MAGELLAN GLOBAL FUND (CLOSED CLASS) (ASX TICKER: MGF) AND (OPEN CLASS) (ASX TICKER: MGOC)

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The Magellan Global Fund is a core holding that seeks to invest in the world's best 20 to 40 global stocks. The fund aims to deliver 9% p.a. over the economic cycle while reducing the risk of permanent capital loss.

PERFORMANCE

Global stocks soared to record highs in the 12 months to June 2021 after government and central bank stimulus helped economies recover from the pandemic, pharmaceutical companies hastened economic reopenings when they developed vaccines against the virus that causes the illness known as covid-19, the new US administration of President Joe Biden used the unexpected control of Capitol Hill it gained in January after surprise Senate election victories in Georgia to implement more fiscal stimulus, investors decided the Democrats' narrow control of Congress would prevent anti-business measures becoming law, and tech stocks reported earnings that showed how much they have benefited from the shift to online.

The Magellan Global Fund (Open Class) (Managed Fund) recorded a return after fees of 10.8% for the 12 months while the Magellan Global Fund (Closed Class) recorded a return after fees of 7.5% since its inception on 30 November 2020. The stocks that performed best over the 12 months included the investments in Alphabet (+3.5% of the total portfolio return), Facebook (+2.2%) and Starbucks (+1.8%). Alphabet rose after its Google subsidiary's advertising revenue showed a better-than-expected rebound from the coronavirus-triggered slump and the US election outcome and a court ruling in June appeared to reduce the risk of a crackdown on Big Tech that would ensnare Google, which is already under anti-trust scrutiny by the US Department of Justice. Facebook climbed enough to record a market cap in excess of US$1 trillion after earnings beat expectations, the social-media company said its main site has a record 2.9 billion 'active' monthly users, and a US judge in June unexpectedly dismissed two complaints against the social-media giant from the US regulator because the judge said the Federal Trade Commission failed to prove the company was a monopoly. Starbucks rose as economies reopened and the coffee chain deepened its penetration into China.

The only stock held over the year that detracted from performance was the investment in Reckitt (-0.4%). Reckitt slid on a view that the easing of the pandemic would reduce demand for the sanitary products of the UK-based, multinational consumer-packaged-goods company.

OUTLOOK

The global economic upswing appears set to last a couple of years, driven by a record level of monetary and fiscal stimulus as well as a vaccine-driven reopening. However, there are two key risks.

The first is that the supply side of the economy takes much longer to recover than the demand side, leading to inflationary pressures that are larger or more persistent than expected. While we and most central banks expect inflationary pressures to be transitory, a surprise here may force central banks to tighten policy faster than expected, perhaps materially so. The second is a covid-19 mutation that requires replacement vaccines to be developed and distributed, a process that could take three to six months.

Covid-19 has not changed our longer-term economic outlook. The global economy remains structurally low growth and low inflation, resulting in structurally low interest rates. What has changed is a steep rise in government debt and potentially a greater acceptance of central-bank-financed government deficits.

The equity market outlook for the next 18 months is more challenging than usual to predict. The cyclical economic upswing and policy accommodation should support equity returns, but the two economic risks mentioned earlier could trigger a 20% or more decline in equity prices. Another potential trigger is a correction in overvalued pockets of the market such as 'meme' stocks, as this could spread to the broader equity market.

We have reduced the cash holding in the fund from 15% to 5% in the past year. This reduction has been driven by the less-uncertain market outlook, particularly after the announcement of positive vaccine results in November.

PORTFOLIO POSITIONING[1]

Top-10 holdings at 30 June 2021

Security	Weight (%)
Microsoft Corporation	7.8
Alphabet Inc	6.8
Facebook Inc	6.4
Starbucks Corporation	5.3
Netflix Inc	4.8
Alibaba Group Holding Ltd	4.8
Visa Inc	4.6
Tencent Holdings Ltd	4.5
SAP SE	4.3
Yum! Brands Inc	4.1
Total	**53.4**

We believe our portfolio of 23 high-quality businesses remains well positioned to offer downside protection and to generate satisfactory returns over the medium to long term.

With these objectives in mind, the portfolio has been constructed to account for the cyclical economic recovery underway while considering key nearer-term risks associated with higher-than-expected inflation, an escape mutation and pockets of investor risk-seeking. Portfolio positioning also reflects the longer-term challenges to economies presented by lower structural growth and a likely rise in interest rates over time.

Central to our portfolio construction, now and always, is a gravitation towards high-quality businesses available at attractive prices. It is this approach – a considered and balanced selection of exceptional businesses possessing a competitive moat plus deliberate risk management – that provides conviction in the portfolio's ability to satisfy its dual objectives over time.

