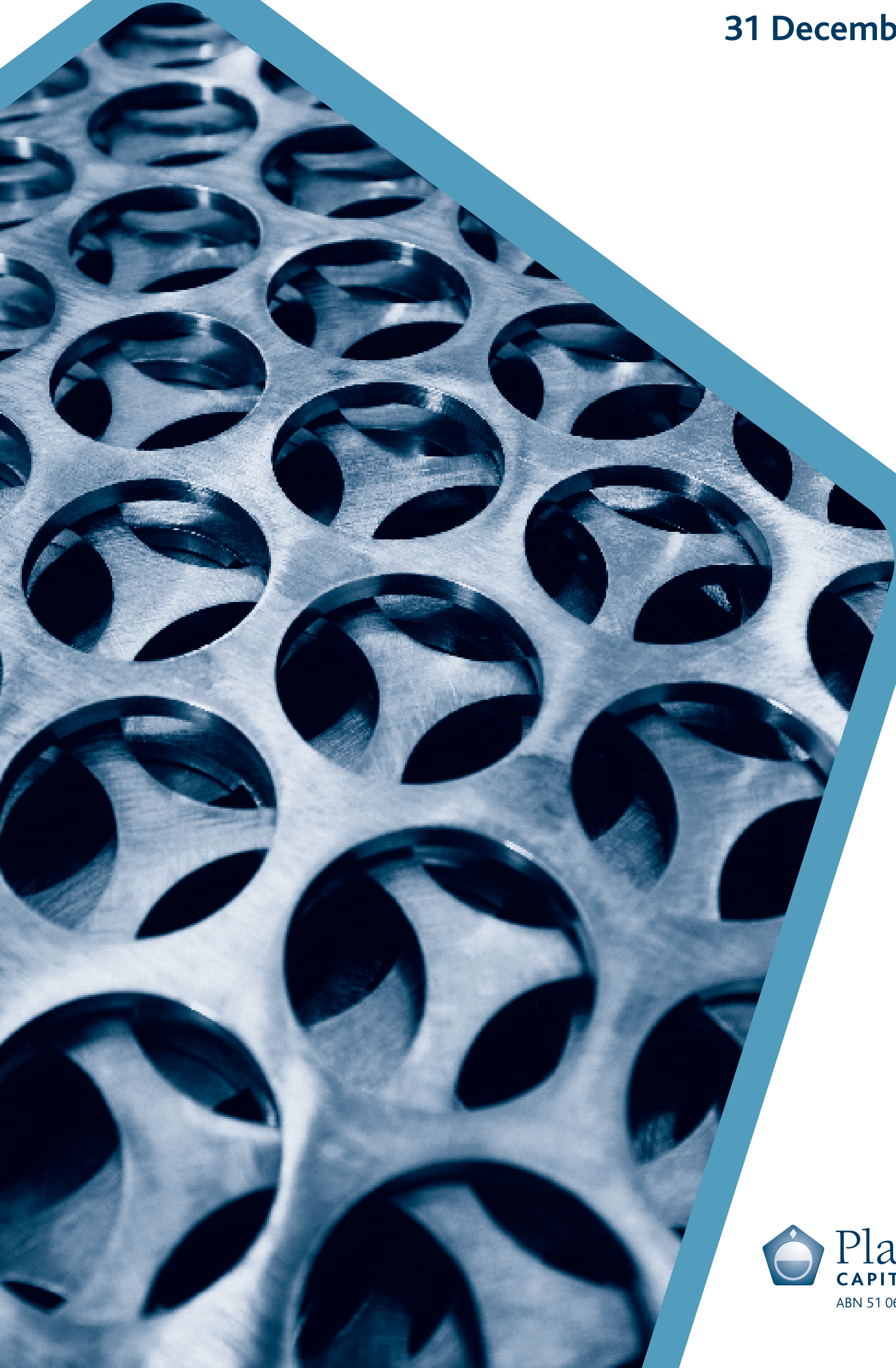
Platinum Capital® Limited Quarterly Report

31 December 2008



Platinum® CAPITAL LIMITED

ABN 51 063 975 431

PERFORMANCE

The Company has continued to be remarkably stable during these highly turbulent times. What one avoided was of as much importance as what one owned.

