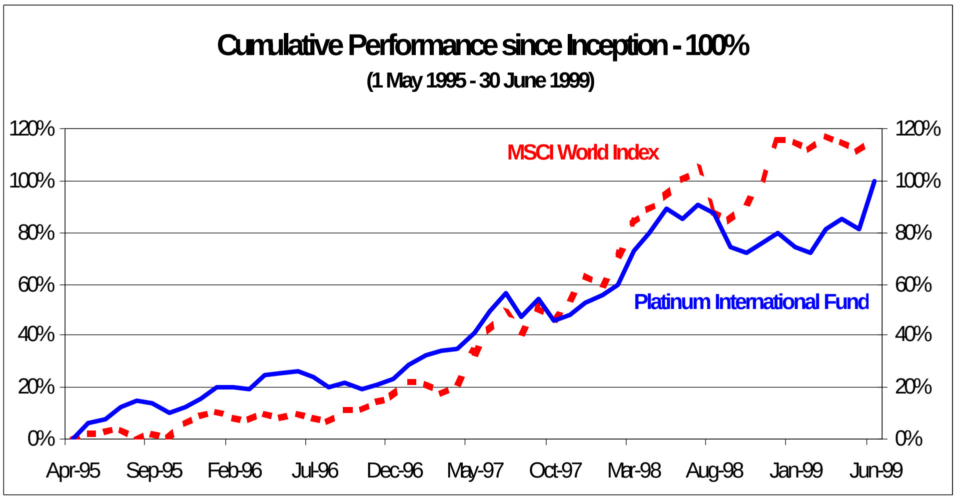
The Platinum International Fund

Quarterly Report

30 June 1999

Performance



It was the emerging markets that skyrocketed this quarter with some extraordinary returns being achieved by tiny markets such as Indonesia which rose 76%, followed by Korea with a 55% lift. Europe went sideways, while the US advanced 7% and Japan pushed on higher with a 10% upward move. The MSCI World Index (A$) was flat for the quarter yet our big positions in Japan and Korea paid off handsomely to give the fund a return of 10.1% over the same period.

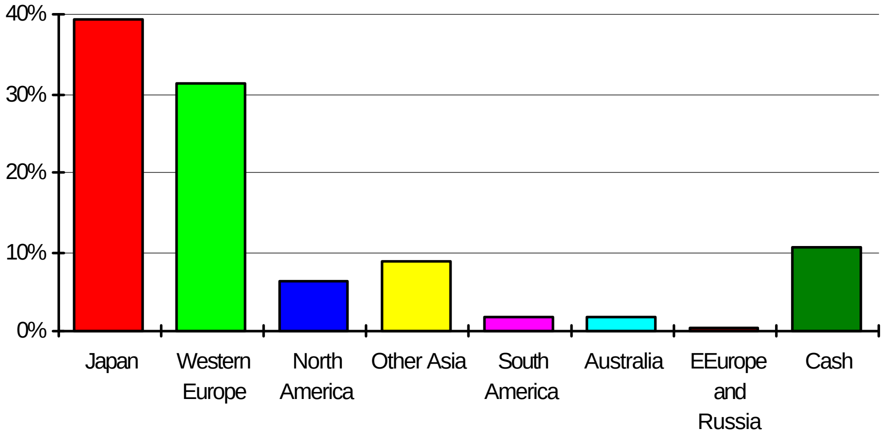
Changes to the Portfolio

Apart from our very large holdings in Japan and Korea, the thrust of the changes made to the portfolio related to telecoms and telecom equipment manufacturers. We added to our holding of Alcatel in France, introduced Ericsson, and added three telecom operators; GTE in the US, Korea Telecom (just before the ADR listing), and Hellenic Telecom (when it was depressed by the Kosovo crisis). We have also made a start on acquiring enterprise resource planning (ERP) plays such as JD Edwards and returned to our old friend Novell.

Breakdown of Portfolio (30 June 1999)

Manufacturing	SIG, MHI, Schindler, Lagardere	16%
Consumer Goods	Unilever, Canon, Citizen Watch, Lotte Confectionery	16%
Telecoms	DDI, NTT, Korea Telecom, GTE	14%
Hardware	Toshiba, Fujitsu, Samsung Electronics, Kyocera	12%
Service	Star City, Jupiters, Burswood	9%
Medical	Daichi, Acuson, Diagnostic Products, Hoechst	8%
Software	Intec, Softbank, Trans Cosmos, Novell, Samsung Corp	6%
Retail	Rinascente, Douglas, Hornbach	6%
Finance	Deutsche Bank, Toro, ICICI, Daiwa Securities	5%

Disposition of Assets



Commentary

To repeat the comment we made last quarter – the underlying drivers of this bull market remain intact. Most gratifying from our perspective has been the migration of investors towards the stocks and markets that we have favoured.

