Magellan – In The Know: Episode 55

Three Investment sectors offering growth, innovation and opportunity

Announcement ([00:00](#)):

The information contained in this podcast is for general information purposes and does not constitute investment advice. You should seek investment advice tailored to your circumstances before making an investment decision.

Host ([00:14](#)):

This is In The Know, a monthly investment podcast brought to you by Magellan Asset Management.

Hannah Dickinson ([00:20](#)):

When we are looking for consumer companies that are well-positioned, we are looking for companies that either continue to have a really strong value proposition, so a company like Chipotle. Or we're looking for companies that are relatively well-positioned within their category, so a company like L'Oreal that is competing against players like e.l.f. Beauty. e.l.f. Beauty manufactures 80% of its products in China, so if there are tariffs being imposed on Chinese imports, e.l.f. is going to have to increase its prices. Whereas L'Oreal, which has a lot more local manufacturing, it's going to be well-protected.

Host ([00:58](#)):

That's Magellan Portfolio Manager and Sector Head: Franchises & Healthcare Hannah Dickinson explaining how to still pick consumer sector winners in a time of great insecurity. Welcome to Magellan In The Know.

([01:14](#)): Today, we look at three interconnected investment sectors: consumer, technology, and infrastructure. As well as Hannah, we have investment analysts, Adrian Lu and Fiona Wu, each in conversation with investment director Elisa Di Marco. First up, Elisa and Hannah explore the consumer world. Here's Elisa.

Elisa Di Marco ([01:36](#)):

Today we're going to be talking about the consumer. The consumer makes up the largest part of the economy and has been a really attractive industry that we've been investing behind here at Magellan for many, many years. We've invested in luxury companies, consumer discretion, consumer staples. So what is the most important thing about that when we are thinking about the timing of when to invest behind the consumer is really that consumer sentiment piece and how they're feeling. So Hannah, can you talk to us a little bit about what your perspectives are on the consumer and how that's been evolving over the last 12 to 24 months?

Hannah Dickinson ([02:07](#)):

When we look at the consumer and break down the trends, we are looking at the three key consumer cohorts, so the lower, middle, and upper income consumer cohorts, and there have been different trends between them. The lower income consumer has really been through a very challenging 12 to 24

months. They've been dealing with an incredible increase in the cost of household essentials like food, rent, groceries. So their cost of living has increased at a significant pace and they've been under a lot of pressure. What we're seeing in that cohort is a bit of a moderation in the pace of inflation and a stabilisation in those trends.

(02:54): Then when we look at middle and upper income cohorts, they've been a lot more resilient as a whole, a lot healthier.

Elisa Di Marco (03:03):

I'd really like to pivot now to really the headlines that we're seeing on President Donald Trump. There's so many different policies and initiatives that he's been talking about that do relate to the consumer, be it tariffs, immigration, or diversity. How are his initiatives impacting the consumer companies?

Hannah Dickinson (03:22):

I think what it means for consumer companies is another four years of a really complicated operating environment and just more headline noise. When it comes to consumer companies, the main issue we're focused on out of all of the kind of policy discussions that Trump has been talking about, the main one that we are looking at is tariffs. And that's because we're dealing with companies that are multinationals and often have complex global supply chains.

(03:52): Tariffs create two risks. One is simply the need to increase prices to offset the impact to your cost base. But the other is just the flow-on effects from that. So accelerating inflation again and potentially meaning that rate cuts that we'd all hoped for won't actually be coming down the pipe. So for consumer companies, what we're thinking about is their ability to offset tariffs through pricing power. I guess the consumer is at a difficult point in the cycle to be taking on more price increases because we've already seen so much over the past few years.

(04:33): So when we are looking for consumer companies that are well-positioned, we are looking for companies that either continue to have a really strong value proposition, so a company like Chipotle. Or we're looking for companies that are relatively well-positioned within their categories, so a company like L'Oreal that is competing against players like e.l.f. Beauty. e.l.f. Beauty manufactures 80% of its products in China, so if there are tariffs being imposed on Chinese imports, e.l.f. is going to have to increase its prices. Whereas L'Oreal, which has a lot more local manufacturing, it's going to be well-protected.

Elisa Di Marco (05:12):

So Hannah, given that backdrop that there has been quite a bit of uncertainty around the consumer sector more broadly, it's not a surprise that the consumer staples, consumers discretionary has been a bit of a laggard versus the market. But what's interesting is that there are differences within that consumer staples sector where your household goods have been performing better than food. Can you talk us through that dynamic and whether or not you view that that will continue going forward?

