MFG Core ESG Fund

(Managed Fund) (Ticker: MCSE)

A low-cost diversified global equities portfolio of 70-90 of the world's best companies

MFG CORE SERIES

Fund Update: 31 March 2021

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 Chi-X 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

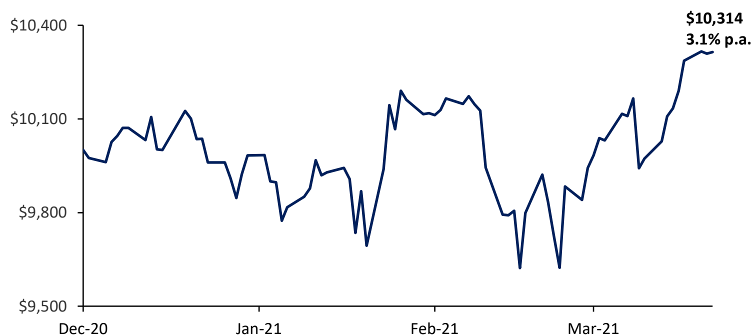
Fund Facts

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[1]	0.50% per annum		
Buy/Sell Spread[1,2]	0.10%/0.10%		
Minimum Investment[2]	AUD$10,000		
Fund Size/NAV Price	AUD $11.6 million /$3.6077 per unit		
Distribution Frequency	Semi-annually		
Chi-X Ticker	MCSE		
iNAV tickers	Bloomberg	MCSE AU Equity	MCSEAUIV Index
	Thomson Reuters	MCSE.CHA	MCSEAUiv.P
	IRESS	MCSE.CXA	MCSE-AUINAV.NGIF
Carbon Intensity (CO_2t/US$1m revenues)	Fund:24	Index: 140	

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

[1]All fees are inclusive of the net effect of GST;
[2]Only applicable to investors who apply for units directly with the Fund

Performance Chart growth of AUD $10,000*



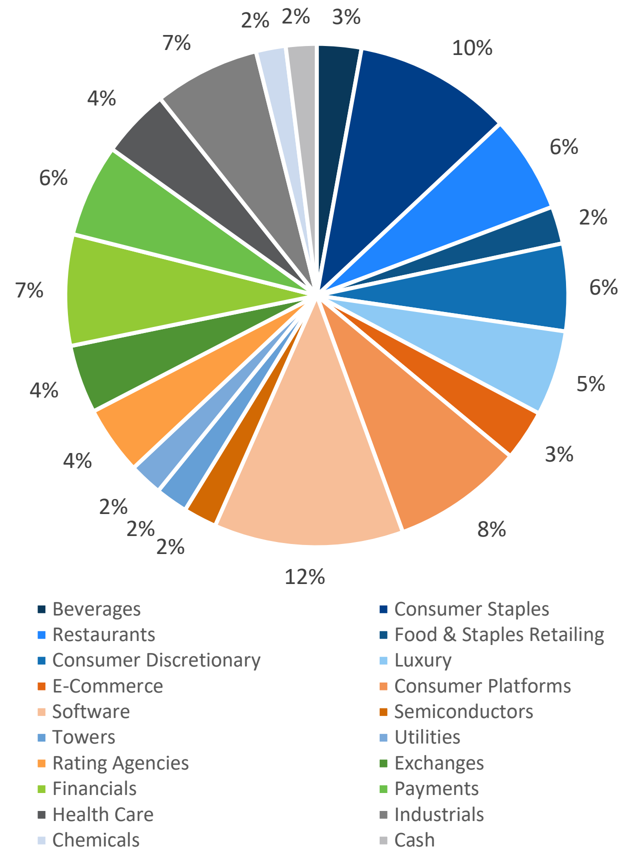
Performance*

	Fund (%)	Index (%)**	Excess (%)
1 Month	5.3	5.0	0.3
3 Months	2.8	6.3	-3.5
Since Inception (p.a.)	3.1	6.0	-2.9

Top 10 Positions

Company	Sector#	%
LVMH Moet Hennessy Louis Vuitton	Luxury	2.5
Moody's Corporation	Rating Agencies	2.3
Alphabet Inc	Consumer Platforms	2.2
Facebook Inc - Class A Shares	Consumer Platforms	2.2
Kering SA	Luxury	2.2
Adobe Inc	Software	2.2
Yum! Brands Inc	Restaurants	2.2
Alibaba Group Holding Ltd	E-Commerce	2.2
S&P Global Inc	Rating Agencies	2.1
MSCI Inc	Financials	2.0
	TOTAL:	22.1

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). # Sectors are internally defined. Exposures may not sum to 100% due to rounding.

