Fund Update: 30 June 2019

Magellan Global Equities Fund (Currency Hedged) (Managed Fund)

ARSN: 606 840 206

ASX code: MHG

Fund Facts

Portfolio Manager	Hamish Douglass		
Structure	ASX-quoted Global Equities Fund, $AUD Hedged		
Inception Date	4 August 2015		
Management & Administration Fee[1]	1.35% per annum		
Fund Size	AUD $101.7 million		
Distribution Frequency	Annually at 30 June		
Performance Fee[1]	10.0% of the excess return over the higher of the Index Relative Hurdle (MSCI World Net Total Return Index (hedged to 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.		
iNAV tickers	Bloomberg Thomson Reuters IRESS	MHG AU Equity MHG.AX MHG.AXW	MHGIV Index MHGn.IDOC MHGNAV.ETF

[1]All fees are inclusive of the net effect of GST

Capital Preservation Measures^

Adverse Markets	3 Years	Since Inception
No of observations	7	11
Outperformance consistency	86%	91%
Down Market Capture	0.5	0.6

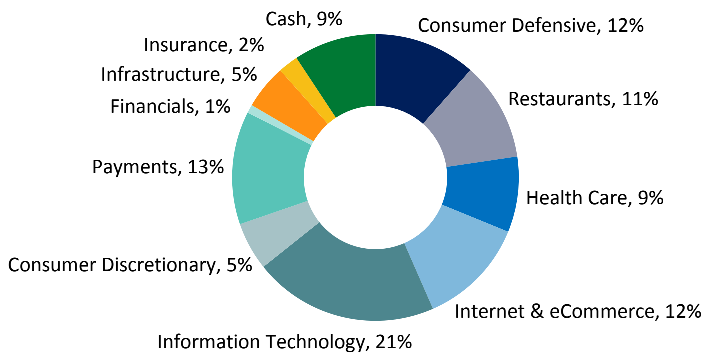
Top 10 Holdings

	Sector#	%
Microsoft Corp	Information Technology	7.2
Facebook Inc-A	Internet & eCommerce	6.6
Visa Inc	Payments	5.8
Starbucks Corp	Restaurants	5.7
Alphabet Inc	Internet & eCommerce	5.6
Apple Inc	Information Technology	5.3
HCA Healthcare Inc	Health Care	4.5
SAP SE	Information Technology	4.5
MasterCard Inc	Payments	4.3
Novartis AG	Health Care	4.0
	TOTAL:	53.5

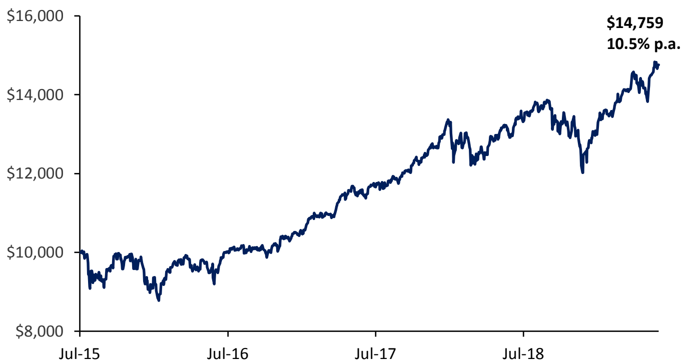
Fund Features

- Currency hedged version of the ASX-quoted Magellan Global Equities Fund (Managed Fund)
- Fund is actively managed
- Minimum administration for investors; no paperwork needed to trade
- Units can be bought or sold on the ASX like any other listed security
- Efficient and live pricing
- Provision of liquidity by the Fund
- Settlement via CHESS
- Magellan has significant investment alongside unit holders.

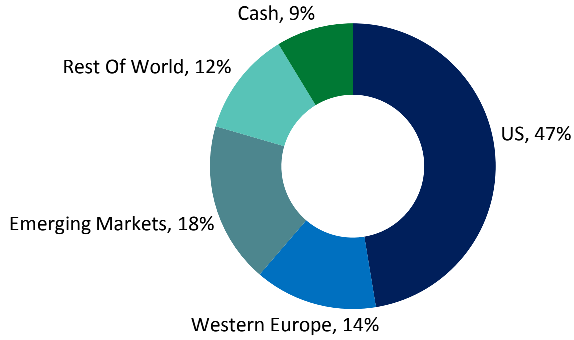
Sector Exposure by Source of Revenue#



Performance Chart growth of AUD $10,000*



Geographical Exposure by Source of Revenue#



Fund Performance*

	Fund (%)	Index (%)**	Excess (%)
1 Month	5.8	5.8	0.0
3 Months	5.8	3.5	2.3
6 Months	17.7	16.5	1.2
1 Year	13.9	6.4	7.5
3 Years (% p.a.)	15.7	12.6	3.1
Since Inception (% p.a.)	10.5	8.4	2.1

