Fund Update: 31 March 2022

MAGELLAN
EXPERTS IN GLOBAL INVESTING

Magellan Global Fund (Open Class) (Managed Fund)

ARSN: 126 366 961

Ticker: MGOC

Fund Facts

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 $11,109.4 million / $2.4730 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 (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.

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	142
Average excess return (% p.a.)	-3.2	1.2	1.0	3.7
Outperformance consistency	8%	64%	72%	82%

Fund Performance^

	Fund (%)	Index (%)+	Excess (%)
1 Month	-2.8	-0.7	-2.1
3 Months	-12.4	-8.2	-4.2
1 Year	1.1	11.7	-10.6
3 Years (p.a.)	6.6	12.9	-6.3
5 Years (p.a.)	10.6	12.8	-2.2
10 Years (p.a.)	14.0	14.5	-0.5
Since Inception (p.a.)	10.8	7.4	3.4

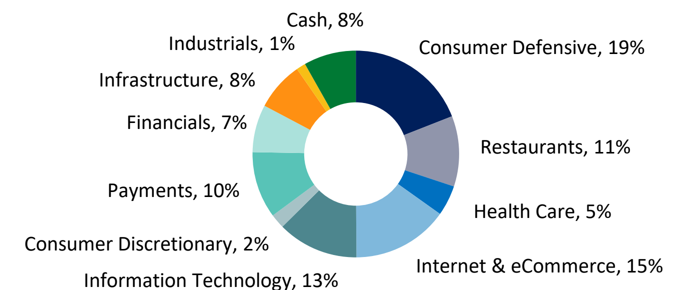
Capital Preservation Measures**

Adverse Markets	3 Years	5 Years	Since Inception
No of observations	6	13	55
Outperformance consistency	67%	69%	75%
Down Market Capture	0.7	0.6	0.5

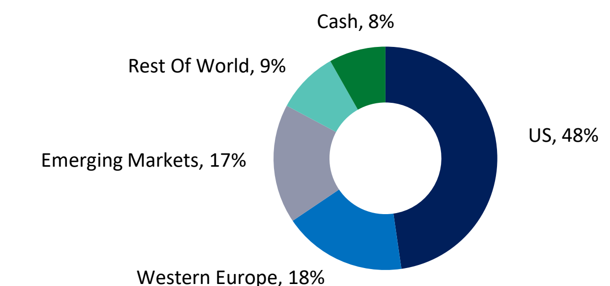
Top 10 Holdings

	Sector#	%
Microsoft Corporation	Information Technology	8.2
Alphabet Inc	Internet & eCommerce	6.7
Visa Inc	Payments	5.6
Pepsico Inc	Consumer Defensive	4.8
MasterCard Inc	Payments	4.8
Intercontinental Exchange Inc	Financials	4.2
Yum! Brands Inc	Restaurants	3.9
McDonald's Corporation	Restaurants	3.9
Novartis AG	Health Care	3.9
Nestle	Consumer Defensive	3.8
	TOTAL:	49.8

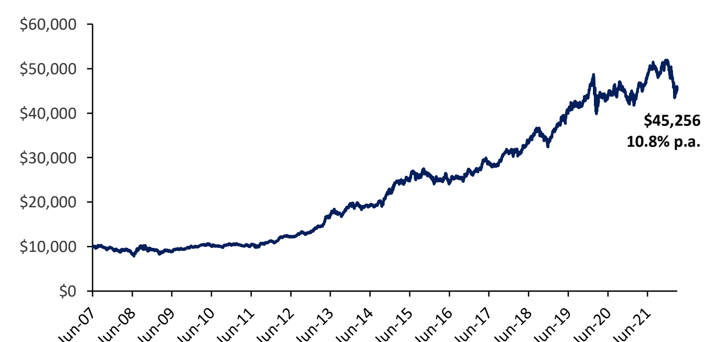
Sector Exposure by Source of Revenue#



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).
** Risk measures are calculated after fees. An adverse market is defined as a negative three-month return rolled monthly for the MSCI World Net Total Return Index (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. Exposures may not sum to 100% due to rounding.

