MAGELLAN

Magellan Core ESG Fund

(MANAGED FUND) (TICKER: MCSE)

A diversified global equities portfolio of 70-90 high quality global equities with ESG risk integration

ARSN 645 514 110 **APIR MGE8722AU** **AS AT 31 MARCH 2024**

Fund Features

- A portfolio of high-quality securities that is actively constructed and rebalanced quarterly
- Integrated quality framework to identify companies with sustained competitive advantages, and with a forward-looking view to the evolution in technology, consumer behaviour and other fundamental impacts to businesses
- Rebalanced quarterly, and continuously monitored, to ensure relevant and updated views on ESG, quality and risk
- Investors can buy or sell units on the Cboe securities exchange like any other listed security or apply and redeem directly with the Responsible Entity

ESG Philosophy and integration

- Integrated proprietary ESG risk assessment process and low carbon framework
- The fund excludes companies whose activities in our view may have wide-ranging detrimental impacts on society for example tobacco production, controversial weapons and mining of coal^
- Companies are reviewed and scored for the materiality of their exposure to environmental, social and governance factors. The assessment is a direct input into portfolio management
- Exposure to industry exclusions is assessed by reference to the total (gross) revenue+ of the company provided by MSCI ESG Manager
- We overlay our proprietary low carbon framework to deliver a portfolio with meaningfully lower carbon intensity than broader equity markets++

Fund Facts

Portfolio Manager	Elisa Di Marco	
Structure	Global Equity Fund, A$ Unhedged	
Objective	Achieve attractive risk-adjusted returns over the medium to long term, through investment in a diversified portfolio of high-quality companies. This objective incorporates consideration of environmental, social and governance (ESG) risks and the application of a proprietary low carbon framework.	
Investment Risks	All investments carry risk. While it is not possible to identify every risk relevant to your investment, we have provided details of the risks that may affect your investment in the relevant Product Disclosure Statement. You can view the PDS for the fund at www.magellangroup.com.au.	
Inception Date	11 December 2020	
Management Fee[1]	0.51% per annum	
Buy/Sell Spread[2]	0.10%/0.10%	
Minimum Investment[2]	AUD$10,000	
Fund Size/NAV Price	AUD $17.5 million / $4.6166 per unit	
Distribution Frequency	Semi-annually	
Cboe Ticker	MCSE	
Tickers	**Solactive iNAV**	**ICE iNAV**
Bloomberg (MCSE AU Equity) **Refinitiv (MCSE.CHA)** **IRESS (MCSE.CXA)**	MCSEAIV MCSEAUDINAV=SOLA MCSEAUDINAV	MCSEAUIV Index MCSEAUiv.P MCSE-AUINAV.NGIF
Carbon Intensity[3] **(CO_2t/US$1m revenues)**	Fund: 20	Index**: 96

Visit www.magellangroup.com.au for more information, including: fund performance, unit prices and iNAV, investment insights, PDS & forms

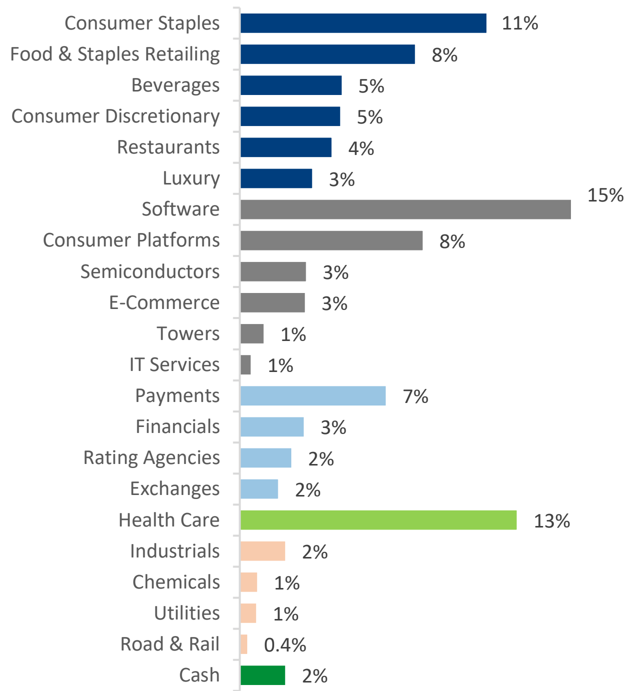
[1] Transaction costs may also apply – refer to the Product Disclosure Statement. All fees are inclusive of the net effect of GST;
[2] Only applicable to investors who apply for units directly with the Responsible Entity
[3] As at 31 March 2024. Carbon intensity data available on a quarterly basis. Certain information ©2023 MSCI ESG Research LLC. Reproduced by permission. The Fund's carbon intensity score is calculated using MSCI data. In a limited number of circumstances, where data is not available or Magellan deems it appropriate, manual adjustments are made to the MSCI carbon intensity score for certain investments held by the fund.

