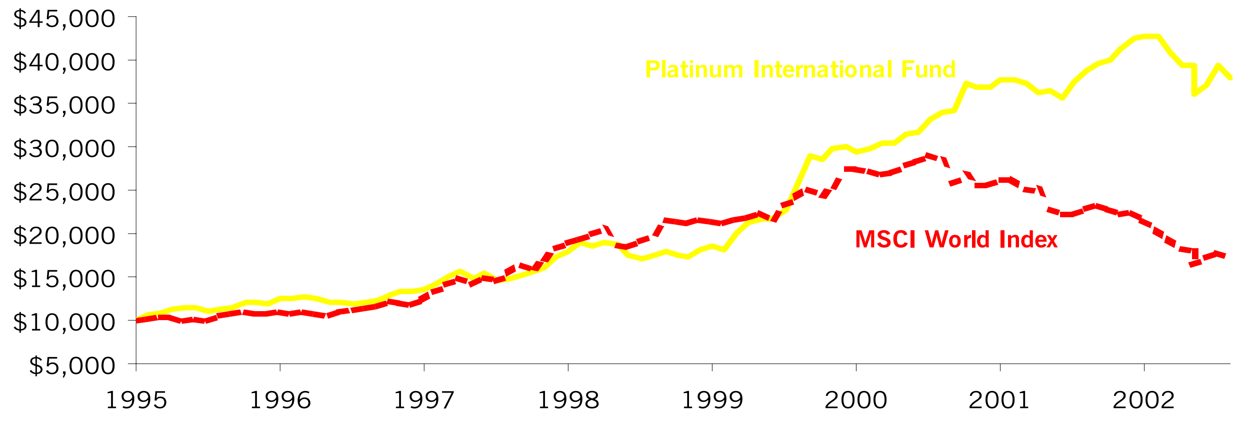
Platinum International Fund

Performance

REDEMPTION PRICE: $1.5563

VALUE OF $10,000 INVESTED SINCE INCEPTION (1 MAY 1995 – 31 DECEMBER 2002)



Source: Platinum and MSCI

The best description for 2002 is that it was not a pleasant experience. All the big markets were down hard by between 25% and 35%. Ironically, the emerging markets of Eastern Europe produced returns of around 15%. Russia was a stand-out, benefiting from its large oil producers. Other smaller markets were typically down by 15%.

Looking at the performance by economic sector, we find the contradiction of defensives and commodity producers out-performing the other sectors but still ending down by around 15% for the year. Over the last three months, the pariahs, telcos and IT leapt from their heavily oversold position and were up 24% and 15% respectively. They nevertheless dropped by 36% to 44% for the full 12 months.

For all our efforts to protect the Fund via stock selection, currency management and short selling we have ended the 12 months with a loss. The Fund is down 3.9% for the year. To some extent this is inevitable because we seldom have less than a net 50% long position and to this extent the theoretical damage should have been in the region of say, minus 12 to 15%.

In this respect we have been successful and it is certainly true that to build off a base of $96 (a loss of 4% on $100) is easier than the job facing others who start at $70 or $75 (losses of 25-30%). More importantly, the net returns that we have made over the last three years, approximately 10% compound pa means we start Year 4 at $132. Most international funds would have a similarly constructed starting figure well below $100.

MSCI WORLD INDEX – INDUSTRY BREAKDOWN

Sectors	3 months	1 year
Consumer Staples	-2.9%	-13.2%
Consumer Discretionary	-0.3%	-29.9%
Utilities	0.0%	-25.8%
Health Care	0.7%	-26.0%
Industrials	0.7%	-30.2%
Energy	3.5%	-16.4%
Financials	4.3%	-25.2%
Materials	6.1%	-14.5%
Information Technology	15.8%	-44.2%
Telecommunications	24.9%	-36.5%

Source: MSCI

Changes to the Portfolio

DISPOSITION OF ASSETS

Region	Dec 2002	Sep 2002
Western Europe	34%	31%
Japan	19%	18%
North America	14%	13%
Emerging Markets (incl. Korea)	10%	11%
Australia	2%	2%
Cash	21%	25%
Shorts	24%	27%

