Strategy Update: 30 September 2014

MFG Select Infrastructure

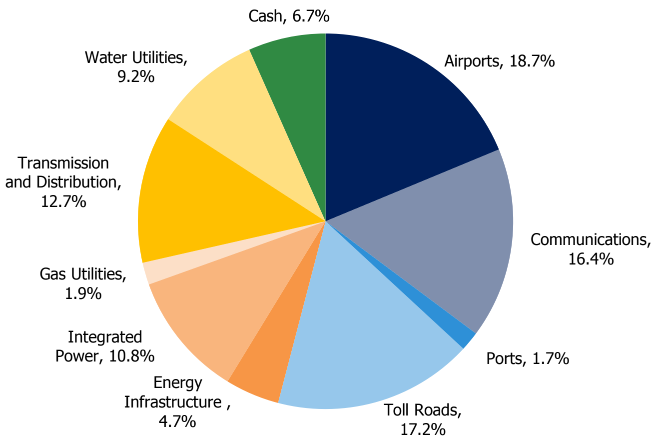
Key Facts

Portfolio Manager	Dennis Eagar / Gerald Stack
Inception Date	1 July 2007
Total Infrastructure Assets[1]	USD $3,834.9 million
Composite Size[2]	USD $255.1 million
Total Select Infrastructure Assets	USD $824.3 million

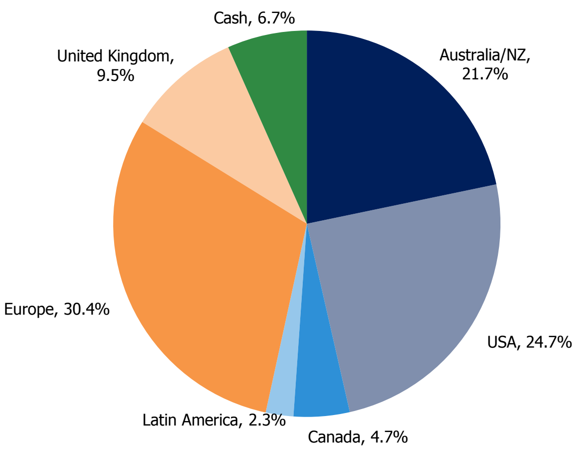
Top 10 Holdings[4]

		% of Strategy
Transurban Group	Toll Roads	8.6
National Grid	Transmission and Distribution	6.5
Crown Castle International	Communications	6.4
Atlantia	Toll Roads	6.4
SES	Communications	6.2
Fraport	Airports	5.4
Zurich Airport	Airports	4.7
Enbridge	Energy Infrastructure	4.7
Sydney Airport	Airports	4.5
Auckland Airport	Airports	4.2

Industry Exposure



Country Exposure by Domicile of Listing[4]



Performance

During the September 2014 quarter in USD terms, the MFG Select Infrastructure Strategy ('Strategy') returned -4.7%, compared with the benchmark UBS Infrastructure and Utilities Index's return of -4.3%. The returns for the calendar year to the end of September were 8.8% for the Strategy and 10.4% for the benchmark. The returns for the 12 months to the end of September were 14.5% for the Strategy and 13.4% for the benchmark.

During the quarter, the cash holding of the Strategy was increased to approximately 8% (in line with a similar increase in the MFG Global Strategy) reflecting our concerns with global bond market developments (see below for further comments). The increase in cash was achieved by reducing the Strategy's exposure to energy and water utilities to 34% while approximately 58% of the Strategy continued to be invested in infrastructure stocks, e.g. toll roads, airports, ports and communications assets.

MFG Asset Management ('MFGAM') considers that there is an elevated probability that the massive compression in risk premia that has occurred across multiple asset classes over the last 18 months will unwind over the next 12 months or so, as the US Federal Reserve ends Quantitative Easing and investors focus on a normalisation of US interest rates. As a result, the decision was made to raise the Strategy's cash weighting to increase its defensiveness during the period.

The best performing stocks in the Strategy during the quarter were Dutch oil and chemical tank storage company Vopak (Total Shareholder Return (TSR) of +19.7%), Zurich Airport (TSR of +10.0%), US mobile phone tower company Crown Castle International (+8.9%) and Canadian oil and gas pipeline company Enbridge (+6.6%).

The Strategy's utility exposures were a drag on performance with both water and energy utilities down over 3% for the quarter. Most of this fall occurred in the last month as investor sentiment was impacted by rising bond yields in the USA. MFGAM believes there may be further weakness in utility share prices over coming months, but we are confident that the regulatory regimes to which the Strategy's utilities are exposed will provide more than adequate protection (albeit with some regulatory lag) from the impact on those businesses of higher interest rates. Additionally, many of MFGAM's utility holdings in the US have the capacity to increase dividends because of declining capex requirements, which will help mitigate the effects of rising rates. Notwithstanding, we have reduced the holdings of US utilities from a peak of almost 43% of the Strategy in 2011 to under 17% at the current time.

In terms of stocks included in the benchmark index but excluded from MFGAM's universe of investable stocks, the unregulated power generation market again performed poorly delivering an average TSR of -5.6% while French construction and toll road company, Vinci, delivered a TSR of -15.7%. Countering those falls were strong performance from Korean utilities (average TSR of +23.7%) and Japanese stocks (TSR of +4.4%). Stocks in these two markets have been particularly poor performers over recent years so some recovery in their share prices does not surprise us.

