Platinum
CAPITAL LIMITED

ABN 51 063 975 431

Platinum Capital Limited Quarterly Report

31 December 2004

PERFORMANCE

All stock markets enjoyed strong rises in the three months to the end of December despite an initial dip caused by a spike in oil prices which at one point threatened to reach US$60 per barrel. Confidence grew as the quarter progressed and fund managers reduced their cash balances so as to correct previously underinvested positions. Currency movements played a large part in determining the magnitude of the gains as the A$ rose against the US$ by some 8%, was flat against the yen and fell in value against the euro by 2%.

A rise in investors' appetite for risk was apparent from the out-performance of emerging markets, with those in South America and the Middle East gaining more than 20% in their home currencies, followed closely by Asia ex-Japan. Developed markets generally rose by single figures with the Bloomberg Europe 500 gaining 6%, the Japanese Topix up 4% and the S&P 500 rising 9%. Converting all this into A$, saw the MSCI rise by 3.7% for the quarter. The Company gained 3.5% for the quarter, capping off a flat first half for our financial year 2004. Examining the calendar year as a whole, it is apparent that our stock selection in terms of long positions was good with large exposure to emerging markets like India and Korea adding zip to our core of excellent European and Japanese holdings. The currency positioning also made a small contribution. Offsetting this underlying strong showing was the negative impact of our short positions which reduced our six month returns to -0.3% versus the MSCI return of -0.9%.

MSCI ALL COUNTRY WORLD INDEX
INDUSTRY BREAKDOWN (US$)

SECTORS	QUARTER	1 YEAR
TELECOMMUNICATIONS	16.1%	16.3%
UTILITIES	13.8%	23.9%
FINANCIALS	13.7%	15.5%
CONSUMER DISCRETIONARY	13.7%	14.0%
INFORMATION TECHNOLOGY	13.3%	2.4%
INDUSTRIALS	11.8%	17.9%
MATERIALS	11.4%	17.9%
CONSUMER STAPLES	11.4%	10.4%
ENERGY	6.5%	25.0%
HEALTH CARE	6.2%	4.7%

Source: Bloomberg

A revealing picture for the quarter is shown in the Industry breakdown table (shown in US$ to remove the impact of the strong A$). In contrast to the September quarter, where the table was dominated by falls, every industry rose. Differing factors were at work, with corporates beginning to spend some of their built-up cash reserves through takeovers especially in telecoms, utilities and IT. Bringing up the rear were health care which suffered from damaging drug revelations, and energy, which was adversely affected as oil prices reversed earlier gains.

The following Net Asset Value figures (cents per share) are after provision for tax on both realised and unrealised income and gains.

NET ASSET VALUE (CPS)	
31 OCTOBER 2004	157.07
30 NOVEMBER 2004	160.28
31 DECEMBER 2004	162.71

Source: Platinum

SHORTING

This has been a painful experience, particularly in the last quarter. Our successes have been small and our losses large. We achieved some of the desired smoothing of performance, particularly in July, but overall the exercise cost us over 4% for the year. Detailed examination of our positioning shows that the damage was largely the work of three specific stock shorts. The price behaviour of these lamentable three in the opening days of 2005 suggests that our negative assessment may still justify itself. Why endure this pain you may ask? Essentially we are attempting to guard against loss in an environment where, in our opinion, liquidity is wallpapering over some serious cracks.

The main fault line we fear is the combination of large deficits but low interest rates exacerbated by huge, highly geared positions in derivatives. What we underestimated in 2004 was the slowness of interest rate rises, the controlled decline of the US$ and the remarkable support for bonds by governments who recycled surpluses more to keep their currencies undervalued than on rational investment criteria. Has anything changed? Well, US interest rates are creeping up and perhaps there are signs of a weakening demand for US bonds. However, on account of the fall in the cost of puts prior to years' end, the sky being "perfect blue", and the timing problems we have had with specific shorts, we have introduced put options to somewhat modify our exposure to short sales.

CURRENCY

A bearish stance towards the US$ was the prominent market view in the final quarter of 2004, a somewhat unsettling consensus. Should the US administration pay more heed to international concerns regarding the twin deficits by action to support tough talk, it is possible for the currency to rally. Fundamentally we still favour the Japanese yen and European currencies but have adjusted our position to own some US$ for now. We have been surprised by the relative softness of the yen against the euro and are positioned for this to change. The A$ hedge has been held steady.

