

# MFG Core ESG Fund

(Managed Fund) (Ticker: MCSE)

A diversified global equities portfolio of 70-90 high quality global equities with ESG risk integration

Fund Update: 30 September 2022

ARSN: 645 514 110  
APIR: MGE8722AU

## Fund Features

- A portfolio of high-quality securities that is actively constructed and rebalanced quarterly
- Integrated quality framework to identify companies with sustainable competitive advantages, and with a forward-looking view to the evolution in technology, consumer behaviour and other fundamental impacts to businesses
- Quarterly rebalanced, and continuously monitored, to ensure relevant and updated views on ESG, quality, value and risk
- Investors can buy or sell units on Cboe like any other listed security or apply and redeem directly with the Responsible Entity

## ESG Philosophy and integration

- Integrated proprietary ESG risk assessment process and low carbon framework
- Companies with material exposures to operations considered detrimental to society or the environment are removed from the universe
- Companies are reviewed and scored for the materiality of their exposure to E, S and G issues. The assessment is a direct input into portfolio management
- We overlay our proprietary low carbon framework to deliver a portfolio with a much lower carbon risk exposure than world markets

## Fund Facts

Portfolio Manager	Elisa Di Marco	
Structure	Global Equity Fund, A\$ Unhedged	
Objective	Achieve attractive risk-adjusted returns over the medium to long term, through investment in a diversified portfolio of high-quality companies, whilst reducing ESG risk exposures.	
Inception Date	11 December 2020	
Management Fee <sup>2</sup>	0.50% per annum	
Buy/Sell Spread <sup>1,2</sup>	0.10%/0.10%	
Minimum Investment <sup>2</sup>	AUD\$10,000	
Fund Size/NAV Price <sup>4</sup>	AUD \$12.4 million / \$3.4385 per unit	
Distribution Frequency	Semi-annually	
Cboe Ticker	MCSE	
Tickers	Solactive iNAV	ICE iNAV
Bloomberg (MCSE AU Equity)	MCSEAIV	MCSEAUIV Index
Refinitiv (MCSE.CHA)	MCSEAUDINAV=SOLA	MCSEAUiv.P
IRESS (MCSE.CXA)	MCSEAUDINAV	MCSE-AUINAV.NGIF
Carbon Intensity (CO <sub>2</sub> t/US\$1m revenues) <sup>3</sup>	Fund: 31	Index <sup>**</sup> : 145

Visit [www.mfgcoreseries.com.au](http://www.mfgcoreseries.com.au) for more information, including: fund performance, unit prices and iNAV, investment insights, PDS & forms

<sup>1</sup> All fees are inclusive of the net effect of GST. <sup>2</sup> Only applicable to investors who apply for units directly with the Responsible Entity. <sup>3</sup> As at 30 September 2022. Carbon intensity data available on a quarterly basis. Certain information © 2021 MSCI ESG Research LLC. Reproduced by permission

## Performance Chart growth of AUD \$10,000\*



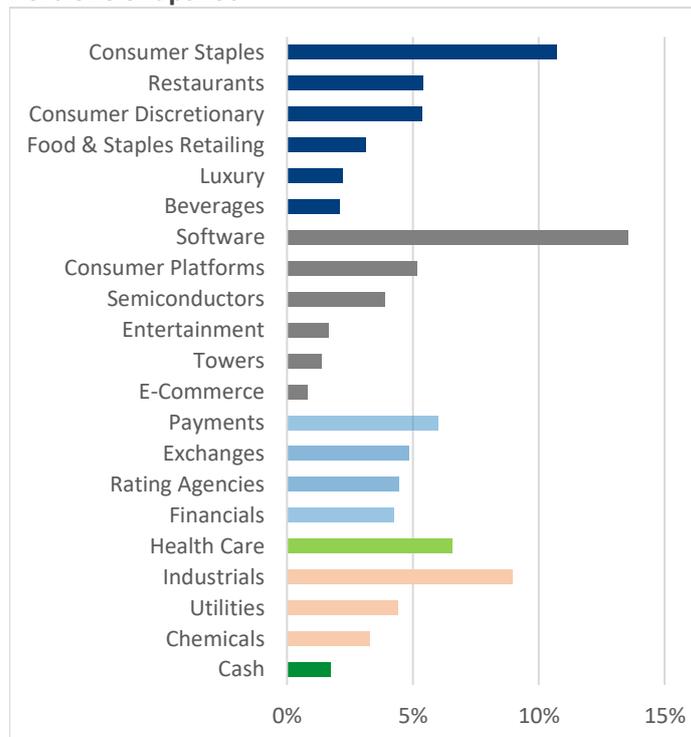
## Performance\*

	Fund (%)	Index (%)**	Excess (%)
1 Month	-3.5	-3.3	-0.2
3 Months	1.2	0.3	0.9
6 Months	-7.9	-8.2	0.3
1 Year	-13.4	-9.7	-3.7
Since Inception (p.a.)	2.1	4.8	-2.7

## Top 10 Positions

Company	Sector <sup>#</sup>	%
Microsoft Corporation	Software	2.5
Alphabet Inc	Consumer Platforms	2.5
American Water Works	Utilities	2.3
S&P Global Inc	Rating Agencies	2.2
Deutsche Boerse AG	Exchanges	2.2
Moody's Corp	Rating Agencies	2.2
Rockwell Automation Inc	Industrials	2.2
L'Oreal SA	Consumer Staples	2.1
MSCI Inc	Financials	2.1
Ecolab Inc	Chemicals	2.1
TOTAL:		22.4

## Portfolio Snapshot<sup>#</sup>



\* Calculations are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). Fund Inception 11 December 2020. Returns denoted in AUD.

