



PLATINUM
ASSET MANAGEMENT

investor
REVIEW
NOVEMBER 2003

MLC – Platinum Global Fund

QUARTERLY REPORT

Performance (as at 31 October 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 [†]	9.0%	24.3%	16.2%	15.0%
Morgan Stanley Capital International World Index (Accumulation)	-0.5%	-2.8%	-2.4%	7.2%

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

† SOURCE: MLC INVESTMENTS LIMITED

In response to the brightening economic statistics and torrents of fresh liquidity, stock markets continued their advance. There was a clear preference for the more levered opportunities as investors sought growth sensitive sectors such as IT, materials and industrials. Simultaneously they eschewed the defensives such as health care and utilities - see the accompanying table.

MSCI World Index – Industry Breakdown (A\$) Period ending 31 October 2003

Sector	Quarter	Year
Information Technology	11.2%	25.4%
Materials	10.2%	0.8%
Industrial	7.1%	-1.9%
Financials	4.7%	1.3%
Consumer Discretionary	4.2%	-2.7%
Consumer Staples	2.1%	-16.8%
Utilities	-1.1%	-8.9%
Energy	-1.6%	-10.9%
Health Care	-3.3%	-11.2%
Telecommunications	-4.6%	8.4%

By region, there was corroborating behaviour as the emerging markets way outperformed their industrialised market counterparts. The stock markets of developing countries, which are generally regarded as higher risk and dependent on commodity prices, typically rose between 10 to 30%.

The developed markets were comparatively sluggish. The outstanding exception was Japan, which rose by 10%. All the above figures are given in A\$ terms which on account of its strength, tends to understate the US\$ increases.

With its emphasis on Asia, and hedging strategy, the fund acquitted itself well and outperformed the MSCI by 9.5% for the quarter and 27.1% for the year. You should be aware that we have a very different tilt of assets than the typical global fund, which for the moment is proving rewarding but there are likely to be times when this can work against us.

Platinum Global Fund Q

Disposition of Assets (net invested position)

Region	Oct 2003	Jul 2003
Western Europe	31.4%	34.7%
Japan	25.2%	22.9%
North America*	9.7%	8.4%
Other (emerging markets incl. Korea)*	12.4%	14.3%
Australia	0.7%	0.0%
Cash	20.6%	19.8%

SOURCE: MLC INVESTMENTS LIMITED

* The Fund has a short position in the US against the Standard & Poors 500 Index of 2.3% at 31 October 2003 (7.2% at 31 July 2003) and 1.5% against the NASDAQ Index. The Fund has a short position of 0.9% against the Hang Seng Index (Hong Kong) at 31 October 2003.

Breakdown by Industry

Categories	Examples of Stock	Oct 2003	Jul 2003
Cyclicals/Manufacturing	Schindler, Siemens, Bayer, Linde, Océ	26%	26%
Financials	Assicurazioni Generali, Allianz, Alleanza	13%	12%
Gold and Resources	Barrick Gold, Newmont Mining, Gold Fields	10%	8%
Technology/Hardware	Agere Systems, Infineon Tech, Samsung, AMD	7%	9%
Medical	Yamanouchi, Takeda, Draegerwerk, Novartis, Merck KGaA	9%	9%
Software/Media	Sky Perfect Communications, Seoul Broadcasting	6%	8%
Retail/Services/Logistics	Hornbach	5%	7%
Telecoms	Hellenic Telecom, Ericsson, NTT	6%	5%
Consumer Brands	Citizen Watch, Adidas Salomon, Lotte Confectionery	3%	4%

SOURCE: PLATINUM

Changes to the Portfolio

Our tendency was to continue to shift the emphasis to Asia at the expense of the US and Europe.

