PLATINUM ASSET MANAGEMENT

Platinum Japan Fund

Quarterly Report

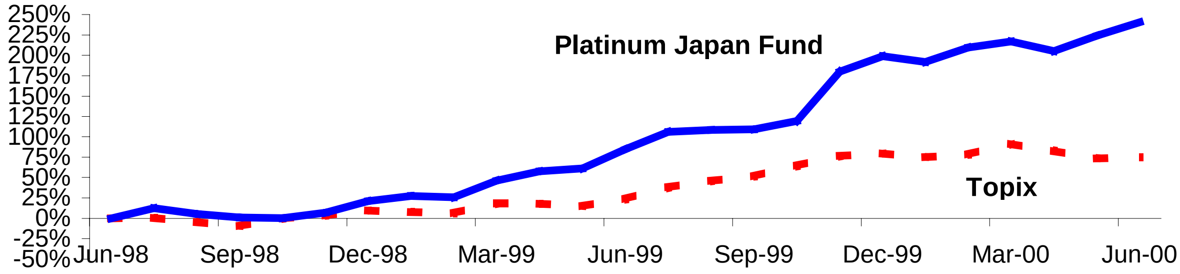
30 June 2000

Performance

The Japanese stock market suffered a correction in the Topix index during the quarter. Sharp declines in the new economy were the feature with communications down 26% and software/internet related stocks down 28% while good performances in semiconductor stocks held the electronics sector decline to 3%. Banks were also an area of weakness with 10% falls on further large scale corporate failures. The Fund, however, rose 7.4% versus a decline of 5.2% in the MSCI Japan index in A$ terms.

This was a good result and was attributable to taking a very defensive position through short futures contracts on the Nikkei index and short selling of individual stocks prior to the worst of the declines. Some of the stocks we shorted were Tokyo Electron, Nikon, Japan Telecom and Itochu Techno Science, which on average declined by 32% before they were covered. For the first half of calendar 2000, the Fund returned 14% versus the MSCI Japan Index of 3% both in A$ terms. Since inception two years ago, the Fund has returned 241% (or 84% pa compound) versus the MSCI Japan index of 70% (or 30% pa).

Cumulative Performance Since Inception - 241% (A$)
(1 July 1998 - 30 June 2000)



Commentary

Concerns about global growth and Asia's sensitivity to tech exports following the Fed's 50bp increase in May, triggered a wave of foreign selling. Compared to last year's strong accumulation, foreigners, mainly American investors, disgorged some US$22 billion of holdings in the three months to June. Typically, US investors had concentrated their portfolio on the globally competitive tech names and when the mood changed, they were reluctant to rotate into the domestic orientated companies. In this sense, the market acted much more like the Nasdaq Index than the S&P although it has been slower to recover than the Nasdaq mainly due to lingering uncertainties about whether Japan is really moving forward.

With so much uncertainty it is helpful to put some of the recent events into context.

1. With the correction, the Topix is still up 29% from June 1999 in US$ versus a S&P move of 6%. Hence Japan is merely retracing some of the large outperformance it has had and those foreigners who sold tended to be overweight the country. This is no cause for major concern.

2. The Japanese market has been very narrow during the past year with a handful of high flying stocks leading the market up and subsequently taking it down. These included NTT DoCoMo, NTT Data, Softbank, Seven Eleven and Hikari Tsushin. These stocks, at their peaks, traded on wild valuations with

even the cheaper ones on 100x prospective earnings. What we have witnessed is a discriminating decline in these excessively hot areas of the market. Regular readers will know that we exited largely these types of companies before the end of last year – seemingly giving up too early!

3. Corporate earnings for the market as a whole saw a 20% increase last year on sales that were slightly down. Margin spread was gained at the manufacturing level rather than the SG&A level. What this tells one is that companies have been quite good at restraining manufacturing and inventory costs but have been slow to restructure their bloated back offices which would give a more sustainable earnings improvement. Forecasts suggest that earnings will grow another 20% this year on the back of the recovering economy. The market would then be on 40x earnings. We think this is a justifiable valuation when low interest rates and recovering profitability prospects are taken into account.

4. The economy is clearly showing improved signs but scepticism still reigns. In the financial year to 31 March 2000, real GDP grew 0.5% with consumption spending rising by 1.2%. However in the latest quarter, real growth was 0.7%, even with weak government spending because consumption was up by 1.1% yoy and capex of +3.7% yoy. Bulls will argue there is an accelerating recovery based on real private sector growth rather than the chronic government spending of recent years. Corporate profits are rising and in the labour market there is stabilisation of employment and rising wages. Conversely the bears would point to export dependence on the US economy. In addition, the GDP deflator fell 1.7% yoy in the latest quarter which means in nominal terms the economy continues to shrink! There is clearly no money allusion here to help over-borrowed companies.

The pessimists are inclined to argue that the economy will invariably fall back into recession as it did on occasions in the 1990s. However, care should be taken when analysing the past to exclude the special factors such as the consumption tax, the falling-off of public investment and of course the Asian crisis. The most apparent risk now is a sharp slowing in the US economy. Casual inspection may give the impression that Japan has a relatively closed economy with exports accounting for a mere 14% of GDP. However the true exposure to external shocks was revealed by the Asian crisis when intricate modelling underestimated the impact. Even so, our view is that the Japanese economic recovery is building and is somewhat reminiscent of the very gradual recovery seen in the US after its banking crisis in the early nineties.

