

Platinum International Fund  
Platinum Asia Fund  
Platinum European Fund  
Platinum Japan Fund  
Platinum International Brands Fund  
Platinum International Health Care Fund  
Platinum International Technology Fund

# The Platinum Trust Quarterly Report

**30 September 2004**



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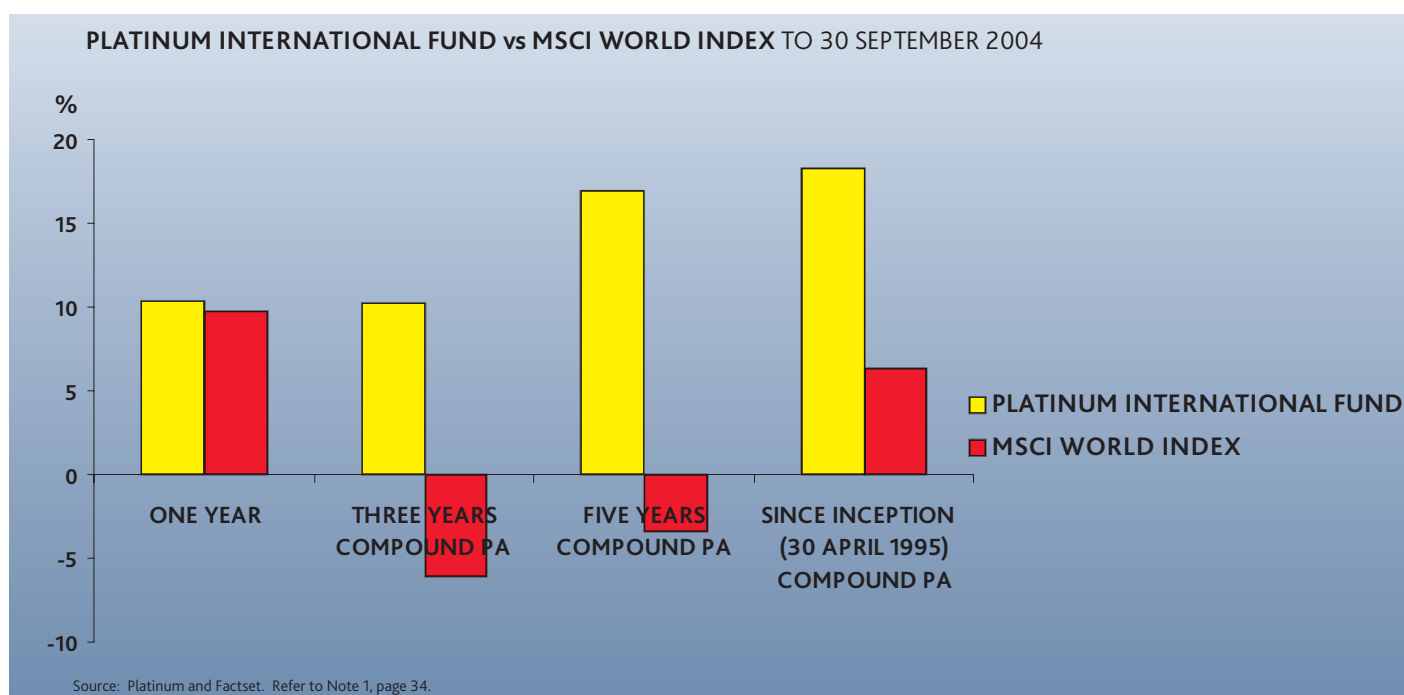
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## PERFORMANCE RETURNS TO 30 SEPTEMBER 2004

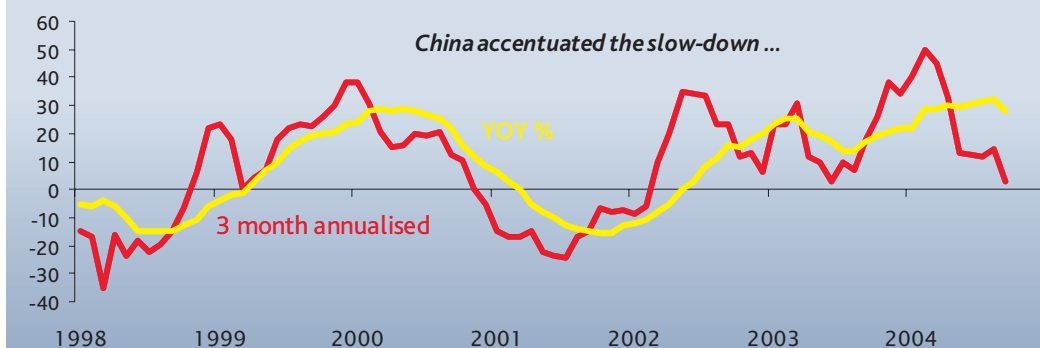
FUND	FUND SIZE	QUARTER	1 YEAR	2 YEARS COMPOUND PA	3 YEARS COMPOUND PA	5 YEARS COMPOUND PA	SINCE INCEPTION COMPOUND PA
<b>INTERNATIONAL FUND</b> MSCI AC* WORLD INDEX	<b>\$5,069M</b>	<b>-3.8%</b> -4.4%	<b>10.4%</b> 9.8%	<b>14.8%</b> 5.5%	<b>10.2%</b> -6.1%	<b>16.9%</b> -3.4%	<b>18.3%</b> 6.4%
<b>ASIA FUND</b> MSCI AC ASIA EX JAPAN INDEX	<b>\$277M</b>	<b>9.8%</b> 2.5%	<b>17.1%</b> 10.3%	-	-	-	<b>32.7%</b> 19.8%
<b>EUROPEAN FUND</b> MSCI AC EUROPE INDEX	<b>\$161M</b>	<b>-5.2%</b> -2.5%	<b>15.6%</b> 17.4%	<b>23.0%</b> 9.9%	<b>9.1%</b> -3.7%	<b>22.9%</b> -1.7%	<b>16.0%</b> -2.9%
<b>JAPAN FUND</b> MSCI JAPAN INDEX	<b>\$203M</b>	<b>-4.1%</b> -11.0%	<b>15.3%</b> 3.8%	<b>14.8%</b> -0.7%	<b>12.6%</b> -7.1%	<b>13.4%</b> -8.0%	<b>24.4%</b> -0.9%
<b>INTERNATIONAL BRANDS FUND</b> MSCI AC WORLD INDEX	<b>\$112M</b>	<b>-2.9%</b> -4.4%	<b>9.9%</b> 9.8%	<b>12.0%</b> 5.5%	<b>13.7%</b> -6.1%	-	<b>14.2%</b> -9.0%
<b>INTERNATIONAL HEALTH CARE FUND</b> MSCI AC WORLD HEALTH CARE INDEX	<b>\$6M</b>	<b>-5.5%</b> -6.6%	<b>(LAUNCHED NOVEMBER 2003)</b>				<b>1.3%</b> 8.9%
<b>INTERNATIONAL TECHNOLOGY FUND</b> MSCI AC WORLD IT INDEX	<b>\$58M</b>	<b>-10.8%</b> -13.5%	<b>3.8%</b> -5.2%	<b>21.6%</b> 9.2%	<b>7.8%</b> -8.5%	-	<b>11.2%</b> -24.5%

\* Morgan Stanley Capital International All Country

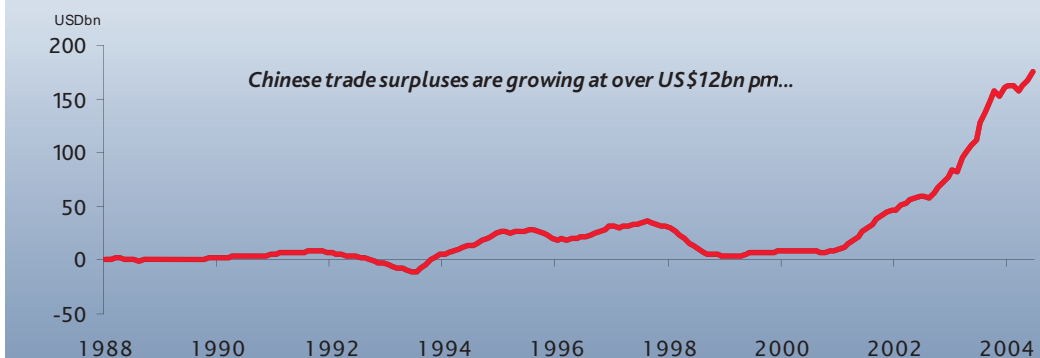
Source: Platinum and Factset. Refer to Note 1, page 34.



## DEVELOPED ASIAN TRADE (EXPORTS AND IMPORTS)



## CHINA - CHANGE IN FX RESERVES



## DIVIDEND CONTRIBUTION TO TOTAL RETURN - MSCI WORLD IN USD

*Dividends do count! ...*

	<u>Price % Change</u>	<u>Dividend Contribution</u>	<u>Total Return</u>	<u>Dividends % of Total</u>
<b>1970s</b>	28.1%	62.5%	90.6%	69.0%
<b>1980s</b>	331.4%	181.3%	512.7%	35.4%
<b>1990s</b>	139.7%	55.8%	195.5%	28.6%
<b>2000s</b>	-21.9%	7.7%	-14.2%	53.8%*

2000s through to September 2004  
Source: Deutsche Bank

\* absolute value

# PLATINUM INTERNATIONAL FUND



Kerr Neilson Managing Director

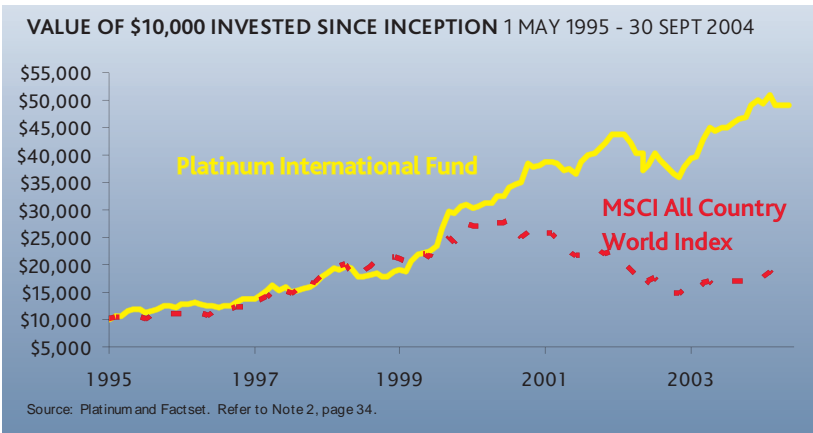
## PERFORMANCE

There was a strange divergence in the behaviour of markets in the face of apparent concerns about faltering growth over the quarter. Some countries that one would imagine would be adversely affected, like Hong Kong and Australia, all made strong gains of around 5% in Australian dollars, while Japan swooned a full 11%. Perhaps it was consideration of the adverse impact of higher oil import bills, but why then did India, Indonesia and Brazil, each of whom is in oil deficit, rise by 10% or more? Valuations, liquidity, and an acceptance of the growth prospects of these smaller economies are the best explanations we can offer. The other large traditional markets were flat to down. This resulted in the MSCI being weak for the quarter at -4.4%.

The industry segmentation seems easier to explain with Energy being the star performer, up over 5%, while IT trailed at minus 13%. IT suffered in particular from concerns of stock accumulation on weak sell-through of flat TV screens and mobile handsets. As has become a feature of the present environment, some sectors that would normally have been protected by their defensiveness such as health care and consumer staples, were adversely affected by deteriorating circumstances. For example, there were profit warnings from the likes of Coke, Colgate, Unilever and Nestlé as they battle for shelf space against own-label brands in a fast changing environment (a subject that we have identified in several earlier reports). The major drug companies also had problems with product disappointments and recalls, driving big names like Merck and Pfizer down to between 60% and 40% of their peak levels.

MSCI WORLD INDEX INDUSTRY BREAKDOWN (A\$)		
SECTORS	QUARTER	1 YEAR
ENERGY	5.2%	29.2%
MATERIALS	2.8%	19.6%
UTILITIES	0.9%	14.1%
TELECOMMUNICATIONS	-1.6%	9.1%
FINANCIALS	-3.3%	9.2%
INDUSTRIALS	-4.1%	13.3%
CONSUMER DISCRETIONARY	-6.4%	7.4%
HEALTH CARE	-6.9%	1.5%
CONSUMER STAPLES	-9.6%	2.0%
INFORMATION TECHNOLOGY	-13.5%	-5.2%

Source: Bloomberg



Within the markets themselves there has also been the strange phenomenon of PE compression. CSFB has found that the dispersion of PEs for 19 of the 26 sectors globally are at historically narrow levels. This implies that investors are unwilling to differentiate between the great and the good companies in these industries!

