

Reporting Season Update May 2025

Introduction: Hello, my name is Elisa Di Marco, Investment Director and Analyst at Magellan and welcome to our short video today where we're going to unpack the key observations from the recent US reporting season. Reporting season is an important time of year for our companies. They provide an update on financial performance and operations. This is a health check of sorts for our companies, for sectors and for the economy more broadly. It gives us a sense on the long-term investment thesis but also speaks to the key investment debates that we may have.

This quarter impressively almost 80% of companies with the S&P 500 beat the expectations set by the market for both earnings and revenue. Impressively, earnings growth in the quarter was around 13%. However, it was clear that tariffs and uncertainty were weighing on our companies.

From Magellan's perspective, there are four key observations from reporting season. First, that tariffs were weighing on uncertainty. Second, that the low-income consumer remains pressured. Third, that tech sector remains resilient. And fourth, that investing in quality companies makes a difference. Before unpacking each of those observations overall, our findings from reporting season as well as recent economic data points give us confidence in our base case that we should be looking through any short-term noise or softness in the economy, that over the medium-term deals will get done and policy initiatives will lead to improved growth and markets grinding higher.

Observation 1: Uncertainty linked to tariffs. During reporting season, we saw that companies at the coalface of tariffs or economic prosperity needed to pull their future guidance. Importantly for Magellan's global portfolios, we were less exposed to this observation. Within the Magellan Global Portfolio, we're primarily invested in services companies or companies manufacturing essential goods.

These companies are less impacted by tariffs on the first order. These companies will, however, be impacted by changes to the overall health of the consumer. We view this to be an opportunity for our investors. As we mentioned during the reporting season, we saw companies that were manufacturing and reliant on the import of goods or reliant of economic prosperity, that they saw increased uncertainty during the quarter.

Car manufacturers like Ford, General Motors and Stellantis all pulled their FY25 guiders. Executives at Ford noted that they are unable to give us confidence in future earnings because of this elevated uncertainty. Likewise, we saw at American airline companies like American Airlines, United Airlines and Southwest Airlines that they also pulled their FY25 guidance, citing that the consumer is uncertain and that there's elevated and that is an increased volatility in fuel costs. More recently, over the past week, we have increased confidence that we'll be able to move past this period of uncertainty. We've seen a trade deal with the United Kingdom and increased whispers of a trade deal between the US and China. This gives us confidence that we are past peak fear and that trade deals will be done.

Observation 2: Increased pressure on the low-income consumer. So, first at the aggregate level, the consumer does remain resilient. Companies like Visa and Mastercard, who are the leading global payment networks, continue to reiterate that the consumer is resilient. We saw this through the first quarter but then also their observations from April.

We've seen from the credit card companies like American Express, Capital One, and Synchrony, that credit quality of the US consumer also remains resilient. However, when we peel that one level below, we continue now to see that the low-income consumer is pressured. Leading into reporting season, the low-income consumer was already at a tough point after several years of higher

inflation. Tariff uncertainty has led to increased uncertainty for this cohort with respect to future economic growth and inflation.

For one of the companies, we invest in, Chipotle, they noted that in February there's been increased uncertainty with the low-income consumer. McDonald's, the largest restaurant company in the world, has also cited double-digit weakness in the low-income consumer and noted that the middle-income consumer is also citing to show signs of weakness. Starbucks also spoke to similar industry themes. What is clear is that strategy and pricing initiatives are incredibly important when in these periods of economic and consumer uncertainty, where the consumer is increasingly price conscious. Young Brands has been doing an exceptional job at addressing this. Through its Taco Bell brand, it has been investing in price and investing in innovative consumer proposition, driving same-source sales growth of 9% per annum during the quarter.

We view that investing in high quality consumer staples and restaurant companies can add defensive growth to the portfolio, and they're incredibly valuable in times of uncertainty, but also through the cycle. As we've seen during this reporting season, companies like Young Brands and Chipotle that are investing in price and their brands, and their digital strategy are paying rewards. Importantly, in the consumer staples space, we're looking for companies that didn't take too much price during COVID and are less exposed to tariffs. So, companies like L'Oreal and Procter & Gamble have been key investments.

Observation 3: Resilience within the technology sector. Heading into reporting season, there was a lot of pessimism around the technology sector and the Magnificent 7. The tech sector has experienced five years of incredible growth, driven by double-digit earnings growth and in the longer-term tailwind of generative AI. In the first quarter of 2025, that all changed. We saw the tech sector sell off around 12%.

This was driven by uncertainty, but also industry-specific news. We saw DeepSeek come out earlier in the year with a new model which suggested that the longer-term demand for compute power could decline. Pleasingly, reporting season was a reminder that we should be looking through the noise and focused on these long-term opportunities. Within our Global Fund, we are invested behind some of the key tailwinds of AI, cloud computing and digitalisation, all of which continued to grow strongly during the quarter.

Some of the examples from reporting season which give us confidence in these opportunities include Microsoft. Microsoft delivered more than 20% growth within the non-AI cloud business and acceleration quarter on quarter. In addition, we got data points on their co-pilot AI product with increasing sales through their Microsoft Office suite. SAP was another great example debunking some of the uncertainties leading into reporting season. With respect to uncertainty and future growth within the sector, management reiterated that the pipeline for 2025 looks incredibly strong. With respect future AI demand, management commented that AI is a key driver of the shift to cloud and the products that SAP are offering. And finally, on that aggregate demand on capex spend from our hyperscalers, we continued to see that these businesses are spending and investing for the future. We continue to view that the technology sector is attractive with high quality names like Microsoft, Amazon, Meta and TSMC offering attractive and reliable returns for our investors.

Observation 4: The importance of investing in high quality companies. High quality companies are those that have a competitive advantage or a unique attribute like scale advantages, network effects or a strong brand that will enable that company to protect and grow earnings into the future. Consistently during this reporting season, we saw the strength of these high-quality companies delivering attractive returns for our investors.

Netflix is a great example of a high-quality company that continued to deliver during the quarter. Netflix is the leading global streaming company with over 300 million subscribers. During the quarter, its scale advantages and its strength in back catalogue was on show. It delivered net new subscriber growth of 6 million subscribers. Importantly, it did this while increasing prices and also managing its costs, delivering strong and sustainable returns for investors.

In summary, we continue to view that fundamental analysis is critical in identifying high-quality companies that can deliver attractive returns through the cycle, especially in periods like now that have elevated uncertainty. Thank you so much for listening in, please feel free to share with colleagues and clients.

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