MLC-Platinum Global Fund

QUARTERLY REPORT

PERFORMANCE (AS AT 31 DECEMBER 2004)

Fund Size: $3.79bn	Last Quarter	Last 12 months	5 years (compound pa)	Since Inception (compound pa)
MLC-Platinum Global Fund	5.7%	13.4%	6.8%	14.8%
Morgan Stanley Capital International All Country World Net Index (A$)	3.7%	10.8%	-5.7%	7.0%

Source: MLC Investments Limited and Platinum

All stock markets produced strong rises in the December quarter despite a rough start with oil prices threatening to rise towards US$60 per barrel. Confidence grew as the quarter progressed and fund managers reduced their hitherto underinvested positions. Currency movements played a large part in determining the magnitude of the gains with the A$ rising against the US$ by some 8%, being flat against the yen and falling in value against the euro by 2%.

The rise in the appetite for risk was apparent from the out-performance of emerging markets with those in South America and the Middle East gaining more than 20% in their home currencies, followed closely by Asia ex-Japan. Developed markets generally rose by single figures with the Bloomberg Europe 500 gaining 6%, the Japanese Topix up 4% and the S&P 500 rising 9%. Converting all this into A$, saw the MSCI rise by 3.7% for the quarter and 10.8% for the year.

The Fund gained 5.7% for the quarter, producing an almost flat second half to 2004, and achieving a rise of 13.4% for the year. Examining the year as a whole, it is apparent that our stock selection in terms of long positions was good with large exposure to emerging markets like India and Korea adding zip to our core of excellent European and Japanese holdings. The currency positioning also made a small contribution.

A revealing picture for the quarter is shown in the Industry breakdown table (shown in US$ to remove the impact of the strong A$). In contrast to the September quarter where the table was dominated by falls, every industry rose. Differing factors were at work, with corporates beginning to spend some of their built-up cash reserves through takeovers especially in telecoms, utilities and IT. Bringing up the rear were health care (damaging drug revelations) and energy (losing some gloss with the retracing oil price).

MSCI All Country World Index Industry Breakdown (US$)

Sectors	Quarter	1 year
Telecommunications	16.1%	16.3%
Utilities	13.8%	23.9%
Financials	13.7%	15.5%
Consumer Discretionary	13.7%	14.0%
Information Technology	13.3%	2.4%
Industrials	11.8%	17.9%
Materials	11.4%	17.9%
Consumer Staples	11.4%	10.4%
Energy	6.5%	25.0%
Health Care	6.2%	4.7%

Source: Bloomberg

SHORTING

Short selling indices against the portfolio had more of a smoothing effect on performance than any benefit. In fact for the year as a whole, the use of shorts to protect against volatility cost the fund just over 1%.

Platinum ASSET MANAGEMENT

MLC A National Company

CURRENCY

A bearish stance towards the US$ was the prominent market view in the final quarter of 2004. This type of consensus tends to rattle us. Should the US administration pay more heed to international concerns regarding the twin deficits, it is possible for the currency to rally. Fundamentally we still favour the Japanese yen and European currencies but have adjusted our position to own some US$ for now. We have been surprised by the relative softness of the yen against the euro and are positioned for this to change. The A$ hedge has been held steady.

CHANGES TO THE PORTFOLIO

Disposition of Assets (Net Invested Position)

Region	Dec 2004	Sep 2004
Western Europe	32.6%	32.2%
Japan	29.5%	28.0%
Other (emerging markets eg. Korea)	14.2%	12.7%
North America*	11.9%	5.6%
Australia	0.0%	1.5%
Cash	11.8%	20.0%

Source: MLC Investments Limited

* At 31 December 2004, the Fund has a short position in the US against the Standard & Poor's 500 Index of 3.5% (2.6% at 30 September 2004), and 2.6% against the Russell 2000 Index (3.9% at 30 September 2004).

Transaction levels were relatively subdued as we were mainly adding to existing holdings such as Credit Agricole, Carrefour, Liberty Media, News Corp, Mosaic, Norske Skog, and Reliance Industries.

In Japan we shifted the emphasis more towards domestically orientated companies by adding to the home builders, financials and television broadcasters. These companies are on depressed valuations that reflect the prevailing pessimistic view about domestic demand. A closer look at these companies' profit histories reveals remarkable resilience through the last twelve years of slough.