Thankfully we continued to avoid the western financials, resource producers and energy plays, while we benefited from favouring the strong currencies, in particular the Japanese yen. The stocks we held recorded ups and downs. Companies with debt levels that would normally be regarded as tolerable were harshly treated early in the quarter on concerns about refinancing risk but subsequently recovered strongly. Hence, the Company was up 1.5% (pre-tax) for the quarter, up 7.7% for the last six months but down for the year by 10.3%.

Though clients lost money, we certainly gave them more protection than was afforded by the vast majority of our international peers and, as well, can report an outcome that is superior to that typically achieved in the Australian market. For the record, the MSCI All Country World Index (A$) was down 12.2% for the quarter, -10.9% for the last six months and -27.2% for the year. Since inception the return from Platinum Capital Limited has been 13.5% compound pa versus 4.8% compound pa for the MSCI World Index.

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

NET ASSET VALUE (CPS)	
31 OCTOBER 2008	124.40*
30 NOVEMBER 2008	124.05
31 DECEMBER 2008	127.60

* After provision for the 5 cent final dividend and shares issued under the rights issue.
Source: Platinum

CURRENCIES

We reversed some of our US dollar exposure during the quarter in favour of the Euro and continued to trust in the Japanese yen. This has worked well but the untangling of debt, which we have previously alluded to as the supporting mechanism for the US dollar, remains intact and this will guide our positioning for a while yet. The Australian dollar has been trading more strongly during the quarter but at this stage it seems unlikely to strengthen much past the mid-70s to the US dollar. In retrospect we re-entered the Australian dollar hedge a little early but, with some 24% of the portfolio hedged, we have benefited.

MSCI* WORLD INDEX SECTOR PERFORMANCE (AUD)

SECTOR	QUARTER	1 YEAR
TELECOMMUNICATIONS	5%	-19%
UTILITIES	2%	-12%
HEALTH CARE	1%	-1%
CONSUMER STAPLES	-2%	-4%
INDUSTRIALS	-12%	-31%
CONSUMER DISCRETIONARY	-13%	-27%
ENERGY	-14%	-27%
INFORMATION TECHNOLOGY	-15%	-30%
MATERIALS	-19%	-40%
FINANCIALS	-25%	-42%

Source: MSCI
* Morgan Stanley Capital International

CHANGES TO THE PORTFOLIO

We have been relatively inactive in value terms during the quarter and have tended to use the high volatility to either add to core positions or to trim those that moved out of line with their peers. While marginal in terms of its impact on the overall portfolio the inter-week moves have been colossal and have allowed us to take advantage of senseless panic.

GEOGRAPHICAL DISPOSITION OF PLATINUM ASSETS

REGION	DEC 08	SEP 08
ASIA AND OTHER	23%	19%
EUROPE	23%	23%
NORTH AMERICA	21%	24%
JAPAN	22%	19%
CASH	11%	15%
SHORTS	19%	24%

Source: Platinum

PLATINUM CAPITAL LIMITED – TOP 20 STOCKS

STOCK	INDUSTRY	DEC 08
MITSUBISHI UFJ FINANCIAL GROUP	FINANCIAL	3.4%
SIEMENS	ELECTRICAL	2.9%
MICROSOFT CORP	TECHNOLOGY	2.9%
CISCO SYSTEMS	TECHNOLOGY	2.4%
HUTCHISON WHAMPOA	TELCO/TRANSPORT	2.1%
SANOFI-AVENTIS	HEALTH CARE	2.0%
OBAYASHI CORP	CONSTRUCTION	1.8%
JOHNSON & JOHNSON	HEALTH CARE	1.7%
MERCK & CO	HEALTH CARE	1.7%
DENSO CORP	AUTO	1.7%
BOMBARDIER	TRANSPORT	1.6%
JGC CORP	CONSTRUCTION	1.6%
SAMSUNG ELECTRONICS	ELECTRICAL	1.6%
SUMITOMO REAL ESTATE SALES	PROPERTY	1.5%
HENKEL KGAA	CONSUMER	1.5%
HORNBACH BAUMARKT	RETAIL	1.5%
PPR	RETAIL	1.4%
HENDERSON LAND DEV	PROPERTY	1.4%
LAGARDERE	MEDIA	1.4%
EBAY	TECHNOLOGY	1.4%

