

Magellan High Conviction Fund

ARSN: 164 285 947

Fund Facts

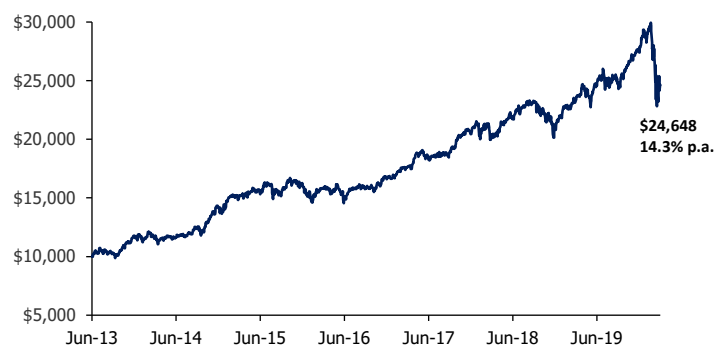
Portfolio Manager	Hamish Douglass and Chris Wheldon
Structure	Global Equity Fund
Inception Date	Magellan High Conviction Fund Class A: 1 July 2013 Magellan High Conviction Fund Class B: 15 November 2017
Management Fee ¹	Magellan High Conviction Fund Class A: 1.50% per annum Magellan High Conviction Fund Class B: 0.78% per annum
Buy/Sell Spread ¹	0.07%/0.07%
Fund Size ²	AUD \$551.1 million
Distribution Frequency	Annually at 30 June
Performance Fee ¹	10.0% of the excess return of the units of the Fund above the Absolute Return performance hurdle (10% per annum). Additionally, the Performance Fees are subject to a high water mark.

¹All fees are inclusive of the net effect of GST²Includes High Conviction Fund Class A and High Conviction Fund Class B units

Fund Features

- Unconstrained, long-only, highly concentrated
- High quality global equity strategy
- High individual stock exposure – 8 to 12 stocks
- Ability to actively hedge currency exposures, currently 26% hedged to AUD*
- Maximum cash position of 50%
- AUD \$10,000 minimum initial investment.

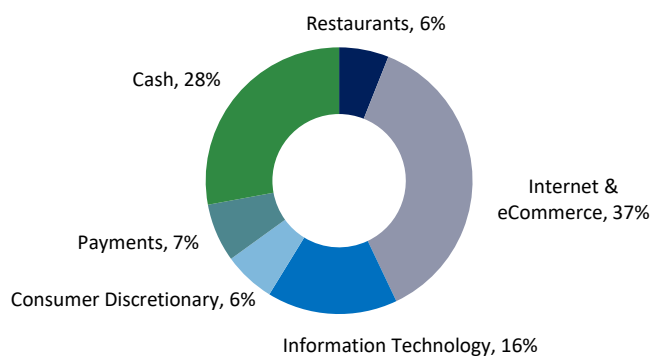
Performance Chart growth of AUD \$10,000*



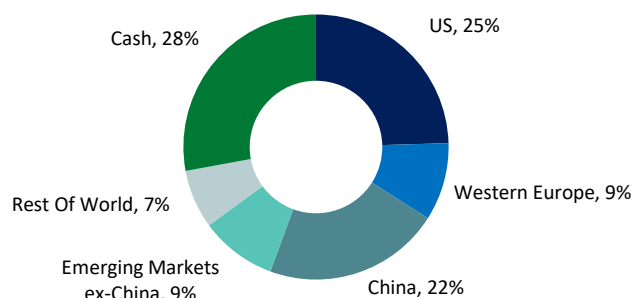
Top 5 Holdings

In alphabetical order	Sector [#]
Alibaba Group Holding Ltd	Internet & eCommerce
Alphabet Inc	Internet & eCommerce
Facebook Inc-A	Internet & eCommerce
Microsoft Corp	Information Technology
Visa Inc	Payments

Sector Exposure by Source of Revenue[#]



Geographical Exposure by Source of Revenue[#]



Fund Performance*

	Magellan High Conviction Fund - Class A (%)	Magellan High Conviction Fund - Class B (%)	Magellan Global Fund (%)	Magellan Global Fund (Hedged) (%)
1 Month	-9.4	-9.3	-4.0	-9.9
3 Months	-10.1	-10.0	-1.2	-14.6
6 Months	-0.9	-1.3	1.9	-9.1
1 Year	6.0	6.0	14.8	-2.5
3 Years (% p.a.)	11.8	-	16.1	7.4
5 Years (% p.a.)	10.3	-	11.7	7.2
Since Inception (% p.a.)	14.3	8.5	-	-

* The Fund is currently exercising its ability to hedge some of the capital component of the foreign currency exposure of the Fund arising from investments in overseas markets back to Australian dollars.

* 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. Magellan High Conviction Class B inception 15 November 2017. Returns denoted in AUD.

