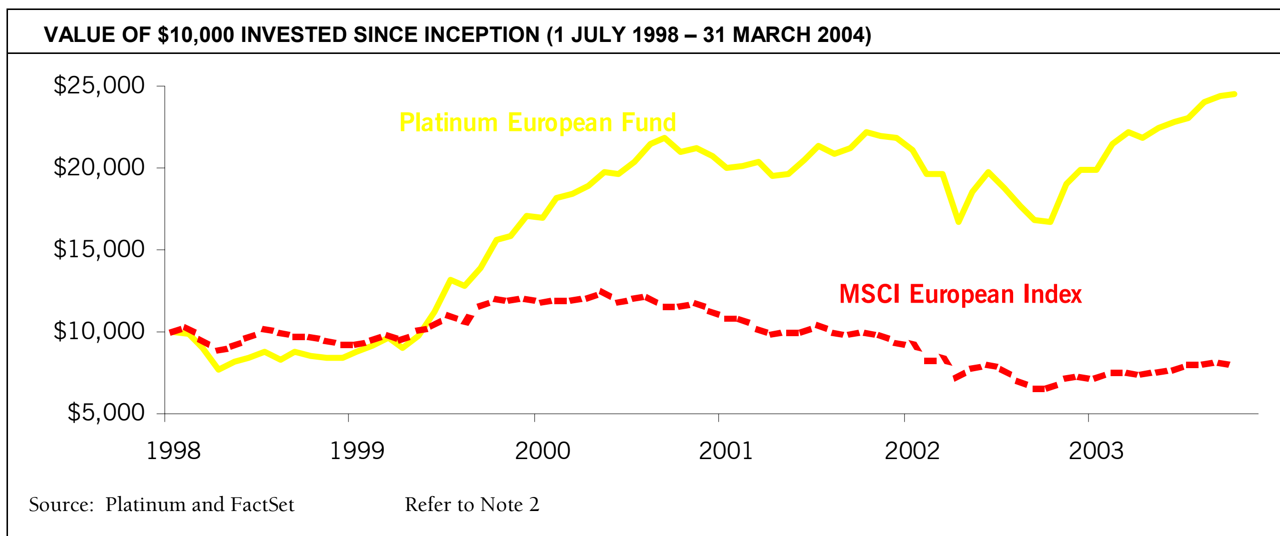
Platinum European Fund

Performance

REDEMPTION PRICE: $1.8313



Source: Platinum and FactSet Refer to Note 2

European markets little changed, reflecting tricky economic prospects

European stockmarkets were marginally higher over the three months to 31 March: a rally in January was largely reversed in March. Interestingly, while an index of the 50 largest companies (by market value) was flat in the period, a broader index of 500 stocks was up 3%. An optimistic explanation is that this reflects good "breadth" in the market (an encouraging technical indicator); consideration of the institutional perversion in markets, however, means it is more likely that fund managers are chasing smaller stocks simply because smaller stocks have performed well in recent quarters. The MSCI Europe index was +1% (euro) in the March quarter.

Telecom equipment as a group jumped up 30% (Ericsson +62%, Alcatel +26%, Nokia +21%), but the only other notably strong sectors were gas (+15%), real estate (+14%) and tobacco (+12%). The worst performing sector was the autos index which lost just 5% (most of which was Volkswagen –19%); many sectors were plus or minus 3% in what was one of the more sedate quarters in Europe for many years. This may reflect the mixed economic prospects around the world. The message that seems to be coming from the macroeconomic data is that the US is seeing some impact from its policy combination of emergency low interest rates and fiscal profligacy (though commentators have been puzzled by the atypically slow employment response). Europe, by contrast, continues with subdued economic prospects, as unemployment and limited corporate capital expenditure mean that once again rate cuts are anticipated from the ECB in coming months.

The euro, having trended stronger against the US$ for 2002 and 2003, moved a little higher (into the high 1.20s) in January before drifting back to finish the quarter at US$1.23. This has been an uninspiring US$ revival after two years of declines, and perhaps suggests that the "reserve currency" may be yet to find its nadir. We have noted on several occasions that the Australian dollar has traded in a narrow band of euro 54-62c since late 2000; this quarter the A$ moved to the higher end of that band, thus wiping out the gain by the MSCI Europe index when measured in A$.

