Strategy Update: 31 December 2020

MFG Global Equity (USD)

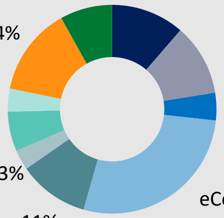
Portfolio Manager	Strategy Inception Date	Total Strategy Assets	Total Global Assets [1]
Lead Portfolio Manager: Hamish Douglass Co-Portfolio Manager: Arvid Streimann	1 July 2007	USD $44,326.4 million	USD $57,944.3 million

Objective	Approach
Capital preservation in adverse markets Pre-fee return of 10%p.a. through the economic cycle	High conviction (20-40 securities), high quality focus Dual-sleeve portfolio construction with dynamic allocation to cash (max 20%) Combined Risk Ratio cap of 0.8^

Strategy Fundamentals[2]	Strategy
Number of Holdings	24
Return on Equity	25
P/E Ratio (1 year forward)	26.8
Interest Cover	13
Debt/Equity Ratio	75
Active Share	89
Weighted Average Market Cap (AUD million)	452,353

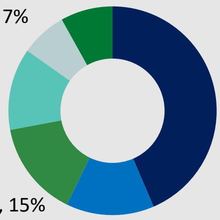
Top 10 Holdings[2]	Sector[2]	%
Microsoft Corporation	Information Technology	7.0
Alphabet Inc	Internet & eCommerce	6.6
Tencent Holdings Ltd	Internet & eCommerce	5.7
Starbucks Corporation	Restaurants	5.5
Facebook Inc - Class A Shares	Internet & eCommerce	5.5
Alibaba Group Holding Ltd	Internet & eCommerce	5.4
Netflix Inc	Internet & eCommerce	4.5
Novartis AG	Health Care	4.3
Reckitt Benckiser Group	Consumer Defensive	4.2
SAP SE	Information Technology	3.9
	TOTAL:	52.6

Sector Exposure[2]



Capital Preservation Measures[3]	3 Years	5 Years	7 Years	10 Years	Since Inception
Adverse Markets					
No of observations	11	15	22	30	48
Outperformance consistency	91%	93%	95%	97%	94%
Average return – Strategy	-3.4%	-3.2%	-2.3%	-1.7%	-3.8%
Average return – Benchmark	-6.6%	-6.0%	-5.1%	-5.6%	-8.1%
Down Market Capture	0.5	0.5	0.4	0.3	0.5
Drawdown					
Maximum Drawdown - Strategy	-15.3%	-15.3%	-15.3%	-15.3%	-36.0%
Maximum Drawdown - Index	-21.1%	-21.1%	-21.1%	-21.1%	-54.0%

Geographical Exposure[2]



Cumulative Performance[4]	3 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	7 Years (% p.a.)	10 Years (% p.a.)	Since Inception (% p.a.)
Composite (Gross)	3.7	11.2	13.1	13.7	11.2	14.1	12.4
Composite (Net)	3.5	10.3	12.2	12.8	10.4	13.2	11.5
MSCI World NTR Index	14.0	15.9	10.5	12.2	9.2	9.9	6.0
Excess (Gross)	-10.3	-4.7	2.6	1.5	2.0	4.2	6.4
MSCI World Qual. Mix NTR Index	11.9	10.0	9.5	11.5	9.4	10.3	6.9
MSCI Min. Vol. NTR Index	5.7	2.6	7.4	9.3	9.0	9.7	6.5

Annual Performance[4] (%)	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010
Composite (Gross)	11.2	29.7	0.4	25.2	4.7	4.2	6.6	30.8	21.6	11.9	18.3
Composite (Net)	10.3	28.7	-0.4	24.2	3.9	3.4	5.7	29.8	20.7	11.0	17.4
MSCI World NTR Index	15.9	27.7	-8.7	22.4	7.5	-0.9	4.9	26.7	15.8	-5.5	11.8
Excess (Gross)	-4.7	2.0	9.1	2.8	-2.8	5.1	1.7	4.1	5.8	17.4	6.5
MSCI World Qual. Mix NTR Index	10.0	27.7	-6.5	21.5	7.9	1.6	7.3	24.5	13.0	0.7	11.4
MSCI Min. Vol. NTR Index	2.6	23.2	-2.0	17.3	7.5	5.2	11.4	18.6	8.1	7.3	12.0

