# Platinum International Fund

**Kerr Neilson** Portfolio Manager

## Disposition of Assets

| REGION | MAR 2010 | DEC 2009 |
|---|---|---|
| Europe | 26% | 26% |
| North America | 24% | 25% |
| Asia and Other | 21% | 21% |
| Japan | 18% | 17% |
| Cash | 11% | 11% |
| Shorts | 21% | 18% |

The Fund also has a 17% short position on Japanese Government Bonds.

Source: Platinum

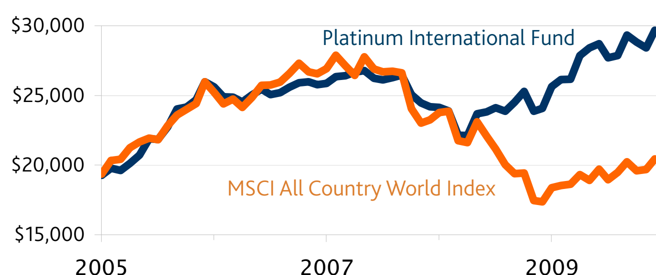
## Performance

The price deterioration of the credit default swaps, which we highlighted with a chart last quarter, forewarned observers of the impending problems with Greece and other Club Med members even if the rating agencies followed their normal market-trailing ways. These concerns spilled over into the equity markets in February spoiling sentiment that had already been softened by the problems besetting Dubai. However, with most economic pointers suggesting that the global recovery was broadening out, investors took the opportunity of the dip to employ some of their accumulated cash holdings.

Within markets there was a pattern of the earlier leaders like China and other emerging markets tending to lag while the slower markets of late 2009, mainly the developed markets, tended to speed up. There was not much change in sectorial leadership with investors still favouring those industries that benefit from stronger economic activity. The laggards remained the defensives such as health care, telecoms and utilities. Late in the quarter the financials showed more form on the basis of an improving view about delinquencies.

**Value of $20,000 Invested Over Five Years**

*31 March 2005 to 31 March 2010*




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

The MSCI All Country World Net Index rose in Australian dollars by 1.1%, while our Fund achieved 1.2%. The positive contributors by region were (in order), Japan, North America and Europe, while Asia was flat. Our short positions cost around 0.5%. This is obviously disappointing but given the uncertainties of the times, and the predilection of this manager to attempt to mitigate risk, the strong showing in the last 12 months of 23.2%, inclusive of the losses on the shorts, may be acceptable. Over the last 12 months the MSCI has returned 17.7%. Taking a ten year view, the Fund has compounded at 9.4% pa, while the MSCI has experienced a net contraction of 3.5% pa compound.

### MSCI World Index Regional Performance (AUD)

| REGION | QUARTER | 1 YEAR |
|---|---|---|
| Japan | 6% | 4% |
| US | 3% | 13% |
| India | 3% | 63% |
| Australia | 2% | 41% |
| Korea | 2% | 35% |
| Hong Kong | 0% | 25% |
| Emerging Markets | 0% | 37% |
| Brazil | -2% | 53% |
| United Kingdom | -3% | 21% |
| Germany | -5% | 15% |
| France | -6% | 14% |

Source: MSCI

### MSCI World Index Sector Performance (AUD)

| SECTOR | QUARTER | 1 YEAR |
|---|---|---|
| Industrials | 6% | 27% |
| Consumer Discretionary | 4% | 25% |
| Financials | 2% | 35% |
| Consumer Staples | 2% | 10% |
| Materials | 1% | 35% |
| Information Technology | 1% | 21% |
| Health Care | 0% | 2% |
| Energy | -3% | 6% |
| Telecommunications | -4% | -3% |
| Utilities | -5% | -4% |

Source: MSCI

### Currency

Concerns about Dubai and the peripheral economies in Europe, directed investors to continue to favour the USD. The Euro was particularly weak, falling by 5.5% versus the USD while the Yen is now showing a weakening tendency. Interestingly, the AUD has not been able to exceed the highs reached in November against the USD, even with remarkably strong metal and energy prices. During the height of the concerns about Greece, the AUD revealed its sensitivity to concerns about global prosperity. We have allowed our holdings of AUD to slip lower and shifted further out of the Yen into USD. Our principal exposures are now USD and related currencies 55%; Euro 17%; AUD 15%; Yen 6%.

### Shorting

As noted earlier, our shorts have been costly. The main pressure point has been our positions against several industrial companies that are factoring in a totally normal cycle. To argue this is to dismiss the turmoil of the last two years as no more than a bad dream. On account of the difficulty and volatility of individual stocks during this phase of the rebound we have, however, moved more to generic index shorts such as the retail Exchange Traded Funds and leading indices.

## Changes to the Portfolio

Strong price rises among tech stocks caused us to trim back our exposure to several large holdings such as Microsoft, Micron (memory chips) and SAP (software systems). We also cut the holding of China Resource Holdings, the valuation of which now recognises the quality of its brewing business with a PE of 25 times 2010 earnings. Several smaller positions were added while larger holdings have been built in Applied Materials, Allianz AG, UPM, Stora Enso and T&D in Japan.

