PLATINUM INTERNATIONAL FUND

Kerr Neilson
Managing Director

PERFORMANCE

All stock markets produced strong rises in the December quarter despite a rough start with oil prices threatening to rise towards US$60 per barrel. Confidence grew as the quarter progressed and fund managers reduced their hitherto underinvested positions. Currency movements played a large part in determining the magnitude of the gains with the A$ rising against the US$ by some 8%, being flat against the yen and falling in value against the euro by 2%.

The rise in the appetite for risk was apparent from the out-performance of emerging markets with those in South America and the Middle East gaining more than 20% in their home currencies, followed closely by Asia ex-Japan. Developed markets generally rose by single figures with the Bloomberg Europe 500 gaining 6%, the Japanese Topix up 4% and the S&P 500 rising 9%. Converting all this into A$, saw the MSCI rise by 3.7% for the quarter.

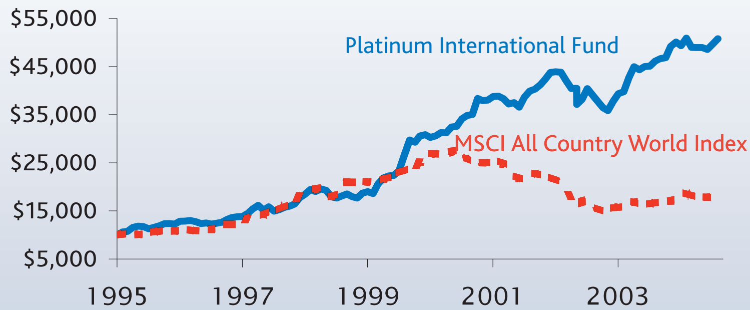
The Fund gained 3.8% for the quarter, capping off a flat second half to 2004, and achieved a rise of 10.2% for the year. Examining the year as a whole, it is apparent that our stock selection in terms of long positions was good with large exposure to emerging markets like India and Korea adding zip to our core of excellent European and Japanese holdings. The currency positioning also made a small contribution. Unravelling our underlying strong showing was the negative impact of our short positions that reduced the annual return to slightly less than that of the MSCI, which rose by 10.8% for the year.

MSCI WORLD INDEX INDUSTRY BREAKDOWN (US$)

SECTORS	QUARTER	1 YEAR
TELECOMMUNICATIONS	16.1%	16.3%
UTILITIES	13.8%	23.9%
FINANCIALS	13.7%	15.5%
CONSUMER DISCRETIONARY	13.7%	14.0%
INFORMATION TECHNOLOGY	13.3%	2.4%
INDUSTRIALS	11.8%	17.9%
MATERIALS	11.4%	17.9%
CONSUMER STAPLES	11.4%	10.4%
ENERGY	6.5%	25.0%
HEALTH CARE	6.2%	4.7%

Source: Bloomberg

VALUE OF $10,000 INVESTED SINCE INCEPTION
1 MAY 1995 TO 31 DECEMBER 2004



Source: Platinum and Factset. Refer to Note 2, page 9.

A revealing picture for the quarter is shown in the Industry breakdown table (shown in US$ to remove the impact of the strong A$). In contrast to the September quarter, where the table was dominated by falls, every industry rose. Differing factors were at work, with corporates beginning to spend some of their built-up cash reserves through takeovers especially in telecoms, utilities and IT. Bringing up the rear were health care (damaging drug revelations) and energy (losing some gloss with the retracing oil price).

SHORTING

This has been a painful experience, particularly in the last quarter. Our successes have been small and our losses large. We admittedly derived some smoothing of performance, particularly in July, but overall the exercise cost us over 4% for the year. Careful examination of our behaviour and stock selection shows that the damage was largely the work of three specific stock shorts. The price behaviour of these lamentable three in the opening days of 2005 suggests that our negative assessment may still prove correct. Why endure this pain you may ask? Essentially we are attempting to partially guard against loss in an environment where liquidity is wallpapering over some serious cracks.