Regular readers will know that we have been espousing a pro Eastern hemisphere top-down view on the basis of superior growth and attractive valuations. China is proving a valuable stimulus for Japanese exports and on the domestic front there are signs of the property market stabilising and some inner precincts of Tokyo are even recording property price rises. With the Yen likely to show some strength versus the US\$, we have emphasised

domestic oriented companies such as Aiful Corp (consumer credit), Credit Saison (credit cards) and introduced Mitsubishi Tokyo Financial group (Japan's largest bank) and we added further to the general insurers, Millea Holdings and Mitsui Sumitomo insurance. House builders - Daiwa House and Panahome Corp are promising an attractive turn around from improved demand and Mitsubishi Heavy industries looks well placed for much stronger performance. Exporters such as Shimano, Fanuc and Sony, whilst all outstanding businesses, were sold on the basis of relative profit growth and valuations.

Quarterly Report(Continued)

In Europe we either reduced or eliminated some of the heavier industrial holdings such as Linde, ThyssenKrupp and Michelin due to the headwinds caused, by among other things, the strength of the Euro. We re-entered Munich Re after it had a setback in preference to Allianz AG. Two new holdings are Deutsche Post (DP) and Nordea. The former is an interesting transformation play where it is using its enormous cash flows derived from the postal monopoly to augment investment in logistics.

The name familiar to most is DHL, which DP acquired full control of in 2002 and is now at the heart of the group's international expansion. Adding near term excitement to the share is the prospective listing of its German postal savings bank, which is thought to be worth 25% of the group's market capitalisation.

Nordea is a fallen angel. Formerly considered the perfect Nordic bank consolidator, it is now viewed with suspicion and dismay. There have been all manner of rumours about management dissension, failed promises etc. What we find is a perfectly respectable banking conglomerate passing through a difficult integration phase accentuated by abnormally low interest rate spreads in parts of its business. This is unlikely to persist as the Nordic economies eventually see interest rates rise and as fees are earned on selective services. It sounds immensely dull but we are paid while we wait with a 5% dividend yield and experience has shown us that these types of investment are often remarkably profitable!

We have continued to reduce our Tech holdings that were acquired during the bust. Their valuations suggest outcomes that we regard as highly challenging.

Currency

We continued to favour the Australian Dollar over the quarter with 52% of the portfolio in \$A. The remainder was principally in European and Asian currencies. The substantial rise of the \$A late in the quarter was cushioned to some extent by the large hedged position.

Commentary

Markets have come a long way since the gloomy days of March. Activity has picked up across the globe and the Stock markets have been pricing in the anticipated profit recovery. At the same time, the Cancun and Dubai meetings in the quarter, highlight the lack of international co-operation and have refocussed investors' minds on the imbalances in the system, which we continuously ruminated over.

From the American side we hear incessantly about free markets and the dangers of unfair trade practices yet, as Australian farmers will attest and as the poor agricultural countries found at Cancun, reality is rather different. There is also the view that America is acting in the interests of all by virtue of US consumers continuing to borrow and spend.

China and the rest of Asia see it from a different perspective having endured a loss or potential loss of output following the IMF crisis of 1997-98. They delight in their improved competitiveness and are extremely reluctant to allow the surpluses (which they see as a springboard to growth and economic independence) to be reflected in higher exchange rates versus the US. The irony lies in the consequent recycling of these growing foreign exchange reserves back into *foreign* bonds, mainly US treasuries and corporates. Apart from the paradox that the normally capital-hungry developing world is lending to the Industrial giant of our time, the real problem lies in the magnitude of the imbalance. Each day foreigners need to acquire some US\$ 1.5 billion of American assets to keep the books in balance.

The debate has moved to the realisation that the US cannot grow its way out of its dilemma and it is now a matter of **sharing the burden of adjustment**. This entails a period of high risk. The US consumer (and for that matter, the politically-sensitive Fed) is reluctant to recognise the need for belt tightening, while Central bankers in Asia are loath to abandon the mercantilist policy that has proven so successful in Japan's post war transformation. For their part, the Europeans see the need for lower levels of consumption in the US but if they do not assist in moving their economies along, they run the danger of

the Euro carrying a disproportionate share of this rebalancing. Currencies are at the fulcrum of this action and the danger lies in the US\$ losing value too fast. (At some stage it is possible that higher savings in the US could mean a stronger US\$, but that is not in prospect now).

