MAGELLAN INFRASTRUCTURE FUND
MAGELLAN INFRASTRUCTURE FUND (UNHEDGED)

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The Magellan Infrastructure Fund and the Magellan Infrastructure Fund (unhedged) seek to provide efficient access to the stable returns offered by infrastructure and utility stocks while protecting capital in adverse markets by investing in infrastructure companies that we consider provide essential services and generate predictable long-term earnings. Infrastructure and utility stocks that will help achieve these aims generally have strong underlying financial performance over the medium to long term, which we expect to translate into reliable, inflation-linked returns. The strategy typically holds between 20 and 40 stocks. The unhedged version of the fund makes no attempt to protect returns from currency movements.

PERFORMANCE

Global stocks soared to record highs in the 12 months to June 2021 after government and central bank stimulus helped economies recover from the pandemic, pharmaceutical companies hastened economic reopenings when they developed vaccines against the virus that causes the illness known as covid-19, the new US administration of President Joe Biden used the unexpected control of Capitol Hill it gained in January after surprise Senate election victories in Georgia to implement more fiscal stimulus, investors decided the Democrats' narrow control of Congress would prevent anti-business measures becoming law, and tech stocks reported earnings that showed how much they have benefited from the shift to online.

The portfolio recorded a return after fees of 7.9% for the 12 months while the unhedged version recorded a return of 3.0%. Stocks that contributed the most included the investments in Enbridge of Canada (+1.4% of the total portfolio return), CSX Corp of the US (+1.0%) and American Tower Corp (+0.6%). Enbridge benefited as President Joe Biden issued an executive order revoking the presidential permit for Keystone XL, a pipeline that was being developed between Canada and the US, increasing Canadian producer reliance on Enbridge's pipelines combined with the progress of the construction on the Line 3 replacement project as well as benefiting from the increase in oil prices – even though changes in the oil price have little immediate effect on their revenues. CSX (and other North American railroad companies) gained after cargo levels held up better than expected amid pandemic-related restrictions and the benefits of increased efficiency measures that have persisted even as volume has recovered. American Tower rose after the company that provides co-location space to wireless carriers across more than 186,000 communication sites globally announced decent earnings and lifted full-year guidance on increased tower use as people and businesses turned to the internet when under pandemic restrictions.

Stocks that detracted the most included the investments in Royal Vopak of the Netherlands (-0.8%), FirstEnergy Corp of the US (-0.7%) and Atmos Energy of the US (-0.5%). Vopak, which stores oil, gas and chemicals, fell as the oil market slipped into 'backwardation', a term for when the price of a commodity's forward or futures contract is trading below the expected spot price at contract maturity. The unusual pricing condition reduces the demand for short-term storage. FirstEnergy plunged after the US Attorney's Office of Ohio charged House Speaker Larry Householder and five others with bribery and money laundering tied to a bill that effectively was a US$1.5 billion bailout of a former subsidiary of FirstEnergy's nuclear plants in the US state. Atmos Energy, the largest gas-only distributor in the US, was among US utilities to slide on concerns that utilities were most vulnerable to any rise in interest rates.

POSITIONING AND OUTLOOK

At 30 June 2020, not long after the onset of the covid-19 pandemic, the investment portfolio comprised a defensive positioning of about 45% regulated utilities, 45% infrastructure and 10% in cash. As the crisis abated, we reduced our allocation to cash and reinvested in regulated utilities and infrastructure sectors. At the end of June 2021, the investment portfolio had a small amount in cash and the remainder approximately equally split between regulated utilities and infrastructure.

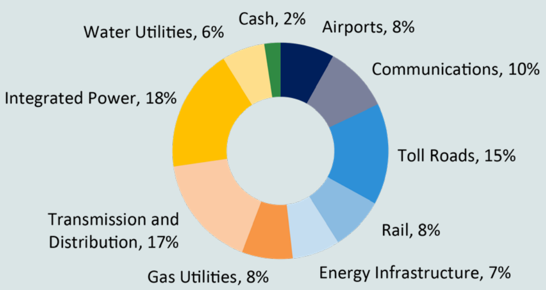
There are three key issues that are influencing our outlook:

- The return to 'normal' as covid-19 abates as a threat.
- The drive towards net-zero emissions.
- The outlook for inflation and interest rates.

