

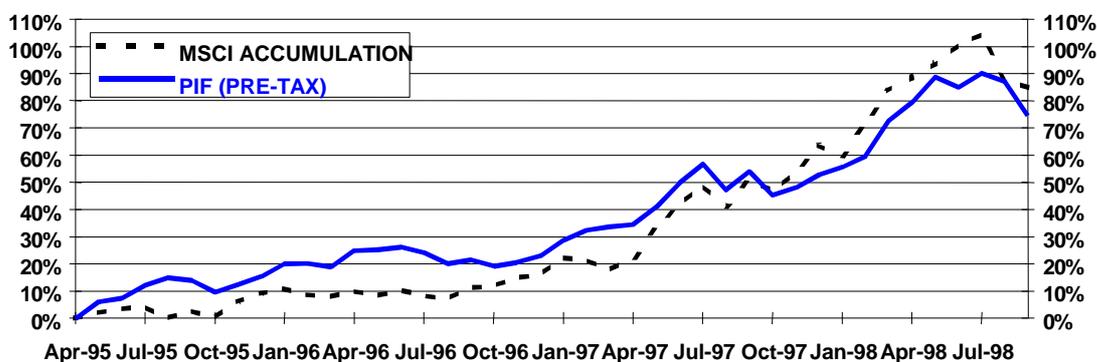


Platinum International Fund

Quarterly Report

30 September 1998

Performance



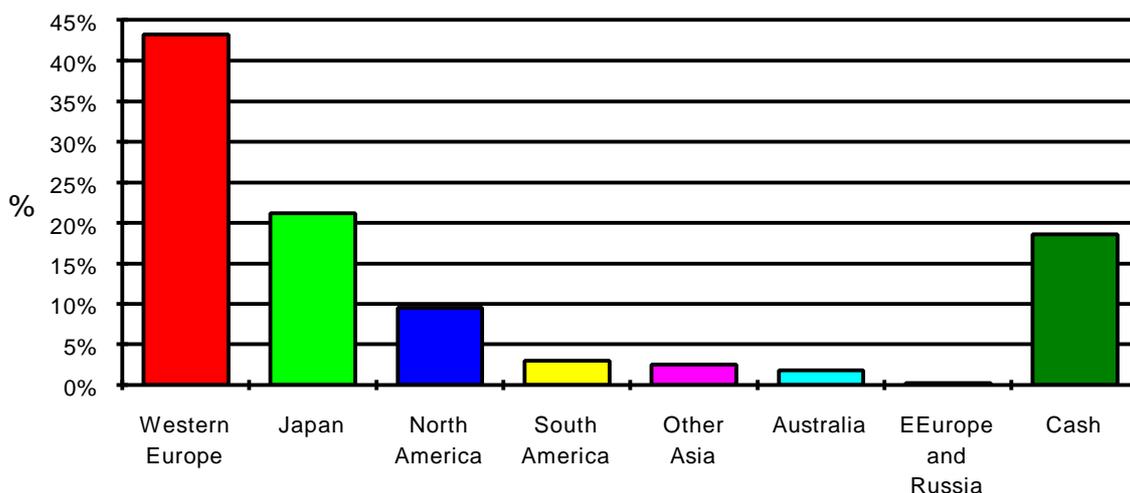
PIF Cumulative Performance versus MSCI World Accumulation Index

Reality caught up with levitation this quarter with the realisation that economic growth would fall short of expectations and that within an environment of weak pricing, earnings disappointments were probable. The peripheral markets faced a continuing flight of capital, which adversely affected their currencies and stock markets but the approach of the contagion to the shores of the US and Europe, equally, took its toll on these markets. The Euro 500 index was down by 19%, the US by 9%, Japan by 17% (local currency). The peripherals, largely emerging markets, suffered most because of poor liquidity and the mass exodus of capital. Overall, the fund's performance for the quarter was down 5.7% versus the MSCI World Index of -8.0%.

Top Ten Holdings as at 30 September 1998

Stock	Country	Industry	% Holding
Rinascente	Italy	Retail	5.3%
Acuson	US	Medical Equipment	2.7%
Siemens	Germany	Electrical Engineering	2.6%
Yamanouchi Pharm.	Japan	Pharmaceutical	2.6%
Sony Corporation	Japan	Electrical Equipment	2.5%
San Paolo	Italy	Banking	2.4%
Deutsche Bank	Germany	Banking	2.4%
Swiss Industrial Group	Switzerland	Packaging/Engineering	2.4%
Suzuken	Japan	Pharmaceutical	2.3%
Douglas	Germany	Retail	2.3%
Total			27.5%

