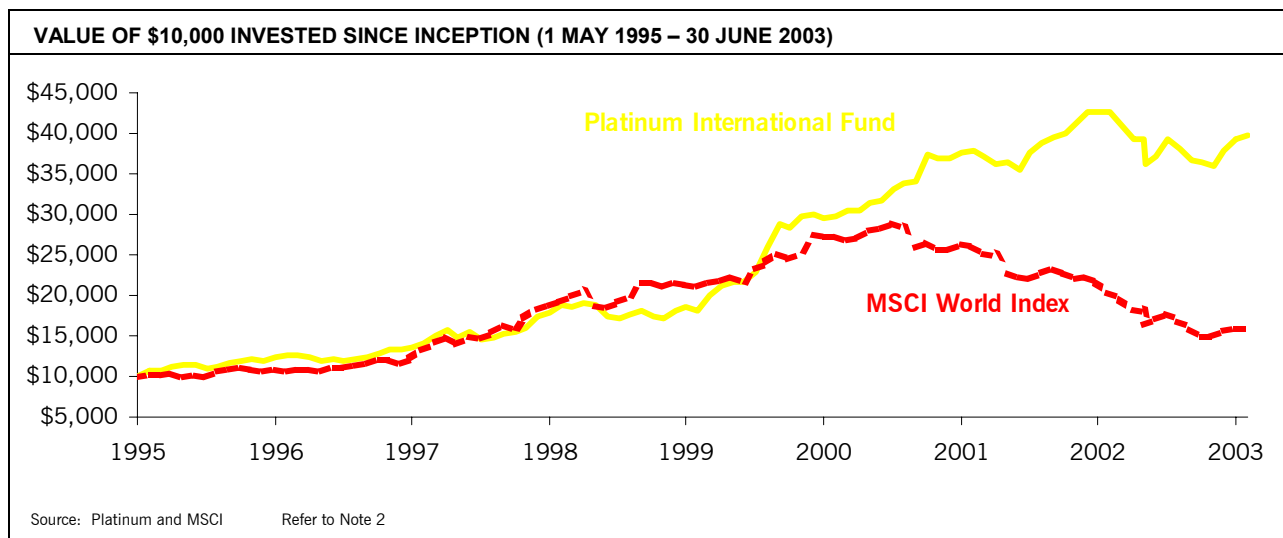


# Platinum International Fund

## Performance

REDEMPTION PRICE: CUM \$1.5840 EX \$1.5062



After the harrowing sell-off in late February, associated with concerns about the invasion of Iraq and deteriorating economic news, returns from almost all asset classes in the first half of 2003 have been positive. The true believers will now know that the Fed chairman does indeed have a magic wand! There will be sceptics like those left holding US dollars who have seen a good 14% drop (yoy) in their value relative to the euro or that barbarous relic, gold. This also gives a hint of the serious imbalances in the system, more of which we will pursue later. But for now, investors are focusing on the ever cheapening trend of money worldwide, and are seeing nascent evidence that a general expansion is in the offing. The combination of these factors is inducing investors to seek remunerative places for their wealth other than cash.

The accompanying table shows how the various industry groupings fared in the last three, six and twelve month periods. Note that over the year it's all pretty glum, accentuated of course, by the 19% lift in the A\$. Even in terms of the weak US\$, the MSCI World Index is down 2.4%. Over the shorter span, there has been a clear move away from defensive consumer staples to those areas that benefit from discretionary spending.

By country there was an equally interesting dispersion, with the seemingly most risky countries showing the best returns. Pakistan, Argentina, Venezuela, Sri Lanka and Israel have all risen more than 50% in US\$ over the last year, while the large

### MSCI WORLD INDEX – INDUSTRY BREAKDOWN (A\$)

Sectors	3 mths	6 mths	1 year
Consumer Staples	-1.2%	-14.6%	-23.9%
Energy	-0.6%	-10.9%	-23.3%
Health Care	0.6%	-7.2%	-13.4%
Materials	2.4%	0.3%	-25.4%
Utilities	3.8%	-6.2%	-19.8%
Industrials	4.9%	-7.3%	-23.4%
Consumer Discretionary	7.9%	-4.6%	-19.9%
Information Technology	8.1%	-0.8%	-13.2%
Telecommunications	8.1%	-7.4%	-5.7%
Financials	9.3%	-5.6%	-20.0%

Source: MSCI

markets and those seen as sensitive to Western imports have been almost flat to down, by as much as 16% in US\$ at the extreme.

