

Magellan Global Fund (Hedged)

ARSN: 164 285 661

Fund Facts

Portfolio Manager	Lead Portfolio Manager: Hamish Douglass Co-Portfolio Manager: Arvid Streimann
Structure	Global Equity Fund, \$A Hedged
Inception Date	1 July 2013
Management Fee ¹	1.35% per annum
Buy/Sell Spread ¹	0.07%/0.07%
Fund Size	AUD \$1,677.3 million
Distribution Frequency	Semi-annually
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 (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.

¹All 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)^{^^}

Against MSCI World NTR Index	Last 12 Months	Last 36 Months	Last 60 Months	Since Inception (61 Months)
Average excess return (% p.a.)	1.6	2.2	1.3	1.3
Outperformance consistency	67%	83%	72%	70%

Fund Performance[^]

	Fund (%)	Index (%) ⁺	Excess (%)
1 Month	1.9	2.4	-0.5
3 Months	6.4	7.6	-1.2
1 Year	19.5	35.6	-16.1
3 Years (p.a.)	12.4	13.4	-1.0
5 Years (p.a.)	14.0	14.4	-0.4
7 Years (p.a.)	11.5	11.5	0.0
Since Inception (p.a.)	12.0	13.0	-1.0

Capital Preservation Measures^{**}

Adverse Markets	Last 36 Months	Last 60 Months	Since Inception
No of observations	10	12	19
Outperformance consistency	100%	92%	95%
Down Market Capture	0.5	0.6	0.6

[^] 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.

^{*} 3-year returns are calculated and rolled monthly in AUD, with the outperformance consistency indicating the percentage of positive excess returns since inception.

[#] 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.

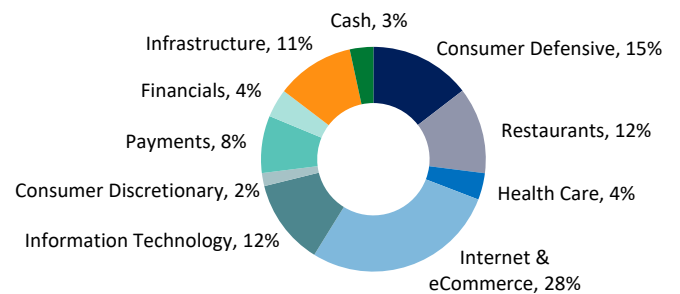
⁺ MSCI World Net Total Return Index (A\$ hedged)

^{**} 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.

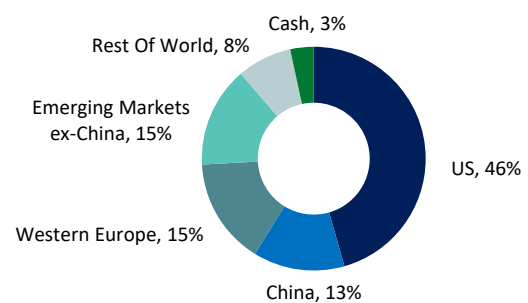
Top 10 Holdings

	Sector [#]	%
Microsoft Corporation	Information Technology	7.9
Alphabet Inc	Internet & eCommerce	7.0
Facebook Inc	Internet & eCommerce	6.5
Starbucks Corporation	Restaurants	5.4
Netflix Inc	Internet & eCommerce	5.0
Alibaba Group Holding Ltd	Internet & eCommerce	4.9
Visa Inc	Payments	4.7
Tencent Holdings Ltd	Internet & eCommerce	4.6
SAP SE	Information Technology	4.4
Yum! Brands Inc	Restaurants	4.2
TOTAL:		54.6

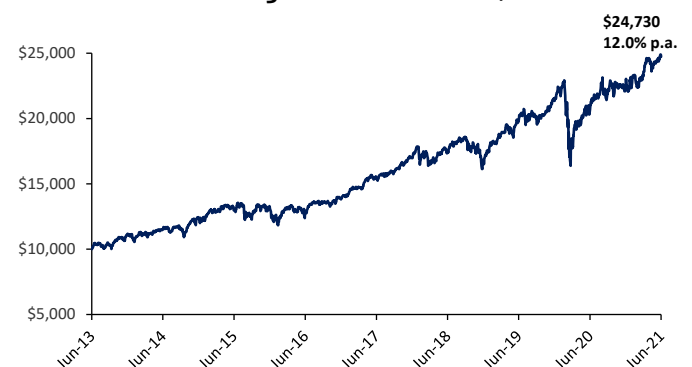
Sector Exposure by Source of Revenue[#]



Geographical Exposure by Source of Revenue[#]



Performance Chart growth of AUD \$10,000[^]



Market Commentary

Global stocks soared to record highs as they rose for the ninth quarter in 10 during the three months to June after investors backed that vaccines and more government spending would drive economies, dismissed an acceleration in inflation as transitory, and thus believed statements from central banks they would keep monetary policy loose. During the quarter, 10 of the 11 sectors rose in US-dollar terms. Information technology (+12%) climbed the most on healthy earnings while utilities (-0.7%) declined on concerns that longer-term bond yields might rise. The Morgan Stanley Capital International World Index surged 7.7% in US dollars and 9.3% in Australian currency.

