

MFG Global Equity (USD)

Portfolio Managers	Strategy Inception Date	Total Strategy Assets	Total Global Assets ¹
Lead Portfolio Manager: Hamish Douglass Co-Portfolio Manager: Arvid Streimann	1 July 2007	USD \$46,143.7 million	USD \$60,421.8 million

Objective	Approach
Capital preservation in adverse markets	High conviction (20-40 securities), high quality focus
Pre-fee return of 10%p.a. through the economic cycle	Dual-sleeve portfolio construction with dynamic allocation to cash (typically between 0% - 20%) Combined Risk Ratio cap of 0.8 [^]

Strategy Fundamentals ²	Strategy
Number of Holdings	24
Return on Equity	27
P/E Ratio (1 year forward)	26.0
Interest Cover	14
Debt/Equity Ratio	77
Active Share	89
Weighted Average Market Cap (USD million)	472,678

Top 10 Holdings ²	Sector ²	%
Alphabet Inc	Internet & eCommerce	7.3
Microsoft Corporation	Information Technology	6.8
Tencent Holdings Ltd	Internet & eCommerce	5.8
Alibaba Group Holding Ltd	Internet & eCommerce	5.5
Facebook Inc - Class A Shares	Internet & eCommerce	5.1
Starbucks Corporation	Restaurants	5.0
Visa Inc	Payments	4.4
SAP SE	Information Technology	4.3
Intercontinental Exchange Inc	Financials	4.2
Pepsico Inc	Consumer Defensive	4.1
	TOTAL:	52.5

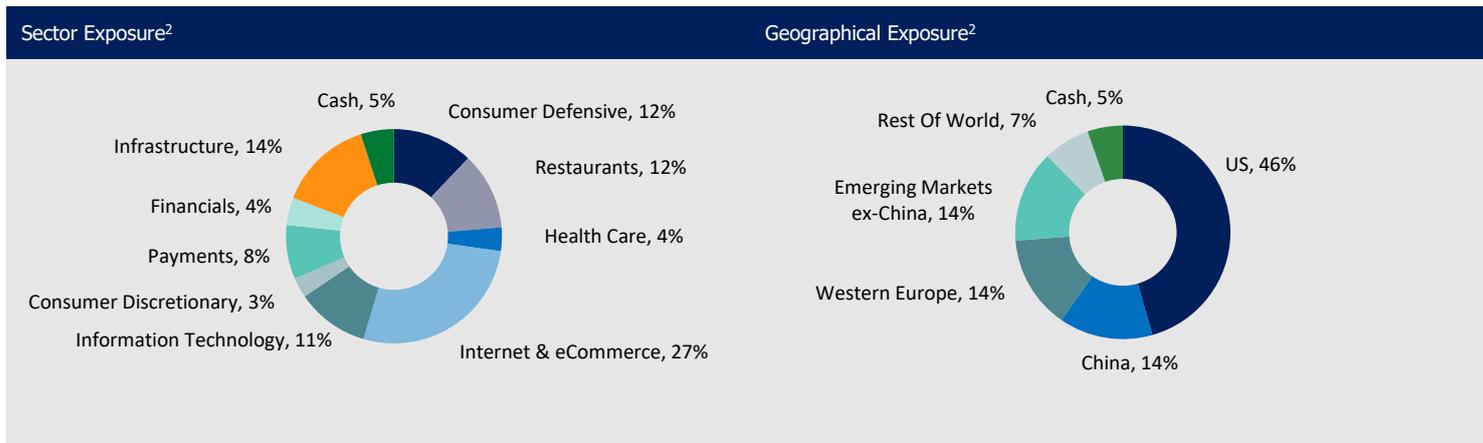
3 Year rolling returns ³ (measured monthly)	Last 12 Months	Last 36 Months	Last 60 Months	Since Inception (130 Months)
Against MSCI World NTR Index				
Average excess return (% p.a.) (Gross)	4.6	4.0	3.3	6.2
Average excess return (% p.a.) (Net)	3.7	3.1	2.4	5.3
Outperformance consistency (Gross)	100%	100%	100%	100%
Outperformance consistency (Net)	100%	100%	98%	99%

Capital Preservation Measures ⁴	3 Years	5 Years	10 Years	Since Inception
Adverse Markets				
No of observations	10	12	30	48
Outperformance consistency	90%	92%	97%	94%
Average return – Strategy	-3.7%	-3.2%	-1.7%	-3.8%
Average return – Index	-7.1%	-6.1%	-5.6%	-8.1%
Down Market Capture	0.5	0.5	0.3	0.5
Drawdown				
Maximum Drawdown - Strategy	-15.3%	-15.3%	-15.3%	-36.0%
Maximum Drawdown - Index	-21.1%	-21.1%	-21.1%	-54.0%

