MFG ASSET MANAGEMENT

MFG Core Infrastructure

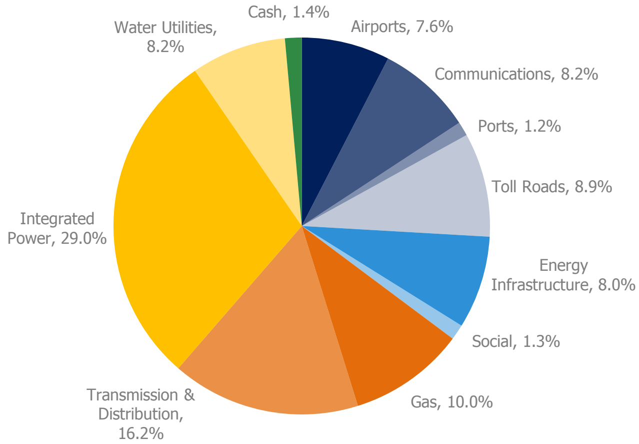
Key Facts

Portfolio Managers	Gerald Stack & Dennis Eagar
Inception Date	19 December 2009
Total Infrastructure Assets[1]	USD $3,948.8 million
Total Core Infrastructure Assets	USD $2,968.3 million

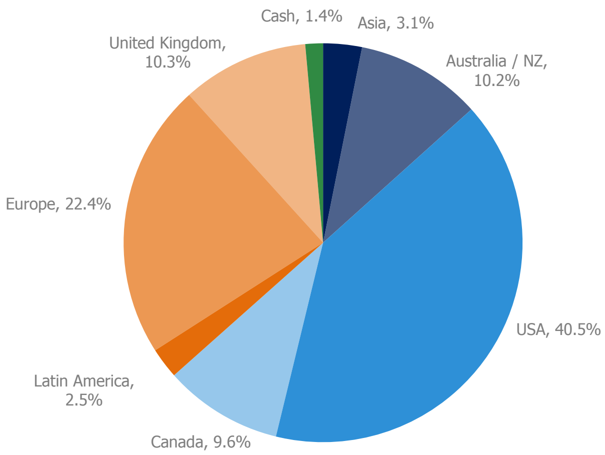
Top 10 Holdings[3]

	Sector	% of Strategy
Power Assets Holdings	Integrated Power	3.1
Abertis	Toll Roads	3.0
National Grid PLC	Transmission and Distribution	2.9
Enbridge Inc	Energy Infrastructure	2.9
Transurban Group	Toll Roads	2.9
TransCanada Corp	Energy Infrastructure	2.9
SES GDR	Communications	2.8
United Utilities Group Plc	Water Utilities	2.6
Atlantia SpA	Toll Roads	2.5
Red Electrica De Espana SA	Transmission and Distribution	2.4

Industry Exposure[3]



Country Exposure by Domicile of Listing[3]



Performance

During the March 2015 quarter in USD terms, the MFG Core Infrastructure Strategy ('Strategy') generated a before-fee return of -2.2%, underperforming the S&P Global Infrastructure Index return of -0.9%. Over the past 12 months the Strategy has delivered 6.4% and the index has delivered 5.4%.[2]

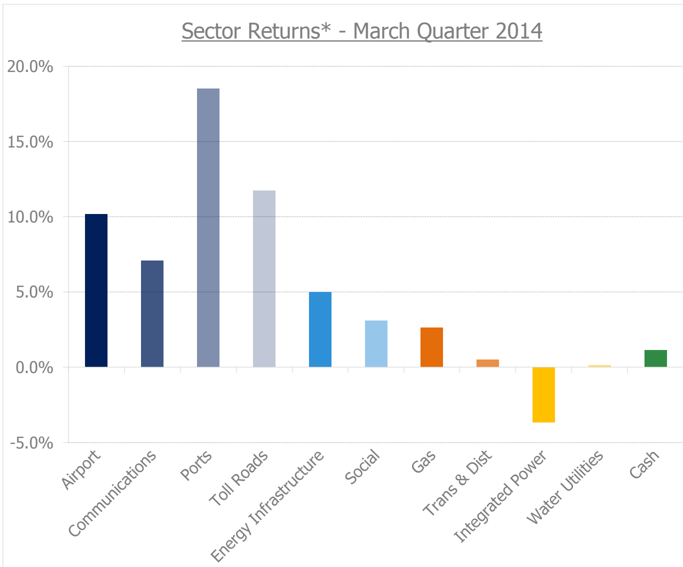
The Strategy's utility exposures were a drag on performance* during the quarter with a weighted average return of -0.9%. Utility returns were dragged down by the integrated power sector which returned -3.7% for the quarter. In contrast, the Strategy's infrastructure exposures returned a weighted average +9.3% for the quarter.

