Fund Update: 30 September 2021

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 $14,064.1 million / $2.7012 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 Thomson Reuters IRESS	MGOC AU Equity MGOC.AX MGOC.AXW	MGOCIV Index MGOCAUiv.P 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	136
Average excess return (% p.a.)	0.0	2.2	1.5	4.1
Outperformance consistency	42%	78%	77%	86%

Fund Performance^

	Fund (%)	Index (%)+	Excess (%)
1 Month	-4.2	-3.0	-1.2
3 Months	0.4	3.9	-3.5
1 Year	7.6	27.8	-20.2
3 Years (p.a.)	10.2	13.2	-3.0
5 Years (p.a.)	13.8	15.1	-1.3
10 Years (p.a.)	16.4	16.1	0.3
Since Inception (p.a.)	11.7	7.8	3.9

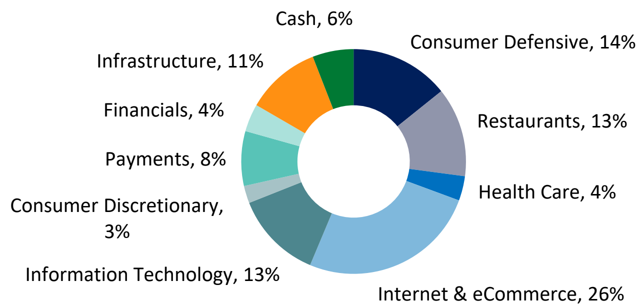
Capital Preservation Measures**

Adverse Markets	Last 36 Months	Last 60 Months	Since Inception
No. of observations	8	12	53
Outperformance consistency	100%	83%	77%
Down Market Capture	0.3	0.4	0.5

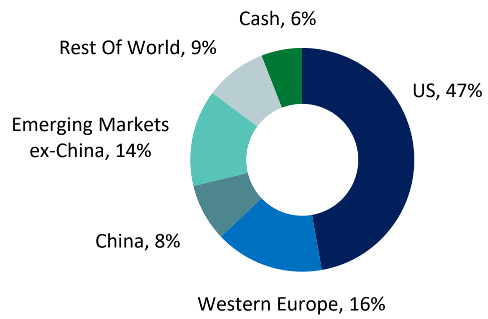
Top 10 Holdings

	Sector#	%
Microsoft Corporation	Information Technology	8.4
Alphabet Inc	Internet & eCommerce	6.7
Facebook Inc	Internet & eCommerce	6.4
Netflix Inc	Internet & eCommerce	5.8
Starbucks Corporation	Restaurants	5.4
Visa Inc	Payments	4.5
Yum! Brands Inc	Restaurants	4.5
SAP SE	Information Technology	4.3
Pepsico Inc	Consumer Defensive	4.2
Intercontinental Exchange Inc	Financials	4.0
	TOTAL:	54.2

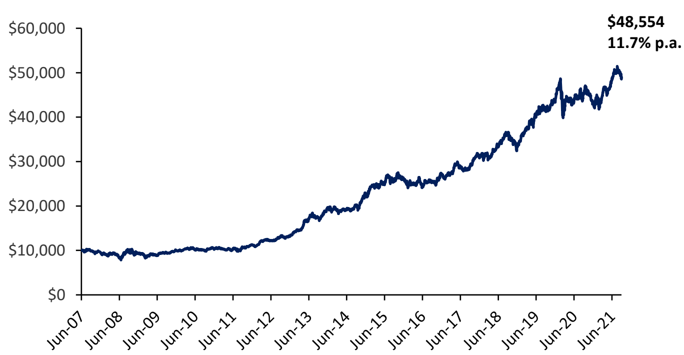
Sector Exposure by Source of Revenue#



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 after fees in AUD and rolled monthly, with 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 NTR 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 ended the September quarter almost unchanged, to end a run of nine rising quarters in 10. Stocks reached record highs over the first two months of the quarter after the Federal Reserve said it wouldn't overreact to higher inflation readings, US companies delivered better-than-expected earnings reports for the second quarter, and the eurozone and Japanese economies returned to growth. But these gains eroded in September after inflation concerns grew, rising interest rates reduced the value of future profits, Congress failed to lift the US debt ceiling or pass more stimulus, worries emerged about China's economy, energy prices soared in Europe and covid-19 infections rose worldwide. During the quarter, seven of the 11 sectors fell in US-dollar terms. Materials (-5.0%) fell the most on China concerns while financials (+2.1%) rose most as higher interest rates helped bank margins. The Morgan Stanley Capital International World Index fell 0.01% in US dollars and gained 3.9% in Australian currency.