Within this environment, the Fund's performance has been acceptable by beating the MSCI marginally over the quarter but still declining by 3.8%. For the year, the Fund is up 10.4%.

## SHORTING

Note, with our large exposure to growth sensitive Asia, it behoves us to maintain downside protection in a highly uncertain commercial environment. Year to date, shorting has done us little good.

## CURRENCY

We are finding it very difficult to read the markets at present. The Japanese yen has been remarkably sluggish for the currency of a country that is generating a current account surplus of 4% of GDP pa. If the lull in growth has passed, as we believe, the yen should appreciate unless we are under-estimating the market's appraisal of the deterioration of Japan's terms of trade ie. strong energy and

commodity prices relative to manufactured goods. Our currency disposition has barely changed.

## CHANGES TO THE PORTFOLIO

Instead of seeing the benefits of the higher oil price that we have been predicting, we have to report sound foresight but little profit. As Toby reported last quarter, our investment in **Yukos** has been disappointing. We bought a small stake in this privatised Russian oil giant after a 30% collapse of its share price following the arrest of its principal shareholder. However, backing reason in the face of the imprisonment of our dubious champion in a politically charged contest, proved the virtue of peripheral circumspection over opportunism. Our deep regard for history and some hasty reading of Russia's past experience with single-minded rulers led us to slink away with relatively minor wounds: a total loss to the Fund of two tenths of one percent.

On the other hand, this has not been our response to the dull news from **Shell**. We have been using moments of price weakness to add to our holding. The issue about classification of its hydrocarbon reserves, while disappointing, has limited impact on the longer term value of this oil giant (though it reveals a certain muddling of priorities). As mentioned before, we are particularly attracted to its natural gas deposits and at the current level of oil and gas extraction of 1.5 billion boe pa, it has extractable resources to last 40 years.

Brascan, the Canadian listed parent of another of our resource holdings (**Noranda**), has chosen a suitor for its subsidiary as it continues its anticipated course of vacating the sector. **Noranda** has been given a Chinese government sponsored mining trading

DISPOSITION OF ASSETS		
REGION	SEP 2004	JUN 2004
WESTERN EUROPE	29%	31%
JAPAN	27%	28%
NORTH AMERICA	14%	13%
EMERGING MARKETS (INCL KOREA)	14%	12%
AUSTRALIA	2%	2%
CASH	14%	14%
SHORTS	30%	30%
Source: Platinum		



company as its preferred negotiating partner. We are however a little apprehensive that in its eagerness to reshuffle its portfolio, Brascan will settle on a MIM-style cheap sale. To date it has been a good investment, benefiting from strong nickel and copper prices.

We used a run-up in share prices to restructure our gold share holdings in favour of lower cost producers, by selling Harmony and reducing Gold Fields in favour of Anglogold, Newmont and Barrick.

Among new additions are IMC Global, Carrefour and Fuji Electric. IMC Global had found itself at the bottom of the fertilizer cycle after a hectic debt funded expansion programme and in its weakened state was forced to accept a merger proposal with Cargill. The latter is one of the world's great private agricultural companies, and has injected its fertilizer production and distribution business into the new entity. The positional strength of the merged entity, together with Cargill's proven management, should ensure that these excellent underlying assets are optimised in the present up-cycle.

Carrefour is a readily classified fallen angel. Its rating has deteriorated dramatically since the late 1990s when it experienced its first earnings setback after years of successful expansion at home and abroad. The worry at the moment is the loss of share in its home market of France. As this still accounts for half of the group's sales and more of its profits, this is a valid issue. However, by devolving a greater share of influence back to the hypermarket and supermarket managers and by fundamentally changing the emphasis of the buying department, we believe their French base will stabilise, albeit on slightly lower profit margins. At the same time we can expect continuing good growth from expansion in Latin America and Asia, including China. This is still a wonderfully profitable company and earnings per share have grown each year, barring 1999, to yield a trend rate of 15%.

#### BREAKDOWN OF FUND'S LONG INVESTMENT BY INDUSTRY (% OF ASSETS)

CATEGORIES	EXAMPLES OF STOCK	SEP 2004	JUN 2004
<b>CYCLICALS / MANUFACTURING</b>	TOYOTA MOTOR, SCHINDLER, SIEMENS, LINDE, OCÉ	<b>25%</b>	<b>21%</b>
<b>FINANCIALS</b>	CREDIT AGRICOLE, MITSUBISHI TOKYO FINANCIAL, MITSUI SUMITOMO INSURANCE, NORDEA	<b>15%</b>	<b>15%</b>
<b>TECHNOLOGY/HARDWARE</b>	AGERE, INFINEON TECH, SAMSUNG, AMD, SUN MICROSYSTEMS	<b>8%</b>	<b>9%</b>
<b>MEDICAL</b>	TAKEDA, SCHERING, NOVARTIS, MERCK KGaA, GLAXOSMITHKLINE	<b>8%</b>	<b>8%</b>
<b>GOLD AND OTHER RESOURCES</b>	SHELL, BARRICK GOLD, NEWMONT MINING, GOLD FIELDS, NORANDA	<b>7%</b>	<b>7%</b>
<b>RETAIL/SERVICES/LOGISTICS</b>	VEOLIA ENVIRON, DEUTSCHE POST, HORNBAACH, MITSUBISHI CORP	<b>7%</b>	<b>7%</b>
<b>CONSUMER BRANDS</b>	HENKEL, ADIDAS SALOMON, LOTTE	<b>6%</b>	<b>7%</b>
<b>SOFTWARE/MEDIA</b>	SKY PERFECT COMMS, SEOUL BROADCASTING, NEWSCORP	<b>6%</b>	<b>6%</b>
<b>TELECOMS</b>	ALCATEL, NTT DOCOMO	<b>4%</b>	<b>6%</b>

Source: Platinum



## COMMENTARY

As the quarter unfurled, it became evident that the markets were seeking confirmation that economic growth was not about to peter out. Valuable market signals were given by world bond markets where yields drifted down, signalling a world where inflation risks were remote and growth scarce or fleeting. Commodity prices, excluding oil which has its own peculiarities, were generally mixed with grains being weak in response to strong North American harvests, while metals were generally firm throughout. The two leading engines, the US and China gave off conflicting signals. By the close of September the view had formed that there was an easing in credit conditions for large Chinese corporations who through the kerb market were then able to ameliorate the funding shortages of smaller private companies. Bonds corroborated the positive growth interpretation by weakening in price.

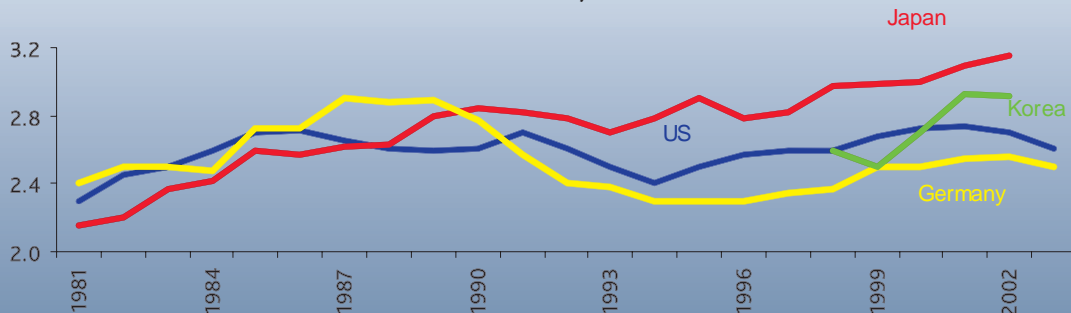
We spent some time in Japan during September. Prior to one of these excursions, where we meet with senior representatives of twenty or more companies, there is several weeks of intense activity. This is directed at identifying key variables that will help us understand whether or not there is a gap in the market's assessment of a company's

position and prospects. (Brokers' analysts can assist to some extent but invariably it is the meeting with the company that seals our opinion). On this occasion we were focusing on new technologies, in particular hybrid drive systems, photovoltaic (PV) cells, energy storage systems, light sources and fullerines. **In each of these areas Japan is the undisputed world leader in terms of development and mass production.**

While there are endless references to the frailties of the Japanese economy, sight often seems to be lost of the unremitting commitment to greater R&D spending throughout this post-bubble period. So much so that the country ranks second only to Sweden in terms of the proportion of its economy so engaged. The accompanying two graphs are quite illuminating in terms of trends, and sources of funding. Thus of global expenditure on R&D totalling some US\$760 billion, the US accounts for 38%, the EU 26% and Japan 14%, with a notable preponderance of funding by industry in Japan versus some other major industrial countries.

We covered with some enthusiasm the progress Toyota has made with its petrol/electric hybrid drive system found in the *Prius* in the March edition. As noted at the time, this led us to examine tangential opportunities regarding drive systems and

TOTAL NATIONAL R&D AS A PERCENTAGE OF GDP, 1981-2003



Source: National Science Foundation, National Patterns of R&D Resources and OECD, Main Science and Technology Indicators

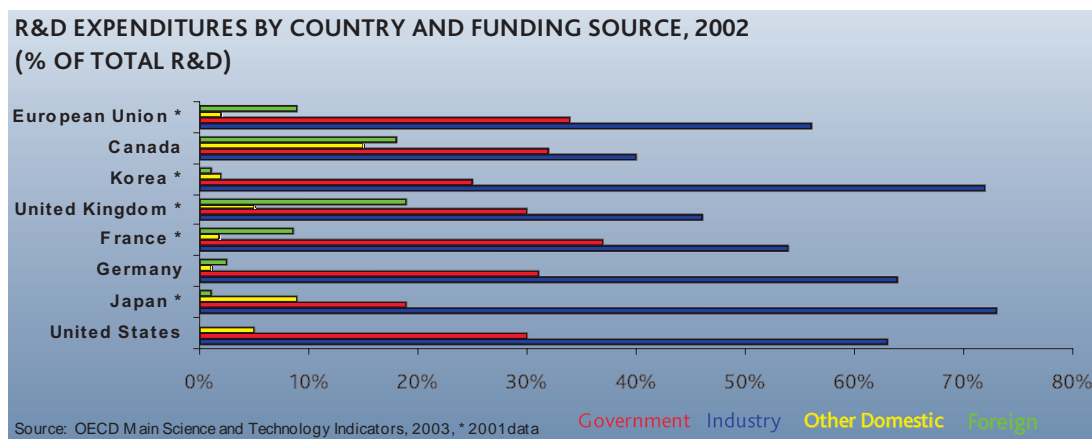
energy storage. For example, one of the problems Toyota has faced in giving an eight year guarantee for the battery of the *Prius* is to over-specify the size to ensure it stands up to the large number of recharge cycles. A fluke discovery, together with clever current control software, may in due course obviate the need for such over-engineering. A Japanese development team has discovered a way to produce a power storage device that combines the storage capacity of a battery yet can accept and dispense power in the manner of a capacitor. As it is a non-chemical reaction the cycle life is exceptionally high and because of its high power-taking characteristics it could allow the capture of as much as 80% of regenerative power created when the vehicle (or other moving conveyance) brakes. As always there are some trade-offs, one being cost and the other being the 30% greater size over a traditional lead-acid battery. Should this development live up to its promise and achieve cost reductions from the application of mass production techniques, its use could displace present battery technology - to the benefit of its two listed backers among others!

Another area that has fired up our imagination is the use of solar power. At present it is a hostage to subsidies. In green conscious countries such as Japan and Germany, consumers are guaranteed a payback via

receipt of high rebates when they feed domestically generated photovoltaic power into their local grids. These subsidies are gradually dropping but there is no sign of interest flagging. The accompanying chart (see page 21) may surprise some!