An area that has become conspicuously unfashionable is pharmaceuticals. As a group, the drug stocks have suffered a major de-rating as the implications of the side effects of so-called Cox-2 inhibitors has damaged the prospects of Pfizer and Merck Inc. Having assessed the longer term implications of these problems and the general concerns regarding viable pipelines and the regulatory environment, we have chosen to add both companies to the portfolio. At current price levels, the market is implying that longer term growth prospects have fallen considerably and also that risks have risen markedly.

Breakdown of fund's long investments by Industry (% of assets)

Categories	Examples of Stocks	Dec 2004	Sep 2004
Cyclicals/Manufacturing	Toyota Motor, Schindler, Siemens, Linde, Océ	29%	24%
Financials	Credit Agricole, Mitsubishi Tokyo Financial, Mitsui Sumitomo Insurance	17%	15%
Consumer Brands	Henkel, Adidas Salomon, Lotte	8%	8%
Medical	Takeda, Schering, Merck KGaA, GlaxoSmithKline	8%	9%
Technology/Hardware	Agere, Infineon Tech, Samsung, AMD, Sun Microsystems	8%	8%
Gold and Other Resources	Shell, Barrick Gold, Newmont Mining, Noranda	8%	7%
Software/Media	Seoul Broadcasting, Newscorp	6%	6%
Retail/Services/Logistics	Carrefour, Deutsche Post, Hornbach, Mitsubishi Corp	5%	7%
Telecoms	Alcatel, NTT Docomo	5%	5%

Source: Platinum

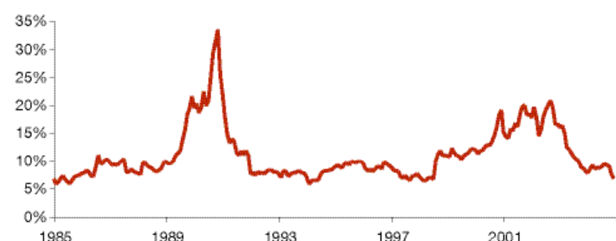
At the same time we have been adding to our biotech holdings to emphasise those companies that will help support drug discovery and diagnostics. On account of its relative strength and no fundamental improvement of its relative merits, we sold Novartis and used the proceeds to buy the above companies and to add to GlaxoSmithKline.

COMMENTARY

An important principal of economics and finance is that the abundance of capital ultimately diminishes profits: conversely shortages provide the fuel for future profits. Yet here is the paradox in the markets today. Liquidity is so abundant that it is promoting convergence of returns as investors search high and low trying to identify the next big idea. Markets which were formerly uncorrelated, now behave as if they are closely related. For example, the amount of extra yield that was traditionally required from B rated corporate bonds has shrunk in synchrony with the lower implied volatility of various share indexes. At the same time, Euro and US bonds have become correlated as have emerging market bonds. This is significant as it was the **uncorrelated behaviour** of various traded assets that was the **foundation of the hedge fund movement**. If most assets become correlated, what are hedge managers supposed to hedge with?!

The **aberrant effect of cheap money is also evident in the anxious desire for risk.** The range of examples is wide: starting with the markets apparent nonchalance regarding the virtual confiscation of Yukos assets. Though the stock price was hammered, the effect on the broader Russian index or other dubious markets was relatively slight. Closer to home, the revelation of a probable breach of SEC accounting rules and consequent departure of the top two executives (on extremely generous severance terms) from the world's largest hedge fund, Fannie Mae, barely made the headlines. This is no trifling matter as the revealed capital short-fall of over $9 billion has wide implications not least for the availability of mortgage finance in the US and significant effects on derivative markets, yet the share is now trading above pre-revelation levels. There are lesser examples of typical excess such as the China Aviation Oil futures gamble that cost US$550 million compared to its net assets of US$140 million at the start of 2004. Best of all has been the reopening of the triple C or lower rated bond market. Traditionally, one third of loans raised by these walking-dead default within a year, yet so ravenous are investors that apparently the extra yield of about 6% is worth the bet!