The Platinum European Fund advanced 6% for the quarter as the strong performance from Ericsson complemented solid performances from some of our larger holdings such as Schindler (elevators/escalators, +22%), German Merck (chemicals, +16%), and Novozymes (industrial enzymes, +14%). We had some benefit from the modest hedge into the A$, good performances from some of the smaller companies in the Fund (which we have been selling into the general enthusiasm for small caps referred to above), and some profits from short positions – especially on the German DAX index during March.

For the twelve months to 31 March 2004, the Platinum European Fund advanced 46%, while the MSCI Europe Index, measured in A$, was up 22% in that time (February/March 2003 marked a recent low point in European markets).

Eastern Europe (and Asia) – good for Western European companies but probably not for Western Europe

The 1996 crop of annual reports from the Europe-based multinationals tended to feature, boldly in the opening pages, the business being done in Asia. Proud statements were made about 20%+ sales growth in (or to) the region, even if Asia accounted for just a few percent of a company's overall activities. In the subsequent years, as the "Asia crisis" ended the illusion of riskless Asian growth, the Europeans devoted themselves to their own backyard (and, in many cases unwisely, to investment opportunities in the US). Ever greater integration among EU countries, including the launch of the common currency in the late 1990s, meant that consolidation in Europe was a sensible and useful focus.

Today, however, the annual reports penned in early 2004 are starting to arrive, and they once again have an eastern mysticism to them. This time, however, there is more of a balance between the Europeans' "near east" (including the ten countries being welcomed to the European Union club in the coming weeks), and the "further east". And, there is more of a focus on shifting production rather than merely exporting to, or expanding sales efforts in, Asia and Eastern Europe.

A consideration of the position and actions of electro-engineering giant Siemens illustrates the differential prospects for Germany versus German companies. The company employs around 414,000 people worldwide, of whom 60% are outside Germany. Recent reports from Bavaria indicate that Siemens wishes to either cut (another) 10,000 jobs (of which 5,000 are in Germany), or increase the work week from 35 (!!) hours to 40, while abolishing Christmas and holiday bonuses. This (credible) threat reflects and illustrates a number of things: the company has plenty of orders, and yet sees itself as having spare (labour) capacity (relative to *potential*). Secondly, it suggests that the perplexing political stalemate in Berlin is not necessarily stopping the major companies from attempting their own labour market reform. And third, the small part of the week Germans actually use for working, highlights the probability that, with China and Poland (rather than Sweden or Northern Italy) as the relevant marginal competition, the undermining of the privileged position of European employees is only in its early stages. Siemens itself, however, sails on with steadily improving profitability, and its unwavering commitment to research and innovation continues to generate strong sales growth and thus the ongoing internal renewal of this giant.

The admission of the ten eastern European countries to the European Union (with the market access, integration and greater stability implied) in the coming weeks means that the shifting of production to Poland, Hungary etc will continue. It augurs poorly for the old east German parts of today's Germany however – Chancellor Helmut Kohl's "gift" of wage equalisation a decade ago has meant east German workers are lost in the middle ground – hopelessly expensive relative to their Polish cousins, far less productive than their (west) German colleagues. On the other hand, the "near east" has its own concerns: already we hear reports that for example some car parts being made in Czech and Hungary could be produced even more cheaply further east (whether "further east" refers to the countries of the former Soviet Union, or east to India/China is not yet clear).

Thus overall we can see little reason to anticipate a European domestic economic boom, but note at the same time that many Europe-based multinationals have reason for optimism.

BREAKDOWN OF FUND'S LONG INVESTMENTS BY INDUSTRY (% OF ASSETS)

Categories	Examples of Stocks	Mar 2004	Dec 2003
Miscellaneous Services	Deutsche Post, SGS Surveillance	15%	17%
Pharmaceutical/Biotechnology	Novozymes, Novartis	14%	11%
Chemicals/Materials	Linde, Merck KGaA	12%	11%
Tech/Media	Ericsson, Infineon Tech	11%	8%
Retail	Hornbach, Douglas	9%	12%
Consumer	Adidas, Henkel	9%	8%
Capital Goods	Océ, Schindler, Siemens	7%	11%
Financials	Credit Agricole, Nordea	5%	7%

Source: Platinum

Several changes to the portfolio; tricky prospects reflected in cautious positioning

Early April data shows a good improvement in US employment, and UK house prices up 19% for the year to March (the Bank of England has been raising rates). The euro has been drifting off – a little against the US$, somewhat more versus the yen. The central bank of Sweden cut rates on 1 April, and the ECB may well do the same at its next meeting. In theory, we have the ingredients for a "decoupling" of (continental) European stock (and bond) markets from the Anglo markets. In practice, the nearly one for one correlation between European markets and Wall Street continues. At the same time, we find plenty of reasonably priced stocks in Europe (more large companies than small), but are alarmed by the valuations of most US stocks. The implied dilemma – ie. given Wall Street's influence - for a European portfolio is the reason for the 5-15% short position in the German DAX index held by the Platinum European Fund for much of 2004. At the end of March the Fund was 18% in cash, and 17% short for a net exposure of 65% - should we stay cautiously positioned? Is 65% still too high?