Source: Platinum

Weakness early in the quarter allowed us to add to existing positions. At the same time it threw up the opportunity to start to put together a mini portfolio of biotech companies. We have built a basket of seven biotechnology companies which are at the forefront of medical science, but have seen their share prices fall 80-90% since their valuation peaks in the biotech bubble of 2000. Currently, even though many have programs testing new drugs in the advanced stages of clinical trials, they are valued at little more than their cash holdings (1-2 times). Although the biotechnology arena provides almost daily excitement as new discoveries are made ranging from genetic identifiers of predisposition to disease, to potent new treatments for notoriously hard-to-treat diseases, it is still very risky. Any individual biotechnology company tends to be dependent on a key technology or core element of science, which is then developed into a few drug development programs limited necessarily by the smaller size and resources of these companies. Many of these companies have partnerships with the large pharmaceutical companies who in turn have their own in-house biotech departments. They need to replenish their drug pipelines as they face the threat of generic competition and political interference on drug pricing for their current ageing product portfolios. As the era of more focused treatments and the dream of personalised medicine develop, we believe it is the smaller, more focused companies that will reward the investor. The basket compensates for the risks of individual failures of some of the biotech drug development programs versus the attractions of scale and the cash flows of the established giants.

The weakness of the Nikkei index saw some of Japan's leading companies fall to attractive levels. In particular we started acquiring Canon, Fanuc and Sony. These are unquestionably leading global entities with long histories of growth, high profitability and now relatively low ratings. In the short term, Canon will benefit from very strong and profitable digital camera sales. As chip-making capex recovers, it is highly probable that Canon will gain share in the stepper market from Nikon. At the same time, sales of colour printers, copiers and of course toner and inks, which are wonderfully profitable, keep churning along. Sony is also feeling the slipstream of the digital revolution and in addition is looking very strong with Playstation and its movie business. Fanuc is the world's largest manufacturer of industrial robots. Apart from its scale advantages, which include the bizarre reality of robots making other robots, the company is unrivalled in profitability, making 26% return on capital employed. As important users such as automobile assemblers cut back their new investment, Fanuc is finding a growing market in other applications such as hazardous industries (foundries), picking and packing etc.

In Europe we introduced the Danish company, Great Nordic. Once a market darling because of its telco testing division, the shares have fallen a long way. The testing business has recently been sold and will no longer be a drain so the two other divisions will be the profit drivers. The company is ranked as number three in the global hearing-aid market and the second in the world headset business. Both these businesses are growing and benefit from the consolidation of production at a company-owned facility in China. An exciting twist for the company is the recent launch of "blue tooth" technology which allows headsets for fixed and mobile phones to be wireless and indeed for all aural devices to be untethered from the transmitter. We also took a small position in ThuyssenKrupp. This steel and engineering giant is now priced at a fraction of its steel-making replacement cost, even though it is now perhaps the lowest cost strip maker in Europe and has a portfolio of very interesting traditional and advanced engineering businesses.

On the selling front, we reduced our highly profitable holding in Gold Fields of South Africa in favour of the politically less risky Barrick Gold Corp. The latter partially hedges its gold production but if the gold market remains strong, the net affect of its hedging on performance may prove immaterial. We also sold Rinascenti which was bid for and eliminated Mediaset after a good price appreciation.

We continue to see opportunities for short positions, particularly in the United States. There are three broad themes that we are pursuing here. These are:

- Companies with opaque or incomprehensible accounting (of which Tyco recently disclosed years of “aggressive accounting”).
- High valuation consumer product companies (which have often been bid to very high levels as investors seek shelter in perceived stability). These companies have often leveraged-up buying back stock at high prices and we believe that those seeking shelter might find there is more risk there than they previously considered.
- Financial institutions more generally (which we see as leveraged to the weak balance sheets and stretched consumers throughout the US).

