

MLC-Platinum Global Fund

QUARTERLY REPORT

PERFORMANCE

Fund Size: \$2.5 bn	Last Quarter	Last 12 months	5 years (compound pa)	Since Inception (compound pa)
MLC-Platinum Global Fund	0.5%	3.2%	13.9%	13.8%
Morgan Stanley Capital International All Country World Net Index (A\$)	-1.0%	0.2%	8.2%	7.7%

Source: MLC Investments Limited and Platinum

Several factors are beginning to play out well for the portfolio. Low exposure to financials, the emphasis on less economically sensitive companies, and world-beaters on historically low valuations, have greatly assisted the portfolio since fears emanating from the credit squeeze emerged in the second quarter. Not that we haven't had disappointments, but we are very clear on what we wish to avoid and believe that the shares that we own, and which have been dull, have very little downside from here. This statement is made with a clear understanding of the need to avoid "value traps". We are now gradually pulling away from the MSCI for the quarter, half year and year.

CURRENCY

In view of a period of slower global growth ahead, we have tended to reduce exposure to the Australian dollar in favour of such underpriced Asian currencies as the Malaysian ringgit, Singapore dollar and Taiwanese dollar. Exposure to the Yen has been stable (and helpful) as has been the underlying holding of Euro currencies. It looks as though the US dollar is in the process of basing out against the Pound and perhaps

the Euro. We prefer the US dollar to the likes of the Pound sterling but not so much as to favour it over the Asian currencies nominated above, even with their negative carries. Part of the rebalancing we envisage calls for Asian currencies to appreciate on a trade weighted basis.

As seen from the table below, yearly returns from the large international markets have been further reduced by the strong Australian currency.

MSCI WORLD INDEX WEIGHTINGS AND MSCI INDEX PERFORMANCE (LOCAL AND AUD), 12 MONTHS TO 31 DECEMBER 2007

Region	Weighting	Local	AUD
Asia ex Japan	7%	33%	26%
Emerging Markets	12%	38%	25%
Japan	8%	-10%	-14%
Europe	30%	6%	3%
US	41%	5%	-5%
World		7%	0%

Source: MSCI

SHORTING

Having started the quarter close to 11% short, we added to the position in November and ended the quarter close to 13% short. As we note in our commentary, we are ambivalent about general valuations but believe areas such as commodities and some emerging markets harbour unrealistic expectations. We are short the Korean market as well as small capitalisation stocks in the US. The latter are showing a tendency to weaken versus the broader indices.

CHANGES TO THE PORTFOLIO

DISPOSITION OF ASSETS (net invested position)

Region	Dec 07	Sep 07
Japan	23.3%	23.4%
Other* (emerging markets eg. Korea)	18.6%	18.8%
North America*	18.5%	23.9%
Western Europe*	17.9%	15.4%
Australia*	-1.8%	-2.6%
Cash	23.4%	21.1%

Source: MLC Investments Limited

*At 31 December 2007, the Fund has a short position in the US against the Russell 2000 Index of 6.2% (30 September 2007: 4.3%); in Australia against the SPI 200 Index of 1.8% (30 September 2007: 2.6%); in Germany against the Dax of 3.7% (30 September 2007: 2.1%) and in Korea against the Kospo of 1.0% (30 September 2007: 1.6%).

Two shares that have sold-off meaningfully in anticipation of slower world growth are the Paris based companies, Schneider and Pinault Printemps Redoute (PPR).

Schneider is the world leader in low voltage electrical distribution equipment. While evidently facing diminishing demand from US housing, Schneider is extremely well-placed

in emerging markets, which represent some 30% of sales and of equal importance, it is exploiting the awakening awareness for energy saving devices in homes and offices. It has a well-established global supply chain and has progressively broadened its reach by acquiring related businesses worldwide. We believe temporary doubts about growth give us an unusually good opportunity to buy a trend mid-teens grower for a low-teens valuation.

