



PLATINUM ASSET MANAGEMENT

The Platinum Trust Quarterly Report

30 September 2001

Incorporating the:

International Fund

European Fund

Japan Fund

International Technology Fund

International Brands Fund

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Incorporating the:

International Fund

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International Technology Fund

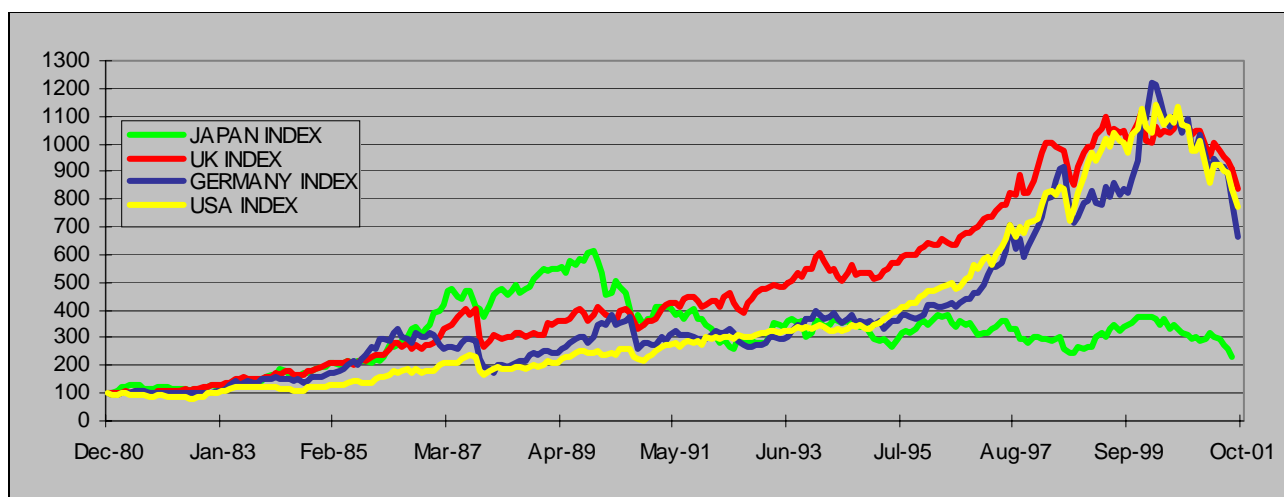
International Brands Fund

PERFORMANCE RETURNS TO 30 SEPTEMBER 2001 (A\$)

Fund	Fund Size	Quarter	1 year	2 years (compound pa)	3 years (compound pa)	5 years (compound pa)
International Fund	\$567mn	-4.6%	12.2%	27.8%	26.7%	23.9%
Japan Fund	\$72mn	-9.9%	-15.0%	14.6%	39.6%	-
European Fund	\$53mn	-2.7%	3.0%	46.9%	36.1%	-
International Technology Fund	\$20mn	-21.0%	-5.9%	-	-	-
International Brands Fund	\$12mn	-3.0%	17.4%	-	-	-
MSCI Indices *						
MSCI World		-11.7%	-21.1%	1.4%	6.5%	14.9%
MSCI Japan		-15.7%	-30.2%	-9.2%	9.8%	
MSCI European		-9.1%	-18.6%	1.7%	3.3%	
Nasdaq		-28.6%	-55.2%			

* Morgan Stanley Capital International Index

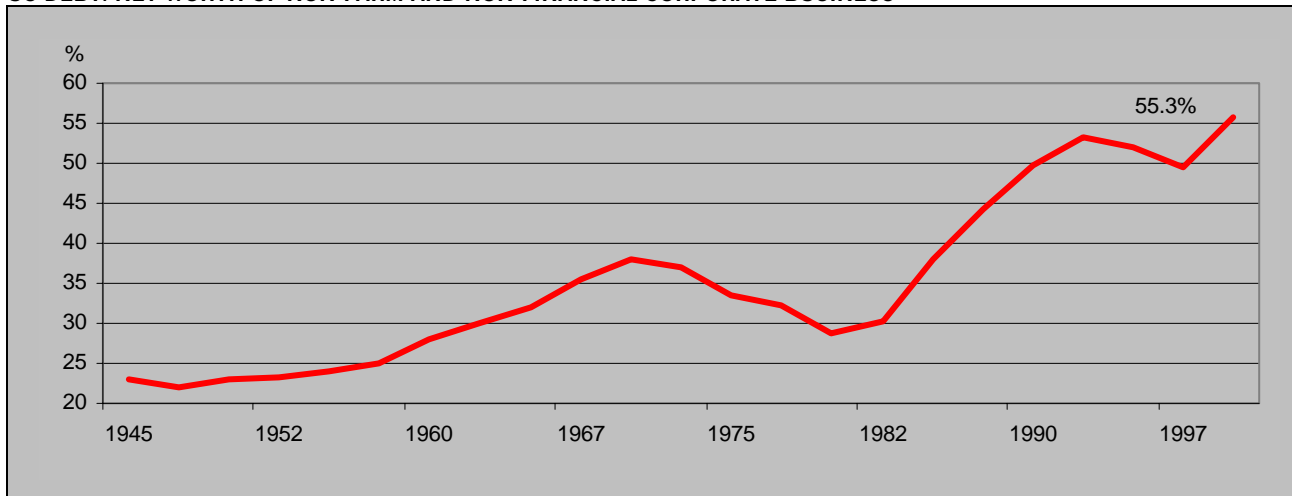
MSCI US, UK, GERMANY AND JAPAN SINCE 1987 (LOCAL CURRENCIES)



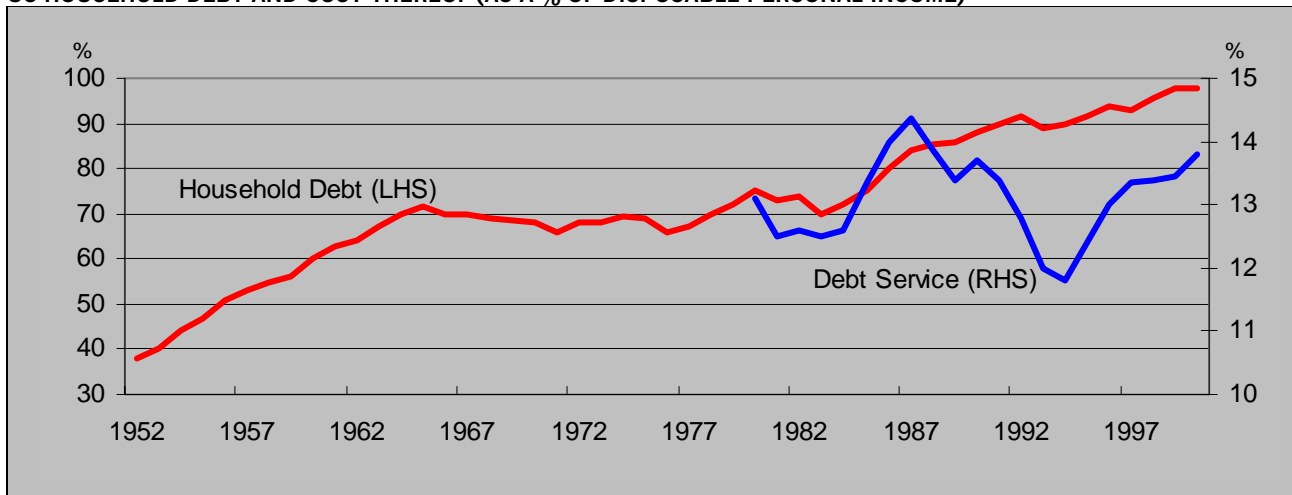
Information about the units on offer in the Platinum Trust are contained in the Platinum Trust Prospectus No. 4 lodged at ASIC on 25 May 2001. Persons wishing to acquire units must complete the application form from the current prospectus. Reliance should not be placed by anyone on this document as the basis for making any investment, financial or other decision. Past performance is not indicative of future performance. Platinum Asset Management does not guarantee the repayment of capital, payment of income or the performance of the Funds.

QUARTERLY HIGHLIGHTS:

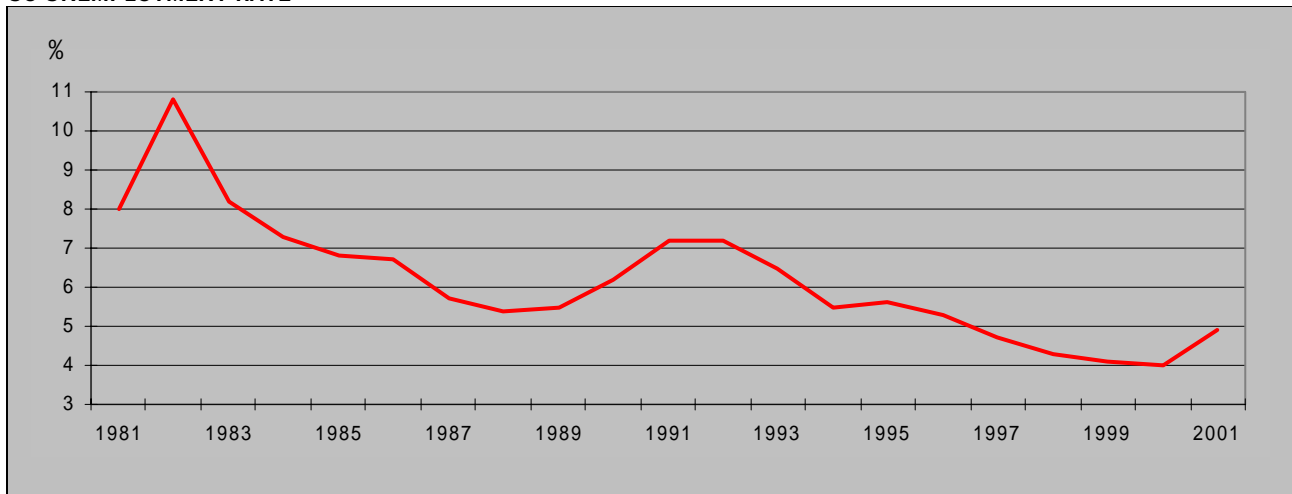
US DEBT/NET WORTH OF NON-FARM AND NON-FINANCIAL CORPORATE BUSINESS



US HOUSEHOLD DEBT AND COST THEREOF (AS A % OF DISPOSABLE PERSONAL INCOME)



