MAGELLAN ASSET MANAGEMENT LIMITED

HALF YEARLY INVESTOR REPORT

31 DECEMBER 2010

Magellan Global Fund

Investment Manager's Report

Dear Investor,

I am delighted to write to you as an investor in the Magellan Global Fund for the six months ended 31 December 2010.

For the 6 months to 31 December 2010, the net fund return was 1.02% and for the 12 months, the net fund return was 2.41%. Over the 6 month period the Fund underperformed the market benchmark by -1.12% and over the 12 month period the Fund net return exceeded the market benchmark by 4.36%. Since inception on 1 July 2007, the Fund net return has been 1.97% which exceeded the market benchmark by 30.77%.

We have received some feedback (recently and in prior years) that Magellan's investment philosophy of focusing on very high quality businesses within our three areas of expertise (i.e. our circle of competence) is too narrow and has the risk of underperforming markets for periods of time. We firmly believe that our investment approach is sound and will deliver attractive and lower risk investment returns for our investors over the medium to long-term. We will not be overly concerned if we underperform some short-term performance benchmark. Given our approach, and our objective of preserving investors' capital, the probability of this occurring is a near certainty as experienced over the last 6 months. We simply will not make investment decisions designed to outperform the market on a short-term basis.

The core of our investment philosophy is to invest in outstanding businesses that have very attractive underlying business economics which are protected by sustainable long-term competitive advantages, or in Warren Buffett's words an "economic moat". We believe that investing in outstanding businesses at appropriate prices is lower risk and will produce more certain investment returns over time than many other investment approaches. Warren Buffett wrote in his 1992 annual letter to shareholders: "Your goal as an investor should be simply to purchase, at a rational price, a part interest in an easily understood business whose earnings are virtually certain to be materially higher five, ten and twenty years from now. Over time, you will find only a few companies that meet those standards – so when you see one that qualifies your should buy a meaningful amount of stock."

In our view, the Magellan Global Fund is full of easily understood businesses whose earnings are virtually certain to be materially higher five, ten and twenty years from now.

We believe that a key lesson from the global financial crisis is that prudent portfolio construction is critical for reducing risk. Many investors assume that prudent portfolio construction equates to holding a widely diversified portfolio of investments. In our opinion, holding a widely diversified portfolio does nothing more than ensure that an investor's portfolio will produce returns that are not too dissimilar to the performance of the market. This indexed-based approach to portfolio construction often causes centric portfolios to become more exposed to certain sectors as they become more and more over priced and vulnerable. In fact, using indices as the basis of portfolio construction can actually increase risk as the market or sectors become more fully priced. The global Dot Com and Telecom bubble in the late 1990s/early 2000s and the Australian REIT bubble in

2006/2007 are classic examples of index centric investors becoming more and more exposed to high risk sectors as they increase in value.

Some investors with concentrated value investment styles assume that it is not necessary to diversify if individual investments are purchased at a sufficient discount to underlying value, or in Benjamin Graham's words, have an adequate "margin of safety". In our view, numerous concentrated value investors were caught wanting during the financial crisis as they held large correlated exposures to particular sectors (such as financials) that were particularly exposed to the global credit crisis. It is not unusual that many value based investment opportunities appear, like mushrooms in a moist dark environment, in similar industries at the same time. An investor could unwittingly aggregate risk by constructing a portfolio solely on valuation grounds, as regrettably many of the standard quantitative risk tools rely on historical share price correlations to predict risk.

In our view, the key to prudent portfolio construction is to ensure an investment portfolio does not have a high level of aggregation risk (i.e. the risk attached to similar economic, competitive or regulatory forces) and avoiding or minimising exposure to speculative excesses or bubbles.

At Magellan, we combine our focus on investing in outstanding businesses with long-term competitive advantages at attractive prices with prudent portfolio construction, with the aim of reducing aggregation risk and avoiding exposure to speculative excesses.

PORTFOLIO SUMMARY

Magellan Global Fund - as at 31 December 2010			
Wells Fargo	8.16%	Procter & Gamble	5.39%
eBay	7.41%	Colgate-Palmolive	5.29%
Google	6.17%	Johnson & Johnson	4.57%
Nestlé SA	5.95%	PepsiCo	4.06%
US Bancorp	5.93%	McDonald's	3.98%
Coca-Cola	5.84%	Danone	3.88%
Lowe's	5.79%	Other	13.19%
Kraft Foods	5.49%	Cash	3.44%
Yum! Brands	5.46%	**Total**	**100%**

As at 31 December 2010, the Global Fund's portfolio consisted of 23 investments (in comparison with 25 investments at 30 June 2010). The top 10 investments represented 61.59% of the portfolio at 31 December 2010, compared with 58.46% at 30 June 2010.