Our principal shorts relate to interest rate/derivative risk and to this end we have underestimated the slowness of interest rate rises, the controlled decline of the US$ and the remarkable support for bonds by traditional investors and Governments, who were pursuing mercantilist policies. Has anything changed? Well, US interest rates are creeping up and perhaps there are signs of a weakening demand for US bonds. However, on account of the fall in the cost of puts prior to years' end (the sky being “perfect blue”) and the timing problems we have had with specific shorts, we have introduced put options to augment our short sales.

CURRENCY

A bearish stance towards the US$ was the prominent market view in the final quarter of 2004. This type of consensus tends to rattle us. Should the US administration pay more heed to international concerns regarding the twin deficits, it is possible for the currency to rally. Fundamentally we still favour the Japanese yen and European currencies but have adjusted our position to own some US$ for now. We have been surprised by the relative softness of the yen against the euro and are positioned for this to change. The A$ hedge has been held steady.

CHANGES TO THE PORTFOLIO

DISPOSITION OF ASSETS

REGION	DEC 2004	SEP 2004
WESTERN EUROPE	30%	29%
JAPAN	28%	27%
NORTH AMERICA	17%	14%
EMERGING MARKETS (INCL KOREA)	15%	14%
AUSTRALIA	0%	2%
CASH	10%	14%
SHORTS	26%	30%

Source: Platinum

Transaction levels were relatively subdued as we were mainly adding to existing holdings such as Credit Agricole, Carrefour, Liberty Media, News Corp, Mosaic, Norske Skog, and Reliance Industries.

In Japan we shifted the emphasis more towards domestically orientated companies, adding to home builders, financials and television broadcasters. These companies are on depressed valuations that reflect the prevailing pessimistic view about domestic demand. A closer look at these companies' profit histories reveals remarkable resilience through the last twelve years of slough.

An area that has become conspicuously unfashionable is pharmaceuticals. Drug stocks have suffered a major de-rating as the implications of the side effects of so-called Cox-2 inhibitors has damaged the prospects of Pfizer and Merck Inc. Having assessed the longer term implications of these problems and the general concerns regarding viable pipelines and the regulatory environment, we have chosen to add both companies to the portfolio. At current price levels the market is implying that longer term growth prospects have fallen considerably and also that risks have risen markedly.

At the same time we have been adding to our biotech holdings to emphasise those companies that will help support drug discovery and diagnostics. On account of its relative strength and no fundamental improvement of its relative merits, we sold Novartis and used the proceeds to buy the above companies and to add to GlaxoSmithKline.

COMMENTARY

An important principal of economics and finance is that an abundance of capital ultimately diminishes profits: conversely, shortages provide the fuel for future profits. Yet here is the paradox in the markets today. Liquidity is so abundant that it is promoting convergence of returns as investors search high and low trying to identify the next big idea. Markets which were formerly uncorrelated, now behave as if they are closely related. For example, the amount of extra yield that was traditionally required from B rated corporate bonds has shrunk in synchrony with the lower implied volatility of various share indexes. At the same time, Euro and US bonds have become correlated as have emerging market bonds. This is significant as it was the **uncorrelated behaviour** of various traded assets that was the **foundation of the hedge fund movement**. If most assets become correlated, what are hedge managers supposed to hedge?

The **aberrant effect of cheap money is also evident in the anxious desire for risk**. The range of examples is wide, starting with the markets' apparent nonchalance regarding the

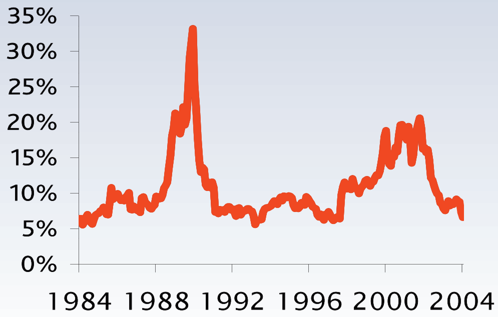
BREAKDOWN OF FUND'S LONG INVESTMENT BY INDUSTRY (% OF ASSETS)