CHANGES TO THE PORTFOLIO

Transaction levels were relatively subdued during the quarter and we mainly added to existing holdings such as Credit Agricole, Carrefour, Liberty Media, News Corp, Mosaic, Norske Skog, and Reliance Industries.

In Japan we shifted the emphasis more towards domestically orientated companies, adding to home builders, financials and television broadcasters. These companies are on depressed valuations that reflect the prevailing pessimistic view about domestic demand and ignore profit histories which reveal remarkable resilience through the last twelve years of very low growth of the economy.

An area that has become conspicuously unfashionable is pharmaceuticals. Drug stocks have suffered a major de-rating as the implications of the side effects of so-called Cox-2 inhibitors has damaged the prospects of Pfizer and Merck Inc. Having assessed the longer term implications of these problems and the general concerns regarding viable pipelines and the regulatory environment, we have chosen to add both companies to the portfolio. At current price levels the market is implying that longer term growth prospects have fallen considerably and also that risks have risen markedly.

At the same time we have been adding to our biotech holdings in favour of those companies that will help support drug discovery and diagnostics. On account of its relative price strength, despite no fundamental improvement of its relative merits, we sold Novartis and used the proceeds to buy the above companies and to add to GlaxoSmithKline.

DISPOSITION OF ASSETS

REGION	DEC 2004	SEP 2004
WESTERN EUROPE	31%	31%
JAPAN	28%	29%
NORTH AMERICA	18%	14%
EMERGING MARKETS (INCLUDING KOREA)	16%	15%
AUSTRALIA	0%	1%
CASH	7%	10%
SHORTS	31%	35%

Source: Platinum

BREAKDOWN OF COMPANY'S LONG INVESTMENTS BY INDUSTRY (% OF ASSETS)

CATEGORIES	EXAMPLES OF STOCKS	DEC 2004	SEP 2004
CYCLICALS/MANUFACTURING	TOYOTA MOTOR, SCHINDLER, SIEMENS, LINDE, OCÉ	27%	24%
FINANCIALS	CREDIT AGRICOLE, MITSUBISHI TOKYO FINANCIAL, MITSUI SUMITOMO INSURANCE,	17%	16%
CONSUMER BRANDS	HENKEL, ADIDAS SALOMON, LOTTE	10%	9%
MEDICAL	TAKEDA, SCHERING, MERCK KGaA, GLAXOSMITHKLINE	8%	8%
TECHNOLOGY/HARDWARE	AGERE, INFINEON TECH, SAMSUNG, AMD, SUN MICROSYSTEMS	8%	8%
RETAIL/SERVICES/LOGISTICS	CARREFOUR, DEUTSCHE POST, HORNBACH, MITSUBISHI CORP	7%	8%
GOLD AND OTHER RESOURCES	SHELL, BARRICK GOLD, NEWMONT MINING, NORANDA	6%	7%
SOFTWARE/MEDIA	SEOUL BROADCASTING, NEWSCORP	6%	6%
TELECOMS	ALCATEL, NTT DOCOMO	4%	4%

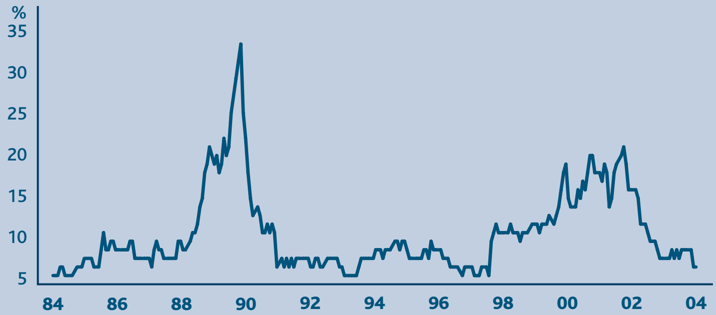
Source: Platinum

COMMENTARY

An important principal of economics and finance is that an abundance of capital ultimately diminishes returns: conversely, shortages provide the fuel for higher yields. In the markets today, liquidity is so abundant that it is promoting convergence of returns as investors search high and low trying to identify the next big idea. Markets which were formerly uncorrelated now behave as if they are closely related. For example, the amount of extra yield that was traditionally required from B rated corporate bonds has shrunk in synchrony with the lower implied volatility of various share indexes. At the same time, Euro and US bonds have become correlated as have emerging market bonds. This is significant as it was the uncorrelated behaviour of various traded assets that was the foundation of the hedge fund movement. If most assets become correlated, what are hedge managers supposed to hedge?