The surge in economic sensitive stocks has been an important signal of the change in sentiment of market players. In the month of April the Morgan Stanley Cyclical index surged no less than 20%. This movement was accompanied by a further rise in the yield of most bonds (led by US treasuries) which serves to confirm a change in the view of market participants of two things: firstly, deflationary pressures are easing and secondly, that the gap between price-taking enterprises and those with price-making power had simply widened too far. To justify such low prices it was necessary to believe that economic activity outside the US was likely to continue to worsen.

Since our last report there have been other encouraging signals. The debt ravaged economies of Asia have continued to achieve very strong export growth and in cases such as Korea, Singapore and Taiwan there is evidence that these economies are clearly growing again. In these three countries, industrial production is up over 10% on a year ago with Korea leading the field with an advance in excess of 20% in May. Inter-Asian trade is tending to bolster the laggards and it is likely that Thailand and Malaysia will be growing in the second half of 1999 which could lead to production across Asia, excluding Japan, rising by around 10% in the latter half of this year. Helping these economies has been the flood of foreign capital which has seen their currencies appreciate and liquidity conditions improve as their governments have intervened in their foreign exchange markets (thereby further adding to liquidity and dropping interest rates). Optimism and liquidity has seen their stock markets explode to levels at or above those prevailing before the “Asian crisis” (and up on average 52% year to date).

Just as Asia has surprised professional forecasters with its resilience (in the face of a bankrupt banking system), so Latin America has surprised with its resilience and remarkably low inflation in the face of currency devaluations.

The economic figures coming out of Japan are mixed and the responses we got from our recent visit to a broad range of Japanese companies suggests that the consumer is still very cautious. However, we think the economy has stabilised in view of the trade figures with the rest of Asia and from reports by US technology companies trading in Japan. The official figures, the Tankan survey, just released, showed an improvement in business confidence and the intention to cut capital spending remains in place. To reiterate our thinking, the stock market in Japan will continue to rise on the basis of corporate restructuring and reduced capital spending which will lead to higher levels of returns on assets. Our bullishness is not predicated on a strong economy in the first instance.

An element of patchiness remains in the capital-spending-sensitive economies of Europe such as Germany and Italy but given the strength of the small European economies and the prospect for improving exports, it is likely that Europe will finish the year strongly. Further evidence of a more friendly attitude towards business was evident in Germany with the passing by the Centre-left coalition of the tax reform bill which will reduce corporate taxes to 35% in 2001. However, legislators continues to drag their feet on important but sensitive reforms such as pensions.

Without wishing to be churlish, we feel obliged to point to the role that debt has played in bolstering activity in the strongest economy of all: the US. In the 18 months since Mr Greenspan's celebrated enunciation on market exuberance, debt has risen by US$3.3 trillion or 40% of GNP. House owners, who constitute 66% of households, have generally taken full advantage of falling interest rates to do two things. They have rolled-down their mortgages into lower rates, mostly on fixed terms, and secondly, in doing so, they have tended to add to their indebtedness and to cash out an average of US$15,000 per household for use elsewhere (not an insignificant sum in relation to median household income of US$37,000).

Personal debt now stands at US$5.6 trillion of which US$4.2 trillion is mortgage debt. The non-mortgage obligations will be sensitive to further rises in interest rates while existing mortgagors will only typically face rising rates when they wish to buy a new home (normal occupancy is for 7 years). The duration and steadiness of this economic expansion has done wonders to inject confidence across all strata of consumers (confidence is now at a 50 year high). This is highlighted by the retail sales growing at close to 6% versus incomes of 3.5%, pushing the official measure of the savings rate to minus 1%. With this in mind, we were puzzled by the Fed's meek response of one quarter of a percent rate hike in June and believe it is going to be a game of catch-up through the rest of the year. The Fed is evidently looking for more concrete evidence of price inflation and perhaps they still have an eye on the precarious situation of external economies. We believe that there are very strong reinforcing elements within the US economy and the interest rate medicine that is eventually administered will need to be a lot stronger than many presently contend. Hence the risk is that bonds peak at much higher yields than investors presently envisage.

Currency

Presently 55% of assets are hedged into the A$. The portfolio has exposure to the Yen of 15%, the Euro, Pound and Swiss Franc of 20% and the remaining being to US dollar and related currencies. We have a somewhat agnostic view on the Yen in that surpluses and remittances are working to strengthen the currency and yet the Bank of Japan is trying hard to prevent it strengthening and in the last month has spent some US$22 billion selling Yen.

Outlook

We can see very little standing in the way of stock markets entering a period of euphoria. The central banks, led by Japan, continue to feed liquidity into the system. Corporate activity continues to absorb the stock of outstanding shares at a faster rate than new issuance. While economic expansion will broaden out in Europe and Asia, it seems unlikely to grow at a pace that threatens relative price stability or indeed fully absorbs the pool of cheap funds. Equity markets will respond with alacrity to an environment of positive earnings surprises and the absence of attractive alternative investments, notably, cash or bonds. Only in the US and UK (among the major markets) are we seeing much leakage into property. While the Japanese market has run hard in anticipation of better things, we do not believe a retracement will be particularly harsh on account of continuing positive news flow and the need for domestic savings to seek higher rewards.

