

**Notwithstanding the considerable uncertainty in financial markets we remain calm and comfortable with the risk profile of the Magellan Global Fund.** Since the inflection of market sentiment in early April, the Magellan Global Fund unit price has remained stable.

In our view the portfolio is well constructed to deal with these events and is focussed on extremely high quality businesses that continue to excel in the current environment. Almost without exception the companies in the Magellan Global Fund which have recently reported have delivered outstanding operating performance with improved competitive positions, strong revenue and earnings growth.

<u>Performance 1 April to 5 August 2011:</u>	Change	MGF Excess
<b>Magellan Global Fund</b>	-1.7%	
S&P/ ASX 200 Index	-14.7%	13.0%
MSCI World Net TR AUD	-10.6%	8.9%

The sovereign debt issues in Europe and recent poor economic data out of the United States have led to considerable market volatility in recent days and months. **The sovereign debt issues in Europe cross two complex and associated issues.**

**The first issue is a solvency issue.** In our view Greece is effectively insolvent and Portugal and Ireland have potential solvency issues. The good news is that the European Union and the European Central Bank have finally recognised the insolvency issue in Greece. The new Greek bailout package is a fundamental step in the right direction. The package materially reduces Greece's financial burden via the extension of loan terms and the reduction in interest rates; these measures were also extended to Ireland and Portugal. The proposed involvement of private sector creditors to swap Greek sovereign debt for longer duration lower interest debt will also materially reduce the present value of Greece's outstanding debt. This reduction in Greece's debt burden is a fundamental step in putting Greece on a path to sustainability. We suspect that more still needs to be done, however we are optimistic that the tools and policies are now in place to address Greece's solvency issues.

**The second issue engulfing Europe is a potential sovereign debt liquidity crisis affecting larger European countries,** particularly Italy and Spain. We do not believe that either of Spain or Italy are insolvent, however a collapse in bond market confidence could push yields on sovereign debt to levels that create a true liquidity crisis. In our view monetary union presents particular challenges to addressing this situation. For a country that has its own currency and an independent central bank able to readily print money this situation would be addressable. In such circumstances the central bank could print money and buy bonds on the open market to drive down yields and monetise government funding requirements. The current policy path potentially involves the European Stability Fund (which is constrained in size) and the ECB buying affected bonds (with necessary offsetting asset sales) on the market to stabilise yields.

Unfortunately if this situation continues to escalate and in the absence of a dramatic and possibly unlimited increase in the size of the European Stability Fund, this policy path is akin to bringing a pea shooter to a gun fight.

We do believe that there are two potential policy options which would address these

liquidity difficulties; either allowing the ECB and EU central banks to print money or allowing the EU to issue Eurobonds to finance the struggling economies.

**We feel it is unlikely that these liquidity issues will result in a financial Armageddon scenario and that correct policies will eventually be pursued.** However there are divergent views on the correct path of action and thus we could have a sustained period of considerable volatility until this is resolved.

**We remain realistic and relaxed about the difficulties facing the US economy.** The recent decision to raise the US debt ceiling has removed considerable risk in the short term and we are confident that the US will take action over the next few years to ensure it is on a sustainable long term fiscal path.

Magellan continues to focus on the preservation of investors' capital and our disciplined approach to investing in the world's highest quality companies and we are confident of delivering the portfolio's objectives over the long term.

Kind regards,

Magellan Asset Management

