Strategy Update: 31 March 2016

MFG Global Equities

Key Facts

Portfolio Manager	Hamish Douglass
Strategy Inception Date	1 July 2007
Total Global Equity Assets[1]	USD $25,549.3 million
Total Strategy Assets	USD $22,512.0 million

USD Gross Performance[2]

	Composite	MSCI World NTR	MSCI World Qual. Mix NTR	MSCI Min. Vol. NTR
3 Months (%)	1.0	-0.3	2.3	6.1
6 Months (%)	5.6	5.1	8.2	12.0
1 Year (%)	3.0	-3.5	1.3	7.4
3 Years (% p.a.)	9.6	6.8	8.4	9.3
5 Years (% p.a.)	14.4	6.5	8.7	10.7
7 Years (% p.a.)	19.8	13.1	14.2	14.4
Since Inception (% p.a.)[3]	11.4	2.5	4.5	5.4

	Composite	MSCI World NTR	MSCI World Qual. Mix NTR	MSCI Min. Vol. NTR
2007 (%)*	0.0	-0.1	1.0	1.0
2008 (%)	-21.6	-40.7	-35.4	-29.7
2009 (%)	39.4	30.0	27.7	16.4
2010 (%)	18.3	11.8	11.4	12.0
2011 (%)	11.9	-5.5	0.7	7.3
2012 (%)	21.6	15.8	13.0	8.1
2013 (%)	30.8	26.7	24.5	18.6
2014 (%)	6.6	4.9	7.3	11.4
2015 (%)	4.2	-0.9	1.6	5.2
2016 CYTD (%)	1.0	-0.3	2.3	6.1

Top 10 Holdings[4]

	GICS Sector	%
Microsoft Corp	Information Technology	6.2
Visa Inc	Information Technology	4.8
Lowe's Co Inc	Consumer Discretionary	4.6
Yum! Brands Inc	Consumer Discretionary	4.5
PayPal Holdings Inc	Information Technology	4.5
Intel Corp	Information Technology	4.4
Oracle Corp	Information Technology	4.4
Apple Inc	Information Technology	4.2
CVS Health Corp	Consumer Staples	4.1
Target Corp	Consumer Discretionary	3.9
	TOTAL:	45.6

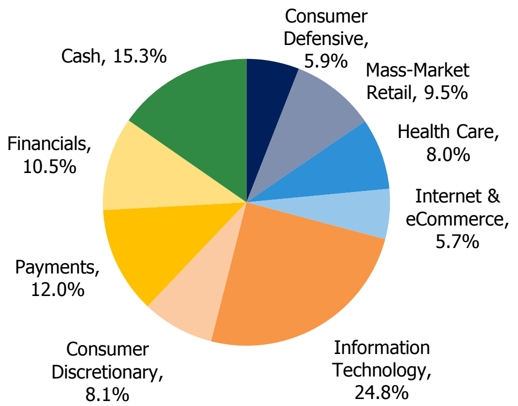
Strategy Fundamentals

	Strategy[5]	Index[3]
Number of Holdings	26	1,647
Return on Equity	20	12
P/E Ratio (1 year forward)	15.5	15.8
Interest Cover	21	10
Debt/Equity Ratio	18	52
Active Share	81	n/a
Weighted Average Market Cap (USD million)	140,073	n/a

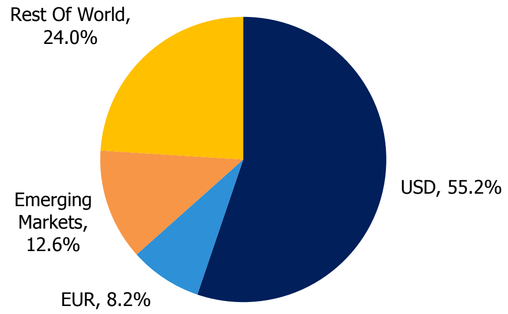
USD Risk Measures[2]

Risk Measures	3 Years	5 Years	Since Inception[4]
Upside Capture	1.0	1.0	0.9
Downside Capture	0.8	0.5	0.5
Beta	0.8	0.7	0.7
Information Ratio	0.7	1.4	1.2
Tracking Error (% p.a.)	4.0%	5.8%	7.2%
Standard Deviation – Strategy	10.4%	10.5%	14.2%
Standard Deviation – Index	11.7%	13.2%	17.4%
Worst Drawdown – Strategy	-7.3%	-7.3%	-36.0%
Worst Drawdown – Index	-12.0%	-19.6%	-54.0%
Turnover[5]	26.7%	21.8%	16.7%

