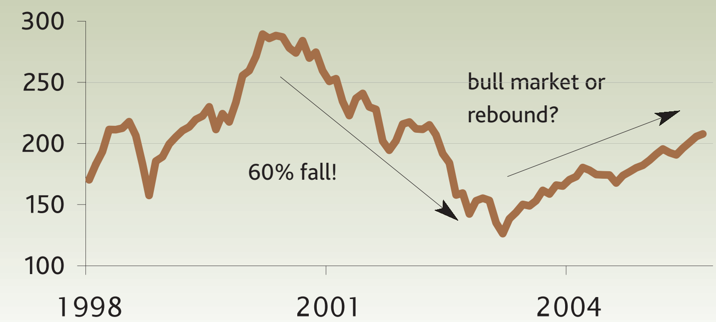
# PLATINUM EUROPEAN FUND

Toby Harrop
Portfolio Manager

## PERFORMANCE

Political gridlock and domestic economic gloom in Europe have contrasted with euphoria in the cyclical parts of the stock market. Even setting aside the arguably unrepresentative "European" mining index (+30% for the three months), results in steel (+19%), autos (+18%), machinery (+16%), and energy (+14%) together with 10% plus returns in chemicals and construction/engineering have resoundingly carried the bull market (or rebound?) into its third year. Only the retail (-2%) and media (flat) sectors belie the overall excitement: these laggards reflect the reality of the consumer: cautious (in France), bruised (in the UK), bewildered (in Italy), and alarmed (in Germany).

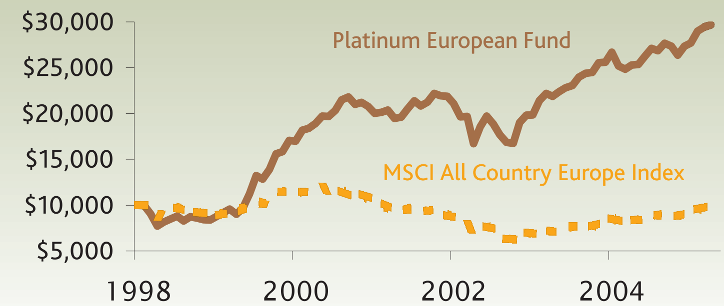
**Europe's Leading 500 Stocks Over 8 Years**




Source: Bloomberg

Spain and Germany were notably strong markets (though even these were left in the shade by the "emerging markets" of Poland, Turkey, Romania and especially Russia); across the board investors in shares had a relaxing time with four-fifths of the largest 500 European stocks gaining for the quarter.

**VALUE OF $10,000 INVESTED SINCE INCEPTION**
1 JULY 1998 TO 30 SEPTEMBER 2005




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

European stocks overall returned 9% this quarter; the marginally higher A$ against European currencies resulted in the MSCI A$ return for the period being 8%. For the latest 12 months European markets have risen a handsome 19% (MSCI, in A$).

The Platinum European Fund was a little behind the index at +7% for the quarter. The Fund was well served by its cyclical stocks, while a net invested position of 70-75% through the quarter was clearly too cautious in the circumstances. Over the 12 months to September 2005, the Fund is up 17%.

## COMMENTARY

### Germany

The "astonishing" German federal election outcome - that Angela Merkel's (centre right) CDU could blow such a lead in the polls (over the incumbent centre-left government of Chancellor Schröder) in just two months, to deliver political gridlock - was in fact surprising only in that the German voters managed to deliver such a stalemate. It is interesting that a population of 85 million can "chaotically" organise a virtual dead heat! The two things which struck us during the campaign, aside from the CDU bungling the explanations of their proposed reforms, were (a) Schröder's charisma was always going to undermine the CDU's lead as Merkel's inexperience was revealed; and (b) the appalling behaviour seen during and after Hurricane Katrina in New Orleans (the US being the archetypal market-oriented economy which the CDU could be easily caricatured as advocating), if properly handled by Schröder, would remind Germans that the system they were being asked to erode has some merit. For Schröder the outcome is a political triumph: there are more people unemployed in Germany today than in the turmoil of the early 1930s, and yet a government with no achievements to its name, far from being cast into political irrelevance, is in the midst of forming a "grand coalition". While many commentators have despaired at this apparent stalemate, it is interesting that voter turnout was 77% (the UK election in May managed only 61%), and that the far-right nationalist party (NPD) failed to clear the 5%-of-the-vote hurdle (and thus gets no seats at all) - and this at a time when the labour market situation, not to mention EU accession talks with Turkey, gave the NPD plenty to wail about. The point is that simple slogans - of nationalism or of market solutions to complex issues - have been rejected by the electorate. The politicians, to have any effect at all, will have to balance the competing claims.