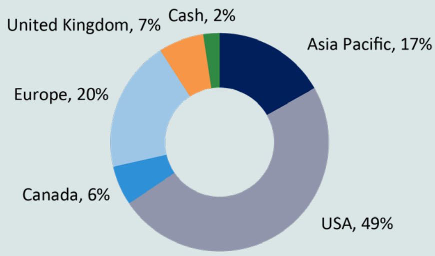
Top-10 holdings at 30 June 2021[1]

Security	Weight (%)
Transurban Group	7.1
Enbridge Inc	5.8
Sempra Energy	5.1
Atmos Energy Corporation	5.0
Crown Castle International	4.9
American Tower Corporation	4.9
Vinci SA	4.6
Eversource Energy	4.3
Xcel Energy Inc	4.1
Red Electrica Corporacion	4.0
Total	**49.8**

Sector Exposure[2]



Geographical Exposure[2]



The return to 'normal'

The businesses in regulated utility, communications infrastructure and rail sectors have proved resilient in the face of the economic upheaval forced by the pandemic.

- Regulated utilities typically generated financial performance in line with expectations. While the pandemic led to a reduction in the volume of electricity, gas or water transported by providers of essential services, these utilities were able to reduce their operating costs or work with their regulators to achieve financial performance in line with their expectations prior to the pandemic.
- Communications infrastructure businesses provide the infrastructure that supports the broadcasting and transmission of voice, video and data across communities. These businesses have benefited over the past decade from the explosion in the amount of data consumed through mobile, smart televisions and computer systems and were largely immune to the economic damage of lockdowns. We consider the outlook for continued strong growth in the volume of data broadcast across communications networks amid the transition to 5G networks well positions communications infrastructure companies in the coming decade.
- In the initial stages of the pandemic, rail companies in North America experienced sharp declines in freight volumes. Notwithstanding this deterioration in activity, margins proved more resilient than expected and an acceleration in the implementation of productivity measures delivered leaner cost structures. Freight volumes rebounded in the second half of 2020, and in many instances they approached pre-pandemic levels by year end. The recovery in volumes revealed further lasting improvements in efficiency. Our outlook remains bright as we expect freight volumes to reflect a growing US economy and rail companies to become even more efficient.

The shutdown of aviation by governments in response to the pandemic crushed passenger numbers – the International Air Transport Association (IATA) estimates passenger numbers plunged 94% in April 2020. Such declines led to sharp share price declines for airport stocks in the first half of 2020. News of successful vaccine trials in November 2020 triggered a significant bounce in airport stocks. Notwithstanding higher share prices, the operating performance of airports remains depressed relative to pre-covid-19 levels and will take some time to recover. IATA estimates, for example, that global aviation passenger numbers in April this year were down by more than 65% compared with April 2019. As vaccines are rolled out, we expect the airports to experience significant growth in passenger numbers. IATA predicts a recovery to 2019 passenger levels by 2023.

Similar to airports, traffic on toll roads plummeted at the start of the pandemic as governments restricted freedom of movement and people opted to stay home. Toll roads have generally experienced a rebound of traffic from 2020 lows but subsequent waves of the pandemic have typically led to periodic reductions in traffic. However, where health outcomes have improved and government restrictions on movement have eased, strong improvements in traffic levels have occurred. Toll roads offer an essential service to communities and we are confident that, as the vaccine rollouts progress and society reopens, traffic levels will recover.

The drive towards net-zero emissions

Regulated electricity utilities are major beneficiaries of the energy transition already underway. Communities around the world are embracing the challenge to reduce carbon emissions to net zero as a key plank in limiting global warming to 1.5°C. The commonly agreed path to achieve net zero includes the replacement of fossil-fuel-based energy sources with renewable energy sources combined with a significant investment in the electricity grid to enable increased electrification of the economy. Increased renewables and increased electrification are key steps to reducing carbon emissions and both present meaningful opportunities for regulated utilities to expand their earnings. We expect that the transition to net zero is likely to underwrite decades of earnings growth for electricity utilities.

The outlook for inflation and interest rates

There has been much commentary over the past year about the likelihood of faster inflation and higher interest rates. Reports have shown evidence of an acceleration in inflation but we expect higher inflation to be a temporary phenomenon. Even so, we expect interest rates to increase somewhat from current levels. Increasing interest rates represent a challenge for infrastructure, as it does for all investment classes.

