

Magellan Global Fund (Hedged)

ARSN: 164 285 661

Fund Facts

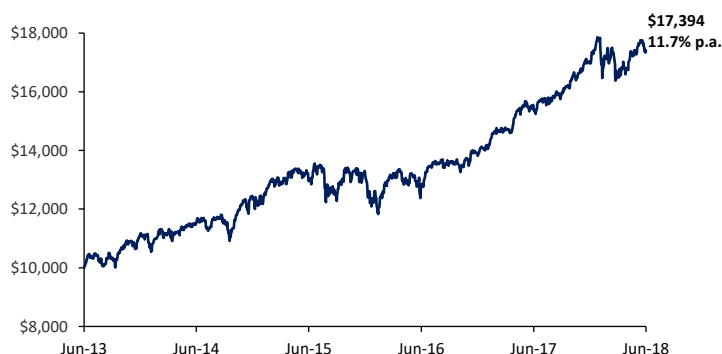
Portfolio Manager	Hamish Douglass
Structure	Global Equity Fund, \$AUD Hedged
Inception Date	1 July 2013
Management & Administration Fee ¹	1.35% per annum
Buy/Sell Spread ¹	0.10%/0.10%
Fund Size	AUD \$481.2 million
Distribution Frequency	Annually at 30 June
Performance Fee ¹	10.0% of the excess return 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.

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
- Maximum cash position of 20%
- \$10,000 minimum investment amount.

Performance Chart growth of AUD \$10,000*



Fund Performance*

	Fund (%)	Index (%)**	Excess (%)
1 Month	0.4	0.4	0.0
3 Months	4.4	3.8	0.6
6 Months	2.5	1.4	1.1
1 Year	13.1	11.5	1.6
3 Years (% p.a.)	10.3	9.8	0.5
4 Years (% p.a.)	10.9	10.0	0.9
5 Years (% p.a.)	11.7	12.8	-1.1
Since Inception (% p.a.)	11.7	12.8	-1.1

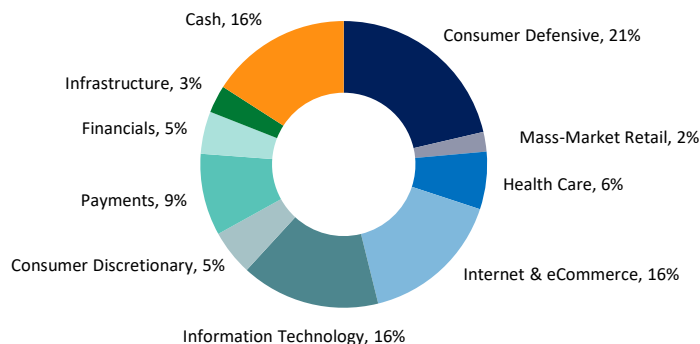
Capital Preservation Measures[^]

Adverse Markets	3 Years	5 Years	Since Inception
No of observations	8	9	9
Outperformance consistency	88%	89%	89%
Down Market Capture	0.6	0.6	0.6

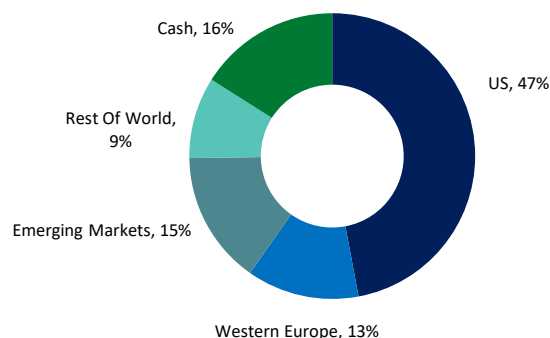
Top 10 Holdings

	Sector [#]	%
Alphabet Inc	Internet & eCommerce	7.0
Facebook Inc-A	Internet & eCommerce	6.8
Kraft Heinz Co	Consumer Defensive	5.6
Visa Inc	Payments	5.4
Apple Inc	Information Technology	5.3
Lowe's Co Inc	Consumer Discretionary	5.1
Wells Fargo & Co	Financials	4.6
Starbucks Corp	Consumer Defensive	4.3
MasterCard Inc	Payments	3.9
Microsoft Corp	Information Technology	3.8
TOTAL:		51.8

Sector Exposure by Source of Revenue[#]



Geographical Exposure by Source of Revenue[#]



* 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 rose over the June quarter, to mark their eighth gain in the past nine quarters, after companies posted higher-than-expected earnings, especially the US internet giants, the US economy headed towards its 10th year of expansion, the Federal Reserve only tightened monetary policy as expected, Italy formed a workable coalition that said it wanted to stay with the euro, and Japan's central bank promised to keep up monetary stimulus. Gains were capped when US President Donald Trump imposed import restrictions that could lead to trade wars with the EU and China.