The continued decrease in cash weighting from 5.95% to 3.44% over the past 6 months is consistent with our view that it remains an attractive time to be investing in a carefully selected portfolio of stocks. The portfolio is well balanced and exposed to themes, such as emerging markets consumption growth, rising bond yields and ecommerce.

The major changes to the Fund's portfolio during the past six months have been:

- the purchase of an investment in Lowe's: a home improvement retailer based in the United States;

- the sale of a number of infrastructure investments (including the investments in Intoll and ConnectEast); and

- a decrease in the Fund's weighting to the payments industry due to increased regulatory uncertainty (including decreased exposure to American Express, Visa and MasterCard).

We continue to hold approximately 48% of the Fund's portfolio in multinational consumer franchises that have at least 20-25% of the sales revenue from emerging markets. We remain cautious about the outlook for economic growth in the major developed economies over the next 5-10 years and we strongly believe that these companies are well positioned to prosper almost irrespective of the growth outlook for the developed world. In our view, these companies are very well positioned to benefit from ongoing urbanisation and the very substantial growth in the middle class in the major emerging markets over the next 10, 15 and 30 years.

In the past 6 months we have increased our exposure to US banks (Wells Fargo and US Bancorp) to approximately 14% of the portfolio and made a material investment in Lowe's (approximately 6%), the US based home improvement retailer. These investments are in line with our view that the recovery in the US is likely to be more robust than many have been expecting, largely due to the aggressive action taken early by the US Federal Reserve to address the capital positions of the major US Banks, the US Federal Reserve's very aggressive monetary policy and the ongoing fiscal stimulus. The investments in the US banks are also consistent with our view that US inflation and long-term bond rates are likely to be rising in the years ahead. We believe, that each of these companies are outstanding businesses with strong long-term competitive advantages. Whilst we believe that the recovery in the United States will be more robust than many have been expecting, we are realistic about the challenges that lie ahead and the high likelihood that the United States, along with many other developed nations, is likely to grow at subdued rates for the next five years or so.

I normally detail investment mistakes that I feel I have made over the period. Fortunately, there are no glaring mistakes that have had materially negative consequences over the past six to 12 months. I should note that we have become increasingly cautious on the increasing regulatory risk that the major payment networks (particularly Visa and MasterCard) are exposed to in the United States and elsewhere. Over the past 6 months legislation has been passed in the United States to dramatically reduce interchange fees (i.e. the fees that the card payment networks pay the card issuers) for debit cards in the United States and to change the rules around exclusivity on debit card processing which is likely to reduce the value of Visa and MasterCard. Whilst these rules did not impact American Express directly (as they do not issue debit cards), the US Department of Justice has recently launched an action against American Express regarding their card rules which prevent merchants from steering or encouraging customers to use other payment alternatives. Whilst American Express believes this action is without merit, it reflects the current regulatory risk in the U.S. We still believe that the fundamental drivers of the global payments space are highly attractive, however the regulatory risk has increased and we have taken a decision to reduce our overall exposure to these companies for the time being. We continue to hold a material exposure to eBay which owns PayPal, an electronic wallet and ecommerce payments network.

MARKET COMMENTARY

I outlined in the 2010 Magellan Global Fund Annual Investor Letter the following key themes for the likely shape of the global recovery:

- We believe many major Northern Hemisphere developed economies are entering a prolonged period of structural adjustment where households deleverage and governments are forced to undertake substantial fiscal adjustments in order to ensure the level of government debt is sustainable. This is highly likely to lead to a period of sub-par economic growth in many developed world nations.

- We are optimistic that the recent European bailout packages for EU member states, and the recent decision to put in place a permanent EU liquidity facility, have substantially reduced the risk of a sovereign default of a European nation at a time when the banking system remains fragile. We are very conscious that there continues to be considerable sovereign and financial stress in Europe and there is a reasonable likelihood that a few EU nations will need to undertake some form of debt restructure in the future. We do, however, believe that the current liquidity issues are manageable provided the major European nations retain the political will to see it through.

- We continue to believe that the United States is likely to report accelerating economic growth over the next 12 months. We believe that the announcement by the Federal Reserve that they will extend its quantitative easing programme to purchase an additional US$600 billion of bonds and the recent agreement to extend the Bush tax cuts for two years and to introduce a payroll tax holiday will further stimulate the US economy in the short term.

