investor
REVIEW
AUGUST 2003

MLC — A National Company

PLATINUM ASSET MANAGEMENT

MLC – Platinum Global Fund

QUARTERLY REPORT

Performance (as at 31 July 2003)

Fund Size: $2.7bn	Last Quarter	Last 12 months	% pa Compound Return over 5 years	% pa Compound Return Since Inception
MLC-Platinum Global Fund†	15.9%	5.1%	12.1%	14.3%*
Morgan Stanley Capital International World Index (Accumulation)	6.0%	-8.2%	-3.5%	7.4%

* The inception date for the MLC-Platinum Global Fund was 23/06/1994

†SOURCE: MLC INVESTMENTS LIMITED

After the harrowing sell-off in late February, associated with concerns about the invasion of Iraq and deteriorating economic news, returns from almost all asset classes in the first half of 2003 have been positive. There are some who still believe in the Fed Chairman's magic but there are also those left holding US dollars who have seen a good 16% drop (yoy) in their value relative to the euro or that barbarous relic, gold. This gives a hint of the serious imbalances in the system, more of which we will pursue later. But for now, investors are focusing on the world's bond markets and are seeing evidence that a general expansion is taking hold. The combination of these factors is inducing investors to seek remunerative places for their wealth other than cash.

MSCI World Index – Industry Breakdown (A$)

Sector	3 months	6 months	1 year
Utilities	-1.7%	-1.9%	-13.7%
Consumer Staples	-0.3%	-4.9%	-20.0%
Telecommunications	0.2%	-1.5%	-3.9%
Health Care	0.6%	-0.3%	-10.4%
Energy	2.5%	-2.6%	-16.5%
Industrials	5.9%	7.7%	-15.6%
Financials	7.7%	9.6%	-8.0%
Consumer Discretionary	8.0%	9.2%	-7.9%
Materials	8.9%	6.8%	-8.8%
Information Technology	11.4%	14.6%	1.8%

SOURCE: MSCI

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

By country there was an equally interesting dispersion, with the seemingly most risky countries showing the best returns. Pakistan, Argentina, Venezuela, Sri Lanka and Israel have all risen more than 50% over the last year, while the large markets and those seen as sensitive to Western imports have been almost flat to down, by as much as 20% at the extreme.

Platinum Global Fund Q

Disposition of Assets (net invested position)

Region	Jul 2003	Apr 2003
Western Europe	34.7%	37.1%
Japan	22.9%	19.5%
North America*	8.4%	12.3%
Other (emerging markets eg. Korea)	14.3%	10.9%
Australia	0.0%	1.4%
Cash	19.8%	18.8%

SOURCE: MLC INVESTMENTS LIMITED

* The Fund has a short position against the Standard & Poors 500 Index of 7.2% at 31 July 2003, up from 2.9% as at 30 April 2003

Breakdown by Industry

Categories	Examples of Stock	Jul 2003	Apr 2003
Cyclicals/Manufacturing	Schindler, Siemens, Bayer, Linde, Océ	26%	22%
Financials	Assicurazioni Generali, Allianz, Alleanza	12%	10%
Gold and Resources	Barrick Gold, Newmont Mining, Gold Fields	8%	9%
Medical	Yamanouchi, Takeda, Draegerwerk, Novartis, Merck KGaA	9%	9%
Technology/Hardware	Agere Systems, Infineon Tech, Samsung, AMD	9%	8%
Software/Media	Sky Perfect Communications, Seoul Broadcasting	8%	4%
Telecoms	Hellenic Telecom, Ericsson, NTT	7%	8%
Retail/Services/Logistics	Hornbach	5%	8%
Consumer Brands	Citizen Watch, Adidas Salomon, Lotte Confectionary	4%	5%

SOURCE: PLATINUM

Against these figures, the performance of the Fund can be regarded as reasonable, with a return of 5% for the year. More significant though is the long term outcome; over the last five years $10,000 placed in the Fund, together with reinvestment of distributions, would be worth some $17,700, while the same amount invested in the index (or a standard fund) would be worth $8,400 today.

Changes to the Portfolio

In the last quarter we reported the aggressive buying of various German multi-nationals into the teeth of the market collapse. Our judgement that they were grossly over-sold proved correct and shares like Allianz, Munich Re and Metro came hurtling back this quarter. Although not reflecting their full value, the 13 to 50% rises persuaded us to reduce some of our German-based holdings and to eliminate Metro.

There were similar spectacular moves in IT and microbiology stocks. Here again we engaged in switching out of excited companies such as Nvidia (+34%), National Semi (+19%), and Agere (+57%) to replace them with Infineon Tech (the ex-Siemens DRAM chip maker), Agilent and Toshiba. In bio-techs we bought Vertex Pharmaceutical, which has a broad pipeline of potential clinical products directed at alleviating diseases from HIV to rheumatoid arthritis. At the same time we sold Millenium which had doubled on the excitement of its cancer drug.

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

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

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

Currency

We remain principally hedged into A$ at 54% and own euros, yen and some Korean won. Although the US$ may show some resilience in the short term, we have no intention of owning more US$.

Commentary

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

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

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

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

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

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

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

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

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

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

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

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

Conclusion

The back-up in bond yields (reflecting promising growth statistics and significant negative technical factors) has taken the wind out of share markets for the moment. Even without this "threat" of higher bond yields, it seemed that markets were getting ahead of themselves. However, there are some surprisingly good figures coming out of the corporate sector in Asia and improving consumer sentiment in Europe. This could underpin markets to some extent and providing the imbalances that we have harped on about prove manageable, shares could later resume their advance.

Kerr Neilson
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If you have any questions about your investment in the MLC – Platinum Global Fund, please contact MLC MasterKey on

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For a greater insight into our process, please visit our web site at *www.platinum.com.au*

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