

# How to position your portfolio in a deleveraging world

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**MAGELLAN**  
ASSET MANAGEMENT LIMITED

# Disclaimer

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Any general advice about the Funds in this document have been prepared without taking into account your personal objectives, financial situation or needs. You should consider the appropriateness of the information having regard to your personal circumstances.

# Magellan Financial Group

## Key information

- Attractive business model:
  - ASX listed, 25% owned by key principals, Hamish Douglass & Chris Mackay
  - \$100 million capital base with c. \$A 500 million of funds under management
- Clear investor alignment:
  - Proprietary investment of over \$A 70 million in the funds we offer investors
- Focused research:
  - Long-only, benchmark unaware
  - High conviction portfolios

# Agenda

- Drivers of recent economic growth
- The impact of deleveraging
  - On Economic Growth
  - On Property Prices
- Portfolio Construction Implications
- Stock example: The Coca-Cola Company

# Drivers of economic growth 1992 – 2007

## Consumption, consumption, consumption

[5]

Accelerated consumption growth (which is c. 70% of GDP in most of the rich world) was facilitated by increased household debt, driven by:

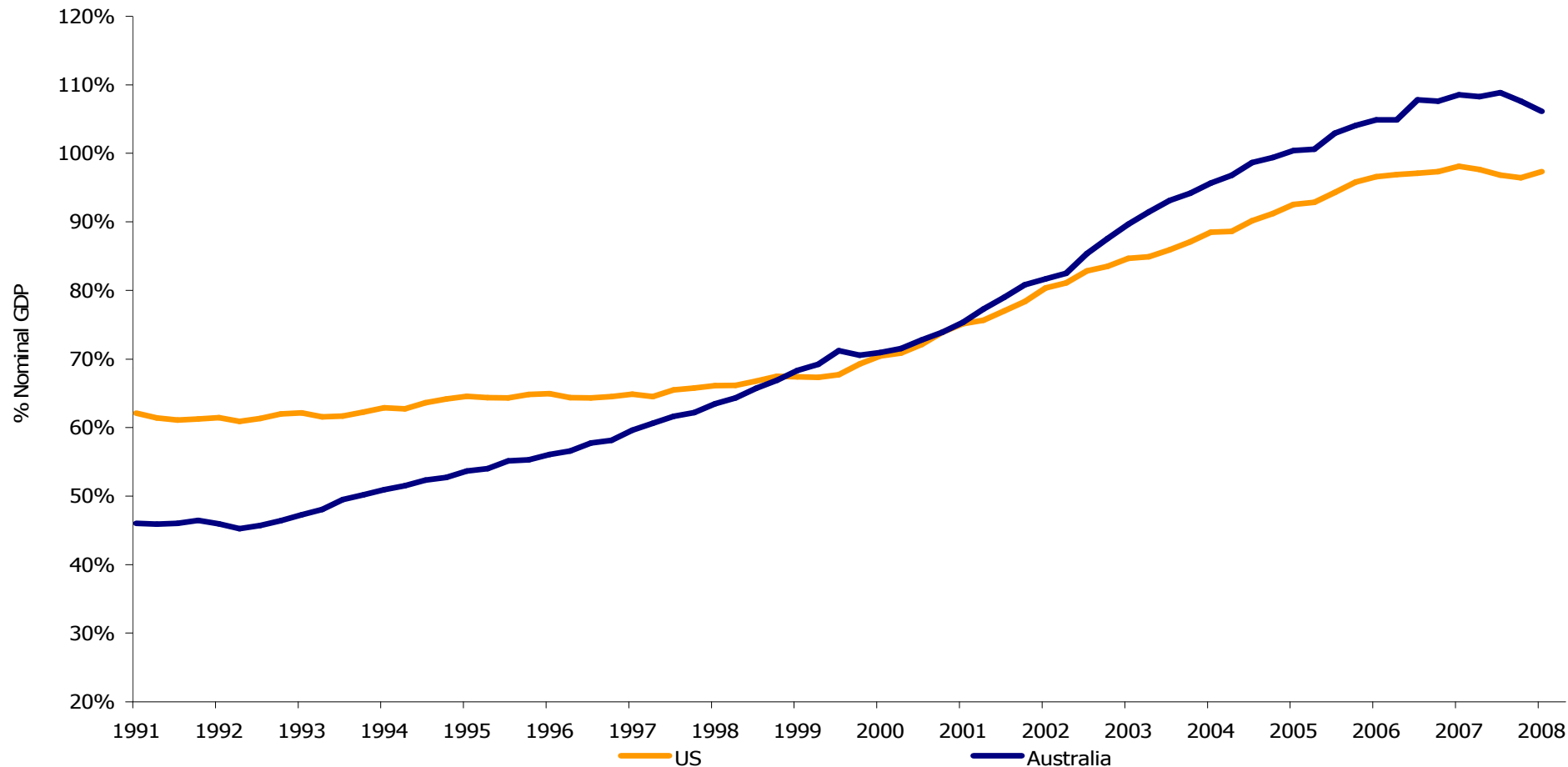
- Free flow of credit
- Low interest rates
- Increasing asset values (real estate, equities)

*This has resulted in households holding the highest level of debt  
(both relative to GDP and household income) on record*

# Unprecedented debt levels

## Household Debt, Percentage of Nominal GDP

[6]



