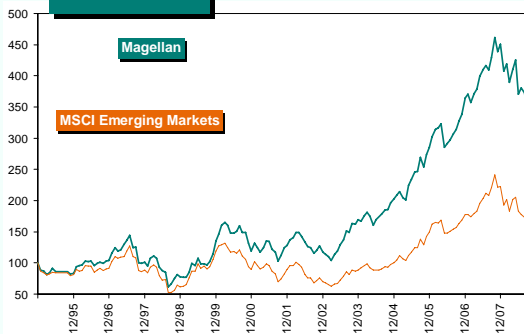


Performance



NAV per share:

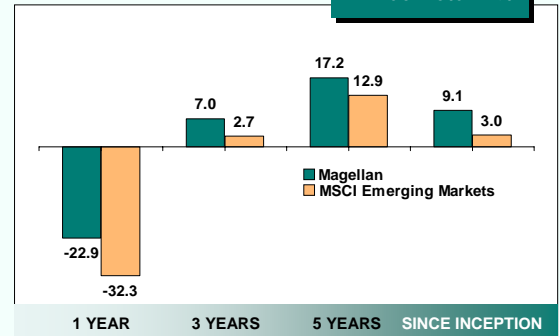
1,171.56 EUR

Total net asset value:

1,584.43 million EUR

As of 01/01/06, the MSCI Emerging Markets was changed to become dividends reinvested

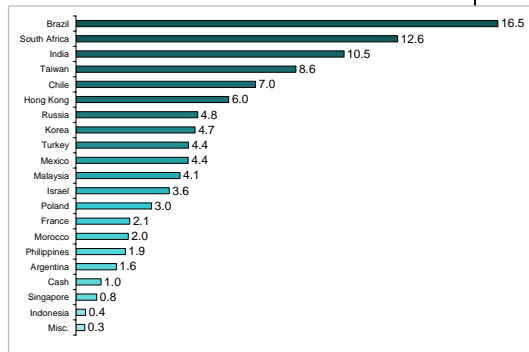
Annual return %



The third quarter, especially the month of September, saw sharp declines on all stock markets globally. The theme of the "decoupling" of emerging markets from their developed counterparts - a concept that we have been firmly opposed to - has proved to be only a myth: for the large part, equity investors in emerging stock markets come from developed economies, seeking in these newly industrialised countries that extra bit of growth that was missing in their own homeland. In these challenging circumstances, **Magellan's** net asset value declined by 10.9% over the quarter and by 26.7% since the beginning of the year. The MSCI Emerging Markets index fell to a greater extent, tumbling by 18.1% and 32.9% respectively over the same periods.

Over the past five years, the world banking system has grown its assets at a rate which is five times faster than the growth of the real economy thanks to securitization and the use of financial leverage. We have now entered the phase wherein the leverage of hedge funds and many other financial institutions has gone into reverse, with two sets of consequences:

- The forced liquidation of a large number of assets



bought with debt: real estate, raw materials, Asian and Emerging Market equities;

- The simultaneous reduction in liabilities, largely in the form of the debt massively contracted in Japanese yen (because of rock-bottom interest rates) and in US dollars (under the false hope of an inevitable fall). The sudden closing of these positions has resulted in an increasingly volatile foreign exchange market. The visibility of the earnings of companies based in this region will be impaired.

The Asian banking system, which suffered terribly during the 1997-98 crisis, is likely to have had a limited exposure to "toxic assets". Nevertheless, because of the globalization of financial flows, secondary effects are unavoidable:

- The banking system in South Korea is being tested by the sharp reversal of the US dollar because

of the massive borrowings contracted in that currency. As a result, many Korean corporates are also expected to be in trouble. Hidden liabilities, either off-balance sheet or parked in foreign subsidiaries, are likely to surface in due course in such a notoriously opaque system.

- In Russia, numerous oligarchies purchased stocks using significant levels of debt. Banks are forced to liquidate these stocks.
- Large investment projects in the emerging countries are chiefly financed by international banking groups. The sharp risk aversion we are witnessing at present will cause many projects with shaky financing to be cancelled.

In the current mood of extreme pessimism, it seems reasonable for us to sound a somewhat more optimistic tone:

- The current crisis is not the death sentence of capitalism. It is rather the end of the road for a perverted system, akin to a gigantic kleptocracy in which employees in the banking industry stole profits ... which turned out to be non-existent!
- The financial system in the U.S. and in Europe will resume its lending function even if massive nationalizations are required;
 - The financial crisis will have a silver lining in that it will trigger a Darwinian selection process: those companies that have healthy balance sheets and strong cash-flow generation will lead the consolidation in many industries and will come out reinforced from this turmoil. The access to credit will become another barrier to entry.

Amongst the main positions in your portfolio:

- The stock price of RESORTS WORLD suffered as a result of the political confusion in Malaysia surrounding the growing popularity of former Minister of Finance Anwar Ibrahim in the upcoming elections. The market is concerned that existing gaming laws could be called into question, although we believe that this is highly improbable. Indeed, Ibrahim was extremely pragmatic whilst in power and in this respect it seems unlikely that he would threaten an activity which is the second largest contributor to Malaysia's budget.

Mobile telephone service suppliers fared very well, with just one exception:

- MTN of South Africa announced a 26% rise in first-half adjusted headline earnings per share. This strong growth can be linked in part to the good results recorded in Nigeria and Iran, whose populations are benefiting from the surge in the price of oil. Russian group MTS recorded an increase in net earnings of 30% over the same

period. In spite of strong penetration, this market continues to grow thanks to intensifying telephone usage. MAROC TELECOM's earnings rose 18% in the first half of the year. Victim of ferocious competition from TELEFONICA (VIVO) and AMERICA MOVIL (CLARO), Brazilian company TIM disappointed investors. The recent counter-offensive did not bring about the desired results and weighed on the company's short-term profitability. With a high-quality clientele and the best national coverage, we still believe TIM to be well-positioned in the long term. However, the firm's short-term results will depend on the ability of its competitors to offer new subscriptions at a loss.

- NOBLE'S second quarter results were exceptional. The Singaporean group posted a 75% rise in sales and a 120% surge in earnings. Energy and agriculture were the two best performers. The group's gross margin rose 4.1%, up 0.8%, which explains the sharp rebound in NOBLE'S operating profit. Although company earnings are not directly linked to the price of raw materials, the firm's stock price tumbled significantly in the wake of the violent market consolidation affecting commodity-related stocks.

- ARACRUZ of Brazil disappointed investors as a result of its rather imprudent hedging policy, whose negative consequences were heightened by the spectacular currency fluctuations in numerous emerging economies, Brazil in particular. Exporting 95% of its production, the firm is one of the world's leading producers of bleached eucalyptus pulp. Its strong vertical integration in forests, production units and transport infrastructures give it a competitive advantage over its major Northern rivals. Given ARACRUZ'S excellent management history, an internal control breach seems to be the only possible explanation for the group's accounting loss which will weigh on net earnings in the short term.

Vincent Strauss & Wojciech Stanislawski

Top five holdings (%)

MTN Group	South Africa	4.3
Taiwan Semiconductor	Taiwan	3.8
Souza Cruz SA	Brazil	3.6
Amdocs Ltd	Israel	3.6
Empresas Copec SA	Chile	3.3