PLATINUM ASSET MANAGEMENT

MLC - Platinum Global fund

Quarterly Report
30 April 1999

Performance

Fund Size: $442mn	Last Quarter	Last 12 months	Return Since Inception
MLC - Platinum Global Fund	10.2%	12.6%	106.8%
Morgan Stanley Capital International World Index (Accumulation)	-0.1%	14.1%	137.3%

The world's stock markets have continued to rise in this last quarter with the smaller markets tending to perform much better than their larger brethren. The exception to this rule was Japan which surged after a long period of hibernation and rose by 19% in yen. However, when these rises are converted to Australian dollars, which rose by 4% (versus US$) over the period, the Morgan Stanley Capital International (MSCI) Index was fractionally down. By comparison, the MLC Platinum Global Fund returned 10.2%. This type of variance in performance is not altogether surprising given the significantly different structure that the fund has compared to the MSCI and indeed to most international funds. In particular, we benefited from our large exposure to Japan as the Nikkei was feverishly pushed up by foreigners trying to reposition their portfolios to match the weightings of the MSCI. In addition, several of our holdings in Europe were bid for, notably Telecom Italia, Banca de Roma and Albright & Wilson. The portfolio also gained from its exposure to smaller markets and stocks, which are now being seen in a more favourable light.

Top Ten Holdings as at 30 April 1999

Stock	Country	Industry	Holding
Softbank	Japan	Technology	3.5%
DDI Corporation	Japan	Mobile Telephony	2.7%
Sony	Japan	Electronics/Entertainment	2.6%
Siemens	Germany	Electrical Engineering	2.5%
Suzuken	Japan	Pharmaceuticals	2.4%
Alcatel Alsthom	France	Telecoms	2.4%
NTT Mobile Comms.	Japan	Telecoms	2.4%
WPP	UK	Advertising	2.3%
SIG	Switz.	Packaging/Engineering	2.2%
Deutsche Bank	Germany	Banks	2.2%
Total			**25.2%**

Changes to the Portfolio

In changing the portfolio we face an unusual dilemma in the present environment. There are a large number of smaller companies which have sound growth prospects and balance sheets and yet are being treated as pariahs in a world that favours large corporations. Our problem is in deciding what proportion of the portfolio should be exposed to these companies versus those larger enterprises with no greater prospects but a higher likelihood of participating in this liquidity-led bull market. The dilemma is accentuated by the value gap having so widened that large firms are almost compelled to make takeovers of their smaller competitors.

On balance, we are inclined to stay with our quality small companies provided that their good prospects compensate for their lower liquidity.

Readers may observe a shift in our top ten holdings, in particular, the exposure to companies involved in telecommunications and software. These are businesses that were principally bought early in this calendar year and reflected the neglect that was evident in Japan while their peer group were enjoying great popularity abroad. Moreover, companies such as NTT Mobile and DDI are at the forefront of mobile telephony and will be offering the Japanese public very sophisticated facilities including large scale mobile data transmission by as much as a year before it is introduced in leading markets such as Sweden and Finland. Softbank is the leading software reseller in Japan with a host of investments in Silicon Valley-based software houses. At the time of purchase, the company was somewhat under a cloud relating to the activities of the founder and virtually no value was being attached to its investment portfolio. Since then the company has been anointed as Japan's principal internet stock (much to the delight of shareholders).

We also added to old favourites like Nippon Broadcasting, Sony Corporation, NTT and Citizen Watch while reducing Yamanouchi Pharmaceutical and Daiichi Pharmaceutical.

Some time ago, we wrote glowingly about the Japanese coca-cola bottlers. These have taken off in the last six months because of recognition of their low valuations and some additional news. The Coca-Cola company of Atlanta has encouraged two of our holdings to merge, offering the carrot of their becoming so-called "anchor" bottlers. This has set-off a chain reaction among the squad and their prices have doubled. We chose to surrender some of our holdings after prices surged. There were also adjustments made to the European component of the portfolio where we reduced our large exposure to Rinascente and San Paolo/IMI on Kosovo-based fears. Further we sold the entire position in Valora while Albright & Wilson was taken over. In the US, King World Productions was also bid for, and we reduced our position in Great Lakes Chemical.

Disposition of Assets

Region	**30 April 1999**	**31 January 1999**
Japan	38%	32%
Western Europe	32%	39%
North America	6%	7%
Other Asia	6%	6%
South America	1%	2%
Australia	2%	3%
Cash	15%	11%

Commentary

The underlying drivers of this bull market remain intact. In some respects, recent developments have improved prospects. Notably the resignation of the German Finance Minister, Mr Lafontaine, removes concerns about the left-ward drift that was evident in Germany. At the same time, French economic policy seems to be more pragmatic. However, the most important development is the decision by the European Central Bank to cut short-term interest rates by 0.5% which leaves them at 2.5%. This strong medicine was administered in the face of a noticeable slowing in the export-sensitive economies such as Germany and Italy in the fourth quarter. We therefore believe the outlook for Europe has improved markedly with the only blemish being the crisis in Kosovo.