Supplementary Statistical Measures [5]	3 Years	5 Years	7 Years	7 Years	Since Inception
Turnover	23.6%	19.8%	18.2%	15.5%	13.2%
Beta	0.7	0.7	0.7	0.7	0.7
Tracking Error (% p.a.)	8.0%	6.7%	6.0%	6.4%	6.7%
Standard Deviation – Strategy	13.7%	11.7%	11.4%	10.9%	13.3%
Information Ratio	0.3	0.2	0.3	0.7	1.0

Market Commentary

Global stocks soared to record highs in the December quarter after pharmaceutical companies developed a vaccine against the virus that causes the illness known as COVID-19, the Democratic party's subdued performance in the US senate appeared to rule out radical anti-business measures during the administration of president-elect Joe Biden, and US congress agreed to more fiscal stimulus. During the quarter, all 11 sectors rose. Energy (+27% in US dollars) climbed most while Consumer Staples rose least (+6.4%). The Morgan Stanley Capital International World Index soared 14% in US dollars over the quarter to give an increase of 16% for 2020.

US stocks rallied to record highs after a vaccine with 90%-plus effectiveness in achieving an immune response was announced and distributed, the election result lowered the risk of radical measures passing congress, the Federal Reserve said it would provide open-ended stimulus to help the economy, and lawmakers passed the second big fiscal package since the virus struck. These developments overcame concerns about a third wave of infections flaring up across the country and President Donald Trump's refusal to concede defeat while alleging voter fraud. The vaccine euphoria kicked off in November when Pfizer/BioNTech and Moderna announced successful phase three vaccine trials using a novel mRNA technology, while Oxford University and AstraZeneca came out with vaccines using traditional technology. In the election, the lack of a strong Democratic wave improved the outlook for profit growth because the lack of a strong showing in the senate reduced the mandate and political leeway for new laws that would reduce corporate profitability. Even though the US economy expanded at an annualised rate of 33.4% in the third quarter, more up-to-date reports showed the latest burst of infections, which took the number of Americans struck by the virus to more than 20 million, is hurting business. Retail sales, for example, fell in November, the largest decline since April, while jobless claims rebounded towards year end. The S&P 500 Index added 12% over the quarter, to be up – led by Big Tech – 16% for 2020.

European stocks soared as the arrival of a vaccine, a last-minute deal that completed the procedure of the UK's departure from the EU and an agreement over the EU's budget and stimulus package overshadowed a fresh wave of infections and restrictions across the continent. In economic news, a report showed the eurozone expanded 12.5% in the third quarter, after shrinking 11.7% in the previous three months. The Euro Stoxx 50 Index rallied 11%, meaning it fell only 5.1% over 2020.

Japan's Nikkei 225 Index gained 18%, to break the previous high set in 1991, after a report showed Japan's economy expanded 5.3% in the third quarter, its first expansion in four quarters. China's CSI 300 Index rose 14% as manufacturing's 9th consecutive monthly increase in November showed the economy was coping through the pandemic. Australia's S&P/ASX 200 Accumulation Index jumped 14% after the Reserve Bank of Australia cut the cash rate to a record low 0.1% and announced it would buy A$100 billion of long-term bonds under a quantitative easing program. The MSCI Emerging Markets Index rallied 19% in US dollars as investors thrilled to the vaccine and a lower US dollar eased the burden of emerging countries with steep US-dollar-denominated debt.

Strategy Commentary

The strategy recorded a positive return for the quarter. The biggest contributors were the investments in Alphabet, Starbucks and Tencent Holdings. Alphabet rose after its Google subsidiary's advertising revenue showed a better-than-expected rebound from the coronavirus-triggered slump and the US election outcome reduced the risk of a crackdown on Big Tech that would ensnare Google, which is already under anti-trust scrutiny by the US Department of Justice. Starbucks gained after the coffee chain, when announcing a smaller-than-expected drop in same-store sales of 9% for the fourth quarter, signalled that the worst is past. Tencent climbed after its 28% increase in revenue for the first half from a year earlier beat expectations.

