

# Magellan Global Fund (Hedged)

ARSN: 164 285 661

## Fund Facts

Portfolio Managers	Nikki Thomas, CFA and Arvid Streimann, CFA
Structure	Global Equity Fund, A\$ Hedged
Inception Date	1 July 2013
Management Fee <sup>1</sup>	1.35% per annum
Buy/Sell Spread <sup>1</sup>	0.07%/0.07%
Fund Size	AUD \$602.9 million
Distribution Frequency	Semi-annually
Performance Fee <sup>1</sup>	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 (A\$ hedged)) 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 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
- Typical cash exposure between 0% - 20%
- \$10,000 minimum investment amount.

## 3 Year Rolling Returns (measured monthly)<sup>^^</sup>

Against MSCI World NTR Index (A\$ Hedged) <sup>+</sup>	1 Year	3 Years	5 Years	Since Inception
No of observations	12	36	60	79
Average excess return (% p.a.)	-5.8	-1.2	-0.1	-0.2
Outperformance consistency	0%	39%	58%	54%

## Fund Performance<sup>^</sup>

	Fund (%)	Index (%) <sup>+</sup>	Excess (%)
1 Month	-5.6	-5.1	-0.5
3 Months	5.4	7.2	-1.8
1 Year	-21.8	-17.7	-4.1
3 Years (p.a.)	-2.1	4.0	-6.1
5 Years (p.a.)	3.4	5.7	-2.3
7 Years (p.a.)	6.3	8.3	-2.0
Since Inception (p.a.)	7.6	9.5	-1.9

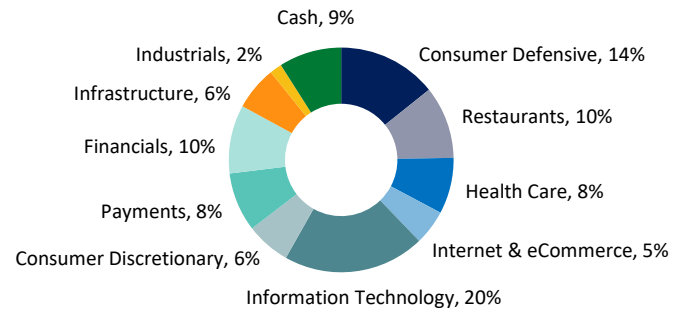
## Capital Preservation Measures<sup>\*\*</sup>

Adverse Markets	3 years	5 years	Since Inception
No of observations	16	23	30
Outperformance consistency	44%	57%	67%
Down Market Capture	1.0	0.9	0.8

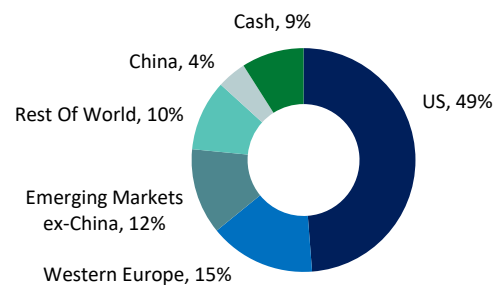
## Top 10 Holdings

In alphabetical order	Sector <sup>#</sup>	%
Microsoft Corporation	Information Technology	6.2
Visa Inc	Payments	4.5
Intercontinental Exchange Inc	Financials	4.3
McDonald's Corporation	Restaurants	4.2
MasterCard Inc	Payments	4.0
ASML Holding NV	Information Technology	3.8
Diageo Plc	Consumer Defensive	3.8
Yum! Brands Inc	Restaurants	3.7
Nestlé SA	Consumer Defensive	3.7
Intuit Inc	Information Technology	3.6
TOTAL:		41.8

