Recommended

LIT Review
Magellan Global Trust

About this Trust

LIT REVIEWED	MAGELLAN GLOBAL TRUST
ASX CODE	MGG
TRUST OBJECTIVE	TO ACHIEVE ATTRACTIVE RISK-ADJUSTED RETURNS OVER THE MEDIUM TO LONG-TERM, WHILE REDUCING THE RISK OF PERMANENT CAPITAL LOSS.
EXPECTED TRUST SIZE	MINIMUM SUBSCRIPTION IS $250M. THE TRUST HAS NO UPPER LIMIT ON THE AMOUNT OF CAPITAL THAT CAN BE RAISED.
DISTRIBUTION POLICY	THE TRUST AIMS TO PAY A CASH DISTRIBUTION YIELD OF 4% P.A.
IPO UNIT PRICE	$1.50
INITIAL NET ASSET VALUE	$1.50
STRUCTURE	NO OPTIONS ATTACHED TO THE UNITS
MANAGEMENT FEE	1.35% P.A. (INCLUSIVE OF GST) OF NET ASSET VALUE (NAV); EXCLUDES ALL TRUST COSTS
PERFORMANCE FEE	10% OF EXCESS RETURN ABOVE HURDLES

About the Investment Manager

INVESTMENT MANAGER	MAGELLAN ASSET MANAGEMENT LTD
OWNERSHIP	PUBLICLY LISTED ON THE ASX
ASSETS MANAGED IN THIS SECTOR	$41.3B (JULY 2017)
YEARS MANAGING THIS ASSET CLASS	10

Investment team

PORTFOLIO MANAGER	HAMISH DOUGLASS & STEFAN MARCIONETTI
INVESTMENT TEAM SIZE	40
INVESTMENT TEAM TURNOVER	LOW
STRUCTURE / LOCATION	GLOBAL INDUSTRY / SYDNEY

Investment process

STYLE	QUALITY / VALUE (GARP)
BENCHMARK	NO STATED BENCHMARK
RISK OBJECTIVE	CAPITAL PRESERVATION
TYPICAL NO. OF STOCKS	15-35
STOCK Limits	15%
SECTOR CONSTRAINT	NO LIMIT
REGION CONSTRAINT	NO LIMIT
CASH LIMIT	0%-50% OF NAV
CURRENCY EXPOSURE	ACTIVE HEDGING 0 – 100%

Trust rating history

AUGUST 2017	RECOMMENDED

What this Rating Means

- The **'Recommended'** rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with the relevant objectives. The financial product is considered an appropriate entry point to the asset class or strategy.

Strengths

- The Trust leverages an established investment philosophy and process that has been successful over the longer term.
- Experienced portfolio management team with a long pedigree in managing global equity strategies.
- The Trust benefits from a unit-holder friendly structure including all upfront cost being borne by Magellan which should result in the IPO unit price being equal to NAV.
- Key investment staff are well-aligned with the firm and there has been limited staff turnover.
- The Trust's stated distribution policy provides investors with greater certainty of distributions.

Weaknesses

- Douglass has material non-investment business responsibilities.
- The payment of distributions can be funded through the return of capital, which can reduce the capital base during periods of modest or negative growth.
- Above average base management fees relative to peers while charging a performance fee
- The Manager has significant funds under management (FUM). Considering their concentrated investment approach, the larger FUM has the potential to make implementing this approach more difficult.

Scope of this Rating

- Lonsec has used its Managed Funds research process in forming a 'point-in-time' opinion on this Listed Investment Trust's (LIT) ability to meet its investment objectives as outlined in the Product Disclosure Statement (dated 21 August 2017) ('the PDS'). This research process, however, does not include an assessment of the likelihood and extent of a Trust's unit price trading at a discount to its Net Asset Value (NAV) per share beyond reviewing the Trust's approach to managing this event should it occur. Lonsec considers an investment in the LIT sector to be suitable for investors with a long-term (5+ years) investment horizon.
- The Lonsec rating will expire upon the listing of the Trust (MGG) on the Australian Stock Exchange (ASX).

Magellan Global Trust

Trust Risk Characteristics

	LOW		MODERATE		HIGH
CORPORATE RISK			●		
CAPITAL VOLATILITY					●
SECURITY CONCENTRATION RISK					●
FOREIGN CURRENCY RISK				●	
SECURITY LIQUIDITY RISK		●			
LEVERAGE RISK		●			

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the product's asset class and the risks relative to other products in the relevant Lonsec sector universe.

Suggested Lonsec risk profile suitability

SECURE	DEFENSIVE	CONSERVATIVE	BALANCED	GROWTH	HIGH GROWTH
		●	●	●	●

BIOmetrics

Aggregate Risk Measure

	1	2	3	4	5	6	7
STANDARD RISK MEASURE						●	

A Standard Risk Measure score of 6 equates to a Risk Label of 'High' and an estimated number of negative annual returns over any 20-year period of 4 to less than 6. This is a measure of expected frequency (not magnitude) of capital losses, calculated in accordance with AFSA/FSC guidelines.

Features and benefits

	LOW		MODERATE		HIGH
COMPLEXITY		●			
ESG AWARENESS			●		

Fee profile

	LOW		MODERATE		HIGH
FEES – VS LONSEC UNIVERSE					●
FEES – VS ASSET CLASS					●

What is this Trust?

