PLATINUM ASSET MANAGEMENT

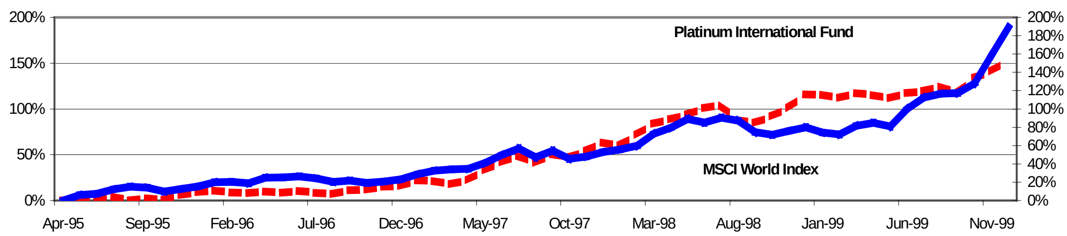
The Platinum International Fund

Quarterly Report

31 December 1999

Performance

Cumulative Performance since Inception - 189% (A$)
(1 May 1995 - 31 December 1999)



After a dull period from July through to September, world share markets had their "traditional dip" in October and then recovered to end the year on a thundering note. The notable feature was the performance of the secondary markets such as Brazil and Indonesia – up by 55% and 42% respectively in A$ over the quarter, indicating investors' willingness to assume greater risk in recognising these countries' improved prospects in a strongly growing world. Among the large markets, France and Germany achieved gains in excess of 20% while the likes of Japan rose 16% and the US by 17%.

The fund's investments have done well in this period outpacing the MSCI World Index by 16% to rise by 33%. This strong performance, despite our retained 20% short on Wall Street, was a function of our large exposure to telecoms and IT type companies. Combine the retention of insurance with the cash we traditionally hold, and it is apparent that our stock selection skills have shone through.

Changes to the Portfolio

It has been a difficult period to maintain one's investment disciplines as information technology, the telecoms and their suppliers have flown in recent months. With many of these holdings having more than doubled over twelve months, mainly on changes of perceptions rather than reality, we have tended to gradually sell down into the buying splurge (companies such as DoCoMo, DDI, Ericsson, Alcatel). That bandwidth will be sought in ever greater quantities we do not doubt, however, there is great excitement in this market segment and valuations reflect this.

There are times though when despite great excitement, unusual investment opportunities come along. A case in point was SK Telecom in Korea. As Korea's leading mobile telecom carrier, it was languishing under heavy selling pressure from forced liquidation by a well-known hedge manager. This technical factor, plus well-aired concerns about the behaviour of its parent, were upper-most in investors' minds. It was our appraisal that the issues were transient and the concerns exaggerated, particularly when evaluated against its dominance in mobile, with a market share of 42%, represented by some ten million subscribers. Compared with similar businesses elsewhere, it was a fraction of its appropriate valuation. This has been partially rectified with the share having trebled in the intervening three months, though it still is not expensive. It is for this reason that our exposure to telecoms remains high notwithstanding some significant culling of existing holdings.

A similar pattern prevails in IT and software. The group of companies through which we have chosen to exploit the theme of web-enablement, namely PeopleSoft**,** i2, JD Edwards, Baan and Novell have all performed well. However, the price action of i2 has been exceptional rising from $34 in July to its present level of $200. We have been selling it continuously since it rose above $90. This again masks the underlying change in the composition of our holdings as the proceeds from i2 have been used to acquire small stakes in Manugistics, Seagate, AMD and National Semiconductor.

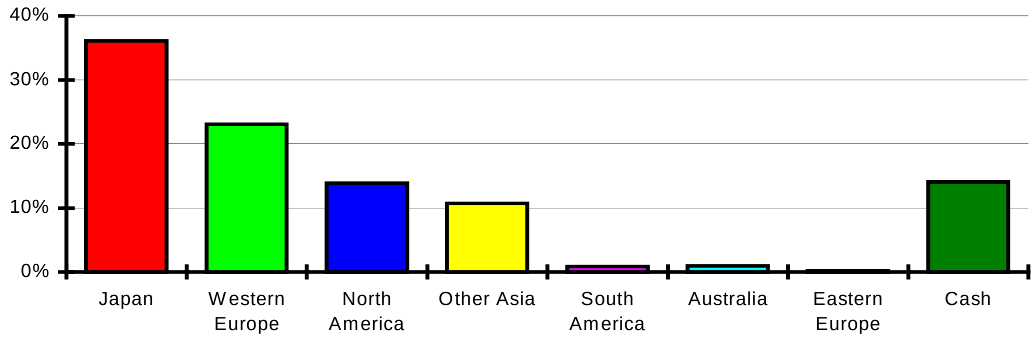
We have written before about the need to appraise companies on the basis of their position within global industries. However, to the extent that we do look at the portfolio on a geographic basis, it might be described thus: information technology holdings are concentrated in the US, telecoms in Asia and cyclical type of companies in Europe. As we have sold down the telecom equipment companies (Ericsson and Alcatel) we have been adding the likes of Akzo, Bayer, Linde and Stinnes.