US UNEMPLOYMENT RATE

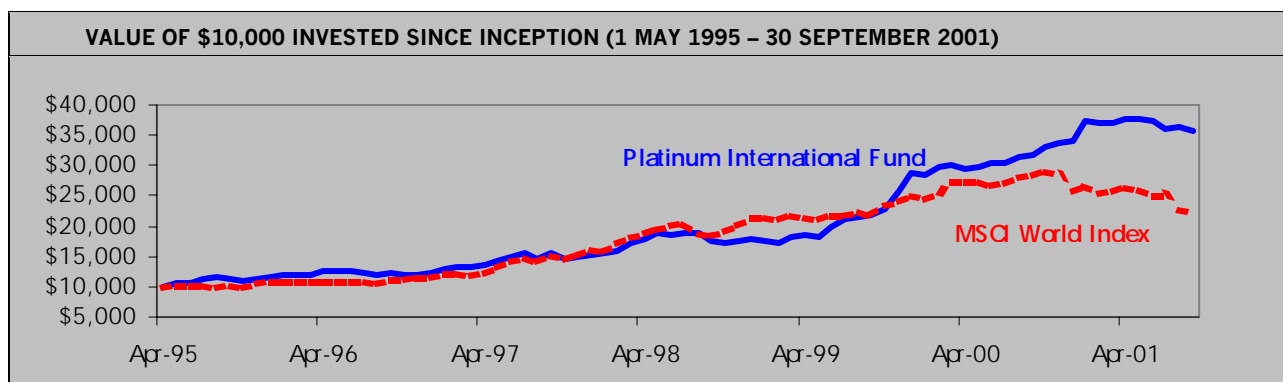


The Platinum International Fund

REDEMPTION PRICE: \$1.5665

FUND SIZE: \$567 MILLION

Performance



It has been a most testing quarter. The extent to which shares were seemingly indiscriminately sold was alarming but this also gave rise to some good buying opportunities. One developed the impression that there was a selling panic in Europe, whereas this was less evident in the US market. For the period, the MSCI World index declined by 11.7% in A\$ terms. Of the ten designated sectors, information technology fell the most, -31%; followed by consumer discretionary -23%, industrials -20% and materials -13%. (This sector had been strong last quarter as investors bought into the idea that the recovery was

around the corner). The sectors that rose were health care +2% and consumer staples +0.6%. Compared to these outcomes, the Fund's performance was relatively satisfactory even though it lost 4.6%. Mitigating the severe markdowns to some of our holdings, which are viewed as sensitive to a recession, was the strong performance of several holdings that benefit from the present uncertainty, such as defence and gold shares. In addition, our shorts on consumer stocks and those sensitive to employment, paid off well.

Over the last 12 months, the Fund achieved a return of 12.2%, while the MSCI fell by 21.1%.

Changes to the Portfolio

DISPOSITION OF ASSETS		
Region	Sep 2001	Jun 2001
Western Europe	36%	34%
Japan	15%	16%
North America	14%	18%
Emerging Markets (incl. Korea)	12%	11%
Australia	1%	1%
Cash	22%	19%
Shorts	19%	21%

On a geographic basis there was a continuing drop in our exposure to the US and Japan while more funds were employed in Europe and developing markets. Some of the new inflows were left in cash.

The change in the US masks considerable activity. At the beginning of the quarter we continued to reduce the tech stocks we had bought in the previous six months, like Peoplesoft and Foundry Networks, only to repurchase these at much lower prices at the end of the quarter, together with other tech names such as Sun Microsystems and Parametric. We continued to add to i2 Technologies, Agere Systems and some of our non-tech holdings. While we are very aware that there was a super-cycle in tech capital spending, and that capex will be subdued for some time to come, we

believe that this is being adequately reflected in prevailing weak share prices.

In Japan, we chose to surrender some long-held shares such as Fujitsu, Nomura and KDDI to build larger holdings in NTT, Toshiba, MEI and Furukawa. The latter is an interesting example of the market severely punishing a capital spending sensitive company. Furukawa which manufactures optic cable and components has now fallen 80%, back to its pre-boom base, having once enjoyed the reflected glory of JDS Uniphase of which it owned nearly 20%. However, in the meantime it has sold down part of its JDS holding, raising some US\$2 billion and used this to acquire the optic cable interests of Lucent. Yes, spending on cable will fall precipitously but along with this purchase, Furukawa acquired cross licence technology rights with Corning and was buying from a forced seller. In earlier negotiations, Lucent had been hoping to raise US\$5.5 billion but both Perelli and Alcatel withdrew. Furukawa paid US\$2.5 billion for this business and this places them as the principal supplier after

Corning. The shares at ¥680 are priced as they were before the boom and before it had enjoyed the windfall gains on its trade investment in JDS Uniphase, worth approximately ¥400 per share.

In Europe, we sold out of Diageo, Wella and reduced the Halifax position. The defensive qualities of these companies were being priced at a premium. Halifax has now merged with Bank of Scotland and our original case has been largely realised. We continued to add to existing positions and introduced Novozyme, the world's leading industrial enzyme producer, and Mediaset. This Italian media giant accounts for about 44% of the free-to-air TV audiences with its three channels and 66% of TV advertising spending. Along with other media plays it has been hammered as the fairy dust of the internet has settled and as growth expectations have shrivelled. It is now back to valuations that reflect the impending contraction of media spending and very little recognition is being given to its dominant position and free cash flow generating capacity.

BREAKDOWN BY INDUSTRY

Categories	Examples of Stocks	Sep 2001	Jun 2001
Cyclicals/Manufacturers	RMC, Akzo Nobel, Bayer, Linde, Océ	22%	18%
Technology/Hardware	Sun Micro, Toshiba, Samsung Electronics, AMD, Foundry	11%	12%
Retail/Services/Logistics	Hornbach, Jones Lang LaSalle, Fraport, Stinnes	9%	12%
Consumer Brands	Adidas-Salomon, Coke Bottlers, Lottecon	8%	10%
Financials	Lippo, Nordea, Halifax, Deutsche Boerse	7%	12%
Telecoms	NTT, Verizon, Korea Telecom	6%	6%
Medical	Draegerwerk, Merck KGaA, Novartis	6%	5%
Software & Media	Mediaset, Novell, Nippon Broadcasting, Seoul Broadcasting, Peoplesoft	6%	3%
Gold and Other	Gold Fields, Newmont Mining	3%	3%

Currency

The US\$ has been remarkably resilient in the face of the assault of 11 September. Apart from a temporary strengthening of the Yen which experienced strong demand as money was funnelled home in response to uncertainty and mid-year repatriation, the currency markets were pretty uninteresting. We chose to

extinguish any exposure to the US\$ by buying Swiss Francs but otherwise held our stance. At quarter end we were long A\$ to 45%; Euro/European currencies 55% and remained fully hedged out of US\$, Yen and Won.

Commentary

The attack in the USA on 11 September exacerbated what we believe was an already deteriorating economic picture. The appalling loss of life and destruction has escaped no one's attention. What is more difficult to gauge is the likely impact on the behaviour of ordinary citizens. Regular readers will know of our deep concern about the rise in the use of debt, by both companies and individuals. (On page 3 of this report we reproduce the relevant charts. For readers with stamina, I recommend that you read John Hempton's piece on Securitisation with its insight regarding the forces at work that promote debt creation).

To appraise the current economic situation, many commentators focus on the historic pattern of economic adjustment and the swiftness of the response of the Federal Reserve Board. The Fed funds rate has now been cut by 4 per cent since January to 2.5%, which reduces the cost of money to below the current inflation rate of 2.7%. There is still the overwhelming belief that lower interest rates will promptly and significantly turn confidence around, even in the face of companies laying-off supposedly surplus workers. Admittedly the change in US employment is still relatively low, some half million workers, but the populace is made keenly aware of these actions as the media almost delights in trumpeting the startling scale of lay-offs by some companies - Boeing being conspicuous with its 30,000 slash. Given the prior commitments of the average family, corroborated by rising delinquencies and foreclosures, we believe that consumers will draw in their spending. The economists' term for this is a 'rise in liquidity preference'. Simultaneously, companies are entering a slow environment with all the capacity they need. The remaining impulses could come from an improvement in exports and increased spending by the Government. These stimuli will not all be immediate.

The rest of the world is equally feeling this chill. Euroland has been very disappointing as exports have slowed and private consumption has barely increased. Asia is in a similar predicament. We, along with others, have been dismayed by the lack of progress with the Japanese reform program. Ironically the

social contract which requires firms to honour employment obligations may prove helpful to sustaining private consumption but at a heavy cost to industry. Essentially the social burden of over-employment is at the cost of company profitability.