- The Magellan Global Trust ('MGG' or 'the Trust') is a long only, high conviction global equities strategy. The Trust will be an ASX listed investment (ASX code: MGG) which is a closed-end registered managed investment scheme. The Trust's Responsible Entity ('RE') and investment manager is Magellan Asset Management Ltd ('the Manager' or 'MAM'). MAM is a wholly owned subsidiary of the ASX listed Magellan Financial Group Limited ('MFG').
- The Manager is seeking to raise a minimum of $250 million and has flagged the potential for at least $1 billion to be raised at the offer price of $1.50 per unit. The Trust has no upper limit on the amount that can be raised under this offer. In contrast to many other similar listed offers, subscribers will not receive options, although there is a loyalty reward mechanism.
- The Trust is aiming to provide investors with attractive risk-adjusted returns over the medium to long-term, while reducing the risk of permanent capital loss. The Trust does not state an internal absolute return objective, however, it is worth noting that similar MAM strategies target absolute returns of 9% to 10% p.a. net of fees over a business cycle (five to seven years). Lonsec notes that the Trust will target an absolute total return and considers the 9%-10% p.a. range to be broadly applicable to this Trust. To achieve this, the Manager will use a long-term investment approach focused on capital preservation and absolute wealth accumulation.
- The Trust's investment strategy is to actively manage a high conviction portfolio of global securities, actively manage currency hedging. It also has relatively few formal investment parameters and is a benchmark unaware investment vehicle. The Trust will typically hold between 15 to 30 securities and can invest up 50% of the portfolio in cash (currency denomination at the portfolio manager's discretion) as a capital preservation / risk control mechanism. The Trust is also able to borrow up to 20% of the Trust's gross assets. While the Trust is expected to predominately invest in global listed securities, it is permitted to invest in a large number of assets, including, but not limited to, unlisted securities, equity swaps and options.
- MFG are bearing all the costs associated with establishing the listed vehicle and fund raising, which Lonsec believes reflects MFG's strong commitment to the Trust. This should result in the Trust's unit price at ASX-listing being equal to NAV. Lonsec notes that with most other LIT/LIC IPO structures, the unit price lists at a discount to NAV as investors, through the listed vehicle, bear the costs associated with the capital raising. Further, MFG's support of the IPO should also mean that all capital raised will be available for investment by the Manager providing an additional incremental benefit to unitholders.
- The Trust has a priority offer available to all existing Magellan Financial Group shareholders and/or registered unit holders of Magellan's active ETFs and unlisted managed funds as at 1st August 2017. The eligibility criteria is set out in the Trust's PDS. Eligible investors can subscribe under the priority offer for the higher of either $30,000 equivalent to 20,000 units; or $1 worth of units for every $10 directly or indirectly held in eligible vehicles. These investors will be eligible to receive a maximum number of additional loyalty units equivalent to 6.25% of the units received under the priority offer, subject to vesting conditions and other terms specified in the PDS being met.
- MFG will subscribe at the IPO for the number of loyalty units issued under the priority offer. The Trust will issue MFG a separate unit class, Class A Units. These Class A Units will be acquired at the same ordinary unit price of $1.50 per unit and they will be subject to the same fees as the ordinary units. The Class A Units will be held by a Magellan Special Purpose Vehicle (SPV) during the vesting period and will be transferred to eligible investors in January 2018, after the vesting conditions have been satisfied. After the vesting period, the Class A Units will be consolidated down by the number of Loyalty Units that are issued and will automatically convert to an equal number of ordinary units. MFG will retain ownership of any loyalty units where investors do not subsequently meet the vesting requirements.

- MFG will fund the acquisition of Class A Units from their own balance sheet, which Lonsec believes reflects significant commitment from MFG to the Trust. As MFG acquire the Class A Units from day one, forming part of the Trust's capital base, their value will grow in-line the 'ordinary' units. Importantly, the Trust and non-eligible investors should not incur any costs relating to the priority offer and their investment should not be diluted as a result of the mechanism.
- MGG is considered to include some features which make it one of the more investor friendly LIT's Lonsec has researched to date. In particular, this includes MFG bearing all the establishment costs, resulting in the unit's invested NAV from first day of listing been equal to paid-in capital. Additionally, Lonsec believes that the Trust's priority offer makes the Trust a compelling investment offer for those who qualify.
- The Trust has a distribution policy of targeting a cash distribution yield of 4% p.a. which is to be paid semi-annually. Distributions will be based on an average monthly NAV over a two-year rolling period after the Trust has been in operation for two years. During the first two years from the Trust's inception date, the Manager intends to pay a $0.03 per unit distribution semi-annually, equating to a 4% p.a. yield based on the IPO price of $1.50 per unit. The Manager has sought to establish this distribution policy in order to provide greater certainty to unit holders on the value of upcoming distributions. The fixed two-year schedule is necessary given the rolling two-year NAV on which the policy will be normally based. Nonetheless, Lonsec notes that the Manager retains full discretion to amend this distribution policy without unitholder approval.
- The Trust will fund distributions from accrued income, return of capital and cash holdings. While the Trust is also able to fund distributions from the Trust's debt facility, the Manager has advised that it is highly unlikely that they would do this.
- Lonsec notes that Magellan's strategies have traditionally not exhibited high dividend yields (Magellan Global Fund has produced a dividend yield circa 2% p.a. since inception). Given the Trust will be managed similarly to these other strategies, The additional yield to make up the shortfall will be manufactured through the return of capital to unitholders, e.g. via a proportional sell-down across the whole portfolio. Lonsec notes that this can have heightened tax consequences for a range of investors. If the Trust consistently generates total returns of 9% p.a. in line with the Magellan flagship Global Fund objective, the capital base should still continue to grow. However, Lonsec believes that the capital base is at risk of erosion in the event of a prolonged period of underperformance, specifically either negative total returns or total returns that are less than 4% p.a., after inflation.
- The Manager has an active currency hedging investment mandate and will manage the Trust's currency exposures with the dual aims of generating positive total returns and risk management. The Fund can range from unhedged to fully hedged, at times, depending on the Manager's currency views. The Manager will only hedge a currency position if the exposure to that currency within the portfolio is greater than 5% of NAV.
- The active currency hedging has the potential to both add and detract value and also impact the Trust's ability to meet distributions from accrued income. If the Trust experiences losses from currency hedging, the Trust's pool of distributable income is reduced and the Manager would then be required to sell more capital to meet the 4% distributable yield hurdle. Lonsec highlights that another MAM strategy has active currency hedging and that this Trust will utilises the same process.
- The Trust utilises the same investment philosophy, process and team to other Magellan global equities products. Lonsec observes that the Trust sits between the Magellan Global Fund and the Magellan High Conviction Fund across most measures. The Trust differs from the Magellan Global Fund, as the Trust has greater stock concentration; less constrained risk parameters; active currency hedging; and a Combined Risk Ratio of 1, as opposed to the Global Fund's Combined Risk Ratio of 0.8. Additionally, the Trust is a less concentrated version of the Magellan High Conviction Fund.
- Furthermore, the Trust's stock selection utilises the same list of investment committee approved stocks that all existing MAM funds use. The Trust's portfolio is likely to have a high degree of stock commonality with the Global Fund, albeit more concentrated.
- The Fund has an annual management cost of 1.35% p.a. which is one of the highest in the broader developed markets global equities peer group. The Fund is also one of the few long only global equity strategies rated by Lonsec that has a Performance Fee. The Manager is entitled to 10% of net excess returns above the higher of either (a) the Australian 10-year Government Bond yield and (b) the MSCI World Net Total Return A$ Index. This performance fee is calculated over six-month periods ending 31 March and 30 September and paid at the end of these periods. The first calculation period will end on the 31 March 2018. Lonsec believes the use of a dual performance benchmark is positive and reflects the Fund's focus on absolute rather than relative performance. The performance fee is also subject to a 'high water mark'. Considering the performance fee, Lonsec would ideally expect a commensurately lower (constant) management fee.
- The Manager has established a distribution reinvestment plan (DRP). Investors, at their discretion, can reinvest all or part of their distributable income into the Trust. Reinvestment under the DRP, which has been made voluntarily by investors, is expected to be a 5% discount to NAV. This discount will be funded by MFG and there will be no subsequent dilution to investors who choose to not participate in the DRP.
- Lonsec consider that the DRP should help the LIT trade close to NAV. However, MFG is a listed company and there is the risk that management and / or shareholders no longer wish to underwrite the Trust's discounted DRP. There is also a risk too that MFG's financial fortunes decline through time and may not be in a sustainable position to continue the DRP support.