* 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 in the three months ended March 31st staged their biggest quarterly decline in more than 10 years after the coronavirus that causes the illness called covid-19 escaped from China and battered global economic activity, corporate earnings and investor sentiment to such an extent the pandemic threatened to usher in a global recession. During the quarter, all 11 sectors dived in US-dollar terms. Energy (-45%) declined the most after Saudi Arabia and Russia commenced an oil price war while healthcare (-12%) fell least. The Morgan Stanley Capital International World Index fell 21% in US dollars – its biggest quarterly drop since the global financial crisis struck in the December quarter of 2008 – but lost only 9.3% in Australian currency due to this currency's depreciation.

US stocks fell as companies withdrew guidance as authorities enforced lockdowns, shut service industries and told people to 'self-isolate' as the virus took hold across the 50 states but with particular venom in New York. Emergency fiscal stimulus and radical monetary easing failed to arrest the economic emergency that some commentators said could lead to at least a 10% decline in GDP in the June quarter. Congress passed a package worth US\$2 trillion to help households and businesses cope. The Federal Reserve in two unscheduled steps in March cut the US cash rate by 150 basis points to near zero, promised unlimited bond buying to stabilise government and corporate credit markets and announced a US\$300 billion program to lend to US companies. Neither stopped a record 3.28 million people from claiming unemployment insurance in the week ended March 21, up 3.0 million from the week before and more than four times the previous record of 695,000 in October 1982. In political news, former vice president Joe Biden all but clinched the Democratic Party's nomination to contend the presidential election against Donald Trump in November by winning most of the primaries held in March after the party's establishment united to defeat the bid by self-described socialist Bernie Sanders. The S&P 500 Index plummeted 20% after reaching a record high in February due to robust earnings reports.

European stocks sank as the coronavirus epidemic took hold, especially in Italy, Spain and France, German politics became unsettled and reports showed the eurozone economy was struggling even before the virus hit. Towns in northern Italy were quarantined in February after they formed the first area in Europe to experience a stream of infections from the novel coronavirus but such steps failed to spare Italy or stop the spread of the pandemic across Europe. German political uncertainty rose when Annegret Kramp-Karrenbauer, the leader of the Christian Democrats, said she would not run for chancellor in next year's election, which threw open the race to succeed Angela Merkel as chancellor. A report in February showed the eurozone economy expanded only 0.1% in the fourth quarter – Germany's economy showed no growth for the three months. Reports in March, when the virus had enforced lockdowns across Europe, showed consumer confidence at a five-year low and business activity plunging – the IHS Markit purchasing managers index for Germany, for example, fell from 50.7 points in February (any figure over 50 indicates expansion) to 37.2 in March. The Euro Stoxx 50 Index plummeted 26%.

In other markets, Japan's Nikkei 225 Index dropped 20% after a report showed the economy shrank at an annualised pace of 6.3% in the fourth quarter due to an increase in the consumption tax and covid-19 posed such a threat schools were closed and large gatherings and sports events were cancelled or curtailed. China's CSI 300 Index lost 10% as measures to contain the coronavirus kept businesses and ports closed and prevented workers from returning to their jobs and the official manufacturing purchasing managers index fell to a record low of 35.7 in February from 50 in January. The S&P/ASX 200 Accumulation Index slumped 21% as authorities froze much economic activity, sparking immediate job losses, and the virus jolt to the global economy mauled material prices. The MSCI Emerging Markets Index shed 24% in US dollars on the prospect of a global recession.

Movements in benchmark indices are in local currency unless stated otherwise.

Fund Commentary

The portfolio recorded a negative return for the quarter. The biggest detractors were the investments in Yum! Brands and Facebook. Yum! Brands fell as it shuttered outlets to help stop the transmission of the virus and the company reported a 2% decline in Pizza Hut's same-store sales for the fourth quarter. Facebook fell after demand for advertising dropped amid the health and economic emergency and the prospects of a global recession prompted investors to lower earnings growth for one of the two companies that dominate digital advertising.

The biggest contributor was Microsoft. Microsoft surged to a record high over the quarter after its cloud business helped the software giant beat earnings and revenue forecasts for the fourth quarter of 2019 and then held up relatively well after it was judged a stock that would benefit from the world's switch to online due to the pandemic.

Stock story: Alibaba



Top this for a company head's farewell to staff. A tearful Alibaba co-founder Jack Ma wore oversized purple-tinged glasses, a studded leather jacket with chains and a braided long-haired wig and sang Chinese pop songs accompanied by two other co-founders, a rock-star-decked Lucy Peng, and Joe Tsai, who opted for a 'Marilyn Monroe'-style dress and a blonde wig. And these were just some of the antics at a four-hour celebration in front of 60,000 employees in September last year in the eastern Chinese city of Hangzhou to mark Ma's achievements and the e-commerce giant's 20th birthday.¹

The company that earned 377 billion yuan (US\$56 billion) in revenue in fiscal 2019 had much to celebrate. Alibaba, with more than 60% market share, is the leading e-commerce marketplace operator in China, which is one of the world's fastest-growing online retail markets thanks to rising incomes, the proliferation of smartphones and the fact that traditional western-style retailing never fully developed in the country. Alibaba's domestic consumer-to-consumer platform Taobao (launched in 2003) and its business-to-customer platform Tmall (launched in 2008) that houses the world's most valuable brands have 820 million monthly users today. The platforms generate transactions worth almost US\$950 billion a year, an amount twice that of Amazon's. Alibaba is behind the world's largest shopping event; the company's annual 'Singles Day', which on November 11 last year notched a record US\$38.4 billion in sales across Alibaba's main e-commerce sites.