As you look at the value of your share investments you will know that none of the above is a mystery to the market at large. The Japanese market is at a 17 year low, the French and German markets are now about *half* the value of March 2000, while London and New York are down some 30%. The puzzle here is that the European markets are showing much smaller changes in expectations about company profits and yet have fallen more than the US. The consensus is for earnings in Europe ex-UK to drop by 9% this year followed by an 8% increase in 2002. The same figures for the US are respectively -21% and +10%. Even prior to September, the consensus was for European earnings to be less affected than those of the S&P500 index.

We remain of the view that we are in difficult markets. By our reckoning we are well into the second phase of the bear market. This is identified by the nature of general comments and by the market's actions. There are still conflicting views about the market's primary direction; great faith is placed on the powers of the authorities and many still declare that they are holders for the long haul. On the technical front, there is huge volatility, robust inter-market rotation and broadening number of shares in decline.

Apart from the above, our caution mainly stems from high valuations. Having trawled through our list of mouth-watering businesses, we are disappointed with the scant catch. Here we are assessing highly defensible franchises that can be expected from past experience to become bigger and stronger over the next few years. The average PE of such a group would be well into 30 times earnings which we judge to be highly priced in a slow growing world *sans* a mild inflationary lubricant. Duller companies, which includes commodity and other cyclical companies, are generally more attractively priced and as we have noted before, smaller companies tend to be cheaper than the leviathans.

Conclusion

Guessing the general direction of markets is obviously a game of chance. Investors reacted very negatively to the WTC attacks and shares tumbled, presumably to *fully* reflect the change in the world environment. That we now witness a strong bounce is a better than an even chance. Aiding and abetting such enthusiasm is the action of the Federal Reserve Board and the favourable affect of lower oil prices. However, the indicators we shall be watching for are corporate profits and lay-off activity. We expect many companies to use the excuse of the bombings to take write-offs that in fact relate to earlier indiscretions ie. previous over-

statement of profits. We have been using this uncertain period to look for great franchises at attractive prices but are failing to come up with much. Further, we have been very active in shorting those companies which are being treated by investors as safe havens and are on improbable ratings. In addition, our concern about credit is reflected in short positions in sub-prime lenders and other over-ambitious granters of loans. We have removed most of our shorts on tech names as we believe many of these companies have reached more appropriate values. As growth cyclical, this group is now showing some good buys.

Kerr Neilson
Managing Director

Feature Article - Securitisation

The US consumer has more debt than they have ever had. Despite *much* lower interest rates, debt service costs are as high as they have ever been (averaging 14% of household income). The US economy has (at least until very recently) been supported by consumers who are willing to spend *despite this very high debt burden*. It's our view that **cut-throat competition amongst lenders has lowered lending standards** and fuelled this consumer boom. At the edge, some of these lenders are using very questionable practices to make their accounts look good. These make excellent shorting candidates for the Fund.

Old-style US banking and the new competitors

The US banking industry used to be very diffused. Literally thousands of small banks and savings and loans (S&Ls) had local deposit bases and local lending. Two factors have changed this dramatically. These are the expansion of two Government Sponsored Enterprises (GSEs) in the mortgage market and the

entrance to the lending market by new classes of lenders who are *not dependent on a deposit base from which they lend*.

The GSEs – Fannie Mae and Freddie Mac

In the late 1960s Congress gave a legislative charter to two companies in the mortgage market – the GSEs. These two companies, “Federal National Mortgage Association” and the “Federal Home Loan Mortgage Corporation”, now known as “Fannie Mae” and “Freddie Mac”, over-extended themselves in the early eighties but subsequently prospered and now dominate the mortgage business.

The charters gave the GSEs a huge cost advantage over other institutions. In particular, they were given a large and “free” line of credit from the US Treasury to support their capital base and *implicitly* have a Federal Government guarantee. They are also exempted from various Federal and State taxes and charges.

The companies have used their advantages to grow rapidly – more than 15% per year. Their stated goal is to maintain this growth rate even though they already insure almost half of all mortgages in the USA. In their search for growth they have widened the range of mortgages that they will underwrite. Also they have taken to holding the mortgages on their own balance sheets whereas before they would simply insure mortgages created by others for a 0.25% fee per year.

As the GSEs have grown they have squeezed the original S&Ls. The GSEs are now (a) underwriting credit risk, and (b) hold the mortgage on a large proportion of US mortgages - competing with the core business of the S&Ls and smaller banks.

The new-style “securitisation” lenders

Simultaneously the smaller banking participants are being squeezed by new-style lenders who facilitate lending by “securitisation” of mortgage pools.

Lenders have long realised that if an assortment of mortgages (say 10,000 mortgages) are mingled, it is almost certain that the lender will get 80% of his money back. The next 5% is slightly less certain (riskier), while the 5% after that is riskier still and the last 5% (depending on the quality of the borrowers) has considerable risk. The last slither is known as the “equity tranche”.

By means of clever software, the packager (securitiser) can tier the rights to payment from even poor quality loans, to produce very secure rights and offsetting highly dubious ones. The top quality paper trades at Triple A ratings (say 0.15% more than government bond yields) while the low quality end can offer as much as 6% more than government bond yields.

In securitising a bundle of mortgages, the owner of a tranche has the right to receive interest and principal. The equity tranche is retained by the “new style lender” – from which they earn spread income over the life of the loan. Some lenders often can’t fund even the equity tranche out of their own resources so they borrow further.

These securitisation lenders have several advantages over traditional smaller banks. Firstly, they do not need to maintain a deposit base and hence do not need an expensive branch network. Secondly, as most of the funding is the very low risk “first 80%”, they can fund themselves very cheaply. (Most this funding trades at Triple A credit ratings). Finally, deposit taking institutions are regulated to ensure deposits are safe. However, the securitisers often take no deposits and consequently are not heavily regulated

and can operate with very little equity capital. Many of these companies have BB credit ratings (mild junk debt ratings) and some have B ratings (deep junk debt ratings). Running a financial institution with a single B credit rating was unheard of a decade ago. Now it is not uncommon. We believe that this is a case of technology outstripping legislation.

What has happened to the traditional lenders?

Competition from the GSEs and competition from securitisation funded new-style lenders has made life very difficult for old-style lenders.

Effectively they have either had to sell out (which most have done) or become compliant with the GSE system (which generally means getting smaller and less profitable) or underwrite the loans that the GSEs won’t ie. extend riskier loans.

Many have taken the last route – but here a plethora of new style lenders pose competition almost as intense as the GSEs. This intensity is not just in mortgages but in credit cards and car loans and many other classes. Be clear how significant securitisation has become. From a small base in 1990, total securitisations (not including those done by the GSEs) account for at least \$1.7 trillion – about 14 per cent of all household and commercial debt in the US.

The range of non-GSE compliant loans made common in the last decade is breathtaking. There are high-loan-to-value lines of credit. There are mortgages with 125% loan to value ratios. There are sub-prime mortgages to chronic defaulters. It is even possible to get a loan with no documentation (no proof of ID, no proof of income etc) in rapid time. These products are risky and competition has forced many old-style lenders into these fringe areas. Cheap funding and competition mean there are plenty of new lenders there as well.

The fringe-dwelling companies (those outside the GSE led establishment) have some pretty strange characteristics. There are some good lenders there. But there are some whose books are deceptive and there are strange practices used to make the books look better than they might.

Strange practices amongst the fringe dwellers

Regular disclosures by the trustee allows lenders to monitor the quality of the securitisation pool ie. repayment and delinquency rates. Hence it is very important to the securitisation issuer that their credit data and profits look good. This enables them to get a low funding cost for the securitisation paper they sell and also to raise equity cheaply. Most of these companies also need equity because they can’t

otherwise fund ownership of the equity tranches of securitisation pools.

The first strange practice is “gain-on-sale” accounting. In gain-on-sale accounting all the profit likely to be recognised over the life of a loan is declared as profit when the loan is “sold” in a securitisation (even where most of the credit risk is maintained). This gives lenders an incentive to (a) under-estimate the credit losses they are likely to have so as to over-estimate the profit that is brought forward and (b) lend higher and higher amounts each year to keep the gains-from-sale accounts growing. This has further increased the competition in lending and increased willingness to write loans to poor credits (dubious borrowers).

The second strategy is simply to fudge the data collection processes. The securitisation holders are entitled to cash flows from the loans when those cash flows come. However, a company can reduce the measured default rate and delinquency rate by delaying the cash flows. We have found mortgage lenders who will give serial forbearances (deferment of payment) to borrowers so they do not have to show a delinquent account. (Strategy: If you have someone that can't pay you give them permission not to pay for

three months. Result: They are no longer delinquent because *they have no obligation to pay.*) We have also found an auto lender who has slowed the rate at which they sell repossessed cars - important because they only have to show a default *when the repossessed inventory is sold.*

These problems have increased as the economy has slowed. We are short selling several of these companies – looking carefully at credit data to determine which companies are using these practices. Several will go insolvent. The historic default rate for double B rated credits is over 4% per year and these companies are BB credits and there is a downturn going on so their default rate should be much higher. The ones which were hiding problems with suspect collection practices a year ago will almost certainly go bust because the problems are now getting worse.

We are not sure whether the problems caused by excessive lending (driven by competition amongst lenders) will lead to general systemic problems. They will however lead to a consumer slowdown because at some point it will be patently unprofitable to lend more to ever more stretched consumers.

