

MLC-Platinum Global Fund

QUARTERLY INVESTMENT MANAGER'S REPORT

PERFORMANCE (as at 30 September 2012)

Fund Size: \$904mn	Last Quarter	Last 12 months	5 years (compound pa)	Since Inception (compound pa)
MLC Platinum Global Fund	6.0%	6.6%	-0.6%	9.9%
Morgan Stanley Capital International All Country World Net Index (A\$)	5.3%	13.1%	-5.2%	4.2%

Source: MLC Investments Limited and Platinum

The simmering uncertainty that had been emasculating markets faded as the quarter advanced. The speech by the President of the European Central Bank (ECB) on the eve of the summer Olympics where he declared, "... the ECB is ready to do whatever it takes to preserve the Euro. And believe me, it will be enough" set markets alight. This was followed by the German Constitutional Court approving Europe's bailout fund, Dutch voters giving overwhelming support to pro-European parties in their national election, and then the announcement of Quantitative Easing (QE3) by Federal Reserve Chairman, Ben Bernanke. This announcement was very clear regarding their intent to keep the Fed funds rate close to zero into 2015, with the target of bringing down the unemployment rate

to between 6.5% and 7%. The expenditure on bond buying suggests that the Federal Reserve will increase its balance sheet by at least another \$1 trillion! The Bank of Japan is also stepping-up its bond buying programme but as was learned in the 1930s, those who move slowly suffer from relatively firm currencies.

MSCI* WORLD INDEX SECTOR PERFORMANCE (AUD)

Sector	Quarter	1 year
Energy	8%	12%
Financials	7%	15%
Health Care	6%	18%
Materials	6%	3%
Information Technology	5%	18%
Telecommunications Services	5%	9%
Consumer Discretionary	5%	16%
Consumer Staples	4%	14%
Industrials	3%	12%
Utilities	-1%	-2%

* Morgan Stanley Capital International
Source: MSCI

These assurances saw all major markets, barring Japan which fell by 2.3%, rise by between 5% in the US, to 14% in India (A\$ terms). Overall, the MSCI World Index rose by 5.3% for the quarter and 13.1% for the last 12 months. The Fund is starting to gain traction with good returns from both price makers and price takers¹ notwithstanding the market's perception of lower risk. There are still, however, areas of disappointing performance such as Japan, China and in the context of the gold price, gold shares. For the quarter, the Fund earned 6% and for the year, 6.6%; thus trailing the MSCI World Index.

MSCI* WORLD INDEX REGIONAL PERFORMANCE (AUD)

Region	Quarter	1 year
India	14%	0%
Germany	12%	17%
Hong Kong	11%	21%
Australia	9%	15%
Korea	8%	14%
Asia ex Japan	8%	12%
Europe	7%	10%
Emerging Markets	6%	9%
France	6%	5%
United Kingdom	6%	13%
Developed Markets	5%	14%
United States	5%	21%
China	3%	10%
Japan	-2%	-8%

* Morgan Stanley Capital International
Source: MSCI



With you

MLC-Platinum Global Fund

CURRENCY

The implications of wholehearted money creation by the Fed persuades us to reduce our US dollar exposure in favour of the Euro. Perhaps not a perfect choice in a highly imperfect world. Our current position is 44% US and Hong Kong dollars, 34% in the Euro and other European currencies, 12% various Asian currencies, 6% in the Canadian dollar, 2% in the Australian dollar and 2% in the Japanese yen.

CHANGES TO THE PORTFOLIO

DISPOSITION OF ASSETS (NET INVESTED POSITION)

Region	Sep 12	Jun 12
Europe	31.4%	31.1%
North America*	22.5%	23.4%
Asia and Other	15.5%	16.4%
Japan	14.4%	15.8%
Australia	1.4%	1.0%
Cash	14.8%	12.3%

Source: MLC Investments Limited

* At 30 September 2012, the Fund had a short position in the US against the Russell 2000 Index of 7.5% (30 June 2012: 5.7%) and the S&P 500 Index of 1%.

