PLATINUM ASSET MANAGEMENT

THE PLATINUM JAPAN FUND

Quarterly Report

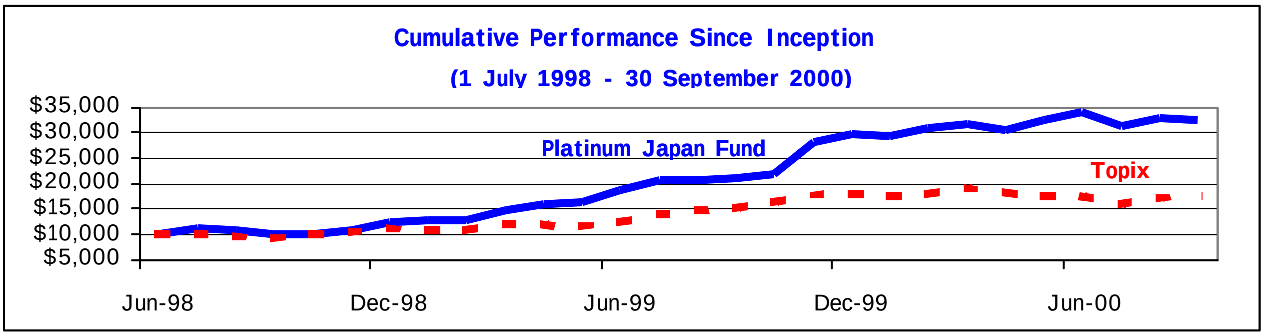
September 2000

Redemption Price: $2.0703 Fund Size: $83 million

Performance

The quarter saw the continuation of very difficult conditions for the Japanese equity market with the benchmark Topix index declining by 7.6% over the quarter. The decline continued to be led by IT with the electric machinery and precision instruments sectors down 9.5% and 20.5% respectively. There were also pockets of weakness in the domestic economy plays, most notably the retailers. On the positive side, banks put in a better performance benefiting from market rotation.

The Fund was not able to withstand the downdraft and declined by 5.1% in $A terms versus the MSCI Japan index which fell 0.7%. If we dissect our performance the big negatives were mainly from our holdings in Korea where the market fell 21% in $A terms and from our currency hedges into Australian dollars and the Euro. These detracted from our performance by –3.1% and –3.8% respectively.



Commentary

Whilst there is a lot of negative comment surrounding the Japanese economy, this primarily relates to macroeconomic events emanating from the US and the likely effect this may have on Japan. Looking purely at the domestic scene there are some positive developments especially with regard to corporate profits. Back in March, company forecasts were for aggregate sales growth of 2.3% and recurring profit growth of 20.5%. Six months on, these forecasts have risen to sales growth of 4% and recurring profit growth of 32.6%! Looking at the number of companies revising earnings in the past three months we have seen 152 upward revisions versus 76 downward revisions. Interestingly only 64 of the upward revisions were in the technology area, suggesting an economy-wide recovery. Clearly whilst there is skewing toward the technology area, other parts of the economy are benefiting from the general lift to GDP. We estimate it is growing in the 3% annual range with industrial production rising by around 8%. Earnings expectations imply a market PE multiple somewhere in the region of 30 times for 2000 earnings, a figure which we would regard as quite justifiable in the context of a 2% long bond yield.

Positive themes for the market have been few and far between, however the recent push into optical communications related stocks is worthy of comment. The US has been the pioneer in the early adoption of DWDM (Dense Wave Division Multiplexing – the technology that compresses optical signals for cable transmission) led by the exploding data demand of the internet. Whilst the Japanese were initially thought of as laggards, it is now apparent that they have a thriving industry based on component supply to the US majors such as JDS Uniphase, Corning, Lucent and Nortel. The biggest discovery in this area has been Furukawa Electric which for years had appeared as the number two ranked cable manufacturer with poor profitability and little sign of energy. However, as the DWDM market has mushroomed it has become apparent that Furukawa's technology is very much in demand. Its primary product, with a 70% worldwide market share, is laser pulse diode modules. These are essential in the amplification of the light signals as they pass down the optical cable. Further, it has emerged with a 10% stake in JDS Uniphase (after selling down from 20%), an investment it has held for some time and which highlights its excellent positioning in this area. We would expect to see the company widen its product range considerably in the future. Other interesting suppliers in this arena include Sumitomo Electric, Seikoh Giken and Nippon Sheet Glass. We also believe that Fujitsu is well positioned to supply the Japanese market.