The biggest detractors were the investments in Alibaba Group, SAP and RB. Alibaba dropped after its about-33%-owned Ant Group suspended its IPO, Chinese authorities said they would investigate the company for "suspected monopolistic conduct", key founder Jack Ma disappeared after criticising financial authorities, and the company's results for the September quarter displayed mixed results across segments. SAP dropped after Europe's largest software company lowered medium-term revenue and profit forecasts and its third-quarter result fell short of expectations as cloud revenue growth slowed. RB dropped on expectations sales for its sanitary products would drop once the pandemic is brought under control.

Index movements and stock contributors/detractors are based in local currency terms unless stated otherwise.

Stock story: Novartis

Over recent generations, ageing populations, biologic breakthroughs, scientific innovations allowing companies to safely mass-produce drugs, greater access to healthcare across the emerging world and the formation of national healthcare systems have boosted global healthcare spending to about 10% of the world economy.[1] These forces, to varying degrees, will bolster this percentage higher still in decades to come.

The pharmaceutical sub-segment of an expanding healthcare industry is well placed to provide selective opportunities that are economically defensive if a business can deftly and consistently manage the scientific risks of research projects and major periodic patent expiries. One of the best placed to manage this dilemma is the Swiss-based pharmaceutical company Novartis, which has a leading innovation track-record.

The company that seeks to 'reimagine medicine to improve and extend people's lives' spends about US$9 billion a year on research and development. The aim is to tackle some of society's most challenging healthcare issues and deliver them to as many people as possible. Novartis, which earned US$49 billion in fiscal 2019, already provides 70 billion doses to one billion patients a year.

Novartis, which traces its roots to 1758, now comprises two global operating divisions since it spun off its Alcon eyecare-devices business in 2019. Novartis's key arm is Innovative Medicines, which delivers about 85% of Novartis's earnings and seeks to develop patent-protected prescription medicines that change the standard of care for often acute ailments and diseases. The other division is Sandoz, which mass markets generic pharmaceuticals and biosimilars.

The Innovative Medicines division researches, develops, makes, distributes and sells patented prescription medicines. The division is in turn split into two business units: Novartis Oncology and Novartis Pharmaceuticals. The latter consists of the following global business franchises: ophthalmology; neuroscience; immunology, hepatology and dermatology; respiratory; cardiovascular, renal and metabolism; and established medicines. Novartis's leading global capability in emerging gene and cell therapies also complements these therapeutic areas.

Some of the world's amazing and lucrative drugs have emerged from these businesses. Novartis has more than 15 innovations that each haul in more than US$1 billion in revenue every year. These innovations include the multiple sclerosis drug Gilenya (and the recently launched Kesimpta improvement in the standard of care for sufferers of multiple sclerosis); psoriasis and arthritis drug Cosentyx; heart-failure-prevention medication Entresto; and the neuroscience drug Zolgensma that almost cures previously terminal spinal muscular atrophy in babies.

Zolgensma, a future gene therapy blockbuster, is worthy of special mention. Accumulative sales already top US$1 billion for a medication that is the world's most expensive at about US$2 million a dose. Novartis is pioneering gene therapy as a new class of treatment. Novartis's prescient AveXis acquisition and buildout of the global infrastructure necessary to commercialise this technology and expand the market via manufacturing cost innovation has significant potential given its first-mover advantage.

The Sandoz division develops, makes, distributes and sells prescription medicines and active ingredients that are not protected by patents (because they have expired). Sandoz is organised globally into three franchises: retail generics; anti-infectives (antibiotics); and biopharmaceuticals. It's from its biopharmaceuticals franchise that Sandoz develops more complex biosimilars and provides biotechnology manufacturing services to other companies.

CEO Vas Narasimhan, a doctor by qualification who was appointed in 2018, has reshaped Novartis via acquisitions and divestments (and careful cost-cutting; US$2 billion in costs pruned so far and another US$2 billion to come). In 2020, for instance, Novartis paid US$9.7 billion for Medicines Co, the maker of Inclisiran, a low-risk and promising novel solution for bad cholesterol and heart disease. Similar strategic acquisitions, along with the sale of assets such as Alcon and Novartis's stake in a venture with GlaxoSmithKline (consumer health), has refocused the once-sprawling conglomerate.

