The Platinum Japan Fund

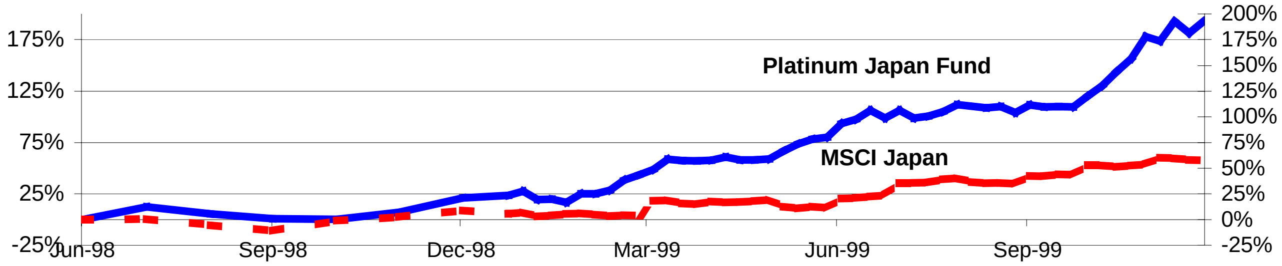
Quarterly Report

31 December 1999

Performance

The Japanese stock market continued to move higher with the benchmark Topix index rising by 14%. A feature was the continued exuberance of the "new economy" stocks which was reflected in a 16% gain in the OTC index. The "old economy" stocks continued to perform very badly mirroring global trends. The Fund performed well with its emphasis on the tech sector and over the quarter returned 43% as against 16% for the MSCI Japan index, both in $A terms. This brings the return for 1999 to 147% and 200% since inception in July 1998.

Cumulative Performance Since Inception - 200% (A$)
(1 July 1998 through 31 December 1999)



Commentary

A feature of the Japanese market has been the rising level of merger and acquisition activity from $US18 billion in the total value of transactions in 1998, to $US78 billion in 1999. Initially most activity was between companies operating in the weaker parts of the economy, primarily the financial and older industrial sectors, which are facing the reality of overcapacity, lack of growth and high cost structures. We would expect this activity to accelerate as banking sector reform forces reorganisation amongst the *Keiretsu*. The high profile deals announced during the quarter were in banking (Sumitomo and Sakura Banks), general insurance (Mitsui, Nippon and Koa) and oil refining (Mitsubishi and Cosmo Oil). More recently we have seen activity emerge amongst companies that are not so much under financial pressure but see a strategic benefit from a tie-up or acquisition. The largest has been the $US25 billion deal involving the merger of telecommunications carriers DDI, IDO and KDD to become the second largest integrated telecom carrier after NTT. This merger saw two competing rivals in major shareholders Toyota and Kyocera finally agreeing to put aside their differences to take on the might of NTT. We would expect to see many more deals as the economy progresses further with its restructuring, perhaps even hitherto unthought of events such as hostile takeover bids, more foreign activity as seen with the likes of Renault and Nissan or the "new Japan" entrepreneurs buying up older companies that have latent technology. All of this activity should be highly beneficial to our holdings in the brokers such as Nikko and Nomura Securities who stand to intermediate these deals. Foreigners will be a strong competing influence but cultural ties still argue for a large amount of business going to the locals. For reference, the $US78 billion in Japanese mergers and acquisitions is a drop in the ocean of some $US2 trillion in global deals in 1999.

A notable event during the quarter was the ascension of NTT DoCoMo (Japan's largest mobile phone network operator) to the position of number one stock by market capitalisation, surpassing that of its parent NTT. The stock has been driven by the global theme of convergence of the mobile phone and the internet - an area in which it is clearly a world leader. DoCoMo was one of the first companies in the world to offer a mass market data service to its clients when it launched "I-Mode" in February 1999. In the ten months since, it has seen three million subscribers sign-up for the service as compared with a total subscriber base of 27 million. It is adding to this at the rate of 400k per month. The service essentially allows a subscriber to send and receive e-mail and provides access to 3,400 information sites for such things as bank account details, ticket reservation, directory services, news, weather and software downloads. For example, one could locate the nearest Italian restaurant (very fashionable at present in Tokyo) from an on-line directory and be automatically connected via the voice function if you choose to make a booking. DoCoMo makes its money by charging monthly and per transmission fees but also from the percentage of revenues it takes from service providers if transactions are made on-line. It is also finding it can sell advertising space as users spend more time on their phones. Present indications are that the average "I-Mode" user is spending about 13% extra on his monthly bill (that's the equivalent of one transaction and eight e-mails per day) and this is likely to rise as users become more familiar and greater utility is added to the service eg. bill paying function, on-line shopping etc. The beauty of this business is that DoCoMo are merely taking what they already have, some 27 million mobile voice subscribers, and offering them the additional utility of on-line services. Whilst there is some upgrade cost for internet access servers, the overall utilisation of the network infrastructure is much higher and hence the return on the marginal dollar of data revenue is very high.