Performance ⁵	3 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	10 Years (% p.a.)	Since Inception (% p.a.)
Composite (Gross)	2.3	31.9	14.4	14.0	14.2	12.4
Composite (Net)	2.1	30.8	13.4	13.1	13.3	11.5
MSCI World NTR Index	4.9	54.0	12.8	13.4	9.9	6.3
Excess (Gross)	-2.6	-22.1	1.6	0.6	4.3	6.1
MSCI World Qual. Mix NTR Index	5.0	43.0	11.7	12.1	10.4	7.2
MSCI Min. Vol. NTR Index	1.2	23.0	8.3	8.3	9.5	6.4

Annual Performance ⁵ (%)	CYTD	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Composite (Gross)	2.3	11.2	29.7	0.4	25.2	4.7	4.2	6.6	30.8	21.6	11.9
Composite (Net)	2.1	10.3	28.7	-0.4	24.2	3.9	3.4	5.7	29.8	20.7	11.0
MSCI World NTR Index	4.9	15.9	27.7	-8.7	22.4	7.5	-0.9	4.9	26.7	15.8	-5.5
Excess (Gross)	-2.6	-4.7	2.0	9.1	2.8	-2.8	5.1	1.7	4.1	5.8	17.4
MSCI World Qual. Mix NTR Index	5.0	10.0	27.7	-6.5	21.5	7.9	1.6	7.3	24.5	13.0	0.7
MSCI Min. Vol. NTR Index	1.2	2.6	23.2	-2.0	17.3	7.5	5.2	11.4	18.6	8.1	7.3

Supplementary Statistical Measures ⁶	3 Years	5 Years	7 Years	10 Years	Since Inception
Turnover	23.7%	19.7%	17.9%	15.7%	13.2%
Beta	0.6	0.8	0.8	0.8	0.8
Tracking Error (% p.a.)	8.0%	6.7%	6.1%	6.4%	6.7%
Standard Deviation – Strategy	13.1%	11.3%	11.2%	10.9%	13.2%
Information Ratio	0.2	0.1	0.3	0.7	0.9



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. ³ The Index is the MSCI World NTR Index. Refer to the Important Notice below for further information.

³ Rolling 3-year returns are calculated and rolled monthly for the duration of each period shown. The average excess return is then calculated for each period, with the outperformance consistency indicating the percentage of positive excess returns.

⁴ Capital preservation measures are calculated before fees and in USD. An adverse market is defined as a negative 3-month return for the MSCI World NTR Index (USD), rolled monthly, whilst drawdown is based on rolling monthly returns.

⁵ 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.

⁶ 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.

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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.

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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.

Market Commentary

Global stocks reached record highs as they rose for the eighth quarter in nine for the three months to March after the vaccine rollout intensified, US President Joe Biden capitalised on the Democrat's surprise control of Congress to launch massive fiscal stimulus, the Federal Reserve reiterated it would keep interest rates low, encouraging reports emerged on the US economy, and investors welcomed Italy's new prime minister. Gains were capped as US bond yields rose on concerns that the fiscal stimulus could revive US inflation and a third wave of covid-19 infections swept through Europe. During the quarter, 10 of the 11 sectors rose in US dollars. Energy (+22%) climbed most while consumer staples fell (-0.6%). The Morgan Stanley Capital International World Index climbed 4.9% in US dollars.

US stocks gained as the White House count showed 37% of Americans had received one vaccine dose by quarter end and Democrat control of Capitol Hill allowed Biden to force a US\$1.9 trillion bill through Congress that, at 9% of GDP, will boost the budget shortfall for fiscal 2021 to 18% of output. The Democratic party gained control of the Senate after winning the two seats in Georgia that went to a special election (by-election) on January 6. The result tied the Senate 50-50 but new Vice President Kamala Harris's tie-breaking vote gives the party control of the upper chamber to go with its control of the House of Representatives and the White House. In other political news, outgoing president Donald Trump was impeached and acquitted for a record second time. The House in January impeached Trump for helping to incite a mob that breached congress during a protest on January 6 against the election result. The Senate in February acting as an impeachment court acquitted Trump when it failed to gain the required two-thirds majority, though seven Republicans were among the 57 who voted for a guilty verdict while 43 senators voted not guilty. The Fed soothed concerns about bond yields rising on inflation concerns. Fed Chair Jay Powell testified to Congress that the US's recovery is "far from complete" and that the central bank intends to keep interest rates at levels that support employment growth while concerns about inflation remain low. In economic news, the US economy grew at a (revised) annualised speed of 4.3% in the last three months of 2020. The March quarter was marked by individual investors on Reddit and Robinhood bidding up selected stocks that heightened concerns of a stock bubble and the liquidation of Archegos Capital Management's leveraged bets that hurt selected stocks and its banking counterparties. The S&P 500 Index rose 5.8%.

