

MAGELLAN HIGH CONVICTION TRUST (MHH)



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The Magellan High Conviction Trust is an ASX-listed trust (ASX: MHH) that is a more concentrated and less constrained version of Magellan's core global strategy. The trust seeks to deliver an attractive risk-adjusted absolute return by investing in eight to 12 of the world's best global stocks. The trust employs an active currency-hedging program to reduce the impact of foreign currency exposure when the Australian dollar trades outside its historical range.

PERFORMANCE

Global stocks rose from mid-October 2019, when the trust was launched, to June 2020 after huge fiscal and monetary stimulus just 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 3.5% from 11 October 2019 until 30 June 2020. The stocks that performed best included the investments in Microsoft (+4.5% of the total portfolio return), Alibaba (+2.5%) and Tencent Holdings (+1.3%). 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. Alibaba rose on better-than-expected earnings, a successful IPO in Hong Kong and the likely boost to earnings from China's switch to online during the pandemic. Tencent rose on an improving earnings outlook and as the virus forced Chinese citizens to work from home and engage more with the company's suite of digital services.

The stocks that detracted from performance included the investments in Yum! Brands (-1.5%), Starbucks (-1.1%) and Estée Lauder (-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. Starbucks fell after its outlets were closed when countries ordered lockdowns or restrictions on restaurants to stop the transmission of the virus. Estée Lauder was hit by retail closures, particularly in its highly profitable travel retail channel.

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.

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 the cautious economic outlook and the risks confronting equities, we boosted the cash holding from approximately 9% of the portfolio at inception to 22% at 30 June 2020.

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 High Conviction Trust (MHH)	-	-	-	-	-	3.5

¹ Calculations are based on the ASX released net asset value with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). Trust inception date 11 October 2019 (inclusive). Returns denoted in AUD.

PORTFOLIO POSITIONING²

Holdings at 30 June 2020

Security	Weight (%)
Microsoft Corporation	13.8
Alibaba Group Holding Ltd	13.7
Tencent Holdings Ltd	9.5
Alphabet Inc	8.6
Facebook Inc - Class A Shares	7.8
Starbucks Corporation	7.4
SAP SE	5.9
Visa Inc	5.7
Estee Lauder - Class A Shares	5.1
Total	77.5

Notwithstanding our cautious outlook, we believe our portfolio of nine 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 concentrated portfolio of high-quality businesses, our best ideas, purchased at reasonable prices will generate attractive returns and prove resilient in times of economic uncertainty. Near-term portfolio resiliency is provided by the balance sheet strength and advantaged competitive positions of our holdings, which we expect to remain highly profitable through the economic cycle given the necessity or desirability of their offering. Longer-term portfolio returns will be supported by the favourable industry and geographic positioning of our holdings, recognising that each company's advantages provide conviction that it will benefit disproportionately from these enduring growth tailwinds and, critically, see this growth translated into rising shareholder value over time. As always, we evaluate these 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:

- The Chinese-consumer-related stocks (technology-platform companies Alibaba and Tencent and consumer companies Estée Lauder of the US and Starbucks) that comprised 35% 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/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.
- Enterprise-software companies (Microsoft and SAP of Germany) that comprised 20% 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.
- Advertising technology-platform companies (Alphabet, the owner of Google, and Facebook) that represented 16% of the portfolio. These companies benefit from the shift in marketing expenditure from traditional media properties to digital platforms.
- A payment-platform company (Visa) that represented 6% of the portfolio. Visa possesses a classic 'network effect' business model that connects millions of merchants with billions of cardholders. It provides the 'rails' upon which global electronic payment systems run.
- A 22% holding in cash, held primarily in US dollars.



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