Zenith Investment Partners

Highly Recommended
Recommended
Approved
Not Rated
Redeem

Product Assessment

Rating issued on 29 Aug 2017

Magellan Global Trust

VIEWPOINT & RATING

The Fund is a newly created Listed Investment Trust (LIT) managed by Magellan Asset Management (Magellan), a Sydney-based fund manager. Magellan provides investors an exposure to international equities through a concentrated, benchmark unaware investment approach that focuses on capital preservation and providing a stable distribution yield. Zenith rates the investment team and process highly.

Magellan was incorporated in July 2006 and is a wholly owned subsidiary of the ASX listed Magellan Financial Group (ASX code: MFG). Magellan was co-founded by Chris Mackay and Hamish Douglass, who both came from investment banking and corporate advisory backgrounds. In his role as Chief Executive Officer and Chief Investment Officer, Douglass is ultimately responsible for the investment team and corporate strategy. Zenith believes Douglass is an intelligent and insightful investor, who demonstrates a deep understanding of the macroeconomic and thematic drivers of global financial markets. Head of Investments, Gerald Stack, who is also highly regarded by Zenith, is responsible for co-ordinating the day-to-day research effort of the wider investment team, which includes 36 investment professionals. The Fund will be managed as a dual portfolio management structure with Stefan Marcionetti assisting Douglass. Marcionetti has been an assistant portfolio manager on the Magellan Global Fund since 2016. While we believe Marcionetti is a capable investor, we note that this is his first portfolio management role.

Magellan's investment process is premised on the belief that investment in high quality, lower volatility companies can enhance the downside protection of a portfolio, resulting in superior long-term risk-adjusted performance. Magellan undertakes a fundamental research effort in seeking to identify companies which exhibit sustainable competitive advantages and the ability to deliver returns on capital materially in excess of their cost of capital. Zenith believes Magellan’s process is based on a sound investment thesis and retains a high level of confidence that it will continue to deliver strong absolute returns over the longer-term.

All stocks are scrutinised using bottom-up fundamental analysis with approval required from the investment committee prior to a security being considered for inclusion into Magellan's portfolios. Company analysis involves a detailed due diligence process and extensive financial modelling to ensure that only high quality companies trading at a significant discount to intrinsic value are considered for the portfolio. In constructing the Fund, Douglass considers the global macroeconomic environment, with the intention of positioning the portfolio in sectors and regions that are likely benefit from prominent economic themes.

The Fund essentially comprises two discrete sub-portfolios: a more conservative, less market sensitive portfolio; and a thematic portfolio, through which Magellan will typically implement shorter cycle investment ideas. Douglass is not constrained by the number of stocks that can be held in each portfolio. Zenith believes there is a strong connection between the Fund and the underlying research conducted by Magellan's investment team, with Douglass considering both qualitative and valuation factors when constructing the Fund.

The Fund is not as constrained as the Magellan Global Fund with the market sensitivity of the aggregated portfolio allowed to be up to 1.0 compared to 0.8 in the Magellan Global Fund. Therefore, Zenith expects the Fund will potentially exhibit greater performance volatility than the Magellan Global Fund, in addition to having greater upside potential in stronger equity markets. Zenith notes the level of overlap in holdings between the Fund and the Magellan Global Fund is expected to be high.

Eligible investors who invest under the priority offer may be eligible to receive additional units, (Loyalty Units), equivalent to 6.25% of the number of units allotted under the priority offer, at no cost. The economic cost of Loyalty Units will be borne by Magellan Group.

FUND FACTS:

- Investors can buy and sell units in the Fund via the ASX
- Concentrated portfolio of 15 to 35 securities, can hold up to 50% cash
- Active currency hedging

ABSOLUTE RISK (SECTOR)

- VERY HIGH
- HIGH
- MODERATE
- LOW
- VERY LOW

RELATIVE RISK (FUND WITHIN SECTOR)

- Geared
- Active - Benchmark Unaware
- Active - Benchmark Aware
- Index - Enhanced/Fundamental
- Index

INCOME DISTRIBUTIONS PER

MONTH | QUARTER | 6 MONTH | ANNUM

INVESTMENT TIMEFRAME

1-2 YRS | 3-4 YRS | 5-6 YRS | 7+ YRS

APIR Code

ASX:MGG

Asset / Sub-Asset Class

International Shares
Listed Investment Companies - LICs

Investment Style

Value

Investment Objective

To achieve attractive risk-adjusted returns over the medium to long-term, whilst reducing the risk of permanent capital loss.

Zenith Assigned Benchmark

MSCI World ex Aust $A

Fees (% p.a., Incl. GST)

Management Cost: 1.35%
Performance Fee: 10% of total return having beaten relative & absolute benchmark hurdles

APPLICATIONS OF INVESTMENT

SECTOR CHARACTERISTICS

Listed Investment Trusts (LITs)

In assessing the performance of LITs, it is vital to understand how their structure affects the final performance figures as it is materially different to unlisted funds. As listed vehicles, the portfolio returns generated are exposed to additional volatility from unit price movements and can trade at significant premiums or discounts to Net Asset Value (NAV).