John Hempton
Investment Analyst

HOME GROWN SNAPSHOTS - EUROPE AND CHINA TRIP

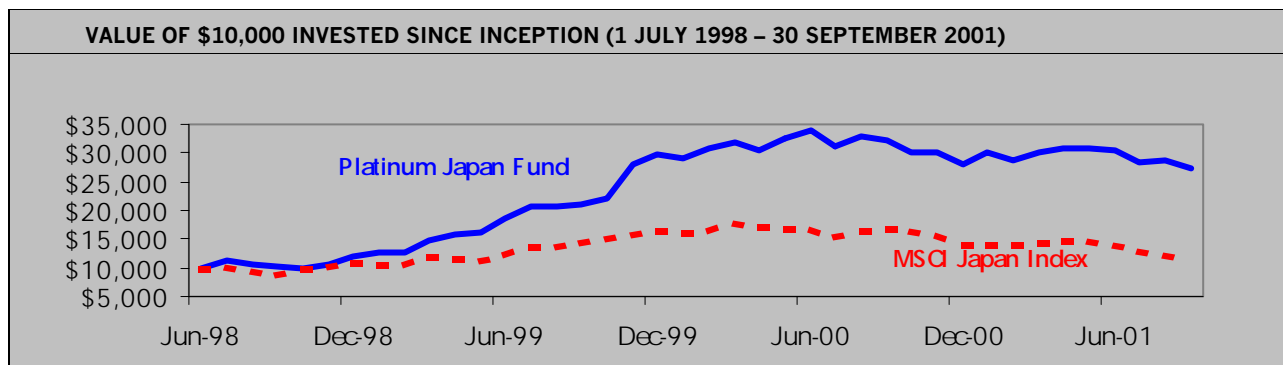


The Platinum Japan Fund

REDEMPTION PRICE: \$1.6958

FUND SIZE: \$72 MILLION

Performance



The Japanese equity market continued to perform poorly with the MSCI Japan index falling by 21.8% in yen terms and 18.1% in US\$ over the quarter. The market declined fairly steadily throughout the quarter as investors factored in the rising risk of a global recession as the last bastion of world growth and the US consumer, started to falter after a sharp rise in job layoffs. This in turn took the US equity market down 14% for the quarter, with flow-on effects in Europe (-12%) and Japan. Within the market, the patterns were the same as previous quarters, with large sell-offs in global growth (technology) and stockmarket sensitive areas (brokers), in favour of domestic plays. This was reinforced by a surprisingly strong yen, on a flight-to-safety argument following the terrorist attacks on the US, which knocked export stocks further. In the domestic areas, the standout was the real estate sector, which actually rose over the quarter. Here we had the launch of the first Real Estate Investment Trusts (REITs) in Japan. These vehicles offer dividend yields of around 4.5% and hence, are likely to be attractive to retail investors who currently earn zero per cent at

the bank. REITs have also had spin-off effects on the wider property market, as the new capital attracted to these vehicles is likely to chase the existing stock of quality office portfolios, pushing up prices.

Over the quarter, the Fund performed reasonably well in a relative sense, falling by 9.9% in A\$ terms against the index move of -15.7%. The factors affecting performance, as usual, were quite disparate. Gains were made from the Fund's holdings of real estate stocks purchased early in the quarter ahead of the strength related to the REITs' launch. In addition, our shorts in names like Hitachi, Ricoh and Daikin made us money as these stocks fell sharply. However, the Fund suffered from its holdings of technology stocks like MEI, Toshiba and Furukawa Electric. Another key driver of relative performance was the Fund's hedge-out of Japanese yen back into the Australian dollar. This cross-rate declined by around 7.8%, and although the Euro/yen cross-rate rose by 3%, the net effect on relative performance was around -3.1%.

Changes to the Portfolio

The disposition of assets by country changed little. In terms of short positions, we reduced our short against the Korean market to 4.5% of the Fund from 10%, as that market fell considerably. We increased our shorts against specific stocks in Japan, mainly concentrated in more defensive sectors that have performed well but are now expensive. In terms of

currencies, our position was mostly unchanged with an exposure of 53% to the A\$, 26% to the Euro, and 21% in yen. We remain cautious on the yen due to the expected need for any economic recovery to involve substantial printing of yen which should drive down its price.

DISPOSITION OF ASSETS			
Region	Sep 2001	Jun 2001	Mar 2001
Japan	68%	65%	75%
Korea	21%	22%	20%
Cash	11%	13%	5%
Shorts	11%	18%	8%

We have changed the categorisation of our Japanese stocks to better reflect the way we are thinking about ideas within the portfolio. In general terms, we continued to shift away from cyclical growth areas such as technology toward domestic growth areas on account of our concerns regarding global growth. Whilst we remain sceptical of rapid restructuring in Japan, we feel that the Japanese authorities will feel

compelled to act more aggressively on banking sector reform and in reflatting the economy because of deteriorating global growth. This thinking has been reflected in the inclusion of bank stocks in the portfolio for the first time in the Fund's history. Whilst on a fundamental basis we find it hard, as we always have, to justify these stocks, they remain the most sensitive to government policy actions. Hence, whilst we do not regard them as core positions, the balance of probabilities favours these stocks receiving support from the market place. In addition, we have looked for peripheral plays based on this same logic, and feel somewhat more comfortable with the domestic asset plays, such as selected real estate stocks, and other names, such as NTT, where 25% of the share price could be accounted for by latent property assets. One should note that within the thematic category displayed in the table below, the holdings are broken down as 10% real-estate related, 6% bio/nanotechnology and 6% banks.

BREAKDOWN BY INDUSTRY		
	Stocks	Sep 2001
Thematic	Japan Real Estate, Noritake, Mizuho, TOC Corp	22%
Restructuring	NTT, MEI, Toshiba, Wacoal	16%
Hidden Assets	Nippon Broadcasting, Toyo Tec, Taikisha	9%
Growth Stocks	Furukawa Electric, Aiful Corporation	9%
Cash Generators	Air Liquide Japan, Enix Corporation	6%
Other	Koito Manufacturing	5%
Korea	LG Chemical	22%
Cash/Margin Deposits		11%

Commentary

We have just returned from a trip to Japan during which we visited 15 companies and a number of broking analysts. Our overriding feeling (sadly) remains that whilst business conditions faced by most companies are dire, their sense of urgency to act is low. We think it is fair to say that most managements are now aware of the reality of their positions, and can even see the avenue by which they may get some alleviation (eg. personnel cuts), but very few are willing or able to do a lot about it. This is extremely disappointing to equity investors. A case in point is

Wacoal, which is Japan's leading maker of women's underwear. The company has a 40% domestic market share but profit margins at 6% are low for the type of dominance they have. Why is this? The company tells us that only 10% of products are made overseas. The reason offered for this is that the quality of materials from overseas is inferior to what is made in Japan, even though the second largest player in the market wholly imports its products and is gaining market share. The inferiority of foreign materials has often been used as an excuse by Japanese companies

for delaying shifting production overseas. The real, but unstated reason, is that Wacoal employs around 2,000 people at its domestic sewing plants, and these people would be out of work, were the company to shift to overseas sourcing. We were able to determine that management is actively considering down-sizing its domestic operations, and is involved in union talks to negotiate labour issues. Of course, we have seen time and again how Japanese companies hold onto old (ie. post-war) attitudes of needing to care for employees, rather than making the inevitable adjustment which would be less costly in every sense over the longer term (including securing the viability of the enterprise). Many Japanese managers take the hopeful stance that time is on their side, banking on the idea that natural attrition will gnaw away at over-sized labour forces in due time. At Wacoal, we would expect to see some sort of restructuring involving early retirement, but it is unlikely to occur at the pace or on the scale we would regard as ideal. So an otherwise very interesting story, with dominant market positions at home, very strong positions in other Asian countries accounting for 20% of profits, and \$US700 million of cash on the balance sheet, is spoilt by this timidity. The issue for wider corporate Japan is how to break free of the social contract with labour, where a recent sense of tradition remains a stubborn opponent, at the expense of economic rationalism. While this continues to be the case, Japan will remain no more than a cyclical market, riding world economic growth rather than seeing any structural improvement in profit margins.

On a more uplifting note, we saw Orix, a diversified financial services company with its core business in equipment leasing. The refreshing point about this company is that they have always operated on the fringe of the Japanese financial system, (outside the clique dominated by the MOF and the banks), lending on commercial terms to small and medium sized companies. They talk incessantly about profitability

and they have the financial record to back this up, albeit dependent somewhat on the very low interest rates available in Japan. Management is now leveraging that strong operating and capital base into a more diversified financial services company with focus on the retail side of the market. They are also quite proactive in M&A, a rarity in Japan, having recently bought leasing books from large manufacturing companies and housing loan portfolios off the banks. They are also a clear beneficiary of deregulation moves in Japan, in areas like REITs and asset securitisation, where they have been concentrating efforts to develop markets for some time. The culture of this company is very non-traditional and profit-focused, and is therefore a prime candidate for our investment funds. However, the story appears to be well known, and the core leasing business, which provides all of the profits, will not grow. This means the growth will be dependent on its success as a retail lender. Without a natural retail base, it probably needs to buy something large to make a material difference. For the moment, aggressive competitors are stealing a march on Orix, who is ending up as the under-bidder. On balance, the market seems to have priced the stock correctly, but we remain watchful for opportunities to buy on dips.

Thematically, we remain interested in the bio/nanotechnology areas. Both fields are areas in which the Japanese are likely to be prominent and are spending large sums of money. On this recent visit, we saw three companies that are likely to benefit from these themes, and will write more about them when our investigations are complete. We also think that the broadband internet theme will resurface both this year and next, as the number of ADSL users reaches a critical mass, though some years behind other countries. This could have profound competitive implications in areas like computer games, where the dominance of the consoles could be challenged by other software vendors.

