

Magellan Global Equities Fund

ARSN 603 395 302

ASX code: MGE

Fund Facts

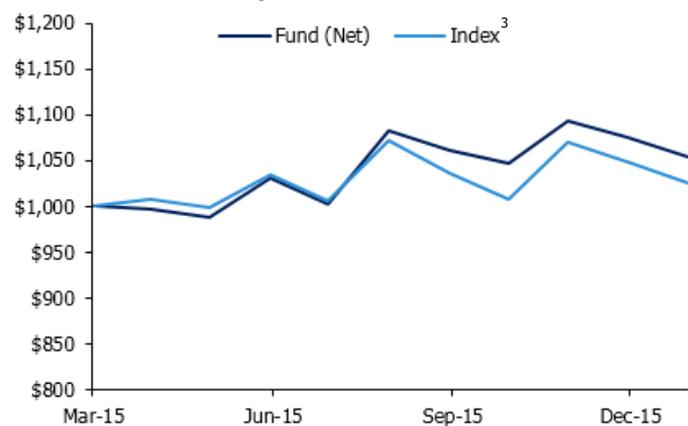
Portfolio Manager	Hamish Douglass		
Structure	ASX-quoted Global Equities Fund		
Inception Date	2 March 2015		
Management & Administration Fee ¹	1.35%		
Fund Size	AUD \$432.9 million		
Performance Fee ¹	10.0% of the excess return of the units of the Fund above the higher of the Index Relative Hurdle (MSCI 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.		
iNAV tickers	Bloomberg	MGE AU Equity	MGEIV Index
	Thomson Reuters	MGE.AX	MGEin.IDCC
	IRESS	MGE.AXW	MGENAV.EFT

¹All fees are inclusive of the net effect of GST

Fund Features

- ASX quoted version of Magellan Global Fund
- Fund is actively managed
- Minimum administration for investors; no paperwork needed to trade
- Units can be bought and sold on the ASX in the same way as any other listed security
- Efficient and live pricing
- Provision of liquidity by the Fund
- Settlement via CHES
- Magellan has significant investment alongside unit holders.

Performance Chart growth of AUD \$1,000²



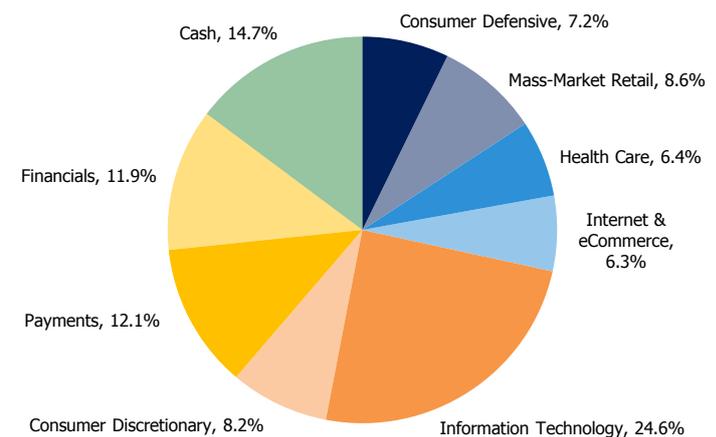
Fund Performance²

	Fund (%)	Index (%) ³	Excess (%)
1 Month	-2.0	-2.2	0.2
3 Months	0.7	1.8	-1.1
6 Months	5.1	2.0	3.1
Since Inception	5.4	2.6	2.8

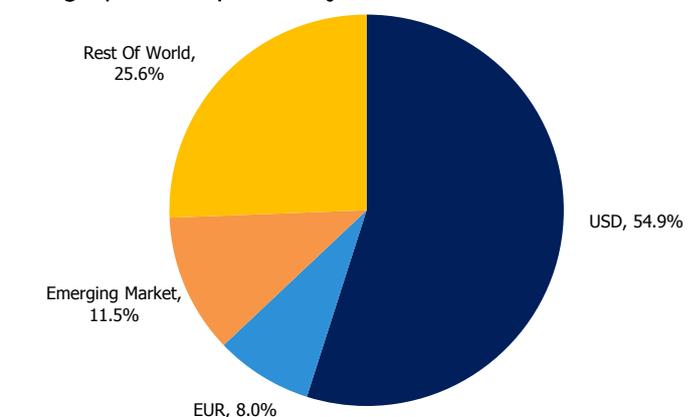
Top 10 Holdings

	GICS Sectors	% of Fund
Microsoft Corp	Information Technology	6.8
Visa Inc	Information Technology	5.0
Intel Corp	Information Technology	4.8
Lowe's Co Inc	Consumer Discretionary	4.7
PayPal Holdings Inc	Information Technology	4.3
Wells Fargo & Co	Financials	4.3
Yum! Brands Inc	Consumer Discretionary	4.1
IBM Corp	Information Technology	4.1
eBay Inc	Information Technology	4.0
Oracle Corp	Information Technology	4.0
TOTAL:		46.1

Industry Exposure by Source of Revenues⁵



Geographical Exposure by Source of Revenues⁵



²Calculations 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 2 March 2015. Returns denoted in AUD.