Source: Platinum

SHORTING

The market rewarded us for short selling defensives in the packaged goods industry, some boldly priced transport intermediaries, a REIT ETF (real estate investment trust exchange traded fund), as well as the Russell 2000 Index. We have gradually reduced exposure to index shorts like the Russell and replaced them with specific company shorts. Overall the level of shorting has been reduced to around 19% and we continue to migrate to those areas still priced as impregnable.

COMMENTARY

As we look back over this year, it is notable that even those who identified the reckless extravagance that resulted from easy money[1] were surely surprised at how quickly the environment changed and at the damage wrought to the global economic order. George Soros, prescient as ever, in his article in the *Financial Times* (22 January 2008) pointed to the crazy belief in the perfection of markets when so much evidence supports the thesis that they are inherently unstable and need close supervision. His main point, however, was that **we had come to the end of a 60 year credit boom** and that *"the ability of the (US) financial authorities to stimulate the economy is constrained by the willingness of the rest of the world to accumulate additional dollar reserves"*.

The Fed, following a pattern of ever quicker responses to economic distress, acted well-ahead of any pronouncements of a recession[2] and by mid-December had dropped rates to virtually zero. **It has further entered the unknown by directly buying long-dated treasuries in order to reduce interest**

1 Regular readers of this quarterly will be familiar with our bleating about cheap and abundant money and forewarnings of the likely consequences.

2 Though US unemployment has been rising all year the official declaration of a recession only occurred in the fourth quarter.

rates right along the yield curve. This is already beginning to help the refinancing of mortgages at lower rates and has begun to improve the level of activity in the corporate debt markets. As an aside, it is also in effect, punishing all those savers who had hopes of saving for their future security, but in this politically charged panic that is the least of the Fed's concerns. Followers of the Austrian school of economics view the Keynesian approach adopted by the Fed as tantamount to adding fat to the fire because they believe that without a balance between saving and investment an economy starves itself of growth potential and condemns itself to weak formation of wealth.

We have entered the unknown to the extent that we cannot know how enthusiastic lenders will be to extend credit nor how willing borrowers will be to take on more debt. We should not forget that the level of outstanding interest bearing obligations in the US now exceeds 350% of GDP. The consumer accounts for nearly four tenths of this figure and servicing it absorbs 14% of disposable income. The government accounts for one sixth, and the balance is owed by the financial sector and ordinary businesses. This compares with a total figure of 155% in the early 1980s when consumer debt accounted for about one third. For over 50 years there has been an almost incessant increase in the use of debt throughout the English speaking world.

A major problem now is that most Western banks are **extremely thinly capitalised and will have difficulty expanding their lending further.** For example, the top 19 US banks had net equity at the end of September 2008 of US$552 billion, implying a Tier 1 capital ratio of 4.4%: quite slender when set against the declines in housing values and before the news is out on the deterioration of their commercial books. It may be instructive to note that subsequent to the Japanese credit bubble that peaked in 1990 domestic banks failed to increase the net level of loans for the following 18 years.

As 2009 unfolds the performance of the manufacturing sector may take centre stage. As we toured European companies in mid-December we noted the recurring observation that orders fell-off sharply from mid-October and that in November and December to receive orders at all was a source of jubilation. The effect of this hiatus will be revealed in the next reporting season. Of concern is not so much the one-off reduction of activity as destocking takes effect but the actuated feedback loop as it impinges on employment, involuntary working capital increases, bad debts and the need for additional funding. It is precisely this concern about a loss of business confidence that is motivating pre-emptive action by the Fed and other Central Banks.