- We regularly review the state of the US Federal Reserve's Balance sheet to ascertain the extent of quantitative easing and whether the resultant increase in the monetary base has found its way into the economy. Of particular interest is the size of the Federal Reserve's Balance Sheet which has grown from around US$940 billion in August 2008 to around US$2,423 billion in December 2010 and reserves balances (or deposits) held with the Federal Reserve from US banks which have increased from US$11 billion to US$1,025 billion over the same period. The increase in the size of the Federal Reserves balance sheet largely reflects the purchase of US treasuries and mortgage backed securities under the quantitative easing program. It is particularly noteworthy that the increase in the monetary base from the quantitative easing program has largely been put back on deposit with the Federal Reserve. As the economy starts to pick up it is likely that banks will start to withdraw these reserve balances and inject the money into the economy via extension of credit.

- It is highly likely if the US economy starts to pick up this monetary stimulus will need to be withdrawn. In our view when the Federal Reserve commences its "exit strategy" both short-term and long-term interest rates will be pushed up which will act to slow an economic recovery. We continue to believe that it is likely (although not certain) that highly leveraged economies (like the US, the UK and much of Europe) will deleverage which will result in subdued economic growth for an extended period of time. We hold this view notwithstanding that it is likely that economic growth in the US is likely to pick up over the next 12 months.

In addition to these views which were outlined in the last Annual Investor letter we believe that the following two issues are important for investors:

- Short-term economic outlook for China – it is reasonably evenly balanced as to whether the Chinese economy will slow down over the next 12 months. A slow down in the Chinese economy could have a material impact on investor sentiment and is likely to directly impact the Australian dollar and commodity prices. In 2009 and 2010 the Chinese government pursued extremely aggressive policies (credit expansion and fiscal stimulus) to maintain strong economic growth in response to the global economic slow down. As a direct consequence of these policy actions there has been a massive expansion in outstanding loans in the Chinese banking system (an increase by over 50% in the last two years). This has led to a huge increase in fixed asset investment (most notably property and infrastructure development) and increased inflation. The Chinese government is currently enacting policies to slow the rate of credit growth in the economy. To date, these policies have had limited impact with fixed asset investment in November up 24.9% year on year and inflation is currently at 5.1%. There is a risk that the government will be forced to take more dramatic policy action which could lead to a slow down in the economy in the absence of successful offsetting policy moves, most likely increased government expenditure.

- Outlook for inflation – the world will be facing increasing inflation and rising bond rates in the future. This is contrary to a view that has been prevalent in the past 6-12 months that there is a material risk of deflation together with very low bond rates.

Although we remain cautious about the economic outlook we remain of the view that it is an excellent time to be investing in the portfolio of companies held by the Magellan Global Fund. It is very difficult to predict what the stockmarket will do over the next 12 months, however we believe that the companies held by the Magellan Global Fund are well positioned to prosper over the next 3-5 years almost irrespective of the economic outlook.

KEY STOCK IN FOCUS

LOWE'S

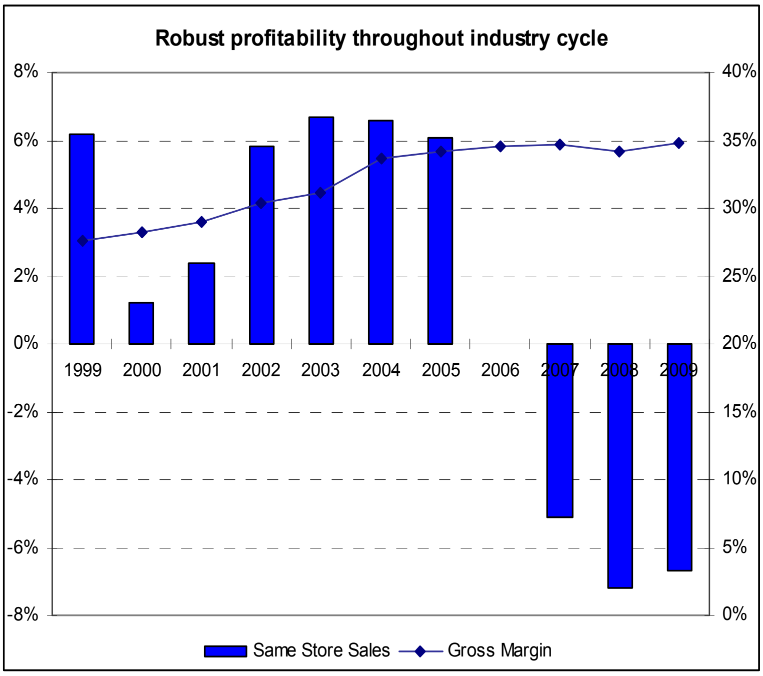
Lowe's is the world's second largest home improvement retailer and eighth largest retailer in the U.S. with fiscal year 2009 sales of $47.2 billion. Founded in 1946, the company serves approximately 15 million customers a week at more than 1,725 stores in the United States, Canada and Mexico.

