PLATINUM ASSET MANAGEMENT

The Platinum International Fund

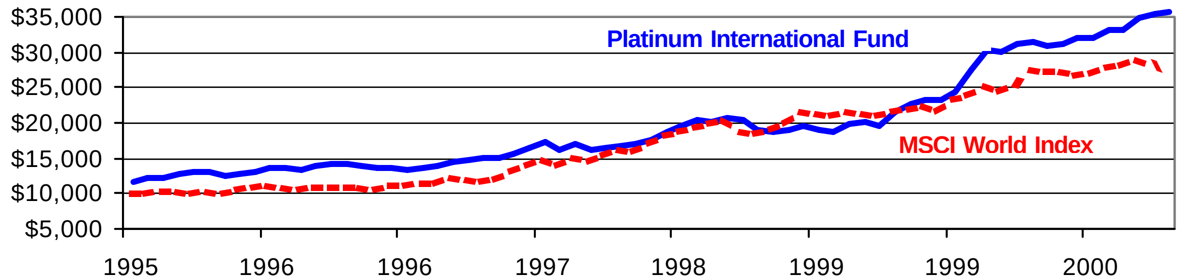
Quarterly Report

31 December 2000

Redemption Price: $1.6369 Fund Size: $180 Million

Performance

CUMULATIVE PERFORMANCE SINCE INCEPTION (1 MAY 1995 – 31 DECEMBER 2000)



It has been a gruelling quarter for investors. Initially some thought the market was simply accommodating a convergence of valuations between the highly valued tech stocks and the rest. Subsequently, the massive erosion of Nasdaq (down 33% for the quarter) and the other *Neuer Markts* of the world had a knock-on effect as concerns emerged about the broader implications of such value destruction. These included margin calls, credit delinquencies and other factors associated with a slowing world economy. Investors are now starting to come to terms with the reality that shares are not a non-stop express to wealth accretion. The Fund has been relatively well positioned for this change in sentiment. Apart from allowing cash to rise we have been actively shorting individual shares for which the valuations made no sense – companies such as EMC, Sun Microsystems, i2 Technologies, Oracle and so on.

As the quarter progressed we rotated into shorting other so-called defensive issues. These include banks/brokers and consumer branded goods – notably Bank of New York, Schwab, Budweiser and Colgate. While it is true that these companies can either benefit from lower interest rates and have more predictable profits, investors have, we believe, put too much store in these qualities and here at the end of the bull market are using them as hiding places rather than liquidating positions and building cash balances. Further we have maintained our shorts on the S&P index, which from here may give more protection than the Nasdaq index shorts.

The consequence of this activity is that the Fund has managed to rise by 18% for the year, after a fourth quarter advance of 8%. By way of contrast the MSCI returned 2% for the year, having had a miserable last three months when it declined by 9%.

The table below highlights the extremes of sector movements over the year within the MSCI.

INTERNATIONAL SECTOR EXTREMES

Sector	1 Year Change
Health Services	+90%
Healthcare	+57%
Industrial Services	+32%
Consumer Non-durables	+18%
Finance	+15%
Technical Services	-44%
Communication	-41%
Retail	- 9%

Currency

Over the quarters we have written about the effect of the US economy growing faster than the rest of the world, as well as M&A and investment demand causing an over-valuation of the US currency. We

believe this tendency reversed decisively in the fourth quarter as the US economy slowed and inward flows diminished.
This greatly helped the hedging position we had taken (albeit far too early) as we saw the Euro climb 7% versus the US$ and 13% versus the Yen. At year-end the Fund's main exposure was A$ at 45% and Euro/European currencies at 39%. Nearly all Yen exposure is hedged into A$, while half of the US exposure is hedged back into A$.

Portfolio Structure

Apart from sound stock picking and short selling, our relatively strong performances can be attributed to the changes in emphasis of the portfolio throughout the year. By March we had exited most of the over-priced tech and telecom stocks and began to move to low priced "old economy" companies which were very out of favour. This also happened to lead to greater exposure in Europe where we reasoned companies would be least affected by a retrenchment by the consumer in the USA. These simultaneous movements built-up our holdings in Europe and reduced them significantly in Japan. The following table quantifies these changes.

BREAKDOWN BY INDUSTRY

Categories	Examples of Stocks	Dec 2000	Jun 2000	Dec 1999
Cyclicals	RMC, Akzo, Bayer, Stinnes, Linde	19%	17%	12%
Financials	Lippo, Nordea, Japanese Brokers, Halifax	12%	9%	6%
Technology Hardware	Toshiba, Samsung, AMD, Fujitsu	11%	11%	12%
Telecoms	NTT, DDI, SK Telecom, Lucent	11%	11%	16%
Software & Media	Novell, Peoplesoft, Nippon Broadcasting	7%	9%	19%
Medical	Draegerwerk, Merck KgaA, Novartis	6%	5%	5%
Consumer Brands	Adidas-Salomon, Japanese Coke Bottlers, Wella	6%	6%	5%
Retail/Services/Other	Hornbach, Raytheon	5%	3%	3%
Consumer Durables	MEI, Sony	4%	4%	7%

DISPOSITION OF ASSETS

Region	Dec 2000	Jun 2000	Dec 1999
Western Europe	34%	26%	23%
Japan	19%	30%	36%
North America	18%	16%	14%
Emerging Markets (incl. Korea)	5%	8%	12%
Cash	24%	20%	14%

The Fund's short position is 5.5% against the S&P500 and 16% against individual companies.