The past 12 to 18 months provided investors with another visceral reminder of the importance of a long-term orientation and of business quality. By virtue of their competitive advantages, their importance to customers and their robust fiscal positions, high-quality businesses proved resilient through the depths of events last year. As importantly, these businesses have emerged from the crisis in a more advantaged position. Given their strength and capabilities, these businesses were able to innovate and adapt while reinvesting for growth through the crisis. Many observed an acceleration in the adoption of their products and services, particularly those with any form of digital exposure. Some have business units that stand to benefit from further lifting of mobility restrictions. High-quality businesses can weather the inevitable storms, allowing them to capitalise during calmer tides.

Embedded within our definition of business quality is an insistence that a company be on the winning side of disruptive shifts. This exposes the portfolio to businesses that can achieve growth that is less dependent on the underlying strength of the economy. The corollary is that the fundamental results of these businesses, though more attractive through the cycle, can lag companies that benefit from having a purer economic exposure during a strong recovery but whose performance will be challenged in its absence. Our approach remains to invest in businesses that we consider will 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 2021 were:

- An investment across a range of highly resilient businesses that represented 36% of the portfolio. These businesses primarily offer ballast and downside protection to the portfolio. The fundamental performance of these companies is largely immune to the economic cycle, given their products and services are either essential or in increasing demand. The performance should also be only modestly affected by measures that would likely be required to contain further covid-19 outbreaks. We have been mindful with respect to the form and degree of inflation and interest-rate exposure across these holdings. These investments offer attractive risk-adjusted returns under a wide range of potential economic outcomes. They comprise:
  - Consumer staples at 14% of the portfolio (Nestlé, PepsiCo, Procter & Gamble and Reckitt).
  - Regulated US utilities and communications infrastructure at 11% of the portfolio (Crown Castle International, Eversource Energy, WEC Energy and Xcel Energy).
  - Franchise-model restaurants at 7% of the portfolio (McDonald's and Yum! Brands).
  - A diversified healthcare business, Novartis, at 4% of the portfolio.
- The Chinese consumer (technology-platform companies Alibaba Group and Tencent and consumer companies LVMH and Starbucks) that comprised 16% 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, owning the leading gaming, social media and e-commerce platforms respectively. They are also the two leading cloud-computing and digital-payment businesses in China. The Western consumer businesses have strong brands and significant leverage to the growth in China's middle to upper class over time.
- Advertising technology-platform companies (Alphabet, the owner of Google, and Facebook) that represented 13% 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) that comprised 12% of the portfolio. These companies are deeply 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.
- Companies benefiting from technology-enabled growth (Netflix and Intercontinental Exchange) that accounted for 9% of the portfolio. Netflix is leveraged to the broad shift from pay TV to streaming video on demand, while Intercontinental Exchange's efforts to digitise the US residential mortgage process complement its resilient exchange business.

- Payment-platform companies (Mastercard and Visa) that represented 8% of the portfolio. These are classic 'network-effect' business models that connect millions of merchants with billions of cardholders. These companies provide the 'rails' upon which global electronic payment systems run.
- A 5% holding in cash (held in US dollars).[1]

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Performance as at 30 June 2021 [2]

	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 (Open Class) (Managed Fund) (ASX: MGOC)	10.8	13.2	14.4	14.2	16.7	11.9
9% p.a. objective excess	1.8	4.2	5.4	5.2	7.7	2.9
Magellan Global Fund (Closed Class) (ASX: MGF)	-	-	-	-	-	7.5
9% p.a. objective excess	-	-	-	-	-	n/a

Rolling 3-year returns (measured monthly) [3]

Against MSCI World Index	1 year	3 years	5 years	Since inception
No. of observations	12	36	60	133
Average excess return (% p.a.)	1.8	2.4	1.6	4.2
Outperformance consistency	67%	81%	78%	88%

Capital Preservation Measures [4]

Adverse Markets	Last 36 months	Last 60 months	Since inception
No. of observations	8	13	53
Outperformance consistency	100%	77%	77%
Down Market Capture Ratio	0.3	0.4	0.5

1 Based on Magellan Global Fund (Open Class). Portfolio positioning may not sum to 100% due to rounding.

2 Returns denoted in AUD. Open Class fund 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). Closed Class calculations are based on net asset values with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). Open Class inception date is 1 July 2007 (inclusive). Closed Class inception date is 30 November 2020 (inclusive), part-period since inception return is not annualised.

3 Based on Magellan Global Fund (Open Class). 3-year returns are calculated and rolled monthly in AUD, with the outperformance consistency indicating the percentage of positive excess returns since inception. 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 date is 1 July 2007 (inclusive).

4 Based on Magellan Global Fund (Open Class). Capital preservation measures are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). An Adverse Market is defined as a negative 3-month return for the MSCI World NTR Index (AUD), rolled monthly. The Down Market Capture Ratio shows if a fund has outperformed a benchmark during periods of market weakness, and if so, by how much. Fund inception date is 1 July 2007 (inclusive).

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