Performance*

	Fund (%)	Index (%)**	Excess (%)
1 Month	0.2	3.0	-2.8
3 Months	10.3	13.9	-3.6
6 Months	17.6	20.0	-2.4
1 Year	22.3	28.4	-6.1
3 Years (p.a.)	12.6	14.4	-1.8
Since Inception (p.a.)	12.5	15.0	-2.5

Past performance is not a reliable indicator of future performance.

Portfolio Snapshot#



^ Please see the PDS for a full list of industry exclusions and revenue thresholds for exclusion.
+ Net revenue or an estimate of gross (or net) revenue will be used where gross revenue is not available.
++ Our low carbon framework aims to limit the carbon intensity of the portfolio to one-third of the weighted average carbon intensity of the MSCI World Index, as reported by MSCI. Please see the PDS for further detail.
* 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 11 December 2020. Returns denoted in AUD.
** Benchmark is the MSCI World NTR Index (AUD). All MSCI data used is the property of MSCI. No use or distribution without written consent. Data provided "as is" without any warranties. MSCI and its affiliates assume no liability for or in connection with the data. Please see complete disclaimer in www.magellangroup.com.au/funds/benchmark-information.
# Sectors are internally defined. Exposures may not add to 100% due to rounding.

Performance Chart growth of AUD $10,000*

Past performance is not a reliable indicator of future performance.

Top 10 Positions

Company	Sector#	%
Alphabet Inc	Consumer Platforms	3.12
Home Depot Inc	Food & Staples Retailing	3.05
ASML Holding NV	Semiconductors	3.04
Eli Lilly & Co	Health Care	3.00
Amazon.com Inc	E-Commerce	2.99
Mastercard Inc	Payments	2.98
Microsoft Corporation	Software	2.97
Apple Inc	Consumer Platforms	2.93
Visa Inc	Payments	2.90
Hermes International	Luxury	2.88
	TOTAL:	29.88

Market Commentary

Global equity markets posted strong returns in the March quarter, with the MSCI World Index rising 8.9% in USD and 13.9% in AUD. The sectors with the largest gains were Communication Services (up 13.7%), followed by Information Technology (12.8%) and Financials (12.0%), while the laggards were Utilities (down 2.2%), Consumer Staples (-4.8%) and Materials (-5.6%). The Nikkei 225 rose 20.6% in the quarter, outpacing the S&P 500 (10.2%), STOXX Europe 600 (7.0%), S&P/ASX 200 Accumulation Index (5.3%) and the MSCI Emerging Markets Index (1.9%). China's CSI 300 rose 3.1%.

The main drivers of these strong returns were improved earnings outlooks and sentiment. US economic data released during the quarter were stronger than expected, though not strong enough to suggest that a broad-based reacceleration in inflation was likely. Earnings results for the December quarter released in the March quarter led to sizeable earnings upgrades. Overall, this dataflow saw investors reduce the number of quarter percentage point (0.25%) Federal Reserve rate cuts they expect by the end of 2024 from six to three, while also pushing up the US 10-year Treasury yield by 30bp to 4.2%.

In Europe, several countries including Germany, Finland, the UK and Ireland entered a technical recession by posting two consecutive quarters of negative GDP growth for the second half of 2023. The 10-year German government bond yield increased 30bp to 2.3%, a move broadly in line with movements in global sovereign bond yields.