\*\* Benchmark is the MSCI World NTR Index (AUD). All MSCI data is the property of MSCI. No use or distribution without written consent. Data provided "as is" without any warranties. MSCI and its affiliates assume no liability for or in connection with the data. Please see complete disclaimer in <https://www.mfgcoreseries.com.au/benchmark-information/>

<sup>#</sup> Sectors are internally defined. Exposures may not add to 100% due to rounding.

## Market Commentary

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Global stocks slumped for a third consecutive quarter in the three months to September after a higher-than-expected reading on US inflation signalled the Federal Reserve would respond aggressively, faster inflation fuelled by higher energy prices and a rising US dollar pressured other central banks to raise rates, talk rose that China's economy is in trouble, and new UK Prime Minister Liz Truss lost the confidence of investors when announcing an unfunded widening of the budget deficit. During the quarter, nine of the 11 sectors fell in US-dollar terms. Communications (-12%) fell the most while consumer staples (+2.1%) rose most. The Morgan Stanley Capital International World Index lost 6.2% in US dollars but rose 0.3% in Australian currency after the Australian dollar dived.

US stocks dropped after the inflation report for August fanned expectations the Fed would need to raise the cash rate more than expected and keep it higher for longer. While the report showed consumer prices were flat in August (for a 12-month rate of 8.3%), the core measure that strips out food and energy prices jumped a higher-than-expected 0.5% in the month (for a 12-month rate of 6.3%). The Fed responded to evidence inflation is more about economic momentum than transitory shocks by raising the cash rate by 0.75% in September to between 3% and 3.25%. This followed a similar hike in June and July and marked the fifth increase since March when the rate was close to 0%. In political news, Congress passed a bill dubbed the Inflation Reduction Act, which, as it contains an estimated US\$375 billion in measures to fight climate change, President Joe Biden hailed as the "biggest step forward on climate ever". To much controversy, the FBI raided the Florida home of Donald Trump, an unprecedented move against a former president, as part of an investigation into his handling of classified documents. The S&P 500 Index slumped 5.3%.

European stocks dropped after the European Central Bank raised interest rates for the first time since 2011 and warned "sacrifice" was needed to tame inflation. Eurozone inflation accelerated to a fresh record high. Italy's government fell and sent the country to a snap election, and the UK opted for a new prime minister who triggered a financial and political crisis with unfunded fiscal stimulus that included tax cuts for higher earners and relief for higher energy prices. The ECB raised its key rate in two steps by a bigger-than-expected 125 basis points to 0.75%, to end eight years of negative rates. The central bank acted after monthly reports showed inflation setting fresh record highs every release – culminating in a reading of 10% in the 12 months to September. Inflation rose as benchmark electricity prices peaked 1,000% above their average of the past decade, and the euro fell to a 20-year low against the dollar (which boosts import prices). The central bank unveiled its 'transmission protection instrument' that is designed to stop the spread between sovereign yields widening too much. In political news, Italy's prime minister elect after the September poll is Giorgia Meloni of the Brothers of Italy party, who is described as centre right by the Italian media. In the UK, Prime Minister Boris Johnson resigned after losing the confidence of his party and was replaced by Truss. The new leader announced a 'mini-budget' that added to government debt and inflation pressures and triggered talk she would soon be removed. The Bank of England was forced to intervene to stop a systemic crash after bond prices plunged. The Euro Stoxx 50 Index shed 3.3%.

Japan's Nikkei 225 Index dipped 1.7% as news the economy expanded a revised annualised 3.5% in the three months to June limited losses. In July, Prime Minister Fumio Kishida's ruling Liberal Democratic Party won a landslide victory in

elections for the upper house, two days after former LDP prime minister Shinzo Abe was assassinated by a lone gunman. Australia's S&P/ASX 200 Accumulation Index rose 0.4% on higher commodity and energy prices, even as the Reserve Bank of Australia raised the cash rate every month by 50 basis points, taking the rate to 2.35%, to fight inflation that reached 6.1% in the 12 months to June. China's CSI 300 Index plunged 15% as reports showed repeated zero-covid-related lockdowns and heatwaves had inflicted so much damage on the economy authorities needed to respond with stimulus, the yuan slumped to a record low in offshore trading of below 7.2 to the US dollar, and China fired ballistic missiles over Taiwan to protest against a visit by US House of Representative Speaker Nancy Pelosi. The MSCI Emerging Markets Index shed 13% in US dollars as concerns rose a higher US dollar, rising food prices and higher US interest rates could destabilise countries, and Brazil's presidential election loomed that could send the country into a political crisis if either right-leaning President Jair Bolsonaro or former leftist president Luiz Inacio Lula da Silva or their supporters refused to accept the result.