European stocks rallied after the vaccine rollout gained enough pace, the European Central Bank loosened monetary policy even more and Mario Draghi won parliamentary backing to become Italy's next prime minister. Draghi, the former president of the European Central Bank, accepted a mandate from the Italian President Sergio Mattarella to lead the eurozone's third-largest economy after Italy's 66th post-war government collapsed. The European Central Bank officials spoke to calm investors about the risk from rising bond yields as it stepped up the pace of bond-buying to arrest the rise in borrowing costs. This offset the damage from a third wave of infections that forced fresh restrictions across Europe. An economic report showed the eurozone GDP fell a revised 0.7% for the fourth quarter. The Euro Stoxx 50 Index jumped 10.3%.

In other markets, Japan's Nikkei 225 Index rallied 6.3% after the Diet approved a record budget worth 106.6 trillion yen (US\$976 billion) for the fiscal year starting on April 1 and a report showed the economy expanded a revised 2.8% in the fourth quarter. China's CSI 300 Index slid 3.1% as Chinese interest rates rose and the government set a modest growth rate of above 6% for 2021. The S&P/ASX 200 Accumulation Index added 4.3% as company earnings for the period ending December 31 exceeded expectations, the jobless rate fell below 6% and a report showed the economy expanded a higher-than-expected 3.1% in the December quarter. The MSCI Emerging Markets Index edged up 1.9% in US dollars on the better outlook for the world economy.

Strategy Commentary

The strategy recorded a positive return for the quarter in absolute terms. The biggest contributors were the investments in Alphabet, Tencent Holdings and Microsoft. Alphabet rallied 18% after its 23% surge in revenue for the fourth quarter that was driven by Search and YouTube advertising beat expectations. Tencent gained 8.2% after it was among the Chinese stocks that the Trump administration spared from its 'blacklist' of Chinese stocks. Microsoft added 6.2% after fourth-quarter sales advanced a higher-than-expected 17% on pandemic-driven demand for video games and cloud resources.

The biggest detractors were the investments in Netflix, PepsiCo and SAP. Netflix lost 3.5% as risk-taking investors rotated from streaming to legacy media companies. PepsiCo fell 3.8% as further restrictions on out-of-home activity were implemented, especially in Europe. SAP declined 2.6% as investors balked at its shift to a cloud-based subscription model (rather than relying on selling licences).

In relative terms, the strategy underperformed over the quarter. While the portfolio performed strongly during the pandemic up to the end of October, it has lagged the benchmark since November for three main reasons.

The first was, to conform with portfolio risk controls (a combined risk-ratio cap of 0.8%), about half of the portfolio was invested in cash and defensive equities such as utilities, consumer staples and defensive healthcare. This portion of the portfolio has delivered lagging returns compared with the benchmark (but not noticeably against defensive stocks overall), highlighting the unusually strong preference among investors for riskier investments. The flipside is that these stocks are at their cheapest in many years, giving us comfort about future portfolio returns.

The second reason for the underperformance was the stock-specific issues faced by companies such as Alibaba. Despite their volatile stock prices, we remain comfortable with holding our investments and we see a high likelihood of them delivering attractive returns over our horizon of three to five years. The third reason was our underweight exposure to cyclical equities. We are more attracted to defensive equity valuations compared with those of cyclicals.

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

NETFLIX

Competition under the capitalist system in theory works something like this. An entrepreneur has a bright idea. That leads to a business making, or promising to make, excess profits on the capital invested. Others see the riches to be made. They set up rival companies. The extra competition reduces the prices consumers pay. Profits decline, even for the pioneering business. The loss-makers fold while the industry survivors eke out their cost of capital.

Let's see how the theory applies to the on-demand-video or streaming industry. The pioneer for watching TV shows and movies over the internet in a personalised way is Netflix. In 1997, Reed Hastings and Marc Randolph founded the company in the US as a movie-rental service, where people ordered DVDs via the Netflix website that were then posted out. The company listed in 2002 and successfully saw off a challenge from Blockbuster. Recognising that streaming was the future of video distribution, in early 2007 Netflix introduced its Watch Now product as part of its DVD subscription that allowed people to choose from about 1,000 movies they could watch instantly on their PCs.

