MFG Core Infrastructure

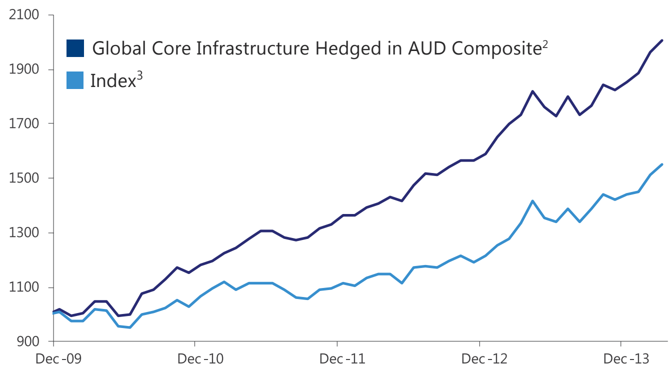
Strategy Update: 31 March 2014

Portfolio Manager	**Total Infrastructure Assets**[1]
Dennis Eagar/Gerald Stack	USD $3,745.9 million / GBP £2,246.9 million
Inception date	**Composite Size**[2]
19 December 2009	USD $424.7 million / GBP £254.7 million

AUD Hedged Gross Performance[2]

	Composite %	Index %[3]	Excess Return %
1 Month	2.1	2.4	-0.3
3 Months	8.2	7.5	0.7
6 Months	13.5	11.5	2.0
1 Year	15.6	16.3	-0.7
2 Years (% p.a.)	19.4	16.1	3.3
3 Years (% p.a.)	17.2	12.5	4.7
4 Years (% p.a.)	17.6	11.1	6.5
5 Years (% p.a.)	na	na	na
Since Inception (% p.a.)	17.6	10.8	6.8
Since Inception	100.6	55.0	45.6

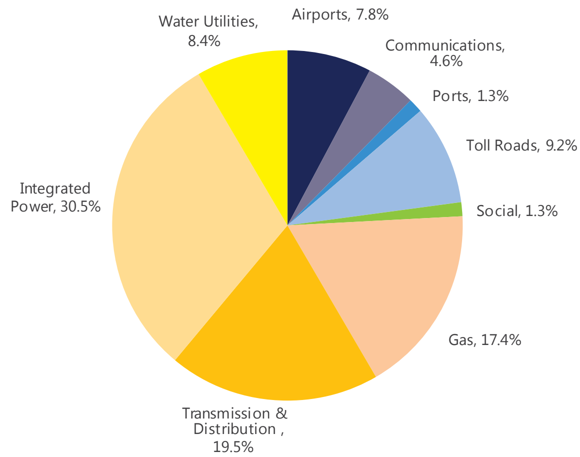
Performance Chart Growth of AUD $1,000



AUD Hedged Gross Performance - Calendar Year[2]

	Composite %	Index %[3]	Excess Return %
2009 (part year)	1.9	0.9	1.0
2010	15.9	5.7	10.2
2011	15.6	4.7	10.9
2012	16.3	9.1	7.2
2013	16.7	18.5	-1.8

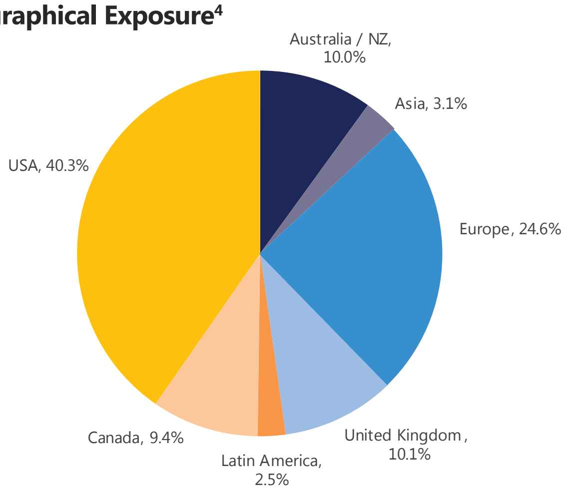
Industry Exposure[4]