Against these figures, the performance of the Fund can be regarded as reasonable, with the loss for the year confined to 5.5%. More significant though is the long term outcome; over the last five years \$10,000 placed in the Fund, together with reinvestment of distributions, would be worth some \$21,500, while the same amount invested in the index (or a standard fund) would be worth \$7,900 today.

## Changes to the Portfolio

DISPOSITION OF ASSETS		
Region	Jun 2003	Mar 2003
Western Europe	32%	32%
Japan	20%	20%
North America	15%	13%
Emerging Markets (incl. Korea)	12%	10%
Australia	0.3%	2%
Cash	21%	23%
Shorts	19%	30%

Source: Platinum

In the last quarter we reported the aggressive buying of various German multi-nationals into the teeth of the market collapse. Our judgement that they were grossly over-sold proved correct and shares like Allianz, Munich Re and Metro came hurtling back this quarter. Although not reflecting their full value, the 45 to 80% rises persuaded us to reduce some of our German-based holdings and to eliminate Metro.

There were similar spectacular moves in IT and microbiology stocks. Here again we engaged in switching out of excited companies such as Nvidia (+78%), National Semi (+16%), and Agere (+53%) to replace them with Infineon Tech (the ex-Siemens DRAM chip maker), Agilent and Toshiba. In biotech we bought Vertex Pharmaceutical, which has a broad pipeline of potential clinical products directed at alleviating diseases from HIV to rheumatoid arthritis. At the same time we sold Millenium which had doubled on the excitement of its cancer drug.

We also added US\$ devaluation beneficiaries in the US; Weyerhaeuser and International Paper. These companies appeal to us because of their large lumber holdings and the fact that the global paper industry has consolidated and become more careful with incremental capacity additions.

We have also been adding to our holdings in Japan believing that the market has now bottomed. With

this in mind we have been buying the trading houses and the general insurance companies. The traders attract our attention on account of the repositioning of their enormous balance sheets towards concentrated investment in specific areas such as natural gas and resources. They have always been credited with high quality management but until they recognised the need to change their business emphasis, this potential lay fallow. We believe the gearing from these changes over the last five years will now become apparent. The insurance companies are in a similar position. Having made good and rising profits throughout the economic malaise of the last twelve years, the industry has consolidated. We have acquired the two largest players, Millea and Mitsui Sumitomo. Apart from their underlying profitability we like the fact that we are buying them below book value and for each yen of net asset value they have over two yen in share market exposure.

The other theme that we are pursuing is the emergence of a major bull market in India. As noted later, this has had earlier false starts but in the meantime the market has de-rated to unusually attractive levels. Liquidity is flowing, balance sheets are mended, surplus capacity is being absorbed and profits are rising strongly. Like the countries of the Pacific basin, India is trying to hold the value of the rupee steady with the US\$ and this is having the effect of injecting liquidity into the local market. This is happening just as the banks are all promoting consumer lending. We have acquired a range of companies from the State Bank of India and other recently privatised banks, to TV content and delivery provider ZEE TV, to the truck and car manufacturer, Tata Engineering.

### Shorting

This has been an unprofitable exercise for the last six months. The injection of liquidity has reinvigorated the dubitable financial intermediaries and pollinated the earnings-manipulators. Fortunately we reduced the position markedly but our speed of response was well short of optimal.

**BREAKDOWN BY INDUSTRY**

<b>Categories</b>	<b>Examples of Stocks</b>	<b>Jun 2003</b>	<b>Mar 2003</b>
Cyclicals/Manufacturing	Schindler, Siemens, Bayer, Linde, Océ	23%	21%
Financials	Assicurazioni Generali, Allianz, Alleanza	11%	9%
Medical	Yamanouchi, Takeda, Draegerwerk, Novartis, Merck KGaA	8%	9%
Gold and Other	Barrick Gold, Newmont Mining, Gold Fields	8%	8%
Technology/Hardware	Agere Systems, Infineon Tech, Samsung, AMD	8%	8%
Telecoms	Hellenic Telecom, Ericsson, NTT	7%	7%
Software/Media	Sky Perfect Communications, Seoul Broadcasting	7%	3%
Consumer Brands	Citizen Watch, Adidas Salomon, Lotte Confectionary	4%	5%
Retail/Services/Logistics	Hornbach	3%	7%

Source: Platinum

## Currency

We remain principally hedged into A\$ at 58% and own euros, Swiss francs, yen and some Korean won. Although the US\$ may show some resilience in the

short term, we have no intention of owning more US\$.