As an indication however, a series of return data can be viewed on the basis of the returns generated by:

- Unit price and distributions
- Change in NAV and distributions
- Returns generated internally by the investment portfolio

For comparison purposes, the use of the internal portfolio returns versus the benchmark gives the closest measure of the investment manager's skill in generating returns. However, these returns may not be able to be fully crystallised to unitholders holders given the potential for unit price movements on the ASX.

At various times when assessed on a purely quantitative basis, a LIT can trade away from its NAV which may represent good buying or selling opportunities. While these instances may boost investment returns, there is no guarantee that the discount or premium will converge to NAV, therefore, gains cannot be crystallised.

LITs differ in several important ways from Listed Investment Companies (LICs). Of particular note, owing to the trust structure used by LITs, 100% of net trust income must be paid as a distribution in the year it is earned. As a company, LICs will pay dividends at the election of the Board in accordance with the LICs dividend policy. LIC profits may be retained in order to create a more even flow of dividends.

International Equities

International equities offer Australian investors the ability to access a broader opportunity set, with the potential to invest in sectors not represented or not well represented in the Australian market. Given international markets are not perfectly correlated with the Australian market, International equities also afford portfolio diversification benefits.

The sector incorporates both benchmark aware and benchmark unaware strategies that focus predominantly on larger capitalisation stocks. The sector is one of the most competitive fields in the investment landscape, based on the number of managers and strategies available to investors.

Zenith benchmarks all funds in this sector against the MSCI World Index ex-Australia (Unhedged), which corresponds with the benchmark employed by the majority of funds in this space. The index is market-capitalisation weighted, resulting in those companies with the largest market capitalisations receiving the heaviest weightings. The index consists of approximately 1,500 securities listed in 22 developed markets (Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States) with the United States currently representing approximately 60% of the index; Japan and the United Kingdom being the next largest constituents, with approximately 9% and 7% respectively. The index excludes emerging and frontier markets but many managers retain the mandate flexibility to invest in emerging markets.

The global share market, as represented by the MSCI World Index ex-Australia (Unhedged), is far more diverse, in terms of sector exposures, than the Australian market. Although the Financials sector represents the largest sector index weight, many sectors not well represented in the Australian market, such as Information Technology and Healthcare, are well represented in the global index, each with approximately a 15% and 12% weighting respectively. Despite the market capitalisation weighting methodology, the top 10 index stocks represent only approximately 11% of the weighting of the index, reflecting the larger universe and less top heavy nature of the universe.

PORTFOLIO APPLICATIONS

In general, compared to most other asset classes, equities offer investors the opportunity for higher capital growth over the longer-term with some income. However, this higher growth is also often associated with higher volatility. International equities provide investors with a broad exposure to industries and countries. With such a broad universe, it is expected that managers can deliver superior returns to Australian equities and more conservative asset classes. However, the expectation of greater returns comes with increased volatility, especially when currency is factored in. Therefore, it is recommended that investors adopt a longer time frame when investing in international equities. It is also recommended that investments in international equities be blended with domestic equities and other non-correlated asset classes such as fixed income to diversify the impact of a downturn in the global economy.

Given Magellan's value investment style, Zenith would expect the Fund to have stronger performance relative to competitors in flat or falling market environments. As the Fund is concentrated and benchmark unaware, investors should be cognisant that its returns and volatility may vary considerably relative to both the benchmark and its peers. To achieve a more diversified exposure to international equities, Zenith believes the Fund may be blended with other style-neutral or growth orientated international equity products.

Zenith notes that the currency exposures within the Fund may be actively hedged. Investors should be aware that active currency hedging has the potential to result in significantly different investment outcomes when compared with an unhedged or fully hedged portfolio.

Zenith believes the Fund's structure allows small investors easier access to a highly regarded global equities strategy without investment platforms, which tends to add another layer of fees.

The Fund’s portfolio turnover is expected to be approximately 30% p.a., in normal market conditions. Zenith considers this to be low. Investors should therefore be aware that the Fund's returns are likely to be delivered via a combination of capital appreciation and income (short-term realised gains). This approach will therefore more likely suit high marginal tax rate payers.

Liquidity

Investors can buy and sell units in the Fund via the ASX using an online broking account. Like traditional ASX transactions, settlement is via CHESS.

Once quoted, units will be traded on the subject to liquidity. Magellan will provide an intraday indicative Net Asset Value (iNAV) which will be published on a continuous basis on the Magellan website. iNAV will reflect adjustments for exchange rates, portfolio changes and equity price movements. As parts of the portfolio will be trading on international exchanges outside ASX trading hours, the iNAV will be exposed to stale pricing, meaning whenever portfolio stocks do not have live trading prices during the ASX trading day the Fund's iNAV will not update them. Given the current composition of the strategy, the majority of movements in the iNAV will be reflecting movements in foreign exchange.

Zenith also notes that Magellan may undertake an on market buyback of units as an attempt to mitigate unit price trading away from NAV. Buybacks are primarily expected to be funded by borrowings against the portfolio, with any units acquired by Magellan under a buyback to be immediately cancelled.