Initial positions have been established in **Sberbank**, the dominant bank in Russia; **Lloyds Banking Group**, the largest bank in the UK; **Casino Guichard-Perrachon**, an interesting retailer with businesses in France and strong positions in Brazil, Colombia, Thailand and Vietnam; **Las Vegas Sands Corp**, the owner of significant casino operations in the Macau and Singapore; and **Baker Hughes**, the oil and gas service company to complement our holding of Halliburton. We used periods of stock price weakness to add to our existing holdings in Microsoft, Toyota, Sina, Sohu and Ericsson.

To fund these purchases we sold out of **China Mobile**, **Fraser and Neave**, and **Allianz Insurance**. After a very strong 12 month run of between 40% to 80%, we chose to reduce positions in several of our price-making companies such as **Pernod Ricard**, **Henkel**, **Amadeus**, **Gilead Sciences** and **Sanofi**. Underpinned by bids, we reduced our positions in **TNT Express** and **Nexen** in order to deploy the funds in companies that have been laggards.

COMMENTARY

It is likely that investors have had their fill on the subject of QE, fiscal rectitude, conditional assistance to European governments² and the rhythm of 'risk-on' and 'risk-off'. For all their apparent relevance, we have noted frequently that the behaviour of individual stocks can be in total apparent contradiction to these supposedly over-arching issues. In Spain, for example, our principal investment, Amadeus, has completely ignored the chaos surrounding it and outperformed the index by 60%; rising in the last 12 months in a €12 to €18 range per share. Likewise in China, where the market has been weak over the year, China Mobile has risen by 15%. All eyes have been focused on the runaway success of the world's largest listed entity, Apple, which we do not own, and which has risen by 64% over the last 12 months. Less attention has been paid to the dominant smartphone maker, Samsung Electronics, which we do own, and which has risen by 59% over the same period. With this in mind, it seems more useful if we outline the case we see for two of our largest holdings and a third holding which has a very different pay-off profile.

When one mentions **Microsoft**, investors may express concerns about the historic bond between PC/laptop sales and the refresh cycle of sales of the Windows operating system. This pattern is progressively fading with the shift to the Internet and the rise of smartphones and sophisticated tablets. The arrival of employee-owned tablets at the workplace is a paradigm shift that creates new challenges for IT departments. It is also a challenge for Microsoft, but it could also be an interesting opportunity.

Gone are the days when the company could imperiously set a dollar price for pre-installed operating system software; trying to extract a fixed software fee of between \$40 to \$90 for each PC sold for say \$1,000, is a very different proposition to providing the same software for devices selling for \$200–\$600 each or less. Fortunately, as tablets became ubiquitous because of their low price and remarkable capability, the revenue implications for Microsoft need not be deleterious. Much faster ownership cycle times and the potential to sell other software and services could be accretive. **Microsoft's opportunity stems from the fact that they have produced both an innovative touch interface for Windows and still they maintain a near monopoly in office productivity software.** The combination of

¹ Price makers are those companies which have a degree of freedom to set prices i.e. companies that provide unique products and services such as drug makers, strong consumer brands, both durable and consumable, as well as some IT companies. By contrast, the price takers, the vast majority, the price is dictated entirely by market forces (miners, energy producers, pulp and paper makers, financials and some industrials).

² There have been swingeing cuts to government expenditures in Greece and Spain between 2009 and 2012. Excluding interest payments, Greek Central Bank outlays have shrunk by a quarter and tax revenues have risen from 38% to 42% of a diminished GDP. Spain and Italy have followed the same course though with much less intensity with each being willing and able to raise gross tax revenues by 4% and 7% respectively.

Quarterly Report (Continued)

these puts the company in a unique position. With the release of the Windows 8 operating system, the company is attempting to **bridge this gap** and give the user the benefit of touch technology that also syncs with their workplace functions.

Reviews to date have been lukewarm but the leading device makers are supportive with new tablet designs, and Microsoft itself is launching the **Surface tablet**, together with a rapid rollout of its own retail outlets. A product that rivals those of one's customers obviously creates tensions within the supply chain but fortunately, Apple has created a large price umbrella with the bill of materials (BoM) accounting for only about half of an iPad's selling price; there can therefore be reasonable co-habitation so long as the Surface is priced towards the top of the pricing range. The **danger** is that if the tile-based metro function of Windows 8 and Windows phone 8 fail to achieve widespread acceptance, the relevance on the **Windows operating system** could wither.

