PLATINUM CAPITAL LIMITED

ACN 063 975 431

1997

ANNUAL REPORT

DIRECTORS

Michael Darling
Philip Pearce
Kerr Neilson
Andrew Clifford
Malcolm Halstead

SECRETARY

Malcolm Halstead

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SOLICITORS

Allen Allen & Hemsley
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STOCK EXCHANGE LISTING

Official list of the Australian Stock Exchange Limited
Ordinary Shares ASX Code: PMC

INVESTMENT MANAGER

Platinum Asset Management

Kerr Neilson ~ *Global, South America*
Andrew Clifford ~ *S.E. Asia, Japan, India*
Jim Simpson ~ *S.E. Asia, Japan*
Doug Huey ~ *S.E. Asia*
Toby Harrop ~ *Europe, Currencies*
Rod Sleath ~ *Europe*
Hugh Giddy ~ *North America*
Liz Norman ~ *Shareholder Liaison*

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Investment Performance

The Net Asset Value of Platinum Capital Limited grew by 11.7% last year after allowing for all tax liabilities, both realised and unrealised. On a pre-tax basis the growth figure was 15.9%.

By way of comparison, these performance figures are better than last year, but not as good as the appreciation in the Morgan Stanley Capital International World Accumulation {Net Return} Index in A$ (MSCI) which is often used as a benchmark for the performance of international investment funds.

The table below sets out the performance for Platinum Capital in each of the three years of its operation and compares these figures to the MSCI. The total cumulative return to investors over the three years is also shown.

PCL pre-tax NAV versus MSCI (%)

	1994/95	1995/96	1996/97	3-YEAR CUMULATIVE
PCL	**13.0**	**12.2**	**15.9**	**47.0**
MSCI	**14.1**	**6.7**	**28.5**	**56.3**

Platinum Capital's performance in each of the three years has been fairly consistent and, taking a long-term view, is very much within the sort of return parameters that can be expected from equity investment. The MSCI over that time has been more varied and is ahead both this year and over the three years. This is in large measure due to the index's heavy weighting in the US equity market, a weighting which is not reflected in Platinum's portfolio. The Investment Manager discusses the reasons for Platinum's approach more fully in its report.

In assessing Platinum's performance we consider it to be reasonable, but below our aspirations. Over time it is still our goal to offer good returns and to outperform the MSCI.

Share Price

The share price movement has continued to be fairly volatile and, in common with many listed investment companies, does not fully reflect the underlying value of the company.

In an effort to address this issue last year, we sought and won shareholder approval to buy back up to 20% of the issued capital of the company in a year rather than the 10% allowed under the Corporations Law.

The intention was that if the share price went to a substantial discount to NAV it would be in the interest of all shareholders to, in effect, invest in our own stock by buying it back.

On 3 March 1997, the Company announced it would seek to buy back up to five million shares and more recently on 19 June 1997, the buy-back period was extended for a further six months to 19 December 1997.

To date, no shares have been purchased under this arrangement because the discount to NAV has never been sufficiently large.

Whether the share buy-back announcement has had any effect in limiting the discount is hard to tell, but the company considers the power to buy up to 20% of its capital may be useful in the future and a resolution to that effect is on the agenda for the Annual General Meeting.

Dividends

The company's dividend policy is to make relatively modest regular dividends which can be built up over time. In addition, an occasional special dividend might be declared to pass on accumulated franking credits. The total of these credits was 21.4 cents at 30 June 1997.

This year, Directors are recommending an increased regular dividend of 3.0 cents per share (last year 2 cents per share).

The issue of how best to pass on accumulated franking credits is still under discussion. A significant number of Platinum shareholders are New Zealand residents and discussions are currently in progress between the Australian and New Zealand Governments on issues such as double taxation.

We have decided to take no further action in this area for the time being in the hope that new arrangements will emerge such that special dividends will be less disadvantageous for our New Zealand shareholders.

Outlook for 1997/98

The overall outlook for the world economy and for many of the important national economies within it is somewhere between positive and benign. The economic fundamentals of low inflation, readily available money, moderate and synchronised growth underpinned by productivity gains from technology and restructuring are about as good as things get. To an investor the issue is value: how do you buy value in markets whose valuations largely reflect all the positive factors with little margin for any negative news?

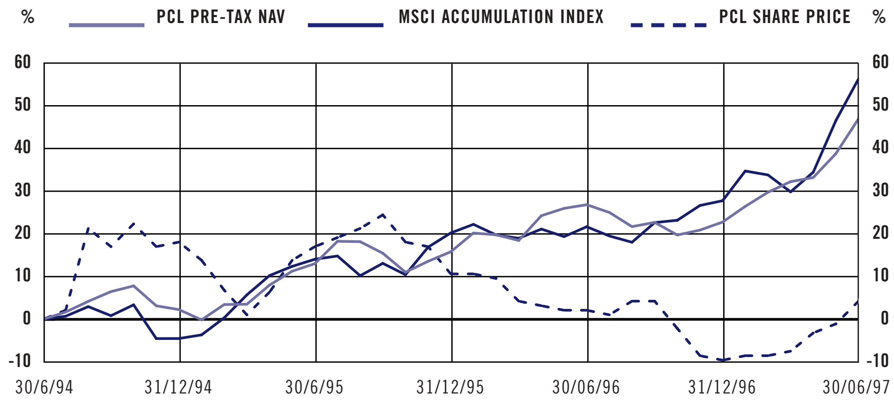
Platinum will continue to assiduously seek value rather than just go with the flow of money. At times this will put us out of step with the received wisdom. Over the longer term, it remains our view that this approach has a better chance of producing superior returns for shareholders.

Michael Darling Chairman

Performance

The performance for the year can be viewed as comprising two distinct halves. The first half, which we discussed at length in the interim report, highlighted the culmination of poor outcomes of decisions taken during the previous year and which resulted in some losses. The second half showed a significant improvement with the company's assets appreciating in excess of 19%. Taking the year as a whole though, the pre-tax return of 15.9% is short of the 28% gained by the Morgan Stanley Capital International Index (MSCI).

PCL cumulative performance of NAV (pre-tax) and share price versus MSCI World Accumulation Index



We are not, however, discouraged by this under performance as it was achieved while following our distinct investment style which we regard as being risk averse. This involves buying companies, which for transient reasons, are trading at valuations that are below their inherent business value; by avoiding over priced momentum driven stocks; and by investing for absolute returns rather than seeking refuge in relative performance alone. (Sadly, the momentum element of these markets has taken its toll on many global funds with the average manager in the Micropal Survey achieving similar returns to ourselves, with the damage being done by the explosion of prices in June, notably in the US, where most managers have been underweight.)

When we look behind the bland figures to evaluate the constituent decisions made in building a portfolio, we take comfort from the underlying pattern. In Japan for example, against a market that retreated through the year, we have made some handsome profits, and in Europe we are seeing our stock picking methodology work well. The cost of hedging the US portfolio is evident. However, we have difficulty reconciling the valuations of the leading stocks in that market with the reality as we know it and have sought protection in the belief that adverse price action in Wall Street will have a negative effect on markets elsewhere. (By our measures, some of the momentum-driven big names look to be overvalued by 50% or more. For reasons that we describe in an article in the back of this report, this can continue for a while but has more to do with market psychology than inherent business value).

Changes to the Portfolio

As you will see, we continue to find interesting companies in North East Asia. In the last quarter, we have added a blend of domestic orientated and export sensitive stocks in Japan such as Japan Tobacco, Asahi Breweries; Kyocera, Shimano and Toshiba. In Korea, we have continued to add to Samsung Electronics and have introduced Samsung Fire & Marine. We have re-entered the Indian market taking a position in ICICI (a provider of long term finance) and VSNL (the international Telecoms carrier). Further investments have been made in Siemens and we have introduced Rinascente in Italy (one of the country's largest retail chains, principally hypermarkets and supermarkets). At the same time, we have reduced our holdings in those companies where the values have accelerated past their longer term norms.

You will notice that we have withdrawn from our Russian investment, the Firebird Fund. This has proved a most successful venture giving us a return of some 169% over 2.75 years. The thinking behind this decision relates to the inflexible nature of such a vehicle as to applications and redemptions, and we believe it will serve our interests better by either investing direct or through a publicly listed investment fund. (Though the Russian market has got itself very excited for the moment, we are still long term believers in the potential of that country).

Top Ten Holdings AS AT 30 JUNE 1997

STOCK	COUNTRY	INDUSTRY	% HOLDING
Fuji Photo Film	Japan	Photographic Equipment	**4.6%**
Yamanouchi Pharm.	Japan	Pharmaceutical	**3.9%**
Schindler	Switzerland	Construction	**3.5%**
Daiichi Pharm.	Japan	Pharmaceutical	**3.3%**
Siemens	Germany	Electrical Engineering	**2.7%**
Samsung Electronics	Korea	Electronics	**2.7%**
Swiss Industrial Group	Switzerland	Packaging/Engineering	**2.5%**
Canon	Japan	Office Equipment	**2.5%**
Lagardere	France	Media/Defence	**2.5%**
Nintendo	Japan	Home Entertainment	**2.4%**
Total			**30.6%**

Disposition of Assets

REGION	30 JUNE 1997	30 JUNE 1996
Western Europe	**31.9%**	**25.7%**
Japan	**31.8%**	**31.0%**
Other Asia	**11.0%**	**9.5%**
South America	**5.6%**	**5.2%**
North America	**2.9%**	**14.5%**
Australia	**1.1%**	**3.4%**
Cash	**15.7%**	**10.2%**

Currencies

With continuing uncertainty over the timing and structure of European Monetary Union (EMU), we have removed the hedge on our Deutsche Mark and Swiss Franc holdings but continue to hedge the bulk of our French Franc exposure. Italian Lire is fully hedged reflecting the assymetric risk of holding this currency (regarding its possible exclusion from EMU). We own Sterling given its macro fundamentals and at around 74.5 cents, we are looking for lower levels to increase our Australian dollar hedge.

Australian Dollar	**45%**	Pounds Sterling	**4%**
Japanese Yen	**14%**	French Franc	**1%**
Deutsche Mark	**8%**	Italian Lire	**0%**
Swiss Franc	**8%**	US Dollar related assets	**20%**

Market Commentary

The markets continue to soar in the world of Goldilocks (economic activity that is not so fast as to create inflation problems and higher interest rates, and yet fast enough for companies to achieve profit growth). As noted in previous commentary, the headwind of restructuring and fiscal rectitude is retarding the recovery in Japan and Western Europe. However, the benefits of cheap money are coming through and growth is apparent on the broadening front. Aiding matters further is the relative calm in currency markets which have allowed Japan and Europe to maintain the competitive advantage their currencies have gained against the dollar starting in mid-1995. The dream run of moderation in the United States continues with the Federal Reserve Board (Fed) apparently unwilling to pre-empt a rise in inflation with the emphasis seemingly having shifted to a more reactive stance. The concern about asset price inflation has not diminished but in terms of its political brief, the Fed is focusing on consumer price inflation for now.