In several countries, though not all, the authorities have made it clear that their next step is "quantitative easing", a process which involves the buying in of government and other debt so as to flood the credit market with additional funds. This involves either attracting money from overseas by raising interest rates, the reverse of what is required, diverting investment from the private sector, equally undesirable, or printing money. There is little doubt which of these options the authorities have in mind.

Some commentators have expressed concern that printing money will lead to rising inflation and, if interest rates are concomitantly held down, the destruction of savings. Our view is that the sheer magnitude of debt in many developed economies will militate against lenders' pricing power and hence the risk of inflation is some way off. We should all keep at the back of our minds, however, that history is studded with examples of **governments abrogating their**

obligations when cornered and, indeed, we suggest that the intractability of the obligations now being incurred will in time drive those in power to follow the expedient route of allowing inflation to reduce the real burden of their debt. **Equities in such an event, while not perhaps ideal, will be a lot more interesting than cash or bonds.**

OUTLOOK

We are asked about the timing of an equity market bottom. It is not possible to oblige. What we see is an **overlapping three phase bear market**. The first phase was the **seizing up of the credit markets**. This is now well on the way to being resolved.

The second phase is the **collapse of profitability** led by commodity producers and manufacturers of durable consumer goods but also apparent in service sectors such as retailers, media and the like. Some industries will be largely immune, areas like power, water and communication utilities. As noted last quarter, analysts are lagging well-behind fund managers in their revisions of earnings. The pattern of downgrades is now accelerating, however, and we would guess that by the end of the first quarter 2009 reporting season reality will have well and truly set in. A factor to be watched over the longer term is the damage likely to result from government intervention to prop-up ailing businesses.

The third phase will probably reveal **a change in portfolio and geographic preferences**. We have already seen some of this with the voluntary or forced liquidation of equity positions as investors increased their cash holdings partly to prop up less liquid assets such as property and commercial paper. It would be surprising if this down phase is not marked by investors questioning the true merit of owning shares and some vowing never to participate again!

In the meantime we are quite upbeat. The new administration in the US is bound to spend liberally to try to avert a deep recession. The temptation may be to favour expediency over the longer serving benefits of bolstering the country's infrastructure. Other governments worldwide can be expected to deficit spend with some emphasis on capital works. At the same time the effect of a lower oil price is highly beneficial to consumer incomes and this should lift consumer confidence, at least partially mitigating reduced employment opportunities.

From the compositional angle, in general terms **we still favour Asia over the Western hemisphere**. Asian economies will not escape a reduction in foreign direct investment nor deteriorating trade surpluses. Their state finances are in good shape, moreover, their banks' solvency ratios are barely affected by the credit crunch/write-offs and their bank funding tends to be from domestic sources. Countries such as India may face a weaker Rupee to reflect its less favourable fiscal position but, on the other hand, it has far less exposure to external trade than, say, China.

For most markets the technical factors are also encouraging.

- The reopening of the corporate bond markets will relieve refinancing risk concerns for companies with above average debt levels but satisfactory cash flows.
- Company valuation measures, such as price to book value or enterprise value to capital employed, are back to levels last seen in 1985.
- The relative value of defensive companies compared to those which have cyclical earnings are at an historic extreme as investors have sought the comfort of predictability.

OUTLOOK CONTINUED

A survey of investor sentiment by Merrill Lynch[3] reveals that a majority of professional investors already expect corporate profits to "deteriorate strongly" and hence one can surmise that this is priced into most valuations.

Portfolio cash levels are also high by historic comparison with figures out of the US suggesting they are equivalent to 75% of the US equity market capitalisation.

Lastly, selling pressure seems to be abating and share prices are tending to move sideways-to-up even in the context of a crescendo of bad tidings. Historically, iconic insolvencies have often been closely related to market lows; in this instance we can consider Lehman and the big three US auto companies.

The coming months will require some agility. We will be looking for the opportunity to continue to strengthen the portfolio with superior companies which, even though their profits may come under pressure, will be able to generate free cash flows. Our shorts are continuing to be directed at companies at extreme valuations which reflect their over-use as defensive hiding places.

Kerr Neilson
Managing Director

3 The Merrill Lynch Fund Manager global survey with 206 respondents from 5-11 December 2008.

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