

MLC-Platinum Global Fund

QUARTERLY REPORT

PERFORMANCE (as at 30 September 2008)

Fund Size: \$1.7 bn	Last Quarter	Last 12 months	5 years (compound pa)	Since Inception (compound pa)
MLC Platinum Global Fund	0.8%	-17.5%	5.8%	11.5%
Morgan Stanley Capital International All Country World Net Index (A\$)	1.5%	-18.0%	4.7%	5.9%

Source: MLC Investments Limited and Platinum

We are at last moving to the rhythm of global markets. The reversal of the emerging markets and commodity producing industries was slow to come but supported our view that they should be avoided. The related trade of having little exposure to the Australian dollar also proved correct having been a discouraging drag on performance in the previous two quarters. Even so, the Fund was dragged down by the general market weakness and rose a mere 0.8% for the quarter producing a 12 month outcome of -17.5%. This compares with the MSCI that was up 1.5% for the quarter and down 18% for the year. A more helpful perspective perhaps is the ten year return where this Fund has grown by close to 10.3% compound pa and the MSCI by 1.4% pa.

Investors rotated away from cyclicals over the quarter in favour of defensives, and financials are now seeing reduced selling pressure — as is shown in the accompanying table below.

MSCI* WORLD INDEX SECTOR PERFORMANCE (AUD)

Sector	Quarter	1 Year
Consumer Staples	18%	3%
Health Care	18%	-2%
Consumer Discretionary	9%	-21%
Financials	9%	-29%
Information Technology	2%	-19%
Telecommunications	1%	-19%
Utilities	0%	-7%
Industrials	-1%	-24%
Energy	-14%	-9%
Materials	-23%	-26%

* Morgan Stanley Capital International
Source: MSCI

CURRENCIES

We have held the view that the burden of debt in the US is tantamount to a giant short on the US dollar and as the unwinding occurs, the US currency will strengthen against most comers. Fortunately, we abandoned our earlier view that the Asian currencies would be strong, along with the US dollar, and now see them as vulnerable, as foreign flows reverse and internal liquidity tightens. The Japanese yen being a savings-driven currency, is our second choice.

PORTFOLIO CHANGES

DISPOSITION OF ASSETS (NET INVESTED POSITION)

Region	Sep 2008	Jun 2008
Europe	24.7%	20.8%
Japan	20.4%	20.3%
Emerging Markets	18.3%	20.0%
North America*	13.3%	17.5%
Australia	0.0%	-1.7%
Cash	23.3%	23.1%

Source: MLC Investments Limited

* At 30 September 2008, the Fund has a short position in the US against the Russell 2000 Index of 13.2% (30 June 2008: 8.3%).

There were no significant changes over the quarter. Some long-held positions moved out of our buy/sell range and holdings were adjusted accordingly. There have been several opportunities to exploit anomalies; for example, we sold out of our US airlines that we had bought into the teeth of the oil spike. This yielded over 50% in three months. Another recent opportunistic purchase was China Mengnui Dairy Company when its share price collapsed from around the mid-HK\$20 to HK\$7 on implications of product contamination.

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The case for putting half a percent of the Fund into China Mengnui Dairy was based on the observation that the contamination was perpetrated by the milk aggregators, not the branded packers. Moreover, the government wishes to protect this important rural industry and continue to promote milk as a dietary supplement in schools and hence would work with the industry to quickly re-establish consumer confidence with tight regularity oversight. We estimated that sales would take 12 to 18 months to get back on track and that the withdrawal of contaminated stock and associated compensation would fully deplete the company's coffers but not put the whole business at risk. It could then resume expanding its product range and network, and quite probably resume its historic growth rate of some 20% pa. This growth rate is based on the tiny consumption of milk products in China of about two litres per head versus say 20 litres per head in Taiwan.

