

# Magellan Global Fund

Fund Update: 30 June 2013

## Key Facts

|  |   |
|--|---|
| Portfolio Manager<br>Hamish Douglass               | Management and Administration Fee <sup>1</sup><br>1.35% |
| Structure<br>Global Equity Fund, \$AUD<br>unhedged | Buy/Sell Spread <sup>1</sup><br>0.10%/0.10%             |
| Inception date<br>1 July 2007                      | Fund Size<br>AUD \$3,656.7 million                      |

## Performance Fee<sup>1</sup>

10.0% of excess return over the higher of the Index Relative Hurdle (MSCI World Net Total Return Index (AUD)) and the Absolute Return Hurdle (the yield of 10-year Australian Government Bonds). Additionally, the Performance Fees are subject to a high water mark.

<sup>1</sup>All fees are exclusive of the net effect of GST

## AUD Performance<sup>2</sup>

|                         | Fund % | Index % <sup>3</sup> | Excess Return % |
|-------------------------|--------|----------------------|-----------------|
| 1 Month                 | 3.0    | 2.2                  | 0.8             |
| 3 Months                | 16.8   | 14.6                 | 2.2             |
| 6 Months                | 29.0   | 23.0                 | 6.0             |
| 1 Year                  | 39.7   | 32.8                 | 6.9             |
| 2 Years ( p.a.)         | 28.5   | 14.8                 | 13.7            |
| 3 Years ( p.a.)         | 19.2   | 10.7                 | 8.5             |
| 4 Years ( p.a.)         | 17.8   | 9.4                  | 8.4             |
| 5 Years ( p.a.)         | 15.6   | 3.7                  | 11.9            |
| Since Inception ( p.a.) | 9.3    | -0.9                 | 10.2            |
| Since Inception         | 70.9   | -5.4                 | 76.3            |

## Top 10 Holdings

|                  | Sector                 | % of Fund |
|------------------|------------------------|-----------|
| Microsoft Corp   | Information Technology | 6.6       |
| Google Inc       | Information Technology | 6.2       |
| eBay Inc         | Information Technology | 5.4       |
| Lowe's           | Consumer Discretionary | 5.3       |
| Wells Fargo      | Financials             | 4.8       |
| Tesco Plc        | Consumer Staples       | 4.7       |
| American Express | Financials             | 4.6       |
| Yum! Brands Inc  | Consumer Discretionary | 4.5       |
| Oracle           | Information Technology | 4.5       |
| Danone           | Consumer Staples       | 4.4       |

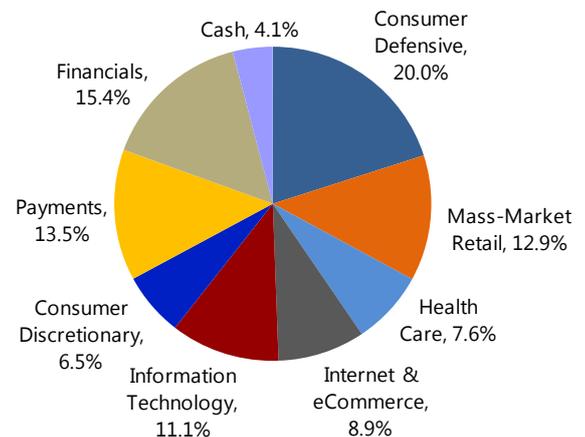
## Regional Breakdown

|                            | % of Fund  |
|----------------------------|------------|
| Multinational <sup>4</sup> | 46.6       |
| North America              | 44.6       |
| United Kingdom             | 4.7        |
| Australia                  | 0.0        |
| Europe                     | 0.0        |
| Japan                      | 0.0        |
| Asia Ex-Japan              | 0.0        |
| Cash <sup>5</sup>          | 4.1        |
| <b>TOTAL</b>               | <b>100</b> |

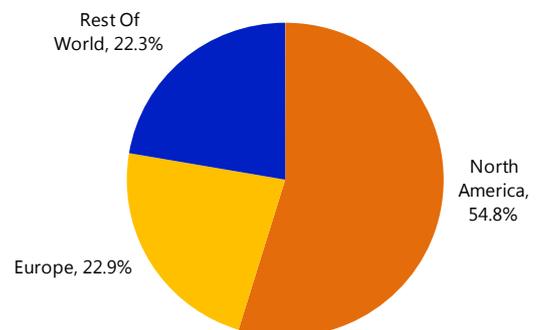
## Performance Chart Growth of AUD \$1,000<sup>2</sup>



## Industry Exposure by Source of Revenues<sup>6</sup>



## Geographical Exposure by Source of Revenues<sup>6</sup>



<sup>2</sup>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 1 July 2007.