Hannah Dickinson (05:38):

Yeah, sure. So just to unpack what we've seen in consumer staples more broadly is, yeah, bifurcation as you say. So we tend to break consumer staples down into household and personal goods companies and then packaged food companies. So it's packaged food that has really underperformed on a relative basis. When we're looking at sector performance, we are always thinking about whether the performance has been related to cyclical or structural factors. By cyclical, I mean short-term in nature and likely to mean

revert. Whereas when we're thinking about structural issues or risks, we are thinking about bigger picture, broader risks that are likely to impact the category on a long-term basis.

(06:26): For packaged food, I'd say there's been a combination of factors at play. In terms of cyclical factors, it's this inflation and the price increases that we've been talking about. Because they're exposed to agricultural commodities, there was significant inflation in agricultural commodities and packaged food players really had to take a lot of price over the past few years to offset that impact to their cost base.

(06:52): That has started to weigh on volume growth for many players, and we've seen a negative impact on volume growth and a negative impact on sentiment flowing from that pricing that's been taken. Then when we think about structural factors, that is a bit more of an unusual dynamic that's been going on in the sector, and I'd say part of it is related to GLP1s or anti-obesity medication. There has obviously been an uptick in discussion and analysis of what this actually means for the packaged food sector that has been historically a real bellwether. These are household essentials. But when we're talking about these new obesity drugs that are coming to the market and being adopted widely by consumers, what we're starting to see now is research and of course anecdotal evidence that these are having a real impact on household spending on packaged food.

(07:51): So overall what we've been doing is leaning out of packaged food and leaning into household and personal goods products, which do still offer downside protection and better risk adjusted earnings in our view. So we're liking companies like Colgate, L'Oreal, Procter & Gamble.

Elisa Di Marco (08:08):

Let's unpack a little bit of those household goods companies that you just mentioned. L'Oreal is one of the names that we've been invested in in our global fund for a few years now. Can you talk us through what it is that you like about L'Oreal and why it still remains an attractive investment?

Hannah Dickinson (08:24):

L'Oreal is one of my highest conviction picks at the moment in the consumer sector. I have always liked beauty category because it has a really nice structural growth profile. It's a category that's grown at about four to 5% per annum for many decades, and I don't see any reason why that won't continue. L'Oreal as a company is a really high quality company. I think what's interesting about it is, despite its scale, and it is the biggest player in the beauty space, despite its scale, it's demonstrated an amazing organisational agility. It's had great innovation. It invests a lot into R&D, and it's been really agile in adapting to a fast-changing consumer environment.

(09:09): Beauty, it's a structural growth category, but it is experiencing some unique cyclical headwinds at the moment related to China and the macro landscape there, but then also related to the US. But my view is that the market is really focused on short-term noise and these factors are cyclical, they are not structural. So I think the investment thesis for L'Oreal at the moment is it's an attractive category, it's a high-quality player, and it's experiencing some headwinds that are cyclical rather than structural, so you are able to purchase it at a really attractive valuation.

Host (09:48):

That's Magellan portfolio manager and investment analyst, Hannah Dickinson. Consumers also love their technology, and all those gadgets rely on semiconductors. Next up, Elisa Di Marco turns our attention to

this fascinating and deeply complex industry. She's in conversation with tech team investment analyst, Adrian Lu. Here's Elisa again.

Elisa Di Marco ([10:09](#)):

So Adrian, semiconductors is an industry that you specialise in and it's something that you've spoken to our audience several times about. But just as a reminder, semiconductors power, everything electronic that we are using on a day-to-day basis. That ranges from the basic kettle that you have in your kitchen to the electronics in your car and also the software on your smartphone.

Adrian Lu ([10:31](#)):

That's right, Elisa. They really are the building blocks of technology, and they're so pervasive across so many industries.

Elisa Di Marco ([10:38](#)):

Yeah. So with this backdrop, it's no surprise that the semiconductor industry has been growing rapidly in recent years and now makes up around 9% of the market. What's your view on the industry on a forward-looking basis?

Adrian Lu ([10:53](#)):

Elisa, the future for semiconductors looks as bright as ever. We think that growth in semiconductors is going to continue to be strong over the years to come. The reason for that is simply that our rate of technology adoption is just going to continue to rise rapidly, which is really just another way of saying that we are going to use more and more of it.

