Fund Update: 30 June 2017

MAGELLAN
EXPERTS IN GLOBAL INVESTING

Magellan Global Fund (Hedged)

ARSN: 164 285 661

Fund Facts

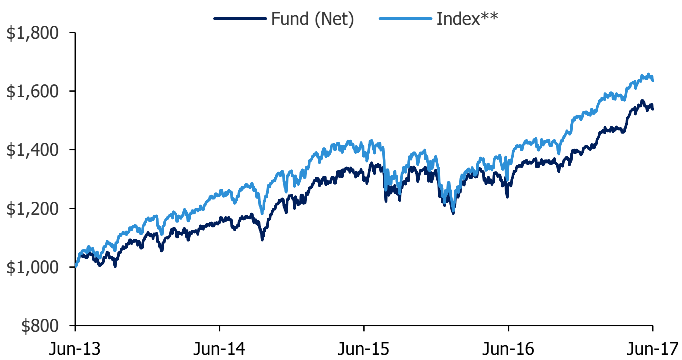
Portfolio Manager	Hamish Douglass
Structure	Global Equity Fund, $AUD Hedged
Inception Date	1 July 2013
Management & Administration Fee[1]	1.35% per annum
Buy/Sell Spread[1]	0.10%/0.10%
Fund Size	AUD $436.8 million
Distribution Frequency	Annually at 30 June
Performance Fee[1]	10.0% of the excess return of the units of the Fund above the higher of the Index Relative Hurdle (MSCI World Net Total Return Index (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.

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

Fund Features

- An active, long only global equity fund
- Aims to substantially hedge the capital component of the foreign currency exposure of the Fund arising from investments in overseas markets back to Australian dollars
- Relatively concentrated portfolio of typically 20 to 40 high-quality securities
- Benchmark unaware
- Maximum cash position of 20%
- $10,000 minimum investment amount.

Performance Chart growth of AUD $1,000*



Fund Performance*

	Fund (%)	Index (%)**	Excess (%)
1 Month	-0.7	0.1	-0.8
3 Months	4.3	3.0	1.3
6 Months	11.3	8.9	2.4
1 Year	19.8	20.4	-0.6
3 Years (% p.a.)	10.1	9.6	0.5
Since Inception (% p.a.)	11.4	13.1	-1.7

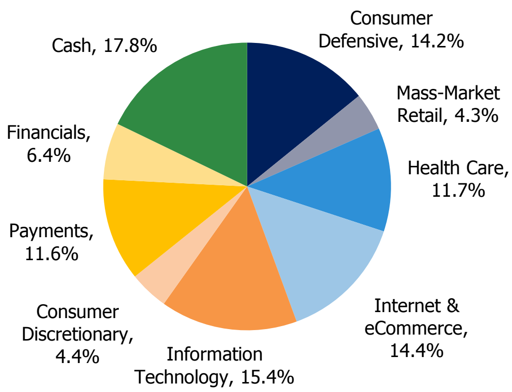
Capital Preservation Measures^

Adverse Markets	3 Years	Since Inception
No of observations	7	7
Outperformance consistency	100%	100%
Down Market Capture	0.5	0.5

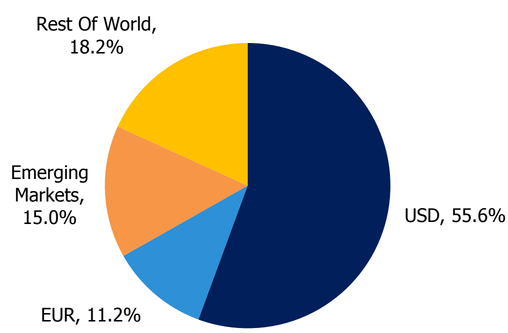
Top 10 Holdings

	Sector#	%
Apple Inc	Information Technology	7.1
Alphabet Inc	Internet & eCommerce	5.7
Visa Inc	Payments	4.9
Facebook Inc-A	Internet & eCommerce	4.8
Lowe's Co Inc	Consumer Discretionary	4.4
Microsoft Corp	Information Technology	4.4
Oracle Corp	Information Technology	3.9
Wells Fargo & Co	Financials	3.9
eBay Inc	Internet & eCommerce	3.8
Nestle SA	Consumer Defensive	3.8
	TOTAL:	46.7

Sector Exposure by Source of Revenues#



Geographical Exposure by Source of Revenues#



* 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 2013. Returns denoted in AUD.
** MSCI World Net Total Return Index (hedged to AUD).
^ Risk measures are calculated before 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.