<sup>3</sup>MSCI World Net Total Return Index (AUD)

<sup>4</sup>Multinational: Greater than 50% of revenues outside home country.

<sup>5</sup>Cash component includes provisions for payment of distribution of approximately 2%, dated 1 July 2013

<sup>6</sup>Calculated on a look through basis based on underlying revenue exposure of individual companies held within the portfolio.

[www.magellangroup.com.au](http://www.magellangroup.com.au)

Important Information: Units in the Magellan Global Fund are issued by Magellan Asset Management Limited (ABN 31 120 593 946, AFS Licence No 304 301). Past performance is not necessarily indicative of future results and no person guarantees the future performance of the Fund, the amount or timing of any return from it, or that it will achieve its investment objective. This material has been prepared for general information purposes and must not be construed as investment advice. This material has been prepared without taking into account the investment objectives, financial situation or particular needs of any particular person. Investors should consider obtaining professional investment advice tailored to their specific circumstances and should read the relevant Product Disclosure Statement (PDS) prior to making any investment decisions. The PDS is available at [www.magellangroup.com.au](http://www.magellangroup.com.au) or can be obtained by calling 02 8114 1888.



## Market Commentary

During the June 2013 quarter, global markets were focused on the implications of central bankers' actions globally, the inevitable unwinding of QE in the US, the three pronged "Abenomics" approach in Japan and a renewed focus on China's apparent tightening of short term liquidity and risks within its shadow banking system.

There continues to be encouraging signs that the US is undergoing a modest economic recovery. Importantly, house prices appear to have stabilised and housing starts are gradually normalising. We believe that there is unlikely to be a significant reduction in the unemployment rate in the short term until housing construction reverts to more normalised levels, which we consider will take another two or so years. When this occurs, the US economy should recover significantly.

We continue to believe that many European countries face a prolonged period of sub-par economic growth due to the combined effects of fiscal austerity by governments, deleveraging of bank balance sheets and household deleveraging. A major near-term risk for Europe would be a dramatic uplift in European sovereign bond yields (particularly in Spain or Italy) which could be triggered by a disorderly unwinding of QE in the US. This scenario would really test the resolve of the ECB and test the veracity of the OMT, where the ECB would intervene in the bond market of a troubled EU country in an unlimited way.

## Fund Commentary

As at 30 June 2013, the Fund consisted of 25 investments, with the top ten holdings representing 51% of the portfolio. During the quarter, the Fund returned 16.8% net of fees against the benchmark return of 14.6%, resulting in relative outperformance of 2.2%.

Over the quarter, the three stocks with the strongest returns in local currency were Microsoft (+21.6%), Wells Fargo (+12.4%) and American Express (+11.2%) while the three stocks with the weakest local currency returns were Tesco (-10.5%), Nestle (-6.9%) and eBay (-4.6%).

The significant changes to the Fund during the quarter were the result of active portfolio management regarding relative valuation and opportunity cost. We sold the entire position of Mondelez which had appreciated materially since our investment subsequently reducing our margin of safety. We continued to increase the holding in Microsoft and purchased a new holding in Oracle. Both of these companies remain the dominant companies in their markets and have been priced by investors assuming that their earnings and dominant positions will soon rapidly erode. Whilst both companies have faced some near-term uncertainty, both companies have very strong futures, and their earnings are likely to be materially higher in five years.

The Fund remains fully invested, reflective of our comfort with the current macroeconomic environment and subsequent view that it remains an attractive time to be investing in a select portfolio of extremely high quality multinational companies.