([11:18](#)): I mean, you just have to look across the many growth dynamics we see across the space, from artificial intelligence to robotics to autonomous vehicles to cloud compute, edge compute and so on and so forth. All of this requires chips to run on. The thing is, no matter which of these growth dynamics you may favour as an individual investor, one thing you can bet on is that all of this is going to require more chip supply to sustain. And so that's a beauty of investing in this space.

([11:52](#)): Now, not only is our demand or our reliance on technology rising, but so too will the reliance of these technologies on chips. And just to give you a good example of that, if you take the electric vehicle, for instance, the dollar amount of chip content in an electric vehicle today, let's call it $1,500 or so. That's already twice the value of the content you would find in a modern combustion engine vehicle. So even if you were to sell the same number of cars, even if the car industry wasn't to grow, you've already doubled the market opportunity for semiconductors just on that electrification thematic alone. And that's before I've even laid in vehicle autonomy and the array of sensors and vision and controllers that it pulls in, all of which rely on a tonne of semiconductors, which would make that number even greater.

([12:47](#)): And so, the industry is currently predicting that global spending on semiconductors is going to reach a trillion dollars in 2030, but I suspect the way things are going at the moment we could well surpass that number, notwithstanding cyclicality and any bumps we might encounter along that road.

Elisa Di Marco ([13:06](#)):

Thanks, Adrian. That's quite the scene and quite the opportunity that we have in front of us with respect to the semiconductor industry. One thing that I'd like to touch on now is artificial intelligence. There's a

strong link between the demand for semiconductors and developments within the artificial intelligence industry. Now, earlier this year we saw news come out about DeepSeek and the amount of compute power that is needed to drive their technology. Can you talk to us a little bit more about that and how that may impact the industry outlook?

Adrian Lu ([13:37](#)):

Yeah, that's a great question, Elisa. The thing about DeepSeek is they really made a lot of waves when they released their latest AI models in January this year. Not so much because they had produced something that had suddenly surpassed the state of the art or that they had leapfrogged Google or OpenAI, but because they had produced something that was pretty close to the state of the art but at a much lower cost. That stoked market fears because it made the market ask, "Hey, do we really need to spend as much on GPUs as we thought we did?"

([14:17](#)): Now, we can have a debate around whether it was really as cheap to build these models as DeepSeek claims it was. But I think that's beside the point because what there's no denying is this company came up with some genuinely clever techniques and methods that made it cheaper to build these models, to refine these models, and to run these models. Having said that, I do think that this was made out to be a bigger deal than it was. We've been very close observers and followers of AI progress, and this was not some sudden pivotal moment. AI models have been already going down this path of becoming more efficient, more lightweight, cheaper to run, and just generally more effective. And so, not to take away anything from DeepSeek because what they did was genuinely impressive and innovative, but to us, this was just a continuation down this trend of greater efficiency, which is actually one of the primary reasons we've been more cautious about the strong levels of GPU spend that we've been observing in the market.

([15:26](#)): What I found interesting was actually the market's delayed reaction to the Deepseek developments because DeepSeek's original V-3 paper was published in December, and its follow-on R1 paper was published in January, a full week before we even saw the market react.

Elisa Di Marco ([15:42](#)):

Thanks, Adrian. That's been really interesting scene-setting with respect to the industry and the long-term demand for the usage of semiconductors. With our final minutes here, let's talk about the stocks, the companies that are going to be benefiting from this long-term tailwind of semiconductor adoption. TSMC is one of our highest conviction picks within the sector. It's a stock that we've owned within our High Conviction Fund and Global Opportunities Fund for around two years and more recently within our Global Fund. Can you talk to us about TSMC and why you view it to be an attractive opportunity?

Adrian Lu ([16:16](#)):

Well, the first thing I'll say is that semiconductors is such a broad and expansive sector spanning everything from intellectual property to design software, right down to the semiconductor manufacturing equipment. TSMC plays a unique role within this value chain as the contract manufacturer of its customers chip designs.

([16:42](#)): Now, you can have many companies designing their own chips, but very few companies can actually go and manufacture them. Why is that? It's because the capital costs you require to establish your own semiconductor manufacturing capability is enormous. We're talking double-digit billions of US dollars just to build a single moderately-sized fab today. And that's a number, by the way, that's

continuing to rise quickly just because of the greater levels of sophistication we are building into these chips every single year. So if you're a company looking at advanced manufacturing, it almost never makes any sense for you to go out and build the chips yourself because you simply can't justify the scale that's required to do so.

