PLATINUM EUROPEAN FUND

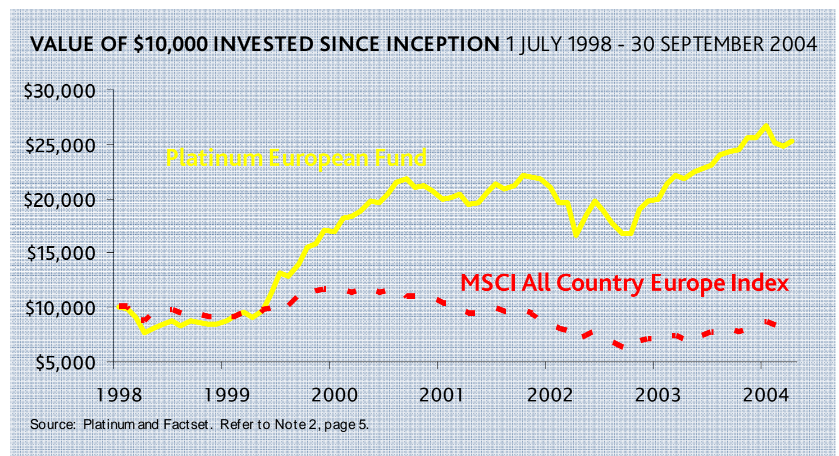
Toby Harrop Portfolio Manager

PERFORMANCE

European stock markets traded in a narrow range this quarter and finished, in aggregate, pretty well unchanged. Notably strong sectors were metal and mining +15% (the London listings of Anglo American, Rio Tinto, and BHP account for this), steel +11% and gas +9%. Higher commodity prices explain such moves. More interesting were the losing sectors: computer services fell 19% - in general the Indian IT industry continues its merciless assault on pricing; more specifically the share price of the big French player Cap Gemini fell 43% for the three months. Other losers were consumer products -15%, and food -14%. These sorts of declines in the "defensive" part of the market normally occur when excitement over economic growth prompts investors to switch from such "predictables" to technology and cyclical stocks – but this was not the pattern in recent months. Something more fundamental is undermining the valuations of the consumer products businesses.

Individual stock highlights included the UK-based cement business RMC which rose 40% after global giant Cemex agreed to acquire the company; also strong was nuclear energy plant builder Areva, as oil, gas and coal prices force renewed interest in nuclear power. Apart from Cap Gemini, notably weak performances came from catering group Compass PLC (-34%), and Alcatel (-26%) and Infineon (-25%), in a generally weak showing from "technology" company share prices.

The Australian dollar appreciated a little against most European currencies (eg. by 2% versus euro, by 4% versus Swiss franc and by 4.5% versus pound Sterling), so that the MSCI Europe index fell 2.5% measured in A$.



The Platinum European Fund lost 5.2% for the three months ended 30 September 2004, a poor showing. Strong performances from Adidas (+14%) and Danish food enzyme business Chr. Hansen (+18%) were offset by our holdings in Alcatel and Infineon, as well as the dramatic declines of Medion (which halved) and Epcos (-29%). These four "tech" holdings collectively cost the Fund over 3% in the three months, and in hindsight our error was to pay too much for these businesses (even if "too much" was generally one tenth to one fifth of their valuations during the technology bubble). Elsewhere, our short positions had mixed results with Tesco and Intertek drifting up on more good results and AstraZeneca coming down with a thump after the rejection of its new drug by the US regulator. The partial currency hedge back into A$ was a small benefit over the quarter.