CATEGORIES	EXAMPLES OF STOCK	DEC 2004	SEP 2004
CYCLICALS/MANUFACTURING	TOYOTA MOTOR, SCHINDLER, SIEMENS, LINDE, OCE	**28%**	**25%**
FINANCIALS	CREDIT AGRICOLE, MITSUBISHI TOKYO FINANCIAL, MITSUI SUMITOMO INSURANCE	**16%**	**15%**
CONSUMER BRANDS	HENKEL, ADIDAS SALOMON, LOTTE	**8%**	**6%**
TECHNOLOGY/HARDWARE	AGERE, INFINEON TECH, SAMSUNG, AMD, SUN MICROSYSTEMS	**8%**	**8%**
MEDICAL	TAKEDA, SCHERING, MERCK KGaA, GLAXOSMITHKLINE	**8%**	**8%**
RETAIL/SERVICES/LOGISTICS	CARREFOUR, DEUTSCHE POST, HORNBACH, MITSUBISHI CORP	**6%**	**7%**
GOLD AND OTHER RESOURCES	SHELL, BARRICK GOLD, NEWMONT MINING, NORANDA	**6%**	**7%**
SOFTWARE/MEDIA	SEOUL BROADCASTING, NEWSCORP	**6%**	**6%**
TELECOMS	ALCATEL, NTT DOCOMO	**4%**	**4%**

Source: Platinum

virtual confiscation of Yukos assets. Though the stock price was hammered, the effect on the broader Russian index and other dubious markets was relatively slight. Closer to home, the revelation of a probable breach of US SEC accounting rules and consequent departure of the top two executives (on extremely generous severance terms) from the world's largest hedge fund, Fannie Mae, barely made the headlines. This is no trifling matter. The revealed capital short-fall of over $9 billion has wide implications, not least for the availability of mortgage finance in the US and significant effects on derivative markets, yet the share is now trading above pre-revelation levels. There are lesser examples of typical excess such as the China Aviation Oil futures gamble that cost US$550 million compared to its net assets of US$140 million at the start of 2004. Best of all, however, has been the reopening of the triple C or lower rated bond market. Traditionally, one third of loans raised by these "walking-dead" default within a year, yet so ravenous are investors that apparently the extra yield of only about 6% is worth the bet!

TRIPLE C BORROWING MARGIN (spread over 5 year US treasury yield)

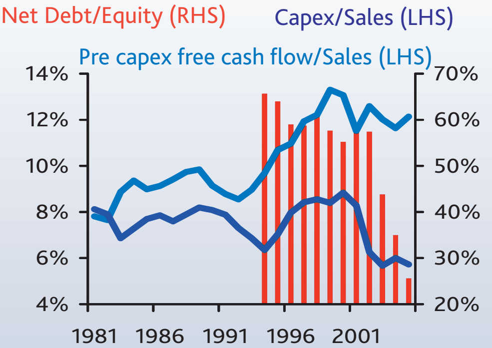


Source: Bloomberg, Citibank

In case you have missed some of the above, do **take note of the competition that has re-entered the private equity market**. Data compiled by Bloomberg show that buyout firms like Blackstone, Warburg Pincus and Carlyle have spent a record US$180 billion on deals in 2004, way outpacing the global IPO raisings estimated at US$128 billion. Like the hedge fund industry, this was formerly the domain of wealthy families but success has attracted many new players, most notably less affluent investors and perhaps less experienced equity specialists. Returns have fallen as bidders compete in an ever more crowded pool. Several private players can make no sense of prevailing prices and are suspending their activity while those operating with OPM (other peoples' money) are snatching at every morsel. Some are even doing a fine trade in taking listed companies private, sheltering them for long enough to enhance their indebtedness and little else, and within 12 months offering them to the public again at a considerably higher gross price. No logical explanation seems necessary for the "now listed; now delisted; now listed again" trick in the IPO offer documents! For the moment though, some may dismiss these examples as merely the observations of a sour deprecator.