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- Lonsec notes that the whole distribution is subject to income tax at a unit-holders marginal tax rate regardless of the amount of the distribution and, if above 4% in any given year, the portion that is received as units instead of cash. Lonsec notes that for tax payers on higher tax rates, this may lead to instances where the cash distribution received is less than the income tax payable on the distribution. This would only occur in instances where the actual distribution is substantially above the 4% hurdle. Investors should seek professional taxation advice surrounding the implications of MGG's distribution policy for their personal circumstances.
- The Manager's capital management provisions to help ensure that the Trust trades as close to the portfolio's NAV include the Manager's discretionary on-market buyback of units program when units are trading at below NAV and that the Manager is able to issue further units at NAV if the Trust is trading above NAV. Lonsec notes the inherent issues of buybacks when it is related party RE. Additionally, the Manager can manage deviations between NAV and the units price through the leverage facility, which can be utilised to reduce any premiums to NAV.
- Magellan will act as both the Responsible Entity and investment manager for Trust. Lonsec highlights that this has the potential to create conflicts of interest with respect to capital management decisions. This may be particularly the case when evaluating capital management options (e.g. buy backs) for dealing with the circumstance where the units are trading at a discount to NAV. Lonsec believes that Magellan has appropriate policies and procedures in place to manage this risk.
- The Manager will provide ongoing disclosure including:
  - Declare a daily NAV by 9.30am each trading day;
  - Intra-day indicative NAV;
  - Monthly fund fact sheets with top 10 holdings
  - Full portfolio disclosure quarterly with a two-month delay.
- In addition to this Trust, Lonsec also reviews the four different versions of the Magellan Global Fund, including hedged and unhedged and unlisted managed funds and exchange quoted managed funds as well as the High Conviction strategy.

Using this LIT

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

- The Trust provides investors with variable currency hedged exposure to global equity stock markets and accordingly may experience both positive and negative, at times sharp, movements in the value of capital invested. In particular, investors need to be comfortable with the highly concentrated nature and heightened single sector / region exposure of the Fund, which may add to the magnitude of capital movements.
- Considering the Trust will at times pay distributions from capital, investors need to be comfortable with the likelihood of capital being return as income, which can lead to the unit price reducing equal to the portion of capital distributed. The distribution policy can exacerbate reductions in the capital base at times of negative capital returns during market downturns and periods of heightened market volatility. Investors should also seek professional tax advice to further evaluate any implications from the distribution policy to their personal circumstances.
- With the Fund's unconstrained investment style and the potential to be invested up to 50% in cash, investors should also be prepared to tolerate performance that may differ significantly from a market benchmark at times. Lonsec notes the Fund is expected to demonstrate a moderate to high level of Tracking Error, relative to its benchmark.
- Given the Fund's high conviction approach and stock and sector concentration, Lonsec believes it may make it suitable for use as a focused 'growth asset' exposure in a balanced portfolio. Furthermore, Lonsec recommends the Fund is best suited for investors with an investment time horizon of at least seven years.
- It is important to note that while 'valuation' and not overpaying for cash flows are a key discipline of the Manager's process, 'quality' tends to be associated with Growth at Reasonable Price 'GARP' investors. The Manager has historically shown a consistent bias to growth factors over time. The Manager expects to outperform in markets where there is uncertainty or a flight to quality, and underperform in more speculative markets.
- As with all LITs, a key consideration for investors is the expected propensity for a new trust to trade at a premium or discount to its portfolio NAV. Investors should consider the mitigating features that are present which may prevent a LIT from trading at a significant (+10%) discount to its NAV for a prolonged period.
- The Trust's PDS was lodged with ASIC on 21 August 2017.

Lonsec Opinion of this Trust

People and resources — Investment Manager

- The Trust is led by portfolio manager Hamish Douglass, who is ultimately responsible for all portfolio decisions. Additionally, Douglass is the CIO and co-founder of the Magellan business. Douglass has 26 years of experience in financial services (primarily in investment banking) and prior to starting MAM, was the co-Head of Global Banking at Deutsche Bank Australasia. Lonsec considers Douglass to be an astute investment manager and business operator.
- Douglass was responsible for forming the Manager's investment philosophy and approach, which began in 2007 with the inception of the Manager's flagship fund, the Magellan Global Fund. Lonsec believes he has proven himself as a highly capable portfolio manager. In addition, Lonsec considers the framework within which Douglass makes portfolio buy and sell decisions to be well defined and logical.