Industry Exposure by Source of Revenue[6]



Geographical Exposure by Source of Revenue[6]



[1] Comprised of all Global Equity strategies.
[2] Returns and risk measures are for the Global Equity Composite and denoted in USD. Refer to the end of the document for further information.
[3] The inception date of the Composite and the Index, the MSCI World NTR is 01 July 2007.
* Returns are only for part year.
[4] The exposures are by domicile of listing.
[5] The data is based on a representative portfolio for the strategy. Refer to end of document for further information.
[6] Calculated on a look through basis based on underlying revenue exposure of individual companies held within the portfolio – MFG defined sectors.

Market Commentary

The March quarter saw volatile conditions persist in global equity markets amid further signs of emerging weakness for the global economy. Markets sold off heavily in January in reaction to heightened concerns over China's growth and the extent to which weakness in key domestic activity indicators may translate to the other major economies. Crude oil prices also plunged to their lowest level since 2004, as investors puzzled through possible weaker demand and continued concerns of oversupply by large oil producing countries, and associated geopolitics. The oil price subsequently recovered, as did global equity markets to end the quarter closer to levels at the end of 2015.

European markets were led lower by these offshore developments and on speculation over whether the European Central Bank (ECB) will take action to ease monetary settings – moves that had been flagged in the preceding months. The ECB delivered its latest injection of stimulus at its March meeting, announcing a further cut to the overnight cash rate to -0.4% and announced a new series of targeted longer-term refinancing operations (TLTRO II), each with a maturity of four years, aiming to provide cheaper financing to certain investments. The ECB also announced an expansion of its monthly asset purchases program to €80 billion. Equity markets responded favourably to the announcements, while the UK's stock market received a boost following a strong rebound in key commodity prices.

In the US, market observers were preoccupied with the US Federal Reserve's (Fed) path to interest rate normalisation. Amid growing concerns over China and the likely impact on domestic settings, equity markets sold off and acted to alert the Fed. Later in the quarter, Janet Yellen sought to clarify thinking around the future trajectory of interest rates, indicating the need to see a sustained development of domestic labour market, business and consumer health. Data released during the quarter provided evidence of buoyant conditions in the labour market, with US Non-Farm Payrolls continuing to expand and the unemployment rate remained stable at 5%. Statistics on lending to the private sector also showed continued growth, although retail sales (ex-automobiles) have moderated in recent months. While these indicators provide some comfort, Yellen cited concerns over depressed inflation, falling earnings expectations and foreign growth forecasts and placated markets with a message that the Fed is more inclined to be late in raising rates rather than being too early. US Treasury yields weakened further following the speech, while the S&P500 moved higher to end the quarter in a marginally stronger position.

Macroeconomic developments are likely to remain at the forefront of concerns for equity markets, suggesting that the future influence of central bank policy actions will periodically dominate sentiment. Policy makers are acutely aware of the sensitivity to interest rates, constrained fiscal conditions and the unwelcomed prospect of deflationary pressures, hence the lower for longer mantra is likely to dominate opinion. With risks to the global economy balanced between an uncertain slow-down trajectory for China and Emerging Markets, stabilising Europe and a growing U.S., we retain a cautious approach in terms of where to prudently place capital.

Strategy Commentary

As of 31 March 2016, the Strategy consisted of investments in 25 companies, consistent with the number held as at 31 December 2015. The top ten investments represented 45.6% of the Strategy on 31 March 2016, while they represented 45.8% of the Strategy on 31 December 2015. The cash position at 31 March 2016 was 15.3%, consistent with the level at the end of 2015.

The Strategy declined in value over the quarter, albeit to a lesser extent than the benchmark, with significant contributions from its major holdings. The largest contributor to returns over the quarter was the position in YUM! Brands. The global operator of fast food brands KFC, Pizza Hut and Taco Bell rallied as sentiment on China's outlook improved and risks associated with the forthcoming separation into two companies reduced. The stock continued to recover through the quarter and we believe prospects for investors remain favourable. The company is on track to finalise the separation of its China business, by which time the company should complete its return of capital which we expect to be a positive for shareholders.