Loyalty Units

Eligible investors who invest under the priority offer may be eligible to receive additional units, (Loyalty Units), equivalent to 6.25% of the number of units allotted under the priority offer, at no cost. The economic cost of Loyalty Units will be borne by Magellan Group. Zenith also notes that Magallan will meet all costs associated with the offer, so that the application price will match the opening NAV per unit.

Priority applicants need to be a unitholder on the Loyalty Unit Determination Date of 11 December 2017 in order to receive Loyalty Units. Priority applicants who, on this date, hold at least the same number of units allotted to them under the priority offer will receive 100% of their Loyalty Units. Applicants holding a lower number of Units will receive a correspondingly lower number of units.

Transparency

Zenith notes that in addition to providing a fund iNAV before the commencement of each trading day and intraday iNAV, Magellan will also provide full transparency on portfolio holdings on a quarterly basis subject to a two month lag. While this feature is common for 'Active' Exchange Traded Funds (of which Magellan currently has three listed), this level of transparency is uncommon in LICs and LITs. Zenith views such levels of disclosure as a positive for investors.

RISKS OF THE INVESTMENT

SECTOR RISKS

Funds within the “International Equities/Listed Investment Company” sector are exposed to the following broad risks:

MARKET & ECONOMIC RISK: Global equity markets present a risk in protracted downturns or bear markets. Changes to economic, social, technological or geopolitical circumstances of a region may lead to different risk return profiles as compared to historically. It may possibly change the equity risk premium profile of the region's equities asset class, impacting on returns. This risk can be mitigated by adhering to the LITs prescribed investment timeframe.

CURRENCY RISK: Changes to currency values may alter an international equity investment’s return if the denominated currency appreciates or depreciates by a material amount. This risk is greatly reduced by the Manager’s ability to hedge currencies.

REGULATORY RISK: A change in the geopolitical circumstance of a global region may adversely impact on both the value of the underlying securities and the currency of denomination. In extreme cases, it may lead to exchange controls which limit the ability of foreign investors to repatriate funds to the home country.

LIQUIDITY AND CAPACITY RISK: In some cases, global equities may present low liquidity in particular regions. Emerging markets and small cap stocks may display low liquidity due to low volume and fewer market participants than the major bourses.

PREMIUM/DISCOUNT TO NET TANGIBLE ASSETS (NTA): Investors need to be aware that as a LIT, the Company's shares will have their own trading patterns and may trade away from their Net Tangible Assets (NTA) which at times may impact the effectiveness of the Company's investment process and/or expected risk-return profile.

FUND RISKS

Zenith has identified the following key risks associated with the Fund; this is not intended to highlight all possible risks:

KEY PERSON RISK: Notwithstanding the depth and experience within Magellan’s investment team, Zenith regards Hamish Douglass as integral to the ongoing success of the strategy, particularly given his macroeconomic insights and overall input into Magellan’s investment process. Zenith believes that his departure would have a material impact on the business, and would warrant an immediate re-assessment of our rating on the Fund.

CAPACITY RISK: Excessive levels of funds under management (FUM) can inhibit a manager's ability to trade portfolio positions effectively, and therefore limit outperformance potential. As at 31 July 2017, Magellan managed approximately $A 41.3 billion within the strategy, including $A 365 million in the High Conviction strategy, a more concentrated version of the global strategy.

Given Magellan's mega cap bias and longer-term investment approach, Zenith does not believe that capacity risk is currently a material concern; however Zenith will continue to monitor Magellan's level of FUM in its global strategies and corresponding excess return generation closely to ensure that increasing levels of FUM do not begin to negatively impact performance.

CONCENTRATION RISK: Zenith notes that the Fund is highly concentrated, holding between 15 and 35 securities. Zenith believes that a concentrated portfolio has greater exposure to stock specific risk than more diversified strategies, and as such investors should be cognisant that the Fund may experience capital volatility in excess of a more diversified strategy.

CURRENCY RISK: Zenith notes the Fund's currency exposures may be actively hedged, with the level of hedging to be determined by portfolio manager Hamish Douglass. Notwithstanding Douglass' historical ability to add value through his macroeconomic insights, Zenith believes it is extremely difficult to consistently forecast longer term currency movements. As such, investors should be aware that the active currency hedging has the ability to result in materially different outcomes when compared with an unhedged or fully hedged portfolio.

INVESTMENT STYLE RISK: Although the benchmark unaware, high conviction approach is an appealing feature of the Fund, it could lead to materially different performance from the benchmark. While over the longer term this has resulted in superior performance for the strategy it could also result in relative under performance during certain market conditions.

INITIAL OFFER / LIQUIDITY RISK: There is a risk that the initial capital raising of the Fund fails to raise sufficient capital to enable efficient market liquidity and pricing in the units. Should the Fund fail to raise a level of capital that Zenith believes is required for the Fund to be priced effectively, Zenith will retain the right to revisit our issued rating.

iNAV RISK: Intraday unit pricing published by the Fund (iNAV) is indicative only and may not accurately reflect issues such as currency movements or stocks in the portfolio which are trading outside the hours of operations of the ASX.

LEVERAGE RISK: The Trust may borrow against all or part of the Portfolio to fund a buyback of Units and/or for investment purposes. Borrowings can magnify the gains and losses in the Trust.