Strong growth, full employment, and low (though upward-creeping) inflation, remain the hallmark of the US economy. Still patchy pricing power is restraining profit growth but the numbers in the first quarter were good. By contrast the figures published by the Commerce Department for corporate profits for 1998 show profits fell 2.2% despite economic growth of almost 4.0%. A tough business climate is fuelling the "urge to merge" as many companies face the hard edge of intense global competition and seek the benefits they hope to extract from economies of scale and greater reach. The excitement this adds to an already heady atmosphere generated by the internet, has the bulls rushing onwards. Speculators have been playing the internet gatekeepers such as America Online (which now constitutes 1.5% of the S&P index, from only 0.9% at the beginning of the year), and also switching back to the facilitators such as Sun Microsystems, Microsoft, Cisco and IBM. We made reference to this in our last report and forecast a pause to refresh followed by further excitement. Analysts no longer comment about the valuations, instead it is fashionable to relate to "eyeballs" (viewing internet sites), customer acquisition and retention costs, and so forth. Positive cash flows are rare but the potential of a cyberlinked world is all.

These comments are not meant to be taken cynically. Seldom does one witness such significant change, made all the more attractive by the ability of companies to roll out successful domestic formulas that can be almost instantly replicated across the entire globe – with all the attendant attractions of scale, blocking power and so forth epitomised by the Microsoft business model. The weight of these ultra-large capitalisation stocks is resulting in an ever narrowing band of companies driving the S&P higher while the "dull" majority of companies languish.

For example, in the three months to March, the top 20 US stocks (by market size) rose 13.7% on average. By contrast more than half of the top 500 declined. If one analyses the S&P500 by size, the differences in performance are very stark:

	% of Index	**1st Quarter Return 1999**	**1998 Return**
Top 100 companies	72.5%	7.0%	47.3%
101-200	14.6%	2.3%	18.9%
201-300	7.4%	-2.7%	6.6%
301-400	4.0%	-6.3%	-4.7%
401-500	1.5%	-11.8%	-25.0%

S&P 500 Share Index ranked by Size (US$ market capitalisation)

The Japanese market has been the recent wild card. Happily many of our views are now being more widely accepted. Barely a day goes by without an announcement of further restructuring and capacity closure. Merger and acquisition activity is accelerating, unemployment is mounting and foreigners are crowding hotels in their efforts to fulfil their long held desires to have a more meaningful presence in this, the world's second largest economy. Apart from the evident acceptance of the need for change, perhaps the two most important drivers of the stock market have been the infusion of public funds into the leading banks, and secondly, the action of the Bank of Japan to add liquidity to the system.

After much discussion, an agreement was reached between the Financial Reconstruction Commission (FRC) and the banks for the infusion of ¥7.45 trillion. This took effect from the first day of April in exchange for equity in the banks. During the process each bank participating in the scheme had to firstly reappraise its loan book according to much more stringent regulation and was required to submit detailed plans with quantified targets. The outcome was that only one city bank, Bank of Tokyo–Mitsubishi has not accepted government funds, with fifteen others having issued convertibles of varying duration and varying yields. These have differed according to the inherent viability of the institution involved.

Having met with a member of the FRC, it is evident to us that they favour further staff cuts and mergers and foresee the likelihood of another tranche of public money being injected as the next group of economic sensitive companies face difficulties. In the meantime, the FRC will have its hands full taking over the bad loans from failed banks and also acting as an administrator of bad loans acquired from viable banks.

The second factor bolstering the Japanese stock market has been the activity of the Bank of Japan in the short end of the money market. This has effectively made credit almost free (would you believe that 3 month CDs yield 0.09% per annum). Simultaneously, the government extended its loans guarantee program to small companies to ¥30 trillion.

In response to these measures and finding themselves underweight in a seemingly improving environment, foreign investors went on an unprecedented buying rampage, spending trillions of yen over sixteen consecutive weeks.

Elsewhere in the world there are signs of improving confidence. The new governor of the Central Bank of Brazil has been able to begin to cut interest rates against a backdrop of surprisingly moderate inflation in the face of a weak *real*. The political environment in that country remains turbulent with a power struggle among the coalition partners. The smaller economies of Latin America are still feeling the noose of tight liquidity with credit lines having been cut.

Parts of South East Asia are benefiting from an improvement in their net exports which is helping to fund their recovery in the absence of foreign credit. Korea has enjoyed a particularly strong turnaround and is now the net beneficiary of foreign direct investment. As you will be aware our principal interests in South East Asia have been in Korea.

Currency

The behaviour of bonds and commodities suggest that we are entering a broader growth cycle. This should favour a commodity based currency such as the Australian dollar. For this reason we have been adding to our Australian dollar hedge. At present the fund is 61% hedged into Australian dollars with residual exposure of 19% to US$ and related currencies and 18% to European currencies.

Outlook

Many of the traditional indicators are suggesting that the world is embarking on a broad economic recovery. Ultra cheap money in Japan and Europe should help to fuel a higher level of activity while the fall in interest rates in emerging countries and the time that has elapsed since the meltdown is allowing these economies gradually to heal.