* Calculations are based on the monthly ASX released net asset value with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). Fund Inception 4 August 2015. Returns denoted in AUD.
** MSCI World Net Total Return Index (hedged to AUD)
^ Risk measures are calculated after fees. An adverse market is defined as a negative quarter, rolled monthly, for the MSCI World Net Total Return Index (Hedged to AUD). Down market capture shows if a fund has outperformed a benchmark during periods of market weakness, and if so, by how much.
# Sectors are internally defined. Geographical exposure is calculated on a look through basis based on underlying revenue exposure of individual companies held within the portfolio. Exposures may not sum to 100% due to rounding.

Market Commentary

Global stocks rose for a second consecutive quarter when they surged in the three months to June after the Federal Reserve and the European Central Bank flagged fresh stimulus to protect their economies, investors grew hopeful the China-US trade war would be contained and US companies on average reported better-than-expected earnings for the March quarter. During the quarter, 10 of the 11 sectors in the MSCI World Index rose in US-dollar terms. Financials (+6.2%) climbed the most while energy (-1.6%) fell.

US stocks reached record highs as they rose for a second straight quarter after the Federal Reserve hinted it would cut rates if clashes on trade drag on the US economy. Even as trade tensions fanned speculation the Fed would cut the cash rate as soon as July, stocks rose on hopes that China and the US would settle differences at the meeting of their leaders at the G20 meeting in Japan in June when they duly agreed to restart talks. In news on the economy, a report showed the US economy expanded at a faster-than-expected annualised pace of 3.1% in the first quarter, up from 2.2% in the last quarter of 2018. The S&P 500 Index rallied 3.8%.

European stocks gained for a second straight quarter after ECB President Mario Draghi said the central bank was prepared to "use all the instruments that are in the toolbox" to help the eurozone's weak economy and political tensions eased. The welcome political news was that populist parties failed to gain a destabilising grip on the European parliament in European elections in May, Spain's government won the country's general election in April, and European leaders eased some uncertainty over the UK's departure from the EU by extending the departure deadline to October 31. Economic news was mostly glum. The eurozone economy expanded only 0.4% in the March quarter, to give a 12-month reading of 1.2%. The Euro Stoxx 50 Index added 3.6%.

Japanese stocks rose after the central Bank of Japan said it would keep interest rates "extremely low" well into 2020. Chinese stocks fell as concerns grew the trade war with the US will hamper its economy. Japan's Nikkei 225 Index rose 0.3%. China's CSI 300 Index fell 1.2%. The MSCI Emerging Markets Index slid 0.3%.

Movements in benchmark indices are in local currency unless stated otherwise.

Fund Commentary

The portfolio recorded a positive return for the June quarter. The biggest contributors included the investments in Facebook, Microsoft and SAP. Facebook climbed after first-quarter sales jumped a higher-than-expected 26%, monthly visitor numbers to the main site over the three months exceeded forecasts, the company hinted it was near a settlement with US authorities over privacy violations, and its plans for a digital currency Libra were well received. Microsoft surged to record highs as March-quarter earnings exceeded expectations thanks to strong growth from the Azure cloud-computing business. SAP climbed after the German software company raised its fiscal 2019 profit forecast thanks to its thriving cloud-computing business, and prominent 'activist' shareholder Elliott Management announced it had bought a stake in SAP and endorsed the company's new plan.

The largest detractors included the investments in Alphabet and Lowe's. Alphabet declined after the House of Representatives said it was launching a broad anti-trust investigation into technology companies including Alphabet's Google. Lowe's fell after rising merchandise costs forced the home-improvement retailer to report lower-than-expected earnings for the March quarter and to reduce its full-year profit forecast.

Stock story: Mastercard

Teaser: Its business model benefits from a more cashless world while being hard to disrupt.

Vocalink is a payments-technology company that was set up by 18 UK banks and building societies to run the UK's network of cash machines. In 2016, Mastercard paid 700 million pounds for the company that processes about 11 billion transactions a year, to beef up its presence in the UK and add real-time payments to the services it offers worldwide. Mastercard's history of acquisitions and innovations such as 'virtual cards' – where one-time card numbers are issued for specific transactions at specific merchants – have helped the New York-based company become the second-largest global payment network in a world that is using less cash and fewer cheques each year.

