MFG ASSET MANAGEMENT

MFG Global Equities

Key Facts

Portfolio Manager	Hamish Douglass
Strategy Inception Date	1 July 2007
Total Global Equity Assets[1]	USD $27,064.4 million
Total Strategy Assets	USD $23,946.4 million

USD Performance[2]

	Composite (Gross)	Composite (Net)[3]	MSCI World NTR Index	MSCI World Qual. Mix NTR	MSCI Min. Vol. NTR
3 Months (%)	6.2	6.0	4.9	3.4	-0.9
6 Months (%)	3.0	2.6	5.9	4.9	4.2
1 Year (%)	8.8	7.9	11.4	13.4	16.7
3 Years (% p.a.)	8.0	7.1	5.8	7.9	10.4
5 Years (% p.a.)	15.6	14.7	11.6	11.9	11.9
7 Years (% p.a.)	14.8	13.9	8.5	9.8	10.6
Since Inception (% p.a.)[4]	11.1	10.3	3.0	4.8	5.6

	Composite (Gross)	Composite (Net)[3]	MSCI World NTR Index	MSCI World Qual. Mix NTR	MSCI Min. Vol. NTR
2007 (%)*	0.0	-0.4	-0.1	1.0	1.0
2008 (%)	-21.6	-22.3	-40.7	-35.4	-29.7
2009 (%)	39.4	38.3	30.0	27.7	16.4
2010 (%)	18.3	17.4	11.8	11.4	12.0
2011 (%)	11.9	11.0	-5.5	0.7	7.3
2012 (%)	21.6	20.7	15.8	13.0	8.1
2013 (%)	30.8	29.8	26.7	24.5	18.6
2014 (%)	6.6	5.7	4.9	7.3	11.4
2015 (%)	4.2	3.4	-0.9	1.6	5.2
2016 CYTD (%)	4.0	3.4	5.6	7.3	10.5

Top 10 Holdings[5]

	Sector[6]	%
Apple Inc	Information Technology	6.5
eBay Inc	Internet & eCommerce	5.2
Visa Inc	Payments	5.1
Alphabet Inc	Internet & eCommerce	5.0
Yum! Brands Inc	Consumer Defensive	4.9
Microsoft Corp	Information Technology	4.7
Intel Corp	Information Technology	4.4
Oracle Corp	Information Technology	4.1
PayPal Holdings Inc	Payments	4.0
Lowe's Co Inc	Consumer Discretionary	3.8
	TOTAL:	47.7

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

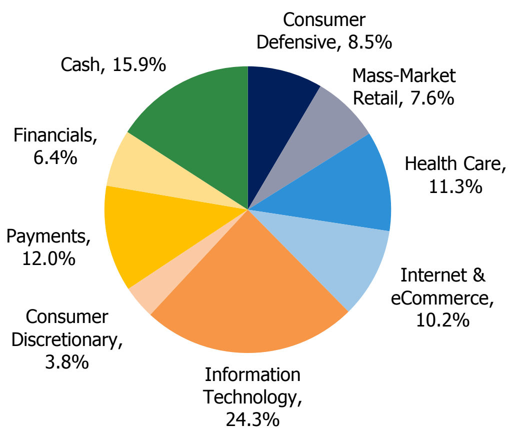
Strategy Fundamentals

	Strategy[5]	Index[4]
Number of Holdings	26	1,637
Return on Equity	21	13
P/E Ratio (1 year forward)	15.6	16.2
Interest Cover	14	10
Debt/Equity Ratio	19	52
Active Share	81	n/a
Weighted Average Market Cap (USD million)	158,533	n/a

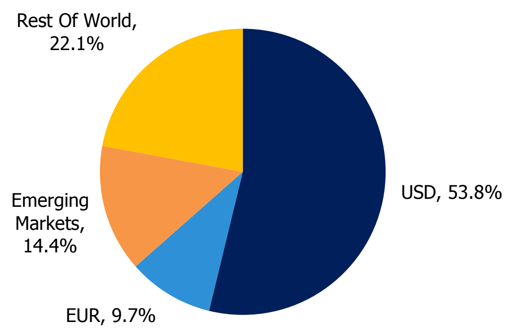
USD Risk Measures

Risk Measures	3 Years	5 Years	Since Inception[4]
Upside Capture	1.0	1.0	0.9
Downside Capture	0.8	0.6	0.6
Beta	0.9	0.8	0.7
Information Ratio	0.5	0.7	1.1
Tracking Error (% p.a.)	4.2%	5.4%	7.2%
Standard Deviation – Strategy	10.4%	10.3%	13.9%
Standard Deviation – Index	11.0%	11.9%	17.0%
Worst Drawdown – Strategy	-7.3%	-7.3%	-36.0%
Worst Drawdown – Index	-12.0%	-12.0%	-54.0%
Turnover[5]	27.3%	21.9%	16.3%

Industry Exposure by Source of Revenue[5, 6]



Geographical Exposure by Source of Revenue[5 6]



Market Commentary

Comments from central bankers remained in focus, particularly the US Federal Reserve which released updated projections for the Federal Funds rate, suggesting a further extension in its policy normalisation timeline. Meanwhile, in response to risks associated with Brexit, the Bank of England cut the Bank Rate for the first time since the global financial crisis and announced a new round of Quantitative Easing along with a £100 billion term funding scheme to lower funding costs for banks.