There are two key areas we focus on when considering inflation and interest rates:

- **The impact on the businesses in which we invest**. We remain confident that the businesses that meet our investment-grade infrastructure criteria are well placed to meet our investment expectations over the medium term even through a period of rising inflation and interest rates. The businesses that meet our criteria provide essential services and face minimal competition and as a result are often regulated or have long-term contracted revenues that allow for inflation. When inflation or interest-rate conditions become challenging, we consider that regulation or long-term contracts protect these businesses and enable them to earn a fair return. In addition, many infrastructure and utilities businesses have increased the duration of their debt over recent years, essentially locking in today's low interest rates for long periods, which makes them less sensitive to movements in interest rates. We are confident that any shifts in inflation and interest rates will fail to hamper the financial performance of the companies in the portfolio for the foreseeable future.
- **Impact on valuations and on debt and equity markets**. An increase in interest rates can be expected to lead to a higher cost of debt, and an increase in the rate at which investors value future earnings. (The higher this 'discount rate', the less investors are willing to pay for future income streams.) Our forecasts and valuations take these factors into account. However, the history of financial markets leads us to expect increasing uncertainty if rates rise or look like rising. Stocks that are regarded as 'defensive' are often shunned when interest rates rise as investors prefer higher-growth sectors. However, it is our experience that provided businesses have solid fundamentals, their stock prices over the longer term will reflect their underlying earnings.

We believe that infrastructure assets, with their reliable earnings that are protected to a degree from inflation, are an attractive long-term investment proposition. The predictable nature of their earnings compared with those offered by other asset classes means that infrastructure assets can offer diversification benefits. In uncertain times, the reliable financial performance of infrastructure stocks can make them particularly attractive. An investment in listed infrastructure can reward patient investors and we remain confident that the strategy will continue to meet its objectives of delivering attractive risk-adjusted investment returns over the long term and protecting capital in adverse markets.

Gerald Stack

Performance as at 30 June 2021 [3]

	1 year (%)	3 years (% p.a.)	5 years (% p.a.)	7 years (% p.a.)	10 years (% p.a.)	Since inception (% p.a.)
Magellan Infrastructure Fund	7.9	4.6	5.9	8.4	10.5	7.6
Magellan Infrastructure Fund (Unhedged)	3.0	4.9	5.8	9.3	-	10.9

Rolling 3-year returns (measured monthly) [4]

Against Global Infrastructure Benchmark (A$ Hedged)	Last 12 months	Last 36 months	Last 60 months	Since inception (133 Months)
Average excess return (% p.a.)	3.0	2.9	3.3	4.0
Outperformance consistency	100%	94%	97%	96%

Capital Preservation Measures [5]

Adverse Markets	Last 36 months	Last 60 months	Since inception
No. of observations	10	13	56
Outperformance consistency	70%	62%	73%
Down Market Capture Ratio	0.5	0.5	0.4

1 Based on Magellan Infrastructure Fund, weights may not sum to total due to rounding.
2 Based on Magellan Infrastructure Fund. Sectors are internally defined. Geographical exposures are by domicile of listing. Cash exposure includes profit/loss on currency hedging. Exposures may not sum to 100% due to rounding.
3 Returns denoted in AUD. 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). Magellan Infrastructure Fund inception date is 1 July 2007 (inclusive), Magellan Infrastructure Fund (Unhedged) inception date is 1 July 2013 (inclusive).
4 Based on Magellan Infrastructure Fund. 3-year returns are calculated and rolled monthly in AUD, with the outperformance consistency indicating the percentage of positive excess returns since inception. 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). The Global Infrastructure Benchmark is the S&P Global Infrastructure Net Total Return Index (A$ Hedged) spliced with the UBS Developed Infrastructure and Utilities Net Total Return Index (A$ Hedged) prior to 1 January 2015. Fund inception date is 1 July 2007 (inclusive).
5 Based on Magellan Infrastructure Fund. Capital preservation measures are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). An Adverse Market is defined as a negative monthly return for the MSCI World NTR Index (A$ Hedged). The Down Market Capture Ratio shows if a fund has outperformed a benchmark during periods of market weakness, and if so, by how much. Fund inception date is 1 July 2007 (inclusive).

IMPORTANT INFORMATION

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