AUD Hedged Risk Measures Since Inception[2]

Upside Capture	1.1
Downside Capture	0.5
Beta	0.8
Information Ratio (% p.a.)	1.7
Tracking Error (% p.a.)	4.1%
Worst Drawdown - Composite	-5.2%
Worst Drawdown - Index	-6.4%

Geographical Exposure[4]



Top 10 Holdings[4]

	Sector	% of Strategy
Enbridge Inc	Gas Utilities	3.0
SES GDR	Communications	3.0
Power Assets Holdings	Integrated Power	2.9
Transurban Group	Toll Roads	2.8
TransCanada Corp	Gas Utilities	2.8
Abertis	Toll Roads	2.8
National Grid PLC	Transmission and Distribution	2.8
Snam Rete Gas SpA	Gas Utilities	2.8
United Utilities Group Plc	Water Utilities	2.5
Atlantia SpA	Toll Roads	2.4

[1] Comprised of the total Firm Infrastructure assets, comprising the Select Infrastructure strategy and Core Infrastructure strategy.
[2] Returns and risk measures are for the Global Core Infrastructure Hedged in AUD Composite. *Refer overleaf for further information.
[3] Index: UBS Developed Infrastructure & Utilities Net Total Return Index (Hedged to AUD). Source: UBS
[4] Representative Portfolio. ^Refer overleaf for further information.

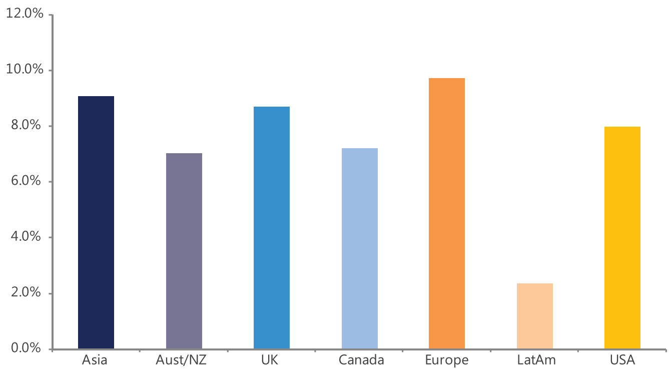
MFG ASSET MANAGEMENT

Performance

During the March 2014 quarter, the MFG Core Infrastructure Strategy ('Strategy')returned 8.2%, compared with the benchmark UBS Infrastructure & Utilities Index's return of 7.5%. The returns for the 12 months to the end of March were 15.6% for the Strategy and 16.3% for the benchmark.

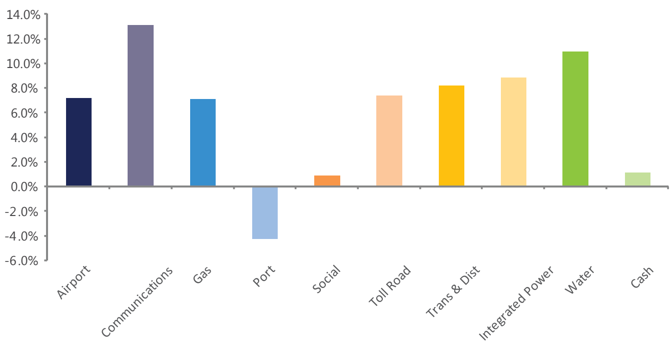
The fund's European, Asian & UK exposures provided the highest returns but, as the following graph illustrates, all regions except Latin America showed very solid returns for the quarter.

Figure 1: Regional Returns, March Quarter 2014



The Ports sector was the only sector to record negative returns for the quarter. This sector represents less than 2% of the total Strategy's exposures so it had little impact on total returns. The following graph shows returns for the quarter by sector.