US stocks rose on buoyant company and economic news. Financial research and data company FactSet said that about 80% of companies announced earnings per share above mean estimates, the highest rate since FactSet began tracking this measure in 2008. In economic news, the Fed, as expected, in June raised the cash rate by 25 basis points to between 1.75% and 2%, the seventh rate increase since the onset of the global financial crisis. The central bank once again signalled four rate increases would be made over 2018, implying another two before the end of the year. A report showed a Fed gauge of inflation, the core personal consumption expenditure price index, rose 2% in the 12 months to May, the first time it has hit the Fed's price target since 2011. Reports pointed to the US economy expanding briskly in the June quarter, by when the economy would have completed nine years without recession. Among highlights, the jobless rate fell to an 18-year low of 3.8% in May, while retail sales grew 0.8% over the same month, their biggest gain in six months.

European stocks gained after a left-right populist coalition took control of Italy in May after elections in March (even if it is Eurosceptic), moderate Socialist Pedro Sanchez was installed as prime minister in Spain after Mariano Rajoy lost a vote of no confidence over a corruption scandal, and inflation reached the European Central Bank target of 2%, which justified the central bank's decision to end its asset buying by year end. Stocks fell steadily from mid-April highs as concerns about a trade war with the US mounted and Angela Merkel's coalition in Germany threatened to break apart over immigration policy.

Japanese stocks rose after the Bank of Japan said it would persist with monetary stimulus, reports on employment and manufacturing showed the economy might rebound from a contraction in the first quarter and the country was judged insulated from any trade wars. Chinese stocks plunged on concerns about the growing clash with the US on trade and on signs the economy is slowing. Emerging markets struggled as tighter US monetary policy boosted the US dollar and Argentina negotiated an IMF rescue.

Fund Commentary

The portfolio recorded a positive return for the quarter. Stocks that performed best included the investments in Facebook, Visa and Apple. Facebook surged on a view that privacy issues surrounding user data wouldn't impede user and advertising growth, which showed gains in the first-quarter earnings report released in late May. Visa gained after higher consumer spending helped the payments company post higher-than-expected revenue growth of 11.5% and 30% earnings growth for the first quarter, which prompted it to boost guidance for fiscal 2018. Apple rallied following a result that showed an acceleration in services revenue and healthy iPhone revenue growth, an increase that was helped a few days later by news that the Warren Buffett-run Berkshire Hathaway had bought another 75 million Apple shares. Another boost was that The South China Post also reported the Chinese government has no plans to target US firms in China in response to the Trump administrations trade threats.

Stocks that lagged included the investments in Starbucks, eBay and Yum! Brands. Starbucks declined after disappointing sales growth in the US prompted the coffee chain to reduce outlets in its home market, sales growth in China disappointed and Moody's Investors Services downgraded the company's debt rating by one notch to Baa1 due to an increase in borrowing. Online retailer eBay fell after the US Supreme Court overturned a 1992 ruling that enabled internet retailers to avoid state sales taxes. Yum! Brands slid after the owner of KFC and Pizza Hut reported first-quarter comparable sales that missed estimates due to discounting across the fast-food industry.



Lowe's - A new shareholder is driving a challenge to The Home Depot's No. 1 ranking in the US home-improvement market.

In 1946, Carl Buchan was the part owner of a hardware store in North Carolina. Anticipating a post-World War II housing boom, Buchan envisaged creating a hardware chain, so he bought out his brother-in-law. More than 70 years later, his efforts have culminated in Lowe's, the US's second-largest chain of home-improvement and hardware stores.

Buchan and his successors have done much right in the past seven decades to create a retailer with 2,154 stores across North America that in fiscal 2017 recorded a net profit of US\$3.7 billion from US\$68.6 billion in sales.

Recent times have been buoyant for Lowe's and other housing-related businesses. The nine-year expansion of the US economy and the interrelated recovery in housing have buoyed a retail segment that has proved relatively insulated from internet disruption.