- Supporting Douglass is portfolio manager, Stefan Marcionetti. Marcionetti joined Magellan in 2013 as an analyst within the Technology, Communications and Media sector and still has limited stock coverage. He was appointed portfolio manager for the global equities strategies in mid-2016. Lonsec believes Marcionetti displays strong insight into the existing global equities strategies, but notes that his portfolio management skills remain largely untested although is viewed as operating mainly in a support capacity.
- Douglass currently has a wide range of business and investment responsibilities. Lonsec notes MAM's considerable growth in recent years and believes that as a mature and ASX-listed business, MAM could likely benefit from a dedicated and focused business management leader. Additionally, while noting the increased support now available to Douglass in the management of the Trust and other global equity strategies, Lonsec nonetheless believes their management could benefit from an increased focus by Douglass to investment related responsibilities.
- Lonsec notes that the Manager has increased the number of product offerings in recent years and Lonsec holds some reservations regarding the rate of product growth. Lonsec is conscious that product growth can lead to senior members of the investment team with new responsibilities having less time to focus on their stock coverage responsibilities.
- That said, the investment team is considered to be very well resourced with 40 professionals across portfolio management and research roles. Team numbers have been stable over the last two years, following a period of rapid growth in the number of investment personnel (15-member investment team in 2012). Importantly, there has been reasonable stability in the team over this period. The newly hired staff have mixed levels of experience and while average tenure has decreased, Lonsec has observed while reviewing other MAM products in recent years that MAM appears to have managed to maintain its culture.
- Lonsec believes that MAM has to date, successfully managed the challenges that come with a rapidly growing business, in particular, creating opportunities within the organisation for existing members to develop and take on more responsibilities. Lonsec believes that the Manager has been successful in doing this via the promotion of senior staff into portfolio management roles, and is also evident from the limited turnover.
- Lonsec believes the team is appropriately resourced for MAM's investment approach (namely, highly research intensive targeting a few new stock ideas each year, typically translating to only a few year-to-year changes in portfolios). Additionally, the Manager's senior investors are of a high calibre and experienced, and exert a significant influence over the research process and the Trust's eligible investments.
- Lonsec considers key person risk with Douglass to be high. While the investment philosophy is very well defined, Douglass has a pivotal role not only in terms of investment decisions, but in the business as a whole. However, mitigating the level of key person risk associated with Douglass is, primarily, the significant tie-in to the MAM business via personal capital investment and equity ownership. Lonsec notes key person risk as a potential risk for investors, although one of Lonsec's core beliefs is that given sufficient conviction, key person risk is often a risk worth taking.
- MFG is considered to be well-capitalised, and given the scale of their funds management business, to have sufficient cash flows to support operations and cover the cost associated with establishing the Trust, the initial loyalty offering and the ongoing cost associated with the discounted DRP as at the date of this report. Additionally, any volatility in performance detracting from performance fees is not considered to be detrimental to operations in the short to medium term.

Research approach and portfolio construction

- MGG will be managed to the same style and approach as MAM's other existing global equities strategy which Lonsec is familiar with and researches.
- While the Trust is a new investment vehicle, it benefits from a MAM investment process that has been in operation for 10 years. Lonsec considers this process to be well structured and driven by detailed 'bottom-up' analysis with a strong focus on valuation and internally generated research. Magellan's process aims to identify 'outstanding' companies at attractive prices with assessment criteria that evaluate companies on their respective Economic moat; Reinvestment potential; Business risk and Agency risk. Lonsec believes that the Manager has a long track record of consistently applying this investment approach.
- The Trust is differentiated from other MAM offerings, particularly in that it has a stated distribution objective of 4% p.a., however, the Manager's investment process remains unchanged. Lonsec expects this Trust to exhibit a growth at reasonable price (GARP) bias over time. Given this, the Manager is cognisant that the Trust is unlikely to have sufficient accrued income from stock dividends to meet the 4% yield objective. The Manager will seek to meet the ongoing yield objective from a combination of accrued income, the return of capital or cash holdings. Lonsec believes that the Manager has the necessary portfolio management systems and experience to manage this process.
- Lonsec notes the potential for the funding of distributions, either fully or partially, from the return of capital can result in a diminution of the Trust's capital base. Lonsec considers that this may be exacerbated during periods of modest (e.g. less than 4% inflation-adjusted) or negative capital growth. Additionally, given that global securities, and equities generally, are a volatile asset class, Lonsec believes that this could further complicate the relationship between the potential return of capital and the capital base during times of heightened market volatility.

  Furthermore, funding distributions via the return of capital may increase portfolio turnover and increase trading costs to the trust.
- The Trust will typically have a highly concentrated 15-35 stock portfolio that is significantly differentiated from the benchmark. The Trust does

not have a track record so Lonsec cannot comment on the portfolio composition. But as the Trust is leveraging the same research that is used for the Magellan Global Fund, it is expected to be a subset of the highest conviction ideas.

