Magellan Global Quarterly Update

January 2024

Felicity Haines:

Hello, and welcome to this quarterly update for the Magellan Global Fund. My name's Felicity Haines, I'm a Key Account Manager with the Magellan team. And, today, I'm speaking with Portfolio Manager, Nikki Thomas, and Portfolio Manager and Head of Macro, Arvid Streimann. Thanks so much for joining me, Nikki and Arvid, and happy new year to you both.

Nikki Thomas:

Thanks, Flick, and to you.

Arvid Streimann:

Yeah, great to be here.

Felicity Haines:

So, Arvid, first question to you, 2023 was lead higher, but just by a smaller group of very large companies, and the interest rates were at high levels. So what turned out to be the things that mattered and didn't matter in this past year?

Arvid Streimann:

Yeah, well, Felicity, it was a really interesting year last year. So you had global equity prices up around over 20%. And as you said, they were focused in a small group of companies. And we'll get onto that in a moment. But I think what the thing which mattered last year was that that small group of companies, and a lot of other companies which did quite well, were, firstly, that they were high quality companies. Now, remember, when you've got interest rates which are higher than average, typically, that's when higher quality companies outperform. Those lower quality companies tend to outperform when there's a lot of easy money around. And that certainly wasn't the case last year. So companies which have durable business models, which are resilient to the economic cycle, they were the types of companies which did quite well.

The second thing which those companies tended to have was that there was a very powerful structural growth tailwind behind them. And we saw the rise of AI last year, and everyone couldn't stop talking about AI last year. And I would say that when you're comparing AI to what happened during dot-com, back in the late 1990s, it's very different. Because what's happening right now is that AI is being used by companies with, in a large part, companies with existing customers. And back in dot-com, it was really companies that said, "Hey, we've got a great product here and we're going to get those new customers." So I would say it was very different to what happened in the dot-com period. And when we're thinking about those big companies, the Magnificent Seven, which you were referencing earlier, I would say that they're high quality companies, by and large, and also they had that very powerful tailwind. It wasn't just so much that they were tech, I would say that it was the quality and the structural growth thematic. I would say that was what mattered.

What didn't really matter last year, I would say, that there was a lot of talk last year around a hard landing at the start of the year, and I think people have really flipped on that, consensus has flipped. But when people were thinking about the hard landing, I think they were really thinking about don't fight the Fed. And what really happened was that what the Fed was doing was they were fighting, or trying to offset, the very large fiscal stimulus that was out there. So this was a very different type of cycle. So I would say that didn't really matter, that hard landing.

One last thing, which I think some people would say doesn't really matter, I think, given that defensives underperformed last year, some people will say that defensives don't matter. And I would just remind people that there's always an economic cycle, and defensives will have their day at some point in the future. And I think that they're important for portfolio construction purposes through the cycle as well.

Felicity Haines:

Nikki, the Global Fund delivered a really pleasing return of 22% for the calendar year of 2023. Can you talk us through some of the decisions that you made for the portfolio?

Nikki Thomas:

Yeah, sure, Flick. So I guess, to start, let's frame it up. What are we trying to do? We're trying to deliver double-digit gross compound returns over the long-term, while minimizing the risk of a permanent capital loss. So that's our objective. And that grounds us every single day in terms of the decision-making that we undertake. We then narrow our universe down to high-quality companies. And the reason why we do that is it helps protect on the risk front. It keeps us away from businesses that have poor competitive exposures. And so we're looking for those companies that can win competitively in their industries. And it makes sure that we're finding the companies that are really well managed. We want to find good execution, not just a great company, but one that's being run well. So we do that. That brings us back to a smaller universe.

And then we go looking at what's going on at a macro level to make sure that we're finding the opportunities in the right places. So we're always thoughtful around economics, geopolitical backdrops, political backdrops, and, of course, the interest rate environment that we're working in. And that is really important because all corporates make decisions based on what's in front of them. So if a government changes a policy, if a central bank changes a policy, it changes the future for companies. And so they have to lean forward in the right ways.

To give you an example, the world is trying to get towards a zero carbon future. And so governments are leaning forward on that and they're saying, "If you buy a EV, we'll give you a subsidy as a consumer." Or they're saying to companies, "If you build things that relate to getting us towards zero carbon, we're going to give you some money to help you along that path." And so you have to be thoughtful about those decisions that are being made in the background to make sure you continue to lean towards the companies that are going to win. And not just find a great business, but actually they're on the wrong side of those sorts of large trends that emerge because of government and central bank policy decisions.

So last year, obviously, interest rates were an important part of how we had to think about where the portfolio winning positions were going to come from. But we always are taking this very long-term approach. And so decarbonization, digitization, and deglobalization are very simple ways of saying there are big thematics going on in the world today, often with policy support behind them. And there are companies then that are competitively advantaged in trying to extract the benefits of those shifts. And that's where we're always going to lean forward.