Convenience is a big reason why the industry is internet-proof. A large number of stores in close proximity to much of the population service people when they need advice on technical products. The shopping mission often includes bulky goods or urgent purchases that are best done in person. Costly consumables and DIY projects require product selection and planning, both easier done in store. On top of that, demand has been strong for home-related professionals who prefer to buy in store rather than on the internet.

The favourable environment has helped Lowe's boost revenue by 20% over the past three years though this performance of late has been more sluggish, particularly in the first quarter of 2018. The company's share price climbed 37% over the past calendar three years.

Lowe's, however, has an overarching problem in terms of its operational performance. The company isn't judged as well run as the No. 1 home-improvement company. The Home Depot, based in Atlanta, which recorded a net profit of US\$8.8 billion on sales of US\$100.9 billion in fiscal 2017, is better at retail basics. Home Depot attracts more people to its stores. The company converts more of those who enter into customers. It entices those supporters to spend more as a proportion of their household budgets. It turns a greater portion of revenue into profits. Home Depot has boosted its same-store revenue for nine consecutive years and the share price has climbed more than Lowe's in recent years; it rose 83% over the past three calendar years – more than double

the gain in Lowe's. Lowe's challenge has long been how to stop being overshadowed by Home Depot.

Enter DE Shaw, a New York-based hedge fund. In January this year, Shaw announced it had spent US\$1 billion to buy about 1% of Lowe's and it would use this shareholding to shake up the company. Shaw quickly engineered the appointment of three new directors to the board of Lowe's. One of the new directors is David Batchelder, co-founder of Relational Investors, who when on the board of Home Depot, a decade ago helped turn around that company. In April, Shaw aided the search to replace departing Lowe's CEO Robert Niblock, who had spent 13 years in the role. And in May a new CEO, Marvin Ellison, who led retailer JC Penny from 2015 and who worked in senior roles at Home Depot for 12 years, was appointed. Investors can expect to be well rewarded if the new management can make Lowe's as honed as Home Depot. Management is confident that better execution of retail basics means Lowe's can.

To others, Home Depot has some advantages over Lowe's that will hobble Lowe's efforts to match its bigger rival. One hurdle is that Home Depot had a 15-year head start in placing large 'box' stores in the best locations in the best cities – and in the homeware and hardware segments, location amounts to a local monopoly. Other challenges for Lowe's include that housing-dependent businesses are hostage to macroeconomics. Any slowing in the economy and housing and all housing-related industries tend to struggle. The internet will always remain a potential threat.

But Lowe's under fresh guidance could surmount these challenges or be better placed to cope during any economic and housing downturn. Company insiders estimate that better online offerings, a more appropriate product offering, an enhanced customer experience, and superior servicing of builders and other professionals could reap an extra US\$8 billion in revenue each year for Lowe's while costs could be reduced by some US\$1 billion, especially by making its supply chain more efficient. Confidence that Lowe's can revamp itself is growing, even though the loss of customer traffic and other structural problems won't be easy to overcome. Evidence? 'Activist' investment firm, William Ackman's Pershing Square Capital Management, in May revealed it had bought US\$1 billion worth of Lowe's shares.

Beyond the US

Lowe's became the US's – and the world's – second-largest home-related retailer by offering low prices and one-stop shopping. The company's margin is based on 'everyday low costs' in its supply chain, allowing it to offer profitable 'everyday low prices' to people who buy its products and services for home improvement, home décor, home maintenance, home repair, and remodelling and maintenance of commercial buildings.

Lowe's large-format stores host about 40,000 items over 214 million square feet (19.9 million square metres) of floor space that cater to the 'do it yourself' and 'do it for me' customers. The latter are professionals who cater for older and time-poor households whom Lowe's target via the Lowe'sForPros.com website.

While it will always face competition from Home Depot, Lowe's is protected against other formidable competitors because it operates in a structured and stable duopoly market. Home Depot and Lowe's control about 24% of the market. The cheaper sources of supplies based on such buying power mean they can undercut smaller competitors. The pair's size alone gives them much bargaining power with suppliers.

Lowe's, which was listed in 1961, has a presence in Canada (since 2007) and Mexico (since 2010). For now, though, it's whether or not the company can meet basic goals such as getting more people into its US stores that will determine how fast goes the expansion that Buchan initiated seven decades ago.

Sources: Company filings and website.