[1] Comprised of the total Firm Infrastructure assets, comprising the Select Infrastructure strategy and Core Infrastructure strategy.
[2] Returns and risk measures are for the Global Select Infrastructure USD Composite. *Refer overleaf for further information.
[3] Index: UBS Developed Infrastructure & Utilities Net Total Return Index (USD). Source: UBS
[4] Representative Portfolio. ^Refer overleaf for further information.

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

Figure 1: Sector returns – September 2014

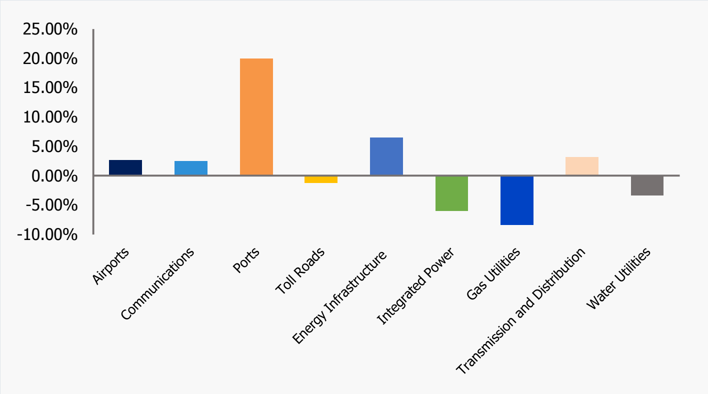
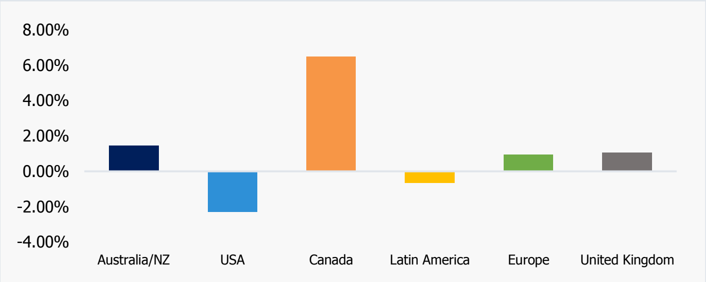


Figure 2: Region returns – September 2014



Portfolio

During the quarter, two changes were made to the constituent stocks in the Strategy. US energy utility Alliant Energy and Italian gas utility Snam SpA were both removed as a result of their share prices appreciation to levels materially exceeding MFGAM's valuation. As a result, the Strategy consisted of 28 stocks at the end of the quarter.

The graphs on page 1 show the sector and regional exposures of the Strategy during the September 2014 quarter.

Investment in Telecommunication Towers

Communications towers are structures designed to hold communications equipment for wireless applications such as mobile telephony, television, radio, public safety communications networks and so on. The focus of Crown Castle International, the US-listed tower owner held by the Strategy, is facilitating the transmission of mobile telephony and data.

Growth Market

Demand for mobile data is very strong, driven by widespread adoption of smartphones and tablets. Humans have a seemingly insatiable desire for increased connectivity. Cisco estimated that in 2013:

- Global mobile traffic grew 81%. 45% of global mobile traffic was offloaded to WiFi networks or femto cells, without which traffic would have grown by 98%.
- Smartphones represented 27% of mobile handsets but 95% of mobile handset traffic.
- 4G devices represent just 3% of all mobile connections, but 30% of the mobile traffic.
- The average mobile-connected tablet generates 2.6x more traffic than the average smartphone, and the average mobile-connected laptop 4.6x more.
- Video represented over 50% of mobile traffic.

Cisco is forecasting mobile data traffic will expand 11 times between 2013 and 2018, representing a compound annual growth rate of 61%. This is from a combination of increased penetration of mobile-connected devices and increased data use per device.

The only way that telecommunications companies can meet this demand is with improved technology, more spectrum, or more cell sites. Given the scale of the demand increase and the limitations of the laws of physics, growth in cell sites (situated on towers or other structures) is an absolute certainty.

Towers are Critical

Wireless transmission equipment can be placed on any structure. However, as signals degrade when faced with obstacles like buildings and trees, the best results are typically achieved when equipment is placed high above the clutter level. This is where towers come in. Tower-mounted wireless equipment is known as a macro cell site for its wide footprint relative to other "small" cells. Wireless towers are generally the least expensive way for a carrier to achieve broad coverage over a given geographic area.

As mobile telephony became possible, carriers first built their own towers to hold only their own equipment. Later, independent wireless tower companies built towers on which they co-located multiple carriers, making it cheaper for each carrier. At the same time, each new tenant provides very high incremental margins to the tower owner, generating strong returns and free cash flow as more tenants use the tower.

Carriers typically choose a tower based solely on location to improve coverage or capacity of their wireless networks. There is typically little competition between existing towers. In addition, it is very difficult to build new towers due to local community opposition, providing an effective barrier to entry. Very few new towers are being built in the US.

Once equipment is mounted on a tower, it is very costly for a carrier to switch due to the actual moving costs and the fact that one transmitter cannot be moved in isolation without impacting overall coverage and therefore the potential need to move adjacent equipment. Reflecting the long term importance of towers to network integrity, carriers typically enter 10 year contracts for new equipment installations.

The Strategy's exposure to this sector is achieved through its holding in Crown Castle International (CCI). This is a top 10 holding for the Strategy. CCI owns 31,500 communications towers in the US and Australia. While its towers hold an average of 2.4 tenants per tower, CCI notes that every tower can support at least one more tenant at little incremental cost.

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 MFGAM's 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% 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 with a three to five year timeframe.

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Performance is compared to the UBS Developed Infrastructure & Utilities Index Net Total Return 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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