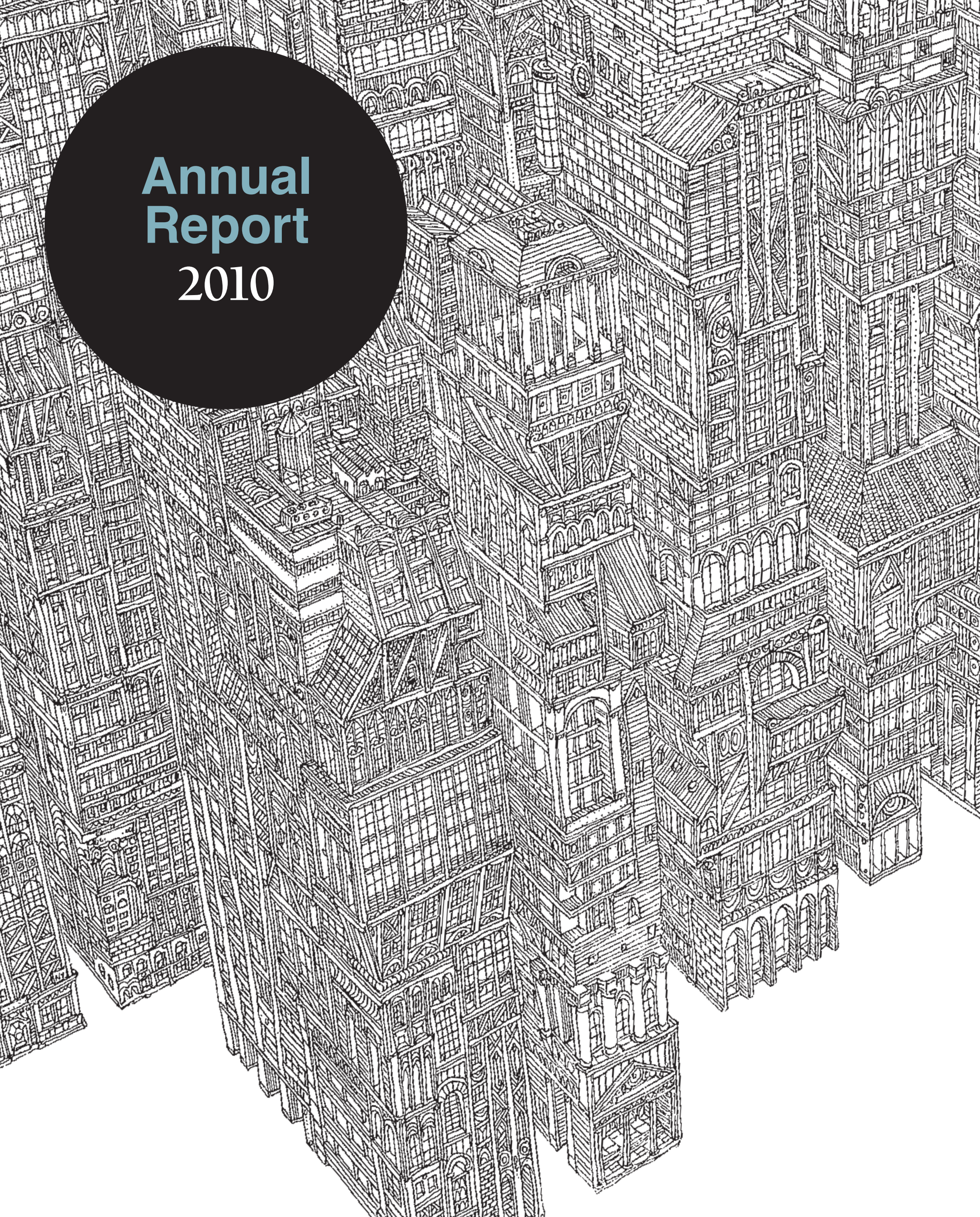
Annual Report 2010



Platinum®
ASSET MANAGEMENT

Platinum Asset Management Limited
ABN 13 050 064 287

Directors

Michael Cole
Margaret Towers
Malcolm Halstead
Bruce Coleman
Kerr Neilson

Secretary

Malcolm Halstead

Shareholder Liaison

Liz Norman

Registered Office

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Sydney NSW 2000

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Share Registrar

Computershare Investor Services Pty Ltd
Level 3, 60 Carrington Street
Sydney NSW 2000

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Auditors and Taxation Advisors

PricewaterhouseCoopers
201 Sussex Street
Sydney NSW 2000

Securities Exchange Listing

Ordinary Shares listed on the Australian Securities Exchange
ASX Code: **PTM**

Website

http://www.platinum.com.au/paml_shares.htm

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Chairman's Report

Performance

The Company has performed reasonably, given the prevailing uncertainty and weakness of the global economy. Funds Under Management ("FUM") increased by $4.4 billion (31.5%) to $18.4 billion at 30 June 2010. The increase in FUM comprises net inflows of $2.5 billion and investment performance of $1.9 billion. It is pleasing to report this included inflows of some $1.2 billion of institutional money, which was a management focus highlighted last year.

Our clients' short and long-term investment performance remains strong. The Managing Director's letter details the returns and movement in FUM.

Net profit after tax for the year was $136.9 million (2009: $126.1 million), an increase of 8.5%. Diluted earnings per share were 23.33 cps (2009: 21.62 cps). The increase in profit primarily arises from an increase in management fees of 16% to $217.4 million.

Costs

Expenses incurred by Platinum continue to be closely monitored. Costs have increased by 31%, mainly owing to performance related employee remuneration and to the full-year expense relating to a grant of options in June 2009. No options were granted in the 2010 financial year.

Dividend

A fully franked dividend of 14 cents per share will be paid on 22 September 2010.

A fully franked dividend of 8 cents per share was paid on 16 March 2010. The total dividend payout is in line with the Dividend Policy (of paying out 80-90% of net profit after tax) and consistent with our working capital needs.

The Directors are confident that future dividends will be fully franked.

I note that whilst the Company has a Dividend Reinvestment Plan in place, it is not activated and unlikely to be so in the near term.

The Board and its Committees

Both the Remuneration and Audit Committees had a productive year.

Environment

Your Company remains carbon neutral, having purchased carbon credits to offset its carbon emissions.

Conclusion

It is difficult to forecast or predict what will happen to our fee base and profit over the course of the next year, other than to say our relative investment performance when compared to the relevant MSCI indices remains encouraging across all our investment vehicles and we are hopeful this will translate to higher inflows and ultimately higher dividends for shareholders. A particular positive has been the increasing acceptance of our investing style by investment consultants and institutional investors.

Michael Cole
Chairman

Managing Director's Letter to Shareholders

Investment Performance

The investment team at Platinum Asset Management has continued to do a solid job. As is shown by the table below, virtually all of our Funds have beaten their respective benchmarks by a sound margin.

Platinum Trust Funds' Performance (% compound pa, to 30 June 2010)

FUND	1 YEAR	3 YEARS	5 YEARS	10 YEARS
Platinum International Fund	11.8	3.5	8.3	9.1
MSCI* All Country World Net Index	7.0	-10.4	-0.9	-3.6
Platinum Unhedged Fund	22.7	3.4	12.7	n/a
MSCI All Country World Net Index	7.0	-10.4	-0.9	n/a
Platinum Asia Fund	14.0	4.2	13.9	n/a
MSCI Asia ex Japan Net Index	16.9	-1.8	9.1	n/a
Platinum European Fund	21.0	-4.6	5.2	7.7
MSCI All Country Europe Net Index	2.0	-14.8	-1.7	-2.8
Platinum Japan Fund	-1.8	-0.3	3.6	4.0
MSCI Japan Net Index	-3.6	-11.9	-2.2	-6.6
Platinum International Brands Fund	32.3	5.2	10.1	13.8
MSCI All Country World Net Index	7.0	-10.4	-0.9	-3.6
Platinum International Health Care Fund	12.2	-0.2	4.0	n/a
MSCI All Country World Health Care Net Index	4.9	-4.9	-1.3	n/a
Platinum International Technology Fund	7.5	2.4	8.2	7.9
MSCI All Country World IT Net Index	10.3	-6.2	-0.1	-11.4

* Morgan Stanley Capital International

Source: *Platinum and MSCI*

Fund returns have been calculated by Platinum using the unit prices for the standard retail investment option and represent the combined income and capital return (for the named Fund) for the specific period. Returns are net of ongoing fees and costs, are pre-tax, and assume the reinvestment of distributions. Index returns have been calculated by Platinum using information sourced from MSCI Inc.

The Business

There has been a trend over time to consolidate the distribution platforms[1] used by financial planners. Given this backdrop, the ACCC's rejection of the proposed bid by NAB for the retail platform of AXA was an important development. The commonly accepted belief is that these platforms flourish with scale because of the greater spread of overheads in relation to assets. However, in the Australian context our observation is that such consolidation tends to reduce choice and the resulting rise in profitability of platforms has more to do with market dominance than increased efficiency or benefit to the public.

The consequent pressure on manager fees does not perturb us, as we ardently believe that our franchise has been built on a reputation of clear and time-tested business principles, which centre on the creation and preservation of wealth. The emphasis on market share and funds under management is putting the cart before the bull. Further, the gradual phasing out of commissions for financial advice, in favour of fees for advice, may see a gradual shift of allegiances. (The legislation may in the meantime discourage switching but ultimately differences in performance do matter!)

In our view, the review of the Superannuation System by Jeremy Cooper makes sensible observations about the public's understanding and engagement regarding compulsory super. Importantly for Platinum, the panel believes there is no need to change the current workings of Self-Managed Super Funds (SMSF). The proposals relate mostly to streamlining of the record-keeping system and the use of Tax File Numbers to keep track of "lost" contributors/ions. The establishment of a default provider, "My Super", will also have no effect on our opportunities as the panel recognises that fee scales should vary according to the value added by fund managers. We do, however, diverge in our thinking regarding the panel's observation that fees should fall in accordance with the rise of scale of funds under management. We have not been able to observe a positive correlation between scale and performance. To the contrary, we see price as a rationing device.

1 These are the record-keeping functions supplied by several large financial organisations, like banks and insurance companies, to facilitate the back office workings of financial planners. They allow planners to keep records of super and investment portfolios, to notify fund managers of changes to their clients' portfolios, keep track on distributions, and pay fees and expenses directly from the client's account.

Managing Director's Letter to Shareholders Continued

The Team

The team is working well, as can be deduced from the performance table. We continue to bring new members aboard but, sadly, not all develop into long-term members. It is a source of frustration that we have not yet found a fault-free way of selecting candidates, and this leads to attrition. It is self-evident that not all are cut out for the calling of funds management; describing a company is very different from understanding it, painting with numbers does not work particularly well in the hurly-burly exchange of the markets.

Our data and information sharing platform is proving highly valuable for the dissemination of information and the sharing of knowledge. The quantitative templates which are automatically produced remove duplication and expedite data handling. These tools, however, in no way remove the time-consuming process of analysing the peculiarities of each stock idea or indeed the germination of ideas. This comes from ability, hard work and a gift of weighing-up the relevant information appropriately.

Costs

Costs have moved up, as we anticipated. Performance related bonuses and advancing seniority being the major contributor. As we suggested last year, the performance bonus is constructed to be self-funding.

Profits

Success in signing up profit sharing investment accounts has started to rebuild our performance fee potential. As you can see this proportion of our funds under management has risen to $1.5 billion. In addition, our traditional retail base has been very loyal and the firm started to see positive flows from about May of 2009.

Funds Under Management ($m, to 30 June 2010)

FUND	OPENING BALANCE (30 JUNE 2009)	FLOWS	DISTRIBUTION	INVESTMENT PERFORMANCE	CLOSING BALANCE (30 JUNE 2010)
Platinum Trust Funds	10,614	1,867	(70)	1,405	13,816
MLC Platinum Global Fund	1,522	(292)	–	281	1,511
Management Fee Mandates	1,221	128	–	169	1,518
"Relative" Performance Fee Mandates	45	853	–	10	908
"Absolute" Performance Fee Mandates	564	(4)	–	50	610
TOTAL	**13,966**	**2,552**	**(70)**	**1,915**	**18,363**

Source: *Platinum*

With performance fees there is a trade-off: the modest flat fee is complemented by a performance component that will share in the degree to which we are able to outperform the benchmark (MSCI). For these fees to give us a yield equivalent to the standard flat fee, Platinum needs to outperform by approximately 5%. Our historic outperformance over the last 15 years has averaged 10% per annum compound with great variances in between. Do note that this change in the blend of our fee base will introduce lumpiness in our profits. In a good year the upside can be very exciting and vice versa.

Outlook

We do not believe we are in or about to enjoy a secular bull market. We see many obstacles ahead and describe these in our quarterly reports to our investors. With this in mind, creating real value will be unusually challenging. Assisting us though is a maturing team of investment experts and a growing interest among professional investors in our products. As Platinum is an active manager, we are forced to have strong views about the absolute value of companies (investments). This adds to our professional burden, as we need from time to time to diverge from the pack. This can add to the risks of the business, but to the extent that our judgement prevails, the rewards can be spectacular!