BREAKDOWN BY INDUSTRY

Categories	Examples of Stocks	Dec 2002	Sep 2002
Cyclicals/Manufacturing	Schindler, Siemens, RMC, Bayer, Linde, Océ	21%	22%
Technology/Hardware	Agere Systems, National Semiconductor, Samsung, AMD	10%	8%
Retail/Services/Logistics	Hornbach, Jones Lang LaSalle, Fraport	8%	9%
Medical	Yamanouchi, Takeda, Draegerwerk, Novartis, Merck KGaA	8%	5%
Telecoms	Hellenic Telecom, Ericsson, NTT	8%	7%
Gold and Other	Barrick Gold, Newmont Mining, Gold Fields	8%	5%
Financials	Assicurazioni Generali, Allianz, Alleanza	7%	9%
Consumer Brands	Citizen Watch, Adidas Salomon, Lotte Confectionary	5%	7%
Software/Media	Sky Perfect Communications, Seoul Broadcasting	4%	3%

Source: Platinum

Currency

There has been no change in the currency position. The rise in the Euro relative to the US$ is working in our favour. We are positioned for the A$ to continue to rise relative to the US$ in 2003 with a hedged position of 60%.

Commentary

Late in the year we visited a broad cross section of high quality companies in Japan. The general impression was one of quiet yet growing confidence. One could sense a rise in their self-belief as the merits of pursuing their traditional patient and systematic planning and execution has begun to bear fruit. With the demise of Wall Street's fund-raising magic, which so tormented these great companies during the tech boom, there has been some backsliding regarding shareholder openness. This is not always fun for analysts but the Japanese have long valued a good engineer in preference to some deal-touting investment banker or fund manager.

The constant theme was to raise productivity and to reduce costs. This in Japan means finding ways to harness technology, and not necessarily throwing money at the problem, to reduce weight, size and to improve manufacturability. One is constantly reminded of the depth of know-how with tremendous specialisation by individuals and companies which through gradual incremental embellishments builds extraordinary competence. Most of the companies visited have been increasing their R&D spend, capex was typically below depreciation and where serious money was being spent it was in low cost countries. One of the benefits of specialisation and a loyalty to staff is clearly seen by the mutual trust and cohesion found in most Japanese companies. Yes, there are costs to this approach in the short term, but long term tenure was common in European companies well into the 70s and even the 80s. Our sense of the matter is that the hidden costs of hiring and firing, like many things in business, only reveal themselves when it's too late.

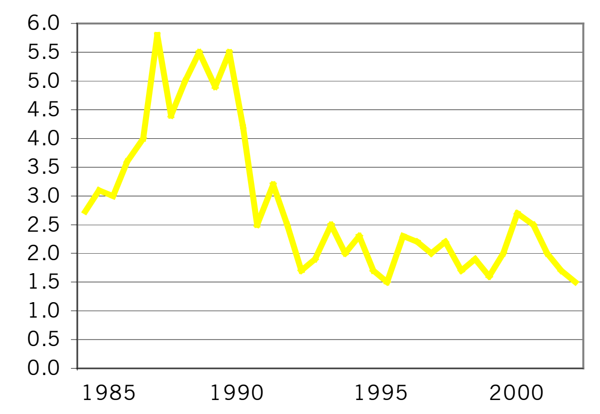
The big idea in Japan at present is the emergence of China as the next great market. To some extent, company management is using the threat of Chinese low production costs to drive through reforms on the home front. There was not a single company visited that was not expanding or enlarging its presence in China. Some of the figures quoted for the difference in costs were frightening and in some instances products were being landed in Japan at the value of their raw material costs. Shimano noted Chinese-made bicycles were being landed at Yen 3800 a unit - most bikes sell for 10 times this and more. Admittedly the quality verged on the dangerous.

On earlier visits we would spend time discussing incentive systems, lay-offs and board restructuring. These are no longer discussion topics as they have invariably been implemented. The new topic is price deflation, a subject that the Japanese are particularly well qualified to report and act upon. The quality companies are generally unusually well-positioned as their balance sheets are often debt free and cash rich. They have been operating in China for several years and have mastered many of the problems of quality local sourcing and distribution. They are not alone versus say the Koreans and leading Western companies but they are certainly not at the trailing edge either.

After perhaps a decade of price decay influenced by weak demand, new supply channels and by easier access to imports, domestic prices in Japan no longer seem out of alignment with those of other developed countries. At the current exchange rate this competitiveness is evident with the country being able to run a trade surplus of around US$100 billion per year. This attests to their producing what their trading partners want and gives Japan an ability to project considerable economic power abroad.