**For a sense of scale, current world production of solar cell modules, in terms of nominal electrical producing capacity, is 744 MW** which is equivalent to three quarters of the capacity of a medium sized power station of 1000 MW. However, the latter would typically operate for 350 days at say 16 hours a day, to produce 5,600MWh of electricity (and plenty of pollution) per year. By contrast a typical 3 kW unit sold to householders in Japan (costing about US\$20,000, weighing 300kgs and covering an area of 5 by 6 metres) is expected to *function for an average of 3 hours per day* to produce 3000 kWh a year or about 70% of average annual householder consumption in that country. With an electricity fee of Yen 23, the payback is about 20 years while the installation's life is as much as 100 years!

The two important variables are sunshine and conversion efficiency. The latter is normally around 15 to 18% with Sharp, the world's biggest producer, projecting gradual improvements in efficiency and manufacturing costs. Even with these handicaps, PV demand is growing very



strongly at perhaps 30% pa. The polysilicon crystal, which acts as the photon-absorbing substrate of these electron generators, is presently in short supply with the PV industry currently accounting for nearly as much demand as the semiconductor industry. We can't know that Sharp will hold its lead in this race but it is generally acknowledged that *manufacturability* is the key to reducing the cost of this energy source. Giving comfort however is the fact that Sharp is nearly three times the size of each of the next three largest players (Kyocera, Shell solar and BP solar) and has achieved improving margins in its PV division over the last few years.

To lead us back to where we started, Japan has a wealth of these technologies, yet investors are often critical about the apparent low economic pay-back. Our view is that with so many industries becoming commoditised by emerging market competition, holders of such differentiating technology should be more favourably rated. Simple PEs do not describe the depth of a company's resources and often mask the creation of longer term competitive advantages. How, for example should we evaluate Toyota which in terms of PEs is more expensive than GM, its larger rival, yet Toyota outspends GM on R&D by 1.6 to 1 and has demonstrable technical superiority? Leading Japanese companies remind us of the building period of the US multi-nationals of the 1960s and 70s: far from being profligate, we see these companies building for the future.

We have noted before the transformation of the balance sheets of large Japanese companies as profits are returning to the previous peak and as capex has been reined in. At the same time there has been a great deal of corporate activity as companies have eliminated their minorities in subsidiaries and have swapped divisions to consolidate activities among fewer players. We have identified US\$67 billion of these transactions among industrial companies since 1998 on

top of US\$175 billion of financial sector transactions.

The short term risk for Japan, and for that matter our portfolio, is the behaviour of the Chinese economy. By resisting an upward movement of its currency, and recycling funds into US\$ assets, principally bonds, the Chinese authorities are limiting their options. The easing of credit controls should remove the danger that the slow-down turns into a rout. **The remaining concerns will be exchange rates and energy prices.** All we can add on the former is that although it is becoming popular to regard Asia as some sort of US\$ block, these things often only seem so until the subtleties expose themselves. Our currency position reveals our skepticism.

The other worry weighing on markets are the oil and gas prices. The loss of tax breaks this quarter in the US and the extra cost of winter heating will impair discretionary spending power. Continental Europe continues to plod, though there have been some surprisingly positive turns in France. We see growth remaining subdued, inflation very mild and the cost of money likely to stay low enough to bolster spluttering activity.

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## SUMMARY

China is likely to be foremost in investors' appraisal of the investment scene. Our reading is that concerns about growth are receding and that this is highly beneficial for Asia and commodities. The hope is that this will allow for more balanced growth globally but with this there may be risks on the currency front. There has been a very clear de-rating of equities in general but against the uncertain backdrop, this seems appropriate.

Kerr Neilson  
Managing Director

# PLATINUM ASIA FUND



Andrew Clifford Portfolio Manager

## PERFORMANCE

Uncertainty about the Chinese economic growth dominated Asian markets in the latest quarter, with a strong rally occurring in the second half as the picture emerging from the People's Republic of China (PRC) brightened. The MSCI Asia Ex Japan index rose by 6.4%, although due to the appreciation of the A\$ this was reduced to 2.5% in A\$ terms. The Fund increased by 9.8% over the same period. For the last 12 months, the Fund has risen by 17.1% versus the index return of 10.3%.

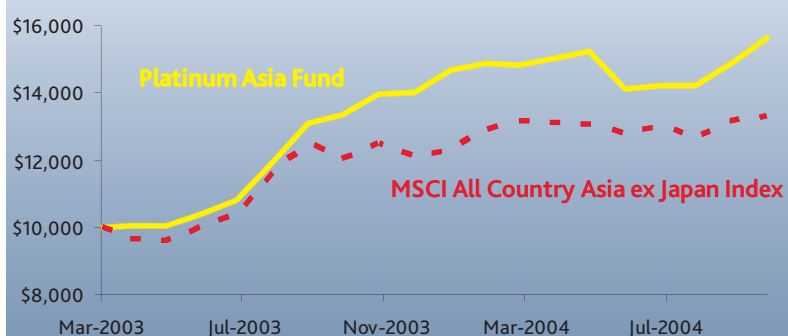
The best performing market was India (up 16%) as fears over the policy direction of the new government subsided and economic growth continued to gain momentum. Other strong performers included Indonesia (up 12%) on optimism that the likely election of Susilo Bambang Yudhoyono as the country's new president would bring much needed reform, and the Philippines (up 11%) also on the promise of reform with the re-elected President Arroyo's party now in control of the Senate. The lagging markets were Taiwan (flat) due to a weakening outlook for many technology companies that dominate that market, and Thailand (flat) where economic growth continues to subside. The portfolio's large weighting in the Indian market was an important contributor to performance. Amongst the best performing stocks were Canara Bank (India), Jaiprakash (Indian construction company), and ZTE (Chinese telecom equipment supplier). The weakest area for the portfolio were its holdings in Korean and Thai stocks.

### DISPOSITION OF ASSETS

REGION	SEP 2004	JUN 2004
CHINA	3%	3%
HONG KONG – CHINA H SHARES*	7%	8%
HONG KONG	5%	2%
TAIWAN	12%	13%
GREATER CHINA TOTAL	27%	26%
INDIA	36%	30%
KOREA	17%	13%
INDONESIA	4%	4%
THAILAND	3%	4%
SINGAPORE	3%	3%
MALAYSIA	1%	1%
CASH	9%	19%
SHORTS	0%	1%

Source: Platinum \* H Shares are shares of Chinese State Companies listed in HK.

### VALUE OF \$10,000 INVESTED SINCE INCEPTION 3 MARCH 2003 - 30 SEPT 2004



Source: Platinum and Factset. Refer to Note 2, page 34.

## CHANGES TO THE PORTFOLIO

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The Fund's cash weighting was substantially reduced through the purchase of a number of new stocks as well as additional purchases across a wide range of existing positions. The remaining short stock positions were also closed out. New holdings included two companies with significant investments in Hong Kong hotels which will benefit from the influx of mainland tourists to the territory. Positions in Hong Kong Exchange, Rico (Indian auto parts), were sold as these stocks reached full valuations. Beijing Airport was sold due the massive capital requirements of the planned airport expansion for the Olympics. Although profitable this has been a disappointing investment for the Fund and highlights the problem of investing in Chinese state enterprises where often the interest of the state is placed before those of shareholders.

## COMMENTARY

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The Asian markets were once again dominated by fluctuating expectations for the Chinese economy as the impact of the austerity measures put in place by the PRC authorities started to take hold. Credit controls put in place to restrict lending to targeted areas of over-investment, such as cement and steel, resulted in an almost complete cessation of new lending by the end of June. The result was indeed much more severe than one would have expected given the authorities goal of slowing investment in very specific industries and one that raised concerns of a severe slowdown in economic activity.

Banks faced with the problem of withdrawing funds from projects that were only partially completed, which would immediately create a new non-performing loan, elected instead to cut back on short term working capital loans in order to meet the central bank targets. Banks

also biased their lending toward the old state-owned enterprises (SOEs), which they perceive to be risk free, and cut off lending to the private sector which has been the driving force of the economy. The unavailability of letters of credit for financing trade saw importers cancelling orders for commodities which resulted in a fall in many commodity prices during May and June. Businesses fell back on suppliers for funding, evidenced by a build-up in trade creditors for listed PRC companies during the quarter, a pattern well known from previous credit crunches in China. Private enterprises desperate for credit accessed funds from the kerb market<sup>1</sup> at interest rates up to 25% versus official rates of 5%.

The severity of the credit crunch appeared to peak in June and July with lending picking-up in August. (When data is released for September this trend is expected to continue). Anecdotal evidence suggests that banks are advancing funds for projects that had previously been approved and that there has been an easing of working capital loans. Given the huge pipeline of investment projects that were underway prior to the credit controls being put in place this should ensure good economic growth well into 2005 as these projects are completed. This easing in Chinese credit markets is probably the best explanation for the rally in commodity prices (including oil) and Asian stock markets during September. As this new capacity comes on stream the question then becomes whether enthusiasm for further capital spending remains and whether funding will be available. Indeed the changes in the availability of credit do not appear to be a change of heart from authorities and the most recent reports on kerb market interest rates still have them at over 20%.

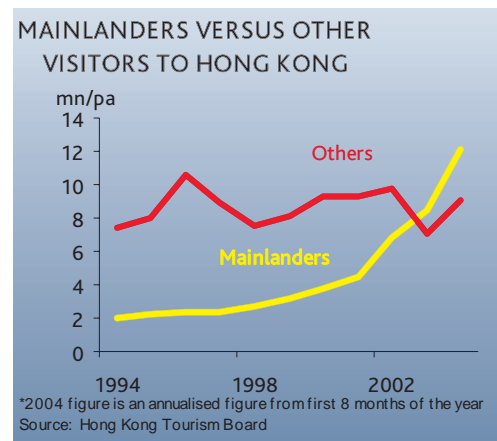
<sup>1</sup> In times of tight credit there will always be those with cash or with access to funds who are prepared to lend. The key lenders into the kerb market in the PRC are believed to be the SOEs who have access to funds at official interest rates.

Given the tremendous growth in the PRC over the last three years, one of the most disappointing markets in the region has been Hong Kong, which is up only 10% or so from the highs that market reached during 2002, and in fact has not progressed much beyond the highs reached in the 1993 bull market.

The rule of law, a strong banking system, and a convertible currency, place Hong Kong in a prime position to become the key service centre for the PRC economy. Hong Kong already plays a major intermediation role in PRC trade as a provider of trade finance, insurance, and logistics. It also plays a key role in the provision of accounting, legal, and marketing services as well as being a centre for capital raisings by Chinese businesses.

Yet despite a booming China, the performance of the Hong Kong economy and asset markets has been lacklustre. During the Asian crisis, China and Hong Kong were the only economies not to devalue their exchange rates, which resulted in these economies entering a sustained period of deflation. The result for Hong Kong was a bursting of the property bubble with residential property prices falling by almost 70% and leaving many households with significant negative equity in their residence. The response of consumers to falling prices was to defer consumption and increase savings, further exacerbating the deflationary trend. As China's growth has exploded in the past two to three years those sectors in Hong Kong that directly benefit have also grown, but with consumer confidence at low levels this has failed to materialise in broader economic growth for the territory. Even mortgage rates at incredibly low levels (the current mortgage rate is at 2.5%, with further discounts in the first three years that make the effective rate even lower) failed to encourage consumers back into the property market. Indicative of the weakness in demand for credit is that banks are lending into the mortgage market at rates that barely cover their cost of funding.

The last twelve months have finally seen a turnaround in Hong Kong which began in July 2003 with the announcement of CEPA (Closer Economic Partnership Arrangement), a package of initiatives that aimed to increase Hong Kong's integration into the PRC economy. Although many of these initiatives are more symbolic than real, the decision to ease travel restrictions on mainland citizens visiting Hong Kong has resulted in a major tourism boom, with mainland visitors expected to increase by 40% to over 12 million during 2004.



The obvious benefits of the increase in tourist arrivals are apparent in higher hotel occupancy (running at 86% versus 70% prior to the changes) and stronger retail sales (up 11% yoy). The benefits of a more open border move well beyond this with mainland residents now able to access a broad range of services such as banking and health care in Hong Kong. For mainland companies it is more practical to open a Hong Kong office, restrictions on which have also been relaxed. Residential property has also become a new investment class available to mainlanders, who have made their presence felt in the high-end residential market in recent months.