Kerr Neilson
Managing Director

Financial Statements
2010

Shareholder Information

Substantial Shareholders

The following parties have notified the Company that they have a substantial relevant interest in the ordinary shares of Platinum Asset Management Limited as at 17 August 2010:

	NUMBER OF SHARES	%
J Neilson, K Neilson	323,074,841	57.55
J Clifford, Moya Pty Limited, A Clifford	32,831,449	5.85

Distribution of Securities

(I) DISTRIBUTION SCHEDULE OF HOLDINGS	CLASS OF EQUITY SECURITY ORDINARY
1 – 1000	5,136
1,001 – 5,000	13,564
5,001 – 10,000	2,738
10,001 – 100,000	1,406
100,001 and over	57
Total number of holders	22,901
(ii) Number of holders of less than a marketable parcel	110
(iii) Percentage held by the 20 largest holders	82.63%

Shareholder Information
Continued

Twenty Largest Shareholders

The names of the 20 largest holders of each class of listed equity securities as at 17 August 2010 are listed below:

	NUMBER OF SHARES	%
Platinum Investment Management Limited	223,896,858	39.89
J Neilson	136,250,000	24.27
JP Morgan Nominees Australia Limited	22,206,881	3.96
Citicorp Nominees Pty Limited	14,101,954	2.51
HSBC Custody Nominees (Australia) Limited	10,808,722	1.93
Charmfair Pty Limited	10,000,000	1.78
Jilliby Pty Limited	10,000,000	1.78
National Nominees Limited	9,311,227	1.66
Cogent Nominees Pty Limited	8,179,384	1.46
J Clifford	5,000,000	0.89
Xetrov Pty Limited	4,000,000	0.71
Citicorp Nominees Pty Limited	3,081,320	0.55
Cogent Nominees Pty Limited	2,303,217	0.41
ANZ Nominees Limited	1,038,689	0.19
AMP Life Limited	864,014	0.15
Warbont Nominees Pty Limited	692,009	0.12
RBC Dexia Investor Services Australia Nominees Pty Limited	565,649	0.10
Smallco Investment Manager Limited	537,518	0.10
Questor Financial Services Limited	500,521	0.09
S Gilchrist	479,651	0.08

Voting Rights

Ordinary Shares

On a show of hands, every member present in person or represented by a proxy or representative shall have one vote and on a poll, every member who is present in person or represented by a proxy or representative shall have one vote for every share held by them.

Platinum's Commitment to Carbon Neutrality

Platinum Asset Management remains carbon neutral, having purchased carbon credits to offset its carbon emissions.

Distribution of Annual Report to Shareholders

The Law allows for an "opt in" regime in which shareholders will receive a printed "hard copy" version of the Annual Report only if they request one. The Directors have decided forthwith to only mail out an Annual Report to those shareholders who have "opted in".

Questions for the AGM

If you would like to submit a question prior to the AGM for it to be addressed at the AGM, please eMail your question to invest@platinum.com.au.

Financial Calendar

Ordinary Shares trade ex-dividend	24 August 2010
Record (books close) date for dividend	30 August 2010
Dividend paid	22 September 2010
Annual General Meeting	5 November 2010

These dates are indicative and may be changed.

Directors' Report

Your Directors present their report on the consolidated entity consisting of Platinum Asset Management Limited (the "**Company**") and the entities it controlled at the end of, or during, the year ended 30 June 2010.

Directors

The following persons were Directors of the Company at the end of the financial year and up to the date of this report:

Michael Cole	Chairman and Non-Executive Director
Bruce Coleman	Non-Executive Director
Margaret Towers	Non-Executive Director
Kerr Neilson	Managing Director
Malcolm Halstead	Finance Director and Company Secretary

Principal Activity

The Company is the non-operating holding company of Platinum Investment Management Limited. Platinum Investment Management Limited, trading as Platinum Asset Management, operates a funds management business.

Trading Results

The profit after tax of the consolidated entity for the year was $136,852,000 (2009: $126,145,000) after income tax expense of $61,540,000 (2009: $55,267,000).

Dividends

Since the end of the financial year, the Directors have declared a 14 cents per share ($78,589,000) fully franked dividend payable to shareholders on 22 September 2010.

A fully franked dividend of 8 cents per share ($44,880,000) was paid on 16 March 2010.

A fully franked dividend of 12 cents per share ($67,320,000) was paid on 22 September 2009.

Review of Operations

The consolidated profit before tax was $198,392,000 (2009: $181,412,000).

Changes in the State of Affairs

There were no significant changes in the state of affairs of the Company that occurred during the year not otherwise disclosed in this report or the financial statements.

Events Subsequent to the End of the Financial Year

Since the end of the financial year, the Directors are not aware of any matter or circumstance not otherwise dealt with in this report or financial statements that has significantly affected the operations of the Company, the results of those operations or the state of affairs of the Company in subsequent financial periods.

Likely Developments and Expected Results of Operations

The Company continues to pursue its business objectives, by continuing to be the holding company of the Platinum Asset Management funds management business. The methods of operating the consolidated entity are not expected to change in the foreseeable future.

Rounding of Amounts

The consolidated entity is of a kind referred to in the Australian Securities & Investments Commission's Class Order 98/0100 (as amended) and consequently amounts in the Directors' Report and financial statements have been rounded to the nearest thousand dollars in accordance with that Class Order, unless otherwise indicated.

Environmental Regulation

The consolidated entity is not adversely impacted by any particular or significant environmental regulations under a Commonwealth, State or Territory Law.

Auditor

PricewaterhouseCoopers continues in office in accordance with section 327 of the *Corporations Act 2001*.

Non-Audit Services

The Directors, in accordance with advice received from the Audit Committee, are satisfied that the provision of non-audit services is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The Directors are satisfied, considering the nature and quantum of the non-audit services, that the provision of non-audit services by the Auditor, as set out below, did not compromise the auditor independence requirements of the *Corporations Act 2001*.

Directors' Report
Continued

Details of the amounts paid or payable to the Auditor (PricewaterhouseCoopers) for audit and non-audit services provided during the year are set out below.

	2010 $	2009 $
Audit services – statutory	**271,775**	260,508
Taxation services – compliance	**466,100**	454,417
Taxation services – foreign tax agent	**18,149**	69,527
Other audit and assurance services	**31,174**	5,958
Advisory services – restructuring and related costs*	**227,265**	354,285
Total	**1,014,463**	1,144,695

* For 2010, the advisory services provided by PricewaterhouseCoopers predominantly related to legal work associated with the payment of stamp duty, arising from the restructure of the Company, prior to the offer of shares to the public in the 2007 IPO.

Auditor's Independence Declaration

A copy of the Auditor's Independence Declaration as required under section 307C of the *Corporations Act 2001* is set out on page 20.

Information on Directors

Michael Cole BECON, MECON, FFIN

Independent Non-Executive Director, Chair and member of the Audit and Remuneration Committees since 10 April 2007. (Age 62)

Mr Cole has over 32 years' experience in the investment banking and funds management industry. He was an Executive Director/Executive Vice President at Bankers Trust Australia for over 10 years. Mr Cole is Chairman of Ironbark Capital Limited and IMB Limited. Mr Cole is a Director of Challenger Listed Investments Limited.

Bruce Coleman BSC, BCOM, CA, FFIN

Independent Non-Executive Director, Chair of the Remuneration Committee and member of the Audit Committee since 10 April 2007. (Age 60)

Mr Coleman has worked in the finance and investment industry since 1986. He was the CEO of MLC Investment Management from 1996 to 2004. He has held various directorships within MLC Limited, Lend Lease and National Australia Banking groups. Mr Coleman is a Director of Platinum Capital Limited.

Margaret Towers CA, GAICD
Independent Non-Executive Director, Chair of the Audit Committee and member of the Remuneration Committee since 10 April 2007. (Age 52)

Ms Towers is a Chartered Accountant with over 28 years' experience in the financial markets. She was formerly an Executive Vice President at Bankers Trust Australia. Ms Towers currently acts as an independent consultant to a number of Australian Financial Institutions. She was previously with Price Waterhouse.

Kerr Neilson BCOM (UCT), ASIP
Managing Director since 12 July 1993. (Age 60)

Mr Neilson was appointed as Managing Director upon incorporation. He is the Managing Director of Platinum Investment Management Limited and Platinum Capital Limited. Prior to Platinum, Mr Neilson was an Executive Vice President at Bankers Trust Australia. Previously he worked in both the UK and South Africa as an investment analyst and fund manager.

Malcolm Halstead CA
Finance Director and Company Secretary since 20 February 2007. (Age 52)

Mr Halstead has been a Director of Platinum Investment Management Limited and Platinum Capital Limited since their formation in 1994. Prior to Platinum, Mr Halstead was a Vice President at Bankers Trust Australia. Previously he was with Price Waterhouse, Sydney and Jolliffe Cork, London.

Directors' Meetings

The following table sets out the number of meetings held and attended by the Company's Directors during the year ended 30 June 2010.

	BOARD MEETINGS		AUDIT COMMITTEE MEETINGS		REMUNERATION COMMITTEE MEETINGS	
	HELD WHILE A DIRECTOR	ATTENDED	HELD WHILE A MEMBER	ATTENDED	HELD WHILE A MEMBER	ATTENDED
NAME						
M Cole	4	4	4	4	4	4
B Coleman	4	4	4	4	4	4
M Towers	4	4	4	4	4	4
K Neilson	4	2	–	–	–	–
M Halstead	4	4	–	–	–	–

Directors' Report
Continued

Remuneration Report (audited)

Principles used to determine the nature and amount of remuneration
The Executive Directors review and determine the remuneration of the Non-Executive Directors and may utilise the services of external advisors. It is the policy of the Board to remunerate at market rates commensurate with the responsibilities borne by the Non-Executive Directors. The remuneration of the Directors is not linked to the performance or earnings of the Company or consolidated entity.

Directors' fees
Non-Executive Directors' base remuneration is reviewed annually.

Retirement benefits for Directors
No retirement benefits (other than mandatory superannuation) are provided to Directors.

Other benefits (including termination) and incentives
No other benefits and incentives (other than those disclosed below) are paid to Directors.

Details of remuneration
Non-Executive Directors
All remuneration of the Non-Executive Directors is paid by Platinum Investment Management Limited. The Non-Executive Directors received the following amounts during the financial year.

NAME	SHORT-TERM BENEFITS SALARY $	POST-EMPLOYMENT BENEFITS SUPERANNUATION $	TOTAL $
M Cole	200,000	14,461	214,461
B Coleman	175,000	14,461	189,461
M Towers	175,000	14,461	189,461
Total remuneration	550,000	43,383	593,383

Executive Directors
AASB 124: *Related Party Disclosures* defines key management personnel as "persons having authority and responsibility for planning, directing and controlling activities of the entity". The only employees who have this authority and responsibility are the Directors of Platinum Asset Management Limited.

Other than those disclosed on the following page, there are no employees who hold an executive position within the Company.

Key management personnel compensation

The Executive Directors (K Neilson and M Halstead) are employed by Platinum Investment Management Limited and receive their remuneration from Platinum Investment Management Limited.

AASB 124 requires compensation provided by the Company or on behalf of the Company to be disclosed.

A portion of the compensation paid by Platinum Investment Management Limited to its employees is in relation to managing the affairs of the Company. Platinum Investment Management Limited has not made any determination as to what proportion of its employees' compensation relates to the Company. Platinum Investment Management Limited paid: K Neilson a salary of $364,468 (2009: $313,756) and superannuation of $49,993 (2009: $99,989) and M Halstead a salary of $314,468 (2009: $263,756), and superannuation of $49,993 (2009: $99,989).

For the full financial year, A Clifford was a Director of the operating subsidiary, Platinum Investment Management Limited. A Clifford was paid a salary of $339,464 (2009: $313,747) and a bonus of $630,000 (2009: $nil), superannuation of $24,997 (2009: 49,997) and share-based compensation as disclosed below.

Platinum Investment Management Limited provided for an increase in long service leave as follows: K Neilson $7,258 (2009: $12,753), M Halstead $5,980 (2009: $10,339) and A Clifford $7,216 (2009: $12,926) and provided for an increase/(decrease) in annual leave as follows: K Neilson ($13,793) (2009: ($1,282)), M Halstead ($20,115) (2009: ($3,803)), and A Clifford ($4,023) (2009: ($17,213)).

Relevant interests of Non-Executive and Executive Directors in shares

The relevant interest in ordinary shares of the Company that each Director has at balance date is as follows:

NAME	BALANCE 1/07/09	ACQUISITIONS	DISPOSALS	BALANCE 30/06/10
M Cole	300,000	–	–	300,000
B Coleman	200,000	–	–	200,000
M Towers	20,000	–	–	20,000
K Neilson	322,074,841	–	–	322,074,841
M Halstead	22,834,931	–	5,836,932	16,997,999

Directors' Report
Continued

Share-based compensation

No options or performance rights have been granted to any Non-Executive or Executive Directors of the Company in the financial year. On 17 June 2009, A Clifford was granted 3,844,350 options. No options were granted in the 2010 financial year. The options were granted at a strike price of $4.50. The options vest after four years and have a further two-year exercise period.

The assessed fair value of options granted on 17 June 2009 was $1.14 per option. The share-based payments expense relating to this grant to A Clifford was $1,091,795 (2009: $41,820). The Executive Directors did not receive any other short-term or long-term incentives, other than what is disclosed above.

Service agreements

Remuneration and other terms of employment for the Non-Executive Directors are formalised in service agreements. The Executive Directors do not have service agreements, as they are employees of the Investment Manager, Platinum Investment Management Limited.