The aberrant effect of cheap money is also evident in the anxious desire for risk. The range of examples is wide, starting with the markets' apparent nonchalance regarding the virtual confiscation of Yukos assets. Though the individual stock price was hammered, the effect on the broader Russian index and other dubious markets was relatively slight. Closer to home, the revelation of a probable breach of US SEC accounting rules and consequent departure of the top two executives (on extremely generous severance terms) from the world's largest hedge fund, Fannie Mae, barely made the headlines. This is no trifling matter. The revealed capital short-fall of over $9 billion has wide implications, not least for the availability of mortgage finance in the US and significant effects on derivative markets, yet the share is now trading above pre-revelation levels. There are lesser examples such as the China Aviation Oil futures gamble that cost US$550 million compared to its net assets of US$140 million at the start of 2004. Best of all, however, has been the reopening of the triple C or lower rated bond market. Traditionally, one third of loans raised by these "walking-dead" default within a year, yet so ravenous are investors that apparently the extra yield of only about 6% is worth the bet.

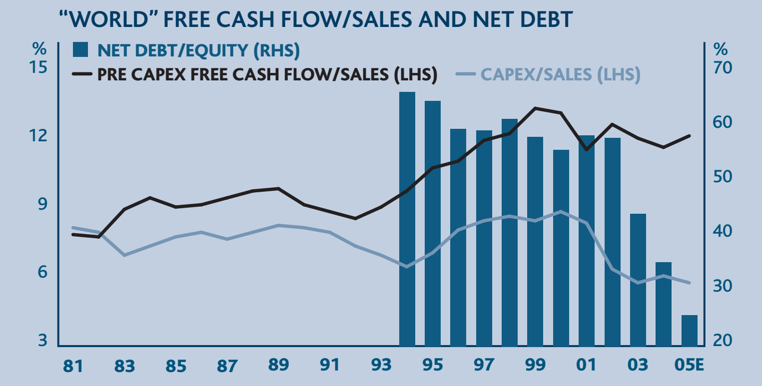
TRIPLE C BORROWING MARGIN
SPREAD OVER 5 YEAR US TREASURY YIELD



Source: Bloomberg, Citibank

It is equally revealing to observe the huge surge of activity in the private equity market. Data compiled by Bloomberg show that buyout firms like Blackstone, Warburg Pincus and Carlyle have spent a record US$180 billion on deals in 2004, way outpacing the global IPO raisings estimated at US$128 billion. Like the hedge fund industry, this was formerly the domain of wealthy families but success has attracted many new players, notably less affluent investors and less experienced equity specialists. Returns have fallen as bidders compete in an ever more crowded pool. Several long established private players have said they can make no sense of prevailing prices so are suspending their activity, but those operating with OPM (other peoples' money) are snatching at every morsel. Some are even doing a fine trade in taking listed companies private, sheltering them for long enough to enhance their indebtedness and little else, and within 12 months offering them to the public again at a considerably higher gross price. No logical explanation seems necessary for the "now listed; now delisted; now listed again" trick in the IPO offer documents!

Easy money has, however, had a highly beneficial effect on corporate profitability and balance sheets. Companies have engaged in massive refinancing exercises and, unlike householders, have generally reduced their financial leverage thereby reducing the risk to shareholders. Also enterprise profits are at record levels in the principal markets or back to peak levels in the case of Japan.



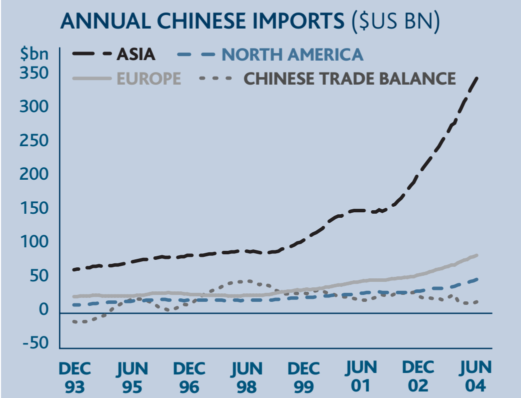
Source: UBS

Whilst the US provided the most growth in absolute terms during 2004, the most dynamics, in rates of expansion and in economic philosophies were seen in Asia, particularly the two giants, China and India.

