MFG CORE ESG FUND (MANAGED FUND)

TICKER: MCSE | APIR: MGE8722AU | ARSN: 645 514 110

Elisa Di Marco
Portfolio Manager

A diversified portfolio of 70-90 of the world's best companies – those with sustainable business models that meet our nuanced and proven ESG risk assessment process. These competitive advantages enable them to continually earn excess returns.

Dear Investor,

As we end another financial year, we are presented with the opportunity to reflect. We believe FY2023 was a reminder of why investing in high-quality companies is important. Over the past 12 months the fund returned 25.9%, pleasingly beating the index by over 3.5% net of fees.

As always, how one defines quality is key. At Magellan, we consider that a quality company is one that possesses a unique set of attributes that should enable it to generate sustainable excess returns for years to come. Businesses with attributes such as a favourable industry structure, strong pricing power and high barriers to entry have the potential to deliver meaningful shareholder returns through the cycle. We look for favourable trends in business quality alongside structural tailwinds or defensive characteristics. Some of the qualitative factors we consider are outlined below, with examples of how they apply to companies in the portfolio:

- **Industry structure** – A favourable industry structure is likely to lead to superior economics, especially when an industry is experiencing structural growth at a rate faster than the broader economy. We believe that ASML, as the leading manufacturer of semiconductor lithography equipment with a >80% market share, benefits from a favourable industry structure. ASML benefits not only from its industry position (with few, if any, viable competitors) but also from the acceleration in demand for semiconductors, powered by trends in fast-growing areas such as Artificial Intelligence (AI).
- **Pricing power** – Over the past two years, as cost inflation headwinds have increased, pricing power – or a company's ability to protect returns by repricing products or services – has become paramount. In our detailed assessment of pricing power, we consider a company's exposure to commodity and transport costs, its bargaining power relative to retailers or distributors, and the loyalty of its customer base. McDonald's, Chipotle and Mondelez are fitting examples of portfolio companies with pricing power. These companies can offset cost inflation with pricing initiatives (and in the case of McDonald's, a favourable franchised business model) to protect profit margins and shareholder value.
- **Barriers to entry** – Barriers to entry can take several forms. They could be the cost to build new infrastructure, a technology advantage or the time to build a brand. High barriers to entry are core quality attributes of Salesforce.com, Intuitive Surgical and SAP. These companies continue to gain market share and have pricing power because it is harder for competitors to get a foothold in the industry. For example, Intuitive Surgical is the leading player in robotic surgery. The barriers to entry are elevated given their leading technology and high switching costs. (There are costs and risks to changing providers including the need to train staff on new equipment, as well as buying new equipment.)
- **Scale** – Relative scale can imbue a company with cost advantages in manufacturing, distribution, marketing, and R&D. During periods of social or economic disruption, such as China's zero-Covid policy, large companies like L'Oréal and Nestlé benefited from unrivalled supply chain muscle and an ability to continue spending on marketing. More recently, L'Oréal's acquisition of luxury body care brand Aesop highlights its ability to deploy capital strategically and opportunistically when smaller competitors succumb to economic pressures.

But why did quality matter this year in particular? As we've mentioned, quality companies give us greater certainty in the sustainability of future cash flows. In a world of uncertainty, which we have been in in the years post the pandemic (geopolitics, inflation, interest rates and risk premiums), greater certainty in cash flows is valuable to shareholders. Quality companies tend to reinvest through the cycle, often leading to a stronger company on a relative basis when the cycle turns. Our view on quality is a fundamental input into the portfolio construction process, with what we consider to be higher-quality companies upweighted. Given quality companies improve through cycles, we believe that should major economies enter a recession in the coming 12 months the portfolio is well positioned.

In summary, there is a finite number of outstanding companies in the world that can sustainably generate value for shareholders through the cycle. Identifying these companies is not something investors can just download from Google or get from AI. It requires forward-looking active research and industry knowledge to make considered assessments. While many of these companies are well-known 'blue chip' investments, we must be prudent in monitoring these companies as capitalism's creative and destructive forces are forever reshaping industries by growing new businesses and destroying dominant firms.