For Germany proper, an emasculated government means that economic reform will continue to come from the actions of others - companies, unions, employer federations etc. The stock market confirmed this appraisal with one down day following the election weekend, before making new highs two weeks later. Having said that, we were surprised - and thus unfavourably positioned with 10% short the DAX index to "protect" our much larger German stock positions - that the election result was not at least an excuse for a few months' pause in the price rises, as the foreigners (the locals are minority owners and not really buying) were forced to accept the apparently disappointing outcome.

### German auto sector - reform (and other developments) in motion

The German car companies - principally VW, DaimlerChrysler (Mercedes), BMW but also Porsche - have made a lot of headlines as they force improvements in labour "productivity": slowly increasing the hours up towards 40 per week, changing overtime calculations etc, generally by threatening to move production out of Germany. The impact on their own profitability is one thing, the example set to suppliers and the wider engineering industry is where the auto industry alters the entire economy more effectively than the politicians in Berlin.

In fact this high profile industry has been especially newsworthy of late. In June, Volkswagen had lurid tales of some of its executives' extra-curricular travel activities leaked to the press by certain parties intending to undermine the apparent pact between the union and some key supervisory board member(s). The outlandish wages of VW employees in Germany (even compared to other domestic car companies) had to be addressed somehow, and the new head of the VW brand (one Mr Bernhard, who had considerable "success" in eliminating 26,000 jobs at Chrysler in the US) seems to be making progress now.

At the end of July, a change in leadership at DaimlerChrysler (finally) occurred. After ten years which have included the poorly-timed purchase of Chrysler, as well as anaemic profitability at Mercedes Benz, Jurgen Schrempp is retiring. His replacement is the German national credited with fixing (saving) Chrysler. To add insult to poor Schrempp's injury, the DaimlerChrylser share price rallied strongly in response to the news. The Fund took a trade out of the stock on this story, but has no position at the time of writing.

Most interesting of all, though, has been last week's announcement by Porsche that it will buy 20% of Volkswagen to strengthen the technical links (eg. Porsche's Cayenne is the same car as the VW Touareg, give or take some leather seats and a hotted-up engine) and developmental partnership (eg. hybrid engines) between the two companies. This apparently requires a Eu3-4 billion (over A$6 billion!) *cash investment* rather than mere contracts, due to the perceived risk of "foreign predators" breaking-up Volkswagen without regard for its various arrangements with Porsche. Naturally, given that the VW supervisory board chairman happens to be the patriarch of one of the two families controlling Porsche, there was some scepticism in the market as to whether the industrial logic provided was the full story: in London the auto analysts muttered disapprovingly of the "Deutschland AG way" - political intervention was suspected too, as the VW share price had been moving higher on speculation of "hedge funds" buying stock in order to break-up the company and fire the army of German workers. Either way, our Porsche short looks better for this development: the company is either not free to make its own decisions (and thus the listed non-voting preference shares - the ordinary shares are unlisted - seem unreasonably expensive), or the given reason is real (in which case this marketing-led luxury goods producer is perhaps a **car company** after all, with the consequent heavy investment requirement - and modest returns).

In fact the idea of a “financial investor” buying VW to break it up by selling Audi etc is preposterous. Aside from the political firestorm that would ensue, the commonality of platforms, and certainly of components and systems between the (smaller) Audis and the VW cars is so great that Audi could not exist independently of VW. The compelling restructuring case at VW is to **reduce manufacturing complexity**. For example, 240 engine models are used in the company - it is estimated that 40 different engines would suffice. This is a job for hands-on managers, not financial speculators!