This "ideal environment" of slow if stodgy growth has however been at a cost to some of the tiger economies of the Pacific. Most notable is Thailand which has long feasted on a rich diet of heavy inward investment and low cost short term money. It now finds itself losing competitiveness and as the economy has slowed, servicing this debt is proving burdensome.

The Korean economy, with its high dependence on world trade, has also suffered from an over-investing binge but its relatively low dependence on external capital flows protects it from many external pressures. It is starting to see the benefits of accelerating exports and falling imports, particularly of investment related items.

The general wash of events that has overshadowed the Pacific Basin region has passed Hong Kong unscathed. It is continuing to benefit from the relatively low cost of money (related to its fixed exchange rate to the US dollar) which together with a booming hinterland, is creating unrealistic expectations in its property market (a little apartment on the Island without views would now cost around US$1 million).

Indonesia is receiving more favourable commentary now that the elections are out of the way. The managed float of the currency has given the Central Bank a degree of control over monetary policy. This combined with the migration of manufacturing from its higher cost northern neighbours, is permitting the economy to grow strongly without undue inflation pressures.

The search for yield is greatly benefiting Latin America. Foreign buyers of traded securities and the flow of direct investment is acting to reinforce the reforms that have been in place for some while now. Corporate borrowers have moved with alacrity to lock in relatively low fixed term borrowings with quality names being able to raise loans paying barely 3% more than the US Government.

The big event in Western Europe has been the election of socialist governments in both the UK and France. In the case of Britain, the policies of the new government look like having little adverse effect on the established pattern. The decision to give greater independence to the Bank of England and the emphasis of the Government's first budget suggest that the new regime is following orthodox economic policies. The electoral decision by the French population has resulted in a coalition of socialists and communists and is reminiscent of the Mitterrand era of 1981. The initial utterances indicate a high degree of government intervention and a slowdown of reform. However, it seems unlikely that France can by itself resist the prevailing global pressure to reduce State intervention in the economy. As far as its immediate effect on European Monetary Union, it is clear that fiscal discipline will be treated as a lower priority. The prospects are surely now for a broad and flat grouping rather than a deep and narrow model that seemed probable only recently.

The case for our position on specific stocks in Japan has been thoroughly covered in correspondence over the last eighteen months. The positive price action reaffirms our stated views.

Outlook

The positive forces that have been driving stock markets are still intact.

The lack of price pressure caused by abundant capacity should continue to encourage Central Banks in most of Continental Europe and Japan to maintain easy money conditions. The lessons learned from the US model, and which is now something of a reference point, is that the reordering of the linkages within an economy should produce a relatively long and gradual recovery which is very different from the inflation-prone cycles of the Seventies and Eighties. (The ability of the US to tap significant resources on its borders - Mexico and Canada plus the requisitioning of imports further afield aided by a strong currency, do make comparisons a little uneven but nevertheless the big surprise in this environment has been from the supply side). Even as growth synchronises, cost pressures in the laggards (Japan and mainland Europe) will be held in abeyance by virtue of still under-utilised resources. The likely pattern is that the leaders within the cycle will continue to raise rates ahead of the others and hence interest rate differentials should widen.

The US economy is surprisingly robust given the duration of the current economic upswing. The market is predominately focused on the idea that the low level of unemployment poses a threat to the current level of relative price stability. It is evident that the financial market boom is creating a virtuous circle of confidence and expenditure yet it would be wise to monitor signs of economic weakness. Credit card delinquencies are exceedingly high and durable good sales and orders have stalled.

Enhancing the general feeling of well being in the US is the notion that we are entering a period of greater economic stability on the back of the information technology revolution and that the American model, which looked rather dowdy in the mid-Eighties, has now come into its own. The belief that the "business cycle is dead" may have a short life but for the moment it is a popular view. The unusual convergence of events which stem from significant and protracted currency cycles which have unleashed a whole galaxy of sub-events, or which have coincided with such events, should not be misinterpreted as a new economic paradigm. After all, at the macro level, Asia has just demonstrated errors of expectations with a super investment cycle; the micro-chip industry has had a similar binge and nowhere is there better evidence of the vitality and exuberance of crowd behaviour than the current headlong charge into equities.

With most of the indicators suggesting relative price stability, the bets must be with the Fed being reactive rather than proactive notwithstanding its concerns about asset price inflation. In this environment, valuations of stocks will play second fiddle to the tidal wave of money that is seeking higher returns.

The realisation that supply side changes have shifted the level of inflation back to that last seen in the late Fifties and early Sixties, has added another leg to the bull market. The folklore built around the threat of upward racheting levels of inflation during the Seventies and Eighties, has taken a long time to dispel. The problem now facing investors is that their cash deposits are earning seemingly meagre returns at a time when they observe others capitalising on the rising valuation of long duration assets (especially equities). We are now entering an environment where the stock market is creating its own folklore involving the open vistas of opportunity available to multi-nationals and the selective evidence that equities always produce superior returns through time. So long as the competition for these funds remains low, and there are no exogenous shocks, the compulsion to own equities will grow.

As usual, despite our caution, we are concentrating on the areas where there is some value and maintaining an element of protection through cash and derivatives.

Swiss Industrial Group (SIG) (Switzerland)

Most of us probably know Tetra-Pak's Brik-Paks, which are used to hold fruit juices, long life milk, soups and stock for a variety of producers. The secret of the Tetra Brik-Pak boxes is layers of foil, polyethylene and cardboard which create packaging that stops light, air and bacteria from corrupting the contents. Combined with quick heat treatment of the contents, this allows for long life storage without refrigeration or the addition of preservatives. The process is known as aseptic packaging.

A name you may not know is PKL. PKL, with their *Combibloc* product, are the only real competitor to Tetra in aseptic packaging. Interestingly, PKL invented the original aseptic packaging process, sold the technology to Tetra, then later, realising their misjudgement, developed a new process that circumvented the earlier patents.

Aseptic packaging is technically difficult to make. The machines produced by PKL have to take a packaging blank, fold it, glue the sides, snap heat the container and the liquid (in a clean air environment) as filling takes place and then seal the package. PKL's machines can do this 12,000 times per hour. The technical difficulty of the process, the patent protection and the dominance of the major player have ensured the aseptic packaging market remains a duopoly. This in turn has allowed it to become a very profitable business. However, what makes this a great business is not the machines but the packaging blanks. Once you own a PKL packaging machine you need the pre-formed blanks to feed into it. The only company that may supply these is PKL. The customers are locked in. Every new PKL client represents a long term stable flow of very profitable revenue.

PKL was purchased by SIG in 1989 and it has flourished under the new owners who have been willing to spend money on expanding the business and have encouraged innovation. These innovations have included the introduction of two litre containers, easy to open tops, resealable lids, faster filling speeds and more flexible carton lines. Around 70 billion aseptic packages are consumed each year of which PKL accounts for 7 billion. Historically the market has grown at 6-8% pa and strong growth in Asia and Latin America (where refrigeration is a luxury) suggest that this growth rate is sustainable. PKL should grow faster than the market as they gradually take share from Tetra-Pak.

PKL has become steadily more important to SIG and today accounts for 60% of sales and we suspect almost all of operating profits. The remaining 40% of sales are divided between SIG packaging technology which produces machines for more conventional packaging and SIG Neuhausen which is a mixture of businesses including small arms and mechanical drives and automation equipment. A management change in late 1996 is leading to active restructuring of these businesses and those that don't earn an adequate return on capital are likely to be sold.

When we first started buying SIG, the negative news surrounding the stock related to the strength of the Swiss currency and the company's apparent dependence on engineering. Even the then little known PKL was under pressure on account of a sharp rise in pulp and plastic prices. We subsequently added to the holding after a change in ownership in Tetra-Pak which we believed would lead to better pricing in the industry and again as it became clear that changes in SIG's management were putting more emphasis on extending the packaging business. The share has nearly doubled since our first entry point (April 1995), but we still see it having significant upside potential as people catch on to the importance of the high recurrent income stream generated by the *Combibloc*.

Asahi Breweries (Japan)

Asahi Breweries is one of Japan's great corporate success stories. Its share of the Japanese beer market has risen from a lowly 10% in 1986 to 34% today and rising. These huge gains have been the result of the stunning success of its *Super Dry* brand launched in 1987 when dry beers became popular worldwide. Asahi people relate the story of a struggling minor player hitting upon a beer with a sharp and refreshing taste that appealed to Japanese tastes and especially the younger generation. They then used slick marketing campaigns revolving around the theme that "dry" signifies "he means business!" This was highly effective against stodgy existing beer advertisements that emphasised traditional themes. Their banner advertisement was an endorsement by a popular writer of spy novels.

The fact that Asahi's initial success survived a loss of enthusiasm for dry beers and the company has gone from strength to strength can be put down to the quality of management. Asahi appears to have been able to identify with the changing aspirations of the consumer market. One of its most important breakthroughs was to foster new distribution channels which have allowed it to circumvent the market dominance of the traditional leader, Kirin. Today, the company is well established among the discount liquor and convenience stores that have usurped the traditional mom and pop delivery service. As a result, the company's market share in places like Tokyo is over 40%. Even with its success, the company maintains a youthful enthusiasm derived from its former status as the underdog to Kirin.

The lure of the bubble economy proved too great for the company and it, along with many other corporates, was sucked into the mêlée of the late Eighties bubble. The subsequent losses and poor reported results masked the remarkable improvement in underlying profitability that is associated with the benefits of scale. As this suppression falls away with completion of the write-offs, core profitability will start to show through and be appreciated by the market. In addition, the company has taken some actions which we would view as positive. These include repurchases of stock, moves toward instituting stock options for management and sales of non-core assets, the most significant of which was the sale of their stake in Fosters.

So in essence we have a company that is growing its core earnings at 15% per year with a much improved balance sheet and actions that appear likely to enhance shareholder returns. On an earnings yield of 4.8% compared with a long term bond of under 3%, the market seems to be mispricing the company, especially when considering the growth potential. Despite anticipated faster growth and the lower discount rate in Japan, Asahi enjoys no premium in valuation to its international peer group.

FINANCIAL STATEMENTS

1997

In respect of the year ended 30 June 1997 the Directors of Platinum Capital Limited (the Company) submit the following report made out in accordance with a resolution of the Directors.

Directors in Office at the Date of this Report

Michael Darling	*Chairman and Non-Executive Director*
Philip Pearce	*Non-Executive Director*
Kerr Neilson	*Managing Director*
Andrew Clifford	*Director*
Malcolm Halstead	*Director and Secretary*

Principal Activity

The principal activity of the Company during the financial year was the investment of funds internationally into securities of companies which are perceived by the Investment Manager to be undervalued.

Trading Results

The net profit of the Company for the year was $7,738,000 (1996: $13,040,000) after income tax expense of $5,103,000 (1996: $9,087,000).

