

MAGELLAN GLOBAL FUND

MAGELLAN GLOBAL FUND (HEDGED)



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The Magellan Global Fund is a core holding that invests in the world's best 20 to 40 global stocks. The portfolio aims to deliver 9% p.a. over the economic cycle while reducing the risk of permanent capital loss. The hedged version of the portfolio aims to protect returns from currency movements.

PERFORMANCE

Global stocks rose in the 12 months to June 2020 after huge fiscal and monetary stimulus offset the damage from the coronavirus to economic activity, company profits and investor confidence. Over the last three months of 2019-2020, stocks recovered from post-virus lows after an ebbing in infection rates in developed countries allowed governments to ease restrictions on everyday life, even though the economic hit from the virus was so stark that the US entered its first recession in nearly 11 years.

The portfolio recorded a return after fees of 9.0% for the 12 months while the hedged version's return after fees was 4.5%. The stocks that performed best included the investments in Microsoft (+3.3% of the total portfolio return), Alphabet (+1.9%) and Apple (+1.6%). Microsoft surged to a record high over the period after its cloud business helped the software giant beat earnings and revenue forecasts and then held up relatively well when covid-19 hit because it was judged a stock that would benefit from greater online activity. Alphabet, the owner of Google, gained as it reported higher earnings over the 12 months and as online advertising held up better than expected during the pandemic. Apple gained after the company boosted sales forecasts, citing the popularity of the latest iPhone 11, new services such as Apple TV+ and items such as AirPods, and trade tensions between China and the US fell short of Beijing placing tariffs on iPhones.

The stocks that detracted from performance included the investments in Yum! Brands (-0.9%), Anheuser-Busch InBev (-0.9%), and

HCA Healthcare (-0.3%). Yum! Brands fell after posting downbeat earnings and after its KFC, Pizza Hut and Taco Bell outlets were closed when countries ordered lockdowns or restrictions on restaurants to stop the transmission of the virus. Anheuser-Busch InBev fell after the world's biggest brewer said that a decline in beer sales in Brazil, China and the US slowed profit growth and the company said it expects only "moderate" full-year earnings growth, down from "strong" before. HCA Healthcare dropped on disappointing earnings and after elective surgeries were deferred as hospitals built capacity to respond to the pandemic and investors weighed the impact of the unprecedented jump in US unemployment on HCA's revenue.

OUTLOOK

The outlooks for the economy and equity markets remain uncertain. Key will be the pace of economic reopening and policymaker responses. We continue to see four scenarios.

The best scenario is a V-shaped recovery; a fleeting recession. This would require a quick and successful reopening supported by policymakers, with most furloughed workers returning to their pre-pandemic hours. This scenario still appears relatively unlikely.

The worst scenario is a depression, where reopening is very slow and there is a policy error, hurting employment and output. This would be the worst outcome for markets but also appears relatively unlikely.

Performance as at 30 June 2020¹

| | 1 Year (%) | 3 Years (% p.a.) | 5 Years (% p.a.) | 7 Years (% p.a.) | 10 Years (% p.a.) | Since inception (% p.a.) |
|-------------------------------|---------------|---------------------|---------------------|---------------------|----------------------|--------------------------------|
| Magellan Global Fund | 9.0 | 15.3 | 12.0 | 14.3 | 15.8 | 12.0 |
| Magellan Global Fund (Hedged) | 4.5 | 10.4 | 9.8 | 10.9 | - | 10.9 |

¹ 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). Magellan Global Fund inception 1 July 2007 (inclusive), Magellan Global Fund (Hedged) inception 1 July 2013 (inclusive). Returns denoted in AUD.

The two middle scenarios are a U-shaped recovery from a recession and a prolonged and deep recession. The downturn that occurred after the global financial recession lay between these two scenarios. It is still challenging to definitively predict if the current downturn will be more or less severe than the recession of 2008-2009.