US stocks edged up as investors baked in expectations that monetary policy would stay loose for a while yet. In a key speech in August, Fed chair Jerome Powell emphasised that rate increases were a long way off and the central bank was conscious of the economic hit stemming from surging delta cases. In September, however, Powell said inflation might last longer than thought and that while the central bank is unlikely to hike rates anytime soon it might announce plans to taper "soon". On the fiscal side, the House of Representatives failed to pass President Joe Biden's US$4.5 trillion agenda as Democrats squabbled though Congress passed a measure that kept the US government funded until December 3. Republicans in the Senate blocked moves to raise the US debt ceiling and thus kept alive the possibility the US could default, insisting Democrats had the numbers to lift the ceiling through the budget-reconciliation process. A boost for stocks was that almost 90% of companies beat expectations for the second quarter, the highest percentage of 'beats' since Refinitiv began keeping such records in 1994. Backing the Fed's view, investors regarded reports that showed consumer prices rising at a pace of about 5.3% in the 12 months to August as most likely driven by temporary supply constraints. The S&P 500 Index added 0.2%.

European stocks fell as German inflation notched a 29-year high when it reached 4.1% in the 12 months to September (while eurozone inflation stood at 3.0% in the 12 months to August), business confidence dropped, and a fresh wave of covid-19 infections threatened. In better economic news, a report showed the euro area's economy expanded a revised 2.2% in the June quarter, after shrinking 0.3% in the previous three months. In political news, Germany's left-leaning Social Democrats won the greatest voting share in the general election and looked to be in the stronger position to form a coalition government with party leader Olaf Scholz as chancellor. The Euro Stoxx 50 Index eased 0.4%.

Japan's Nikkei 225 Index added 2.3% after the economy expanded a faster-than-expected 0.5% in the second quarter, after contracting in the previous three months, as Fumio Kishida became prime minister after Yoshihide Suga quit unexpectedly. China's CSI 300 Index slumped 6.8% as property developer Evergrande threatened to default, the delta variant spread, key indicators showed the economy is slowing, producer prices reached their highest since 2008, and regulators homed in on technology companies. Australia's S&P/ASX 200 Accumulation Index rose 1.7% as companies reported healthy earnings for the period to June 30 and an end loomed for the Melbourne and Sydney lockdowns. The MSCI Emerging Markets Index dived 8.8% in US dollars as China's economy slowed and Brazil's central bank raised the key rate to 6.25% from 2% at the start of the year and signalled another increase of 100 basis points in October to slow surging inflation.

Index movements are in local currency terms.

Fund Commentary

The portfolio recorded a positive return for the quarter. The biggest contributors were the investments in Netflix, Alphabet and Microsoft. Netflix gained after its 19% jump in revenue from a year earlier to US$7.3 billion highlighted its success, some of its new titles proved popular, and in anticipation of the release of new seasons of popular shows in the coming months that had been delayed due to covid-19. Alphabet surged after the parent of Google posted a higher-than-expected profit of US$21.7 billion in the June quarter after online advertising rebounded. Microsoft beat expectations when the software giant reported revenue of US$46 billion for the June quarter, an increase of 21% on a year earlier, and CEO Satya Nadella said the performance showed the jump in tech spending since the pandemic began was not a one-off but indicated that businesses were digitising their operations.

The biggest detractors were the investments in Alibaba Group, Tencent Holdings and Crown Castle International. Alibaba dropped after Chinese authorities cracked down on tech with a focus on antitrust, security and inequality issues. Tencent slumped amid this crackdown that restricts gaming by children and saw the cyber-regulator fine the company for sexually suggestive content while antitrust authorities fined Tencent for unfair practices and ordered the company to end exclusive music-licensing deals. Crown Castle, a US-based owner of telecom towers, fell as rising interest rates undermined stocks that investors consider bond proxies.