Dividends

In respect of the year ended 30 June 1997 the Directors recommend the payment of a 3 cents per share fully franked dividend out of profits for the year payable to Shareholders recorded on the Share Register on 30 September 1997, the Ex-Dividend date.

The final dividend of 2 cents per share together with a special dividend of 4 cents per share was paid on 12 November 1996 out of profits for the year ended 30 June 1996.

Review of Operations

Operating Revenue

The operating revenue for the year was $110,504,000 (1996: $76,762,000).

Operating Profit

The operating profit before tax was $12,841,000 (1996: $22,127,000) and $7,738,000 (1996: $13,040,000) after tax.

Taxation

Income tax expense for the year was $5,103,000 (1996: $9,087,000).

Changes in the State of Affairs

There were no significant changes in the state of affairs of the Company that occurred during the financial year not otherwise disclosed in this report or the financial statements.

Events Subsequent to Balance Date

Since the end of the financial year the Directors are not aware of any matter or circumstance not otherwise dealt with in this report or financial statements that has significantly or may significantly affect the operations of the Company, the results of those operations or the state of affairs of the Company in subsequent financial periods.

Likely Developments

The Company will continue to pursue its investment objectives so as to increase the net asset value of the Company during the next financial year.

Rounding off of Amounts

The Company is of the kind referred to in the Corporations Law Regulation 3.6.05(6) and, in accordance with section 311 of Corporations Law Regulation 3.6.05, amounts in the financial statements and Directors' Report have been rounded off to the nearest thousand dollars unless specifically stated to be otherwise.

Accounting Issues

The Directors have determined to report in accordance with AASB 1033 "Presentation and Disclosure of Financial Instruments" in so far as it is relevant to the Company. While AASB 1033 is not yet mandatory the Directors believe this more effective disclosure assists in a proper understanding of the investment process undertaken by the Investment Manager.

Directors' Benefits

No Director of the Company has, since the end of the previous financial year of the Company, received or become entitled to receive a benefit (other than a benefit included in the total emoluments received or due and receivable by Directors shown in the financial statements) by reason of a contract made by the Company, or a related entity with the Director or with a firm of which the Director is a member, or with an entity in which the Director has a substantial financial interest.

Directors' Interests in Contracts

The three Executive Directors are employees of and have a relevant interest in the Investment Manager and accordingly will receive some portion of the Management fee; they do not receive any Directors' remuneration from the Company.

Insurance

During the year the Company incurred a premium in respect of a contract for indemnity insurance for the Directors and officers of the Company named in paragraph 1 of this report.

The Company has effected a 'Key Man' insurance policy in its favour upon the life of WK Neilson.

INFORMATION ON DIRECTORS

Michael G. Darling BA Law (Oxon), MBA (Harvard)
Chairman, Age 51
Relevant interest in 3,300,000 shares in the Company.

Mr Darling has extensive experience in international investment markets and has lived and worked in Japan, Europe, North America and Papua New Guinea.

He is Chairman of resource company Devex Limited and of portfolio investment company Caledonia Investments Limited. Other Directorships include Pilatus Capital Limited, Art Exhibitions Australia Limited and The Centre for Independent Studies Limited. He is a former Director of the Australian Stock Exchange (1986–87).

Philip A. Pearce BCom
Non-Executive Director, Age 62
Relevant interest in 10,000 shares.

Other Directorships include Australian Resources Limited, SGIO Insurance Limited, J Boag & Son Limited, Becker Group Limited and NM Rothschild & Sons (Australia) Pty Limited. Formerly he was Chief Financial Executive Officer of Woolworths Limited and Managing Partner of Arthur Andersen & Co.

Kerr Neilson BCom, AIIMR
Managing Director, Age 47
Relevant interest in 1,152,401 shares.

Appointed as Managing Director upon incorporation. Mr Neilson is an experienced investment analyst and fund manager. He is a Director of Platinum Asset Management, the Company's Investment Manager. Previously to Platinum Asset Management he was an Executive Vice-President at Bankers Trust Australia Limited. Prior to BT he worked in both the UK and South Africa as an investment analyst and fund manager.

Andrew M Clifford BCom(Hons), ASIA, ASA
Director, Age 31
Relevant interest in 1,002,401 shares.

Appointed a Director of the Company upon incorporation. He is also a Director of Platinum Asset Management, the Company's Investment Manager. Previously to Platinum Asset Management he was a Vice-President at Bankers Trust Australia Limited.

Malcolm Halstead ACA
Director and Secretary, Age 39
Relevant interest in 992,401 shares

Appointed a Director of the Company upon incorporation. He is also a Director of Platinum Asset Management, the Company's Investment Manager. Previously to Platinum Asset Management he was a Vice-President at Bankers Trust Australia Limited. Prior to BT he was with Price Waterhouse, Sydney and Thornton Baker, London.

Directors' Meetings

The following table sets out the number of meetings of the Company's Directors held during the year ended 30 June 1997, and the number of meetings held and attended by each Director.

	BOARD MEETINGS		SUB-COMMITTEE MEETINGS	
	HELD	ATTENDED	HELD	ATTENDED
MG Darling	9	9		
PA Pearce	9	7	1	1
WK Neilson	9	8		
AM Clifford	9	8	1	1
RM Halstead	9	9		

A Sub-Committee consisting of PA Pearce and AM Clifford was formed for the purposes of signing the financial statements for the year ended 30 June 1996.

For and on behalf of the Board

MG Darling Director

WK Neilson Director

Sydney
6 August 1997

Board Membership

The Board has a policy of having an equal number of non-Executive and Executive Directors, excluding the Managing Director's role.

The Board may use external advisers to assist in such a process.

The Executive Directors were nominated by the Investment Manager, Platinum Asset Management.

The Managing Director is appointed in accordance with the Investment Management contract with Platinum Asset Management and the Articles of Association. Under the Articles of Association, Directors other than the Managing Director, must retire from office no later than the third Annual General Meeting following their last election and they may offer themselves for re-election.

Directors' Access to External Advice

The Board has a policy of enabling Directors to seek external advice at the Company's expense after first notifying the Board. The Board will review the estimated costs for reasonableness but will not impede the seeking of advice. The Board will not approve for payment costs that are unreasonable in amount.

Directors' Compensation

The Executive Directors receive no remuneration from the Company. The Executive Directors review and determine the remuneration of the non-Executive Directors and may utilise the services of external advisers. It is the policy of the Board to remunerate at market rates commensurate with the responsibilities borne by the non-Executive Directors. The maximum amount of non-Executive Directors' fees is set at $150,000 per annum for the first five years of operation of the Company. Current fees amount to $45,000 per annum.

Ethical Standards

The Board has instituted compliance with the Institute of Directors' Code of Conduct.

Audit Committee

The Company does not have an audit committee. It is the Directors' opinion that all matters of significance which would otherwise be dealt with by an audit committee are dealt with by the Board and that as a consequence, a separate audit committee is not warranted.

Significant Business Risks

The Company is an Investment Company with a stated purpose and investment mandate. The Board has determined to regularly monitor the investment risks, including various derivative instrument risks, inherent in that investment mandate. This is achieved through regular reporting mechanisms from the Investment Manager to the Board.

PROFIT AND LOSS ACCOUNT

	NOTES	1997 $'000	1996 $'000
Operating revenue	3	**110,504**	**76,762**
Operating profit/(loss)	4	**12,841**	**22,127**
Income tax attributable to operating profit/(loss)	5	**5,103**	**9,087**
Operating profit/(loss) after income tax		**7,738**	**13,040**
Amounts transferred (to)/from reserves	11	**(47)**	**141**
Retained earnings/(accumulated losses) at the beginning of the financial period		**3,791**	**(3,390)**
Total available for appropriation		**11,482**	**9,791**
Dividends	18	**3,000**	**6,000**
Retained earnings at the end of the financial year		**8,482**	**3,791**

THE ACCOMPANYING NOTES FORM AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

	NOTES	1997 $'000	1996 $'000
Investments	1(c), 6	99,690	112,832
Current Assets			
Cash at bank	13	59	25
Receivables	7	16,064	7,127
Future income tax benefit		43	68
Total Current Assets		16,166	7,220
Total Assets		115,856	120,052
Current Liabilities			
Creditors	8	2,190	1,349
Provisions	9	5,181	14,956
Total Current Liabilities		7,371	16,305
Total Liabilities		7,371	16,305
Net Assets		108,485	103,747
Shareholders' Equity			
Share capital	10	100,000	100,000
Reserves	11	3	(44)
Accumulated profits/(losses)		8,482	3,791
Total Shareholders' Equity		108,485	103,747

THE ACCOMPANYING NOTES FORM AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

	NOTES	1997 $'000 INFLOWS (OUTFLOWS)	1996 $'000 INFLOWS (OUTFLOWS)
Cash Flows from Operating Activities			
Dividends received		1,382	1,958
Interest received		250	186
Cash paid for purchases of investments and currencies		(86,209)	(88,336)
Cash proceeds from sale of investments and currencies		106,074	83,830
Management fees paid		(1,667)	(1,692)
Other expenses		(876)	(879)
Income tax paid		(11,853)	(1,568)
Net Cash from Operating Activities	13(b)	7,101	(6,501)
Cash Flows from Financing Activities			
Dividends paid		(5,946)	–
Net Cash from Financing Activities		(5,946)	–
Net increase/(decrease) in cash held		1,155	(6,501)
Cash held at the beginning of the financial year		5,766	12,962
Effects of exchange rate changes on cash		58	(695)
Cash Held at 30 June 1997	13(a)	6,979	5,766

THE ACCOMPANYING NOTES FORM AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements are a general purpose financial report prepared in accordance with Accounting Standards and Urgent Issues Group Consensus Views.

The accounting policies adopted by Platinum Capital Limited (the Company) in preparing the financial statements have been consistently applied by the Company except as otherwise indicated.

(a) Basis of Accounting

The financial statements have been prepared on the basis of historical cost, except where otherwise stated.

(b) Foreign Currency Translation

Transactions denominated in foreign currencies are translated at the rates of exchange ruling on the date of the transaction. All realised exchange gains and losses are taken to account in the period in which they arise. Foreign currency monetary assets and liabilities existing at balance date are revalued at the rates of exchange ruling at balance date.

(c) Investments

(i) Classification

Investments have not been classified in the balance sheet as current or non-current assets. This treatment constitutes a departure from AASB 1034. In the opinion of the Directors, having regard to the nature of the business conducted by the Company, the period of investment is not known at the time of purchase and therefore this departure from AASB 1034 has been made to the extent necessary to give a true and fair view.

(ii) Valuation

With the exception of monetary items, which are stated at current market value, investments are valued at cost. Where, in the opinion of Directors, there has been a permanent diminution in the value of an investment, the carrying amount of such an investment is written down to its recoverable amount.

(iii) Treatment of unrealised gains and losses on monetary items

Realised and unrealised gains and losses on market value adjustments of monetary items are reflected in the profit and loss account. The unrealised gains and losses are then transferred to a revaluation reserve.