M Cole, Chairman and Non-Executive Director

– Agreements have no termination date. Tenure is subject to approval by shareholders at every third AGM.
– Base annual salary, inclusive of superannuation is $214,461.

B Coleman, Non-Executive Director

– Agreements have no termination date. Tenure is subject to approval by shareholders at every third AGM.
– Base annual salary, inclusive of superannuation is $189,461.

M Towers, Non-Executive Director

– Agreements have no termination date. Tenure is subject to approval by shareholders at every third AGM.
– Base annual salary, inclusive of superannuation is $189,461.

Directors' interests in contracts

The Directors receive remuneration and dividends which are ultimately derived from the net income arising from Platinum Investment Management Limited's investment management contracts.

Directors' insurance

During the year, Platinum Investment Management Limited incurred a premium in respect of a contract for indemnity insurance for the Directors and Officers of the Company named in this report.

This report is made in accordance with a resolution of the Directors.

Michael Cole
Chairman

Kerr Neilson
Director

Sydney, 19 August 2010

Auditor's Independence Declaration

As lead Auditor for the audit of Platinum Asset Management Limited and its controlled entities for the year ended 30 June 2010, I declare that to the best of my knowledge and belief, there have been:

(a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and

(b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Platinum Asset Management Limited and its controlled entities during the period.

A J Loveridge
Partner
PricewaterhouseCoopers

19 August 2010

Liability limited by a Scheme approved under Professional Standards Legislation.

Corporate Governance Statement

The following provides a summary of the main corporate governance practices adopted by the Board, and exercised throughout the year, for the Company.

The Company has followed the ASX Corporate Governance Council's *Corporate Principles and Recommendations* ("**Governance Principles**"), except where indicated.

Company policies, Charters and codes referred to in this Statement are provided in the 'Shareholder Corporate Governance' section of the Company's website at www.platinum.com.au ("**Company's website**").

The Company and its controlled entities together are referred to as "**the Group**" in this Statement.

1. The Board of Directors

Members: M Cole (Chair), B Coleman, M Towers, K Neilson and M Halstead.

The Board has adopted a Charter, which details the functions and responsibilities of the Board.

1.1 Role of the Board

The role of the Board is to oversee the activities of the Executive Directors, ensuring the Company operates in compliance with its regulatory environment and that good corporate governance practices are adopted.

1.2 Responsibilities of the Board

The principal responsibilities of the Board include:

- considering and approving the strategy of the Company;
- monitoring the performance and financial position of the Company;
- overseeing the integrity of the Group's financial accounts and reporting;
- assessing the performance of Management and itself;
- reviewing the operations and findings of the Company's risk management, compliance and control frameworks; and
- monitoring the Company's compliance with regulatory, legal and ethical standards.

1.3 Structure of the Board

The Board currently comprises five Directors: three Non-Executive Directors (M Cole, B Coleman and M Towers) and two Executive Directors (K Neilson and M Halstead).

Details on the background, experience and professional skills of each Director are set out on pages 14 and 15 of the Directors' Report.

Corporate Governance Statement
Continued

The Chair of the Board is an independent Director, and the roles of Chair and Managing Director (Chief Executive Officer) are not exercised by the same individual.

The Chair is responsible for leading the Board, ensuring that the Board's activities are organised and efficiently conducted and ensuring Directors are properly briefed for meetings.

The Managing Director is responsible for the management and operation of the Company. Those powers not specifically reserved to the Board under its Charter and which are required for the management and operation of the Company, are conferred on the Managing Director.

1.4 Director Independence

The Non-Executive Directors of the Company have been assessed as independent. In reaching its decision, the Board has taken into account the factors outlined below.

The Board regularly assess the independence of each Director. For this purpose an Independent Director is a Non-Executive Director whom the Board considers to be independent of Management and free of any business or other relationship that could materially interfere with, or could reasonably be perceived to interfere with, the exercises of unfettered and independent judgement.

Directors must disclose any person or family contract or relationship in accordance with the *Corporations Act 2001*. Directors also adhere to constraints on their participation and voting in relation to matters in which they may have an interest in accordance with the *Corporations Act 2001* and the Company's policies.

Each Director may from time to time have personal dealings with the Company. Each Director is involved with other companies or professional firms which may from time to time have dealings with the Company.

Details of offices held by Directors with other organisations are set out on pages 14 and 15 of the Directors' Report. Full details of related party dealings are set out in the notes to the Company's accounts, as required by law.

In assessing whether Directors are independent, the Board takes into account (in additional to the matters set out above):

- the specific disclosures made by each Director as referred to above;
- where applicable, the related party dealings referable to each Director, noting whether those dealings are 'material';
- whether a Director is (or is associated directly with) a substantial shareholder of the Company;

- whether the Director has ever been employed by the Group;
- whether the Director is (or is associated with) a 'material' professional adviser, consultant, supplier, or customer of, the Group; and
- whether the Director personally carries on any role for the Group other than as a Director of the Company.

The Board also has regard to the matters set out in the Governance Principles. The Board does not consider that a term of service on the Board should be considered as a factor affecting a Director's ability to act in the best interests of the Company.

If a Director's independent status changes, this will be disclosed and explained to the market in a timely manner and in consideration of the Company's Communications Plan.

Materiality

The Board determines 'materiality' on both a quantitative and qualitative basis. An item that affects the Company's net assets by approximately 5%, or affects the Company's distributable income in a forecast period by more than approximately 5% of the Company's net profit before tax, is likely to be material. These quantitative measures, however, must be supplemented with a qualitative examination. The facts (at the time) and the context in which the item arises will influence the determination of materiality.

1.5 Selection and Appointment of Directors

Recommendation 2.4 of the Governance Principles provides that 'the board should establish a nomination committee'.

Given the size of the Company and the Board, the Board considers a nomination committee is not warranted. The full Board considers the issues that would otherwise be a function of a nomination committee.

When evaluating, selecting and appointing Directors, the Board considers:

- the candidate's competencies, qualifications and expertise and his/her fit with the current membership of the Board;
- the candidate's knowledge of the industry in which the Company operates;
- directorships previously held by the candidate and his/her current commitments to other boards and companies;
- existing and previous relationships with the Company and Directors;
- the candidate's independence status and the need for a majority or equal balance on the Board; and
- requirements of the *Corporations Act 2001*, ASX Listing Rules, the Company's Constitution and Board Policy.

Corporate Governance Statement
Continued

The Board seeks to ensure that:

– its membership represents an appropriate balance between Directors with investment management experience and Directors with an alternative perspective; and
– the size of the Board is conducive to effective discussion and efficient decision-making.

Under the terms of the Company's Constitution:

– an election of Directors must be held at each Annual General Meeting and at least one Director (but not the Managing Director) must retire from office; and
– each Director (but not the Managing Director) must retire from office at the third Annual General Meeting following their last election.

Where eligible, a Director may stand for re-election.

1.6 Access to Information and Independent Advice

All Directors have unrestricted access to records and information of the Group.

Non-Executive Directors regularly receive updates and reports from Management.

The Board of Directors' Charter provides that the Directors may (in connection with their duties and responsibilities) seek independent professional advice at the Company's expense, after first notifying the Board. The Board will review the estimated costs for reasonableness, but will not impede the seeking of advice.

1.7 Performance Assessment

The Board of Directors' Charter requires:

– the Board to review its performance (at least annually) against previously agreed measurable and qualitative indicators;
– the Chair of the Board to review each Director's performance;
– a nominated Director to review the Chair's performance; and
– the Board to undertake a formal annual review of its overall effectiveness, including its Committees.

These assessments were undertaken.

As a result of these assessments, the Board may implement changes to improve the effectiveness of the Board and corporate governance structures.

2. Board Committees

The Board has established a number of committees to assist in the execution of its duties and (from time to time) to deal with matters of special importance.

Each Committee has a documented and approved Charter under which authority is delegated from the Board.

2.1 Audit Committee

Members: M Towers (Chair), M Cole and B Coleman.

The purpose of the Committee is to assist the Board in fulfilling its responsibilities relating to the financial reporting and accounting practices of the Company. Its key responsibilities are to:

– review the financial information presented by Management;
– consider the adequacy and effectiveness of the Company's administrative, operating and accounting controls as a means of ensuring the Company's affairs are being conducted by Management in compliance with legal, regulatory and policy requirements;
– review any significant compliance issues affecting the Company and monitor actions taken by Management;
– review recommendations from the Finance Director and/or external Auditor on key financial and accounting principles to be adopted by the Company; and
– recommend to the Board the appointment of external auditors and monitor the conduct of audits.

All members of the Committee are independent Non-Executive Directors.

The Audit Committee has authority (within the scope of its responsibilities) to seek any information it requires from any Group employee or external party.

Members may also meet with Auditors (internal and/or external) without Management present, and consult independent experts where the Committee considers it necessary to carry out its duties.

All matters determined by the Committee are submitted to the full Board as recommendations for Board decisions. Minutes of a Committee meeting are tabled at the subsequent Board meeting. Additional requirements for specific reporting by the Committee to the Board are addressed in the Charter.

2.2 Remuneration Committee

Members: B Coleman (Chair), M Cole and M Towers.

The Committee advises the Board on remuneration and incentive policies and practices generally and makes specific recommendations on remuneration packages and other terms of employment for Executive Directors, other Senior Executives and Non-Executive Directors.

Corporate Governance Statement
Continued

Members of the Remuneration Committee have access to the Company's officers and advisers, and may consult independent experts where the Committee considers it necessary to carry out its duties.

Remuneration Policies

Remuneration for the Executive Directors consists of salary, bonuses or other elements. Any equity based remuneration for Executive Directors will be subject to shareholder approval where required by law or ASX Listing Rules.

Remuneration for Non-Executive Directors must not exceed in aggregate a maximum sum which shareholders fix in a general meeting. The current maximum aggregate amount fixed by shareholders is $2 million per annum (including superannuation contributions). This amount was fixed by shareholders at the 10 April 2007 general meeting.

Executive and Non-Executive Directors may also be reimbursed for their expenses properly incurred as Directors.

Further information is provided in the Remuneration Report.

Remuneration Paid

Remuneration paid to the Executive and Non-Executive Directors for the 2009/2010 reporting year is set out on pages 16 to 19 of the Directors' Report.

3. Company Auditors

The policy of the Board is to appoint auditors who clearly demonstrate competence and independence.

The performance of the Auditor is reviewed annually and applications for tender of external audit services are requested as deemed appropriate, taking into consideration assessment of performance, existing value and tender costs.

PricewaterhouseCoopers was appointed as Auditor in 2007. It is PricewaterhouseCoopers policy to rotate audit engagement partners on listed companies at least every five years.

An analysis of fees paid to the Auditor, including a breakdown of fees for non-audit services, is provided in the Directors' Report. It is the policy of the Auditor to provide an annual declaration of its independence to the Audit Committee.

The Auditor is required to attend the Company's Annual General Meeting and be available to answer shareholder questions about the conduct of the audit and the preparation and content of the Auditor's Report.

4. Company Policies

4.1 Directors' Code of Conduct

The Board has adopted a Directors' Code of Conduct which is based upon the Australian Institute of Company Directors' Code of Conduct. It requires the Directors to act honestly, in good faith, and in the best interests of the Company as a whole, whilst in accordance with the letter (and spirit) of the law.

4.2 Trading in Company Securities

All Directors and staff of the Group must comply with the Company's Share Trading Policy. In summary, the policy prohibits trading in the Company securities:

- when aware of unpublished price-sensitive information;
- from the first day of the month until announcement of the Company's monthly funds under management figure to the ASX;
- from 1 January (each year) until announcement of the Company's half-yearly financial results to the ASX;
- from 1 July (each year) until announcement of the Company's annual financial results to the ASX; and
- during any other black-out period (as notified).

Directors and staff are prohibited from entering into transactions in associated products which operate to limit the economic risk of holding PTM shares over unvested entitlements.

4.3 Financial Reporting

In respect of the year ended 30 June 2010, the Managing Director and Finance Director have made the following certifications to the Board:

- The Company's financial reports are complete and present a true and fair view, in all material respects, of the financial condition and operational results of the Company and the Group and are in accordance with relevant Accounting Standards.
- The above statement is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the Board and that the Company's risk management and internal compliance and control system is operating efficiently and effectively in all material respects.

Corporate Governance Statement
Continued

4.4 Continuous Disclosure
The Board is committed to:

- the promotion of investor confidence by ensuring that trading in the Company shares takes place in an efficient, competitive and informed market;
- complying with the Company's disclosure obligations under the ASX Listing Rules and the *Corporations Act 2001*; and
- ensuring the Company's stakeholders have the opportunity to access externally available information issued by the Company.

The Company Secretary is responsible for coordinating the disclosure of information to Regulators and shareholders, and ensuring that any notifications/reports to the ASX are promptly posted on the Company's website.

4.5 Shareholder Communication
The Board has adopted a Communications Plan which describes the Board's policy for ensuring that shareholders and potential investors of the Company receive or obtain access to information publicly released by the Company. The Company's primary portals are its website, Annual Report, Annual General Meeting, Half-Yearly Financial Report and monthly notices to the ASX.

The Company Secretary oversees and coordinates the distribution of all information by the Company to the ASX, shareholders, the media and the public.

