

# PLATINUM EUROPEAN FUND



Toby Harrop  
Portfolio Manager

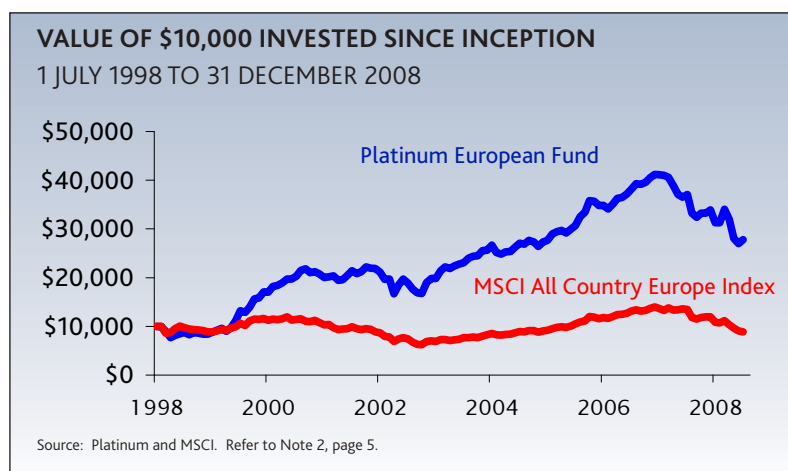
## PERFORMANCE

European stock markets fell again in the December quarter, by 21% in local currency. While the “safe” areas of pharmaceuticals and telecoms fell only 6%, the moves elsewhere were dramatic: auto parts (-39%), steel (-40%), banks (-41%), real estate (-41%), and mining (-44%). Nearly 200 of the 500 largest European stocks fell by a quarter or more; 50 of them halved (or worse) in just three months!

For the 2008 calendar year as a whole, European markets fell 45% and the breadth of the decline left few viable places to hide. The “best” sector, pharmaceuticals, fell 17% (even food stocks were -23%!). The five cyclical sectors mentioned above each fell between 60% (steel) and 77% (real estate) over the year. The Australian dollar fell against the Euro, both over the last quarter and the full year, so that the MSCI All Country Europe Index (A\$) was down 14% for the quarter and 34% for the 12 months.

The Platinum European Fund fell 13% and 25% for those respective periods, with engineering, consumer and technology stocks hurting the portfolio, even if bank, real estate, mining and energy exposures were very low.

The causes of weak stock markets around the world have been exhaustively covered in most media, and we will look forward more than back in this report.



## COMMENTARY

---

### We invest in companies, not markets

The “macro” (ie. the general economic conditions) this past year have been as surprising as ever, and it is hard to say what 2009 may hold. Making investments based on macro-economic predictions, or indeed on the level of the overall stock market, is not something where we can claim any advantage. On the other hand, we can ground our investment strategy in something solid when we focus on individual companies and their industry. Assessing a few German newspaper stories<sup>1</sup> from the quiet last week of 2008 may illustrate this point:

What are the macro prospects for 2009? Who knows!? Not SAP:

*In an interview with "Der Spiegel", the co-founder of (enterprise resource planning software giant) SAP, said that the company has “not the slightest clue“ how business will develop in 2009.*

But if you didn't mortgage your future in the credit bubble, as an individual or a business, then life goes on:

*Daimler (ie. car-maker Mercedes Benz) will invest 14bn euros in research and development by 2010 as planned, "Automobilwoche" reported, citing Daimler's head of development.*

*Competitors of Deutsche Telekom plan to install (their) own V-DSL high-speed internet network, which would be significantly cheaper, "FT Deutschland" reports.*

*(German truck maker) MAN has bought call options on the voting stocks of Scania, giving it access to more than 20% of the Swedish truck maker.*

*Head of (German retail conglomerate) Metro's electronics subsidiary Media-Saturn said Christmas sales have met expectations, "Sueddeutsche Zeitung" reported. (Generally), German retailers are “satisfied“ with this year's Christmas sales, the president of retailer association HDE told "Dow Jones“.*

A brief comment on each of those stories may illuminate:

SAP as a company is in good shape, with a remarkable position at the administrative core of many businesses around the world (its “weakness“ is a low exposure to US financials!). But clearly, demand for its product is a function of corporate expenditure, and that is hard to project over the short run. Hence the founder's definitive statement.