MLC PLATINUM GLOBAL FUND – TOP 20 STOCKS

Stock	Industry	Sep 08
Microsoft	Technology	3.5%
Mitsubishi UFJ Financial	Financial	3.5%
International Paper	Paper	2.9%
Hutchison Whampoa	Telco/Transport	2.8%
Siemens	Electrical	2.8%
Cisco Systems	Technology	2.6%
Barrick Gold	Gold	2.4%
Bombardier	Transport	2.3%
Johnson & Johnson	Health Care	2.3%
Bangkok Bank	Financial	2.1%
Sanofi-Aventis	Health Care	2.0%
Samsung Electronics	Electrical	2.0%
Obayashi Corp	Construction	1.9%
Pernod Ricard	Beverage	1.7%
Henkel	Retail	1.7%
SAP	Technology	1.7%
BMW	Auto	1.7%
JGC Corp	Construction	1.6%
Denso Corp	Auto	1.6%
Toyota Industries	Auto	1.6%

Source: Platinum

COMMENTARY

It cannot be much fun sitting in the audience as the high priests of finance attempt their sorcerous acts to cause the overburden of debt to disappear. The habitual manipulation of the yield curve (with the Fed dropping the cost of short-term money and facilitating a widening of bank spreads) has encouraged borrowers in the Anglo Saxon world (and its imitators) to become careless about the dangers of excessive debt. The trouble this time around is that the concerns about the system itself, and the deflationary effect of over-indebtedness, is diminishing the efficacy of this standard response. The onion-peeling act that is the centre of our attention, will presumably continue to produce surprises but the undercurrent will remain the same:

Debt is being repaid, reduced or denied and this will impinge on the value of assets.

In these circumstances, fund managers find themselves in an invidious position. How do they communicate with clients in a meaningful way without drawing on over-worked phrases such as “invest for the long-term” or “expect high volatility” or such?

We do not know the most acceptable answer to this but are clear on the following certain, basic principles:

- By owning fine companies, we are able to participate in the clear trend¹ of rising global (material) living standards.
- Be sure to pay the appropriate price for these implied future income streams.
- The changing composition of a well-managed portfolio can enhance this return and reduce some of the risks.
- Investors at large are hard wired to over-react to recent events and will tend to extrapolate from the current environment. This adds opportunity but also risk.

With this background as context, we are **becoming increasingly excited about the choice of companies that are now available** to us worldwide. Before expanding on this, may I blindfold you and lead you through an exercise relating to a specific company in which we have an interest. This company is not a singular example, but on account of being in a relatively dull industry, it serves to highlight the sort of opportunities current market conditions have delivered.

¹ Though the share of the economic pie will shift periodically between geographic areas and among resources, labour and capital, there is a fundamental order that has ensured a rebalancing over time. Returns have exceeded inflation by a good margin. The real return to holders of US equities from 1900 to 2005 was 6.5% pa, 5.5% for the UK, 4.5% for Japan and 3.1% for Germany.

Quarterly Report (Continued)

This company is big; sales over US\$40 billion a year having grown steadily by 9% pa over the last 10 years. Profits in recent years have improved at a faster pace helped by a prolific R&D effort that has created many clever new products. This in turn has resulted in market share gains and a reduced dependence on its principal customer, which itself has been growing at speed and in strength. Though annual sales have risen 2.5 fold in 10 years, the profits by 3.5 fold, the book value from US\$10 billion to US\$22.8 billion, the market capitalisation is now just US\$16.6 billion. Offset by accumulated net cash and investments, the enterprise value falls to only US\$8 billion. **This is below its market cap of 1988!**

So what is the problem? Are its sales going to nosedive; is its principal customer about to go bust and leave it with unpaid bills; has it created an environmental accident of extreme proportions; has one or more of its products created a civil liability suit that will bring the company close to extinction?

These are the sort of issues we as analysts consider when choosing candidates for this global portfolio. We look at both short- and long-term risks and in addition, try to see these entities through the eyes of other investors. Importantly, we also try to segregate the probable from the unknowable. Lastly, we try to balance the tendency of investors to allow recent events and information to be unduly ranked when assembling their judgement about a company.

The company described above is Denso. While it may not be the most exciting company in the world, the important fact is that it is, by virtually all measures, an extremely fine company. Being part of the Toyota family as a component and system supplier places it at the high table of energy efficient and hybrid vehicles. Its new product development is skewed towards alternative drives and the electronic elements of tomorrow's automobiles.

That this will be a bigger and stronger company in the future is highly likely, notwithstanding and even because of, the US\$25 billion attempted bail-out of the Big Three US auto companies whose suppliers are, in several instances, grimly positioned for the future.

