investor
REVIEW
MAY 1998

MLC - Platinum Global Fund

QUARTERLY REPORT AS AT 30 APRIL 1998

Performance

Fund Size: $387 mn	Last Quarter	1998 Year to Date	Last 12 months	Return Since Inception
MLC-Platinum Global Fund	15.6%	19.6%	37.9%	83.8%
Morgan Stanley Capital International World Index (Accumulation)	18.2%	15.5%	55.3%	108.0%

It has been a strong quarter led by Italy and France. Facing the same hunger for yield witnessed in the States, Italy surged 28% (in A$ terms) with the major European markets typically appreciating by an average of 22%. Irrepressible Wall Street wasn't far behind, achieving 20%, and while Japan offered a strong start to the year, it fizzled out and was left virtually unchanged. This led to a weighted increase in world markets (MSCI) of 18.2%. The fund's return for the year to date (19.6%) is impressive given our risk averse investment philosophy. In addition we have run with a high proportion of cash and maintained a fully hedged position on Wall Street.

Changes to the Portfolio

The blistering pace of market appreciation caused some of our European stocks to exceed our target prices and we were obliged to sell. We cut our entire holdings of Nestlé, Accor, Canal Plus, IFI and AMGA, as well as trimming back on several others. We were also active with purchases such as Valora (kiosks and mattresses), Douglas Holdings and Escada (retail/fashion), Pernod Ricard (drinks), Continente (supermarkets) and WPP (advertising).

Early in the year the strong performance in Japan caused us to reduce our position, selling out of Asahi Breweries, KAO, Jusco, Murata, and trimming others. We also trimmed some Korean holdings which have more than doubled since December. Other significant changes were the addition of casino stocks in Australia (temporarily depressed by falling tourism).

Commentary

We have recently completed an extensive trip to South East Asia visiting Kuala Lumpur, Bangkok, Singapore, Manila and Hong Kong. The objective was to try to find those firms that may look sad at present and yet could be the great growth franchise stocks over the next five years or so. The pattern was to see a broad range of companies from property stocks and banks, to industrial companies with interesting business economies. Having seen 51 companies and various specialists, we arrived home with a surprisingly empty net. The problem – which we alluded to in our last communication – is the high valuations being given to the leading companies in each market. However, in nearly every case these companies so enjoyed the good times that they forgot about the obligation that accompanies heavy use of debt.

The most striking example of excess was in Bangkok where the banking system may have as much as one third of its loans either not paying interest and/or unlikely to be repaid. This implies that the system has a deficiency of shareholder's funds and yet international investors have been prepared to refinance the two leading banks which account for some 35% of the system. Thai Farmers Bank and Bangkok Bank have together recently placed US $1.9 billion of new equity. While rectifying the solvency of these institutions, these measures do not address the underlying problems of an over-supplied property market upon which the whole banking system relies for collateral. Deteriorating property prices impedes the extension of

Report from Platinum As

Top Ten Holdings (as at 30 April 1998)

STOCK	COUNTRY	INDUSTRY	% HOLDING
Rinascente	Italy	Retail	4.6%
Swiss Industrial Group	Switzerland	Packaging/Engineering	3.2%
Valora	Switzerland	Retail/Distribution	2.9%
Mikuni Coca Cola	Japan	Bottler	2.8%
Daiichi Pharm.	Japan	Pharmaceuticals	2.6%
San Paolo	Italy	Banking	2.6%
Hornbach	Germany	Retail	2.5%
Fuji Photo Film	Japan	Photographic Equipment	2.5%
Canon	Japan	Office Equipment	2.4%
Douglas Holding	Germany	Retail	2.4%
TOTAL			28.5%

credit and hence the prospects of an early recovery in the economy are remote even after the devaluation of the baht by 40%.

Moving on to Kuala Lumpur, we witnessed the same excess with the recently completed twin Petronas Towers, the tallest building in the world (offering 2.4 million square feet of office space) epitomising the boom mentality. Such was the excitement that buildings were built with an eye to capital appreciation rather than recurrent income. In central Kuala Lumpur, new supply could add 22 million square feet versus the existing prime stock of around 30 million square feet. As take-up in good years is around 3 million square feet per year, there is clearly going to be significant surplus office space for years to come.