If one paid heed to the sentiment of the day, these companies almost fall into the no-hoper category. The fact that they have dominant positions in parts of their various businesses, have a history of continuous growth – even through the recession of recent years – and in fact grew their earnings in most years and continue to work assiduously on their costs and asset utilisation, seems of little interest to most. However, it's of considerable interest to us.

This is because we see Euroland entering one of the most positive cycles in recent history and increasing attention is being paid to supply-side reforms now that member countries no longer have individual control of their interest rates and exchange rates. Government retrenchment has ceased, traded goods prices are no longer falling, while the service sector faces significant price erosion with the likes of telecom and electricity prices falling significantly. With services accounting for two thirds of the economy, this will keep downward pressure on general price levels. Further, credit reflation, rising optimism and surging exports - aided by a weak Euro - will allow economically sensitive companies that were on the receiving end of deflationary pressures to flower over the next two to three years.

While investors' eyes have been attracted to the excitement of internet and related IT stories, traditional manufacturers in Europe have languished. Even though the game may not be over for the tech sector, some of the most interesting values lie in the pure price taking companies (generally commodity producers of steel and other metals). However, we are more interested in the likes of Akzo, Bayer and Linde which have greater ability to differentiate their products and hold major strategic positions in their various market segments.

Disposition of Assets



Breakdown of Industries

Categories	**Examples of Stocks**	**Holding**
Software & Media	Nippon & Tokyo Broadcasting, Novell, JD Edwards, PeopleSoft, i2	19%
Telecoms	NTT, DDI, DoCoMo, S K Telecom	16%
Technology	Toshiba, Samsung, Kyocera	12%
Consumer Durables	MEI, Citizen Watch, Nippon Electric Glass	7%
Financials	Lippo, Toro	6%
Engineering	Sekisui Chemical, Siemens	8%
Consumer Brands	Lotte Confectionary, Japanese Coke Bottlers	5%
Medical	Acuson, Draegerwerk	5%
Commodities	Great Lakes Chemical, RMC, Akzo	4%
Retail	Douglas, Hornbach, Continente	3%

Currency

Presently 47% of assets are hedged into A$, 23% remain in the Euro, Pound and Swiss Francs, 18% in Yen and the balance, 12%, in US$ and related currencies.

Commentary

Investors who have been around for a while probably find this to be the most exuberant bull market in memory. The narrowness of the advance – being led by the technology shares; plentiful credit; the excitement of the new paradigm with its seemingly boundless opportunities, sufficient to dull one's critical faculties; the alchemy that allows newcomers to create fortunes almost overnight and the willingness of investors to pay up for promise, *on the basis that it is different this time,* all point to a classic bubble.

Before dismissing this as the ramblings of some burnt-out relic of past bear markets, consider this. i2, a share we are selling, having appreciated six times in four months is capitalised at $16 billion, has projected annualised sales of $850 million and profits of $80 million. By contrast, Microsoft first saw its capitalisation rise above $10 billion in 1991 when it had annualised sales of $1.8 billion and net profits of $462 million. We like i2 a lot, but the price is not building in much for the vicissitudes of the real world.

The concentration of assets and flows into the hands of leading fund managers is accentuating price movements. Strange as it may seem to lay investors, once a company has a capitalisation in excess of US$10 billion, it attracts the interest of large cap managers. This factor is made all the more important when a stock is included in the index against which they are measured. There tends to follow a buying splurge as these managers seek to re-weight their portfolios to include the new entrant.

Jonathan Wilmot, a global strategist with CSFB, puts it well "... factoring the technology revolution into stock-price performance is not a question of tidy, sensible valuations, but rather a chaotic discovery process that will eventually sort-out a relatively small number of huge winners from the hopeful crowd". He then takes readers through the economics of winning technology companies with s-curves and steep start-up hump curves and so-forth, which indeed is the way of the e-world. What none of us can know is when expectations exceed what is likely to be delivered.