And e-commerce is just one of Alibaba's businesses. The company has used the profits from its lucrative e-commerce arm to expand into other large, fast-growing and often-complementary industries. Two of its most promising businesses include Alibaba Cloud Intelligence (founded in 2009), which is one of the world's largest cloud-computing businesses, and Ant Financial (established in 2004, 33% owned by Alibaba), which is China's largest payments and digital financial services platform. In addition, Alibaba operates China's leading digital advertising platform, emerging international e-commerce platforms (AliExpress and Lazada), one of China's leading online-food delivery and local-services platforms (Ele.me), a logistics business that supports the delivery of millions of items daily (Cainiao), a grocery business pioneering online-offline integration (Hema) and a leading digital media and entertainment business (Youku). Together, these businesses are supporting enterprise digitalisation in China and, in aggregate, have helped Alibaba notch revenue growth of 48% p.a. over the past five years.

Alibaba is well placed to record impressive earnings growth in coming years. The company is positioned to benefit from

growing consumer spending in China and rising online penetration in rural cities. Network effects, user data insights, economies of scale and an ability to outspend competitors are sealing Alibaba's market supremacy across many e-commerce segments. The synergies across Alibaba's many units attract and retain people to its sites, which presents opportunities to cross-promote, hone algorithms and monetise data through targeted ads. The cloud arm, which is twice the size of its next Chinese rival, is well positioned to add to its 1.4 million paying customers that include more than half of the A-share listed companies in China and 80% of Chinese technology companies. All up, Alibaba's wide reach presents as a unique opportunity to benefit from China's digital transformation and shift to a consumption economy.

Alibaba comes with risks, to be clear. One that is common to Chinese stocks is that, to skirt government restrictions on foreign ownership of 'sensitive' businesses, foreign investors can gain exposure to Alibaba only by investing in 'variable interest entity' structures where they don't own shares in the operating companies directly. Another risk is interference from the Chinese government and its omnipotent regulatory powers. Although these market nuances create uncertainty for foreign shareholders, the probability of them transpiring into material shareholder losses for high-profile companies such as Alibaba is considered to be low, particularly given the importance of foreign capital to the Chinese economy. Another risk is that Alibaba competes for the attention and business of Chinese consumers in a dynamic market against the formidable Tencent, JD.com and Meituan-Dianping. Notwithstanding the intense competition, Alibaba is likely to deliver the earnings growth in coming years that justify its risks.

Four reporting segments

In 1999, Ma was one of 18 people who gathered in his small, shared apartment in Hangzhou to form Alibaba. The company's first initiatives were to create the English-language global wholesale marketplace Alibaba.com and a domestic-based marketplace, now known as 1688.com, for domestic wholesale trade. By the end of 2001, Alibaba.com had more than one million registered users and within another 18 months the company was profitable.

Skip to 19 September 2014 and Alibaba, after 15 years of excelling in e-commerce and branching beyond by organic investment, acquisition, forming alliances and minority investments, emerged as one of the world's most valuable technology companies, raising a record US\$25 billion for its New York Stock Exchange debut.

Alibaba's secondary listing on the Hong Kong Stock Exchange in 2019 was just as successful for the company now under CEO Daniel Zhang that reports its earnings across four key segments. The 'core commerce' division earned 86% of group revenue in fiscal 2019 from commission fees, memberships and advertising on Alibaba's e-commerce platforms. Core commerce also includes revenue generated from the sale of goods (i.e. first-party sales), primarily through Alibaba's New Retail initiative, Hema, as well as revenue generated from the provision of logistics services (through Cainiao) and local services (through Ele.me and Koubei).

¹ See Reuters. 'Tearful Ma bids Alibaba farewell with rock star show.' 9 September 2019. [reuters.com/article/us-alibaba-jackma-idUSKCN1VU0VY](https://www.reuters.com/article/us-alibaba-jackma-idUSKCN1VU0VY)

The next most important division is cloud computing, which earned 7% of Alibaba's revenue by providing cloud solutions. The unprofitable 'digital media and entertainment' segment attracted 6% revenue from membership fees and advertising. This revenue was mainly derived from Alibaba's online video platform, Youku, and online browser, UCWeb, as well as through diverse content platforms that provide film, online ticketing, music, news, literature and gaming.

The other division is the loss-making 'innovation initiatives and others' segment, which earned 1% of revenue. Within this division are found the company's operating system, navigation technology, AI-powered voice assistants and smart speakers, and enterprise-communication software, where revenue is typically generated through software or annual fees.

With so many dominant positions across so many industries likely to ensure that these four segments generate strong growth over time, the party marking Alibaba's next birthday of note could be the most bizarre yet.

Sources include company filings and website, Bloomberg and Hoover's, a Dun & Bradstreet Company.