ANNUAL INVESTOR REPORT

30 JUNE 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 ('Global Fund') for the 12 months ended 30 June 2010.

For the 12 months to 30 June 2010 the net fund return was 13.9%, which exceeded the market benchmark by 8.4%. Since inception on 1 July 2007, the net fund return has been 0.9% which exceeded the market benchmark by 31.2%. Whilst we are satisfied that the Global Fund has preserved investors' capital during this extremely difficult period, we are mindful that the absolute return since inception remains below our objective of delivering returns above our target 9% per annum over the medium to long term. We note that over the past 2 years the Global Fund has returned 10.4% per annum. We remain confident that over time our investment strategy is likely to deliver satisfactory investment returns whilst minimising the risk of a permanent capital loss.

In order to be a successful investor over the long term, we believe it is critical to understand, and hopefully overcome, common human cognitive or psychological biases that often lead to poor decisions and investment mistakes. Cognitive biases are "hard wired" and we are all liable to take shortcuts, oversimplify complex decisions and be overconfident in our decision making process. Understanding our cognitive biases can lead to better decision making which is fundamental, in our view, to lowering risk and improving investment returns over time. I have outlined below five key cognitive biases that can lead to poor investment decisions:

1. Confirmation bias

Confirmation bias is the natural human tendency to seek or emphasise information that is confirmatory of an existing conclusion or hypothesis. In our view confirmation bias is a major reason for investment mistakes as investors are often overconfident as they keep getting data that appears to confirm the decisions they have made. This overconfidence can result in a false sense that nothing is likely to go wrong which increases the risk of being completely blindsided when something does go wrong.

In order to minimise the risk of confirmation bias we attempt to challenge the status quo and seek information that causes us to question our investment thesis. In fact, we are always seeking to "invert" the investment case to critically analyse why we might be wrong. We continuously revisit our investment case and challenge our assumptions. It is much more important to ask oneself "why you are wrong than why you are right". Charlie Munger, the Vice Chairman of Berkshire Hathaway and Warren Buffett's business partner, said: "We all are learning, modifying, or destroying ideas all the time. Rapid destruction of your ideas when the time is right is one of the most valuable qualities you can acquire. You must force yourself to consider arguments on the other side".

In our view, the strength of many of history's most accomplished scientists and mathematicians has been their ability to overcome their confirmation bias and to see all sides of a problem. Carl Jacobi, the famous 19th century mathematician, said: "Invert, always invert".

2. Information bias

Information bias is the tendency to evaluate information even when it is useless in understanding a problem or issue. The key in investing is to see the "wood from the trees" and to carefully evaluate information that is relevant to making a more informed investment decision and to discard (and hopefully ignore) irrelevant information. Investors are bombarded with completely useless information everyday, from financial commentators, newspapers and stockbrokers, and it is difficult to filter through it to focus on information that is relevant. In our view, daily share price or market movements usually contain no information that is relevant to an investor that is concerned about the medium-term prospects for an investment, yet there are entire news shows and financial columns dedicated to evaluating share price movements on a moment by moment basis. In many instances investors will make investment decisions to buy or sell an investment on the basis of short-term movements in the share price. This can cause investors to sell wonderful investments due to the fact that the share price has fallen and to buy into bad investments on the basis that the share price has risen.

In general, investors would make superior investment decisions if they completely ignored daily share price movements and focused on the medium-term prospects for the underlying investment and looked at the price in comparison to those prospects. By ignoring daily commentary regarding share prices, investors would overcome a dangerous source of information bias in the investment decision making process.

3. Loss aversion/endowment effect

Loss aversion is peoples' tendency to strongly prefer avoiding losses than obtaining gains. Closely related to loss aversion is the endowment effect where people place a higher value on a good that they own than on identical good that they do not own. Loss aversion/endowment effect can lead to very poor and irrational investment decisions whereby investors refuse to sell loss making investments in the hope of making their money back.

The loss aversion tendency breaks one of the cardinal rules of economics; the measurement of opportunity cost. To be a successful investor over time you must be able to properly measure opportunity cost and not be anchored to past investment decisions due to the inbuilt human tendency to avoid losses. Investors who become anchored due to loss aversion will pass on mouth watering investment opportunities in order to retain an existing loss making investment in the hope of making their money back.