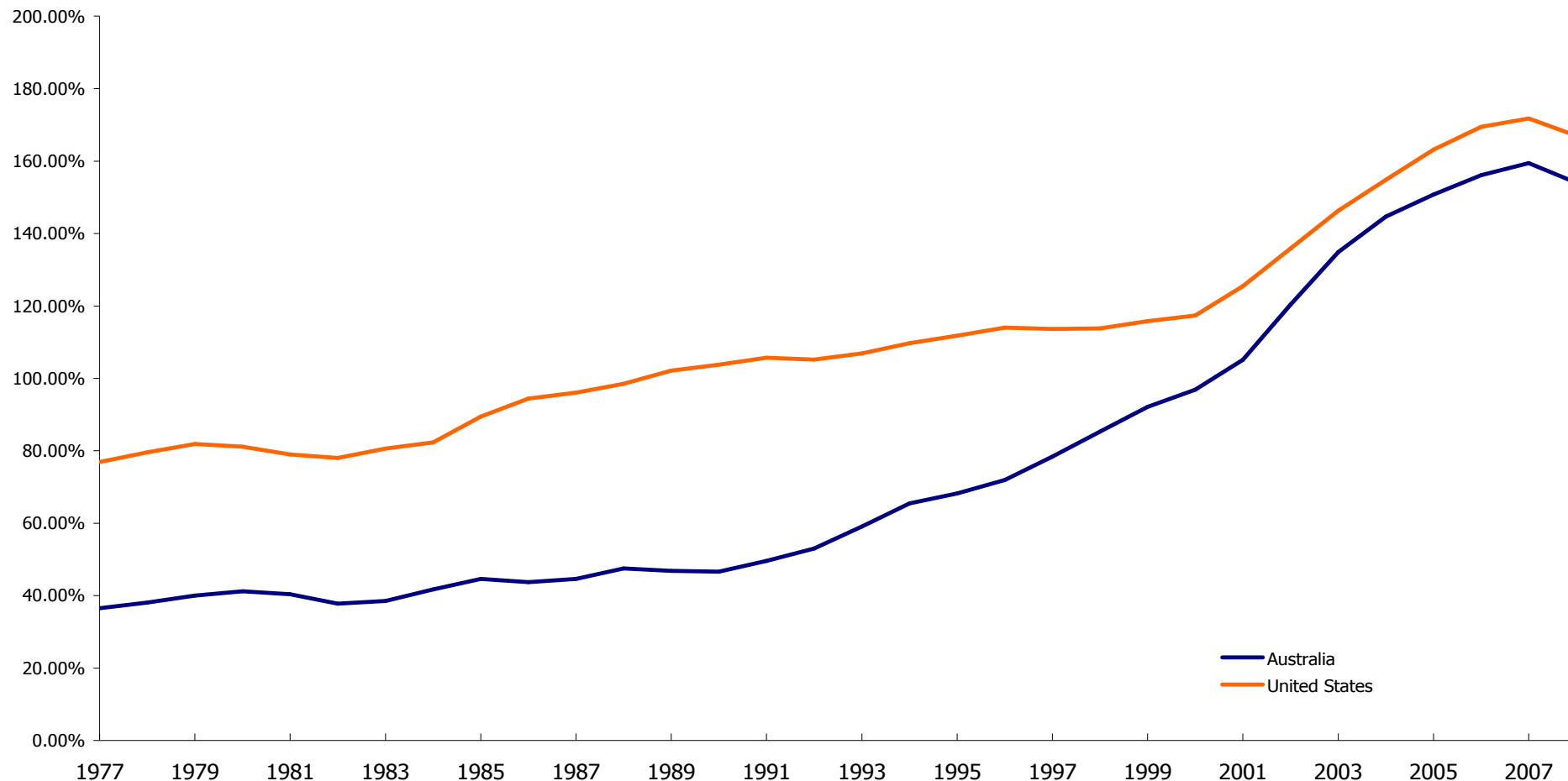
Source: National Sources



# Unprecedented debt levels

## Household Debt, Percentage of Household Income

[7]