**Applied Materials** makes the equipment used to manufacture micro chips. As the leader in the field, the share price is close to a multi-year low on account of the perceived weakness in the outlook for capital spending on chip making equipment. Another factor is the company's missteps in developing thin film manufacturing technology for solar panels. We cannot identify any fundamental deterioration in the market position of Amat even if the growth rate for its semi-conducting equipment may now be on a lower trajectory. The company has

been active in shifting their cost base offshore, and given the surprising improvement in demand for IT and consumer electronic products, we would be surprised if the company doesn't exceed its critics' expectations. In addition, there could be an interesting opportunity in supplying thin film solar manufacturing equipment but that would be a bonus.

**Allianz and T&D** are insurance companies that have been out of fashion during this early stage of the market's recovery. T&D in particular, is the quintessential play on rising interest rates in Japan because there is such a mismatch between its long-term liabilities as a life insurance company and its shorter dated portfolio of assets. Allianz, based in Germany, has been punished for the current negative underwriting cycle and the dull outlook for traditional private and commercial insurance. Both companies sell for less than their embedded value, which makes them interesting in absolute terms and extremely attractive versus alternatives.

We couldn't resist a return to our truncated theme of the growing shortage of market pulp and the rising price of waste paper. These are now back to pre-crises levels and yet the Nordic paper producers, **UPM and Stora Enso** are still hugging their lows. Trading for less than book value and having adjusted their cost bases, and with new capacity coming on in Latin America, these are interesting investments even though they are price takers.

## Commentary

The gears of international trade and commerce are gradually re-meshing but on account of the earlier excesses, fundamental damage has been done and the recovery can be expected to be protracted and accompanied by setbacks. Greece, while causing consternation is merely part of the tapestry that made up the earlier boom. Without an exchange rate mechanism to adjust living standards to reinvigorate that nation's competitiveness, there is undue pressure exerted on the government to make the necessary adjustments. How is this going to work? The political process gives little comfort to those who want to believe that the pleas by the under-employed will go unnoticed. Can one really envisage that those nations which hosted a blow out in central spending and accumulated deficits in the good times will somehow have the character to face down their electors in circumstances of underemployed resources and deepening gloom? Surely the odds favour ultimate ejection by compliant states who believe there are no easy remedies other than discipline and thrift, even if it is at the cost of the realisation of the dream of an integrated greater Europe. The pressures of national self-interest are conspiring against those with the lofty ideals of the greater good and a tightly unified Europe - surely federation at best beckons.

In the meantime, Greece has to find buyers for €35 billion of its debt this year to meet government expenditure and bond roll-overs. Their ten year bonds are required to yield a full three percent more than Germany's simply to attract buyers.

The other issue that is still far from resolved is the need for a more open engagement by China with the rest of the world. Here we have the world's largest exporter and second largest economy, yet it operates with a closed currency market (termed a managed floating exchange rate). We should indeed be most grateful to China for the short-term benefits it bestowed on the world with its massive intervention, both fiscal and monetary to offset the global financial crisis, but the persistent accumulation of foreign exchange reserves tells of the underlying problem.

The internal political dilemma is painful. Investment activity has clearly shifted to the poorer inner provinces and presently investment is running at about twice the level, as a proportion of activity, as compared to the coastal provinces. Inflation across the country is showing signs of accelerating and there are signs of tightness in the labour markets in the coastal states. The government is already directing lending and attempting to avoid an overheating of the property market, yet the Centre is loath to ease off until these less fortunate provinces gain their own momentum. To counter the problem of Beijing trying to control too many variables at once, it seems inevitable that the yuan will be the 'sacrifice' and will gradually revalue upwards. With a current account surplus of over USD200 billion dollars a year, it is difficult to argue that the yuan is anything but undervalued, though the extremes of logic may be tested with the current utterances in Europe that Germany should surrender its hard-won competitiveness in order to assist the weak within the European Monetary Union (EMU).

We see the months ahead revealing many contrasts and contradictions. There will be talk of the Fed tightening cycle and how shares traditionally respond to this. Currency movements will throw-up winners and losers; pressure from gigantic issuance of bonds to meet the profligate's budget deficits will impinge on the bond markets and create a lively debate about the appropriate clearing level of interest rates for long dated paper. Muddying the issue will be the activities of the banks and the extent to which they accumulate government paper in the face of reluctant lending or borrowers. These probably should be regarded as sideshows and distractions from the behaviour of employers regarding staffing needs in the developed economies and how companies capitalise on the available opportunities.

We have to admit surprise at the very strong profit recoveries we have witnessed to date. In terms of valuations, most developed markets are fairly valued but this depends on the premise that the developing world fully compensates for the impaired position of the developed world which will be preoccupied in righting their lopsided economies.

## Outlook

While the stock markets have followed a very traditional two thirds recovery after a serious recession, the induced shock of the crises has ensured a healthy divergence of views. This is manifested in attractive divergence of valuations. We are still finding a large number of companies that look attractively priced or indeed underpriced. It is from this ground-up analysis that we form the view that we should be able to make positive returns in the year ahead even though there are likely to be periodic concerns.

## 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: 1 May 1995
   Platinum Unhedged Fund: 31 January 2005
   Platinum Asia Fund: 3 March 2003
   Platinum European Fund: 1 July 1998
   Platinum Japan Fund: 1 July 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$20,000 invested in the relevant Fund over five years from 31 March 2005 to 31 March 2010 relative to their Index (in A$) 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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