HALF YEARLY INVESTOR REPORT

31 DECEMBER 2008

Magellan Global Fund

MAGELLAN ASSET MANAGEMENT LIMITED

Investment Manager's Report

Dear Investor

I am delighted to write to you as an investor in the Magellan Global Fund for the 6 months ended 31 December 2008.

For the 6 months to 31 December 2008 the net fund return was 12.87%, compared with the market benchmark [MSCI World Net Total Return Index $A] of -8.75%. Since inception of the fund on 1 July 2007 the net fund return was -6.58% [or -4.43% per annum], which compares with the market benchmark of -27.94% [or -19.62% per annum] over the same period. Whilst it is encouraging that the fund's relative performance has been materially better that the market, we are realistic that these statistics are short term and the absolute performance since inception is far from satisfactory. Over time we are confident that the fund will achieve our investment objectives of delivering very satisfactory investment returns whilst minimising the risk of a permanent capital loss.

We remain extremely risk averse and minimising risk remains at the core of our investment philosophy. We will not attempt to "swing for the fences" and buy higher risk investments in this environment in order to gamble on outsized investment returns. I have stated previously that we are very conscious that many investors have caught "falling swords" by striving for outsized investment returns. They have bought investments that have dramatically fallen in price only to find that the situation has continued to deteriorate. If we assess that there is any material risk of a permanent loss of capital on an investment, we will simply not participate, no matter how "mouth watering" the potential upside may be.

We are reminded of Warren Buffett's sage advice on risk when he says "To finish first, you must first finish." We are intent of remaining in the game for the long term and we will never knowingly speculate or gamble with your or our money.

We have often been asked what we consider as very satisfactory investment returns over the medium to long term. Our answer to this is to beat the market return by a satisfactory margin over a minimum of a five year period. It is reasonable to expect that equities will achieve returns in the range of 7-9% over the medium to long term and we believe that very satisfactory investment returns would be to beat this market return by a satisfactory margin. We are assembling a portfolio of very high quality (and relatively low risk) companies that, in our assessment, are likely to beat the market return over a longer term time frame.

PORTFOLIO SUMMARY

Magellan Global Fund - Top 10 Investments as at 31 December 2008			
Yum! Brands Inc	8.2%	Wal-Mart Stores Inc	5.3%
Google Inc	6.7%	Tesco Plc	4.8%
eBay Inc	6.4%	Pepsico Inc	4.4%
Nestle SA	6.0%	American Express Inc	3.8%
Proctor & Gamble Co	5.4%	McDonald's Corp	3.5%

As at 31 December 2008, the Global Fund portfolio consisted of 24 investments (in line with the number of investments at 30 June 2008), and over the same period we increased our cash weighting from 23.9% to 31.2%. The increase in cash weighting was primarily as a result of fund inflows in December and as at 22 January

2009 the cash weighting of the fund had fallen to 23.5% following further investment. The top 10 investments represented 54.5% of the portfolio at 31 December compared with 54.6% at 30 June.

The major new portfolio additions since 30 June were investments in Google and McDonald's and the Fund materially increased its investment weighting in Yum! Brands and Procter & Gamble.

The major sector change to the portfolio during the half year was to substantially reduce the Fund's exposure to financials. As at 30 June 2008 the Fund had 23.4% of the portfolio in financials however this had reduced by 31 December 2008 to 5.4%. During this period the Fund sold its investments in Bank of America, SLM Corporation and Wells Fargo and substantially reduced its exposure to Lloyds TSB and US Bancorp. I am pleased to advise that we sold at a premium over the purchase price for each of the four banks and achieved very satisfactory prices for our investments.

In light of the decision to effectively exit the bank investments, it is disappointing that the Fund retained any exposure to Lloyds TSB. This error was entirely mine. Whilst it is difficult for me to entirely rationalise what I was thinking in deciding to retain part of the investment, it may have been partly due to the fact that the investment in Lloyds TSB was a very recent addition to the portfolio (made in June 2008) and I wasn't ready to admit so quickly that I had made a mistake. The reality is that the facts had changed substantially, as Lloyds TSB announced in mid-September that it was taking over HBOS which was effectively impaired and this had significantly changed Lloyd's risk profile and capital position. This substantially changed the original investment thesis. Over the longer term the merger between Lloyds and HBOS should create the clear market leader in retail banking in the UK.

