The Platinum Trust Quarterly Report

30 September 2002

Incorporating the:

International Fund
European Fund
Japan Fund
International Technology Fund
International Brands Fund

PERFORMANCE RETURNS TO 30 SEPTEMBER 2002

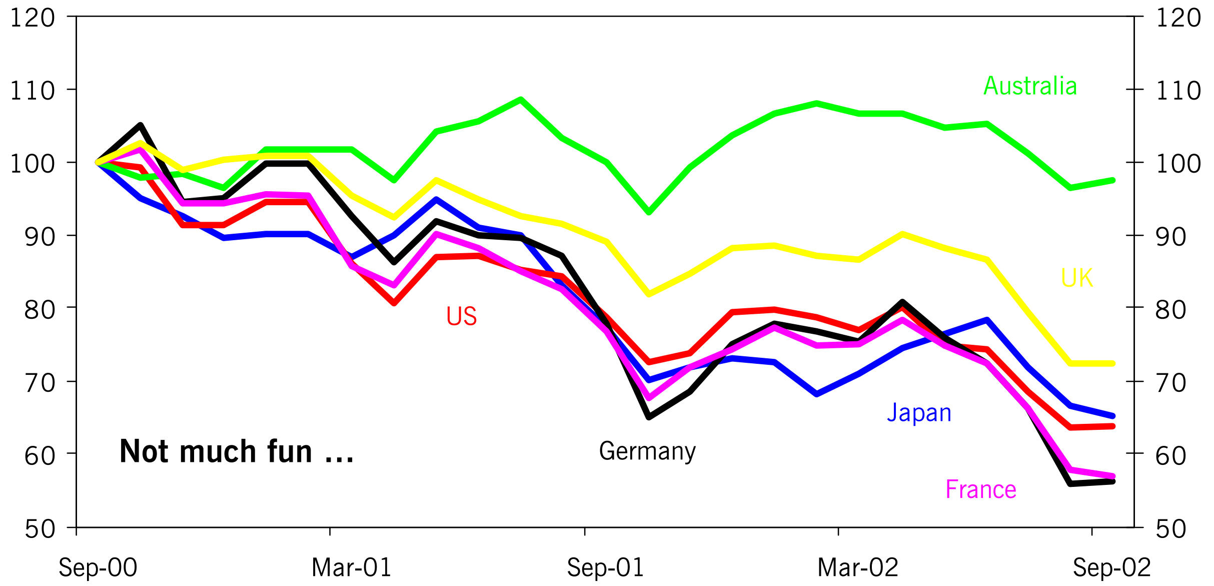
Fund	Fund Size	Quarter	1 Year	2 years (compound pa)	3 years (compound pa)	5 years (compound pa)	7 years (compound pa)
International Fund	**$1989mn**	**-11.7%**	**1.5%**	**6.8%**	**18.4%**	**18.5%**	**17.9%**
MSCI * World Index		-15.7%	-26.6%	-23.9%	-9.0%	1.7%	6.9%
Japan Fund	**$74mn**	**-3.5%**	**8.3%**	**-4.0%**	**12.5%**	**-**	**-**
MSCI Japan Index		-9.1%	-18.7%	-24.7%	-12.5%		
European Fund	**$79mn**	**-20.8%**	**-14.2%**	**-6.0%**	**22.8%**	**-**	**-**
MSCI European Index		-20.3%	-26.4%	-22.6%	-8.7%		
International Technology Fund	**$28mn**	**-17.6%**	**-15.2%**	**-10.7%**	**-**	**-**	**-**
MSCI World Technology Index		-23.4%	-38.6%	-52.3%			
International Brands Fund	**$63mn**	**-9.1%**	**17.3%**	**17.4%**	**-**	**-**	**-**
MSCI World Index		-15.7%	-26.6%	-23.9%			

* Morgan Stanley Capital International

Micropal average int'l fund return (621 funds surveyed)	**-22.5%**

Source: MSCI and Platinum

MSCI US, UK, GERMANY, FRANCE, JAPAN AND AUSTRALIA SINCE 2000 (LOCAL CURRENCIES)

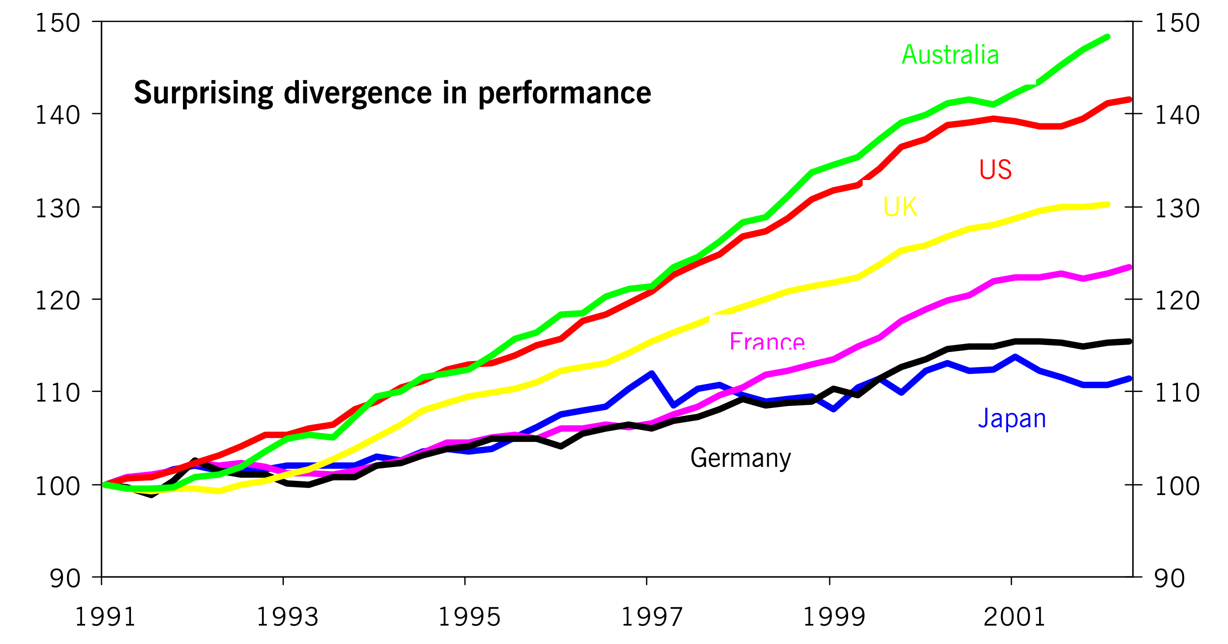


Source: FactSet

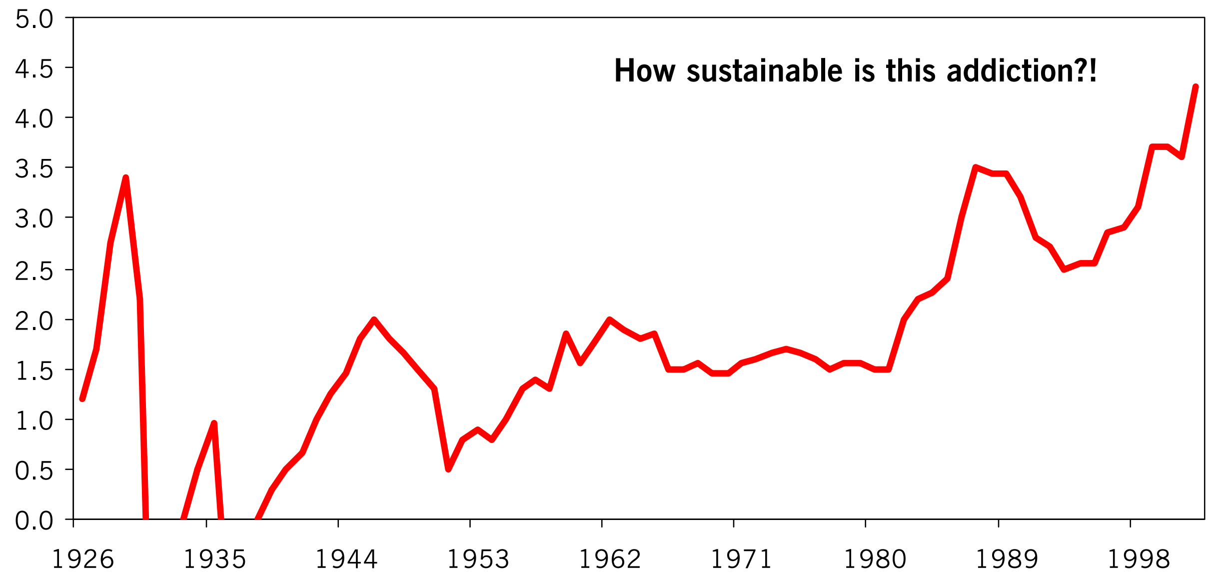
The Platinum Trust Product Disclosure Statement (PDS) provides information about units on offer in the Funds. Anyone wishing to invest in the Funds needs to complete the application form in the current PDS, which can be obtained through your Financial Adviser, from Platinum's Internet site – www.platinum.com.au or by contacting our Investor Services Centre:

Phone - 1300 726 700 or 02 9255 7500   Facsimile – 02 9254 5590   E-mail – invest@platinum.com.au

