MFG Core Infrastructure

Key Facts

Portfolio Manager	Gerald Stack
Strategy Inception Date	18 January 2012
Total Infrastructure Assets[1]	USD $5,071.3 million
Total Strategy Assets	USD $3,026.0 million

Objectives	Approach
Capital preservation in adverse markets	Diversified rules-based portfolio applying MFG Asset Management's proprietary infrastructure classification
Pre-fee return of CPI plus 5%p.a. through the economic cycle	Benchmark unaware
	Highly defensive, inflation-linked exposure

USD Performance[2]

	Composite (Gross)	Composite (Net)[3]	Index[4]	Excess Return
3 Months	-5.3	-5.4	-4.3	-1.0
6 Months	-6.6	-7.0	-1.8	-4.8
1 Year	7.2	6.5	11.4	-4.2
3 Years (% p.a.)	7.9	7.2	3.8	4.1
4 Years (% p.a.)	9.4	8.7	6.3	3.1
Since Inception (% p.a.)	10.9	10.1	6.5	4.4

	Composite (Gross)	Composite (Net)[3]	Index[4]	Excess Return
2012 (%)*	16.4	15.6	7.0	9.4
2013	14.0	13.2	14.4	-0.4
2014	17.4	16.6	14.1	3.3
2015	-0.1	-0.8	-12.2	12.1
2016	7.2	6.5	11.4	-4.2

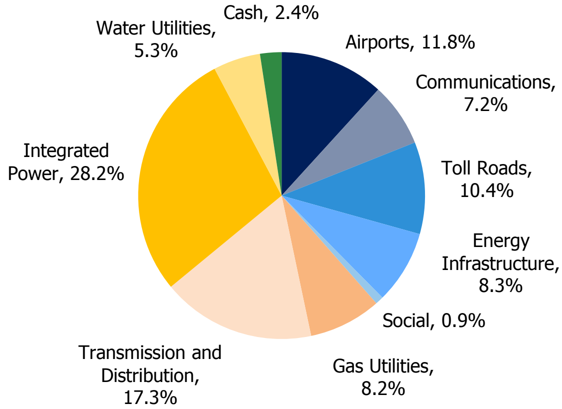
USD 4 Year Risk Measures[5]

	Against Benchmark[4]	Against Global Equities[5]
Upside Capture	1.0	0.7
Downside Capture	0.8	0.4
Beta	0.9	0.6
Correlation	0.9	0.6

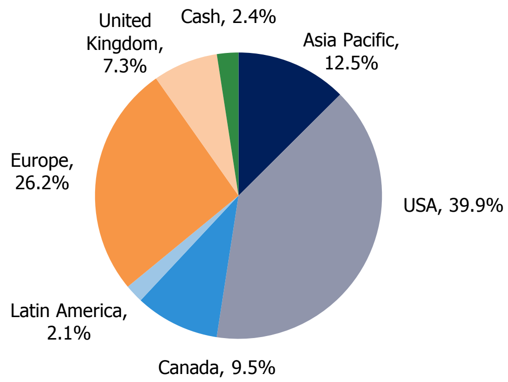
Top 10 Holdings[6]

	Sector	%
National Grid PLC	Transmission and Distribution	3.0
Atlantia SpA	Toll Roads	3.0
Enbridge Inc	Energy Infrastructure	2.9
TransCanada Corp	Energy Infrastructure	2.9
Aena SA	Airports	2.9
Transurban Group	Toll Roads	2.8
Power Assets Holdings	Integrated Power	2.8
Snam Rete Gas SpA	Gas Utilities	2.6
Abertis Infraestructuras	Toll Roads	2.5
Fortis Inc	Transmission and Distribution	2.3
	TOTAL:	27.7

Industry Exposure[6]



Geographical Exposure[6]



[1] Comprised of all Infrastructure strategies.
[2] Returns are for the Global Core 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 at the end of this document for further information.
[3] 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.
[4] S&P Global Infrastructure Index Net Total Return spliced with UBS Developed Infrastructure and Utilities Net Total Return Index. Note: as the UBS Developed Infrastructure and Utilities Net Total Return Index ceased to be published from 31 March 2015, it was replaced on 1 January 2015 with the S&P Global Infrastructure Index Net Total Return.
* Returns are only for part year.
[5] Risk measures are for the Global Core Infrastructure Composite. The Global Equity Index is the MSCI World Net Total Return.
[6] Representative portfolio. The exposures are by domicile of listing.

