Fund Update: 31 December 2021

Magellan High Conviction Fund

ARSN: 164 285 947

Fund Facts

Portfolio Managers	Hamish Douglass and Chris Wheldon
Structure	Global Equity Fund
Inception Date	Magellan High Conviction Fund Class A: 1 July 2013 Magellan High Conviction Fund Class B: 15 November 2017
Management Fee[1]	Magellan High Conviction Fund Class A: 1.50% per annum Magellan High Conviction Fund Class B: 0.78% per annum
Buy/Sell Spread[1]	0.07%/0.07%
Fund Size	AUD $653.5 million
Distribution Frequency	Semi-annually
Performance Fee[1]	Magellan High Conviction Fund Class A: 10% of the excess return of the units of the Fund above the Absolute Return performance hurdle (10% per annum). Magellan High Conviction Fund Class B: 20% of the excess return of Class B Units above the Absolute Return performance hurdle (10% per annum). The performance fee for Class B Units is subject to a cap of 2.22% per annum. Performance fees are subject to a high-water mark.

[1]All fees are inclusive of the net effect of GST

Fund Features

- Unconstrained, long-only, highly concentrated
- High quality global equity strategy
- High individual stock exposure – 8 to 12 stocks
- Typical cash exposure between 0% - 50%
- $10,000 minimum initial investment.

3 Year rolling returns (measured monthly)^*

Against the 10% p.a. Return Objective	1 Year	3 Years	5 Years	Since Inception
No of observations	12	36	60	67
Average excess return (% p.a.)	1.6	3.5	3.5	3.6
Outperformance consistency	83%	92%	93%	94%

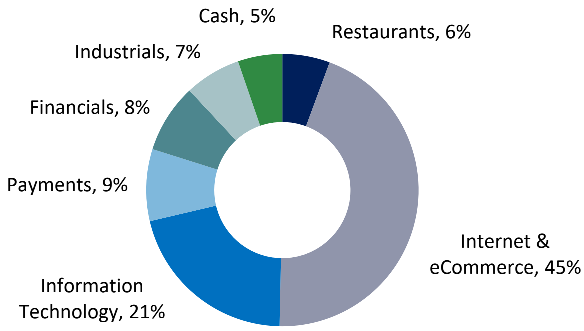
Fund Performance^

	Magellan High Conviction Fund – Class A (%)	Magellan High Conviction Fund – Class B (%)	Magellan Global Fund (Open Class) (Managed Fund) (%)	Magellan Global Fund (Hedged) (%)
1 Month	0.0	-0.1	3.1	5.5
3 Months	4.2	4.2	6.4	7.0
1 Year	20.8	21.1	19.3	13.4
3 Years (p.a.)	15.2	15.4	15.2	15.1
5 Years (p.a.)	14.3	-	13.9	13.2
7 Years (p.a.)	12.6	-	12.6	11.0
Since Inception (p.a.)	14.8	12.1	-	-

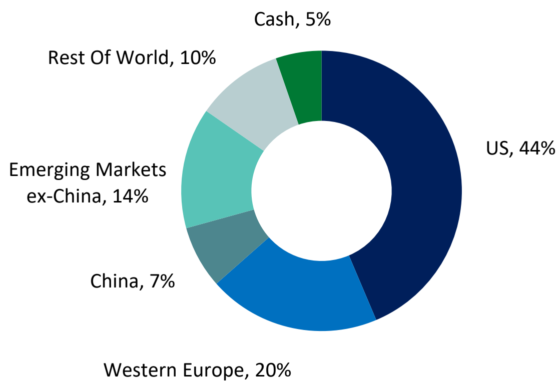
Top 5 Holdings

In alphabetical order	Sector#
Alphabet Inc	Internet & eCommerce
Meta Platforms Inc	Internet & eCommerce
Microsoft Corporation	Information Technology
Netflix Inc	Internet & eCommerce
Visa Inc	Payments