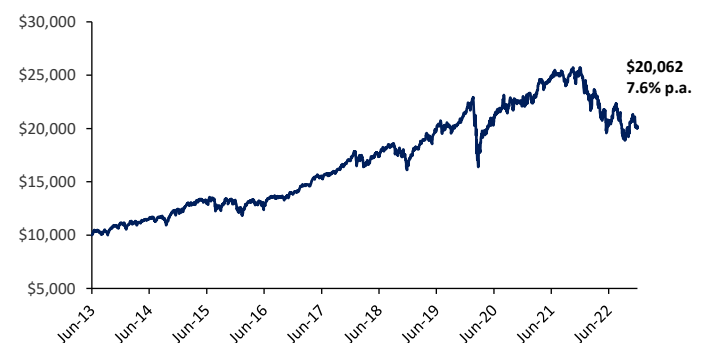
## Sector Exposure by Source of Revenue<sup>#</sup>



## Geographical Exposure by Source of Revenue<sup>#</sup>



## Performance Chart growth of AUD \$10,000<sup>^</sup>


<sup>^</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 2013. Returns denoted in AUD.

<sup>\*</sup> 3-year returns are calculated and rolled monthly in AUD, with the outperformance consistency indicating the percentage of positive excess returns since inception.

<sup>+</sup> MSCI World Net Total Return Index (A\$ Hedged). 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/](http://www.magellangroup.com.au/funds/benchmark-information/)
<sup>\*\*</sup> Risk measures are calculated after fees. An adverse market is defined as a negative three-month return rolled monthly for the MSCI World NTR Index (A\$ Hedged). Down market capture shows if a fund has outperformed a benchmark during periods of market weakness, and if so, by how much.

<sup>#</sup> 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. Cash exposure includes profit/loss on currency hedging. Exposures may not sum to 100% due to rounding.

## Market Commentary

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The final quarter of 2022 saw a rally in equity markets with the Morgan Stanley Capital International World Index up 9.8% in US dollars. We note in Australian dollars, the index rose 4.1% as the Australian currency rose. The US dollar's strength notable for most of the year fell away in the quarter, as did the dominance of US markets. During the quarter, sector performance was disparate with six of the eleven industry sectors rising double digits in US-dollar terms and two sectors falling. Gains were led by Energy (+17.1%), Industrials (+14.1%) and Materials (+13.1%) while falls occurred in Consumer Discretionary (-4.8%) (a sector dominated by Amazon) and Communication Services (-1.15%). Real estate was next lowest at +3.94%.

In the US, the S&P 500 Index rose 7.1% even as the Federal Reserve raised the cash rate by 125bp to 4.25%-4.5% and maintained it would keep interest rates higher for longer through 2023. Politically, we saw the mid-term elections, which saw the Republicans win back control of the House of Representatives, ending control of Congress by President Joe Biden's Democratic Party.

The Euro Stoxx 50 Index closed out the quarter strongly (+14.3%) despite the European Central Bank also raising interest rates aggressively and still high inflation. The milder European winter, a marked drop in demand by consumers and good levels of energy storage meant the concerns of a deep energy crisis were somewhat allayed.

But perhaps most importantly, things began to take an initially gradual and then accelerated shift for the better in China. While the CSI 300 closed the quarter up just 1.8%, we saw a widespread shift that reduced the economic risks in China, a positive development for investors. After a spate of riots internally, Chinese policy towards its zero-Covid stance began to ease and has since rapidly unwound. As we write, borders have opened a good three months ahead of most people's expectations. We would caution though on being too sanguine as the long-term issues will not be easily or quickly resolved and the distancing of US-China relations is unlikely to turn fully.

With the ongoing persistence of inflationary pressures, alongside slowing economies in most of the developed world, and a rally in share prices across October and November that seems inconsistent with the risks that lie ahead, we felt some caution into the close of the year was appropriate. We added modestly to our cash holding during December, bringing cash to 8.5%, and retained a defensive tilt to our portfolio holdings. As 2023 kicks off, we see growing earnings risks in parts of the market for the coming year and expect share prices to respond to these risks. We anticipate the coming reporting season may throw up some attractively priced opportunities for us to redeploy for higher risk-adjusted returns. Within Magellan's high-quality investment universe, a large proportion of the companies have what we believe are attractive medium-term return prospects. We are delighted with the quality and diversity of the Magellan Global portfolio and the longer-term prospects for our companies. These are advantaged companies with excellent track records of outsized business returns, skilled management and disciplined capital management.