The changes brought about by CEPA have acted as a circuit breaker with a significant lift in confidence levels of both business and consumers in Hong Kong. Over the last year residential property prices have moved up over 40% with secondary market transactions increasing by 70%. Even after this move, prices remain 40% below the peak levels reached in 1997. The foundations for the property market look strong with a generation of home buyers having held back on purchases over the last seven years and a relatively low level of new apartments coming onto the market in the next three years. To date demand for mortgages has remained relatively weak which suggests home buyers in aggregate are drawing on savings to fund purchases.

With the Hong Kong market having turned the corner it is unlikely that this new trend will be easily broken. The boom-bust swings of the Chinese economy will continue to impact Hong Kong, as will US interest rates, due to the currency peg. One of the interesting questions will be what changes are made to the exchange rate mechanism when China moves away from its US dollar peg for Renminbi and the impact it has on interest rates in Hong Kong. The key risk for the market lies in the calls for greater democracy in Hong Kong and how these are handled by Beijing. However the recent elections suggest that if the economy is travelling well, calls for political independence will subside, even if only temporarily.

Andrew Clifford  
Portfolio Manager



# PLATINUM EUROPEAN FUND



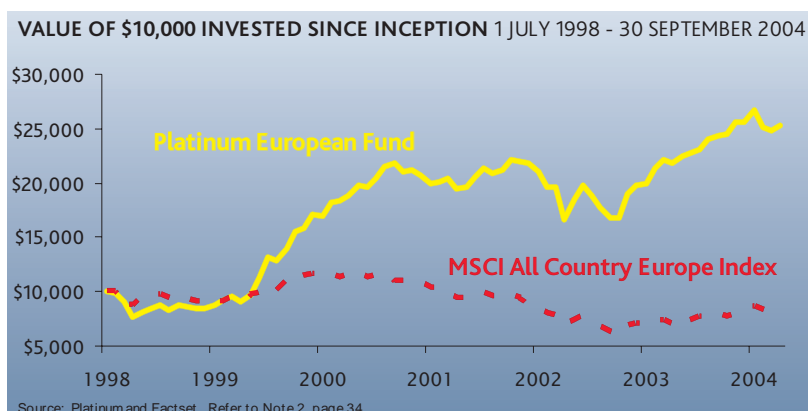
Toby Harrop Portfolio Manager

## PERFORMANCE

European stock markets traded in a narrow range this quarter and finished, in aggregate, pretty well unchanged. Notably strong sectors were metal and mining +15% (the London listings of Anglo American, Rio Tinto, and BHP account for this), steel +11% and gas +9%. Higher commodity prices explain such moves. More interesting were the losing sectors: computer services fell 19% - in general the Indian IT industry continues its merciless assault on pricing; more specifically the share price of the big French player Cap Gemini fell 43% for the three months. Other losers were consumer products -15%, and food -14%. These sorts of declines in the “defensive” part of the market normally occur when excitement over economic growth prompts investors to switch from such “predictables” to technology and cyclical stocks – but this was not the pattern in recent months. Something more fundamental is undermining the valuations of the consumer products businesses.

Individual stock highlights included the UK-based cement business RMC which rose 40% after global giant Cemex agreed to acquire the company; also strong was nuclear energy plant builder Areva, as oil, gas and coal prices force renewed interest in nuclear power. Apart from Cap Gemini, notably weak performances came from catering group Compass PLC (-34%), and Alcatel (-26%) and Infineon (-25%), in a generally weak showing from “technology” company share prices.

The Australian dollar appreciated a little against most European currencies (eg. by 2% versus euro, by 4% versus Swiss franc and by 4.5% versus pound Sterling), so that the MSCI Europe index fell 2.5% measured in A\$.



The Platinum European Fund lost 5.2% for the three months ended 30 September 2004, a poor showing. Strong performances from Adidas (+14%) and Danish food enzyme business Chr. Hansen (+18%) were offset by our holdings in Alcatel and Infineon, as well as the dramatic declines of Medion (which halved) and Epcos (-29%). These four “tech” holdings collectively cost the Fund over 3% in the three months, and in hindsight our error was to pay too much for these businesses (even if “too much” was generally one tenth to one fifth of their valuations during the technology bubble). Elsewhere, our short positions had mixed results with Tesco and Intertek drifting up on more good results and AstraZeneca coming down with a thump after the rejection of its new drug by the US regulator. The partial currency hedge back into A\$ was a small benefit over the quarter.

Over the last twelve months, the Fund is up 15.6%, shy of the 17.4% gain of the MSCI Europe index, measured in A\$. The performance of the Fund partly reflects its lower net invested position (which has generally been in the 70-80% range over the past year – the MSCI is of course 100% “invested”). Mathematically this accounts for “more than all” the difference in returns; however being less-than-fully invested is a stance the Fund has had through much of the last six years (and of course it is a deliberate

tactic in preparation for attractive investment opportunities), so other factors are responsible for the recent dull performance. The key factor has been a coincidence in performance of large parts of the portfolio over the 12 months to March/April 2004 – big holdings such as Merck of Germany, Novozymes of Denmark and SGS of Switzerland saw their share prices move up to or above fair value. We trimmed these holdings, but were reluctant to sell them out completely as the underlying businesses are growing well, and after a pause for breath we expect these to be worthwhile investments over the next 3-5 years. However this has resulted in strong portfolio performance up to March/April, and a dull time in the subsequent six months.

During the quarter, positions in Scandinavian trucking company DSV, Swiss textile machinery leader Rieter, and Heidelberg Cement of Germany were sold out after their share prices reached fair valuations. Influencing these decisions also was our concern that small/mid sized company share prices have had a strong run over the last couple of years, and in many cases trade at a “growth premium” to the market (after several years of enduring a “small stock discount”). We added to the positions in Alcatel, Infineon, Epcos and Medion at the attractive prices prevailing in August.

#### BREAKDOWN OF FUND'S LONG INVESTMENT BY INDUSTRY (% OF ASSETS)

Categories	Examples of Stock	SEP 2004	JUN 2004
<b>PHARMACEUTICAL/BIO TECHNOLOGY</b>	NOVOZYMES, NOVARTIS	<b>13%</b>	<b>14%</b>
<b>MISCELLANEOUS SERVICES</b>	DEUTSCHE POST, SGS SURVEILLANCE	<b>12%</b>	<b>13%</b>
<b>CHEMICALS/MATERIALS</b>	LINDE, MERCK KGaA	<b>12%</b>	<b>13%</b>
<b>CAPITAL GOODS</b>	OCÉ, SCHINDLER, SIEMENS	<b>11%</b>	<b>12%</b>
<b>FINANCIALS</b>	CREDIT AGRICOLE, NORDEA	<b>8%</b>	<b>9%</b>
<b>TECH/MEDIA</b>	INFINEON TECH	<b>7%</b>	<b>8%</b>
<b>CONSUMER</b>	ADIDAS, HENKEL	<b>7%</b>	<b>7%</b>
<b>RETAIL</b>	HORNBACH, DOUGLAS	<b>6%</b>	<b>5%</b>

Source: Platinum

## COMMENTARY

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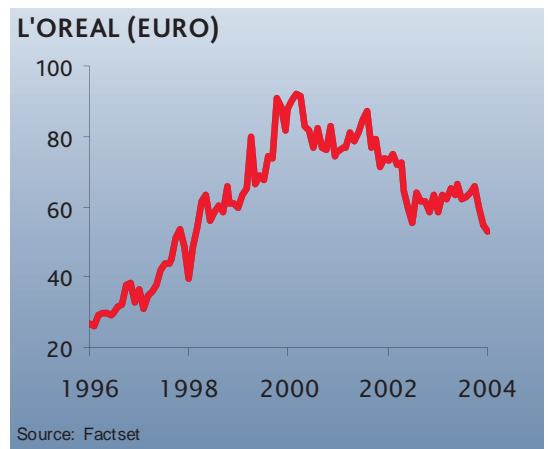
### German labour markets; consumer good companies

We have referred in recent quarterlies to the labour market reform in Germany, and specifically to our view that necessity would over-ride the ineptitude of the government, so that the private sector would achieve what legislation cannot. Landmark deals between both Siemens and Mercedes-Benz and (some of) their respective employees (more hours and more flexible hours for unchanged pay in preference to mass sackings) are encouraging in this respect. As the time of writing, we await the outcome of crucial talks between Volkswagen and IG Metall – the former wishing to reduce its German wage bill 30% by 2011, the latter insisting on another 4% wage rise this year and next, and job guarantees for 100,000 union members working for VW Germany. Admittedly, the first couple of rounds of this negotiation look and sound more like the mindless 1970s style of industrial relations – and light years from market leader Toyota's relationship with its staff. It is a source of concern also that following the few weeks' rest between rounds one and two of wage bargaining, the company and union's only agreement to this point is to another holiday before resuming the tussle!

A crude but roughly accurate characterisation of continental European versus UK/US/Australian economic growth at the moment is that the former is disproportionately dependent on net exports, and the latter on debt-funded consumption (and asset bubbles). It is thus unsurprising that the household goods and retail sectors are having a more favourable time in the Anglo economies than they are on the continent. However along with this cyclical effect is a more worrying structural change that is starting to make the "predictables" in Europe anything but. As mentioned earlier, share prices of erstwhile stalwarts Nestlé, L'Oréal, Unilever etc have had a difficult time, as a combination of "own label"

discounters grow more powerful in the retail scene, consolidating supermarket/hypermarket chains demand better purchasing conditions, and the colossal Americans (Procter & Gamble etc) make targeted price attacks in specific product areas in the core European markets.

A disconcerting aspect is that the economics and profitability of these businesses – not to mention the excessive valuations they reached a few years ago – means that pricing could be under pressure for some time. Consider L'Oréal – one of the great French – indeed global – companies, founded about 100 years ago by a scientist who had come up with a safe ("Inoffensives") hair dye. With research and product innovation always at its core, the company grew steadily, acquiring new brands to enter markets as necessary, so that today the group markets some 2,000 products under 500 brands through various retail channels. Its 50,000 staff (3,000 or so work in research) achieved sales in 2003 of over Eu14 billion, and after tax profits in excess of 10% of that revenue. Note however that the market capitalisation of the company on the drunken stock markets of 2000 was over Eu60 billion – so that the subsequent fall from grace only brings the share back to reality, not to a bargain level.



While L'Oréal will defend its pricing with marketing and innovation before succumbing to price pressure, the more mundane food and household product businesses are feeling pressure from competitors and customers – and more recently rising raw material prices have added to their woes. The premium ratings attached to such companies through the 1990s seem less and less appropriate.

## OUTLOOK

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### Reasonable valuations versus slow growth and high oil prices

European companies, through a tight focus on costs, have improved profitability levels, in aggregate, to a level not seen in many years (Morgan Stanley estimate operating profits at 7% of sales, and the return on equity at 13%). This somewhat surprising achievement, in the light of the much-discussed domestic economic stagnation, is best explained by the general industrial consolidation of the last decade, and the healthy business in the emerging markets of Europe's near and far east. Thus despite the recovery in stock markets from the somewhat desperate levels of late 2002 and early 2003, the increase in actual profits (and of course the accompanying enthusiasm of stockbrokers in predicting *future* profits) means that aggregate valuations look reasonable. Both including and excluding the UK, the market appears to trade at around 15 times 2004 likely earnings.

Where we are finding reliable growth stories at these valuations we have some promising investment candidates; as discussed above, however, pricing is still patchy and domestic volume growth sluggish. And, wrongly for the moment, we cannot help but worry about the impact of oil at over US\$50/bbl. While it is difficult to see how higher CPI inflation is very likely (given competition to produce consumer goods), a cycle of input inflation – higher energy prices, higher iron ore prices, steel prices, truck

prices etc – is probable, and we wonder how long global interest rates can stay unflinchingly low.

As at 30 September, 2004, the Platinum European Fund was 76% long, and 8% short for a net exposure of 68% to European equities. The currency exposure was hedged 37% back into the A\$, and we had no exposure to the pound Sterling (which seems to be weakening steadily).