China has achieved the remarkable distinction of increasing its industrial production by more than 13% pa since 1993. Such has been the supply of surplus labour that real earnings of the typical factory worker barely changed in the 1990s but since 2000, real wages have accelerated. (These figures are rubbery on account of the statistics which segregate migrant incomes from those earned by residents: under the *hukou* system migrants still face penalties such as denial of free medical treatment and access to schooling for their children in several major cities). This is being accompanied by tentative indications that there is a lessening desire on the part of rural dwellers to migrate to the tough and tedious jobs that once attracted them in droves. The income gap between the wealthy coastal provinces and the hinterland is still large but government measures and higher agricultural prices are playing a part. Perhaps, too, skill disparities are an issue. As labour typically accounts for about 10% of inputs in manufacturing, the impact of this change in the bargaining power of labour will take time to be expressed but it may signal the beginning of the end of the impact of cheap Chinese manufactured goods on price levels worldwide.

Another important effect of Chinese growth has been via its demand for goods from neighbouring states. (See accompanying graphs).

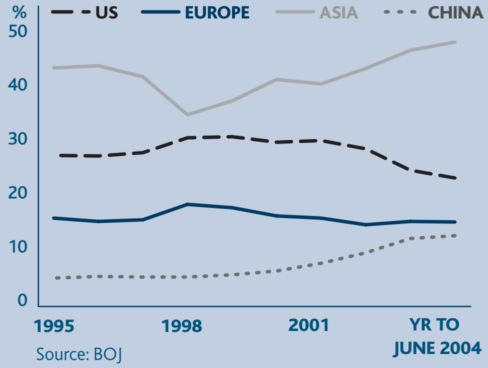
As a relatively closed economy gradually weaning itself off central planning, India has responded relatively slowly to globalisation. This was apparent at the Twentieth annual Indian Economic Summit held in Delhi in December. In earlier times, politicians expected to be treated with gratitude for their munificence, but this is changing. Delegates have become impatient with the endless ruminating over issues that were defined at earlier summits and they now want action in the form of less government interference and more devolution of power. The old Nehru/Gandhi centralist model of self-sufficiency and anti-materialism is no longer acceptable. Though it has been a long time coming we concur with the Finance Minister's view that the country is about to enter a sustained period of economic growth rivalled only by China. Aiding this process is the probable increase in foreign direct investment which is presently running at one tenth of the level to China. The biggest hindrance will be the politicians' resistance to their loss of patronage but no one has missed the significance of the recent election surprise. The Congress party is paying close attention to alleviating the plight of the rural poor and has now accepted that the nation's interests are best served by wealth creation rather than wealth distribution.



Source: CEIC

In Japan we expect record corporate cash flows to be directed at capital spending. A point that should be emphasised is that the yen, while stronger against the US$, has been relatively weak versus the euro. It is from this economic block that it faces its principal competition in elaborate and sophisticated machinery. As companies gradually share some of their surpluses with labour through the biannual bonus system, we can envisage domestic demand being stronger than the present consensus indicates. We see this too, as likely to revive one of the few moribund property markets in the developed world. As has been noted before, land prices are edging upwards and the housing market is showing promise.

JAPANESE EXPORT DESTINATIONS
(% OF TOTAL EXPORTS)



Source: BOJ

There are some signs of change in important economies like France and Germany which have a combined population of some 145 million. The mandated 35 hour week in France is now being eased, though not abolished, while in Germany opinion formers like Robert Bosch, Opel and Siemens are driving through deals with the IG Metal union for longer working hours for no extra wage. This gradual change of perspective reflects the recognition of globalisation, with extra impetus being given by competition from the new Eastern European members of the EU.

CONCLUSION

Cheap money is clouding the financial scene. Traditionally, government and business are the user of savings and these are provided by households. In the US today the opposite applies. Business, which needs savings to invest and grow, is the provider of funds, while the consumer and government are the users. This is an upside-down world. Should US inflation become more troublesome and if too little heed is paid by the Bush administration to the twin deficits, the delicate balance may easily become unsettled.

At the individual share level, company earnings in general are losing momentum, though still growing, and valuations range from acceptable to high.

The strongest growth prospects appear to reside in the emerging markets which are globalisation beneficiaries but, equally, tend to be the most sensitive to volatility in the developed markets.

It is for these reasons that we have maintained short positions in selected stocks and indices.

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