REAL GROSS DOMESTIC PRODUCT – JAPAN, FRANCE, GERMANY, US, UK AND AUSTRALIA



AMOUNT OF DEBT IN DOLLARS TO PRODUCE $1 OF GDP - US



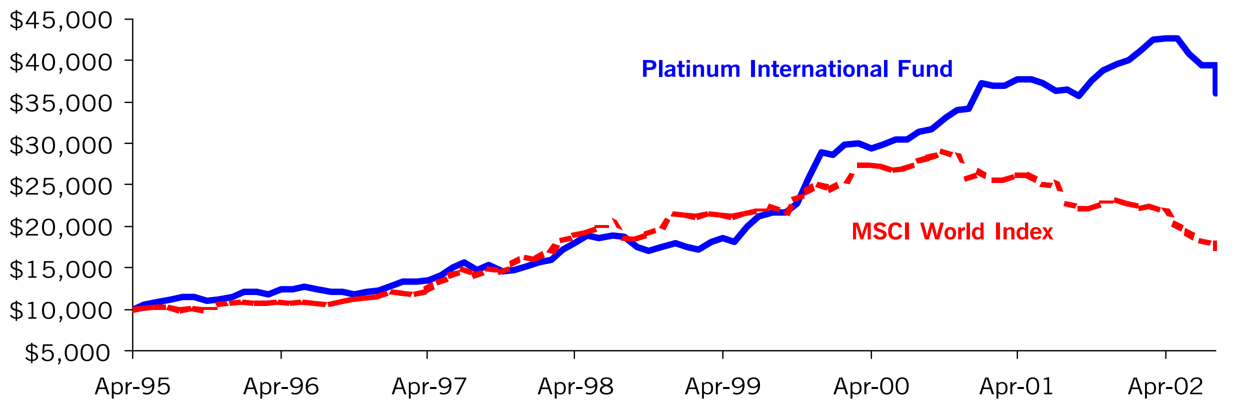
Source: Salomon Smith Barney

Platinum International Fund

Performance

REDEMPTION PRICE: $1.4786

VALUE OF $10,000 INVESTED SINCE INCEPTION (1 MAY 1995 – 30 SEPTEMBER 2002)



Source: Platinum

The prospect of war, continuous glum surveys of consumers in the major economies and disappointing earnings guidance all contributed to a miserable quarter for shares. By contrast, the search for income and other factors that are covered later in this report, pushed the yield on long dated bonds back to levels last seen in the 1960s.

There was wide disparity in the performance between geographic regions as well as between industries. Asia generally held relatively firm, showing smallish losses, Wall Street was weak, with the S&P down 18%, while Europe was clobbered. The European Stoxx index ended with a 28% fall and the German DAX fell 37%. Europe's poor showing is partly due to its index having a heavy bias towards financials and cyclical industrial companies. Poor economic performance, disappointing surveys of business and consumer confidence and the obstinate refusal of the European central bank to reduce interest rates all combined to persuade investors to run down their holdings of stocks sensitive to the trade cycle. Insurance companies and banks were treated particularly harshly on solvency fears as their listed holdings cascaded down in a somewhat self-reinforcing manner.

On a global basis, as the table on the right shows, Information Technology was again the sector where share prices fell most sharply. Only Health Care and Consumer Staples demonstrated any worthwhile defensive qualities.

The Fund's performance during the quarter was disappointing. While we expect to show losses in a down market, we would have hoped to have suffered about half that of the MSCI. When positioning the portfolio with a 2 to 3 year view to favour intrinsically strong companies that will emerge from the present financial dislocation with fewer serious competitors and with the ability to exercise some pricing power, there will be times that we diverge markedly from the index. As we have taken a highly cautious view on the likelihood of the consumer providing powerful impetus to the economy, we are tending to avoid the seemingly predictable components of the market.

MSCI WORLD INDEX – INDUSTRY BREAKDOWN

Sectors	3 months	1 year
Information Technology	-23.8%	-38.4%
Materials	-19.2%	-13.3%
Financials	-18.1%	-26.6%
Telecommunications	-17.8%	-51.1%
Industrials	-17.2%	-24.9%
Energy	-16.1%	-21.0%
Consumer Discretionary	-15.0%	-20.8%
Utilities	-13.8%	-32.2%
Consumer Staples	-7.5%	-12.8%
Health Care	-6.6%	-30.0%

Source: MSCI

We suffered our share of poor stock choices. The most costly was EDS which revealed a significant earnings disappointment and fell by over 50%. Our European insurance holdings were also treated mercilessly as described above and our IT holdings were severely beaten. From point to point companies such as Alleanza, Generali and Allianz fell over 35%, a considerable over-reaction we believe, while Ericsson, AMD and National Semiconductor typically declined by 55%.

We have been progressively migrating our short sales towards consumer staples which, because of their apparent earnings certainty, are being used as hiding places by dedicated long funds. Shorts on the financials have been highly successful and profits were taken as we shifted our attack to the still relatively strong 'earnings-conjurers' and retailers.

Looking at the actual numbers, the value of the Fund fell by 11.7% over the three months, while achieving 1.5% for the year. By contrast, the MSCI world index fell by 15.7% for the quarter and is down 26.6% for the 12 months.

Changes to the Portfolio

DISPOSITION OF ASSETS

Region	Sep 2002	Jun 2002
Western Europe	31%	38%
Japan	18%	18%
Emerging Markets (incl. Korea)	11%	12%
North America	13%	10%
Australia	2%	1%
Cash	25%	20%
Shorts	27%	20%

Source: Platinum

Platinum's main activity during the quarter was adding to existing holdings. As noted above, the price decay in some areas was astounding. It is ironic that one was criticised during the bull market for taking so-called "directional bets". Now as the market seems to be in free fall, the same observers are doing just that and wishing to avoid the difficult decisions regarding when to purchase. The cases in point are the insurance companies like Allianz (Germany) and Alleanza (Italy). The former is one of the world's premier insurers with premium income of some E60 billion pa, a massive solvency surplus and an AA+ credit rating from S&P. That it squandered resources during the boom is not in dispute. Its management fell in love with the bank assurance model and exchanged a partial ownership of Hypovereinsbank for full ownership of Dresdner bank which went on a balance sheet expansion splurge just in time to catch many of the tail-end bad credits of the boom. Appraisal of Allianz's statutory filings suggests there are still approximately E4 billion of outstanding write-offs although they do not seem to have been caught with the really nasty securitisation strips that many will rue. We believe that Allianz's mistakes are well understood by the market as is the possibility of a credit down grade.

This leaves one with an entity that is vigorously addressing its cost base, a giant competing in a capital-constrained industry so giving it that rare quality of pricing power. The main concern of the stock market appears to be directional because each 10% move in equity markets adds or subtracts 14% from the firm's embedded value. The collapse of the share price allowed us to top up our holding late in the quarter when we also added to Generali and Alleanza. Under current circumstances we would treat further price weakness as a buying opportunity.

We have also made modest additions to existing tech holdings and bought Nvidia (US) and LSI Logic (US). As the prospect of recovery is pushed further out, these companies are experiencing investor surrender. Long gone are 'buying the dip' and the illusion of perpetual growth; the focus now is on IT capital spending surveys, cash burn, balance sheet robustness and survival. In many instances tech companies with good growth potential are not even flattered with the ratings attached to dull cyclicals.

We also started to buy China Mobile. This company is the principal provider of mobile telephony in China having 100 million subscribers and covering 21 provinces. The important feature of its business has been the shift of the bulk of its revenue from long term contracts to pre-paid subscribers. This has clearly stimulated growth at the cost of Revenue Per User. The so-called RPU has fallen dramatically and has now stabilised at around US$15 per month with usage of 209 minutes. With the death of the internet hype, the share has fallen from HK$80 to $18 and is on a prospective PE of 11 times. While growth will slow from the frenetic pace of recent years, we cannot identify many factors that will adversely affect the rating from here.

Sales included Pernod Ricard, Givaudan and Stinnes. The first two performed splendidly on account of their defensive qualities but, as suggested in the last quarterly, as markets sell off relative valuations can become misaligned as investors pay too much for perceived excellence only to find later that there was better value elsewhere. Stinnes is in a different category having been bid for by Deutsche Bahn. It was a very successful holding, again bought when its pivotal role in European logistics was poorly priced, earning the Fund nearly 100% in 24 months.

BREAKDOWN BY INDUSTRY

Categories	Examples of Stocks	Sep 2002	Jun 2002
Cyclicals/Manufacturing	Schindler, Siemens, RMC, Bayer, Linde, Océ	22%	17%
Retail/Services/Logistics	Hornbach, Jones Lang LaSalle, Fraport	9%	12%
Financials	Assicurazioni Generali, Allianz, Alleanza	9%	10%
Technology/Hardware	Agere Systems, National Semiconductor, Samsung, AMD	8%	8%
Consumer Brands	Citizen Watch, Adidas Salomon, Lotte Confectionary	7%	10%
Telecoms	Hellenic Telecom, Verizon, Ericsson, NTT	7%	6%
Medical	Yamanouchi, Takeda, Draegerwerk, Novartis, Merck KGaA	5%	6%
Gold and Other	Barrick Gold, Newmont Mining, Gold Fields	5%	5%
Software/Media	Sky Perfect Communications, Mediaset, Seoul Broadcasting	3%	6%

Source: Platinum

Currency

We did not change our currency positions over the quarter. At quarter end, 69% of assets were hedged into A$; 16% held in Euro/European currencies, with the rest mainly in Korean Won.

Commentary

The fierce sell off over the last three months has certainly winded the bulls badly as almost any purchase has proved wrong within a short time. Price action in Europe suggests the bulls are in full retreat and in the US there are only pockets of determined resistance. Even so we do not see investors as having done much to reduce their exposures overall.