## Commentary

Since 2001 we have been writing about the three phases of a bear market.

This most recent rally is in keeping with the traditional pattern and was anticipated in our March communication. As has been noted on several occasions, we find it difficult to believe that the large Western economies are on the cusp of a new bull market. **By contrast we see the Eastern hemisphere as beginning a major upward thrust.** Some may find this improbable by virtue of their belief that without the benefit of an expanding US economy, Asia and the emerging economies cannot prosper.

This may be less contradictory than it appears at first sight. Supposing that the Fed and other Central banks' actions contribute to a gradual improvement in aggregate demand, it is not necessarily so that company earnings as a whole will grow strongly once their initial spurt caused by cost cutting and utilisation benefits has passed. In the period of weak prices in Britain in the **last quarter of the 19th century, profit share of GDP contracted and thus lagged the rise in the economy.** Companies faced intense margin pressure and it was a period of feverish mergers.

With the anaemic growth that seems probable in the next few years, we would expect the distribution of profits to shift within the corporate sector and also between labour and capital. Globalisation brings Asian labour costs to the supermarket checkout of the West and even in the event of a revaluation of the Chinese renminbi – there are movements to depress profit growth. Some segments of the economy will benefit from cheap imports while others will lose to foreign competition in traded goods and specific services (eg. call centres and information technology).

Our circumspection stems from the exponential use of debt to support current consumption levels, most notably in the Anglo Saxon countries. Falling interest rates have allowed many households to exercise their right to refinance their mortgages, often releasing equity that is then spent. Even after the sharp rise in housing prices, the amount of residual equity is at an all time low in the US (similar patterns apply in Australia, the UK and Holland). As a further warning we note the experience of the 1930s.

Through time the idea has grown that it was solely the raising of interest rates that set off the Great Depression. In fact, the cost of margin borrowing rose progressively through the late 1920s and the New York discount rate rose from 3% in 1925 to 6% in late 1929 and then dropped precipitously with the collapse of the stock market to a low of 1.5% in the late summer of 1931. Unlike today, the linking of currencies to gold constrained the creation of liquidity so when Britain, and later Japan, abandoned the gold standard in September and December of 1931 respectively, and the US chose to hold firm, it was forced to raise rates. This was a relatively short-lived affair as the loss of competitiveness caused massive lay-offs throughout 1932, and in March 1933, the US too left the gold standard, banned the export of gold and effectively devalued the dollar. **Without the constraint of gold reserves, the treasury could provide unlimited amounts of liquidity.** Short rates plunged, the stock market soared and gold expressed in US dollars progressively rose from \$20 to \$35 and was then officially capped in February 1934. Interestingly, the big move in gold only started once **ownership of monetary gold by US citizens became unlawful** in April of 1933.

Where this merry-go round is leading is that **so long as foreigners are content to own the US\$, the system can muddle through.** However, with a massive current account deficit, such faith cannot be taken for granted. It puts immense pressure on its European trading partners who are subject to the loss of competitiveness of the euro and time will test their resolve to bear this burden (of competitive devaluations). The rest of the requisite savings needed to fund the US deficit is coming from Asian investors - to the tune of over US\$200 billion pa. These countries are still pursuing mercantilist policies which favour keeping their currencies aligned to the US\$ and hence the Chinese renminbi. Their central banks are actively intervening which tends to both facilitate credit growth at home and fund the purchase of US government and commercial paper noted above. This is all very well while their economies operate below their potential as the over-investment in the run-up to the 1998 IMF crisis is absorbed and debt repaid. At some stage it will become clear that there is a cost to this exercise and that the longer term solution resides in encouraging more domestic driven activity ie. consumption growth. This will diminish their ability to fund excess US demand. Combining these various strands, **one can envisage episodes of excited currency speculation and a growing call for the Chinese to revalue the renminbi.** In this scenario,

the dearth of alternatives could find gold becoming a fashionable hedge notwithstanding its lack of yield in a still low yield world where investors hesitate to over-expose themselves to the euro.