(d) Risk Management

(i) Currency hedges

Forward foreign exchange contracts, including options on forward contracts, are entered into, in the normal course of investing internationally, as a hedge against the currency risks associated with investments. Contracts open at balance date are accounted for as foreign currency monetary assets and liabilities – refer Notes 1(b) and 1(c)(iii) above. Currency positions are disclosed in Note 16(ii).

(ii) Derivatives

All derivative transactions – futures, options – are for risk management purposes; that is to protect the investment portfolio from either being invested or uninvested. All such contracts are primarily for the purpose of portfolio protection and are aimed at decreasing the level of market risk in the portfolio.

All derivatives are valued at cost. Where, in the opinion of Directors, there has been a permanent diminution in the value of a derivative, the carrying amount of such a derivative is written down to its recoverable amount. Derivative positions are disclosed in Note 16(i).

(e) Income Recognition

Interest income is recognised on an accruals basis. Dividend income is brought to account as income on the ex-date applicable to each investment.

(f) Directors' Entitlements

Liabilities for Directors' entitlements to salaries are accrued at nominal amounts calculated on the basis of current salary rates. Contributions to Directors' superannuation plans are charged as an expense as the contributions are paid or become payable.

(g) Income Tax

Income tax has been brought to account using the liability method of tax effect accounting.

(h) Earnings per Share

Basic earnings per share is determined by dividing the operating profit after income tax by the weighted number of ordinary shares outstanding during the year.

2. COMPARATIVE FIGURES

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

3. OPERATING REVENUE

	1997 $'000	1996 $'000
Gross proceeds from disposal of investments and currencies	**108,638**	**74,678**
Dividend income	**1,617**	**1,876**
Interest income	**249**	**208**
	110,504	**76,762**

4. OPERATING PROFIT/(LOSS)

	1997 $'000	1996 $'000
Operating profit/(loss) before income tax has been determined after:		
Crediting		
– Dividends received/receivable from other entities	1,617	1,876
– Interest received/receivable	249	208
– Net profit on sale of investments	7,513	6,539
– Net profit on foreign currency hedging transactions	6,619	16,807
Charging as Expense		
– Auditors' remuneration		
Auditing services	23	26
Other	4	(2)
– Investment management fees paid/payable	1,669	1,708
– Share registry and custodian fees	330	281
– Directors' Remuneration		
Income received or due and receivable by Directors of the Company	45	45
Amounts paid or payable to superannuation plans	3	2

5. INCOME TAX

The aggregate amount of income tax attributable to the financial year differs from the prima facie amount payable on the operating profit/(loss). The difference is reconciled as follows:		
Prima facie income tax on operating profit/(loss) at 36%	4,623	7,966
Tax effect on permanent differences which:		
Increase Tax Payable		
– Non-deductible expenses	6	2
Reduce Tax Payable		
– Capital Gains Indexation	(326)	(308)
– Allowable credits	(86)	(156)
– Non-taxable receipts	(9)	(33)
Future income tax benefit not recognised	892	1,611
Under provision of previous period tax	3	5
	5,103	9,087

5. INCOME TAX continued

	1997 $'000	1996 $'000
The income tax expense attributable to operating profit/(loss) comprises:		
Current income tax provision	4,911	9,163
Deferred income tax provision	164	(46)
Future income tax benefit	25	(35)
Under provision of previous period tax	3	5
	5,103	9,087

Future income tax benefit

Potential future income tax benefits of $3,535,000 (1996: $2,643,000) arising from $9,083,000 (1996: $6,605,000) of quarantined foreign losses and a permanent diminution in the value of investments of $736,000 (1996: $736,000) have not been brought to account at balance date as the Directors do not believe it is appropriate to regard realisation of the future income tax benefits as virtually certain.

6. INVESTMENTS

	MARKET VALUE 1997 $'000	COST/ CARRYING VALUE 1997 $'000	MARKET VALUE 1996 $'000	COST/ CARRYING VALUE 1996 $'000
Listed securities	102,705	92,770	107,799	106,511
Unlisted securities	–	–	578	580
Currency hedges	(1,482)	–	622	–
Cash on deposit	6,920	6,920	5,741	5,741
	108,143	99,690	114,740	112,832

7. RECEIVABLES

	1997 $'000	1996 $'000
Current		
Unsettled trades	15,839	6,657
Accrued dividends and interest	199	433
Other	26	37
	16,064	7,127

8. CREDITORS

Current		
Unsettled trades	1,822	1,003
Trade creditors (unsecured)	314	346
Other	54	–
	2,190	1,349

9. PROVISIONS

	1997 $'000	1996 $'000
Current		
Dividends	3,000	6,000
Taxation	1,911	8,850
Deferred income tax	270	106
	5,181	14,956

10. SHARE CAPITAL

Authorised Share Capital		
5,000,000,000 Ordinary shares of $1.00 each	5,000,000	5,000,000
Issued Share Capital		
100,000,005 Ordinary shares fully paid of $1.00 each	100,000	100,000

11. REVALUATION RESERVE

Balance at 1 July	(44)	97
Amounts transferred (to)/from Profit and Loss Account:		
– Unrealised profits/(losses) on revaluation of monetary items	47	(141)
	3	(44)

12. EARNINGS PER SHARE

	1997	1996
Basic earnings per share – cents per share	7.74	13.04
Weighted average number of ordinary shares on issue used in the calculation of basic earnings per share	100,000,005	100,000,005

There have been no conversions to, calls of, or subscriptions for ordinary shares, or issues of potential ordinary shares during the financial year.

13. NOTES TO THE STATEMENT OF CASH FLOWS

	1997 $'000	1996 $'000
(a) Reconciliation of Cash		
For the purposes of the Statement of Cash Flows, cash includes deposits at call, and cash at bank. Cash at the end of the financial year, as shown in the Statement of Cash Flows, is reconciled to the related items in the Balance Sheet as follows:		
Cash at bank	59	25
Cash on deposit (Note 6)	6,920	5,741
	6,979	5,766
(b) Reconciliation of Net Cash from Operating Activities to Operating Profit/(Loss) after Income Tax		
Operating profit/(loss) after income tax	7,738	13,040
Decrease/(increase) in investment securities	14,321	(22,415)
(Increase)/decrease in cash due to exchange rate movements	(58)	695
(Increase)/decrease in settlements receivable	(9,182)	(5,952)
Decrease/(increase) in dividends receivable	235	(81)
(Increase)/decrease in interest receivable	(1)	22
Decrease/(increase) in prepayments	11	1
(Decrease)/increase in accrued expenses	(32)	84
(Increase)/decrease in settlements payable	819	586
(Decrease)/increase in income tax payable	(6,939)	7,600
Increase/(decrease) in future income tax benefit	25	(35)
Increase/(decrease) in deferred income tax	164	(46)
Net Cash from Operating Activities	7,101	(6,501)

14. STATEMENT OF NET ASSET VALUE

Taking Investments at Market Value and Providing Realised and Unrealised Taxes		
Net Asset Value per Balance Sheet (historical cost basis)	108,485	103,747
Add Revaluation of investments	8,453	1,909
Proposed dividends	3,000	6,000
Less Deferred income tax on revaluation of investments	(2,378)	(85)
Future income tax benefit on revaluation of investments	–	(17)
Net Asset Value	117,560	111,554
Net Asset Value – cents per share	117.56	111.55

For Net Asset Value purposes all investments, currencies and derivatives are valued at net market value.

15. INVESTMENT PORTFOLIO

	QUANTITY	MARKET VALUE $'000
JAPAN		
Asahi Breweries	59,000	1,162
Canon	86,000	3,091
Daiichi Pharmaceutical	171,000	3,980
Fuji Photo Film	105,000	5,577
Iino Kaiun Kaisha	110,000	445
Japan Tobacco	59	615
Kinki Coca Cola Bottling	79,000	1,447
Kita Kyushu Coca Cola Bottling	2,000	60
Kuraya Yakuhin	16,900	310
Kyocera	20,000	2,097
Matsushita Electrical Industries	108,000	2,875
Mikuni Coca Cola Bottling	104,000	2,037
Navix Line	105,000	246
Nintendo	26,000	2,870
Rinnai	28,900	819
Sanyo Coca Cola Bottling	97,900	1,703
Sekisui House	182,000	2,432
Shikoku Coca Cola	33,000	525
Shimano Industrial	28,000	778
Toshiba	103,000	875
Xebio	4,100	133
Yamanouchi Pharmaceutical	133,000	4,722
		38,799
OTHER ASIA		
Hong Kong		
Giordano	200,000	181
QPL International Holdings	336,500	376
		557
India		
Industrial & Credit Corporation of India – GDR	43,500	833
Videsh Sanchar Nigam	21,500	591
		1,424
Indonesia		
Bank Danamon	220,000	152
Ciputra Development	845,000	1,113
Citra Marga Nusaphala	150,000	116
Citra Marga Nusaphala – Rights	150,000	41
HM Sampoerna	42,000	212
Indonesian Satellite	219,500	867
Jaya Realty – Foreign	671,000	1,193
		3,694

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

15. INVESTMENT PORTFOLIO continued

	QUANTITY	MARKET VALUE $'000
Korea		
Cho Hung Bank	145,486	1,281
Cho Hung Bank – GDR	50,000	474
Chosun Brewery – Listed participation note	18,000	621
Korea First Bank	108,810	601
Korean Exchange Bank	69,000	603
Samsung Electronics	2,880	409
Samsung Electronics – Rights	47	3
Samsung Electronics – Swap Goldman Sachs 11/3/2000	13,077	1,376
Samsung Electronics – Swap Goldman Sachs 20/7/98	7,554	795
Samsung Electronics – Swap Salomon Bros 10/2/99	6,608	696
Samsung Fire & Marine Insurance	1,770	889
		7,748
Total Other Asia		13,423
AUSTRALIA		
Boral	106,316	442
News Corporation	35,900	227
News Corporation – Deferred preference	123,700	643
		1,312
WESTERN EUROPE		
France		
Accor	9,601	1,898
Banque Nationale de Paris	44,527	2,423
Banque Nationale de Paris – New	797	43
Bollore Technologies	3,575	594
Lagardere	78,168	2,998
St Gobain	6,360	1,225
Suez Lyonnaise Des Eaux	14,527	1,932
		11,113
Germany		
AG fuer Industrie und Verkehrswesen	39,190	1,179
Carl Schenck	554	59
Daimler Benz	18,200	1,949
Daimler Benz – Convertible bond 5.75% 14/6/2002	326	37
Deutsche Bank	12,350	953
Draegerwerk – Preferred	17,660	515

