Platinum Capital Limited 30 June 2008
Investment Manager's Report

Performance

Markets have been very challenging since evidence of the excesses of the credit cycle first came to light in May 2007. In the most recent quarter there has been a division between those companies that are seen as beneficiaries of continued growth in the developing world and those that are on the receiving end of the credit unravelling. Stock markets have seen the commodity and resource producers continue to roll while the financials have slumped.

A clear distinction has been less evident at the country level where the developed and developing markets have moved in similar ways. Striking exceptions were Brazil and Russia, where energy and resources predominate, with companies like Vale, Petrobras and Gazprom soaring. China and India have lost their lustre to tightening credit and inflation pressures.

Tables of global regional and sector returns are shown below.

MSCI* WORLD INDEX REGIONAL PERFORMANCE (AUD)

Region	Quarter	1 Year
United Kingdom	-6%	-23%
India	-24%	-23%
Korea	-12%	-23%
US	-7%	-23%
Japan	-3%	-22%
France	-9%	-22%
Germany	--7%	-17%
Australia	-1%	-14%
Hong Kong	-9%	-9%
Emerging Markets	-6%	-8%
Brazil	13%	36%

* Morgan Stanley Capital International

Source: MSCI

MSCI* WORLD INDEX SECTOR PERFORMANCE (AUD)

Sector	Quarter	1 Year
Financials	-16%	-38%
Consumer Discretionary	-13%	-33%
Industrials	-11%	-22%
Health Care	-5%	-19%
Information Technology	-4%	-19%
Telecommunications	-8%	-18%
Consumer Staples	-11%	-13%
Utilities	-2%	-7%
Materials	4%	4%
Energy	12%	9%

* Morgan Stanley Capital International

Source: MSCI

Your Company's performance has fluctuated. While doing better than the MSCI World Index for the year at -17.2% (pre-tax) versus -19.8%, our absence from resource companies and our currency allocation were detrimental to performance over the last three months (-8.7% pre-tax versus -6.4% for the index). As regard currencies, had we joined the momentum brigade and loudly proclaimed "stronger for longer" over this period we would have done better. This slogan is likely to be tested in coming months but recently it has held the Australian dollar, where we are underweight, high. It has also reduced the potency of our shorts. While underlying stocks in Japan are showing resilience the currency has sold-off.

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

30 April 2008	31 May 2008	30 June 2008
138.81	138.17	128.69

Source: Platinum

Currencies

While the Yuan continued its climb, rising by 10% versus the US dollar over the year, the other Asian currencies lost momentum and those without natural protection against the rising oil price started to sag. This was detrimental to our position as we had expected them to move-up with the Yuan so these holdings have now been cut. Further, the Australian dollar tilted higher as investors paid more heed to revised expectations about this country's current account deficit in the light of its strong iron ore, coal and natural gas industries. We ended the quarter with only 8% long the Australian dollar and with most of our physical share holdings being carried in their underlying currencies. We remain of the view that the US dollar is bottoming, perverse as this may seem, as competitiveness is now trending in that currency's favour.

Shorting

Throughout the quarter we have progressively moved the shorts towards those areas that are bloated by expectations of growth. These include some emerging markets such as Brazil, steel companies, small caps and reits (real estate investment trusts); only in the last days of the quarter did these bastions of hope for growth start to fall, a movement which has accelerated into July.

Portfolio Changes

GEOGRAPHICAL DISPOSITION OF PLATINUM ASSETS

Region	Jun 2008	Mar 2008
North America	24%	24%
Europe	23%	23%
Emerging Markets	20%	21%
Japan	19%	20%
Cash	14%	12%
Shorts	28%	31%

Source: Platinum

PLATINUM CAPITAL LIMITED – TOP 20 STOCKS

Stock	Industry	Jun 08
Microsoft	Technology	3.2%
Mitsubishi Tokyo Financial	Financial	3.0%
Hutchison Whampoa	Telco/Transport	2.9%
Siemens	Electrical	2.7%
Bombardier	Transport	2.7%
International Paper	Paper	2.3%
Samsung Electronics	Electrical	2.1%
Cisco Systems	Technology	2.1%
Hornbach Baumarkt	Retail	1.8%
Denso Corp	Auto	1.8%
Johnson & Johnson	Health Care	1.8%
JGC Corp	Construction	1.8%
SAP	Technology	1.7%
Henderson Land Dev	Property	1.7%
Sanofi-Aventis	Health Care	1.6%
Polaris Securities	Financials	1.6%
Pernod Ricard	Beverage	1.6%
Bangkok Bank	Financial	1.5%
Newmont Mining	Mining	1.5%
BMW	Auto	1.5%

Source: Platinum

Strong relative moves during the quarter gave us the opportunity to rebalance several holdings. In particular we cut back on our positions in the Bank of China, Sony and Bombardier, all of which rose by 20 to 30%. We consolidated holdings by selling Oracle for more SAP (IT business systems) and Chiyoda for more JGC (constructors of refineries and LNG plants). In other cases we exited companies that had held-up relatively well but which now look less attractive in a relative sense; Ajinomoto, Yamato and Rohm were used to fund initial stakes in the highly oil-punished segment of airlines and aircraft support. Other activities were to exchange Pfizer for Sanofi-Aventis and to sell the regional banks in Japan for the two largest city banks.