Outlook

Our feeling is that the terrorist attacks of September 11 have merely served to reinforce the prospects for a global recession which were already becoming apparent prior to this event. We feel the knock-on effects of less activity, as people take a more sober view of the world and stay at home, will feed through to declining consumption, particularly in areas like holidays and eating out. Risk premiums for financial assets have probably risen on a long-term basis (back

to where they were historically). While we acknowledge the tremendous liquidity being provided to the markets through central bank easing, this is likely to merely cushion the fallout from the US economic bubble, rather than lead to a new one. If it does manage to ignite some element of recovery, this is likely to be a playable rally but probably no more than that, as lows are revisited at a later date. Japan has seen a large element of the fallout already and has

The Platinum Japan Fund

retreated to 1998 Asian crisis lows. At this level, one would have thought that most of the bad news had been priced in. However, we remain cautious of high

US valuations and domestically, slow corporate restructuring.

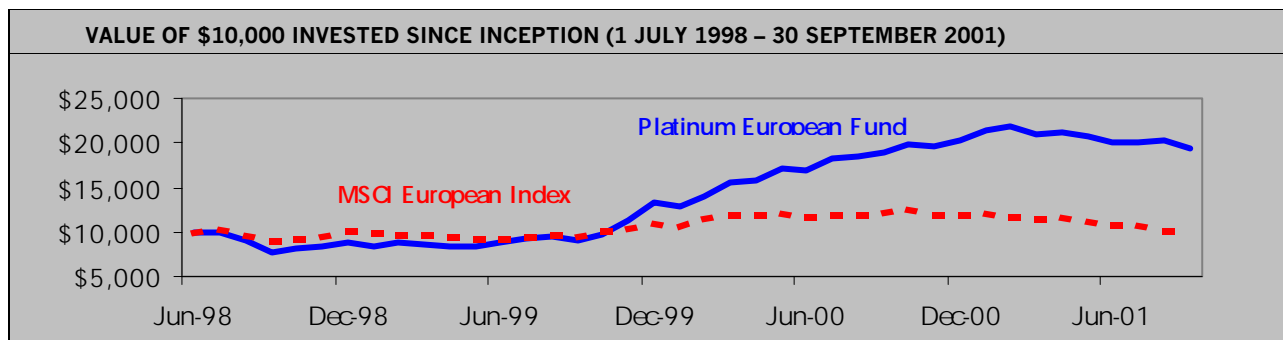
Jim Simpson
Portfolio Manager

The Platinum European Fund

REDEMPTION PRICE: \$1.5939

FUND SIZE: \$53 MILLION

Performance



Performance – European markets hammered, weak A\$ flatters outcome

Between 30 June and 10 September this year, European stock markets fell by 16%. By 30 September the overall decline for the quarter was 19% – clearly the terrorist attacks were not the main reason for the collapse in stock prices.

Over the quarter, only one industry group (tobacco) was up (and only by 4%). All the others were down, with 20 industry groups down by more than 20%. Interestingly, especially in the light of their terrible performance over the past year, computer hardware/software and telecom equipment were the weakest areas, both down 40% for the September quarter. In the light of the terrorist attacks travel/leisure made a late collapse (-39%), while manufacturing (-37%) and autos (-32%) were two big industrial areas whose recent resilience disappeared. There was no help in the less capital-intensive businesses with computer services (-31%) and media (-29%) offering little resistance. Lower losses were to be found in the predictable areas of health care (-8%), water utilities (-5%) and food manufacturers (-13%).

Of the 500 largest European companies, 86 saw their stock prices down by more than 40%, and only six companies managed a gain of over 10%. In fact only

30 of the 500 had stock prices that were not negative over the period.

It is worth noting just how far markets have fallen since the March 2000 peak – overall Europe is down 35% and within that the German DAX has declined 47%, France's CAC is -41% and the London FTSE is off 30% (note the timing of the peaks for these individual markets varied over several months in 2000). The now forgotten Neuer Markt (the once highflying European answer to NASDAQ) has come from 8,565 to 837 for a return of -90%. Now is probably not the time to position the portfolio for a bear market – we have had a very grizzly one already!

The market, then, was -19% for the quarter in local currencies; a weak A\$ (and a strengthening Euro) improved this outcome to -9% for the MSCI measured in A\$. The Platinum European Fund fell 3%. Profits on short selling Porsche and Peugeot helped a little; also the Fund has a hedge into the Swiss franc which helped as “safe haven” currencies were sought immediately after the terrorist attacks.

Over the last twelve months, MSCI Europe is -19% in A\$; the Fund has returned +3% over that period.

BREAKDOWN BY INDUSTRY		
Categories	Examples of Stocks	Sep 2001
Growth	Novartis, Siemens, Merck KGaA	16%
Capital Goods	Océ, Schindler, Metso	10%
Consumer	Lagardere, Mediaset, Adidas-Salomon	12%
Financials	Deutsche Boerse, Nordea	9%
Miscellaneous Services	Rinascente, Hornbach, Stinnes	24%
Chemicals/Misc.	Akzo Nobel, Linde, Bayer	26%

Commentary

Mergers and acquisitions, the confusion of “globalisation” and European competition policy

In several recent reports the issue of industrial consolidation in Europe has been a key topic. In July 1999, just after the Bank of Italy had scuttled two Italian bank mergers, we wrote:

“we are still of the view that (mergers/acquisitions) are not unambiguously good news. For a start many are prevented (by the authorities) ... and of those that succeed there are logistical issues of a vast scale on which to squander management time. Europe has been and continues to cry out for consolidation in many industries, but when it happens, the work (certainly for the management and probably for the stock price) is just beginning”.

The events of last year, and especially the last fortnight, suggest that another caveat must be added to the great European corporate carve-up story: competition policy. It could be argued that the European Commission’s veto in 2000 of the Air Liquide purchase of BOC was sensible in that industrial gas companies are a series of regional monopolies anyway. Or that the dramatic European rejection of GE’s purchase of Honeywell could be put down to the French wishing to obstruct the US champion of economic rationalism. However you would still be gasping with disbelief at last week’s announcement that the Schneider-Legrand deal is off. These are both French companies!!! What happened to the supposed French power in Brussels? And how was the deal in breach of the competition policy anyway? These issues and their implications are worthy of some consideration.

In the 1990s the “national champion” model in Europe was giving way to the perceived benefits of

scale, market share and capacity rationalisation, cheered on by the prospect of the Euro. Overriding this has been the general corporate strategy of addressing the reality of “globalisation” – by this we mean the removal of much trade and market entry protection. As Europe transformed from a few large economies (and a dozen smaller ones) to one vast economic area, it was clear that the potential for concentration in all industries would be immense. And so it was that deal after deal was announced – in all industries from telecoms to autos and retailers to banks.

However it is one thing for the European Commission to preside over “Europe”, and another for its functionaries to see matters on a continent-wide scale. Jack Welsh’s attitude is that if a business is not #1 or #2 in an industry (or likely to get there soon) then it is not worthwhile. Among his great achievements was the harnessing of scale (and the removal of much of the concomitant bureaucracy) to dominate several industries on a global basis. The wider agenda of Europeans (and certainly of the politicians, both national and European), with their concern for social aspects (widely and variably defined), means that for the moment at least global industry dominance of the GE variety is at odds with the European viewpoint.

Excerpts from Jack Welsh’s autobiography reveal his shock at the difference in philosophy. The US Justice Department approved the deal in May this year subject to minor disposals by GE. Six days later the EC put out a “155-page statement of objections”. In the end, the way Mr Welsh tells the story, European Competition Commissioner Monti had a meeting with him in Brussels after their respective minions

had supposedly done the detail work. Mr Monti read through a new list of demands that cut the heart out of the Honeywell business, and effectively ended the acquisition on the spot.

As implied above, however, the news which really surprised was Mr Monti's late September recommendation to the commission that Schneider's acquisition of Legrand be disallowed. With a modest shareholding in the group, the Platinum European Fund has suffered from this decision (Schneider stock fell 20% on the news).

Schneider and Legrand were two separately listed French "electricals" companies. A key part of Schneider's business is "low voltage" electricals. This encompasses all "end user" electrical products found in a house or in a building – from the complicated cabling running office intranets to the power boards in the core of the building, to the light switches in a residential kitchen. It is a nice business because the standards are different in each country, and continual training of local electricians ensures their loyalty to the company's equipment. Schneider was present in France and had a good Scandinavian market share. Low voltage was Legrand's only business, and it was the world market leader with a big position in France, a fantastic share in Italy, and a growing presence in North America.

Clearly the position in France was the difficulty. Schneider was willing to divest their own position in low voltage in France in favour of keeping that of Legrand – on this basis the competitiveness of the French industry would be unchanged. Thus something beyond any aspect the companies understood has caused Mr Monti to veto the acquisition. Schneider have released no details other than to comment that the commission's position is "incomprehensible".

The deal thus seems to be in tatters and (if the above turns out to be correct when the official ruling is announced in mid-October) Schneider will seemingly have to divest Legrand (or most of it at least). Consider that the stock-for-stock purchase has already gone through (French law disallows deals to be done conditional on external approval, so Schneider was forced to buy Legrand some months ago), that the new Schneider-Legrand share has been busily trading for weeks, and that thousands of employees from both sides have been integrating the two companies – clearly this is a mess indeed.