Note that companies with cyclical earnings patterns, together with those companies sensitive to interest rates, now constitute 31% of the portfolio versus 18% a year ago. Technology, telecoms, and software are still well represented at 29% but well down from 47% last year. Moreover, within this category the valuations of our holdings are a fraction of those typically found in Nasdaq – specifically an average PE of 16.7x 2000 earnings versus an estimate of 115x for the NDQ 100 index.

Commentary

To counter the problem of myopia - caused by doing daily battle with markets – it is helpful to review the key points that were made about the US in our last three quarterly reports. Starting in March, we referred to Mr Soros' concept of reflexivity and how once the tide changed the trend becomes mutually reinforcing. In June we alluded to the risk of deteriorating consumer confidence in the face of falling stock market values. By September we were pointing to the Euro and oil price as damaging the "priced-for-perfection" mentality and introduced the prospect of a soft landing. Intertwined throughout were references to the over-leveraging of US consumers and companies, the poor pricing environment facing companies, the distortions within the system (tracking stocks, excessive option grants, deteriorating credit) and other evidence of a mania which was most starkly revealed by eccentric valuations of tech stocks relative to the so-called "old economy companies".

As we enter the new year, the tone of the market has changed considerably. There is consternation about the speed of the slowing in the US economy as witnessed by the recent decision by the Fed to cut the discount rate by 0.5%. In time, one can envisage the discussion moving as to the next rate cut and to the debate on tax cuts as the evidence of economic slowing intensifies.

At this stage we are largely agnostic about the degree of softening that the US economy may experience. From our work on credit we get no comfort.

As you know, our underlying fear in the US has been the growth in debt and the impact of stock market weakness on consumer confidence. In the last five years the debt/equity ratio of US corporations has risen from 74% to 82.6% despite an extraordinary rise in company profitability. This is reflected by the decline in labour's share of the cake when expressed as labour costs to companies revenues; towards the base of the normal band of 62-68%. By contrast, earnings per share has accelerated from the normal trend of 7% pa to around 12% pa since 1995. This latter growth rate is partly attributable to massive share buy-backs – amounting to $416bn (partly funded by greater borrowing) but underlying margins have also widened as a consequence of robust demand and well contained costs.

As some share prices collapse, the wisdom of buy-backs will come under scrutiny. More importantly though, the concerns about the burden of debt – which was in earlier years expressed in terms of optimising a firms balance sheet – is being reflected in a significant blow-out in lending spreads. BAA companies, the average of the S&P500 index, must now pay 2.6% more than US treasuries (versus 1.2% in January 2000) and even top AAA's credits are required to pay 1.8% over treasuries. (The treasuries themselves have continued to strengthen – perhaps warning of a more difficult environment as well as the fact that the budget surplus is curtailing supply of government bonds).

The banks are already experiencing a rise in non-performing loans (NPLs) but in very specific areas where it became fashionable to borrow against supposedly secure income streams – notably funeral homes, cinema chains and at the extreme, competitive local exchanges (CLXs).

There is not much evidence yet of rising consumer delinquencies.

We remain highly vigilant because of the still large balance of outstanding share margin accounts at $219 billion in November. Further, we believe that households applied some of the benefits of mortgage refinancing to play the market. Lurking in our subconscious is the belief that the credit induced mania just witnessed must have cultivated some extraordinary expectations, the folly of which will only be revealed gradually, if starkly.

One should not, however, paint too gloomy a picture for the US. As noted earlier, the government's finances are in the best position for years – which will allow for massive tax cuts. Even so, we are somewhat circumspect about the US$1.2 trillion touted in view of the balance of power in Washington – any deal is likely to be protracted. Further, the Fed can drop rates significantly to prop-up confidence. We believe the inflation implications are very low even with the US$ weakening, principally against the Euro, because of the deflationary bias around the world. However, these steps will only partially ameliorate the likelihood of labour's share reverting to the mean. By way of example, Microsoft has already indicated that it will bolster wages in the face of the loss of value of its staff option schemes.

We are somewhat more sanguine about Europe. While the EU is also slowing, there are several factors that should provide a growth buffer. Firstly, the big economies of Europe have been lagging behind North America and consequently they are at a different phase of the cycle. Europe has only recently began to issue stock options and the public's ownership of shares is relatively small. Further, European predilection towards shares is notoriously lower than in the Anglo Saxon countries so the adverse affect on consumer sentiment will be correspondingly lower. After five years of belt-tightening by governments, 2001 will be the first year of fiscal expansion, led by Germany, with tax cuts equivalent to 1.2% of GNP. France and Italy have smaller cuts but the move to tax reform is well established.