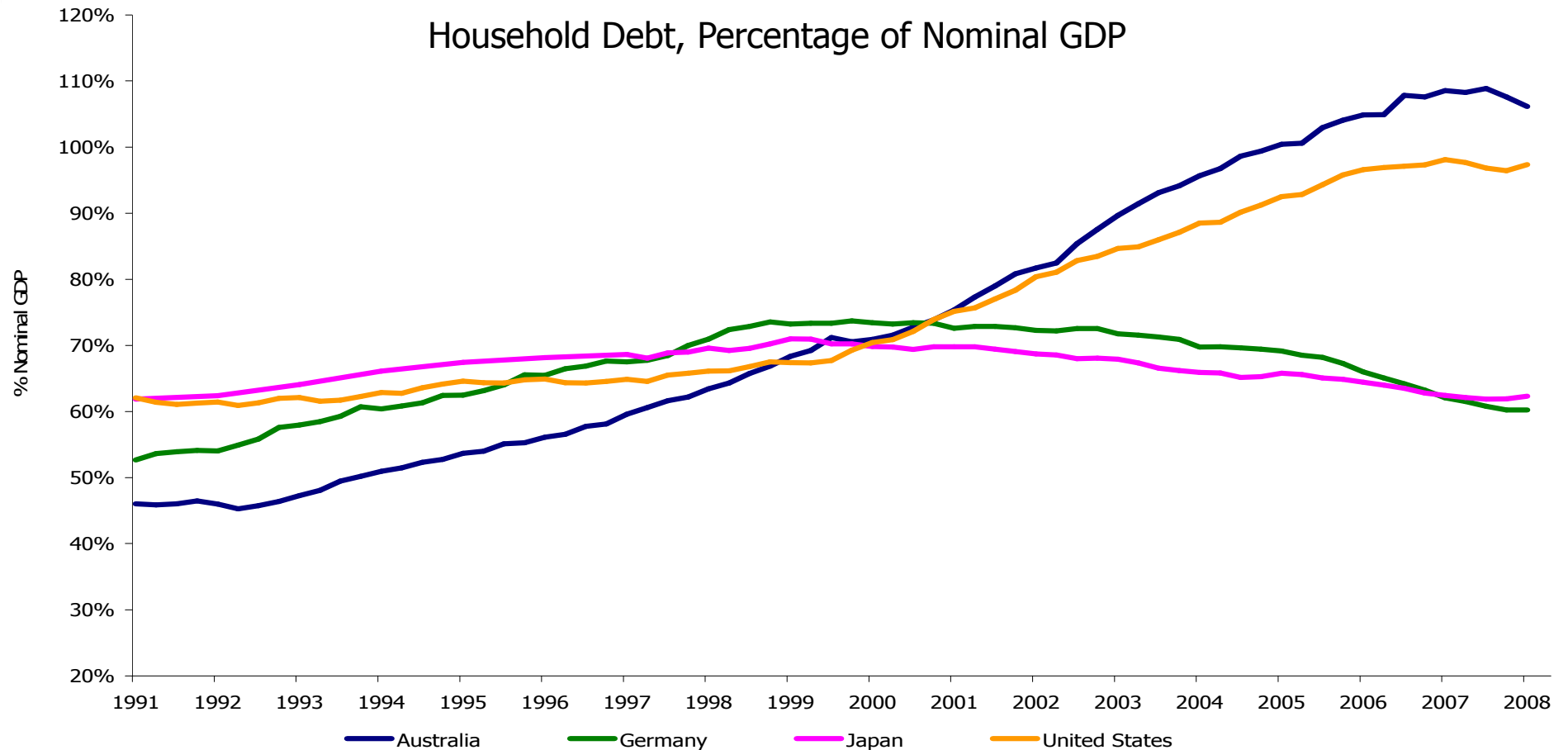


Source: RBA, Federal Reserve Board.  
Data for the United States includes non-profit organisations

# Case Studies of Deleveraging

## Japan & Germany

[8]



Source: Bloomberg, National Sources



# The impact of deleveraging on economic growth

[9]

Between 1992 and 2007, nominal economic growth per annum:

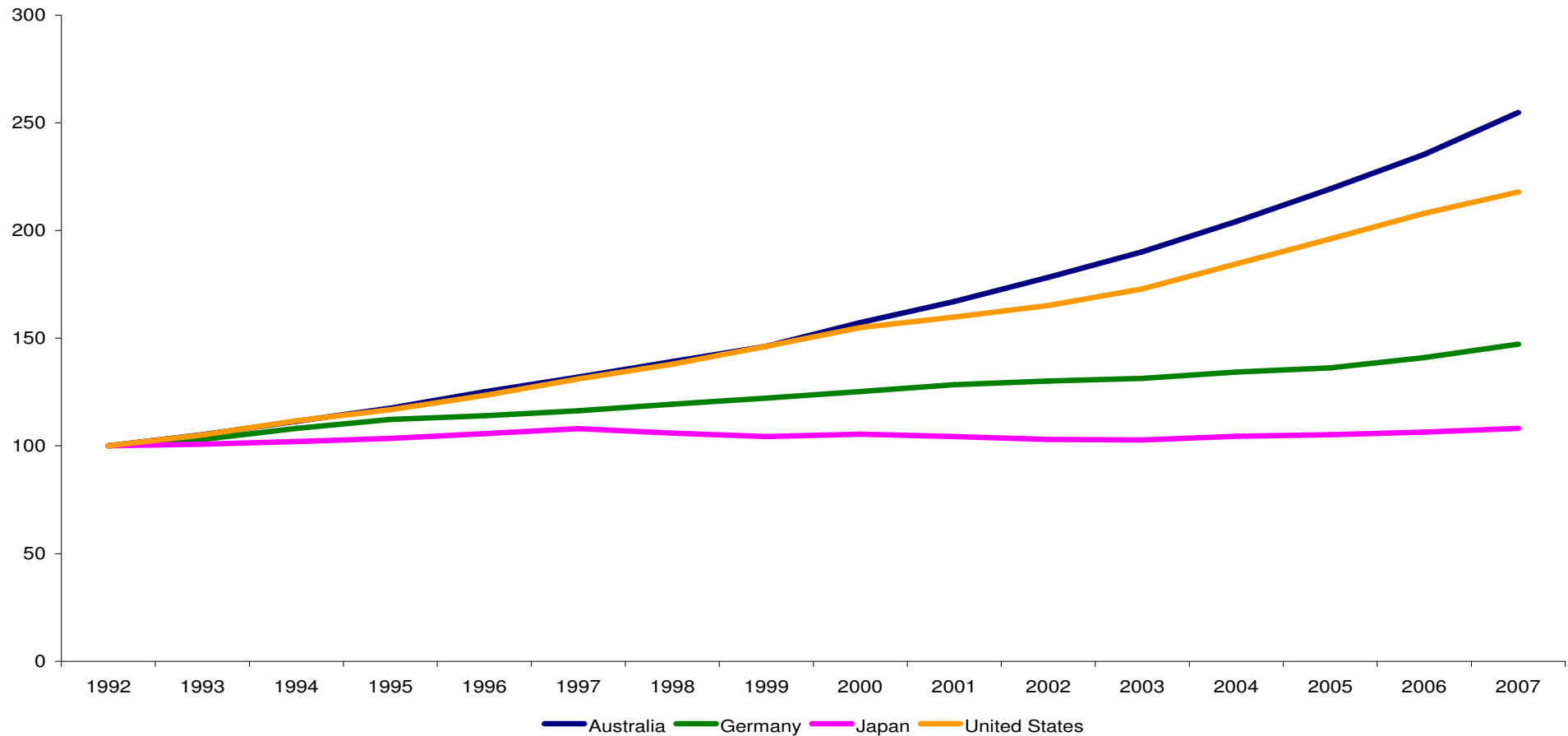
- In the US and Australia was 5.3% and 6.4% respectively
- In Germany and Japan was 2.6% and 0.5% respectively

*The impact of domestic household deleveraging dramatically held back economic growth in Germany and Japan, despite a significant export sector and large increases in household leverage (and thus demand) by their trading partners*

# Deleveraging – impact on economic growth

Nominal GDP (Index: 1992 = 100)

[10]



Source: Bloomberg, National Sources

# The impact of deleveraging on property prices

Between 1992 and 2007, nominal property prices:

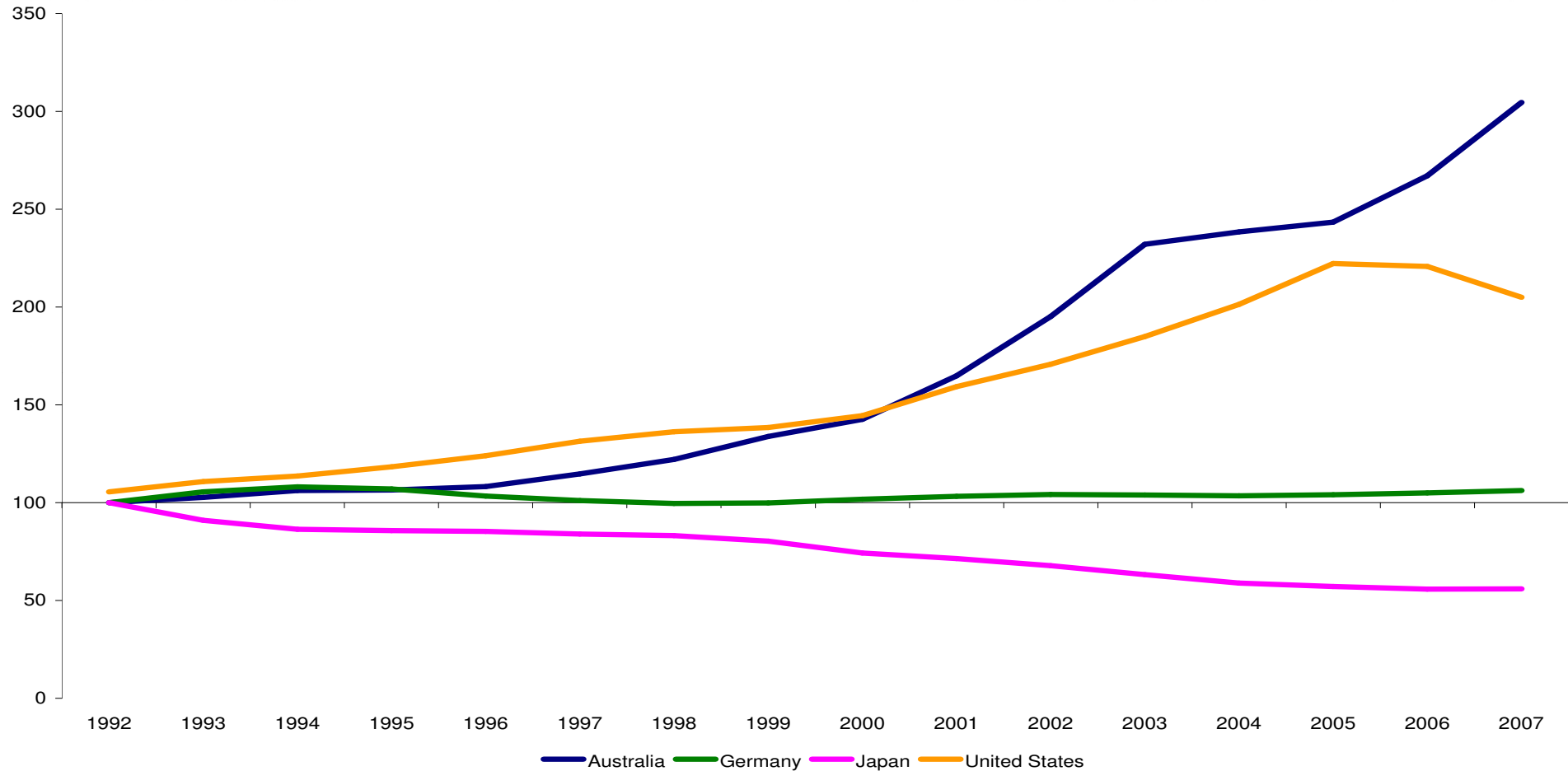
- In the US and Australia increased over 200% and 300% respectively
- In Germany remained broadly flat (up 10%) and Japan declined over 40%

*The prospect of deleveraging presents significant challenges to asset prices*

# Deleveraging – impact on property prices

## National Residential Property Prices (Index: 1992 = 100)

[12]



Source: National Sources

# Now for the hangover?

The consumption bubble that has developed in much of the rich world (funded largely by the savings of emerging economies) has caused two key outcomes:

- The consumer in most of the rich world has entered this economic downturn with the highest level of debt relative to income on record
- Massive global savings imbalances