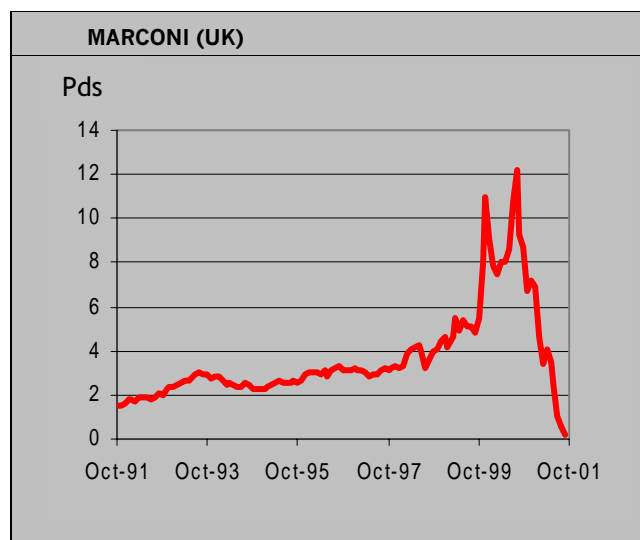
The more general point is that appropriate corporate responses to globalisation are difficult to start with. On top of that, mergers or acquisitions are difficult to

execute and the problems of dealing with two corporate cultures cannot be overstated. Thus to buy shares in recently merged companies we would need to demonstrate considerably more upside than is available in independent companies with similar earnings growth prospects.

And it is not overstating matters to conclude that the EU is sending a strong signal to advocates of "Anglo-Saxon style" market capitalism, that protection of consumers (and small/local companies) is very much on the agenda. Does this reduce our estimate of the potential profitability of corporate Europe over time? It must do so. More problematic would be a wholesale move by investors to favour investing in US stocks over those in Europe – already US-based fund managers are questioning some of their positions in Europe after these EC outcomes.

Marconi – a dramatic example of the difficulties of positioning and the danger of debt

Marconi is the new name of the British industrial business known for a long time as GEC. The stock price is pictured below so I note now that we do not, and have never, owned it; nor unfortunately did we short it. However the lesson it provides is chilling and crucial.



As the company capitalised in the late 19th and early 20th centuries on its founders' appreciation of the importance of electricity, the company which would become GEC grew steadily. In both world wars it made dramatic progress, providing various supplies for the war effort. During the 1920s it even helped build out the national grid in the UK. In 1963 Mr Arnold Weinstock took over as managing director (when GEC bought his family company) and over the

next three decades GEC consolidated large parts of British industry. By 1996 GEC was a conglomerate of defence, telecoms, and various engineering businesses. It had annual sales of £11 billion (A\$30 billion), pre-tax profits of nearly £1 billion and employed 83,000 staff. GEC also had net cash of £2.5 billion. Lord Weinstock was due for retirement and the City (ie. the London investment banking community) was pleased to see him go – he had continually dismissed their calls to spend the cash in the dramatic deals favoured by bankers.

It is not correct to describe GEC as “great” by 1996 (other than in its size and presence). Importantly, it was run “for cash” and research and development was neglected to the extent that GEC had often needed to buy companies to access innovations. However it was pretty solid and with energy and imagination could have improved further. Perhaps it was in this potential that the seeds of the catastrophe lay.

Mr George Simpson started his career in the Scottish gas industry and progressed through the auto companies Leyland and then Rover. By way of Lucas Industries and British Aerospace, he was eventually appointed as the successor to Lord Weinstock in 1996. Later that year Mr John Mayo, ex-investment banking “deal maker”, was appointed finance director and the excitement in the city was palpable.

Simpson and Mayo delighted the City with a string of disposals, which generated fat commissions for the investment bankers. But the real excitement was to come. With billions to spend and a telecommunications boom in full cry, GEC changed its name to Marconi and bought telecom equipment businesses in the heat of one of the great asset bubbles of all time. Devastatingly, some of these acquisitions were of companies that were owned by venture capitalists and had been hawked around a seller’s

market (without success) for some time. Other acquisitions were of “dead cert” technologies that never really took off.

To cut a long and sad story short, Marconi today has around £4.5 billion of debt which it is struggling to service. Estimates are falling by the month and sales will probably not exceed £5.5 billion this year. The level of likely losses is hard to estimate but it will be some hundreds of millions of pounds *before* interest payments on the mountain of debt. The market capitalisation of the business is now just a few hundred million pounds, having been around £10 billion in 1996 (and a remarkable £34 billion in the 1999/2000 bubble – the investment banking spin doctors pushed their own creation enthusiastically).

Obviously there are many stories of wealth destruction from the dot com bubble – but most of these are trivial in the sense that there was no business to start with so it was only the coming and going of illusory value that was at issue. In the case of Marconi a large and profitable business was destroyed in a quite remarkably short time.

There are several points to the story. The immediate problem is that even with interest rates at multi-decade lows, servicing debt requires a healthy core business and is not a function of the “balance sheet efficiency” nonsense that investment bankers blustered about over recent years. There will be more bankruptcies – and in many cases debt will be the eventual killer.

The more difficult aspect of the Marconi demise is its illustration of the difficulties of responding to the challenges of globalisation. We are not against companies acquiring or merging but we do note that it is awfully difficult to assess the success of most deals, especially in economic boom times when trouble is disguised by growth.

Outlook

Stock markets in Europe have fallen a long way (admittedly from unrealistic peaks). Perhaps more importantly there was a crescendo of distressed selling and panic on the Thursday and Friday ten days after the terrorist attacks which several London veterans described as well in excess of that in the October 1987 collapse.

This technical signal and the decline of many stock prices to reasonable valuations (based on through-cycle prospects) has led us to fully invest the cash we

were holding in the Fund toward the end of September. We added to Adidas and Linde which were sold off heavily (and have since rebounded) and also we introduced Mediaset, the Italian TV company, as media stocks fell to valuations unseen for years. We also added to our position in Schneider after the collapse in the stock. Finally, we have kept 11% of the Fund in short positions (in several highly priced pharmaceutical stocks).

Dramatic changes in the relative valuation of stocks in the market mean that there are opportunities to buy some shares which have been too expensive for several years. As we write, the truly great European

companies have not come down in price sufficiently to make good investments; continuing volatility in the market means however that there may be chances in some of these companies in the coming months.

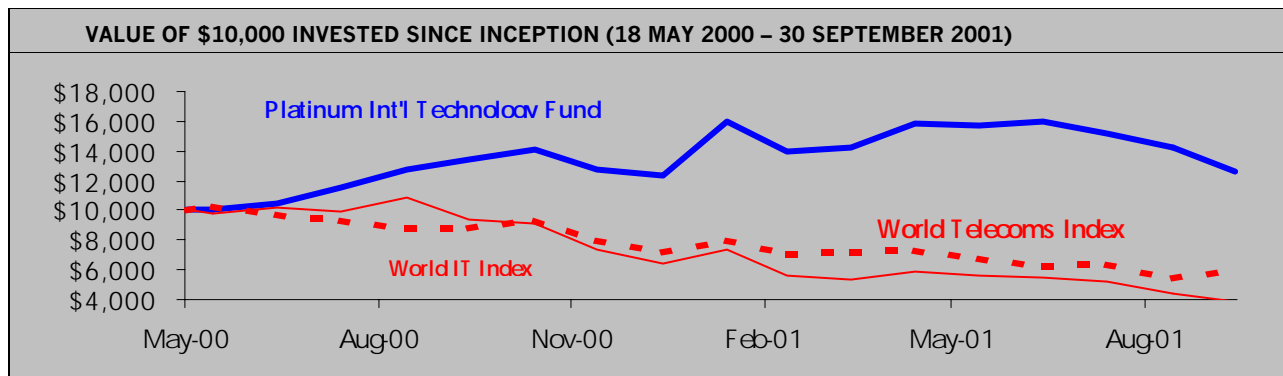
Toby Harrop
Portfolio Manager

The Platinum International Technology Fund

REDEMPTION PRICE: \$1.0043

FUND SIZE: \$20 MILLION

Performance



The Fund turned in a disappointing quarter, falling 21% as technology stocks across the globe suffered a savage sell-off, with the MSCI Information Technology index down 30%. Telecom stocks fared somewhat better with the MSCI Telecom Services index down only 4%. The falls were widespread across all sectors of technology and subsequently many of our holdings saw significant declines. Of benefit to the Fund were short positions held in a number of semiconductor capital goods producers and

the Fund's substantial cash holdings. Over the last 12 months, the Fund has returned -6% versus falls of 59% and 31% from the information technology and telecom sectors. During the quarter, the sell off provided the opportunity to add to existing positions at attractive prices. Holdings such as Samsung Electronics, Agere Systems, i2 Technologies and Foundry networks were amongst the most significant additions. The major new position for the Fund was Sun Microsystems.

DISPOSITION OF ASSETS

Region	Sep 2001	Jun 2001
US	46%	53%
Other Asia (incl. Korea)	14%	8%
Japan	9%	7%
Europe	0%	0%
Cash and Other	31%	32%
Shorts	8%	19%

BREAKDOWN BY INDUSTRY

Categories	Sep 2001	Jun 2001
Semiconductor	22%	20%
Software	8%	12%
Electronic Components	15%	11%
Telecom Equipment & Suppliers	10%	11%
Other	14%	14%

Commentary and Outlook

In our last quarterly report, we made the point that although most technology stock prices had fallen 80% or more from their highs, they were not yet good value simply because of the extraordinary levels reached during the bubble. Certainly the risks remain high as companies struggle to deal with levels of

demand that is down by 50% or more. ***However, the latest collapse in prices now sees many IT companies valued at historically low levels and for the first time since the Fund's inception, we believe there are a wide range of technology stocks selling at prices that make them attractive,***

long term investments. Below we discuss three of the Funds holdings, Sun Microsystems, Foundry Networks, and i2 Technologies, which we believe are good illustrations of such opportunities.

