Platinum European Fund

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Disposition of Assets

REGION	MAR 2011	DEC 2010
Australia	1%	1%
Belgium	3%	3%
Finland	2%	3%
France	22%	25%
Germany	45%	42%
Italy	4%	2%
Netherlands	2%	1%
Sweden	2%	2%
Switzerland	1%	1%
UK	10%	11%
US	3%	2%
Cash	5%	7%
Shorts	0%	4%

Source: Platinum

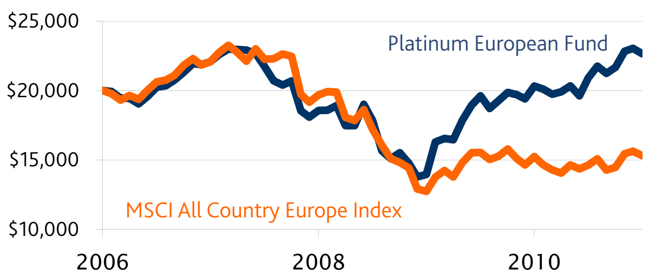
Performance

The prevailing trend of outperformance by stocks linked to the Asian growth theme was reversed in the first quarter. Continued worries about inflation at home and in the East, the oil price and turmoil in the Middle East, and Japan, provided the flashpoints for investors to take a more defensive position.

The standout performers for the quarter were those on the opposite side of the worries, namely, the interest rate sensitive stocks and beneficiaries of a higher oil price. Insurance was the best performing sector in Europe (Legal & General +20%, AXA +20%, Allianz +13%) as hawkish statements from both the European Central Bank and Bank of England triggered a sharp rise in short-term interest rates (the yield on two year German government bonds more than doubled from 0.8% in January to 1.8% by the end of March). Unsurprisingly the oil and oil services stocks were strong amongst worries around supply disruptions from the Middle East (seismic player CGG Veritas +12%, Statoil +10%) whilst the renewable energy sector was seen as the winner from the political rethink of the role of nuclear generation going forward (SMA solar +29%, polysilicon producer Wacker Chemie +21%, Renewable Energy Corp +10%).

Value of $20,000 Invested Over Five Years

31 March 2006 to 31 March 2011



Source: Platinum and MSCI. Refer to Note 2, page 5.

The Euro strengthened against all its major currency pairs; +9% versus the Yen, +6% versus the US dollar and +4% versus the Australian dollar. The currency position of the Fund is relatively unchanged at 54% Euro, 13% Australian dollar, 11% British pound, 11% US dollar and 8% Norwegian krone.

In Australian dollar terms, over the last three months the Fund returned 4.5% slightly trailing the MSCI Europe index which returned 5.8% over the same period.

Commentary

As we write, the newly announced counter bid by Nasdaq (IT Index) and IntercontinentalExchange (ICE) for the New York Stock Exchange (NYSE) Euronext (disturbing the latter's proposed merger with Germany's Deutsche Börse) means we now have no less than ten securities exchanges currently involved in merger and acquisition proceedings. The sector of course is no stranger to consolidation, the latest wave a continuation of trends seen through 2006-2007 which saw Euronext fall to the NYSE, Nasdaq purchase Scandinavia's OMX and the Chicago Mercantile Exchange buy both the CBOT (Chicago Board of Trade) and NYMEX (New York Mercantile Exchange).

The primary trends behind this thirst for consolidation are:

1. The significant market share gains by new entrant high speed/low cost electronic equity trading platforms since deregulation of cash equity trading in the early 2000s.
2. The relative attractiveness of higher growth/higher profit derivative trading businesses.
3. Post the Global Financial Crisis, the desire of regulators to bring over-the-counter (OTC) derivatives 'on exchange' and for these instruments to be centrally cleared.

