Magellan High Conviction Funds

MAGELLAN HIGH CONVICTION FUND CLASS A | APIR: MGE0005AU
MAGELLAN HIGH CONVICTION FUND CLASS B | APIR: MGE9885AU
MAGELLAN HIGH CONVICTION TRUST (MANAGED FUND) | TICKER: MHHT

MAGELLAN ASSET MANAGEMENT

AS AT 31 MARCH 2023

PORTFOLIO MANAGERS NIKKI THOMAS, CFA AND ALAN PULLEN

INVESTMENT PHILOSOPHY

To invest in outstanding companies at attractive prices, while exercising a deep understanding of the macroeconomic environment to manage investment risk.

OBJECTIVES

To achieve attractive risk-adjusted returns over the medium to long-term.

PORTFOLIO CONSTRUCTION

A concentrated portfolio of 10-20 high quality companies meaningfully diversified in risk exposure and correlations seeking to achieve strong risk-adjusted, not benchmark-relative returns.

Typical cash and cash equivalents exposure between 0 - 50%.

INVESTMENT RISKS

All investments carry risk. While it is not possible to identify every risk relevant to an investment in a fund, we have provided details of risks in the relevant Product Disclosure Statement or offer document. You can view the PDS for the relevant fund here www.magellangroup.com.au

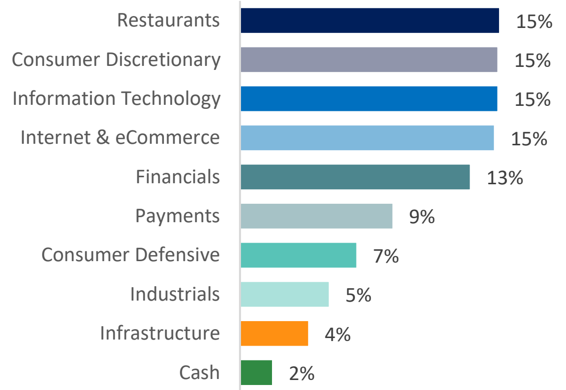
MAGELLAN HIGH CONVICTION FUNDS: KEY PORTFOLIO INFORMATION

TOP 5 HOLDINGS

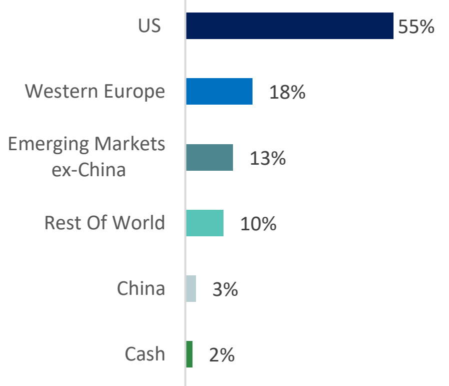
STOCK	SECTOR[1]
Microsoft Corporation	Information Technology
Intercontinental Exchange Inc	Financials
Yum! Brands Inc	Restaurants
Visa Inc	Payments
Booking Holdings Inc	Consumer Discretionary

Holdings based on the Magellan High Conviction Fund. Exposures in the Magellan High Conviction Trust may slightly vary.

SECTOR EXPOSURE BY SOURCE OF REVENUE[1]



SECTOR EXPOSURE BY SOURCE OF REVENUE[1]



Exposures based on the Magellan High Conviction Fund. Exposures in the Magellan High Conviction Trust may slightly vary.

CALENDAR YEAR PERFORMANCE[2]

	CYTD (%)	2022 (%)	2021 (%)	2020 (%)	2019 (%)	2018 (%)	2017 (%)	2016 (%)	2015 (%)	2014 (%)
Magellan High Conviction Fund - Class A	12.5	-27.8	20.8	-2.4	29.6	3.4	23.3	3.5	13.6	19.8
Magellan High Conviction Fund - Class B	12.7	-27.3	21.1	-1.9	29.2	3.3	-	-	-	-
MHHT	12.6	-27.7	21.2	-1.6	-	-	-	-	-	-

Past performance is not a reliable indicator of future performance.