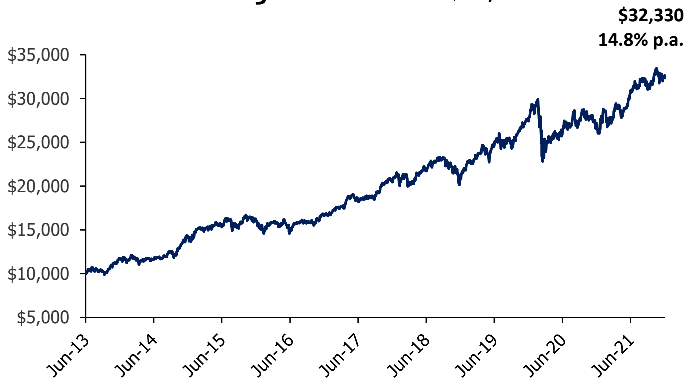
Sector Exposure by Source of Revenue#



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 2013. Returns denoted in AUD.
* 3-year returns are based on the Magellan High Conviction Fund - Class A, calculated and rolled monthly in AUD, with the outperformance consistency indicating the percentage of positive excess returns since inception.
# 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 surged to record highs in the December quarter as concerns abated about the economic damage of the new Omicron covid-19 variant, US companies posted stellar earnings reports, and US Congress postponed a debt-ceiling showdown and passed more stimulus. The rise occurred even though the Federal Reserve decided to reduce its asset purchases after US inflation reached a 39-year high and inflation accelerated worldwide. During the quarter, 10 of the 11 sectors rose in US-dollar terms. Information technology (+13.2%) rose the most while communication services (-1.7%) was the sector that fell. The Morgan Stanley Capital International World Index rallied 7.8% in US dollars, to be up 21.8% for 2021. In Australian dollars, the index gained 7.1% in the quarter and 29.3% over the year.

US stocks climbed as better jobless numbers and encouraging reports on earnings, especially from the banks and Big Tech. A report showed consumer prices climbed 6.8% in the 12 months to November, the most since 1982. In response, the Federal Reserve said it would accelerate its 'tapering' of monthly bond purchases. The central bank said it would prune its asset buying such that in January it would buy only US$60 billion of Treasuries and mortgage-backed securities compared with US$120 billion a month pre-tapering, while most Fed policymakers said they were prepared to raise the US cash rate three times in 2022. While reports showed an economy at full employment (the jobless rate fell to a pandemic low of 4.2% in November), the US economy expanded at a revised annualised rate of only 2.3% during the September quarter. In political news, the House of Representatives, over the unanimous opposition of Republicans, passed the US$2.2 trillion Build Back Better Act only for the centrepiece of President Joe Biden's domestic agenda to be blocked in the Democrat-controlled Senate. The House, with some Republican support, approved a US$1.2 trillion infrastructure package that had already passed the Senate. A proposal to raise the federal government's borrowing limit by US$2.5 trillion passed both chambers of Congress just before the December 15 deadline. The S&P 500 Index soared 10.6%, to up 26.9% for 2021.

European stocks advanced on encouraging earnings results and improved economic news. A report showed the eurozone economy expanded 2.2% in the September quarter after pandemic restrictions eased, the same speed it grew in the June quarter. A report that showed eurozone inflation reached 4.9% in the 12 months to November proved no dampener after the European Central Bank indicated it would not overreact to rising prices. The Euro Stoxx 50 Index added 6.2% over the quarter and 21% over 2021.

Japan's Nikkei 225 Index lost 2.2% in the quarter, reducing 2021's gain to 4.9%, as the new covid-19 variant prompted authorities to close the national border to foreigners and a report showed the economy shrank a larger-than-expected 0.9% in the September quarter, a contraction that prompted the re-elected Liberal Democrat government to promise US$350 billion in fresh fiscal stimulus. Australia's S&P/ASX 200 Accumulation Index rose 2.1% over the quarter (and 17.2% over 2021) as iron ore prices recovered and governments eased pandemic restrictions.

China's CSI 300 Index edged up 1.5% over the quarter (to be down 5.2% for 2021) on talk the regulatory crackdown on tech stocks has peaked. A report showed the pandemic had slowed economic growth to a 12-month rate of 4.9% in the September quarter. The MSCI Emerging Markets Index shed 1.7% in US dollars over the quarter and 4.6% over the year as emerging countries were hit harder by the new variant.

Index movements are in local currency.

Fund Commentary

The portfolio recorded a positive return in the quarter. The biggest contributors included the investments in Microsoft and Intercontinental Exchange. Microsoft surged on a 22% jump in revenue for the third quarter as its cloud business benefited from the global shift to remote work. Intercontinental Exchange rose as energy derivative volumes climbed on the back of rising energy price volatility.

The biggest detractors were the investments in Alibaba Group and Meta Platforms. Alibaba dropped after the Chinese tech company announced sales figures that disappointed for a second straight quarter and lowered its fiscal outlook for 2022, which fanned concerns about slowing consumer spending in China. Still, Alibaba announced a 29% rise in revenue for the September quarter and forecast 20% to 23% growth in fiscal 2022 revenue, rather than the 27% analysts were expecting. Meta fell after the renamed Facebook warned revenues in the fourth quarter will be knocked further by Apple's privacy changes that restrict its ad-targeting, its third-quarter revenues fell short of expectations on Apple's restrictions, and the company faced a public-relations blow and possible legal difficulties after a former employee exposed issues at the social-media company and that it was losing younger audiences.

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

Stock Story:
Intercontinental Exchange (ICE)

In 1997, Jeff Sprecher of the US, who had spent years developing power plants, decided to provide transparent pricing to the US power market. Well before electronic trading of financial securities became the norm, Sprecher paid US$1 for a tech start-up so he could build a web-based trading platform.

