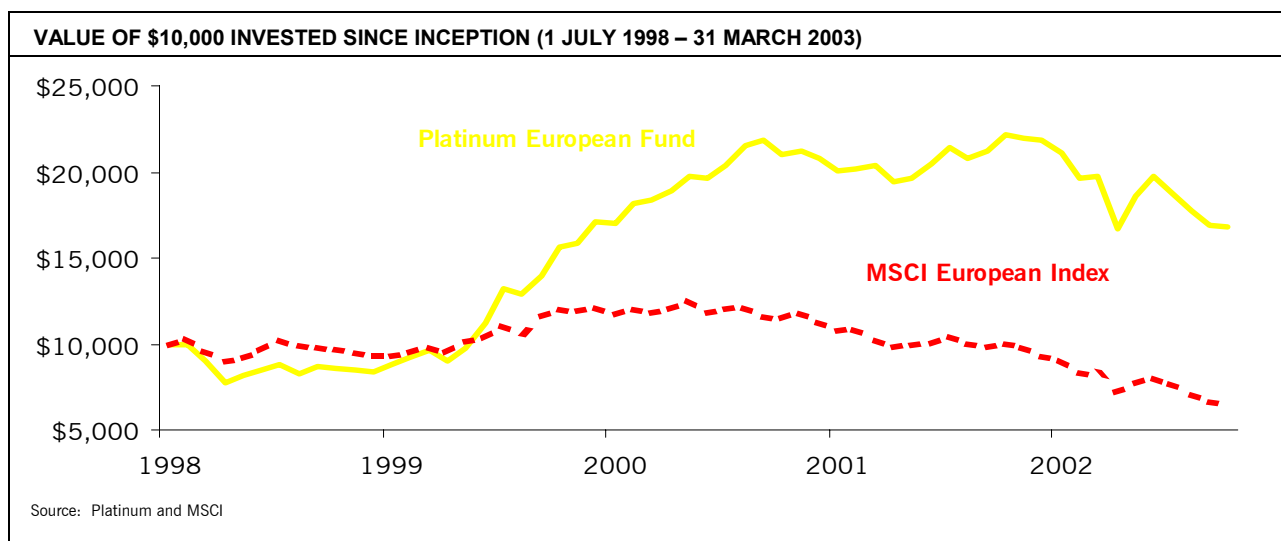


Platinum European Fund

Performance

REDEMPTION PRICE: \$1.2810



Stock prices fall – financials distressed and strong Euro exacerbates cyclicals' woes

European stocks fell 13% in the March quarter, with cyclicals (steel, auto parts, chemical companies etc) and financials (insurers mostly but banks also) leading the declines. One slightly surprising sector to suffer was the water utility area (-25%), driven down primarily by the two French giants (Vivendi Environnement and Suez-Lyonnaise). Country differences were significant with Germany (-16%) again being thrashed, France (-15%) suffering, while Italy (-10%), UK (-7%) and Sweden (-7%) were steadier. After the Ahold revelations, the Dutch market (-19%) received some especially vigorous selling attention. Stock prices in Europe have fallen in eight of the last 12 quarters, and the market overall is down 56% from its March 2000 high.

Once proud UK companies such as ICI and Invensys (both of which are now minnows due to years of mismanagement) fell 60-80% in the last three months, and the American division of Dutch retailer Ahold assured virtual oblivion for the company with its US-style accounting trickery uncovered in February. Among serious businesses the insurance companies – life, general and reinsurance – continued their remarkable share price declines: Swiss Life -54%, Munich Re -54%, Allianz -50%, Aegon -44%, Baloise -43%, Royal&Sun Alliance -43% etc. Banks also featured heavily among the casualties: Hypovereinsbank -55%, Egg PLC -42%, Banco Comercial Portugues -39%, Abbey National

-36%, BHW Holding -34%. In addition, many cyclicals suffered, such as chemical companies Clariant (-44%), Akzo Nobel (-40%), and Bayer (-39%).

