MAGELLAN GLOBAL TRUST (MGG)

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The Magellan Global Trust is an ASX-listed trust (ASX: MGG) that invests in the world's best 15 to 35 global stocks. The fund is a core holding that aims to deliver a cash yield of 4% p.a. while delivering attractive risk-adjusted returns over the medium to long term and protecting investors from the risk of permanent capital losses.

PERFORMANCE

Global stocks rose in the 12 months to June 2019 after companies posted higher-than-expected earnings, the US economy expanded briskly without generating inflation, the Federal Reserve indicated it would stop, and possibly reverse, its gradual tightening of US monetary policy, and the European Central Bank said it would "use all the instruments that are in the toolbox" to help the eurozone's weak economy. Gains were capped by concerns global growth might slow, driven by China-US tensions and rising political uncertainty in Europe.

The portfolio recorded a return after fees of 15.9% for the 12 months. The stocks that performed best included the investments in Starbucks (+4.0% of the total portfolio return), Microsoft (+2.5%), HCA Healthcare (+2.0%), Visa (+1.9%), Mastercard (+1.8%) and Yum! Brands (+1.7%). Starbucks rose after the coffee chain spoke of plans to improve delivery in China, boosted marketing in the US to revive sales growth, posted global sales growth that topped expectations and said it would cut about 5% of the workers at its headquarters. Microsoft gained after releasing earnings results that consistently showed strong growth in cloud revenues. HCA rallied after the US hospital chain reported higher-than-expected profits and revenue due to higher patient numbers and an increase in higher-paying procedures. Visa and Mastercard benefited from sustained growth in consumer spending and greater card use in a world going more cashless. Yum! Brands rose after same-store sales and profit numbers of the owner of KFC, Pizza Hut and Taco Bell persistently outdid expectations.

The only stocks to detract from performance to any extent were Kraft Heinz (-2.7%), eBay (-0.9%) and Wells Fargo (-0.3%). Kraft Heinz staged its big tumble in the March quarter after the packaged-goods company wrote down the value of underperforming brands by US$15.4 billion, reported earnings that fell short of expectations due to higher costs, and said it was subject to a probe by regulators. Online marketplace eBay fell after the company lowered revenue forecasts amid worries about its competitive edge against Amazon. Wells Fargo fell as the US bank faced challenges to boost revenue due, in part, to the restrictions regulators have imposed following a series of scandals. We have exited Kraft Heinz, eBay and Wells Fargo.

OUTLOOK

Equity prices rose in the June quarter even though risks remain elevated.

While the likelihood of a deal between China and the US plummeted in May, an agreement to restart talks following the G20 meeting in June raised hopes that the two sides would ultimately settle their differences. This buoyed equity prices, as did central banks signalling their willingness to loosen monetary policy in order to counter risks to growth. But the risk persists that protracted China-US negotiations could undermine global growth so much the deterioration would not be offset by a deal or easier central bank settings.

We see three broad scenarios for equity markets. The first, which we rate about a 50% probability, is that there is no significant increase in US inflation or a sharp slowdown in global growth, with further rate cuts likely. Under this outcome, broad equity indexes would most likely provide satisfactory returns.

In the second scenario (25% probability), global growth slows to a level that forces central banks to respond more aggressively. Needless to say, the more growth slows, the worse it is for equity prices. The final scenario (25% probability) is that interest rates rise on inflation concerns. A spike in interest rates would weigh on the growth outlook and lift risk premiums, potentially triggering a 20% to 30% fall in equity prices.

Notwithstanding the risks confronting equities, we reduced the cash position in the strategy

Performance as at 30 June 2019 [1]

	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	7 Years (% p.a.)	10 Years (% p.a.)	Since inception (% p.a.)
Magellan Global Trust (MGG)	**15.9**	–	–	–	–	**16.2**

1 Calculations are based on the monthly ASX released net asset value with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). Fund inception date 18 October 2017. Returns denoted in AUD.

from 21% to 12% over the 12 months, allocating that cash primarily to 'defensive' stocks. This reflects our decision to adopt a lower-than-historical interest rate in our valuation models and our view that the probability of the third scenario occurring has fallen over the past six months.

PORTFOLIO POSITIONING

Top-10 holdings at 30 June 2019

Security	Weight (%)
Facebook	7.8
Microsoft	7.6
Alphabet	6.7
Starbucks	6.7
Apple	6.1
Visa	5.9
HCA Healthcare	5.8
Mastercard	5.1
Reckitt Benckiser	3.8
Yum! Brands	3.6
Total	**59.1**

Notwithstanding our cautionary outlook, we expect that our portfolio of 22 high-quality businesses to generate a satisfactory return over the medium to long term.

Capitalism is brutal. Typically, excess profit opportunities are competed away in short order. Investing in companies unable to defend against capitalism's relentless march is not compatible with our objectives. High-quality businesses, however, are the rare subset of the investment universe because they have an ability to resist the natural forces of capitalism, and sustainably generate excess returns and appreciate in value over the long term. We refer to companies possessing this quality as having an 'economic moat' or sustainable competitive advantage.

In addition to the realities of capitalism, as the pace of technology change around the world accelerates, many traditional industries are facing increasing disruption risks. At the same time, the changing world presents opportunities. The tides of disruption will buoy certain industries and business models while threatening others. And if the world experiences a long-term future of more modest growth and lower inflation, businesses that benefit from enduring, structural tailwinds—those businesses that can generate compounding returns for an extended period—are likely to become increasingly valuable.

Recognising the forces of capitalism, disruption and compounding, we seek to build a portfolio of investments in advantaged and undervalued businesses that will be on the right side of history over the long term.

The core investment themes in our portfolio at 30 June 2019 were:

- Enterprise-software companies (Microsoft, Oracle and SAP) that comprised 14% of the portfolio. These companies are deeply integrated within the operations of their business customers, which lowers the risk these customers will switch software vendors. They are benefiting from the transformational growth in cloud computing.
- Payment-platform companies (Visa, Mastercard and American Express) that represented 14% of the portfolio. These are classic 'network effect' business models that connect millions of merchants with billions of cardholders. These companies provide the 'rails' upon which global electronic payment systems run.
- Advertising technology-platform companies (Alphabet, the owner of Google, and Facebook) that represented 15% of the portfolio. These companies benefit from the shift in marketing expenditure from traditional media properties to digital platforms.
- Healthcare companies (HCA Healthcare, Novartis and Reckitt Benckiser) that represented 12% of the portfolio. These companies benefit from ageing populations that spend more on healthcare. Consumers place a high value on trusted brands for health-related products, lowering the risk of disruption.
- The Chinese consumer (Starbucks and others) that comprised 8% of the portfolio. The Chinese middle class is forecast to double in size over the next five to 10 years with the high-end cohort growing even faster. These companies are benefiting from this expanding consumer class and deriving 50% or more of their future revenue growth from the Chinese consumer.
- An investment in Apple that represented 6% of the portfolio. We believe that Apple is a highly advantaged consumer-services platform with high consumer loyalty and a long-term opportunity to monetise the one billion Apple devices in use.
- A 12% holding in cash (held in US dollars).

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