The best performing sectors were Ports (weighted average return of +18.5%), Toll Roads (+11.7%), Airports (+10.2%) and Communications (+7.1%). Of particular note were the returns from Italian toll road company SIAS (+35.5%), another Italian company Atlantia (which owns the significant majority of the inter-urban toll roads in Italy as well as Rome Airport) of +26.5%, Australian Pipeline Group +21.5%, Oil & Gas Storage Tank company Vopak +19.3%, US Utility UIL +19.1%, German Airport company Fraport +15.4% and satellite company Eutelsat +15.1%.*

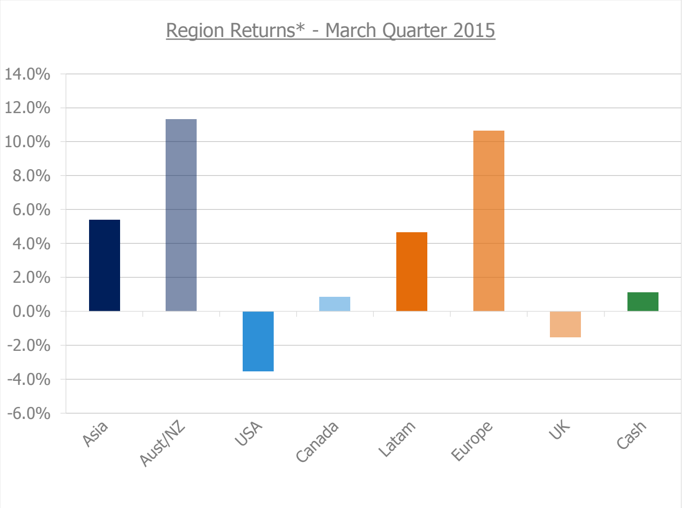
Regionally, the United States (which is almost exclusively Utilities) and the United Kingdom performed poorly, delivering returns of -3.5% & -1.5% respectively. These regional returns were offset by strong performance from the Australasian (+11.3%) and European (+10.6%) markets.*

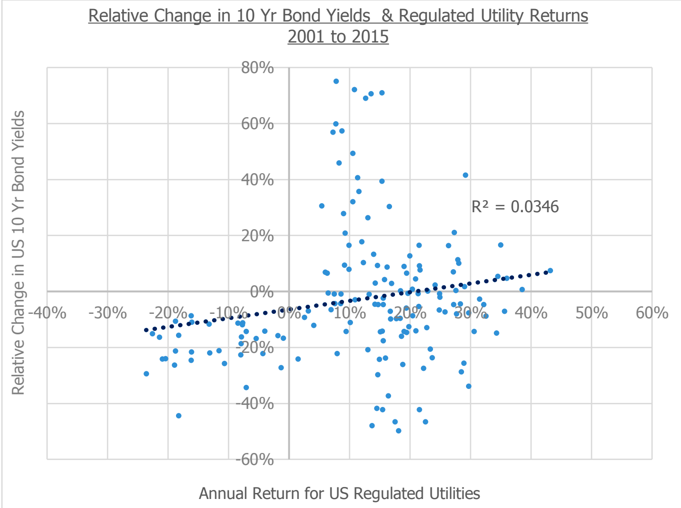
There were quite divergent returns from stocks included in commonly used benchmark indices but excluded from MFGAM's universe of investable stocks. On the positive side for excluded stocks, Chinese infrastructure stocks increased by an average of 17% for the quarter while European utilities with significant competitive power generation businesses increased by approximately 7%. In contrast, US competitive energy businesses declined by an average of 5%, US Oil & Gas MLPs were down an average 4% as were US rail companies. Brazilian infrastructure stocks also fell an average 10% during the period.*

The Strategy's returns by sector and region are shown in the following graphs.



*Returns are stated in local currency terms.
1 Comprised of the total Firm Infrastructure assets, comprising the Select Infrastructure strategy and Core Infrastructure strategy.
2 Index: S&P Global Infrastructure Index (USD) Net from 1 January 2015 spliced with UBS Developed Infrastructure and Utilities Net Total Return Index (USD) prior to that date
3 Representative Portfolio.



