

# PLATINUM INTERNATIONAL FUND



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## PERFORMANCE

As you will see from the body of this report, the trend of world stock markets has been set by the conviction that the world is “growing stronger for longer”. Years of underinvestment by many processed commodity industries, ranging from mining to refining have resulted in dramatic price rises, a resulting surge in profitability and explosive gains in their share prices. Australia, with its abundant natural resource base has been a prime beneficiary of this trend as it enjoys its fifteenth year of uninterrupted growth.

We have been inadequately positioned for this trend even though we were early to recognise the significance of China and India in terms of the physical off-take of commodities they lacked. This view found expression in holdings such as MIMS and Noranda. We then moved too aggressively into the one laggard in the piece, Japan, with the logic that growth would be good for one of the world’s leading exporters. However, *ideal* positioning called for maximum exposure to highly cyclical companies and financials, with the currency exposure being hedged fully into commodity rich currencies. We were not so positioned.

For those of us trying to read the tone of the market, the surprise has been the relatively mild sell-off of equities in the face of a clear “market failure” in the credit markets. Skyrocketing share prices since the Fed cut short-term rates, by a surprising fifty basis points, simply reinforce the bullish sentiment of the day.

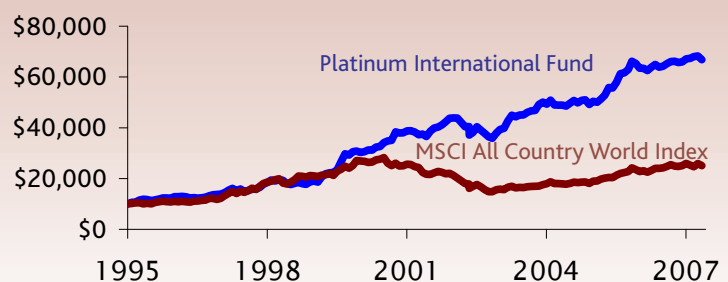
**MSCI WORLD INDEX COUNTRY PERFORMANCE (AUD)**

REGION	QUARTER	1 YEAR
HONG KONG	19%	27%
BRAZIL	16%	66%
INDIA	15%	38%
KOREA	9%	22%
AUSTRALIA	7%	31%
GERMANY	-1%	24%
US	-2%	-2%
UK	-4%	3%
FRANCE	-5%	5%
JAPAN	-5%	-10%

Source: MSCI

**VALUE OF \$10,000 INVESTED SINCE INCEPTION**

1 MAY 1995 TO 30 SEPTEMBER 2007



Source: Platinum and MSCI. Refer to Note 2, page 5

DISPOSITION OF ASSETS		
REGION	SEP 2007	JUN 2007
NORTH AMERICA	27%	26%
JAPAN *	22%	23%
EMERGING MARKETS	20%	19%
WESTERN EUROPE	18%	19%
CASH	13%	12%
SHORT	26%	25%

\* The Fund also has a 11% short position in Japanese Gov't Bonds

Source: Platinum

For the quarter, our cautious positioning has barely helped our performance. Even as the markets recovered, the Australian dollar acted like a lead weight on our recovery just as its weakness had shielded the down-draught. The short sales helped with some profits being taken but some of this was undone as the markets quickly resumed their uptrend within days. This has left us feeling most frustrated and ever more eager to remove our protective strategy, relegating it to the “bad-idea bin” of portfolio management.

For the quarter we fractionally outperformed the MSCI All Country World Index but for the last 12 months we are trailing the MSCI return of 4.6% by 1.6%. The five year and longer numbers are still very respectable.

## CURRENCY

We presently have virtually no US dollar exposure. We are 27% long the Australian dollar, 23% long the Japanese yen, 22% long the European currencies and the remainder is an exposure to the underlying Asian currencies.

