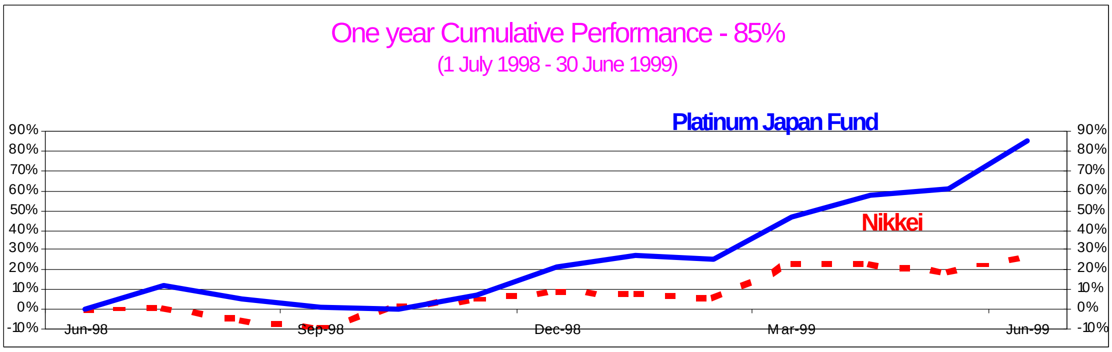
PLATINUM ASSET MANAGEMENT

The Platinum Japan Fund

Quarterly Report
30 June 1999

Performance

The Japanese stock market continued to move ahead strongly with the benchmark Nikkei index rising by 11% (in yen terms) during the quarter. However, in contrast to the previous quarter the advance was concentrated more in the secular growth areas of telecoms, high technology and consumer lending rather than the cyclical areas such as banks and construction which saw declines. Small stocks (the OTC market) were also strong rising by 42%. The fund was well positioned in these areas with the likes of NTT DoCoMo, DDI, Fujitsu and Shinkawa all rising by more than 25%. In addition, the Korean holdings performed very well on the back of a reviving economy. The consequence of this was a rise of 26% in $A terms in the portfolio versus 3% for the index. For the year, the fund achieved an 85% return versus a Nikkei index return of 27% ($A).



Commentary

The surprising development was the reporting of 7.9% annualised GDP growth for the March quarter. Whilst not really believable in terms of its magnitude, it did however combine with other data suggesting some stabilisation in the economy to challenge many investors' notion that Japan is a country in terminal decline. In addition, the Bank of Japan reiterated its zero interest rate policy and aggressively intervened in the currency markets to the tune of $US22 billion ostensibly to prevent currency appreciation heading off the fledgling recovery. Together, these two events reinforce our belief that we are in the very early stages of an economic up-cycle. It is likely to remain patchy for some time as corporates restructure and unemployment grows.

However, we believe there is an inevitability about it given the improvement being seen in neighbouring countries and on account of overnight money earning zero return.

As noted previously, it is the corporate sector that will lead change in Japan. This will come in the form of a greater awareness of the need for profits and a reassessment of the imbalance of the labour/capital profit share in the economy as firms restructure. Further, we believe that many of the government agencies have lost credibility in the eyes of the public and this has diminished their influence in political circles. Initiatives have however been proposed which will help corporations restructure their businesses with the aid of tax breaks. At the same time, job creation schemes are being dreamed up by the bureaucrats with banner headlines proclaiming the magnitude of these proposals. To some extent we regard these as a confidence boosting exercise.

The quarter saw a continued flood of restructuring announcements which included paring of workforces, linking of pay rates to performance and joint venturing of loss making businesses. We highlight the linking of Hitachi and NEC in the joint development of memory chips as highly significant in that it reduces costs and leads to consolidation of market share. It would not have been long ago where an alliance of such magnitude between these fierce competitors would have been taboo but such have been the pressures for change that the walls are starting to break down. From our visits to Japan, it is clear that many more things are being talked about behind closed doors. Another interesting development was that of British Telecom and AT&T buying into Japan Telecom, the third largest operator in Japan. This highlights the impact of globalisation on the behaviour of corporations within Japan. We would expect to see many more deals like this and expect that it also has the positive side effect of imposing much more discipline on corporate returns than has been the case.