## Fund Commentary

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The Magellan Global strategy rose for the quarter. The biggest positive contributions came from the investments in Mastercard, Visa and HCA, as well as McDonald's and Yum! Brands. With high inflation as a backdrop, these companies have positive exposure to nominal growth, and the resilience of consumer spending benefits these businesses. HCA and the restaurant chains are supported by normalising demand patterns in their businesses post the pandemic period.

The biggest detractors in local-currency terms in the quarter were Amazon, Alphabet and Crown Castle. Both Amazon and Alphabet have found themselves on the wrong side of excess demand driven by pandemic stimulus that is now unwinding, and ultra-low interest rates. Both are needing to cut costs to realign to normalising revenues and margins have been pressured. Crown Castle, like most in real estate, has been de-rated on higher interest rates but is also experiencing a slower outlook for growth in 2023 on lower demand from its telecommunications customers. We exited Crown Castle during the quarter.

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

## Outlook

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After the extremes of 2022 where returns across almost all, if not all, asset classes fell, 2023 looks to be shaping up as a year of two halves. The runaway inflation is finally starting to slow down, especially in the goods part of the measure, with the key piece to watch from here being wages inflation. If (when) this can be reined in, central banks will start to respond by leaning back on their aggressive interest-rate hiking. Even still, we believe the three-decade-long fall in interest rates has ended and our world is adjusting.

We are now a long way through the adjustment process in markets. The benchmark US 10-year bond, used for discounting cash flows and thus crucial to determining valuations, is settling into a range in the high 3% at present. We think this looks sustainable and so while near-term volatility (associated with oscillations in this) is not off the table, the major repricing of duration is finished in our view. Elsewhere the tone of the Ukraine conflict also appears to have turned and while a compromise still lies ahead, it seems unlikely to create any further material new news to affect markets negatively. If anything, some sort of stalemate or solution would likely be positive.

The other major news in late 2022 was the change of tone and direction in China. We anticipate this will be the scene setter for 2023 and we will finally put Covid-related disruption in the rear view mirror during the 2023 year. China has moved swiftly since first wavering on its strict zero-Covid policy and, given the lack of truly effective vaccines, seems now to be pursuing a 'herd immunity' response. The implications of this are, in our view, widespread and potentially materially positive for world markets. China is stimulating to rebuild domestic growth and confidence. It has eased aggressive regulatory constraints on the technology and other sectors with the recent capital raising by Ant Financial and Jack Ma ceding control all evidencing that shifts are underway. Stimulus in China flows out, especially to Europe. The opening of China's borders will allow the free distribution of the significant and well-educated Chinese population, potentially a material factor in addressing the labour shortages that have plagued many economies and held up wages.

But these things will take time to flow through and the near-term risk of the reopening is a flare-up of Covid symptoms globally and the initial wave of pain inside China may hurt growth statistics. Further, the aggressive action by western central banks have known lags in taking effect and the slowing, especially in the US, could be material. Parts of the economy built up unsustainably high cost structures as excesses of stimulus drove extraordinary revenue growth; unwinding these costs takes time. So we expect margin pressures in parts of the US lie ahead and it will be important to anticipate where earnings expectations are inappropriate as we traverse this first part of the year.

We continue to dig within our investment universe to find those companies that not only have strong competitive advantages but also can deliver cash flows and earnings that are resilient in the coming year. In December, we simultaneously increased cash and further de-risked portfolio exposure to deteriorating earnings, even in those operating from a position of strength, and feel some caution is prudent as equity prices do not appear to fully capture the downside risks associated with the economic slowdown. Our intention is to take advantage of opportunities in the coming months as the impacts of the economic slowdown become clearer. We believe the portfolio can deliver our clients strong double-digit returns over coming years, even if broader indices fall further in the short term, as we continue to hold strong, well-capitalised and well-positioned companies that can benefit from the changing shape of economies and industries. We thank you for the trust you place in us.