([17:32](#)):

And so, if you can find someone, if you can find a partner who can manufacture those chips for you more quickly, more efficiently and better than you could ever do, that's a win-win. And that someone who happens to be TSMC. So much so, in fact, that TSMC has virtually now no competition for advanced manufacturing processes. It's literally become the only and the company that every single design company will partner with in the value chain. This is a tough, tough game to be in, Elisa, and TSMC is the one still standing.

([18:09](#)):

And so, for all of the reasons that we're positive about semiconductors, I think TSMC is one of the most attractive ways to play this thematic. And if you think about it, virtually all the future most consequential innovations we are going to see coming down the pipe will most likely have to go through TSMC's fabs. So strong growth prospects, attractive valuation, and favourable growth dynamics makes it a top pick for me.

Host ([18:40](#)):

That's investment analyst, Adrian Lu. All that technology needs energy to run on, so let's now take a look further back up the supply chain. This time we hear from Fiona Wu, Investment Analyst from Magellan's infrastructure team, discussing how the compounding dependable infrastructure sector offers huge growth. Here's Elisa again.

Elisa Di Marco ([19:00](#)):

Today we're going to be talking about the demand and supply for energy within the United States and then stepping back and looking at the broader investment landscape and why we're excited to be investing in utilities over the decades to come. So Fiona, just to start with, let's set the scene. Can you talk us through energy demand in the US?

Fiona Wu ([19:21](#)):

So the landscape of the US demand market has changed significantly over the last two years. So if we're looking back, for much of the last decade, the energy demand was mostly flat because of the energy efficiency gains of sales growth from economic activities and population growth. Looking at today, we're seeing 2 and 2.5% percent annual growth rate. This is a large number in industry where brand new supply takes years of planning, construction, and connecting to the grid. Looking ahead, we can see this growth rate can be doubled, driven by AI data centre and ensuring of manufacturing.

([20:04](#)):

To give you a close look at the mix of the drivers, up to half of the incremental growth is coming from data centre. US has around more than 5,000 data centre in around half of the world total. So the Department of Energy forecasts, by 2028, the US data centre will consume up to 12% of the total US electricity compared to just under 5% today.

([20:32](#)):

A great example is Dominion Energy, which is one of our key holdings in the slack infra portfolio. Dominion Energy serves Virginia, were is the world largest data centre. So capacity run just under four gigawatt, but it's greater than the next four market combined globally. The company also said to increase by more than 10 times to 40 gigawatt over the next four to seven years.

(21:00): I want to give you some sense about the size of the data centre. So on the hottest day last December, the Australian national electricity market peaked at 32 gigawatt demand. Meanwhile, the US data centre consumes around just under 20 gigawatt today, and that number is still growing.

Elisa Di Marco (21:20):

Thanks, Fiona, for providing that backdrop. It's pretty incredible the growth that we've seen within data centres, but what you did touch on there is that AI is such a big part of the growth within data centres. But given the uncertainty in the demand for AI compute power going forward, how does that change your view in that energy demand profile going forward?

Fiona Wu (21:41):

There has been lots of excitement around AI. This technology innovation is reshaping the energy demand curve. Now, the debate is where it will stabilise. On one hand, we can see the AI model getting more efficient. Take the most recent example, DeepSeek, the Chinese AI model, consumes significantly less power, sparking the debate around whether less data centre and less electricity will be needed in the future.

(22:13): On the other hand, energy efficiency tend to drive more usage as you've probably seen in the mobile phone and also the computer market. As costs going down, AI could penetrate more industry and lock new applications and drive even greater electricity demand over time. So at the end of the day, at Magellan, we are not investing in data centre because of their unpredictable cash flows. Instead, we're focused on the regulated utilities providing part to those growing sector where we see the opportunities.

Elisa Di Marco (22:51):

So Fiona, a big part of the discussion in the increased energy demand coming from data centres has been the potential supply from nuclear. Could you talk us through your views on nuclear power?

Fiona Wu (23:04):

For years, people has been searching for reliable, clean base load energy source. Nuclear has been always part of the conversation. In the last two years, it's gained accelerated interest, primarily because of the massive energy demand from data centre and AI. So nuclear now is around 20% of the energy mix and remain fairly stable over the years. So Trump's administration has eased some regulatory hurdles which could speed up the development, but those projects are really complex and capital-intensive with a history of cost overruns and delays. Take the most recent example, Vogtle Nuclear Plant in Georgia. It was completed seven years behind of the schedule and double its initial cost.