Market Commentary

Global stocks tumbled in the March quarter after Russia's invasion of Ukraine heightened uncertainty about the global economic outlook and boosted energy and grain prices in a world where inflation is at decade highs, and the Federal Reserve embarked on the first of an expected series of rate increases to quell US inflation which is at its highest in 40 years. During the quarter, eight of the 11 sectors fell in US-dollar terms. Consumer discretionaries (-11%) plunged the most while energy (+30%) soared most. The Morgan Stanley Capital International World Index dropped 5.2% in US dollars and 8.2% in Australian currency.

US stocks slid as bond yields surged, companies said higher inflation would curb margins and investors readied for up to another 11 US rate increases by the end of 2023. Inflation reached 7.9% in the 12 months to February, the fastest pace since 1982. Soon after, the Fed raised the US cash rate by 0.25% from close to zero. Projections released after the central bank's policy-setting board meeting showed the median board member expects to authorise another 11 rate increases of 25 basis points by the end of 2023 that would lift the key rate to 2.8%. Fed Chair Jerome Powell further boosted bond yields when he warned the central bank might increase the cash rate in steps of 50 basis points if inflation stayed high. The S&P 500 Index lost 4.9%.

European stocks fell as higher inflation prompted the European Central Bank to warn it would tighten monetary policy even though the Russian invasions of Ukraine raised prospects of a eurozone recession, boosted energy and grain prices and prompted sanctions designed to wreck Russia's economy. Eurozone inflation accelerated to a record high of 5.8% in the 12 months to February. The ECB signalled it was more worried about high inflation than slowing economic growth when it said it would phase out its bond-buying program by September or even sooner, overriding previous guidance the purchases would last until October at least. The Bank of England in March lifted its key rate by 0.25% to 0.75%, marking three rate increases in three months, to curb inflation that reached 6.2% in the 12 months to February, its highest in three decades. The Euro Stoxx 50 Index plunged 9.2%.

Japan's Nikkei 225 Index lost 3.4% amid global uncertainty. Australia's S&P/ASX 200 Accumulation Index, however, gained 2.2% as commodity and energy prices rose, reports showed the economy was strong, and the government delivered a generous budget as it readied for an election in May. China's CSI 300 Index dived 14.5% after covid-19 infections prompted lockdowns, investors speculated that sanctions against its ally Russia could spread to China and after a crisis in property slowed economic growth to a 12-month rate of 4% in the December quarter. The MSCI Emerging Markets Index lost 7.3% in US dollars as Russia's economic outlook collapsed and there was talk that higher US bond yields would lead to sovereign defaults.

Fund Commentary

Performance

Over the quarter, the portfolio recorded a return of -12.4% while the MSCI World Net Total Return Index delivered a return of -8.2%. We appreciate that investors expect the portfolio to provide downside protection through most market declines. We believe that recent portfolio changes will strengthen the portfolio’s ability to attain the strategy’s long-term objectives of competitive returns while avoiding permanent capital loss. The fund’s long-term returns have been achieved by assembling a portfolio of resilient businesses that produce compounded returns that are acquired at what we regard as a material discount to their long-term prospects.

The March quarter was characterised by outsized share-price responses to any earnings announcements that surprised investors. The fund is a long-term investor in businesses with above-average long-term prospects. Thus, the fund is well positioned for the long term, even allowing for volatility in shorter term share-price movements.

During the quarter, three portfolio holdings announced earnings results and provided updated outlooks that contained unexpected earnings downgrades. These were Netflix, Meta Platforms and Starbucks:

- Netflix fell over 30% during the quarter after the streaming service said it expected near-term subscriber growth to slow and profit margins to narrow.
- Meta fell over 30% after the owner of Facebook offered only a weak revenue forecast due to Apple privacy restrictions inhibiting the reach and effectiveness of its advertising and its Facebook site suffered its first drop in regular users in part due to the popularity among the young of TikTok.
- Starbucks faced a number of issues during the quarter and dropped over 20%. Starbucks has a significant exposure to China and the covid-19 issues that plague consumption have held back sales, while in the US Starbucks is more exposed to wage inflation than its franchise-model counterparts (such as other portfolio holdings McDonald's and Yum! Brands). Additionally, the CEO resigned with Howard Schulz (co-founder and prior CEO) inserted as Interim CEO and subsequent to quarter-end the company has announced the suspension of its sizeable buyback program.