Triple C Borrowing Margin
(spread over 5 year US treasury yield)



Source: Bloomberg, Citibank

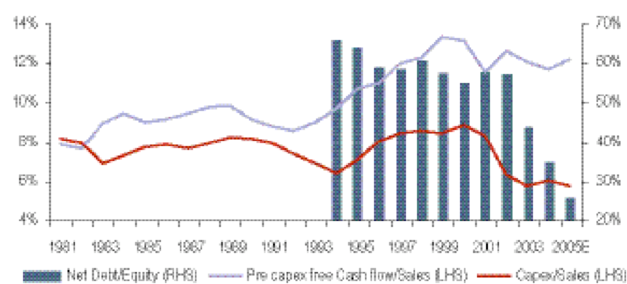
In case you have missed some of the above, do take **note of the competition that has re-entered the private equity market.** Data compiled by Bloomberg show that buyout firms like Blackstone, Warburg Pincus and Carlyle have spent a record US$180 billion on deals in 2004, way outpacing the global IPO raisings estimated at US$128 billion. Like the hedge fund industry, this was formerly the domain of wealthy families but success has attracted many new players, most notably less affluent investors and perhaps less experienced equity specialists. Returns have fallen as bidders compete in an ever more crowded pool. Several private players can make no sense of prevailing prices and are suspending their activity

(Continued)

while those operating with OPM (other peoples' money) are snatching at every morsel. Some are even doing a fine trade in taking listed companies private, sheltering them for long enough to enhance their indebtedness and little else, and within 12 months offering them to the public again at a considerably higher gross price. No logical explanation seems necessary for the "now listed; now delisted; now listed again" trick in the IPO offer documents! For the moment though, some may dismiss these examples as merely the observations of a sour deprecator.

Easy money has however had a highly beneficial effect on corporate profitability and balance sheets. Companies have engaged in massive refinancing exercises and unlike householders, have generally reduced their financial leverage thereby reducing the risk to shareholders. Also enterprise profits are at record levels in the principal markets or back to peak levels in the case of Japan.

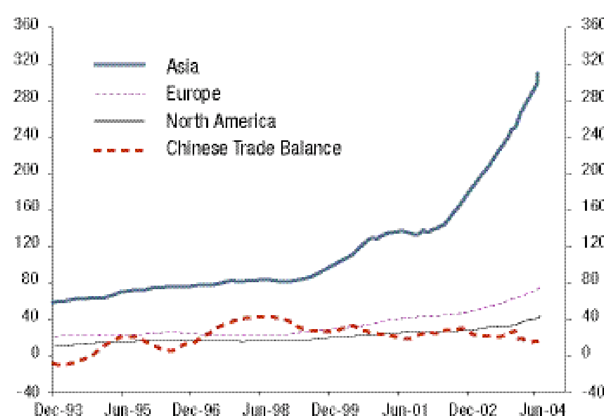
"World" Free Cash Flow/Sales and Net Debt



Source: UBS

Yes, the rate of change of activity is tending to slow in the major industrialised economies but India, China and much of Asia continue to grow. **Their dependence on traditional markets is diminishing** as inter-regional trade whirls around the Middle Kingdom; see the accompanying graphs.

Annual Chinese Imports ($US bn)



Source: CEIC

As a relatively closed economy gradually weaning itself off central planning, **India has responded relatively slowly to globalisation.** This was apparent at the Twentieth annual Indian Economic Summit held in Delhi in December. In earlier times, politicians expected to be treated with gratitude for their munificence, but this is changing. Delegates have become impatient with the endless ruminating over issues that were defined at earlier summits and they now want action in the form of less Government interference and more devolution of power. The old Nehru/Gandhi centralist model of self-sufficiency and anti-materialism is no longer acceptable. Though it has been a long time coming we concur with the Finance Minister's view that the country is about to enter a sustained period of economic growth rivalled only by China. Aiding this process is the probable increase in foreign direct investment which is presently running at one tenth of the level to China. The biggest hindrance will be the **potential loss of patronage** but no one has missed the significance of the recent election surprise. The Congress party is paying close attention to alleviating the plight of the rural poor and has now accepted that the nation's interests are best served by **wealth creation rather than wealth distribution.**