MARKET COMMENTARY

Global shares gained in the June quarter, with the MSCI World Index adding 6.8% in USD and 7.5% in AUD as the Federal Reserve approached the end of its rate-hiking campaign, US bank turmoil eased with few observable new casualties and optimism about the potential of recent developments in AI continued. Nine of the eleven sectors advanced in local currency terms, but gains were largely concentrated in the Information Technology (+15.0%), Consumer Discretionary (+11.3%) and Communication Services (+10.2%) sectors that benefited from growing confidence in the potential for AI to drastically influence societies and economies. The detractors were the Energy (-1.0%) and Utilities (-0.7%) sectors that fell as the outlook for commodity prices softened.

On a regional basis, Japanese shares, as measured by the Nikkei 225 index, added 18.4% on growing confidence in the outlook for profit growth and still accommodative monetary policy pursued by the Bank of Japan under new leadership. US shares were the other standout performer, with the S&P 500 rising 8.3% in the June quarter on the back of continued excitement about developments in AI and signals that the Federal Reserve was nearing the end of its rate-tightening cycle as inflation continued to improve. Importantly, economic momentum in the US appeared to be relatively sound, with unemployment still low, and construction activity assisted by increased homebuilder confidence and the Inflation Reduction Act.

Across the Atlantic, pressures on economic activity have been larger and inflationary pressures more intense, partly because wages in Europe are more often contractually tied to past increases in consumer prices than in the US and are hence stickier. The Euro Stoxx 600 added just 0.9% during the quarter. Australia's ASX 200 increased 1.0%.

Chinese shares meanwhile came under pressure, with the CSI 300 index falling 5.1% as fears about the Chinese economic recovery continued to mount. Expectations for a reopening boom have failed to materialise so far this year, forcing policymakers to step in with some incremental interventions to increase stimulus during the quarter. To date, interventions have been small scale rather than material as policymakers balance competing priorities including reducing leverage in the system.

Global shares rose in the past 12 months, with the MSCI World Index rising 18.5% in USD and 22.4% in AUD, despite an aggressive tightening of monetary policy from global central banks, turmoil in the banking sector, and elevated geopolitical tensions. The key drivers of the positive sentiment included rapid advances in Artificial Intelligence, still solid economic momentum in the US and signs that inflation, while still too high, was likely to steadily improve (reducing the need for such high interest rates). All but one of the eleven sectors rose in local currency terms, with Information Technology (36.7%) and Industrials (27.0%) adding the most. The Real Estate sector fell –5.5% after continued pressure on office landlords from high vacancy rates and high interest rates, the former a symptom of post-pandemic work-from-home policies.

US shares rose, with the S&P 500 adding 17.6% in USD in a 12 month period that included the release of ChatGPT by OpenAI, turmoil in the US banking sector, the mid-term elections, a showdown over the Federal debt ceiling, and continued geopolitical tensions between the US and China, which included a suspected Chinese spy balloon being shot down by a US fighter jet off the East Coast of the US. The Federal Reserve increased interest rates by 350bp to 5.0-5.25% before pausing at its June meeting, with inflation much improved over the past year. The consumer price index rose 4.0% in the 12 months to May, down from 8.6% a year earlier. Long-term risk-free interest rates such as the 10-year US Treasury yield remained relatively well-contained, ending the period at 3.81%.

European shares also increased in the past year, with the Euro Stoxx 600 index rising 13.4% in Euro terms. The European economy was more resilient than expected to the winter energy shock caused by the Russian invasion of Ukraine as LNG imports and alternative sources of energy supplemented the shortfall and weather proved milder than historical averages. But, economic growth including in the German industrial base ended the period at stagnant levels. Interest rates rose sharply in Europe too, with both the European Union and the United Kingdom struggling with much-too-high inflation. A resolution of the war in Ukraine looks no closer, with limited progress made during the much-anticipated Ukrainian counteroffensive that began in May.

Japanese shares stood out in Asia, as the Nikkei 225 advanced 25.7% on the back of strong Japanese earnings growth and still accommodative monetary policy at the Bank of Japan. Chinese shares, as measured by the CSI 300 index, fell 14.3%

after optimism that the reopening of the Chinese economy would kickstart growth faded. Towards the end of the period, Chinese policymakers began to ease policy further, but we have yet to see the type of large-scale stimulus unleashed post the global financial crisis that accelerated the growth of Chinese industry. Australian shares ended the period 14.8% higher.