As we have noted on numerous occasions, we believe the nature of the tech boom and the high degree of consumer indebtedness precludes a strong economic rebound. What has become clearer through this last quarter is just how difficult trading conditions really are. This is evident from the many profit warnings and equally from official statistics which show wide-spread retail price deflation. This is true from China to Europe and the US. In each case retailers are selling goods for between 2 to 3% less than last year; this makes overhead absorption considerably more difficult. Further, we are witnessing a change in "behavioural patterns". In the US consumers are beginning to save again and even more interestingly, there is clear evidence that they are trading-down. This pattern ranges from quasi fashion statements, shoes (Nike) to tobacco (Philip Morris) and cosmetics (Estee Lauder). It is not clear that this is confined to the US where one might put it down to individual caution and financial strain as evidenced by growing mortgage and credit card delinquencies, both, coincidentally, running at 4.77% as at June.

For the months immediately ahead it is difficult to become particularly optimistic. It seems probable that there will be an easing of credit conditions in Euroland but the high oil price is debilitating to consumers world-wide and the threat of war is destructive to confidence. On this subject we can look forward to a frenzy of muddled media coverage. What is clear is that the inhabitants of the cradle of western civilisation, Mesopotamia, will not welcome foreign visitors whether UN endorsed or not. Writing in a calmer time of the late seventies [1], Peter Ustinov, the actor and writer, eloquently observed, "Just over two hundred years ago, the United States emerged like a phoenix from just such a third world.

[1] "Dear Me" by Peter Ustinov, published by Mandarin 1977, p283

Has she forgotten so quickly what it was like to be poor, and pure, and young? Must she so soon filch the musty robes of power from the wardrobe, and behave as the British, and others did when they were the flagellating fathers of the pupil world? Why this pharisaic impatience with those just fallen from the nest? Is it merely the impatience of the young with those still younger, or is it a trap laid by stealthy nature to try and lure America into a posture which was the cause of her own rebellion, her own birth".

Pardon this philosophising but military history is strewn with examples of consequences, intended or not, that haunt subsequent generations.

Turning back to developments in markets, we wrote last quarter about the privileged position of the Government Sponsored Enterprises (GSE's) in the US leading them to become giant hedge funds. Their significance in the fixed interest markets has been particularly noticeable in recent weeks as they engage in the so-called convexity trades. This stems from the effect that the refinancing of mortgages has upon their balance sheets. To make up for the loss of long term assets as consumers renegotiate their mortgages (to take advantage of lower fixed interest rates), the GSE's have been actively, though indirectly, purchasing long term debt mostly through entering interest rate swaps. The consequence of this is to drive down the yield on long dated securities, giving the impression that the bonds are being priced for deflation. Thus technical factors emanating from the unbridled growth of the GSE's is reinforcing the downward move in long rates.[2] Today the market value of mortgage-backed securities is greater than the Government bond market. From being about 60% to 70% of Treasury debt, securitised mortgages now represent 130%. The GSE's have nearly "shot themselves in the foot" as the "convexity trade" has influenced the shape of the yield curve to the disadvantage of all the financial intermediaries who had hitherto exploited the large spread between call rates and longer term bonds. This provides some attractive shorting opportunities!

Dresdner Kleinwort Wasserstein do some interesting quantitative studies to assess market expectations. The recent findings are that share analysts have down-graded their implicit growth expectations to a 15-year low. Their forecasts have shown a pattern of steady deterioration but bottom-up estimates have in the past invariably proved to be too high. Some markets, notably in Europe, now seem reasonably valued, but expectations in the US are still high. We have often commentated on the unreal expectations that the protracted bull market embedded in forecasts and DrKW's findings are that US long term earnings expectations through the nineties rose on an almost continuous trend versus nominal GDP. The expectation is presently for long term earnings to grow at 2.6 times nominal GDP <u>even though, with the single exception of the nineties, the quoted sector's earnings growth has always trailed behind money GDP</u>.

Among other important developments are the outcome of the German elections and the proposed buying of shares by the Bank of Japan. Another four years of rule by the SPD in coalition with the Greens is generally seen as negative by those who were hoping for economic reform to re-energise the moribund economy. Germany has been stagnating for some time and it may come as a surprise to learn that real GNP has risen only 12% over the last ten years, barely better than Japan's 10% and well behind the US figure of about 40% and Australia's 50%. Germany's unemployment rate of four million is in stark contrast to its more agile neighbours who moved early with labour reform.

The message coming from the Bank of Japan (BoJ) to buy shares directly from banks is a significant departure from its former position and at this stage it may merely reflect political intrigue among the ministries to give the Prime Minister more breathing space. One needs to recall earlier protests by the public regarding the use of taxpayer's funds to bail out the banks. It is possible, however, that by invoking a sense of crises, the BoJ will be able to nationalise some of the risks within the banks and ultimately free up capital for more productive uses. Even so, it is our contention that the main problems within Japan are proper financial intermediation and the debilitating effect of deflation rather than bad bank loans alone. The statistics clearly point to large corporations reducing their debt and meeting capex from their own resources but it is the small companies that are feeling the funding squeeze and going under. To be more than a short term palliative, the BoJ will need to expand the money base faster than hitherto and on this point there is as yet no clarification.

[2] Apart from insuring mortgages, the GSE's also borrow and invest in mortgages. In so doing, they attempt to match the terms of their assets and liabilities. However, as rates drop and consumers' refinance their mortgages, these assets on the books of the GSE's are repaid ahead of schedule. This put option of mortgagees causes the GSE's balance sheets to become lopsided – with too little asset duration. (The negative convexity of mortgages causing the duration of assets to decline faster than the duration of liabilities). Hence, the GSE's search for long-dated fixed income assets to redress the balance.

Outlook

There are many issues to trouble investors. The immediate concerns relate to consumer behaviour in the face of potential war, high fuel costs, weak employment growth and doubts as to whether low or even falling interest rates can reignite the growth flame. It is very clear that companies have become more cautious so one cannot expect buoyant investment spending until the profit cycle has started to recover.

Our problem as investors is to assess whether this dreary outlook is now fully reflected in specific share prices. We cannot know because as we have noted in the past, this bear market will be accompanied by a gradual erosion of valuations.

We do observe that there is not the normal gnashing of teeth and misery that would be associated with a bottom of the bear market. Against this however, is the astonishing destruction of prices. One way of assessing this is to observe the divergence between stock prices and their moving averages. We suggest that these are now stretched to extreme levels, particularly in Europe. At the very least, this could point to the prospect of a bounce, if not a bottom.

On historic valuations our holdings look attractive. For example, in Europe we think the average PE of our holdings on forward earnings is around 13 times while our holdings in Korea and Japan are around 16 times. The figures for the US are distorted by losses from some of our companies and that creates a negative PE. That there will be companies that fall short of our hopes is inevitable but price declines have left many company capitalisations back to levels seen before the boom and even earlier.

With our continuing activity in shorting the well-owned and seemingly over-valued areas, we feel reasonably confident to be selectively buying now.

Kerr Neilson
Managing Director

Ratings Agencies

A research house recently chastised Platinum Asset Management for apparently being wanting in the areas of strategic planning, management procedures and systems. It is the considered view of the board that their observations are without merit. As the principal owners of this business and having the largest individual pool of assets within our funds, it behoves us to take any external critical analysis seriously. However, we genuinely believe that our clients want a range of funds, which attempt to achieve absolute returns. That the last thing they wish is for Platinum Asset Management to divert its focus from funds management and engage in distribution strategies, marketing and benchmark hugging.

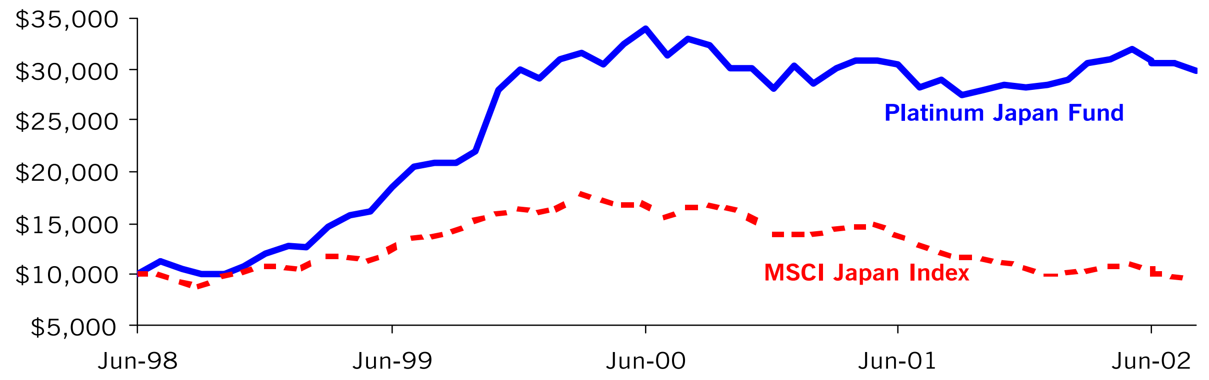
Proof of our systems lies in turn around time of applications, redemptions and the fact that unit holders were mailed their tax statements within twelve days of the fiscal year end. Further, that a real person (who is hopefully helpful and polite) answers your queries and that you do not have to spend an interminable amount of time on keypad chess - trying to get answers to your questions.

Platinum Japan Fund

Performance

REDEMPTION PRICE: $1.6919

VALUE OF $10,000 INVESTED SINCE INCEPTION (1 JULY 1998 – 30 SEPTEMBER 2002)



Source: Platinum

The Japanese and Korean markets were negatively impacted this quarter by the deterioration in global investor sentiment as a result of weakening global growth and geopolitical fears. In Japan, the Topix declined by 9% in local currency terms whilst in Korea the Kospi fell by 13%. However it should be noted that these markets still performed better than the US and European equity markets, perhaps because they never really saw the bull market excesses that characterised these markets. The one bright spot was Japanese banking stocks which rose by 8% over the quarter as there was speculation that the government would shore up their finances by injecting public funds. Exchange rates were relatively stable over the quarter.