Toby Harrop  
Portfolio Manager

# PLATINUM JAPAN FUND



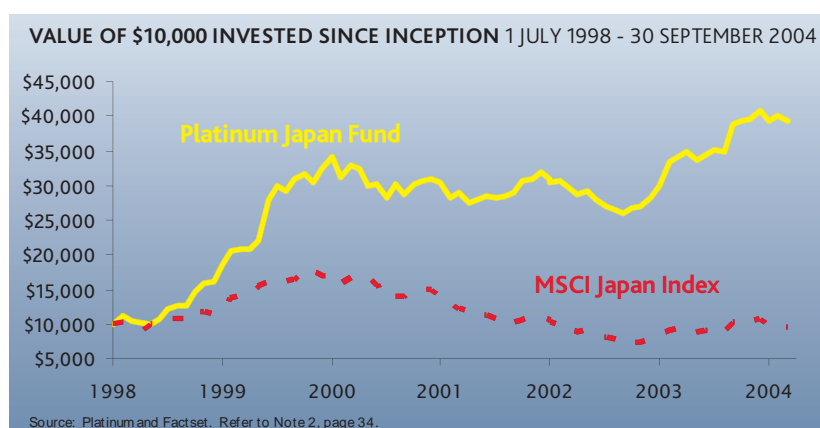
Jim Simpson Portfolio Manager

## PERFORMANCE

Global equity markets struggled to make headway this quarter curbed by the headwinds of slower economic growth and higher oil prices. The Japanese market was more adversely impacted by these forces given its position as a major net importer of energy and the MSCI Japan index fell by 11% in A\$. The majority of this however was due to an exceptionally strong A\$ which rose along with surging commodity prices. The Platinum Japan Fund kept its losses to only 4.1% due to its holdings of cash, a strong performance from our Korean stocks and our low weighting in stocks related to the Japanese deflation trade. The latter trade suffered from a global shift away from the view that inflation was an immediate prospect and was reflected in large declines in the financial and real estate sectors as well as small stock indices such as the Mother's index which fell by 38% over the quarter. The one year performance of the Fund remained robust at 15.3% compared with a rise of 3.8% in the MSCI.

DISPOSITION OF ASSETS		
REGION	SEP 2004	JUN 2004
JAPAN	69%	58%
KOREA	13%	10%
CASH	18%	32%
SHORT DERIVATIVES	0%	-5%
LONG DERIVATIVES	0%	5%
NET DERIVATIVES	0%	0%
NET INVESTED	82%	68%

Source: Platinum



## CHANGES TO THE PORTFOLIO

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We took advantage of the decline in the Japanese market to add selectively to the Fund. A new purchase during the quarter was Mitsubishi Chemical which had been poorly treated by the market due to earnings disappointments in its pharmaceutical division. However the market is failing to appreciate the dramatic changes internally with regard to research and development processes that could deliver surprising results. Other names where we increased our position during the quarter included Sumitomo Corp, Aiful, Mitsui Sumitomo Insurance and Ushio. We removed our position in NEC as our investigations revealed little additional appetite for structural adjustment post the recent debt crisis. We also removed our positions in Suzuki Motor, Olympus and Nikko Cordial.

## COMMENTARY

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### Fundamental Strength

To the casual observer it would be apparent that the success of Japanese industry in the past 50 years has been in manufacturing high quality, low priced consumer durables such as TVs and automobiles - think brand names such as Sony or Toyota. But what are the foundations of that success?

- 1) A long term view of investing in the three P's - process, product and people. This stands in sharp contrast to much of western industry that has drifted toward the short term in line with the financial incentives provided to senior management.
- 2) An "engineers" obsession with product quality control. Most companies still exhibit great pride in their history and product. They believe that without a

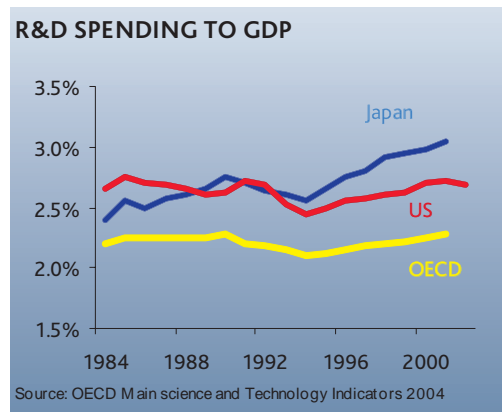
great product the company will cease to exist.

- 3) Innovation as the key to longevity. Japanese industry has intensely competitive foundations as it was borne out of the post-war industrial reorganisation as a sort of social plan. For instance Sony has the likes of Panasonic, Sanyo, Sharp et al barking at its heels.
- 4) The consensus style culture of the Japanese probably lends itself better to process driven industries such as manufacturing. The key seems to be the harmonisation of the corporate culture so that all are moving together as a unit.

This last point needs some refinement as it sounds a bit like a cliché. There have been many books written about Toyota and its famed Toyota Production System or TPS. But despite this, its lead over its Western competitors is as wide as ever. Why? Because observing and writing about a culture without imbibing the culture will always give you a different take. So whilst it may be obvious from these books that Toyota takes a world beating 20 man hours to produce a vehicle because it has fewer platforms or because its plants are organised into cells, that hardly tells you anything about the subtleties of the system. It might be just as important to point out that the culture is one where management start on the factory floor, where production workflow is standardised with feedback loops so that problems are immediately identified and where workers are given responsibility for designing improvements to their own workflow.

Some may be tempted to dismiss this analysis as cultural drivel and not particularly insightful because western manufacturing has been falling behind for some time. However, the truth is that increasingly the west will have to pay for the reimport of these goods. Furthermore, we get a very strong sense that the Japanese are about to take their "model" to another level. As the chart over demonstrates, the Japanese have been

outspending other major economies in research & development since the early 1990s and the gap is continuing to widen! We would expect to see the Japanese advantage start to extend deeper into its existing areas and also to widen into new areas primarily through the introduction of new technologies. The alternative energy solutions outlined below could be just one area. Is it possible that the Japanese recession of the nineties is the pause that merely sharpens the focus of their attack?



### Alternative Energy

A common theme running through our company visits in Japan during September was the development of new technologies in the area of alternative energy. It should be no surprise that the Japanese are extremely active in this area on account of their dependence on imported energy (21% of their imports) and the “green” aspirations of the community - note the hosting of the Kyoto Protocol on global climate change. What is clear to us is that with increasing urgency and on many levels, the Japanese are applying their core manufacturing and science skills to the development of fuel replacement technologies. With oil prices likely to remain structurally high due to depleting supplies, these developments are likely to be very valuable. The two examples we highlight below are illustrative of the pipeline of new technologies.

### Supercapacitors

One of the biggest barriers to the adoption of alternative energy technologies is the efficient storage of electrical energy. Existing rechargeable batteries are inadequate because the charging process is slow and inefficient and they degrade each time they are charged and discharged, requiring frequent replacement. However the development by Japanese researchers of supercapacitors, which represent a quantum leap over existing capacitor technologies, hold out the hope of a stunning revolution in energy storage.

The principle behind capacitors has been known for more than 100 years and today they are used in virtually all electrical devices as electrical filters. However, even the highest density capacitors (5Wh/kg) have never approached the 20Wh/kg of basic lead acid batteries ... until now. The Japanese have improved on existing technologies in two ways. Firstly, they have developed advanced electronic circuitry that raises the efficiency of storage and discharge. Secondly, they have developed new nanoscale carbon materials for the electrodes which dramatically increase the effective charge that can be held by the capacitor. The result is a capacitor that despite being first generation is able to produce 75Wh/kg which is competitive with nickel metal hydride (60Wh/kg) and lithium ion (100Wh/kg) batteries. But the real beauty is that now that the capacity is competitive the other benefits of capacitors can show through. Because capacitors store the actual charge, as opposed to indirectly through a chemical reaction, they can be charged in seconds, used 100,000 times without any change in capacity (batteries are limited to about 500 cycles), and are also much safer than batteries.

The advent of the supercapacitor is likely to open up a swathe of possibilities in replacing as well as extending battery technology:

- When coupled with electric motors, supercapacitors will mean more braking energy can be recouped, making them even more fuel



efficient and virtually maintenance free. This could be applied in any moving machinery such as Hybrid cars, trains and elevators. It is possible that we could eventually move to full electrification of transportation vehicles.

- Portable devices such as mobile phones, digital cameras and laptop PCs could be fully recharged in less than a minute and because of the ability for capacitors to be trickle-charged, small solar cells could be used to charge them when the devices aren't being used.

- Alternative generation technologies such as solar energy could benefit immensely due to the life cycle benefits of capacitors.

### Solar Energy

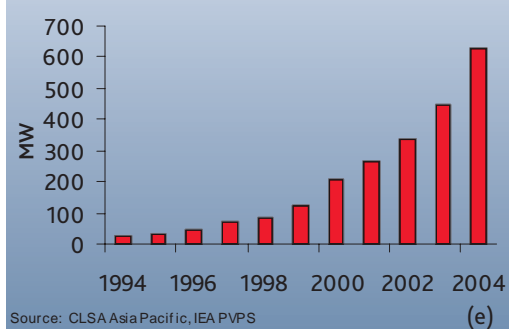
Solar has been hyped as an alternative energy for many years but has failed to deliver because its cost remains more than double the household electricity tariff in most countries. Despite this, worldwide solar installations are growing rapidly as subsidy programs in many countries bring down the effective cost of installation. Germany is the most aggressive with solar-generating households paid 57euro/kWh for the power they generate which compares with 15euro/kWh in household electricity tariffs! Subsidies aside, dwindling oil supplies and a recognition that the real cost of energy (including environmental costs) will remain high into the future seem likely to drive further interest in solar despite the high upfront cost of installation.

What is not well appreciated by many is that the Japanese are at the forefront of solar power development through companies such as Sharp and Kyocera. This shouldn't be surprising because the current technology for solar power generation is based upon silicon, the same material from which most computer chips are made. Indeed Sharp is both a leading LCD producer as well as being the world leading solar power module producer. The Japanese are about to embark on a very aggressive expansion in the area of solar to compensate for the relative maturity of the markets for higher value added

uses of silicon. This will have significant implications for the cost of solar energy. Indeed on our recent visit to Japan we were told of new techniques for making the solar silicon that will lower costs by 30%. In addition Sharp was talking about new generations of solar panels that will deliver between 28-38% light efficiency as opposed to the current standard of around 15%. Furthermore costs throughout the entire chain of production which have traditionally been high due to low volumes and non-standardisation will start to come under serious assault but much of this will be cured by rising volumes.

Where the solar story potentially gets much more interesting than a mere focus on production costs is in the diversification of the materials used and applications. Traditionally we think of roof-top installations but Sharp is working on flexible technologies that will allow solar panels to be placed anywhere including mobile phones, backpacks and car roofs etc. The supercapacitors we talked about above could be bundled with solar panels to allow for storage of electricity and help with peak loads. New materials such as nano plastics could displace silicon and result in much cheaper material costs while new production processes based on traditional printing press technology could materially reduce manufacturing costs.

**ANNUAL INSTALLATIONS OF SOLAR POWER IN OECD**



Forecasts for solar energy demand display a wide variance depending on assumptions about subsidies, costs and prices of fossil fuels. However if we were to assume that 1% of global electricity supply were to be met from solar energy in the year 2020, then this would require 245gW of installed solar capacity. This translates to average installations of about 15gW per annum over that period, about 24x last year's annual supply of 0.6gW. As a rule of thumb used in the industry, a doubling of cumulative output translates into a 20% reduction in cost. On that basis by the year 2020 the cost of solar will be competitive with existing grid prices!

## OUTLOOK

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The constraints to global economic growth are now being felt and reflected in soaring commodity prices. This is only likely to worsen as China seems to have eased back on its pre-emptive tightening policies. In this environment the risks to Japan have risen given their dependency on manufactured exports, resource imports and with little sign of domestic growth gathering pace. Despite this the portfolio remains well balanced in strong, technically oriented growth companies and resource plays.

Jim Simpson  
Portfolio Manager

# PLATINUM INTERNATIONAL BRANDS FUND



Simon Trevett Portfolio Manager

## PERFORMANCE

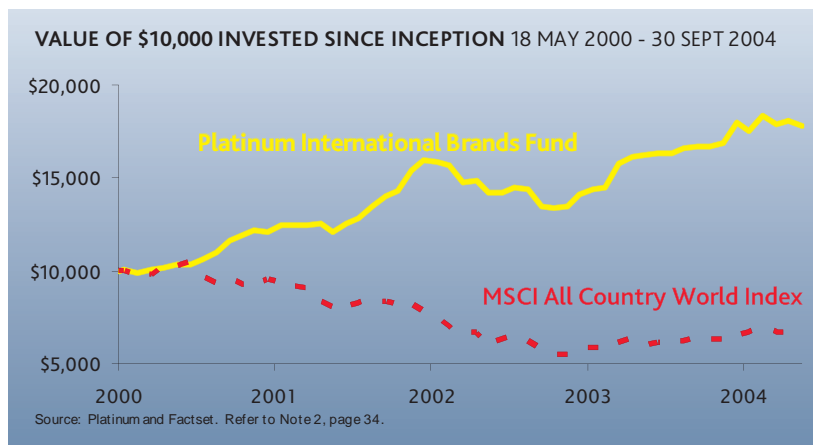
During the quarter, the Platinum International Brands Fund fell 2.9%. The Fund's performance ended slightly ahead of that of the MSCI World Index (-4.4%), albeit through the quarter the performance was quite mixed.