The decision to substantially reduce the Fund's exposure to financials was made following the collapse of Lehman Brothers on 15 September 2008. In the days following the collapse of Lehman Brothers the global commercial paper market froze, which resulted in a complete seizure of the interbank funding market. This was a 1 in a 100 year event that nearly lead to the collapse of the world's banking system. In our view, the freezing of the interbank funding market and the subsequent loss of depositor confidence substantially altered the risk profile of banking institutions. It was for this reason that we decided to effectively exit the bank investments in the Global Fund.

We remain of the view that the leading strongly capitalised retail focused banking institutions are likely to emerge from the current financial crisis with even stronger competitive positions and profitability. However, we would prefer to wait until we gain confidence on the stability of the funding environment and can better assess the full cost of government intervention before re-entering this sector. We believe that investing in the strongest retail focused banking institutions have a high likelihood of delivering outsized investment returns, however we will only invest when we have sufficient confidence that there is a minimal risk of suffering a permanent capital loss.

MARKET COMMENTARY

I have written on numerous occasions that the global financial crisis is probably the most serious issue which has arisen in financial markets for the past 20 years. It is becoming evident that this is the most serious event since the Second World War and probably since the Great Depression in the 1930s.

In our view the world has on two occasions been on the brink of an uncontrolled meltdown of the global financial system.

- The first event involved the collapse and bail-out of Bear Stearns in March 2008. We believe that had the US Treasury and Federal Reserve not backed the bail out of Bear Stearns, it is highly probable that it would have triggered the almost immediate collapse of two or three other major US based investment banks. Had this occurred, asset prices and derivative values are highly likely to have collapsed which could have resulted in the failure of many financial institutions around the world.
- The second event involved the collapse of Lehman Brothers and the subsequent freezing of the commercial paper and inter-bank funding markets around the world in September 2008. The seizure of these markets nearly resulted in a collapse of the world's banking system. The response by Governments and central banks around the world to guarantee deposits and debt issuance by banks and to inject capital into banking institutions has in our view substantially mitigated the risk of the collapse of the banking system.

The good news is that we believe that Governments and central banks will take whatever action is necessary to prevent the failure of systemically important financial institutions. In our view this will prevent a collapse of the world's financial system. This view is supported by the recent actions by the US Government and Federal Reserve to insure certain assets and provide capital to Citigroup and Bank of America, by the UK Government to insure assets of UK banks and provide additional capital to Royal Bank of Scotland and by the German Government to inject capital into Commerzbank. I have stated previously, this does not mean that there will not be serious ongoing implications from the global credit crisis. There is likely to be more failures (or near failures) of financial institutions (including hedge funds) around the world. This is likely to result in ongoing volatility for investors.

We believe that financial markets will remain very volatile for the next 6-12 months and it is unlikely the equity markets will stabilise until there is clear evidence that world's credit, banking and debt capital markets have stabilised. In a recent speech at the London School of Economics, the Chairman of the US Federal Reserve, Ben Bernanke, said: "In my view .... fiscal actions are unlikely to promote a lasting recovery unless they are accompanied by strong measures to further stabilise and strengthen the financial system." Whilst there were some encouraging signs in early January with the contraction in funding spreads in interbank funding costs, we believe that it is unlikely that we will see a quick stabilisation given the depth and scale of the issues faced by financial institutions. There are still enormous challenges ahead. The world's banking system and capital markets are currently operating only with the support of government guarantees. It is concerning that major bank balance sheets remain exposed to high risk assets and major credit write-offs relating to core consumer, commercial and real estate lending are only just starting and the depth and duration of the credit downturn is difficult to predict. It is more than probable that given the likely depth of the economic downturn that further government support/intervention will be required. It the absence of wide scale global nationalisation of the banking sector, a recovery in the credit markets is likely to require a clear pathway to the removal of government support for the banking sector. How and when government support for the banking sector is to be removed is anything but clear.