4.6 Risk Management and Compliance
The Board, through the Audit Committee, is responsible for ensuring that:

- there are effective systems in place to identify, assess, monitor and manage the risks of the Company; and
- internal controls and arrangements are adequate for monitoring compliance with laws and regulations applicable to the Company.

The Group has implemented risk management and compliance frameworks based on AS/NZS 31000:2009 *Risk Management Principles and Guidelines* and AS 3806-2006 *Compliance Programs*. These frameworks (together with the Group's internal audit function) ensure that:

– emphasis is placed on maintaining a strong control environment;
– accountability and delegations of authority are clearly identified;
– risk profiles are in place and regularly reviewed and updated;
– timely and accurate reporting is provided to Management and respective Committees; and
– compliance with the laws (applicable to the Company) and the Group's policies (including business rules of conduct) is communicated and demonstrated.

Management reports periodically to the Audit Committee and the Board on the effectiveness of the Group's risk management and compliance frameworks.

4.7 Business Rules of Conduct

Platinum's Business Rules of Conduct ("**BROC**") applies to all staff of the Group. It communicates the appropriate standards of behaviour, provides a framework for the workplace, and informs staff of their responsibilities with respect to legal compliance, confidentiality and privacy, conflicts of interest, investment activities and operational processes.

Compliance is monitored by the Compliance team. Regular training sessions are provided by the Compliance Manager. All employees are required to sign an annual declaration confirming their compliance with the BROC and the Group's policies.

Statement of Comprehensive Income

For the year ended 30 June 2010

	NOTES	CONSOLIDATED 2010 $'000	CONSOLIDATED 2009 $'000
Income			
Management fees		**217,398**	187,447
Performance fees		**10,702**	6,171
Administration fees		**11,155**	9,431
Interest		**8,024**	9,712
Net gains on financial assets at fair value through profit or loss		**1,328**	240
Net (losses) on foreign currency contracts		**(17)**	(1,125)
Net gains/(losses) on foreign currency bank accounts		**(258)**	7,442
Other investment		**23**	166
Total income		**248,355**	219,484
Expenses			
Staff		**18,781**	15,428
Custody and unit registry		**11,330**	9,195
Share-based payments	7	**6,611**	2,575
Business development		**5,568**	3,397
Research		**1,494**	1,368
Rent and other occupancy		**1,447**	1,398
Technology		**1,089**	837
Restructuring and related costs		**568**	505
Legal and compliance		**553**	544
Other professional		**509**	780
Miscellaneous		**456**	458
Depreciation		**417**	430
Share registry		**388**	362
Mail house		**284**	299
Auditor's remuneration		**272**	261
Periodic reporting		**196**	235
Total expenses		**49,963**	38,072
Profit before income tax expense		**198,392**	181,412
Income tax expense	2(a)	**61,540**	55,267
Profit after income tax expense		**136,852**	126,145
Other comprehensive income		**–**	–
Total comprehensive income for the year		**136,852**	126,145
Basic earnings per share (cents per share)	9	**24.39**	22.49
Diluted earnings per share (cents per share)	9	**23.33**	21.62

The above Statement of Comprehensive Income should be read in conjunction with the accompanying notes.

Balance Sheet
As at 30 June 2010

	NOTES	CONSOLIDATED 2010 $'000	CONSOLIDATED 2009 $'000
Current assets			
Financial assets at fair value through profit or loss		**663**	59
Cash and cash equivalents	12(a)	**29,758**	14,269
Term deposits and bank certificates of deposit		**194,128**	165,332
Trade receivables		**21,446**	24,295
Interest receivable		**3,062**	3,835
Prepayments		**956**	1,027
Total current assets		**250,013**	208,817
Non-current assets			
Deferred tax assets	2(b)	**2,030**	3,078
Fixed assets	3	**2,550**	2,660
Total non-current assets		**4,580**	5,738
Total assets		**254,593**	214,555
Current liabilities			
Payables	4	**11,418**	7,048
Current tax payable		**15,204**	10,418
Provisions	5	**1,626**	1,802
Total current liabilities		**28,248**	19,268
Non-current liabilities			
Deferred tax liabilities	2(c)	**921**	1,145
Provisions	5	**26**	7
Total non-current liabilities		**947**	1,152
Total liabilities		**29,195**	20,420
Net assets		**225,398**	194,135
Equity			
Contributed equity	8(a)	**629,091**	629,091
Reserves	8(b)	**(573,126)**	(579,737)
		55,965	49,354
Retained profits	10	**169,433**	144,781
Total equity		**225,398**	194,135

The above Balance Sheet should be read in conjunction with the accompanying notes.

Statement of Changes in Equity

For the year ended 30 June 2010

	CONTRIBUTED EQUITY $'000	RESERVES $'000	RETAINED PROFITS $'000	TOTAL $'000
Balance at 1 July 2008	**629,091**	**(582,312)**	**130,836**	**177,615**
Total comprehensive income for the year	–	–	126,145	126,145
Transactions with equity holders in their capacity as equity owners:				
Share-based payments	–	2,575	–	2,575
Dividends paid	–	–	(112,200)	(112,200)
Balance at 30 June 2009	**629,091**	**(579,737)**	**144,781**	**194,135**
Total comprehensive income for the year	–	–	136,852	136,852
Transactions with equity holders in their capacity as equity owners:				
Share-based payments	–	6,611	–	6,611
Dividends paid	–	–	(112,200)	(112,200)
Balance at 30 June 2010	**629,091**	**(573,126)**	**169,433**	**225,398**

The above Statement of Changes in Equity should be read in conjunction with the accompanying notes.

Statement of Cash Flows

For the year ended 30 June 2010

	NOTES	CONSOLIDATED 2010 $'000	CONSOLIDATED 2009 $'000
Cash flow from operating activities			
Interest received		**8,797**	5,953
Receipts from operating activities		**242,111**	197,473
Payments for operating activities		**(38,638)**	(34,270)
Income taxes paid		**(55,930)**	(54,732)
Cash flow from operating activities	12(b)	**156,340**	114,424
Cash flow from investing activities			
Receipts from sale of investments		**14,010**	21,129
Payments for purchases of investments		**(13,491)**	(13,982)
Purchase of fixed assets		**(311)**	(348)
Proceeds on maturity of term deposits and bank certificates of deposit		**167,315**	–
Purchase of term deposits and bank certificates of deposit		**(196,111)**	(165,332)
Cash flow from investing activities		**(28,588)**	(158,533)
Cash flow from financing activities			
Dividends paid		**(112,194)**	(112,194)
Cash flow from financing activities		**(112,194)**	(112,194)
Net increase/(decrease) in cash and cash equivalents		**15,558**	(156,303)
Cash and cash equivalents held at the beginning of the financial year		**14,269**	171,160
Effects of exchange rate changes on cash and cash equivalents		**(69)**	(588)
Cash and cash equivalents held at the end of the financial year		**29,758**	14,269

The above Statement of Cash Flows should be read in conjunction with the accompanying notes.

Notes to the Financial Statements

30 June 2010

1. Summary of Significant Accounting Policies

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied to all periods presented, unless otherwise stated.

The financial report includes the financial statements for Platinum Asset Management Limited as a consolidated entity, consisting of Platinum Asset Management Limited and its subsidiaries. The *Corporations Amendment (Corporate Reporting Reform) Act 2010*, became effective from 1 July 2010, and allows entities that present consolidated financial statements, to no longer have to present separate parent entity financial statements. The Company and consolidated entity have applied this change for the 30 June 2010 accounts.

The financial report was authorised for issue by the Directors of the Company on 19 August 2010. The Directors have the power to amend the financial statements after issue.

(a) Basis of Preparation

This general purpose financial report has been prepared in accordance with Australian Accounting Standards (including AASB 101: *Presentation of Financial Statements*), other authoritative pronouncements of the Australian Accounting Standards Board, Urgent Issues Group Interpretations and the *Corporations Act 2001*.

Compliance with International Financial Reporting Standards (IFRS)

Australian Accounting Standards include Australian Equivalents to International Financial Reporting Standards (AIFRS).

Compliance with AIFRS ensures that the consolidated financial statements, and notes thereto, comply with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

Historical Cost Convention

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of "financial assets at fair value through profit or loss".

Critical Accounting Estimates

The preparation of the financial statements, in conformity with AIFRS, requires the use of certain critical accounting estimates and judgements, of which other than what is included in the following accounting policies, there are none.

1. Summary of Significant Accounting Policies CONTINUED

(b) Principles of Consolidation

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries controlled by Platinum Asset Management Limited (the "Company") as at 30 June 2010 and the results of all controlled entities for the year then ended. Platinum Asset Management Limited and its subsidiaries together are referred to in this financial report as "the consolidated entity" or "Group".

Subsidiaries are those entities over which the Company has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one-half of voting rights. The existence or effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity.

Where control of an entity is obtained during the financial year, its results are included in the consolidated Balance Sheet from the date control commences. Where control of an entity ceases during a financial year, its results are included for that part of the year during which control existed.

The effects of all transactions between entities in the consolidated entity are eliminated in full. Accounting policies of various companies within the consolidated entity have been changed to ensure consistency with those policies adopted by the consolidated entity.

Minority interests in the results and equity of subsidiaries are shown separately in the consolidated Statement of Comprehensive Income and Balance Sheet. The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group.

The Group's policy is to treat transactions with minority interests as transactions with equity owners of the Group. For purchases from minority interests the difference between any consideration paid and the relevant share acquired of the carrying net assets of the subsidiary is deducted from equity.

(c) Income Tax

The income tax expense for the period is the tax payable on the current period taxable income based on the current income tax rate adjusted by changes in deferred tax assets and liabilities attributable to temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements, and to unused tax losses.

Under AASB 112: *Income Taxes*, deferred tax balances are determined using the Balance Sheet method which calculates temporary differences based on the carrying amounts of an entity's assets and liabilities in the Balance Sheet and their associated tax bases.

Notes to the Financial Statements
30 June 2010

1. Summary of Significant Accounting Policies CONTINUED

(c) Income Tax CONTINUED

Tax Consolidation Legislation

In accordance with the (Australian) *Income Tax Assessment Act* (1997), Platinum Asset Management Limited is the head entity of the tax consolidated group which includes Platinum Asset Management Limited, Platinum Asset Pty Limited, Platinum Investment Management Limited and McRae Pty Limited.

Any current tax liabilities of the consolidated group are accounted for by Platinum Asset Management Limited.

Current tax expense and deferred tax assets and liabilities are determined on a consolidated basis and recognised by the consolidated entity.

(d) Financial Assets at Fair Value through Profit or Loss

Under AASB 139: *Financial Instruments: Recognition and Measurement*, investments are classified in the Balance Sheet as "financial assets at fair value through profit or loss". These financial assets are initially recognised at fair value, excluding transaction costs, which are expensed as incurred.

Gains and losses arising from changes in the fair value of the financial assets are included in the Statement of Comprehensive Income in the period in which they arise.

(e) Transaction Costs

Initial measurement (cost) on acquisition of trading securities shall not include directly attributable transaction costs such as fees and commissions paid to agents. Incremental transaction costs are expensed as incurred in the Statement of Comprehensive Income.

(f) Foreign Currency Translation

The functional and presentation currency of the Company as determined in accordance with AASB 121: *The Effects of Changes in Foreign Exchange Rates* will be the Australian dollar.

Transactions denominated in foreign currencies are translated into Australian currency at the rates of exchange prevailing on the date of the transaction. Foreign currency assets and liabilities existing at balance date are translated at exchange rates prevailing at balance date. Resulting exchange differences are brought to account in determining profit and loss for the year.

1. Summary of Significant Accounting Policies CONTINUED

(g) Revenue Recognition

Management, Administration and Performance Fees

Management, Administration and Performance fees are included as part of operating income and are recognised as they are earned.

The majority of management fees are derived from the Platinum Trust Funds. This fee is calculated at 1.44% per annum (GST inclusive) of each Fund's Net Asset Value and is payable monthly.

Interest Income

Interest income is recognised in the Statement of Comprehensive Income using the effective interest method, which allocates income over the relevant period.

Dividend Income

Dividend income is brought to account on the applicable ex-dividend date.

(h) Directors' Entitlements

Liabilities for Directors' entitlements to fees are accrued at nominal amounts calculated on the basis of current fees rates.

Contributions to Directors' superannuation plans are charged as an expense as the contributions are paid or become payable.

(i) Cash and Cash Equivalents

In accordance with AASB 107: *Statement of Cash Flows*, cash includes deposits at call and cash at bank which are used to meet short-term cash requirements. Cash equivalents include short-term deposits of three months or less from the date of acquisition, which are readily convertible into cash. Cash and cash equivalents at the end of the financial year, as shown in the Statement of Cash Flows, is reconciled to the related item in the Balance Sheet.

At 30 June 2010, the Group also holds term deposits that have maturities of more than three months from the date of acquisition.

Under AASB 107, deposits which have maturities of more than three months are not included as part of "cash and cash equivalents" and have been disclosed separately in the Balance Sheet. All term deposits are held with licensed Australian banks.

Notes to the Financial Statements
30 June 2010

1. Summary of Significant Accounting Policies CONTINUED

(i) Cash and Cash Equivalents CONTINUED

Receipts from operating activities include Management, Administration and Performance fees receipts. Payments for operating activities include payments to suppliers and employees.