Stock Story

With all the excitement about the internet and e-commerce, our unitholders must wonder what we're doing about "getting a share of the action". The problem we have as professional investors is to identify which are truly durable businesses versus ones that start well only to fizzle out on account of the e–road taking an unexpected turn. Having looked at a wide range of offerings, we concluded that the most attractive way to pursue the inevitable growth of e-commerce is to search for those companies that are not directly in the spotlight and yet will play a significant role in facilitating its advance.

Ericsson (Sweden)

A company that we have long followed found itself unusually friendless a few months ago. The shares of the giant telecoms equipment manufacturer Ericsson experienced two years of virtual hibernation as investors expressed concern about its relatively poor showing in mobile hand-set model releases (mobile phones) and continuing losses in the company's traditional business of telephone switches (exchanges). As is usually the case, the market was right in having reservations, particularly as newcomers such as Cisco were completely changing the rules by offering "routers" which in the internet protocol (IP) world all but obviate the need for traditional exchange equipment. Further, the street's blue-eyed boy Nokia had gained a lead over Ericsson in the highly profitable and fast-growing arena of mobile handsets. Adding to the discomfort was the concern about the company's exposure to big markets that were caught up in a credit crunch, in particular China and Brazil.

Our assessment was these were purely transient matters and did not detract from what is a core position in the emerging scene of mobile internet access. There is a lot written about the diffusion of personal computers (PCs) and availability of bandwidth but already in the advanced markets for mobile telephony such as Finland and Sweden, the volume of data is exceeding that of voice. Before we get onto that let's examine what Ericsson has to offer. Firstly it is by far the world's largest provider of wireless infrastructure (the base stations and network management software, which are the heart and soul of the network) with more sales than its three top competitors combined - Lucent, Motorola, and Nortel. Even more importantly, unlike these competitors, it can offer the full range of standards (GSM, TDMA and CDMA). Secondly, it is number two to Nokia in the supply of mobile phones and is likely to ship about 33 million units this year, some 14% of the world market. The profitability of the handset division should benefit from the release of several new high performance models this quarter. The business that has been causing problems is that of the traditional wireline exchanges. Here too, the company is a global leader with an installed base of 105 million lines and is presently downsizing the business. (As these facilities become more sophisticated they rely on more embedded software to the extent that their latest AXE switch occupies one tenth of the space of its predecessor.)

The growth in mobile telephony is truly colossal: from a base of about 300 million users at the beginning of 1999, the market is likely to expand to 1200 million users by 2003 with the peak in growth rate of new subscribers only expected to be reached in 2002, at 200 million pa. For those having concerns about our optimism, spend a moment on a street corner observing passers-by. Australian usage is now 30 % of the population while in Finland it is 60%. Crucially, the US market is just coming alive with penetration at 28% and climbing fast. The spend on infrastructure is therefore likely to grow at over 20% pa over the next four years.

The mobile phone market is equally interesting as users upgrade to take advantage of smaller phones or new features and standard changes (from analogue to digital etc.) Half of this year's sales, perhaps 120 million sets are expected to come from replacement demand. The problem one can envisage is that the very evident scale of demand is encouraging the entrance of new suppliers. This will be exacerbated by the convergence of standards which sees the Asian suppliers, Panasonic and Samsung, joining the fray significantly this year. Hand-set prices have been falling by around 20% pa and are expected to average US$196 this year. (Ericsson's strength in infrastructure rather than phones versus its principal rival Nokia sits well with us on this account. Nokia though, has done well to stay at the top end of the market by adding new features and due to clever manufacturing and marketing, has continued to earn high margins even as prices have fallen).

All this points to the company achieving sales growth of around 20% pa for several years. Profits could do better as the traditional wireline switching business returns to profit and the US based CDMA business expands. The exciting part though is the build-up in the use of mobile data transmission. This may sound dull, but think what it means. In this digital age, all information, speech and images can be converted into ones and zeros and hence data can mean sending a “movie” to a handset or laptop PC or say a salesman interrogating the company’s databank remotely, using a hand held device, while in the field. (Kyocera has already released a mobile phone with a built-in video camera plus display for those who like to chat and gaze!). The world of fully mobile, multi-media is right upon us. Ericsson is at the forefront of this aspect of e-commerce and just as the use of mobile phones has astounded some of us, so too will mobile commerce. The Japanese mobile operator DoCoMo will be the first to roll-out the new wide band CDMA standard in 2001 which will allow full video transmission to a mobile terminal (at 2 megabytes per second). But in the meantime operators everywhere are beginning to introduce equipment upgrades which will allow mobile users to receive and transmit data at high speed.

Unlike some areas of the internet, the roadmap is fairly clear and Ericsson’s place in the market reasonably well defined.

The shares have moved up some 20% since we bought them but as a leading contender in this booming industry, we believe it will continue to achieve its trend growth rate of the last 15 years of over 15% pa.

Kerr Neilson
Managing Director
8 July 1999

The distribution at 30 June 1999 was 20.7 cents.
This amount has been automatically reinvested into additional units.