



MFG ASSET  
MANAGEMENT

# Annual Investor Report 2019

MFG Select Infrastructure Strategy

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## MFG SELECT INFRASTRUCTURE STRATEGY



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The strategy seeks to provide efficient access to the stable returns offered by infrastructure and utility stocks, while protecting capital in adverse markets. Infrastructure and utility stocks that will help achieve these aims generally have strong underlying financial performance over the medium to long term, which is expected to translate into reliable, inflation-linked returns. The strategy typically holds between 20 and 40 stocks.

### PERFORMANCE

Global stocks rose in the 12 months to June 2019 after companies posted higher-than-expected earnings, the US economy expanded briskly without generating inflation, the Federal Reserve indicated it would stop, and possibly reverse, its gradual tightening of US monetary policy, and the European Central Bank said it would “use all the instruments that are in the toolbox” to help the eurozone’s weak economy. Gains were capped by concerns global growth might slow, driven by China-US tensions and rising political uncertainty in Europe.

The strategy recorded a gross return of 15.5% for the 12 months in US dollars. The stocks that contributed over the 12 months included the investments in Transurban (+1.7% of the total strategy return) and US-based companies American Tower (+1.3%), Crown Castle International (+1.2%), Eversource Energy (+1.2%), and Atmos Energy (+1.1%).

Transurban rose when investors turned to longer-duration assets as the Reserve Bank of Australia indicated it would cut the cash rate to help Australia’s slowing economy. American Tower, which is judged another winner from the potential Dish entry to the market, jumped after the owner of wireless communications towers raised guidance for fiscal 2018 and reported higher-than-expected earnings and sales figures. Crown Castle surged after the US cell-tower operator reported higher-than-expected earnings and boosted full-year guidance and after reports Dish, the US pay TV operator, was in talks to acquire some of the assets of Sprint and T-Mobile in order to establish itself as a fourth carrier in the event that the merger between

Sprint and T-Mobile merger is approved. Eversource gained after the power utility announced operating revenue for the third quarter that beat estimates and management indicated that it would increase capital expenditure guidance for the full-year result. Atmos Energy rallied as investors backed a gas utility that, due to increased investments to replace its ageing pipelines, is expected to enjoy high earnings growth for a utility for an extended period.

The stocks that detracted over the 12 months were Atlantia of Italy (-1.4%), ADP of France (-1.0%), Zurich Airport (-0.3%), United Utilities of the UK (-0.1%) and Severn Trent of the UK (-0.04%).

Atlantia declined following the collapse of a bridge in Genoa that was a tolled section of the A10 motorway operated under a concession contract by Autostrade per l’Italia, an 88% owned subsidiary of Atlantia of Italy and its largest asset. ADP fell after France’s constitutional court suspended the further sale of the government’s 50.6% stake in the operator of Paris’s airports ahead of a possible referendum on any sale proposed by political parties opposing the sale. Zurich Airport fell after revealing steps announced by Switzerland’s regulator to reduce the allowed return of its aeronautical revenue business by more than what was anticipated by the market. United Utilities and Severn Trent declined on concerns that the opposition Labour Party has promised to nationalise key utilities and only pay prices below their prevailing market capitalisations on the stock market.

### Performance as at 30 June 2019<sup>1</sup>

Performance (USD) <sup>1</sup>	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	7 Years (% p.a.)	10 Years (% p.a.)	Since inception (% p.a.)
MFG Select Infrastructure Strategy (Gross)	<b>15.5</b>	<b>10.6</b>	<b>9.2</b>	-	-	<b>10.6</b>
MFG Select Infrastructure Strategy (Net)	<b>14.6</b>	<b>9.7</b>	<b>8.4</b>	-	-	<b>9.7</b>

<sup>1</sup> Returns are for the Global Select Infrastructure Composite and denoted in USD. Performance would vary if returns were denominated in a currency other than USD. Refer to the GIPS Disclosure section 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.

## OUTLOOK

In our view, the likely time frame and trajectory of interest rate movements have shifted to a 'lower for longer' scenario where we see the balance of probabilities in the near term for rates to stay low or indeed be cut further before rising in the medium term. We have previously focused on the risks posed by a material increase in rates and we see a risk of inflation leading to an increase in interest rates. However, in the current outlook, the probability of this risk has reduced.

Irrespective of the macro-economic outlook, we expect the underlying earnings of infrastructure and utility companies in our conservative universe to remain reliable and predictable. Ultimately, the values of the companies in our strategy reflect the future cash flows they are expected to generate, and the risks associated with those revenue flows. Even allowing for the resilient nature of the stocks held in the strategy, if interest rates rise, we expect to see volatility in equity markets. We are confident, however, that any increase in interest rates will fail to hamper the financial performance of the stocks in the strategy for the foreseeable future.

We believe that infrastructure assets, with their reliable earnings that are protected to a degree from inflation, are an attractive, long-term investment proposition. The predictable nature of their earnings compared with those offered by other asset classes means that infrastructure assets offer diversification benefits. In uncertain times, the reliable financial performance of infrastructure stocks makes them particularly attractive. An investment in listed infrastructure can be expected to reward patient investors.

