Fund Update: 31 December 2020

MAGELLAN
EXPERTS IN GLOBAL INVESTING

Magellan Global Fund (Open Class) (Managed Fund)

ARSN: 126 366 961

Ticker: MGOC

Fund Facts

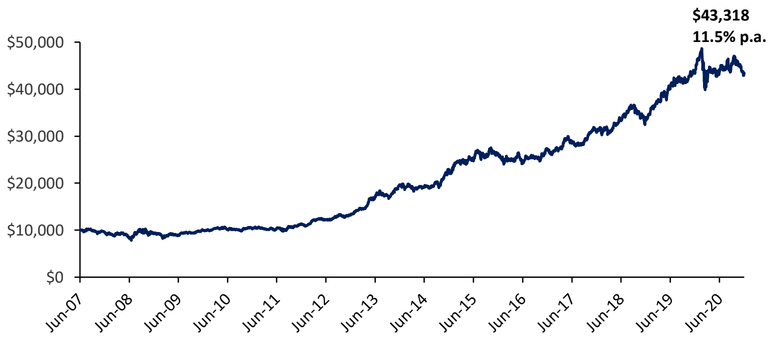
Portfolio Manager	Lead Portfolio Manager: Hamish Douglass Co-Portfolio Manager: Arvid Streimann
Structure	Global Equity Fund (Open Class Units), $A Unhedged
Inception Date	1 July 2007
Management Fee[1]	1.35% per annum
Buy/Sell Spread[1,2]	0.07%/0.07%
Fund Size / NAV Price	AUD $13,393.2 million / $2.4556 per unit
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+ and the Absolute Return Hurdle++. Additionally, the Performance Fees are subject to a high water mark.
iNAV tickers	Bloomberg MGOC AU Equity MGOCIV Index Thomson Reuters MGOC.AX MGOCAUiv.P IRESS MGOC.AXW MGOCAUDINAV.ETF

[1]All fees are inclusive of the net effect of GST; [2]Only applicable to investors who apply for units directly with the Responsible Entity

Fund Features

- 'Open-ended' unit class of the Magellan Global Fund (Ticker: MGOC)
- A specialised and focused long-only global equity fund
- Relatively concentrated portfolio of typically 20 to 40 high-quality securities
- Benchmark unaware
- Typical cash exposure between 0% - 20%
- Target Cash Distribution of 4% per annum, paid semi-annually
- Investors can buy or sell units on ASX like any other listed security or apply and redeem directly with the Responsible Entity

Performance Chart growth of AUD $10,000*



Fund Performance*

	Fund (%)	Index (%)+	Excess (%)
1 Month	-3.2	-0.5	-2.7
3 Months	-4.0	5.9	-9.9
6 Months	-0.7	9.7	-10.4
1 Year	0.0	5.6	-5.6
3 Years (p.a.)	12.0	11.0	1.0
5 Years (p.a.)	10.7	10.9	-0.2
7 Years (p.a.)	11.9	11.5	0.4
10 Years (p.a.)	15.6	13.0	2.6
Since Inception (p.a.)	11.5	6.8	4.7

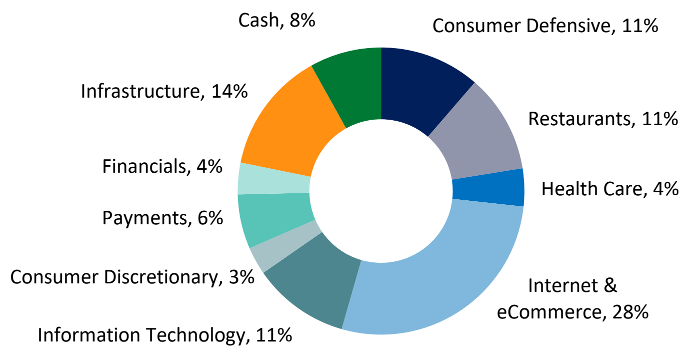
Capital Preservation Measures^

Adverse Markets	3 Years	5 Years	7 Years	10 Years	Since Inception
No of observations	11	15	22	30	48
Outperformance consistency	91%	93%	95%	97%	94%
Down Market Capture	0.6	0.6	0.5	0.4	0.5