Magellan boils Novartis's sustainable competitive advantages down to two key drivers. The first is the breadth and depth of Novartis's R&D capability in areas of significant unmet need. The stock market is undervaluing the 150 or so projects that are in development, especially those that are line extensions and lower risk. Novartis's other advantage is that these research efforts are largely independent of each other in terms of medical efficacy and commercial success. One going wrong doesn't mean the others will fail, which helps us manage our exposure to the inevitable failure of expensive research projects – and this also decreases the risk of irrational internal capital allocation. All up, Novartis is one of the leading pharmaceutical innovators with encouraging early evidence of much-improved capital allocation. That bodes well for future shareholder returns.

Novartis, which operates in an industry that is ever more complex in terms of the science it advances, the trials it conducts and the regulation it must navigate, faces risks. The COVID-19 pandemic has hurt Novartis's sales growth because fewer people visited their doctors so fewer prescriptions were written. However, this setback to revenue growth will pass when a vaccine is widely distributed. Novartis's exposure to political reimbursement risks, especially in the US, is shared by all pharmaceutical companies but Novartis benefits from a relatively favourable geographic mix of global revenue. Expiring patents are also a key threat to revenue growth – that's a standard challenge for successful pharmaceutical companies. Only about 5% to 10% of medicines developed for trials work on humans and that success could take 10 to 15 years to achieve from discovery to the launch of a commercial product. This is a risk all pharmaceutical companies face.

Novartis is less of a risk on this basis than many of its peers because its pipeline of projects is relatively transparent, there's so much intellectual capital in the firm, and it has so many 'bets' on different drugs where the success or failure of each is bespoke. Novartis will grow through pending patent expiries, with attractive forecast returns driven by steady earnings growth and material unpriced option value from leadership in emerging gene, cell and nuclear medicine technologies.

[1] World Bank. 'Current health expenditure (% of GDP)'. data.worldbank.org/indicator/SH.XPD.CHEX.GD.ZS

Sources: company website, Bloomberg, Dunn & Bradstreet.

1 Comprised of all Global Strategies.
2 The data is based on a representative portfolio for the strategy. Sectors are internally defined. Geographical exposure is calculated on a look through basis based on underlying revenue exposure of individual companies held within the portfolio. Exposures may not sum to 100% due to rounding. The Index is the MSCI World NTR Index. Refer to the Important Notice below for further information.
3 Risk measures are calculated before fees and in USD. An adverse market is defined as a negative quarter, rolled monthly, for the MSCI World Net TR USD Index, whilst drawdown measures are measured monthly.
4 Returns are for the Global Equity Composite and denoted in USD. Performance would vary if returns were denominated in a currency other than USD. Refer to the GIPS Disclosure section below for further information. Composite (Net) returns are net of fees charged to clients and have been reduced by the amount of the highest fee charged to any client employing that strategy during the period under consideration. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. Fees are available upon request.
5 Supplementary Statistical Measures Beta, Tracking Error and Information Ratio are calculated in USD using the MSCI World NTR Index.
^ Combined risk ratio is a measure of relative beta and relative drawdown to MSCI World NTR USD Index. Please contact MFGAM should you wish for further details on the calculation.

The MSCI World Index (Net) is a free-float adjusted market capitalization weighted index that is designed to measure the equity performance of 24 developed markets. Index results assume the reinvestment of all distributions of capital gain and net investment income using a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties.

GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS®) DISCLOSURE

Magellan Asset Management Limited, doing business as MFG Asset Management in jurisdictions outside Australia and New Zealand, (MFG Asset Management) 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 MFG Asset Management, excluding brands managed by subsidiaries operating as distinct business entities. MFG Asset Management is a wholly-owned subsidiary of the publicly listed company Magellan Financial Group Limited. MFG Asset Management is based in Sydney, Australia. Total Firm assets is defined as all assets managed by MFG Asset Management, excluding assets managed by subsidiaries operating as distinct business entities.

The Global Equity composite is a concentrated global equity strategy investing in high quality companies (typically 20-40 stocks). High quality companies are those companies that have sustainable competitive advantages which translate into returns on capital materially in excess of their cost of capital for a sustained period of time. The investment objectives of the Global Equity strategy are to earn superior risk adjusted returns through the business cycle whilst minimising the risk of a permanent capital loss. The composite was created in December 2011.

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 copy of the composite's GIPS compliant presentation and/or the firm's list of composite descriptions are available upon request by emailing client.reporting@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 the 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.

USD is the currency used to calculate performance.