In a European context, the implementation of MiFID (Markets in Financial Instruments Directive) in 2007 opened the door to new entrants to offer alternative platforms for the trading of cash equities. New technology-focused competitors like Chi-X gained meaningful market share, offering a service that was '10x faster and 10x cheaper', triggering both a wave of heavy catch up IT spending by the majors and a price war – trade fees now sit 60% below their 2006 level. Interestingly, despite being the most successful in attracting trade volume (Chi-X holds 21% and 30% of the DAX (German Index) and FTSE (UK Index) trading volume respectively versus 70% and 55% for Xetra (Frankfurt Exchange) and the LSE (London Stock Exchange)), the market share gains are now levelling out and Chi-X is still barely profitable. This alludes that the exchanges have seen out the worst in their cash equities businesses, but given ongoing competition and low growth in equity trade volumes, future actions will be more about acquiring further scale and cutting costs. The exchanges have to focus elsewhere for growth. That focus is derivatives.

Unlike one's ability to buy and sell a listed stock on several exchanges, say transacting in Tesco on the LSE or Chi-X, a futures contract on the DAX can only be opened, cleared and closed through the Eurex platform owned by Deutsche Börse. This is due to **derivative securities operating in 'vertical silos'**, namely the promoter of the derivative contract has control of where that contract is **traded and cleared**. This system provides the established players two major competitive advantages – a pool of liquidity and to a lesser extent the benefits of cross margining at the clearing level[1] making it very difficult to establish competing products. Unless regulators force the break-up of the vertical silo system[2], the prospect of little competition and strong profitability in derivatives looks set to continue.

[1] 1. Liquidity - once a contract has attracted a deep pool of buyers and sellers it is extremely difficult to convince market participants to use your initially highly illiquid 'copycat' contract no matter how attractive your fee schedule. 2. Margin netting at the clearing level – when you open a derivative contract you must also post a sum of cash (or other collateral) that acts as a first buffer to loss should your position move against you. This is a risk control procedure called margining. Broker dealers when dealing with one clearing house need only to post margin for the net, rather than gross risk position of their account i.e. equal but opposite positions held by clients (one opening a long DAX index future, the other selling short the same DAX future) offset each other and do not need to carry margin. If users start splitting their trade volume across two competing contracts (and clearing houses) they will forego this netting benefit, and essentially have to post two sets of margin increasing the capital required to do business.

[2] The discussion of how this may happen through 'interoperability' and the linkages of clearing houses is another essay in itself. Essentially we have explored this in detail and given the difficulty of implementation, the risks involved and the practical time horizon even if it were implemented, we are willing to look through this for the moment.

Adding to the appeal of derivatives is the growth prospect from the regulatory push to put OTC derivatives on exchange. The opportunity for the exchanges is not in the electronic trading fees of the OTC derivatives (this is expected to be captured by the broker dealers) but in the provision of clearing services through their clearing houses. Those that can offer scale (from a margin netting perspective) and common products (i.e. those already clearing on-exchange interest rate products have an advantage clearing OTC interest rate products) will have the advantage in attracting OTC clearing volumes and this is being evidenced by the moves of the exchanges as they jostle for position. (NYSE's LIFFE derivative business which controls the short-term European interest rate futures is seen as a beachhead in going for the OTC interest rate products – and hence the battle between Deutsche Börse and the ICE to win its hand in marriage).

Given the activity, how can we make money from all of this? For us, the standalone business of Deutsche Börse holds many attractions; 47% of profit is linked to our Eurex derivatives business which aside from operating Europe's largest clearing house, controls the on-exchange futures and options for two product groups – European equity indexes (Eurostoxx, DAX and Swiss Index) and German interest rates (the 2 year, 5 year and 10 year bonds). Pre-crisis growth at Eurex has been running at >20% pa for much of the last decade, and while growth will inevitably slow from those levels, on a longer term view there is no reason why we should not see a return to +10% growth rates. This will be assisted by winning clearing business and the boost to volumes as high frequency traders become more active in the futures markets. Another 34% of profit originates from Clearstream, which is involved in **asset custody and account administration** after a trade is settled. The bulk of Clearstream's profits come from its International Central Securities Depository (ICSD) which facilitates cross border financial transactions and operates in a global duopoly with Euroclear. The bulk of Clearstream's revenue is linked to a percentage of assets under custody (mostly Eurobonds) and the interest earned on its float – giving it a positive link to higher inflation and a big profit kicker on higher short-term interest rates.

