MFG Core International Fund

(Managed Fund) (Ticker: MCSG)

A low-cost diversified global equity portfolio of 70-90 of the world's best companies

Fund Update: 30 June 2022

ARSN: 645 515 082
APIR: MGE3851AU

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 on businesses
- Quarterly rebalanced, and continuously monitored, to ensure relevant and updated views on quality, value and risk
- Investors can buy or sell units on the Cboe securities exchange like any other listed security or apply and redeem directly with the Responsible Entity

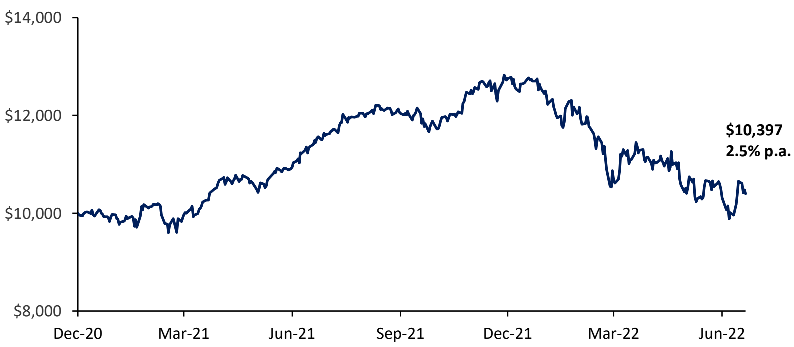
Fund Facts

Portfolio Manager	Vihari Ross	
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	
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[4]	AUD $17.6 million / $3.4876 per unit[4]	
Distribution Frequency	Semi-annually	
Cboe Ticker	MCSG	
Tickers	**Solactive iNAV**	**ICE iNAV**
Bloomberg (MCSG AU Equity)	MCSGAUIV	MCSGAUIV Index
Refinitiv (MCSG.CHA)	MCSGAUDINAV=SOLA	MCSGAUiv.P
IRESS (MCSG.CXA)	MCSGAUDINAV	MCSG-AUINAV.NGIF

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.
[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*



* 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.

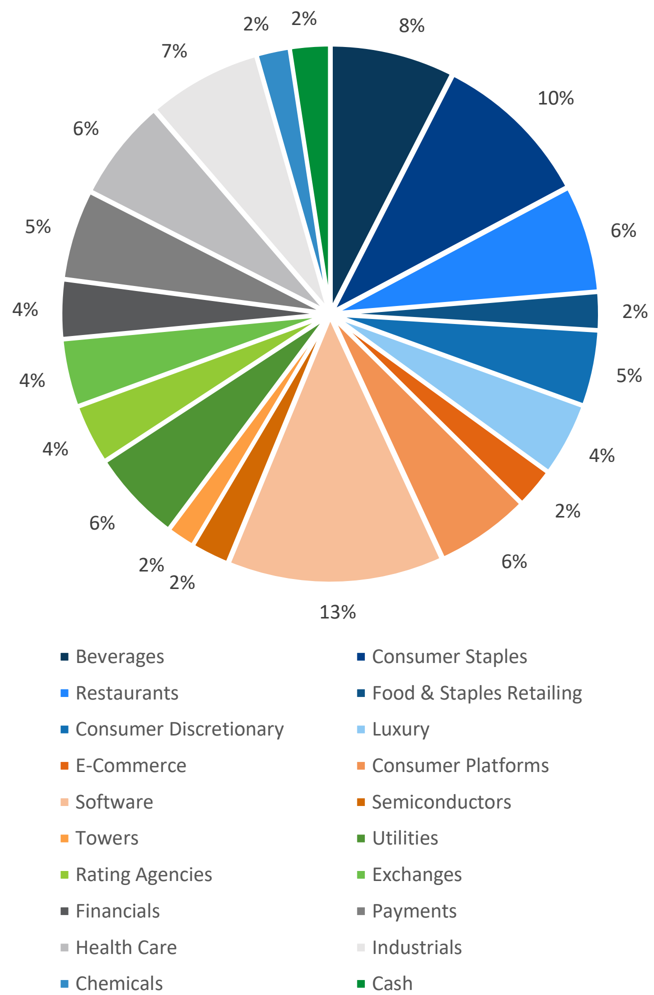
Performance*

	Fund (%)	Index (%)**	Excess (%)
1 Month	-2.1	-4.7	2.6
3 Months	-7.4	-8.5	1.1
6 Months	-18.1	-16.0	-2.1
1 Year	-9.2	-6.5	-2.7
Since Inception (p.a.)	2.5	5.3	-2.8

Top 10 Positions+

Company	Sector#	%
Microsoft Corp	Software	2.9
Alphabet Inc	Consumer Platforms	2.8
Starbucks Corp	Restaurants	2.3
Adobe Inc	Software	2.3
Louis Vuitton Moet Hennessey	Luxury	2.2
Yum! Brands Inc	Restaurants	2.2
Nestle SA	Consumer Staples	2.1
S&P Global Inc	Rating Agencies	2.0
CME Group Inc	Exchanges	2.0
Diageo PLC	Beverages	2.0
	TOTAL:	22.8

Portfolio Snapshot# +



+ Top 10 Positions and Portfolio Snapshot based on portfolio holdings at 29 June 2022 to exclude the timing impact of a significant cashflow on 30 June 2022.

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 reelected 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, Netflix and Amazon. Airbnb fell as a larger discount rate was applied to a company considered high growth. Netflix fell on a decline in its subscribers in its first quarter result and weak guidance on subscribers and future pricing growth potential. Amazon declined after the online retailer saw cost headwinds impacting its retail business.

The biggest contributors, as defensives outperformed cyclicals, were the investments in Kweichow Moutai of China, McDonald's, and Colgate-Palmolive. Kweichow Moutai's quarterly result beat expectations given strong volumes and pricing outcomes in its direct-to-consumer e-commerce platform. McDonald's saw strong demand trends drive revenue ahead of market expectations and Colgate-Palmolive, saw a re-rate of its price-earnings ratio due to extrapolation of signs of improving execution in North America and accelerated pricing in the face of a challenging cost environment.

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.