Sun Microsystems was one of the leading stocks of the technology bull market. Sun has over one third of the world market for Unix servers, computers that power large corporate networks as well as much of the internet. Also, the company invented Java, a computer language that allows applications to be run on any computing platform and a key technology in developing web-enabled applications. Unlike PC makers who rely on the Windows operating system and Intel's microprocessors, Unix suppliers such as Sun, have developed their own microprocessors and modified versions of the Unix operating system. Sun's ability to differentiate through its technology, together with an aggressive approach to sales, has seen the company consistently take share from the likes of IBM, Hewlett Packard, and Compaq. Not surprisingly the frenzy of spending on the internet by companies and telecom providers saw their sales boom, doubling to US\$18 billion over the three years to June 2001. At the peak of the market, Sun's stock was valued at US\$20.5 billion, up from a mere US\$2.5 billion in mid-1998. Today the stock is again valued at US\$2.5 billion.

Although Sun faces significant challenges, there are good reasons to be optimistic on a longer term view. As we have stated in these reports over the last year, many of the visions of the internet boom are in fact likely to be realised, it is just that it will happen within the usual economic constraints of "return on investment" and that they will take time to unfold. The move from the traditional client-server computing environment to web-enabled applications is a massive technical discontinuity that will not only allow many new solutions to be developed, but also for existing ones to be made much cheaper. The potential benefits of e-commerce are huge, but the complexity of relationships between companies, their suppliers and their customers simply mean that it will take time to establish new ways of doing business. Even the more discredited concepts of the boom, such as wireless data where we access the web from our mobile phones, or web sites which earn returns through advertising, should not be spurned. The bottom line is that in time investment in IT will recover and when it does Sun's products will be in demand once more.

i2 Technologies is the leading supplier of "supply chain management" software. Their products are used by companies to help optimise production schedules,

logistics, and inventory levels, as well as manage relationships with suppliers. At the end of 1997, a year in which i2 earned revenues of US\$200 million, the company was valued at US\$1.5 billion. By 2000, the company had grown sales to \$1.1 billion and at its peak price in 2000, the company was valued at \$4.4 billion. Today, the company is facing a tough environment which has seen its software sales fall by more than 50%, plunging the company into the red.

Analysts who previously predicted huge growth for the company now fear that the "supply chain" market is mature. It is unlikely that this is the case. The origins of the i2 product set were in factory planning, where the software is used to improve production scheduling. Companies such as Dell use the product to help run their lean manufacturing operations. Although this market is relatively well established, many companies are still in the process of moving toward "just in time" and "manufacture to order" processes. Meanwhile, the "optimisation" engines i2 have developed have been applied to solving other problems. Solutions are available to help trucking operators optimise their fleets, retailers to optimise their inventory levels, or to answer long term planning issues such as "where or how many factories do we need and where should they be placed?" Further, the company has made a number of acquisitions that complement their existing products. The most important of these was Aspect Development, whose products help companies manage their relationships with suppliers, allowing them to extract better pricing and terms.

The fall in sales i2 is experiencing is not a function of market maturity but the end of the corporate IT investment boom. Although a turnaround in sales may be some time away, due to declining corporate profits, ultimately companies will invest again to improve the efficiency of their businesses. Meanwhile, the challenge for i2 is to cut overheads in line with the lower level of sales. However, a net cash balance of \$400 million gives it plenty of time to deal with this problem. The company is currently valued at \$1.7 billion, essentially the same level it was at when the business was a fraction of its current size.

Foundry Networks is a manufacturer of LAN (Local Area Network) and WAN (Wide Area Network) switches and routers. Their products are used by telecom service providers, ISPs, portals, governments, financial and manufacturing companies to build and upgrade their telecom and data networks. Internet traffic continues to grow much faster than switching speed and this calls for a constant need to upgrade

installed equipment (either new "boxes" or modules to expand capacity). Data networking within the enterprise has been long dominated (and still is) by Cisco Systems, but the explosion of the Internet traffic during the late 90s has favoured the creation of many new companies able to offer products with comparable (if not better) performance at lower prices. Foundry itself was set-up in 1997 by a small group of Bay Network's engineers who foresaw the opportunities in this growing market.

At the end of 2000, Foundry had sales of US\$377 million and net profit of \$92 million, a remarkable result for a three year old venture. The market cap at its peak price in March 2000 was a huge \$25.5 billion. The company along with many others has been hit by the slowdown in capex spending by the telecom industry, especially new entrants and ISPs which represented a large part of their customer base. After the crisis in telecom capex in the USA, Foundry has been able to redeploy quickly their resources to service more enterprise customers (where a recovery in spending is probably closer) and into overseas markets (with recent and important orders from China

Telecom and Korea Telecom). Currently, Foundry are selling \$80-85 million of products on a quarterly basis (an excellent result given their market) and has maintained very respectable profit margins, at a time when most of their competitors have suffered huge losses. Net cash on the balance sheet is \$260 million. Today, the entire company is valued at US\$760 million.

Although we now believe the above companies, and others in the portfolio are promising investments, the risks remain high. Despite the well understood problems of the sector, it is to our amazement that companies announcing or warning of poor results are still being treated harshly by the market. In recent days, Micron Technology (memory chips) and Corning (optical fibre) have seen their stock price hit by 15% to 20% after announcements that should have had little element of surprise. The conclusion one draws from this behaviour is that there remains an element of hope in current stock prices, a risk from which the Fund's portfolio is not immune.

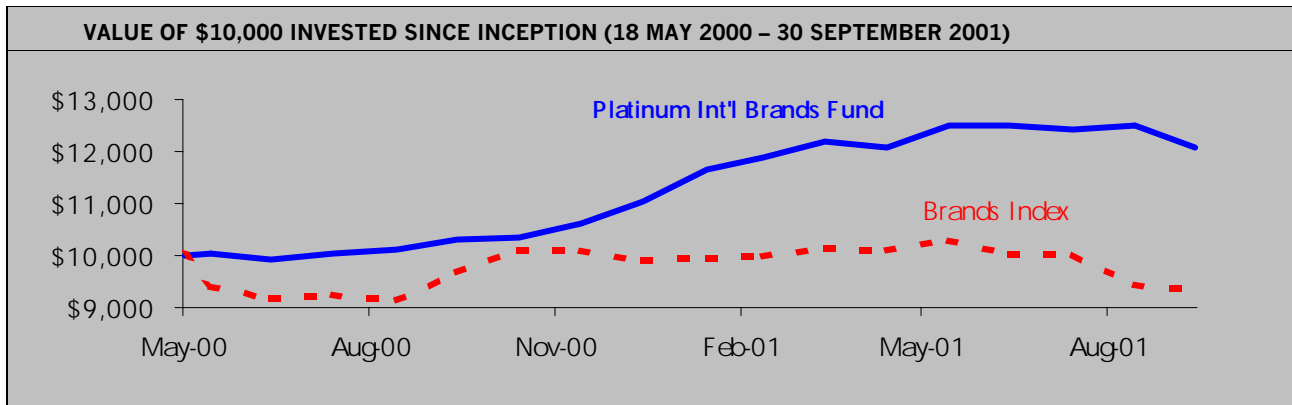
Andrew Clifford
Portfolio Manager

The Platinum International Brands Fund

REDEMPTION PRICE: \$1.1723

FUND SIZE: \$12 MILLION

Performance



The last quarter was challenging for everyone in the markets and the brands portfolio was no exception. The unit value fell by 3% versus a fall of 7% for our index of global brands and a 12% fall in the Australian dollar value of the MSCI. In our branded goods companies index, the winners were few, but the weakness was not universal:

- Tobacco and brewing stocks performed relatively well, with Philip Morris and Anheuser Busch showing modest gains.
- Food stocks like Wrigley and Sara Lee also held up well.
- Apparel retailers were off heavily, for instance Gap lost 57% of its value.
- General retailers tended to do badly, with K-Mart off 38%, while the leading discounter, Wal-Mart, rose by 3%.
- Beverage producers generally performed well, with Coke adding 6%.

- Household and personal care product companies performed relatively well: Beiersdorf rose 11% and L'Oreal 5%.
- General consumer discretionary companies suffered, with Sony off 42% and Eastman Kodak 28%.
- Luxury goods companies predictably did badly, with Richemont, Tiffany, Bulgari and LVMH all losing more than 25%.
- Hotel and travel related stocks were the biggest losers. For instance Carnival Cruises, the world's largest cruise ship operator, fell 32% when Wall Street reopened on 17 September and lost 26% of its value in the quarter.

Of the stocks in the Platinum Brands Fund, Procter & Gamble was particularly strong with a return of 16.7%. We sold this position believing that it had become overvalued as some in the market sought "safe havens" for their money.

Commentary

It is becoming clear that consumers are drawing in their horns in the face of uncertainty. A survey conducted after the events of 11 September by the US National Retailers' Federation showed that the number of respondents planning to spend more than last year over Christmas dropped sharply from 27% to 18%. Another survey from the business research organisation, the Conference Board, showed that just under half of the American households surveyed thought that the attacks on the US would tip the country into recession. The same body's regular monthly consumer confidence figures showed the

sharpest decline since October 1990. More concrete evidence of consumer behaviour is found in the deterioration of automobile sales: Daimler Chrysler witnessed a fall of 28% in September while even the strongest performer, GM, lost 3% versus September 2000.

Clouds on the horizon have virtually put a stop to corporate activity in branded goods industries. The long-awaited initial public offering of fashion house Prada has been delayed indefinitely and the sale of US menswear retailer Brooks Brothers by Marks &

Spencer is on hold for the time being. One deal that has gone ahead is a move by warring parties LVMH and Pinault Printemps Redoute to resolve their differences over ownership of fashion group Gucci. The wrangling between the two French giants and their chiefs Bernard Arnault and Francois Pinault has been protracted and often acrimonious. The latest deal will see PPR buy a third of LVMH's stake in Gucci in order to secure control of the company and then it will acquire all minority holdings in 2004 for a "guaranteed" price of \$101.50. This deal helped Gucci's share price resist the weakness that has affected most of the luxury goods sector. We have been watching this company closely because it has the potential to increase its earnings meaningfully via its acquisition and planned turnaround of the Yves Saint Laurent label. We feel however that the stock's valuation does not adequately reflect the level of risk in the luxury goods industry at present, with travel sure to taper off and the all-important Japanese consumer in poor shape, even before September's attacks on the US.