- Lonsec has observed the growing importance of macro themes within Magellan's investment process in recent years and greater use of 'top-down' research. Furthermore, the Manager's FUM in global equites has considerably increased in recent years. That said, Lonsec still considers the Manager's process to be grounded in 'bottom-up' analysis.
- MAM applies a long-term, unconstrained and concentrated approach to investing. The investment philosophy underpinning the Fund has several elements in common with that of the approach used by Warren Buffett of Berkshire Hathaway (quality businesses at attractive valuations). This type of approach is generally associated with a GARP style. Investment decisions are driven by in-depth financial analysis and qualitative research that aims to identify 'outstanding' companies at attractive prices that can potentially be held for a minimum of three to five years.
- The Manager initially applies a detailed initial screening process to reduce the wider universe of stocks, then undertakes extensive qualitative and quantitative research in a well-structured and consistent method. The Manager has detailed valuations on circa 250 securities across both global and infrastructure stocks, which is a large number when compared to peers.
- Given the Manager's targeted industry sector focus, Lonsec believes the stock level load per MAM analyst compares favourably with that of other well regarded global equity managers assessed. In addition, Lonsec has viewed a sample of research reports produced by MAM, and considers the quality of its research output to be of a very high standard, due to its thoroughness and depth of coverage. Lonsec observes that the breadth of coverage has increased with the addition of new investment analysts in recent years.
- Lonsec regards the level of accountability in the MAM research and portfolio construction process, at an individual level, to be high, despite the level of control exerted by the Investment Committee (IC). While the 12 member IC is responsible for decisions regarding additions to and removals from the 'approved list', stocks are championed by individual analysts and portfolio decisions are the responsibility of the portfolio manager, Douglass. That said, Lonsec understands Douglass is not required to attend and vote on all IC decisions. Given the concentrated nature of the portfolio, Lonsec believes that the process could be strengthened by having Douglass (the CIO) attend all discussions relating to stocks candidates for this Fund.
- MAM has considerable FUM in global equities, as at June 2017 the MAM had A$50.6 billion in FUM. Lonsec considers the sources of the FUM to be diversified, being not overly concentrated with any specific client, asset consultant or region.
- The Manager indicates that the theoretical capacity of the Global Equities strategy to be around US$40 billion, based on the liquidity requirements of the existing strategy. Based on the AUD/USD foreign exchange rate at August 2017, the Fund is below its theoretical capacity. However, the Manager has flagged this is the theoretical capacity level only and will be revised to reflect the growth of world equity markets. The Manager has soft closed the global fund to new institutional investors and has closed its US Global Equity pooled vehicle. Lonsec believes that the growth in FUM in existing strategies and the launch of low carbon strategies by the Manager has made capacity more difficult to assess.

Risk management

- Lonsec notes that given the limited or very broad formal constraints, the portfolio's sector and country weights may vary considerably from the benchmark. As such, the level of active risk in the portfolio can potentially be higher than other global equities products assessed by Lonsec.
- MAM's primary consideration of risk is the probability of permanent capital loss associated with an investment, not the risk relative to a benchmark or the volatility of a company's share price. Underlying the company research, stock selection and portfolio construction is the Manager's macroeconomic view. As such, the firm's macroeconomic view is critical to its risk management process as it will likely greatly influence the Fund's economic / thematic exposures and the level of cash held, which can be as high as 50%. To date, Lonsec has been comforted by the Manager's conservatism and its willingness to actively position their strategies away from significant risks it has identified.
- Macro factor risks (such as underlying earnings exposures, cyclical / high beta exposures, interest rate sensitivities) and stock correlations are also considered at the time of portfolio construction. Despite the measures in place, the effect of poor stock selection can have a material effect on performance due to the highly concentrated nature of the portfolio and the absence of sector constraints. Lonsec reminds investors that the unconstrained, highly concentrated nature of the Fund translates into concentrated single-name positions and, at times, significant sector biases. That said, Lonsec believes the depth and quality of the Manager's research helps manage these risks.
- This Trust will be actively hedged with a target ratio range of 0% - 100%. The objective of the active hedging is to reduce the impact of foreign currency exposures when the AUD is trading outside its historical normal range, and secondly, to generate profits over time via an asymmetric hedging profile. Lonsec notes that currency hedging is separate from stock decisions, and is more related to long term currency mean reversions. A currency will only be hedged if the portfolio's exposure to that currency is greater than 5% (i.e. no pure currency plays). Lonsec believes that their active currency strategy is well structured. Lonsec notes that this has the potential to both add and detract value and also impact the Trust's ability to meet distributions from accrued income at times.
- An evolution to Magellan's investment process has been the change from the Beta Cap to the Combined Risk Ratio. The Trust has a maximum Combined Risk

Ratio of 1.0x, compared to the Global Fund's 0.8x, allowing the Trust to have slightly higher conviction. MAM historically used a Beta Cap as a risk measurement that sought to limit a portfolio's sensitively to the market and protect during a downturn. MAM has changed this risk measure to include a combination of market beta and a draw-down ratio. The updated risk measurement aims to provide a better indication of a portfolio/stocks downside protection. Lonsec is generally supportive of this evolution of risk measurement.

- Lonsec is pleased that MAM employs a Chief Risk Officer (CRO) who has reporting lines separate to the investment team. The CRO reports directly to MAM's Board of Directors on all risk and compliance matters, and to the Chief Operating Officer on operational issues.

Performance

- The Trust, which is not yet listed, does not have an operational track record so no performance data available. Nonetheless, MAM has a similar strategy that has a meaningful track record. This Magellan Global Fund has different investment objectives and investment parameters to the Trust, particularly regarding stock concentration, levels of cash and hedging policies. But Lonsec consider the performance history of this fund relevant considering it utilise the same investment team and process.
- The Magellan Global Fund was launched in July 2007 and over the last 10 years to 31 July 2017, the Fund returned 11.1% p.a., while global shares over the same period, as measured by the MSCI World NR Index AUD returned 5.2% p.a. The Magellan Global Fund's objective is to deliver a return of 9% p.a. net of fees over a business cycle (five to seven years) and has achieved this to date. The Fund's Tracking Error has ranged between 4% and 5.7% over all assessed periods, this is reflective of the benchmark agnostic portfolio construction. Over longer periods, five to seven years, the Fund's outperformance consistently has been relatively equal in both up markets and down markets

Overall

- Lonsec has assigned the Trust a **'Recommended'** rating. Underpinning the rating is Lonsec's long held conviction in MAM's investment team and Hamish Douglass as portfolio manager. Lonsec believes that the Trust greatly benefits from MAM's detailed investment process which has been consistently applied across multiple MAM strategies for over 10 years. Furthermore, Lonsec believes that the Manager's high conviction approach results in significant exposure to the team's best ideas and gives investors a meaningful chance of outperformance.
- Lonsec believes that the structure of the LIT has many positive unit-holder initiatives, chiefly the Manager bearing the cost associated with establishing the LIT. Additionally, the loyalty bonus offered to existing Magellan Group investors makes the Trust a compelling investment option. Critically, the cost associated with the loyalty bonus is again borne by MFG such that investors are not diluted. This also applied to the DRPs discount, which is again funded by MFG.
- Lonsec believes that the Trust's stated distribution policy provides investors with greater certainty of distributions and should contribute positively to investor sentiment and should assist to minimise the risk of the units trading at a discount to NAV. That said, Lonsec notes that the underlying strategy is not expected to generate sufficient sustainable yield sourced from the stock themselves (e.g. dividends or buybacks) and will likely require enhancement through the return of capital to meet the 4% p.a. hurdle. Lonsec holds reservations regarding the payment of capital as income believing that it can result in a diminution of the capital base particularly during periods of modest or negative capital growth and increased portfolio turnover.
- The Trust's above average base management fees relative to broader peers while charging a performance fee is viewed as detracting from the offing. In saying that, Lonsec does considers the performance fee to be reasonably structured well, considering its use of a dual benchmarks.