(j) Receivables

All receivables are recognised as and when they are due. Debts which are known to be uncollectible are written off. A provision for doubtful debts is raised when there is evidence the amount will not be collected.

(k) Payables

All payables and trade creditors are recognised as and when the Company becomes liable.

(l) Provision for Employee Entitlements

A provision for employee entitlements is recognised by the Group when there is an obligation to the employee. This is consistent with the legal position of the parties to the employment contract. Provision for employee entitlements to salaries, salary-related costs, annual leave and sick leave are accrued at nominal amounts calculated on the basis of current salary rates.

Provision for long service leave which are not to be paid or settled within 12 months of balance date, are accrued at the present values of future payments. Contributions to employee superannuation plans are charged as an expense as the contributions are paid or become payable.

(m) Share-Based Payments

The Group operates share-based remuneration plans, which include the granting of options and performance rights. The Group also operates a Fund Appreciation Rights Plan (FARP) whereby it purchases shares in Platinum Asset Management Limited on behalf of employees, if the employee satisfies, principally a time-based vesting condition. The value of shares purchased will be equivalent to a notional value in the Platinum Trust Funds, notionally allocated to employees and adjusted for the accumulated performance of the Funds over the vesting period.

Share-based payments are granted to some employees of the Company's operating subsidiary, Platinum Investment Management Limited.

1. Summary of Significant Accounting Policies CONTINUED

(m) Share-Based Payments CONTINUED

Details relating to share-based payments are set out in Note 7.

AASB Interpretation 11 AASB 2: *Group and Treasury Share Sale Transactions* addresses whether certain types of share-based payment transactions should be accounted for as equity-settled or as cash-settled transactions and specifies the accounting in a subsidiary's financial statements for share-based payment arrangements involving equity instruments of the parent. The Group applies this Standard with the impact being that the expense related to grants made during the year is recognised in the employing entity.

The fair value of share-based payments granted is recognised in the consolidated accounts as an expense with a corresponding increase in equity. The fair value is measured at grant date and amortised over the period during which the employees become unconditionally entitled to the share.

For options and performance rights, the fair value at grant date is independently determined using a Black-Scholes option pricing model that takes into account the exercise price, the term of the option or right, the impact of dilution, the share price at grant date, expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the options or performance rights.

For shares to be purchased on behalf of employees, the fair value is measured based on the notional investment in the Platinum Trust Funds.

The fair value is subsequently amortised on a straight-line basis over the applicable vesting period and adjusted at each balance date for accumulated investment performance.

At each balance date, the Group revises its estimates of the number of options and performance rights exercisable and shares to be purchased on behalf of employees.
The share-based payments expense recognised each period takes into account the most recent estimate. The impact of any revision to the original estimate (e.g. forfeitures) will be recognised in the Statement of Comprehensive Income with the corresponding adjustment to equity.

(n) Contributed Equity

Ordinary shares are classified as equity.

Notes to the Financial Statements
30 June 2010

1. Summary of Significant Accounting Policies CONTINUED

(o) Earnings per Share

(i) Basic earnings per share
Basic earnings per share is determined by dividing the profit attributable to equity holders by the weighted average number of shares outstanding during the financial year.

(ii) Diluted earnings per share
Diluted earnings per share adjusts the figure used to determine basic earnings per share to take into account the options and performance rights issued, but not vested, under the Options and Performance Rights Plan (OPRP) (see Note 9).

(p) Depreciation

Fixed assets are stated at historical cost less depreciation. Fixed assets (other than in-house software) are depreciated over their estimated useful lives using the diminishing balance method.

The expected useful lives are as follows:

Computer Equipment	4 years
Software	2.5 years
In-house Software	4 years
Communications Equipment	4 – 20 years
Office Fitout	5 – 13⅓ years
Office Furniture and Equipment	5 – 13⅓ years

Gains and losses on disposals are included in the Statement of Comprehensive Income.

(q) Operating Leases

Platinum Investment Management Limited has entered into a lease agreement for the premises it occupies and pays rent on a monthly basis.

Payments made under the operating lease are charged to the Statement of Comprehensive Income. Details of the financial commitments relating to the lease are included in Note 16.

(r) Rounding of Amounts

The consolidated entity is of a kind referred to in the Australian Securities & Investments Commission's Class Order 98/0100 (as amended) and consequently amounts in the financial report and financial statements have been rounded to the nearest thousand dollars in accordance with that Class Order, unless otherwise indicated.

1. Summary of Significant Accounting Policies CONTINUED

(s) Goods and Services Tax (GST)

Revenue, expenses and assets are recognised net of the amount of associated GST, unless the GST is not recoverable from the tax authority. In this case, it is recognised as part of the cost of the acquisition of the asset or has been expensed.

Cash flows are presented on a gross basis.

(t) New Accounting Standards and Interpretations

Certain new accounting standards and interpretations have been published that are not mandatory for the 30 June 2010 reporting period. The Company's and consolidated entity's assessment of the impact of these new standards and interpretations are set out below:

(i) AASB 9: *Financial Instruments* and AASB 2009-11: *Amendments to Australian Accounting Standards arising from AASB 9* (effective for annual periods beginning on or after 1 January 2013)

AASB 9: *Financial Instruments* provides revised guidance on the classification and measurement of financial assets. The requirements of this standard represents a significant change from the existing requirements of AASB 139 in respect of financial assets. The standard contains two primary measurement categories of financial assets: amortised cost and fair value.

The standard eliminates the existing AASB 139 categories of held to maturity, available for sale and loans and receivables. Equity instruments will be measured at fair value with fair value changes in traded equity investments taken to the profit or loss. The standard would not have a significant impact on the Company or consolidated entity as its equity instruments are already recognised at fair value. The Company and consolidated entity will apply the revised standard from 1 July 2013.

(ii) AASB 2009-8: *Amendments to Australian Accounting Standards – Group Cash-Settled Share-based Payment Transactions (AASB 2)* (effective from 1 January 2010)

This standard amends AASB 2: *Share-based Payment* and supersedes Interpretation 8 Scope of AASB 2 and Interpretation 11 AASB 2: *Group and Treasury Share Transactions*.

Notes to the Financial Statements

30 June 2010

1. Summary of Significant Accounting Policies CONTINUED

(t) New Accounting Standards and Interpretations CONTINUED

The amendments clarify the scope of AASB 2 by requiring an entity that receives goods or services in a share-based payment arrangement to account for those goods or services regardless of which entity in the group settles the transaction, and regardless of whether the transaction is settled in shares or cash. The standard is consistent with the Company and consolidated entity's existing policies. The Company and consolidated entity will apply the amended standard from 1 July 2010.

(iii) AASB 2009-5: *Further Amendments to Australian Accounting Standards arising from the Annual Improvement Project* (effective from 1 January 2010)

In May 2009, the AASB issued a number of improvements to AASB 5: *Non-current Assets Held for Sale and Discontinued Operations*, AASB 8: *Operating Segments*, AASB 101: *Presentation of Financial Statements*, AASB 107: *Statement of Cash Flows*, AASB 117: *Leases*, AASB 118: *Revenue*, AASB 136: *Impairment of Assets* and AASB 139: *Financial Instruments, Recognition and Measurement*.

The Company and consolidated entity do not expect that any adjustments will be necessary as a result of applying the revised rules.

The Company and consolidated entity will apply the revised standards from 1 July 2010.

(iv) Revised AASB 124: *Related Party Disclosures* (effective for annual periods beginning on or after 1 January 2011)

The revised AASB 124 simplifies the definition of a "related party", clarifying its intended meaning and eliminating inconsistencies from the definition. The standard would not impact on the disclosures contained in the financial report.

The Company and consolidated entity will apply the revised standard from 1 July 2011.

(v) AASB 2009-12: *Amendments to Australian Accounting Standards* AASBs 5, 8, 108, 110, 112, 119, 133, 137, 139, 1023 and 1031; and Interpretations 2, 4, 16, 1039 and 1052 (effective for annual periods beginning on or after 1 January 2011)

The standard contains a variety of "editorial corrections", many of which reflect changes made to the text of equivalent IFRSs by the IASB.

These changes will have no impact or effect on the financial report of the Company and consolidated entity.

The Company and consolidated entity will apply the revised standards from 1 July 2011.

	CONSOLIDATED 2010 $'000	CONSOLIDATED 2009 $'000

2. Income Tax

(a) The income tax expense attributable to profit comprises:

Current income tax provision	**60,718**	52,705
Deferred tax assets	**1,048**	1,405
Deferred tax liabilities	**(224)**	1,145
Under/(Over) provision of prior period tax	**(2)**	12
Income tax expense	**61,540**	55,267
The aggregate amount of income tax attributable to the financial year differs from the prima facie amount payable on the profit. The difference is reconciled as follows:		
Profit before income tax expense	**198,392**	181,412
Prima facie income tax on profit at 30%	**59,518**	54,424
Tax effect on amounts which:		
Reduce tax payable:		
– Allowable credits	**(1)**	(3)
– Non-assessable income	**(1)**	–
Tax-effect of amounts which are non-deductible		
Increase tax payable:		
– Share-based payments	**1,983**	772
– Depreciation	**41**	59
– Other non-deductible expenses	**2**	3
Under/(Over) provision of prior period tax	**(2)**	12
Income tax expense	**61,540**	55,267

Notes to the Financial Statements

30 June 2010

	CONSOLIDATED 2010 $'000	CONSOLIDATED 2009 $'000
2. Income Tax CONTINUED		
(b) Deferred tax assets		
The balance comprises temporary differences attributable to:		
Capital expenditure not immediately deductible	**1,204**	2,027
Employee entitlements:		
– Long service leave	**245**	305
– Annual leave	**243**	236
Unrealised foreign exchange losses	**21**	176
Legal fees	**105**	105
Tax fees	**85**	87
Periodic reporting	**40**	58
Audit and accounting	**50**	44
Printing and mail house	**27**	27
Fringe benefits tax	**2**	4
Unrealised capital losses	**–**	4
Shareholder relations	**–**	3
Payroll tax	**8**	2
Deferred tax assets	**2,030**	3,078
(c) Deferred tax liabilities		
The balance comprises temporary differences attributable to:		
Interest receivable on term deposits and bank certificates of deposit	**916**	1,145
Unrealised capital gains	**5**	–
Deferred tax liabilities	**921**	1,145

3. Fixed Assets

	CONSOLIDATED 2010 $'000	CONSOLIDATED 2009 $'000
Computer equipment (at cost)	**780**	632
Less: Accumulated depreciation	**(608)**	(547)
	172	85
Purchased and capitalised software (at cost)	**2,379**	2,270
Less: Accumulated depreciation	**(1,703)**	(1,482)
	676	788
Communication equipment (at cost)	**120**	132
Less: Accumulated depreciation	**(85)**	(106)
	35	26
Office premises fit out (at cost)	**1,696**	1,696
Less: Accumulated depreciation	**(269)**	(210)
	1,427	1,486
Office furniture and equipment (at cost)	**476**	473
Less: Accumulated depreciation	**(236)**	(198)
	240	275
	2,550	2,660

Notes to the Financial Statements
30 June 2010

	CONSOLIDATED COMPUTER EQUIPMENT 2010 $'000	CONSOLIDATED COMPUTER EQUIPMENT 2009 $'000	CONSOLIDATED PURCHASED AND CAPITALISED SOFTWARE 2010 $'000	CONSOLIDATED PURCHASED AND CAPITALISED SOFTWARE 2009 $'000

3. Fixed Assets CONTINUED

Asset Movements during the year

	2010 $'000	2009 $'000	2010 $'000	2009 $'000
Opening	**85**	114	**788**	728
Additions	**149**	43	**130**	298
Disposals	**–**	–	**(1)**	–
Depreciation expense	**(62)**	(72)	**(241)**	(238)
Closing balance	**172**	85	**676**	788

	COMMUNICATIONS EQUIPMENT 2010 $'000	COMMUNICATIONS EQUIPMENT 2009 $'000	OFFICE PREMISES FITOUT 2010 $'000	OFFICE PREMISES FITOUT 2009 $'000
Opening	**26**	39	**1,486**	1,550
Additions	**30**	2	**–**	–
Disposals	**(3)**	–	**–**	–
Depreciation expense	**(18)**	(15)	**(59)**	(64)
Closing balance	**35**	26	**1,427**	1,486

	CONSOLIDATED OFFICE FURNITURE AND EQUIPMENT 2010 $'000	CONSOLIDATED OFFICE FURNITURE AND EQUIPMENT 2009 $'000
Opening	**275**	311
Additions	**2**	5
Disposals	**–**	–
Depreciation expense	**(37)**	(41)
Closing balance	**240**	275

The closing balance of purchased and capitalised software disclosed above includes amounts recognised in relation to software in the course of construction and development of $8,000 at 30 June 2010 (2009: $132,000).

	CONSOLIDATED 2010 $'000	CONSOLIDATED 2009 $'000

4. Payables

Current		
Trade creditors	**9,613**	5,595
Goods and Services Tax (GST)	**1,658**	1,312
Unclaimed dividends payable to shareholders	**147**	141
	11,418	7,048

Trade creditors are unsecured and payable between seven and 30 days after the consolidated entity becomes liable.

Information relating to the consolidated entity's exposure of payables to liquidity risk is shown in Note 18.