Even if this does not tempt you, as your mind races to the prospects of a global downturn and acceptance that economic de-coupling was a passing fad, surely private equity and sovereign funds are potential buyers?

Despite reservations we may have about private equity funds², sovereign funds will, in all probability, find this type of asset more interesting than continuing to add to their bank holdings.

The choice of Denso can assist in illustrating another point. Japan has been in the economic slow lane since its own banking crises of the late 1980s. Foreigners have been the big swing factor in their share market ever since, as the locals lost their nerve and preferred

the safety of government bonds or cash in the ensuing 18 years of flat to falling consumer prices. **This market has been through the very thing that is now threatening other markets and yet investors are weary of shares even at give-away prices.** (Do please recall the extravagant claims and expectations that accompanied Japan's great boom — all of which is now forgotten.)

No, this is not a case of a repetitive plea for Japan but an ideal opportunity to remind clients of the **persistence of trends and the unwillingness of most to look for the break from past patterns.** The whole Japanese market is a dream-world for unlocking value and its companies are beginning to use their cashed-up balance sheets to pick through the wreckage of Western markets. Note in particular, the opportunistic purchase of 21% of Morgan Stanley by Mitsubishi UFJ Financial Group, one of our top three holdings and Nomura's purchase of the Asian and European businesses of Lehman for no goodwill. Among smaller Japanese companies there are now many examples of gifts like Denso, but at even better value on account of being smaller businesses, sporting PEs in single figures and with half their capitalisation in cash or investments!

You may prefer to focus on recent winning markets with all their promise of hyper-growth from emerging markets, technical innovation and so on. Denso, however, perfectly illustrates **the importance of paying the appropriate valuation of standardised earnings.** As has been our recurring theme, the earnings of many companies are way above trend and so even though valuations now look enticing on price earnings grounds, being say 30% below the historic average of 14 to 15 times, the "e", earnings, are simply not likely to be sustained.

This is where a good fund manager can make a valuable contribution. When all the numbers and discernable facts point to a company being abnormally cheap using 20 to 30 year relationships of price to book, enterprise value to sales and understanding of the company's inherent cash generating capacity, the shares have a high probability of making you a handsome return. This addresses the key a, b, c and d principles that were enunciated above.

² We encountered one unusually perspicacious Pennsylvanian family who, having been an early supporter of private equity as it redirected its interests from sun-set industries, had begun to remove itself from private equity a full 18 months ago. We saw the wisdom of this as deal valuations reached silly levels and private equity funds were increasingly resorting to high leverage or exotic concepts to achieve satisfactory returns.

OUTLOOK

Markets are likely to remain highly volatile and one should brace for earnings disappointments in the months ahead. Being an economic downturn that was caused by financial crises, it is bound to result in a slower recovery than a standard recession. There are likely to be recurrent concerns about the credit markets and an increasing realisation that the banks need to bolster their shareholder funds from rights issues and in some cases, partial or full government ownership. In any event, politicians and regulators are going to seek their vengeance for having been duped by these central agents in our economic system. Future returns in the banking industry are consequently likely to be a lot lower than in the last five years.

The experience gained from the credit bubble of Japan in the late 1980s may be more instructive than some would admit³. What is encouraging is that the Nikkei had a very strong 30% rally once the realisation of the problem was generally articulated.

We would expect the same thing now, and only await the commentary that the Chinese economy is, veritably, of this world, and is expected to grow at less than 7 or 8% in the period ahead.

We can identify broad swathes of value across the globe and generally they are not in the recent hot spots of resources and energy. They are also not in most defensive industries. The most prospective areas are those which most tend to dismiss because of their dull near term prospects.

Will we make you money in the next few quarters? We cannot know. We are now in the earnings down-cycle and valuations in some cases are unusually attractive, providing opportunities that are discounting more than just a weak profit outlook. Some of these companies will be seen in retrospect as once-off opportunities.

³ As their credit-fed boom lifted share prices, impetus was added from ever tighter cross-ownership and the self reinforcing spiral of rising land and property values. In this crisis, the delusion came from derivatives and the self-reinforcing effect of rising valuations as easy credit led to frantic overbidding in the form of take-overs, share-buybacks, private equity and other vehicles exploiting OPM (other people's money).

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

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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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