Disposition of Assets



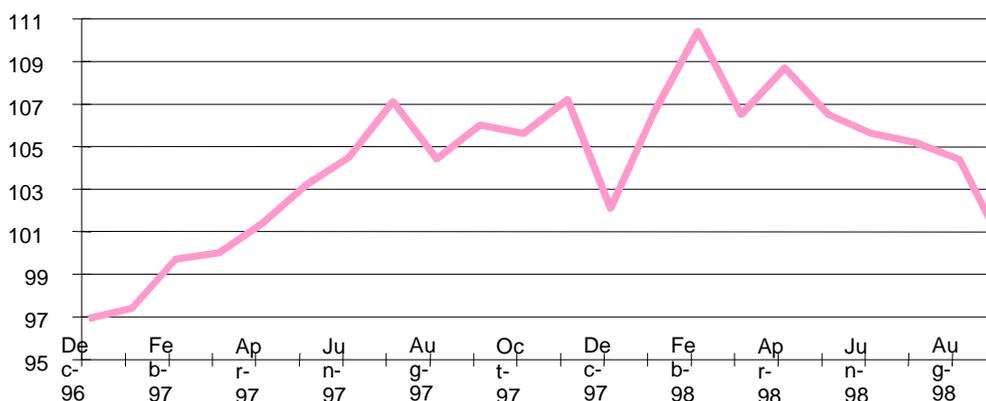
Commentary

One might appraise the global markets in terms of three broad concepts:

- a) the US consumer;
- b) importance of economic policy;
- c) the surrendering of economic sovereignty.

With price deflation being evident in traded goods, caused to a large extent by over-investment in Asia, it is hardly an exaggeration to say that the hopes of the world are being carried on the backs of the American "mall shuffler". The problem with this is that the American consumer has already been doing more than his fair share to support the troubled world's hunt for outlets for its products. US consumer debt is running at record levels, being 67.4% of GNP and interest payments being the equivalent of 17.3% of monthly incomes. The consequence of this is found in the growing trade deficit, which will probably top US\$250 billion for this year. While job growth could support enthusiastic spending patterns, the real unknown is the behaviour of the consumer in the face of a weaker stock market. The following graph of US consumer sentiment is not reassuring.

US Consumer Sentiment



(Source: University of Michigan)

Authorities are preoccupied with the malaise in financial markets and developing economies. However, feasible policy options are limited and political conditions add to the problem. Japan's low interest rates and easy fiscal policy has not succeeded in invigorating the economy. The US is unwilling to lower interest rates significantly while the domestic economy remains robust. Furthermore, the President's leadership has been undermined by his well-publicised sexual misdemeanours. Europe remains focused on monetary union.

As we wrote in September 1997, the surrendering of economic sovereignty to the flows of hot money is adding to the problem of weakening aggregate demand as developing countries use high interest rates to stem the flow of funds out of their markets. Matters came to a head in

August when Russia effectively reneged on its debts. Thus countries such as Brazil find it necessary to push-up interest rates to levels that are certain to result in a severe recession on account of their dependence on foreign savings to balance their trade deficit. Resources of the IMF are almost depleted with the institution having dispensed large tranches of capital in the earlier part of this saga. More importantly, its loss of standing in the world community and among congressmen in Washington couldn't have come at a worse time. We have seen countries such as Malaysia revert to seemingly old-fashioned remedies by blocking capital account transactions in a desperate effort to remedy its problems without having to resort to high interest rates or IMF intervention. Sadly, capital has a unique ability to find loopholes and typically this style of intervention has not been very successful over a long period. In the coming months we should expect a fair amount of discussion about possible hybrid solutions for some of the troubled countries together with the general focus on market "inefficiency".

The problems involved in the "bail out" of Long-Term Capital Management highlight the extent of the leverage within the system. The regular (and hopefully continuous) repricing of financial assets that is associated with securitisation shifts the underwriting risk from the traditional bearer, the banks, to a broader group of decision makers (managers of pension and mutual funds) and ultimately to the end-users of the products, the public. While this is not news, the surprises lie in the scale of the leverage and consequent distortions. The source can be tracked back to the attempt at kick-starting the Japanese economy, which gave the impression that abundant funds were available at low cost. It is the misallocation of assets resulting from this that has generated the extraordinary sell-off in the shares of financial intermediaries early in the cycle - rather than following the normal late-cycle pattern. The danger lies in the prospect that market participants now over-compensate for their previous cavalier attitude to risk.

Evidence of the underlying problem of sloppy aggregate demand and poor pricing power has been gradually revealing itself to the stock market. We have long cautioned about the sustainability of earnings and have been outright dismissive of the notion that the aggregate earnings performance seen on Wall Street over the last five years could be replicated or even surpassed in the next five years (as forecast by IBES analyst figures). It has therefore not come as a surprise to see several high profile companies such as Gillette, Proctor & Gamble and Coke cautioning analysts about their current prospects. Less predictable has been the profit performance of those companies that are in industries purveying new technology and innovation. Here the stand out has been the French telecom supplier, Alcatel, where a profit warning resulted in a 38% single day collapse in the share price. Investors are responding by migrating to areas that have seemingly greater predictability and where valuations are less dependent on promises. This has suited us well with our heavy exposure to retailers (18%).

