

# MFG Global Equity (USD)

**AS AT 31 DECEMBER 2023**
**PORTFOLIO MANAGERS**
**NIKKI THOMAS, CFA AND ARVID STREIMANN, CFA**
**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; while reducing the risk of permanent capital loss.

Aims to deliver pre-fee return of 10% p.a over the economic cycle.

**PORTFOLIO CONSTRUCTION**

High conviction (20-40 securities), high quality focus.

Portfolio construction with dynamic allocation to cash (typical exposure between 0% - 20%).

Combined Risk Ratio cap of 0.8<sup>^</sup>

## MAGELLAN GLOBAL EQUITY (USD)

STRATEGY SIZE	TOTAL GLOBAL EQUITY ASSETS <sup>1</sup>	INCEPTION DATE
USD \$8,147.1 million	USD \$9,819.4 million	1 July 2007

**USD PERFORMANCE<sup>2</sup>**

	3 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	10 Years (% p.a.)	Since Inception (% p.a.)	OUTPERFORMANCE CONSISTENCY*
Composite (Gross)	13.5	24.6	4.2	10.3	9.1	10.9	82%
Composite (Net)	13.3	23.6	3.4	9.4	8.2	10.0	80%
MSCI World NTR Index (USD)*	11.4	23.8	7.3	12.8	8.6	6.3	-
Excess (Gross)	2.1	0.8	-3.1	-2.5	0.5	4.6	-
MSCI Min. Vol. NTR Index*	6.7	7.4	3.5	7.0	7.3	5.9	-

**CALENDAR YEAR RETURNS<sup>2</sup>**

	2023 (%)	2022 (%)	2021 (%)	2020 (%)	2019 (%)	2018 (%)	2017 (%)	2016 (%)	2015 (%)	2014 (%)	2013 (%)	2012 (%)	2011 (%)	2010 (%)	2009 (%)
Composite (Gross)	24.6	-20.2	13.9	11.2	29.7	0.4	25.2	4.7	4.2	6.6	30.8	21.6	11.9	18.3	39.4
Composite (Net)	23.6	-20.8	13.0	10.3	28.7	-0.4	24.2	3.9	3.4	5.7	29.8	20.7	11.0	17.4	38.3
MSCI World NTR Index (USD)*	23.8	-18.1	21.8	15.9	27.7	-8.7	22.4	7.5	-0.9	4.9	26.7	15.8	-5.5	11.8	30.0
Excess (Gross)	0.8	-2.1	-7.9	-4.7	2.0	9.1	2.8	-2.8	5.1	1.7	4.1	5.8	17.4	6.5	9.4
MSCI Min. Vol. NTR Index*	7.4	-9.8	14.3	2.6	23.2	-2.0	17.3	7.5	5.2	11.4	18.6	8.1	7.3	12.0	16.4

Past performance does not predict future returns.

**STRATEGY FUNDAMENTALS<sup>3</sup>**

Number of Holdings	29
Return on Equity (%)	40
P/E Ratio (1 year forward)	27.1
Interest Cover	17
Debt/Equity Ratio	89
Weighted Average Market Cap (USD million)	634,799
Carbon Intensity (CO <sub>2</sub> t/US\$1m revenue)	81.0

**PERFORMANCE CHART GROWTH OF USD \$10,000 (NET)<sup>2</sup>**


Past performance does not predict future returns.

<sup>1</sup> Comprised of all Global Equity strategies.

<sup>2</sup> Returns are for the Global Equity Composite and denoted in USD. Performance would vary if returns were denominated in a currency other than USD. Refer to the GIPS Disclosure section below for further information. Strategy inception is 1 July 2007. Composite (Net) returns are net of fees charged to clients and have been reduced by the amount of the highest fee charged to any client employing that strategy during the period under consideration. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. Fees are available upon request.

<sup>3</sup> The data is based on a representative portfolio for the strategy. 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. Refer to the Important Notice below for further information.

<sup>^</sup> Combined risk ratio is a measure of relative beta and relative drawdown to MSCI World NTR USD Index. Please contact MFG Asset Management should you wish for further details on the calculation.