Interest in the US presidential campaign gathered momentum, as investors increased speculation over policy and associated implications for markets and the US economy. Political risks in the euro zone remained elevated, in particular in Italy where the upcoming Constitutional Referendum and capital shortfalls at Italian banks added to uncertainty.

The US economy's trajectory of steady growth continued during the quarter, evidenced by growing personal consumption expenditures, rising consumer sentiment and an improvement in labour market conditions. Economic data in the UK stabilised during the quarter, exceeding expectations, while continental Europe's gradual recovery appeared little affected by the Brexit vote. In China, the ongoing economic slowdown was temporarily alleviated by a bout of rapid, credit-fuelled growth in China's property market.

We remain cautious about the outlook for equity markets, and retain exposure to high quality companies together with a large weight in cash to preserve capital.

Strategy Commentary

As of 30 September 2016, the Strategy consisted of investments in 25 companies, compared with 24 companies held as at 30 June 2016. The top ten investments represented 47.7% of the Strategy on 30 September 2016, while they represented 46.6% of the Strategy as at 30 June 2016. The cash position has declined marginally to 15.9% as at 30 September 2016 from 16.4% at the end of June.

The Strategy outperformed the benchmark in the September quarter, driven by strong contributions from many of its largest positions. The largest contributor to performance this quarter was eBay. The company's stock price rose strongly in July following its latest earnings release which was favourably received by the market. The company exceeded consensus expectations for revenue and earnings per share growth, showing a sequential improvement in US Gross Merchandise Value growth in the quarter. Apple also performed well following the release of its quarterly results and received a further boost following the release of its latest iPhone 7 product in September. Intel performed strongly through the quarter, primarily due to improving sentiment around the outlook for the PC market (the PC segment constitutes a majority of Intel's revenue). The company formally increased its guidance for third-quarter revenue growth in September, citing channel inventory build and early signs of improving end-user demand.

The major detractors from performance were positions in Lowe's, Sanofi and CVS Health. Lowe's was weak following its second quarter earnings release, with its comparable sales growth slowing to 2%. However, the company maintained full-year guidance of 4% and reiterated confidence in growth improving in the second half of 2016. Sanofi declined following the surprise exclusion of its key insulin product, Lantus, from CVS and UnitedHealth's formularies and after losing to Pfizer in the bidding war for Medivation.

CVS Health's share price declined through the latter part of the quarter due to weakening sentiment around regulatory risks which were exacerbated by the US election cycle and the heightened public scrutiny following Mylan Pharmaceutical's EpiPen pricing scandal.

Lloyds Banking Group was a significant detractor from performance this quarter, largely due to the Brexit outcome which impacted UK focused companies. We do not foresee any direct operational implications for Lloyds, although a likely slowdown in UK economic activity will pose challenges for the Bank. The exact economic impact of the Brexit vote will remain unclear for some time and downward pressure is likely to remain on interest rates with heightened risks for the British pound. Lloyds is well placed to meet these challenges, reflecting its significant restructuring post the financial crisis into a retail focused bank with a simple, relatively low risk, business model. Following the recent sell-off, Lloyds' is trading at a material discount to our assessment of its long-term intrinsic value, notwithstanding its near-term challenges.

Key Stock in Focus - Alphabet

Alphabet

Google was formed by two Stanford PhD students in 1998 using an innovative technique to rank websites for relevancy in the early growth phase of the internet. It has since grown into the largest advertising company in the world, driven by the mission to organise the world's information and make it universally accessible and useful.

Alphabet, the parent entity of Google, is a highly innovative company with an incredibly valuable and dominant search business which continues to grow strongly and generate substantial free cash flow. This has enabled it to invest in new, often radical, products and services with a long-term view to building leading positions in potentially massive markets.

Leader in search and mobile

Alphabet's primary business is Google Search, which represents around three-quarters of its total sales and an even higher proportion of its earnings. Google's Search is a highly effective, measurable and scalable form of advertising, which has grown from next to nothing in 2000 to around 15% of global media advertising spending in 2015.

We estimate Google has over 80% share of the global search market (ex-China). The economics of Search favour the market leader, given significant fixed-cost hardware and software investments and the virtuous cycle of greater usage. More user data (what a user does, and does not, click through) allows the incumbent to test changes, iterate and improve search results faster and more effectively than competitors. Google's strong brand and continually improving product has stymied competitors' attempts to attract users away. Microsoft's Bing, the second largest search engine outside China, achieved profitability for the first time in late 2015.