The same sort of problem prevailed in the early 1970s during the "Nifty Fifty" bull market. This group of branded goods and information technology companies outperformed the general index for 5-6 years and *peaked* in mid-1970 yet their combined earnings continued to rise faster than the market average for the subsequent 17 years!! Some of the super heavy-weights of that era such as Disney and McDonalds achieved earnings growth of twice that of the S&P index over the subsequent 27 years and yet still *underperformed the market over that period*!! As always, it is not so much the potential of this era that is the question, but the price we should pay for the promise.

The scale of the opportunity, the sheer excitement of the daily announcements and the plentiful supply of credit lead us to believe that even after weeks of uninterrupted advances on Nasdaq, there could be more to come – after a short period of indigestion. How do we participate? In the first instance, the nature of these moves tends to reward slow sellers. However, this creates problems given our predilection for allowing a margin for error and trying to identify factors that are not common currency. Hence we are re-entering segments of the "old economy" that will not necessarily surrender their share of the cake – to the benefit of the "new economy" - and indeed will continue to earn attractive returns on capital employed. Helping them achieve this is an environment of less strict government treatment of mega-mergers. Over the coming months we are likely to build these investments at the expense of those IT and telecom stocks that have rewarded us so handsomely.

Conclusion

It seems highly likely that world growth will be very strong this year even if somehow the US consumer retrenches. Interest rates will rise which together with high valuations and fluctuations of currencies will destabilise share markets. These and other factors we have alluded to in earlier notes should encourage investors to take defensive positions.

Stock Story – Linde (Germany)

As has been noted in the above text and in earlier correspondence, the glitter of the new internet world has mesmerised investors. There are swathes of companies in the "old economy" which are unlikely to be harmed by e-commerce and yet have tended to be dull stock market performers, principally through lack of immediate vivacity. Linde is such a company which has a history of above average earnings growth during a period of difficult economic circumstances in its principal markets. When describing the underlying divisions, one is at a loss to make them sound fascinating.

Linde's main business is industrial gases. This involves separating air into its component parts of nitrogen, oxygen, argon via cryogenic fractional distillation or more recently, the use of clever membranes. Once separated, the gases are either piped to large customers, transported and stored in liquid form for smaller users or indeed distributed in steel bottles to smaller users still. The business tends to grow at twice the pace of the economy and as old uses decline in importance, such as oxygen feed to steel plants, new uses emerge such as its use in the purification of waste water. Alternatively, some of the rarer gases play an important role in the manufacturer of semiconductors.

The attraction of the business is the concentration that is taking place with several dominant players now setting the global scene. Linde, which is now the second largest air-separation company in Euroland, following its acquisition of the Swedish company AGA, is negotiating further to acquire Messer and this will take it to the position of number two worldwide. Though heavily concentrated in Europe, these acquisitions/mergers bring considerable economies and vastly enhance the company's longer term strategic standing. Savings are made through combining depots, sharing existing pipelines, optimising research and so forth.

The merger also brings a deeper set of skills such as a membrane technology from AGA and broader geographic coverage. AGA for example is the largest player in Latin America. The most important outcome from combining these companies (to include Messer) is the prospect of reduced competition. Both AGA and Messer, who like Linde have been investing heavily, have tended to aggressively cut prices in order to improve the loadings of recently erected plants.

The group's second largest division relates to fork-lift trucks. It is ranked number one in the world with sales 50% larger than the likes of Nacco and Toyota. This industry too has seen massive consolidation with Linde itself acquiring six companies since 1989. The business has consistently produced profits, though they are cyclical. Helping to smooth out the business cycle is the move to outsourcing. Here firms rely on suppliers like Linde to own and manage the fleet under long-term fleet management agreements. The company continues to improve its geographic reach with, for example, a joint venture in China. This factory will also target export markets in South East Asia.

Linde's other two businesses are engineering and contracting, and refrigeration. These have become less important as the industrial gases now account for 75% of profits and will become less so if the merger with Messer proceeds. However, they are both strong global businesses which have entrenched themselves through their commitment to R&D and global sourcing.

As investor sentiment gradually floats back to reality, we believe companies like Linde will benefit. They are relatively inexpensively priced, in fact cheap by historic standards, even as the company has gained a stronger commercial position. Moreover, profits are likely to accelerate as the Euro economy gathers momentum and its plant loadings rise and competition diminishes.

The Fund Size is currently $69 million.