While the headlines might remain on PCs/laptops and tablets, **the core of Microsoft's business has long shifted**. Two thirds of profits are now derived from the enterprise-focused businesses of Server and Tools, and Microsoft's Business Systems. Profits from these businesses have been growing at double digit rates as the company gradually shifted from a defensive posture that tried to protect the Windows operating system, towards a more offensive posture with virtualisation and web hosting. While admittedly slow reacting and at times confused, the company has progressively enhanced these products and they are being well-received. On account of its huge installed base, Microsoft **can continue its historic marketing gambit of bundling, which together with linked-in peripheral services** can provide a highly profitable competitive edge.

Without wishing to trivialise the challenges, the commentary about the company and its valuation suggests that there are **very low expectations** being priced into the shares. Net of cash, current free cash flow would allow one to **recover one's investment within seven years!** We feel this is a remarkably low valuation for a company with such a huge installed base, strong independent value at risk (VaR) and developer support, and a business that is not in run-off mode. Even if the tile-based touch interface is poorly received³, we believe there is enough momentum from the company's other divisions, for the group to achieve low single digit growth (pre-share buy-backs).

The market seems to be emphasising the downside risks of potentially wasteful acquisitions and technological substitution, with virtually **no credit being given for the company's unique position** as the principal global productivity tool provider (the Office suite) to users of computational devices. A free cash flow P/E of 10x for Microsoft is, in our view, a lot more interesting than the 14x one pays for the mythical average company in the S&P 500 Index which incidentally needs higher retentions to grow.

Toyota, held through Toyota Motor Corp and Toyota Industries, is the largest combined holding in the portfolio at 3.1%. Having once been regarded as an all-conquering Leviathan with more cash on hand than many banks, it is now treated as a corporate cripple. Even within the company, it is acknowledged that their former focus on size and market share was an error and under the leadership of Akio Toyoda, a descendant of the founder, the company has been on the comeback trail.

- Reporting lines have been streamlined, management layers removed and the new CEO takes personal interest in product design/development.
- Design philosophy has shifted to emphasise a more exciting driving experience, while maintaining the traditional high design standards and reliability upon which the group was built.
- In production, a modularity concept similar to that pioneered by VW is being implemented with commonality of inherent designs. Local sourcing has been extended, and two thirds of the company's nine million car capacity is located outside of Japan. One third of output is in emerging markets.
- Evidence of a more open culture can be found in co-operation agreements such as those with BMW where Toyota is sharing its lithium-ion battery technology, while BMW will supply compact diesel engines. This co-operation with BMW is now extending into hybrid drive systems and fuel cell technology.

The benefit of all these changes is still to be revealed. Following recent refreshes of the Prius and Camry, we will see renewal of 34 models ranging from the Lexus, Crown, RAV4 and others hitting the showrooms from now until 2013. What is undeniable is the company is experiencing runaway sales in the important US market, up 41% and 36% year-on-year in August with both the Toyota and Lexus brands. Presale orders for one of its new designs, the FT-86, designed in conjunction with the 16% owned associate, Subaru, go beyond anyone's expectations; the waiting list for the GTS model is 18 months. For the current year ending in March 2013, Toyota (excluding subsidiaries Daihatsu and Hino trucks) plan to sell 8.8 million cars, with over one million of these being hybrid drives. According to their guidance they plan to make operating profits of ¥1 trillion (more than US\$12 billion) this financial year.

³ To date about 40% of enterprises have upgraded to Windows 7 and the discussion around the adoption of Windows 8 is a whole subject on its own. We believe the compromise of a touch screen, operating in conjunction with mouse and keyboard, will face several initial hurdles as it attempts to become accepted by mainstream enterprise users. However, Nokia showed how fickle users can be and it is not improbable that the tile-based interface on mobile devices, with their ability to simultaneously run multiple apps, could gain a solid following by users and manufacturers who are seeking product differentiation.

Of course, there are negatives which include an increasingly **crowded field of car brands** led by the Korean champion, Hyundai; the still-large production base in Japan and the **on-going animosity** between China and Japan. This is significant given the fact that China is likely to account for around 20% of the global car market for some time to come. There is also the negative tag of being **unfriendly to shareholders**, with the company sitting on cash and investments that amount to about \$90 billion and compared with a market capitalisation of \$125 billion.