## Outlook

We remain focused on prudent portfolio construction with emphasis on the avoidance of aggregation of risk within the Fund. We feel comfortable with the overall portfolio and believe it is likely to exhibit substantially less downside risk than the market in the event that global markets deteriorate materially.

Within the current macro environment we continue to see value in high quality companies exposed to certain investment themes. Our Fund has material exposure to the following themes:

- Emerging market consumption growth via investments in multinational consumer franchises.
- The move to a cashless society. There continues to be a strong secular shift from spending via cash and cheque to cashless forms of payments, such as credit cards, debit cards, electronic funds transfer and mobile payments.
- Internet/e-commerce convergence. There are a number of internet enabled businesses that have very attractive investment characteristics with increasing competitive advantages.
- US housing Recovery. A recovery in new housing construction should drive a strong cyclical recovery in companies exposed to US housing and also provide a strong boost to the overall economy.
- US interest rates normalising over the next 3-5 years as the US economy recovers.

## Key Stock in Focus - Microsoft Corporation

Microsoft is the largest software company in the world, accounting for approximately 20% of revenue generated by the global software industry. Over 1.5 billion customers use Microsoft's products every day. It is best known for its ubiquitous computer operating system, Microsoft Windows, and its productivity suite, Microsoft Office. Its other major business, Server & Tools, is a collection of software used by businesses to run their computer networks. These three businesses make up all of Microsoft's earnings. Microsoft's two other businesses – Bing, the search engine which competes with Google, and Xbox, the gaming console – are not material to the investment case.

Microsoft's primary customers are small, medium and large enterprises that rely on its software to run their businesses. We estimate that approximately 80% of Microsoft's earnings are sourced from its business customers.

### Microsoft Office

Microsoft's biggest business, contributing almost 50% of its earnings, is the Office productivity suite and associated software. Microsoft Office has over 90% market share of the office productivity software market. A major benefit of a single productivity suite used by all businesses is that files can be read within and among businesses flawlessly, enabling easy sharing and greater productivity. Microsoft has positioned its business well for cloud delivery and user access from multiple devices with the release of Office 365 in 2012. This division has grown earnings by over 10% per annum over the past three years.

### Servers and Tools

Microsoft sources 20% of earnings from its Server & Tools segment. This is a collection of software that businesses use to run their computer networks. Microsoft Windows Server has approximately 70% market share of the server operating system market. Microsoft has also positioned this business well for cloud delivery. This division has grown earnings by over 15% per annum over the past three years.

### Microsoft Windows

Over 30% of Microsoft's earnings are generated from Microsoft Windows. The Windows software runs on over 90% of all PCs globally. The market for computer operating systems favours a winner-takes-all outcome. It is costly to develop computer applications for each operating system, so application developers favour the operating system with the most users. Concurrently, computer users will favour the operating system with the most applications. The most popular operating system will also attract the largest number of support professionals to help users.

An investment in Microsoft is not without its risks, including businesses not adopting Windows 8 tablets/hybrids, cloud-delivered software eroding the competitive advantages enjoyed by Windows, Google winning Office customers and cloud hosting eroding Windows Server share. Microsoft's management also has a mixed record, having missed major shifts in technology and made questionable large acquisitions.

However, with multiple businesses, high entrenched market share in growing global software markets, strong returns on capital, favourable capital allocation policies (US \$158 billion returned to shareholders over the last decade), and 70% of its businesses growing at attractive rates, at the current share price we believe that expected returns more than compensate investors for the risks.

[www.magellangroup.com.au](http://www.magellangroup.com.au)

Sydney Head Office  
Level 7, 1 Castlereagh  
Street Sydney NSW 2000  
Telephone: 02 8114 1888  
Facsimile: 02 8114 1800

Melbourne  
Suite 127, 1 Queens Road  
Melbourne Vic 3004  
Telephone: 03 9863 9746  
Facsimile: 03 9863 9741

Brisbane  
Level 22, 127 Creek St  
Brisbane Qld 4000  
Telephone: 07 3218 2122

New Zealand  
Level 4, 17 Albert Street  
Auckland City,  
New Zealand  
Telephone: +64 9 215 1531



**MAGELLAN**  
ASSET MANAGEMENT LIMITED