With less support for the US\$, how far will the US treasuries back-up in yield? Mr Greenspan can continue to manipulate the short end of the curve but as the sell-off of the treasuries in June revealed, the longer-term cost of money is hostage to foreigners who own over 40% of US bonds outstanding!!

There is a tantalising aspect to the recycling of funds into the US bond markets. It is at one time both denying the consumers of those countries the higher living standards a stronger exchange rate would bring, and also exposing their central banks to loss when their currencies do eventually revalue and/or the yields on bonds rise. The latter could arise from a buying strike in the US and/or an early surrender by one of the recent significant recyclers. The picture coming to mind is one of musical chairs: there is no dispute about the loss of chairs, but uncertainty about the number that are to be removed at each interlude and when.

Though not a trendy subject to raise, the Gold price is suggesting growing disquiet among players as

they all try to hedge their risks. One is seeing more and more written about *fiat* money (the notion of governments being free to create money while the rest of us would be imprisoned for doing so). There are also more articles covering the subject of so-called hedonic adjustments to both output and inflation which adds to the uncertainty of the worth of official statistics. Weak demand and central bank policy is ensuring that short term interest rates barely match the rate of inflation. This we believe is leading to a misallocation of resources second to none. Banks have largely been disintermediated out of the corporate lending market and instead are aggressively going after consumer lending and mortgages. Only the most Panglossian internet survivor would regard the property exuberance in the Anglo Saxon world as evidence that all is well. The Australian median house price of \$350,000 is some 6 times net disposable income.¹ This is a modern day record. In the States the comparable figure is US\$182,000, representing 4.6 times disposable family income.

Tax peculiarities regarding mortgage deductibility, together with record low rates have boosted affordability in the US to a 27-year high in April. Even so, the use of mortgage debt is outpacing recent house price appreciation, resulting in home owner's equity falling to a record low of 54.3% of current values.

¹SOURCE: HIA/CBA

Congressional Budget Office "Alternative" assessment of Bush Budget Policies

On-Budget only Fisc Yrs, \$Bill. Except debt	Clinton 2001	Bush 1st Term				Next four years				Following four years				2002- 2013
		2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	
Baseline deficits	+31	-381	-562	-644	-520	-425	-421	-434	-426	-417	-298	-143	-105	-4,776
Adjustments	-	-	-67	-158	-	-257	-327	-390	-467	-545	-733	-881	-998	-4,822
Adjusted deficits	+31	-381	-562	-711	-678	-682	-748	-824	-893	-962	-1,031	-1,024	-1,103	-9,599
% of outlays borrowed	-2%	23%	31%	37%	33%	31%	32%	33%	33%	34%	34%	33%	33%	33%
Deficit/GDP	-0.3%	3.7%	5.2%	6.3%	5.7%	5.4%	5.7%	5.9%	6.1%	6.3%	6.4%	6.1%	6.2%	5.8%
National debt w/SS (\$trill)	4.5	4.9	5.5	6.2	6.8	7.5	8.3	9.1	10.0	11.0	12.0	13.0	14.1	+9.6
National debt/GDP	45%	47%	51%	55%	58%	60%	63%	66%	68%	71%	75%	77%	79%	
Interest as % of domestic discret.	69%	62%	58%	65%		77%	87%	95%	101%	106%	111%	116%	120%	
Tax cuts w/o sunsets including interest	-129	-198	-275	-292		-320	-363	-402	-453	-519	-575	-609	-649	
% of deficit	34%	35%	39%	43%		47%	49%	49%	51%	54%	56%	60%	59%	
Deficits by term		-2,333				-3,146				-4,119				
Tax cuts by term		-895				-1,536				-2,349				
% of deficit by term		38%				49%				57%				

These "alternative" figures incorporate the following:

- (a) Expiring tax cuts (such as the family spending rebate) are renewed whereas they are not renewed in the official estimates.
- (b) \$87 billion of not-yet-legislated Iraq spending is included whereas it is not included in the official estimates.
- (c) \$400 billion over ten years in Pharmaceutical spending which is promised but not yet legislated has been included.