While these near-term share price falls have been amplified in the current environment, the value of the long-term compounding of returns remains extremely attractive for advantaged businesses over longer horizons despite short-term volatility. For example:

Company	10 Year Local Return (p.a.)	10 Year Multiple	No. of Drawdowns > -10%*
Microsoft	28%	12x	15
Visa	23%	8x	13
Yum! Brands	11%	3x	15

* >-10% Drawdown finishes when there is a recovery of >10% and then resets for the next observation.

Portfolio

The portfolio offers an exposure to companies that we consider are advantaged with highly attractive long-term business prospects that are relatively insensitive to geopolitical and economic cycles. Provided that we continue to be disciplined with valuation, we believe this can translate into above-average long-term returns for investors.

We are not complacent and remain vigilant in assessing the investment cases for the businesses we own and watching for any shift in long-term opportunities and portfolio changes over the quarter were primarily driven by three thematics.

The first thematic was to further increase the portfolio's tilt to geographies offering relatively attractive growth prospects. We believe the US is the best-positioned region owing to very strong private sector balance sheets and its reopening. Consequently, the portfolio entered positions in Lowe's and Diageo (Diageo is UK-listed however is experiencing very strong growth in North America which contributes close to 40% of sales) and increased its positions in Visa, Mastercard and McDonald's. The US's outlook contrasts with that of China, where government policies such as covid-zero and regulatory crackdowns are likely to weigh on growth. The portfolio trimmed the portfolio's positions in Starbucks and Yum! Brands, while exiting Alibaba Group. The portfolio no longer has any direct investments in Chinese-domiciled companies.

The second thematic was management of interest-rate risk as central banks signalled an acceleration in policy tightening. The portfolio entered positions in US Bancorp and Lloyds as their earnings benefit from increased interest rates, while it trimmed its exposure to companies whose valuations are most sensitive to interest rates such as utilities (Eversource, WEC Energy and Xcel Energy) and Netflix, whose earnings are further into the future than most companies.

The third thematic was a reshaping of the portfolio's defensive company holdings. This partly reflected the actions just described, but also our desire to increase the diversity of businesses in an environment of slowing growth. The portfolio entered a position in HCA Healthcare.

Elsewhere, the portfolio trimmed its position in SAP as we have incrementally less conviction in returns at prevailing prices. We further reduced our position in Meta Platforms as we have ongoing concerns around regulatory change, revenue growth and margin risks.

Outlook

More persistent than expected, inflationary pressures are causing central banks to accelerate their tightening of monetary policy. This was a key source of investment market uncertainty and volatility in the quarter, and it is likely to persist in the short term. Russia's invasion of Ukraine was an additional source of uncertainty and amplified inflationary pressures while placing downward pressure on the growth outlook.

Major turning points in monetary policy have historically only occurred once or twice a decade and have two broad impacts on investment returns. The first is slower growth, which will ultimately weigh on earnings growth. The second is elevated uncertainty around the economic and earnings outlooks, with these outlooks more sensitive to other shocks.

In the medium term and beyond, we think investors should be prepared for market returns that are below those recorded in the past 20 or so years. The global economy remains structurally low growth and low inflation, resulting in structurally low interest rates. What has changed is a steep rise in government debt and potentially a greater acceptance of central-bank-financed government deficits.

Overall, the short- to medium-term outlook for markets is more uncertain than usual. As a result, the portfolio holds cash at 8%.

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

Stock Story: Nestlé

Vrimp, the vegan alternative to shrimp, is made from peas, seaweed and konjac root, a vegetable found in Asia. The vEGGie, a vegan egg, is a mixture of soy protein and omega-3 fatty acids. Wunda is a pea-based alternative milk. Offered too are the Vuna, a vegan tuna alternative, and vegan burgers, while an experiment is underway to make vegan chicken that comes with fake skin and bones. These products add to the plant-based dairy alternatives for chocolate, coffee, creamers, ice cream and malt beverages. Such are newest offerings of the Swiss-based Nestlé, the world’s biggest food and drinks maker, as it responds to the latest twist in consumer demand.

The innovation drive extends to the staples that bring in so much of Nestlé’s revenue, which reached 87.1 billion Swiss francs in fiscal 2021, a jump of 7.5% on an organic basis from 2020 and the fastest pace in 13 years.