Market Commentary

Global stocks set record highs in the June quarter after US companies posted better-than-expected earnings for the first quarter, readings showed the US economy was expanding sufficiently and the Federal Reserve reconfirmed that monetary policy would only be tightened gradually. Gains were capped when higher bond yields and the Conservative Party's unexpected loss of its parliamentary majority in the UK election undermined European stocks.

In the US, the Fed raised the cash rate by a quarter point to between 1% and 1.25% and outlined a plan that was seen as credible to reduce its balance sheet. Economic reports released over the quarter were judged as passable. They showed the US economy expanded at an annual pace of 1.4% in the first quarter and that 362,000 jobs were added from March to May, while the jobless rate fell to a post-crisis low of 4.3% in May. The S&P 500 Index rose 2.6%.

In Europe, the Conservatives were only able to form a minority government in the UK and talk is mounting of another general election before too long. Bond yields rose after the European Central Bank said the reflating economy might allow it to reduce its asset purchases in early 2018. The German 10-year government bond yield, for example, rose from 0.20% to 0.46% over the three months, while a report showed the eurozone economy expanded 0.6% in the first quarter, and 1.9% from a year earlier, thanks to a rise in investment. Stock losses were limited as investors were reassured when the pro-EU Emmanuel Macron defeated the anti-euro populist Marine Le Pen in the French presidential election that was held over two rounds in April and May. The Stoxx Europe 600 Index slid 0.5%.

At an industry level within the benchmark, healthcare, industrials and financials performed the best while energy and telecoms declined.

Movements in the S&P 500 and Stoxx Europe 600 indices and stocks are in local currency.

Fund Commentary

The portfolio recorded a positive return in the quarter. At an industry level, investments in technology companies contributed the most.

At a stock level, the best performers included investments in PayPal, McDonald's and Nestlé. PayPal gained after better-than-expected first-quarter earnings allowed the company to boost annual guidance and PayPal announced a US$5 billion share-repurchase program. McDonald's jumped after first-quarter same-store sales growth beat expectations due to pleasing growth in the US where the company's more-focused execution is winning customers. Nestlé rose 11% in anticipation that cost-saving measures will boost profit margins.

Stocks that detracted included investments in Lowe's and Tesco. Lowe's fell after the US home-improvement chain posted first-quarter comparable-store growth that was below that of The Home Depot. Tesco, despite announcing better-than-expected like-for-like growth during its June trading update, fell along with other bricks-and-mortar retailers when Amazon's purchase of Whole Foods signalled further disruption for traditional retailers.

Key Stock in Focus - Paypal

PayPal

Making payments on the internet safe and easy

In the late 1990s, several tech whiz kids in the US were searching for a way to disrupt finance. Elon Musk's initial attempt was to create one of the world's first online banks in 1999. The year after, Musk teamed up with Peter Thiel and Max Levchin who had devised a way for people to send money via Palm handhelds. Then came their brainwave – formulate a way for people to buy over the internet without having to hand over credit-card details every time.

Thus, PayPal was born in 2000. Nowadays, the company is the biggest global digital wallet and a leader in mobile payments. The company operates across more than 200 markets, processing transactions in more than 100 currencies. In fiscal 2016, PayPal's 188 million 'active' account holders conducted more than 6.1 billion transactions worth US$354 billion in payments on PayPal's digital platform, a 28% increase from the previous year. Of this, US$102 billion (two billion transactions) were via mobile devices.

PayPal's success is built on the way it allows people to purchase online quickly and securely after giving their financial information only once to PayPal. The company never divulges this information to merchants. PayPal allows its customers' digital wallets to be loaded with credit cards, debit cards and consumers' transaction bank accounts, so that they can have various payment options. PayPal's security and ease of use encourages more online shopping and reduces the risk for merchants that people will abandon online-shopping carts because they must enter payment details on the merchant's website, along with concern that payment details might be hacked from the merchant. PayPal is especially useful for smaller merchants that would find it difficult and expensive to obtain similar payment services through banks.