[1] 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.

[2] 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). Returns denoted in AUD. Calendar year returns exclude any initial part-year returns. Magellan High Conviction – Class A inception date is 1 July 2013 (inclusive), Magellan High Conviction – Class B inception date is 15 November 2017 (inclusive), Magellan High Conviction Trust inception date is 11 October 2019 (inclusive).

MAGELLAN HIGH CONVICTION FUND – CLASS A | ARSN 164 285 947

TICKER	FUND SIZE	NAV PER UNIT	BUY/SELL SPREAD	MANAGEMENT AND PERFORMANCE FEES[3]	INCEPTION DATE
-	AUD $187.8 million	$1.7886 per unit	0.07% / 0.07%	1.51% p.a. and performance fee of 10% of excess return^	1 July 2013

PERFORMANCE[4]

	1 MONTH (%)	3 MONTHS (%)	1 YEAR (%)	3 YEARS (% p.a.)	5 YEARS (% p.a.)	7 YEARS (% p.a.)	Since Inception (% p.a.)	OUTPERFORMANCE CONSISTENCY⁺
Magellan High Conviction Fund - Class A	7.9	12.5	-4.1	2.1	5.2	7.5	10.4	78%

CALENDAR YEAR RETURNS	CYTD (%)	2022 (%)	2021 (%)	2020 (%)	2019 (%)	2018 (%)	2017 (%)	2016 (%)	2015 (%)	2014 (%)	2013 (part year)
Magellan High Conviction Fund - Class A	12.5	-27.8	20.8	-2.4	29.6	3.4	23.3	3.5	13.6	19.8	17.7

Past performance is not a reliable indicator of future performance.

PERFORMANCE CHART GROWTH OF AUD $10,000[4]

Past performance is not a reliable indicator of future performance.

3 Transaction costs may also apply – refer to the Product Disclosure Statement. All fees are inclusive of the net effect of GST.
4 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). Returns denoted in AUD.
^ 20.0% of the excess return of Class A Units of the Fund above the Absolute Return hurdle of 10% per annum. Additionally, Performance Fees are subject to a high water mark.
⁺ Outperformance consistency indicates the percentage of positive excess returns for rolling 3 year returns since inception.

MAGELLAN HIGH CONVICTION FUND – CLASS B | ARSN 164 285 947

TICKER	FUND SIZE	NAV PER UNIT	BUY/SELL SPREAD	MANAGEMENT AND PERFORMANCE FEES[3]	INCEPTION DATE
-	AUD $45.0 million	$1.1099 per unit	0.07% / 0.07%	0.78% p.a. and performance fee of 20% of excess return^^	15 November 2017

PERFORMANCE[4]

	1 MONTH (%)	3 MONTHS (%)	1 YEAR (%)	3 YEARS (% p.a.)	5 YEARS (% p.a.)	Since Inception (% p.a.)	OUTPERFORMANCE CONSISTENCY[+]
Magellan High Conviction Fund - Class B	8.0	12.7	-3.4	2.7	5.6	5.2	41%

CALENDAR YEAR RETURNS	CYTD (%)	2022 (%)	2021 (%)	2020 (%)	2019 (%)	2018 (%)	2017 (part year)
Magellan High Conviction Fund - Class B	12.7	-27.3	21.1	-1.9	29.2	3.3	1.0