In our view, all past decisions are sunk costs and a decision to retain or sell an existing investment must be measured against its opportunity cost. In order to increase our focus on measuring opportunity cost we run the Magellan Global Fund like a "football team" where we have the ability to put about 25 players onto the paddock at any one time. This forces us to focus on the opportunity cost of retaining an existing investment versus making a new investment in the portfolio. We believe many investors would make superior investment decisions if they constrained the number of investments in their portfolios as they would be forced to measure opportunity cost and make choices between investments. Warren Buffett often gives the illustration that investors would achieve superior investment results over the long-term if they had an imaginary "punch card" with space for only 20 holes and every time they made an investment during their lifetime they had to punch the card. In Buffett's view, this would force investors to think very carefully about the investment, including the risks, which would lead to more informed investment decisions.

4. Incentive caused bias

Incentive caused bias is the power that rewards or incentives can have on human behaviour, often causing folly. The sub-prime housing crisis in the United States is a classic case study in incentive caused bias. Notwithstanding that financiers knew that they were lending money to borrowers with appalling credit histories, and in many cases people with no incomes or jobs and limited assets ("NINJA" loans), an entire industry, with intelligent people, was built on lending to such people.

How did this happen on such a massive scale? We believe the answer can be found in the effect of incentives. At virtually every level of the value chain there were incentives in place to encourage people to participate. The developers had strong incentive to construct new houses, the mortgage brokers had strong incentive to find people to take out mortgages, the investment banks had strong incentive to pay mortgage brokers to originate loans so that they could package and securitise these loans to sell to investors, the ratings agencies had strong incentive to give AAA ratings to mortgage securities in order to generate fees, and banks had strong incentive to buy these AAA rated mortgage securities as they required little capital and produced enormous, leveraged profits.

Warren Buffett said: "Nothing sedates rationality like large doses of effortless money. After a heady experience of that kind, normally sensible people drift into behaviour akin to that of Cinderella at the ball. They know that overstaying the festivities — that is, continuing to speculate in companies that have gigantic valuations relative to the cash they are likely to generate in the future — will eventually bring on pumpkins and mice. But they nevertheless hate to miss a single minute of what is one helluva party. Therefore, the giddy participants all plan to leave just seconds before midnight. There's a problem, though: They are dancing in a room in which the clocks have no hands."

One of the key factors we focus on in making investment decisions is our evaluation of agency risk. We evaluate the incentives and rewards systems in place to assess whether they are likely to encourage management to make rational long-term decisions. We prefer companies that have incentive schemes that focus management on the downside as well as the upside and encourage management to return excess cash to shareholders. For instance, executive compensation that is overly skewed towards share option schemes can encourage behaviour that is contrary to the long-term interests of shareholders, such as retention of earnings above those that can be usefully reinvested into the business.

5. Oversimplification tendency

In seeking to understand complex matters humans tend to want clear simple explanations. Unfortunately some matters are inherently complex or uncertain and do not lend themselves to simple explanations. In fact, some matters are so uncertain that it is simply not possible to see the future with any clarity. In our view, many investment mistakes are made when people oversimplify uncertain or complex matters.

Albert Einstein said: "Make things as simple as possible, but no more simple".

A key to successful investing is to stay within your "circle of competence". A key part of our "circle of competence" is to concentrate our investments in areas that exhibit a high degree of predictability and to be wary of areas that are highly complex and/or highly uncertain. We believe that forecasting the volume growth for Colgate-Palmolive, Coca-Cola or Procter & Gamble is relatively foreseeable over the next 10 years and is well within our circle of competence. Investing in financials is far more complex and we are disciplined to try to ensure we do not overly simplify the inherent complexity of a major financial institution. If we cannot understand the complexity of a financial institution we simply will not invest, no matter how compelling the "simplified" investment case may appear. Notwithstanding that our investment team has over 50 years combined experience in analysing financial institutions, there are many institutions that we believe are simply too difficult to assess.

In our view the majority of the investment mistakes we have made can in large part be attributed to our cognitive biases, where we have fallen susceptible to confirmation bias, have oversimplified a complex problem or strayed outside our circle of competence. Unfortunately these cognitive biases are "hard wired" and we will make mistakes in the future. Our aim is to have systems and processes in place in order to minimise the number of mistakes we will inevitably make due to our cognitive biases.