Easy money has, however, had a highly beneficial effect on corporate profitability and balance sheets. Companies have engaged in massive refinancing exercises and, unlike householders, have generally reduced their financial leverage thereby reducing the risk to shareholders. Also enterprise profits are at record levels in the principal markets or back to peak levels in the case of Japan.

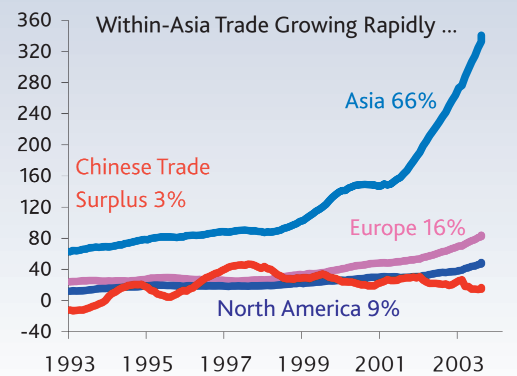
"WORLD" FREE CASH FLOW/SALES & NET DEBT



Source: UBS

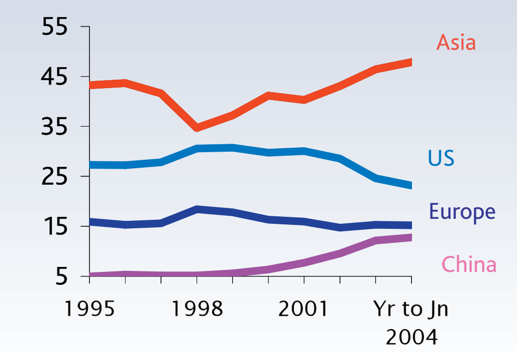
Yes, the rate of change of activity is tending to slow in the major industrialised economies but India, China and much of Asia continue to grow. Their **dependence on traditional markets is diminishing** as inter-regional trade whirls around the Middle Kingdom; see the accompanying graphs.

ANNUAL CHINESE IMPORTS (US$bn)



Source: CEIC

JAPANESE EXPORT DESTINATIONS (% of total exports)



Source: BOJ

As a relatively closed economy gradually weaning itself off central planning, **India has responded relatively slowly to globalisation**. This was apparent at the Twentieth annual Indian Economic Summit held in Delhi in December. In earlier times, politicians expected to be treated with gratitude for their munificence, but this is changing. Delegates have become impatient with the endless ruminating over issues that were defined at earlier summits and they now want action in the form of less government interference and more devolution of power. The old Nehru/Gandhi centralist model of self-sufficiency and anti-materialism is no longer acceptable. Though it has been a long time coming we concur with the Finance Minister's view that the country is about to enter a sustained period of economic growth rivalled only by China. Aiding this process is the probable increase in foreign direct investment which is presently running at one tenth of the level to China. The biggest hindrance will be the **potential loss of patronage** but no one has missed the significance of the recent election surprise. The Congress party is paying close attention to alleviating the plight of the rural poor and has now accepted that the nation's interests are best served by **wealth creation rather than wealth distribution**.

While the Indian economy has chugged along at around 6% pa, China has achieved the remarkable distinction of **increasing its industrial production by more than 13% per year** since 1993. Such has been the supply of surplus labour that real earnings of the typical factory worker barely changed in the 1990s but since 2000, real wages have accelerated. (These figures are rubbery on account of the statistics which segregate migrant incomes from those earned by residents: under the *hukou* system migrants still face penalties such as denial of free medical treatment and access to schooling for their children in several major cities. For further information on this refer to the article overleaf). This is being accompanied by tentative indications that there is a lessening desire on the part of rural dwellers to migrate to the tough and tedious jobs that once attracted them in droves. The income gap between the wealthy coastal provinces and the hinterland is still large but government measures and higher agricultural prices are playing a part. Perhaps, too, skill disparities are an issue. As labour typically accounts for about 10% of inputs in manufacturing, the impact of this change in the bargaining power of labour will take time to be expressed but it may signal the **end of the deflationary pulse from China**.