LOYALTY UNIT VESTING RISK: Priority applicants eligible to receive Loyalty Units are required to be unitholders in the Fund on 11 December 2017. Loyalty Units will only be issued in proportion to the number of units held at that date. The number of Loyalty Units a Priority Applicants could receive is capped at the maximum amount they could be issued under the Priority Offer (ie 6.25% of units allotted under the Priority Offer).

QUALITATIVE DUE DILIGENCE

ORGANISATION

Magellan Asset Management (Magellan) was incorporated in July 2006 and is a fully owned subsidiary of the Magellan Financial Group (ASX Code: MFG). Magellan was co-founded by Chris Mackay (ex CEO UBS Australasia) and Hamish Douglass (ex co-Head Global Banking at Deutsche Bank). Founders, Directors and Staff own over 25% of the company.

Magellan launched the Magellan Global Fund and the Magellan Infrastructure Fund (Hedged) in July 2007 as unlisted registered managed investment schemes, with the wholesale Magellan Core Infrastructure Fund following in December 2009. In July 2013, Magellan launched a Global High Conviction strategy as well as providing investors with a hedged version of the Global Fund, and an unhedged version of the Infrastructure Fund.

In September 2011, Magellan announced it had appointed US-based Frontier Partners to distribute Magellan's global equity and infrastructure strategies to institutional clients based in the USA and Canada, which has further diversified Magellan's client base.

In October 2013, Mackay stepped down from his role as Chairman of the MFG Board, to focus on the management of the listed Magellan Flagship Fund. Mackay has been replaced by Executive Chairman Brett Cairns and will remain a special advisor to the board.

Magellan has experienced rapid growth in funds under management (FUM) over the past few years, with $A 49.6 billion total FUM across the business, as at 31 July 2017. Whilst the inflows are undoubtedly a net positive for the organisation, Zenith believes further net inflows has the potential to impact the capacity of the organisation.

Zenith retains a high level of conviction in the Magellan organisation, based on the co-founders strategic ability to build the business in a sustainable manner.

INVESTMENT PERSONNEL

Name	Title	Tenure
Hamish Douglass	Managing Director and CIO	11 Yr(s)
Gerald Stack	Head of Investments	10 Yr(s)
Nikki Thomas	Head of Research	10 Yr(s)
Domenico Giuliano	Deputy CIO	10 Yr(s)
Stefan Marcionetti	Portfolio Manager	4 Yr(s)

The investment team of 34 (plus three dealers) is led by Hamish Douglass, who retains ultimate responsibility for the Fund as lead portfolio manager. Zenith holds Douglass in the highest regard and believe his previous investment banking experience has him well placed in understanding and analysing global companies.

The Fund will be managed as a dual portfolio management structure with Stefan Marcionetti assisting Douglass. Marcionetti has been an assistant portfolio manager on the Magellan Global Fund since 2016. While we believe Marcionetti is a capable investor, we note that this is his first portfolio management role.

Magellan's research effort is overseen by Gerald Stack (Head of Investments) and Nikki Thomas (Head of Research), with whom Zenith has met on a number of occasions and holds in high regard. The investment team is primarily based in Sydney, with an additional office located in New York.

The investment team is structured along sector lines, with each sector being led by a senior analyst. Sectors covered by Magellan's research team include:

- Infrastructure, Transport and Industrials
- Financials
- Healthcare
- Franchises
- Technology, Communications & Media

During 2014, Magellan developed an internal macroeconomic team led by Sam Churchill, which is responsible for the identification and analysis of macroeconomic themes and trends.

Furthermore, as a result of Magellan's increased presence in global markets, an internal Governance and Advisory team has been developed. Comprising four members, this team reports to Douglass and is led by Head of Governance and Advisory

Craig Wright. The team is responsible for proxy voting and engaging with companies in an advisory capacity. This allows Magellan to separate the research and governance functions creating better consistency across the business.

Magellan has historically experienced low levels of staff turnover, which Zenith believes is attributable to a strong working culture and the success of the broader business.

While Douglass retains ultimate responsibility for portfolio construction, stocks can only be included in the Fund if they have been approved by the Investment Committee (IC) and given an investment grade rating. The IC is chaired by Gerald Stack and meets on a monthly basis (or more frequently as deemed necessary), and in total consists of 12 voting members. It is expected that all members of the investment team will attend IC meetings, along with Brett Cairns, Chairman of the MFG board.

The investment team is incentivised through a remuneration structure consisting of a base salary with the potential to participate in additional short and long-term discretionary incentive programs. The short-term plan is dependent on the profitability of Magellan, and is determined based on the individual's performance against an internally agreed upon set of objectives. This short-term incentive typically comprises a cash bonus and a deferred amount paid out over the following 12 month period. Longer-term incentives give staff the opportunity to participate in the Share Purchase Plan (SPP), with Magellan affording staff an interest free loan for a percentage of the shares.

In Zenith's view, the collective ability of Magellan's investment team to assess and value investment opportunities remains strong. Having met with a number of the senior staff members on numerous occasions, Zenith has been highly impressed with the team's expertise and depth of knowledge. In addition, Zenith believes Douglass is an intelligent and insightful investor, who demonstrates a deep understanding of the macroeconomic and thematic drivers of global financial markets.