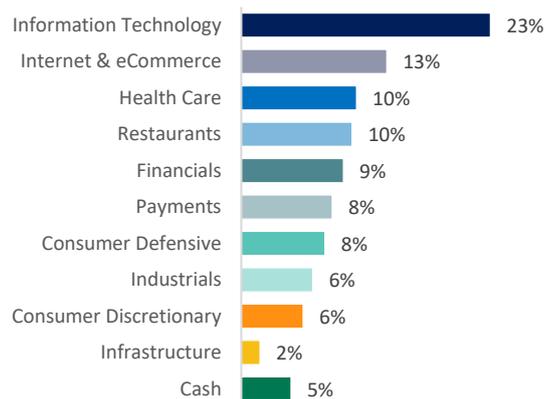
\* Outperformance consistency indicates the percentage of positive excess returns for rolling 3 year returns since inception.

<sup>+</sup> All MSCI data used is the property of MSCI. No use or distribution without written consent. Data provided "as is" without any warranties. MSCI and its affiliates assume no liability for or in connection with the data. Please see complete disclaimer in [www.magellangroup.com.au/funds/benchmark-information/](http://www.magellangroup.com.au/funds/benchmark-information/)

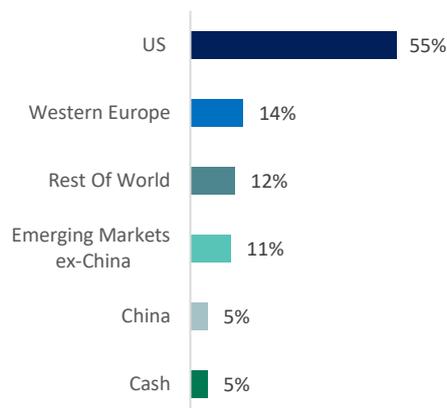
## TOP 10 HOLDINGS<sup>3</sup>

STOCK	SECTOR <sup>4</sup>	%
Microsoft Corporation	Information Technology	7.2
Amazon.com Inc	Internet & eCommerce	7.1
Intercontinental Exchange Inc	Financials	4.4
MasterCard Inc	Payments	4.3
Chipotle Mexican Grill Inc	Restaurants	4.3
Intuit Inc	Information Technology	4.2
SAP SE	Information Technology	4.2
UnitedHealth Group Inc	Health Care	4.1
ASML Holding NV	Information Technology	4.1
Visa Inc	Payments	4.0
	<b>TOTAL</b>	<b>47.9</b>

## SECTOR EXPOSURE BY SOURCE OF REVENUE<sup>3</sup>



## GEOGRAPHICAL EXPOSURE BY SOURCE OF REVENUE<sup>3</sup>



## CAPITAL PRESERVATION MEASURES<sup>4</sup>

ADVERSE MARKETS	3 Years	5 Years	10 Years	Since Inception
No of observations	15	22	42	77
Outperformance consistency	33%	55%	62%	73%
Average return - Strategy (%)	-4.3	-3.9	-3.2	-2.7
Average return - Index* (%)	-4.2	-4.5	-3.8	-4.0
Down Market Capture	1.0	0.9	0.8	0.7
<b>DRAWDOWN</b>				
Maximum Drawdown - Strategy (%)	-26.6	-26.6	-26.6	-36.0
Maximum Drawdown - Index* (%)	-25.4	-25.4	-25.4	-54.0

## SUPPLEMENTARY STATISTICAL MEASURES<sup>5</sup>

	3 Years	5 Years	10 Years	Since Inception
Turnover	23.9%	21.4%	15.3%	12.3%
Beta	1.0	0.8	0.8	0.8
Tracking Error (% p.a.)	4.9%	6.9%	5.8%	6.9%
Standard Deviation - Strategy	16.8%	16.0%	13.3%	14.0%
Information Ratio	-0.6	-0.4	0.1	0.7

<sup>4</sup> Capital preservation measures are calculated before fees. An adverse market is defined as a negative monthly return for the MSCI World NTR Index (USD). Down market capture shows how the fund performed relative to the index while the market is falling.

