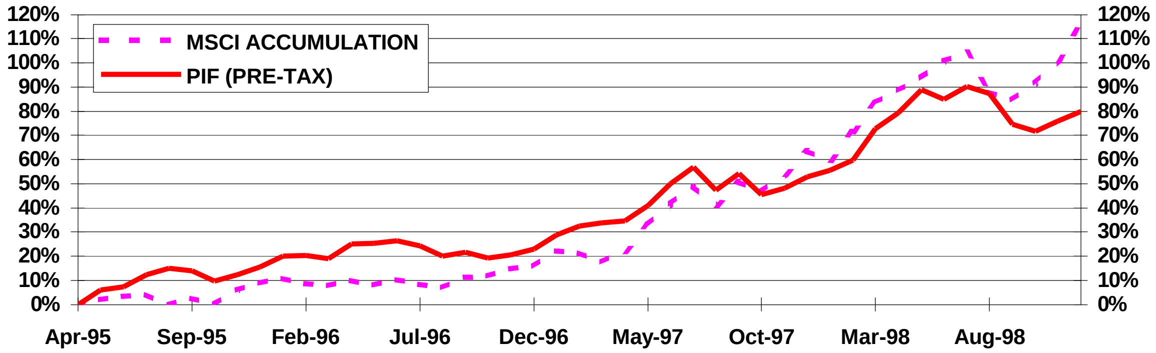
PLATINUM ASSET MANAGEMENT

The Platinum International Fund

Quarterly Report
31 December 1998

Performance



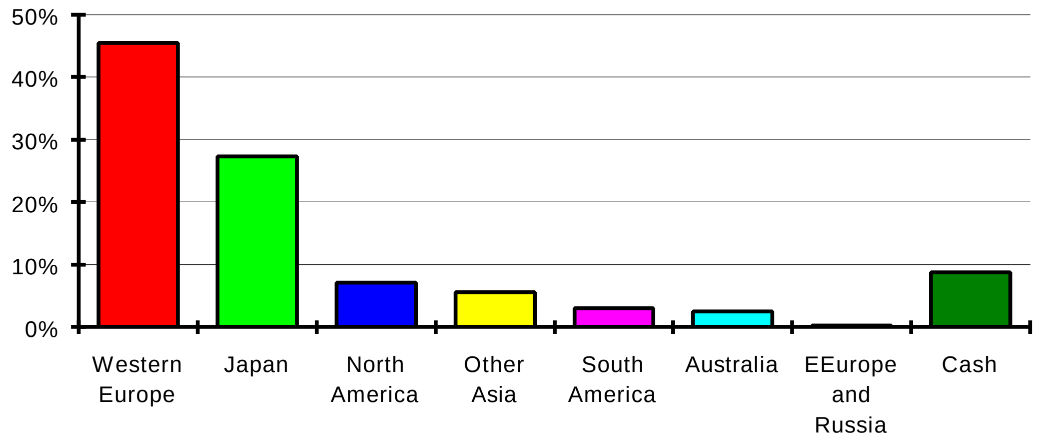
PIF Cumulative Performance versus MSCI World Accumulation Index

The strategic positioning of the fund has cost unitholder's returns. However, this is a decision based on fundamentals rather than short term tactical considerations. A more expedient approach, and regrettably a more profitable one, would have been to ignore market risk, though we are sure that late in the third quarter shareholders felt differently and enjoyed having the protection. As a reminder, the short S&P position is predicated on the US being the leader in the profit cycle and also the benchmark for the pricing of global financial assets. All our work points to a dearth of attractively priced *investments* in that market. Our objective is to create value from stock picking and indeed the efficacy of this approach is borne out by our gains in Europe and Japan, 36% and 45% respectively over 1998.