³MSCI World Net Total Return Index (AUD).

⁵Calculated on a look through basis based on underlying revenue exposure of individual companies held within the portfolio – Magellan defined sectors.

Market Commentary

Volatile conditions persisted in global equity markets through the December quarter, reflecting a confluence of economic drivers. The growing dichotomy between the US and other G7 countries was particularly evident during the period, with investors showing support for US equities ahead of the major European, Chinese and other emerging markets. After delivering a strong rebound in October, investor sentiment gave way to concerns over global growth prospects to lead most major markets lower in December.

In Europe, equity markets moved higher ahead of the European Central Bank's (ECB) decision in early December to extend its quantitative easing program. The ECB will continue to inject €60 billion each month through to March 2017 – an extra six months than earlier indicated. The program has also been expanded to include purchases of regional and local government debt. The move was foreshadowed by the ECB which boosted European stocks in October and November. Markets were also supported by a generally favourable economic backdrop, with consecutive positive prints of the manufacturing Index and the region's unemployment rate which reached a four-year low.

Growth momentum in the US economy continued to gather pace, evidenced by further strength in retail sales, house prices and the labour market, with net new job creation pushing the unemployment rate down to 5% for November. The strong data supported the equity market and validated the US Federal Reserve's ("Fed") anticipated official interest rate hike announced on 16 December. The third quarter corporate reporting season was buoyant, with around 74% of the S&P500 companies exceeding consensus earnings expectations. However, caution is warranted here given the degree of negative earnings guidance for the already underway Q4 reporting season.

With the Fed's first move now out of the way, considerable uncertainty remains around monetary policy effectiveness in Europe, China and Japan. With a fair degree of divergence in policy settings among the majors, markets are at risk of mispricing the trajectory of bond yields which has a flow-on impact on equity valuations. We retain a cautious stance for this reason and hold approximately 15% in cash to enhance the capital preservation characteristics of the portfolio.

Fund Commentary

As of 31 December 2015, the Fund comprised of investments in 25 companies, consistent with the number held as at 30 September 2015. The top ten investments represented 46.1% of the Fund on 31 December 2015, compared with 48.0% of the Fund as at 30 September 2015. The cash position was 14.7% compared with 15.3% at the end of the prior quarter.

The Fund's Technology stocks made a strong contribution to returns over the quarter. Microsoft was the top contributor with the share price benefitting from its latest quarterly earnings result which came in ahead of consensus. The result reflected continued success in execution across key business lines, with particularly strong performance within its Intelligent Cloud business which offset weaker revenues from Personal Computing products. The result contributed to the share price rising to a 15-year high.

Also within the technology space, Intel contributed to performance on the back of its quarterly earnings release, which exceeded the market expectations of performance for computer hardware sales. The release was followed by favourable guidance from the company on earnings for the remainder of the year which further supported the share price.

Other major contributors for the quarter included the Fund's material positions in PayPal, Visa and Lowe's. PayPal has continued to gain recognition for its strong operational performance since its launch as a separate entity in July 2015, while Visa was buoyed by strong payments and processed transactions volumes. Lowe's was supported by continued momentum within the US housing market.

Detracting from returns this quarter were positions in Yum! Brands and IBM. Yum! Brands' share price experienced a material decline following the release of its quarterly earnings result which was below consensus estimates. This was due to a sharp deterioration in trading at its Pizza Hut Casual Dining chain, which took investors by surprise. It added to concerns about its exposure to China's slowing economic growth. This announcement was followed swiftly by the announcement of activist Keith Meister (Corvex) joining its Board and then its decision to split the company, separating its China operation into a Master Franchisee by end 2016. This was received positively and the stock recovered slightly towards the end of the period. IBM also weakened following its Q3 earnings release, with revenues falling below consensus expectations. However, the company reported strong revenue growth from Cloud services and Business Analytics – two of its core business lines. Although the company reduced earnings guidance for the full year, we continue to retain confidence in the business strategy.

