PLATINUM ASSET MANAGEMENT

MLC - PLATINUM GLOBAL FUND

QUARTERLY REPORT
31 January 1998

Performance

Fund Size: $357mn	Last Quarter	Last 12 months	Return Since Inception
MLC Platinum Global Fund	6.5%	24.2%	59.0%
Morgan Stanley Capital International World Index (Accumulation)	8.9%	30.8%	76.2%

The last three months have witnessed an astonishing divergence in performance of stock markets around the world. In the Far East, the markets of Korea, Indonesia, Malaysia and Thailand have seen their indices decline and recover by amounts that are typical of full blown bear and bull markets (although these normally take place over many months). Nevertheless, the region has suffered wealth destruction on a scale that has not been seen since the 1930's. By contrast, the European markets were strong, improving in a range between 12-23% while the US continued its seemingly inexorable climb, rising by 10% (in A$ terms).

Our heavy exposure to European and North East Asian companies paid off in the last three months: in particular our companies in the European financial sector raced ahead with AGF (insurance) being bid for 70% above our entry price of just four months ago, while San Paolo and Mediobanca (banking) have run on consolidation considerations. Greater belief in the government's determination to stimulate the economy has led to a strong rally in Japanese domestic orientated companies. This was beneficial to our portfolio which has been gradually shifting away from exporters towards companies sensitive to the local economy such as Nippon Broadcasting, the Coca Cola bottling companies, house building (National House), retailing (Jusco) and consumer finance (Takefuji). In response to the successful outcome of the debt negotiations, Korea rebounded led strongly by our two holdings - Samsung Electronics and Samsung Fire & Marine, the former nearly doubling over the quarter.

As an aside, it is interesting to observe how the Italian public, who have traditionally been large savers and investors in government bonds, have taken to investing in shares. With bond yields having converged with the low levels of their EU neighbours, flows into share funds were approximately A$9 billion in January. This wave of money, principally collected by the large banks, is very similar to the experience in the US market.

Changes to the Portfolio

As noted above, we have been gradually shifting the holdings in Japan away from exporters like Fuji Photo Film, Canon and Nintendo towards the domestic orientated companies. We also took advantage of depressed conditions to take small positions in Daewoo Electronics and LG Electronics and added to Samsung Electronics, while in Europe, we acquired UBS (banking), Deutsche Telecom, Canal Plus (pay TV) and Sainsbury. Having been a good performer, yet facing the prospect of a deterioration in some of its Asian growth markets, we chose to dispose of Guinness. The hype surrounding its merger with Grand Met made for a particularly attractive exit price.

Top Ten Holdings (as at 31 January 1998)

Stock	Country	Industry	Holding
Fuji Photo Film	Japan	Photographic Equipment	3.8%
Rinascente	Italy	Retail	3.7%
Siemens	Germany	Electrical Engineering	2.9%
Schindler	Switzerland	Lifts/Escalators	2.8%
Swiss Industrial Group	Switzerland	Packaging/Engineering	2.7%
Samsung Electronics	Korea	Electronics	2.6%
Daiichi Pharm.	Japan	Pharmaceutical	2.6%
Yamanouchi Pharm.	Japan	Pharmaceutical	2.5%
Lagardere	France	Media/Defence	2.4%
Suez Lyonnaise	France	Water Utility	2.1%
Total			**28.1%**

Disposition of Assets

Region	31 January 1998	31 October 1997
Western Europe	37%	35%
Japan	27%	29%
North America	7%	6%
South America	5%	5%
Other Asia	5%	4%
Australia	1%	0%
Cash	18%	21%

Outlook

Commentators are remarking on the similarities between the events in South East Asia and those of Mexico at the time of the devaluation of the peso in early 1995. The circumstances of each case are different. Although much of the immediate damage has been revealed and indeed the shortcomings of credit allocation within Asia have been exposed by the markets, there still remains the uncertainty of a period of declining economic activity, rising domestic prices and the resulting political uncertainty. The same held in Mexico with the stockmarket anticipating the turnaround in the real economy by many months. In the case of Asia, the effect of a co-ordinated effort by the IMF and major banks to reschedule debt repayments has given some stability to currency markets by shifting some of the lenders credit risk onto the shoulders of government.