The Fund fell by 3.5% (A$ terms) which was better than the 9.1% decline in the MSCI Japan index. The Fund was protected by its short positions and cash holdings. Within the stocks owned by the Fund, Shimano, Olympus and Korea Telecom did very well on company specific news whilst on the negative side many of our smaller stocks had large falls as investors reduced exposure to riskier, smaller capitalisation shares. For the year to 30 September 2002 the Fund rose 8.3%, comfortably ahead of the MSCI Japan which declined by 18.7%.

Changes to the Portfolio

DISPOSITION OF ASSETS

Region	Sep 2002	Jun 2002
Japan	65%	68%
Korea	24%	20%
Cash	11%	12%
Shorts	13%	18%

Source: Platinum

There were quite substantial changes in the Japanese segment of the portfolio as the market decline presented opportunities. Generally we were adding positions in higher quality, larger capitalisation issues with good records at the expense of companies where we were uncomfortable either because they were trading positions or their fundamentals were questionable in a difficult economic environment. We added positions in Takeda, Yamanouchi, Ushio, Olympus and Fuji Photo. We also increased positions in Credit Saison and Aiful. These stocks have been hurt by the rise in delinquencies as a result of the weak economy but are now very cheap for the type of growth rates they can attain. However if the economy continues to deteriorate they will be subject to some downside. To finance these purchases we sold our entire positions in Sekisui Chemical, Fujikura Kasei, Hitachi Capital, Enix, TOC and Nippon Broadcasting.

Fundamentally we are defensive in our thinking due to our feeling that global economic growth will go through a “payback” period for the high growth rates experienced in the late nineties capital spending boom. In this environment companies promising too much into the future (high PE’s), having lots of debt and subject to management uncertainties will not be treated favourably by the market. Small companies on balance will probably struggle to gain a foothold in the industrial consolidation. When we look at how defensively we are positioned we take into account many factors, some of which we have outlined below.

	% of total portfolio
Cash and Shorts	24%
High Debt/Equity Stocks (mostly utilities)	13%
Financial Stocks (primarily Japanese credit card companies)	12%
High PEs (companies with losses such as MEI)	10%
Small companies	6%

Source: Platinum

As is clear we are shying away from the riskier parts of the market. A new addition to the portfolio was Ushio Denki. It is a specialist in the field of industrial lighting, supplying high powered lamps and equipment to clients over a broad range of industries covering office automation, semiconductors, visual imaging and specialty lighting. The company has focused on light applications since its inception and holds very significant market positions with about 70% of its product lines having greater than 50% world market shares. For example, the company holds 65% of the world market for exposure lamps used in copiers and printers and it holds 50% of the world market for high powered projection lamps for cinema projectors. Recently the shares were sold down because of its classification as a light source supplier to stepper makers but in reality this is a much broader company (less than 10% of sales in this area) and is heavily weighted toward consumable supplies of lamps which are much more stable than equipment sales. We see interesting growth potential for the company in stepper light sources and cleaning lamps for LCD screens as well as in digital cinema as the old fashioned film based analog projectors are replaced. In addition the use of light is a highly effective, clean and safe method for manufacturing in the nanotechnology world which we are rapidly entering.

Commentary

The most interesting piece of news out of Japan this quarter was the announcement by the Bank of Japan (BoJ) that it would buy some cross shareholdings from the banks. These are shares held as assets by the banks in their clients listed shares and because of their magnitude (about A$370 billion) they represent a real threat to bank solvency as the equity market declines. Central banks almost never buy equities because of the moral hazard it creates so it certainly marks a significant new chapter in Japan’s struggle with depression. At this stage, given the relatively small amount of money involved (perhaps up to A$45 billion), it seems that the BoJ is trying to deflect criticism of its inaction back onto the politicians by invoking a sense of financial crisis and forcing the lawmakers to inject public funds into the banks. One needs to recall earlier protests by the public regarding the use of taxpayer funds to bail out the banks. Its aim would seem to be to nationalise the problem by putting the banks on a sounder footing. Simultaneously, this could be expressed in looser monetary policy which could help boost the real economy. We remain of the view that Japan’s main problem is deflation and with general price levels having adjusted to western levels, the onus is on the BoJ to act. Putting the banks on a more stable footing may just give the BoJ the chance to allow its monetary policy to work. However, it probably needs to do more in terms of quantitative easing and it has said nothing about this at this stage.

In Korea we continue to run a somewhat defensive position. This is in contrast to our more positive medium term view and reflects a number of factors including the good performance of the market in the past year, slowing export growth and the prospect of tighter monetary conditions as a result of the recent consumer boom. Traditionally the time to sell Korea is when everyone is positive (which largely they are) and after a good cyclical run in the economy. Further grist to the mill has been provided by the recent government moves to guide the banks to rein in credit card lending and for the banks generally to raise provision levels. In addition a lot of the positive comments about Korea derive from the very good performance of Samsung Electronics in global markets which we think is probably well discounted and may see some slowdown. Having said that we remain positively disposed to the market and buyers on weakness as the market seems to be discounting a 40% decline in earnings next year which is probably about as bad as it could get. In the meantime the utilities may do quite well. Korea Telecom and particularly Korea Electric Power look very attractively priced investments.

Another interesting aspect to the Korean market has been the flurry of activity surrounding North Korea. Recently the North significantly raised prices and wages for a large part of the population which may be the first moves to a market-based economy. In addition there has been high level diplomatic activity with visits made by senior leaders to China and Russia as well as the historic visit by Japanese Prime Minister Koizumi to Pyongyang. The North and the South, despite the recent naval clash, have agreed to reopen the border with a train service and take other measures to generally reduce tensions. It is not entirely clear what is driving this action but on the whole the reduction in tensions is positive. The hurdle at present is the US which named the country in its "axis of evil" and it is possible that the North is making these efforts mindful of being on the wrong side of US foreign policy.

Outlook

We continue to believe that we have a portfolio of very attractive stocks. However, the global outlook continues to deteriorate and this will make it hard for us to achieve much absolute performance. We have seen some major deterioration in prices of stocks, but there are still some names that probably have further to fall. In addition, there is the prospect that equity losses sear investor's confidence and that asset preferences move away from equities. On balance, the odds favour a defensive portfolio at present. We will remain nimble and alert to changes in central bank policy and global conditions.

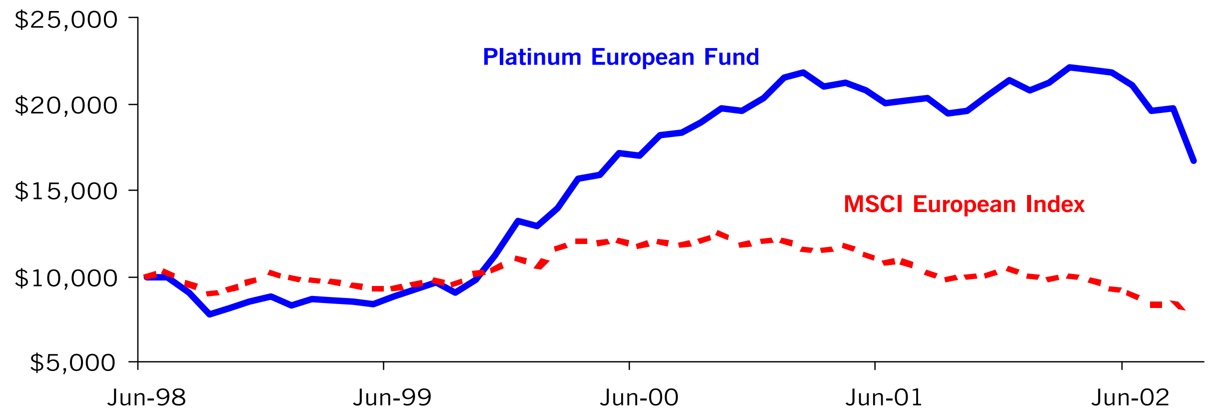
Jim Simpson
Portfolio Manager

Platinum European Fund

Performance

REDEMPTION PRICE: $1.2782

VALUE OF $10,000 INVESTED SINCE INCEPTION (1 JULY 1998 – 30 SEPTEMBER 2002)



Source: Platinum

Broad bear market in Europe, spectacular declines in Germany

European share prices collapsed in the three months to 30 September 2002; the breadth of the sell-off was the distinguishing feature of the period. Every sector of the market fell, so that although food, beverages and pharmaceuticals (all traditional "safe havens") were only down about 10%, the rotation that has characterised so much of the last five years (ie. money reluctant to leave the market) was replaced by almost indiscriminate selling.

The weakest sectors were computer services (-53%), and software (-45%) reflecting concern over corporate expenditure. Note that these two sectors also fell 40% in the previous quarter. The industrial products (-45%) and manufacturing (-35%) groups fell heavily as markets discounted a generally weak globally industrial economy. And the sell-off in insurance stocks (-45%) was savage for reasons explored below. In a way, however, the 32% sell-off in water utilities and the 26% fall in food retail stocks better illustrate the frenzy of selling seen in the last few months.

The breadth of the bear market can be seen in the individual stocks: of Europe's 500 largest, just 12 shares rose by 5% or more, while 44 companies saw their share prices halve, and 130 lost over a third of their value (in just three months).