US stocks gained as companies, especially tech ones and the banks, reported healthy earnings reports for the first quarter, the administration of President Joe Biden announced plans for another US\$4 trillion in spending (that Congress is still to approve), consumers spent as they grew in confidence, and, by the White House count, 67% of adults have received one vaccine dose. Reports, however, on inflation provoked spasmodic caution. Consumer inflation rose 5.0% in the 12 months to May, the fastest pace since 2008, while producer prices surged 6.6% in the year to May. These reports fanned talk the US Federal Reserve might rethink its loose monetary policy. A Fed survey of its policymakers show they had brought forward their expectations of when they would sanction a higher US cash rate. They (as represented by their median forecast) now expect to approve two increases in the cash rate from close to 0% by the end of 2023. The S&P 500 rallied 8.2%.

European stocks rose as countries relaxed pandemic restrictions as vaccine programs rolled out and the European Central Bank said it would keep aggressive monetary stimulus in place, though gains were limited by news that an ever-more debt-heavy eurozone economy is contracting. A report showed the eurozone economy shrank 0.3% in the March quarter, which followed a contraction of 0.6% in the December quarter. Another report showed government debt stood at 98% of eurozone GDP at the end of December. The Euro Stoxx 50 Index rose 3.7%.

Japan's Nikkei 225 Index defied the global trend and fell 1.3% after a resurgence in covid-19 infections extended restrictions and a report said the economy shrank 1.0% in the first quarter. China's CSI 300 Index rose 3.5% as a release showed the economy expanded a record 18.3% in the March quarter from a year earlier. Australia's S&P/ASX 200 Accumulation Index gained 8.3% after the major banks reported upbeat results, energy and material prices climbed (iron ore prices reached record highs), the federal government's budget for 2021-22 came with more stimulus, and a report showed the economy expanded 1.8% in the March quarter, to be larger than before the pandemic. The MSCI Emerging Markets Index increased 4.4% in US dollars on signs the world economy is recovering even as covid-19 ravaged emerging countries especially India.

Fund Commentary

The portfolio recorded a positive return for the quarter. The biggest contributors were the investments in Alphabet, Microsoft and Facebook. Alphabet rallied after the parent of Google reported that rising spending on digital ads boosted first-quarter sales to US\$55.3 billion, a higher-than-expected rise of 34% from a year earlier. Microsoft rose as rising demand for PCs, gaming consoles, and digital services delivered over the cloud boosted the software giant's first-quarter sales by a higher-than-expected 19% to US\$41.7 billion. As well, in April, Microsoft agreed to buy speech-recognition firm Nuance Communications for US\$19.7 billion, to expand the services it can offer business customers. Facebook surged after first-quarter sales smashed expectations to rise 48% to US\$26.2 billion as advertisers sought access to the social media platform's 2.9 billion users and a US judge unexpectedly dismissed two complaints against the social-media giant from the US regulator because the judge said the Federal Trade Commission failed to prove the company was a monopoly.

The biggest detractors were the investments in Eversource Energy of the US, Tencent of China and WEC Energy of the US. Eversource Energy fell after the Connecticut Public Utility Regulatory Authority slammed the utility that through subsidiaries offers electricity, natural gas and water services for its preparation for and response to Tropical Storm Isaias that hit in 2020. In a politically charged decision, the authority found that Eversource did not satisfy relevant performance standards, ordered an indefinite reduction of 90 basis points to subsidiary Connecticut Light & Power's authorised return on equity, ordered the opening of a regulatory docket to consider issuing civil penalties against the subsidiary and foreshadowed the disallowance of certain costs that the authority asserts were imprudently incurred were Eversource to seek recovery. Eversource has indicated it will appeal these findings. Tencent fell as the Chinese government stepped up regulatory scrutiny of the country's largest technology stocks. WEC Energy, which provides electricity and gas across four Midwest states, slid on concerns that utilities were most vulnerable to any rise in interest rates.

In relative terms, the portfolio underperformed the benchmark over the quarter. This reflected a modest outperformance of cyclical stocks over defensive stocks, on average, within the index. Uncertainty around the Chinese regulatory outlook weighed on Chinese technology platforms, while the portfolio's utility holdings were hampered by a company-specific regulatory decree and the threat of higher interest rates in the medium term.