Turning to the corporate scene, there has been considerable activity within the NTT group of companies. Firstly, NTT announced the acquisition of Verio (US) for US$5.5 billion. Verio's basic business is that of an internet solutions provider whereby it provides generally small and medium sized companies with high capacity telecom lines, web page hosting, and solutions to e-commerce and virtual private networks. It is the largest web hosting company in the world with 400,000 customers in 127 countries. Clearly NTT, with its focus on the internet needs of customers, wants to access Verio's expertise as well as cross sell to their respective customer bases. Secondly, NTT DoCoMo, the group's cellular subsidiary, took a 15% stake in KPN mobile for US$4.8 billion. KPN mobile has operations in the Netherlands, Belgium and Germany amongst others and has 7.3 million subscribers. This complements their cellular plans which include 19% in Hutchison Telecom of Hong Kong and the intention to acquire stakes in SK Telecom of Korea and Voicestream of the US. As a global leader in development of the forthcoming Wideband CDMA or "3G" mobile services and already having the world's most successful cellular data service in "I-Mode", DoCoMo is trying to leverage its balance sheet and technology into a global position. We feel the acquisitions signal a change in thinking at NTT where they recognise the need to diversify and exploit their enormous domestic strength. We see this as a further move away from government tutelage of the company. Of course, the need to lift profits is paramount. The latest results were encouraging with the basic fixed line business achieving operating profit growth of 22%, despite slightly lower sales.

You may be interested in the fate of Hikari Tsushin, a retailer of mobile phones, which we wrote about in one of our previous quarterlies. Having peaked at 230,000 yen per share, it is now down to around 3,600 yen; a fall in total market capitalisation of over US$70 billion to US$1.2 billion. Having being lauded for its superior business model by locals and foreign investors alike, reality has hit home with the company having over-stretched itself in its chase for growth at a time when its main supplier and chief architect, DDI has decided to cut back on its sales incentives. The company is now faced with scaling back its investment in shops and is trying to liquidate a myriad of "dot com" investments to pay back its debt. The future of the company probably rests with DDI for whom it would make great sense to take control of its distribution channel as well as the embedded value in the subscriber base. At its peak, Hikari was held up as the prime example of the new entrepreneurial Japan and now it is pillared as a fraud. While it is a setback for the new Japan story and many stocks have fallen in sympathy, we believe that businesses with better models than Hikari and innovative management will continue to lead the way in Japan. Moreover it really does highlight the pitfalls of momentum investing when proper heed is not paid to the cashflows and the inherent franchise of a business. To highlight the delusions of crowds; at its peak one was paying US$15,000 for each customer of Hikari (4.5 million subscribers), a customer who would only bring in US$38 per year in revenue. That's a return on capitalilsation of 0.25% pa even if one assumes optimistically that its sales were all profit!

The quarter was punctuated by one of the great opportunities of all time to profit from index changes. The Nikkei 225 Index was reconstituted with the addition of 30 new names mainly in the Telecom and Technology area with the hope of making the Nikkei a more liquid and representative index. Whilst it has achieved these aims, it also created a one-off opportunity as investor's sensitive to the Nikkei Index had to buy those 30 names aggressively and sell those departing from the index while reducing their exposure to the other 150 names. As the new 30 stocks were to account for about 50% of the newly constituted index, and index sensitive funds had only one week to enact the change, there was bedlam! We took the opportunity to short sell a number of the new additions as their prices were pushed well beyond realistic levels. These included Matsushita Communication Industrial and Tokyo Electron. On the other hand we bought Noritake which was leaving the index after its price had suffered a 30% fall on account of eviction. This is however an interesting company with some exciting technologies in next generation wafer polishing materials and also a potential replacement material for plasma display screens.

Changes to the Portfolio

During the quarter we adopted a more defensive stance to both the Japanese and Korean markets. In Japan we removed our holdings in NTT DoCoMo and Kyocera and substantially reduced positions in the broking companies and Nippon Broadcasting. We added positions in more cyclical and domestic names such as Coca Cola West, Nippon Sanso, Noritake and shipping companies NYK and Mitsui. We increased positions in Kuraya Sanseido, Anritsu and Taikisha. In Korea we cut our position in the high flying new technology names and removed positions in Hyundai Group companies as fears rose about solvency. We added a number of short positions in stocks such as Taiyo Yuden, Toyota and Nippon Television. In terms of currency, we hedged out of our Korean Won and US$ exposure into yen (currently 51% hedged into Yen, 24% in AUD, 23% into Euro).

Distribution ~ 30 June 2000

This year's distribution of 88.59 cpu is abnormally large on account of our opportunistic rotation in a volatile market. Please note that the apparent fall in the unit price is entirely attributed to this 88 cent distribution.

Breakdown of Portfolio

Categories	Examples of Stocks	June 2000	March 2000
Cyclical Growth	Toshiba, Matsushita Electric, Citizen Watch	24%	20%
Deep Value Cyclicals	National House, Taikisha, Sekisui Chemical	16%	11%
Steady Growth	Coca Cola Bottlers, Drug Wholesalers	11%	7%
High Growth	Mobile Telecoms – DDI Broadcasters – Tokyo and Nippon Broadcasting	14%	17%
Market Sensitive	Daiwa, Nikko and Nomura Securities	4%	11%
Korea	SK Telecom, Lottecon, Medison	18%	21%
Cash		13%	13%

Invested Position

	Long Position	Net Position
Japan	69%	61%
Korea	18%	18%
Total Invested	87%	79%
Cash and Other	13%	21%
Total	**100%**	**100%**

The Fund size is currently $89 million.

10 July 2000