Top Ten Holdings (as at 31 December 1998)

Stock	**Country**	**Industry**	**Holding**
Rinascente	Italy	Retail	5.7%
Samsung Electronics	Korea	Electronics	3.5%
San Paolo	Italy	Banking	3.1%
Siemens	Germany	Electrical Engineering	2.9%
Suzuken	Japan	Pharmaceuticals	2.8%
Yamanouchi Pharma.	Japan	Pharmaceutical	2.6%
Lagardere	French	Media/Defence	2.5%
Telecom Italia	Italy	Telecoms	2.5%
SIG	Switzerland	Packaging/Engineering	2.4%
Deutsche Bank	Germany	Banking	2.3%
Total			**30.3%**

Disposition of Assets



Portfolio

In Europe, we used the October sell-off to acquire new holdings and add to existing positions. These included WPP (advertising), Alcatel (telecom equipment), Toro (insurance), UBS, Deutsche Bank, Rinascente and Telecom Italia.

In Japan, we continue to take advantage of the mispricing of shares in that dysfunctional economy. As the market washes in a morass of bad news, opportunities are being thrown up regularly as cross-holdings are dislodged or shares are violently sold down. We have segmented the market into distinct categories and find the growth companies, and cyclical growth companies, to be among the cheapest in the world. Among the cyclicals, we are commonly finding companies at values last seen twenty years ago (when they were smaller and weaker enterprises), some trading for less than the cash on their balance sheets.

We have very few investments in South East Asia and have regarded Korean companies as being some of the most prospective investments. Our principal holding is the Samsung group which has been highly rewarding. As the standard bearer of excellence in that country and as an emerging micro-electronics powerhouse, the shares have been aggressively purchased as investors confidence has returned. We added to our position in the dark days and have seen the shares rise 150% since. They are still not expensive.

Our holdings in Latin America have been dull. The stock markets, punished by the retreat of foreign capital, have now fallen to bargain basement prices. On a medium term view, there are companies which are likely to give far better returns than most traditional western companies. We are tentatively repositioning our holdings away from the defensive plays that have outperformed in a weak environment.

Currency

We have been adding to the A$ hedge. Presently 37% of assets are hedged into A$, 39% remain in the Euro and Switzerland, 6% in Yen and the balance, 18%, in US$ and related currencies.

Commentary

The issues that seemed so vivid to investors when the markets were collapsing in early October have faded. Indeed, the US consumer barely paused for breath in the face of stockmarket adversity (even though consumer sentiment dipped). Important developments include the provision of stand-by facilities to Brazil and the action of the Federal Reserve Board which lowered interest rates three times in seven weeks. The result was a sharp v-shaped recovery in Wall Street led by the triumphant tech stocks. The intra-market behaviour, which has seen companies that issue profit warnings being duly penalised, confirms that the market has clearly accepted the negative aspects of the deflationary shock and the loss of pricing power that we have been warning about for some time. Indeed, the hunger for returns in the face of low nominal yields continues and is focused increasingly on those few remaining market segments that can produce exciting revenue growth, namely info tech stocks in general and internet stocks in particular. Combined with related sectors such as telecoms, this group constitute less than 20% of the

S&P500 index and are the motor behind the market's extraordinary turnabout since October's gloom.

Where to now? There seems little prospect of much reduction of pricing pressure. If anything, capital spending in the US looks to be continuing imperiously even though capital utilisation is running at only 80% - recession type levels. In Europe and Asia, the same picture emerges of oversupply. This will keep the lid on prices for the while and in the face of a weak consumer, particularly in Europe and Asia, the general growth rate must be subdued.

With this difficult tendency, central bankers are likely to further lower short term rates to contribute to price stability and help employment (especially in Europe and Asia). In the US, the immense growth in lending for financial activity since October, (40% annualised), could add to stockmarket euphoria, but the likelihood of a weak US$, could lead to further instability. Hot as the info-tech stocks have been in 1998, the excitement could be heightened even further in 1999 by the growing availability of broad band cable, further developments in mobile phone/palm-sized organiser technology and a marked lift off in e-trading. E-commerce is now on the cusp of more general usage and thus could invigorate the existing excitement in the trading of internet related shares. In December, activity in these shares was frantic with many rising over 40% in the month and Schwab (an e-trade broker), rising 70% in eight trading sessions.