In the "old world", we have also found interesting opportunities. Specifically we have taken a position in the shipping companies, Mitsui OSK and NYK. We see in these companies the prospect of riding a strong world trade cycle, which is driving freight rates up across the board and also deriving the benefit from companies strongly committed to restructuring their businesses.

It is easy to dismiss the shipping industry as the antithesis of the sexy opportunities that can be found in the IT arena. However, this might be a classic example of confusing a good company with a sound investment. Having been one of the principal beneficiaries of easy credit and sympathetic tax treatment, the shipping industry fell into all the usual traps. This is now being speedily reversed.

Looking at Mitsui OSK we observe that the return on capital has risen steadily over the last eight years and is now at an all-time high. Last year the container shipping division (41% of revenues) made a profit for the first time in more than 20 years. We are impressed with the gradual remanning of the fleet to employ cheaper labour and the clearly enunciated targets for profits and the return on assets. There is a commitment to pay down debt by keeping capex below depreciation and the expectation that the merger with Navix Line will bring about significant cost savings.

On the operating front, the company is a prime beneficiary of the recovery in shipping rates. With greater dependence on OPEC, users are experiencing shipping shortages as cargos travel longer distances (though incurring a greater number of days at sea). This has driven up daily charter rates for very large crude carriers (VLCC's) from say $25,000 per day to over $50,000 per day at present. Mitsui OSK is well positioned for this with the world's largest VLCC fleet comprising twenty eight vessels and some eight smaller oil carrying craft as well as a massive Natural and Petroleum Gas fleet. Approximately six VLCC's are presently trading on the spot market and a further six new vessels are being delivered for long term charter at prevailing high rates.

While the case is somewhat sensitive to world growth and has the ever-present danger of shippers responding to current high spot rates (which are now at 10 year highs), by ordering new vessels, the share price barely reflects the changed outlook for this industry. Trading close to its 10 year lows, and a third of its peak, the share price is lagging well behind the recovery recently seen in European based shipping companies. Moreover, at 3.5 times cash flow, the upside is promising.

Changes to the Portfolio

We removed positions in domestic oriented companies where we believe the earnings growth, while improving, will trail other parts of the economy. This included the housing stocks and Coca Cola bottlers. We also sold our holding in Daiwa Securities in favour of larger holdings in Nikko and Nomura Securities. We purchased positions in shipping companies Mitsui OSK and Nippon Yusen and added Sumitomo Electric and FDK in the optical equipment space. In terms of short selling we increased our exposure to shorts from 8% to 17% of the portfolio. We are taking a view that the very highly valued stocks in the Japanese market will suffer as investors shift back to the broader market.

Outlook

The outlook for global growth is one of deceleration as the lagged impact of monetary tightening and the "tax" of higher oil prices begins to bite into corporate profits. This will mean that the main engine of the Japanese economy, technology exports, must come under some pressure. However, there has been a clear strengthening of investment spending as companies respond to improved demand and the need to modernise their plant. Whilst we see positive steps in the way many companies are approaching the future, the political backdrop is overwhelmingly one of feet-dragging and indecision.

By managing the portfolio from a global perspective, we are able to periodically cross-pollinate emerging investment ideas. Examples of these themes are the shipping group and telecom testing and internet switching plays such as Anritsu. Likewise, the behaviour of the Nasdaq index has given rise to some useful shorting ideas. Overall, the current level of the Topix index at 1470, and the outlook for profits among the quality companies, suggests that the downside risk for the market is limited.

Breakdown of Portfolio

Categories	Examples of Stocks	Sep 2000	Jun 2000
Cyclical Growth	Toshiba, Matsushita Electric, Citizen Watch	32%	24%
High Growth	Mobile Telecoms – DDI Broadcasters – Tokyo and Nippon Broadcasting	18%	14%
Deep Value Cyclicals	Mitsui OSK, Taikisha	17%	16%
Steady Growth	Kuraya Sanseido, Japan Airport Terminal	7%	11%
Market Sensitive	Nikko and Nomura Securities	6%	4%
Korea	SK Telecom, Lottecon, Medison, LG Chemical	14%	18%
Cash		6%	13%

Invested Position

	Long Position		Net Position
Japan	80.9%	→	64.2%
Korea	14.2%		14.2%
Exposure	95.1%		78.4%
Cash and Other	4.9%		21.6%
Total	100.0%		100.0%