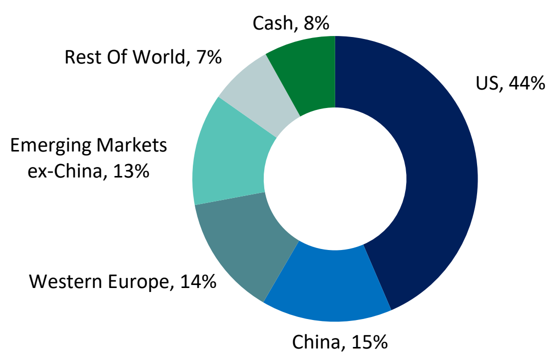
Top 10 Holdings

	Sector#	%
Microsoft Corporation	Information Technology	7.0
Alphabet Inc	Internet & eCommerce	6.6
Tencent Holdings Ltd	Internet & eCommerce	5.7
Starbucks Corporation	Restaurants	5.5
Facebook Inc - Class A Shares	Internet & eCommerce	5.5
Alibaba Group Holding Ltd	Internet & eCommerce	5.4
Netflix Inc	Internet & eCommerce	4.5
Novartis AG	Health Care	4.3
Reckitt Benckiser Group	Consumer Defensive	4.2
SAP SE	Information Technology	3.9
	TOTAL:	52.6

Sector Exposure by Source of Revenue#



Geographical Exposure by Source of Revenue#



^ Risk measures are calculated after fees. An adverse market is defined as a negative quarter, rolled monthly, for the MSCI World Net Total Return Index (USD). Down market capture shows if a fund has outperformed a benchmark during periods of market weakness, and if so, by how much.
+ MSCI World Net Total Return Index (AUD) ++ 10-year Australian Government Bonds Yield
* 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 2007. Returns denoted in AUD
# 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. Exposures may not sum to 100% due to rounding.

Market Commentary

Global stocks soared to record highs in the December quarter after pharmaceutical companies developed a vaccine against the virus that causes the illness known as COVID-19, the Democratic party's subdued performance in the US senate appeared to rule out radical anti-business measures during the administration of president-elect Joe Biden, and US congress agreed to more fiscal stimulus. During the quarter, all 11 sectors rose. Energy (+27% in US dollars) climbed most while Consumer Staples rose least (+6.4%). The Morgan Stanley Capital International World Index soared 14% in US dollars and 5.9% in Australian currency over the quarter to give increases of 16% and 5.6% respectively for 2020.

US stocks rallied to record highs after a vaccine with 90%-plus effectiveness in achieving an immune response was announced and distributed, the election result lowered the risk of radical measures passing congress, the Federal Reserve said it would provide open-ended stimulus to help the economy, and lawmakers passed the second big fiscal package since the virus struck. These developments overcame concerns about a third wave of infections flaring up across the country and President Donald Trump's refusal to concede defeat while alleging voter fraud. The vaccine euphoria kicked off in November when Pfizer/BioNTech and Moderna announced successful phase three vaccine trials using a novel mRNA technology, while Oxford University and AstraZeneca came out with vaccines using traditional technology. In the election, the lack of a strong Democratic wave improved the outlook for profit growth because the lack of a strong showing in the senate reduced the mandate and political leeway for new laws that would reduce corporate profitability. Even though the US economy expanded at an annualised rate of 33.4% in the third quarter, more up-to-date reports showed the latest burst of infections, which took the number of Americans struck by the virus to more than 20 million, is hurting business. Retail sales, for example, fell in November, the largest decline since April, while jobless claims rebounded towards year end. The S&P 500 Index added 12% over the quarter, to be up – led by Big Tech – 16% for 2020.