Having seen about 25 companies in the seven days we have just spent in Japan, we kept being reminded of the technical competence that pervades this country. At every level there is a commitment to the improvement of processes and the development of innovative products. Throughout this post-bubble period companies have continued to deepen their technical competence with some of the largest research and development budgets in the world. Japan is ideally situated in this *digital age* which calls for expertise in the areas of optics, miniaturisation, micro-chip design and production. For those sceptics who believe that the Japanese have poor chip design and software skills, we suggest they examine the products being developed by the likes of Sony and Nintendo and several game software houses. Not only are these products world beating, but the power and speed of the logic and graphic chips are quite as interesting as anything coming out of Silicon Valley. The visit to Matsushita (which is the largest supplier of consumer electronic goods in the world and the owner of the National Panasonic brand), was particularly memorable. While conceding they had paid too little attention to profitability in the past, they exuded a calm and deliberate confidence in their technical prowess which they believe is unmatched in their field. A product they are particularly proud of is their achievement of condensing the principal workings of a digital TV receiver onto a single chip.

Our major theme in Japan remains information technology which we broadly define as telecommunications, computer hardware, semiconductors and software. Japanese companies are typically well behind their international counterparts in terms of their systems to manage information flow. This shows up most starkly in rates of PC penetration, internet usage and adoption of package software solutions such as SAP. The reality is that pressures from globalisation and changes in issues such as accounting standards will require much greater standardisation of effort. The opportunity is that people are conditioned by the past history of sales and risk underestimating the spending that will be unleashed as corporate profits improve. Already PC shipments have started to grow at 50% pa and this will be just the beginning as these machines are linked into networks and the internet.

Breakdown of Portfolio

Categories	Examples of Stocks	Holding
Cyclical Growth	Sony, Kyocera, Fuji Photo Film, Canon	21%
High Growth	Mobile Telecoms – DDI, DoCoMo Outsourcing – AIM Services, Trans Cosmos	20%
Deep Value Cyclicals	National House, Taikisha, Rinnai	15%
Steady Growth	Coca Cola Bottlers Drug Wholesalers and Pharmaceutical Companies	9%
Market Levered	Daiwa Securities, Nikko Securities	7%
Korea	Samsung Electronics, Korea Telecom	16%
Cash		12%

Outlook

Clearly with such a strong performance in our inaugural year, investors will ask where do we go from here? Our view is that we are in the early stages of a multi-year bull market which will be driven by a rising share of corporate profits of GDP. We think that it will unfold something like this:~

Bottom – The economy seems like it will never recover. The Bank of Japan moves to zero interest rates but locals run scared. People dismiss the reality of the impact of restructuring on corporate profits and look only at the behaviour of consumers in aggregate.

Early realisation – The economy shows no signs of life but corporations act independently to cut costs and restore profits (helped by government tax reforms). Restructuring announcements and merger and acquisition activity gains momentum. The market moves up with sporadic bursts, climbing a wall of worry.

Dawning of reality – Corporate profits start to lift and the economy shows some small signs of life. Participation by individual investors broaden from the initial broker margin players. Institutions start to fret about their low weightings in shares versus bonds (which by now are looking more dangerous as yields creep up).

Reality – Locals start to act on their new-found confidence and buy the market. Land prices start to move as the wealth effect kicks in.

Hyper reality – Newspapers start eulogising about the new Japan economic growth machine and carry stories about the new rich - individuals who set-up their own business and have made good.

We believe we are still in the ***early realisation*** stage with local institutions still very wary (and tending to sell shares into strength) and the market is being carried by foreigners and some brave private investors. There will be setbacks as markets typically run ahead of the reality and perhaps external events come to the fore but as the process gathers momentum, the market should become more robust and move considerably higher on a three year view. In simple terms, the index at 18,000 is still only 50% of its previous peak made some nine years ago! Just as importantly, when we look at the stocks we own, whilst some have run hard, on a three year view all of them still offer considerable share price appreciation and once again our problem is choosing from the smorgasbord of opportunities. Lastly, ownership of Japan by foreign private investors is still tiny and one can imagine how foreign buying pressure can build.

US Mutual Funds – categorised by regional funds in US$ billion.

International Equity	$229
European	$42
Emerging Markets	$27
Asia ex Japan	$10
Japan	$3

Note. International funds are barely at index weight and the Japanese economy is much larger than all the emerging markets, including Asia.

Please note that the minimum investment for the Japan Fund is now A$20,000 and the fund is valued on a weekly basis (close of business Friday).

The Fund size is A$23 million.

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