We remain very cautious on the outlook for the world's economy and believe the probability of a quick turnaround is low. In our view, the scale of the deleveraging of the world's financial system will result in a prolonged (possibly multi-year) downturn. Consumers in developed countries (such as Australia, the US and UK) have entered this downturn with the highest levels of debt relative to income and lowest levels of savings on record. It is highly likely that savings rates will increase which will put further pressure on consumption. This is what John Maynard Keynes referred to as the "Paradox of Thrift". The newly appointed head of the panel tasked with overseeing the distribution of the US Government's Troubled Asset Relief Program, Elizabeth Warren, recently said: "The idea that the American family will quickly spend us out of this recession is a fantasy. It won't happen."

The twin problems of very high levels of consumer indebtedness and low savings could result in an unusually long downturn. Conventional monetary policy in this environment has become ineffective (even with rates at close to zero consumers are not spending) and some central banks are toying with quantitative easing (ie printing new money to buy assets) as a way of injecting money into the economy. The quantitative easing route could only be contemplated by the strongest economies, as in weaker economies it is likely to result in spiralling inflation and a collapse in the currency. Many governments have reverted to Keynesian economics to use large fiscal injections in an attempt to stimulate their economies. This is likely to result in countries running large budget deficits. In our view many nations may not have the financial strength to continue to run large budget deficits through a prolonged downturn. Already major nations such as Greece, Portugal and Spain have had their sovereign credit ratings downgraded and numerous countries (such as Italy, Ireland, Poland and New Zealand) have been put on credit watch for a possible downgrade. There is a reasonable probability that some major developed nations will be unable to continue to respond to the downturn with either fiscal or monetary policy.

We remain very cautious on the economic outlook and the time it will take to stabilise financial markets. We will continue to make investments in outstanding businesses during this period of extreme pessimism as we believe that these are exactly the economic times when investments can be purchased at prices that are likely to produce outsized investment returns over a medium term investment horizon. We are not seeking to pick the bottom of markets and will only make an investment if we believe the returns will be attractive and there is a minimal risk of a permanent capital loss. In April 2007 Warren Buffett was quoted as saying in an article in Forbes: "Uncertainty is actually the friend of the buyer of long term values."

KEY STOCK IN FOCUS

YUM! BRANDS

Yum! Brands Inc. (YUM) is the world's largest quick-service restaurant company by restaurant count, with more than 35,000 restaurants in over 100 countries. Its major brands, KFC, Pizza Hut and Taco Bell, are the leaders in the chicken, pizza and Mexican-style food categories. YUM! describes itself as "The Global Growth and Cash Machine".

We believe that YUM! has a long runway for growth. In the United States it has 20,000 restaurants serving 300 million people, YUM! Restaurants International (YRI) has 12,900 restaurants serving 4 billion people and YUM! China has 2,800 restaurants servicing 1.3 billion people. Whilst its business in the United States is mature, there is tremendous growth potential for store roll-out in YRI and YUM! China. YRI is currently opening approximately 900 restaurants per annum and YUM! China is opening approximately 400 restaurants per annum. YRI is currently developing new restaurants in over 75 countries with over 200 franchisees.

YUM! China is the "jewel in the crown". YUM! China currently produces approximately 25% of the group's operating earnings and the company estimates that YUM! China will produce approximately 40% of the group's operating earnings within 10 years. Importantly, YUM! China earns highly attractive returns for shareholders with EBIT margins of approximately 20%, return on capital of approximately 50% and operating profit of approximately US$500 million. KFC is the most recognised foreign brand and leading quick-service restaurant company in China. KFC operates approximately 2,400 restaurants in over 475 cities in China, Pizza Hut has established itself as the leading casual dining restaurant chain in China with approximately 400 units. YUM has estimated that it has the potential to roll-out around 20,000 restaurants in China.

YUM has highly attractive economics:

- Pre-tax return on total capital employed is approximately 38%, which is materially in excess of YUM!'s cost of capital
- Notwithstanding YUM!'s strong growth characteristics the company consistently produces free cash flow of more than 100% of profit after tax and returns free cash flow to shareholders via dividends and share buybacks.
- It has consistently grown EPS in excess of 10% per annum. It has forecast that EPS will grow at 12% for the year ended 31 December 2008 and in excess of 10% for 2009.

Yours sincerely

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January 2009

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