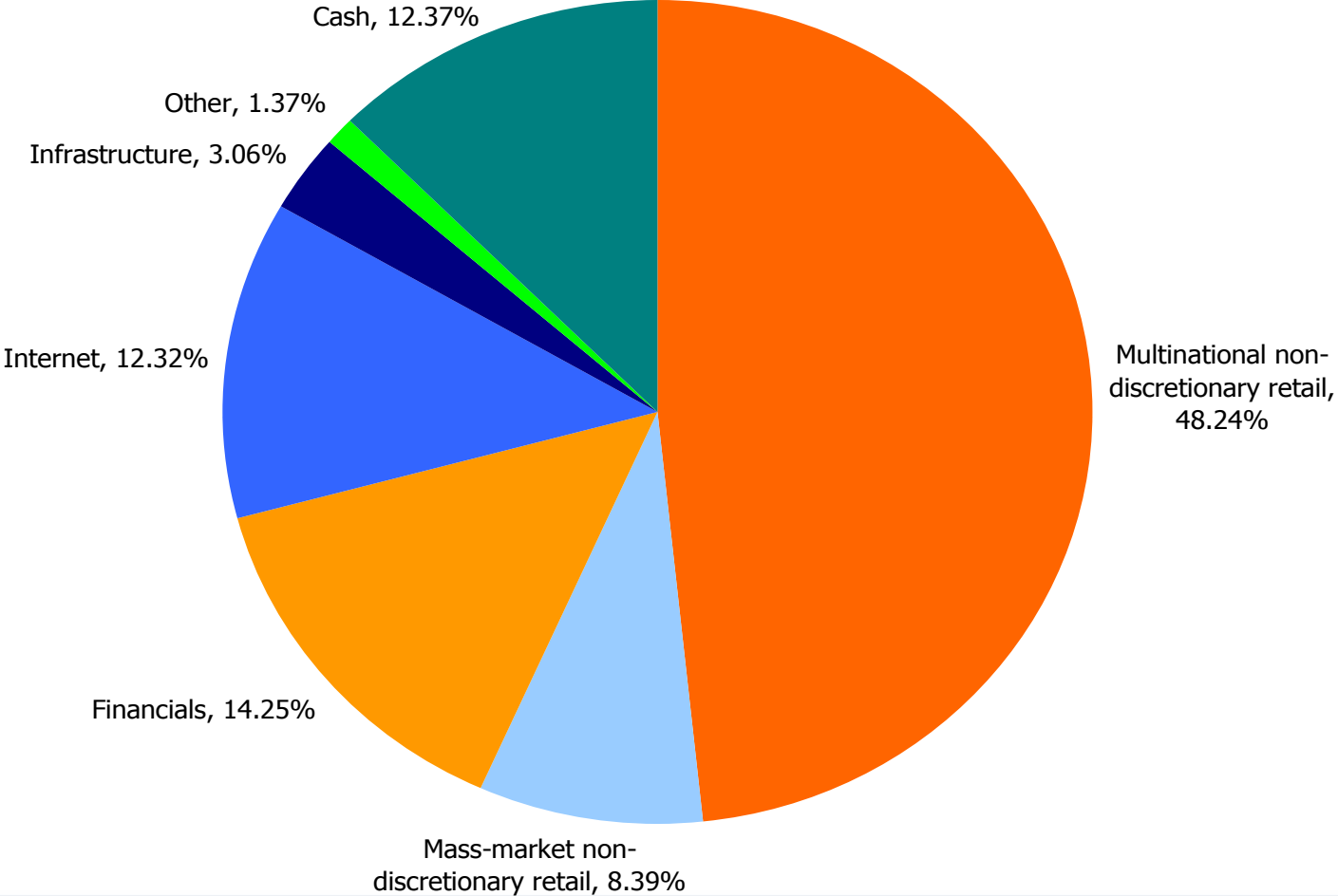
# Portfolio construction implications

Portfolios need to consider:

- The potential for disappointing returns from both real estate and domestically focused businesses in rich world nations
- The increased likelihood than exposure to major stock market indices (S&P 500, FTSE, S&P/ASX200) may not meet investor requirements, thus passive and index-aware strategies may be less attractive than in the past
- Manager selection will become very important, as alpha (representing a greater portion of total return) becomes far more valuable

# Magellan Global Equities

Portfolio Construction as at 31 July 2009



# Portfolio strategy

Always focus on quality and minimising the risk of permanent capital loss

- Invest into extremely high quality “cash cows” with low risk exposure to consumer growth in the developing world



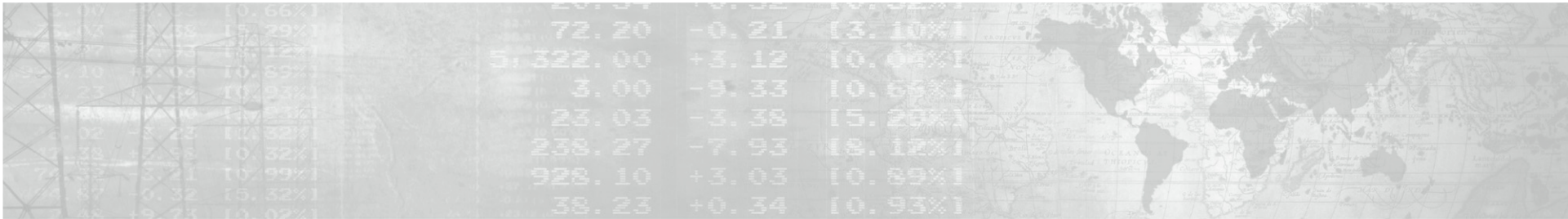
- Invest into lowest cost, market leading, non-discretionary retailers



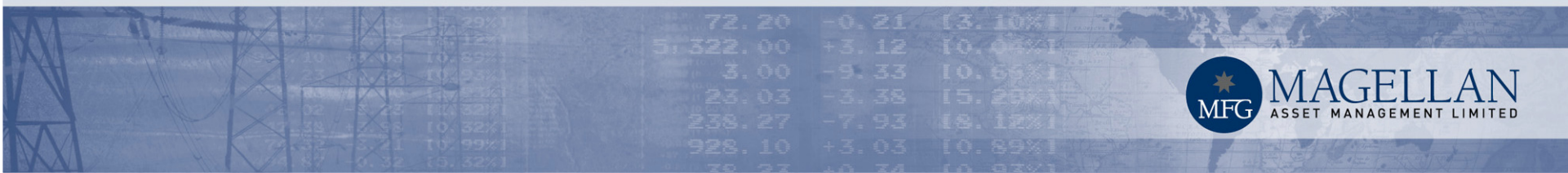
- Invest into businesses that exhibit powerful “network economics”