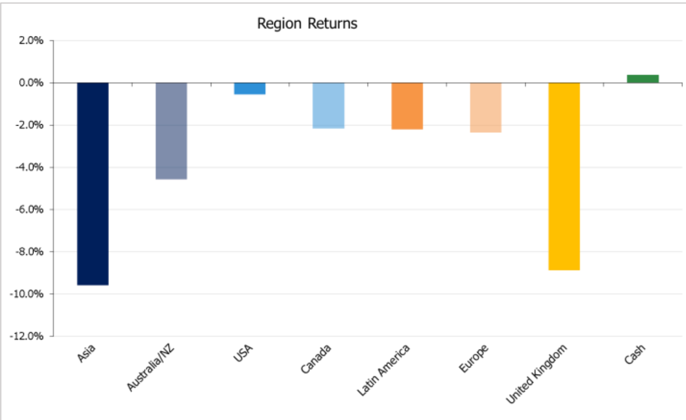
Performance

Over the December 2016 quarter, in US dollar terms, the Strategy returned -5.3% before fees. This was 1.0% lower than the benchmark return of -4.3% and in line with the Dow Jones Brookfield Global Infrastructure Index return of -5.3%. The one year return to 31 December 2016 for the Strategy was +7.2%. This was 4.2% below the benchmark return of +11.4%.

During the year, the Strategy was impacted by two unexpected political events - Brexit and the election of Donald Trump. Brexit was initially a positive for the Strategy, at least as far as UK stocks were concerned. When the Brexit vote occurred in June 2016, the Strategy's UK stocks were up more than 9% on average. However, those stocks have been subsequently sold down as investors switched from the safety of highly defensive stocks and back into stocks more exposed to the economic cycle. Brexit also impacted sentiment towards some European stocks as markets drew a connection between a populist vote to leave the European Union and the potential for something similar to happen in other European countries, particularly Italy.

Performance by Region

The following graph shows the returns for the Strategy by region for the December 2016 quarter in local currency terms.



The Strategy's US and Australia/New Zealand (which is largely representative of the Asia Pacific region) exposures significantly declined in value during the second-half of the year. In our view, this had virtually nothing to do with the underlying financial or operating performance of the stocks in those markets and almost everything to do with broader macro sentiment regarding defensive stocks.

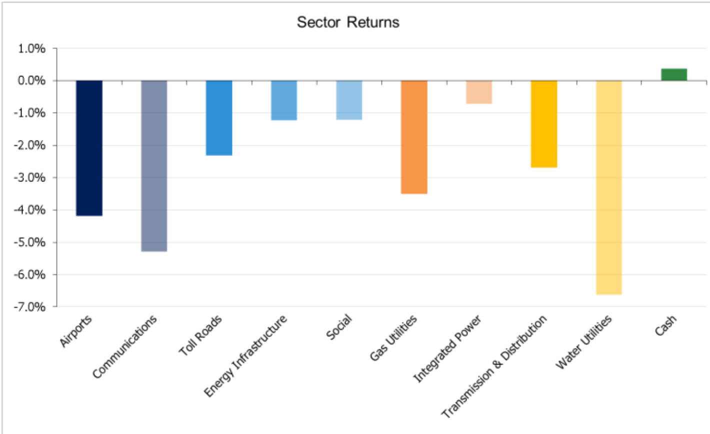
The second half of 2016 has seen a relatively large increase in interest rates in the US, UK and Australia as markets regained some confidence that rates would begin normalising. Donald Trump's election spurred those markets even further on the somewhat doubtful logic that a Trump administration would be good for economic growth. As we have discussed in previous updates, the companies held within the Strategy are seen to be interest rate sensitive by investment markets and have been sold off as rates have risen.

