MAGELLAN INFRASTRUCTURE FUND

MAGELLAN INFRASTRUCTURE FUND (UNHEDGED)

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The Magellan Infrastructure Fund seeks to provide efficient access to the stable returns offered by infrastructure and utility stocks, while protecting capital in adverse markets. Infrastructure and utility stocks that will help achieve these aims generally have strong underlying financial performance over the medium to long term, which is expected to translate into reliable, inflation-linked returns. The Fund typically holds between 20 and 40 stocks. The unhedged version of the portfolio makes no attempt to protect returns from currency movements.

PERFORMANCE

Global stocks rose in the 12 months to June 2020 after huge fiscal and monetary stimulus offset the damage from the coronavirus to economic activity, company profits and investor confidence. But infrastructure stocks fell over the 12 months as the restrictions on everyday activity, including air and road travel, hit these stocks to a greater degree.

The portfolio recorded a return after fees of minus 8.9% for the 12 months, 7.3% above the portfolio's benchmark (S&P Global Infrastructure Index A$ Hedged Net Total Return), while the unhedged version recorded a return of minus 6.8%. Stocks that detracted the most included the investments in the airport operators ADP of France (-1.6%), Aena of Spain (-1.5%) and Sydney Airport (-1.5%). ADP, which runs the airports of Paris, Aena, the world's largest airport operator, and Sydney Airport dived after the outbreak of the virus that causes the illness called covid-19 prompted governments to close borders and order their populations not to travel to control the pandemic.

Stocks that contributed the most included the investments in Crown Castle International of the US (+1.1%), Koninklijke Vopak of the Netherlands (+0.6%) and US utilities Evergy (+0.6%). Crown Castle rose as investors judged that the company that owns more than 40,000 communications towers in the US that provide co-location space to wireless carriers would benefit from higher demand for data across mobile telephony and the internet as a locked-down world went online. Vopak gained as demand for oil storage surged as the oil price fell. The US integrated power utility Evergy rose as investors sought the best defensive stocks.

OUTLOOK

Notwithstanding our expectations for greater volatility in the short to medium term driven by the covid-19 crisis, we are confident that the underlying businesses that we have included in our defined universe and in our investment strategy will prove resilient over the longer term. We regard the businesses that we invest in to be of high quality and, while short-term movements in share prices reflect issues of the day, we expect that share prices over the longer term will reflect the underlying cash flows leading to investment returns consistent with our expectations.

The strategy seeks to provide investors with attractive risk-adjusted returns from infrastructure securities. It does this by investing in a portfolio of listed infrastructure companies that meet our strict definition of infrastructure at discounts to their assessed intrinsic value. We expect the strategy to provide

Performance as at 30 June 2020 [1]

	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	**-8.9**	**4.3**	**7.7**	**10.3**	**12.9**	**7.6**
Magellan Infrastructure Fund (Unhedged)	**-6.8**	**7.0**	**8.6**	**12.0**	**-**	**12.0**

1 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 1 July 2007 (inclusive), Magellan Infrastructure Fund (Unhedged) inception date 1 July 2013 (inclusive). Returns denoted in AUD.

investors with real returns of about 5% above inflation over the longer term. We believe that infrastructure assets, with requisite earnings reliability and a linkage of earnings to inflation, offer attractive, long-term investment propositions. Furthermore, given the resilient nature of earnings and the structural linkage of those earnings to inflation, investment returns generated by infrastructure stocks are different from standard asset classes and offer investors diversification when included in an investment portfolio. In the current uncertain economic and investment climate, the reliable financial performance of infrastructure investments makes them attractive and an investment in listed infrastructure can be expected to reward patient investors with a long-term time frame.

PORTFOLIO POSITIONING

Top-10 holdings at 30 June 2020[2]

Security	Weight (%)
Transurban Group	**6.1**
Atmos Energy Corporation	**5.8**
Crown Castle International	**5.2**
Red Electrica Corporacion	**5.0**
Eversource Energy	**4.6**
Enbridge Inc	**4.5**
Sempra Energy	**4.5**
Xcel Energy Inc	**4.3**
Vopak NV	**4.2**
Snam SpA	**3.6**
Total	**47.8**

As noted earlier, we are cautious about the path ahead and have positioned the infrastructure portfolios with a defensive mindset.

At 31 December 2019, the investment portfolio had an allocation of about 55% to infrastructure, including an allocation of about 18% to airports and about 40% to utilities with less than 5% in cash.

At the end of June 2020, the investment portfolio comprised about 45% regulated utilities, 45% infrastructure and 10% in cash.

As noted above, following the onset of the covid-19 crisis we adopted a more defensive positioning. We reduced exposure to infrastructure, and particularly to airports, and increased our allocation to regulated utilities and cash. Airports businesses were significantly affected by the crisis and the allocation to airports hurt the investment performance of the portfolio.

We have increased the allocation to regulated utilities. Regulated utilities might face some short-term declines in earnings but we do not expect significant changes to their long-term earnings outlooks. Their earnings are highly defensive and regulators generally allow for losses due to issues outside of the control of the regulated utility to be recovered over the medium term.

Infrastructure businesses typically face less intrusive regulation than utilities that allows their earnings to rise and fall with the volume of business they do. As the government-mandated quarantine has reduced the volume of aviation, traffic and rail services so too the earnings of airports, toll roads and railroads have declined in the short term. Experience of previous demand shocks in the transport industry gives us confidence that the demand for transport will recover over the longer term, which will lead to resilient earnings and dividends.

Airports are the infrastructure sector most challenged by the crisis. Airports provide essential services and we are confident that the demand for their services will return over time. However, the duration of the lockout and any following economic downturn will be key to how these companies recover. Much uncertainty remains around the near-term outlook for the aviation sector and we remain cautious about the investment prospects for airports compared with other infrastructure sectors. As a consequence, we have reduced the allocation to airports.

We have maintained the allocation to communications infrastructure and energy infrastructure:

- The portfolio has an allocation to the US-based communications infrastructure company Crown Castle International. We expect the earnings of communications infrastructure companies to be highly defensive in response to this crisis. The demand for data across mobile telephony and the internet is expected to grow strongly and more investment in telecommunications infrastructure is necessary for this demand to be satisfied. Recent reporting from communications infrastructure companies suggests that the covid-19 crisis has not materially slowed the pace of development of telecommunications infrastructure that is central to future earnings growth for communications infrastructure companies.
- The energy infrastructure companies in the strategy generate earnings by storing oil, gas and chemicals or transporting oil and gas across their pipeline networks. These companies have limited exposure to changes in the oil price and, while the revenues they earn from transporting oil and gas can change with movements in volumes, underwritten 'take or pay volumes' usually account for the majority of revenues so we assess their exposure to volume decreases as low. If the customers of these businesses have solvency issues then this could cause problems, but access to energy infrastructure services is essential to their ability to earn revenues.

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2 Top-10 holdings of the Magellan Infrastructure Fund.

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