5. Provisions

Current		
Long service leave	**816**	1,015
Annual leave	**810**	787
	1,626	1,802
Non-Current		
Payroll tax	**26**	7
	26	7

6. Franking Account

Opening balance based on tax paid and franking credits attached to dividends paid – converted at 30%	**98,276**	93,627
Dividends paid – franked at 30%	**(48,086)**	(48,086)
Tax paid or payable	**60,717**	52,735
Estimated franking credits available	**110,907**	98,276

Notes to the Financial Statements

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7. Share-Based Payments

(a) Options and Performance Rights Plan (OPRP)

On 22 May 2007, the Group established an OPRP to assist with the retention and motivation of employees. Options were granted under this plan on 22 May 2007 and 17 June 2009.

Options

On 22 May 2007, some employees were initially granted 27,010,467 options under the OPRP, to take up shares in Platinum Asset Management Limited at a strike price of $5.00. The options vest after four years and have a further two year exercise period.

On 17 June 2009, some employees were granted 8,783,205 options under the OPRP to take up shares in Platinum Asset Management Limited at a strike price of $4.50. The options vest after four years and have a further two year exercise period.

Performance Rights

On 22 May 2007, some employees who were not granted options under the OPRP, were granted performance rights to take up Platinum Asset Management Limited shares at a strike price of $0.00. These performance rights vested after three years and had a further two year exercise period. Employees were initially granted 372,703 performance rights. No performance rights have been granted since 2007.

All performance rights that were granted to employees (net of forfeitures) vested on 22 May 2010.

Options and performance rights on issue are as follows:

	2010 QUANTITY	2009 QUANTITY
Options Granted on 22 May 2007		
Opening balance	**16,547,817**	23,139,567
Forfeitures – 24 October 2008	**–**	(981,750)
Forfeitures – 8 May 2009	**–**	(5,610,000)
Closing balance	**16,547,817**	16,547,817
Options Granted on 17 June 2009		
Opening balance	**8,783,205**	–
Grant – 17 June 2009	**–**	8,783,205
Closing balance	**8,783,205**	8,783,205

	2010 QUANTITY	2009 QUANTITY

7. Share-Based Payments CONTINUED

(a) Options and Performance Rights Plan (OPRP) CONTINUED

Performance Rights Granted on 22 May 2007		
Opening balance	**356,503**	377,803
Forfeitures – 11 July 2008	**–**	(5,400)
Forfeitures – 1 August 2008	**–**	(5,400)
Forfeitures – 3 October 2008	**–**	(10,500)
Forfeitures – 15 February 2010	**(8,625)**	–
Vested – 22 May 2010	**(347,878)**	–
Closing balance	**–**	356,503
Closing balance of options and performance rights on issue	**25,331,022**	25,687,525

	OPTIONS 22/05/07	OPTIONS 17/06/09	PERFORMANCE RIGHTS
Model inputs for options and performance rights granted included:			
(a) Exercise price	$5.00	$4.50	$0.00
(b) Grant date	22 May 2007	17 June 2009	22 May 2007
(c) Expiry date	22 May 2013	17 June 2015	22 May 2012
(d) Days to expiry (mid-point) at grant date	1,825 days	1,825 days	1,095 days
(e) Share price at grant date	$5.00	$4.10	$5.00
(f) Assumed volatility of the Company's shares	22.50%	42.00%	22.50%
(g) Assumed dividend yield	5.35%	4.30%	5.35%
(h) Risk-free interest rate	6.11%	5.01%	6.17%

In relation to the options and performance rights granted in May 2007, there was no historical basis to work out the assumed price volatility of the Company's shares. Therefore, the volatility was based on an analysis of comparable listed funds management companies. For options granted on 17 June 2009, the volatility was based on the Company's share price movement since December 2008.

Notes to the Financial Statements

30 June 2010

7. Share-Based Payments CONTINUED

(a) Options and Performance Rights Plan (OPRP) CONTINUED

Fair Value of Options and Performance Rights

The assessed fair value of options and performance rights granted on 22 May 2007 was $0.82 per option and $4.26 per performance right. The assessed fair value of options granted on 17 June 2009 was $1.14 per option.

(b) Fund Appreciation Rights Plan (FARP)

On 1 April 2009, the Group established the FARP to assist with the retention and motivation of the Group's investment analysts.

Under the FARP, shares in Platinum Asset Management Limited are purchased by the Group on behalf of employees, if they satisfy a time-based vesting period requirement of three years continuous employment with the Group.

The total number of shares to be purchased by the Group are equivalent to the notional investment in the Platinum Trust Funds, notionally allocated to employees, adjusted for the accumulated performance of the Funds over the vesting period. This interest is "notional" only, meaning employees have no entitlement to units in the Platinum Trust Funds. A notional investment in the Platinum Trust Funds occurred on 1 April 2009, with a further notional investment on 1 April 2010.

Fair Value of the Fund Appreciation Rights (FARs) Granted

The assessed fair value of FARs at 30 June 2010 is based on the notional market value of the investment in the Platinum Trust Funds at the two grant dates (i.e. 1 April 2009 and 1 April 2010 respectively) adjusted for the movement in notional value of units to 30 June 2010.

The fair value of FARs granted on 1 April 2009, to be amortised over a three year vesting period was $550,000. The movement in the notional value of units between 1 July 2009 and 30 June 2010 was $69,587 (2009: $83,025 from 1 April 2009 to 30 June 2009).

The fair value of FARs granted on 1 April 2010, to be amortised over a three year vesting period was $1,015,000. The movement in the notional value of units between 1 April 2010 and 30 June 2010 was $9,195.

7. Share-Based Payments CONTINUED

(c) Expenses Arising from Share-Based Payment Transactions

	CONSOLIDATED 2010 $'000	CONSOLIDATED 2009 $'000
Total expenses arising from share-based payment transactions were as follows:		
Options granted on 22 May 2007	**3,384**	1,888
Options granted on 17 June 2009	**2,494**	96
Performance rights granted on 22 May 2007 (vested 22 May 2010)	**405**	462
Fund appreciation rights granted on 1 April 2009	**253**	129
Fund appreciation rights granted on 1 April 2010	**75**	–
Total share-based payments expense	**6,611**	2,575
Associated payroll tax expense/(write-back) on options and performance rights*	**(3)**	6
Associated payroll tax expense on fund appreciation rights*	**18**	7
Total	**6,626**	2,588

* Amounts are included in staff expense in the Statement of Comprehensive Income.

At 30 June 2010, the fair value remaining to be amortised over the remainder of the vesting period is $3,013,315 for the options granted on 22 May 2007, $nil for the performance rights granted on 22 May 2007, $7,387,745 for the options granted on 17 June 2009, $321,001 for the FARs granted on 1 April 2009, and $930,725 for the FARs granted on 1 April 2010.

In order to retain and motivate employees, additional options, performance rights or FARs may be issued under the OPRP or FARP, over time, in compliance with the *Corporations Act 2001* and relevant ASIC relief.

Notes to the Financial Statements
30 June 2010

	CONSOLIDATED 2010 QUANTITY	CONSOLIDATED 2010 $'000	CONSOLIDATED 2009 QUANTITY	CONSOLIDATED 2009 $'000
8. Contributed Equity and Reserves				
(a) Movement in share capital				
Ordinary Shares – opening balance	**561,000**	**629,091**	561,000	629,091
Ordinary Shares – issued 24 May 2010*	**348**	**–**	–	–
Total Contributed equity	**561,348**	**629,091**	561,000	629,091

* On 24 May 2010, 347,878 performance rights which had vested were converted to ordinary shares.

Ordinary Shares
Ordinary Shares entitle the holder to participate in dividends and the proceeds on winding up of the Company in proportion to the number of shares held.

All Ordinary Shares are issued and authorised.

	CONSOLIDATED 2010 $'000	CONSOLIDATED 2009 $'000
(b) Movement in reserves		
Opening balance – Brought forward capital reserve	**(579,737)**	(582,312)
Unvested shares – Options (granted on 22 May 2007)	**3,384**	1,888
Unvested shares – Options (granted on 17 June 2009)	**2,494**	96
(Un)vested shares – Performance rights	**405**	462
Unvested shares – Fund appreciation rights (granted on 1 April 2009)	**253**	129
Unvested shares – Fund appreciation rights (granted on 1 April 2010)	**75**	–
Closing Balance	**(573,126)**	(579,737)

In 2007, in preparation for listing, a restructure was undertaken, in which the Company sold or transferred all of its assets, other than its beneficial interest in shares in Platinum Asset Management Limited and sufficient cash to meet its year to date income tax liability.

The Company then split its issued share capital of 100 shares into 435,181,783 ordinary shares. It then took its beneficial interests in Platinum Investment Management Limited to 100%, through scrip for scrip offers, in consideration for the issue of 125,818,217 ordinary shares in the Company.

8. Contributed Equity and Reserves CONTINUED

(b) Movement in reserves CONTINUED

As a result of the share split and takeover offers, the Company had 561,000,000 ordinary shares on issue and beneficially held 100% of the issued share capital of Platinum Investment Management Limited. Subsequently, 140,250,000 shares on issue representing 25% of the issued shares of the Company were sold to the public by existing shareholders.

The opening brought forward capital reserve for 2009 represents the difference between consideration paid for the purchase of the minority interests and the share of net assets acquired in the minority interests. This was deducted from equity.

	CONSOLIDATED 2010	CONSOLIDATED 2009
9. Earnings per Share		
Basic earnings per share – cents per share	**24.39**	22.49
Diluted earnings per share – cents per share	**23.33**	21.62
Weighted average number of ordinary shares on issue used in the calculation of basic earnings per share	**561,036,217**	561,000,000
Weighted average number of ordinary shares on issue used in the calculation of diluted earnings per share	**586,684,311**	583,333,867
	$'000	$'000
Earnings used in the calculation of basic and diluted earnings per share	**136,852**	126,145

10. Retained Profits

Retained earnings at the beginning of the financial year	**144,781**	130,836
Net profit	**136,852**	126,145
Dividends paid	**(112,200)**	(112,200)
Retained earnings at the end of the financial year	**169,433**	144,781

Notes to the Financial Statements
30 June 2010

	PARENT ENTITY 2010 CENTS PER SHARE	PARENT ENTITY 2010 $'000	PARENT ENTITY 2009 CENTS PER SHARE	PARENT ENTITY 2009 $'000
11. Dividends (Fully Franked)				
Paid – 22 September 2008	–	–	12.00	67,320
Paid – 13 March 2009	–	–	8.00	44,880
Paid – 22 September 2009	**12.00**	**67,320**	–	–
Paid – 16 March 2010	**8.00**	**44,880**	–	–
		112,200		112,200

Dividends not recognised at year-end

In addition to the above dividends paid, since year-end the Directors have declared the payment of a dividend of 14 cents per fully paid Ordinary Share, fully franked based on tax paid at 30%. The aggregate amount of the dividend expected to be paid on 22 September 2010 but not recognised as a liability at year-end is $78,588,703.

	CONSOLIDATED 2010 $'000	CONSOLIDATED 2009 $'000
12. Notes to the Cash Flow Statement		
(a) Reconciliation of Cash and Cash Equivalents		
Cash at bank	**45**	143
Cash on deposit (at call)	**16,213**	14,126
Term deposits (three months or less from date of acquisition)	**13,500**	–
	29,758	14,269

Information in relation to the consolidated entity's exposure to interest rate risk is provided in Note 18.

12. Notes to the Cash Flow Statement CONTINUED

(b) Reconciliation of Net Cash from Operating Activities to Profit After Income Tax

	CONSOLIDATED 2010 $'000	CONSOLIDATED 2009 $'000
Profit after income tax	**136,852**	126,145
Depreciation	**417**	430
Fixed assets scrapped	**4**	–
Share-based payments	**6,611**	2,575
(Gain)/loss on investments	**(1,123)**	(6,179)
Decrease/(Increase) in cash due to exchange rate movements	**69**	588
Decrease/(Increase) in trade receivables	**2,849**	(5,696)
Decrease/(Increase) in interest receivable	**773**	(3,759)
Decrease/(Increase) in prepayments	**71**	25
Decrease/(Increase) in deferred tax assets	**1,048**	1,405
(Decrease)/Increase in trade creditors and GST	**4,364**	(644)
(Decrease)/Increase in annual leave, long service leave and payroll tax provisions	**(157)**	404
(Decrease)/Increase in income tax payable	**4,786**	(2,015)
(Decrease)/Increase in deferred tax liabilities	**(224)**	1,145
	156,340	114,424

13. Contingent Assets, Liabilities and Commitments to Capital Expenditure

No contingent assets or liabilities exist at 30 June 2010 and 30 June 2009.

The consolidated entity has no commitments for significant capital expenditure.

14. Subsequent Events

No significant events have occurred since the balance date which would impact on the financial position of the consolidated entity as at 30 June 2010 and on the results for the year ended on that date.

Notes to the Financial Statements

30 June 2010

15. Segment Information

Under AASB 8: *Operating Segments*, the consolidated entity is considered to have a single operating segment being funds management services, however AASB 8 requires certain entity-wide disclosures, such as source of revenue by geographic region.

The consolidated entity derives management and performance fees from Australian investment vehicles and its US-based investment mandates.