Positions in Target and Oracle also made strong contributions for the quarter. Target rose strongly in February after releasing its fourth quarter earnings result and providing 2016 guidance for 9-15% earnings per share growth (EPS), which was ahead of consensus estimates. Oracle performed well through the quarter and experienced a spike in its share price following the release of its third quarter earnings result. The company reported a significant acceleration in cloud subscription growth together with gross profit margin expansion, with overall earnings being ahead of management guidance. We continue to believe that Oracle stands to benefit significantly from the shift to cloud services in the long-term and is a high quality operator in the software and services space.

Of the Strategy's major holdings, Intel was a notable detractor from returns. Intel declined through the first half of the quarter before recovering most of its losses. The stock's decline was reflective of weakness in the IT sector more broadly amid the general rotation back to more defensive sectors. Intel's fourth quarter earnings result was weaker than expected, after being impacted by a stronger US dollar and still soft demand for personal computers.

Key Stock in Focus - Apple

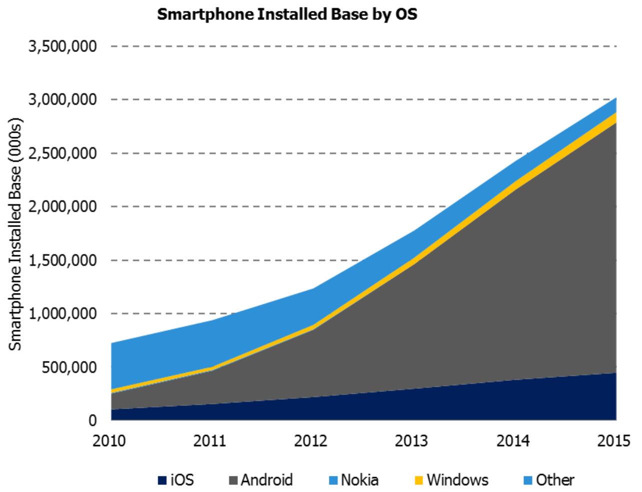
Apple is amongst the largest companies in the world. The company enjoys strong brand recognition globally and extensive market penetration for its flagship products, most notably the iPhone. While speculation around the success of Apple Watch, Apple TV, iPad, or even the likelihood of an Apple Car often captures headlines, we estimate that iPhone and iPhone-related services represented around 70% of Apple's revenue and 80% of Apple's gross margin in FY15. Despite its relatively high price, there is strong demand for the iPhone in both developed and emerging markets, with China now contributing 24% of Apple's total revenue.

Apple's growth has been driven through its position as a consumer hardware vendor. There are few, if any, examples of consumer hardware vendors which have endured over the long term as the products have typically commoditised over time. However, having built a powerful, enduring ecosystem, we view Apple today as a leading mobile platform and services company with sales of its devices reflecting effectively a "subscription" payment to access its platform and services.

Apple displays several attractive investment characteristics which support our longer term outlook for the company.

Global digital platform

Along with Windows and Android, Apple's iOS is one of the major global digital platforms. There are only two main mobile platforms globally – Apple's iOS and Google's Android – which is unlikely to change in the foreseeable future. Almost all consumer software and services will be developed for these two platforms and the vast majority of digitally connected people will connect via one of the two. Importantly, while iOS is not the leading mobile platform by users, it currently dominates use among premium phones and the highest-spending consumer demographic, which is particularly valuable.



Source: Gartner

Mobile devices are increasingly central to people's lives, with a 2015 Deloitte study finding that the average American checks his or her phone 46 times per day. Being the mobile platform owner provides Apple with tremendous optionality in terms of new devices and services such as Apple Pay (payments), HealthKit (health wearables) and HomeKit (home network connectivity). Even though it is very difficult to estimate the impact of these on Apple's consolidated earnings given the immense profitability of the iPhone, more iOS devices and services make the platform increasingly valuable and make switching harder, thereby lowering iPhone churn and helping to cross sell other Apple devices.