We acknowledge that the value of the Strategy's assets is sensitive to real interest rates. However, to the extent that inflation pushes bond rates higher, almost all of the stocks in the Strategy have either the express (e.g. CPI toll increases) or implied (e.g. regulated utility returns) ability to pass inflation impacts through to customers, thereby preserving the real value of the asset cash flows.

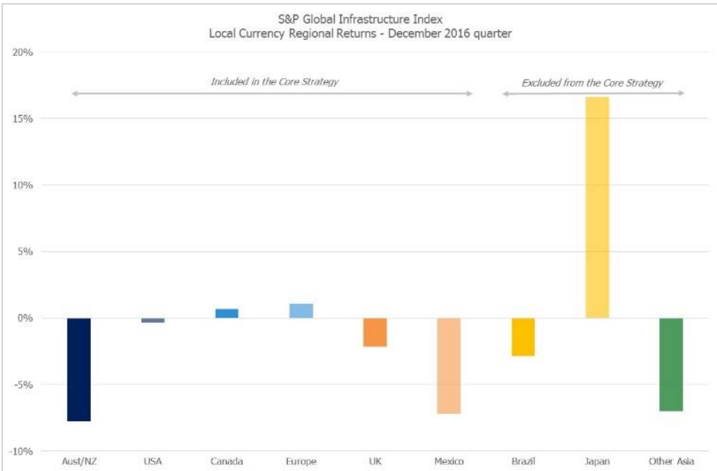
As we have demonstrated, we confidently expect that the stocks held within the Strategy will continue to see earnings growth over the next two to three years. Over the medium term we expect that this will be reflected in the share prices of those stocks. However, we do acknowledge that there will be periods of volatility as markets swing between enthusiasm for growth stocks and other periods where defensive stocks find favour on the realisation that risks are building up in financial markets.

Performance by Sector

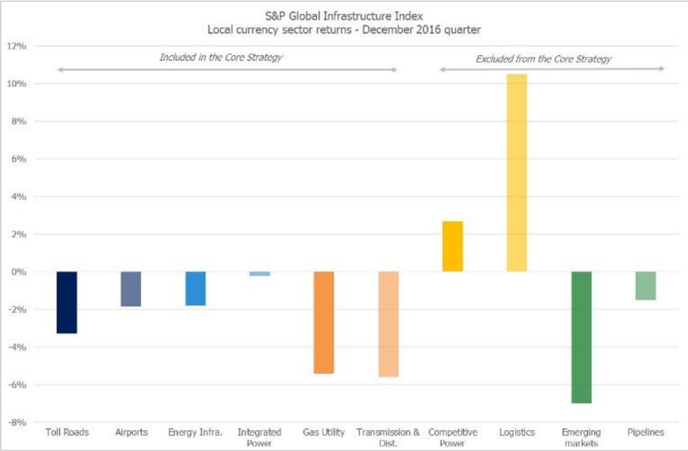
The following graph shows the returns for the Strategy by sector for the quarter in local currency terms. The graph highlights that the sell-off of high quality defensive stocks was broadly based.



Finally, it should be noted that the benchmark's performance improved significantly on account of its holdings of Japanese stocks which fall outside of the Strategy's investment universe. These included three logistics companies (Kamigumi Co, Sumitomo Warehouse Co and Mitsubishi Logistics Corp) as well as Japan Airport terminal Co (which, despite the name, is a large retail shopping complex).



The strong performance of Japanese logistics companies is also reflected in the sector performance chart shown below.