## STRATEGY POSITIONING

### Top-10 holdings at 30 June 2019<sup>2</sup>

Security	Weight (%)
Transurban	6.2
Atmos Energy	5.9
Aena	5.3
Enbridge	5.0
Xcel Energy	4.9
Groupe ADP	4.7
Atlas Arteria	4.4
Sempra Energy	4.3
Eversource Energy	4.0
Crown Castle International	3.7
<b>Total</b>	<b>48.4</b>

At 30 June 2019, the strategy consisted of 31 investments compared with 29 investments a year earlier. The 10 biggest investments represented 48% of the strategy at 30 June 2019.

The strategy held about 4.9% in cash on 30 June 2019, down about 4% from 12 months prior. We had previously held an elevated cash holding to reflect a view that the accommodative monetary policy of recent years had boosted global asset prices and that the unwinding of this policy could lead to a repricing of assets. However, as central banks around the world have indicated a willingness to ease monetary policy again, and as there are increasing headwinds to global growth, we are less concerned about rising interest rates than we were.

The key changes to the strategy over the year were a 12% increase in the allocation to utility segments as share prices fell from what we felt were elevated levels, funded by a reduction in the level of cash and a reduction in the allocations to the communications infrastructure and toll roads segments. Within utilities, we have increased the allocation to integrated power and gas utilities while we have reduced exposure to the water utility segment.

The reduction in the allocation to the water segment reflects our concerns over sovereign risk in the UK, specifically, the policy of the opposition Labour Party to nationalise these utilities at significantly less than market value.

In the toll road segment, the largest change was the removal of Italian toll road company Atlantia from the strategy. Following the collapse of the Morandi Bridge in August 2018, the government commenced a process that could lead to it revoking the single concession that governs all of Autostrade per l'Italia's toll road network in Italy. Our consultation with different legal experts indicated that if the government proceeded with revoking the toll road concession, it would be required to provide compensation to Autostrade per l'Italia based on market value (albeit the timing and value of the compensation would be inherently uncertain). However, if Autostrade per l'Italia were to be found to have been grossly negligent or even criminal, then the discussion on compensation would change and the company's claim on compensation could be effectively zero. Given these risks, we assessed that the range of likely outcomes was too wide to be consistent with one of our key investment objectives – capital preservation.

In terms of geographic allocation, while we have increased the share of the strategy invested in North America over the course of the year, we remain underweight relative to our universe as the bulk of the available opportunities in North America are regulated utilities, many of which are less attractive than other opportunities. We also remain underweight the UK given the issues with UK utilities described above.

Gerald Stack

<sup>2</sup> Holdings based on a representative portfolio for the strategy.

#### IMPORTANT INFORMATION:

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The investment program of the Strategy presented herein is speculative and may involve a high degree of risk. The Strategy is not intended as a complete investment program and is suitable only for sophisticated investors who can bear the risk of loss. The Strategy may lack diversification, which can increase the risk of loss to investors. The Strategy's performance may be volatile. The past performance of the Strategy is not necessarily indicative of future results and no person guarantees the performance of the Strategy or the amount or timing of any return from it. There can be no assurance that the Strategy will achieve any targeted returns, that asset allocations will be met or that the Strategy will be able to implement its investment Strategy or achieve its investment objective. The management fees, incentive fees and allocation and other expenses of the Strategy will reduce trading profits, if any, or increase losses. The Strategy will have limited liquidity, no secondary market for interests in the Strategy is expected to develop and there are restrictions on an investor's ability to withdraw and transfer interests in the Strategy. In making an investment decision, you must rely on your own examination of any offering documents relating to the Strategy.

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The Global Infrastructure Benchmark is comprised of the following: from inception to 31 December 2014 the benchmark is UBS Developed Infrastructure & Utilities Net Total Return Index and from 1 January 2015 the benchmark is S&P Global Infrastructure Net Total Return Index. The benchmark changed because UBS discontinued their index series.

The UBS Developed Infrastructure & Utilities Net Total Return Index 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.

The S&P Global Infrastructure Net Total Return Index is a market capitalisation weighted index that is designed to track 75 companies from around the world diversified across three infrastructure sectors energy, transportation and utilities. 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.

#### GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS®) DISCLOSURE

Magellan Asset Management Limited, doing business as MFG Asset Management in jurisdictions outside Australia and New Zealand, (MFG Asset Management) claims compliance with the Global Investment Performance Standards (GIPS®).

For the purpose of complying with GIPS, the Firm is defined as all discretionary portfolios managed by MFG Asset Management, excluding portfolios managed by subsidiaries operating as distinct business entities. MFG Asset Management is a wholly-owned subsidiary of the publicly listed company Magellan Financial Group Limited. MFG Asset Management is based in Sydney, Australia. Total Firm assets is defined as all assets managed by MFG Asset Management, excluding assets managed by subsidiaries operating as distinct business entities.

The Global Select Infrastructure composite is a concentrated global strategy investing in strictly defined or "pure" infrastructure companies, (typically 20-40). The filtered investment universe is comprised of stocks that 1. generate reliable income streams 2. benefit from inflation protection and 3. have an appropriate capital structure. The investment objective of the strategy is to minimise the risk of permanent capital loss; and achieve superior risk adjusted investment returns over the medium to long-term. The composite was created in May 2013.

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](mailto: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.