Such a scenario discourages us from paying high valuations in the West when we find companies in Asia - with reciprocal benefits - selling on low valuations. It is true that their transparency is sometimes capricious but their growth prospects and valuations are enticing. Careful stock selection is of paramount importance.

In keeping with our favourable view of the East, we have just spent nine days visiting **Indian companies.** We have followed their progress since the early nineties. On earlier visits we were concerned about valuations and the political will of the government to embrace change. Even though economic reform has been tantalisingly slow, the economy has grown faster than most through the nineties at around 5% pa. Under the present coalition headed by the BJP, **the pace has accelerated.** Privatisation of State banks and industrial enterprises is being accompanied by deregulation of State run industries. Import restrictions have been removed and tariffs reduced. Like other mixed economies, the government is faced with awkward choices as it removes distortions in one area, to throw-up hardships elsewhere. Rubic cube-like, the reduction of subsidies to both fuel and fertilisers, harms part of the farming community yet places them on a commercial footing as inputs elsewhere. In a working, if chaotic democracy, where politicians are not always reliable, the outcry from these reforms can be thunderous. In several ways it reminded us of our experiences in Latin America in the early nineties. While still in the early stages and recognising that bad habits die slowly, the gains to efficiency are already clear. Most important of all is that once companies become truly private, the **patronage** enjoyed by politicians and top bureaucrats **gradually withers.**

Another important element of deregulation is the opening up of the ports to private enterprise and the road building initiative. The so-called **golden quadrilateral, to link up the great cities** of Mumbai, Chennai (Madras), Calcutta and Delhi is due for completion in late 2004. The entire route of 5,846 kms will then be a four lane highway (sans cows), and will completely transform the movement of goods and people within the sub-continent. This is being complemented by the North-South/East-West corridor which is due for completion in 2007.

Evidence of obstruction to “Nirvana” is seen everywhere and probably the worst offenders are the ruling elite. Clearly many have benefited from influence peddling, though there is **corruption at every level**, and of great concern is **weak tax enforcement**. So today, State expenditure accounts for approximately 20% of GNP, which is about twice the tax base. Fortunately there is a high savings rate which allows this deficit to be funded out of bond sales but it also inhibits the Government’s ability to help redistribute income. Continuation along the current course looks irreversible, but so it must be

for our investment case to yield the enormous rewards that await long term investors.

We have not lost interest in Asia or Europe. Nearly all are following loose monetary policy that can help asset prices. As noted earlier, the strong euro is a depressant so it is encouraging that the recent IG Metall strike was abandoned with loss of face for the union as members walked across picket lines. This is a significant, if overdue, recognition of the new order.

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## Conclusion

Even we have been surprised at the continuing vigour of these stock market rallies in the first week of July. Selling pressure has completely subsided and money is evidently moving out of bonds into shares. The prospect of the Fed sitting on interest rates for some while has fired up investors’ belief that the economy will respond positively.

It is probable that our shorts and currency positioning will detract from our performance in the short term. Hopefully, our large exposure to Asia, and Japan in particular, should partially compensate. While these comments may hint of complacency, our experience is that it is improbable to fine-tune market timing and better to focus on the larger trends.

Kerr Neilson  
Managing Director

## Trip to India – July 2003

The current phase of economic liberalisation started in the early 1990s and though it has been a halting process, it has continued to gain momentum. The Indians are generally of the view that it suits both sides of politics for the process to continue. The government is pushing reforms on two fronts:

- Privatisation (overseen by the Ministry of Disinvestment) and deregulation of state dominated industries – banking, petroleum, telecom, power, roads, etc.
- Legislative reform eg. the power sector, and more effective debt recovery laws.

It is worth discussing some specific examples of this process, in addition to some of the less than obvious effects. India is the world's most populace democracy and the benefits of this include freedom of speech, pluralism and some sense of the rule of law; the major cost is that much-needed reforms tend to be delayed due to short-term political expediency. Whilst this pattern is common to most democratic countries, the size of the population and the extent of the wealth disparities represent unique challenges. For example, all farmers/rural workers are exempt from income tax, pay very little for electricity and receive the benefit of heavily subsidised fertiliser, kerosene and LPG. Whilst many of these farmers/workers are desperately poor and any humane government would extend to them some form of support, many are also comparatively well-off (as our city based Indian friends never failed to point out). The blanket approach to rural welfare places a significant burden on the overall economy and discriminates against the urban poor. However, unwinding this is far from easy; it requires a crisis. This is best illustrated by the ongoing reform of the power sector.

