

# MLC-Platinum Global Fund

## QUARTERLY REPORT

Here at Platinum, we are beginning to favour companies that will be reasonably well-placed if ultimately inflation threatens. We are also tending to emphasise those countries which have low government debt and high savings as we believe they have greater scope for growth than those labouring under the burden of rising national debt.

A country that does not fit this description and yet will in all probability continue to grow is India. Its Central and State government funding is a mess with deficits around 6% of national GDP. Company balance sheets have deteriorated as a consequence of what we internally describe as global conquest; in the boom it seemed to become almost mandatory to acquire some foreign trophy. Bank credit grew during the boom by about 25% a year, fuelling a classic chase into property and house building but fortunately most were too busy at home, with the exception of ICICI, to get caught with nasty paper.

During our visit to India in March, most of the banks we met seemed unduly complacent about the quality of their books. Even so, there has been a profound rebirth of national pride and a general belief that the country can and should grow faster than the 4% rate of the past. With a high savings rate of 30% of GDP and relatively low external exposure, all that is missing is an upward shift in the tax base. Criticism of the corruption at the centre seemed more prevalent than on earlier visits but the prospect of higher income tax collection seems about as remote as the nation abstaining from chapattis.

We met with a broad variety of companies and felt that the prices have come back to levels that are bordering on attractive. A near term danger rests on the outcome of the May 16 general election. Of concern is the support being given to Mayawati, the Chief Minister of India's most populous state, Uttar Pradesh. Although Mayawati has a sad reputation, she may be able to be a powerful broker in a much more fractured parliament. With the country already critical of the remote, venal and vacillatory nature of Delhi, the prospect of even more dithering in the leadership is a disturbing possibility.

**Platinum Asset Management is an Australian based international fund manager. For greater insight into our process, please visit our website at [www.platinum.com.au](http://www.platinum.com.au)**

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### OUTLOOK

We cannot know whether the markets have established a bottom.

The nature of the world's current problem is highly complex and the outcome will depend heavily on how individuals respond to uncertainty. We are clear that there was a great deal of fear factored into prices as we entered March.

Simply by gauging the number of disbelievers, our instincts are that the rally will proceed higher. When we look at the opportunities available, we are encouraged by the holdings we have and see a likelihood of making money for investors. We can now buy many companies at or below their book value. This is most rare. It implies that there is no intrinsic value in the work of decades of putting together the whole neural system that comprises a successful company – the totality of which make-up a modern market-based economy.

**If you have any questions about your investment in the MLC-Platinum Global Fund, please contact the MasterKey Service Centre on**

**132 652** from anywhere in Australia or  
**0061 2 9466 7180** from overseas

### PERFORMANCE (as at 31 March 2009)

Fund Size: \$1.48 bn	Last Quarter	Last 12 months	5 years (compound pa)	Since Inception (compound pa)
MLC-Platinum Global Fund	-4.2%	-10.7%	2.3%	10.8%
Morgan Stanley Capital International All Country World Net Index (A\$)	-10.4%	-25.2%	-1.0%	4.0%

Source: MLC Investments Limited and Platinum

The Fund has been doing relatively well in these weak and unstable markets. This is attributable to the geographic diversity of the portfolio and the stock selection, which includes some exposure to gold shares. Those holdings that were badly treated last quarter such as auto-related entities, performed the best in the recent rally and we are using this volatility to make small changes to exposure without significantly altering the overall balance.

For the quarter, the Fund returned -4.2%, for the last six months -3.8% and for the year -10.7%. The corresponding numbers for the MSCI All Country World Index were respectively, -10.4%, -21.3% and -25.2%.

Some investors have expressed concern that we might slip back to the pack. Clearly this is possible but our view is that we have been relatively well prepared for this test and it is not as though we are complacently sitting back reviewing the wreckage. The team has been actively scouring the market for companies whose prices overly discount their prospects, diminished though they may be compared to earlier times.