15. INVESTMENT PORTFOLIO continued	QUANTITY	MARKET VALUE $'000
WESTERN EUROPE continued		
Germany continued		
Hornbach Baumarkt	7,250	403
Hornbach Holdings – Preferred	7,200	807
Siemens	41,527	3,255
		9,157
Italy		
Assicurazioni Generali	68,000	1,632
Azienda Mediterranea Gas e Acqua	880,000	811
Banca Popolare di Novara	95,000	466
Istituto Finanziaro Industriale	39,320	655
La Rinascente	108,500	796
La Rinascente – Bond rights	231,818	17
La Rinascente – Ordinary rights	231,818	54
La Rinascente – Preferred	151,986	403
La Rinascente – Savings	55,832	180
		5,014
Switzerland		
Kuhne and Nagel – Bearer	910	740
Nestlé – Registered	688	1,198
Schindler – Participating certificates	1,706	2,814
Schindler – Registered	839	1,422
Schweizerische Industrie Gesellschaft Holdings – Bearer	85	340
Schweizerische Industrie Gesellschaft Holdings – Registered	1,353	2,653
		9,167
United Kingdom		
Bakyrchik Gold	85,711	94
Guinness	160,300	2,074
J. Sainsbury	52,020	417
Pentland Group	847,000	1,780
		4,365
Total Western Europe		38,816
NORTH AMERICA		
Canada		
Indochina Gold	30,900	192
Royal le Page	87,000	282
Toronto Dominion Bank	27,700	1,084
		1,558

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

15. INVESTMENT PORTFOLIO continued	QUANTITY	MARKET VALUE $'000
United States		
Acuson	3,900	119
Biomet	2,000	49
Diagnostic Products	16,300	680
Fila Holdings – ADR	14,750	652
Overseas Shipholding	13,506	350
S&P 500 Sept 97	–14	111
		1,961
Total North America		3,519
SOUTH AMERICA		
Brazil		
Antarctica Paulista – Common	889	120
Banco Bradesco – PN	72,794,375	969
Banco Itau – PN	973,980	721
Cemig – PN	6,852,000	467
Oderbrech – ON	72,800,000	696
Souza Cruz – ON	92,609	1,290
Vale Do Rio Doce – PN	17,000	497
		4,760
Peru		
Bayer Peru – Trab	74,230	37
Cerveceria Backus & Johnson – Trab	294,062	404
Cerveceria Backus & Johnston	24,209	325
Industrias Pacocha – Trab	520,390	423
Peru Real Estate – B common	2,000,000	887
		2,076
Total South America		6,836
Liquids		
Outstanding settlements		14,211
Foreign exchange contracts		(1,482)
Cash		6,920
		19,649
Total Portfolio – Note 16 (i) & (ii)		122,354
Accounted for in Creditors		1,822
Accounted for in Receivables		(15,839)
Accounted for in Receivables		(194)
Total Portfolio – Note 6		108,143

16. RISK MANAGEMENT

It is the Company's investment objective to seek long term capital growth through value investing internationally in businesses and companies. The Investment Manager may also invest in fixed interest investments, although this is not the primary investment objective. The Company's investments are therefore subject to currency, interest rate and stock market risks.

The Company has adopted a policy of not borrowing moneys, other than on a short term basis for settlement, trading and like purposes.

The Company's investment restrictions prohibit it from taking positions in futures, options or other derivative products or short sales of securities if the aggregate exposure to those products exceeds 50% of the net asset value of the Company.

The Company's primary risks are related to the investment activities undertaken on its behalf by the Investment Manager.

The Board monitors the level of risk in the Investment Portfolio regularly through formal Directors' meetings with the Investment Manager. The Investment Manager monitors the risks daily and implements risk management strategies consistent with the invested position as it believes necessary. The effective exposure to currencies and markets is continuously monitored by the Investment Manager and the Company.

The Company is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but it does not expect any counterparties to fail to meet their obligations given their high credit ratings. Where appropriate the Company utilises master netting agreements. The Company is also exposed to liquidity risks – the possibility of being unable to obtain the fair market value of a derivative owing to prevailing market conditions – and manages this risk by only using derivatives in liquid markets.

Refer to Note 1 for the Accounting Policies adopted with respect to Derivatives and Currencies.

16. RISK MANAGEMENT continued

(i) Investments at Net Market Value and Derivatives Exposure

	PHYSICAL $'000	FUTURES & OPTIONS $'000	UPSIDE (A) $'000	FUTURES & OPTIONS $'000	DOWN-SIDE (B) $'000
Japan	**38,799**		**38,799**		**38,799**
Other Asia	**13,423**		**13,423**		**13,423**
Australia	**1,312**		**1,312**		**1,312**
Western Europe	**38,816**		**38,816**		**38,816**
North America	**3,519**	**(8,372)**	**(4,853)**	**(8,372)**	**(4,853)**
South America	**6,836**		**6,836**		**6,836**
	102,705	**(8,372)**	**94,333**	**(8,372)**	**94,333**
Liquids	**19,649**	**8,372**	**28,021**	**8,372**	**28,021**
Total Net Market Value of Portfolio	**122,354**	**–**	**122,354**	**–**	**122,354**

The above table categorises the Investment Portfolio in the same way that the Investment Manager does for day to day management.

The physical column simply shows the location of the Company's investments.

(A) The upside column is an approximation of the Portfolio's exposure to upward movements in markets. This is calculated by making two adjustments to the physical position. The first is to subtract, from the physical position, any short (sold) and add any long (bought) positions in shares or share index futures. For example, if 5% of the Portfolio was invested in Japan but there was a 2% short position in Nikkei futures, then the upside column would show 3%. Conceivably the figure could show a negative exposure which would indicate the Portfolio was net short the Japanese market. The second adjustment is for options held to buy shares (bought calls). A call option with the premium representing 0.5% of the Portfolio to buy shares in Toyota worth, say, 3% of the Portfolio would require an additional 2.5% to be added to the Japanese exposure (thus determining underlying exposure).

(B) The downside column is an approximation of the Portfolio's exposure to downward moves in the market. It is calculated by adjusting the physical position for any short or long positions in shares or share index futures and bought put options. It is not necessary to adjust for call options as only the option premium (already included in physical) is at risk, not the underlying holding callable by the option.

16. RISK MANAGEMENT continued

The Company uses futures contracts in liquid markets and generally utilises short dated contracts; those with 90 day maturities. Initial margin requirements and daily variation margin requirements on Futures contracts are met in cash. Futures contracts have little credit risk as they are traded on recognised exchanges.

The Company uses Exchange Traded and Over The Counter Options where the maximum potential loss is paid up-front by way of a premium. There is little credit risk attached to these instruments as they are traded on recognised exchanges or with high credit rating counterparties.

(ii) Currency Exposure at Net Market Value

	PHYSICAL $'000	BOUGHT $'000	SOLD $'000	NET EXPOSURE $'000
Japan	41,230		(24,376)	16,854
Other Asia	7,952			7,952
Australia	343	54,882		55,225
Western Europe	39,842	73	(15,571)	24,344
North America	23,804	46,647	(61,655)	8,796
South America	9,183			9,183
Total Net Market Value of Portfolio	**122,354**	**101,602**	**(101,602)**	**122,354**

The above table categorises the investments in the Portfolio into the currencies that the securities are issued in. For example a security issued by a Japanese company in US$ will be categorised as a US$ exposure. Forward foreign currency contracts and options on forward currency contracts are adjusted against the physical column to arrive at a net exposure to each currency grouping. The Company generally utilises short-dated (90 day maturities) currency agreements with high credit rated counterparties.

(iii) Interest Rate Exposure

The Company had no fixed interest investments or derivatives thereon at balance date.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

17. FRANKING ACCOUNT

	1997 $'000	1996 $'000
Opening Balance – Class C	12,731	2,388
On dividends received:		
Franked at 33% (B)	–	43
Franked at 36% (C)	8	–
On tax paid and payable:		
1995–96	–	16,291
1996–97	8,730	–
Prior year tax provision – franking adjustment	6	9
Proposed dividends	(3,000)	(6,000)
	18,475	12,731
Amount of retained earnings that could be distributed as dividends and be franked out of existing credits or out of franking credits arising from the payment of income tax in the period subsequent to 30 June 1997 after deducting franking credits applicable to any proposed dividends:		
Accumulated profits	8,482	3,791
Amounts transferred to/(from) reserves	3	(44)
	8,485	3,747

18. DIVIDENDS (FULLY FRANKED)

	1997 CPS	1997 $'000	1996 CPS	1996 $'000
Proposed – Final	3.00	3,000	2.00	2,000
– Special	0.00	–	4.00	4,000
	3.00	3,000	6.00	6,000

19. INVESTMENT MANAGER

(a) The Investment Manager is Platinum Asset Management. It receives a monthly management fee for investment services provided in accordance with the Investment Management Agreement. This agreement provides for a management fee payable monthly and calculated at 1.5% per annum of the Portfolio Value.

(b) Additionally a Bonus (Performance) fee is payable at 10% of the amount by which the Portfolio's annual performance exceeds the return achieved by the MSCI plus 5%. (MSCI is the Morgan Stanley Capital International World Accumulation Net Return Index in A$.) Where the Portfolio's annual performance is less than the MSCI the amount of the underperformance is aggregated and carried forward and deducted from the annual performance in the subsequent year before calculating any Bonus fee for that year. The aggregate of underperformance is carried forward until a Bonus fee becomes payable.

(c) At 30 June 1997 the cumulative pre-tax performance of the Portfolio for management fee calculation purposes was 16.07% and the corresponding MSCI was 28.46%. Accordingly, a performance fee has not been accrued. The 16.07% represents an underperformance against the MSCI of 12.39%; this amount will be carried forward as a deduction against subsequent years' performance fee calculations.

(d) The Investment Manager is to be paid a lump sum termination fee of 1.5% calculated on the value of the Portfolio on the 1st day of the month in which termination is effective. The fee is not payable if the termination results from the default or insolvency of the Investment Manager. Additionally a Bonus fee is payable for the period from the last calculation of the Bonus fee (as described in (b) above) to the date of termination.

	1997 $'000	1996 $'000
Amounts paid and payable to the Investment Manager for the year	**1,669**	**1,708**

20. CONTINGENT LIABILITIES

No contingent liabilities exist at balance date.

21. SEGMENT INFORMATION

The Company was predominantly engaged in investment activities on world markets and derived revenue from sale of investments, interest and dividends. The Investment Manager does not invest with any predetermined asset allocation ranges as it uses a stock selection methodology. Accordingly the results of the Company are a function of the Investment Portfolio and its make-up is a function of the stock selection process. As the Investment Portfolio's composition varies dependent on stock selection decisions it is not considered appropriate to allocate revenues to some predetermined contrived segment, which would be contradictory to the investment objective of the Company.

22. SUBSEQUENT EVENTS

No significant events have occurred since balance date which would impact the financial position of the Company as at 30 June 1997 and the results for the year ended on that date.

23. RELATED PARTY INFORMATION

(a) Directors

The Directors named in the attached Directors' Report each held office as a Director of the Company throughout the financial year to 30 June 1997.