From our perspective, this last decade was not entirely lost by Japan and so long as savings are generated at home and locals own the Government bonds, it may be possible to extricate themselves from the mire without resorting to excessive use of the printing press. After all, interest rates are perhaps below the economy's medium term growth rate. The outstanding stock of debt is unquestionably large so it is likely to be a tight race. However, valuations in Japan reveal a total lack of belief in the ability of firms to earn a sensible return on assets employed (see chart below). For those who question the absence of commentary about the Japanese banking system and the rising bankruptcies, the answer lies in our ability to be highly selective with the shares we hold and to take appropriate positions regarding the currency.

PRICE/BOOK (TOPIX INDEX EX –BANKS)



Source: Smithers

One of the benefits of following the fall-out from the Japanese bubble is to attempt to identify lessons for the US market. We often hear that the US will prove much more responsive than Japan in getting to grips with its problems. This may be so though we believe there are obstructions to market-clearing such as Chapter 11 bankruptcy protection, litigation hurdles, state subsidies and so on. Either way, we would expect the US market to continue gradually to de-rate just as we saw in Japan. New share leadership will emerge and it is almost certain not to be the information technology sector. Companies heavily burdened by debt are likely to be ill-treated (the slogan being debt and deflation don't mix). So-called, "quality of earnings" is paramount in an environment of weak pricing power and a mere sniff of accounts fiddling will set off a fury of selling. Investors will pay above the odds for growth and certainty of earnings.

Several of these factors can already be seen at work in Wall Street and in the case of defensive stocks, it has perhaps been taken too far. This has given us some useful short selling opportunities. In particular selling consumer non-durable companies like Anheuser Busch, Procter & Gamble and Colgate. The market also seems to be over optimistic in its expectations for the profit growth of several financials. This false optimism is all part of what we describe as using the "retrospectascope". By the time the bear market has woven its web, investors will have given up on any fantasy about the Fed or tax cuts as panaceas for the natural deflating of a massive financial bubble. Quite the contrary, it is probable that questions will be asked about the efficacy of the various forms of intervention.

Why shouldn't Europe share the same fate? There are some factors that suggest Europe should have a similar outcome but for the fact that debt is much lower on the Continent (than in the USA) and also valuations are considerably lower. The worst performing market and indeed the one with the worst outlook, Germany is however now capitalised at Euro 380 billion, putting it in line with Australia!! Even making adjustments for what is not listed in Germany, this is truly astonishing. Further we feel the accounting on the Continent is less promotional although it has become far less conservative than say, ten years back. There is one serious cloud that needs to be watched. Should the US dollar weaken further, one of the European drivers, namely exports, would suffer.

A weak dollar would of course have other serious implications including an adverse affect on US fixed interest securities and shares. Foreign ownership of US assets is now over 70% of US GDP (having more than doubled since 1990) and of the US treasuries in issue, over one third are held by foreigners, who also own some 23% of the corporate bond market and over 12% of US equities. With a relatively poor choice of alternatives, the mired Yen and the politically incohesive Euro, speculators seem to be seeking refuge in gold. Writing in a book just released, "Tomorrow's Gold – Asia's Age of Discovery" (published by CLSA Books), Mark Faber, a highly successful seasoned campaigner with great historic insight, suggests that the liquidity which has been created will find itself expressed in higher prices of many commodities including gold and silver. We share many of his views and see the Fund's 5% position in gold producers as protection against likely currency instability.

We think currencies will be a major topic as 2003 unfolds. As noted in our quarterly of June 2002,on the basis of purchasing power parity, the Chinese economy is massively larger than the current renminbi exchange rate would suggest. The growing trade surplus and foreign direct investment that is running at around US$120 billion per year, would normally ensure a strong appreciation of the Chinese currency. However, currency restrictions and other devices such as internal US$ accounts and now the opening up of an internal gold market all conspire to keep the currency fixed to the US$.

Conclusion

Terrorism, war and high oil prices are all damaging to consumer confidence and business investment in the short term. Longer term there is reason for optimism. Valuations have come back to sensible levels in markets of Asia and Europe and quality companies will be able to achieve modest earnings growth. The level of debt and general uncertainty will promote volatility as short term events are periodically given too much emphasis.

Kerr Neilson
Portfolio Manager