For three years, Sprecher and his team met oil, natural-gas and power companies to learn what people sought in a trading platform. Some of the innovations that resulted included pre-trade credit limits, counterparty credit filters and electronic trade confirmations – novelties taken for granted now. By 2000, the trading platform was set for launch. Sprecher renamed the shell company Intercontinental Exchange to highlight the trading platform's ability to cross oceans, let alone borders.

In 2001, the International Petroleum Exchange of London wanted to evolve from floor to electronic trading. At the time, the exchange was a regional one that offered oil futures contracts and had less than 25% share of the global oil futures market. Intercontinental Exchange, which promotes itself as ICE, saw an opportunity to branch into energy futures and clearing and purchased the exchange. Thanks to the ability of ICE's platform to increase price transparency, handle high volumes efficiently and lower transaction costs, the volume of oil futures traded on what is now called ICE Futures Europe swelled. A regional exchange grew into a global one.

From 2007, the year ICE listed (with the ticker ICE), the company went on a buying spree of exchanges. The company snared the New York Board of Trade, which barters commodities such as cocoa, coffee and cotton, ChemConnect, which trades chemicals, and the Winnipeg Commodity Exchange, now ICE Futures Canada that mainly trades canola. A sign of ICE's ambitions was the company's failed bid that year for the commodities-based Chicago Board of Trade.

Undaunted, the ICE takeover quest continued such that ICE, which earned US$6.6 billion in revenue in fiscal 2020, owns an exchange arm that boasts 12 global exchanges and six clearing houses that service the energy, agricultural and financial sectors. The haul includes the purchase in 2013 of the New York Stock Exchange, the world's biggest by volume. Among feats, ICE hosts nearly 66% of the world's traded oil futures contracts and is the world's leading clearer in energy and credit defaults. On top of that, ICE's exchange arm manages key global benchmark contracts. This list includes Brent oil, Euribor, natural gas, sterling short and long rates and sugar barometers of performance.

In recent years, ICE has branched out such that the exchange business, which brought in 55% of ICE revenue in fiscal 2020, is one of three divisions. The second arm, responsible for 27% of revenue in fiscal 2020, is the fixed income and data services business that sells data and technology to help investors make and execute decisions. ICE assess prices for roughly three million fixed-income securities spanning about 150 countries in 73 currencies, as well as providing advanced analytics and indexes for fixed-income markets.

ICE's other business is mortgage technology, which pulled in the remaining 18% of revenue in fiscal 2020. This arm has digitalised the mortgage process to reduce costs and increase efficiencies. The ICE mortgage business is the largest to automate the entire process, is the industry's leading platform with more than 3,000 customers, partners and investors, and the industry's only loan registry. This platform offers significant growth potential as more US mortgage originators are expected to turn to ICE's digitised offering.

ICE is a promising investment in three ways. The first is that the exchanges and other businesses possess sustainable competitive advantages that form a daunting 'moat' for the parent company – where moat is a colloquial way to say a company is protected from competition. Most of ICE's earnings are derived from trading and clearing fees from the exchange businesses and linked data. These businesses are moated because they enjoy economies of scale, network effects and industry structure that intimidate would-be competitors. Another moat for ICE is that when it comes to derivatives and listing, there are limited substitutes. The holder of benchmark contracts is favoured in negotiations, even if others are seeking to undercut on price.

A second advantage ICE enjoys is that the company is vertically integrated – it controls the execution and clearing of contracts. This enables the company to exert pricing power, attract volumes, and improve counterparty and systemic risk management.

The other advantage that makes ICE an attractive investment is the company is well managed. While ICE has a history of disrupting others, the Sprecher-led team has prevented ICE being disrupted. Management has steered the business towards attractive industry structures (derivatives exchanges), unique data sources and value-add analytics. As important, the team has largely directed ICE away from equities exchanges, where regulation and technology have upended the pricing power and volumes over the past 15 years. All up, ICE is well placed to provide compounded returns for its investors for the foreseeable future.

ICE, as do all businesses, faces risks. One is that the company's revenue is tied to trading volumes over which it has little influence. The fact that trading volumes often increase in turbulent and falling markets means that ICE is well placed to weather a market slump that falls short of a prolonged 'bear market' where trading was light. ICE's other risk is that its business is exposed to adverse changes to regulations. Moves by regulators to separate execution and clearing, and actions that might reduce trading volumes, would disrupt ICE's revenue. ICE is protected to some extent in this regard because regulators are aware that such moves against exchanges, especially ones that feature large derivatives trading, would boost trading costs, hamper innovation and, possibly, increase systemic risks.

ICE, thus, is well placed in a world where Sprecher's vision has helped electronic trading become the norm.

Sources: ICE filings and company website.