PORTFOLIO SUMMARY

Magellan Global Fund - as at 30 June 2010			
eBay	7.4%	Pepsico	4.3%
Yum! Brands	7.1%	Visa	3.9%
Wells Fargo	6.8%	Wal-Mart	3.3%
Coca-Cola	6.2%	US Bancorp	3.3%
Google	5.8%	American Express	3.2%
McDonalds	5.7%		
Procter & Gamble	5.2%	Other	17.4%
Colgate - Palmolive	5.1%	Cash	6.0%
Kraft Foods	4.8%		
Nestle	4.5%	**Total**	**100%**

As at 30 June 2010 the Global Fund's portfolio consisted of 25 investments in comparison with 25 investments at 30 June 2009. The top 10 investments represented 58.6% of the portfolio at 30 June 2010 compared with 58.4% at 30 June 2009.

The continued decrease in cash weighting from 12.7% to 6.0% over the past 12 months is consistent with our view that it remains an attractive time to be investing in a carefully selected portfolio of stocks. In our assessment, this is the most attractive time to be purchasing the portfolio of stocks held by the Global Fund since March 2009 and believe that the Global Fund is well placed to deliver very satisfactory investment returns over the next 3 to 5 years whilst minimising the risk of a permanent capital loss. The portfolio is well balanced and exposed to themes (such as the urbanisation of emerging markets and the payments industry) which should exhibit attractive growth, notwithstanding the very subdued economic outlook for much of the developed world.

The major changes to the Global Fund's portfolio during the prior twelve months have been:

- the introduction of six new investments (including the investments in Kraft, Mastercard and Visa);
- the sale of six investments (including the investments in Abercrombie & Fitch, Reckitt Benckiser, Nutrisystem and Lloyds Banking Group);
- an increase in the Fund's weighting to the payments industry (including increased exposure to eBay, which owns the PayPal ecommerce payments business and purchases of shares in Visa and Mastercard); and
- an increase in the weighting in Yum! Brands and Wells Fargo.

We hold approximately 46% of the Fund's portfolio in multinational consumer franchises that generate at least 20-25% of the sales revenue from emerging markets and have a very low exposure to cyclical or consumer discretionary businesses. 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.

The Global Fund held four investments which have direct exposure to the payments industry eBay (via its ownership of PayPal], American Express, Mastercard and Visa. Combined, these investments represent approximately 16% of the Global Fund's portfolio at 30 June 2010. We believe that the payments industry is an attractive space which is likely to grow at more than twice the rate of world GDP growth over the next decade as world commerce continues to transition from a cash and cheque based payments system to a largely cashless payments system. Each of these companies exhibit highly attractive economic characteristics with an effective gross profits royalty over the payments processed by their networks and strong "network economics" which provide enormous long-term competitive advantages.

I normally detail investment mistakes that I feel I have made over the period. Fortunately, and possibly due to my cognitive biases, I am happy to report that there are no glaring mistakes to report over the past 12 months. Unfortunately, it is a virtual certainty that I will make mistakes in the future, and there could well be mistakes in the current portfolio of which I am unaware. When I become aware of mistakes I will continue to candidly report these to you.

MARKET COMMENTARY

There has been considerable debate over the past six months on the shape of the global economic recovery. We continue to believe that the economic background surrounding the current situation in many developed economies is very different to past recessions. It appears that the "debt supercycle" which has been a major driver of economic growth in the developed world over the last 15-20 years is now over.

Over the past 12 months there has been considerable debate amongst the major developed nations about the right way forward. The United States and France have continued to take a "Keynesian" economic view; that it is too early to withdraw fiscal stimulus and the correct economic policy is for governments to undertake fiscal expansion (funded by debt) during an economic downturn. Much of the remainder of the developed world (led by Germany, the UK and now Japan) believe that continued fiscal expansion in an era of extremely high government and private sector debt is unsustainable and is at best delaying "judgment day" or at worst putting economies on a path towards insolvency and financial ruin. These countries are actively pursuing fiscal austerity policies aimed at reducing fiscal deficits to put the economies on a more sustainable footing. The "Keynesians" believe that such policies are wrong and will push many economies back into recession.

We believe that the economic factual situation faced by many major developed economies - high government and private sector debt, fragile banking systems, high dependence on foreign lenders, high structural unemployment, high current account deficits, aging populations [with unfunded retirement and healthcare liabilities] and the likely decreasing marginal benefits of productivity gains resulting from globalisation - make many of these economies especially vulnerable to a liquidity shock where foreign lenders refuse to roll government and private sector debt. This is the lesson that the recent events in Greece have taught us. This makes "Keynesian" fiscal expansion extremely problematic for economies in weaker positions and could in fact be a road to ruin.

There is unlikely to be any "free lunch" from the short-term stimulus measures and we believe that most of the major developed economies are entering a prolonged period of structural adjustment where households deleverage and governments are forced to undertake substantial fiscal reductions 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.