DEVELOPMENTS IN SUSTAINABILITY

Regulation was centre stage during the quarter. IFRS Foundation's International International Sustainability Standards Board (ISSB) officially announced the new global sustainability and climate disclosure standards for annual reporting periods beginning January 2024. Individual jurisdictions will determine whether these standards will be mandatory and the timeline for implementation. In addition, the EU Parliament voted on new rules that require companies to not only identify risk exposures but to report on the impact of their activities related to human rights and the environment. Failure to comply could lead to punitive fines. These are important initiatives to drive improved transparency and comparability on sustainability reporting.

The northern hemisphere's main Annual General Meeting and proxy-voting season drew to a close. Board structure and executive compensation remain the focus for management proposals, and 2023 saw another busy season for shareholder proposals. Key topic areas include climate, diversity, equity and inclusions, human rights, plastics, content and privacy of data as well as consideration of shareholder rights.

Climate risk was a focus in the past 12 months, with the announcement of the US Inflation Reduction Act (IRA) providing significant funding to support and accelerate the transition. The positive impact of the IRA will be seen by US consumers and companies for years to come. The United Nations' annual Climate Change Conference (COP27) was also a key event. Positively, the conference concluded with the announcement of a 'Loss and Damage Fund', to assist nations most vulnerable to climate change. The United Nations Biodiversity Conference (COP15) also had positive outcomes. After more than four years of negotiations, governments (remarkably not the US) signed the Kunming-Montreal Global Biodiversity Framework. Within the agreement are four long term 2050 goals supported by 23 global 2030 targets; these includes the 30 by 30 target, which aims to protect 30% of the planet for nature by the end of the decade, restore 30% of the planet's degraded terrestrial, inland water, coastal and marine ecosystems and reform $500bn of environmentally damaging subsidies.

We also saw significant progress towards improved regulation of sustainability reporting and risk management. The European Parliament and European Commission have announced new rules for packaging and waste, as well as reporting on risks related to human rights and the environment. In addition, global standards from

IFRS Foundation's International Sustainability Standards Board (ISSB) on climate disclosure and Taskforce on Nature-related Financial Disclosures (TNFD) are further honing their draft framework for nature-related risk management and disclosure. These are important steps towards improved and consistent reporting on sustainability issues to give investors more confidence in the identification and management of these risks.

While there are potential benefits from AI across many industries including technology, healthcare and clean energy, investors and regulators are focused on Responsible AI with the launch of ChatGPT earlier in the year. Regulations across many jurisdictions are being developed, for example in the EU a draft AI Act was recently passed by parliament. This is to ensure AI systems are safe, transparent, traceable, non-discriminatory and environmentally friendly.

The last 12 months weren't all supportive of disclosure and management of ESG risks. States in the US remain divided on the regulation of climate change and ESG investing. This has led to some companies sanitising their commentary regarding ESG to remain bipartisan, and others pulling back on ESG expenditure.

PORTFOLIO COMMENTARY

The portfolio recorded a positive return for the quarter in Australian dollars. The biggest contributors included the investments in technology companies, Amazon.com, Apple Inc and Microsoft. Amazon's sentiment improved significantly during the quarter reflecting: 1) solid progress in improving efficiency in Retail; 2) the bottoming of forward growth expectations for AWS as optimisation headwinds eased; and 3) increasing appreciation of the ramifications for Amazon of rapid developments in generative AI. Apple delivered better-than-expected performance during the quarter, driven by continued iPhone share gains in emerging markets. Microsoft was a beneficiary of the rapid developments in generative AI. Microsoft's early leadership has boosted sentiment about the market opportunity. These developments lend support to our thesis of new market opportunities beyond traditional IT spend and Microsoft's unique ability to capture them.

The biggest detractors in the quarter include Nike Inc, Estée Lauder and The Walt Disney Company. Nike underperformed given the increasing risk of a US consumer slowdown, lingering concerns around excess inventory in the wholesale channel and more cautious outlook on the Chinese consumer recovery post reopening. Estée Lauder faced headwinds during the quarter with retailer destocking and a slower-than-anticipated recovery in the important China travel retail channel. Disney underperformed with continued deterioration in linear subscriber trends, with inflation weighing on Parks margins and direct-to-consumer subscriber growth still anaemic.