Feet on the ground at Adidas

One of our key holdings, Adidas-Salomon, was mauled late in September. Having spent time with the company's CFO recently we saw this as a buying opportunity. He took us through some technical innovations that the company has in store, such as running, and basketball shoes that guide an athlete's footfall, providing drive and momentum. More interesting still is the development of a running shoe that allows sweat to escape through a porous sole. This enhances comfort but also greatly reduces the risk of blisters and conditions like tinea. Considering that a runner can shed a champagne glass of perspiration from each foot during a marathon, one can see that this may have considerable appeal for serious runners.



At that meeting we also gained an insight into the importance of the urban youth market, with the revelation that young men can buy as many as ten pairs of flashy sports shoes each year! Adidas-Salomon's strategy for growth in the urban youth market, particularly in the US, along with strong technical expertise in running, tennis, soccer, skiing and golf (through Taylor Made) leave us convinced that it will see out the current difficult environment admirably. This conviction is reinforced by encouraging signs that the newly-installed US management team is gaining momentum and re-establishing strong links with its distribution

channels. We sense that its senior people are now more cohesive following a period characterised by dissension. This change is of great significance as the firm's push into the USA, from its strong European base, has produced some very uneven results over the last four years.



Another ongoing story is that of Pernod-Ricard. The wine and spirits company is making steady progress in its efforts to offload

peripheral, slow growing and low yielding divisions. In September it sold the majority of its soft drinks business to Cadbury-Schweppes, leaving it with fruit processing assets and a distribution operation to sell.

However, wine and spirits now accounts for most of the groups sales. Its core brands, such as Pernod, Jacob's Creek and Jameson's Irish whiskey increased volumes by an impressive 12% in the first half of 2001 (year on year) and helped boost profits by 30%. The sale of the above businesses will allow for some de-leveraging following its



highly ambitious purchase of key brands from Seagram. These are Seagram's Gin, Martell Cognac, Chivas Regal, Glen Grant, Royal Salute and Glenlivet scotches as well as local brands in Europe, Latin America and Asia. The acquisition places Pernod in the top three of global liquor purveyors. The growing belief in the company's transformation is illustrated by the share's strong performance since the Seagram deal was first announced.

A strong brew

During the quarter we acquired a holding in Interbrew. Ten years ago this company was a Belgian brewer on the fringes of the global brewing industry. Since then it has grown net earnings at 58% compound, versus 15% for Heineken and 10% for Anheuser Busch. These three companies are now the largest brewers in the world. The company has joined this exclusive club by acquiring local operations and applying modern production methods, management expertise and purchasing power to lift returns on capital. Several of Interbrew's targets were in Russia and Eastern Europe after the crises of 1997/98 – places which were generally seen as difficult and risky. Interbrew has begun to prove the value of its foresight with 21% organic growth in operating earnings from

these businesses in this last half. The company's 30 acquisitions in ten years have not all gone smoothly – it was recently forced by British competition regulators to sell its prized Carling lager label in the UK. Nevertheless it is left with a significant market share in the UK, particularly in premium lager – a growing segment in the relatively mature UK beer market. More than that though, Interbrew has a portfolio of brands and operations that is well balanced across both developed and developing markets in Europe, the Americas and the Asia Pacific.



There is still scope for the company to grow sales and lift performance, for its margins and returns on capital are below those of its principal competitors.

Having bought a strong presence with a dominant local brewer, Interbrew's strategy is to persuade local distributors to stock higher margin, international brands, which

until recently meant *Stella Artois*. With the recent acquisition of Beck's, this *modus operandi* will take on new significance. Beck's had been run as a traditional family concern in the desperately competitive and unprofitable German beer market. Many have suggested that Interbrew paid too much for this relatively small, if well known brewer, which sold 430 million litres last year (versus 2.2 billion litres sold by Heineken). We disagree, believing that the global rollout of this brand using Interbrew's distribution network and marketing budget will produce a remarkable increase in volumes.

Opportunity knocks

The message at the quarter's end: we continue to be on the lookout for opportunities to get into steady, Warren Buffet-style companies that can systematically grow earnings over time. Companies like Kimberly-Clarke and Nestle are in our sights at present. We intend to build positions patiently at valuations that we are comfortable with. While general market weakness may encourage some to over-pay for these types of businesses, we will not participate.

Kerr Neilson/Julian McCormack
Portfolio Manager

Airline Travel in the US - My experience

I travelled last weekend to Canada for a university reunion. I needn't have bothered, as no one is travelling, including those close to home. But the experience was interesting. Here's the rundown:

LAX (Los Angeles Airport) is closed to private vehicles. Police block all entrances. Only commercial vehicles (taxis, hotel and parking lot shuttles, limousines, etc) are permitted to drive around the airport. Today, apparently, the National Guard has been called in to take up the police patrols at the entrances.

All private traffic is re-routed to off-airport parking lots, where passengers are dropped off to board LAX shuttles to the terminal. The process works in reverse for arrivals. This system actually seems to work smoothly, as traffic flow on the airport proper was heavily congested and had slowed to a crawl in the recent couple of years. It remains to be seen whether such a system can cope with increased passenger volume.

Speaking of which, volumes were anaemic last weekend. I travelled Air Canada - hardly a terrorist threat (we hope). My original flight was cancelled (no passengers on the LAX-bound flight from Toronto), and the flight I travelled on was, perhaps, 40-50% full. Air Canada shares a terminal with Virgin Atlantic. Dead quiet, as Virgin had suspended all Trans-Atlantic flights. The terminal was eerily empty. Passengers speeded (relatively speaking) through check-in and security,

though some additional checking of bags, carry-ons, etc is conducted.

After a quiet flight and a strangely grateful safe landing, upon arrival in Toronto, it was much the same story. Little passenger volume upon international (mainly US) arrival = speedy exit through immigration. Actually, a pleasurable flight experience with zero delays. In Canada, many stories of people not bothering to travel. On two occasions, I ran into travellers from the US. In both instances, they were the only travellers on their respective flights (from the eastern US). These planes flew with two and one passenger(s) respectively.

On the return, a normal minimum 30 minute line-up at Air Canada to the US was reduced to nil. Check-in, and pass through of US Customs and Immigration, were both immediate. Clearly, no one was travelling to the US. This time, the plane was probably 20-25% full. Upon return to LAX, normal frenetic airport activity was very subdued.

Clearly, travel is heavily impacted, and will never be quite the same. If not a permanent reduction in travel (certainly it will be more costly in terms of fares and "transaction" costs, which will depress demand), then it will be several months, without any further domestic US violence, before things return to "normal". I think it's optimistic for any near-term improvement in the travel landscape.

The Market Mood

I read an article in the NY Times last weekend about a NY City resident who was to purchase a new car. When he postponed the purchase in the face of the mess in NYC, he explained to his small daughter his reason for not buying the vehicle: "You have to be in a good mood to buy a car."

That about sums it up for the American consumer these days. Combined with the wealth effect, consumer activity will likely be depressed for the next quarter, into the Christmas season. Morgan Stanley believes that we are slipping into a synchronous worldwide

recession, as the US, and the consumer sector in particular, has now fallen out of bed. Consensus seems to be building that a recovery, on the back of Fed easing, will occur mid-2002, and that, therefore, now is the beginning of the time to buy stocks. The contrarian view is that a "final" sell-off has not occurred, stocks are still "over-owned" (whatever that means), and that, since everyone is looking for the recovery, any disappointment is not factored in (certainly any delay in the timing of that recovery is not), despite the pessimism.

David Benwell
Our West Coast based associate

Short Selling

In our reports we refer to positions in our portfolio's where we have "sold short", "shorted", or had "short positions" in particular shares. The idea behind short selling of shares is to profit from a fall in the share price of a particular company. How can this be done?

Let's say our analysis shows that XYZ Ltd is overvalued and that we expect the share price to decline. To take advantage of this view we would "short sell" shares of XYZ. To do this we would simply sell the shares of XYZ even though we don't currently own them. The problem we then face is that we must deliver the shares to the buyer. The way we do that is by borrowing the shares from another shareholder of XYZ, who lends them to us for a fee (in the same way a bank would charge you for borrowing money). In the meantime, the proceeds from selling these shares is placed on deposit at money market rates. This interest income accrues to the short seller (ourselves) and depending on the duration of the short position, it would generally pay for the borrowing fee several times over. Naturally any dividends that are declared while the shares are borrowed accrue to

the lender of the shares. Assuming we sold a share of XYZ at \$20 and it then fell to \$14, upon buying them back we would make \$6! If instead the share price went up, we would lose money. Once we have bought the shares back we would "return" the stock to the lender and "close" the loop.

The concept of short selling shares is neither new or unusual, having been around from the day stock markets were first created. In fact most stock markets and countries have rules and laws that specify the manner in which short sales can be made. The major investment banks all run "stock lending" organisations who source the shares from owners who are prepared to lend them (usually the large fund managers) and then on-lend them to the short sellers for a fee. In fact, more often than not, when we take a short position in a share, this is done through what is know as a "swap" arrangement with one of these major investment banks. This is effectively a contract between ourselves and the bank that has an identical effect as a short sale, but is somewhat more efficient from an administrative perspective, and can lower the transaction costs of dealing.

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