Coffee (26% of fiscal 2021 sales) has benefited from the launch of Starbucks at Home, a tie-up with Starbucks and Nespresso, and innovation in Nescafé instant coffee. Bean selection is now approached in much the same way as wine makers grade grapes and there’s an organic option. Providing high-quality flavour at scale isn’t easy. In 2021 Nestlé scientists discovered two novel plant varietals of the coffee tree that produces Robusta beans. The result is a jump in yields by up to 50% and lower carbon emissions; as a result, people can enjoy a super-premium barista blend in their soluble coffee. Every second of every day, the world enjoys another 5,500 cups of Nescafé, including the premium Nescafé Gold.

Innovation in pet care (18% of sales) has become personalised (animalised?) with science aiding the production of healthy high-end labels. In many parts of the world, even where production volumes achieve economies of scale, Fido can receive a personalised blend of dog food and supplements delivered to the home with his name stamped on the front.

For house pets so inclined, there's a pet food line where insects and plant protein from fava beans and millet are mixed with meat. Pet carers are considered too. Improved online ordering means people can buy pet food in bulk without the need to lug it home.

KitKat was revitalised by a marketing campaign in Japan in 2014 that exploited how the Japanese pronunciation of KitKat (kitto katto) resembles the phrase 'you will win' (kitto katsu). Owing to that success, KitKat now has stand-alone stores across the globe. These 'KitKat bars' offer almost countless flavours including a vegan option (KitKat V) and let people devise their own recipes – 'create your break'.

Such is the revamp of a company with a history stretching to 1866 since Mark Schneider became CEO in 2017. Key drivers of success under Schneider include a switch into healthier products such as plant-based foods and vitamins and supplements, and a focus on novel products with faster times to market for the latest offerings. Schneider has also reshaped the company's portfolio of assets by conducting some 85 divestments and acquisitions over the past five years.

Nestlé shares are trading around a record high set in November last year because investors recognise that an overhauled company with great brands is enjoying a virtuous cycle kicked off by digitalisation. The enhanced consumer insights improve innovation, which leads to the creation and successful launch of better products produced at economies of scale that bestow an unassailable competitive advantage on the company.

Nestlé has 31 'mega-brands' including Coffee mate, Haagen-Dazs ice cream, Maggi noodles, Milo, Nescafé, Nesquik, Nespresso, Purina pet care and San Pellegrino mineral water. Each has loyal consumers, which means these products command a premium price and superior access to supermarket shelves. Each generates global sales of more than one billion Swiss francs every year.

Nestlé, in all, boasts 2,000-plus brands that are sold in 186 countries, and many hold the No. 1 or No. 2 positions in their categories. The brands are split across seven segments. These are in order of fiscal 2021 sales: powdered & liquid beverages (28%), pet care (18%), nutrition & healthcare (15%), prepared dishes & cooking aids (14%), milk products & ice cream (12%), confectionery (9%) and water (5%).

Nestlé's great brands mean the company has steady cash flow and earnings streams no matter the state of the economy. As such, the stock has a 'defensive' appeal, which is why it's held up better than most during the market-wide share slide so far in 2022. Since Nestlé is well positioned to achieve its organic sales growth target of 4% to 6% in coming years, the stock is likely to generate superior returns for investors for a long while yet.

To be sure, Nestlé products face ferocious competition. Some products (confectionery) are struggling to boost sales. But the success of coffee and pet foods make up for these laggards. The health push exposes the food manufacturer to charges of hypocrisy because many of its goods are unhealthy and cannot easily be made wholesome. But the company is out to reduce that percentage with new product offerings, acquisitions of healthy brands and increased vitamin fortification in emerging markets. For all its global reach, Nestlé is overexposed to a downturn in the US, where it sources about 33% of its sales and profits. The company has warned that higher costs for its agricultural ingredients, packaging, energy and shipping threaten margins. Russia's invasion of Ukraine has intensified that challenge, especially that wheat and energy prices are rising. However, as a third of sales come from premium products, and its economies-of-scale advantage keeps unit costs low, Nestlé is better placed than most of its peers to manage and pass on rising costs in time.

A business that has changed so much since two Americans established the Anglo-Swiss Condensed Milk Company 156 years ago (that eventually merged with a company Henri Nestlé founded to sell milk-based baby food one year later) is used to overcoming challenges. If Nestlé can make such a successful start even to going vegan (sales of 800 billion Swiss francs in fiscal 2021), what can't it do?

Sources: Company filings and website, Bloomberg News and Dunn & Bradstreet.

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