The geographical breakdown of revenue is as follows:

	2010 $'000	2009 $'000
Australia	**234,481**	207,178
North America	**13,874**	12,311
Unallocated	**–**	(5)
	248,355	219,484

16. Lease Commitments

Total lease expenditure contracted for at balance date but not provided for in the accounts is as follows:

	CONSOLIDATED 2010 $'000	CONSOLIDATED 2009 $'000
Operating leases		
Payable not later than one year	**1,354**	1,304
Payable later than one, not later than five years	**5,411**	5,875
Payable later than five years	**–**	957
	6,765	8,136

17. Auditor's Remuneration

During the year the following fees were paid or payable for services provided by the Auditor to the consolidated entity.

The fees were paid by Platinum Investment Management Limited on behalf of the consolidated entity.

	2010 $'000	2009 $'000
Audit services – statutory	**272**	261
Taxation services – compliance	**466**	454
Taxation services – foreign tax agent	**18**	70
Other audit and assurance services	**31**	6
	787	791
Advisory services – restructuring and related costs	**227**	354
	1,014	1,145

18. Financial Risk Management

The consolidated entity's activities expose it to both direct and indirect financial risk, including market risk, credit risk and liquidity risk. Direct exposure to financial risk occurs through the impact on profit of movements in funds under management ("FUM"), and indirect exposure occurs because Platinum's operating subsidiary is the Investment Manager for various Platinum investment vehicles (which includes investment mandates, various unit trusts, known as the Platinum Trusts and its ASX-listed investment vehicle, Platinum Capital Limited). This note discusses the direct exposure to risk of the consolidated entity.

The Investment Manager's risk management procedures focus on managing the potential adverse effects on financial performance, caused by volatility of financial markets.

The direct risks and mitigation strategies are outlined below:

(a) Market Risk

The key direct risks associated with the consolidated entity are those which are driven by investment and market volatility and the resulting impact on FUM, or a reduction in the growth of FUM. Reduced FUM will directly impact on management fee income and profit, because management fee income is calculated as a percentage of FUM. FUM can be directly impacted by a range of factors including:

Notes to the Financial Statements

30 June 2010

18. Financial Risk Management CONTINUED

(a) Market Risk CONTINUED

(a) poor investment performance: absolute negative investment performance will reduce FUM and relative under performance to appropriate market benchmarks could reduce the attractiveness of Platinum's investment products to investors, which would impact on the growth of the business. Poor investment performance could also trigger the termination of Investment Mandate arrangements;

(b) market volatility: Platinum invests in global markets. It follows that a decline in overseas markets, adverse exchange rate or interest rate movements will all impact on FUM;

(c) a reduction in the ability to retain and attract investors: which could be caused by a decline in investment performance, but also a range of other factors, such as the high level of competition in the funds management industry;

(d) a loss of key personnel; and

(e) investor allocation decisions: investors constantly re-assess and re-allocate their investments on the basis of their own preferences.

Investor allocation decisions could operate independently from investment performance, such that funds outflows occur despite positive investment performance.

A decline in investment performance will also directly impact on performance share fees and performance fees earned by the consolidated entity. Historically, the amount of performance share fees earned by the consolidated entity have fluctuated significantly from year to year and can be a material source of fee revenue.

Performance share fees are based on a proportion of each Investment Mandate's investment performance. It is calculated at the end of each calendar year and is based upon the actual performance of each Investment Mandate for the year.

Performance fees may be earned by the consolidated entity, if the investment return of a Platinum Trust Fund (or Platinum Capital Limited) exceeds a specified benchmark. Should the actual performance of a Platinum Trust Fund/Platinum Capital Limited be higher than the applicable benchmark, a performance fee would be receivable for the financial year. As at 30 June 2010, performance fees of $1,036,950 were receivable (2009: $6,128,667).

18. Financial Risk Management CONTINUED

(a) Market Risk CONTINUED

If global equity markets fell 10% over the course of the year and consequently the consolidated entity's FUM fell in line with global equity markets, it follows that management fees would fall by 10%. If there was a 10% decrease in performance of Investment Mandates over the course of the calendar year, which resulted in an actual negative performance for the Investment Mandate for the year, then no performance fee would be earned.

The above analysis assumes a uniform 10% fall across all global equity markets. This is extremely unlikely as there is a large degree of variation in volatility across markets. For example, it is quite feasible for the Japanese market to fall whilst other Asian markets exhibit strong growth.

To mitigate the impact of adverse investment performance on FUM, the Investment Manager may employ hedging strategies to manage the impact of adverse market and exchange rate movements on the funds it manages. Market risk may be managed through derivative contracts, including futures, options and swaps. Currency risk may be managed through the use of foreign currency contracts.

The section below discusses the direct impact of foreign exchange risk, interest rate risk and price risk on the consolidated entity's financial instruments held at 30 June 2010.

(i) Foreign Exchange Risk

The consolidated entity has US dollar Investment Mandates and derives fees in US dollars from these. In addition, the consolidated entity held US$1,671,092 in cash at 30 June 2010 (2009: US$2,852,265). Therefore, the consolidated entity is directly exposed to foreign exchange risk arising from movements in exchange rates.

If the Australian dollar had been 10% lower/higher against the US dollar, than the prevailing exchange rate used to convert the Mandate fees and foreign currency holdings, with all other variables held constant, then net profit after tax would have been A$1,254,714 higher/A$1,026,946 lower (2009: A$727,036 higher/A$594,930 lower).

(ii) Interest Rate Risk

At 30 June 2010, term deposits are the only significant asset with potential exposure to interest rate risk, held by the consolidated entity.

An interest rate movement of +/–1% occurring on 30 June 2010 will have no impact on profit, as the interest rate on term deposits are determined on purchase date.

Notes to the Financial Statements

30 June 2010

18. Financial Risk Management CONTINUED

(a) Market Risk CONTINUED

(iii) Price Risk

At 30 June 2010, financial assets at fair value through profit or loss represent an immaterial amount of the consolidated entity's total assets and net profit.

Accordingly, the consolidated entity does not have a significant direct exposure to price risk.

(b) Credit Risk

Credit risk relates to the risk of a counterparty defaulting on a financial obligation resulting in a loss to the Company (typically "non-equity" financial instruments). Credit risk arises from the financial assets of the consolidated entity which includes cash, receivables and term deposits.

All term deposits are held with licensed Australian banks.

The maximum exposure to direct credit risk at balance date is the carrying amount of financial assets recognised in the Balance Sheet. The consolidated entity may hold some collateral as security (e.g. margin accounts) and the credit quality of all financial assets is consistently monitored by the consolidated entity. No financial assets are past due or impaired.

Any default in the value of a financial instrument held within any of the Platinum Trusts, Platinum Capital or the Investment Mandates, will result in reduced investment performance. There is no direct loss for the consolidated entity other than through the ensuing reduction in FUM, as noted above in market risk. The Investment Manager employs standard market practices for managing its credit risk exposure.

(c) Liquidity Risk

Liquidity risk is the risk that the consolidated entity will encounter difficulty in meeting obligations associated with financial liabilities. The consolidated entity manages liquidity risk by maintaining sufficient cash reserves to cover its liabilities and receiving management fees to meet operating expenses on a regular basis. Management monitors its cash position on a daily basis and prepares cash forecasts on a weekly basis.

18. Financial Risk Management CONTINUED

(c) Liquidity Risk CONTINUED

Contractual maturity analysis

At 30 June 2010, the consolidated entity has an obligation to settle trade creditors of $9,612,788 (2009: $5,594,964) between seven and 30 days after becoming legally liable, Goods and Services Tax liability of $1,658,140 (2009: $1,311,779) within 21 days and estimated income tax payable of $15,204,065 (2009: $10,417,848) within approximately five months and unclaimed dividends payable to shareholders of $147,314 (2009: $141,060), long service leave of $816,000 (2009: $1,015,547) and annual leave of $810,181 (2009: $786,752) payable at call. In addition, a payroll tax amount of $25,803 (2009: $7,400) has been provided for and is payable on vesting date of rights under the FARP (March 2012 and March 2013).

At 30 June 2010, the consolidated entity has sufficient cash reserves of $29,757,789 (2009: $14,128,132) and a further $24,507,333 (2009: $28,129,331) of receivables to cover these liabilities. The consolidated entity may also convert into cash those term deposits not categorised as cash and cash equivalents in the Balance Sheet to settle any liabilities.

At 30 June 2010, term deposits totalled $194,127,738 (in 2009: bank certificates of deposit totalled $165,332,030).

All term deposits have maturities of less than 12 months. The portfolio takes into account all projected cash outflows.

Accordingly, the consolidated entity does not have a significant direct exposure to liquidity risk.

(d) Fair Value Hierarchy

The consolidated entity has adopted the amendments to AASB 7: *Financial Instruments: Disclosures* effective 1 July 2009. This requires the consolidated entity to classify fair value measurements using a fair value hierarchy that reflects the subjectivity of the inputs used in making the measurements. The fair value hierarchy has the following levels:

(i) quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1);

(ii) inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly (as prices) or indirectly (derived from prices) (level 2); and

(iii) inputs for the assets or liability that are not based on observable market data (unobservable inputs) (level 3).

Notes to the Financial Statements
30 June 2010

18. Financial Risk Management CONTINUED

(d) Fair Value Hierarchy CONTINUED

At 30 June 2010, all financial assets at fair value through profit or loss are classified as level 1 as all financial assets are valued based on quoted arm's length prices in active markets.

(e) Capital Risk Management

(i) Capital requirements
The Company has limited capital requirements and its need for retained profits is slight. Owing to the volatility caused by the performance share fee component of revenue, the Directors smooth dividend payments and have a policy of paying out 80% to 90% of net profit after tax. This is a policy, not a guarantee.

(ii) External requirements
In connection with operating a funds management business in Australia, the operating subsidiary of the Company (which conducts the funds management business) is required to hold an Australian Financial Services Licence (AFSL). As a holder of an AFSL, the Australian Securities & Investments Commission (ASIC), requires the subsidiary to:

- hold at least $5 million Net Tangible Assets in respect of its managed investments and custody services;
- have Adjusted Surplus Liquid Funds ("ASLF") of:
  - $50,000; plus
  - 5% of adjusted liabilities between $1 million and $100 million; plus
  - 0.5% of adjusted liabilities for any amount of adjusted liabilities exceeding $100 million, up to a maximum ASLF of $100 million.
- have at least $50,000 in Surplus Liquid Funds ("SLF") (i.e. its own funds in liquid form).

The operating subsidiary has complied with all externally imposed requirements to hold an AFSL during the financial year.

19. The Company

Platinum Asset Management Limited ("the Company") is a company limited by shares, incorporated and domiciled in New South Wales. Its registered office and principal place of business is Level 8, 7 Macquarie Place, Sydney NSW 2000.

The Company is the ultimate holding company for the entities listed in Note 20.

20. The Subsidiaries

The consolidated financial statements incorporate the assets, liabilities and results of the following subsidiaries in accordance with the accounting policy described in Note 1(b):

(a) McRae Pty Limited (incorporated in Australia) – (100% owned by the Company).

(b) Platinum Asset Pty Limited (incorporated in Australia) – (100% owned by the Company).

(c) Platinum Investment Management Limited (incorporated in Australia) – (indirectly 100% owned by the Company).

(d) Platinum Asset Management Pte Ltd (incorporated in Singapore) – (indirectly 100% owned by the Company).

Notes to the Financial Statements
30 June 2010

21. Related Party Dealings

(a) Directors' remuneration

Details of all remuneration paid to Directors is disclosed in the Directors' Report and Note 22.

(b) Subsidiaries

Interests in subsidiaries are set out in Note 20.

(c) Transactions with related parties

Platinum Investment Management Limited provides investment management services to related party unit trusts – the Platinum Trust Funds and to the ASX-listed investment company, Platinum Capital Limited. Platinum Investment Management is entitled to receive a monthly management fee from Platinum Capital Limited and the Platinum Trust Funds, a monthly administration fee from the Platinum Trust Funds and in some instances a performance fee (which is calculated annually) based upon the relevant Funds and Platinum Capital Limited's investment return over and above a specified benchmark.

The total related party fees received and receivable by Platinum Investment Management Limited for the year ended 30 June 2010 was $194,882,770 (2009: $170,596,253).

(d) Tax consolidation and dividend transactions

Any tax payments and dividends are sourced from the operating subsidiary, Platinum Investment Management Limited, and paid out by the Company. Platinum Asset Management Limited is the head entity of the consolidated tax group and is the entity that ultimately pays out dividends to shareholders.

22. Key Management Personnel Disclosures

(a) Details of remuneration

The consolidated entity paid Executive and Non-Executive Directors total short-term compensation of $2,198,400 (2009: $1,441,259) and superannuation of $168,366 (2009: $291,210). Also provided for the Executive Directors of the Company was an increase in long service leave of $20,454 (2009: $36,018) and a decrease in annual leave of $37,931 (2009: $22,298).

The above includes remuneration paid and provided to A Clifford, who is a Director of the operating subsidiary, Platinum Investment Management Limited. A Clifford also received share-based compensation which is disclosed below.

(b) Interests of Non-Executive and Executive Directors in shares

The relevant interest in ordinary shares of the Company that each Director has at balance date is M Cole 300,000 (2009: 300,000), B Coleman 200,000 (2009: 200,000), M Towers 20,000 (2009: 20,000), K Neilson 322,074,841 (2009: 322,074,841) and M Halstead 16,997,999 (2009: 22,834,931). M Halstead disposed of 5,836,932 shares during the year.