The portfolio recorded a positive return for the prior 12 months in Australian dollars. The biggest contributors included the investments in Amazon.com, Apple Inc and ASML Holdings. Amazon's performance was bifurcated over the past 12 months. In the first half of the period, Amazon was impacted by cost headwinds due to inflation (wages, freight) and logistic inefficiencies as demand for online retail normalised post-covid. Growth in AWS was also impacted by lower demand as its customers braced for a more austere macroeconomic environment. This was more than offset by the second half of the period, where Amazon performed strongly as it demonstrated good cost control in its Retail business, and investors began to appreciate the future benefits of AI and Amazon's positive positioning in this space. Apple's strong performance was driven by several factors including: (1) a continued shift in the business towards the higher margin Services segment; (2) continued iPhone share gains in emerging markets; and (3) news of further internalisation of manufacturing of components of the iPhone, increasing gross margins. ASML benefited from strong lithography tool shipments and resilience in ASML's order book in the face of broader industry headwinds. This was further supported by favourable sentiment for AI-driven demand.

The biggest detractors over the year include UnitedHealth Group, American Tower and Estée Lauder. UnitedHealth was impacted by higher-than-expected utilisation over the near term, negatively impacting margins. American Tower came under pressure due to rising bond yields, high financial leverage and concerns around the solvency of peer Dish. Estée Lauder's full year was negatively impacted by the most recent quarter with retailer destocking and a slower-than-anticipated recovery in the important China travel retail channel weighing on the stock.

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

PORTFOLIO POSITONING

The strategy is based on Magellan's forward looking, researched definition of 'quality'. This definition is actively monitored by the investment team, and an active input in the rules-based portfolio construction process. The portfolio is determined by selecting the top 70-90 companies, whilst allowing for diversification, from our Investment Committee approved quality universe. Changes to portfolio holdings is driven by additions/deletions to our approved list of 'quality' companies and changes in our view of quality. When our view on quality or ESG opportunity/risk management strengthens, the company is ranked higher and more likely to be included in the portfolio. When our view on quality or ESG opportunity/risk deteriorates, the company is ranked lower, and is more likely to be downweighed or excluded from the portfolio.

Over the past 12 months, Tractor Supply, Ulta Beauty and Zoetis were new additions to the investment universe, and were included in the portfolio at the respective quarterly rebalance based on their ranked quality. Kone, Schindler and UnitedHealth were added into the portfolio following quality score reviews, which led to a higher ranking within the approved universe. Over the past 12 months, PayPal was removed from the portfolio following a quality score review, which led to a lower quality score and hence a lower ranking within the approved universe. Medtronic, Illumina and Experian, were removed from the portfolio, on relative scoring grounds, as new companies entered our quality universe.

Overall, we are pleased with the positioning in the portfolio. Our definition of quality favours companies that are exposed to structural tailwinds, enabling these companies to generate attractive sustainable returns for years to come.

OUTLOOK

We are at the point in the cycle where inflation is slowing, cash interest rate settings by central banks are rising and economic growth is looking increasingly at risk of recession. We believe inflation will continue to be the core focus of central banks and we will need to continue to see lower inflation data points over 2023 if central bank rate rises are to pause. Recessionary conditions in the coming months continue to be our base case, though we believe in the US this is likely to be mild with potentially slight positive nominal growth (barring a financial shock).

We have confidence should major economies enter a recession in the coming 12 months that the portfolio is well positioned. This is largely driven by our definition of quality - that is identifying companies with unique attributes that enable the business to generate attractive and sustainable returns. This definition is valuable in the current market environment for several reasons: 1) quality companies tend to reinvest through the cycle, often leading to a stronger company on a relative basis when the cycle turns; 2) when defining quality, we look for favourable trends in business quality, alongside structural tailwinds, or defensive characteristics; and 3) where uncertainty is present, greater certainty in cashflows is valuable to shareholders.