(b) Directors' Remuneration

Remuneration received or receivable by the Directors of the Company, including aggregate amounts paid to superannuation plans, is disclosed in Note 4 to the Accounts. The number of Directors of the Company included in the figures disclosed in Note 4 to the Accounts are shown below in their relevant income bands:

	1997 $'000	1996 $'000
$20,000 – $29,999	**2**	**2**

The three Executive Directors are employees of and have a relevant interest in the Investment Manager and accordingly will receive some portion of the Management fee; they do not receive any Directors' remuneration from the Company.

The aggregate number of shares and share options held by Directors of the Company and their Director-related entities at balance date:

	1997 ORDINARY SHARES	1996 ORDINARY SHARES	1996 OPTIONS
MG Darling	**3,300,000**	**3,300,000**	**–**
PA Pearce	**10,000**	**25,000**	**12,500**
WK Neilson	**1,152,401**	**1,152,401**	**100,000**
AM Clifford	**1,002,401**	**1,002,401**	**25,000**
RM Halstead	**992,401**	**992,401**	**20,000**

The Options expired on 1 July 1996.

In accordance with a resolution of the Directors of Platinum Capital Limited, in the opinion of the Directors:

(a) the accounts of the Company are drawn up so as to give a true and fair view of the profit of the Company for the year ended 30 June 1997 and the state of affairs of the Company as at 30 June 1997;

(b) at the date of this statement there are reasonable grounds to believe that the Company will be able to pay its debts as and when they fall due; and

(c) the accounts of the Company have been made out in accordance with Division 4A and 4B of the Corporations Law and so as to give a true and fair view of the profit of the Company for the year ended 30 June 1997 and the state of affairs of the Company as at 30 June 1997.

For and on behalf of the Board

MG Darling Director   **WK Neilson** Director

Sydney
6 August 1997

Scope

We have audited the financial statements of Platinum Capital Limited (the Company) for the year ended 30 June 1997 as set out on pages 23 to 43. The Company's Directors are responsible for the preparation and presentation of these financial statements and information contained therein. We have conducted an independent audit of these financial statements in order to express an opinion on them to the members of the Company.

Our audit has been conducted in accordance with the Australian Auditing Standards to provide reasonable assurance as to whether the financial statements are free of material misstatement. Our procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial statements, and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion as to whether, in all material respects, the financial statements are presented fairly in accordance with Accounting Standards, other mandatory professional reporting requirements, being Urgent Issues Group Consensus Views, and the Corporations Law so as to present a view which is consistent with our understanding of the Company's state of affairs, the results of its operations and their cash flows.

The audit opinion expressed in this report has been formed on the above basis.

Audit Opinion

In our opinion the financial statements of the Company are properly drawn up:

(a) so as to give a true and fair view of:
(i) the state of affairs of the Company as at 30 June 1997 and its results and cash flows for the financial year ended on that date; and
(ii) the other matters required by Divisions 4, 4A and 4B of Part 3.6 of the Corporations Law to be dealt with in the financial statements;
(b) in accordance with the provisions of the Corporations Law; and
(c) in accordance with applicable accounting standards and other mandatory professional reporting requirements

Price Waterhouse
Chartered Accountants

PK Merrett

PK Merrett Partner

Sydney
6 August 1997

Substantial Shareholders

The Company's Register of Substantial Shareholders, prepared in accordance with section 715 of the Corporations Law, recorded the following information as at 23 July 1997.

Name	NUMBER OF SHARES	CLASS OF SHARE
Credit Union Services Corporation (Australia) Limited	5,005,260	ordinary
Telstra Super Pty Limited	5,000,000	ordinary

Distribution of Securities

	CLASS OF EQUITY SECURITY ORDINARY
(i) Distribution schedule of holdings	
1-1,000	133
1,001 – 5,000	2,512
5,001 – 10,000	1,346
10,001 and over	1,393
Total number of holders	5,384
(ii) Number of holders of less than a marketable parcel	14
(iii) Percentage held by the 20 largest holders	36.98%

Twenty Largest Shareholders

The names of the twenty largest holders of each class of equity securities as at 23 July 1997 are listed below.

	NUMBER OF SHARES	%
National Nominees Limited	7,131,300	7.13
Credit Union Services Corporation (Australia) Limited	6,888,710	6.89
Perpetual Trustee Company Ltd	4,201,944	4.20
Caledonia Investments Limited	3,050,000	3.05
ANZ Nominees Limited	2,508,056	2.51
Austrust Limited	1,863,205	1.86
Westpac Custodian Nominees Limited	1,476,378	1.48
RPG Management Pty Limited	1,404,418	1.40
Merrill Lynch (Australia) Nominees Pty Ltd	1,207,500	1.21
Perpetual Trustee Company	1,154,500	1.15
Cox Bros Coffs Harbour Pty Limited	1,000,000	1.00
FAI General Insurance Company	948,000	0.95
Mr John Hall	679,000	0.68
MLC Limited	678,810	0.68
Dr John Orde Poynton	600,000	0.60
Mr Archibald Norman Douglas	500,000	0.50
Mr Gordon Douglas	500,000	0.50
Mr Gregory Mitchell Maughan	500,000	0.50
Stamford Associates Limited	360,267	0.36
Yui Kuen Chun	332,533	0.33

Voting Rights

Ordinary Shares

On a show of hands, every member present in person or represented by a proxy or representative shall have one vote and on a poll every member who is present in person or represented by a proxy or representative shall have one vote for every share held by them.

Financial Calendar

Annual General Meeting	**29 September 1997**
Ordinary Shares trade Ex-Dividend	**30 September 1997**
Record (books close) date for Final dividend	**9 October 1997**
Final dividend paid	**14 October 1997**

These dates are indicative and may be changed.

Additional Information in accordance with the ASX listing requirements for the Company

1. The total number of securities transactions entered into during the reporting period, together with total brokerage paid during the reporting period:
Number of transactions – 980 Total brokerage paid – $663,853

2. Shareholders may review a list of investments acquired or disposed of by the Company in the reporting period at the Registered Office.

3. A listing of the Investment Portfolio may be found in Note 15 to the Accounts.

4. A summary of the fees paid or payable to the Investment Manager may be found in Note 19 to the Accounts.

5. A summary of the salient provisions of the Investment Management Contract are as follows:

(a) the Investment Manager will invest the Portfolio in accordance with the investment objectives and restrictions of the Company and subject to the Articles, the Management Agreement, the ASX Listing Rules, the Corporations Law and investment restrictions and directions from the Company;

(b) confer with the Company at regular intervals;

(c) administer the borrowings of the Company;

(d) the Investment Manager may appoint the Managing Director of the Company;

(e) the Investment Manager is required to publish the Net Asset Value of the Company monthly at the ASX and in an Australian national daily newspaper;

(f) the Agreement will continue for a term of five years, the Investment Manager cannot retire in the first three years but thereafter may retire after giving six months notice;

(g) the Agreement may be terminated or renewed by the Members of the Company in a General Meeting at the end of each five-year term; and

(h) the Agreement may be immediately terminated by the Company in the event of:

- **(i)** a breach of a material obligation by the Investment Manager; or
- **(ii)** the Investment Manager going into liquidation or having an administrator or receiver appointed.

There is merit in keeping alive the memory of those days. For it is neither public regulation nor the improving moral tone of the financial markets which prevents these recurrent outbreaks and their aftermath. It is the recollection of how, on some past occasion, illusion replaced reality and people got rimmed.

JK Galbraith *The Great Crash of 1929*

déjà vu

US equities: have we been here before?

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time *and the dimming of memory*

An illustrated essay on the US equities market

The bewildering rise

of world stockmarkets, and of Wall Street in particular, is generating a great deal of excitement but increasingly is causing an equal amount of anxiety. To try to give our shareholders some sort of framework with which to analyse the behaviour of markets, we have outlined some of the forces at work that are lifting prices of shares to record highs.

The essay focuses on US equities and takes a closer look at the rolling reallocation of resources through the economic system in a way where the beneficiaries change through time. Starting in the early Eighties when the great fight against high inflation was finally won, we have witnessed an extraordinary reallocation of resources away from the providers of labour to the owners of equities. This has resulted in the total return from equity ownership being almost twice that of the historic average in this century.

The unusual feature of this cycle is the confluence of events. Major distortions in currency markets, the opening up of new markets and resources, great strides in the application and power of technology and so forth, have caused some to question whether we face a new utopian economic order. Our article deals with some of these issues and concludes that international corporatism and other features of today's economic landscape are merely passing scenes in the scheme of the economic cycle.

The danger of the current super bull market turning into a fully fledged mania is real. Some may even point to the excesses (for instance, change in corporate ownership via options, massive flows into mutual funds etc.) as evidence of some markets already being afflicted by a mania. Weak growth and still concentrated liquidity is such that low yields on cash deposits are "forcing" investors to take more risk to augment returns. The seductive mirage of the new information age, with its capitalist white knight finally defeating the evil empire of collective ownership, is a powerful stimulant to investors' inclination to greed.

When one reads the history of manias, the recurrent pattern over the centuries is very clear. The markers include an abundance of credit, a new exciting world of change, the emergence of financial cult figures, and so forth. As fund managers we are torn between following a fundamental approach and yet being sufficiently agile to recognise the unfolding pattern. History is a valuable guide but, sadly, only provides a crude street map without any indication of scale.

To alert readers of the possibilities of what may lie ahead, we have illustrated our text with quotes from JK Galbraith's classic, "The Great Crash of 1929".

Kerr Neilson

On December 4, 1928, President Coolidge sent his last message on the state of the Union to the reconvening Congress. "No Congress of the United States ever assembled, on surveying the state of the Union, has met with a more pleasing prospect than that which appears at the present time."

The bull market

in US equities is in its fifteenth year,

and over that period it has delivered a cumulative return that exceeds the bull markets in the US of equivalent duration that ended in 1929 and 1957, and the bubble which peaked in 1989 in Japan. Since the beginning of 1995, the 100% return from the US market compares to 33% from 30 year bonds, 32% from the world stock market excluding the US, 10% from residential housing in America, and 10% from cash. The only stock markets to outperform the US over the last two and a half years have been Russia, Spain and Sweden.

So what has been going on and how do we make sense of it? The bull market in equities that began in 1982 can best be explained by changes in relative prices. Traditional economics divides the economy into three constituencies: labour, natural resources, and capital. By capital we mean the productive assets of the economy, which we can also think of as the corporate sector. In the last thirty years, each component of the economy has experienced imbalances in supply and demand that has caused it to be bid up in price (both absolutely and relative to the other sectors).