PPR was known traditionally as a department store operator in France. Via a remarkably adept acquisition strategy it has transformed itself to now derive only half of its profits from the slow growing European retail businesses and 40% from luxury brands, such as Gucci, YSL and Bottega Veneta. While one can over-state the delight with which consumers relish the wearing of brands, it is a fact that PPR has achieved unusual success at reinvigorating its labels and is receiving a warm welcome in Asia and the emerging markets. Reaching far back into its history the group also owns a significant trading company in Africa that principally distributes cars and light trucks. It has progressively widened its network and now covers 26 African countries. As capitalism becomes the norm in Africa, we suspect this division's growth rate will accelerate above its traditional mid-teens pace. The group has achieved an outstanding record and with the founder's son fully engaged in running the business, we believe it deserves a rating that more appropriately reflects its underlying growth rate and profitability.

Reed Elsevier and SAP are companies with a low cyclical profile. Reed has an underlying growth rate of around 10%, selling professional services

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to the likes of lawyers and accountants. This growth has been masked in recent times on account of the weakness of the US dollar versus the Pound and as a consequence the rating has suffered and has fallen back to a market average despite the defensive nature of the business. This appeals to us particularly as the Pound looks set to reverse its earlier strength.

SAP is of even higher quality. It has successfully migrated its business applications platform from mainframes to servers and now onto the web. It supplies the principal IT platform to some 400 of the Fortune 500 companies and as they have migrated to the new release, SAP is in the midst of a strong up-selling cycle. At the same time group margins should expand as it stabilises its R&D relating to a new hosted software system targeted at businesses of up to 500 employees. On approximately 19 times 2008 earnings and likely to grow into the mid-teens range for a few years, this is the ideal purchase in what we believe will be a world where earnings growth is scarce.

MLC PLATINUM GLOBAL FUND - TOP 20 STOCKS

Stock	Industry	Dec 07
Microsoft	Technology	3.7%
Siemens	Electrical	3.0%
Bombardier	Transport	3.0%
Hutchison Whamoa	Telco/Transport	2.9%
International Paper	Paper	2.6%
Denso Corp	Auto	2.3%
Cisco Systems	Technology	2.3%
Henderson Land Dev	Property	2.1%
Barrick Gold	Gold	2.1%
Samsung Electronics	Electrical	1.9%
Henkel KGAA	Consumer	1.9%
Pernod Ricard	Beverage	1.9%
Sony Corp	Electrical	1.8%
Credit Agricole	Financial	1.6%
Ericsson	Telecom	1.6%
Toyota Industries Corp	Auto	1.6%
Royal Dutch Shell	Oil	1.5%
News Corp	Media	1.5%
Hornbach Holding	Retail	1.5%
BMW	Auto	1.4%

Source: Platinum

(Continued)

COMMENTARY

The question we are asked most frequently relates to the prospects for there to be a so-called decoupling between the developed economies and those of Asia and the large commodity producers such as Brazil and Russia. There is now a general realisation that the game has changed in terms of easy money and all that went with it. Namely, extravagantly priced M&A transactions, the flooding of money to private equity funds, bank-sponsored off-balance sheet vehicles and securitisation in general. (In time we can expect enquiry into the segregation of loan originations from ownership, and the function of the rating agencies.) Stephen Roach of Morgan Stanley has expressed the view that there can be no decoupling as globalisation is essentially about integration of the global economy. This, however, has not been seamless, as witnessed by the mercantilist policies pursued by some, with the consequent accumulation of huge foreign exchange surpluses. Had the system been totally fluid, significant currency adjustments might have ensured less misallocation of resources and perhaps this may have constrained some of the financing excesses that are now unravelling. Also, the momentum behind some of the emerging economies is very strong on the back of heavy investment in infrastructure and resource development. That there will be a negative pulse from the West, as well as from their own interest rate tightening (notably India and China) and perhaps from currency appreciation, is likely. However, in the event of an undue slowing, these countries have plenty of latitude to foster greater consumer demand. The decoupling of equity markets though is more problematical.