The depth of the sell-off varied across the region, with the UK falling the least (-21%) and Germany the most (-37%). In fact the German DAX had its worst quarterly performance since 1959. Some explanations for the capitulation in Germany are offered later in this report. European bond markets, as measured by the German 10 year government bonds, were strong over the three months, with yields falling from about 5% to under 4.3%, reflecting the weak economy and the institutional switch from equities to bonds.

The MSCI European index fell 23% over the three months, and the Euro appreciated 4% against the A$ over the period (the pound Sterling rose 6% against the A$). These currency movements exacerbated the variation among countries, with the German DAX down 35% in A$, while the UK FTSE fell 16%. Overall, the A$ return for the MSCI Europe index was –20%.

The Platinum European Fund fell sharply over the three months, down 21%. This disappointing outcome reflects the 40% or so of the Fund invested in Germany (and only 5-6% in the UK – note that the MSCI index weight of the UK is about four times that of Germany). The damage done in Germany offset protection offered by the modest short positions (and cash held) in the Fund.

Commentary

European insurance companies – the viscous circle for stock markets

The importance of the breadth of the sell-off in stocks is that it helps illustrate the motivation of the sellers. Institutions (pension funds, mutual funds, and insurance companies) were effectively forced sellers. Pension fund trustees have begun to question their 5-10 year infatuation with equities and have, in many cases, decided that a 60-80% weighting in shares is too high. Mandates have been switched or reduced, and the fund managers sell down all the holdings proportionately. Similarly, mutual fund investors have been redeeming their investments, forcing their fund managers to sell down holdings across their portfolios. This is of course part of the "Giffen good" nature of shares which exacerbates bull and bear markets: shares are one of the few things that people wish to buy more of as they become expensive, and to buy less of as they become cheaper (houses in Australia are another good example).

The other forced sellers of note are insurance companies, who have prudential regulators compelling them to reduce their investments in shares as share prices fall. This European insurance company selling became very much a self-fulfilling prophecy in recent months as the "thin" markets intensified the share price declines. In addition, financial stocks are the largest single sector of the European stock markets, and the insurers – Allianz and Munich Re in Germany, Generali in Italy, AXA in France, Swiss Re in Switzerland – are (or at least were) among the largest stocks in Europe. As the value of some of the assets (ie. shares) on their balance sheets collapsed, so these companies' own share prices fell too.

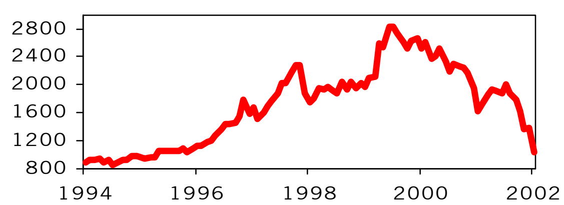
The perversity of all this is that insurance is one of the few businesses which has "pricing power" at the moment. Demand for general insurance (home, car, professional indemnity, earthquake etc) is fairly stable through time, but the supply or capacity to insure is a function of the capital made available to and by the insurance industry. The profitability of insurers (investment returns aside for the moment) is largely a function of the premiums they can charge and the payouts they must make, so clearly this capacity is key to the so-called *insurance cycle*. Insurance payouts have grown, partly due to the insidious effects of American-style litigiousness, and this has caused capacity to leave the industry. Specific events such as the collapse of the buildings in New York a year ago have also weighed on the industry. And the weak share markets have meant that the poorly capitalised insurers have withdrawn capacity still further. The outcome is that insurance premiums have generally been increasing, and with this scenario in mind we have made some investments in the industry over the last 6-12 months.

These investments – in Allianz in Germany and in Generali and Alleanza in Italy (all strong, well capitalised companies) - have been costly, however, partly because of the share price effects referred to above. And in recent weeks the weak insurers (some of the Swiss, Dutch and British in particular) have been forced to raise fresh equity capital. This hurts the whole industry because even though the low share prices of those weaklings means the capital raising is very damaging to their existing shareholders, once the capital is raised, it is available to write insurance. This is an offset to the reduction of insurance capacity described above. In a sector share price sense, it has also damaged our holdings because of the supply of insurance company shares flooding the stockmarket.

Share prices, European economics & capitalism, and the German election.

The above discussion may give some sense of the "flows" of money out of shares in recent months. But what is the underlying fundamental message the market is sending? Was the 1990s strength of European share markets a mistaken capitalist fantasy that is being extinguished? Or is this just a correction (from a "bubble") that has few serious implications for the general direction of the economies? And why did the German voters just re-elect the same government that has presided over the last few years of economic stagnation?

DAX INDEX - 1994 TO SEPTEMBER 2002



Source: FactSet

The Platinum European Fund

Excluding the instances where sharemarkets closed due to world wars, there have been, in the last century or so, only three other instances of developed country share markets suffering bear markets as violent as that which currently afflicts Europe (ie. down more than 50%). These instances were 1929-1932 (US), 1973-74 (US, UK, France), and 1990-1992 (Japan). In each of these cases, the stocks markets were signalling fundamental change in the economic environments of the afflicted countries. With this in mind many commentators are starting to wonder what the coming years hold in a macro-economic sense. The general blueprint is Japan, though the conceit of policy makers (and the faith of most professional economists in the efficacy of monetary policy intervention, especially that of the US Federal Reserve) means that few think the US is headed in this direction. As an aside, it is worth considering the importance of a healthy financial sector to monetary policy as practiced in the last 25 years – in many ways the trouble in Japan is probably the lack of an effective private sector credit creation mechanism. Very high corporate and personal debt levels in the US financial system are, therefore, not just dangerous to the holders of bank equity, but to the economy generally.

Macroeconomic commentators and international strategists are almost uniformly negative about Europe's prospects. While we have observed for a long time that the European stock markets behave as derivatives of Wall St, (tending to exaggerate its movements up or down), it is quite another thing for serious commentators to write of Europe's economic and political status as "a dependency of America".

Growth in Germany is very poor. Inflation is not a risk; deflation probably is. Germany has, these last few months, often been labelled "the next Japan", and its anaemic economic growth means this claim is difficult to refute for the moment. But even assuming that such an analogy proves appropriate in coming years, there can still be many interesting investment opportunities, just as there has been in Japan in the last decade.

The pro-business parties lost what many considered an "unloseable" federal election in Germany a few weeks ago. The incumbent "socialist" coalition (very centralist, but heavily dependent upon German labour unions) retained a slim majority mostly because of the performance of the Greens, who campaigned vigorously *against* Germany supporting an American invasion of Iraq, among other things. But the main point is that there was not a strong vote for change – the pro-business parties were seen as most likely to implement reforms for the labour market etc, and they polled very poorly.

And late in September Deutsche Boerse (the German stock exchange) announced the closure of the German Neuer Markt ("new market" – which we described in 2000 as the "supercharged NASDAQ of Europe"). The whimper rather than bang that marked this occasion perhaps makes it a valid signal for the complete removal of optimism in Germany for shares generally.

The point of all this is that, in the context of the stock market collapse, European share prices have corrected most if not all of their excesses, and there is little "irrational exuberance" remaining in the prices. While we wrote a quarter ago that poorly positioned (and heavily indebted) companies were apparently cheap, now it must be said that many strongly positioned (and securely financed) companies have been sold down to very low levels as well.

Industrial survivors

Several German machinery companies with decent size businesses (sales of up to A$10 billion) and strong market positions in their areas are now trading at a fraction of sales, under 10 times earnings (even in a meagre year like this) and yielding 5% or more (dividend). Where such companies have solid balance sheets, and do not face medium term devastation from Korean or Chinese competitors, they do not even need to grow much to make worthwhile investments (ie. at current ratings). We wrote at length in the mid-1990s how many such German companies had faced despair (union imposed wage and working conditions, threat from cheaper countries, seeming inability to charge a sufficient price for the superiority of their product etc) – and at that point of despair had in fact set about change. Pragmatism has dictated that they outsource some of the basic components and sub-assemblies while reinforcing the core offering of the product and emphasising design, marketing, maintenance, replacements, and upgrades.

Although the stock market is suggesting failure, failure is far from certain. These companies had a solid base to build from, and the extent to which, for example, the heavy industrial product businesses can successfully generate profitable service revenue streams out of their equipment position (and whether this is sensible as a strategy or merely an appealing fashion) is a matter which we are currently considering.

BREAKDOWN BY INDUSTRY

Categories	Examples of Stocks	Sep 2002
Miscellaneous Services	Fraport, Hagemeyer, Draegerwerk	17%
Consumer	Adidas, Michelin, Henkel	14%
Retail	Hornbach, WH Smith, Rinascente	13%
Capital Goods	Océ, Schindler, Siemens	11%
Chemicals/Materials	Linde, Merck	10%
Pharmaceuticals/Biotechnology	Novozymes	9%
Financials	Alleanza, Allianz, Assicurazioni Generali	7%
Health Care	Novartis	6%
Tech/Media	Ericsson, Deutsche Telekom	6%

Source: Platinum

Portfolio Activity and Outlook

In keeping with the view that the price declines had made many stocks more attractive, the principal portfolio activity was steady additions to our existing holdings. Allianz was, as mentioned, a new investment; and earlier in the quarter we took a small position in Deutsche Telekom at E10 per share (this stock has been from E28 to E105 since we last owned it!). And as prices fell, we reduced the short positions in the Fund (halving some, closing others) over the quarter so that by 30 September short positions were down to 7%.

During the quarter we sold the position in German transport/logistics giant Stinnes (which for most of the last year or two has been the largest holding in the Fund) which was taken over – at a very favourable price for us – by Deutsche Bahn (German Rail). Additionally we sold out the remainder of Deutsche Boerse (the German stock exchange), which, considering the collapse in share trading activity by traditional investors, had held up well and has been a good investment for the Fund. And Givaudan, the Swiss flavours and fragrances leader, has had a solid business performance rewarded by a share price going in the opposite direction to the rest of the market. We still like this business, but fear that the stock has been used as a place of refuge for many and that it may reverse in the coming (?) stock market recovery. Overall the net invested position of the Fund has increased over the period from under 70% to 86% as of 30 September 2002.

