microsoft expect to reduce Scope 1 and Scope 2 emissions to near zero by the middle of the decade. The company is achieving this through investment in energy efficiency – zero carbon transport, improving the operational efficiency of buildings, and implementing an internal carbon tax.
Third-party supply and product usage (Scope 3 emissions)	Indirect emissions from the usage of products manufactured (e.g. energy used to operate a Microsoft Surface Pro), purchased goods and services (e.g. business travel and energy used to manufacture servers) or other business activities.	This is one of the more challenging but meaningful commitments a company can make, as it doesn't have control over third-party emissions. The company is committing to reduce Scope 3 emissions by more than half by 2030. While it lacks control over Scope 3 emissions, as a large buyer Microsoft can influence its suppliers and can design devices and software to be more energy efficient. Microsoft now requires the disclosure of emissions as per its supplier code of conduct policy; this data will be assessed in the procurement process and will inform buying decisions. the company is also focused on designing more efficient hardware; the Surface Pro X, for example, uses 28% less power than the Surface Pro 6.
Offsets and removal	A carbon offset looks to balance or 'offset' carbon emissions. While offsets are necessary for many companies, not all carbon offsets are created equal. For an offset to achieve its desired purpose, it needs to be 'additional'. That is, it should be a new project to offset emissions.	Microsoft, through tenders to its suppliers, has set a goal to remove one million metric tons of carbon. The company went in with clear objectives including the length of time for which the carbon would be removed, the amount of carbon that would have been removed without the project, and the avoidance of shifting of emissions from another area. Microsoft has invested in 26 projects to achieve its goal. These include reforestation in India and Peru, improved forestry projects in the US, soil carbon removal and engineered solutions.
Innovation	Innovation is a critical element that enables companies, communities, and countries to achieve net-zero targets.	Microsoft invests and innovates with third parties to drive change globally. The company is investing in carbon sequestration (see picture below of direct air capture technology of CO2), energy transition, sustainable agriculture, data centre storage and low-emission concrete.

Under construction: Climeworks' new large-scale direct air capture and storage plant "Orca".

Source: *https://query.prod.cms.rt.microsoft.com/cms/api/am/binary/RE4MDlc*

While Microsoft is actively investing in environmental initiatives that are beneficial, there are many challenges to its strategy. Challenges come from the circular economy, as well as changing consumer and supplier behaviours.

- **Circular economy:** The ability to reduce waste, to reuse waste and to reuse used products. The circular economy presents an interesting philosophical debate for companies. Companies must decide between selling more goods (positive for revenue growth), building more durable goods (extending the replacement cycle), which parts to use (recycled materials aren't always cheaper or require greater initial investment) and offering affordable goods (a range of price points for consumers across all income ranges). Microsoft continues to navigate its circular economy journey; the company is assessing how to incorporate recycled materials into hardware and is targeting 100% recycled packaging by 2030. The more contentious element, perhaps, is the 'right to repair'. Repairing electronic goods extends the life of the product; in effect, reducing the waste footprint globally but also reducing sales in the short term. Microsoft has always offered repair at authorised retailers; however, the cost can be prohibitive, reducing the likelihood of repair. Historically, Microsoft has received negative press on this topic and has been actively working to improve transparency in repairability of its hardware.
- **Changing consumer behaviour:** Consumers are responsible for how they use a product and how they dispose of a product. While Microsoft invests in more energy-efficient hardware and software, and hardware that is increasingly recyclable, it can't control how consumers use the goods. Consumer behaviour will be one of the most challenging obstacles in reducing Scope 3 emissions. This is an obstacle that most companies are tackling.

- **Changing supplier behaviour:** Driving change at suppliers is another challenge. Microsoft needs to walk the tightrope of business continuity and sustainability. Likewise, it isn't in the best interests of the community for Microsoft to cease working with partners that aren't maintaining the required sustainability standards. Through continuous engagement, Microsoft can work with suppliers to improve operating practices.

Social

Microsoft is proactive on many social initiatives, seeking to use its influence and technology for good while seeking to improve equality and inclusion.

- **Lawful surveillance:** Microsoft provides advocacy services and refuses to deploy facial recognition technology in scenarios that put freedoms at risk.
- **Closing the digital divide:** Microsoft Airband Initiative will bring broadband access to more than 40 million people in unconnected communities around the world by 2022.
- **Affordable housing:** The company is investing US$750m to increase the supply of affordable housing in the Seattle area.
- **Diversity and inclusion:** Microsoft is committed to doubling the number of Black employees in leadership roles by 2025, and doubling the number of Black- owned approved suppliers by 2023.
- **Data privacy:** Microsoft has put systems in place to ensure its customers have full control and rights over their data and privacy.

While Microsoft seeks to use its size and technology for good, size can lead to increased risk. Microsoft stores sensitive information and allows for critical infrastructure operations for its clients. Sensitive information means Microsoft is a more desirable target for bad actors seeking to access that information. It is critical that Microsoft continues to invest in cybersecurity to minimise the risk of security breaches, maintaining the trust of clients and the integrity of client businesses.

Microsoft has shown the world that you don't have to compromise strong shareholder returns for leading sustainability commitments. The company is paving a path for corporations and for governments on environmental initiatives and social impact. We view this forward-looking approach as a key facet of our investment thesis of the software giant. Microsoft is investing in the future of its brand and the community and strengthening the moat around its future cash flows.

Microsoft stock story – October 2021