MLC PLATINUM GLOBAL FUND QUARTERLY REPORT
AS AT 31 OCTOBER 1997

Performance

The Asian markets have been the eye of the storm with concerns about competitive devaluations and capital flight resulting in the markets of the region declining by between 10-35% - all in but three months. The Western Hemisphere faired better but still recorded declines ranging from 1% to 15%. As the Australian dollar depreciated by 4% over the quarter, these declines were correspondingly more muted.

Our absence from the US market which has remained among the best performing market this year, continues to detract from our relative performance. We can identify several factors which will cause a change in this situation.

Fund Size: $335mn	Year to Date	Last 12 months	Last Quarter	Return Since Inception
MLC Platinum Global Fund	20.4%	23.4%	-4.4%	49.2%
Morgan Stanley Capital International World Index (Accumulation)	26.7%	31.4%	-1.5%	61.9%

Changes to the Portfolio

The significant changes in the portfolio included the addition to our interests in Banking and Finance companies in Italy. Coming off a low base, this sector is starting to experience the winds of change that have swept North America and elsewhere. We have added further to our holdings in Rinascente (principally hypermarkets in Italy), where the benefits of a new management/ownership structure is having a significant impact. Elsewhere in Europe, we have continued to add to smaller holdings while selling out of Deutsche Bank and Daimler Benz - both of which have delivered the best part of their potential. In North America, we have added to Great Lakes Chemical and introduced King World Productions while eliminating several smaller holdings.

Our experience in Asia has been fortunate, having sold down Indonesia ahead of the crisis, we have been able to cherry pick some bargains in the subsequent panic. In Japan, our stocks which were picked on the basis of their world competitive qualities and improving profitability have been left largely unscathed by that market's continuing downward re-rating. We are cautiously collecting holdings in some domestic orientated issues.

Concerns about the adverse ripple affect which have been damaging Asia caused us to reduce holdings in Indonesia, Korea and Brazil. Hence the relatively high holdings of cash at present.

Top Ten Holdings (as at 31 October 1997)

Stock	Country	Industry	% Holding
Rinascente	Italy	Retail	3.7%
Fuji Photo Film	Japan	Photographic Equipment	3.5%
Siemens	Germany	Electrical Engineering	3.2%
Schindler	Switzerland	Construction	3.1%
Yamanouchi Pharm.	Japan	Pharmaceutical	3.1%
Daiichi Pharm.	Japan	Pharmaceutical	2.5%
SIG	Switzerland	Industrial Conglomerate	2.4%
Nintendo	Japan	Home Entertainment	2.4%
Canon	Japan	Office Equipment	2.3%
Lagardere	France	Media/Defence	2.3%
TOTAL			28.5%

Disposition of Assets

Region	31 October 1997	31 July 1997
Western Europe	35%	35%
Japan	29%	34%
North America	6%	3%
South America	5%	8%
Other Asia	4%	10%
Australia	0%	1%
Cash	21%	9%

Currencies

Our currency position is as follows:

US Dollar related assets	41%
Australian Dollar	20%
Deutsche Mark, French & Swiss Franc	8%
Pounds Sterling	5%
Italian Lira	5%
Japanese Yen	21%

Current Developments

The precipitous decline in many of the markets of the Pacific Rim reminds us how confidence can shear. The break in confidence is explained by the realisation that the honeymoon period of huge inward investment flows are over for now. These flows in large part originated out of the desire by multinationals to tap low production costs as they adapted their businesses to the new paradigm. Further, it is apparent that these countries will no longer be able to bask in the comfort of low interest rates which resulted from their currencies being tied to the US$. With interest rates now likely to be driven by domestic needs, in particular to attract funds to stabilise their exchange rates, we can expect rates to remain at higher levels than hitherto. This has clear adverse implications for corporate profits and the valuations thereof. (It should also be said that the great surge in these markets in the last 10 years was driven more by a revaluation of earnings than their growth rate, which at around 15% pa, was good but not spectacular).