Daimler, of which Mercedes is the key part, jettisoned its regrettable 1990s idea of a global car platform by (almost) disentangling itself from Chrysler in 2007 (it probably retains some liabilities in the event of Chrysler's bankruptcy if that occurs within the next couple of years). The vast profits flowing from the Mercedes brand are plowed back into product development with almost the same gusto as neighbour and arch-rival BMW. The German strategy of product superiority supporting a price premium, and high-productivity German employees justifying high German operating costs, can be seen clearly in this vast R&D expense (Eu14bn... nearly A\$30bn!). The point is, while development timetables can be adjusted, and perhaps marginal ideas delayed or cancelled in a recession, the core development drive thunders on, economic cycles notwithstanding.

It is interesting that while the Detroit three gasp for survival, and even mighty Toyota reports a big loss for the first time in generations, that the German companies remain (for the moment) in the black, with healthy cash generation. Five years ago we discussed at length such developments as “working time accounts“ (between thresholds, overtime is not paid, with leave instead stored up, which is then taken when plants are idled). Secondly, the large body of temporary workers have been dismissed. And third, the country has a functioning safety net, so that for the next year (if necessary), the companies will pay for 15 worker hours per week, while the social insurance fund will pay for the other 20.

Specifically from an investment perspective: we hold shares of both Daimler and BMW, and as we contemplate their valuations (which are below book value), it is notable that major investment in future model launches has already been paid for. These

<sup>1</sup> Source: Sal Oppenheim brokerage in Frankfurt

companies have considerable competitive advantages, including marvellous brand value. And yet the stock market has the valuations at the lowest for many years, focusing as ever on the short-term (in this case the current demand collapse).

**Telekom:** The story on the roll-out of DSL networks in Germany is a familiar discussion. This investment (and the usual debate about the incumbent or challengers being the appropriate owners of the new capacity) is probably only marginally affected by the recession. The key point is that for a telecom operator, running a mixed network of old voice technology and a modern ADSL network is complicated and expensive. The plan in Germany (expected in 2010) is for every household to have a CPE box installed *on the existing copper line*, so that the network becomes completely data-based from the operator's perspective. There are interesting opportunities for companies such as Infineon to provide semiconductor chipsets for these boxes: for voice, IP, data, cordless, DECT etc. Navigating the industrial downturn (and the chaos in the memory market) is proving challenging for the company, but Infineon has several bright prospects in the coming years if it can escape the current difficulties.

**Trucks:** Munich-based conglomerate MAN, in effectively buying more control of Swedish truckmaker Scania, underlines the ongoing truck industry consolidation in spite of (or perhaps spurred by) the very low current orders for heavy vehicles. It would not be a German auto-industry intrigue without Porsche/VW being involved, and indeed the underlying story here is Volkswagen's plan to merge Scania and MAN with the VW Brazil truck operation to create one large pole in this industry. (VW already has a big share of Scania voting stock, and nearly a third of MAN shares). Scania's modular approach to truck manufacturing has been copied (but probably not bettered) by industry rivals, and with its old boss running MAN in recent years, the intent is clear. Again, the logic of consolidation in this hitherto fragmented industry is undented by short-term economic events.

**Retail:** German retailers have made cautiously optimistic noises about December sales, in stark contrast to the alarming headlines in the UK and the USA. While bank funding for a car loan in Germany is not much easier than in the English-speaking markets, the conservative behaviour of the German consumer this past 10-15 years is evident in today's steadiness. As a reminder, there has been no housing bubble, consumer loan bubble, or credit card bubble in Germany. The household sector is a net saver, exports have boomed for several years, and employment is strong.

Investments in German retailers are not widely available in the public markets as we have noted before; a company like Metro has (due to its success) a very large exposure to Eastern Europe and Russia (as well as to Italy and Spain), diluting it as a play on the German consumer. The Fund has a large holding of DIY retailer Hornbach (about 60% of whose sales are in Germany), and that company has reported encouragingly strong results in recent weeks.

### Company meetings

We spent the middle two weeks of December meeting 40 or so companies in Europe (in London, Paris, Germany, and Switzerland). Given the valuations (most companies we saw had share prices down 50-70% from recent peaks), and given the generally high "quality" of companies we saw (measured by financial track records and market shares), we came back optimistic on many stocks. Several were existing positions, and several more we are further investigating. A couple we have already started to buy for the Fund.

Markets are unfathomable and could fall further (even if the positioning of many participants - lots of cash, and lots of defensive holdings of household goods, pharmaceuticals, utilities etc - indicates a short-term bottom), but many of the companies we visited have good prospects over the coming years and their lowly valuations fail to reflect that.