Japan and Korea give us little room for comfort at the macro-economic level. The leadership under the LDP will go down in history as some of the most inadequate in modern Japan. Fortunately, companies are very aware of the threats and opportunities of globalisation and rather like in Italy, our investment faith resides in the calibre of the people, their education and commitment to leading-edge technologies. Our recent visit highlighted the breadth of know-how in the digital world and optics (the backbone of modern telephony). Our investments in North East Asia are highly selective and tend to have a technology bias. Built in to our stock selection is the view that both Japan and Korea will lose growth impetus as a consequence of a slowdown in the US.

Conclusion

While global headlines may initially carry a prognosis about interest rate and tax cuts, and budgetary stimulus, the key will be the performance of company profits. When we examine the underlying arithmetic of global markets we find that earnings in the last five years have risen about 10% pa which together with rising PE's (multiple expansion) from around mid-teens to 26x has lifted share returns to above twice the historic average of around 9%. While bond rates are likely to remain subdued, which helps valuations, the higher risks associated with slower growth and poor pricing power is likely to cause some multiple contraction – thereby reducing returns. We therefore see further mileage in the theme of the convergence of valuations. At the same time, companies producing volume sensitive items (mostly commodities) are in many instances investing at less than their depreciation rates. This theme of capital starvation, which should logically lead to a period of higher profitability, should throw up some good opportunities – particularly when it is reinforced by plant closures and mergers. In the case of pulp and paper, for example, International Paper, following its acquisition of Champion International, cut a full 825,000 tons of annual capacity – 5.5% of all US production.

Our third theme relates to productivity take-off. Just as the US experienced a productivity surge from the mid-90s, we believe companies in continental Europe and Japan can experience the same benefits attributable to changes in information technology and ways of doing business. Now that the Europeans have bedded down their "systems" in a single market of 350 million consumers, it is quite plausible to expect the growth in labour productivity to outstrip that of real labour costs. Japanese companies will have less help from their domestic economy, which we expect to remain flacid, but the indications to date have exceeded our expectations.

Stock Story

Anritsu (Japan)

Founded in 1895 Anritsu has traditionally focused its business activities on communications systems. It claims to have started mass production of telephones in 1908 and to have produced the world's first wireless phone in 1912. Today the company is best known for its communications testing equipment where it has 15% of the world market and competes against the likes of Agilent (ex Hewlett Packard) and Ando Electric (an NEC affiliate). These testers are used on a wide variety of equipment including fixed line, mobile and optical systems and components. The basic aim of the tester is to measure whether a particular system or component is performing in line with its specifications. For example they can locate faults in undersea communication cables to within a distance of eight metres.

The traditional view of Anritsu is of a company very closely tied to NTT and its spending patterns. The company had a very good time in the 1980s with double digit sales growth and operating margins of around 10% but the good times faded with the economy in the nineties. The international market was seen as problematic for two reasons. The first being the different technology choices taken by NTT in order to protect the local suppliers and the second being the dominance of Agilent and its greater experience with open systems and software.

When we first visited Anritsu in December 1998 they talked openly about these issues and we came away with the impression that in time they could remodel their business away from NTT. The major positive they emphasised was the emergence of WDM technology (wave division multiplexing) which they saw as potentially a very big market. They also talked about a restructuring of the company which could include withdrawal from some previously cherished business lines that were now loss makers. At the time we preferred to wait for some confirmation before becoming more positive while being fully aware of the potential.

Coming into 2000 it became apparent that telecom carriers worldwide were going to have to make major investments to facilitate the data traffic explosion. Anritsu's share price at the time languished at around 1000 yen despite being well positioned with major market shares in many of the areas that would require testing equipment for these upgraded networks. Part of the reason for the lack of interest was the typical time lag between investment in telecom networks and the purchase of testing equipment. This meant Anritsu had not yet seen the benefit in its order numbers. At this time we purchased the stock. Subsequently the orders have come through and in addition the company has raised its global market share from 20% to 60% with its new 10gbps Sonet analyser. This is now the tester of choice.

Apart from testers the company is involved in two other interesting areas. The first is multilayer switches which came out of the acquisition of a Californian company called Wiltron in 1990. These devices are the intelligent switches used to route internet traffic around corporate networks with much higher efficiency. This is an entirely new business for the company where it will be competing against the likes of Cisco. However, expectations for the product are low despite it seemingly being very competitive technically. In terms of the share price there is nothing embedded for this possible new leg to the company. The second area is optical components where the company is a small player but is growing fast. The main products are pump laser diodes used in optical amplifier modules. Recently the stock has moved above 3000 yen and we have started to reduce our position. The good news would appear to be mostly in the price with continual profit upgrades, long lead times on new testing equipment and aggressive talk by management about profitability. However, the reality is that telecom spending will slow and this will have an impact on tester demand. The positives that could boost the stock further are a rise in telecom capex by NTT, including introducing W-CDMA for mobile and broadband solutions for the fixed line.