At a time when most banks have been revealed as under-capitalised and having weak deposit bases, one of the world's biggest banks with the opposite characteristics, is selling at book value. Mitsubishi-UFJ Financial Group has been recapitalised and has a loan to deposit ratio of 75%. Furthermore, for the first time in years it is trading in an environment of rising prices and has the prospect of repricing and expanding its loan book at relatively low risk. In addition, the completion of its IT integration is anticipated to give rise to substantial cost savings. Should the Japanese public change their stance to equities in the face of a deteriorating environment for bonds, the company would get the additional boost from transactional fees and commissions. There is little need to try to pick the low point of the share prices of the western financials when this stock is both cheaper and more soundly based.

The pharmaceutical sector is being punished due to concerns about gaps in the pipeline for new drugs. Sanofi-Aventis has been caught up in this general downgrading and is trading at under eight times earnings. If you strip out the safe and steady vaccine business, the balance of activities is capitalised at approximately Eu43bn which should be covered by cash flow from those activities over no more than the next five years. The R&D pipeline, into which the company has recently been investing between Eu4.5bn and Eu8bn annually, is apparently being valued by the market at zero. There are other good things to be said but the above figures alone are a sufficient indication that Sanofi's current rating is strongly characteristic of value and neglect.

Commentary

Trying to evaluate markets each day is like watching a giant kaleidoscope. Against a dull background there will nearly always be one vividly bright and interesting sector. For a while this particular area generates a massive volume of comment accompanied by extraordinary market activity and volatility. Then, more or less unexpectedly, a new brilliance merges to command attention while the old one fades away.

We do our very best to avoid short-termism and to maintain a balanced view. We are obliged, however, because we necessarily interact with the other market participants, constantly to take account of the intensity and likely durability of the mass reaction to each emergent spectacular. Last week it was securitisation, credit default swaps and bank solvency. This week it is oil and agriculture prices and inflation. Next week, well, that is the big question.

It is a constant balancing act. How much attention should be paid to the past, to what extent can we anticipate the future and when and by how much do we deweight the present but transient?

Many fund managers would today be concerned about whether they have "*enough exposure to oil plays*". The trouble here is that oil has doubled in the last 12 months. We in fact first wrote about the impending boom in the oil price in June 2003 (http://www.platinum.com.au/images/drops.pdf). It is not really "breaking news". Nevertheless, if one were a momentum fund manager it would bear heavily on one's behaviour. The skill we require is to correctly gauge the tone of the market as we buy or sell the shares that we do or don't favour, while neither being too anticipatory nor too hesitant.

At present the market's focus seems to be on:

Growth
Developed economies are slowing to a snail's pace. Developing markets continue to grow but are threatened by rising inflation and, in some cases, the adverse effects of "managed" currencies.

Inflation

The deflationary pulse from China/Asia is reversing. There have been some unpleasant surprises regarding input costs and the movements of wages in Asia/Russia and other developing regions. Agricultural prices may ease but, on account of the fundamental repricing of energy, it is unlikely that they will fall back below the current trading range. Energy prices should stay elevated as demand destruction in developed countries (eg. dramatic shifts to public transport and other measures) is offset by developing world growth. There is very little tolerance in global supply to cope with incidents such as the Japanese nuclear generator fleet being taken offline, causing extra demand for oil of 350,000 barrels per day.

<u>Profits</u>
Forward earnings are likely to sag in the face of weaker demand and strong cost pressures.

<u>Credit</u>
Banks are being recapitalised but the magnitude of the write-offs are causing boards to tighten credit standards and we can expect regulatory oversight to stiffen. Re-intermediation will continue and securitisations will be much rarer.

<u>What is coming into view?</u>

Accelerating inflation rests partly on the effects of currency intervention and the consequent massive build-up of foreign exchange reserves in Asia, Russia and the Middle East. Some of this has been sterilised by way of the issue of domestic bonds, but not in sufficient quantities to offset fully the expansionary effect on money supply. Currency intervention will be a hot topic. Note that in China the government still sets both the maximum rate on deposits and the minimum rate on loans. This has allowed the banks to recapitalise themselves but now, via special reserve requirements, these set rates are throttling the ability to lend to the extent that the credit multiplier has shrunk to about 5.5 times.