Key Stock in Focus – PayPal



PayPal is the leading global digital wallet and a leader in mobile and ecommerce payments. It operates a proprietary global technology platform that connects merchants and consumers around the world. PayPal has approximately 173 million active customer accounts. Last year, it processed over \$235 billion of payments in nearly 4 billion transactions, 1 billion of which were made on mobile devices. PayPal operates across more than 200 markets, processing transactions in over 100 currencies.

PayPal allows consumers to purchase online with convenience and security by entering their financial information only once and never divulging this information to merchants. PayPal offers consumers flexibility of payment sources, allowing its digital wallet to be loaded with credit cards, debit cards and consumers' transaction bank accounts. Consumers then have the flexibility of choosing which payment source to use to pay. PayPal offers merchants a convenient means of accepting payments and reduces online shopping cart abandonment by streamlining transactions. PayPal is particularly attractive to smaller merchants that would otherwise have greater difficulty and expense in obtaining similar payment services through banks.

PayPal's business model is primarily driven by payment volumes through its digital wallet and the spread it makes between negotiated acceptance fees paid by merchants (a percentage of each transaction) and the fees PayPal then has to pay to the consumers' payment source (eg credit card issuers). PayPal's operating margins are lowest when customers choose credit cards to pay since it has to pay higher credit card-related fees through to the issuer of the consumer's credit card. Margins are highest when customers use transaction bank accounts to pay, as the fees it pays to banks for this are negligible.

In July 2015, PayPal was spun out of eBay as a standalone company. This has created an opportunity to focus on the core capabilities of the business to support future success in an increasingly fluid competitive market. PayPal continues to benefit from its former parent eBay through a transitory service agreement that recognises their relationship is mutually beneficial to growing PayPal's business as well as supporting the myriad of small merchants on eBay.

A privileged payment network exposed to secular growth tailwinds

PayPal is a member of a select group of global payment networks, alongside Visa, MasterCard and American Express. PayPal is the only new successful global payment network since the launch of MasterCard in the 1960s. It is extremely difficult to establish a payments network, because there needs to be simultaneous acceptance of the network by both consumers and merchants. This requires mass awareness, simplicity of payment, technology ubiquity, fulfilment of arduous customer and merchant servicing needs, as well as strict regulatory requirements.

In a decades-long global trend, the means of payment continues to shift from cash and cheque towards electronic payments. This is being driven by various factors, including convenience, necessity as commerce shifts to online and public policy. This trend has a long way to go. The number of cash payments in many developed economies still comprises more than 50% of transactions and in developing countries more than 90% of transactions. This trend supports growth rates in electronic payments which are a multiple of nominal GDP growth.

Leading the digital payment revolution

PayPal's competitive strength is in online payments, where it has built a very strong brand position with consumers and merchants. Indeed, it has recently been recognized as a top 100 global brand, by Interbrand, for the first time. Recognition and increasing usage is reflected in extraordinarily high payments volume growth of 26% over the last year. Indeed, over the last 3 years, PayPal has experienced over 20% compound growth in both revenue and operating profit.

PayPal continues to invest in its online and mobile capabilities, having purchased Braintree and Paydiant, which provide merchants with leading capabilities in mobile payments and loyalty. It is also rolling out its One Touch functionality globally, which further simplifies the payment process on all devices and operating systems. However, PayPal has struggled to build an offline presence, ie in physical stores, where the "card" networks dominate. The growth of mobile payments, and increasing "multi-channel" payments & loyalty schemes increasingly supported by large retailers, may help accelerate PayPal's entry into offline.

Competition in the payments sector is increasing, however, with the digital explosion of the past 15 years encouraging the big players of the technology sector to expand their capabilities in the mobile payment space. Apple Pay, Samsung Pay, and Android Pay are all offering mobile and in-app payment facilities via their mobile handsets and through over 1,000 applications. Microsoft and Facebook also have plans to develop their own payment methods. These tech companies do not have direct payments relationships with consumers and merchants, rather these payment capabilities piggyback the existing payments infrastructure of the payment networks, banks and merchants. Nonetheless, they do compete with PayPal for transactions, particularly in the mobile payments area.

Conclusion

PayPal is a highly scalable business. As strong growth continues and PayPal benefits from its global payment infrastructure and customer base, we expect that, over time, operating margins will expand materially.

PayPal is well placed to benefit from the secular shift to electronic payments, and is progressing well in the mobile space. It has various call options in play across the payments value chain, and is extending into balance sheet lending through its relatively small credit programs. We expect coming years to evidence the operating leverage within the business, where we anticipate margins to expand over time, which will drive earning growth ahead of revenue growth over the medium term.