Today there exists the unusual circumstance of many of the major markets around the world – share, bond, property, commodity – simultaneously being either high or in "bubble" territory versus their history. This coincident strength is unusual given the inflation and interest rate implications of strong commodity prices and property bubbles (and consequent impact on bonds and stocks). Perhaps in theoretical perfect circumstances, the current market situation could be reconciled, but the optimism is hard to fathom amidst the economic chaos of globalisation, the declining credibility of the world's reserve currency, and the asset price funded consumption which constitutes economic "growth" in the US, Australia etc. Not to mention wars, bombs, yawning US trade and government deficits etc. Perhaps we have simply had a period of unusually low interest rates, which may be about to reverse.

There has been plenty of equity issuance in Europe – in particular governments are using the rebound in markets to sell big stakes in their telecom utilities. Heavily indebted companies continue to take advantage of conditions to raise equity and refinance debt at very modest spreads. We watch with interest the battle for control of French/German drug company Aventis (which is effectively the merged drug businesses of the old chemical firms Hoechst and Rhone-Poulenc). Smaller (but super-profitable and hence more valuable) French drug company Sanofi – perhaps concerned for its own independence after one of the US drug giants reportedly approached oil company Total about buying its 20% Sanofi stake – bid for Aventis in February. In March Novartis made it clear that in the right circumstances (ie. not too much French political opposition to the Swiss company managing Aventis) it may be happy to "rescue" the outraged Aventis from Sanofi. The saga continues, and as Novartis shareholders we can see the benefit of buying some of the interesting positions Aventis has built-up, so long, of course, as we do not have to pay too much.

The stocks we have added to the portfolio in recent months are in fact a mix of the two ends of the market spectrum in Europe: some "cyclicals" (steel and paper companies in particular), and a few "defensives" (including pharmaceuticals and a food retailer). We sold out of the German group TUI – we were principally attracted to their world-leading container shipping business, and when the market celebrated the company's plans to list (ie. part-sell) Hapag-Lloyd by pushing the TUI share nearly 30% above our December purchase price, we decided it was time to leave. Hellenic Telecom, the ex-monopolist in Greece, has had a good run along with other telecoms, and we sold our holding in favour of some of the opportunities mentioned above. More generally we have trimmed several of the positions in smaller companies in the last few months, as our concern over domestic economic conditions is increasingly at odds with the continuing strong performance of many small caps. With Shell and Yukos (the Russian company at the centre of a political storm late last year), we have nearly 4% in oil companies.

Finally, we reduced the hedge into A$ from 30% to 23%, so at the end of March we had 50% in the euro, and 25% in the Swiss franc, Danish krone, Swedish krona, and pound sterling.

Toby Harrop
Portfolio Manager

Notes

1. The returns represent the combined income and capital return for the specified period. They have been calculated using withdrawal prices, after taking into account management fees (excluding any performance fees), pre-tax, and assuming reinvestment of distributions. The returns shown represent past returns of the Fund only. Past performance is not a reliable indicator of future performance. Due to the volatility of underlying assets of the Funds and other risk factors associated with investing, returns can be negative (particularly in the short-term).

2. The investment returns depicted in the graphs are cumulative on A$10,000 invested in the Funds since inception and relative to their Index (in A$) as per below:

   Platinum European Fund:
   Inception 1 July 1998, MSCI Europe Accumulation Net Return Index in A$

   The investment return in the Funds is calculated using withdrawal prices, after taking into account management fees (excluding performance fees), pre-tax and assuming reinvestment of distributions. It should be noted that Platinum does not invest by reference to the weightings of the Index. Underlying assets are chosen through Platinum's individual stock selection process and as a result holdings will vary considerably to the make-up of the Index. The Index is provided as a reference only.

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Before making any investment decision you need to consider (with your securities adviser) your particular investment needs, objectives and financial circumstances. You should consider the PDS or IS (whichever is applicable) in deciding whether to acquire, or continue to hold, units in the Funds.

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