Over the last twelve months, the Fund is up 15.6%, shy of the 17.4% gain of the MSCI Europe index, measured in A$. The performance of the Fund partly reflects its lower net invested position (which has generally been in the 70-80% range over the past year – the MSCI is of course 100% "invested"). Mathematically this accounts for "more than all" the difference in returns; however being less-than-fully invested is a stance the Fund has had through much of the last six years (and of course it is a deliberate tactic in preparation for attractive investment opportunities), so other factors are responsible for the recent dull performance. The key factor has been a coincidence in performance of large parts of the portfolio over the 12 months to March/April 2004 – big holdings such as Merck of Germany, Novozymes of Denmark and SGS of Switzerland saw their share prices move up to or above fair value. We trimmed these holdings, but were reluctant to sell them out completely as the underlying businesses are growing well, and after a pause for breath we expect these to be worthwhile investments over the next 3-5 years. However this has resulted in strong portfolio performance up to March/April, and a dull time in the subsequent six months.

During the quarter, positions in Scandinavian trucking company DSV, Swiss textile machinery leader Rieter, and Heidelberg Cement of Germany were sold out after their share prices reached fair valuations. Influencing these decisions also was our concern that small/mid sized company share prices have had a strong run over the last couple of years, and in many cases trade at a "growth premium" to the market (after several years of enduring a "small stock discount"). We added to the positions in Alcatel, Infineon, Epcos and Medion at the attractive prices prevailing in August.

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

Categories	Examples of Stock	SEP 2004
PHARMACEUTICAL/BIOTECHNOLOGY	NOVOZYMES, NOVARTIS	**13%**
MISCELLANEOUS SERVICES	DEUTSCHE POST, SGS SURVEILLANCE	**12%**
CHEMICALS/MATERIALS	LINDE, MERCK KGaA	**12%**
CAPITAL GOODS	OCÉ, SCHINDLER, SIEMENS	**11%**
FINANCIALS	CREDIT AGRICOLE, NORDEA	**8%**
TECH/MEDIA	INFINEON TECH	**7%**
CONSUMER	ADIDAS, HENKEL	**7%**
RETAIL	HORNBACH, DOUGLAS	**6%**

Source: Platinum

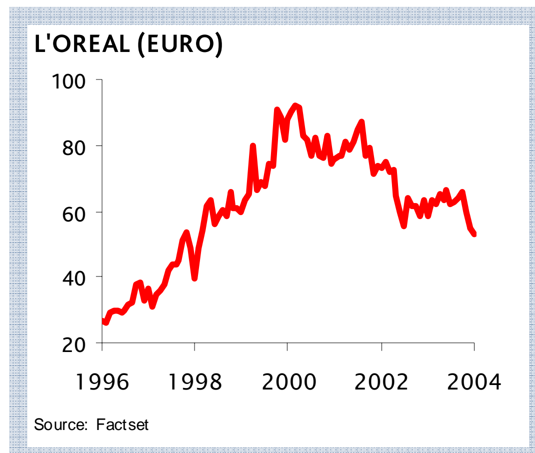
COMMENTARY

German labour markets; consumer good companies

We have referred in recent quarterlies to the labour market reform in Germany, and specifically to our view that necessity would over-ride the ineptitude of the government, so that the private sector would achieve what legislation cannot. Landmark deals between both Siemens and Mercedes-Benz and (some of) their respective employees (more hours and more flexible hours for unchanged pay in preference to mass sackings) are encouraging in this respect. As the time of writing, we await the outcome of crucial talks between Volkswagen and IG Metall – the former wishing to reduce its German wage bill 30% by 2011, the latter insisting on another 4% wage rise this year and next, and job guarantees for 100,000 union members working for VW Germany. Admittedly, the first couple of rounds of this negotiation look and sound more like the mindless 1970s style of industrial relations – and light years from market leader Toyota's relationship with its staff. It is a source of concern also that following the few weeks' rest between rounds one and two of wage bargaining, the company and union's only agreement to this point is to another holiday before resuming the tussle!

A crude but roughly accurate characterisation of continental European versus UK/US/Australian economic growth at the moment is that the former is disproportionately dependent on net exports, and the latter on debt-funded consumption (and asset bubbles). It is thus unsurprising that the household goods and retail sectors are having a more favourable time in the Anglo economies than they are on the continent. However along with this cyclical effect is a more worrying structural change that is starting to make the "predictables" in Europe anything but. As mentioned earlier, share prices of erstwhile stalwarts Nestlé, L'Oréal, Unilever etc have had a difficult time, as a combination of "own label" discounters grow more powerful in the retail scene, consolidating supermarket/hypermarket chains demand better purchasing conditions, and the colossal Americans (Procter & Gamble etc) make targeted price attacks in specific product areas in the core European markets.