# Stock example: The Coca-Cola Company

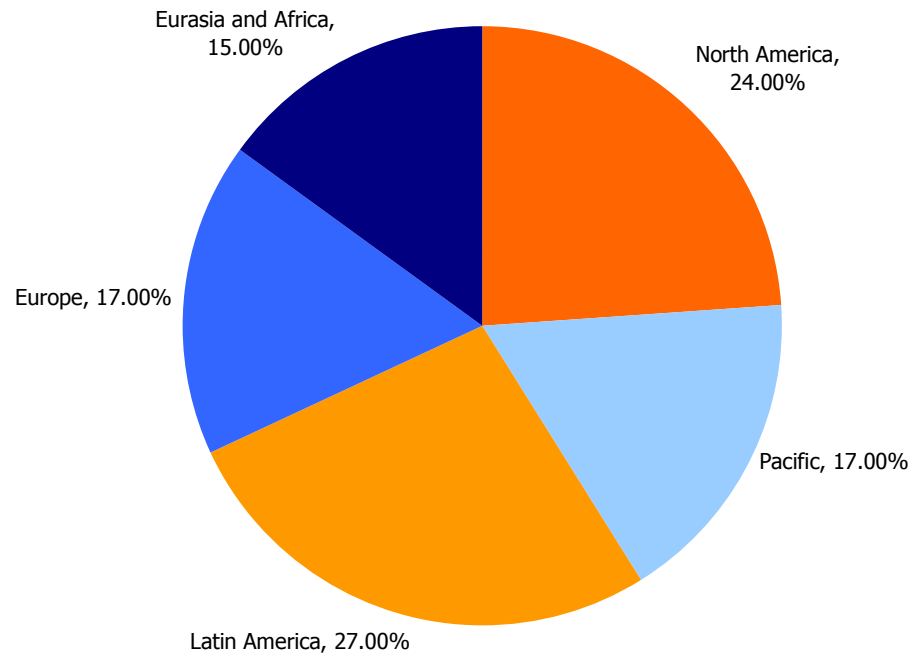


# The Coca-Cola Company

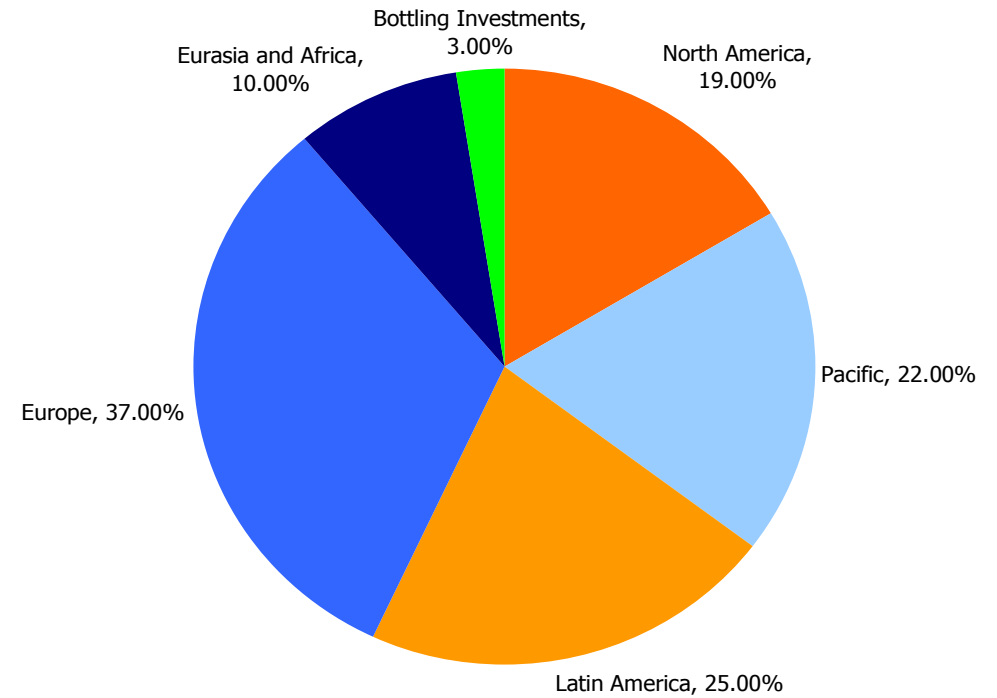
A truly global business...



### 2008 Volume



### 2008 Operating Income\*



Source: Coca-Cola Company  
\* Excludes corporate, -16%

# The Coca-Cola Company

... with unrivalled Commercial Reach



Universally Available...

... Uniquely Merchandised ...