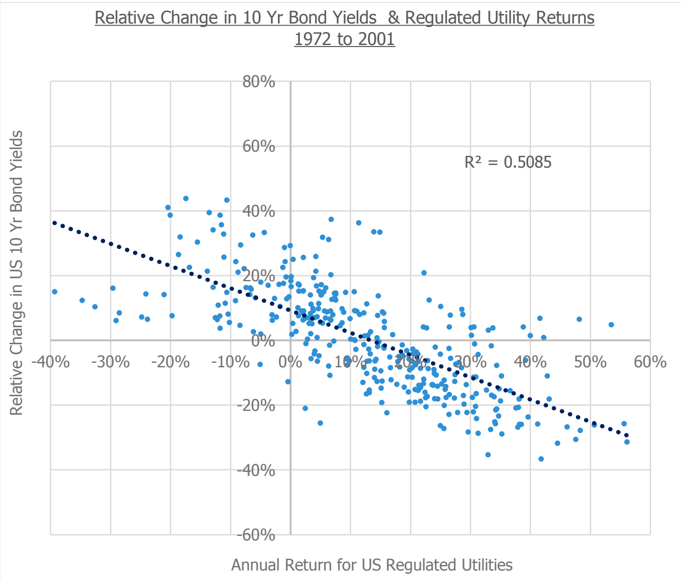


Source: Bernstein, Magellan

Bond Yields and Utility Returns

Over many years markets have traded infrastructure stocks, and particularly utilities, as "interest rate sensitive" stocks – on the logic that they carry more debt than the average industrial company and, therefore, a rise in interest rates will impact their earnings and/or mean that their relative dividend yield will become less attractive compared to less risky alternatives such as bank deposits. Superficially these arguments have merit.

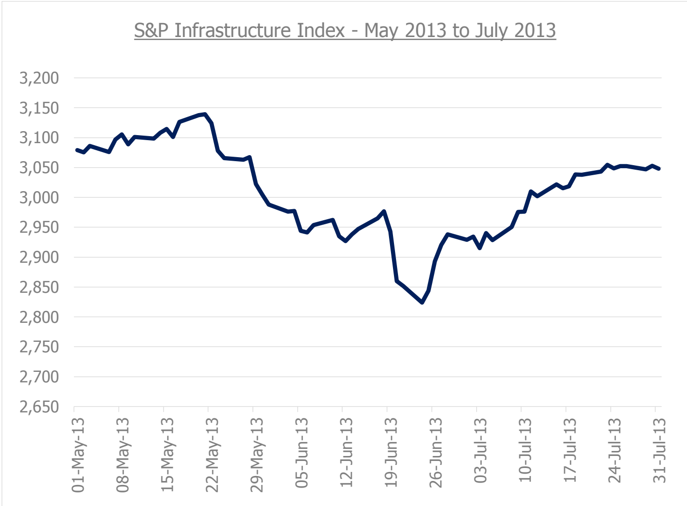
But the relationship between bond yields and the share price performance of utilities can break down for many reasons. The following graph uses a Bernstein index of returns of regulated US utilities and the relative change in yield of US 10 year bonds. As can be clearly seen, the two factors were relatively correlated from the start of the utility return series in 1972 to around 2001.



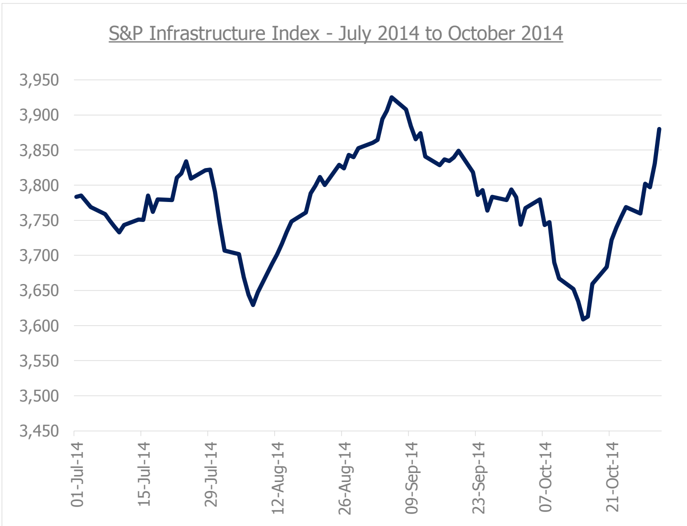
Source: Bernstein, Magellan

However, as shown below between 2001 and today there has been effectively no correlation (R squared of 0.03). Furthermore, there has not been one occasion when utilities have showed a negative annual return when bond yields have risen by any amount over the preceding year (top left quadrant of the following graph). Note that this data presents the absolute return of US regulated utilities, not the relative return. In a rising bond yield environment it is likely that utilities will under-perform the broader equities market.