And then the economic cycle piece, as Arvid was just referencing, this brings a lot of volatility to certain stocks because you get leveraged to that. So it's positive volatility at sometimes, and negative volatility on other times. Because we're focused on absolute long-term returns, we tend to always run a strategy that is less than market risk. So people think about that as a beta. Market has a beta of 1. We will always have a beta below that in our portfolio because we're trying to look for the advantages of compounding. And that means we don't tend to bring huge amounts of portfolio cyclicality into this strategy because of the volatility that that brings. And it makes it harder to deliver on that compound return through time.

Felicity Haines:

Nikki, there are some companies within the portfolio that we've held for a very long time. Microsoft is one of those. And they've had a stellar year this past year. Are you still confident to hold that position, and see that there's prospects and the ability to grow?

Nikki Thomas:

Yeah, thanks, Flick. Look, we're obviously long-term investors and we do always try to look through short-term noise. We saw a bit of that affect Microsoft, actually in the prior year. So 2022 was a tough year for Microsoft as they went through a period of cloud optimization and slowing earnings growth. And that's now reaccelerating. As we look forward for Microsoft, it is unbelievably well positioned. And it's played its hand so well against this shift towards generative AI, and AI just generally. It has a preeminent position across the enterprise. Just about everybody uses Microsoft products. And it has a network effect around that.

So as we look at the opportunity for Microsoft in front of us, it's very hard to know if it comes to be all starting in 2024, or whether it's actually more in 2025. But we have so much conviction that this is a massive opportunity ahead of Microsoft. People sometimes worry when stocks get to all-time highs. If you're not investing in stocks that get to all-time highs, you're not investing in the winning stocks. So that is important that we keep owning those businesses that keep making highs and keep delivering great performance. But what grounds us is the earnings outlooks for these businesses. And can we have confidence that the earnings and cash flows are going to grow and deliver high returns, and thus generate great shareholder returns? And if we do, we're absolutely going to keep those in the portfolio.

Felicity Haines:

Great. So, Arvid, what are the things we should be looking out for, for the year 2024?

Arvid Streimann:

Well, let's go back to last year, where it was all about inflation, all about interest rates. And I would say even maybe a little bit before that, we were talking a lot about inflation as well. I'd say that this year, given that inflation is more or less back to where it should be, or where the central banks want it to be, I think that the focus for investors and global policymakers is going to be on where the unemployment rate's going to be. And what's happening to that job market. Because we know that the job market's been really strong, but if it weakens, we know that consumption will weaken as well, and that could lead to some downward spiral.

And one thing that I think's really important to note here is that one of the reasons why the global economy, and particularly the American economy, has held up so well, despite higher interest rate, is because everyone's got a job. So that's how important this is. Now, what could cause the unemployment rate to go up or employment to go down? It could be the fact that these interest rate hikes, which have occurred in the past, maybe there's some lagged effect. Maybe there's some left field black swan event which occurs. But when it occurs, we have to be, as investors, right on it to figure out what is the likely impact on the unemployment rate. Because if the unemployment rate goes up, there's more likely to be rate cuts. And interest rates have been a very important driver of equity market returns over the past few years.

Conversely, if the unemployment rate stays low, then interest rates may stay high. And there's going to be very different investment implications for either scenario, which I talked about. Interest rates stay high, then I would say that cyclicals are probably going to do relatively well. But if interest rates have to be cut because the unemployment rate's gone up, then that's usually a sign that the economy's not doing so well. So there's some very strong portfolio implications of what happens to the employment outlook.

Felicity Haines:

And does the US election matter?

Arvid Streimann:

Well, I think elections always matter. And I think we need to break down and say, "Well, why does this matter?" Two things which could happen from an election. Again, you've talked about the American election. The first is if there's some sort of supply change. And here, I think there's two things which you should be thinking about, particularly if there's a potential Trump administration. The first is, if there's changes in supply with respect to trade with China. Again, we know that Donald Trump, in his last presidency, was trying to restrict trade with China. That would be a negative supply shock, and that would have ramifications for the global economy and investment markets. The next supply shock could be something around the labor market. We just talked about the labor market. And immigration, and restricting immigration would clearly tighten the labor market up. So that would be the supply side.

The demand side would be around, well, okay, if the result of the US election is a clean sweep, and what I mean there is that the one party wins the White House, and they win the House of Representatives, and they win the Senate, then they have a greater likelihood of introducing some government stimulus. And that, as we've seen in the past, could lead to a stronger economy, inflationary pressures, markets go up, that kind of thing. Now, it's our assessment, at this early stage of the electoral cycle, that it's unlikely that either side, the Republicans or the Democrats, are going to get that clean sweep or trifecta, but I think it's something important to watch.

Felicity Haines:

Thanks, Arvid. Thanks, Nikki.

Nikki Thomas:

Pleasure.

Arvid Streimann:

Pleasure.

Felicity Haines:

And thank you for watching this quarterly update, and your continued support of the Magellan Global Fund. If you have any further questions, please reach out to the Magellan distribution team. And please feel free to share this video with any clients and colleagues.

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