... Enjoyed Daily

20 Million Outlets



10 Million Cold Drink Assets



1.5 Billion Servings Every Day



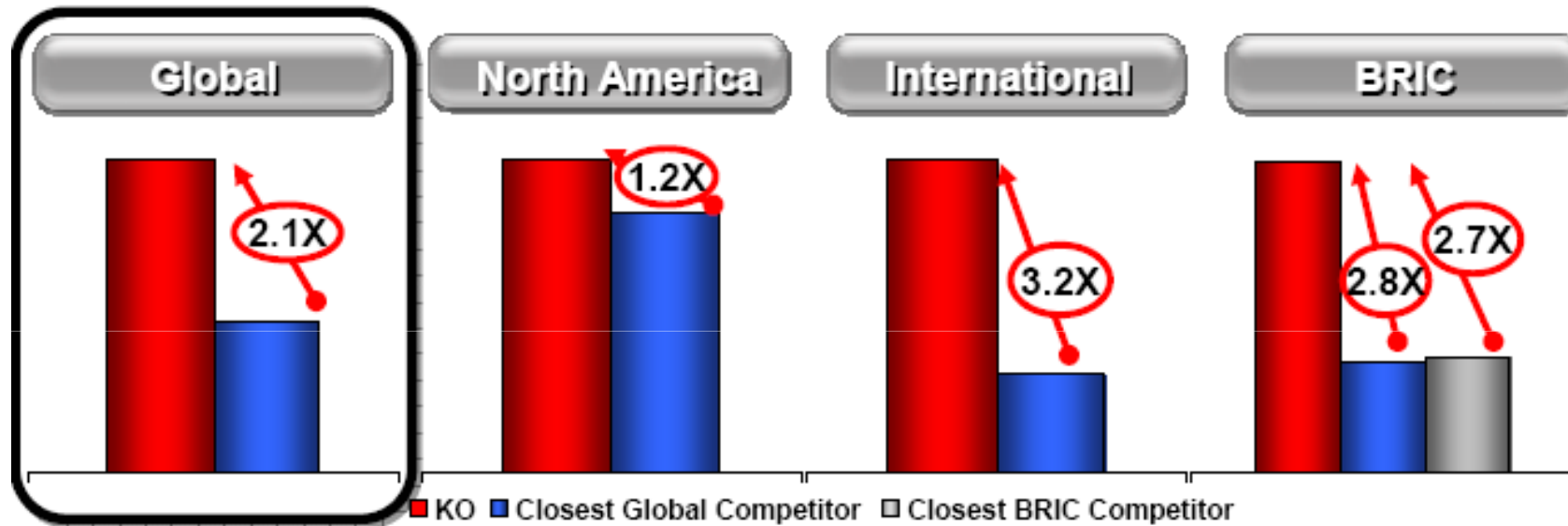
Source: Coca-Cola Company

# The Coca-Cola Company

... and an unmatched global footprint



## Non-Alcoholic, ready to drink market share



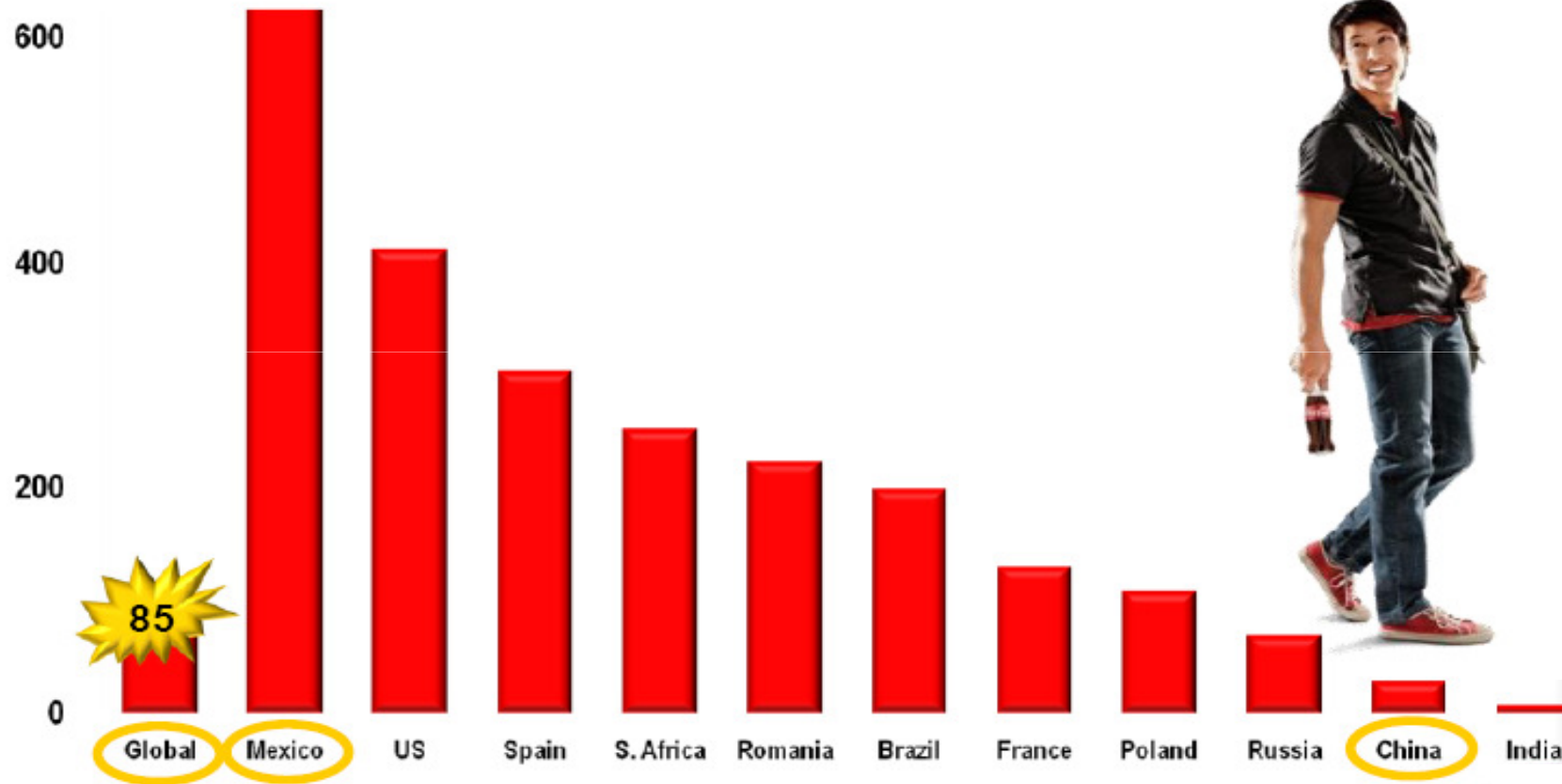
As at 22 February 2008.  
Source: Canadean, Coca-Cola Company.

# The Coca-Cola Company

## Significant upside in per capita consumption



Annual, per capita consumption, 250ml equiv.



As at 9 June 2009.  
Source: Coca-Cola Company.

# The Coca-Cola Company

## Winning in China

[22]



### 2008 Performance



- ▶ 4<sup>th</sup> Largest market in the World
- ▶ No.1 contributor to global growth (~ 1/4 Global incremental volume)
- ▶ Sprite Brand – Global No.1
- ▶ Minute Maid – Global No.2
- ▶ New products: ~1/4 volume growth
- ▶ #1 in NARTD and at least 2x Pepsi

- ▶ Each and Every Day in 2008... **Sold 100 million** 8 oz servings



- ▶ Each and Every Day in 2008...
  - Called on **421,500** outlets
  - Opened **1,064** new retail accounts
  - Placed **735** coolers
  - Hired **8** additional sales people
  - Set up **4** new distribution partners

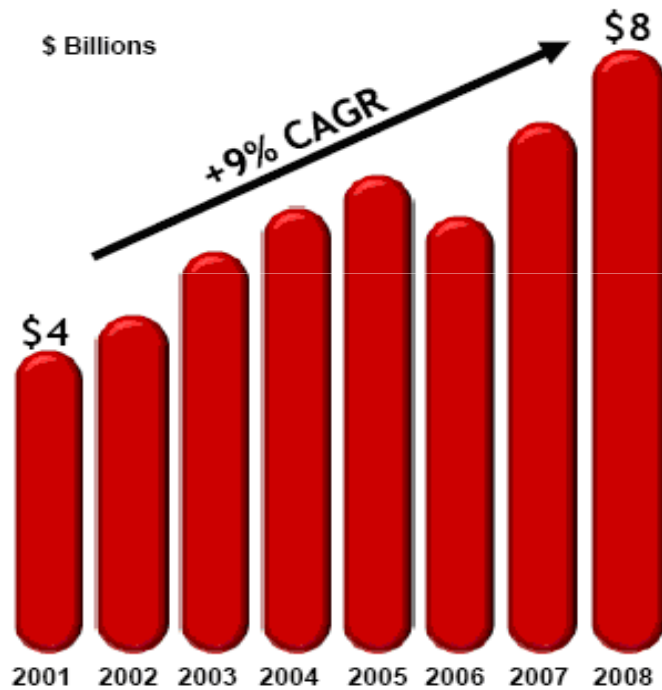
Source: Coca-Cola Company

# The Coca-Cola Company

A cash machine...