At the end of the previous quarter we commented on the decline in the Asian markets, and for the Brands Fund, the influence on performance of our Indian holdings. This quarter those stocks recovered and were the main positive contributors. In Europe, Adidas-Salomon stands out with a +14% performance, an impressive performance especially in light of the generally weak showing of our other holdings. Our positions in European cosmetic companies, Beiersdorf and Oriflame were particularly weak whilst consumer goods companies such as Nestlé, Unilever and Henkel fared little better, all declining by more than 10% in the quarter.

Our short positions contributed marginally with these stocks tending to remain within relatively narrow trading ranges for most of the quarter. As we start to receive the latest quarterly updates from the companies, particularly the US consumer goods companies, the market is starting to question their valuations and prospects. More on this later.

DISPOSITION OF ASSETS		
REGION	SEP 2004	JUN 2004
EUROPE	39%	40%
OTHER ASIA (INCL. KOREA)	24%	22%
JAPAN	19%	16%
NORTH AMERICA	4%	3%
CASH	14%	19%
SHORTS	12%	11%
NET INVESTED	74%	70%

Source: Platinum



## CHANGES TO THE PORTFOLIO

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We have been reluctant to be particularly active with our investments, adding marginally to our short positions and adding to our existing Japanese and Indian holdings. Oriflame declined significantly and we took the opportunity to add to the position. We were also encouraged by the progress being made by Pernod Ricard and increased that holding.

New names for the quarter include Liberty Media Corporation and Carrefour, the French retailer. We have exited our position in Nestlé.

Carrefour is Europe's largest food retailer and operates globally, with leading market positions in France, Spain, Belgium, Brazil, Argentina, Taiwan (and the largest foreign retailer in China). The group runs 750 hypermarkets, 1,500 supermarkets, and 3,500 hard discount stores (and has an additional 4,000 franchise stores). The company is clearly benefiting from the growth of its businesses in emerging markets with the financial markets having been enthusiastic on this aspect of the company's business. Less clear has been the potential of the French hypermarket business which has been losing market share and suffering sales declines across the existing store base. Investors have been disappointed in this home market performance and the stock valuation has suffered accordingly. With the stock at its lowest valuation for many years and perhaps some interesting signs of life in the French economy, we are more optimistic on Carrefour's potential.



Liberty Media Corporation, a holding company, owns some of the US and globally most-recognised and respected brands with interests in a broad range of electronic retailing, media, communications and entertainment businesses. These include controlling and strategic stakes in companies like QVC (Home Shopping Channel), STARZ! (Movie Channels), Discovery (TV Programming), IAC/InterActiveCorp (E:commerce), and The News Corporation Limited. Originally set-up by John Malone as a vehicle to grow in the dynamic American cable TV industry, it is gradually shaping up as a focused group ready to leverage its content on the convergence between TV, telecommunications and the Internet. Liberty has been historically valued at a discount to its intrinsic value due to its holding company structure. We believe that recent restructuring moves will contribute to the closing of this gap.

### Commonality of Holdings

Just over half of the names in the Platinum International Brands Fund are also represented among the Platinum International Fund's holdings.

However, the weightings are completely different.

At quarter end, common holdings represent 56% of the Brands Fund's invested position and yet only 11% of the International Fund's invested capital.

## COMMENTARY

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In the September 2003 quarterly we highlighted two themes; the rising cost of competing for the incremental consumer dollar and the trend to seek growth opportunities in the East. Currently, on an almost daily basis, the results and news releases remind us that both these topics are the focus of attention across the consumer and branded goods industries.

This quarter we have seen announcements from Coke, Colgate and Anheuser Busch among others that describe the difficulties of the current environment. Coke share price fell from \$50 to \$40 and Colgate's dropped by a comparable 20%. There has been a similar pattern across Europe. The companies have tended to describe the circumstances as to do with a specific, transient and identifiable issue. In Coke's case the poor morale at the Atlanta Head Office leading to 'fixable execution issues', which we think means 'stop making mistakes'. However there has also been a litany of *external* excuses; commodity prices, energy prices, the weather, *skittish* consumers, 'low carb' diet fads and unreasonable competition.

We suspect that a number of themes are coming to bear at the same time, particularly in the US. There is no doubt that the companies are facing rising costs at a time when consumers are also starting to question their consumption needs. Pseudo innovation at higher prices is no longer providing the impetus to grow revenues. The battle is shifting to market share, how to defend existing business, as opposed to the more exciting prospects of enjoying the gains of an expanding market.

To defend or grow market share, and to meet revenue targets that are on the whole still built on robust past growth patterns, greater levels of marketing and support expenditures are needed. The rise in input costs, that is occurring at the same time as many of the companies are

completing their major cost reduction initiatives, is inconvenient at best but, more realistically, is likely causing difficulties in reaching similarly ambitious earnings growth targets.

An increasingly difficult environment for these companies in the Western markets, coupled with uncertainty on currency movements, and the inherent volatility in the emerging markets, is leading many to reassess their expectations of growth in revenues and earnings. We are hearing the phrase *double digit* far less frequently and more often *low single digit*. Accordingly the markets rating of these stocks is falling and we suspect in the majority of cases that we are yet to see a realistic assessment of the costs of holding ones competitive position, never mind the hype about growth and margin expansion.

As always we will be opportunistic and whilst our commentary has been somewhat negative there are nonetheless companies that are well placed to press on with what they know best and successfully navigate the machinations of the real world. On the other hand, we have been comfortable to short sell several companies whose earnings are still levitating on past experience.

Simon Trevett  
Portfolio Manager

# PLATINUM INTERNATIONAL HEALTH CARE FUND



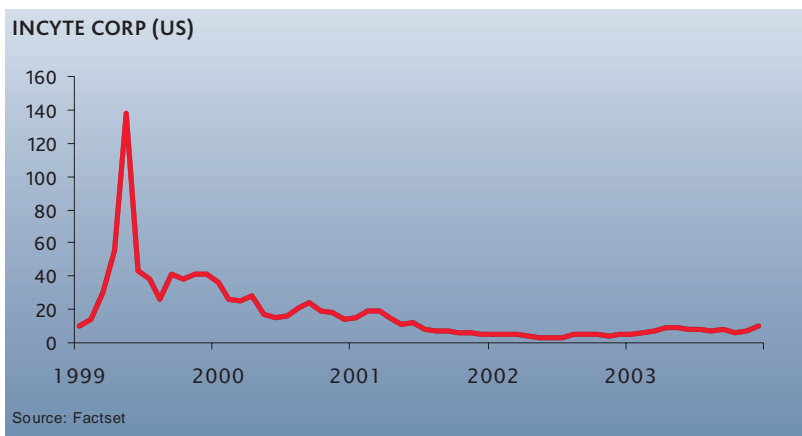
Simon Trevett Portfolio Manager

## INTRODUCTION

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In this first quarterly report of the Platinum International Health Care Fund we introduce some of our investment themes and approaches.

The Health care sector offers a vast number of companies to choose from, some being engaged in early stage research, and are yet to generate any sales, let alone cash or profits, others producing profits with highly successful pharmaceutical products. Despite the variety of options within the sector we adhere to the underlying principles inherent in investing at Platinum. We use a number of techniques and themes, some of which are expounded upon later, to identify opportunities and potential investments. As should be expected from us, we favour areas of neglect where we can see interesting key themes. An example is Incyte Corp, a stock with a rather neglected long term price chart but which detailed work showed us to have interesting potential. This chart is not dissimilar to a number of others from the Biotechnology Sector.



## COMMENTARY

The clarity of hindsight exposes the exuberance of the market, when promises overrode the reality of the inherent complexity of commercial product development. Advancing scientific achievements to commercial fruition requires time and patience. However, the advances in science relentlessly progress, particularly in the field of molecular biology. The results from the application of the billions of dollars raised via the enthusiasm of the markets are beginning to show through. Some companies have made continuous progress and are followed intensely by industry specialists while others have seen their prices struggle and the market has lost interest, even though there is a steady flow of information. There are even occasions when the neglect is such that companies trade below the value of their cash backing.

The Health Care Fund is invested in companies engaged in a wide variety of pursuits, currently ranging in size from US\$100 million through to over US\$200 billion. As seen from the accompanying table the Fund is predominantly invested in North America (58%), followed by Europe (26%). We will continue to appraise investment ideas from Asia, Japan and India, however, it is likely that the current geographic mix will persist for a while given the technological and financing lead that the Western companies seemingly enjoy.

DISPOSITION OF ASSETS		
REGION	SEP 2004	JUN 2004
NORTH AMERICA	58%	56%
EUROPE	26%	23%
JAPAN	2%	3%
OTHER ASIA (INCL. KOREA)	2%	3%
CASH	12%	15%
SHORTS	0%	0%
NET INVESTED	88%	85%

Source: Platinum

Endless reams are written about the ageing demographics, the demanding baby boomers unwilling to grow old gracefully, and the ever increasing incidence in age-related diseases. Likewise, we are also aware of the pressures of politics, drug pricing, expiration patterns of patents on billion dollar drugs and a myriad of headwinds in the sector. Many are legitimate concerns and the stock prices rightly reflect these issues. Others are matters that companies can deal with and emerge with success. It is among this jumble of issues where astute decisions have allowed companies to adjust and adapt, that we attempt to find opportunities.

The mighty Merck Inc, bastion of the US pharmaceutical companies, finds itself facing all these issues. The cause was a highly insular approach to research and development that failed to adequately deliver new compounds at a time they were most needed. This is well understood by investors as they have de-rated the shares from a peak PE in the late 90s of 40x to less than 15x today. A new approach finds Merck Inc actively courting the Biotechnology industry, apparently having entered into more product collaborations and acquisitions in the past two years than in the past decade. It will take time though to assess the cultural changes that are inherent in such a fundamental transformation. More interesting still will be the impact across the industry as each of the giants (Pfizer, GlaxoSmithkline, Novartis et al) all seek out new ways of developing their businesses outside of their own laboratories and offices.

It is interesting to observe how in its own way the financial community is competing for resources as it recruits analysts with PhDs, many with an oncology focus. For many reasons, the advances in molecular biology have been most obvious in the field of cancer research. The aberrant behaviour of the molecular control system of cancerous cells has been studied intensely over decades and is slowly being translated into therapeutic approaches. From a commercial perspective the running of clinical



trials in cancer therapy, are often faster and cheaper than in other therapeutic fields on account of the binary outcome: cancer patients enrolled for these trials have a reduced life expectancy, where existing treatments have failed and as a consequence fewer patients over a shorter time typify cancer trials. In contrast, the development effort for cardiovascular drugs or obesity treatments is associated with lengthy and onerous trials to satisfy safety and efficacy concerns because these drugs tend to be prescribed for long periods of time! As might be expected, we have taken a slightly different track. Rather than relying on the information from the investment community and their almost exclusive focus on the field of oncology, we have sought to have a broader perspective. Aside from a number of investments that are exposed to the progress being made in oncology, we have endeavoured to seek out progress in other areas such as neurological or psychiatric disorders (eg. Multiple Sclerosis, Alzheimers Disease, Depression) and infectious diseases (eg. Hepatitis C and HIV).

We approach our work not from the perspective of stocks and their prices, but from a review of the scientific literature and also seek out the field's specialist luminaries, tracking their progress and associations through to investment opportunities. We have travelled to the US and Europe several times in the past couple of years and visited many companies, public and private, checking and cross-checking the scientific progress. We also actively seek the assessment of others, both more qualified and closer to the industry, to build confidence in our own observations. We place heed in the evaluation made *and actions taken* by potential collaborators, especially where they have performed their own due diligence on a product, a technology or company.