Our main concern lies in valuations at the extremes. Like the tech boom before it, the trap lies in visions of endless demand and the willingness of investors to extrapolate current above-trend prices into the distant future. Copper, a valuable indicator of growth expectations has already come off by 18% from its September highs, as have the prices of other metals. We cannot justify most commodity producer share prices. Likewise, the valuations now common in hot emerging markets such as Russia, India and China leave us unenthusiastic. Having been revalued to unprecedented levels, we would prefer to look elsewhere. We believe the repricing of risk will ultimately bear down on these valuations although accumulating foreign exchange surpluses may delay the adjustment.

This leads to the next question as to whether we are at the beginning of a major inflationary pulse? Certainly, prices have started to surprise on the upside, notably in China where food prices are some 15% higher than last year, but our contention at this stage is that the tightening of credit across the globe will be a counter ripple to the current supply tightness that is apparent in most commodities. Moreover, outsourcing is still exerting pressure on real wages in developed countries even with employment running at historically full levels. The bond markets seem to be endorsing this view about inflation at present, with the yields on most Sovereign debt being near their lows. However, the co-ordinated action by central banks to ameliorate the tightness in the credit markets carries underlying inflationary risks.

So, where should we be seeking opportunities?

The observation that tempers all our thinking (now that our concerns about easy credit have been vindicated) is the unprecedented level of corporate profits, expressed either as a percentage of GDP, or just the return on sales. On the basis of the same argument that market forces do eventually rebalance commodity supply and demand, so the market will rebalance these super normal profits. Remarkably though, those companies that have true pricing power are not being priced for their superiority. One exercise we do is to rank our core universe of some 2000 companies by quality.* Clearly there has been a general lift in profitability, led by the “dross” but more interestingly, the valuation of “quality” is conspicuously low, while the valuation of the “dross” has reached levels normally associated with “quality”. It is these lesser companies that will shortly face the burden of rising costs and depreciation as they expand to meet anticipated demand and they may not have the ability to sustain profits. Yes, “quality” may also feel the chill of softer demand but on account of their superior business dynamics, they should face less margin pressure. The holy grail for us is to identify those who are not particularly operationally geared, have close to normal margins and are on ratings close to their historic average or less. Companies like Microsoft, SAP and Cisco fit this category.

Alternatively, companies exposed to long duration themes such as energy conservation and alternative energy, public infrastructure and the like which have few of the attributes common to price-setting “quality” companies, can still serve us well simply because of the multi-year

back-log of capital projects. In some cases, such as Bombardier, Siemens and JGC, they even have the prospect of achieving margin improvements.

OUTLOOK

On balance we tend to believe that the action of the central banks to flush the system with standby facilities will gradually move the focus away from the so-called sub-prime crises. With write-offs put at say US\$350 billion, this has been a sizable setback to financial intermediaries globally. Fresh equity has been sought and more can be expected in due course. Either way there has been a rude interruption to credit availability in an exuberant world that was running at its fastest pace in history and stretching available resources to the full.

While we fret about the high level of profits, the fact is that developed market equities are by historic standards cheap against other asset classes at a time of falling interest rates. We argue that there is enough momentum to see global growth continuing, albeit at a slower pace, but above all, we are able to identify a broad group of companies we wish to buy. This partly stems from the sharp sell-off in some growth sensitive sectors and markets as they anticipate a slowing, and in addition, there is the phenomenon we describe above of quality companies being rated at multi-year relative lows. The general indices are seemingly inexpensive with the consensus estimates putting global earnings for 2008 on a PE of 14.1 times, the US on 14.7 times and Europe on 12.6 times. We suspect that earnings will fall short of these boom-induced forecasts but nevertheless such ratings are below the long-term averages. International reserve growth

continues apace and as we have noted previously, the appetite of Sovereign funds for equity type investment is on the rise.

There is enough diversity in valuations and enthusiastic profit expectations to maintain short positions to reduce market risk. By seeking out the exceptions either in “quality” or long duration themes, we believe we can achieve solid returns in 2008.

*Some 1500 to 2300 companies are rebased each year to give the top and bottom quintile by profitability and growth in the preceding 10 years.

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

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