<sup>5</sup> Supplementary Statistical Measures Beta, Tracking Error and Information Ratio are calculated before fees in USD against the MSCI World NTR Index.

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The MSCI World Index (Net) is a free-float adjusted market capitalization weighted index that is designed to measure the equity performance of 24 developed markets. Index results assume the reinvestment of all distributions of capital gain and net investment income using a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties.

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The Global Equity composite is a concentrated global equity strategy investing in high quality companies (typically 20-40 stocks). High quality companies are those companies that have sustainable competitive advantages which translate into returns on capital materially in excess of their cost of capital for a sustained period of time. The investment objectives of the Global Equity strategy are to earn superior risk adjusted returns through the business cycle whilst minimising the risk of a permanent capital loss. The composite was created in December 2011.

To achieve investment objectives, the composite may also use derivative financial instruments including, but not limited to, options, swaps, futures and forwards. Derivatives are subject to the risk of changes in the market price of the underlying securities instruments, and the risk of the loss due to changes in interest rates. The use of certain derivatives may have a leveraging effect, which may increase the volatility of the composite and may reduce its returns.

A copy of the composite's GIPS compliant presentation and/or the firm's list of composite descriptions are available upon request by emailing [client.reporting@magellangroup.com.au](mailto:client.reporting@magellangroup.com.au).

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The representative portfolio is an account in the composite that closely reflects the portfolio management style of the strategy. Performance is not a consideration in the selection of the representative portfolio. The characteristics of the representative portfolio may differ from those of the composite and of the other accounts in the composite. Information regarding the representative portfolio and the other accounts in the composite is available upon request.

USD is the currency used to calculate performance.

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## Market Commentary

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The December quarter saw strong global equities returns with the MSCI World Index rising 11.4% in USD driven by lower bond yields. The Information Technology sector led these gains (up 16.9%), followed by Industrials (11.4%) and Financials (11.2%) with these sectors sensitive to interest rate movements and the economic outlook. The Energy sector declined 5.5% as oil prices fell in the quarter. The S&P 500 rose 11.2%, outpacing the S&P/ASX 200 Accumulation Index (8.4%), MSCI Emerging Markets Index (7.4%) and Euro Stoxx 600 (6.4%). In contrast, China's CSI 300 Index fell 7.0%.

The main driver of equity returns in the quarter was a large fall in bond yields. US 10-year Treasury yields fell 70bp to 3.9%, German 10-year Bunds declined 80bp to 2.0% and Japanese 10-year JGBs declined 10bp to 0.6%. These were a response to easing inflationary pressures, with annualised US inflation in the three months to November running at 2% compared with 5.5% just six months earlier. Notably, this development led the Federal Reserve to suggest in December that its policy rate may be "at or near its peak". The tailwind to equity returns from lower interest rates was reinforced by a slightly improved profit outlook, with the gradual slowdown in global growth not hurting profit growth as much as many had feared earlier in the year.

The Chinese growth outlook remains challenged as the country digests its real estate bubble. Poor consumer, business and investor confidence are stiff headwinds to growth and will take time to improve in the absence of economic stimulus. While the Chinese government appears so far to be more focussed on internal security rather than growth, there have been some signs of minor pro-growth policies. These growth headwinds are reducing geopolitical risk in East Asia as the Chinese government focuses more on domestic issues.

## Strategy Commentary

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For the quarter, the largest contributors were the holdings in Microsoft, Amazon, Chipotle Mexican Grill, ASML and Intuit, which all rose 19% or more in the quarter. The moves reflect both bullish expectations for many of these as AI opportunities are considered and a weak period of growth ends, and a shift in sentiment around higher growth investments as policy interest rates are seen to be at peak (and falling in 2024). Microsoft delivered a strong fiscal Q1 result driven by commercial cloud momentum, unexpected Windows growth in a stabilising PC environment, gross margin expansion, and operating leverage. Azure performance provided encouraging early evidence of Microsoft's ability to monetise the AI opportunity despite cloud spending headwinds. Amazon benefited from the broad rally in longer duration growth companies and also reported a strong 3Q23 result. AWS growth stabilised in 3Q23 vs the prior quarter and management indicated growth would inflect in 4Q23/F24 as optimisation efforts reduce and digital transformation programs resumed. ASML rose with semiconductor peers and while its Q3 result was within guidance, it outperformed consensus earnings on stronger gross margin.