In Japan, the Bank of Japan ended its negative interest policy that had been in place since 2016. Japanese equity returns have benefited from corporate governance changes that promote returns and a return of inflation, which boosts nominal growth rates. The yield on Japanese 10-year government bonds rose 10bp to end the quarter at 0.7%. While the Chinese authorities are also attempting to improve corporate profitability, we believe that relatively low trading multiples in China are justified by permanent political and governance risks and the more difficult economic backdrop in the medium term.

Fund Commentary

The portfolio recorded a positive return for the quarter in Australian dollars. The biggest contributors included the investments in SAP, ASML and Hermès. SAP reported a solid quarterly result with accelerating cloud growth and a raise of its mid-term guidance. It also announced a €2b restructuring program as it reinvests in AI capabilities for its products and internal operations. Overall the result supported SAP's cloud growth thesis and we remain positive on the momentum and resilience of core ERP. ASML reported strong growth in quarterly bookings, which were up 45% yoy (against a strong comparative period) and up 250% qoq (against a weak prior quarter). Investors have been hoping for a bookings inflection during FY24 so this was sooner and more resounding than expected, driving greater conviction of a cycle recovery supported by strength in memory demand. Hermès posted a strong quarterly result, with group organic sales growth of 18% yoy supported by double-digit growth across all geographies and categories and strong demand resilience amongst its ultra-high net worth customer base. Brand desirability and pricing power remain incredibly high and we expect Hermès to continue its track record of luxury sector outperformance.

The biggest detractors in the quarter were names in the consumer discretionary space including Apple, Nike and software giant Adobe. Apple was affected by news of a slowing smartphone market in China and the release of an antitrust case brought by the SEC for monopolising the smartphone market. We view the risks to the smartphone market in China as being short term and they are captured in our forecasts. With regards to the anti-trust case, we view that the most probable outcome of the case will be a fine, immaterial to Apple's valuation. As such, we remain optimistic on the future outlook of the business. Nike provided a much-weaker-than-expected near-term revenue outlook in its recent result, reflecting both subdued macro conditions and company-specific "franchise management" actions. The actions seek to protect brand equity in a promotional environment and as part of a strategic repositioning of the company's go-to-market strategy and product innovation pipeline. Adobe underperformed as concerns about disruption from AI and Creative Cloud maturity resurfaced after the release of OpenAI's Sora video generational model and a modest miss on Creative Cloud net new annualised recurring revenue. We view concerns as overblown.

Index movements and stock contributors/detractors are based in local currency terms unless stated otherwise.

Developments in Sustainability

In March 2024, the EU AI Act was approved by the European Parliament. This is a significant piece of regulation to mitigate the social and human rights risks of AI. The use cases of AI are categorised and restricted according to whether they pose an unacceptable, high or low risk to human safety and fundamental rights. It is important for technology providers and users of AI to adhere to this regulation as penalties can include bans and fines. The Magellan Investment Team discuss the social and regulatory risks of AI in our Insights piece: Social and Regulatory Risks of AI – Magellan Financial Group (magellangroup.com.au)

In February 2024, Magellan signed the 2024 Investor statement on Ethical AI. As a new member of the Collective Impact Coalition (CIC) for Ethical AI, we are happy to share that the CIC for 2024 has been launched.

The main Global Annual General Meeting (AGM) season commenced in March. Similar to 2023 we continue to see an increase in sustainability-related shareholder proposals. The proposals are focused on shareholder rights, and the management of material risks ranging from health and wellness to climate, diversity and human rights.

During the quarter, the Magellan Core ESG fund was certified by the Responsible Investment Association Australasia (RIAA). Certification signifies that the fund has implemented an investment style and process that considers ESG, and that the operational and disclosure practices are in line with the responsible investment standards.

Outlook

Similar to last quarter, inflation continues to slow steadily. Given this, we view that interest rates have likely peaked; however, the pace of inflation deceleration is unlikely to see rates lower quickly. We continue to view a soft landing as our base case, given the resilience of the labour market and green shoots in manufacturing PMI data. We do note that there are pockets of weakness in the consumer, especially at the lower-income end which we continue to monitor for any signs of weakness.