We remain extremely cautious on the outlook for much of Europe as many countries are running high structural fiscal deficits, high current account deficits, have unsustainably high levels of government debt, have weak, undercapitalised banking systems that are dependent on foreign providers of capital and have run microeconomic and welfare policies that have left the economies uncompetitive on a global basis. These are very difficult issues which are going to place enormous social and economic pressures on many European economies in the years ahead.

We are, however, optimistic that the recent European bailout packages for EU member states have substantially reduced the risk of a sovereign default of a European nation at a time when the banking system remains fragile. A sovereign default of a European nation may well set off a "chain reaction" that could again place the world's financial system on the brink of collapse. It is critical that Europe deals with the capital adequacy of its major financial institutions. We are hopeful that the stress tests to be announced by the European central banks on 23 July 2010 will be an important first step in addressing this critical issue.

In our view, the United States is likely to report accelerating economic growth over the next 12 months. 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$2,375 billion in June 2010 and reserve balances (or deposits) held with the Federal Reserve from US banks which have increased from US$11 billion to US$1,043 billion over the same period. The increase in the size of the Federal Reserve's 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.

We believe the most probable outcome is that the US economy will accelerate over the next 12 months as this money finds its way into the economy. In fact, given the quantum of the Federal Reserve balances, it is possible that the US economy could accelerate faster than economists are forecasting. The risk to this scenario is an escalating sovereign debt and bank funding crisis in Europe. As suggested above, we are hopeful that the policy makers in Europe are taking meaningful steps to address these issues and we believe that the current financial strains in Europe will start to ease over the coming months.

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 Reserves 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.

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 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 Global Fund are well positioned to prosper over the next 3-5 years almost irrespective of the economic outlook. The caveat to our assessment would be a major financial system collapse which could trigger a very deep recession or even a depression. We believe the risk of such an event has been greatly reduced, however the global financial system remains fragile and the risk is not nil.

KEY STOCK IN FOCUS - COLGATE-PALMOLIVE

Colgate-Palmolive ("Colgate") is the global leader in toothpaste with a market share of approximately 50%. The leading market position that Colgate has established in toothpaste is almost without parallel for any major household and personal care category (other than blades and razors for Gillette which is owned by Procter & Gamble). In addition to toothpaste and toothbrushes, Colgate also manufactures detergents, shampoos, shower gels and deodorants. It also owns specialty pet-food maker Hill's, which sells its products through veterinarians and specialty pet retailers.

Colgate is a truly global company with 75% of sales from outside the United States. Importantly, approximately 50% of its sales are from the emerging markets.

Colgate has established particularly strong toothpaste positions in Latin America (80% market share), India (50% share) and China (30% share) and is benefiting from the high rates of growth from these markets as more consumers move into income brackets where they become consumers of oral care products. The extent of Colgate's global leadership of the toothpaste category is demonstrated by the fact that of the 65 largest toothpaste markets in the world, Colgate is the leader in 56 of those markets.

We believe that the oral care category is fundamentally attractive with very low private label penetration, high brand loyalty, concentrated industry structure with only four global players and significant per capita growth opportunities in the emerging markets (as we believe items such as toothpaste will benefit from early adoption as the population in emerging markets increase per capita incomes). Colgate has very high relative market share position and the fact that it is the only truly global competitor gives it a significant competitive advantage. Its size advantage in the category enables Colgate to leverage enormous economies of scale in relation to manufacturing, distribution, research and development and advertising.

Colgate seeks to create high brand loyalty by maximising endorsements from dentists. This increases switching costs and makes it difficult for competitors to take market share in established markets. As shown in the table below, dentist endorsement is an area where Colgate has been very successful.

% dentists recommending Colgate	Global	Brazil	China	India
2004	33	20	41	77
2008	47	59	58	80
2009	50	67	67	86

In addition, Colgate runs extensive school education programs which promote good oral hygiene practices and expose younger consumers to its brand from a very early age. In emerging markets, these children become "Colgate ambassadors" by spreading the message of good oral hygiene amongst their parents and other relatives.

The attractive industry structure and Colgate's leading market position translates into very attractive underlying economic fundamentals. Colgate's return on equity is in excess of 50% and we believe that the company should continue to deliver high single digit to low double digit earnings per share growth for the foreseeable future.

Yours sincerely

Hamish Douglass
Portfolio Manager
Magellan Global Fund
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MAGELLAN
ASSET MANAGEMENT LIMITED

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
Web:www.magellangroup.com.au