Due to our cautious economic outlook and the risks confronting equities, we raised the cash position in the strategy from 8% to 15% over the 12 months.²

PORTFOLIO POSITIONING²

Top-10 holdings at 30 June 2020

| Security | Weight (%) |
|--|-------------|
| Microsoft Corporation | 8.1 |
| Tencent Holdings Ltd | 6.7 |
| Alibaba Group Holding Ltd | 6.6 |
| Alphabet Inc | 6.0 |
| Facebook Inc - Class A Shares | 5.7 |
| Reckitt Benckiser Group | 4.7 |
| Starbucks Corporation | 4.3 |
| Novartis AG | 4.2 |
| Crown Castle International Corporation | 4.0 |
| SAP SE | 3.9 |
| Total | 54.2 |

Notwithstanding our cautious outlook, we believe our portfolio of 21 high-quality businesses will generate a satisfactory return over the medium to long term.

We have positioned our portfolio cautiously by holding a substantial amount of cash and by investing in businesses that should be largely resilient, or even beneficiaries, in the current environment.

Over the long term, we believe that investing in a portfolio of high-quality defensive and growth businesses bought at reasonable prices will generate attractive returns and prove resilient in times of economic uncertainty. High-quality defensive businesses can be expected to protect the capital of their investors while producing attractive returns through the economic cycle. High-quality growth businesses that drive growth from innovation and gains in market share are more attractive not only because their growth is typically higher than average but also because it makes them less reliant on the underlying strength of the economy. We seek businesses that have a high likelihood of success for decades to come. As always, we evaluate prospective returns in relation to the type and degree of risk we are taking.

The core investment themes in our portfolio at 30 June 2020 were:

- A range of highly resilient businesses that represented 29% of the portfolio. These businesses are largely unaffected by measures that have been enacted to combat the pandemic as their services are either essential or in increasing demand. More importantly, these characteristics give these stocks a high degree of resiliency in a weak economy. In the current environment,

we do not know the ultimate effect the coronavirus will have on society and the economy. These investments offer attractive risk-adjusted returns under a wide range of potential economic outcomes. They comprise:

- Consumer staples at 11% of the portfolio (Nestlé, PepsiCo and the UK-based Reckitt Benckiser).
- A communications infrastructure business and three regulated US utilities at 14% of the portfolio (Crown Castle International, Eversource Energy, Xcel Energy and WEC Energy).
- A pharmaceutical business, Novartis of Switzerland, at 4% of the portfolio.
- The Chinese-consumer-related stocks (technology-platform companies Alibaba and Tencent and consumer companies Estée Lauder of the US, LVMH of France and Starbucks) that comprised 20% of the portfolio. The Chinese middle class is forecast to double in size over the next five to 10 years with the high-end cohort growing even faster. Alibaba and Tencent are structural winners in the Chinese economy as they own the leading ecommerce and gaming and social media platforms respectively. They are also the leading cloud-computing and digital-payment businesses in China. The consumer businesses have strong brands and are well placed to benefit as China's middle and upper classes expand.
- Advertising technology-platform companies (Alphabet, the owner of Google, and Facebook) that represented 12% of the portfolio. These companies benefit from the shift in marketing expenditure from traditional media properties to digital platforms.
- Enterprise-software companies (Microsoft and SAP of Germany) that comprised 12% of the portfolio. These companies are integrated within the operations of their business customers, which lowers the risk these customers will switch software vendors. They are benefiting from the transformational growth in cloud computing, which is likely to become even more popular in the coming years.
- Payment-platform companies (Mastercard and Visa) that represented 6% of the portfolio. These are classic 'network effect' business models that connect millions of merchants with billions of cardholders. They provide the 'rails' upon which global electronic payment systems run.
- An investment in two quick-service restaurants (McDonald's and Yum! Brands) that represented 5% of the portfolio. These businesses have faced some short-term challenges due to restrictions to slow the spread of the virus. Over the longer term, the strength of their brands and resiliency to a weak economy are attractive.
- A 15% holding in cash (held in US dollars).²



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² For the Magellan Global Fund. Portfolio positioning may not sum to 100% due to rounding.

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