This same pulse has helped companies in the developed world to hold onto **a record share of GNP in all major industrialised countries**. This has come from outsourcing production to low cost regions and perhaps delayed passing through of these price benefits. However, enthusiasts be warned that research by the likes of Bridgewater show a strong inclination for economic forces to cause a reversion to the mean. For the moment though we believe these large surpluses will encourage companies to invest in productivity enhancing plant, engage in more industry consolidations and perhaps raise dividend pay-outs.

There are other promising signs of change in important economies like France and Germany, with a combined population of some 145 million. The mandated 35 hour week in France is now being eased though not abolished while in Germany opinion formers like Robert Bosch, Opel and Siemens are driving through deals with the IG Metal union for longer working hours for no extra wage. This gradual change of perspective reflects the recognition of globalisation, with extra impetus being given by competition from the new Eastern European members of the EU.

In Japan we expect record corporate cash flows to be directed at capital spending. A point that should be emphasised is that the yen, while stronger against the US$, has been relatively weak versus the euro. It is from this economic block that it faces its principal competition in elaborate and sophisticated machinery. As companies gradually share some of their surpluses with labour through the biannual bonus system, we can envisage domestic demand being stronger than some presently believe. We also see this reviving one of the few moribund property markets in the developed world. As has been noted before, land prices are edging upwards and the housing market is showing promise.

CONCLUSION

Cheap money is clouding the economic scene. Traditionally, government and business are the user of savings and these are provided by households. In the US today the opposite applies. Business, which needs savings to invest and grow, is the provider of funds, while the consumer and government are the users. **This is an upside-down world.** Should US inflation become more troublesome and if too little heed is paid by the Bush administration to the twin deficits, the delicate balance may become unsettled.

At the individual share level, company earnings in general are losing momentum though still growing and valuations range from acceptable to high, on admittedly above average levels of profitability.

The strongest growth prospects appear to reside in the emerging markets (globalisation beneficiaries) but equally, these markets tend to be the most sensitive to volatility in the developed markets. It is for these reasons that we have maintained short positions in selected stocks and indices.

CHINA'S DIVERGING LABOUR MARKETS

一國
兩勞市

The 1950s saw China's government introduce a household registration (*hukou*) system and other measures to restrict movement around the country and enable better government control of an expanding population. This policy has created a bifurcation in China's labour market, proving to be particularly relevant today.
Reforms to the hukou system have occurred, but only in a piecemeal fashion over the last decade or so, and are by no means complete.
Without a valid hukou, an individual and his/her family are precluded from receiving the usual of health services and education locally. Until 2002, migrants were also subject to hefty fees on 'temporary residency' and 'birth control' by their local authorities. Minimum wage legislation was introduced in 1994s Labour Law, but the government has generally failed to ensure the large pool of unskilled and poorly educated migrant workers benefit from such provisions.
China is trying to increase employment opportunities throughout the country, but the fact is, almost all new jobs, particularly over the last decade, have appeared in urban areas. Still, the urban rate of registered (hukou-holder) unemployment has risen, from 2.5-3% during the 1990s, to 4-5.5% at end-2002 [1], on the back of job losses in the government sector. (At least 25 million SOE and collective employees were laid off during 1998-2002.) This points to a reason for continuing to limit free movement of the population to cities, where greater numbers of unemployed figure as a major worry among government and party officials. (The number of protests across China has been growing significantly in recent years.)
The hukou system only began undergoing gradual changes during the mid-1990s. In 1997, non-locals could apply for registration in "some small towns and cities", provided they could show stable employment or ownership of a local abode - something difficult for the bulk of migrant workers! After three years, only half a million people had applied for hukou registration in small urban areas [2].   2001-02 saw more significant reforms: local registration became a possibility in 20,000 smaller towns and cities. The aim is to still restrict migration to the main metropolitan centres: opportunities in these cities are the main magnets to China's desperates, both in terms of employment chances and coverage by social services.
Mid-2004 reportedly saw a substantial decrease in the number of rural residents willing to uproot themselves and move to cities. In addition to the problem of rights without a local hukou - low wages, poor working conditions, payment of fees, no entitlements to health care or education, and other negative discrimination - better returns for agricultural output in more rural areas and higher inflation in the cities are cited as the reasons for this new phenomenon of a 'labour shortage'. A lesser point again raises the issue of freedoms: couples in urban areas are generally required to adhere to the one-child policy, while this policy is applied less stringently in many rural areas.
The hukou system-induced polarisation of China's workers has seen the entitled urban workers enjoy double-digit growth in official wage rates in most Chinese provinces and sectors over the last two decades, as per figures from China's Ministry of Labour and Social Services for hukou-holding workers. The significantly lower rates paid to migrant labour are much less publicised. [3]
The recent sudden jumps of ten percent or more in wage levels which have been upsetting Hong Kong entrepreneurs and others with their main factories located in southern China's Canton province and other coastal provinces - though reportedly relating to no more than 10-15% of