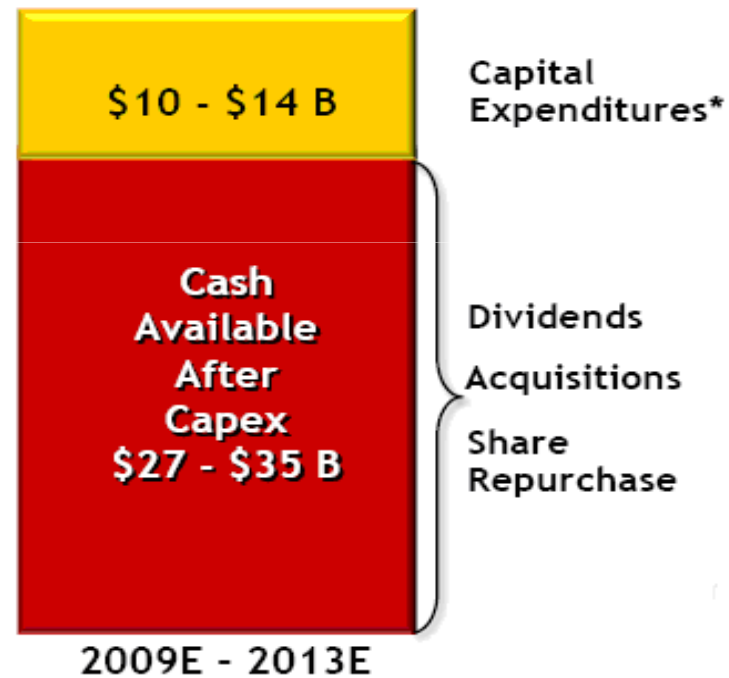


**2001 - 2008 Cash From Operations - \$47B**



*\* Based on assumption of no changes in company owned bottlers.*

**2009 - 2013 Expected Cash From Operations \$41B - \$45B**



Source: Coca-Cola Company

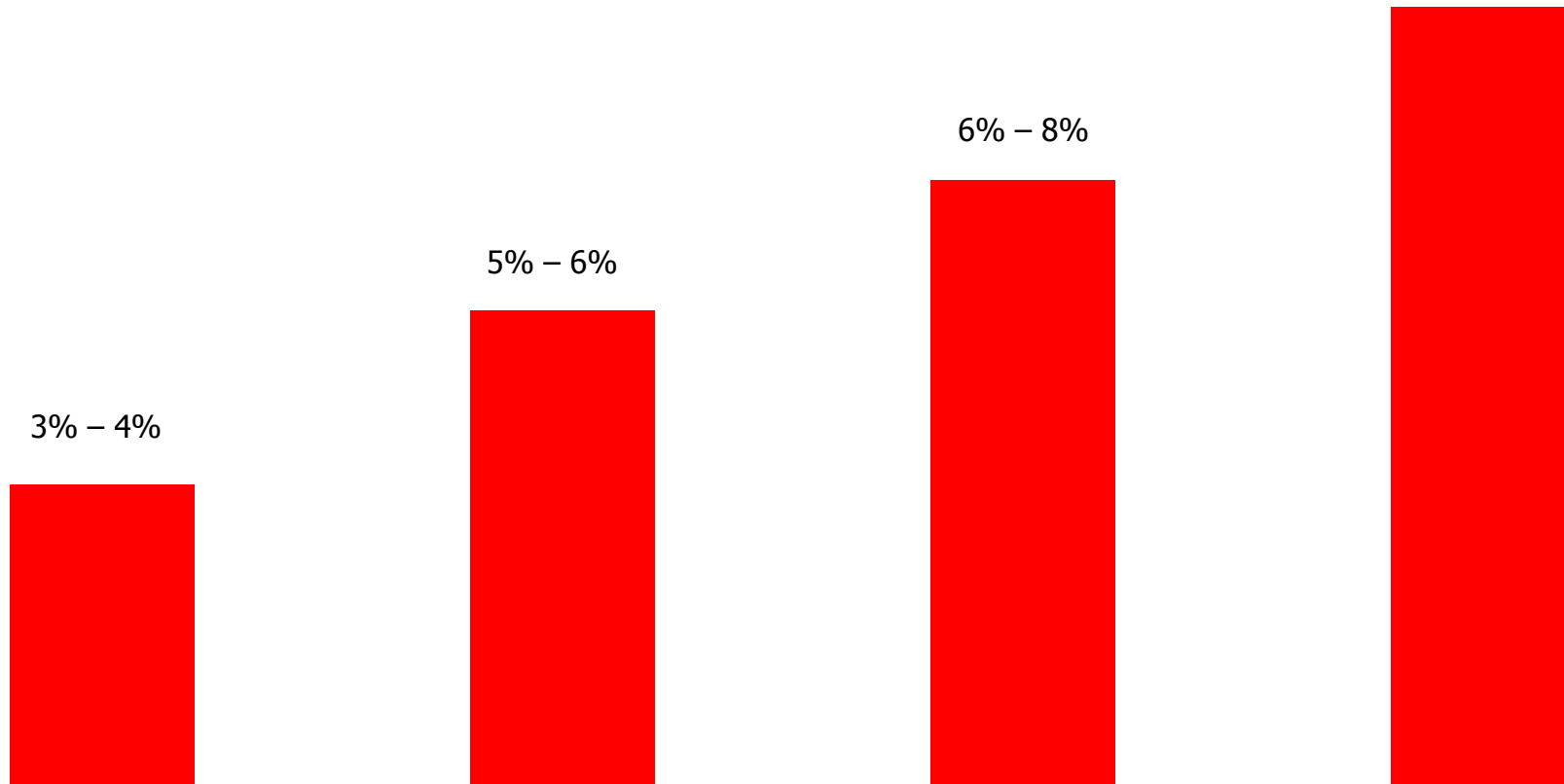
# The Coca-Cola Company

... with strong, sustainable growth prospects



[24]

High single digit



Volume

Net Revenue

Operating Income

EPS

Source: Coca-Cola Company



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