Figure 2: Sector Returns, March Quarter 2014



The best performing stocks during the quarter were Spanish utility Red Electrica (Total Shareholder Return in local currency of +23.5%), Italian toll road company SIAS (TSR of +21.0%), Vienna Airport (+17.9%), US electricity transmission company ITC (+17.4%) and UK water company United Utilities (+17.3%). As previously mentioned, the Ports sector was the only negative performer for the quarter with Dutch oil & chemical tank storage company Vopak generating a TSR of -4.7% while sentiment towards the German port Hamburger Hafen (-1.9%) was impacted by the Ukraine crisis.

In regard to stocks excluded from the Magellan defined infrastructure investment universe but included in commonly used benchmarks, two distinct trends were observed during the quarter. Firstly, stocks significantly exposed to unregulated power generation generally performed strongly during the quarter. Examples included Italian utility Enel SpA (TSR of +29.4% for the quarter), Electricidade de Portugal SA (+26.3%), US utilities Exelon (+23.8%) and Edison International (+23.1%) and French utility GDF Suez (+16.2%). These stocks have been very unhappy places to invest in previous years, e.g. Exelon's TSR for the 3 years ended 31 December 2013 was -23.3% while GDF Suez's was -19.6%.

In contrast to the strong performance of the market generally, Japanese stocks again performed very poorly generating an average TSR of -6.5% for the quarter. Japanese electricity utilities were particularly poor including Hokkaido Electric Power (TSR of -27.9%), Tokyo Electric Power (-19.5%) and Kansai Electric Power (-12.4%). Hokkaido Electric Power has subsequently sought a bailout from a Japanese government-owned bank after three successive years of losses bought on by the enforced closure of their nuclear power plants. The company has been forced to use more expensive energy sources without being compensated through the regulatory process. This was one of the key factors that led to Magellan excluding all the Japanese regulated utilities long before the Fukushima disaster bought the weaknesses of the regulatory regime to light.

Elsewhere, Chinese infrastructure stocks were down an average 2.4%, US oil & gas MLP's were up marginally but results varied from Magellan Midstream Partners (+11.2% TSR) to Boardwalk Pipeline Partners (-47.1%). US & Canadian rail stocks were also marginally up but again quite variable with results ranging from Union Pacific (+12.3% TSR) to Kansas City Southern (-17.3%).

Portfolio

At the end of the quarter, two stocks were added to the portfolio and one, MGE Energy. The two stocks added to the portfolio were PPL Corporation and Crown Castle Inc.

US utility PPL has, over the course of recent years, sold down its exposure to the non-regulated power generation market and acquired regulated energy businesses. It now comfortably meets our requirement that at least 75% of the earnings are from the regulated part of the business.

Crown Castle Inc is a US company whose primary business is networks of towers in the US and Australian that rebroadcast mobile phone telephony. This entity has recently converted to a REIT structure, removing the last impediment to being considered Core infrastructure by Magellan.

MGE Energy was removed because for a vertically integrated power utility to be included in the strategy, the earnings coming from any unregulated power generation must constitute less than 25% of total earnings. In MGE's case, acquisitions and disposals of subsidiary businesses during the last year meant that the company no longer met this requirement.

Magellan's Views on Regulation

Regulated utilities often get a pretty 'boring' wrap, namely that the reliable, but not exactly 'mouth-watering', returns mean that the asset class is treated somewhere between a bond and a typical equity asset. We hold no major issues with this broad view of regulated assets on the risk and return spectrum. However, as you look around the world, we see huge differences in the quality of the regulation and the resultant risk and return of this 'bond-proxy'. In our view, such a high level view of regulated utilities is disingenuous and overlooks the significant differences in the risks associated with different regimes.