### MSCI\* WORLD INDEX SECTOR PERFORMANCE (AUD)

Sector	Quarter	1 Year
Information Technology	3%	-14%
Materials	-1%	-36%
Energy	-6%	-22%
Consumer Discretionary	-7%	-23%
Health Care	-10%	2%
Consumer Staples	-11%	-8%
Telecommunications	-11%	-13%
Utilities	-16%	-17%
Industrials	-16%	-35%
Financials	-20%	-45%

\* Morgan Stanley Capital International  
Source: MSCI

### CURRENCIES

The significant changes we made over the quarter were to slightly increase the hedge into the A\$ to close to 30% and to more than halve the holdings of the Japanese yen to 9%. This leaves the currency positions largely in line with the geographic disposition of holdings, with the exception of Japan. You may recall that we were very aggressive owners of the yen some months back but our conviction has subsequently diminished. This is driven by the deterioration in some key measures such as the savings rate and trade account.

The A\$ continues to attract foreign interest as the appetite for risk has risen though we cannot see reason to alter our view that it should reach the mid-70s versus the US\$. The latter has weakened slightly versus the Asian block and we are keeping a close watch on potential changes in sentiment.

### CHANGES TO THE PORTFOLIO

#### DISPOSITION OF ASSETS (NET INVESTED POSITION)

Region	Mar 2009	Dec 2008
North America	24.6%	20.6%
Europe	22.8%	25.9%
Japan	21.6%	22.2%
Asia and Other	19.8%	16.8%
Australia	0.0%	0.0%
Cash	11.2%	14.5%

Source: MLC Investments Limited

At 31 March 2009, the Fund had no short index positions (31 December 2008: 4.8% short against the US Russell 2000 Index).

Weak prices gave us the opportunity to buy some new holdings and to add to existing positions at knock-down prices. We switched among our gold miners favouring AngloGold Ashanti over Barrick Gold Corp, and chose to reduce further the positions in Bombardier and eBay. These companies share the



# MLC-Platinum Global Fund Quarterly Report (Continued)

common feature of having some wonderful parts whose contribution is being nullified by their weaker businesses. In the case of Bombardier, our faith in rail engineering is proving correct, yet the collapse of private aircraft sales is dragging down the group's results. At eBay the problems stem from repositioning itself as an on-line retailer while Skype and PayPal are thriving.

Returning to the new holdings, AES and Veolia Environnement are each being penalised for their high levels of debt. AES is an independent power producer operating with 43 Gw of capacity in 29 countries. Often working in league with multilateral agencies and with non-recourse fixed rate long-term funding, we are attracted by the price being approximately half replacement value.

Veolia, which we last purchased at the peak of the tech bubble, and then sold too early on its way to quadrupling on a leveraged spree, specialises in water treatment, waste disposal and community transport. Veolia holds contracts with public authorities that are decades long and there are very specific barriers to entry. The price is close to those in 2003 and the yield is 7%.

China Life is a long-term play on Chinese prosperity but is presently being penalised over concerns about low interest rates adversely affecting the profitability of its new strategies. As we believe this is transient, we would prefer to emphasise the company's dominance of the mainland market and premium growth in the mid-teens – not so common these days!

Kerry Properties, best known for its association with the Shangri La hotel chain, has some of the most attractive rent-earning, dominant sites in the principal cities of China. Selling at half book value, with low gearing of around 35%, its potential is presently being undervalued.

Canon, one of the world's great corporations simply got too cheap to ignore when it was trading at book value.

## MLC-PLATINUM GLOBAL FUND – TOP 20 STOCKS

Stock	Industry	Mar 09
Microsoft Corp	Technology	3.7%
Cisco Systems	Technology	3.2%
Mitsubishi UFJ Financial Group	Financial	3.1%
Siemens	Electrical	2.6%
Denso Corp	Auto	2.4%
Hutchison Whampoa	Telco/Transport	2.4%
Anglogold Ashanti	Gold	2.3%
Barrick Gold	Gold	2.1%
Sanofi-Aventis	Health Care	2.1%
Newmont Mining Corp	Mining	2.0%
Samsung Electronics	Electrical	2.0%
Henderson Land Development	Property	1.9%
Henkel KGAA	Consumer	1.9%
Toyota Industries Corp	Machinery	1.9%
Polaris Securities	Financial	1.8%
Merck & Co	Health Care	1.8%
BMW	Auto	1.7%
Johnson & Johnson	Health Care	1.6%
Micron Technology	Technology	1.5%
Schneider Electric	Electrical	1.5%