*Index movements are in local currency. US GDP statistics come from the US Department of Commerce, while US employment and inflation statistics are published by the US Department of Labor. EU economic statistics come from Eurostat. UK statistics are released by the Office for National Statistics. Japanese economic statistics come from the Ministry of Economy, Trade and Industry, the Ministry of Finance and the Ministry of Foreign Affairs (GDP). Australian economic statistics are released by the Australia Bureau of Statistics. China's economic statistics are compiled by the National Bureau of Statistics of China.*

## Fund Commentary

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The portfolio recorded a positive return for the quarter in Australian dollars. The biggest contributors included the investments in Starbucks, Autodesk and PayPal Holdings. Starbucks gained after the coffee chain said it would spend another US\$450 million to overhaul its coffee machines and stores in a quest for growth and Howard Schultz, the company's driving force and interim CEO, predicted "the best days of Starbucks are ahead of us". Autodesk benefited from a quarterly result that beat pessimistic market expectations. PayPal surged after saying activist investor Elliott Investment Management is one of its biggest shareholders and that cost-cutting will save US\$900 million this fiscal year and US\$1.3 billion in the next one.

The biggest detractors in local-currency terms were the strategy's holdings in Adobe Systems, American Water Works and Nike. Adobe slid following the announcement of a strategic acquisition in the creative cloud space, as investors are concerned about competition and growth durability. American Water Works slid as rising interest rates reduced the appeal of safer stocks such as utilities. Nike underperformed as covid-19 lockdowns disrupted its largest growth market, China, currency headwinds intensified and concerns rose about excess inventory and discounting activity in North America and Europe.

*Stock contributors/detractors are based in local currency terms.*

# ASML

ASML is a Netherlands-based group that sells lithography systems, which make microchips. The biggest competitive advantage of the company that earned revenue of 18.6 billion euros in fiscal 2021 is that it sells the most advanced lithography systems.

ASML, which formed as a venture between Philips and ASMI of the Netherlands in 1984 and listed in 1995, extended its industry leadership in lithography with its development of 'extreme ultraviolet' lithography, which is an advance on its 'deep ultraviolet' lithography system. This system is regarded as the best for reliably printing transistors on wafers at high volume using a light wavelength of just 13.5 nanometres.

ASML's customers are microchip manufacturers such as Intel and Micron of the US, Samsung and SK Hynix of Korea and TSMC of Taiwan. All semiconductor producers rely on ASML's equipment to produce the most advanced chips. From an investor's point of view, ASML's technology leadership is its core competitive advantage that has given it an 83% stranglehold on one of the world's most crucial industrial systems. Nikon of Japan is ASML's nearest, even a distant, competitor.

When it comes to staving off competitors, ASML's advantage is not in any singular aspect of the lithography system but across the many complex technologies, including the light source, optics, wafer stage, software, and process control, that need to come together in perfect unison. All of this would take incredible effort to replicate.

ASML has also set up a sophisticated production network underwritten by exclusive agreements whereby it outsources the making of components to about 4,000 companies around the globe. Many of the parts are complex. The mirrors in ASML's lithography machines, for instance, are the smoothest structures produced on earth.

No rival, even if possessing a better design for a lithography system, could quickly or easily build a similar global manufacturing network. The biggest semiconductor manufacturers in the world have a vested interest in ASML's commercial success.

At the very least, it seems ASML is poised to hold onto its market dominance for the foreseeable future; in recent years, the company has widened its lead over competitors as it achieved double-digit sales growth. The stock is found in the Magellan Core portfolio because ASML has the potential to generate excess returns on capital for the foreseeable future.

Among threats to ASML, the shrinking of transistors could reach its physical limits in terms of tininess and finesse. If so, it would buy time for rivals to one day catch up to ASML's lithography standards. But somehow microchip-related technology keeps advancing. Another threat is the Chinese government. Beijing understands the strategic worth of microchips, is investing billions of dollars to catch up with the West and is willing to ignore patents to do so. ASML warned in February that an affiliate of a Chinese company it had accused of stealing its trade secrets is marketing products that could infringe on its intellectual property rights. Hence Washington is keen to keep ASML's lithography systems out of China. ASML, however, has a record of delivering ever-improving lithography machines on time to its customers. If the company keeps doing that, investors will be looked after too.

ASML is focused on sustainability and has goals more proactive and ambitious than other companies in the semiconductor industry. The company has set sustainability goals for material risks, including climate and waste. Investment in sustainability is important for direct emissions and waste (scope 1) and third-party supply and product usage emissions (scope 3). The impact of product investment on scope 3 is perhaps underappreciated. ASML's lithography advancements have made successive generations of chips more power efficient. This innovation does come at a cost, with significant waste generated from its sites. Pleasingly ASML seeks to be zero waste from operations by 2030.

*Sources: ASML Annual Report 2021, company filings, Bloomberg and Dunn & Bradstreet.*

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