Strongly performing shares over the period featured several technology and telecom stocks which bounced off near-bankruptcy levels (Alcatel +64%, Cable&Wireless +62% France Telecom +31%) – which does not necessarily stop those companies being near bankruptcy still. Wella was up nearly 60% for the quarter after Procter & Gamble of the US bid a rich price for the business. Many of the other top gainers, Centrepulse (ex Sulzer Medica) +21%, Safeway PLC +21% and Six Continents +21% were also the targets of bids. Overall 25 companies among Europe's 500 large stocks had share prices up 10% or more; over 100 were down 20% or more in the quarter.

The Australian dollar recovered marginally from its 31 December record lows against major European currencies so that the MSCI measured in A\$ declined 15% for the quarter. The Platinum European Fund declined 11% over the period, as resilience in large holdings such as Novozymes, Adidas and SGS Surveillance was offset by the considerable cyclical exposure in the portfolio (Schindler -26%, Michelin -23%) and the exact halving of our holding in Allianz. The Fund's hedge into A\$ was a small benefit.

Commentary

Circular argument continues for insurers; German banks – misery, some relief in 2005

As noted in recent quarterly reports, not only have insurance stocks been some of the largest decliners in the market, they have simultaneously been some of the largest sellers of the market. This frustrating circularity relates to the solvency position of insurance companies which is undermined by the declining value of shares they hold against their equity capital, and against part of their float (or technical reserve). To reduce the exposure of their capital/float to (declining) shares, they are forced to sell more as stock prices fall.

In addition, the market is discounting the grim reality of insurance, namely that in bull markets, insurers write weaker and weaker combined ratios (ie. accept a lower premium for a given risk) on the assumption that higher stock market returns will improve the yield on their float to at least compensate. These tactics are of course unsustainable and a lower value is now placed on the operating businesses too.

One point which is worth making relates to the consequences of continued forced and/or irrational investment decisions by insurers: they have, in the last 1-2 years, greatly increased their allocation of funds to bonds - at what may well be the top of a massive bull market in bonds! That is, it is possible that when central banks are forced to make the decision to monetise US debt (ie. inflate) then as bond markets around the world collapse, insurance companies will be forced into the next round of asset impairments and threats to their solvency. Having said that, share prices of insurance companies are reflecting today's (miserable) profitability, and in the case of behemoths such as Allianz or Munich Re, the valuations look extremely modest given the "footprint" of these insurers in what is, after all, a favourable premium environment.

Profitability of private sector banks (Deutsche, Dresdner, HypoVereinsbank etc) in Germany is non-existent today, having been anaemic at best through the last decade. The basic explanation is that interest spreads are pressured by state-owned banks who enjoy their parents' very strong credit rating and hence low funding cost. State and mutually owned savings banks (who provide "retail" banking services) ensure that there is little in the way of "free" deposit funding. With deep corporate bond

markets meeting the needs of the big companies, the private banks' business is by necessity with small and medium sized businesses in Germany. This is the part of the economy that has been damaged by unrestrained global competition; and its dependence on domestic German growth (which has been almost zero for much of the past decade) has hurt. Finally, the German economy lost much of its shock-absorption capability with the introduction of monetary union – this means that adjustments in relative competitiveness come the hard way: deflation, unemployment and bankruptcy.

Relief for the listed banks is almost at hand in the form of an agreement between Brussels and Germany that the use by the so-called "Landesbanken" of their parents' quasi-sovereign credit ratings is tantamount to a government subsidy and thus must cease forthwith (well *fifthwith*, at least, in 2005). Two years, however, currently feels like a long time in German banking as liquidity crises jostle with solvency crises (HypoVereinsbank has this week abandoned plans for a capital raising and instead announced it will sell part of its prized Bank Austria business to meet immediate capital needs). And of course once relief arrives – credit rating agencies have already indicated the big cuts they will make to the various state banks' ratings effective 2005 – the better spreads will take time to improve the profitability of the private sector bank loan books.

In the meantime, the German economy continues to struggle, and banks are nothing if not geared to their local economies. What should be said is that Germany, and Europe more generally, is in the grip of a full blown financial crisis in the insurance sector; the risk that this spreads to the banking sector is real. The ability and decisiveness with which the European Central Bank forestalls and/or copes with such a scenario may well be the main issue for at least the next 12 months in Europe (not to mention a stern test of whether the ECB is an adequate replacement for the individual country central banks).