Source: Platinum

## COMMENTARY

With all the market gyrations it is tempting to believe that the “authorities” are getting on top of the problems, and that we may reflect on this period in the future as some sort of transient mishap. Given that the excitement of the potential of equities is still fresh in investors' minds, there is a danger that emotion could be placed above logic. The best protection from this is to keep a check list of the root causes of the current economic contraction:

1. Far from being a free exchange, the imbalances between the large consuming nations and the savings nations must still be addressed to achieve a sustainable world economic order. We are seeing some changes here with the US savings rate climbing towards 5% and of course the reciprocal deterioration in Eastern trade surpluses. However, a fundamental solution requires a significant shift in the profligates towards more investment and self-funding and a change in the institutions of the high savers to encourage greater and sustained domestic demand, perhaps encouraged by a broader social security net.
2. Western banks are deficient in equity and even though the intervention is directed to free-up their balance sheets, their willingness and ability to lend will be closely linked to the rehabilitation of their equity reserves. Spreads have improved somewhat but we are yet to see the bad debts from the second phase of this economic contraction.
3. Profits were at peak levels in 2007/08 worldwide and way above trend. In the initial deflationary phase of debt retrenchment, pricing power will be scant and only if these current resuscitation measures succeed will this change. Importantly, not all areas will recover pricing power on account of increased regulation, protectionist tendencies and perhaps more restricted global trade.
4. There is simply too much debt out there. The measures taken can dislocate the formerly worshipped benefits of market pricing and are evidently already causing distortions. Here one can cite obstruction to clearance of industrial capacity; bond pricing imperfections caused by government guarantees and so on.

Hardly a day goes by without some pronouncement from on high regarding the ‘world financial crises’: deficit spending, industry support measures and in particular massive injections of reserves into the global settlements system via the International Monetary Fund (IMF) and individual banking systems via direct purchase of government bonds. With short-term interest rates in most countries now pitiful, the willingness to take risk has shifted and it seems this is contributing to the global market rally.

The magnitude of these measures is almost beyond our comprehension. Take the US for example; we find that the alphabet proposals (TALF, TARP, PPIP) amount to some US\$2.75 trillion. Should private investors take the opportunity to enter into the latest scheme and help recycle funding, with the aid of the Treasury and the Federal Deposit Insurance Company (FDIC), base money in the system would explode to US\$3 to 4 trillion. Up until recently many believed that the system was adequately stocked with base money of US\$800 billion. This in turn had been geared up over 30 times to create interest bearing liabilities for the US of over US\$30 trillion. The losses to date of some US\$1 trillion have eliminated some of these claims and with it, considerable equity, creating a negative wealth effect and this is hampering the ability of banks to function properly<sup>1</sup>.

The so-called quantitative easing, by creating bank reserves to supercharge the system, is an experiment. In Japan it failed to rejuvenate an economy which had the specific distinction of being surrounded by a sea of growth through much of the 1990s. The present injections are being counteracted by a host of physical and psychological reactions such as massive de-stocking and job losses, plummeting investment, a greater desire to save and banks that have tightened their controls commensurate with their recent shock. Contrary to impressions given by the popular press, they have continued to lend more money (as did the German and Japanese banks after their shocks in the early 1990s), but the evaporation of wealth (equity), and virtual closure of the securitisation markets, has meant there is still too little lending to maintain the existing balloon of debt. Via quantitative easing, effectively swelling the money stock three fold, the US is trying to compensate for the refusal of investors to support a debt pool that had grown too large for the host economy.

No doubt the plan is to reverse this money expansion at some point. The lesson from Japan is that the government was left with a massive debt burden and was reliant on the Central Bank to keep buying its debt to keep its interest bill low and to prevent the crowding out of private investors. Each time it tried to normalise the economic levers, it found the economy wilted.

<sup>1</sup> Interestingly, US banks are themselves reasonably well funded by deposits whereas their UK and some continental counterparts rely more on wholesale funding through the money markets. Government measures during the last major disaster of the 1930s partly account for this in that the Federal agency, Fannie Mae (FNM), was established in 1938 to facilitate affordable lending to home owners. FNM's ambitions expanded and eventually it was leveraging up its balance sheet, on the basis of an implicit government guarantee, to own and also to securitise mortgage backed paper. Others emulated this process as a way to fund other consumer receivables such as auto loans and credit card receivables, whereas the Europeans tended to keep loans on their balance sheets.