PLATINUM ASSET MANAGEMENT

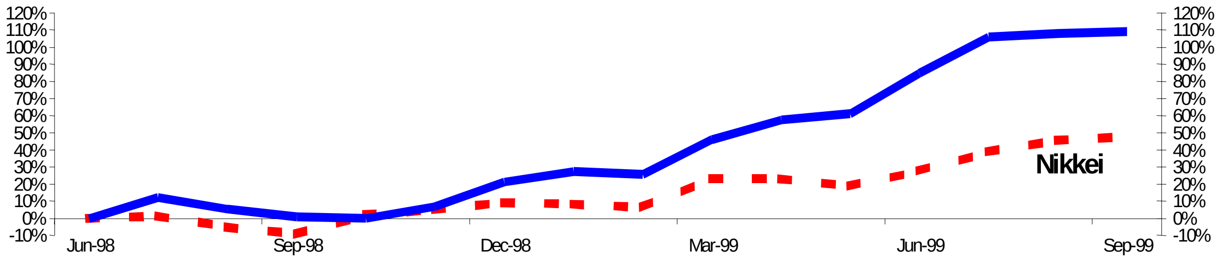
The Platinum Japan Fund

Quarterly Report
30 September 1999

Performance

The Japanese stock market continued to be relatively buoyant and although the headline Nikkei index returned only 0.4% in Yen terms, the broader Topix index was up 6.4%. Furthermore, with a move from 121 to 106 in the Japanese Yen versus the US$, the return on the Nikkei was 14.2% in US$. Within the market there was highly dichotomous behaviour among sectors. As was the case last quarter, the secular growth stories dominated but these were joined by the financials. Simultaneously, the economically cyclical side of the market deteriorated further. The fund received good performance from its brokerage stocks, Nikko and Daiwa Securities, Sony, Fujitsu and the broadcasting companies, Tokyo and Nippon Broadcasting. For this three months, the fund returned 13.2% as against 15.8% for the Nikkei index, each in A$ terms.

Cumulative Performance Since Inception - 109% (A$)
(1 July 1998 - 30 September 1999)



Economic Commentary

The quarter was dominated by a rising belief amongst investors that Japan is after all an attractive destination for investment. This was still primarily foreign driven with their net purchases of Japanese equities continuing at roughly the same pace as the first two quarters, around $US21 billion. However, there were also signs of life in the local investment funds with many launches of new thematic funds which were heavily over-subscribed. As we outlined previously, this probably puts us somewhere between the “early realisation” and “dawning of reality” phases of the unfolding bull market. The source of this greater enthusiasm was continued positive economic news including the release of the second consecutive quarter of positive GDP growth and attendant economic indicators which suggested much greater consumer and business confidence.

The surprisingly good economic data appears not just to be the result of massive fiscal spending by the government but also an improvement in consumer spending, attested by a lower savings rate. The financial stabilisation measures of the government, including capital injections into the major banks and loan guarantees extended to small business, have despite rising unemployment given consumers enough confidence to increase purchases. This highlights that there are vibrant parts of the economy which are offsetting contraction in some traditional areas. This is evidenced by an improvement in the rate of new job creation. The services sector has shown itself capable of compensating for job losses from the manufacturing sector.

The side effect of this rising enthusiasm about Japan has been a sharp rise in the value of the Yen against all major world currencies. This may reflect that Japan is for the moment growing again which should lead to higher investment returns and hence it is attracting capital inflow. Some believe that a strong Yen is a negative force against growth and call on the Bank of Japan (BOJ) to ease monetary policy further. However, the BOJ has limited scope to move and argues that more liquidity by itself is not the solution.

Market Commentary

The most significant corporate event during the quarter was the announcement of a merger between three of Japan's major banks, IBJ, Fuji and Daiichi Kangyo, to form the world's largest bank with $US1.5 trillion in assets. This was a ground-breaking move for the finance industry which has long been acknowledged as the achilles heel of the Japanese economy. It represents the first real move to improve the competitive foundations of the major banks after the government capital injections of earlier this year. It is easy to be cynical about the reasons for the merger, and how such an integration of this scale will be handled but the move is highly positive for corporate restructuring. The reality is that the new bank will own large stakes in or be the largest banker to large swathes of corporate Japan, for instance four of the top five steel companies. It seems inevitable that a concerted effort will be made to rationalise these unprofitable companies into one or two players. Now that the *keiretsu* ties are being addressed at their core, the Japanese economic system can really start to change.