A disconcerting aspect is that the economics and profitability of these businesses – not to mention the excessive valuations they reached a few years ago – means that pricing could be under pressure for some time. Consider L'Oréal – one of the great French – indeed global – companies, founded about 100 years ago by a scientist who had come up with a safe ("*Inoffensives*") hair dye. With research and product innovation always at its core, the company grew steadily, acquiring new brands to enter markets as necessary, so that today the group markets some 2,000 products under 500 brands through various retail channels. Its 50,000 staff (3,000 or so work in research) achieved sales in 2003 of over Eu14 billion, and after tax profits in excess of 10% of that revenue. Note however that the market capitalisation of the company on the drunken stock markets of 2000 was over *Eu60 billion* – so that the subsequent fall from grace only brings the share back to reality, not to a bargain level.



Source: Factset

While L'Oréal will defend its pricing with marketing and innovation before succumbing to price pressure, the more mundane food and household product businesses are feeling pressure from competitors and customers – and more recently rising raw material prices have added to their woes. The premium ratings attached to such companies through the 1990s seem less and less appropriate.

OUTLOOK

Reasonable valuations versus slow growth and high oil prices

European companies, through a tight focus on costs, have improved profitability levels, in aggregate, to a level not seen in many years (Morgan Stanley estimate operating profits at 7% of sales, and the return on equity at 13%). This somewhat surprising achievement, in the light of the much-discussed domestic economic stagnation, is best explained by the general industrial consolidation of the last decade, and the healthy business in the emerging markets of Europe's near and far east. Thus despite the recovery in stock markets from the somewhat desperate levels of late 2002 and early 2003, the increase in actual profits (and of course the accompanying enthusiasm of stockbrokers in predicting *future* profits) means that aggregate valuations look reasonable. Both including and excluding the UK, the market appears to trade at around 15 times 2004 likely earnings.

Where we are finding reliable growth stories at these valuations we have some promising investment candidates; as discussed above, however, pricing is still patchy and domestic volume growth sluggish. And, wrongly for the moment, we cannot help but worry about the impact of oil at over US$50/bbl. While it is difficult to see how higher CPI inflation is very likely (given competition to produce consumer goods), a cycle of input inflation – higher energy prices, higher iron ore prices, steel prices, truck prices etc – is probable, and we wonder how long global interest rates can stay unflinchingly low.

As at 30 September, 2004, the Platinum European Fund was 76% long, and 8% short for a net exposure of 68% to European equities. The currency exposure was hedged 37% back into the A$, and we had no exposure to the pound Sterling (which seems to be weakening steadily).

Toby Harrop
Portfolio Manager

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 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, investment returns can be negative (particularly in the short-term).

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

   Platinum International Fund:
   Inception 1 May 1995, MSCI All Country World Net Index

   Platinum Asia Fund:
   Inception 3 March 2003, MSCI All Country Asia ex Japan Net Index

   Platinum European Fund:
   Inception 1 July 1998, MSCI All Country Europe Net Index

   Platinum Japan Fund:
   Inception 1 July 1998, MSCI Japan Net Index

   Platinum International Brands Fund:
   Inception 18 May 2000, MSCI All Country World Net Index

   Platinum International Health Care Fund:
   Inception 10 November 2003, MSCI All Country World Health Care Net Index

   Platinum International Technology Fund:
   Inception 18 May 2000, MSCI All Country World Information Technology 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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Before making any investment decision you need to consider (with your financial adviser) your particular investment needs, objectives and financial circumstances. You should consider the PDS in deciding whether to acquire, or continue to hold, units in the Funds.

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