Detractors were limited to Nestlé and Diageo, which both fell just over 5% over the quarter. We have high long-term conviction in Nestlé as its ability to deliver steady compound growth in cash flows and earnings remains robust and we anticipate good results in February. Short-term digestion of some supply constraints and related capacity additions has weighed on near-term growth. Diageo is cycling exceptional growth, particularly in the US and its tequila franchises, in the past two years while recent weakness reflected inventory excesses in Latin America which it is working to clear but which will weigh on near term profits.

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

## Outlook

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2023 ended with a bang as markets almost everywhere (OK, not China) rallied. Breadth expanded beyond the few stocks that led 2023 strength and financials caught some interest as a benign US economic backdrop became a more consensus view. We are seeing recessions in Europe, clear weakness in China and still some small risk of a brief period of economic weakness in the US even though in late 2023 US growth accelerated. Without a notable slowdown in its economy, accompanied by deteriorating employment conditions, or a concern that deflation could be ahead, we doubt the US Federal Reserve will feel compelled to cut its policy rates too quickly. We expect US 10-year Treasuries at around 4% for a while yet and quantitative tightening to continue even as inflation further comes back to levels seen as acceptable to central banks around the world. However, this is no longer a major headwind for equity markets and indeed we believe it will likely become a tailwind sometime during 2024. September Federal Reserve projections (rates, GDP growth, unemployment) were all revised to reflect a sustainably stronger economic outlook, and nothing thus far has contradicted this.

In many respects the world looks to be in good shape economically. Measures of Consumer Sentiment show gloominess amongst Americans, but this seems somewhat at odds with prospects and perhaps is a function of social media's negative lens. We continue to see remarkable progress in many areas and excellent opportunities within markets and we encourage a longer-term and disciplined approach by investors.

Areas of consternation largely reflect some level of dysfunction politically and geopolitically – migrant crises, Israel/Hamas, income inequality and high government debt and we can add to that regular weather calamities. Yet in the US economic growth (real) has accelerated and is likely to be close to 3% in 4Q23 vs 0.7% a year ago. Unemployment has been below 4% for the longest period since the 1960s and the participation rate amongst 18- to 64-year-olds is the best it's been since 2009. With falling inflation, real wages are up and wealth drivers of housing and share markets mean household net worth is up strongly.

Prospects for corporate earnings and cash flows mean an exciting backdrop for long-term investors. New projects are being undertaken as the trends of decarbonisation, digitisation and deglobalisation gain momentum. US non-residential construction spend is strong and has one of the highest growth multipliers (estimated at 3x) of any industry. Even if interest rates do not fall materially, we believe opportunities outweigh the risks within equity markets.

Stepping to the portfolio positioning, we are clearly positive on the opportunity to deliver wealth creation in global equities. We believe there are boundless opportunities in front of us for our superbly managed companies with strong competitive advantages to deliver exceptional earnings and cash flow growth in coming years. There may be some share price bumps along the way as bond yields fluctuate and sector rotations within markets affect prices through flows, but we are confident in valuation upside for the portfolio. Strong earnings mitigate rate volatility risk over a longer time horizon and so the portfolio is tilted towards those companies we believe can keep delivering better-than-expected results through time and are yielding high cash flows from their operations even today. Innovation alongside execution excellence is at the heart of many of the companies we own – Microsoft, Amazon, Intuit, SAP, Alphabet, Netflix, Trane Technologies, Stryker and Republic Services, among many others, discuss with us the innovations that place them at the forefront of their industries.

We expect that some volatility in markets may accompany us over the next few months as share prices continue to adapt to the evolving interest rate environment and reshaping of economic growth. Volatility isn't inherently risky. We work diligently to assess the real risks that face our portfolio companies and will continue to hold the line on our absolute return objective. We thank you for the trust you place in us.