INVESTMENT OBJECTIVE AND PHILOSOPHY

Magellan's investment process is based on the belief that superior long-term returns can be generated through the minimisation of negative shocks to a portfolio and that strong long-term risk-adjusted performance can be delivered through the investment in high quality, lower volatility securities.

Consistent with this philosophy, the investment objective of the Fund is to achieve risk-adjusted returns over the medium to long-term, whilst reducing the risk of permanent capital loss. Whilst we believe the investment objective is consistent with Magellan's investment approach, Zenith would prefer to see the delineation of a specific outperformance target, as opposed to a descriptive, qualitative objective. Zenith believes this will provide investors with greater transparency with regards to returns expectations and to the level of risk imbedded in the Fund.

Believing investment markets are not always efficient, Magellan employs a fundamentally driven research process in seeking to identify high quality companies with the ability to generate strong cash flows throughout the economic cycle. This analysis is overlaid with the macroeconomic insights of portfolio manager Hamish Douglass in constructing a highly concentrated and benchmark agnostic portfolio.

Zenith believes Magellan's process is based on a sound investment thesis and retains a high level of confidence that it will continue to deliver strong absolute returns over the longer-term. However given the Fund's value and quality bias, investors should be cognisant that the Fund has the potential to underperform the benchmark during periods of strongly upward trending markets.

SECURITY SELECTION

Magellan's investment universe initially comprises all globally listed securities that have a market capitalisation in excess of $US 5 billion. Magellan conducts a broad fundamental screen in seeking to identify companies that have historically displayed high returns on capital and a strong economic moat. It is expected that the screening process will highlight approximately 200 securities for further analysis.

Magellan defines an economic moat as being the protection around a company's economic franchise (i.e. sustainable competitive advantages) which in Magellan's opinion will enable the company to generate returns materially in excess of their cost of capital. Identification of companies with material economic moats involves the consideration and assessment of the barriers to entry, the risks of substitutes, the negotiating power of buyers and suppliers to a company and the intensity of rivalry amongst competitors.

This initial screening process is supplemented with an industry analysis to enable the investment team to gain a differentiated insight into the attractiveness of the industry and the competitive forces operating within it.

Magellan assesses each company that progresses through the screening process based on subjective factors used to define the quality of an underlying company. The qualitative factors are assessed as follows:

- *Economic moat* - narrow, moderate, moderate/wide or wide (scored out of 20)
- *Reinvestment potential* - low, medium or high (scored out of 10)
- *Business risks* - low, medium or high (scored out of 10)
- *Agency risk* - low, medium or high (scored out of 10)

The scoring of the qualitative factors occurs in increments of 2.5 to avoid over analysis or debate with questionable material impact. This process forces analysts to be decisive, which Zenith believes to be a strong feature of the scoring process.

Analysts are not mandated to meet with company management prior to investment; however, for companies where superior management execution is deemed crucial to the business model, analysts are required to engage with company management as part of the initial qualitative due diligence in seeking to gain increased insight and conviction into management's strategy and their ability to execute upon it. For businesses deemed as having lower execution risk, it is expected that analysts engage with management on an annual basis.

Magellan's valuation process incorporates a longer-term assessment of a company's intrinsic value, with a shorter-term signal based on a three year assessment of Total Shareholder

Return (TSR). On any valuation Magellan looks for a sufficient "margin of safety" (MOS), defined as the share price discount to intrinsic value. The larger the assessed discount, the wider the margin of safety.

The determination of intrinsic value is primarily derived through the use of a three stage discounted cash flow model (DCF) using a weighted average cost of capital (WACC) methodology. The duration of the DCF model is determined by the economic moat of the business to ensure this is in line with the durability of the company's competitive advantage. Companies exhibiting a wider economic moat typically have a DCF analysis undertaken over a period of 25 to 30 years.

While a DCF of this potential time duration would normally cause some concerns with regard to forecasting risk, Zenith is comfortable that this risk is reduced through Magellan's detailed due diligence, the fading of Return on Capital to the cost of capital over the horizon period and the use of a consistent terminal growth rate.

The three year TSR is calculated by applying a forward price-to-earnings ratio (P/E ratio) to the analysts' earnings per share forecasts which is then added to the forecast dividend yield over the period. This process results in a forecasted three year compounded return for each company passing through the filter process. For a security to be considered for the portfolio, it is required to have a minimum TSR of 9% p.a. In rare cases a stock with slightly less than 9% p.a. could be included if it improves the risk characteristics of the portfolio.

Prior to a stock being eligible for inclusion into Magellan's portfolios, the investment case must be approved by the IC. The Investment Committee will test the analysts' qualitative assessments, and examine the assumptions underpinning the valuations. Zenith believes this peer review process adds additional rigour to the security selection effort.

Overall, Zenith regards the investment process undertaken by Magellan's global equity team to be robust, with analyst recommendations supported by in-depth modelling and a detailed qualitative assessment. The use of a consistent template and standard market assumptions ensures ease of peer review and adds rigour to the overall process.