When we refer to the new economic paradigm of the internet, the reference is about a shift in the procedures and agents involved eg. previously information on a holiday resort would have been requested by phone, mailed out, and a booking subsequently phoned in. Now that same information can be requested directly from the resort on-line thus potentially cutting out value added from the travel agents, postal systems and landline connections. The battle for this "on-line activity" is at present being waged between mobile, desktop PC and TV, with each perhaps having a slightly different focus. In Japan, with its very high mobile penetration approaching 50% and lagging landline internet connections, DoCoMo's strategic position is apparent. In fact, DoCoMo will soon rank as the largest ISP in Japan, surpassing Fujitsu. Whilst the stock has priced in a lot of this, rising by over four times in the past year, work from Goldman Sachs suggests that if you assume everyone will eventually be using the service and that data accounts for 25% of revenues, earnings growth will produce a PE of 40x in five years time. Whilst this may look expensive, it may not be so outlandish given a low discount rate environment and high probability of outcomes. We prefer to play DoCoMo through its parent NTT where its holding in DoCoMo accounts for 85% of its market capitalisation.

During the quarter, we lifted our *effective* exposure in Korea from 0% to 25% of the Fund which is the maximum allowed by our investment mandate. We have not retreated from our view that the Daewoo losses are an enormous hurdle for the financial system but rather we felt that the sell-off was overdone. The government has since stepped in to nationalise the problem by supporting the investment trust companies through capital injections and bond purchases. Concurrently, the world economy roars ahead and this will provide great upside leverage to the heavily export-dependant Korean economy. We also saw in Korea some outstanding opportunities in the information technology area. Korea is very open to western influence and it is an early adopter of new technologies. For example, the first working model of the CDMA mobile systems which are now being adopted worldwide originated in Korea. Mobile penetration stands at around 50% and there are seven million internet users, with broadband infrastructure implementation ahead of the Japanese. We applied information gleaned from our global research into these areas to pick some outstanding bargains. We established a large position in SK Telecom, the largest mobile phone service operator, at around 1.3 million won per share. At the time it was selling for less than $US1,000 per subscriber, had over 9 million customers (42% market share) and was about to embark on a data transmission service similar to the "I-Mode" service described above. Investors seemed mesmerised by the past history of the company and failed to see that data would make it a much stronger business going forward. Subsequently, the stock has announced that it will acquire the number three mobile carrier with 3.6 million subscribers and will pursue an alliance with a foreign carrier, probably DoCoMo. At the current share price of 4 million won we have sold some of our position but believe the company will only get stronger and are reluctant to leave too hastily. On a similar note we identified the rising of the new economy stocks through the second board or "Kosdaq" market. Similar to the American Nasdaq or Japanese OTC markets, the shares listed on this exchange represent many of the names that will be prominent in the new Korea. Yet when we discovered them they were unresearched, market capitalisations were only around $US100-150 million and they sold on ten times prospective earnings and had 25% compound earnings growth rates looking forward! Although prices have moved a long way, we still think that these stocks merit attention. However we have taken some profits and moved to better value stocks in growth areas such as advertising.

Outlook

The global economy promises strong growth in 2000. Offsetting the risk of the US succumbing to interest rates or stock market risks, is the prospect of the rest of the world gaining sufficient momentum to sail through such turbulence. In this environment the more IP sensitive countries such as Japan and those in Northern Asia should see better pricing power against a backdrop of loose liquidity generated by their large current account surpluses. This should bode well for equity returns from these countries.

Our view on Japan remains that we are in a multi-year bull market that will initially see low economic growth as corporates restructure but eventually blossom into full scale recovery as the beneficial effects of corporate profits flow through to equity prices and the virtuous cycle takes hold. However the market is presently acting in synchronism with global trends with a large concentration in technology shares and this would make the market indices vulnerable to any pullback in the Nasdaq. Indeed we note that the greatest flows into the market in Japan at present are from the new information technology funds sold to the local retail investors. Our view is that we should selectively move toward those companies with clearly identifiable profit growth in industries that will be beneficiaries of the new economy, specifically those companies that have been left behind because of the headlong pursuit of the "next new tech thing".

Breakdown of Portfolio

Categories	Examples of Stocks	Holding
Cyclical Growth	Sony, Kyocera, Matsushita Electric	22%
High Growth	Mobile Telecoms - DDI, DoCoMo	18%
	Broadcasters – Tokyo and Nippon Broadcasting	
Market Sensitive	Daiwa Securities, Nikko Securities	9%
Deep Value Cyclicals	National House, Taikisha, Sekisui Chemical	9%
Steady Growth	Coca Cola Bottlers, Drug Wholesalers	7%
Korea	Korea Telecom, SK Telecom, Lottecon	24%
Cash		11%

The currency exposure of the fund is currently 60% yen, 25% Korean won, 0% USD and the balance in Australian dollars.

The Fund size is currently $68 million.