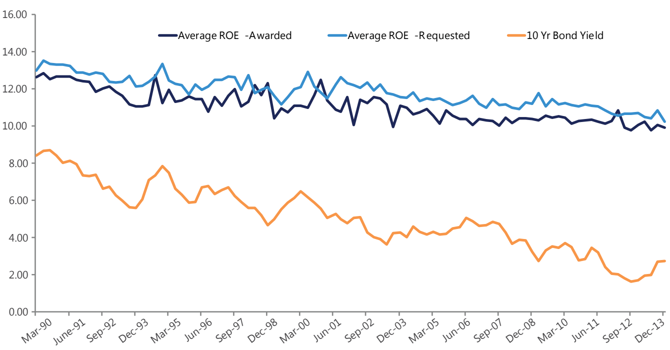
In our investment analysis process, we spend a lot of time trying to understand the dynamics of risk and return in the various regulatory regimes. In our thinking, the keys to a good regulatory regime come down to the fairness of the financial returns allowed by the regulator, the consistency of the rules for determining allowed returns, the transparency of the regulatory framework, and the governance of process.

Fairness of Financial Returns

Acceptable returns are what most investors seek from regulated utilities (along with low risk). The returns don't have to be astronomical, but they do need to be in the right ball-park. In fact, returns that are too high are likely to create risks down the road as 'over-earning' will likely get corrected at some point in the future.

To provide some context to the discussion, we highlight two regulatory regimes where returns have been adequate over a number of years. Firstly, the USA, which we note has had a reasonably consistent level of returns handed down by the 52 State and Federal regulatory commissions. These have provided an average return on equity of 10% or more over three decades, trending higher at times of high interest rates. Investors can be confident that, through the cycle, the majority of assets in this region will have an opportunity to generate acceptable returns.

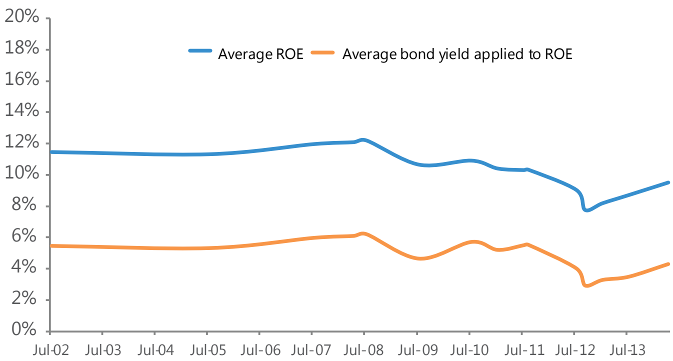
Figure 3: Regulatory Awards in the US



Source: Regulatory Research Associates and Edison Electric Institute

As we now turn to Australia which, as a newer regulatory regime has less history, we note that the returns approved by the regulator have been attractive, but have seen significant declines in the post-GFC period. While, in our view, the allowed financial returns are pushing the lower bounds of a 'fair-return', the decline is due to the decline in the bond yield (which weighs heavily in setting returns in the Australian regulatory regime). In the fullness of time, we have confidence that the risk spread (between the government bond yield and utility returns) will remain intact and that normalising of bond yields to historic averages will be fully reflected in allowed regulatory returns.

Figure 4: Allowed ROEs for Australian Regulated Utilities



Source: Australian Energy Regulator, Magellan Asset Management Limited

When comparing the outcomes of the two regions, it's clear that the USA returns have been more stable through time. This in part reflects the preference of the US regulators to provide more stable returns that don't move as much with the prevailing level of bond rates. We normally have a preference for stable returns, provided the absolute level is fair given the underlying risks.

Predictability

The attraction of investing in regulated utilities is the predictability of their earnings. This requires the regulatory regime to be both consistent and transparent.

Consistency of approach is important. We prefer to invest in regulatory regimes that offer us reliability in both the rules and the application in decisions. Clearly, in an asset that is designed to offer reliable returns, the need for consistency ranks highly. We seek situations where we believe we have a high probability of estimating where regulated returns are likely to move over time. In the above examples of the USA and Australia, we have a high conviction of where returns are likely to trend over time due to the consistency of the regulatory approach.

Consistency also comes through in the length that applies to setting regulatory returns. Regimes such as the UK now offer fairly long-regulatory cycles of 5-8 years providing confidence on the profile of long-term regulated returns.

In order for us to feel comfortable about an investment in regulated utilities, we need to at least have an understanding of the regulatory system and how returns are derived. This means that, even if returns are consistent, we also need to have an understanding of how returns are set.