Yours sincerely,

Elisa Di Marco

Elisa Di Marco

July 2023

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MFG Core ESG Fund (Managed Fund)

TICKER: MCSE | APIR: MGE8722AU | ARSN:645 514 110

AS AT 30 JUNE 2023

Fund Features

- A portfolio of high-quality securities that is actively constructed and rebalanced quarterly
- Integrated quality framework to identify companies with sustained competitive advantages, and with a forward-looking view to the evolution in technology, consumer behaviour and other fundamental impacts to businesses
- Rebalanced quarterly, and continuously monitored, to ensure relevant and updated views on ESG, quality, value and risk
- Investors can buy or sell units on the Cboe securties exchange 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 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 meaningfully lower carbon intensity than broader equity 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. This objective incorporates consideration of environmental, social and governance (ESG) risks and the application of a proprietary low carbon framework.	
Investment Risks	All investments carry risk. While it is not possible to identify every risk relevant to an investment in the fund, we have provided details of risks in the Product Disclosure Statement. You can view the PDS for the fund at www.magellancoreseries.com.au.	
Inception Date	11 December 2020	
Management Fee[1]	0.51% per annum	
Buy/Sell Spread[2]	0.10%/0.10%	
Minimum Investment[2]	AUD$10,000	
Fund Size/NAV Price[3]	AUD $14.9 million / $4.1945 per unit	
Distribution Frequency	Semi-annually	
Cboe Ticker	MCSE	
Tickers	**Solactive iNAV**	**ICE iNAV**
Bloomberg (MCSE AU Equity) **Refinitiv (MCSE.CHA)** **IRESS (MCSE.CXA)**	MCSEAIV MCSEAUDINAV=SOLA MCSEAUDINAV	MCSEAUIV Index MCSEAUiv.P MCSE-AUINAV.NGIF
Carbon Intensity[4] (CO_2t/US$1m revenues)	Fund: 23	Index**: 118

Visit www.magellancoreseries.com.au for more information, including: fund performance, unit prices and iNAV, investment insights, PDS & forms

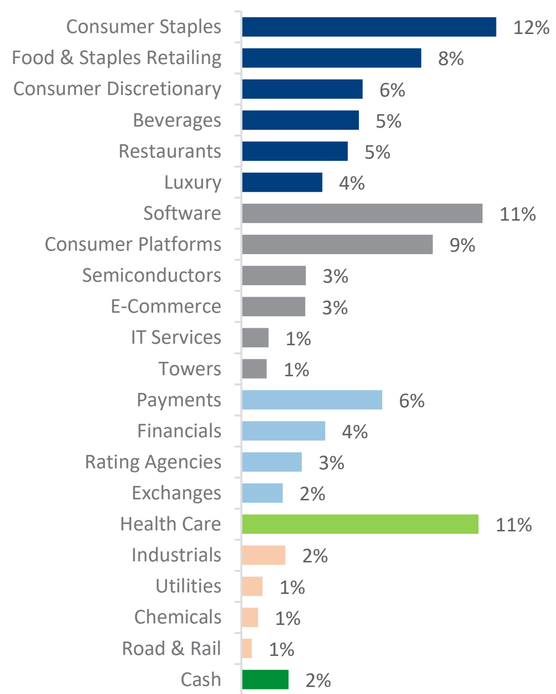
[1] Transaction costs may also apply – refer to the Product Disclosure Statement. All fees are inclusive of the net effect of GST;
[2] Only applicable to investors who apply for units directly with the Responsible Entity
[3] NAV price is cum distribution and therefore includes the distribution of $0.0766 per unit payable on 21 July 2023.
[4] As at 30 June 2023. Carbon intensity data available on a quarterly basis. Certain information ©2023 MSCI ESG Research LLC. Reproduced by permission.

Performance*

	Fund (%)	Index (%)**	Excess (%)
1 Month	2.4	3.1	-0.7
3 Months	7.1	7.5	-0.4
6 Months	18.9	17.2	1.7
1 Year	25.9	22.4	3.5
2 Years (p.a.)	6.0	7.0	-1.0
Since Inception (p.a.)	10.5	11.7	-1.2

Past performance is not a reliable indicator of future performance.

Portfolio Snapshot#



* 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 used 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 www.magellancoreseries.com.au/benchmark-information/.
[#] Sectors are internally defined. Exposures may not add to 100% due to rounding.
^ Exclusions encompass companies with material exposures to the production of tobacco products, "high-roller" casinos, that is casinos targeting high-stakes gaming susceptible to money laundering activities, as well as companies involved in the production of alcohol, adult entertainment and hand-guns. Materiality is normally assessed as greater than 10% of a company's revenues exposed to the exclusionary activity. Revenues are sourced from MSCI ESG Manager.