"Bear market" mergers and acquisitions

During the excitement of the 1999/2000 segment of the bull market, we often commented upon the dramatic mergers and acquisitions which companies made, cheered on by drunken investment banks and short-sighted fund managers. (We often used to be amazed that stock prices would go up - not straight

down - in the day following announcements of the utmost absurdity!). In recent months in Europe the “M&A” has resumed – but it is (in the main) the far more interesting bear market variety. This variety involves cash-rich opportunists – be they family shareholders, patient corporates, or buyout funds – generally buying companies at sensible (sometimes fire-sale) prices.

It has been particularly interesting to see some of the mid-sized Swiss-listed companies (with strong track records in a particular business) being taken private by their controlling family shareholders. Zellweger Luwa, a company specialising in gas detection and “air engineering” systems, was taken private by its majority shareholder in February at half book value, which was a price of less than 30% of sales. Toolmaking business Hilti AG ends its 17-year stock exchange listing as the family takes it private once again. Hilti has earned CHF100-150 per share in recent years and the family bid CHF900 per share (a generous premium to the prevailing price) to buy the listed portion of the company. And CHF1.4 billion

sales fruit preserver Hero AG, owned by the German Oetker family, is being delisted at 14 times last year’s earnings.

One of the Fund’s significant holdings, elevator business Schindler AG of Germany, is widely regarded in Switzerland as facing the same future: the families controlling the company are shocked at the share price and institutional shareholders are being relieved of large blocks of stock each week in the market. We suspect that delisting may not in fact be the ultimate solution for Schindler, if only because of the number of second and third generation family shareholders (for whom a stock market valuation and the potential to sell was the initial attraction of listing). However, the vigorous action by informed buyers illustrates the sort of sensible valuations we have among the Fund’s investments.

Elsewhere we get regular reports of cash-rich companies (who avoided the peculiar “temptations” of share buy backs and investment banker-inspired “strategic acquisitions” in the bubble era) looking at the considerable opportunities now being presented.

BREAKDOWN BY INDUSTRY

Categories	Examples of Stocks	Mar 2003	Dec 2002
Pharmaceutical/Biotechnology	Novozymes, Novartis, Serono	17%	16%
Miscellaneous Services	Fraport, Hagemeyer	14%	14%
Retail	Hornbach, Metro, Kingfisher	13%	14%
Consumer	Adidas, Henkel, Michelin	11%	14%
Capital Goods	Océ, Schindler, Siemens	11%	12%
Chemicals/Materials	Linde, Merck KGaA	10%	10%
Tech/Media	Ericsson, Great Nordic	6%	7%
Financials	Alleanza, Allianz, Assicurazioni Generali	4%	7%

Source: Platinum

Outlook

All of which perhaps at least reminds one that modestly priced, well-run companies in the large economic area of Europe are not without merit as investments. In recent months we have generally been adding to existing positions when we have judged price declines to be reaching crescendos. In one or two cases where stocks have had a sharp move upwards we have reduced the position (the most

notable example being Italian insurer Generali, as various banks bought stock to intervene in the latest Machiavellian plot – we sold most of our holding in the excitement). Six Continents (UK based hotelier) was also sold as it moved up strongly with various (some dubious) parties bidding for pieces of the company. This is the sort of action that we will be continuing, as well as the addition of one or two new ideas.

The Platinum European Fund

Valuations, notwithstanding the financial strains discussed earlier, are appealing across a broad range of stocks in Europe (and Germany especially). Among obvious caveats such as the trouble being made in the Middle East, struggling economies, and continuing forced institutional selling of stocks, the issue of supply should not be forgotten. As we foreshadowed last quarter, a colossal (Eu15 billion – around half of which the French government has

supplied) rights issue is underway from France Telecom, Allianz is raising Eu4 billion, and many other insurers may be forced to replenish their coffers.

At quarter-end the Fund is 86% long, with 4% of short positions for a net exposure of 82% to stocks in Europe. Currency exposure is around 63% A\$, 14% Euro and 23% other European currencies (of which zero in British pounds).

Toby Harrop
Portfolio Manager