Magellan Global Fund (Open Class) (Managed Fund)

ARSN: 126 366 961

Ticker: MGOC

Fund Facts

Portfolio Managers	Nikki Thomas, CFA and 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[3]	AUD $9,491.4 million / $2.3295 per unit[3]
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 NTR Index) and the Absolute Return Hurdle (the yield of 10-year Australian Government Bonds). 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, MGOC-AUINAV.NGIF

[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. [3]NAV per unit is cum distribution and includes a distribution of $0.051 per unit distribution payable on 21 July 2022

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
- Target cash distribution of 4% per annum, paid semi annually
- Benchmark unaware
- Typical cash exposure between 0% - 20%
- Investors can buy or sell units on ASX like any other listed security or apply and redeem directly with the Responsible Entity

3 Year Rolling Returns (measured monthly)^*

Against MSCI World NTR Index+	1 Year	3 Years	5 Years	Since Inception
No of observations	12	36	60	145
Average excess return (% p.a.)	-4.5	0.5	0.6	3.5
Outperformance consistency	0%	56%	67%	81%

Fund Performance^

	Fund (%)	Index (%)+	Excess (%)
1 Month	-3.1	-4.7	1.6
3 Months	-5.8	-8.5	2.7
1 Year	-11.8	-6.5	-5.3
3 Years (p.a.)	2.1	7.7	-5.6
5 Years (p.a.)	8.4	10.0	-1.6
10 Years (p.a.)	13.3	14.0	-0.7
Since Inception (p.a.)	10.2	6.7	3.5

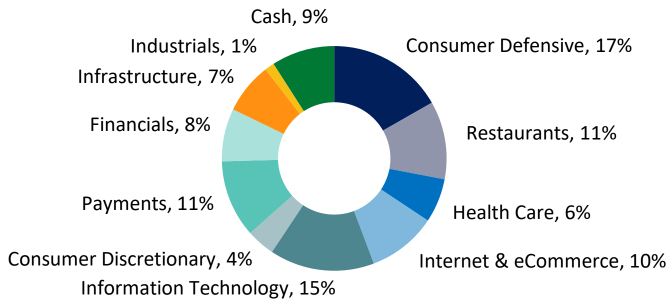
Capital Preservation Measures**

Adverse Markets	3 Years	5 Years	Since Inception
No of observations	9	16	58
Outperformance consistency	56%	63%	72%
Down Market Capture	0.8	0.7	0.5

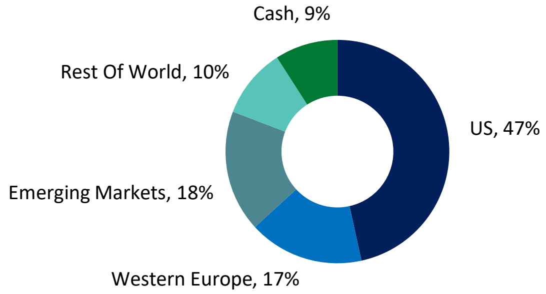
Top 10 Holdings

	Sector#	%
Microsoft Corporation	Information Technology	7.8
Visa Inc	Payments	6.0
Alphabet Inc	Internet & eCommerce	5.6
MasterCard Inc	Payments	5.1
McDonald's Corporation	Restaurants	4.5
Yum! Brands Inc	Restaurants	4.3
Novartis AG	Health Care	4.3
Reckitt Benckiser Group	Consumer Defensive	4.0
Intercontinental Exchange Inc	Financials	3.9
Nestle SA	Consumer Defensive	3.6
	TOTAL:	49.1

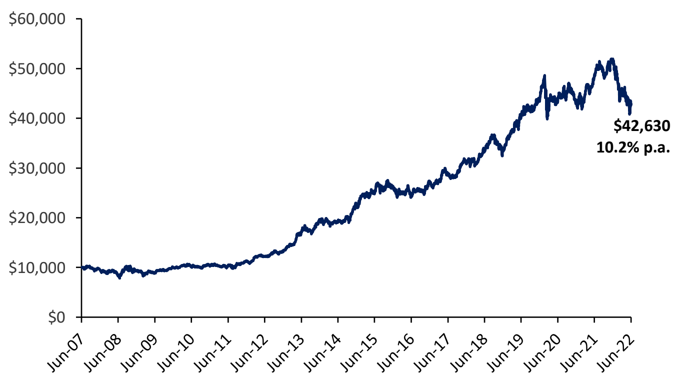
Sector Exposure by Source of Revenue#



Geographical Exposure by Source of Revenue#



Performance Chart growth of AUD $10,000^



^ 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
* 3-year returns are calculated and rolled monthly in AUD, with the outperformance consistency indicating the percentage of positive excess returns since inception.
+ MSCI World Net Total Return Index (AUD). All data 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/.
** 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+. 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. Exposures may not sum to 100% due to rounding.