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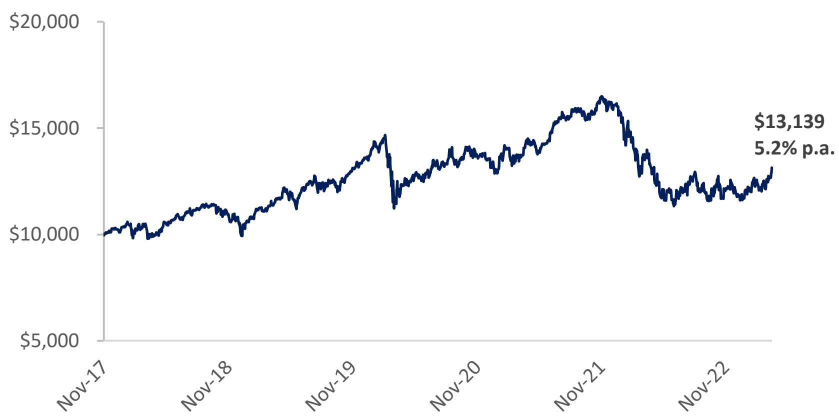
PERFORMANCE CHART GROWTH OF AUD $10,000[4]



Past performance is not a reliable indicator of future performance.

[4] 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). Returns denoted in AUD.

[3] Transaction costs may also apply – refer to the Product Disclosure Statement. All fees are inclusive of the net effect of GST.

^^ 20.0% of the excess return of Class B units of the Fund above the Absolute Return hurdle of 10% per annum. Additionally, Performance Fees are subject to a high water mark. The performance fee for Class B Units is subject to a cap of 2.22% per annum.

[+] Outperformance consistency indicates the percentage of positive excess returns for rolling 3 year returns since inception.

MAGELLAN HIGH CONVICTION TRUST (MANAGED FUND) (ASX: MHHT)| ARSN 634 789 754

TICKER	FUND SIZE	NAV PER UNIT	BUY/SELL SPREAD[5]	MANAGEMENT AND PERFORMANCE FEES[3]	INCEPTION DATE
MHHT	AUD $464.9 million	$1.4147 per unit	0.07% / 0.07%	1.50% p.a. and performance fee of 10% of excess return[#]	11 October 2019

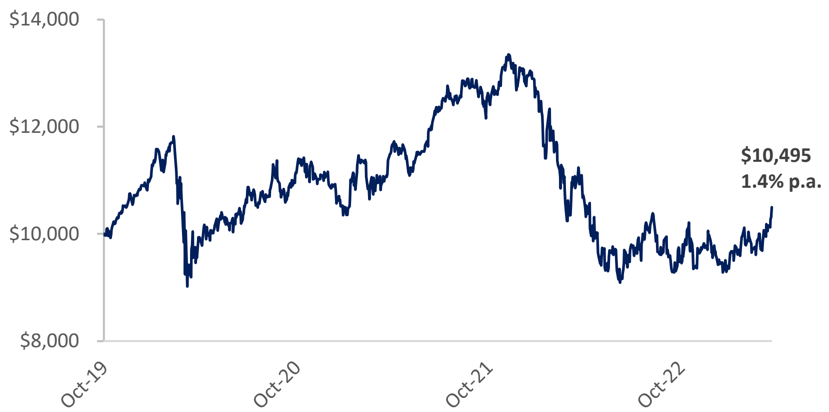
PERFORMANCE[4]

	1 MONTH (%)	3 MONTHS (%)	1 YEAR (%)	3 YEARS (% p.a.)	Since Inception (% p.a.)
MHHT	8.0	12.6	-4.0	2.5	1.4

CALENDAR YEAR RETURNS	CYTD (%)	2022 (%)	2021 (%)	2020 (%)	2019 (part year)
MHHT	12.6	-27.7	21.2	-1.6	8.2

Past performance is not a reliable indicator of future performance.

PERFORMANCE CHART GROWTH OF AUD $10,000[4]



Past performance is not a reliable indicator of future performance.

[3] Transaction costs may also apply – refer to the Product Disclosure Statement. All fees are inclusive of the net effect of GST.

[4] 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). Returns denoted in AUD.

[5] Only applicable to investors applying for units and withdrawing units directly with the Responsible Entity.

[#] 10.0% of the excess return of the Trust above the Absolute Return hurdle of 10% per annum. Additionally, Performance Fees are subject to a high water mark.

