

MLC-Platinum Global Fund

QUARTERLY REPORT

GLOBAL CYCLICAL VERSUS DEFENSIVE SECTORS



Source: Factset

When examining the relative merits of industries and stocks, our proprietary research shows that sectors such as infrastructure, healthcare and software are trading by as much as 1.5 standard deviations below their historic averages (see chart on page 3). By the same measure, industrials, process industries, autos and materials are between 2.2 and 1.3 standard deviations above their respective historic means. This obviously doesn't give timing indications but when one sees that these sectors have moved from very depressed levels to relatively elevated levels over a 10 year span, one is reassured of the benefits of avoiding the crowd.

The Fund is predominantly in these more defensive sectors that have the added virtue of being more inflation protected. We also have areas of strong growth such as social networking sites and gaming as well as some exposure to cyclicals where we believe there is a longer term structural imbalance

CONCLUSION

The stock markets are now entering their third year of recovery. Earnings momentum for sectors such as the industrials, materials and energy will see progressively slower advances. The hitherto neglected sectors of healthcare, technology and utilities may by comparison appear less stodgy. Starting with low valuations and typically better placed in a more inflationary environment, specific companies in these areas can be expected to gain favour. In reality, the portfolio is built-up one stock at a time and this is an on-going process that we believe will reveal itself in coming months.

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

**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**

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PERFORMANCE (as at 31 March 2011)

Fund Size: \$1.34 bn	Last Quarter	Last 12 months	5 years (compound pa)	Since Inception (compound pa)
MLC Platinum Global Fund	-0.6%	-2.7%	0.6%	11.1%
Morgan Stanley Capital International All Country World Net Index (A\$)	3.5%	1.3%	-4.4%	4.6%

Source: MLC Investments Limited and Platinum

The quarter was marked by some quite remarkable events, most notably the civil unrest that toppled regimes in North Africa and is looking to threaten others. There was also more pressure on the structure of the European community as the crushing burden of debt on the periphery tested the political resolve of the centre. Then came the massive earthquake off the East Coast of Japan that wrought physical havoc compounded by a huge tsunami that has left an estimated 27,000 people dead or missing. A tragedy of immense proportions that has been further exacerbated by nuclear leaks and contamination, still to be remedied, but which leaves the country deficient in electrical generating capacity and hence rolling power-shedding arrangements.

Within Asia, the cost of locking into US monetary policy via tightly managed exchange rates revealed itself. While these economies have evident strong endogenous growth drivers, their refusal to allow their currencies to appreciate is exposing them to the full brunt of tight commodity supplies which is being reflected directly in the rising cost of food and energy. Though inflation is being targeted via interest rates and some tacit price controls, they are hostage to their currency management policy but in the meantime have been trying to slow growth to ameliorate the threat.

MSCI* WORLD INDEX SECTOR PERFORMANCE (AUD)

Sector	Quarter	1 Year
Energy	13%	14%
Industrials	5%	7%
Telecommunications	5%	7%
Healthcare	4%	-6%
Financials	3%	-6%
Materials	2%	7%
Consumer Discretionary	1%	6%
Information Technology	1%	-3%
Utilities	0%	-7%
Consumer Staples	0%	-1%

* Morgan Stanley Capital International

Source: MSCI

For all these reverses, came the good news of economic expansion in the leading developed economies to the extent that some members of the US Federal Reserve system were proposing an early exit from quantitative easing and preparing for interest rate rises.

Against this background, the stock markets, led by the developed world, rose in aggregate though some Asian markets were down for the quarter, among them India, Japan, Taiwan and Hong Kong. By industry, there was still a pro-growth bias in the leading sectors but the differences were less stark than in preceding quarters with the likes of healthcare, financials and telcos keeping pace with the average. For the quarter the MSCI World Index rose by 3.5% and is now up by 1.3% for the year in terms of Australian dollars.

The Fund declined in aggregate by 2.7% over the year and continues to lag principally because of our heavy exposure to defensive sectors like healthcare (Johnson & Johnson, Merck) and to specific IT stocks like Microsoft and Cisco which are being classified as cheap but ex-growth (selling at a fraction of previous valuations). For the quarter, the Fund returned -0.6%.

In geographic terms, stock picking in Europe and Japan led to strong outperformance but it was the reverse in the US and in Asia, where India and China were weak.

For all our disappointment with this last year's performance, we do wish to remind investors that the Fund is above its pre-Lehman levels which is very rare among global funds available in Australia.

CURRENCIES

Nearer the end of the quarter we sensed a gradual change in sentiment towards the Asian currencies and shifted our exposures from the US dollar towards Asia.

Though the Australian dollar has been strong in bilateral terms versus the US dollar, for the last three months it has actually lagged behind the Euro and some Asian currencies. When setting our position we focus as much on the cross rates as the bilateral rate USD/AUD and regard, for example, the Canadian dollar and the Norwegian krone as interesting alternative commodity currencies to the AUD. As we have mentioned before, we see the AUD as a proxy on world

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growth and have been reluctant to heavily hedge back into the AUD preferring to favour other currencies like the Canadian dollar, Norwegian krone and selected Asian currencies as more diverse growth proxies.