From the mid 1960s through to the late 1970s, with unemployment at low levels, the scarcity of labour allowed it to command higher rewards at the expense of those employing the labour, thus transferring wealth from capital, or the corporate sector, to labour. In the 70s, commodity prices boomed as a result of a weak world grain harvest and fears of general supply shortages. At the same time restrictions in the supply of oil and gas drove energy prices up dramatically. The US had a legacy of expansionary monetary policy to finance the Vietnam war and this provided the fuel for an extraordinary era for natural resource owners. From the early 1970s through to the early 1980s, they were the winners at the expense of capital, which now had

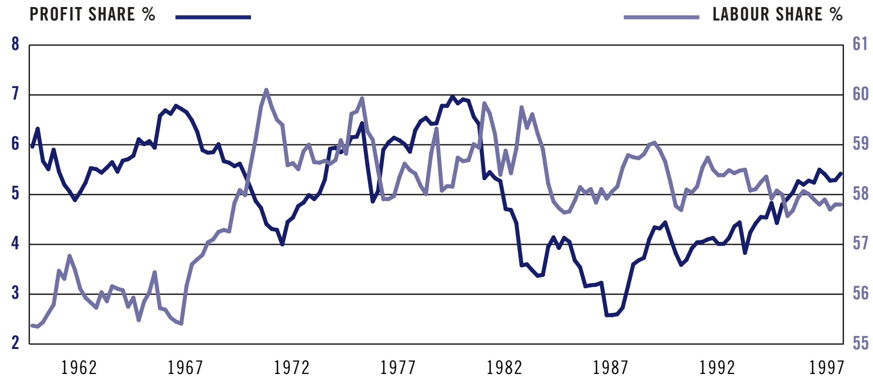
Early in 1928, the nature of the boom changed. The mass escape into make-believe, so much a part of the true speculative orgy, started in earnest. It was plain that an increasing number of persons were coming to the conclusion that they were predestined by luck, an unbeatable system, divine favour, access to inside information or exceptional financial acumen to become rich without work.

to pay more for its inputs. Labour also began to suffer as wages failed to match other price rises.

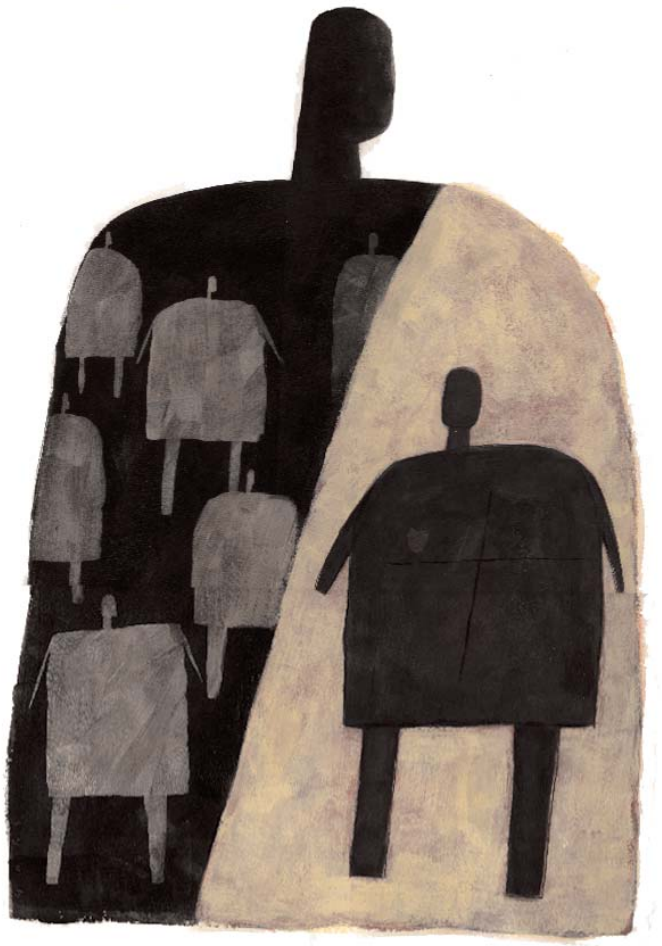
The imbalances which cause price rises in one sector do not continue in perpetuity because of adjustment mechanisms that come into play. The shift of labour intensive industry to developing countries meant unskilled labour in the developed world had to compete with cheaper workers overseas, forcing it to price itself more cheaply. Similarly, increased exploration of oil and more efficient oil consumption served as the release valve for the pressures in the energy market.

From the mid 1960s to the early 1980s, while the labour force and then natural resource owners were being enriched, productive assets provided poor real returns. This was reflected in the poor returns on the instruments used to finance these assets – in fact, the US equity market was essentially flat for a sixteen year period from 1966 to 1982. Businesses responded to this by cutting back their spending on new plant and equipment. The reduction in the supply of productive assets led to an improvement in returns on capital, which was reinforced by the reduction in excess returns to labour and resources. This can be seen from the following chart.

Labour Share and Profit Share*



* Corporate profits expressed as a percentage of GDP



The single feature of the mass escape from reality that occurred in 1929 was that it carried Authority with it. Governments as well as the speculators deemed it unwise to be sane at a time when sanity exposed one to ridicule and condemnation for spoiling the game.

The improvement in corporate profitability has been accentuated by a succession of interrelated events that, while not restricted to the US, have been of more significance to that economy than elsewhere. Productivity growth, government shrinkage (and lower tax rates), a weak currency, consolidation, deregulation, brand premiums and particularly lower interest costs, have helped US companies increase earnings by 100% since 1992, which compares with only 68% growth in German profits and a 39% increase in UK profits.

The very strong dollar in the first half of the 1980s reduced the competitiveness of American industry, resulting in a collapse in exports. The corporate sector responded by engineering a significant improvement in productivity which, with the help of a subsequent depreciating currency, drove exports as a percent of GDP from 7% in 1985 to 11.5% today.

Productivity growth itself has had a second wave, driven by the enthusiastic adoption of information technology in the US, where the level of usage of PCs and the internet far exceeds that of other nations. Innovation has occurred broadly where for example improvements in seismic technology, imaging systems and data processing have lowered the cost of finding and producing a barrel of oil by 30% in just the last four years. These and other techniques to streamline processes has greatly benefited the manufacturing industry which consequently has been able to cut inventories 9% so far this decade, freeing up $82 billion of capital.

American companies have generally been more successful in globalising their activities than European companies, the latter having been distracted by European integration and domestic considerations. With their improved competitiveness, US corporates have been able to compete successfully in overseas markets against less efficient and less aggressive locals.

As the private sector tends to utilise resources more efficiently than the government sector, the reduction in the relative size of the government over the last decade has had a positive effect on the efficiency of the economy. An important part of this has been the

At some point in the growth of a boom all aspects of property ownership become irrelevant except the prospect for an early rise in price.

reduction in the defence budget since the end of the Cold War, freeing up $240 billion or 3% of GDP. Similarly, deregulation of telecommunications, air travel and power have made these industries more efficient and helped suppress inflation.

The process of consolidation, and the movement away from the conglomerate structure so popular a decade ago, has created businesses operating in fewer industries but with a larger share of their core markets. Facilitated by a less interventionist regulatory authority, this concentration of markets has improved returns in many industries, such as banking, defence and aerospace, oil refining, and broadcasting.

It is observable that brands are today able to command a greater price premium, and a greater share of their market than they have for a long time, and hence earn super normal returns for their shareholders. How is that adding a *Swoosh* logo, a $5 T-shirt is converted into one that can be sold for $50, and is an Intel processor really worth twice as much as its technical equivalent from Advanced Micro Devices? The answer to the puzzle must be a behavioural one. Perhaps because of the affect on confidence of corporate downsizing, “tribalism”, or common behaviour, is a very powerful force. Brands provide instant acceptability - no one is considered “uncool” wearing a Nike shirt and drinking Coke - and this acceptability makes the purchase decision an easy one. In developing markets, where people want to associate with American success, these brands have aspirational qualities. The US is a big beneficiary of this tribalism phenomenon as the domicile of many of the world’s leading consumer brands: - Nike, Coke, Gillette, Marlboro, Compaq, Microsoft, Intel, Johnson and Johnson, Campbell’s Soup, Disney, Barbie, Colgate, etc.

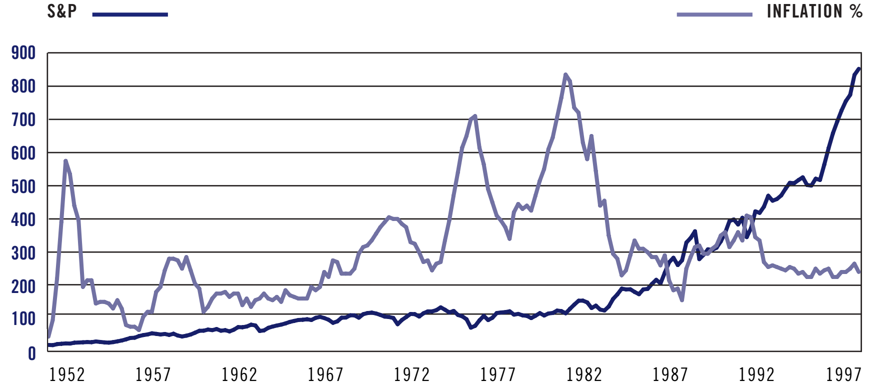
Returns to capital have expanded over the past fifteen years, so why haven’t we seen corporates more enthusiastically adding to their capital base to take advantage of this prosperity; part of the adjustment process that would then work to erode these returns? The high degree of focus in the US on shareholder wealth has meant that despite returns on productive assets being very high, and the cost of financing low, there has been a great reluctance to create excess supply by

Pessimism was not openly equated with efforts to destroy the American way of life. Yet it had such connotations. Almost without exception, those who expressed concern said subsequently that they did so with fear and trepidation.

aggressively adding capital. Executive compensation is now so closely tied to share price performance that management aims may have changed. Could it be that management is more concerned with reporting current profits than accumulating long term wealth for the company? Do all the layoffs and all the industry consolidation make for stronger corporations in the long term?

Part of the bull market in equities has been the improving returns on capital of corporations. The other driver has been the way in which those returns are valued by investors. Share prices have risen because of the secular reduction in consumer price inflation. Why should this be so?

S&P 500 Index and Inflation SINCE 1950



Firstly, when prices are rising rapidly, the depreciation which companies record as a cost to their earnings is much less than the cash they must outlay to maintain and replace their assets. To compensate for the overstatement of earnings, the market attributes a lower value to the reported earnings than when inflation is low. The second dimension to this is that corporates pay tax on artificially high earnings.

Secondly, a lower discount rate makes future cash flows more valuable today. It is for this reason that a decline in inflation has a more favourable effect on the valuation of a stream of cash flows

The end had come, but it was not yet in sight.