What is not yet explicable, but nicely completed the week's events, was DaimlerChrysler's announcement at the end of September that they wanted part of the action, and planned to buy a stake in VW too! In fact what they have in mind is more scale, but the difficulties at GM suggest that scale and model variety are not necessarily the answers.

One other point worth noting is the cost to the companies of reducing their workforces: Daimler announced 8,500 positions would disappear in Germany at a cost of nearly Eu1 billion (say A$200,000 per head) and that is by "voluntary redundancy" not firing.

## Imperfect capital allocation by big business

There were several changes to the portfolio this quarter, at least two partly prompted by investment decisions made in Germany. We do not share adidas's enthusiasm for Reebok, and the market's celebratory reception for the deal gave us a good chance to sell out of the stock. As we have mentioned over time, our five year investment in adidas has been predicated on the company's excellent performance in Europe helping their fledgling position in the US (with product, management, systems etc). For adidas to have abandoned that steady building effort in favour of the Reebok "short cut", looks to us like unimaginative, big company bumbling. adidas has now got scale in the US, but they paid up for a business which for some reason was for sale.

An equally frustrating case is that of Deutsche Post (owner of the DHL and Danzas transport companies in addition to the German post office) paying up for a British logistics company which has been specifically positioned for a large uncritical foreigner to take it over while spouting slogans about breadth of offering and geographic scale. It would have been irritating for Deutsche Post to hand over Eu6 billion any time for such a business, but when the company already has so many units needing operational improvement (indeed that was the investment thesis - DHL makes a little money in Europe, and a loss in the US in what should be a nice business), the distraction of a large external deal is possibly more worrying than the silly price they have paid. Deutsche Post was a big position in the Fund (and has been a profitable one) but has been cut right back.

Other changes of note were the sale of our positions in Swedish bank Nordea and in German industrial gas/forklift conglomerate Linde, both of which had exceeded our price targets. We also parted with the last of our holding in Merck of Germany (the "real Merck"!) which with its pharmaceuticals and especially its liquid crystal mixtures for LCD screens has served the Fund commendably.

We took out our position in the Finnish oil refiner Neste, at what we thought was a very hot point for refinery stocks post the US hurricane Katrina (though the stock, which had already put on 40% for us in quick time, charged on after we sold!), and we introduced three or four new positions in the Fund in diverse European countries and industries.

The Fund, at 30 September 2005, is 84% long and 13% short for a net 71% invested in European stocks; currency exposure is 29% hedged back into Australian dollars.

**BREAKDOWN OF FUND'S LONG INVESTMENTS BY INDUSTRY**

| CATEGORIES | EXAMPLES OF STOCKS | SEP 2005 | JUN 2005 |
|---|---|---|---|
| **CAPITAL GOODS** | SIEMENS, RIETER, METSO | **22%** | **17%** |
| **TECH/MEDIA** | INFINEON, ALCATEL, ERICSSON | **18%** | **15%** |
| **CHEMICALS/MATERIALS** | NORSKE SKOG, UPM, SHELL | **14%** | **15%** |
| **CONSUMER/RETAIL** | HENKEL, HORNBACH, DOUGLAS | **10%** | **14%** |
| **PHARMACEUTICAL/BIOTECHNOLOGY** | NOVOZYMES, GLAXOSMITHKLINE | **10%** | **9%** |
| **MISCELLANEOUS SERVICES** | EUROFINS, TNT | **6%** | **4%** |
| **FINANCIALS** | CREDIT AGRICOLE | **4%** | **5%** |

Source: Platinum

# 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.

Platinum Asset Management Limited ABN 25 063 565 006 AFSL 221935 (Platinum) is the responsible entity and issuer of the Platinum Trust Funds (the Funds).
The Platinum Trust Product Disclosure Statement No. 5 and its Supplementary (PDS), is the current offer document for the Funds. You can obtain a copy of the PDS from Platinum's website, www.platinum.com.au, or by contacting Investor Services on 1300 726 700 (Australian investors only), 02 9255 7500 or 0800 700 726 (New Zealand investors only) or via invest@platinum.com.au.

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.