We anticipate that portfolio returns are more likely to be driven by earnings growth. Given the portfolio's focus on quality, we view our companies are well placed to deliver solid earnings growth in the years ahead. Our definition of quality is valuable in a market focused on earnings growth – for several reasons: 1) quality companies tend to reinvest through the cycle, often leading to stronger earnings growth on a relative basis when the cycle turns; and 2) when defining quality, we look for favourable trends in business quality alongside structural tailwinds, which typical lead to more durable cash flows.

Stock Story: Mondelez

(Lucina Martin – Investment Analyst)

Over the last decade, Mondelez, one of the world's largest snacking companies, has evolved and strengthened its economic moat, reaccelerated growth and increased the reliability of its earnings algorithm.

Although Mondelez itself is a young company, following the split from Kraft Foods in 2012, it stands on the shoulders of a portfolio of iconic, century-old brands including Cadbury, Oreo, Milka and Ritz. Its global biscuit and chocolate categories have delivered steady compound growth of ~+4.5% between 2009 and 2023* and exhibited strong pricing power, rational competition and minimal disruption from private label manufacturers. Thanks to its differentiated brands, product innovation and marketing, Mondelez holds dominant #1 and #2 market share positions in these categories, which together account for 80% of its $36b global revenue base. As a result of its dominance, Mondelez is in a position of strength to negotiate with its key retail partners on pricing programs, shelf allocation and innovation launches. Likewise, its scale advantage across marketing, distribution, research and development, and ingredient procurement are the key foundations of its economic moat.

However, there have been times in the company's history, most recently 2014 to 2018, when poor execution weighed on top-line growth and brand momentum. Mondelez's previous governance structures were rigid, and decision-making was centralised and top-down focused. Prior management teams were too concentrated on cost control and short-term profitability at the expense of innovation and marketing reinvestments to support the long-term brand equity of the portfolio. While global 'power brands' remained a focus, unfortunately there was a long tail of underperforming local brands, which weighed on growth, created complexity within its manufacturing operations and affected their trusted partner status with key retailers.

The acceleration in Mondelez's growth in more recent years has been driven by the culmination of various deliberate actions by the current management team to introduce a longer-term mindset to brand investments and portfolio management. The prior organisational structure was redesigned, decentralising core operations to bring greater decision-making power to the regional teams who know the local consumer best.

Complementing this, a new remuneration framework was introduced to incentivise balanced revenue growth and sustainable margin expansion. Importantly, this framework also aimed to minimise short-term, irrational decisions such as excessive discounting to boost market share growth, and underinvestment in marketing to achieve profitability targets.

**Source: Euromonitor*

These improved foundations have bolstered the key tenets of Mondelez's economic moat and unlocked growth across the business. Since the strategy was first implemented in 2018, the business has delivered ~+8% organic revenue growth and ~+12% constant currency EPS growth, which are well above its long-term objectives of +3-5% and +7-9% respectively. The company has achieved these objectives despite increasing its advertising budget by around 75% and investing in strategic capabilities such as consumer analytics, manufacturing automation and various digital tools to optimise procurement planning and reduce wastage.

Mondelez's in-depth knowledge of its snacking consumer is a key competitive advantage, particularly as the company continues to evolve its portfolio alongside changing consumer preferences. Recently, Mondelez has disposed of certain chewing gum and high-sugar candy brands while remaining focused on its core biscuits and chocolate products that consumers continue to seek out as permissible indulgences. The advent of GLP-1 weight-loss drugs will likely create new consumption trends for a subset of Mondelez's developed market consumers, which the company will need to monitor closely and continue to adapt to. Meanwhile in emerging markets, which account for 39% of total revenue, tailwinds to category growth from rising middle class incomes, premiumisation and expanding distribution to new cities should be enduring.

Mondelez's consumer data advantage, sophisticated manufacturing and distribution capabilities as well as its financial capacity to acquire new brands, position it well to continue to evolve its portfolio and remain an incumbent snacks player over the long term. A capable management team, together with improved governance and incentive structures, further enhances our conviction.