

## MAGELLAN HIGH CONVICTION TRUST (ASX TICKER: MHH)



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The Magellan High Conviction Trust is an ASX-listed trust (ASX: MHH) that seeks to deliver an attractive risk-adjusted absolute return over the long term by investing, at an attractive price, in eight to 12 of the world's highest-quality businesses.

### PERFORMANCE

Global stocks soared to record highs in the 12 months to June 2021 after government and central bank stimulus helped economies recover from the pandemic, pharmaceutical companies hastened the economic reopenings when they developed vaccines against the virus that causes the illness known as covid-19, the new US administration of President Joe Biden used its control of Capitol Hill to implement more fiscal stimulus, investors decided the Democrats' narrow control of Congress would prevent anti-business measures becoming law, and technology stocks reported earnings that showed how much they have benefited from the shift to digital.

The portfolio recorded a return after fees of 18.1% for the 12 months. The stocks that performed best over the 12 months included the investments in Alphabet (+6.9% of the total portfolio return), Facebook (+4.2%) and Microsoft (+3.4%). Alphabet rose after its Google subsidiary's advertising revenue showed a better-than-expected rebound from the coronavirus-triggered slump and the US election outcome and a court ruling in June appeared to reduce the risk of a crackdown on Big Tech that would ensnare Google, which is already under anti-trust scrutiny by the US Department of Justice. Facebook climbed enough to record a market cap in excess of US\$1 trillion after earnings beat expectations, the social-media company said its main site has a record 2.9 billion 'active' monthly users, and a US judge in June unexpectedly dismissed two complaints against the social-media giant from the US regulator because the judge said the Federal Trade Commission failed to prove the company was a monopoly. Microsoft surged to become the first company after Apple to reach a market cap of US\$2 trillion after its

cloud business helped the software giant beat earnings and revenue forecasts and then held up relatively well when covid-19 hit because it was judged a stock that would benefit from greater online activity.

No stock declined in local-currency terms over the 12 months.

### OUTLOOK

The global economic upswing is well underway, driven by a record level of monetary and fiscal stimulus as well as a vaccine-driven reopening. However, there are two key risks.

The first is that the supply side of the economy takes much longer to recover than the demand side, leading to inflationary pressures that are larger or more persistent than expected. While we and most central banks expect inflationary pressures to be transitory, a surprise here may force central banks to tighten policy faster than expected, perhaps materially so. The second is a covid-19 mutation that requires replacement vaccines to be developed and distributed, a process that could take three to six months.

Covid-19 has not changed our longer-term economic outlook. The global economy remains structurally low growth and low inflation, resulting in structurally low interest rates. What has changed is a steep rise in government debt and potentially a greater acceptance of central-bank-financed government deficits.

The equity market outlook for the next 18 months is more challenging than usual to predict. The cyclical economic upswing and policy accommodation should support equity returns, but the two economic risks mentioned earlier could trigger a 20% or more decline in equity prices. Other potential triggers are a correction in overvalued pockets of the market such as 'meme' stocks, as this could spread to

### Performance as at 30 June 2021<sup>1</sup>

	1 year (%)	3 years (% p.a.)	5 years (% p.a.)	7 years (% p.a.)	10 years (% p.a.)	Since inception (% p.a.)
Magellan High Conviction Trust (ASX: MHH)	<b>18.1</b>	-	-	-	-	<b>12.4</b>
10% p.a objective excess	<b>8.1</b>	-	-	-	-	<b>2.4</b>

<sup>1</sup> Returns denoted in AUD. Calculations are based on net asset values with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). Trust inception date is 11 October 2019 (inclusive).

the broader equity market, or a panic in emerging markets possibly sparked by rising interest rates and a stronger US dollar.

We have reduced the cash holding in the fund from 22% to 4% in the past year. This reduction has been driven by the less uncertain market outlook, which was in turn driven by the aggressive monetary and fiscal support by central banks and governments and increased consumer and business confidence after the announcement of positive vaccine results in November.