Opportunities within the markets vary enormously. Many of the large multi-faceted companies have so burdened their balance sheets with US denominated debt, that the sliver of equity that remains causes the shares to be priced like options. Similarly, the credit-granting institutions are difficult to evaluate. On the one hand they look interesting in terms of their historic book value and yet it is obvious that the write-off of non-performing loans will cause book values to shrivel and thereby prevent these businesses from growing for some while. The traditional growth companies that purvey daily necessities have come through with valuations relatively unscathed and hence in a relative sense are not screaming buys. The most interesting category seems to be those smaller companies with a history of strong growth and high profitability. These tended to be sold off in the general panic of the markets.

With prices having recovered strongly we suspect there will now be a period of consolidation as investors try to interpret the unfolding pattern of real activity within these economies (as opposed to the asset repricing which is the role of markets). There are many uncertainties, not least of which is the way China responds to the pressures from its neighbours. Apart from being in the midst of major economic reform and with stresses on its banking system, the Chinese economy has slowed to a snail's pace and exports are under severe pricing pressure. Fortunately, the economy is not dependent on foreign flows on account of its vast internal resources and in an attempt to reignite activity the government has revealed plans to spend heavily on infrastructure. The hope is that these measures prove sufficient to bolster activity and that the country will not need to resort to a devaluation of the yuan.

While we are selectively finding opportunities in the markets of the Pacific Rim, we are still attracted to the valuations and prospects of companies in the Japanese market. Though economic growth will be fragile at best, there are now swathes of companies selling at around book value and indeed quite a few, admittedly with dull growth prospects, that are selling for less than their net cash value. In other words, one could retrieve the full purchase price out of the repayment of cash on the balance sheet and still be left with the underlying business, at no cost. Following the recent collapse in prices, our research has uncovered scores of companies that are selling at valuations last seen in the early Eighties (remember Japan has witnessed a declining stock market for eight years). This work suggests that many of these companies have a high probability of returning up to three times the trend rate one would normally expect from the general market indices in the US and Europe.

For those who think the country is a basket case, it is worth remembering that this is the largest economy after the US and it is largely self-contained with exports representing around 10% of GNP. Such is its savings and wealth creation, that it is the largest owner of US Government debt. That it is bound hand and foot by regulation is apparent to all, as is the present plight of its financial system.

However, deregulation and change are gathering momentum. The tax structure is being overhauled, resulting in lower corporate and transaction taxes, and the finance industry is feeling the fierce winds of competition as the likes of the US investment banks introduce their way of doing business. The Japanese companies we recently visited showed a keen awareness of the need for change. Some are now targeting profitability over market share alone, all are reviewing their employment and remuneration structures and most importantly, they realise that their hitherto successful business model needs significant modification. (A big impediment to change has been the system of paying employees according to seniority, which of course acts as a disincentive to energetic and skilled younger workers). While change in the structure will disenchant many, the general view is that companies need to change the system if they are to attract young recruits.

The long bear market has taken its toll on local investors and even with pitiful returns on cash in the bank and in the bond market, they are loath to buy shares. Is now the time to capitulate to fear, or take heart, from the logic that good companies with sustainable growing businesses can look forward to a continuing weak yen abroad and improving pricing conditions at home? At worst, they will add to their inherent worth at between 6-10% per year. This is a market where companies are already familiar with the difficulties of living with falling prices, and even in this environment, the corporate sector, at still low levels of profitability, is generating the highest net cash flow ever.

With our value-orientated investment approach hindering us from finding broad value in the US market, we submit that Wall Street is providing little latitude for uncertainty. The threat to valuations, we believe, lies more with unpleasant earnings surprises than other factors. The supply of yen being created to stabilise the financial system in Japan and the imminent prospect of the formation of EMU keeps liquidity flooding, but equally it brings the risk of an overvalued US$. This is not helpful for the translation of foreign earnings or exports of US companies. Further, competition from Asian exports will ensure that price competition in internationally traded goods intensifies. That the US market recognises this is evidenced by the recent relative performance of domestic-orientated businesses such as retailers, newspapers and communications.