Magellan Global Trust

People and Resources

Corporate overview

Magellan Asset Management Ltd (MAM) was established in 2006 and is a fully owned subsidiary of the Magellan Financial Group Ltd (MFG). MFG is listed on the Australian Stock Exchange (ASX code: MFG).

MAM currently manages nine funds (year of launch):

- Magellan Global Fund (2007),
- Magellan Infrastructure Fund (2007),
- Magellan Core Infrastructure Fund (2010),
- Magellan High Conviction Fund (2013),
- Magellan Global Fund (Hedged) (2013),
- Magellan Infrastructure Fund (Unhedged) (2013),
- Magellan Global Equities Fund – MGE (2015),
- Magellan Global Equities Fund (Currency Hedged) – MHG (2015),
- Magellan Infrastructure Fund (Hedged) – MICH (2016).

As at June 2017, firm-wide funds under management totalled approximately $50.6 billion.

Size and experience

Name	Position	Experience Industry / Firm.
HAMISH DOUGLASS*	CEO, CIO, MANAGING DIRECTOR, LEAD PORTFOLIO MANAGER – GLOBAL EQUITIES	27/11
STEFAN MARCIONETTI	ASSISTANT PORSTFOLIO MANAGER – GLOBAL EQUITIES	15/4
DOMENICO GIULIANO*	DEPUTY CIO	23/10
GERALD STACK	HEAD OF INFRASTRUCTURE & INDUSTRIALS SECTOR	29/10
NIKKI THOMAS *	HEAD OF RESEARCH, PORTFOLIO MANAGER – GLOBAL EQUITIES	31/10
SAM CHURCHILL	HEAD OF MACRO RESEARCH	9/4
VIHARI ROSS*	SECTOR LEAD – FRANCHISES / INVESTMENT ANALYST	16/10
KRIS WEBSTER*	SECTOR LEAD – TECHNOLOGY, COMMUNICATIONS AND MEDIA / INVESTMENT ANALYST	14/9
ALAN PULLEN*	SECTOR LEAD – FINANCIALS / INVESTMENT ANALYST	17/4
TED ALEXANDER*	SECTOR LEAD – HEALTHCARE / INVESTMENT ANALYST	10/2

* Voting members of the Investment Committee
# Chair of Investment Committee

Hamish Douglass is the CIO and portfolio manager of MAM's Global Equity strategies. Douglass also bears non-investment related responsibilities as the business's Managing Director and CEO.

Stefan Marcionetti supports Douglass as a portfolio manager for the MAM's Global Equity strategies. Marcionetti also retains limited stock coverage responsibilities within the Technology, Communications and Media sector.

Gerald Stack, portfolio manager of the Magellan Infrastructure Fund and Head of Investments, plays a key role in staff management. Stack is involved in recruitment and workload management of the entire analyst team, with all sector heads reporting to him.

As the Head of Research, Nikki Thomas is responsible for ensuring that MAM's research methodology is consistently and accurately applied across all stocks researched at the firm. Thomas also has portfolio management and stock research responsibilities for the Franchises sector.

Deputy CIO Domenico Giuliano provides input to Douglass on deriving investment strategies. He is primarily responsible for the research initiation and review process. Additionally, he will be leading any new product developments. Similar to Thomas, Giuliano also has portfolio management and stock

Investment analysts are structured into sector teams, with each team led by a sector head. There are a total six sector teams covering Franchises (consumer staples and discretionary, home improvement retail); Industrials; Technology, Communications and Media; Financials; Healthcare; Industrials and Infrastructure. Additionally, there is also a Macro Research team.

Remuneration

Employees are rewarded with a base salary, in addition to discretionary short-term and long-term incentive programs.

Short-term incentives (bonuses) are based on performance (stock and fund level), the profitability of MAM and a qualitative assessment by Douglass and Stack. The bonus is not capped and can be multiples of base salary, typically comprising a cash and a deferred component which is paid over the following 12 month period or longer.

For Douglass specifically, his short-term incentives are determined by the investment performance of the strategies he manages. Further, his total base salary is determined as 1.5% of the average operating profit before income tax expense, for the Funds Management operating segment of Magellan Financial Group Limited for the three preceding financial years.

All employees, with the exception of Douglass are also offered longer term incentives via a share purchase plan. This program acts a staff retention mechanism and helps align the long-term interests of employees with those of clients.

Magellan Global Trust

Research Approach

Overview

RESEARCH PHILOSOPHY	FUNDAMENTAL, BOTTOM UP
TARGET COMPANY	A COMPANY WITH A SUSTAINABLE COMPETITIVE ADVANTAGE, HIGH ROIC, PREDICTABLE CASH FLOW / EARNINGS, LOW AGENCY RISK, ETC.
MIN. MARKET CAP	US$5 BILLION
NO. STOCKS IN UNIVERSE	4,000 GLOBAL STOCKS
NO. STOCKS FULLY MODELLED / RESEARCHED	250
RESEARCH INPUTS	VARIOUS (E.G. COMPANY MANAGEMENT MEETINGS)
BROKER RESEARCH INPUTS	MINOR CONSIDERATION
VALUATION OVERVIEW	THREE-STAGE DISCOUNTED CASH FLOW MODEL AND THREE-YEAR FORECAST TOTAL SHAREHOLDER RETURN

Universe filtering

Quantitative and qualitative screens are employed to identify 'outstanding' companies in the investment universe, generally those deemed to have an economic moat (or those building one).