Investment Update

No changes were made to the fundamentals of the Strategy during the quarter. Two US utilities, ITC Holdings Corp and Piedmont Natural Gas Inc, were removed from the Strategy as a result of being taken over by Fortis Inc. and Duke Energy Corporation, respectively. Vienna Airport was removed as the stock's trading liquidity trading fell below acceptable levels. Italgas SpA, which was spun out of an existing portfolio stock, Snam SpA, was added. Italgas is the leading natural gas distribution operator in Italy and the third largest in Europe. With 3,700 employees, it manages, directly or through its affiliates, a natural gas distribution network that covers approximately 65,000 km.

Topic in Focus – Validating our Definition of Infrastructure

Our approach to building an infrastructure portfolio relies on our conservative definition of what constitutes an infrastructure asset. By defining infrastructure in this manner, we exclude a number of companies from our infrastructure investment universe that are commonly included in infrastructure benchmarks and indices. For an asset to be included in our universe it must:

- Provide a service that is essential to the efficient functioning of a community and therefore exhibit reliable demand;
- Generate cash flows that have little or no exposure to exogenous risk factors such as sovereign risk, competitive pressures or commodity prices; and
- Meet specific requirements in relation to gearing.

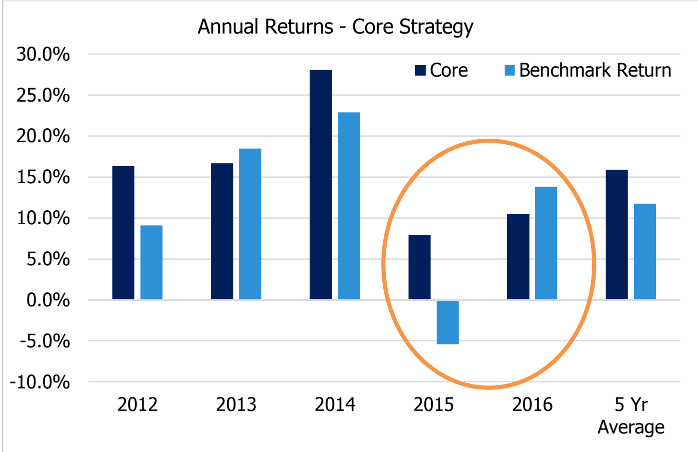
This approach has served investors well since we started running infrastructure portfolios. That said, over the past two years, the *relative* performance of our infrastructure strategies has been impacted by large variations in commodity prices – one of the key variables that we aim to avoid exposure to.

The following discussion utilises the before fee returns of the Global Core Infrastructure Composite Hedged in Australian dollars as a representative for the MFG Core Infrastructure Strategy to demonstrate the benefits of applying our definition of infrastructure. The benchmark is the S&P Global Infrastructure NTR Index (hedged to AUD) spliced with UBS Developed Infrastructure and Utilities Net Total Return Index (hedged to AUD) prior to 1 January 2015.

While we appreciate that investors use comparisons against infrastructure benchmarks to make assessments on relative returns, it is noteworthy to emphasise that our approach takes no consideration of the constituency of infrastructure benchmarks for the reasons outlined above.

The problems with following commodities

The following graph shows the performance of the Strategy against the benchmark for each of the past five years.



In 2015, our approach delivered returns that were significantly ahead of the benchmark, which actually lost value. As we have discussed previously, the relative outperformance of the Strategy was significantly influenced by our conservative definition of the listed infrastructure investable universe and, in particular, the avoidance of stocks whose earnings were materially impacted by commodity prices. The performance during 2015 also clearly demonstrated the downside protection inherent within the Strategy.

The key driver of outperformance in 2015 and the subsequent underperformance in 2016 has been the contrasting impact of falling oil prices in 2015 compared to increasing oil prices in 2016.