European stocks soared as the arrival of a vaccine, a last-minute deal that completed the procedure of the UK's departure from the EU and an agreement over the EU's budget and stimulus package overshadowed a fresh wave of infections and restrictions across the continent. In economic news, a report showed the eurozone expanded 12.5% in the third quarter, after shrinking 11.7% in the previous three months. The Euro Stoxx 50 Index rallied 11%, meaning it fell only 5.1% over 2020.

Japan's Nikkei 225 Index gained 18%, to break the previous high set in 1991, after a report showed Japan's economy expanded 5.3% in the third quarter, its first expansion in four quarters. China's CSI 300 Index rose 14% as manufacturing's 9th consecutive monthly increase in November showed the economy was coping through the pandemic. Australia's S&P/ASX 200 Accumulation Index jumped 14% after the Reserve Bank of Australia cut the cash rate to a record low 0.1% and announced it would buy A$100 billion of long-term bonds under a quantitative easing program. The MSCI Emerging Markets Index rallied 19% in US dollars as investors thrilled to the vaccine and a lower US dollar eased the burden of emerging countries with steep US-dollar-denominated debt.

Fund Commentary

The portfolio recorded a negative return for the quarter. The biggest detractors were the investments in Alibaba Group, SAP and RB. Alibaba dropped after its about-33%-owned Ant Group suspended its IPO, Chinese authorities said they would investigate the company for "suspected monopolistic conduct", key founder Jack Ma disappeared after criticising financial authorities, and the company's results for the September quarter displayed mixed results across segments. SAP dropped after Europe's largest software company lowered medium-term revenue and profit forecasts and its third-quarter result fell short of expectations as cloud revenue growth slowed. RB dropped on expectations sales for its sanitary products would drop once the pandemic is brought under control.

The biggest contributors were the investments in Alphabet, Starbucks and Tencent Holdings. Alphabet rose after its Google subsidiary's advertising revenue showed a better-than-expected rebound from the coronavirus-triggered slump and the US election outcome reduced the risk of a crackdown on Big Tech that would ensnare Google, which is already under anti-trust scrutiny by the US Department of Justice. Starbucks gained after the coffee chain, when announcing a smaller-than-expected drop in same-store sales of 9% for the fourth quarter, signalled that the worst is past. Tencent climbed after its 28% increase in revenue for the first half from a year earlier beat expectations.

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

Stock story: Novartis

Over recent generations, ageing populations, biologic breakthroughs, scientific innovations allowing companies to safely mass-produce drugs, greater access to healthcare across the emerging world and the formation of national healthcare systems have boosted global healthcare spending to about 10% of the world economy.[1] These forces, to varying degrees, will bolster this percentage higher still in decades to come.

The pharmaceutical sub-segment of an expanding healthcare industry is well placed to provide selective opportunities that are economically defensive if a business can deftly and consistently manage the scientific risks of research projects and major periodic patent expiries. One of the best placed to manage this dilemma is the Swiss-based pharmaceutical company Novartis, which has a leading innovation track-record.

The company that seeks to 'reimagine medicine to improve and extend people's lives' spends about US$9 billion a year on research and development. The aim is to tackle some of society's most challenging healthcare issues and deliver them to as many people as possible. Novartis, which earned US$49 billion in fiscal 2019, already provides 70 billion doses to one billion patients a year.

Novartis, which traces its roots to 1758, now comprises two global operating divisions since it spun off its Alcon eyecare-devices business in 2019. Novartis's key arm is Innovative Medicines, which delivers about 85% of Novartis's earnings and seeks to develop patent-protected prescription medicines that change the standard of care for often acute ailments and diseases. The other division is Sandoz, which mass markets generic pharmaceuticals and biosimilars.

The Innovative Medicines division researches, develops, makes, distributes and sells patented prescription medicines. The division is in turn split into two business units: Novartis Oncology and Novartis Pharmaceuticals. The latter consists of the following global business franchises: ophthalmology; neuroscience; immunology, hepatology and dermatology; respiratory; cardiovascular, renal and metabolism; and established medicines. Novartis's leading global capability in emerging gene and cell therapies also complements these therapeutic areas.