Going forward, we believe the economies of Thailand and Malaysia face significant restructuring. Interestingly, large company valuations do not seem to fully reflect the damage that has been wrought. Many now have considerably increased indebtedness because of the translation effect of their large foreign currency borrowings. Combine this with recent additions to capacity, in a world where traded goods are in abundance, and it is clear that deteriorating domestic demand and confidence simply adds to their woes. That the smaller specialised companies are relatively cheap is a reflection of investor emphasis on liquidity and concerns about fair treatment of minorities.

We feel that Indonesia has handled the crisis in a more pro-active manner than their neighbours, although their banking system is impaired. The removal of foreign ownership restrictions that coincided with a panic sell-off has driven down the value of several very attractive Jakarta listed multinationals. Though their growth rates will in the near term decline, their longer term prospects as purveyors of household necessities to a growing population is essentially unaffected. On valuations similar to their inherent growth rates, these are some of the cheapest companies that we have recently found.

The deterioration in the Pacific has important consequences for Japan and China. In the case of China, almost overnight a group of countries with a population total of some 350 million people have taken a “wage cut” varying between 20-50% due to currency devaluations. For a country in the midst of economic transformation, as it attempts to raise the efficiency of State owned enterprises and remove an overhang of surplus capacity, this is an unhelpful development.

For Japan, the deterioration of exports to the region adds to the burden of an economy already writhing under the burden of the higher consumption tax introduced in April. This shock has acted as a catalyst to devalue large segments of the Japanese stock market which had hitherto levitated on hope and history. Broad categories of companies that have paid little heed to profitability for a long time are now being sold down mercilessly to below book value. This process may involve a prolonged period of investor scepticism. However, it can be viewed in a positive light because the correct pricing of risk is a necessary pre-condition for the broader restructuring that the economy needs. If one juxtaposes these massive deratings with the actions already instituted by the leading companies in the form of a cautious adoption of share buy-backs and the introduction of executive share option schemes, it is clear that impetus is being added to the Japanese restructuring story.

However, the Japanese stocks we hold were chosen precisely because they were either already internationally competitive or as domestic-orientated companies had began to emphasise profitability rather than market share alone. In the last 12 months for example, our Japanese stocks have returned 18% against a market that has declined 15%. (Over two years, the return was 40% versus -3% respectively).

Europe contrasts starkly with Asia with valuations improving against a background of low inflation, low interest rates and accelerating activity. Trailing the US by a good 5-7 years, the benefits of restructuring are gradually coming through. We feel our European stocks offer better prospects than the many wonderful companies we have researched in the US which have already seen an extraordinary expansion of their profit margins over the last ten years. For example, the after-tax return on sales of the “Nifty Fifty” group has risen from 8.6% in 1987 to a projected 11.8% for the current year, an improvement of all of 37%. However, as noted in earlier correspondence, the sharp intra market rotations do periodically throw up interesting prospects. (Please do not interpret this as a change in our fundamental view regarding valuations).

Outlook

The events of late October suggest that world share markets are probably entering a new phase. The three areas of concern which we have highlighted in the past remain: weak pricing power, a deflationary bias in prices and currency instability. None of the events in Asia has ameliorated these risks.

The impact of the deterioration in Asia reduces global growth prospects somewhat but equally importantly raises the risk premium attaching to shares. With the liquidity argument clearly having betrayed itself as merely a precondition for strong rises in equity prices, the markets will now be adjusting the valuations to take account of a world where pricing power is rare and where aggregate demand is weaker than some would have expected.

With the veil of liquidity being removed and the concerns about risk being given a higher priority, it is probable that the market will over-react initially. It is possible that companies whose businesses are barely impaired by this transitional phase will be as badly treated as those with lesser prospects. As you are aware, we have been positioning the portfolios for an environment of weak pricing and lower valuations. As a consequence we hold significant amounts of cash and hedges against the US market (net short S&P500 index contracts). The remainder of the assets are deployed principally in Japan and Europe where our chosen stocks are presently trading on sensible valuations and are likely to achieve earnings growth from restructuring and volume gains over the next few years.