To the extent that it is possible to feel enthusiastic about stocks after such a dreadful six months, valuations mean that while underlying economic conditions provide a solid headwind for almost all businesses, as investors we have the best offering that has been available for some years. It is disturbing that the so-called “stability pact” criteria (governments may not run deficit above 3% of GDP) mean that European fiscal policy is effectively tightening into the recession. Given underlying deflationary tendencies, real interest rates look far too high in Europe also, so there should be some monetary policy relief from the ECB imminently.

The history of bear markets, and the destruction of enthusiasm for shares means that sustained uptrends for stock markets are unlikely to come soon. However as the general selling abates, a portfolio of well chosen stocks can make some headway even while the overall market trades sideways. In the absence of indications of a sharply greater macroeconomic downturn in Europe, we will most likely be moving to a highly net-invested portfolio in the coming weeks and months.

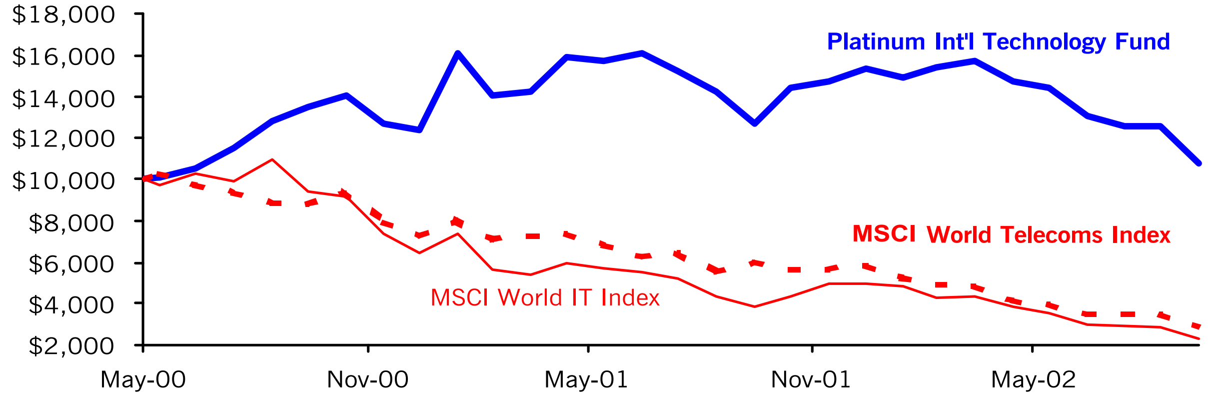
Toby Harrop
Portfolio Manager

Platinum International Technology Fund

Performance

REDEMPTION PRICE: $0.6999

VALUE OF $10,000 INVESTED SINCE INCEPTION (18 MAY 2000 – 30 SEPTEMBER 2002)



Source: Platinum

The Fund fell 18% during the quarter as technology and telecom stocks continue to experience severe markdowns as a result of ongoing profit downgrades. The MSCI Information Technology (A$) Index fell 23% and the MSCI Telecommunication (A$) Index fell 18%. This is a disappointing result given the level of cash and short positions the portfolio held. Almost every holding in the portfolio experienced significant price falls, and although the short positions provided some offset to the poor performance, we closed a number of these (with the benefit of hindsight) too early.

Changes to the Portfolio

DISPOSITION OF ASSETS

Region	Sep 2002	Jun 2002
US	43%	45%
Other Asia (incl. Korea)	17%	12%
Japan	9%	13%
Europe	4%	3%
Cash and Other	27%	26%
Shorts	17%	25%
Net Invested	56%	49%

Source: Platinum

BREAKDOWN BY INDUSTRY

Region	Sep 2002	Jun 2002
Semiconductor	24%	23%
Telecom Equipment and Suppliers	19%	18%
Electronic Components	7%	11%
Software	7%	8%
Other	16%	14%

Source: Platinum

The Fund added a number of new positions during the quarter. Sun Microsystems, a leading provider of Unix computer systems, was once again added to the portfolio as the stock price fell substantially below levels we sold late in 2001. Nvidia is the dominant provider of graphics chips used in PCs and gaming consoles and was marked down due to concerns over falling PC sales. China Mobile is the leading provider of mobile phone services in the PRC, and is one of the few telecom companies that is continuing to show healthy growth in its subscribers and profits. We also took advantage of lower prices to add significantly to our holdings in Ericsson, LSI Logic (semiconductors), and National Semiconductor.

Positions in Toshiba and NEC were sold as these companies continual failure to restructure have left them further and further behind the competition in key markets and in a precarious financial position.

Commentary

Throughout the quarter there has been a steady stream of announcements from technology companies warning of weakening demand for their products. Of particular note was a forecast by EDS that its revenues could fall by as much as 5% for the quarter, a dramatic reversal for a company that has had a long and steady track record of growing at between 5% to 10% annually. EDS's main business is managing the information technology infrastructure of large companies under long term contracts. The company also picks up additional revenues for completing individual projects for their customers. Although there are other company specific issues, it is this project work that has dried up leaving the company short of its revenue target. The implication is simply that companies are cutting back further on technology spending with ramifications for all IT vendors.

So is there an end in sight to this downward spiral in spending on technology? The simple answer is that technology is (in the most part) a capital good and companies will continue to cut capital expenditures when profits are under pressure. As discussed in past quarterly reports, one of our greatest concerns is that excess capacity in many industries combined with highly geared balance sheets and a dull economic environment will continue to squeeze profitability. Thus the answer for the moment is a simple no. It does not follow though that technology stocks will continue their precipitous declines.

Prices for many technology stocks already reflect a very miserable environment. In order to reflect on this hypothesis it is worth considering a number of the Fund's key holdings.

KEY HOLDINGS

Company	Stock Price Decline from High	Market Capitalisation (USD millions)	Net Cash (USD millions)	Sales 12 months to Dec 2000	Sales 12 months to Jun 2002
Sun Microsystems	95%	8,120	4,200	19,182	12,493
Parametric	93%	470	200	924	792
National Semiconductor	86%	2,160	800	2,380	1,580
Ericsson	98%	5,334	950	29,000	20,100

Source: Platinum

As the table above illustrates, the punishment handed out to investors who held these from the high in the market has been severe, with declines ranging from 86% to 98%. Currently these companies are operating at no better than break even, with Ericsson still incurring substantial operating losses. The combination of price declines and the lack of profits creates an impression for some that these are low quality, inconsequential companies, and implies a significant risk of bankruptcy. However, the position of these companies in their markets together with the current level of sales would suggest they are anything but inconsequential and the low net debt (in fact net cash position) on the balance sheets makes bankruptcy a remote scenario.

Sun Microsystems has over a third of the world market for Unix servers, computers that are used to run networks for large companies. Besides the obvious problem of depressed IT spending, there is an additional concern that the company's Unix boxes (which utilise proprietary versions of the Unix operating system - Solaris and proprietary microprocessors) are facing additional competition at the low end from boxes using Intel processors and the Linux operating system (a free version of Unix modified to run on Intel chips). In response to the threat, Sun has launched its own Intel box using the Linux platform. Where this leaves Sun in the short term is in a very depressed market and the prospect of deteriorating profitability over time. An eventual recovery in IT spending will boost Sun's revenues but with a smaller cut for shareholders than in the past.

Even with this grim conclusion we would argue that Sun's stock is considerably undervalued.

There are a number of reasons for one to be more optimistic however. Sun have a significant R&D budget (an average of $1.5 billion pa for the last five years) and the development of new products may allow them to earn better profits than those accruing to a mere commodity producer. Areas of interest include grid computing (where computing tasks are directed to servers on the network that are not being used, so increasing utilisation rates), and blade servers (a new architecture for servers that may yield cost savings). In addition, the merger of Hewlett Packard and Compaq is an interesting development. Although we have no particular insights into the progress at the new Hewlett Packard, mergers of this magnitude are invariably difficult, potentially handing Sun an opportunity to take market share.

Ericsson is the largest supplier of mobile telephone systems in the world. The world's ten largest mobile operators are among Ericsson's customers and the company estimates that some 40% of all mobile calls are made through Ericsson systems. The company has seen a significant collapse in sales as telecom operators have been forced to cut capital expenditures due to falling profits and weak balance sheets. This has plunged the company into the red, recording a loss of SEK13.2 billion (US$1.4 billion) over the last twelve months. The company was forced to have a heavily discounted rights issue to shore up its balance sheet ahead of the costs to be incurred in downsizing the business. This restructuring now is under way, with the handset business, which has been a perennial problem for the company, being placed in a joint venture with Sony.

The next major cycle in spending on mobile networks will be the upgrade to 3G systems. Although there is much scepticism today about the requirement for such networks, next generation services such as multi-media services (or MMS, which for the moment essentially entails taking and sending photographs by phone) are actually taking hold amongst early adopters. Nevertheless, such a pick up in spending seems some way off for the moment. In the meantime, it is not just Ericsson that is under stress with a number of its smaller competitors in the mobile world, such as Lucent, Nortel, and Alcatel are also in dire straits. It is likely that when the next cycle begins Ericsson will face a smaller number of competitors.