Concerns about earnings, and areas of over-valuation, encourage us to maintain our short position in the US as well as partial hedge in the Nikkei. In addition, we have been active in short-selling individual companies where the shares are typically at historically extreme ratings and where sales growth is barely limping along. In our last report we noted the divergence between the strong and the weak, and now believe that the rising risk of unsustainable earnings is directing investors to re-appraise some of the extreme valuations that they were comfortable with until recently.

Outlook

The greater level of uncertainty and the less optimistic view of medium term growth, is having the effect of raising the risk premium on shares. Partially offsetting this is the apparent low opportunity cost of owning shares versus cash or bonds (on account of low interest rates). Moreover in Europe we have already witnessed significant adjustment in prices and this has resulted in the valuations being brought back to realistic levels. High quality companies are now available at historically attractive valuations even in the light of possible slower medium term growth. However, with the general level of uncertainty, it should be expected that share prices trade in a 15% price band for a while yet. An interesting feature is the exceptionally strong director interest in buying their company shares, particularly in the UK.

While there are many stocks in the USA that have adjusted significantly, in aggregate we expect further downward pressure. Earnings are proving elusive and analyst downgrades are common place. Both prospects and profits have fallen short of expectations in Japan as that country struggles with its legacy of a centrally directed economy. While our policy of emphasising very specific niches in that market has been rewarding, the slow response of the politicians and the growing employment anxiety is extending the time frame of recovery.

Currently we continue to witness great turbulence in most financial markets - not least as the tightening of credit lines to leveraged funds forces some liquidation of their positions. We would anticipate a decline in the activity levels of such funds over time.

The fund will maintain its short position on the US and selectively take advantage of over-valued companies to balance our exposure to modestly priced investments.

Stock Story - Suzuken (Japan)

The well publicised contraction of the Japanese economy is bringing about a fundamental reappraisal of traditional Keiretsu business ties as suppliers of credit re-appraise their relationships. Weaker companies are being shut down in record numbers as banks curtail lending and the traditional support of corporate relationships is no longer seen as sustainable. Whilst this is destabilising for corporate Japan, the flip side is that the strong are getting stronger. Suzuken is clearly such a company.

It is the leading wholesaler of pharmaceutical products with a market share of 13%. In many ways the changes going on in its industry are a microcosm of the structural adjustments occurring in the wider economy. The top four wholesalers in Japan only control 35% of the market whereas in the US where a process of consolidation is largely complete, the top four have 70% of the market. We see no reason why in time the Japanese market cannot move much closer to that which prevails in the US and indeed most other markets. The forces likely to promote this process are:

- The wholesaling business is essentially a fixed cost business with the primary costs being those of warehousing, physical distribution and sales and marketing. Because of this, profitability is determined largely by the volume the wholesaler can push through its network. Suzuken has operating margins that are more than 2x the industry average as a result of its scale. Hence it is in a vastly superior position to offer either a better price or a superior service to its customers and must therefore take market share over time. This advantage comes to the fore when the economy turns down as the weaker wholesalers often go into losses and questions are raised over their financial viability.
- The local drug manufacturers seem to be following global trends in gradually consolidating around a powerful R&D effort and working to remove costs in the sales and marketing channels. This is in response to both greater efforts by the government to cut the public health bill and the rising influence of foreign drug companies that now hold 27% of the market. The foreign companies prefer using the large nationwide wholesalers because of their reach. At the same time, they are imposing more rigorous discipline on the payment terms and rebates paid to the wholesalers.

Wholesaling is becoming much more of a value added service business than merely being distribution functionaries of the major drug manufacturers. This is caused by the pressures on the public hospital system where the typical hospital is in deficit yet still supports up to 10 wholesalers each with their attendant costs. Increasingly the better wholesalers are able to provide systems such as on-line ordering or actually go into the hospital and become responsible for aspects of the administration. Also the trend away from hospital dispensing to pharmacies plays to the strength of the larger wholesalers.

It is our view that the smaller, regional wholesalers have a limited life span: they will either have to merge or close. This will clearly benefit Suzuken in that its sales base will rise as it takes market share, or merges with another company. In addition, its margins should benefit in two ways. First it is able to leverage its already existing distribution into higher volumes and secondly it can take a better bargaining position with its suppliers and customers as the number of competitors is reduced. The process has already begun with wholesaler numbers having fallen from 418 to 260 in the past 10 years. Suzuken, for its part, recently merged with a large regional wholesaler in Hokkaido which expanded its sales by 17%, and added to its regional coverage.

When we look at the valuation, the company possess a large amount of cash which either can be paid out to shareholders or used to purchase competitors. If the PE is adjusted for this, the stock sells on 11 times current earnings or 23 times earnings on an unadjusted basis. However, current operating margins at 1.3% compare with typical margins earned by overseas wholesalers at 1.6% to 2.5% and are well below Suzuken's own recent margin highs of 2.5%. So with gains in market share and the expected lift in margins, profit growth looks well set for the next few years.