When meeting with companies we enthusiastically embrace the opportunity to speak with those actively involved in the

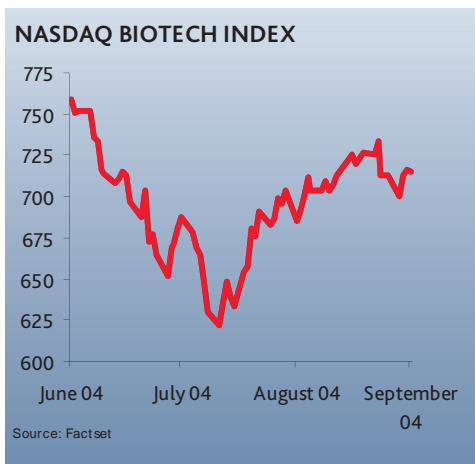
progress of research and development. In many cases we engage the Chief Science Officer or Head of R&D in very extended discussion, often to the disappointment of the CFO or CEO! It is surprising how many companies lament the poor understanding, lack of preparation and dull questions they experience from many of the analysts they encounter. Companies appear to genuinely appreciate our apparently unorthodox approach of trying to understand the business. To quote a Chief Scientist's remark to his CEO from one of our recent meetings "I love it when I get to talk dirty". Apparently an altogether too rare occurrence!

Whilst we also study the progress of products through clinical trials, we are aware that at any stage in the lengthy development cycle of new treatments, unforeseen difficulties will arise. Sometimes these events are sufficiently serious to result in the termination of the program, on other occasions small changes are required and a product launch is delayed. However, such issues frequently result in the loss of years of investment. Thus, we prefer to invest in companies that have a number of dimensions that allow the company to weather such setbacks; albeit sometimes only partially and over time.

Beyond the drug developers, be they pharmaceutical or biotechnology companies, we are developing the theme that very few drugs in this world are truly effective and most also carry an unacceptable side-effect penalty. Surely, without antibiotics mankind would be in some strife, but even in this field where drugs fight the infection, concerns exist over how well individual patients respond. (There are also the ongoing difficulties of bacterial resistance.) We believe there are interesting investment opportunities in the tools and technologies that support the development of tailored therapies and personalised medicine, based on more exquisite knowledge of pathogen, disease or person. More discussion of this theme will appear in future quarterly reports.

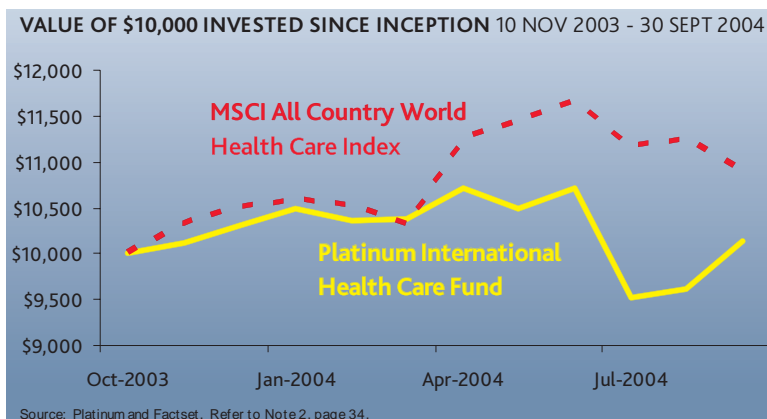
## PERFORMANCE AND OUTLOOK

Performance over any short period may well be quite volatile. The chart below is of the Nasdaq Biotechnology Index for the past quarter: a drop of nearly 20% followed by a more gradual recovery.



Given the exposure of the Fund to the US biotechnology sector, it is likely that over such short time periods the Fund will also display some volatility. The Fund ended the quarter down 5.5% having experienced a similar decline and recovery across the quarter. Currently, the Fund is invested more heavily towards drug development than providers of tools and technologies to support basic research or at the other end of the health care spectrum, hospitals (though we do have a position in a European Hospital company). This coincides with a seasonal tendency for the drug development stocks to be influenced by the many scientific, medical and investor community conferences occurring over the next quarter. There is also the US election, and not unlike our own politicians, there will be plenty of discussion about health care and its funding which may unduly influence stock prices over the short term.

Simon Trevett and Bianca Elzinger



# PLATINUM INTERNATIONAL TECHNOLOGY FUND



Alex Barbi Portfolio Manager

## PERFORMANCE

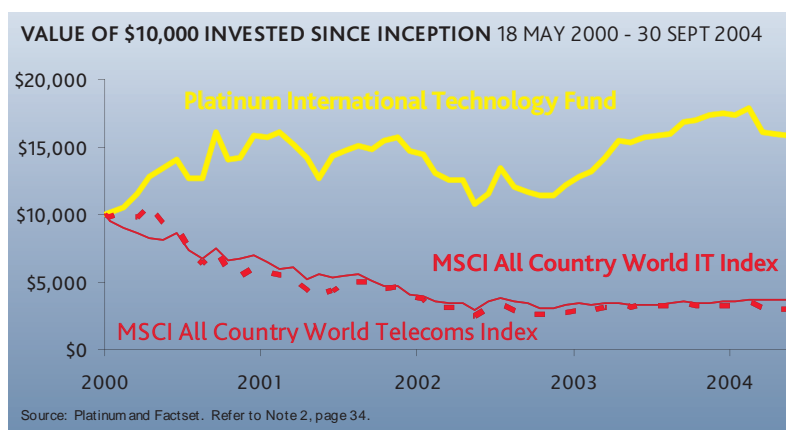
During the quarter, technology shares suffered as a consequence of a sharp inventory correction affecting semiconductor stocks. This was triggered by a slowdown in sales growth of mobile phones, PCs, flat panel displays and communication equipment in Asia and the US. No fewer than three dozen semiconductor companies pre-announced negative earnings surprises! During the same period, the Philadelphia Semiconductor Index (SOX), representing most US semiconductor companies, collapsed by 21% and the broader Nasdaq Composite Index fell 7.4%. The MSCI World Information Technology Index (in A\$ terms) declined by 13.5% and the MSCI Telecommunications Index (A\$) lost 1.6%.

Within technology, fund managers generally abandoned the more cyclical stocks and found refuge in seemingly more defensive stocks like incumbent telecom operators. The Fund's performance was a disappointing -10.8%, with the largest losses experienced by our semiconductor and hardware stocks. Recent additions to our positions in semiconductors and telecom equipment were, with the benefit of hindsight, premature. Asian holdings partly offset the negative performance thanks to the strength of our Indian, Chinese and Indonesian stocks.

Over the last twelve months, the Fund returned +3.8%, while the MSCI World IT Index (A\$) declined 5.2%, and the MSCI World Telecommunications Index (A\$) returned +9.1%.

DISPOSITION OF ASSETS		
REGION	SEP 2004	JUN 2004
NORTH AMERICA	24%	29%
OTHER ASIA (INCL. KOREA)	22%	18%
JAPAN	18%	20%
EUROPE	10%	15%
CASH	26%	18%
SHORTS	15%	5%
NET INVESTED	59%	77%

Source: Platinum



## CHANGES TO THE PORTFOLIO

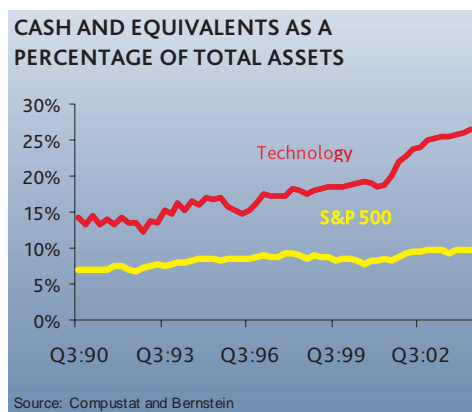
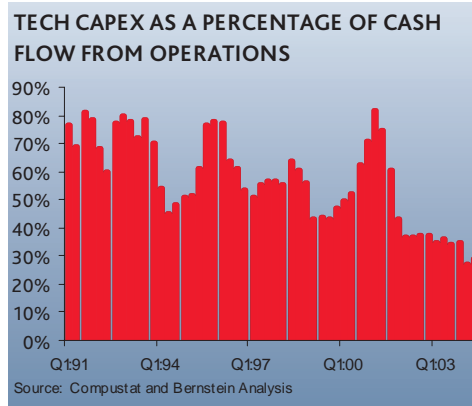
During the quarter, we reduced our net exposure and raised cash holdings from 18% to 26%, reflecting our more cautious view of technology after the short but impressive recovery of the last 12-18 months. We exited our investments in Vivendi Universal and Ericsson after they reached our valuation targets. We introduced a new position in Alcatel, convinced of the need to upgrade existing telecom networks to next-generation technology (ie. fibre optics, internet protocol and broadband). We believe Alcatel has the right combination of strong global presence among telecom operators, and technology know-how to profit from the coming telecom infrastructure upgrade.

## COMMENTARY

### Technology companies awash with cash

We have written extensively about the need for more IT industry consolidation and more specifically, in software. While the Oracle-Peoplesoft saga may be finally close to resolution (with US courts approving the deal and European courts expected to deliberate this month), the majority of large technology companies still seem reluctant to engage in mergers or acquisitions. Most technology companies able to survive the March 2000 tech crash have managed to restructure their balance sheets, courtesy of a general economic recovery and the US Federal Reserves accommodative monetary policy. Cash on balance sheets has been piling up, but appetites for capital expenditure and acquisitions have not returned to the pre-bubble level. Why?

A cynical mind would suggest that many in management prefer to issue options to themselves in large quantities, while buying back



shares on market to avoid share dilutions, rather than expanding capacity or acquiring competitors. A celebrated example is Cisco, which bought back roughly US\$8 billion of shares over the last two years though in total the number of shares on issue stood rock steady. (Cisco still has US\$20 billion cash on their balance sheet.)

On the other hand, there is a growing clamour from the investing community demanding explanations. If there are no suitable investment opportunities, why not give the cash back to shareholders! Even Microsoft had to face reality: with annual free cash flow generation of US\$16 billion, it has hitherto not been a champion for dividend distributions. The surprise announcement came last July when Microsoft announced a doubling of their annual dividend,

though still a paltry 1.1% yield, and a one-off US\$3.2 billion distribution as well as a US\$30 billion buy-back over the next four years.

We believe management's greed can only partly explain this reticence. More likely, the overcapacity of many technology sectors and emerging competition from Asian companies is putting more pressure on Western companies' margins and reducing their appetite for investment. Outsourcing is the new name of the game. Manufacturing and design are increasingly seeing moves overseas.

Indeed in some sectors in Asia, capital expenditure has been decidedly buoyant. In Korea, Japan, Taiwan and China for example, flat panel display makers are all rushing to build multi-billion dollar factories in order to achieve the latest economies of scale. Samsung forecast \$17 billion of capital expenditure to build liquid crystal display (LCD) capacity over seven years and LG-Philips (a JV between LG Electronics and Philips) is budgeting \$22 billion for a ten-year period. In Taiwan, ChiMei and AUOptronics have similarly ambitious plans. NEC set up a factory in China in a joint venture with a local company.

### Digital revolution in the living room

Why are Asian display manufacturers spending such huge sums on new plant and equipment? We have spoken before about the digital revolution in consumer electronics. Digital cameras now outsell traditional film cameras. DVD has replaced VHS as the preferred video recording technology. Yet the digital consumer revolution is still at the very beginning. The next big transition is going to be the replacement of existing cathode ray tube (CRT) TVs with new flat panel displays. This presents a major opportunity for the electronics sector in the medium term. Every year, around 150 million CRT TVs are sold: roughly the same size as the PC market. It is not unrealistic to suggest that there exists more than one billion CRT TVs

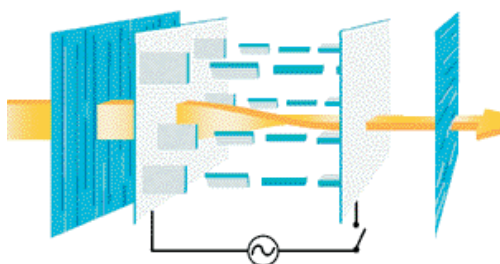
waiting to be replaced. To put this in perspective, in 2004, 8-9 million LCD TVs and 3.7 million plasma TVs are expected to be sold.