PORTFOLIO CONSTRUCTION

The portfolio construction process incorporates the fundamental analysis of Magellan's analysts, combined with a macroeconomic overlay provided by portfolio manager Hamish Douglass. The portfolio construction effort is overseen by the IC which meets at least monthly to appraise and vote on all stocks in the universe. Given the autonomy Douglass has in incorporating his macroeconomic insights into the Fund, Zenith considers the IC to be an important sanity check on portfolio holdings.

In constructing the Fund, Douglass seeks to include high quality companies trading at a significant discount to intrinsic value. To achieve this goal, a Conviction Scoring Matrix is considered which ranks each stock out of 100 with a 50% weight given to qualitative measures and a 50% weight applied to valuation. In Zenith's opinion, the scoring matrix adds discipline to the overall process while still maintaining flexibility without over engineering the inputs.

The Fund is not as constrained as the Magellan Global Fund with the market sensitivity of the aggregated portfolio allowed to be up to 1.0 compared to 0.8 in the Magellan Global Fund. Therefore, Zenith expects the Fund will potentially exhibit greater performance volatility than the Magellan Global Fund, in addition to having greater upside potential in stronger equity markets. Zenith notes the level of overlap in holdings between the Fund and the Magellan Global Fund is expected to be high.

Zenith notes that in July 2017, Magellan made an enhancement to their market sensitivity metric, including observed drawdowns for each stock alongside the existing market sensitivity calculations. Overall, Zenith is supportive of this enhancement to the process.

The Fund is essentially comprised of two discrete sub-portfolios: a more conservative, less market sensitive portfolio; and a thematic portfolio, Douglass is not constrained by the number of stocks that can be held in each portfolio.

Douglass will generally implement shorter cycle investment ideas through the cyclical portion of the Fund. It is anticipated that whilst this component will contain securities that do not have as high a Quality score as the stable sub-portfolio, the cyclical portfolio will be compensated by a higher expected TSR. Magellan expects that the cyclical sub-portfolio will have a shorter holding period than the stable portfolio. It is expected that approximately 40% of the Fund will be held in the stable sub-portfolio.

While the Fund is relatively unconstrained compared to more traditional global equity products, Magellan has implemented a number of tools which allow Douglass to assess the portfolio's exposures at a given time, to ensure the aggregated risks of the Fund are not significantly correlated. Douglass also assesses the exposures of the Fund based on the underlying revenue streams of the holdings, as opposed to the traditional approach of using domicile of listing or sector classification.

The portfolio construction process results in a concentrated portfolio, typically holding between 15 and 35 securities. The Fund is constructed in a benchmark unaware manner, with Douglass having no requirement to hold companies based on sector or index weightings.

Portfolio holdings will typically be sold under the following scenarios:

- Value of a company materially exceeds assessment of intrinsic value
- Underlying fundamentals of business franchise materially weaken
- Directors or management behave against shareholder interest
- Company underperforms expectations or business economics of company have been misjudged
- For risk management purposes where a single position size becomes excessive within the portfolio

The Fund's portfolio turnover is expected to be approximately 30% p.a., in normal market conditions, which is low in both an absolute and relative perspective

The Fund has the ability to tactically allocate up to 50% of the portfolio to cash. Whilst Zenith typically prefers active managers to be more fully invested, we recognise that given the more concentrated nature of the portfolio, this facility enables Douglass to protect investors' capital during periods of market distress. Zenith notes that Douglass has historically displayed an ability to add value for investors through the tactical allocation to cash.

While Zenith acknowledges the Fund's investment approach gives rise to low trading levels and portfolio turnover, we note the absence of a 24-hour trading desk. Given the global nature of the Fund, the vast majority of holdings are listed in North America and Europe, and we believe real-time monitoring of trade execution and holdings is appropriate.

The Fund's currency exposures may be actively hedged, with the level of hedging to be determined by Douglass. Investors should be aware that active currency hedging has the potential to result in significantly different investment outcomes when compared with an unhedged or fully hedged portfolio.

Zenith rates Magellan's portfolio construction process highly, believing it to be consistent with Magellan's stated goal of preserving investor's capital during stressed market periods. Zenith believes the process is robust and disciplined in nature, appropriately referencing the research generated by the analysts, whilst also leveraging the macro-economic insights of Douglass.

RISK MANAGEMENT

Portfolio Constraints	Description
Security Numbers	15 to 35
Weight - Holding Rel. Portfolio (%)	max: 15% Financials limited to 7.5% at purchase
Top 5 Securities Aggregate Weight (%)	max: 50%
Weight - Financials (%)	max: 30%
Cash (%)	max: 50%
Gross Leverage (%)	max: 20%

Risk mitigation is a key consideration throughout the investment process and forms the core component of Magellan's investment philosophy.

The primary means by which risk is managed at Magellan is through the depth and quality of the investment research process. The focus on quality businesses with dominant market positions trading at deep discounts to internal valuations acts as a strong risk management tool. Having viewed examples of Magellan's research and spoken with the analysts on numerous occasions, Zenith has been extremely impressed with their level of understanding and believes that the depth of research is extremely thorough.