Market Commentary

Global stocks fell for a second consecutive quarter in the three months to 30 June as the anticipation of tightening of monetary policy in the face of 40-year highs in inflation squeezed financial conditions. The issues confronting economies and markets remained widespread, from the Ukraine conflict and its ramifications for commodities to eurozone stability and zero-covid policy in China leading to strict lockdowns. While companies typically reported strong results during March and April, a few revealed margin hits from rapid cost increases. During the quarter, all the 11 GICS sectors fell in US-dollar terms. Consumer discretionary (-24%) fell the most while energy (-5.1%) fell least. The Morgan Stanley Capital International World Index overall fell 16% in US dollars and lost 8.5% in Australian currency.

US stocks dropped, with the S&P 500 Index down 16% over the quarter, as the prospect increased that higher interest rates and quantitative tightening by the Federal Reserve to fight inflation could send the US economy into recession. Inflation had reached 40-year highs at 8.6% in the 12 months to May, prompting the Federal Reserve to deliver the first of two rate rises so far, boosting the US cash rate by 1.25% to a range of 1.5% to 1.75%. The market is pricing a series of further rate increases to 3% or higher by year end. Surging inflation has seen US consumer sentiment, as measured by the University of Michigan, slide to its lowest since the survey began in 1952 while mortgage interest rates have risen from low levels to 14-year highs. Fed chair Jerome Powell warned the country must accept a higher risk of recession to curb inflation. A report showed the US economy unexpectedly shrank at an annualised pace of 1.6% in the first quarter, whereas investors had expected a gain of 1.1%.

European stocks slid, with the Euro Stoxx 50 Index down 12% in the quarter, as eurozone inflation set fresh record highs and the European Central Bank warned of tighter monetary policy and held an 'emergency meeting' to deal with the consequences. The European Commission downgraded its growth forecasts and increased inflation predictions due mainly to the energy crisis worsened by the Ukraine war. The UK economic outlook also deteriorated rapidly. As a report showed eurozone inflation at 8.1% in the 12 months to May, ECB President Christine Lagarde said they expect negative interest rates to end by September 2022. The ECB held an unscheduled meeting to alleviate concerns that higher borrowing costs for indebted countries could destabilise the eurozone – the ECB said it would come up with a plan to control sovereign yields. On June 30, indebted Italy sold government 10-year bonds at 3.47%, the highest yields since 2014. The EC reduced its growth forecasts for the EU and euro area for 2022 to 2.7% from 4% previously and said inflation would exceed 6% over the year. A report showed the eurozone economy grew 0.6% in the first quarter. In the UK, the Bank of England raised its key rate for a fifth consecutive month by 0.25%, to boost the key rate to 1.25%, and warned the economy would contract. In political news, Emmanuel Macron in April defeated Marine Le Pen in the French presidential elections, to make Macron the first head of state to be re-elected since Jacques Chirac in 2002. But in June France was said to have become 'ungovernable' when Macron's centrist Ensemble (Together) alliance lost its parliamentary majority in general elections that saw the far left and far right thrive, the first such defeat for a president in the fifth republic that began in 1958.

Japan's Nikkei 225 Index shed 5.1% as a report showed the Omicron variant caused growth to contract at an annualised rate of 1% in the first quarter and an energy crisis loomed. Australia's S&P/ASX 200 Accumulation Index dived 12% after iron ore prices slid and the Reserve Bank of Australia raised its key rate by 0.75% in two steps to combat inflation running at 5.1%, as the Australian Labor Party in national elections secured government after nine years in opposition. China's CSI 300 Index jumped 6.2% as Beijing implemented monetary and fiscal stimulus and large cities reopened after lockdowns enforced under a zero-covid policy. The MSCI Emerging Markets Index tumbled 12% in US dollars as the higher US dollar put pressure on countries with large debts denominated in the US currency and a global economic slowdown loomed.

Fund Commentary

The portfolio posted a negative return for the quarter. Among the biggest detractors were the investments in Alphabet, Microsoft and Intercontinental Exchange. Alphabet, the parent of Google, dropped after first-quarter revenue growth of 20% disappointed high expectations due to poorer-than-expected ad sales in Europe and on YouTube. Microsoft slid on news the EU is probing allegations the software giant has too much market power in the cloud-computing-services market. Intercontinental Exchange fell after it announced it agreed to acquire Black Knight, a software, data and analytics company that serves the mortgage industry, for US$13.1 billion in cash and stock. While the deal will likely take over a year to receive regulatory approval, in our view, it will be a positive transaction for the group as it digitalises the mortgage market.