	WTI Crude Oil Price (US$)	S&P Global Infra. Net Total Return Index (A$ Hedged)	MSCI World Net Total Return Index (A$ Hedged)	Core Strategy Return (A$ Hedged)
Jan 2010 – Aug 2010	-9.4%	-0.9%	-3.6%	7.2%
Sept 2010 – April 2011	58.4%	15.8%	25.4%	17.1%
May 2011 – Sept 2011	**-30.5%**	-9.0%	**-16.1%**	0.4%
Oct 2011 – Feb 2012	35.2%	12.2%	19.0%	8.3%
Mar 2012 – June 2014*	-1.6%	46.4%	52.1%	54.2%
July 2014 – Jan 2016*	**-68.1%**	-0.6%	3.5%	22.3%
Feb 2016 – Dec 2016	59.8%	13.8%	16.7%	7.9%

Source: Bloomberg. *Returns for periods greater than one year are cumulative.

For instance, some of the worst performing stocks in the benchmark in 2015 included oil and gas pipeline companies such as those listed below, with total shareholder returns quoted in local currency terms:

- Targa Resources (-73.4%), a company engaged in midstream oil and gas services;

- Kinder Morgan Inc. (-62.8%), North America's largest oil and gas storage and transmission company (as well as the second largest oil producer in Texas); and
- ONEOK Inc. (-47.4%), a company with interests in natural gas pipelines, gathering and processing.

In line with our philosophical approach to clearly defining infrastructure, the Strategy's investment process excludes companies whose earnings are assessed as being sensitive to oil prices. As a result of this conservative approach, the Strategy is likely to outperform in periods where oil prices are falling and this was a key reason for the Strategy's outperformance in 2015.

In 2016, the oil price staged a significant rebound, rising by 40% for the year which led to a consequent recovery in share prices of these commodity price sensitive companies. Consequently, in 2016:

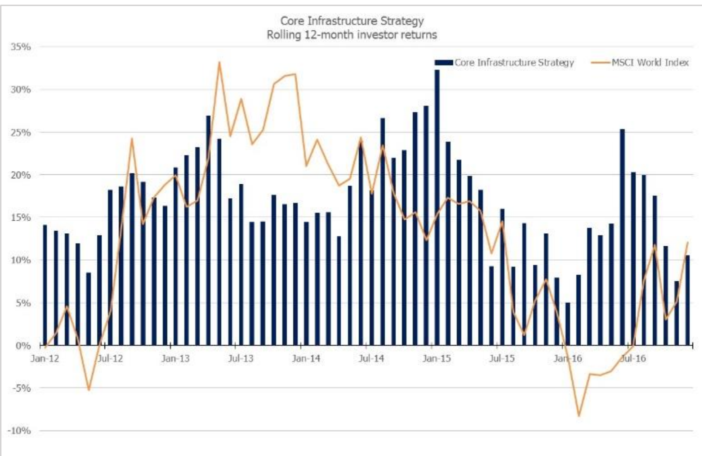
- Targa Resources returned +130.5%, although its share price remains 39% below where it started in 2015;
- Kinder Morgan Inc., returned 42.7% but its share price remains 47% below its starting point in 2015; and
- ONEOK Inc. delivered a return of +149.4%, while its share price is 31% above the level at the start of 2015.

Note that the returns quoted above are expressed as total shareholder returns in local currency terms.

Hence, the benchmark's outperformance of the Strategy in 2016 can be largely attributed to the stock price rebounds of companies that were heavily sold down in 2015. As such, the exclusion of such companies from our defined investment universe is a key reason for the Strategy's underperformance in 2016 and particularly for the December quarter. Despite the lower positive return achieved in 2016, the Strategy has maintained strong outperformance of the benchmark over two years to 31 December 2016.

Lower variability in returns from infrastructure

Notwithstanding the shorter term commodity related impact discussed above, the Strategy's performance over the longer term highlights the value that has been generated through the application of our conservative definition of infrastructure. As the graph below highlights, the Strategy's variability of returns has been significantly less than global equities.