We must, however, acknowledge that the AUD has been a lot stronger than we had anticipated. Though it may be volatile, we suspect the pre-emptive interest action by the Reserve Bank and the fact that the savings rate has been increasing, will give support to the currency for some while yet in a world of poor choices.

At present we have 24% in European currencies (ex the Norwegian krone), 22% exposure to Asian currencies (ex the Hong Kong dollar, which we see for the moment as a US dollar proxy), 21% in the US dollar, 15% in the Australian dollar, 10% combined in the Norwegian krone and Canadian dollar, and 6% in the Hong Kong dollar. We hold little Yen which we believe is now entering a weakening phase on account of the crises and Bank of Japan (BOJ) stimulation, among other things.

CHANGES TO THE PORTFOLIO

DISPOSITION OF ASSETS (NET INVESTED POSITION)

Region	Mar 11	Dec 10
Europe	29.8%	29.0%
Japan	20.0%	20.8%
Asia and Other *	18.8%	18.7%
North America *	17.6%	17.8%
Australia	1.0%	0.5%
Cash	12.8%	13.2%

Source: MLC Investments Limited

* At 31 March 2011, the Fund had a short position in the US against the Russell 2000 Index of 6.3% (31 December 2010: 5.2% and the Hang Seng Index of 1%).

To complement our existing oil exposure we added the Canadian-based oil producer, Nexen. This company, formerly Occidental Canada, has built a business via several extremely bold bets that have elevated it into being a mid-tier player but also more recently, earned the ire of investors when another huge leap into a Canadian tar sands development fell well short of expectations. Its market capitalisation is around \$13 billion with net debt being offset by investment in saleable investment like Syncrude. For this we get the product of capital expenditure and development spending of some \$16 billion over the last five years that gives us a resource base of perhaps 12 billion barrels.

The main producing asset is the Buzzard oil field in the North Sea that provides about half of production and much of the cashflow. Other assets include expiring oil production in Yemen (with some prospects of licence renewal); the Long Lake project in Alberta which together with its 72,000 barrels per day upgrader is running at half design capacity; valuable tight gas acreage in the Horn River basin in British Columbia; the Usan development in Nigeria with Total; and a 20% interest

in Shell's top priority prospect in the Gulf of Mexico. This relative minnow in a global sense is participating with the majors and has built a wide technology and resource platform for the next decade to exploit.

We do not dispute the company's predilection for the 'big hit' but we are attracted to the magnitude and location of its reserves and the prospect of production growing from about 220,000 barrels of oil equivalent (boe) per day at present, to about 290,000 boe per day by 2013. Nominally it is on a standard type of industry rating but at a point of its development spending cycle that should see considerable cash generation and hopefully falling operational risks. New management since 2009 are very focused on bringing the large leaps of the last decade to economic harvest.

We have long held positions in gold shares in the belief that governments find it almost irresistible to dishonour their obligation to preserve the purchasing power of money. The bigger miners have faced the twin challenges of fast rising production costs and the need to replace their gold reserves. With this in mind we have been switching Newmont into Newcrest. The latter's attraction is the extraordinary find in Papua New Guinea which looks like turning into a major copper-gold mine able to produce as much as one million ounces of gold a year and over 400 thousand tonnes of copper pa. The latest exploration hole of 628 metres at 3.06 g/t gold and 2.82% copper should provide high grade initial feed to the mill and allows one to dream of what might be found in the next drill hole! Importantly this 50/50 joint venture project is unlikely to be producing before 2016 but for a gold miner with an existing profile of rising production it adds both huge additional reserves and arguably reduced risk on account of the rich bimetallic nature of the ore bodies.

Among the financials, we have sold our holding of Prudential, which proved a good investment having been bought when it was under a cloud during its saga to acquire the Asian interests of AIG, to enter Deutsche Börse (DB). The exchanges are in the midst of globalising and DB is attempting to merge with the New York Stock Exchange. However, the Nasdaq and IntercontinentalExchange (ICE) have come out with a higher bid. Though it is not certain that the merger will be voted down, even if it does fail, the inherent business of DB with its stranglehold on derivative trading in key products and integrated clearing leaves us with a sound business.

Historically growth was augmented by the introduction of electronic exchanges and then by the introduction of highly successful products like the "Euro Stoxx 50 Equity Index" and the winning over of the German bund contracts from London. Apart from volatility returning to the markets as interest rates normalise and subsequently drive volumes, there are additional prospects of growth from the regulator's desire to shift over-the-counter (OTC) derivatives onto exchanges from which we will gain clearing fees. It is possible that DB may eventually have to pay up to ensure the merger goes ahead but the probable cost relative to a longer term unassailable position looks satisfactory at current prices.