## Stock Story: Yum!

(Emma Henderson – Investment Analyst)



Behind the success of the world's most famous quick-service chicken restaurant, the world's second-largest pizza chain and the US's leading Mexican-style franchise sits Yum! Brands. With over 55,000 restaurants across more than 155 countries and territories, Yum! Brands is the world's largest restaurant company by number of restaurants and second only to McDonald's in total restaurant sales.

The iconic KFC, Pizza Hut and Taco Bell brands were originally brought together under consumer goods giant PepsiCo in the 1970s and 1980s as part of a series of acquisitions to diversify its business away from beverages. In 1997, PepsiCo announced it would be narrowing its focus back to its core beverages and snacks businesses and its fast-food unit would be spun off into an independent public company, ultimately named Yum! Brands.

Over the last 25 years, Yum! Brands has grown its global restaurant base by over 25,000 restaurants and has transformed from a US-centric company to a truly global business. It has also shifted its business model from owning and operating a portion of its restaurants to running an almost entirely franchised model, driving dual benefits of reduced risk and accelerated growth for shareholders.

Today, over 98% of KFC, Pizza Hut and Taco Bell outlets are operated by franchisee and licensee partners who deploy their own capital to open and operate restaurant outlets. These partners in turn pay Yum! Brands a royalty fee of approximately 5% of restaurant sales. In 2022, KFC, Pizza Hut and Taco Bell stores around the world generated US\$60 billion in total system sales, resulting in US\$3 billion in franchise revenue for Yum! Brands and contributing 90% of the company's earnings. Franchise fee revenue is a high-margin, capital-light earnings stream that is insulated from labour and commodity costs increases. The accessible price point and strong value-for-money nature of fast food add to the predictability of this attractive earnings stream throughout economic cycles.

By geography, approximately half of Yum! Brands' franchise revenue is now generated in international markets, including approximately 30% in fast-growing emerging markets like China, India, Southeast Asia and Latin America. While we have seen various misses from Yum! Brands and peers when trying to export US brands internationally, both KFC and Pizza Hut concepts have proven to have strong global appeal, with chicken and pizza products easily customised for local market tastes and preferences. Mexican-style Taco Bell, which is an outstanding business in its home US market, has proven harder to replicate internationally but is beginning to make inroads in markets like Spain, India, the UK, and China.

Despite significant growth and value creation delivered over the past few decades, there remains an exciting growth runway ahead for Yum! Brands, particularly in emerging markets where penetration of its brands remains low, consumer incomes are rising, and the existing restaurant landscape is highly fragmented and unsophisticated. Yum! Brands is targeting global system sales growth of 7% p.a. underpinned by new store growth of approximately 5% p.a. and modest growth in existing store sales through menu and marketing initiatives. The company has been running ahead of this net new store growth target, with over 100 countries contributing to global store growth of closer to 6% in recent years. Highly attractive payback periods on new stores and a more sophisticated and better-capitalised franchisee base relative to peers should prove key advantages to sustaining development in a higher interest rate environment.

Yum! Brands' growth will also be increasingly powered by digital and technology. The company has spent the last few years investing heavily in areas like customer analytics, digital ordering, loyalty programs and back-of-house restaurant technologies, which will be shared across its global system to drive better customer experiences, sales performance and franchisee profitability. One of many examples is the company's acquisition of Dragontail Systems in 2021 for approximately US\$70 million. Dragontail is an AI-based technology that automates and optimises multiple Pizza Hut processes, from preparing the pizzas to dispatching product to delivery drivers and enabling customer tracking. In an increasingly digital world, we expect economies of scale on largely fixed-cost technology investments, as well as consumer data advantages from operating over 55,000 restaurants, to become increasingly important competitive differentiators relative to smaller restaurant players in the highly fragmented US\$900 billion limited services restaurants industry.

Yum! Brands has a strong track record of ensuring its brands remain culturally relevant and loved. However, to ensure its brands can continue to grow sustainably, it will be important to manage food quality and nutrition risks as consumer preferences evolve, social risks as a large global employer and environmental risks as a large procurer of global agricultural and packaging products.

Yum! Brands remains a cornerstone of the Magellan Global portfolios, generating sustainable and defensive cash flows for investors.