PayPal's largest source of profit margin is the spread between negotiated acceptance fees paid by merchants (a percentage of each transaction) and the fees PayPal pays to the consumers' payment source (say, issuers of credit cards). PayPal's operating margins are lowest when customers pay with credit cards because the fees charged by the card issuers are notably higher than other payment sources. Margins are highest when customers use transaction bank accounts, as the fees PayPal pays to banks to withdraw payment from a transaction bank account are negligible. PayPal's revenue in fiscal 2016 reached US$10.8 billion, an increase of 21% from the previous financial year. PayPal is expected to record continued strong revenue growth in coming years as societies become increasingly cashless and ecommerce further penetrates global commerce. The scalable nature of PayPal's cost structure, along with the network effect benefits for revenue growth, leads us to expect that over time PayPal's operating margins will expand significantly

PayPal's earnings outlook would be even stronger if the company could build a presence in physical stores where the

American Express, MasterCard and Visa networks dominate. The lack of an offline presence stymies PayPal's ability to create the habit among its customers of making PayPal their default payment instrument, no matter the merchant or location. Another challenge for PayPal is that competition in the digital-wallet space is increasing. MasterCard and Visa have introduced digital wallets, MasterPass and Visa Checkout, which mimic many of PayPal's user-friendly features. Android Pay, Apple Pay and Samsung Pay now offer mobile and in-app payment facilities via their mobile handsets and through more than 1,000 applications. Microsoft and Facebook have plans to develop payment methods, particularly for mobiles. PayPal, however, with its existing infrastructure and trusted brand, is well placed to fight off such threats and build an offline presence.

Leading the digital-payments revolution

PayPal's big break came in 2000 when eBay allowed the company to promote its services on the online shopping and auction site. PayPal's ease of use for eBay customers and small merchants that had previously found digital payments difficult, particularly across borders, fostered the rapid growth of eBay's small merchants and transactions; so much so that eBay bought PayPal in 2002 only months after PayPal listed on the Nasdaq. The mutually beneficial relationship between eBay's marketplace and PayPal's enablement of digital payments allowed PayPal to become the only new successful global payment network since the launch of MasterCard in the 1960s.

In 2015, PayPal was spun out of eBay and re-listed. This renewed independence has allowed PayPal to focus on its core capabilities in an increasingly fluid and competitive market. Independence from eBay also permits PayPal to target new clients, such as large retailers, that would have previously been reticent, as eBay is a competitor. PayPal still benefits from a service agreement with its former parent, which provides some 16% of PayPal's total payments volume.

It is extremely hard to establish a payments network that could compete with American Express, MasterCard and Visa because an entrant would need to be simultaneously accepted by consumers and merchants. This requires mass awareness, simplicity of payment, technology ubiquity and an ability to meet arduous customer and merchant servicing needs and regulatory requirements. Many companies and large consortia, including groups of very large merchants and some of the world's largest telecoms, have tried to create payment networks over the years and all have failed.

Now that PayPal belongs among the global payment networks the company stands to benefit from the decades-long global trend towards a cashless society. The means of payment has shifted from cash and cheques towards electronic payments due to convenience, necessity as commerce shifts to online, and public policy.

This trend has a long way to go. Cash still comprises 50% of all payments in many developed economies and more than 90% in developing countries.

PayPal's competitive strength is in online payments, where it has built a strong brand position with consumers and merchants. Indeed, it has recently been recognised as a top-100 global brand by Interbrand. Recognition and increasing usage are reflected in sustained extraordinarily high payments volume growth. Over the past three years, PayPal has experienced more than 20% compound growth in revenue and operating profit.

PayPal has invested in online and mobile capabilities by buying Braintree and Paydiant, which provide merchants with leading capabilities in mobile payments and loyalty programs. It is rolling out its One Touch functionality globally, which further simplifies the payment process on devices and operating systems to just that; one touch of a button to process a purchase, with no further details entered by the customer.

While PayPal's founders have moved on from their creation, their ambition to shake up the payments industry still drives PayPal.

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