The importance of definition

We believe that infrastructure assets, with requisite earnings reliability and a linkage of earnings to inflation offer an attractive, long-term investment proposition. Over time, the universe of opportunities in infrastructure has expanded, along with the range of asset types that the broader market has called infrastructure. Applying a disciplined, clearly defined set of parameters to capture the desired characteristics of infrastructure, namely, long term stable cash flows from assets with extensive life spans, protection through effective regulation and close linkages to inflation, provides a solid framework for generating attractive, stable returns over the long term.

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 value. We expect the Strategy to provide investors with real returns of approximately 5% p.a. to 6% p.a. over the longer term.

Outlook for infrastructure

The Strategy remains consistent with previous periods and is not expected to change over the long term. The experience of the past two years has demonstrated that the Strategy can deliver acceptable returns with much lower volatility than strategies using a much broader definition of the infrastructure investment universe.

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 with a three to five year timeframe.

IMPORTANT NOTICE

This material is being furnished to you to provide summary information regarding Magellan Asset Management Limited 'doing business as'/'trading as' MFG Asset Management ('MFG Asset Management') and an investment fund or investment strategy managed by MFG Asset Management ('Strategy'). No distribution of this material will be made in any jurisdiction where such distribution is not authorised or is unlawful. This material is not intended to constitute advertising or advice of any kind and you should not construe the contents of this material as legal, tax, investment or other advice.

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.

No representation or warranty, express or implied, is made with respect to the correctness, accuracy, reasonableness or completeness of any of the information contained in this material. This information is subject to change at any time and no person has any responsibility to update any of the information provided in this material. MFG Asset Management will not be responsible or liable for any losses, whether direct, indirect or consequential, including loss of profits, damages, costs, claims or expenses, relating to or arising from your use or reliance upon any part of the information contained in this material including trading losses, loss of opportunity or incidental or punitive damages.

This material is strictly confidential and is being provided to you solely for your information and must not be copied, reproduced, published, distributed, disclosed or passed to any other person at any time without the prior written consent of MFG Asset Management. Any trademarks, logos, and service marks contained herein may be the registered and unregistered trademarks of their respective owners. Nothing contained herein should be construed as granting by implication, or otherwise, any licence or right to use any trademark displayed without the written permission of the owner.

United Kingdom - This material does not constitute an offer or inducement to engage in an investment activity under the provisions of the Financial Services and Markets Act 2000 (FSMA). This material does not form part of any offer or invitation to purchase, sell or subscribe for, or any solicitation of any such offer to purchase, sell or subscribe for, any shares, units or other type of investment product or service. This material or any part of it, or the fact of its distribution, is for background purposes only. This material has not been approved by a person authorised under the FSMA and its distribution in the United Kingdom and is only being made to persons in circumstances that will not constitute a financial promotion for the purposes of section 21 of the FSMA as a result of an exemption contained in the FSMA 2000 (Financial Promotion) Order 2005 as set out below. This material is exempt from the restrictions in the FSMA as it is to be strictly communicated only to 'investment professionals' as defined in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (FPO).

United States of America - This material is not intended as an offer or solicitation for the purchase or sale of any securities, financial instrument or product or to provide financial services. It is not the intention of MFG Asset Management to create legal relations on the basis of information provided herein. Where performance figures are shown net of fees charged to clients, the performance has been reduced by the amount of the highest fee charged to any client employing that particular 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 and also may be found in Part II of MFG Asset Management's Form ADV.

The Global Infrastructure Benchmark is comprised of the following: from inception to 31 December 2014 the benchmark is UBS Developed Infrastructure & Utilities Index Net Total Return 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 Index Net Total Return 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.

The Global Core Infrastructure composite is a global strategy investing in strictly defined or "pure" infrastructure companies (typically 80-120). The filtered investment universe is comprised of stocks that 1. generate reliable income streams, 2. benefit from inflation protection and 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 February 2012.

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 list of composites and descriptions, as well as policies for valuing investments, calculating performance, and preparing compliant presentations are available upon request by emailing data@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.