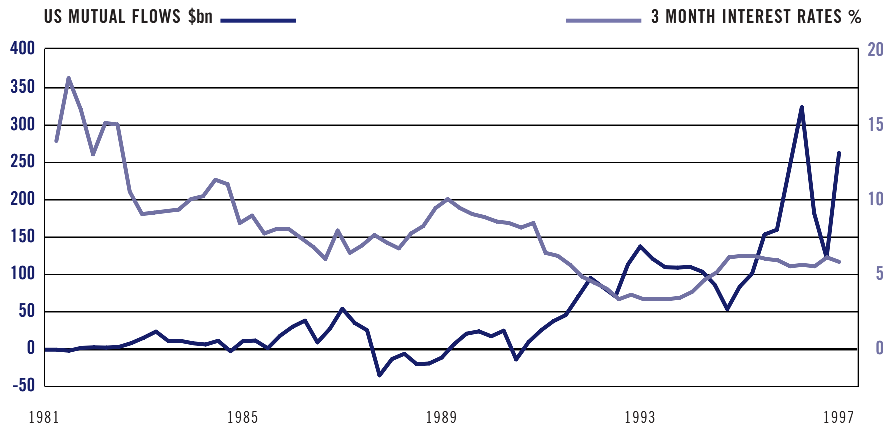
that is growing, than one that is not. Hence, the cumulative performance of equities during this bull market has dramatically outpaced that of other asset classes and, within the equity market, growth stocks have been the strongest performers. Recently, the "Nifty Fifty" type of stock (in both the US and elsewhere) has been revalued based upon the perception of near endless, riskless growth in an environment of scarce growth because corporates can no longer rely upon product price increases.

Low inflation also has important effects on the stability of the economy. The absence of rapidly rising prices greatly improves the confidence businesses have in investing and hiring people:- in fact, in their whole decision-making process. Since 1983, there have been only four quarters of declining GDP, compared to twelve in the prior decade. This stability has been helped, no doubt, by few exogenous shocks such as wars. A more stable economic environment is in fact a less risky one, so the extra return investors require to invest in traditionally risky assets such as shares, declines, and the prices of these assets are bid up. Many have extrapolated current trends to suggest that the business cycle has ended and the chances of a recession have been substantially eliminated by new management techniques and the opening up of the economies in Asia and Eastern Europe. Why has this not happened before as forecast or more importantly, has there been some fundamental change in human behaviour?

Another important factor in the revaluation of financial assets has been the effect of low short interest rates. Individuals tend to respond more to nominal rates than real rates. For instance, they feel that money market rates have become much less attractive as they have fallen from, say, 10% to 5%. This could be an "inflation illusion", for the reality is that their real return after tax is actually much better. Therefore, the fall in short rates has encouraged people to shift savings into bond and equity mutual funds, as shown in the following chart.

It is in the nature of a speculative boom that almost anything can collapse it. Any serious shock to confidence can cause sales by those speculators who have always hoped to get out before the final collapse.

Money Market Rates and US Mutual Flows



The effect of lower short rates in pushing savings into long duration assets in search of higher returns has been amplified by events in Japan. Following the bursting of the bubble in Japanese asset prices in 1990, interest rates have been reduced to extremely low levels to stimulate economic activity and reinflate asset prices in order to bail out the banking system. The Japanese economy has continued to create liquidity through their strong trade performance, but the unattractive domestic interest rates have encouraged these funds to be invested offshore, resulting in a mass of Japanese money purchasing US bonds. This has increased the price of these bonds, leading to higher equity prices. The important point is that the flow of Japanese money to the US, which underpins US financial asset prices, originates from a crisis in the currency and the economy, most particularly the banking sector. Similarly, European rates have been kept low to stimulate activity and improve the competitiveness of the export sector through weaker currencies.

If the forces of falling inflation and robust corporate earnings growth have been driving the market strongly for several years, what can account for the largest nine-week gain in market history over the

Far more important than rate of interest and the supply of credit is the mood. Speculation on a large scale requires a pervasive sense of confidence and optimism.

April to mid-June period? Inflation and earnings have continually bettered expectations, but it has been the increasing degree of conviction in the continuation of these factors that has driven the recent acceleration in the stock market. When a theme or force has been in place long enough, it comes to be perceived as being perpetual.

The expressions "new era" and "new paradigm" have been used a great deal in the last year or so, and the idea that we are in fact in a new world is a seductive one. The US has indeed achieved a great deal economically over the last five years. Since the beginning of 1992, the federal deficit has been reduced from 5% of GDP to 1%, economic growth has been double that of Japan and 75% greater than Europe, the crime rate has been reduced, and despite corporate restructuring, 13.7 million new jobs have been created. Unemployment of 5% compares to 12% for the European Union. Ironically, the only G7 country currently satisfying the European Maastricht criteria is the US. But does the IT revolution have a greater impact on the productive capacity of the economy than did the railroad, the electric motor, the assembly line, the telephone or the jet airliner? Despite improved competitiveness and the benefits of free-trade with Canada and Mexico, America's trade balance hasn't improved, the gap between rich and poor is wider than ever, consumers are indebted to a greater extent than ever, and a social security problem of huge proportions exists on the horizon. How should we best measure prosperity and progress anyway?

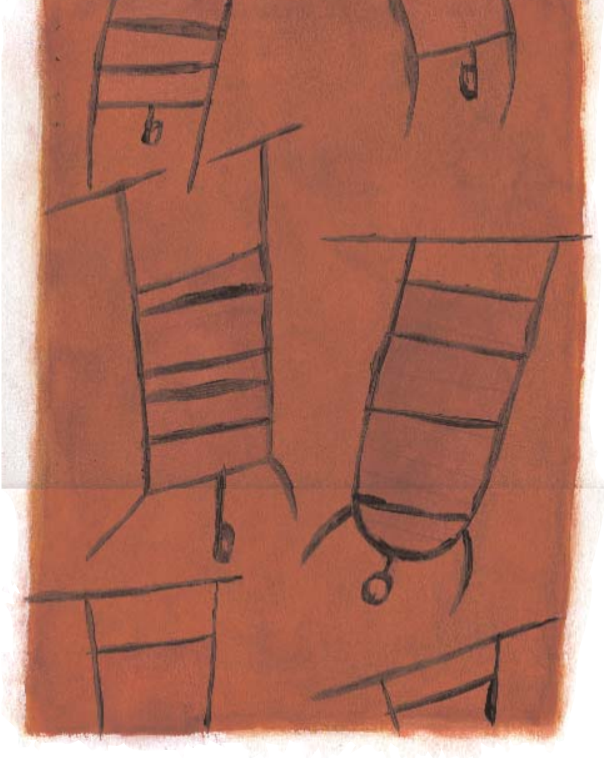
Evidence of infatuation with the stock market abounds. US corporates often judge the performance of their management by that of their stock price, and dramatic rises in executive compensation have gone unchallenged and often bear no relation to the performance of the business. Individuals talk of the stock market as a vehicle for making money, forgetting that "Wall Street is one way only if you are driving a car", let alone that financial assets are simply a claim on the income producing potential of real assets.

One of the features of financial markets is the brevity of its memory. It is only ten years ago that the death of US manufacturing at the hands of the all-powerful Japanese was widely predicted.

On the evening of the 28th October 1929 no one any longer could feel secure in the knowledge that the most powerful banks stood ready to prevent a recurrence of panic. The market had reasserted itself as an impersonal force beyond the power of any person to control, and, while this is the way markets are supposed to be, it was horrible.

Similarly, while the US labour force is indeed flexible and fluid, it is only two decades ago that wages were settled according to CPI expectations. And while government today is highly accommodative to business, it has not always been so docile; recall the break-up of Standard Oil and AT&T and the imposition of Prohibition. Should we believe in the perpetuation of the favourable environment we have today, when we have witnessed change of such scale? In the future, will commentators marvel at the good fortune of companies which have been allowed to corner their markets - such as Boeing taking over McDonnell-Douglas and defence companies merging to effectively limit competition for lucrative contracts?

Within this market psychology can be identified the same distortions and belief patterns that have existed in the advanced stages of other asset price cycles. During the 'tulip mania' that consumed Holland in 1636, a "single bulb of previously no apparent worth might be exchanged for a new carriage, two grey horses, and a complete harness". In favour of loans to the growing railroad industry, it was questioned "who could lose on what was so obviously needed". Similarly, banks in the US nearly went bankrupt lending heavily to Latin American countries in the 1980s - how ridiculous to suggest that these fast growing economic wonders would have trouble repaying their debt. Similar crowd behaviour was exhibited by the rush to invest and build plants in China during 1994-95. The accepted wisdom was that you simply had to be there. How often did we hear "if every person in China consumed but one ....."? The reality has been heavy losses by the majority of players, and one European packaging company has recently walked away from a $100 million investment. There is great attraction in being with the crowd, and questioning of what is perceived to be obvious, is unwelcome. An old Japanese folk saying that was popular when that market was soaring in the late 1980s, is "the fools are dancing, but the even bigger fools are watching". More recently, US senators berated the US Federal Reserve Chairman, Alan Greenspan, for his precautionary comments, such as suggestions of "irrational exuberance" in the market.



Holding for an increase would now become meaningless: the new reality would be falling prices. There would be a rush, pellmell, to unload. This was the way past speculative orgies had ended. It was the way the end came in 1929. It is the way speculation will end in the future.

We are in an environment where the market has recognised lower inflation and is now demonstrating an increasing appetite for risk. This is reflected in lower premiums for risk on the debt of emerging market countries such as Russia and Brazil, and US "junk" bonds. As the appetite for long duration assets becomes overwhelming, the premiums investors require to hold these risk assets will be lowered, driving prices of bonds, and particularly equities, to even higher levels. While we may well get a serious correction before the bull run comes to an end, the market's learned response from the last fifteen years (including 1987!) is to buy the pullbacks.

The final phase of the bull run could possibly see a narrow blow-off of the multi-national growth stocks, or "new Nifty-Fifties". Even though the corporate environment may have deteriorated, investors may cling to the belief in the infallibility of equities (or, at least, selected equities). Remember how gold held up remarkably well after US interest rates were increased in the early Eighties, and yet investors kept thinking that a fall in the price of gold represented a buying opportunity. There are many similar historical examples indicating that crowd psychology changes more slowly than one would expect.

What could bring this bull market to an end? Historical corporate behaviour would suggest that at some point, the chase for market share and subsequent price erosion, or new innovations will erode profitability. Alternatively, foreign companies may build plants in the US to take advantage of market openings or pricing umbrellas and be prepared to accept a lower return of invested capital in order to participate in that economy. Exchange rates could also fluctuate significantly to set up yet another cycle.

Financial asset inflation has begun to spill-over into the real economy. In the last year, some parts of the US have seen rises of about 30% in prices of commercial real estate, the upper end of the residential housing market and even farm prices. House prices in London, Boston and Sydney have all moved up smartly. Leakage into real spending is likely to follow, as higher real estate prices attract building and renovation, and this money is recycled through the economy. Central banks in the affected economies would be forced to respond to this by raising rates, despite product-price inflation remaining benign, and Greenspan has alluded to this on more than one occasion. Activity in Japan and Europe is likely to pick up in the next year, and the absorption of liquidity will tighten monetary conditions. The US economy's growth rate could revive, leading interest rates higher. Few expect the signs of weakness in demand to become more pronounced but this is also possible (not everyone has participated in the financial asset boom; many are struggling to meet their debt repayments despite very low interest rates).

The economy has to continue to walk this narrow line – buoyed by leakages and yet restrained by moderate income growth and high consumer indebtedness – for this bull market to be sustained. As the market continues to advance, the intertwining of the market and the economy becomes more dangerous.