Market Commentary

Global stocks reached record highs as they rose for the eighth quarter in nine for the three months to March after the vaccine rollout intensified, US President Joe Biden capitalised on the Democrat's surprise control of Congress to launch massive fiscal stimulus, the Federal Reserve reiterated it would keep interest rates low, encouraging reports emerged on the US economy, and investors welcomed Italy's new prime minister. Gains were capped as US bond yields rose on concerns that the fiscal stimulus could revive US inflation and a third wave of covid-19 infections swept through Europe. During the quarter, 10 of the 11 sectors rose in US dollars. Energy (+22%) climbed most while consumer staples fell (-0.6%). The Morgan Stanley Capital International World Index climbed 4.9% in US dollars and 6.3% in Australian currency over the quarter.

US stocks gained as the White House count showed 37% of Americans had received one vaccine dose by quarter end and Democrat control of Capitol Hill allowed Biden to force a US$1.9 trillion bill through Congress that, at 9% of GDP, will boost the budget shortfall for fiscal 2021 to 18% of output. The Democratic party gained control of the Senate after winning the two seats in Georgia that went to a special election (by-election) on January 6. The result tied the Senate 50-50 but new Vice President Kamala Harris's tie-breaking vote gives the party control of the upper chamber to go with its control of the House of Representatives and the White House. In other political news, outgoing president Donald Trump was impeached and acquitted for a record second time. The House in January impeached Trump for helping to incite a mob that breached Congress during a protest on January 6 against the election result. The Senate in February acting as an impeachment court acquitted Trump when it failed to gain the required two-thirds majority, though seven Republicans were among the 57 who voted for a guilty verdict while 43 senators voted not guilty. The Fed soothed concerns about bond yields rising on inflation concerns. Fed Chair Jay Powell testified to Congress that the US's recovery is "far from complete" and that the central bank intends to keep interest rates at levels that support employment growth while concerns about inflation remain low. In economic news, the US economy grew at a (revised) annualised speed of 4.3% in the last three months of 2020. The March quarter was marked by individual investors on Reddit and Robinhood bidding up selected stocks that heightened concerns of a stock bubble and the liquidation of Archegos Capital Management's leveraged bets that hurt selected stocks and its banking counterparties. The S&P 500 Index rose 5.8%.

European stocks rallied after the vaccine rollout gained enough pace, the European Central Bank loosened monetary policy even more and Mario Draghi won parliamentary backing to become Italy's next prime minister. Draghi, the former president of the European Central Bank, accepted a mandate from the Italian President Sergio Mattarella to lead the eurozone's third-largest economy after Italy's 66th post-war government collapsed. The European Central Bank officials spoke to calm investors about the risk from rising bond yields as it stepped up the pace of bond-buying to arrest the rise in borrowing costs. This offset the damage from a third wave of infections that forced fresh restrictions across Europe. An economic report showed the eurozone GDP fell a revised 0.7% for the fourth quarter. The Euro Stoxx 50 Index jumped 10.3%.

In other markets, Japan's Nikkei 225 Index rallied 6.3% after the Diet approved a record budget worth 106.6 trillion yen (US$976 billion) for the fiscal year starting on April 1 and a report showed the economy expanded a revised 2.8% in the fourth quarter. China's CSI 300 Index slid 3.1% as Chinese interest rates rose and the government set a modest growth rate of above 6% for 2021. The S&P/ASX 200 Accumulation Index added 4.3% as company earnings for the period ending December 31 exceeded expectations, the jobless rate fell below 6% and a report showed the economy expanded a higher-than-expected 3.1% in the December quarter. The MSCI Emerging Markets Index edged up 1.9% in US dollars on the better outlook for the world economy.

Fund Commentary

The portfolio recorded a positive return for the quarter in absolute terms. The biggest contributors were the investments in Deere, Alphabet and LVMH. Deere soared to record highs as the market repriced economically sensitive stocks, coupled with rising crop prices and an improving agricultural sector. This enabled the producer of John Deere farm and other machinery to lift earnings guidance on expectations more farmers would replace ageing equipment. Alphabet rallied after its 23% surge in revenue for the fourth quarter that was driven by Search and YouTube advertising beat expectations. LVMH rallied after the appeal of its luxury brands such as Louis Vuitton held through lockdowns and enabled the French company's fashion and leather goods unit to post an 18% increase in sales in the fourth quarter.