(24:00): Another interesting point I want to mention is a small modular reactors, SMRs. You might heard of Amazon's recent deal for its data centre on the SMR. On paper, those SMRs has a potential to be more flexible, scalable, and cost-effective compared to the traditional nuclear plant. But there's a catch, there's none of them under operation in the US and none of them under construction either. So there's only two projects in the advanced planning phase. They won't be operational until 2030. So again, at Magellan, we are not investing in merchant power companies because of their exposure to energy price volatilities. But there are some regulated utilities with nuclear assets. They provide reliable authorised return. This is where we see the opportunities.

Elisa Di Marco (24:56):

Thanks, Fiona. That was very interesting perspective of all the elements that go into thinking about building out nuclear power. But I think one thing that was quite surprising is that 20% of the grid is already powered by nuclear. Could you talk us through the broader energy mix and where that's at at the moment?

Fiona Wu ([25:12](#)):

Yeah, let me break it down for you. Right now the US energy mix looks like 40% from natural gas, a quarter from renewables, 15% from coal and 20% from nuclear. So the natural gas and renewables has grown to replace coal plants while nuclear remains stable over the years. So looking ahead, Trump's executive orders on energy project permitting or funding could [inaudible 00:25:40] stop.

([25:41](#)): Looking through the noise and lots of headlines flow around, natural gas will remain the dominant energy source. The renewables have a mixed impact. On one hand, the offshore wind will be at risk under Trump's administration. Solar should continue to grow because it's cheaper and quicker to deploy. To give you some context around solar development, last year, a record 30 gigawatt of utility-scale solar capacity was added to the US grid. It counted around more than 60% of the total new addition last year. So going forward, the energy information administration forecast to add another around 30 to 33 gigawatt this year.

([26:27](#)): So very interesting dynamic I have to mention is most of the Republican states benefit the most from the renewable development. That's why we don't expect a major rolling back on the renewable tax credits. So at the end of the day, US need to grow its supply to match the surging demand, and in the near and medium term we expect that natural gas and the renewables remain to the primary source of the new additions.

Elisa Di Marco ([26:56](#)):

So there's a lot to be thinking about there on both the supply and demand side as well as those long-term trends. How are you then thinking more broadly about investing within the US utilities landscape?

Fiona Wu ([27:07](#)):

The demand tailwinds are hugely beneficial for regulated utilities. In history, those companies focus on great reliability and replacing ageing infrastructures. Going forward, there is also about the story of expansion, scaling up to meet the massive demand. So the demand and supply outlook we talk about earlier will require the utility company to invest in three key areas. So number one, generation, producing power. Number two, transmission, moving power long distance. Number three, distributions, delivering power to home and business. So that's where we see the investment opportunities for regulated utilities, which are regularly return and predictable cash flow. So for those companies, if they invest $1 capex, they will return around nine to 10 cents off that $1 capital. This is a very reliable, predictable growth model.

Elisa Di Marco ([28:10](#)):

So that's a great scene-setting for us in how we're thinking about the industries, which is really important at Magellan. But as investors, the next step is really the companies that we're investing in. Fiona, can you talk to us about a company that you're really excited about at the moment?

Fiona Wu ([28:25](#)):

That's a very great question. So Xcel Energy is a great example. It's one of our key infra holdings. Xcel Energy was amongst the first utilities to announce earning upgrade. In third quarter last year, the company came out, upgraded its capex guidance by around 15%, and also upgrade its earning outlook. What drives that? Because demand is service jurisdictions is doubling over the next five years. One thing I forgot to mention earlier is around the custom bills. When they have large users like Dollar Centre on the network, it will help spread the fixed cost of the grid, keep customer bill manageable, which is a crucial factor when regulator approving regulator returns and rate increase. So we're still in the early stage of major transformation on US energy demand, and driven by AI data centre and manufacturing, that's create a massive investment opportunities for US regulated utilities.

Host ([29:33](#)):

That was investment analyst Fiona Wu in conversation with investment director Elisa Di Marco. We trust you've enjoyed this episode. For more information on previous episodes, visit magellangroup.com.au/podcast, where you can also sign up to receive our regular investment insights programme. Thanks for listening.