This pattern of property over-supply emerged in each country to a greater or lesser extent. There are the same important implications for collateral values and the banking system, with non-performing loans ranging from 30% in Thailand down to 15% in Manila. At the same time, interest rates are being kept high to support their currencies which exacerbates the liquidity squeeze. Hong Kong has by far the most fluid property market with transactions quickly adjusting prices. Residential prices are typically off by 35% but with quality accommodation selling at prices still around US$8,000 square metre, a small flat can cost close to US$1 million! To secure the dollar peg, interest rates have been kept high and this has squeezed this property-mad, service based economy. Tourism has crumbled, hotel occupancy dropped, and the retail scene imploded with most clothing retailers experiencing declines in sales of anywhere between 10-30%. A nice touch, and indicative of the property-centric nature of Hong Kong, is a facility to use one's mobile phone to find the latest residential property prices. This service is available along side that of stock quotes.

There are few short term stimuli to re-energise these ASEAN economies. The weakness in Japan, which takes around 40% of the region's exports, is no help at all.

Tales of cutbacks abounded with, for example, a leading building material supplier preparing for a volume decline of 30-50%. Soft drink bottlers are tentatively putting up their prices by around 15% and yet their input costs are rising faster (eg. Aluminium can costs up by 30%+). Retailers are walking away when leases come up for renewal in Hong Kong and some even when rents are set 30% below former levels. Most difficult to gauge of all is the likely impact on employment levels. It is only now that layoffs and repatriation of foreign workers is starting. Over and above this adjustment to poor demand and rising costs versus sticky selling prices is the prospect of fresh competition. This comes in the form of multi-nationals prizing open markets in the wake of IMF imposed deregulations or simply acquiring market share by buying troubled companies.

Let us go back to the companies we liked. The true growth companies that will ride out the recession in Asia are no cheaper today than they were before the crisis. Regional funds with dedicated portfolios have treated these as places of refuge. Of much more interest to us are those companies which are experiencing some indigestion as they complete longer term projects that happen to coincide with the downturn but where demand for their products will grow anyway. We shall be watching these closely over the coming weeks with a view to acquiring positions. We shall avoid those companies which the market is pricing on the basis of ASEAN economies having a rapid recovery.

Outlook

The most illuminating observation of market behaviour in the last three months is the way the seemingly dysfunctional markets of Italy and France have performed. Just prior to year-end, criticism of the inflexibility of these markets reached a crescendo only to find that within three months they have outperformed most comers. This is perhaps the lesson going forward that just now as we see Japan at its weakest and most inflexible, the stock market is adjusting downwards and possibly entering an interesting level for asset allocators.

The big question is whether US monetary policy will stay loose as the Fed feels the need to consider more than just US factors when setting interest rate policy. The decision to share some of the load of Asia by holding rates at present levels (which would help stabilise their currencies and economies), could allow Western markets to continue to reach higher levels. However, such deferral by the Fed merely stores up longer term problems.

Our travel through Asia constantly reminded us of excessive investor optimism where the purchase of assets was driven purely from a speculative view on capital appreciation rather than an appraisal of the existing cash flows. As we have noted in previous commentary, the probability of many companies achieving projected earnings growth similar to that of the last few years, is very low and hence disappointment is likely.

We remain committed to seeking out those companies which have attractive growth prospects and where prices make allowance for future uncertainties.

Currency

We continue to remain fully hedged out of the yen and have removed the hedge on the European currencies. Some 20% of overseas exposure is hedged back into Australian dollars.

Stock Story

RINASCENTE (ITALY)

Rinascente is a multi-format Italian retailer. The core of the business is food retailing (80% of sales) through a chain of hypermarkets (stores of roughly 5,000-10,000 sq.m.) and supermarkets (stores of a few thousand sq.m.). In addition, Rinascente operates department stores, DIY (home/hardware) outlets, and a chain of variety stores.