Typically, short-listed companies will be in the top quartile of the investment universe on a return on capital measure (exceptions are usually highly cash generative). This narrows the potential universe for investment candidates to approximately 1,000 stocks.

Research Process

The relative attractiveness of investment opportunities is assessed based on four key characteristics MAM considers to define an 'outstanding company'. These include: a wide economic moat (protection around an economic franchise); moderate to high potential to continue to re-invest capital into the business at high incremental returns; low business risks (impacts the predictability of cash flow and earnings projections); and low agency risk (management's shareholder focus). This stage reduces the investment universe to approximately 250 stocks. Sector teams conduct deep, detailed, bottom-up analysis into these companies, with each company assigned a Quality Score (out of 50) and valuation determined.

Once the initial research and review are complete, the analysis is discussed within the sector teams first before being submitted to the Investment Committee (IC) to be considered for inclusion on the firm's approved list.

The role of the IC is to formally evaluate the investment thesis, qualitative criteria and valuation methodology assumptions in order to make a decision on whether or not the company is deemed to be truly 'outstanding'. A majority vote (not unanimous) from the IC is required before a company is included on the firm's approved list. MAM's approved list numbers approximately 100 stocks.

Valuation

A company's valuation is evaluated using a three-stage DCF model and a three-year forecast total shareholder return measure.

The duration of the DCF model is determined by the assessment of the depth or quality of the economic moat around the business. That is, a company with a wide (or large) economic moat will be valued using a longer time horizon. A company with a narrow economic moat will be valued using a shorter time horizon.

The three-year forecast total shareholder return measure is calculated by applying a forward price / earnings ratio to the Manager's earnings per share forecast. This is then adjusted by the Manager's forecast of dividend payments over the period.

MAM developed a 'Conviction Scoring Matrix' to rank companies that have been approved by the IC. The matrix provides a multi-dimensional view of each company's quality (i.e. Quality Score) and value (equally weighting the DCF valuation and total shareholder return), allowing the portfolio manager to focus on both company quality, as well as valuation premiums.

Portfolio Construction

Overview

FUND BENCHMARK	NO STATED BENCHMARK
EMERGING MARKETS PERMITTED	YES
INTERNAL RETURN OBJECTIVE	NOT STATED
INCOME OBJECTIVE	4% P.A.
INTERNAL RISK OBJECTIVE	CAPITAL PRESERVATION
PORTFOLIO MANAGEMENT APPROACH	BENCHMARK UNAWARE
INVESTMENT STYLE	QUALITY
PORTFOLIO MANAGEMENT APPROACH	LEAD PM WITH SECONDARY SUPPORT
STOCK SELECTION	BLENDED BOTTOM-UP AND TOP-DOWN
TOP-DOWN INFLUENCE	IMPORTANT
NO. OF STOCKS	15 - 35
MARKET CAPITALISATION BIAS	LARGE
EXPECTED PORTFOLIO TURNOVER	20% P.A.

Decision making

The Fund is constructed by selecting amongst the highest returning stocks in the approved list based on the three-year forecast total shareholder return measure. Position sizing is at Douglass's, the portfolio manager, absolute discretion (within risk constraints). At the overall fund level, the portfolio manager seeks to ensure the Fund is sufficiently diversified and that any macroeconomic views and risk controls are appropriately applied.

Tools used to assist in portfolio construction include the Conviction Scoring Matrix and Portfolio Construction Worksheet. The Conviction Scoring Matrix ranks the universe of approved stocks based on quality and valuation criteria, while the Portfolio Construction Worksheet details the underlying currency and geographic exposures of the portfolio to help manage unintentional risk exposures.

The portfolio has a maximum Combined Risk Ratio of 1.0x, which is a proprietary Magellan risk management measure which reflects the portfolios drawdown profile. The ratio aims to limit the inclusion of stock within the portfolio with a high equity beta as well as stocks that have historically had drawdowns greater than the market.

Currency management

The portfolio will be predominantly invested in developed markets securities denominated in foreign currencies. The Trust's hedging policy is based on an assessment of fair value for each currency against the AUD and determine upper and lower bounds. While the currency exposure will be actively managed at the discretion of the portfolio manager, it is a largely mechanical process determined by the current exchange rate verse the assessed upper and lower bounds. This active currency management results in a portfolio hedge ratio range of between 0% - 100%. The Manager will only hedge a currency position if the exposure to that currency within the portfolio is greater than 5% of NAV.

The objective of the active hedging is to manage AUD risk over the medium-to-long term and generate profit from the AUD when it trades outside its historical ranges over time via an asymmetric hedging profile.

Currency hedging levels are guided by the assessment of fair value bounds between the AUD and the respective foreign currency. These bounds are determined by internal research undertaken by Magellan, are based on long-term averages, and are reviewed through time. They can be set at different levels. There will be an upper band (0% hedged) and a lower band (100%). This range will encompass 'fair value' where 50% of the exposure will be hedged.

Buy / sell drivers

A stock is purchased based on its relative attractiveness determined by its Quality Score and valuation, with due considerations given to portfolio diversification, risk controls and macroeconomic views. That said, as the Fund is intended to reflect same of the Manager's highest conviction ideas, the portfolio is expected to be a subset of the Magellan Global Fund.

A stock is sold if:

- The value of the company materially exceeds MAM's assessment of intrinsic value;
- The investment fundamentals regarding the strength of the business franchise (and hence economic moat) have materially deteriorated;
- Company management acts in a shareholder unfriendly manner;
- A company has not performed to expectations;
- The opportunity cost of another investment materially outweighs the existing security;
- The Manager believes it has made an error / mistake; or
- Required for risk control purposes (e.g. significant share price appreciation resulting in a position being trimmed).