Stock Stories:

Shimano Industrial (Japan)

Do you ever consider when riding your bicycle down the street who manufactures the intricate metal parts that make up the brake, gear or pedal systems? The chances are that with 70% of the world market for these products it’s made by Shimano. Within the cycling industry, the Shimano name is dominant and synonymous with high quality and performance.

Shimano’s success is based on a strong background in cold forged manufacturing techniques, a culture of leadership in product innovation and the ability to capitalise on trends in the industry such as the mountain bike boom of the late Eighties and early Nineties. It also has a very strong international focus which included the early shift of production into Asia, and a strong international sales force backed by promotion of key cycling events. Shimano has entrenched itself as a must-have brand amongst the professionals which has served it well in the mass market. The top twelve cyclists in the Atlanta Olympics mountain bike events used Shimano components.

The doubts surrounding Shimano have related to its volatile profit record in recent years as the mountain bike boom of the early Nineties faded and the major economies, and in particular Europe, dipped into recession. The market has tended to tag the stock as ex-growth and valued it accordingly. However the reality is that its products are targeted at leisure related markets which would seem to be growing at rates well in excess of GDP attributable to rising wealth levels and the opening of new markets. For example, in bicycles Shimano is seeing very high growth rates from new markets like Brazil and Eastern Europe and at some point the 35 million bikes sold annually in China will start to use Shimano gears.

In essence, we believe that Shimano is a well managed growth company backed by high market shares, a record of innovation, strong consumer brand recognition and of being able to pick trends in its markets. Its competitive position seems as strong as ever with all of the advantages of being at least ten times the size of its nearest competitor. Our first purchases were made at around ¥2100 and subsequently the stock has moved up to around ¥2800 as it recently announced a 32% upward revision to earnings estimates for the November 1997 year. At this price, the stock still appears to have further upside given a modest PE of 27x, significant amounts of cash on the balance sheet and prospective growth in earnings and cashflow.

<u>AGIV (Germany)</u>

How does management react when faced with losing their jobs due to the potential sale of the company they work for?

Sell off two thirds of the business and restructure the remaining third!

AGIV is a German diversified conglomerate which is 50% owned by BHF Bank. After a rash of earnings disasters throughout the first half of this decade, BHF Bank have been threatening to sell AGIV. In fact, it was a bid for the company by Metallgesellschaft that initially attracted our attention. The sale fell through, but our research revealed a company that was going through enormous change as management fought to justify their existence (and preserve their jobs).

In 1995, AGIV had sales of DM10bn which comprised businesses in the property sector, construction, transport logistics, electrical contracting and electronic/mechanical engineering. To give you an idea of the diversity of the portfolio, they also owned a ski resort in Germany and a small travel agency!

Most of AGIV's businesses weren't particularly interesting to us. The exception, however, was the electronic/mechanical engineering division. The businesses in this division (Schenck, Barmag, Spectris, Andritz) have strong technology, are global by nature, and have large shares of their respective niche markets.

As was the experience of other German industrials, the electronic/mechanical engineering division has seen profits subdued by the strong Deutsche Mark and deep European recession. The misery in the environment, and management's need to perform has seen dramatic restructuring take place. **With the more competitive Deutsche Mark, the pick-up in demand and benefits of restructuring coming through, profitability is recovering rapidly.**

As part of a wholesale reorganisation of the company, AGIV are now going to focus on the strong electronic/mechanical engineering businesses. After years of making diverse acquisitions, the mentality shift within the organisation is astounding. Over the last 12 months, AGIV has sold their largest transport business, their largest construction business and a number of smaller companies. In total, this has reduced group sales by 35%. We believe the disposals will continue until only Schenck, Barmag, Spectris and Andritz remain.

When AGIV has finished trimming its portfolio, they should have net cash close to one third of their current market capitalisation. At that point, it is likely cash will be paid back to shareholders. The effective result is that we get to own the well positioned electronic/mechanical engineering businesses, which have rapidly recovering earnings, for a low price.

AGIV shares have risen 50% since we started buying in February. Although getting closer to our targets, we still see upside from here.

Kerr Neilson
Platinum Asset Management