Market Commentary

Global equities have started the 2023 year rising in the first quarter in all major regions though the rally is notably narrow. The MSCI World NTR Index rose 7.7% in USD and 9.1% in AUD, with two key developments – the public launch of ChatGPT, bringing artificial intelligence (AI) to the masses, and a banking crisis that started in the US and spread. On the economic front, there continued to be low unemployment, solid personal income growth and a softening of inflation across the developed world. In local currency terms, 8 of the 11 industry sectors rose, with the information technology (+21.0%), communication services (+17.9%) and consumer discretionary (+16.1%) sectors performing the best. Falls were led by the energy sector (–3.8%), financials (-1.9%) and health care (-1.9%) as commodity prices fell and a banking crisis saw several banks fail and major steps taken by regulators to avert deepening instability.

The S&P 500 Index rose 7.0% in the first quarter of 2023. The US Federal Reserve raised the cash target rate a further 50bp to a 4.75% to 5% target range in two 25bp increments, slowing its pace of increase. With the rise in interest rates by 450bp since the start of this tightening cycle a year ago, the impact on slowing inflation and slowing economic growth is starting to become more apparent, though recent data on US economic growth has remained resilient and ahead of expectations. One clear sign that the sharp move higher in interest rates has consequences was the collapse of Californian-based Silicon Valley Bank, after a run on its deposits led to its inability to meet liquidity needed. The crisis escalated across other smaller US banks and then to Credit Suisse in Europe before the regulators' responses finally worked to avert a systemic crisis. To do this, they provided liquidity to banks on generous terms and galvanised major banks to intervene to help reduce stress in the system.

The Euro Stoxx 50 rose 13.7% this quarter to be just shy of the high of January 2022. This has occurred despite the ongoing war in Ukraine, still elevated, albeit improving, levels of inflation across Europe, ongoing interest rate increases by the European Central Bank and the bank sector stresses noted above. Encouraged by regulators, UBS took over Credit Suisse in March given its pending collapse.

Across the Asian region, Japan's Nikkei 225 Index rose 7.5%, Australia's S&P/ASX 200 Accumulation Index gained 3.5%, China's CSI 300 Index rose 4.6% and the MSCI Emerging Markets Index added 3.5% in US dollars. Japan has a new Bank of Japan Governor, Kazuo Ueda, and his policy decisions, particularly the shift away from Yield Curve Control, will be closely watched, given the implications for global money flows. China continues its committed, albeit chaotic, reopening and cut the Reserve Requirement Ratio for its banks in March to help with efforts to revitalise economic growth. Geopolitical tensions between China and the US were again evident during the quarter, including the cancelling of a visit by the US Secretary of State to Beijing and the coordinated widening of restrictions on the export of advanced semiconductor machinery to China.

Fund Commentary

The portfolio rose over 10% during the March quarter with our holdings in Booking, Microsoft, Alphabet, Chipotle and Amazon leading the way higher. Each of these rose by over 20% in the quarter except Alphabet, which rose by 15%. The significant events of the start of 2023, particularly the banking crisis, has accelerated the pricing of peak rates and recession fears. The portfolio held no exposure to banks and benefited from this. The lessening of risk to higher long-term bonds and concerns of greater economic slowdown have seen the backdrop move strongly in favour of the characteristics we seek for the High Conviction strategy.

In addition, the long-term total addressable market opportunity that we believe is evident for many of our holdings came back into focus as OpenAI launched ChatGPT to the public, acquiring 100m users in just eight days. Artificial intelligence is not a new phenomenon with about 20 large foundational models in existence, including Microsoft, DeepMind, Meta, Nvidia, and the Allen Institute. OpenAI's ChatGPT brought a user interface that did several things; it presented a conversational logic that follows on and has contextual linking; it did not dump blocks of text answers but instead typed out answers word by word, giving the appearance of a person responding; and it was made open to the public.