Stock contributors/detractors are based in local currency terms unless stated otherwise.

Stock story: PepsiCo



The Super Bowl is the most watched television program in the US each year. One of the products to feature during the 2021 final, where a 30-second advertising slot fetched about US\$5.5 million, was the Mountain Dew drink owned by PepsiCo.

PepsiCo generates about half of its revenue from its famous beverage brands, including Mountain Dew, Gatorade, Tropicana, SodaStream and Pepsi-Cola, but they account for only about one-third of the company's profits.

The 110 million or so Americans watching the US football game were probably munching on the products of PepsiCo's most prized asset. This is the savoury snacks business that generates the remaining 50% of the company's revenue, amounting to US\$70.4 billion in fiscal 2020. Thanks to the business's best-in-class operating margins, snacks amount to two-thirds of the company's profits. The division that includes brands like Cheetos, Doritos, Lay's and Ruffles and the breakfast-oriented Quakers enjoys about 65% market share in the US, underscoring its dominance.

These salty treats did especially well during the covid-19 pandemic, as even the healthiest among us turned to comfort food when locked up. Before covid-19, PepsiCo's snacks business had delivered consistent sales growth over the previous decade, thanks to the shift to 'on the go' lifestyles and a trend away from three 'square' meals per day. Although PepsiCo's soft drinks division offers lower growth, it is still a valuable asset that plays alongside Coca-Cola in a branded duopoly with rational competitive dynamics.

The brand equity of PepsiCo's product range is central to the investment case. The company's true edges here are in innovation and marketing, attributes that are often more important than price in determining market share. The company's scale and dominance, particularly in the US, puts it in a strong negotiating position vis-à-vis fragmented retail outlets. This gives it strong pricing power and a secure route to market.

Another key advantage is PepsiCo's distribution system. Unlike competitors that rely on retailers to place their products on the shelves, PepsiCo operates an extensive direct-to-store delivery system in the US, using a truck fleet numbering in the thousands (and one that is larger than that of the US Postal Service). This system gives PepsiCo control of product freshness, presentation, marketing and merchandising at the point of sale. It also enables the swift rollout of new products, and helps to minimise out-of-stocks on high-turnover items. Replicating this expensive infrastructure and expertise would be near-impossible for smaller rivals, which gives PepsiCo an enduring competitive advantage.

Investors are also attracted to PepsiCo's defensive qualities. In a world where macroeconomic and geopolitical uncertainty is palpable, PepsiCo offers time-tested earnings streams. Consumer staples companies such as PepsiCo have often outperformed the broader market during past periods of upheaval. After a brief initial hit from the pandemic, PepsiCo shares have recovered to reach record highs. We are confident the company's promising earnings and profit growth will generate superior returns for investors for a while yet.

PepsiCo faces challenges, of course. There are many substitutes for the company's products and consumers are always keen to experiment. The rise of retailer-led 'private label' strategies, e-commerce and 'guerrilla marketing' tactics has threatened the power of big brands. The sugar and salt content in PepsiCo's products mean sales are vulnerable to a shift to healthier eating or government taxes to encourage the same.

In our view, the company's overall advantages are meaningful enough to overcome these challenges and disruption risks. We think PepsiCo will generate attractive investment returns for years to come, while proving a safer investment in falling markets.

A quack solution

PepsiCo's history starts in 1898 when Caleb Bradham, an entrepreneur from New Bern, North Carolina, created Pepsi-Cola and offered the soft drink to customers within his pharmacy, claiming it cured dyspepsia and indigestion.

Bradham obviously knew he had something popular to sell because in 1903 he registered the Pepsi trademark. Taking inspiration from the Coca-Cola Company, Bradham developed a bottling franchise system. By World War I, 300 bottlers had joined the franchise. After the war, Bradham stockpiled sugar to safeguard against rising costs, but in 1920 sugar prices plunged, forcing him into bankruptcy in 1923.

Pepsi existed on the brink of ruin under various owners until Loft Candy bought it in 1931. Its sales improved in 1933 when during the Great Depression it doubled the size of its bottles to 12 ounces (0.35 litres) without raising the price from 5 US cents.

A pivotal moment in the founding of the modern PepsiCo came in 1965 when the CEOs of Pepsi-Cola and Frito-Lay envisaged what they called "a marriage made in heaven"; namely, creating a single company that offered salty snacks and one of the US's most popular cola drinks.

Nowadays, consumers across the world enjoy PepsiCo products more than one billion times each day. In addition to its North American operations, which account for about 60% of revenue, PepsiCo has four international divisions. Each of these divisions has a distinct history and way of doing business. The dominance and prominence of the products, however, whether on store shelves or when advertised during popular TV shows, is the same the world over.

Sources: Company website, Bloomberg, Dunn & Bradstreet.

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