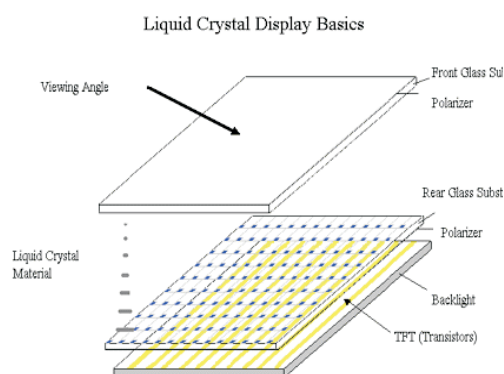
The aesthetic design and reduced mass of flat panel TVs certainly appeal to consumers looking to replace their old TV sets. Paradoxically though, despite the nice appearance and status symbol attached to these products, CRT TVs offer the best visual experience (in terms of contrast, brightness, longevity and viewing angle). Even more important, the price gap in favour of traditional CRT TVs is still too wide. For these reasons we think that the replacement cycle will unfold gradually.

The main component in flat panel TVs is the liquid crystal display panel. Making LCD panels is a complex exercise, and so far the necessary expertise has been concentrated in Japan, Korea and Taiwan. An LCD panel consists of two polarising transparent panels and a liquid crystal solution sandwiched in-between. Liquid crystals are rod-shaped molecules that bend light in response to an electric current. Each crystal acts like a shutter, either allowing light to pass through or blocking the light. The induced pattern of transparent and dark crystals forms the image. It is the same display technology used in digital watches, only more sophisticated. Just imagine how difficult it would be to co-ordinate these millions of little molecular shutters to project rapidly-changing images !!

## HOW A STANDARD TFT (TWISTED NEMATIC) DISPLAY WORKS



## CROSS SECTION VIEW OF AN LCD PANEL



Note: The rear glass substrate contains both the LCD material and each pixel's transistor.

Source: [www.necmitsubishi.com](http://www.necmitsubishi.com)

Generally, LCD TVs are considered to offer better visual performance in the smaller sizes (40 inches and below), while plasma displays are better in larger sizes (40 inches and above). Plasma TVs offer a deeper colour range, brighter pictures and better contrast than LCD TVs. A plasma TV display can be thought of as having one million or more microscopic light bulbs (pixels) arranged between glass plates. These pixels are illuminated by plasma gas, and are able to produce red, green, and blue individually, as well as any of the 16.7 million colours in-between. The biggest shortcoming of plasma TVs is the risk of burn-in: this occurs when a static image is displayed for too long and a ghost image subsequently remains imprinted permanently on the phosphor coating of the display.

To date, a large plasma TV remains far cheaper than a LCD TV of similar size. However, over the next two to three years, the price gap between the two competing formats will narrow as the new LCD panel factories commence production. If one were planning to buy one of these expensive LCD TVs, 2005 may prove to be a good year to do so. We suspect it is almost inevitable that prices for LCD TVs drop substantially in 2005. We would not be surprised if large LCD panel prices decline by 25-30% (or even more) between 2004-2005 for the simple reason that all major LCD panel makers will have to cut prices to stimulate demand in order to keep their new factories fully utilised.

We are watching this industry with great interest and we believe that ultimately lower prices will trigger an acceleration in consumer demand. The Fund is exposed to this theme through our holdings in Samsung Electronics and other selected component makers.

## OUTLOOK

To what extent has the recent slowdown been only a temporary setback? We believe the answer lies in the health of the US and Asian consumers and in the recovery of IT enterprise spending. Early signs of recovery in selected components markets may signal a rebuilding of inventory before the generally strong Christmas period. However, as long as the oil price stays around US\$50 a barrel, we think that consumers will be met by strong head winds, and we remain invested accordingly.

Alex Barbi and Douglas Huey



## NOTES

1. The investment returns are calculated using the Fund's unit price and represent the combined income and capital return for the specific period. They are net of fees and costs (*excluding the buy-sell spread and any investment performance fee payable*), are pre-tax and assume the reinvestment of distributions. The investment returns shown are historical and no warranty can be given for future performance. You should be aware that past performance is not a reliable indicator of future performance. Due to the volatility of underlying assets of the Funds and other risk factors associated with investing, investment returns can be negative (particularly in the short-term).

2. The investment returns depicted in the graphs are cumulative on A\$10,000 invested in the relevant Fund since inception relative to their Index (in A\$) as per below:

Platinum International Fund:

Inception 1 May 1995, MSCI All Country World Net Index

Platinum Asia Fund:

Inception 3 March 2003, MSCI All Country Asia ex Japan Net Index

Platinum European Fund:

Inception 1 July 1998, MSCI All Country Europe Net Index

Platinum Japan Fund:

Inception 1 July 1998, MSCI Japan Net Index

Platinum International Brands Fund:

Inception 18 May 2000, MSCI All Country World Net Index

Platinum International Health Care Fund:

Inception 10 November 2003, MSCI All Country World Health Care Net Index

Platinum International Technology Fund:

Inception 18 May 2000, MSCI All Country World Information Technology Index

(nb. the gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist).

The investment returns are calculated using the Fund's unit price. They are net of fees and costs (*excluding the buy-sell spread and any investment performance fee payable*), pre-tax and assume the reinvestment of distributions. It should be noted that Platinum does not invest by reference to the weightings of the Index. Underlying assets are chosen through Platinum's individual stock selection process and as a result holdings will vary considerably to the make-up of the Index. The Index is provided as a reference only.

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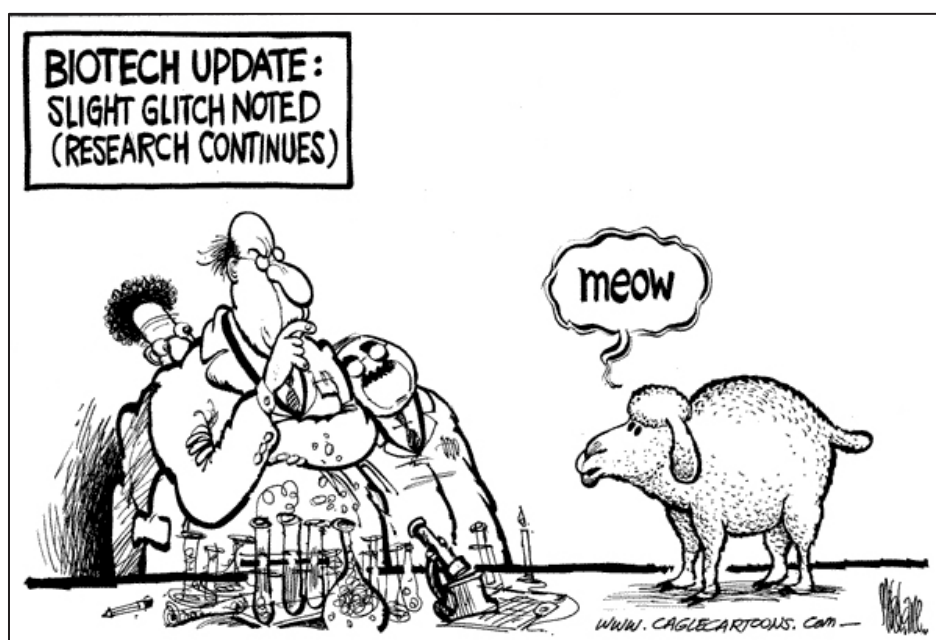
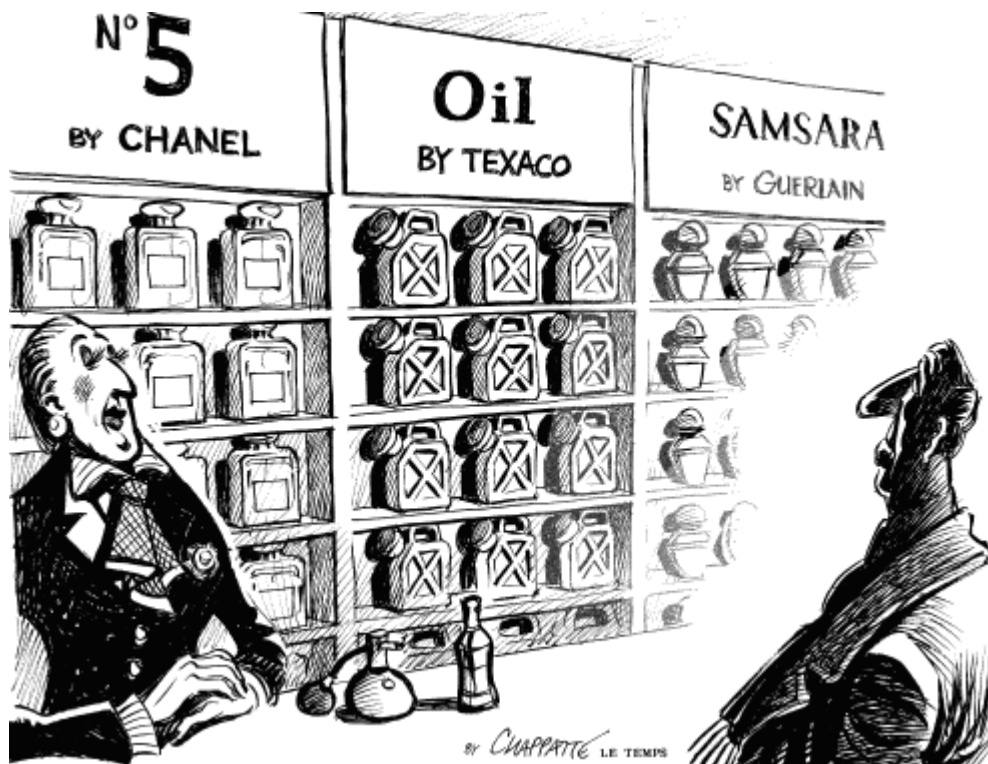
The Platinum Trust Product Disclosure Statement No. 5 (*PDS*), is the current offer document for the Funds. You can obtain a copy of the PDS from Platinum's web site, [www.platinum.com.au](http://www.platinum.com.au), or by contacting Investor Services on 1300 726 700 (*Australian investors only*), 02 9255 7500 or 0800 700 726 (*New Zealand investors only*) or via [invest@platinum.com.au](mailto:invest@platinum.com.au).

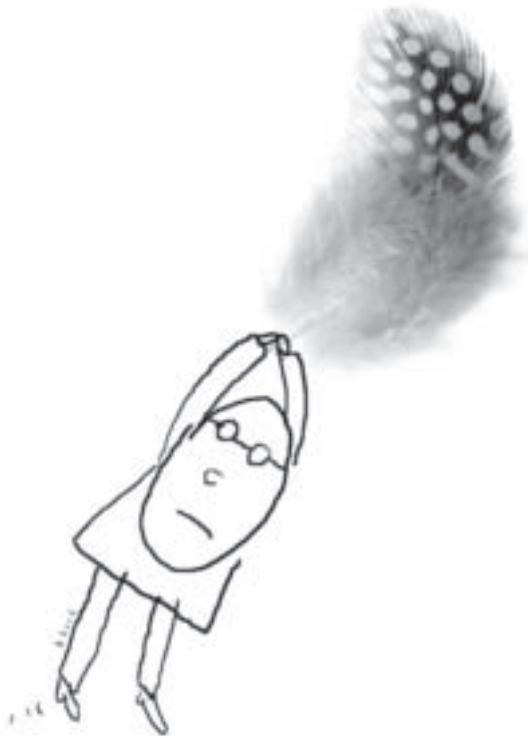
Before making any investment decision you need to consider (with your financial adviser) your particular investment needs, objectives and financial circumstances. You should consider the PDS in deciding whether to acquire, or continue to hold, units in the Funds.

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The firm was founded in February 1994 by a group of professionals who had built an enviable reputation while at Bankers Trust Australia. PAM currently manages around A\$13 billion with over 20% of this coming from overseas investors. The staff are the owners of the company. The emphasis of the organisation is on managing clients' money rather than gathering funds: we have no sales staff and pay no inducements to promoters of our funds.

Since inception, the Platinum International Fund has achieved returns of well over twice those of the MSCI All Country World Index\* and considerably more than interest rates on cash.

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**Facsimile:** 02 9254 5590

**Email:** [invest@platinum.com.au](mailto:invest@platinum.com.au)

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