## CURRENCY AND INVESTED POSITION

It is perhaps notable that the Euro hit a “trade-weighted record high“ in December... but that measure always confounds this observer: surely the exchange rate of your key rival (not your trading partners) is the relevant one for competitiveness? The general economy, rather than price, seems far more relevant to the demand for goods, so trading partners will suffer or prosper from trade-weighted exchange rates. But for individual companies’ profitability, the competitors’ cost positions (not the customers’ wealth) is the relevant measure. Hence our focus on the Euro-Yen exchange rate (which is 25% below its June 2008 level), not the trade-weighted Euro!

The Fund has hedged much of the Euro exposure back into the A\$. While the A\$ seems to have formed a base against the Yen at around Y60, and of course

has bounced 10 cents versus the US\$, at the time of writing it is still close to its lows at about half of one Euro. For that reason, hedging the exposure between 49 and 53 Euro cents has not yet shown any benefit (and in fact has proven a small burden). However, while it is hard to be too excited about the prospects for the A\$, it is harder still to hold the Euro at this level when considering the troubles in southern European economies such as Italy and Spain (especially given the price of, and enthusiasm for, the Euro as it celebrates its tenth year in existence). Thus the Fund’s currency position is 67% A\$, 17% Euro, 8% Norwegian/Swedish crowns, and 8% others.

Reflecting the cautious optimism for the portfolio of stocks mentioned above, the Platinum European Fund is highly invested at year-end 2008: 92% long and just 3% short (two highly-priced consumer stocks) for a net exposure of 89%.

## NOTES

---

1. The investment returns are calculated using the Fund's unit price and represent the combined income and capital return for the specific period. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), are pre-tax and assume the reinvestment of distributions. The investment returns shown are historical and no warranty can be given for future performance. You should be aware that past performance is not a reliable indicator of future performance. Due to the volatility of underlying assets of the Funds and other risk factors associated with investing, investment returns can be negative (particularly in the short-term).

2. The investment returns depicted in the graphs are cumulative on A\$10,000 invested in the relevant Fund since inception relative to their Index (in A\$) as per below:

Platinum International Fund:  
Inception 1 May 1995, MSCI All Country World Net Index

Platinum Unhedged Fund:  
Inception 31 January 2005, MSCI All Country World Net Index

Platinum Asia Fund:  
Inception 3 March 2003, MSCI All Country Asia ex Japan Net Index

Platinum European Fund:  
Inception 1 July 1998, MSCI All Country Europe Net Index

Platinum Japan Fund:  
Inception 1 July 1998, MSCI Japan Net Index

Platinum International Brands Fund:  
Inception 18 May 2000, MSCI All Country World Net Index

Platinum International Health Care Fund:  
Inception 10 November 2003, MSCI All Country World Health Care Net Index

Platinum International Technology Fund:  
Inception 18 May 2000, MSCI All Country World Information Technology Index

(nb. the gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist).

The investment returns are calculated using the Fund's unit price. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), pre-tax and assume the reinvestment of distributions. It should be noted that Platinum does not invest by reference to the weightings of the Index. Underlying assets are chosen through Platinum's individual stock selection process and as a result holdings will vary considerably to the make-up of the Index. The Index is provided as a reference only.

Platinum Investment Management Limited ABN 25 063 565 006 AFSL 221935 trading as Platinum Asset Management (Platinum) is the responsible entity and issuer of the Platinum Trust Funds (the Funds).

The Platinum Trust Product Disclosure Statement No. 8 (PDS), is the current offer document for the Funds. You can obtain a copy of the PDS from Platinum's website, [www.platinum.com.au](http://www.platinum.com.au), or by contacting Investor Services on 1300 726 700 (Australian investors only), 02 9255 7500 or 0800 700 726 (New Zealand investors only) or via [invest@platinum.com.au](mailto:invest@platinum.com.au).

Before making any investment decision you need to consider (with your financial adviser) your particular investment needs, objectives and financial circumstances. You should consider the PDS in deciding whether to acquire, or continue to hold, units in the Funds.

**DISCLAIMER:** The information in this Quarterly Report is not intended to provide advice. It has not been prepared taking into account any particular investor's or class of investor's investment objectives, financial situation or needs, and should not be used as the basis for making investment, financial or other decisions. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. Platinum does not guarantee the repayment of capital, the payment of income or the performance of the Funds.

© Platinum Asset Management 2008. All Rights Reserved.  
Platinum is a member of the Platinum Group of companies.

**MSCI Inc Disclaimer:** Neither MSCI Inc nor any other party involved in or related to compiling, computing or creating the Index data (contained in this Quarterly Report) makes any express or implied warranties or representations with respect to such data (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of such data. Without limiting any of the foregoing, in no event shall MSCI Inc, any of its affiliates or any third party involved in or related to compiling, computing or creating the data have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages. No further distribution or dissemination of the Index data is permitted without express written consent of MSCI Inc.