Microsoft, already an investor in OpenAI, moved swiftly to invest a further $10B and lock up future ownership optionality. It has since added CoPilot to several products and rolled out the new Bing. The opportunity for commercial gains across its business from AI have become increasingly evident to investors.

Initially Alphabet struggled as investors worried Microsoft had 'stolen a march' on it and Bing would take search share from Google (and Alphabet bungled the initial showcase of its AI). We believe Alphabet has a strong position in advertising and Cloud that it can commercialise successfully, and this is not a two-horse race to be won by one. Alphabet, Microsoft and Amazon are also all facing near-term headwinds as Cloud spend is optimised by their clients and this has forced a meaningful reduction of headcount and other costs to be undertaken. We expect the very near-term quarterly results will remain soft as they each work through the rectification of overbuilt cost structures and instil greater discipline, but we consider this will ensure better margins and profitability in the not-too-distant future.

Booking is an online travel agency that we beileve is well positioned to benefit as travel gathers strength across the world. Asia is just moving into a stronger period of reopening and business travel is steadily coming back as borders open and more flights become available. The ongoing return of long-haul travel opens up additional short-haul flight corridors and activities. Chipotle Mexican Grill is a high-quality Mexican food chain (Guzman & Gomez copied the concept in large part) that has an ambition to grow its restaurant footprint by 8% to 10% p.a. for many years. It delivers strong returns on the capital it deploys this way and, as food inflation settles lower, we believe there is room for it to attain strong margin benefits or reinvest to drive traffic. Either way, our view is that its strong long-term compounding growth is evident.

Amazon is also addressing its cost structure to rightsize after overinvesting in the pandemic period when it saw exceptional revenue growth. As growth has returned to trend, the company has had to cut staff levels, reduce fulfilment space and, for AWS, respond to its customers' needs to optimise spending.

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

Outlook

It certainly appears that markets have 'climbed the wall of worry' during 1Q2023, though it is fair to reflect that the overall indices' strengths have been heavily influenced by a few stocks. As the banking crisis broke in March, we were reminded that we have been on crisis watch for some months now; history tells us that significant and rapid monetary policy tightening tends to break things. We would anticipate the tightening to be almost complete (with perhaps one last 25bp increase for the Federal Reserve?) with the Australian Reserve Bank pausing its rate increases as we write. We believe inflation will continue to be the core focus as central banks work to bring inflation down to target levels and we will need to continue to see lower inflation datapoints over 2023 if Central Bank rate rises are to pause.

A systemic crisis in banking has been averted but it seems plausible, if not probable, that further breakages may lie ahead. Analysis of insurance company holdings, commercial real estate and refinancing risks on maturing debt as well as those more exposed to a contraction of lending, especially by smaller banks, will be ongoing. There will be increased regulation of banks in the US and it is likely credit growth has been impaired by the events of recent weeks, laying the case for less economic growth in the months ahead. The risk that these pressures may ultimately translate into an economic recession in many parts of the world is elevated but the depth of the slowdown remains unclear.

Labour markets are lagging indicators and are unhelpful for gauging progress on wage inflation. It is notable that layoffs in the US have picked up and are spreading much further afield than the large numbers being reported for many technology companies. Where surveys collect data on inflation expectations, such as by the University of Michigan, we note that these remain anchored as consumers anticipate current high inflation will fall. Annualised, the month-on-month increase in core PCE inflation data for February is at 3.7%, suggesting improvement in headline figures will continue.

On another positive note, the recent difficulties for financials and progress on inflation likely bias the risks to the long end of the yield curve, or 10-year government bond yields, to stay in the recent range, and below 4% in the US. This is a positive for the valuations of longer-duration investments, especially those with strong cash flows and high returns on capital. The backdrop in which we find ourselves once again feels like one in which the Magellan strategy is advantaged. Our process leads us to highly advantaged companies that are balanced within the portfolio between those with strong secular growth tailwinds and those with low economic sensitivity and resilience.