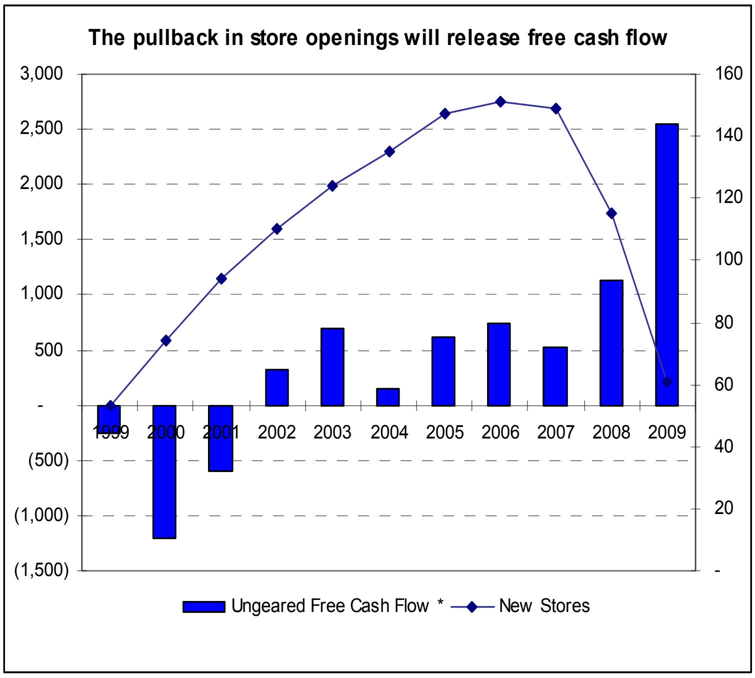
Lowe's stores cater to the do-it-yourself (DIY) and professional customer, selling a wide range of building materials, home improvement, and lawn and garden products, as well as providing a number of installation, repair and project-related services.

We hold a favourable view on the U.S. home improvement industry given its stable, duopoly structure. Lowe's competes directly with Home Depot and both companies have scale, assortment, pricing, location and property ownership advantages over a fragmented network of smaller, privately-owned building material and specialty competitors.

Preceding the U.S. housing downturn, Lowe's pursued a store rollout strategy where cash generated by operations was reinvested into new openings to drive market share growth. Through the recent economic downturn, management has acted to reposition the business while reinvesting in more efficient merchandising, payroll and supply chain operations.

While Lowe's will continue to open stores in underpenetrated markets (including in Australia through its joint venture with Woolworths) sales growth will be less reliant on new stores. Lowe's is thinking beyond current industry softness and investing to gain share in categories where competitors are struggling. With a longer horizon, Lowe's strategy is to evolve from a pure-play retail operation to a more holistic home improvement company. Lowe's aims to solve its customer's home improvement challenges however, whenever and wherever they choose, regardless of their desire for an online or offline experience and mix of DIY or outsourced solutions.





Lowe's has long demonstrated a disciplined approach to capital allocation and balance sheet strength. Opening fewer stores going forward means a lower requirement for internal reinvestment. Lowe's has undertaken to return excess cash flows to shareholders through dividends and buybacks. The company also plans a shift in its capital structure by taking advantage of attractive interest rates currently available on long-term bonds - Lowe's recently issued five, ten and thirty year bonds at 2.1%, 3.8% and 5.8% respectively. This additional debt will also be returned to shareholders through buybacks.

New stores, but more critically improved sales productivity from existing stores, combined with leaner operations, and a meaningful buyback program fuelled by highly cash generative operations will drive double digit earnings per share growth for many years. Lower reinvestment levels with improved asset productivity and merchandising led margin growth will improve Lowe's return on capital, at the same time that the business raises cheap debt that will lower its overall cost of capital.

Yours sincerely

Hamish Douglass
Portfolio Manager
Magellan Global Fund
January 2011

Contact Details:

Magellan Asset Management Limited ABN 31 120 593 946
Level 7, 1 Castlereagh Street, Sydney, NSW 2000 AUSTRALIA

Tel: +61 2 8114 1888
Fax: +61 2 8114 1800
Email: info@magellangroup.com.au
Web: www.magellangroup.com.au