Partly offsetting this brightening prospect is the evident growing concern revealed by the US bond market which finds the Federal Reserve Board (Fed) now dragging its feet to growing inflation concerns. Our assessment is that there will be periodic turbulence caused by tightenings by the Fed since they are what is technically described as being “behind the yield curve”. The US economy will slow down only gradually in the face of a deteriorating trade account but this should allow the rest of the world to gather greater momentum.

As bonds approach 6%, the arithmetic by which shares may be valued suggest that many of the high growth companies are on unsustainable valuations. It is therefore not surprising that more attention is being paid to companies that benefit from broader growth and which are on lower price earnings ratios. Australian resource shares would fit into this category and investor support for these companies suggest they anticipate improving demand for their products together with stronger commodity prices.

It seems that we are entering a paradoxical period when a broadening of growth causes some stocks to be valued downwards and others to be more highly valued. On balance this favours those managers who emphasise stock picking rather than momentum investing. The broad market indices may be hard pressed to rise when the giant capitalisation shares become less fashionable and investors rotate into smaller capitalisation opportunities (note the earlier table where the top 100 companies in the US constitute nearly 73% of the S&P 500 “company” index).

Stock Story ~ Hoechst (Germany)

For the last decade Hoechst has been making the transformation from conglomerate to focussed life sciences business. The recently announced merger with French group Rhone-Poulenc will create Aventis, the world’s second largest pharmaceutical business, after Merck Inc of the USA.

There are two crucial areas to consider when assessing Hoechst as an investment. The first is the practical problems of becoming a very large pharmaceutical business through acquisitions and mergers; indeed the managerial and financial difficulties of this process specifically created the investment opportunity. The second issue is the heritage of Hoechst and the context of its decision to transform itself from conglomerate to pharmaceutical specialist – this issue in a broad sense balances (and in time should outweigh) the practical difficulties referred to above.

The Transformation

Aventis is effectively the merger of Hoechst Marion Roussel (HMR, the Hoechst pharmaceutical business created when Hoechst brought together Marion Merrel Dow and

Roussel Uclaf with its own existing drug business in 1995) and of RP (the life science business of Rhone-Poulenc). The creation of Aventis is scheduled for completion this year and requires that both groups have sold (or "spun-off" to shareholders) their remaining industrial chemicals operations.

The received wisdom in the pharmaceutical industry is that scale is important because of (a) the costs of research and of the "basic tools" required (enormous computing power for high throughput screening and combinatorial chemistry, access to gene technology etc); (b) distribution clout on a worldwide basis needed to justify the research once a product is commercial (literally thousands of sales specialists in the US market alone for example); and (c) the need to have scale in order to be a "partner of choice" for in-licensed products in what is becoming ever more a late-stage development and distribution business. With this logic in mind there is little mystery as to why Hoechst is merging with RP, however the stock market has reservations.

The practicalities of a merger mean it is tricky to arrive at the blissful state of an integrated, smoothly-functioning company on a grand scale. Consider the difficulties of managing multiple research sites all over the world, and of allocating funds to the most promising areas. The new group will have over fifty drug production sites – an over-endowment which illustrates the problem of which thirty-plus to close and which staff to shed in the process. The fact that these processes are complex is illustrated by the dull earnings that HMR has achieved in its own four years of existence.

Thus the opportunity. Despite the scale of the new company, the market has priced the business at a very large (40-50%) discount to its peers on the basis that such a merger will take a long time to consummate. We have confidence in the business because of the late-stage product pipeline (ie. the pharmaceutical products scheduled to come to market in the next 2-4 years). Indeed the HMR "pipeline" is one of the most interesting in the industry. In addition, the R&D processes, and the "science" of the company is highly regarded. The missing link has been speed of commercialisation and aggression in distribution. Hoechst has worked hard on these areas in recent years and we have evidence of much more successful product launches in the last few quarters than was previously the case.

Hoechst's Heritage

The other reason we have confidence in the company successfully transforming itself is the context of the decision to do so. Hoechst is one of the three (roughly equally sized) parts of the traditional German chemical industry. Its competitors are Bayer and BASF, and by the mid 1980s all three had become vast chemical conglomerates. Bayer has decided to remain as a conglomerate, while BASF has focused more on its integrated chemical business. All three are big employers and a crucial part of the German industrial fabric.

The point is that for Hoechst to decide to dispose of these cyclical industrial operations in favour of the potential profits of a big drug company is a very radical and high-profile decision. The German press has been full of commentary on the story for some years already; when some industrial businesses were closed or staff fired, the criticism was vicious. The company's head office has been besieged by protesters, and head office and management have felt the heat from unions, government and shareholders alike. This is not a plan that has been hatched without due consideration to precise execution.

As an investment Hoechst offers some uncertainty over the timing of profit growth, offset by great potential from its R&D efforts and a very modest starting valuation. The stock market does not contain great expectations for the company and we are confident that management will respond to the various pressures to succeed.