The biggest detractors were the investments in Verisk Analytics, MSCI and Autodesk. Verisk slid after its fourth-quarter report revealed the data-analytics and risk-assessment company's earnings per share of US$1.27 had missed analyst expectations. MSCI slid, even as its fourth-quarter result beat expectations, given the market rotation out of growth and higher than anticipated planned investment spend. (we view a positive development for long-term holders.) Autodesk dropped after the software company reported earnings that showed weaker new business activity.

In relative terms, the strategy underperformed over the quarter. The portfolio has lagged the benchmark since inception for three main reasons.

The first was that about a third of the portfolio was invested in cash and defensive equities such as utilities, consumer staples and defensive healthcare. This portion of the portfolio has delivered lagging returns compared with the benchmark (but not noticeably against defensive stocks overall), highlighting the unusually strong preference among investors for riskier investments. The flipside is that these stocks are at their cheapest in many years, giving us comfort about future portfolio returns.

The second reason for the underperformance was the stock-specific issues faced by companies such as Alibaba. Despite their volatile stock prices, we remain comfortable with holding our investments. We see a high likelihood of them delivering attractive returns over our horizon of three to five years.

The third reason was our underweight exposure to cyclical equities. We are more attracted to defensive equity valuations compared with those of cyclicals.

Stock contributors/detractors are based in local currency terms unless stated otherwise.

Stock story: Intercontinental Exchange

The Intercontinental Exchange we see today is a result of the leadership of its founder Jeff Sprecher and his vision of digitising markets, creating networks, and improving efficiency.

ICE Management vs. Sprecher: "What we do is we own and operate critical financial networks. And we bring great technology to those networks to make them more efficient. We put proprietary content into those networks to facilitate the activity in those networks. And we harness the data that emanates from the activity in those networks, to make them stronger."[1]

Intercontinental Exchange, which promotes itself as ICE, has grown from a small company facilitating trading in US energy derivatives to one of the world's largest exchange groups. It owns the New York Stock Exchange and leading derivatives exchanges, servicing the energy, agricultural and financial sectors, and totalling 12 global exchanges and six clearing houses. The company provides essential data to fixed income and other financial markets and is providing technology and infrastructure to digitise the US mortgage market. It is this series of networks that management have created that are a key driver of ICE's economic moat.

ICE's quality extends beyond network effects to favourable industry structures and economies-of-scale advantages. ICE has created virtual monopolies in key derivative benchmarks, including Brent crude oil, natural gas, sugar, and European interest rates. ICE is vertically integrated – meaning it controls the execution and clearing of derivatives contracts – which enables the company to exert pricing power, attract volumes, and improve counterparty and systemic risk management. As one of the largest exchange groups, ICE generates substantial economies of scale from trading volumes and the data business.

The vision of management has been critical to ICE withstanding disruption. Management has steered the business towards attractive industry structures (derivatives exchanges), unique data sources, and value-add analytics. The shift away from equities exchanges has been critical to maintaining strong excess returns. Equities exchanges have been disrupted over the past 15 years, driven by several factors (industry structure, regulation and technology), disruption that eroded business economics (pricing power and volumes).

ICE, like all businesses, has risk exposures; as for most financial and technology companies, regulation is the key risk. For ICE, this means moves by regulators to separate execution and clearing, and actions that may reduce trading volumes; we don't view this risk as likely for derivatives exchanges as liquidity fragmentation would lead to higher trading costs, halt innovation, and potentially increase systemic risks. ESG risks are also a consideration, but not a material risk for ICE.

ICE, like many financial services companies, has low carbon emissions and has little direct impact on the environment. ICE does, however, have a moderate exposure to fossil-fuel derivatives. There is risk to ICE as demand shifts from fossil-fuel derivatives contracts towards renewables and carbon-offset markets. ICE is well positioned in these nascent markets linked to decarbonisation, but becoming a benchmark takes many years to cement. Finally, ICE is well positioned on social and governance risk areas thanks to active employee engagement and management acting in shareholders' interests.

Overall, we view that there is a solid growth opportunity from ICE's core exchanges and data offerings that is complemented by a substantial growth opportunity in mortgages, creating a significant opportunity for shareholders in this high-quality business that is managing ESG risks.

[1] Quoted Raymond James Institutional Investors Conference – March 2021.