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

Stock Story: Microsoft

Microsoft

For Microsoft, October 4 just gone was to be a notable day. The software company had marked the first Monday of this month as return-to-the-office day for its US staff. But the fourth wave of covid-19 tearing through the US ruined such hopes and the office reopenings across the country were postponed indefinitely.

It's probably one of the few events businesswise that has not gone Microsoft's way during the pandemic. Microsoft, along with many other tech companies, has thrived during the health crisis as government restrictions and self-imposed isolation prompted people to work from home, forced students to sit virtual lessons and compelled just about everyone to hang out more on the internet to amuse themselves or shop.

For Microsoft, working from home boosted demand for hardware and software. Among the most notable was Teams, a collaboration and communication app built into Office that enables in-house meetings via video, instant messaging and conference calls. In roughly the first six months of the pandemic, for instance, the numbers of active users using Teams jumped to more than 115 million a day, which meant that people spent 30 billion minutes each day on Teams, for an average of four hours per user. Another work-from-home boost for Microsoft was increased business demand for cloud services. Remote learning and being stuck at home lifted demand for video-chat resources and adequate hardware, as did time on Skype (up 220% in the early phase of the pandemic) and video games.

This accelerated switch to online helped Microsoft deliver revenue of US$168.1 billion in fiscal 2021, up 18% from 2020, and post an operating profit of US$69.9 billion (and a net income of US$61.3 billion).

But don't give too much credit to the pandemic. The company founded in 1975 enjoys such success largely thanks to its thriving business-oriented divisions, which is ironic for a household-name company commonly known for its consumer products, from Windows to Xbox.

One business-focused arm is the Productivity division, which generated 35% of Microsoft's operating profits in fiscal 2021, as its revenue growth accelerated to 16%. The driver here is Microsoft Office, which includes Excel, Outlook, PowerPoint, Word and now Teams, with a 90% global market share in office productivity software. These and Microsoft's other software are best-in-class products protected by the high cost and friction of switching to competing products.

The other business-focused arm is the newer Intelligent Cloud division that includes Microsoft's thriving Azure public-cloud arm, which pulled in 37% of operating profits in fiscal 2021 after a 24% increase in revenue that helped the unit tighten its top-two position in cloud. The third division, the More Personal Computing arm, generated the remainder of fiscal 2021's profits, recording a 12% jump in revenue.

But it's not just products driving Microsoft's recent success. The other ingredient is Satya Nadella, who joined Microsoft in 1992, and was made the company's third CEO in 2014 after Steve Ballmer (2000-2014) and Bill Gates (1975-2000) who resigned as chairman when Nadella took over. At the time, the software giant was criticised for having missed out on the mobile revolution and Microsoft's share price had idled for more than a decade.

Under Nadella, Microsoft has transitioned to selling more subscription and consumption services often tied to multi-year contracts, rather than one-off, upfront product licences for software. Another noticeable feature of the Nadella era has been some of the strategic takeovers. Three among the most notable swoops were on LinkedIn in 2016 for US$26 billion, GitHub, an online code-sharing platform, for US$7.8 billion in 2018 and Nuance Communications this year for US$19.7 billion to help expand the industry cloud opportunity. Other focuses in the Nadella era have been spending discipline, ensuring privacy and cybersecurity, and exploring the opportunities presented by artificial intelligence and the internet of things.

But even in the years of Ballmer as CEO, Microsoft still made substantial revenues from its business products. Such holds on business are what make Microsoft one of the world's most valuable companies (at times, the world's most valuable) and a compelling long-term investment.

To be sure, the pandemic boost is temporary. Zoom is a mighty competitor to Teams. Laptop and other device sales are being hampered by the global chip shortage and other disruptions to supply networks. The growth rate of the cloud and software businesses is likely to slow over time. Big Tech is facing regulatory threats from many angles, though Microsoft has so far avoided the worst of the scrutiny.

While the cloud and business software markets stay strong and Nadella's oversight remains discerning, Microsoft is well positioned even for a more-normal world when Microsoft and other companies have their staff back in the office.

Sources: Company filings and website.