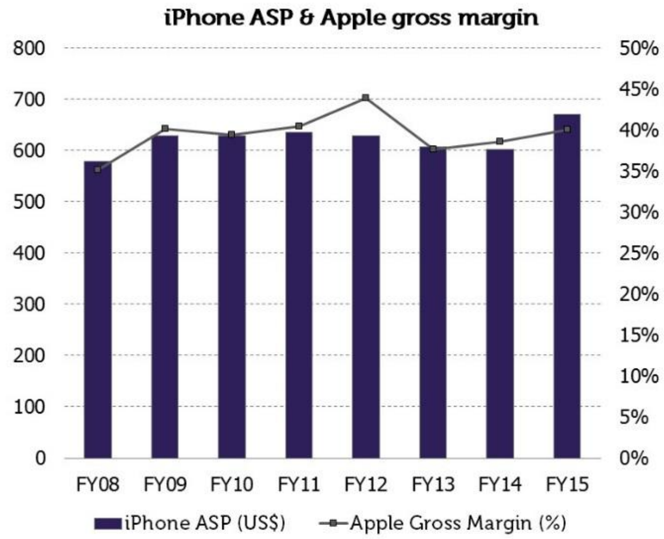
Increasingly annuity-like revenues

iPhone sales are becoming more annuity-like. As the installed base of iPhone users has grown, Apple's dependence on winning new users has diminished. User satisfaction among iPhone users is typically very high and thus renewal rates are also high. We expect sales of new devices to existing users will represent a significant majority of iPhone revenues going forward.

Little exposure to typical hardware commoditisation

During the rapid expansion in the smartphone market over the past decade, we held concerns that these devices would face commoditisation similar to that seen historically in the PC market. Apple has achieved impressive growth as a consumer hardware vendor, but our cautious approach to date has been prompted by the tumultuous history of the mobile phone vendor market structure, with market leadership rapidly changing hands in recent history - consider prior leaders - Motorola, Sony Ericsson, Nokia, Blackberry and HTC.

Our initial concerns were three-fold: (i) the relatively high price of the iPhone, (ii) the continual functional improvements of lower-priced Android phones, and (iii) greater phone price transparency as carriers moved away from subsidies (by explicitly listing the monthly cost of the phone rather than recovering the cost of the phone via service fees). Despite these issues, Apple has continued to grow sales of iPhones and increase average prices at high margins. In 2015, release of the large-screened (and more expensive) iPhones resulted in volumes increasing by 37%, average selling prices rising by 10% and Apple increased its aggregate gross margin. These results displayed little evidence of price sensitivity among existing and new users.



Source: MFG Asset Management, Apple Inc

We believe this resilience in iPhone prices and Apple's margins will continue due to the iPhone's premium positioning, the iOS ecosystem and very high user retention. The latter will be driven by brand loyalty and user preference, as well as the switching costs associated with user reluctance to learn a new interface, desires to maintain access to iOS-only apps (e.g. Facetime) and services (e.g. photo collection in iCloud), and preserving the integration benefits of multiple Apple devices (e.g. iPhone and Apple TV).

Growth opportunity

At the end of 2015, smartphones represented an installed base of approximately three billion phones globally and are expected to reach 4.7 billion in 2020[1]. While smartphones now enjoy very high penetration rates among high-value device user groups, much of the market's growth will come from low-value device users. We see Apple's growth being generated from:

- **Growing share of high value device segment**. Android switchers to iPhone have risen to record levels since release of the large-screened iPhones.
- **Growth in high value device users**. Emerging markets now contribute 34% of Apple's total revenue and the company is seeing rapid growth in the proportion of the population able to afford an iPhone. While there is some caution around global consumer weakness in the short term, the expanding middle class globally is expected to benefit Apple over the long term.
- **iPhone addressable market expansion**. Apple's recent decision to lower the cost of its entry level iPhone demonstrates Apple's increased focus on expanding its market.

Earnings prospects

In the lead up to the December 2015 and March 2016 quarterly results, market fears rose around anaemic iPhone 6S sales volume growth trends as it cycled strong iPhone 6 sales in the prior corresponding period. This was exacerbated by elevated concerns around China's growth. While it is likely that iPhone sales in the March quarter will be below the prior corresponding period, this quarterly growth number belies the strong underlying long term growth prospects. Our view of Apple's long-term prospects is framed by its pricing power, brand strength, installed base size, replacement cycles and optionality. At prevailing market pricing, we consider Apple to be an attractive investment.

[1] Source: Gartner, 24 March 2016

Performance is compared to the MSCI World Index (Net) ('Index'). The Index 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.

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MFGAM claims compliance with GIPS®.

For the purpose of complying with GIPS, the Firm is defined as all discretionary portfolios managed by MFGAM.

The Global Equity Composite is a concentrated global equity strategy investing in high quality companies. The investment objectives of the Global Equity Strategy are to earn attractive risk-adjusted returns through the business cycle whilst reducing the risk of permanent capital loss. 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. A compliant presentation can also be obtained by emailing this address.

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.