The State Government Electricity Boards (SEBs) account for almost all power distribution and around 70% of generation – the Centre Government accounts for most of the remaining generation. Due to massive subsidisation of rural consumers (who account for 30% of consumption and almost no revenue) and power theft (25% of all power generated is lost in transmission and distribution), the SEBs are currently losing US\$7 billion pa (1.5% of GDP). This deterioration (from a breakeven situation five years earlier) has led to significant under-investment. To illustrate, over the recent past

India has only managed to add 4GW pa in capacity; China adds 20GW in a normal year. Consequently, India suffers a base load deficit of around 8% which may itself be underestimated on account of non-availability.

The Centre Government has used the blackouts and brownouts to force change on the States. The Centre has forgiven the debts owed by the SEBs for power purchased from the Centre and in return has obligated the States to carry out tariff reform and to lower unaccounted losses. If a particular state fails to undertake reforms, the Centre can refuse supply (voters dislike blackouts more than paying a fair price for power) and that State will also forego much needed new project funding. The reform minded States (eg. Karnataka, Andhra Pradesh, Rajasthan, etc) are attracting the lion's share of this funding and consequently these states are also attracting new business investment with the lure of uninterrupted power supplies. Hence, interstate rivalry is becoming a major positive force driving reforms. Our discussions with the power utilities and equipment suppliers corroborated the top down story and indicated that action is also taking place at ground level. For example, in Delhi, one of the first cities to privatise its electricity distribution, we saw billboards advertising amnesties for the return and replacement of electricity metres that had been tampered with (see photo page 6).

One other bright spot is the government sponsored road building program. For those who have visited India, the notion of travelling at high speed on a modern tollway, with not a brahman bull in sight, would seem improbable – now it is a reality. The National Highway Authority is in the process of connecting the four major metros Mumbai, Delhi, Calcutta and Chennai with 5,846 kms of dual carriage highway by 2004 - grandly titled the Golden Quadrilateral. The geographical extremities of the sub-continent (Indians often describe their country as a continent) are to be connected by the 7,300 km North-South/East-West corridor by 2007. These projects are progressing on schedule and the benefits are already apparent. State governments have also increased road funding and fly-overs at major intersections are now common in Mumbai and Delhi. As ease of movement improves and the cost of transport falls there will be a huge increase in intra-Indian trade; the economic multiplier on this type of

investment is significant. Much remains to be done, and in a low interest rate environment, we believe infrastructure spending will increase across all areas, eg. airports, ports, railways, power, water and sewage, etc.

A common perception of India is that it is a country strangled by bureaucracy. Deregulation and privatisation is slowly changing this. As industries are sold off/opened up, the politicians/bureaucrats lose their ability to ration scarce resources (be it a phone connection, a loan from a bank, etc) and in the process extract a bribe from the frustrated consumer. The best example of this is telecom – the government has been progressively deregulating the sector since 1994 and in the last year mobile phone subscriber numbers doubled to 13 million. Prior to deregulation, consumers were at the mercy of the state owned monopoly – tales of people waiting thirty years for a telephone connection was barely an exaggeration.

Whilst the opportunities for patronage are declining, the bureaucracy is far from tamed and red tape remains a major problem. One of the petroleum companies we met proudly described the success of their new 7-eleven style retail outlets. After the meeting we dropped by one such outlet and found a slick fit-out with no merchandise for sale - the bemused manager explained that they had been temporarily closed down for failing to complete all thirty forms required for the licence!!

My sense is that the long history of bureaucratic abuse has fostered a deep mistrust of government and a belief that the only way to get ahead is to bypass the system. Whilst most India watchers would understand that the government deficit at 10% of GDP is a major problem – what they may not comprehend is that this is largely because the tax base is extremely narrow – only an estimated 15 million individuals pay income tax. As the power of the bureaucracy declines and private affluence grows, it will be interesting to see whether a large class of tax payers emerge that demand better services from government. If it does, India's deficit would decline rapidly and much needed infrastructure investment would boom.