The company that was formed in 1966 when some US banks created a card network earned US$15 billion in revenue in 2018, up 20% from the previous year. Over the 12 months, this revenue was generated from handling US$5.9 trillion in payments from 2.3 billion cards in more than 150 currencies conducted within 210 countries and territories. Mastercard has enjoyed strong share price gains in recent times because investors assess that it's likely to keep posting strong earnings growth in coming years. Mastercard shares rallied 134% in the five years to 2018 compared with a 48% gain in the S&P 500 Index.

The beauty of Mastercard's business model is twofold. The first is that demand for its services is strong because e-retailing, tap-and-go and mobile payments are taking off in a world where more than 80% of transactions are still in cash and cheque. Another boost is that governments keen on 'inclusive growth' are pushing for financial services to reach more people. The other is that Mastercard's competitors outside of China are likely to remain the existing payments companies namely, American Express, PayPal and Visa, the largest payments company. This is because the payment companies enjoy the strong protections of the network effect that links consumers, merchants and banks – where each additional user boosts the benefits of a network for all users. The businesses of Mastercard and its three competitors are largely impregnable from newcomers. (China has a unique payments ecosystem that is difficult for Mastercard, Visa and others to penetrate.)

To take market share from the four incumbents, any newcomer to the global payments business would need consumers and merchants to simultaneously accept its card. To achieve that, the entrant would need to achieve mass awareness, offer a simple means of payment, have ubiquitous technology, be trusted (even though the issuing bank bears the risk of theft and fraud), meet regulatory requirements in every country it wished to operate, and fulfil arduous customer and merchant servicing needs.

Thus far it has even been too hard for the likes of Apple, Facebook, Google and Samsung. Rather than pose threats to the payments status quo, Apple Pay, Samsung Pay and Android Pay are piggybacking the infrastructure set up by the payment companies. That means that the growth of mobile payments offerings by the tech giants helps Mastercard and its three peers. Cryptocurrencies are no threat either because payments this way are, so far, too slow and insecure to take market share and they face major regulatory impediments. Their volatile prices are another risk too.

Mastercard faces risks, of course. The payment companies are reliant on consumer spending for fees so their share prices can lag if investors become pessimistic about the economic outlook. American Express, PayPal and Visa could dent Mastercard's market share, even if no newcomer is likely to. Another risk is excessive regulation as governments move to protect privacy and competition – evidence of this is that the EU this year fined Mastercard US$650 million for stopping merchants from clinching better deals from banks in other member countries. Another risk is cybersecurity breaches that dent people's faith in mobile payments. Then there is the limit to Mastercard's growth due to China blocking the entry of the US payments companies. But while the world outside China keeps expanding, societies go more cashless and mobile remains a secure way to pay, Mastercard and its competitors are likely to enjoy buoyant times.

Beyond core

Mastercard nowadays describes itself as a "technology company in the global payments industry". The emphasis on technology is to highlight that Mastercard connects financial institutions, partners, merchants and others worldwide so they can use electronic forms of payment. Mastercard's core role is to authorise, clear and settle payments through its global payments network. A typical transaction on Mastercard's core network involves four players plus Mastercard. These four are the account holder, the card issuer, the merchant and the merchant's bank or financial institution.

The company does not issue cards, extend credit, set or receive revenue from interest rates and other charges. These functions are handled by the financial institution that issues cards bearing the interlocking red and yellow brand mark. Mastercard derives most of its revenue from a fee on the gross dollar volume (value) of activity on the products that carry its brands. For consumers, the company that adopted the name Mastercard in 1979 is a one stop for secure domestic and cross-border transactions. Fees on cross-border transactions – a measure of cardholders' spending abroad – account for about 33% of Mastercard's revenue. Also of note is that about 17% of Mastercard's revenue last year was derived from developing countries.

The company is always trying to expand beyond its core services. That's where fits in the Vocalink acquisition that was finalised in 2017. Last year, Mastercard started promoting the real-time accounts-based payments capabilities acquired with Vocalink.

These efforts included the launch of a service in the US (with The Clearing House) that enables people and businesses to send and receive immediate payments. It all helps Mastercard cement its number two spot in a lucrative industry.

Sources: Company filings and website and Bloomberg.