Some of the world's amazing and lucrative drugs have emerged from these businesses. Novartis has more than 15 innovations that each haul in more than US$1 billion in revenue every year. These innovations include the multiple sclerosis drug Gilenya (and the recently launched Kesimpta improvement in the standard of care for sufferers of multiple sclerosis); psoriasis and arthritis drug Cosentyx; heart-failure-prevention medication Entresto; and the neuroscience drug Zolgensma that almost cures previously terminal spinal muscular atrophy in babies.

Zolgensma, a future gene therapy blockbuster, is worthy of special mention. Accumulative sales already top US$1 billion for a medication that is the world's most expensive at about US$2 million a dose. Novartis is pioneering gene therapy as a new class of treatment. Novartis's prescient AveXis acquisition and buildout of the global infrastructure necessary to commercialise this technology and expand the market via manufacturing cost innovation has significant potential given its first-mover advantage.

The Sandoz division develops, makes, distributes and sells prescription medicines and active ingredients that are not protected by patents (because they have expired). Sandoz is organised globally into three franchises: retail generics; anti-infectives (antibiotics); and biopharmaceuticals. It's from its biopharmaceuticals franchise that Sandoz develops more complex biosimilars and provides biotechnology manufacturing services to other companies.

CEO Vas Narasimhan, a doctor by qualification who was appointed in 2018, has reshaped Novartis via acquisitions and divestments (and careful cost-cutting; US$2 billion in costs pruned so far and another US$2 billion to come). In 2020, for instance, Novartis paid US$9.7 billion for Medicines Co, the maker of Inclisiran, a low-risk and promising novel solution for bad cholesterol and heart disease. Similar strategic acquisitions, along with the sale of assets such as Alcon and Novartis's stake in a venture with GlaxoSmithKline (consumer health), has refocused the once-sprawling conglomerate.

Magellan boils Novartis's sustainable competitive advantages down to two key drivers. The first is the breadth and depth of Novartis's R&D capability in areas of significant unmet need. The stock market is undervaluing the 150 or so projects that are in development, especially those that are line extensions and lower risk. Novartis's other advantage is that these research efforts are largely independent of each other in terms of medical efficacy and commercial success. One going wrong doesn't mean the others will fail, which helps us manage our exposure to the inevitable failure of expensive research projects – and this also decreases the risk of irrational internal capital allocation. All up, Novartis is one of the leading pharmaceutical innovators with encouraging early evidence of much-improved capital allocation. That bodes well for future shareholder returns.

Novartis, which operates in an industry that is ever more complex in terms of the science it advances, the trials it conducts and the regulation it must navigate, faces risks. The COVID-19 pandemic has hurt Novartis's sales growth because fewer people visited their doctors so fewer prescriptions were written. However, this setback to revenue growth will pass when a vaccine is widely distributed. Novartis's exposure to political reimbursement risks, especially in the US, is shared by all pharmaceutical companies but Novartis benefits from a relatively favourable geographic mix of global revenue. Expiring patents are also a key threat to revenue growth – that's a standard challenge for successful pharmaceutical companies. Only about 5% to 10% of medicines developed for trials work on humans and that success could take 10 to 15 years to achieve from discovery to the launch of a commercial product. This is a risk all pharmaceutical companies face.

Novartis is less of a risk on this basis than many of its peers because its pipeline of projects is relatively transparent, there's so much intellectual capital in the firm, and it has so many 'bets' on different drugs where the success or failure of each is bespoke. Novartis will grow through pending patent expiries, with attractive forecast returns driven by steady earnings growth and material unpriced option value from leadership in emerging gene, cell and nuclear medicine technologies.

[1] World Bank. 'Current health expenditure (% of GDP)'. data.worldbank.org/indicator/SH.XPD.CHEX.GD.ZS

Sources: company website, Bloomberg, Dunn & Bradstreet.