The biggest contributors were our investments in Reckitt Benckiser, McDonald's and WEC Energy. The three are defensive and resilient businesses in the deteriorating economic outlook we face. All reported excellent results for the first quarter, beating market expectations and benefiting from strong pricing power and thus pass-through of cost inflation. McDonald's is also benefiting from the reopening of economies post the peak of covid-19 as patronage returns to its restaurants. WEC Energy, a US utility that supplies electricity and gas to Midwestern states, operates in a supportive regulatory environment and benefited from strong demand for gas during the US winter and growth in its 'rate base'.

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

DIAGEO

In the mid-2010s, UK-based distiller Diageo invested in proprietary technology tools to uncover growth opportunities and improve returns on marketing spending. The analysis revealed the US was a ripe market for premium tequila, an alcoholic brew made from the blue agave plant that flourishes around the town of Tequila in the western Mexican state of Jalisco. Tequila volumes in the US doubled from 2003 to 2015, as Hispanic influence took hold and millennials-come-mixologists began making margaritas or sipping the liquid straight.

Diageo's key step in its campaign to penetrate the high-end US tequila market came in 2017 when the company spent US$1 billion (including a US$300-million 'earn-out' based on sales) to acquire Casamigos tequila, a company founded four years earlier by US actor George Clooney and two others. Casamigos, which translates to 'house of friends' in Spanish, was the fastest-growing (40%+) 'super premium' tequila in the US. With the purchase, Diageo added Casamigos, which Clooney still promotes, to its tequila portfolio that includes complementary brands such as Don Julio.

By 2021, the campaign's success was obvious. Diageo's 'organic net sales' of tequila in fiscal 2021 had soared 79% from the previous year, numbers that meant tequila sales comprised 8% of the company's organic net sales. (This sales measurement excludes the effects of currency translation and takeovers and divestments.) The company subsequently announced it would spend US$500 million to expand production in Jalisco where it has two tequila plants.

Thanks to strategic portfolio adjustments such as this, Diageo has outperformed peers in the US, which accounts for nearly 60% of group operating profit. Globally, the owner of Baileys Irish Cream liqueur, Captain Morgan rum, Johnnie Walker whisky, Tanqueray gin and Smirnoff vodka posted sales of 12.7 billion pounds in fiscal 2021, an increase of 12% from the year earlier.

Diageo, whose spirits hold the No. 1 spot in six of the nine biggest spirit categories, extends beyond spirits. The company brews beer including Guinness, makes wine and offers ready-to-drink (pre-mixed) options. All up, the company boasts more than 200 global, local, and luxury brands that are sold in more than 180 countries. Through a 34% stake in LVMH's Moët Hennessy, Diageo stretches into the high-end cognac and champagne categories.

Spirits represent about 80% of Diageo's revenue – scotch generates 25% of Diageo sales, while vodka accounts for 10%. Beer brings in about 15% of sales while other categories such as ready-to-drink products and wine generate the remainder. In terms of locations, the company sources about 40% of sales in North America, 20% in Europe (including Turkey) and another 20% in Asia Pacific.

The modern history of Diageo, which can trace its start to 1759 when Arthur Guinness leased a brewery in Ireland, began in 1997 when Guinness and GrandMet merged. This union and subsequent bolt-on acquisitions have created a company with three key competitive advantages.

The first is that Diageo owns the best brands for which consumers are prepared to pay a premium. Spirits variants are distinguishable in terms of flavour, production process, provenance, and vintage. Such points of differentiation allow distillers to charge higher prices for luxury categories. Johnnie Walker's 18-years-to-produce Black Label scotch, for instance, sells at 3.7 times the price of Johnnie Walker Red Label whisky.

Diageo's second competitive advantage is that it has secured superior access to distribution channels. Bars, bottle shops, pubs, restaurants and supermarkets have finite space to display drinks. They favour brands that sell quickly and deliver higher margins. They want brands that can be supplied and restocked by a reputable and reliable company such as Diageo.

The third advantage is Diageo has the turnover to achieve economies of scale in advertising, data analytics, distribution, manufacturing, research and development and procurement of ingredients. Lower average costs mean competitive pricing and higher margins.

Diageo's three key advantages mean that the company is likely to generate superior returns for the foreseeable future, the attribute that stocks must possess to enter the Magellan global portfolio.

To be sure, Diageo faces challenges. Hot categories such as tequila inevitably attract competition. Celebrities Dwayne Johnson (the Rock) and Kendall Jenner have launched tequila brands in recent years that they promote via their widely followed Instagram accounts. There is a risk that this could dent category returns, as new brands take market share and prompt existing players to increase their marketing spending. The counterargument to this point is that new celebrity-backed brands generate buzz for the category, and they typically compete based on product differentiation rather than unhealthy price competition. Diageo must be quick to adapt to fresh competitive threats and new industry trends, as the company did when it stormed the top end of the tequila category in the US in 2017.

Sources: Dunn & Bradstreet, company filings and Bloomberg.

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