As discussed above, in our view, Japan is an example of a region where electric utility regulation has been difficult to understand. We view the regulatory regime as opaque and have struggled to get a clear and firm understanding of the mechanics used to derive energy prices and financial returns to investors. For this (and other concerns on regulation), we have avoided investments in Japan.

Governance

By definition, the regulated utilities that we invest in supply essential services. From a demand point of view, this is an attractive asset class, as demand is relatively stable throughout the economic cycle. However, a risk for investors is that essential services can become a political 'hot-potato' (Who doesn't recall hearing a politician saying that they will reduce power prices if elected?). This normally happens at the worst time - right after you have spent money on infrastructure and need to increase tariffs to pay for it.

For us, the key to managing this risk is the framework under which regulation occurs, i.e. the institutions involved in regulation. Firstly, we have a strong preference for regulator independence. Ideally the regulator is a separate body from the government, governed by a distinct regulator with a clear mandate setting out its power and obligations to stakeholders. Regimes such the UK, Italy, Australia and the USA tend to provide greater confidence that the political process won't see our investments become political footballs.

While regulator independence is first on our list when looking at governance, obviously it's only as good as the regulator. Hence, we prefer regimes where the regulator isn't "judge, jury and executioner", i.e. there is sufficient separation of power. We find a good example of this is the Australian regulatory framework, where there is a high degree of responsible governing. The 'rules' for regulation are set by a body whose job is to create regulations from the national laws. These laws represent a common set of legislation across both state and Federal levels, making change for politics sake much less likely. The national regulator then applies the rules, and if the utilities disagree there is a separate appeals body. This is good governance, with regulatory independence, a separation of powers between the rule makers, the people who implement them and the appeals process. This framework gives us confidence that there are sufficient protections in place to allow a fair process to occur.

Outlook and Strategy

The Strategy is designed to provide investors with real returns of 5% to 6% over the longer term. Such a return assumes that all stocks are fairly priced at the start of the return period, i.e. stocks don't have to be cheap to start with to generate our expected long term return. Despite the fact that returns in recent years from this strategy have been well above our long run return expectations, we continue to believe that it will deliver high single digit absolute returns in the medium term.

There have been minimal changes to the types of stocks held in the Strategy over the last decade and no changes to the rules used to determine what stocks should be excluded or included in the strategy. The Strategy has served investors well up to this time and we firmly believe it will continue to do so while acknowledging that, if markets continue to rise at double digit rates, the Strategy will under-perform the broader equities market.

Regardless, Magellan notes that there remains many potential catalysts for an equity market downturn during which an investment in the Strategy would, on the basis of historical evidence, prove a very valuable defensive hedge against such an event.

GIPS® DISCLOSURE

*MFGAM claims compliance with the Global Investment Performance Standards (GIPS®). For the purpose of complying with GIPS, the Firm is defined as all discretionary portfolios managed by MFGAM. The Magellan Global Core Infrastructure composite is a global strategy investing in strictly defined or "pure" infrastructure companies (typically 80-120). The composite is hedged to Australian dollars with forward contracts. To achieve investment objectives, the composite may also use derivative financial instruments including, but not limited to, options, swaps, futures and forwards. Derivatives are subject to the risk of changes in the market price of the underlying securities instruments, and the risk of the loss due to changes in interest rates. The use of certain derivatives may have a leveraging effect, which may increase the volatility of the composite and may reduce its returns. A list of composites and descriptions, as well as policies for valuing investments, calculating performance, and preparing compliant presentations are available upon request by emailing data@magellangroup.com.au

^The representative portfolio is an account in the composite that closely reflects the portfolio management style of the strategy. Performance is not a consideration in the selection of th e representative portfolio. The characteristics of the representative portfolio may differ from those of the composite and of the other accounts in the composite. Information regarding the representative portfolio and the other accounts in the composite is available upon request. Industry and Geographical Exposures are calculated on a look through basis based on underlying revenue exposure of individual companies held within the portfolio

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