The proliferation of mobile devices over the last decade has made search accessible at all times to more people, increasing usage and improving results with location data. Search queries now mostly come from mobile phones. To protect this share from disintermediation, particularly by Apple, Google released the Android mobile operating system for free to smartphone makers in 2009. Android now has a global market share of over 80%, extending and entrenching Google's position in search.

Aside from continued user and query growth, Search has multiple levers to grow. In 2015 it introduced an additional paid mobile ad unit in some highly commercial transactions. This action materially accelerated growth, despite the already massive scale of the business. Similarly, in 2016 the company announced the introduction of local ads in Maps, a software asset with over one billion monthly active users, which was until that time, largely devoid of advertising. Google is also using smartphone location data to provide advertisers with data on whether physical store visits are driven by search, thereby justifying higher prices for Google's ads.

Leader in machine learning and artificial intelligence

Google has invested considerably in the rapidly advancing fields of machine learning and artificial intelligence (A.I.), in part to improve its search engine so that it provides the most relevant information or content to users. Over a billion people query Google, collectively tens of thousands of times per second on a wide variety of topics. How users interact with search results inform Google as to the relevancy of the results it showed (was the first link clicked? were multiple links clicked?). Google has developed sophisticated machine learning algorithms to use this data to optimise Google's relevancy rankings. Few companies globally have access to anything close to the scope of Google's data –they include Facebook with social search and Amazon with retail search.

Google's data, coupled with its innovation in computer science and machine learning, has helped the company stay ahead of search competitors, but the implications are much broader. These capabilities have the potential to radically improve on and augment human capabilities and analyse complex systems, for example, to improve cancer diagnosis or climate science.
One of the potential uses of A.I. include a digital personal assistant. Google's Chief Executive Officer, Sundar Pichai, has noted:

"Looking to the future, the next big step will be for the very concept of the "device" to fade away. Over time, the computer itself—whatever its form factor—will be an intelligent assistant helping you through your day. We will move from mobile first to an AI first world."

Digital personal assistants have a tremendous opportunity to create improved services and efficiency for users. Meanwhile, the assistant may insert itself even more seamlessly between the user and the transaction than Search does today, providing a large opportunity for the assistant owner. While the major digital platforms are now investing in their own assistants (Siri, Cortana, Alexa), Google is the clear leader in the race. At its 2016 developers' conference, Google announced Home, its voice-activated home appliance that will bring Google's digital assistant into people's living rooms. Ultimately, as Pichai predicts, digital assistants could be a key medium through which people interact with the internet and conduct transactions.

A collection of underappreciated call options

Google has built a collection of adjacent businesses, many leveraging Search's assets, which have large global addressable markets.

YouTube is a video platform with over one billion monthly active users. Video content creators of all sizes can generate revenue on YouTube by showing advertising to their audiences. Google takes around a 45% share of this revenue for facilitating the advertising. Google is bringing the customisation, automation, targeting and measurability of Search to video advertising, which TV has inadequate user data to replicate. As people watch an increasing amount of video content online, YouTube has grown its share of the approximately US$170 billion global (ex-China) video advertising market.

Aside from Search, Google monetises Android through the Google Play Store, a platform where app developers can access well over a billion Android users. Google takes a 30% share of revenue for facilitating these transactions. Google Play is leveraged to the continued growth in smartphone users and usage.

Google Cloud Platform is the company's hyperscale public cloud, which is how enterprises and developers are increasingly purchasing and managing their IT resources. Google has built the largest distributed cloud infrastructure in the world to provide its consumer services - primarily Search. It is leveraging this internal capability to compete with current leaders, Amazon's AWS and Microsoft's Azure, in this nascent market with enormous potential for high levels of growth over the long term.

Alphabet's Other Bets segment represents ventures unrelated to its internet businesses (Google) which are disruptive and could become large stand-alone companies. These include Google Fiber (US wireline internet/TV provider), Nest (home automation devices) and self-driving cars. While Other Bets represented less than 1% of Alphabet's 2015 revenue, they collectively incurred US$4 billion in costs in 2015, representing over 15% of Alphabet's pre-tax earnings.

While many of Alphabet's businesses have entrenched market positions and massive growth opportunities, they do face several threats including government regulation, competition from Microsoft, Amazon, Apple and Facebook, together with potential disruption (e.g. competing intelligent assistants). In addition, there is a lack of transparency with respect to its Other Bets investments and its intentions regarding its large and growing cash balance.

Despite Google's history of successful and profitable innovation and its unique global assets, we believe that Alphabet's current share price materially undervalues its Search (including Maps), YouTube, Play Store, and Google Cloud Platform and incorporates no (possibly negative) value for many of its potentially massively disruptive businesses or success in achieving dramatic advances in A.I.

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

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 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 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.