A conspicuous market feature is the highly dichotomous nature of price movements. While this pattern is evident in Wall Street, one might have thought that the sharp acceleration in economic growth, in tandem with corporate restructuring, might have allowed traditional cyclical plays to have their day in Japan, but in fact the opposite has occurred. For instance, the shares of Asahi Glass which was much touted as a restructuring play after the announcement in February that it would cut 11% of staff within one year, consolidate production sites, trim other fixed costs and withdraw from its unprofitable chemicals business, went from ¥700 to ¥1000 but is now back around ¥700. The message from the market is clearly that any sustainable growth in the economy is going to be limited to a very select set of areas. By contrast, companies like Asahi Glass are only really doing enough to offset shrinkage in their main businesses.

The arrival of a new breed of company is perhaps best illustrated by Hikari Tsushin. Hikari runs a chain of 700 shops selling mobile phones and other electronic goods for a range of vendors. Its primary profit is earned by the commission it receives on the monthly spend of each customer it signs up, typically around $US3.50 per month. Presently it has four million customers but it is growing at the rate of 250,000 per month. The company is in a very strong position because it controls about 25% of subscriptions to the non-NTT carriers which it tends to trade-off against each other. The company is now actively pursuing a customer-focused model whereby it is trying to sell other services such as internet access and credit cards in order to fatten its take per customer. Further, the President is actively pursuing new ideas by investing surplus cashflows into internet venture capital funds both in the US and Japan. All this has thrilled the momentum players. At its recent high, the company was capitalised at US$23 billion. We cannot make sense of this valuation, but more importantly it illustrates the market's support for non-keiretsu new-Japan businesses. Furthermore, it reveals the strong underpinning that companies which produce earnings surprises may expect. We will continue to try to identify these types of companies as we did with Softbank before it became a momentum play.

Outlook

We feel that the recovery in Japan and the consequent movement in the Yen are early warning signs that pressures are building in the global financial environment for higher interest rates. This is likely to be most painful in the US but it will have consequences for Japan and Asia. We see the Asian recovery as perhaps being most marked in 1999 with less help from exports in 2000, which may raise questions about the Asian recovery story.

We have reduced our Korean position to 9% of the Fund and instituted a Kospi index short against this position. Our caution is based upon concerns over the stability of the financial system. The bankruptcy of Daewoo, which has at least $US50 billion of debt and realisable assets of no more than half that, in an economy of $US380 billion, is a truly horrific proposition. The immediate damage has been contained by government promises of support for the system and the fact that the main export products of Korea are doing very well. However, Daewoo highlights how little capital there is backing the Korean financial system and the potential exists for a deterioration in confidence by depositors. At the same time, the environment that has been keeping rates low is less tenable with a soaring domestic economy and rising global rates. We are fully aware that Korea is a country prone to wide cyclical swings because of its highly geared corporate structures and heavy exposure to exports and it is normally wise to be selling the market when everybody is lauding their achievements.

In terms of the portfolio, we have raised the amount invested in cyclical growth or exporting companies by raising exposure to the likes of Toshiba, Citizen and Canon as their share price have weakened with the stronger Yen. Fundamentally these companies are as strong as ever and it makes sense to be accumulating them on any major retracement. We have also been increasing our holding in NTT. This company remains the best positioned for the surge in information technology spending in Japan, with a customer base of some 85 million access lines. Profits have the potential to surge as it has such a large fixed cost base of labour and depreciation both of which are tending to fall. In terms of valuation, we can buy the rump of NTT with its 60 million local access lines, for less than five times cashflow, well below international valuations. The forthcoming government selldown of stock is artificially depressing the shares.

As mentioned earlier, the market is behaving in a highly dichotomous manner. Secular growth stocks have been ascribed large valuation premia while traditional manufacturers and exporters have lost ground. This is throwing up some excellent buying opportunities in companies with commanding positions in their industries and histories of good profit growth and profitability. These companies are found both in traditional Japan and the new information-driven sectors.

Breakdown of Portfolio - Fund Size $36 million

Categories	**Examples of Stocks**	**Holding**
Cyclical Growth	Broadcasters – Tokyo and Nippon Broadcasting Sony, Kyocera, Canon	33%
High Growth	Mobile Telecoms – DDI, DoCoMo	16%
Deep Value Cyclicals	National House, Taikisha, Rinnai	14%
Steady Growth	Coca Cola Bottlers Drug Wholesalers and Pharmaceutical Companies	9%
Market Sensitive	Daiwa Securities, Nikko Securities	7%
Korea	Samsung Corp, Korea Telecom	9%
Cash		12%

The **currency exposure** of the fund is currently 58% Yen, 10% Korean won, 16% US dollar and the balance in Australian dollars.