After a pause to refresh, this gold-boom-like mentality could build into an even greater frenzy. All the conditions are present - an underlying logic, easy and cheap credit and the pavlovian response to an 18 year old bull market. The real danger is that retirement money – notably 401K allocations – gets confounded by this apparent win-win situation and is beached high and dry when the music stops (caused by over-valuation, and the hordes of losers for each great success story).

Dull as warnings are, we wish again to restate the dangers. The US economy is displaying some serious imbalances. Apart from external pressures, domestic capacity is growing faster than final sales, corporate profits are showing signs of contracting and the corporate sector has a growing dependence on external funding. Simultaneously, the consumer is becoming increasingly indebted with savings having turned negative. Traditional observations of money growth fails to reveal rising leverage in the system. As consumption and loan growth are increasingly predicated on asset prices, some of which are inflating at alarming rates, it is evident that the system is becoming inherently less stable. At the same time, there may be a greater reluctance by the Japanese to play a part in augmenting this liquidity. Witness the recent weakness in the dollar versus the yen. The performance of the internet stocks and the seemingly infallible Fed, give the impression that the economic cycle has been banished.

In the meantime, most of Western Europe has embarked on the great experiment of monetary union with the formation of the Euro on 1 January 1999. General enthusiasm abounds at the moment, and as the internal and external implications of the new world of "euroland" become apparent, we anticipate considerable changes in the corporate sector of the continent.

The "restructuring story" to which we have referred for several years should accelerate. Pricing clarity and lower costs of doing business in the region will demand consolidation in many industries as companies try to take advantage of, and defend themselves in, the enlarged "domestic" market.

The sort of consolidation witnessed in pharmaceuticals in recent weeks (Astra merging with Zeneca, Hoechst with Rhone Poulenc and Sanofi with Synthelabo) can be expected to spread to industries such as automobiles, banking, insurance, chemicals and retail etc.

An important issue as always this year will be general economic conditions in Europe. The slowdown in Asia and Latin America and the collapse in Russia considerably reduced the industrial momentum of the large European economies in the final quarter of 1998. It looks as though GDP growth in Europe (ex the UK) will be down 2% this year with a better outlook dependent on greater consumer enthusiasm.

For Japan, we can see no reason to contradict the forecasts of the majority. Apart from the well rehearsed problems within the financial system (not merely the banks), the other great problems that will get plenty of airing in 1999 are the country's almost non-existent welfare safety net, and the urgent need for labour reform. The lifetime employment "contract" is now proving to be one of the greatest impediments to the efficient working of the Japanese economy. Change is taking place with progressive companies changing remuneration to reflect ability and contribution rather than age alone, new recruits are hired on short-term contracts and so forth - but the lifetime employment system that had produced such success in the past and indeed carries reciprocal "rights" is unlikely to be toppled overnight. Without more labour flexibility, however, it will be very difficult for the traditional Japanese company to cut costs and re-engineer processes as their competitors, (not least the Koreans), are doing and hence improve their profitability.

For those readers who sense a contradiction to our stance on the US versus Japan, with the former economy working and the latter floundering, the issue simply relates to relative valuations.

In South East Asia, generally lower interest rates and booming exports to the West have allowed some recovery. These factors and commensurately stronger exchange rates have reduced pressure on corporate solvency. Nevertheless there is still much to do to refinance the banking industry in Asia – a principal facilitator of growth. For example, in Thailand, non-performing loans are now put at close to half of all bank loans which explains why the banks are actually paying out more interest than they are receiving. And this is before normal operating overheads!

Outlook

Within this framework of easy credit, weak growth and weak pricing power, currency instability and low tolerance to shock, returns from equities will be patchy. We believe that money can be made because of the sharp rotation among industries. It is not necessary to change one's investment style and participate in the IT euphoria, but rather to continue seeking those companies which will show inherent growth but which are not directly in the spotlight.

In markets obsessed with a small sub-set of companies, there are many businesses whose shares have fallen to below their long term inherent value.

We feel obliged on fundamental, if not tactical grounds, to maintain our over-hedged position on the S&P500 index. In the highly charged atmosphere of easy credit, this is likely to lead to a performance variance from the pack.

Kerr Neilson
Managing Director
8 January 1999