The Italians refer to a concept called 'modern retail' when the subject of hypermarkets is discussed and this uncomfortable term illustrates the archaic nature of food retailing in the country. Italy has the highest number of shops per capita in Europe – reflecting the success of owner operated 'mom 'n' pop' stores to hold off large scale 'modern' retailing chains. The association of shop owners is very powerful and has in the past been politically protected by the maintenance of astonishingly complicated laws governing licences to open large format retail outlets. For this reason the number of hypermarkets (and large, competent supermarkets for that matter) in the country is very low relative to obvious comparisons such as France and Spain.

Another restraint for Rinascente in the past has been poor operational management – the 25 hypermarkets which they have been operating display sales densities (ie. sales per square metre per year) far lower than their counterparts in France. Profitability has been very poor. This is despite the relative affluence of the (northern) Italian consumer and the virtually non-existent competition (versus the over-supplied and cutting edge competitiveness of the French market, for example). Rinascente profits were basically flat for the several years up until 1997 and despite the fabulous potential for the company (all the best European operators' principal desire for several years has been to break into the Italian market), the stock market had little interest in the shares.

DISPOSITION OF ASSETS

REGION	30 APRIL 1998	31 JANUARY 1998
Western Europe	44%	37%
Japan	25%	27%
North America	7%	7%
South America	5%	5%
Other Asia	3%	5%
Australia	2%	1%
Total Invested	86%	82%
Cash	14%	18%
Total	100%	100%

A stunning opportunity (and a wonderful illustration of the occasional short term focus of stockmarkets) came up in June last year. We had visited Rinascente in April and left thinking that while the position was interesting the operational management was not capable of really capitalising on their hypermarket leadership and with a still dull consumer environment the stock was about the right price (L10,000 per share or so). A few weeks later a deal was struck between the Agnelli clan and the French company Auchan (a very successful hypermarket operator based in France but active around the world) whereby they created a joint venture which would own the Agnelli Rinascente stake. In addition, Auchan put their four Italian stores into the business and assumed operational control of the food retailing side of Rinascente. At a stroke, the Agnellis had added the key ingredient the business had been lacking – expert operational management. However, in the stockmarket's eyes, this deal removed, at a stroke, any chance of a take-over and gave the 'control premium' (Auchan paid the equivalent of L14,000 to IFIL for their stake) only to the Agnellis and not to the minority shareholders of the stock. In disgust the stockmarket sold the share down 20%.

Hence the opportunity – a strong but stagnating position had just been transformed by the input of hypermarket management head and shoulders above the rest of the Italian retail scene. Suddenly the story was interesting. The miserly profitability would likely be multiplied several times and the best potential in European retailing was beginning to be unlocked. And the market took 20% off the shares!!! We bought as much stock as we could between L8,000-9,000, and then fully subscribed to the rights issue in the shares which was being held to fund future expansion.

A visit to the company's headquarters outside Milan a few weeks ago was a stunning contrast to the discussion we had had less than a year earlier. The turnaround in consumption in Italy in recent months, and good restructuring efforts in the non-food side of the business have given a boost to sales and profitability of the whole operation. But more impressive was the wonder in the company representative's voice as he discussed the 'Auchanisation' of the hypermarkets. It was the reaction of someone who has been shown for the first time the difference between 'retailing' (ie. selling) and 'distribution' (ie. merely acting as a passive link in the manufacturer-consumer chain).

The risks are that store openings will continue to be difficult and that the plan to open to 2-3 new stores p.a. will be unachievable. However, the whole approach to vested interests in Italy has changed in recent years with the run-up to EMU and it is scarcely conceivable that the retail scene will be kept in the dark ages.

The stock has performed well as the market has come to appreciate the fact that operational management is good news rather than simply focusing on the disappointment of there not being a full take-over. By the end of April the stock had moved to L19,000. For the moment the stock has run ahead of itself. However, we expect the story to gradually unfold and surprise the market with the magnitude of its profit growth over the next 4-5 years.

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Platinum Asset Management

For those interested, please visit our website at
http://www.platinum.com.au

If you have any questions about your investment in the MLC - Platinum Global Fund, please contact

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