PLATINUM INTERNATIONAL FUND - TOP 15 STOCKS		
STOCK	COUNTRY	SEP 2007
MOSAIC	US	3.1%
CISCO	US	2.9%
MICROSOFT CORP	US	2.8%
ERICSSON	SWEDEN	2.8%
BOMBARDIER	CANADA	2.7%
INTERNATIONAL PAPER	US	2.6%
SIEMENS	GERMANY	2.5%
HUTCHISON WHAMPOA	HONG KONG	2.5%
CREDIT AGRICOLE	FRANCE	2.1%
BARRICK GOLD CORP	US	2.0%
ROYAL DUTCH SHELL	NETHERLANDS	1.7%
DENSO CORP	JAPAN	1.7%
SONY CORP	JAPAN	1.7%
HENKEL KGAA	GERMANY	1.7%
PERNOD RICARD	FRANCE	1.5%

Source: Platinum

By way of background, there follows a brief description of the market's recent travails. Just as all is progressing smoothly, along comes a surprise. On this occasion it was ostensibly related to sub-prime lending. Regular readers would have anticipated such an outcome having been exposed to a high dosage of disapprobation about easy lending and cheap money which would leave lenders unrequited for the risks they had run. However, it was unsettling to find that supposedly deep markets could freeze almost overnight.

The common belief had been that securitisation dispersed the risk among many. This contrasted with earlier times where problems from careless lending would emerge in the banking system, eventuating in a subsequent rationing of credit and withdrawal of lines in the face of credit losses and equity write-offs. This most recent episode of securitisation not only segregated originators from eventual owners but co-mingled and geared the resulting collateralised debt obligations, CDOs,\* the value of which was consequently magnified by

\* For more coverage on this topic, please see the John Hempton article on our website at the following link:  
<http://www.platinum.com.au/images/us-finance.pdf>



this leverage, both up and down. When trouble struck, those trading in these markets became uncertain as to the inherent value of their paper and this resulted in sharp and often unpalatable markdowns. At these prices, most lacked the will to transact. Simultaneously, several leading banks were discovered to have established off-balance sheet entities that were also heavily geared. Fortunately the central banks were able to tide over most of those institutions caught with long-term lending obligations funded with short-term money but not before we were all reminded again of the risks of high leverage.

Gradually the freeze has thawed and as we end the quarter many of the signs of stress have diminished and it is almost back to business as usual. Well, not quite! The leveraged buy-out brigade aka private equity is in some instances reneging on their deals or at least attempting to renegotiate their terms. The banks are trying to extricate themselves from some of their more extravagant commitments and are landed with contingent liabilities that they never envisaged would be called upon. They are still reluctant to lend to “nobodies” and even among themselves there is a clear divide between big and small institutions, with poorly funded long-term lenders such as RAMS or Northern Rock needing to find new owners as losses have impaired their solvency. (The global write downs by the banks alone will run to many billions. Also, as these special off-balance sheet vehicles are brought back on balance sheet, capital constraints could lead to equity raisings.)

## COMMENTARY

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The key ideas one needed to have grasped immediately after the Internet bubble in 2001 were that:

1. the **Federal Reserve Board would act vigorously to support economic activity in the face of weakening activity** (even if Japan has shown that force-feeding credit is no use if people do not wish to borrow or lend);

2. the world would continue to experience a **different type of cycle to anything seen since the 1950s**; and

3. the trade-threatening mercantilist policies being followed in Asia would be **accommodated by the recycling of surpluses** back into the assets of the deficit nations and importantly this would maintain order in the currency markets.

Economic history reveals many events that are completely paradigm changing. On this occasion it is the **entry of say, one third or one fourth of humanity onto the world capitalist stage**. This (in simple terms) is suppressing the cost of labour and transferring jobs dependent on traded goods and some services to these lower cost centres. This in turn is bolstering the profit share of capital in general - hence the super rents we have highlighted in past quarterlies. It is also disproportionately rewarding the nations and owners of the resources who in the past had neglected investment in the face of weak commodity prices. Until these bottlenecks are alleviated, through supply responses or substitution, these heightened rewards will accrue. This in turn has positive implications for resource-backed currencies and negative implications for chronic borrowers.