## Stock Story: Intuit

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# INTUIT

In 1983 former Procter & Gamble employee Scott Cook co-founded Intuit in recognition of the long-term opportunity for software to replace pen-and-paper accounting. Intuit's early products included Quicken for personal finances and QuickBooks accounting software for small businesses. In 1993 Intuit listed and merged with ChipSoft, the maker of TurboTax tax preparation software.

In 1994 Microsoft, who released a competitor to the dominant Quicken called Microsoft Money in 1991, agreed to acquire Intuit for \$1.5b in what would have been the largest software merger to date. The deal was abandoned nine months later after the U.S. Department of Justice, which already had Microsoft on its radar, announced that it would fight the deal due to competitive concerns.

Fierce competition ensued as Microsoft doubled down and sought to leverage its scale and hold over PC makers including pre-installation to dislodge Quicken from its dominant position. Despite Intuit divesting it in 2016 to focus on more prospective opportunities, it was Quicken that prevailed with Microsoft Money discontinued in 2009. A former Microsoft executive attributed this to Intuit's focus on marketing, retailing and ease of use, likely a vestige of Cook's experience at P&G.

Now 40 years after its founding and with Scott Cook still on its Board, Intuit's long-term opportunity remains significant.

While QuickBooks continues to dominate the market and has amassed over 7 million customers, its largest competitor remains manual processes or spreadsheets with less than 33% of US small businesses having adopted accounting software. There is also a significant opportunity to increase penetration of ancillary services including automated payroll and digital payments, which generate almost as much revenue as its core product.

QuickBooks is also moving upmarket. Historically focused on small businesses with 0-10 employees, in 2018 Intuit introduced QuickBooks Advanced targeted at businesses with up to 100 employees. Although there are fewer businesses of this size, higher prices and services attach rate result in 4-5x the revenue per customer. QuickBooks Advanced also allows Intuit to grow with its most successful customers rather than see them migrate to other products. Early signs are encouraging with QuickBooks Advanced finishing 2022 with 165,000 customers, up 40% on 2021.

QuickBooks also expanded its relevance with small businesses via its 2021 acquisition of marketing automation platform Mailchimp. Mailchimp offers Intuit the opportunity to address small business's number one problem of getting customers. Similar to core accounting software, customer adoption is low with about 75% of small businesses yet to adopt customer relationship management software. Intuit offers Mailchimp the opportunity to change this via a large US customer base to which it can cross-sell as well as its best-in-class marketing and onboarding capabilities.

Nearly 50 million people in North America used TurboTax to file their taxes in 2022. From here TurboTax targets 8-12% revenue growth per annum and has modestly exceeded this over the past five years. This ambition is supported by two key drivers. The first is a continuation of the long-term trend away from assisted tax filing via an accountant to DIY filing via accounting software, which has reached about 42% of filers in 2022. The second is Intuit's disruption of the higher revenue per filing assisted tax filing category via its hybrid TurboTax Live products that integrate relevant tax experts and artificial intelligence. Such is the appeal of this offering that after launching in 2018, about 5.5 million people used it to file their taxes in 2022, a number which we believe could quadruple in time.

We consider Intuit well positioned to capture these opportunities and ward off major competitive threats as it did with Microsoft in the 1990's. Key to this are Intuit's category-defining brands in QuickBooks and TurboTax supported by 40 years of history and cumulative ad spend. This is a critical advantage in categories where trust and word of mouth are key. Moreover, the \$1.6 billion Intuit spent on advertising in 2022, including Super Bowl commercials, continues to reinforce this. Another advantage is Intuit's ability to leverage its huge customer base to see how people interact with its products, supported by a \$2 billion per annum R&D budget to enable the business to continually adapt and improve its products.

Intuit's exposure to small businesses and its 2020 acquisition of Credit Karma means we anticipate it will feel some negative impact from an expected slowdown in US economic growth. However, the mission critical nature of QuickBooks and defensiveness of TurboTax should see it fare relatively well. Intuit's high operating margins and capital light business model delivers attractive returns on capital and strong free cashflow generation, positioning it well to pursue share buybacks in support of shareholder returns.

*Sources: Intuit Annual Report 2022, company filings.*

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MGFH44926