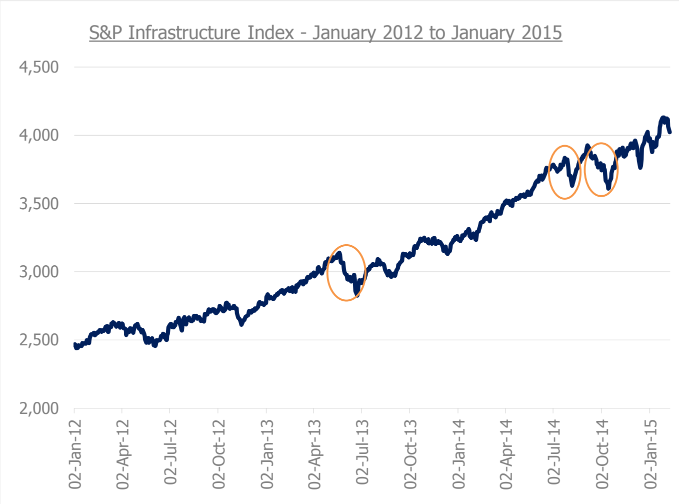
In more recent times, we have seen the knee-jerk reaction of the market to actual or expected increases in short term rates in the US. As the following graph shows between 2 May 2013 and 25 June 2013 (the so-called 'Taper Tantrum'), the S&P Global Infrastructure index fell by 7.5% after 10 year US bond yields increased by 1.0%.



Similarly, twice in the second half of last year the S&P Global Infrastructure Index fell materially as markets became more focussed on potential bond yield increases.



But as the following graph showing the same S&P Global Infrastructure Index highlights that all three previously mentioned downturns are barely noticeable when viewed in the context of the performance of the sector over the last three years.



So what of the next few years? MGFAM believes that, while there is likely to be some short term volatility around US utility prices as interest rates progressively increase, the key determinant of the share price performance of those utilities will be their underlying financial performance. MFGAM believes that rising interest rates will have, at worst, only a very marginal negative impact on their financial performance. This is because:

- High quality regulated utilities have been a major beneficiary of the Global Financial Crisis (GFC) because credit markets now offer debt to these companies that is:
    - Cheaper;
    - Longer term;
    - Available from many more sources.
- Consequently, utilities now carry higher levels of fixed price debt and have relatively less debt maturing in any one year.
- Accordingly, any increase in interest rates will have little impact on their all up cost of debt. Indeed, the cost of debt for a number of companies can be expected to continue to fall over coming years as expensive pre-GFC debt is refinanced with much lower cost debt, (albeit debt that is more expensive than should the utilities refinance right now).
- Finally, many of the US utilities have passed the peak in their capex programs which will allow dividend payout ratios to be increased to offset any comparative disadvantage they may face when traded as a dividend yield play.

Outlook and Strategy

The Strategy seeks to provide investors with attractive risk-adjusted returns from the infrastructure asset class. It does this by investing in a portfolio of listed infrastructure companies that meet our strict definition of infrastructure at discounts to their assessed intrinsic values. We expect that the Strategy should provide investors with real returns of approximately 5% to 6% p.a. over the longer term.

We believe that infrastructure assets, with requisite earnings reliability and a linkage of earnings to inflation, offer attractive, long-term investment propositions. Furthermore, given the predictable nature of earnings and the structural linkage of those earnings to inflation, the investment returns generated by infrastructure assets are different from standard asset classes and offer investors valuable diversification when included in an investment portfolio. In the current uncertain economic and investment climate, the reliable financial performance of infrastructure investments makes them particularly attractive and an investment in listed infrastructure can be expected to reward patient investors within a three to five year timeframe.

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Performance is compared to the S&P Global Infrastructure Index (USD) Net from 1 January 2015 spliced with UBS Developed Infrastructure and Utilities Net Total Return Index (USD) prior to that date, which is a market capitalisation weighted index that is designed to measure the equity performance of listed Infrastructure and Utility stocks. 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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