National Semiconductor is a semiconductor company that has transformed itself over the last five years by refocussing its R&D efforts on the "system-on-a-chip" (SOC) concept. A SOC is simply the combination of all the various semiconductor components of a given system on a single chip. The concept embodies the idea that more and more functionality can be squeezed onto a single chip, and thus the ability to design these more complex chips will be required to both protect and grow the business. This is more easily said than done as it requires the combination of analog and digital components which have historically been manufactured using substantially different processes. Although the company has delivered numerous solutions from these efforts, one of the more interesting has been placing the functionality of a GSM phone into four chips. The commercial significance of this is that when a handset manufacturer uses this chip set, National can earn US$20 per phone sold rather than the typical $2 per phone it would earn by selling individual components. In addition to the SOC efforts, the company has concentrated its traditional analog business on faster growing markets such as mobile phones and flat panel displays. Parametric is one of three major providers of computer aided design (CAD) software. The company built an outstanding position through the nineties based on its technological leadership that allowed it to grow from a start up to a company with over US$1 billion dollars in revenue. By the end of the decade, it was facing enormous pressure from low end offerings that offered less functionality but at a greatly reduced price. Along with a maturing of the market, the result was significant falls in both revenues and sales. Parametric have since fought back with their own "cut down" version of their product and a significant upgrade of their top of the line offering. The excitement at Parametric however is not in the CAD business but in a new product arena known as product lifecycle management (PLM). PLM is essentially a suite of "collaboration" tools that can be used from the design phase of a product, to manufacturing, and through to after sales service and maintenance. As esoteric as it may sound, it is a major area of focus for enterprise software companies such as SAP, but what Parametric brings to the party is a tight integration of its PLM tools with the CAD files of all the major providers. Although Parametric is suffering along with all other IT companies, it has established a clear leadership position in the PLM arena with its Windchill product which will be a substantial source of profits in a recovery.

The point of highlighting these four companies is that the portfolio holds investments in many companies with similar characteristics. They are all suffering from a significant downturn in revenues and struggling to break even, a recovery appears distant, and share prices have collapsed. One could respond that such investments are high risk given the poor short term prospects and profitability and we would agree. However, the stock prices are such that we are at least being compensated to take such risks. The alternative would be to invest in companies such as Microsoft, Cisco, Nokia, or Dell who continue to perform relatively well, and where the business risk is much lower. But our assessment is that the stock prices of these companies are high and that returns from owning them are unlikely to be attractive.

One major risk remains for owners of technology stocks and that is the consumer. Although consumers have cut back their spending on technology products such as phones and PCs, a further deterioration is easily imagined if the US consumer were to start fearing for his job. Although in the most simple terms we would assess the stocks held by the portfolio as significantly undervalued, such an event would see further mark downs in stock prices.

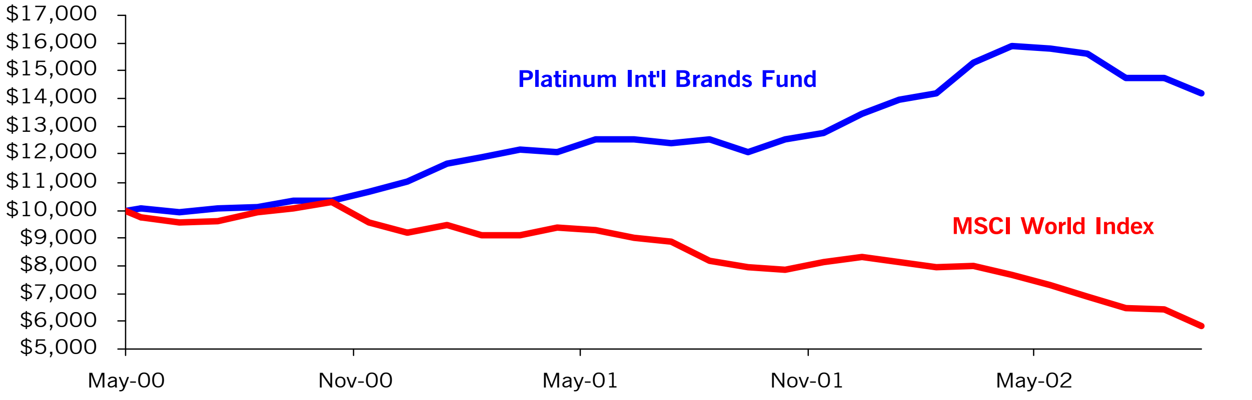
Andrew Clifford
Portfolio Manager

Platinum International Brands Fund

Performance

REDEMPTION PRICE: $1.2951

VALUE OF $10,000 INVESTED SINCE INCEPTION (18 MAY 2000 – 30 SEPTEMBER 2002)



Source: Platinum

The MSCI World Index fell by 15.7% during the quarter. Only five of the nearly 100 branded good stocks that we track performed positively, with many of the retailers losing more than 20% of their value and in some cases up to 40%.

In the quarter, the International Brands Fund fell 9.1%. In our previous quarterly report, we noted that we had become concerned about the relatively high valuations of many major branded goods companies, as investors generally sought out the perceived reliability of earnings from the large well known companies, notably Proctor and Gamble, Coke, Colgate and Anheuser Busch. Accordingly, over the quarter we sold a number of these companies whilst taking the opportunity of lower valuations to add to our positions in Adidas (footwear) and Wella (haircare). The short positions in the portfolio have risen from being less than 5% of the portfolio at the end of the last quarter to around 27% currently, reflecting our growing concerns of deteriorating conditions.

Anecdotes from retailers early in the quarter suggested that consumers, especially in Germany, France and the US, were becoming more cautious. Retailers in turn became more cautious and conscious of their inventory levels, deferring or cancelling orders. In the US, the latter part of the quarter is colloquially known as "Back to School".

This is an important retail period coinciding with a change in seasons, second only to Christmas for some retailers, as students equip themselves with the latest in fashion, sneakers and the now essential mobile phone, ahead of the start of their academic year in October. This year proved to be disappointing to retailers as consumers showed a tendency to be selective, price conscious and a word we heard several times "frugal". Foot Locker, the leading retailer of sneakers, reported significant down trading. Sneakers priced at the US$90-$120 range proved much more popular than the top of the range Nike – Air Jordan's © at US$200, not so long ago the Nike's were "must have", with queues and sell outs for new releases. Adidas, a portfolio stock, was well positioned to benefit from this shift in consumer buying patterns, having recently released a range of new products at these lower price points.

We introduced two new names to the portfolio, Beiersdorf and WH Smith (more on these later). Unfortunately, we were also tempted too early by the 20% fall in value of McDonald's share price, only to have the stock fall another 20% in the recent market downturn. McDonald's is focussing back on the home (US) market with a three part plan to improve performance, including improving quality, cleanliness and service, upgrading a number of outlets especially the drive through, and introducing a 99c menu. We are even more cautious now of any apparently attractive valuations on leading branded goods companies, as conditions look set to become more competitive and the consumer more challenging.

Reviewing the stocks in our proprietary brands index;

- Shares in retailer stocks continued to lose significant value. In an environment where consumers are spending more selectively and cautiously it is probably not surprising that retailers like Tiffany have lost a third of their value. The apparel and electronic retailers have also lost significant value, for example, Best Buy (a US electronics retailer) declined more than 30% and Limited Brands (apparel) lost over a quarter of their value. Perhaps more surprising though is the decline in the supposed defensive supermarket retailers, after all we still have to buy the basics. The German retailer Metro is down 40%, Ahold (an international supermarket company) also losing nearly 40%, and Safeway (a leading US supermarket company) falling 20% in value as investors became more concerned at the increase in discounting and the loss of customers to the major discount stores such as WalMart.

- Tobacco stocks fell as Phillip Morris lowered their earnings expectations for this and next year, highlighting the need to significantly increase promotional expenditure. This relates mainly to the rising cost of providing special offers (get three packs for the price of two) and discounts to compete with cheaper alternatives as consumers shun the "premium brands" in favour of the "discount brands". A trend that we are seeing in a number of consumer's purchases from apparel to cosmetics and even to food items.

- Food companies showed mixed performance, Heinz and Campbell Soup both lost more than 15%, Hershey (US confectionery) managed to hold on for a slight gain of 1%. In Europe, Unilever held their value and Danone (the French dairy/water company) lost 10% in value.

- Notably stronger share price movements came from the household products sector with Colgate up 11%, Alberto-Culver (hair products) up 5%, Clorox and Proctor and Gamble up 2-3%. Reassurances from these companies that earnings growth would be maintained supported these positive outcomes.

Commentary

Perhaps more than anything else this quarter we heard company management discuss the rising costs of competition. Luxury goods companies are competing for fewer tourist dollars as American and Japanese tourists elect to stay home and packaged goods companies are finding consumers more willing to "trade down", that is move from more expensive branded goods to the cheaper brands or generics.

As we discussed in our last report the major companies such as Proctor and Gamble and Unilever, are concentrating their product portfolios, significantly reducing their costs and increasing the advertising and promotional spending behind key brands. At the same time WalMart is benefiting from their reputation for consistently lower prices and is drawing more consumers away from traditional supermarkets. Recently WalMart commented that their sales would be in the range 3-4%, lower than historically achieved and more focussed to basic goods, "household cleaners, underwear and medicine". At the beginning of the year WalMart was forecasting 6-8% growth, this fell to 5-7% in April, 4-6% in July and recently WalMart delivered 3.8% in August. A clear trend of slowing sales that will give rise to increased competition through higher discounting as the smaller competitors try and stem the flow of customers to this leading retailer.