## PORTFOLIO POSITIONING<sup>2</sup>

### Holdings at 30 June 2021

Security	Weight (%)
Microsoft Corporation	15.9
Alphabet Inc	14.3
Facebook Inc	12.4
Netflix Inc	11.2
Alibaba Group Holding Ltd	8.0
Tencent Holdings Ltd	8.0
SAP SE	7.3
Intercontinental Exchange Inc	7.1
Starbucks Corporation	6.3
Visa Inc	5.8
Cash	3.5
<b>Total</b>	<b>100.0</b>

We believe our portfolio of 10 high-quality businesses remains well positioned to generate attractive compound risk-adjusted returns over the medium to long term.

With this objective in mind, the portfolio has been constructed to provide investors with a concentrated exposure to various secular growth tailwinds and highly advantaged businesses while considering key nearer-term risks associated with higher-than-expected inflation, an escape mutation and pockets of investor risk-seeking. Portfolio positioning also reflects the longer-term challenges to economies presented by lower structural growth and a likely rise in interest rates over time.

Central to our portfolio construction, now and always, is a gravitation towards high-quality businesses available at attractive prices. It is this approach – a considered yet concentrated selection of exceptional businesses possessing a competitive moat, our best ideas, plus deliberate risk management – that provides conviction in the portfolio's ability to achieve its objective over time.

The past 12 to 18 months provided investors with another visceral reminder of the importance of a long-term orientation and of business quality. By virtue of their competitive advantages, their importance to customers and their robust fiscal positions, high-quality businesses proved resilient through the depths of events last year. As importantly, these businesses have emerged from the crisis in a more advantaged position. Given their strength and capabilities, these businesses were able to innovate and adapt while reinvesting for growth through the crisis. Many observed an acceleration in the adoption of their products and services, particularly those with any form of digital exposure. Some have business units that stand to benefit from further lifting of mobility restrictions. High-quality

businesses can weather the inevitable storms, allowing them to capitalise during calmer tides.

Embedded within our definition of business quality is an insistence that a company be on the winning side of disruptive shifts. This exposes the portfolio to businesses that can achieve growth that is less dependent on the underlying strength of the economy. The corollary is that the fundamental results of these businesses, though more attractive through the cycle, can lag companies that benefit from having a purer economic exposure during a strong recovery but whose performance will be challenged in its absence. Our approach remains to invest in businesses that have a high likelihood of success for decades to come. As always, we evaluate prospective returns in relation to the type and degree of risk we are taking.

The core investment themes in our portfolio at 30 June 2021 were:

- Advertising technology-platform companies (Alphabet, the owner of Google, and Facebook) that represented 27% of the portfolio. These companies benefit from the shift in marketing expenditure from traditional media properties to digital platforms.
- Enterprise-software companies (Microsoft and SAP) that comprised 23% 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.
- The Chinese consumer (technology-platform companies Alibaba Group and Tencent and consumer company Starbucks) that comprised 22% 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. Alibaba and Tencent are structural winners in the Chinese economy, owning the leading gaming, social media and e-commerce platforms respectively. They are also the two leading cloud-computing and digital-payment businesses in China. Western consumer businesses, like Starbucks, have strong brands and significant leverage to the growth in China's middle to upper class over time.
- Companies benefiting from technology-enabled growth (Netflix and Intercontinental Exchange) that accounted for 18% of the portfolio. Netflix is leveraged to the broad shift from pay TV to streaming video on demand, while Intercontinental Exchange's efforts to digitise the US residential mortgage process complement its resilient exchange and data services businesses.
- A payment-platform company (Visa) that represented 6% of the portfolio. Visa possesses a classic 'network-effect' business model that connects millions of merchants with billions of cardholders. It provides the 'rails' upon which global electronic payment systems run.
- A 4% holding in cash, held primarily in US dollars.



Hamish Douglass



Chris Wheldon

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