Compared to the surpluses of 1998 through to 2001, the deterioration of US finances is alarming – a turn around of nearly \$600 billion in a couple of years.

Never before has this economy been so vulnerable to rising interest rates. The consumer has had a merry time but so has listed America: the financial sector accounted for 30% of the S&P's earnings and that does not capture other sources of interest rate sensitivity such as profit-on-sale of securitisations by companies such as Harley Davidson, John Deere, GM, GE etc.

Yes, we have written about the problem of debt in the past and seem obsessed by it. However, it has reached a magnitude in some countries that suggests it has very little prospect of being repaid. The digital/internet world has not changed the immutable implications of debt.

Even though there are intermediate adjustments needed, we remain very optimistic about the growth prospects for the developing world. Yes, their stock markets are vulnerable to short term shocks mainly because the marginal buyers who have been driving prices upwards are foreigners. When trouble strikes, they invariably reduce their foreign share holdings. However, visits to India and China during the quarter confirm our view that auspicious winds will continue to carry them forward. Even if foreign direct investment were to slow, there is a growing cycle of domestic private investment that is likely to prevail for some time.

Importantly in China, there is a realisation that the rural sector has fallen behind. Specifically Beijing is cracking down on unfair taxes and fees and has reintroduced rural subsidies for health and education. The most important move, however, is land reform (Rural Land Contracting Law, promulgated in March 2003).

Hitherto some 220 million Chinese farming families had no security of tenure and could periodically face reallocation of their plots. (This followed the de-collectivisation under the banner of the Household Responsibility System in the late 1970s). The important element of the reform is that Farmers will now be able to plan ahead and invest in structures etc which under the previous order could have been forfeited. Even better, the certificate of title for 30 years will allow farmers to transact in land and mobilise credit.

Experience in other countries, which have implemented such reforms, suggests that rural economic growth will take-off. Tied into this reform are greater freedom of movement and the establishment of new cities to accommodate the anticipated flood of rural migrants. It is this pressure of the under-employed that torments the bureaucrats in Beijing and hence their apparent intransigence regarding flexible exchange rates. They regard a stronger Renminbi as likely to adversely affect growth and fear the consequences for the banking system as the State owned enterprises face yet one extra burden which is one more than they wish.

Accompanying the Chinese growth theme are observations relating to rising raw material prices; most notably metals. There are three points here. Firstly, the demise of the Russian Empire had a suppressant effect on metal prices through the 1990s, as did the Asian crisis. Secondly, as noted in earlier pieces, current exchange rates underestimate the true size of markets such as India and China (and indeed the whole discussion about the appropriate level for the Renminbi) and hence their demand for materials. Lastly, exploration and development expenditure through the 1990s subsided in response to the 50-year-declining-trend in metal prices and the popular mantra of efficient use of capital. Economists talk in terms of S curves which attempt to chart the likely course of physical demand in relation to living standards (more precisely GNP per head). If China and India comprising some 2.3 billion people, come close to traditional patterns of materials use, it is probable that we are entering a secular rise in the prices of many materials and metals. Already China accounts for a fifth of world consumption of important metals such as steel, copper, aluminium and zinc, see chart on following page.

Just when every Business school is extolling the virtues of service-based business models, capital intensive commodity producers could be having their share of sunshine. This also implies upward pressure on the currencies of commodity producing countries who are simultaneously seeing their terms of trade benefiting from price deflation of traded manufactured goods.

China's share of world consumption



SOURCE: MRMM & CLSA ASIA-PACIFIC MARKETS

Conclusion

Investors are presently taking comfort from evidence that most economies are back on the growth track. Corporate profits are improving and with interest rates being so low, one is tempted to believe the bull market has returned. We suspect however that structural imbalances will prevent economies such as the US and UK from making much headway and with this their markets are less interesting. Japan seems to be in a different phase.

The pull of China and inter regional trade is helping to improve confidence among Japanese consumers, which suggests that we may have seen the worst. Companies have engaged in many reforms and their earnings may pleasantly surprise. The emerging markets seem the most prospective of all but as was noted, their shares are vulnerable to periodic withdrawal by foreign investors.

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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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