At the Fund level, there are a number of formal risk limits in place (listed above) which Zenith believes are prudent given the concentrated nature of the Fund. Whilst Zenith considers these parameters to be relatively flexible, we are comfortable with the way that Magellan manages the risk within the Fund.

Magellan has placed an additional focus on risk mitigation through ensuring the Fund has limited exposure to broad economic themes which are inherent within larger investment positions in the Fund. While the limits on these economic themes are discretionary and less quantitatively driven, we believe it demonstrates the depth of analysis that contributes to the robust portfolio construction and risk management process.

Consistent with Magellan's focus on liquidity, the minimum market capitalisation required for investment is $US 5 billion. However in practise, Magellan is unlikely to invest in a company with a market capitalisation of less than $US 10 billion. Zenith believes this to be a prudent adjustment, particularly in light of Magellan's rapid increase in funds under management over the past three years.

The Fund's currency exposures may be actively hedged, with the extent of hedging being at the discretion of Douglass. Douglass has indicated that initial hedging will be conducted based on the domicile of listing, with analysis being conducted as to the feasibility of hedging the portfolio based on underlying economic revenues.

Notwithstanding the macroeconomic expertise of Douglass, Zenith believes it to be extremely difficult to consistently forecast longer-term currency movements. As such, investors should be aware that active currency hedging has the ability to detract from portfolio performance.

Although no formal risk management software is employed, Zenith remains comfortable with the process adopted by Magellan, believing that the depth of the research ensures that Douglass is aware of the risks inherent in each stock.

INVESTMENT FEES

LICs can broadly be categorised into two groups from a management cost standpoint on the basis of whether they are internally or externally managed (operating under an IMA). Typically, internally managed LICs have lower proportional management costs due to a larger asset pool. Externally managed LICs tend to have management costs that are more in-line with unlisted managed funds. LITs with an active portfolio management strategy have fee structures broadly similar with that of externally managed LICs and Zenith believes that this is the most appropriate peer group for comparison purposes.

Magellan applies a management cost of 1.35% p.a. with a performance fee of 10% of outperformance (gross of fees) over a dual performance benchmark, subject to a high water mark, accrued daily and payable half yearly.

The dual performance hurdle consists of the MSCI World Net Total Return Index and the Australian 10 year bond yield. Whilst Zenith believes the application of a performance fee to be relatively uncommon within a long-only equities product, the dual performance hurdle moderates our concerns regarding the Fund's fee structure and Zenith considers it in-line with industry best practice.

Zenith considers the cost structure to be in-line with best practice however, Zenith considers the fees applicable to the Fund to be higher than its peers.

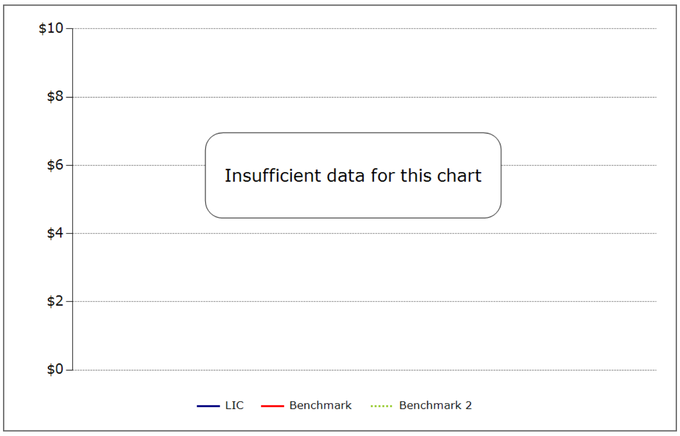
Fee Type	LIC / Peer Group	Fee %
Management Cost	Magellan Global Trust	1.35%
Sector Average - Internally managed [1]	International Equities LICs	N/A
Sector Average - Externally managed	International Equities LICs	1.27%
Performance Fee	10% of outperformance (gross of fees) over a dual performance benchmark comprising the MSCI World Net Total Return Index and the Australian 10 year bond yield	

[1] Internally Managed LICs data use published Management Cost as at 31 July 2017 and are ex-GST. All other fees are inclusive of GST, less Reduced Input Tax Credits. Source: ASX, Zenith.

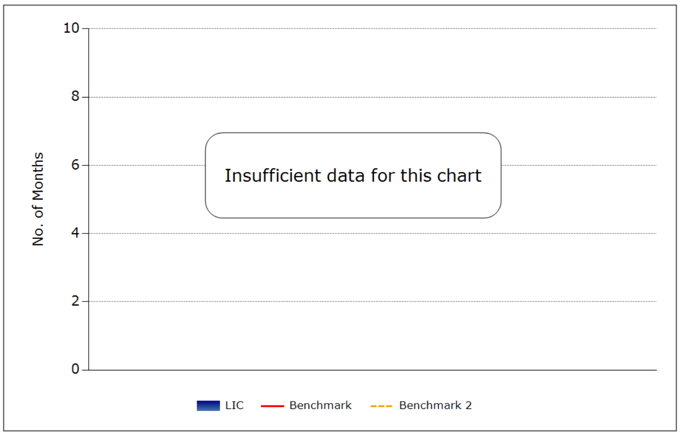
PERFORMANCE ANALYSIS

Monthly Performance History (%, net of fees)