To date we have mistakenly fretted about the **durability of the recycling process, fearing that credit defaults and/or chronic weakness in the US dollar would create circumstances beyond the control of the central banks**. We coincidentally underestimated the willingness of some Western consumers to borrow. Having taken this stance, one was then set on a path of unrewarded caution.

Where does this leave us now? As we noted in July, the outcome from these trade driven (mercantilist) policies is a **wall of liquidity which will find expression in asset prices at the source of these imbalances**. Early and aggressive cuts by the Fed may have the appearance of bailing out the system but we suspect they **simply raise the tempo of the asset chase**.

There are, however, some warning signs that the enthusiastic lending practices of the last several years have left an indelible mark. Firstly, the gold

price has begun to move to yet higher ground even when expressed in strong currencies such as the euro. Secondly, the Chinese buyers of longer dated US Government paper have been absent from the market since the May auction. This incidentally set-off a complicated rebalancing of duration by funds and institutions that in turn unleashed the sub-prime cascade.

**Importantly, the recycling process that is at the heart of the equilibrating act, to compensate for trading imbalances, continues with those countries attempting to manage their currencies' exchange rate recycling to the short-end of the yield curve and now perhaps into real assets.**

Thirdly, high growth markets or those with a surfeit of internal savings have moved to new highs while most of those dependent on foreign savings are still below their earlier peaks. There has clearly been a change of mood but mostly at the extremes. Those with strong internal drivers continue to flourish and those with weaker fundamentals may be losing momentum.

Domestic inflation of asset and other prices potentially threaten the *status quo*. Food inflation has more to do with a global repricing of resources - see previous commentary on our agricultural theme. To dampen down asset speculation, the Chinese authorities have also been proactively introducing selective measures. As we noted last quarter, the Taiwanese tried virtually everything to control asset prices post their currency float but the pressure was inexorably upwards. An important measure to watch is the *rate of change* of urbanisation in China: this would forewarn of any tightening in labour supply and potential wage inflation. For the moment though, all the indicators point to the growing intensity of speculation in China and increasingly, in neighbouring countries and further abroad.

## CONCLUSION

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This period is somewhat reminiscent of the tech bubble where in the latter days we gradually

shifted away from trendy areas to find refuge in non-tech “boring” companies. Today, there is not as wide a valuation gap between hot and cold. The areas of relative safety are the non-levered, non-resource, large capitalisation global companies which display modest operational leverage. Many have records of years of uninterrupted growth and yet have been partly overlooked by investors as they focused on buy-out candidates or simply believe the commodity boom is too compelling to be distracted with other notions. That is not to say we cannot find a large number of interesting investments in Asia which on account of their perceived peripheral participation are still modestly valued. We are therefore **managing a barbell strategy**. This can be characterised as participating at the margin of the asset bubble centred in Asia and offsetting this with a large helping of quality globally dominant players which are trading at below trend valuations. If growth continues to be strong we will enjoy the slip stream and if it turns out to be weaker, we should avoid the nasty surprises.

Post quarter-end we reduced our short positions to 20% but do not wish to be too exposed to the currencies of those nations dependent on others' *largesse*.

We believe our long duration themes such as data mobility, infrastructural deficiency, the pulp and agriculture commodity cycle etc, are well on track. That most of these companies have virtually no debt is an important consideration as is our very limited exposure to financial companies and the Western consumer. While Japan is now perceived as a relic of an earlier industrial age, our exposure there has many companies that are participating in the current boom of world growth but without the financial risk. **Moreover, like other large capitalisation companies they may attract the interest of Sovereign funds who are now looking to invest in real assets, as opposed to nominal claims ie. bonds and bills.**

As we rue our earlier caution, we cannot for the moment identify factors that will dislodge the drivers behind the current upward trend in most equity markets. We have accordingly adjusted to a more optimistic investment stance.

## NOTES

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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.

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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.

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