Subsidies are also likely to receive more press. These are widespread across Asia. Apart from the interest rate subsidy noted above, there are the issues of tax rebates, now being phased out in China, subsidised motor fuels, natural gas prices, electricity prices, fertilisers and so on across the developing world. In the case of India these subsidies are exploding with the rise in the prices of hydrocarbons and food and now, at 5% of the economy, threaten the central government’s finances.

Inflation is starting to really frighten many Asian regimes, with recorded rates ranging between 7% and 14%. They are beginning to recognise the need to allow the true market price to ration the demand for basic necessities and to allocate resources more appropriately. This will likely lead to a change in perception about the risk of emerging markets. In the case of last year’s top favourite, Vietnam, the stock market has already halved in the face of concerns about inflation at 25%, the weakening Dong, and the foreign borrowings of some state owned enterprises and banks.

A growing concern about developing markets is likely to re-establish the risk premium at higher levels. As we all know, the attraction of superior growth had completely changed investors' risk/reward perceptions such that there was little difference in the rating of emergent and developed markets. Some of this new-found faith was always questionable in the case of the resource-rich countries. It was precisely because of their natural resource wealth that their political regimes were intolerant and restricted the development of strong institutions. The natural extension of this has been a trend towards resource nationalism - hardly reassuring to owners of capital.

There is likely to be more attention to corporate earnings. Broker analysts have still barely revised their earnings estimates for the next financial year. The majority of fund managers do not believe the analyst consensus of low teens earnings growth but we are still being told that things will improve in the second half of 2008 although we're here now and it doesn't look great.

As a general statement, we can argue that equity markets are most happy when inflation is around 2%. Less than that and companies are in the difficult position recently experienced by the Japanese. Customers are highly sensitive to price increases and it is often better to absorb the pressure of costs than to lose sales from "*sticker-shock*". However, as inflation rises to higher levels it progressively erodes the valuation of equities. This is so for several reasons, particularly the diminished availability of credit and the effect of taxation on illusory profits. Hence, as concerns about inflation become embedded, the price investors will pay for forward earnings starts to drop.

Should this concern begin to manifest itself, fund managers will start to look for those companies that are relatively protected from inflation. This could lead to defensive, non-capital intensive businesses being favoured over those which are pure price takers and have a lot of money tied up in plant and working capital. For example, food retailers would look very good versus steel mills.

Looking slightly further out, we believe we are approaching the cross-over point where spending patterns will shift. In the West we anticipate savings will rise at the expense of consumption whilst correcting the backlog of investment in public infrastructure plus the need to address alternative energy sources and conservation will also make a positive contribution. We expect the reverse in China and most of Asia, excluding India, where savings will begin to make way for consumption. China is at the extreme where investment and the trade surplus dwarf the consumer, so that one is inclined to believe there will be some painful adjustments as an appreciating exchange rate takes its toll. This may well become an important issue when constructing portfolios in the next few years.

In the last three years Platinum has displayed a pattern of being too preemptive in both its long and short positions. He who wants to be ahead of the crowd undoubtedly runs the risk of acting too early. Our frequently expressed concerns about excessive liquidity, over-borrowing and the weak US dollar all proved perceptive. All those factors did, however, take longer than we anticipated to have their impact which caused us to fail to capture some opportunities.

We are now barely exposed to energy and resources, except pulp and paper. Instead, we are positioning the portfolio for the inevitable burst of activity in creating alternative fuels and the whole investment program this will entail. We own a group of very stable and well-run companies whose valuations are well below their longer-term averages. We have little doubt that there will be some earnings declines but believe that prospective valuations are already anticipating a weak outlook.

Outlook

There are plenty of issues for the market to worry about. Consumers everywhere are feeling the pinch of rising costs, principally for food in the poorer countries and energy in the richer ones. Among the richer countries there is also a housing slump, tighter credit and the real prospect of a significant number of lay-offs. As we have been saying for a while, companies face reduced pricing power and higher input costs.

Investors are well aware that the stock market is an anticipatory mechanism. The conundrum is to assess the degree to which current prices already reflect a miserable outlook. Our view is that the magnitude and length of the boom was such that investors probably still view the future with a slightly rose-tinted blush. Unlike the “tech wreck” of 2001, at the peak of this boom there were few places to hide because of a convergence of valuations. The good were cheaper than the bad but not cheap enough to deal with profit downgrades. This is rapidly changing and those companies with the qualities we sought and highlighted last year, namely prominent business positions that support pricing power; no or low debt; margins close to trend and valuations below their historic average, now represent good absolute value.

We are relatively well-placed with our shorts in emerging markets, small caps and cyclicals. Prices in each of these sectors started to fall sharply in the early days of July.