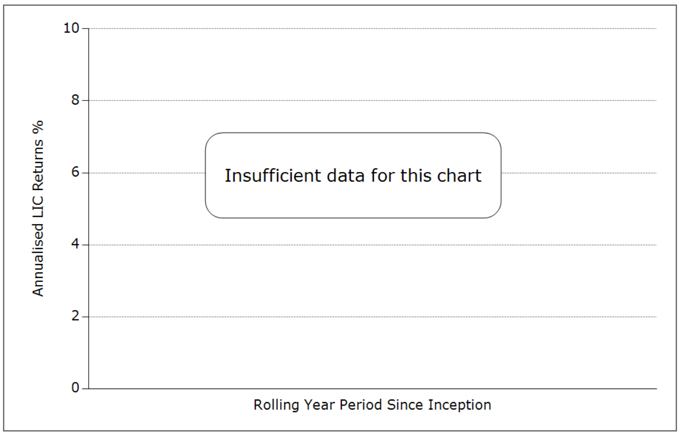
Growth of $10,000



Monthly Histogram



Minimum and Maximum Returns (% p.a.)



ABSOLUTE PERFORMANCE ANALYSIS

The commentary below is as at 29 August 2017.

The Fund aims to achieve risk-adjusted returns over the medium to long-term, whilst reducing the risk of permanent capital loss. Owing to the Fund's recent inception, Zenith believes it is too early to draw any meaningful analysis.

However, Zenith draws conviction in the Fund from the track records of Magellan's unlisted Global Funds, which this Funds process leverages off. Since its inception, Magellan Global Fund has achieved its objective and has consistently outperformed both the benchmark and the median manager over the medium to long-term.

RELATIVE PERFORMANCE ANALYSIS

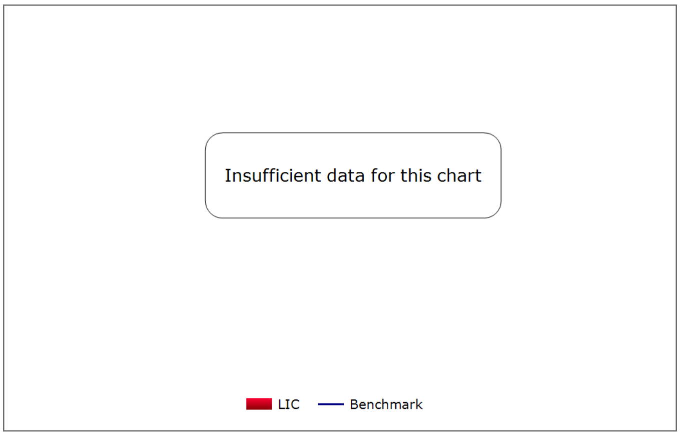
The commentary below is as at 29 August 2017.

Zenith seeks to identify funds that can achieve an outperformance ratio in greater than 50% of months across all market conditions, as we believe that this reflects a consistency of manager skill.

Owing to the Fund's impending inception, Zenith believes it is too early to draw any meaningful analysis. However, Zenith draws comfort from Magellan Global Fund which has delivered strong excess returns since inception. Given its quality and value bias, Zenith believes the Fund is less likely to outperform the benchmark during periods when global financial markets perform strongly.

DRAWDOWN ANALYSIS

Drawdown analysis assesses the relative riskiness of a Fund versus the benchmark, in reference to capital preservation. The maximum Drawdown is recorded as the percentage decline in the value of a portfolio from peak to trough (before a new peak is achieved). All Drawdown analysis is calculated commencing from the inception date of the Fund in question, and Drawdown analysis for the Fund and benchmark(s) are calculated independently. That is, the largest drawdown for the Fund and benchmark(s) will not always refer to the same time period.



The commentary below is as at 29 August 2017.

Owing to the Fund's recent inception, Zenith believes it is too early to draw any meaningful analysis.

INCOME/GROWTH ANALYSIS

Unlike the Magellan Global Fund, this Fund will target a cash distribution yield of 4% p.a. based on the average month-end Net Asset Value (NAV) over a rolling two year period paid semi-annually. However, investors should note that until June 2019, the Fund will not target a distribution yield, instead the Fund intends to distribute 3 cents per unit on a semi-annual basis.

Magellan has established a Distribution Reinvestment Plan (DRP) which will operate at a 5% discount to the NAV per unit. Magellan Group will effectively subsidise the cost of this discount to prevent dilution to non-participants.

The Fund’s portfolio turnover is expected to be approximately 30% p.a., in normal market conditions. Zenith considers this to be moderate. Investors should therefore be aware that the Fund's returns are likely to be delivered via a combination of capital appreciation and income (short-term realised gains). This approach will therefore more likely suit high marginal tax rate payers.

REPORT CERTIFICATION

Date of issue: 29 Aug 2017

Role	Analyst	Title
Author	Jacob Smart	Investment Analyst
Sector Lead	Justin Tay	Senior Investment Analyst
Authoriser	Bronwen Moncrieff	Head of Research

RATING HISTORY

As At	Rating
29 Aug 2017	Recommended
Last 5 years only displayed. Longer histories available on request.	

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