In the US, headline economic statistics report that consumer spending, which accounts for more than two thirds of the US economy, continues to grow. When we look just a little deeper we find mortgage rates at a record 40 year low, with 30 year mortgages now below 6% pa. The US consumer is also being offered financing at 0% and "cash back" discounts to purchase a new vehicle. Faced with the opportunity to refinance the mortgage, perhaps increasing the size of the loan and still pay less per month, *and* purchase a new vehicle at 0%, the US consumer's attention is clearly drawn to these opportunities. Outside of these areas consumer spending is showing significant restraint, decline even. This is now extending to everyday non-essential household items and we even see staple companies such as Kellogg reporting declines in sales of the more discretionary products such as "PopTarts".

In an environment where the consumer is "penny conscious" and growth rates for companies are stalling, weaker brands resort more to price to retain consumers. The brand leaders find the price gap opening up and get drawn into this battle to retain market share. Retailers also turn to the suppliers for support, looking to extract further concessions and discounts in their bid to compete for fewer discretionary consumer euros/dollars. Apart from these consumer, customer and competitor dynamics many branded goods companies are faced with rising input costs with the significant US and Australian drought forcing up grain prices and the difficulties in the Middle East driving up oil and energy costs.

In addition to facing rising corn, wheat and energy costs Kellogg purchased Keebler, a leading US biscuit maker (cookies and crackers) with a strong distribution system that delivers direct to stores. In order to reduce the significant debt associated with this transaction, currently around $6 billion, Kellogg has been increasing prices well ahead of inflation. Advertising expenditure has been increased to support the branding and significant reliance is being placed on their sales systems to push products through to the retailer shelves. Anheuser Busch is following a similar strategy, relying on price increases to fund additional brand advertising whilst driving profit growth of more than 10%. We do not believe that the current valuations of these companies adequately reflect the risks of, what is tantamount to, harvesting the equity in the brand. In a similar fashion, L'Oreal cut advertising expenditure to support the growth in profits, believing that the strength of the brands and the distribution system would carry the growth through for a while. It may, for a while, before competitors start to make in-roads and then the likelihood is that even higher costs will be incurred to win back lost consumers.

We see other examples where these packaged goods companies are reacting to a more difficult environment. The practice of surreptitiously reducing the product size, fewer tissues, nappies or snack bars in the pack for the same price is, in our view, damaging to the brand equity. When consumers finally have enough of these packaging and pricing shenanigans and switch, to discover that the "cheap(er)" product isn't really that different, they can be so much more difficulty and costly to win back. It's clear in many product categories that the cost of retrieving a lost consumer is much greater than the marginal extra that was gouged on the way up. The problem for these companies is defining that point prior to the damage being done.

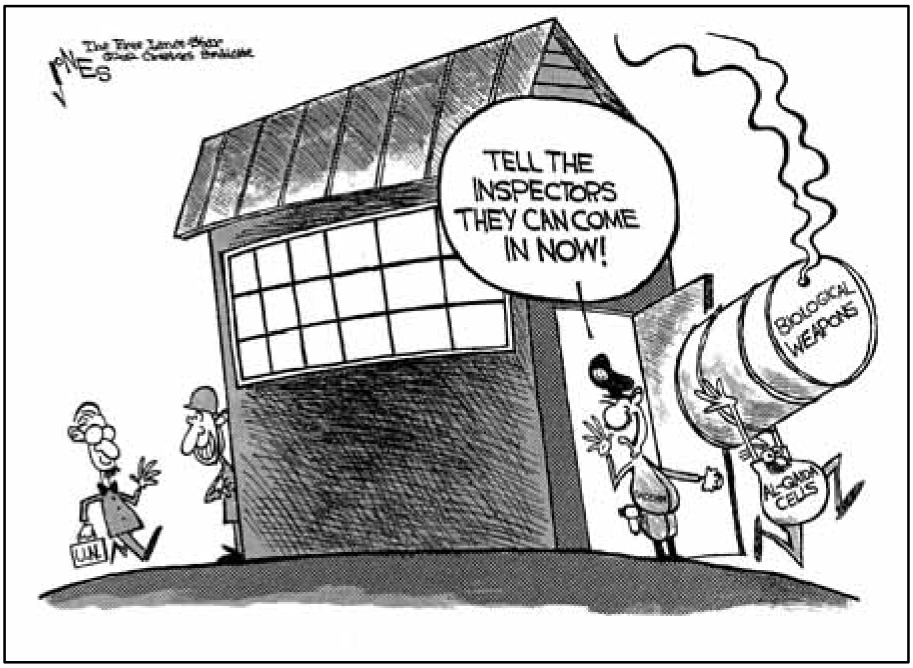
We did see an opportunity to add a leading brand to the portfolio. Beiersdorf is better known for Nivea, having consistently grown this brand by 15% compound annual growth over the past decade. Beiersdorf, through Nivea, has a leading 10% share of the world skin care market and has long been seen as a very attractive acquisition for companies like Proctor and Gamble or L'Oreal. In Germany, given a very difficult consumer environment, Nivea sales in the past quarter fell. This together with indications that Beiersdorf and the major shareholders were not interested in an offer for the company ensured that Beiersdorf fell in value along with the wider sell down of shares in Germany. We commenced buying the share, attracted by the long term growth potential of this brand, the market leading positions and the opportunity to continue to carefully extend this brand into new products (eg. Nivea for Men) and widen distribution.

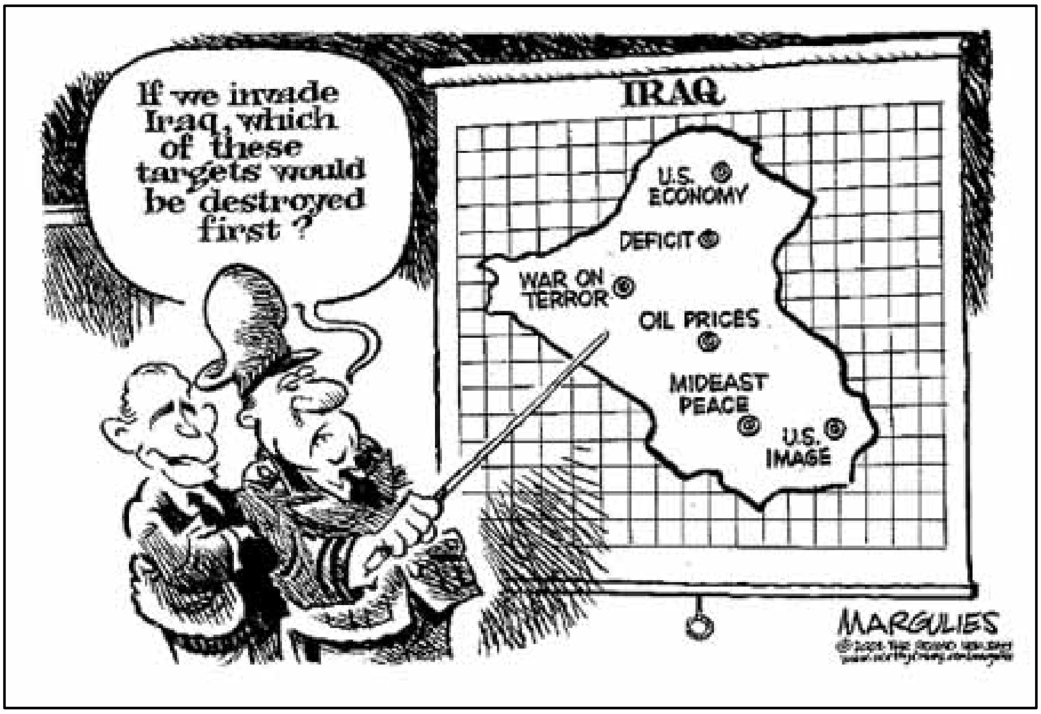
We have also added WH Smith, a dominant newsagency/bookstore business in the UK, well positioned in prime High Street locations, and a well recognised brand. Although its already strong market position means the ability to grow by adding new stores in the UK is modest, over several years it has improved profitability by refurbishing stores and improving its product range and store operations. WH Smith is also the largest UK newspaper distributor, where efforts to improve efficiency through a new IT system are resulting in profit improvement. We bought shares in this company following a decline in the stock due in part to weakness in a small business of WH Smith's, gift shops in US hotels and airports that are sensitive to the drop in the number of travellers. WH Smith's core UK newsagency operations sell relatively low-priced convenience items – newspapers, cigarettes, bestselling paperbacks and in difficult economic conditions sales of these items should prove more resilient. WH Smith has no debt on the balance sheet, and at the current stock price offers an attractive dividend yield for a holding in a business of relatively low risk.

Outlook

The outlook for consumer branded goods companies is not very encouraging. Concerns surrounding the Middle East will continue to curtail tourism, high levels of consumer indebtedness (mortgages, car loans and credit card debt) in the US economy and rising costs in an environment where price increases are difficult at best, all conspire to make trading difficult for many of our companies. In many cases valuations are also at a relative high point as investors have sought out and paid a premium for the perceived security of reliable earnings. As companies bring down growth expectations and adjust to a harsher environment their valuations should come down to more interesting levels and may even provide us with some compelling opportunities. We will continue to be opportunistic and invest only when we believe the fundamentals are not reflected in the share price.

Simon Trevett
Portfolio Manager


TELL THE INSPECTORS THEY CAN COME IN NOW!
BIOLOGICAL WEAPONS
AL-QAIDA CELLS
U.N.


If we invade Iraq, which of these targets would be destroyed first ?
IRAQ
U.S. ECONOMY
DEFICIT
WAR ON TERROR
OIL PRICES
MIDEAST PEACE
U.S. IMAGE
MARGULIES


WE HAVE SOME QUESTIONS ABOUT YOUR CLAIMING FIRST-QUARTER REVENUE OF FOUR MILLION DOLLARS...
JUSTICE DEPT.
LEMONADE 5¢
GORRELL