This incidentally shows how cheap the company really is. If one segregates the commitments of the auto finance business as a stand-alone activity, pre-tax earnings from auto manufacturing should total around US\$11 billion, which on a netted-off capitalisation (market value less net cash and investments) of US\$41 billion, gives a buy-out yield of 26%. On other look-through business valuation measures, it is just as enticing.

Sina is a very different prospect to the two mentioned above. From its origins as a news portal, the company launched its Weibo microblogging site (Twitter-like) in August 2009. This has been a huge success as measured by the growth in the number of registered accounts which now total 368 million with 36.5 million daily active users. The huge development effort of the last 18 months, which has seen the employee count double to 6,000 has focused primarily on the **user experience**. The current beta version 5 promises added features that move it further towards a **social network platform** where Tweets can be directed specifically to close friends/group postings, as well as a potential dating platform where users can enter personal relationship information, status and mood. There is also a facility to prioritise how Tweets appear on a user's page.

The big challenge ahead is how to monetise this **platform**. The company is developing several models including 'top feed' where the advertiser's message is shown at the top of the screen once every 24 hours. Alternatively, enterprises can attach a succinct corporate message to specific Tweets, for example, Adidas, congratulating team members during the Olympics or contextual adverts that are related to keywords in a Tweet.

As far as we can assess, the issues around **user identity** have been largely resolved by the requirement of recording one's mobile phone number. The real risk to the company lies in **substitution**. Tencent, which started life as an instant messaging service looks the closest contender because of its profitability and larger user base. It is attempting to use its messaging app, WeChat, to link with its own Weibo site. The character of its offer and the demographics of its users are markedly different to those who are attracted to Sina Weibo. Fortunately, Sina continues to make good returns on its own portal and is able to fund the development costs which pertain mainly to commercialisation. The market is aware of this blue sky potential but if Sina is able to monetise Weibo at \$50 million a quarter as is anticipated by management, the company will enter a new phase of its development. As noted above, the **pay-off quotient** for Sina is significantly different to that of the two larger companies mentioned. This concept forms an important building block in the construction of the portfolio.

OUTLOOK

The market seems to be entering a new phase. Action by major Central Banks is seemingly reducing the sense of anxiety within markets. To the extent that money has been priced at artificially low levels there is also some effect on the real economy in terms of consumers' ability and willingness to borrow. The strategy of buying highly predictable companies may prove less fruitful in coming months as investors cautiously add more cyclical to their portfolios. As has been noted over the last year or so, we are well-placed to participate in this more diffuse environment. There are many economically sensitive companies that are already priced for weak demand.

Kerr Neilson
Managing Director

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

This document has been prepared by MLC Investments Limited (ABN 30 002 641 661) AFSL (230705), with fund and market commentary written by Platinum Investment Management Limited (ABN 25 063 565 006) and is current as at 30 September 2012. It is provided as an information service without assuming a duty of care. This communication contains general information and may constitute general advice. Any advice in this communication has been prepared without taking account of individual objectives, financial situation or needs. It should not be relied upon as a substitute for financial or other specialist advice. MLC Investments Limited is the issuer of both the MLC-Platinum Global Fund and the MLC MasterKey Unit Trust. The offer of interests in the MLC-Platinum Global Fund and the MLC MasterKey Unit Trust are contained in the MLC MasterKey Unit Trust PDS. Copies of this PDS are available on mlc.com.au. The MLC-Platinum Global Fund was closed to new investors from 1 July 2005. Existing investors wishing to acquire further units should obtain a PDS and consider that document before making any decision about whether to acquire or continue to hold the product. An investment in the MLC-Platinum Global Fund or MLC MasterKey Unit Trust does not represent a deposit with or a liability of MLC Investments Limited, National Australia Bank Limited (ABN 12 004 044 937) or other member company of the National Group of companies and is subject to investment risk including possible delays in repayment and loss of income and capital invested. None of the National Australia Bank Limited, MLC Investments Limited, or any other member company in the National Group of companies or Platinum Asset Management, guarantee the repayment of capital, payment of income or the performance of the MLC-Platinum Global Fund or MLC MasterKey Unit Trust.

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