Risk Management

Risk limits

SEPARATE RISK MONITORING	YES (PERFORMED BY RISK TEAM WITH SEPARATE REPORTING LINES TO INVESTMENT TEAM)
STOCK CONSTRAINTS	MAX. 20% PER STOCK; NO MORE THAN 4 STOCKS >12.5% EACH; NO ADDITIONAL STOCK PURCHASE IF WEIGHT >15% (>12.5% FOR FINANCIALS)
SECTOR CONSTRAINTS	NO LIMIT
COUNTRY / REGION CONSTRAINTS	NO LIMIT
EMERGING MARKETS LIMITS	NO LIMIT
CASH BORROWING	0-20%
MAXIMUM GROSS EXPOSURE	120%
ACTIVE FX HEDGE LEVEL	0-100%

Risk monitoring

Sector, stock and geographical weights are a result of bottom-up, stock selection and top-down macro views– an approach Lonsec views as generally typical with absolute return, fundamental type of portfolio management.

MAM does not employ risk measurement models (e.g. Barra) in managing portfolios. Given the concentrated nature of the strategy, MAM believes there is greater scope for risk factors to be better understood and intuitively interpreted via detailed fundamental analysis.

Pre-trade compliance check is performed by order management system Eze-Castle OMS, whereas post-trade compliance checks are conducted by the external investment administrator. Breaches are automatically reported to the Legal Risk and Compliance Team and assessed by the CRO to determine what action (if any) is required, including escalation to the Risk and Compliance Committee and MAM's Board if an incident is deemed to be a material breach.

Counterparty risk is monitored daily by the Operations Team. MAM only transacts with approved brokers who have a minimum credit rating of A2 or above, which is assessed daily by analysts in the Financials research team. Further, exposure limits are applied to each counterparty. In the event these rules are breached, new trading with the counterparty ceases, the impact assessed and appropriate action taken.

Combined Risk ratio

A Combined Risk Ratio is calculated for each stock and it is a combination of the stock's beta to global markets and a stock's relative performance during market downturns. The portfolio Combined Risk Ratio is then calculated and assessed as a means to measure a portfolio's exposure in a market downturn. The Trust has a maximum Combined Risk Ratio of 1.0x, compared to the Global Fund's 0.8x, allowing the Trust to have slightly higher conviction. The new risk measurement aims to provide a better indication of a portfolio/stocks downside protection. Lonsec is generally supportive of this evolution of risk measurement.

Borrowing

The Fund may borrow against all or part of its investment portfolio provided that, at the time any new borrowing is entered into, the aggregate of those new borrowings and any pre-existing borrowings do not exceed 20% of the gross asset value of the Fund. The Fund will only gear in at times then they believe the market is trading at steep discounts to intrinsic value.

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Important Risks

An investment in the Trust will carry a number of standard investment risks associated with domestic and international investment markets. These include economic, political, legal, tax and regulatory risks. These and other risks are outlined in the Prospectus and should be read in full and understood by investors. Lonsec considers major risks to be:

Currency risk

The Trust predominantly invests in assets that are denominated in non-A$ currencies. A rise in the relative value of the A$ vis-à-vis the currencies in which the assets are denominated will negatively impact the market value of the assets (and vice versa) from an Australian investor's perspective. The Manager has the ability to actively hedge currency exposure with the dual aims both of generating positive total returns and for risk management purposes. The Trust may be 0 to 100% currency hedged at times.

Concentration risk

The Trust will be generally invested in 15 to 35 different stocks and does not have any sector or country constraints. The Manager is expected to build a portfolio that may vary markedly from the benchmark (e.g. concentration risk and/or sector, industry or country exposures). Accordingly, investors should be mindful of the potential for sharper movements in the market price of these movements.

Market risk

The Trust has **no formal limit** to exposures on stocks domiciled in emerging market countries. Stocks domiciled in emerging markets are typically associated with higher market risk, relative to those domiciled in developed markets. Accordingly, investors should be mindful of the potential for sharper movements in market price of these investments.

Leverage risk

The Trust will be permitted to enter into cash borrowing arrangements up to 20% of the NAV of the portfolio. The Manager will seek to limit the Trust's maximum gross exposure to 120% of NAV.

Listed Trust risk

The market price of the Trust's securities may not correlate to the underlying value of the portfolio as reflected in its monthly or weekly NTA backing per share. The securities may trade on the ASX at a discount or a premium to the Trust's monthly or weekly NTA backing per share.

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Glossary

Absolute Return 'Top line' actual return, after fees

Excess Return Return in excess of the benchmark return (Alpha)

Standard Deviation Volatility of monthly Absolute Returns

Tracking Error Volatility of monthly Excess Returns against the benchmark (the Standard Deviation of monthly Excess Returns)

Sharpe Ratio Absolute reward for absolute risk taken (outperformance of the risk free return (Bank Bills) / Standard Deviation)

Information Ratio Relative reward for relative risk taken (Excess Returns / Tracking Error)

Worst Drawdown The worst cumulative loss ('peak to trough') experienced over the period assessed

Time to Recovery The number of months taken to recover the Worst Drawdown

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About Lonsec

Lonsec Research Pty Ltd (Lonsec) is an investment research house with specialist areas of expertise, that was originally established in 1994 and the current entity was registered on 23 June 2011. From 1 July 2011, Lonsec became a fully owned subsidiary of Lonsec Fiscal Holdings Pty Ltd, a privately owned and independent entity with a multi-brand strategy of providing leading financial services research and investment execution.

Lonsec believes that professional financial advisers need informed opinions on the best investment strategies and financial products to provide real value for their clients. To meet this need, Lonsec has in place an experienced research team, which draws on a robust research process to undertake in-depth assessment of managed fund products.

Analyst Disclosure and Certification

Analyst remuneration is not linked to the research or rating outcome. Where financial products are mentioned, the Analyst(s) may hold the financial product(s) referred to in this document, but Lonsec considers such holdings not to be sufficiently material to compromise the rating or advice. Analyst holdings may change during the life of this document. The Analyst(s) certify that the views expressed in this document accurately reflect their personal, professional opinion about the matters and financial product(s) to which this document refers.

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Analyst

Simon Baird

Release authorised by

Rui Fernandes