From a combination of growing IT services, exports and remittances from wealthier Indians' living abroad, the external account has been transformed from a deficit highly sensitive to the oil price (70% of the oil requirement is imported) to one in healthy surplus with Central Bank forex reserves accumulating at a rapid rate – at around US\$20

billion pa and US\$70 billion in aggregate – the eighth highest in the world. These external surpluses are feeding into domestic liquidity and depressing the cost of finance. Over the past five years the cost of a motorcycle loan has fallen from 25% to 15% pa and the cost of a mortgage has fallen from 13% to 8% pa. Further, the opening up of the banking sector to private competition has increased the availability of consumer credit. The significant increase in the affordability of debt finance has been feeding high growth in new home investment and demand for durables such as cars and motorcycles. With consumer debt as a proportion of GDP at a very low 2%, this growth can continue for the foreseeable future.

The average Indian household remains extremely risk adverse – 95% of assets comprise gold, bonds, bank deposits and property - equity holdings are less than 5% and as noted there is little consumer debt. The aversion to equities is largely a result of a share market that has gone sideways for ten years following the scams of 1994. In addition, most years have been punctuated by some unrest - either, domestic or border related. More recently the economy has suffered under the excess capacity left by the general Asian investment cycle that peaked in 1997 and the bursting of the global stock market bubble in 2000. Consequently, in an environment where the ten year bond is yielding 6%, inflation is running at 5%, and the PE of the stock market is around 10x with corporate earnings growing at +10%, we believe there is significant room for households to increase their investment in equities.

The major risk to the India story is that populist governments will always be tempted to pander to Hindu Nationalism at the expense of the Muslim minority. Whilst real set-backs are likely to occur, we believe that India will remain on a relatively high growth path, especially by western standards. In terms of understanding the country and the stock market, we came away thinking that we still have much to learn.

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Some key demographics (as best we can guess) and interesting facts to help build the picture:

- Population of 1.1 billion people and young - 34% <15yrs versus 20% in Australia.
- Wealth disparities are enormous: <0.5 million very rich households account for 20% of

The Platinum International Fund

household income, the next 40 million account for 60%, the next 40 million for 12% and the bottom 110 million for 8%.

- The distribution of income between urban, semi-urban and rural areas is roughly 50%, 25% and 25%, respectively. Rural income is derived from the 30% of GDP accounted for by agriculture, however, the disparity here (as in all areas) is enormous – approximately 20 million agricultural “owners” account for 80% of income whilst the residual 20% is split between 280 million agricultural workers.
- The dispersion of population by concentrations is enormous: 33 cities >1 million population account for only 10% of the population and 600,000 villages of less than 10,000 (average of 1,600) account for 60% of the population.
- Religious groups: Hindu 81.3%, Muslim 12%, Christian 2.3%, Sikh 1.9%, other groups including Buddhist, Jain and Parsi 2.5%.

India:

- Is the second largest cement producing country in the world.
- Has the second largest pool of engineers and scientists in the world.
- Of the Fortune 500 companies, 220 outsource software related services to India.
- Is home to the second largest number of pharmaceutical plants approved by the US Food and Drug Administration outside the US.
- With 800 movies produced per year, by volume, Bollywood overshadows Hollywood.
- The Kumbh Mela festival (an age old hindu festival), held every 12 years in the city of Allahabad, attracts 25 million visitors.
- The Indian city of Varanasi is the oldest continuously inhabited city in the world today.

Source: CLSA Emerging Markets, et al

Jacob Mitchell  
Investment Analyst





## Notes

1. The returns represent the combined income and capital return for the specified period. They have been calculated using withdrawal prices, after taking into account management fees (excluding any performance fees), pre-tax, and assuming reinvestment of distributions. The returns shown represent past returns of the Fund only. 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, 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 Funds since inception and relative to their Index (in A\$) as per below:

Platinum International Fund:

Inception 1 May 1995, MSCI World Accumulation Net Return Index in A\$

Platinum Asia Fund:

Inception 3 March 2003, MSCI Asia Free ex Japan Net Return Index in A\$

Platinum European Fund:

Inception 1 July 1998, MSCI Europe Accumulation Net Return Index in A\$

Platinum Japan Fund:

Inception 1 July 1998, MSCI Japan Accumulation Net Return Index in A\$

Platinum International Brands Fund:

Inception 18 May 2000, MSCI World Accumulation Net Return Index in A\$

Platinum International Technology Fund:

Inception 18 May 2000, MSCI Global Technology index in A\$

The investment return in the Funds is calculated using withdrawal prices, after taking into account management fees (excluding performance fees), pre-tax and assuming 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.