What a great idea. By 2012, Netflix had expanded its catalogue of streamed content significantly and amassed sufficient viewership to begin its inevitable transition towards original content. Netflix's first original series, *House of Cards*, was a huge hit. By 2016, Netflix's streaming service was available globally (ex-China) as Hastings moved rapidly to take advantage of a "competitive window that will be open only temporarily". One year later, Netflix cracked 100 million subscribers of whom more than 50% came from outside the US, won its first Oscar (for a documentary) and released its first feature film.

There was always competition in a broader sense for the streaming services of Netflix (which still operates the legacy DVD and Blu-ray disc hiring business). The company was always competing with linear free-to-air and cable TV for people's viewing time and early on Amazon, Walmart-owned Vudu, and Hulu, owned by a consortium of media companies, offered rival streaming products. More recently, however, the Hollywood studios arrived. Long concerned with cannibalising existing revenue streams, they responded belatedly by launching streaming services.

WarnerMedia, NBCUniversal, ViacomCBS and Disney arrived with immense backlogs of content, the money to create more, and huge marketing budgets to try to convince households to add their service to the emerging streaming bundle. A critical early move of Hollywood was to reclaim their most popular content such as the *Friends* series. In just over a year, Disney's iconic content has seen it attract more than 90 million Disney+ subscribers worldwide, complementing its nearly 40 million Hulu subscribers in the US over which it has control following its 2019 acquisition of 21st Century Fox. WarnerMedia's HBOMax has over 40 million subscribers.

Although Netflix's 204 million subscribers worldwide as at the end of 2020 still provides it with 'scale' advantage, the competitive set in streaming is broadening.

With this increase in competition, is Netflix destined to be a business grafting out its cost of capital? We don't think so. The streaming industry comes with characteristics that when combined with Netflix's bespoke advantages are likely to ensure the company can earn bumper returns on capital for the foreseeable future.

The most notable features of streaming are its popularity and the scalability of content spend. Industry leaders including Netflix are likely eventually to sign up hundreds of millions more households around the globe. As they do so, a portion of the incremental revenue will be reinvested in expanding their content offering, improving the value of the service while concurrently creating ever-growing barriers to new entrants.

Another benefit of these economies of scale is that streaming services are relatively cheaply priced (especially compared with the fees and commitments for pay TV). That means most households will be able to afford two or more streaming subscriptions (reducing direct competition between providers), can easily absorb increases in fees and are likely to hang onto the services they now consider necessities if economic times get tougher. Netflix is well positioned to be one of the services most people pick.

That leads to Netflix's bespoke pluses. Netflix's early-mover advantage has allowed the company to build the reputation as the must-have basic offering that, while innovative, is easy to understand and use. People are likely to subscribe to Netflix and then line up one or two other services that complement Netflix's increasingly broad and deep offering of films, documentaries and series. Given the aforementioned scale advantages, dislodging Netflix from this position will be incredibly difficult.

Another advantage Netflix has is that it has operated in most countries for at least five years, well ahead of its peers. Netflix has thus gained a fair assessment of what people from Brazil to Japan to Germany want to watch, how they interact with the service, and the most efficient way to attract new subscribers. Another benefit from this early global start is that Netflix has a pipeline of local original content that differentiates its service and positions it well to meet local-content requirements that may emerge.

Netflix's positioning as one of the must-haves that dominate the industry gives it 'pricing power'. This term describes Netflix's ability to boost revenue by raising its prices because higher prices won't cost it customers. Even after the Hollywood competition arrived in 2020, Netflix increased the price of its most popular US plan for the second time in two years, raising it US\$1 to US\$14 a month, and raised prices by a similar amount in many other markets. We think the emerging industry structure and the value of Netflix's service mean this will persist for an extended period. It all makes for a stock that is well positioned to deliver attractive returns for investors willing to take a long-term view.

To be sure, while Netflix is nicely positioned, execution still matters. In an industry where low switching costs create the potential for churn, Netflix will need to spend its growing content budget wisely to maintain strong engagement and attract new segments of the market while avoiding controversy. The threat emerging from streaming aggregators – including smart TV manufacturers, Roku and Amazon’s FireTV that are looking to become the starting point of household viewing sessions and participate in the rapid growth in video streaming – also needs to be managed carefully. Netflix’s challenge to match the record subscriber additions in 2020 due to pandemic-induced lockdowns could create pressure from investors focused on near-term performance rather than the journey ahead.

While the entry of Hollywood has intensified near-term competition in streaming, the flipside is that there are unlikely to be many more other entrants into this flourishing industry. Netflix’s ability to withstand the Hollywood push indicates it will thrive in coming years in an industry better explained by theories on oligopolies rather than those on perfect competition.

Sources: Company website, Bloomberg, Dunn & Bradstreet.