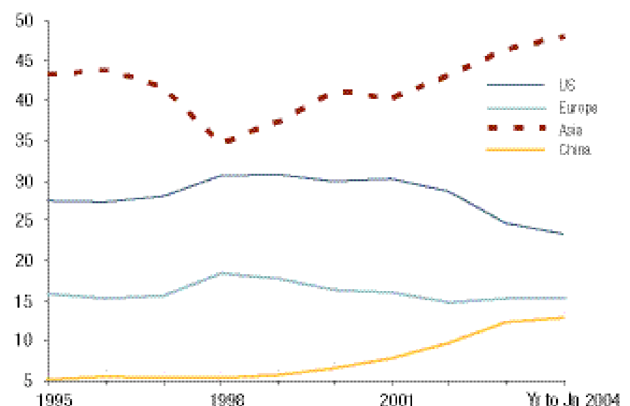
While the Indian economy has chugged along at around 6% pa, China has achieved the remarkable distinction of increasing its **industrial production by more than 13% per year** since 1993. Such has been the supply of surplus labour that real earnings of the typical factory worker barely changed in the 1990s but since 2000, real wages have accelerated. (These figures are rubbery on account of the statistics which segregate migrant incomes from those earned by residents: under the *hukou* system migrants still face penalties such as denial of free medical treatment and access to schooling for their children in several major cities.) This is being accompanied by tentative indications that there is a lessening desire on the part of rural dwellers to migrate to the tough and tedious jobs that once attracted them in droves. The income gap between the wealthy coastal provinces and the hinterland is still large but Government measures and higher agricultural prices are playing a part. Perhaps too, the skill disparities are an issue. As labour typically accounts for about 10% of inputs in manufacturing, the impact of this change in the bargaining power of labour will take time to be expressed but it may signal the **end of the deflationary pulse from China.**

This same pulse has helped companies in the developed world to hold onto **a record share of GNP in all major industrialised countries.** This has come from outsourcing production to low cost regions and perhaps delayed passing through of these price benefits. However, enthusiasts be warned that research by the likes of Bridgewater show a strong inclination for economic forces to cause a reversion to the mean. For the moment though we believe these large surpluses will encourage companies to invest in productivity enhancing plant, engage in more industry consolidations and perhaps raise dividend pay-outs.

There are other promising signs of change in important economies like France and Germany, with a combined population of some 145 million. The mandated 35 hour week in France is now being eased though not abolished while in Germany, opinion formers like Robert Bosch, Opel and Siemens are driving through deals with the IG Metal union for longer working hours for no extra wage. This gradual change of perspective reflects the recognition of globalisation, with extra impetus being given by competition from the new Eastern European members of the EU.

In Japan we expect record corporate cash flows to be directed at capital spending. A point that should be emphasised is that the yen, while stronger against the US$ has been relatively weak versus the euro. It is against this economic block that it faces its principal competition in elaborate and sophisticated machinery. As companies gradually share some of their surpluses with labour through the biannual bonus system, we can envisage domestic demand being stronger than some presently believe. We also see this reviving one of the few moribund property markets in the developed world. As has been noted before, land prices are edging upwards and the housing market is showing promise.

Japanese Export Destinations (% of Total Exports)



Source: BOJ

CONCLUSION

Cheap money is clouding the economic scene. Traditionally, government and business are the user of savings, and these are provided by households. In the US today the opposite applies. Business, which needs savings to invest and grow, is the provider of funds, while the consumer and government are the users. **This is an upside-down world.** Should US inflation become more troublesome and if too little heed is paid by the Bush administration to the twin deficits, the delicate balance may become unsettled.

At the individual share level, company earnings in general are losing momentum though still growing and valuations range from acceptable to high, on admittedly above average levels of profitability.

The strongest growth prospects appear to reside in the emerging markets (globalisation beneficiaries) but equally, these markets tend to be the most sensitive to volatility in the developed markets. It is for this reason that we have maintained short positions in selected indices.

Kerr Neilson
Managing Director
Platinum Asset Mangement

If you have any questions about your investment in the MLC – Platinum Global Fund, please contact the MasterKey Service Centre on

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from anywhere in Australia or

0800 442 550

from New Zealand

Platinum Asset Management is the leading Australian based international fund manager. For greater insight into our process, please visit our web site at *www.platinum.com.au*

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