total costs - refers to their migrant labour workforce, which they have been happily exploiting, given the cheapness of this resource, relative to officially-reported wage levels. While Shenzhen - the city right across the border from Hong Kong - boasted the highest average wage level in mainland China for 2003, at Y30,307, many single female migrant workers tolerate conditions for a few cents an hour of pay, which enables some contribution to the family back home compared to being an unemployed mouth to feed. (In 2003, Beijing workers earned an average of Y25,312; Shanghai's average was Y27,304; all of Canton province averaged Y19,986 - far lower than Shenzhen's record.)

Reports suggest that China's rural population - about 60% [4] of the total nation - still includes a labour surplus of 150 million, while SOEs could lose ten million or so to other employers (to raise state-sector labour productivity levels nearer those in the private sector).

Of China's estimated 750 million-strong labour force [5], about 480 million are officially rural residents, of whom, while estimates vary, 80-150 million have chosen to work in urban areas as migrant workers. The official urban workforce is 270 million.

In the traditionally communist mainland, supply and demand forces are now proving very relevant to both of China's labour markets. On the demand side, restructuring of many SOE and other employers' remuneration packages has affected the comparability of monetary wage levels over recent years, as higher wages substitute for lodging, education and health care provisions. On the supply side, the abundance of tertiary graduates has limited such individuals' bargaining power, and more newcomers are placing emphasis on non-wage considerations: long-term opportunities in terms of training and reputation of both the industry and firm they might join. On the other hand, the high labour turnover of many factories reflects the increasingly choosy attitudes of even the most common of workers, including those from rural areas, who will soon opt for better working conditions at another plant in need of labour. This trend has filtered through to middle and higher levels of management for such manufacturing layouts. Quality managers with decent experience in running operations are proving harder to find, now attracting higher valuations in their segment of the labour market. Overall, in the interests of both efficient resource allocation and improving the human rights and living conditions of the general populace, many encourage the Chinese government to do away with barriers to population movement and remove restrictions on rural-to-urban migration. However, the balance between the pace of economic development and maintaining social cohesion remains precarious in China, where disparity among the haves and have-nots continues to grow, worrying authorities about the prospect of greater concentrations of underemployed and underpaid individuals in urban locations. Though upward pressure on wages is feeding through to the far reaches of the migrant workforce, discrimination based on the hukou will ensure two distinct labour markets continue to exist in China for a time yet.

Charles Evans

1 Total urban unemployment is likely to be 5.5% or higher.
2 As with much of the sourced information in this article, this figure comes from "China's Labor Market Performances and Challenges", by Ray Brooks and Tao Ran, 2004.
3 The discrepancy between principle and practice exists clearly: the 1994 Labour Law is designed to apply to all people; but migrant workers are often subject to harassment by local authorities, including police, for falling outside the technically legal framework of the hukou system, especially when failing to pay required fees while looking for work. Far less do these poor souls find themselves entitled to anything like a fair go, as deemed by distantly-decreed central government legislation.
4 China's rural population was about 80% of the national total in 1980, around the time Deng Xiao-Ping's economic reforms started being introduced.
5 Other estimates of the 15-64 year-old population suggest 930 million people are of 'working age'.

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.