Performance Chart growth of AUD $10,000*

Past performance is not a reliable indicator of future performance.

Top 10 Positions

Company	Sector#	%
Apple Inc	Consumer Platforms	3.11
Home Depot Inc	Food & Staples Retailing	3.07
Hermes International	Luxury	3.02
ASML Holding NV	Semiconductors	2.97
Amazon.com Inc	E-Commerce	2.95
Alphabet Inc	Consumer Platforms	2.88
Novartis AG	Health Care	2.86
Procter & Gamble	Consumer Staples	2.77
Nestlé SA	Consumer Staples	2.73
PepsiCo Inc	Beverages	2.72
	TOTAL:	29.09

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STOCK STORY: RECKITT

Reckitt commits to a greener future

In 1819, Isaac Reckitt and his brother Thomas established a corn mill business in England, marking the beginning of what was to become Reckitt Benckiser, a UK-headquartered multinational business selling household staples the world has come to trust and love. After humble origins, Reckitt Benckiser now has operations in 68 countries, employs nearly 40,000 people, and generated revenue of approximately £14.5bn (ca. US$18bn) in 2022. Brands such as Lysol disinfectant spray, Dettol antibacterial, Finish auto dishwash, Enfamil infant formula and Nurofen analgesic contribute to its performance.

In 2020, Reckitt's portfolio of disinfectant brands became an important weapon in the global fight against the covid-19 pandemic. Reckitt worked responsibly with governments and its employees to ensure increased capacity of sprays, gels, and wipes to help prevent the spread of the novel coronavirus. By the end of 2022, Reckitt's disinfectant brands earned 40% more revenue versus 2019 and Lysol gained 300 bps of global market share. With a growing middle class in emerging markets, aspirations for a more hygienic and healthier way of living should continue to favour structural growth for Lysol and Dettol.

Reckitt's brands are also captive to an ageing population as well as rising demand for trusted and efficacious self-care products. Approximately 18% of Reckitt's revenue is exposed to brands such as Nurofen, Strepsils, and Mucinex, which grew about 10% on average over the last three years.

These trends help explain Reckitt's 7.7% average organic revenue growth from 2019 to 2022, exceeding the usual 4-6% organic revenue growth investors expect from consumer staples companies. The company has reset margins to encourage better growth outcomes through investments in innovation and brand equity as well as growth in new regions. This investment is yielding results, and returns on invested capital are now greater than the company's cost of capital, a key measure in assessing management's effectiveness.

Reckitt has not only benefited from growth in these well-known household brands, but also, it continues to innovate products to improve sustainability characteristics and meet growing consumer demand for environmentally friendly products. The company has prioritised strategic issues such as climate change, setting a net-zero strategy by 2040, and circularity, setting goals to use only recyclable packaging while reducing the use of virgin plastic. To ensure goals are met, Reckitt developed a Sustainable Innovation Calculator to measure the impact of new product innovations on greenhouse gas emissions, waste streams, and consumer health and wellbeing. Key to its challenge in achieving net zero is that 97% of its carbon footprint lies in its supply chain, requiring strategic collaboration with suppliers and careful planning to achieve their goal on time. Half of the company's emissions come from raw materials sourced for its products and their packaging. Their Sustainable Innovation Calculator guides new product development towards Reckitt's climate goals by recommending novel ingredients, alternative packaging inputs, and lighter materials to reduce the carbon intensity of transporting goods to retail locations – a source of another 41% of carbon emissions.

In addition, the Sustainable Innovation Calculator helps move towards Reckitt's goal of a 50% reduction in virgin plastic by 2030. By reducing virgin plastic in packaging and using high-quality recycled plastic resin, the company makes a positive contribution to reducing plastics in our waste streams. These initiatives can help reduce production costs as well as reinforce Reckitt's brand advantage as some consumers increasingly reach for brands with a purpose.

By creating tools that innovate sustainable outcomes and developing a portfolio of brands that benefit from health and wellness trends, Reckitt Benckiser not only positions itself to achieve a stable earnings growth profile with high-quality returns, it also sets itself up to be a trusted provider of brands we expect consumers to choose for decades to come.

Tracey Wahlberg, Investment Analyst

June 2023

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