Stock story: Kering

KERING

Celebrating its centenary year in 2021, Gucci invokes a glamorous, romantic, eclectic and inclusive ideal. The brand, in its premium position in fashion, is cemented in popular culture and beloved by its followers.

Gucci is the flagship and highly profitable brand within the glittering portfolio of greatly coveted brands owned by Kering, one of the largest luxury groups in the world. Kering is controlled and managed by the Pinault family from France.
In addition to Gucci, Kering owns Yves Saint Laurent, Bottega Veneta, Balenciaga and Alexander McQueen among other clothing, jewellery and eyewear businesses.

The business has generated substantial growth in the past decade. The brands have seen insatiable demand from the rapidly growing affluent class of consumers within China and the Gucci brand has enjoyed a revival under the stewardship of star manager Marco Bizzarri, and star designer Alessandro Michelle with his "more is more" aesthetic, since 2015. As such, Kering's sales more than doubled in the five years to 2019 to just short of 16 billion euros.

Kering is a high-quality business with its economic moat supported by four pillars.
The first is the remarkable equity of its brand portfolio dominated by Gucci, which represents more than 80% of company earnings and has Florentine heritage and desirability stretching back to 1921 – Grace Kelly and Jackie Onassis are among the famous wearers of the brand. This positioning cannot be replicated and instils a unique brand cachet and desirability. Gucci is successfully courting millennials, who comprise more than 60% of the brand's sales, and the brand is a fixture among young Hollywood actors and musicians.
The second is the craftmanship of the brands. They are acknowledged for their unique design, instantly recognisable signifiers such as the horse bit, tri-stripe and flora patterns, and designed and made-in-Italy credibility and product quality.

The third is control of its distribution. About 87% of Gucci's products are sold via its owned-retail or online networks, which enables control of the presentation, ambience and, importantly, pricing. The products are never sold at a discount (even by third parties) – an important factor in the maintenance of the cachet of the brands.

The fourth element is economies of scale. This creates a virtuous circle as it gives the company the ability to outspend peers on advertising and promotion and control the customer conversation around its brands. These factors in turn beget its prestige, which in turn supports brand awareness, pricing power and greater potential for revenue growth. Established global brands such as Gucci generate higher profits than smaller and more mass-affluent peers. Gucci enjoys the highest 'earned media value' of any luxury brand.

A further element that ought not to be overlooked within the Kering portfolio are the company's industry-leading environmental and social responsibility credentials. This is intertwined with the brand equity of its portfolio. Kering has shown leadership in carbon neutrality, in removing fur and exotics from its product suite and via investment in sustainable fabrics – a commitment that also resonates for its socially conscious customers. Recently, the company took steps to reduce the speed and inevitable 'waste' of the fashion cycle, having pivoted to fewer show extravaganzas and moved to more intimate customer relationships. Many within the fashion industry have followed Kering's lead on these key issues. Notwithstanding this leadership, the business is still exposed to ESG risks, given leather production has impacts on deforestation, methane production and animal welfare, and cotton production is a water-intensive commodity. Kering has committed to improving traceability across its supply chain, with targets for 100% sustainably sourced leather and cotton by 2025 (currently 88%) and investment in organic cotton. Kering has controlled and integrated production including, in many cases, ownership of sourcing. The company has reduced sourcing from higher-risk locations.

The key disruptive forces relevant to Kering are the shift to e-commerce within discretionary retail, and the saturation of brands in this arena. Although social media has lowered the barriers to entry in fashion and has democratised the ability to create a brand, this does not pose a worrying threat as there are few substitutes for heritage luxury brands such as Gucci, Saint Laurent and Balenciaga, particularly in comparison with alternative brands found on multi-brand sites.

Kering is also leading the industry in using digital marketing (now comprising more than 60% of marketing budgets), digital commerce and appealing to millennials. The brands have substantial followings on social media and have the reach to create newness, engagement and enhance the brand in the digital sphere. Kering's ability to outspend challenger brands is a competitive advantage and thus we regard the business as resilient to disruption risks.

Other risks that are relevant to Kering are macroeconomic ones, given the discretionary nature of purchases, and any damage to customer perception of its brands. Fashion risk is important as there is always a trend element in the brands' sales trajectories as well as the risk of potential missteps such as that seen by peers in China or for Gucci in its historic inspiration from African-American culture in its designs, where appropriate recognition and representation become important. These risks, however, are temporary rather than structural and do not impede the long-term business quality nor the growth opportunities inherent in the business.

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