COMMENTARY

As noted in the introduction, the markets are defying pretty much all bad news. Government stimulus spending that augments the increased savings in the private sector in the developed markets (DMs) is working for now and confidence is returning patchily.

Earnings visibility has been the hallmark of the winning sectors. They have benefited from unusual earnings leverage associated with the recovery, strong investment demand in the emerging markets (EMs) and the sustained benefit from off-shore sourcing. Growth in the EMs barely missed a beat, and if one chooses to ignore the financial devastation in the West, the principal result of the Lehman shock was to suspend many important projects that were either under consideration or development. There has been a consequent surge of activity, particularly in the EMs, in an attempt to catch-up with burgeoning demand for raw materials. As we have noted often, current exchange rates do not properly reflect the physical significance of these economies and can cause one to underestimate their contribution to world growth. In the last 10 years for example, the BRICS (Brazil, Russia, India and China) have grown in aggregate by over 10% pa, other developing and emerging markets at 8.5% pa and the G7 by 3.6% pa. According to International Monetary Fund estimates, world GDP in *purchasing parity* terms amounts to about \$74 trillion of which the BRICs account for \$18 trillion, other emerging economies \$17 trillion and the G7 only \$29 trillion (39%).

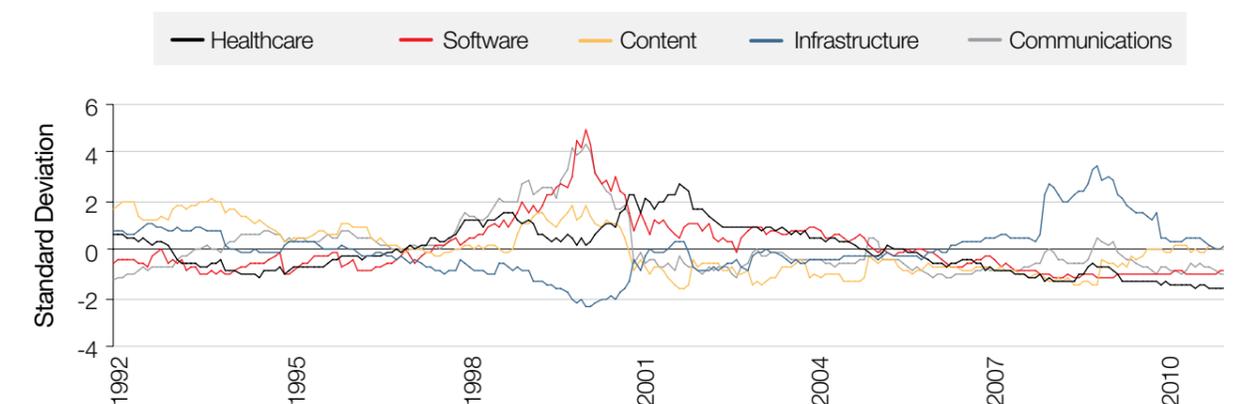
Scale is best understood in physical output where for example China today is producing some 1.7 billion tonnes of cement, 660 million tonnes of steel and about 3.6 billion tonnes of coal. For context, this represents nearly half of total *world production!* Further, China is using more cement per head of population than the former world champ, Korea, at 1.3 tonnes per head per year. By way of context, for all its tectonic challenges, Japan only ever managed to consume 600kg of cement per capita pa and the US typically uses about 80 million tonnes pa.

These gigantic numbers do of course raise issues of how China is to eventually wean itself off an economy so skewed to investment (45% of resource flows). In the near term this may not be a problem given the government's desire to build some 30 million units of low-cost housing over the next three years which will certainly compensate for the clamp-down on the luxury-end of the property market. It does, however, point to longer term issues. Right now, strong investment in the EMs is the inherent propellant of the recovery in the DMs together, of course, with government transfer payments and suppressed interest rates.

It is this cognitive dissonance that has imprisoned our thinking in dealing with the *world as it appears*, and that which *is*. For some, it is not whether these conflicting forces can co-exist, but when they break. A concoction of recent years is the so-called targeting of inflation rates by the Central Banks. Even with these seemingly iron clad obligations it is interesting that the Bank of England have chosen for the third consecutive year to delay tightening on argument that under-utilised resources should ensure that inflation does not become endemic. Importantly, pricing, structural biases, the arbitrary increase of money way in excess of the physical economy and rational expectations are seemingly deemed unworthy of mention when forming these policies—inflation in the UK is running at about 4.5% pa!

Work by numerous economists point to the instability inherent in huge government borrowing requirements when they exceed a tipping point (expressed as a theoretical percentage of debt to revenues or GDP) **and the implicit dead end that comes from prolonged tampering with the yield curve.** Without this context, we may seem somewhat club-footed in managing your money. On the one hand we are trying to participate in the lively party but do not wish to be intoxicated by the hilarity.

DEFENSIVE SECTORS – RELATIVE GLOBAL ENTERPRISE VALUE/OPERATING CAPITAL EMPLOYED



Source: Factset