Even if the minimal inflationary environment allows US long bonds to sag to yields of 5.5%, valuation models are hard pressed to reveal surplus returns from share ownership. Indeed, the Bank Credit Analyst assessment is that the US market is implicitly building in profit growth of 11% per annum for the next ten years to justify current levels. However, real operating profits (as opposed to reported earnings) only managed to grow by 5.5% in aggregate over the past five years - a period of unusually favourable conditions. The market will be hard pressed to meet these implicit expectations.

For those who gain comfort from the idea that there are no signs of excess in the US market, they might consider that if companies were to expense the cost of stock options, like any other form of remuneration, PEs would be considerably higher. From a technical point of view, it is also interesting to observe that shares, as a percentage of household assets, either including or excluding pension fund assets, are back to the high point reached in the market peak of 1966, and this number incidentally is calculated before the exercise of outstanding options. Having shown restraint for some while, foreign investors too seem to have capitulated to this bull market. This is evidenced by record new flows into Wall Street in the third quarter at an annualised rate of $94 billion. The punishment metered out to those who have been underweight the US market (now 50% of the MSCI), discourages most managers from diverging from index weights.

Having lost returns through our US hedging strategy, it is now very tempting to surrender and focus solely on our core strength of stock selection. However, the lessons of South East Asia, and Korea in particular, highlight the importance of the need for a clear overview in building a portfolio. Our methodology identifies areas of neglect and also those of exuberance.

Valuations in Europe are not markedly lower than those in the US but we believe that Europe is at an earlier stage of economic recovery and transformation. Profits are projected to grow at double digit levels over the next two years and with the abundance of resources freed up by deregulation and rationalisation, the threat of inflation is low. There are still resplendent opportunities for both regional and industry rationalisation as is already evident in defence, media, finance, etc and we have positioned ourselves to take advantage of this.

The big event this year will be the choosing of members for Monetary Union in May. As readers will appreciate from previous correspondence, the real dangers of EMU lie in the imposition of a fixed exchange relationship between members ahead of political and fiscal integration. Essentially, the reins of monetary and exchange rate policy are handed over to a new Central Bank with little, if any, compensating freedom to fine tune regional differences via fiscal policies. With a core (principally Germany and France) determining monetary policy (interest rates) and with little need for any change in current levels of interest rates, there is a good chance for peripheral members experiencing conditions that prove highly stimulatory and which results in breakaway consumer growth. The one-size-fits-all approach in a continent with disparate sensitivity to interest rates, varying fiscal regimes and labour mobility impaired by language and cultural barriers, will create severe pressures early in the next century. However, this should throw up interesting investment themes in the meantime.

Emerging markets outside Asia have and will continue to be hampered by their higher cost of capital and by investor awareness of the dangers of currency linkages. Where these currency pegs exist without concomitant government restraint and where the domestic financial system has not evolved sufficiently to create a large domestic savings base, these markets can be expected to suffer from low valuations. In this respect, it is not surprising that our investments in Brazil sell on extraordinarily appealing valuations varying from 6-10x 1997 earnings in companies which are both cash generative and virtually debt free.

Investment Strategy

The risk we face is that the US market breaks to yet higher levels as investors chase “nifty” type stocks which then reach even more exultant valuations à la 1971-73. The sharp inter-market rotation has thrown up value periodically but this could also be a symptom of a rift developing between the value attached to large companies versus small to the detriment of the latter. The second risk is that the Japanese government spending package proves inadequate and that activity fails to improve in that country. This would clearly suppress profit growth and the improvement in the valuations of the quality stocks.

We will continue to move towards domestic companies within Japan and within the rest of Asia seek out companies which will be the leaders in the next bull market. In Europe we will continue to rotate within the restructuring theme as well as pursue the concept that consumer spending in some European countries will outpace others. In view of the high valuations in the Western hemisphere, we continue to supplement our cash holdings with a hedged position in the US market.

We continue to remain hedged out of the yen and partially out of European currencies and into the US dollar. Our current exposure to the Australian dollar is 35%.

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