The proposed merger with NYSE Euronext provides a twist to the investment case; if consummated Deutsche Börse will dominate the European derivatives market giving it both ends of the interest rate curve, leading scale in clearing and putting it in excellent standing to win OTC clearing business. If NYSE's derivative business (LIFFE) falls to the ICE we will be left with a good but reasonably equally matched competitor. It is not evident that our position will be marginalised should our deal fail. Ultimately, in the near-term, as shareholders we run the risk of being caught in a bidding war but with the recent share price fall, this is starting to be discounted in the price given a starting valuation of 11x earnings. The quality of the underlying business and the longer term prospect of growth make Deutsche Börse a worthwhile investment.

Portfolio Changes

Changes for the quarter included taking a 3% position in the previously discussed Deutsche Börse and replacing our position in French building materials player **St-Gobain** (after a good run) with Italian cement producer **Buzzi Unicem**. The markets focus on Buzzi's cement exposure in the US and Italy had seen the stock get very cheap (0.6x book, enterprise value per tonne - €70 versus new build cost of €90 and €300 p/t in Russia and the US respectively) despite the remainder of their capacity being in quite attractive markets (Germany, Russia and Poland). Given that cement consumption in the US is back at levels seen in 1985 and Italian cement prices had fallen below cash costs of production, it was hard to see how things could get much worse and the subsequent improvement in expectations around US cement demand has seen the stock rally 20% versus our entry price two months ago.

Elsewhere we took a position in Dutch nutrition and specialty chemical producer **DSM** and added to our holdings in **Infineon**, **PPR**, **Pernod** and **Daimler** during the Japanese earthquake induced sell-off. To fund these purchases we exited some of our smaller holdings that have done very well for the Fund, namely **BP**, engineering laser manufacturer **Rofin-Sinar**, satellite operator **SES** and textile machinery player **Rieter**.

Outlook

There have been a lot of excuses for European markets to sell-off over the last three months, but aside from a sharp drop and rebound in sympathy with Japan, the trend has been fairly robust. Trends across countries remain mixed. The strength of Germany rolls on while the hands of the policy makers of those in weaker positions are starting to be pushed; the UK faces rate hikes to counter persistently high inflation whilst dealing with higher taxes and public sector job cuts to ease the budget deficit.

The next step for markets is difficult to read. Europe and the US have undoubtedly benefited from the recent shift of sentiment away from the emerging markets, however, giving us confidence is that there is no real sense that markets are frothy with optimism. There are still many examples where the companies are more positive on the prospects for their businesses than investors and we are still finding new opportunities to invest.

Notes

1. The investment returns are calculated using the Fund's unit price and represent the combined income and capital return for the specific period. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), are pre-tax, and assume the reinvestment of distributions. The investment returns shown are historical and no warranty can be given for future performance. You should be aware that historical 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, investment returns can be negative (particularly in the short-term).

   The inception dates for each Fund are as follows:
   Platinum International Fund: 30 April 1995
   Platinum Unhedged Fund: 31 January 2005
   Platinum Asia Fund: 4 March 2003
   Platinum European Fund: 30 June 1998
   Platinum Japan Fund: 30 June 1998
   Platinum International Brands Fund: 18 May 2000
   Platinum International Health Care Fund: 10 November 2003
   Platinum International Technology Fund: 18 May 2000

2. The investment returns depicted in this graph are cumulative on A$20,000 invested in the relevant Fund over five years from 31 March 2006 to 31 March 2011 relative to their Index (in A$) as per below:
   Platinum International Fund - MSCI All Country World Net Index
   Platinum Unhedged Fund - MSCI All Country World Net Index
   Platinum Asia Fund - MSCI All Country Asia ex Japan Net Index
   Platinum European Fund - MSCI All Country Europe Net Index
   Platinum Japan Fund - MSCI Japan Net Index
   Platinum International Brands Fund - MSCI All Country World Net Index
   Platinum International Health Care Fund - MSCI All Country World Health Care Net Index
   Platinum International Technology Fund - MSCI All Country World Information Technology Net Index
   (nb. the gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist).

   The investment returns are calculated using the Fund's unit price. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), pre-tax and assume the 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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