(c) Share-based compensation

No options or performance rights have been granted to any Non-Executive or Executive Directors of the Company. A Clifford, a Director of Platinum Investment Management Limited, was granted nil options in 2010 (2009: 3,844,350 options).

The 2009 options were granted at a strike price of $4.50. The options vest after four years and have a further two year exercise period. The assessed fair value of options granted on 17 June 2009 was $1.14 per option.

The 2010 share-based payments expense relating to this grant to A Clifford was $1,091,795 (2009: $41,820).

Notes to the Financial Statements

30 June 2010

23. Parent Entity Disclosures

Parent entity financial information is as follows:

(a) Current assets $15,352,000 (2009: $10,559,000)

(b) Total assets $660,401,000 (2009: $649,325,000)

(c) Current liabilities $15,351,000 (2009: $10,559,000)

(d) Total liabilities $15,351,000 (2009: $10,559,000)

(e) Issued share capital $629,091,000 (2009: $629,091,000)

(f) Reserves $14,543,000 (2009: $8,261,000)

(g) Shareholders' equity $645,050,000 (2009: $638,766,000)

(h) Operating profit before tax $112,200,000 (2009: $112,200,000)

(i) Operating profit after tax $112,202,000 (2009: $112,200,000)

There are no guarantees entered into by the parent entity in relation to debts of the subsidiaries, no contingent liabilities and no capital commitments.

Directors' Declaration

In the Directors' opinion,

(a) the financial statements and notes set out on pages 30 to 66 are in accordance with the *Corporations Act 2001* including:

  (i) complying with Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and

  (ii) complying with International Financial Reporting Standards as issued by the International Accounting Standards Board; and

  (iii) giving a true and fair view of the consolidated entity's financial position as at 30 June 2010 and of its performance, as represented by the results of its operations and its cash flows, for the financial year ended on that date; and

(b) there are reasonable grounds to believe that Platinum Asset Management Limited will be able to pay its debts as and when they become due and payable; and

(c) the audited remuneration disclosures set out on pages 16 to 19 of the Directors' Report comply with AASB 124: *Related Party Disclosures* and the *Corporations Act 2001*.

The Directors have been given the declaration by the Managing Director and Finance Director required by section 295A of the *Corporations Act 2001*.

This declaration is made in accordance with a resolution of the Directors.

Michael Cole
Director

Kerr Neilson
Director

Sydney, 19 August 2010

Independent Auditor's Report

To the members of Platinum Asset Management Limited

PRICEWATERHOUSECOOPERS

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ABN 52 780 433 757
Darling Park Tower 2
201 Sussex Street
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Report on the financial report

We have audited the accompanying financial report of Platinum Asset Management Limited (the Company), which comprises the Balance Sheet as at 30 June 2010, Statement of Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the Directors' Declaration for Platinum Asset Management group (the consolidated entity). The consolidated entity comprises the Company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The Directors of the Company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1, the Directors also state, in accordance with Accounting Standard AASB 101: *Presentation of Financial Statements*, that the financial statements comply with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the financial report.

Our procedures include reading the other information in the Annual Report to determine whether it contains any material inconsistencies with the financial report.

Our audit did not involve an analysis of the prudence of business decisions made by Directors or Management.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*.

Auditor's opinion

In our opinion:

(a) the financial report of Platinum Asset Management Limited is in accordance with the *Corporations Act 2001*, including:

    (i) giving a true and fair view of the consolidated entity's financial position as at 30 June 2010 and of its performance for the year ended on that date; and

    (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*; and

(b) the financial report also complies with International Financial Reporting Standards as disclosed in Note 1.

Independent Auditor's Report

To the members of Platinum Asset Management Limited continued

Report on the Remuneration Report

We have audited the Remuneration Report included in pages 16 to 19 of the Directors' Report for the year ended 30 June 2010. The Directors of the Company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Auditor's opinion

In our opinion, the Remuneration Report of Platinum Asset Management Limited for the year ended 30 June 2010, complies with section 300A of the *Corporations Act 2001*.

PricewaterhouseCoopers

A J Loveridge

PricewaterhouseCoopers

A J Loveridge
Partner

Sydney, 19 August 2010

Castles in the air

Illustrations by: *Vasco Mourao*

Castles in the air

preface

Castles in the air is the theme and idea behind the images for the editorial section in this year's Annual Report. The articles featured explore some of the fragilities underlying the global investment scenario and look at some difficult but constructive options to secure the future.

Dylan Grice in *Popular Delusions* sets out the case for holding gold as an insurance policy in "environments characterised by monetary mischief".

Grice looks at economic history where governments such as the Roman Empire, the Weimar Republic and the Thatcher government struggled (with different strategies and outcomes) with the need to contract expenditure and adopt strict fiscal policy to restore economic health and sustainability. He concludes that unless there is a crisis of magnitude (and that is not inevitable), a majority opinion and political will to accept that painful measures are unavoidable, will gold fulfil its purpose and value.

"These articles are timely and relevant for investors ... "

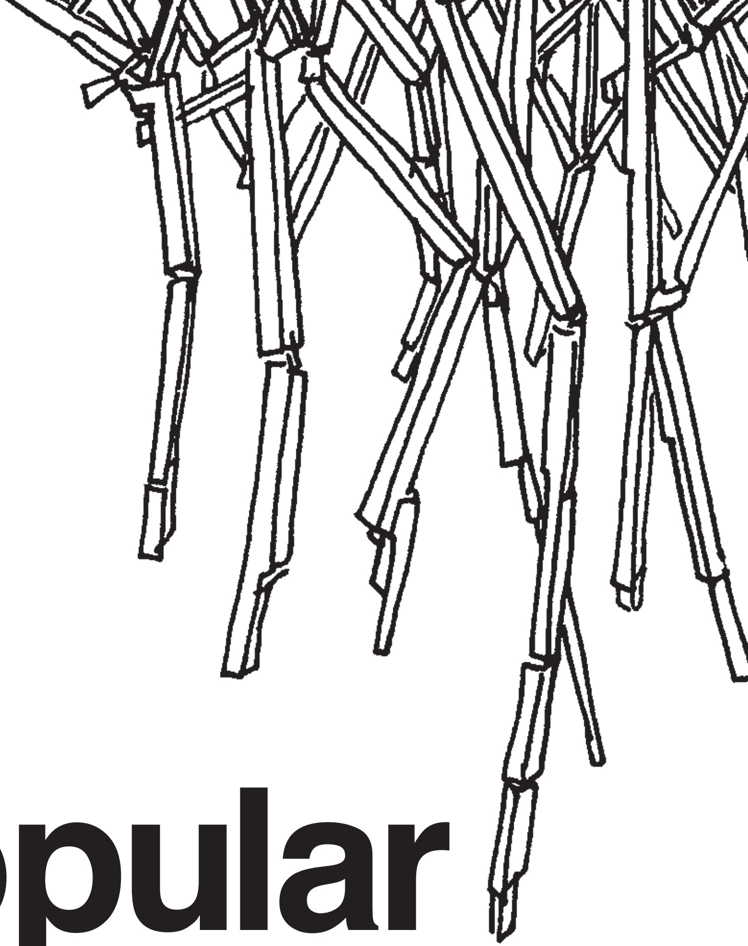
— *Kerr Neilson*

The second article, the interview between Erik Schatzker and Michael Lewis offers a personal insight into the world of Wall Street, tracing the seeds of the global financial crisis back to the eighties where a culture of short-term greed emerged combining with growing complexity in financial instruments and traders' efforts to profit at the expense of customers.

Lewis's focus on specific players in the sub-prime crisis, those who became aware of the risk of the effects of credit defaults and traded them for vast profits provides readers an interesting insight into the psychology of investing. Of broader significance is Lewis's analysis of the current scenario where reform and change are vital to develop a system which is robust and responsible in serving a global economy.

These articles are timely and relevant for investors in the immediate post GFC period and particularly as political parties vie for popular support. We commend these articles for their intelligence and interest.

Kerr Neilson
Managing Director, *August 2010*



popular delusions

When to sell gold

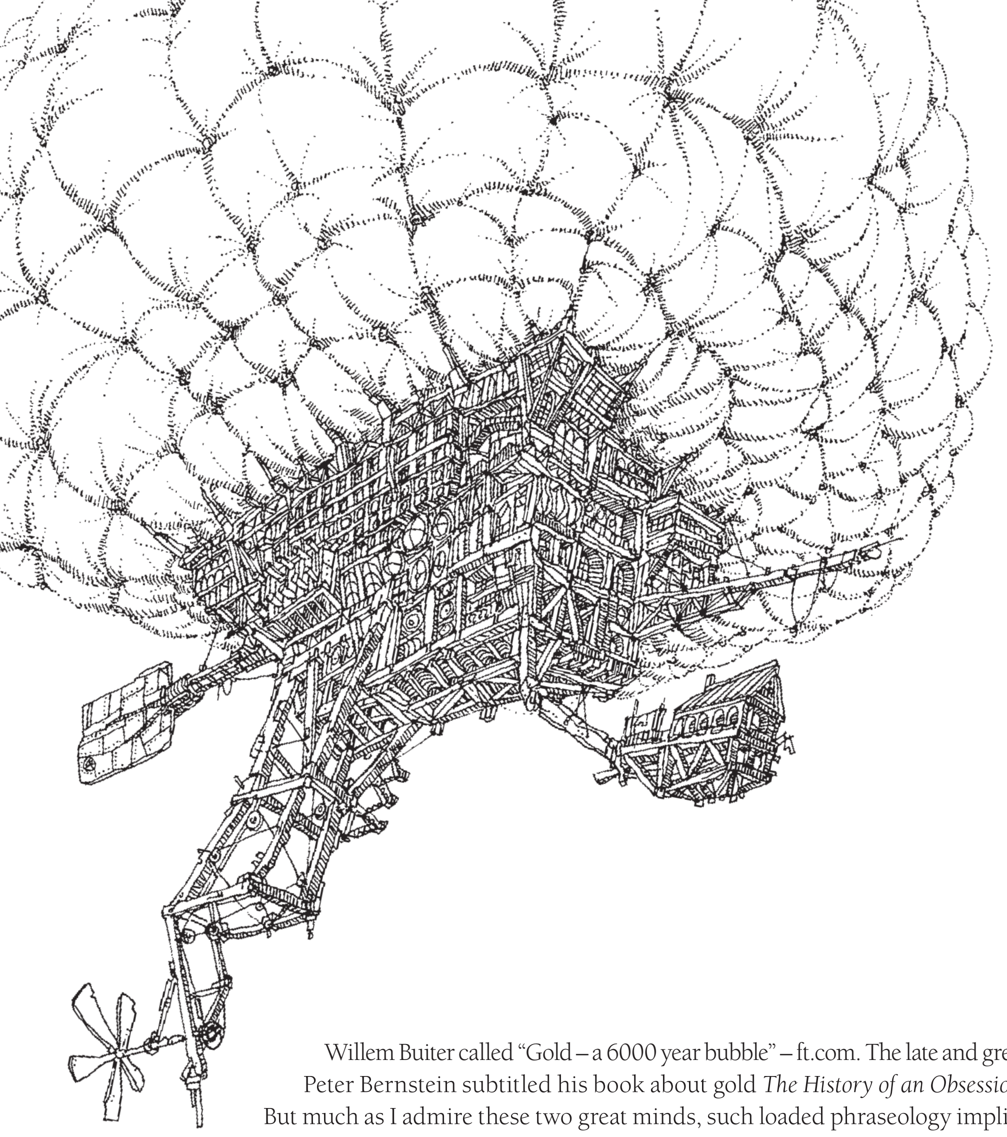
JP Morgan once said he'd made his fortune by selling too soon. We spend much time thinking about what to buy and when to buy it, when in fact knowing when to *sell* is more important. The case for owning gold is clear enough, but when should we look to sell?

By: Dylan Grice
from Société Générale
Cross Asset Research
Strategy Document
23 March 2010

Some would say the time to sell is now. Gold just isn't the misunderstood, widely shunned asset it was a few years ago. Isn't the gold bull market now long in the tooth, with better opportunities to be found elsewhere? I can understand this view. Had you bought stocks at the bottom of the bear market in 1974 and held them for ten years you'd have seen them go from being hated to being loved. And as the number of mutual funds exploded you could have plausibly argued that since stocks were no longer the deeply contrarian plays they'd been, they should be sold. But you'd have missed spectacular gains over the next 15 years because the social contrarian indicators said nothing as to how favourable underlying conditions were for risk assets.

Though developed market governments are insolvent by any reasonable definition, it's far from *inevitable* that this insolvency will precipitate an extreme inflationary event … it's just that it *might* … And although I've wondered aloud if Ben Bernanke is in fact the reincarnation of Rudolf von Havenstein – the tragic president of the German Reichsbank who presided over the Weimar Hyperinflation – I don't think he *actually* is … it's just that he, and other central bankers, might be closer than they think …

Gold, like all other commodities, is *inherently* speculative. Unlike well chosen stocks which you buy to hold to take advantage of their wealth-compounding properties, you only ever buy commodities to sell later. With this in mind, when should you sell gold?



Willem Buiter called "Gold – a 6000 year bubble" – ft.com. The late and great Peter Bernstein subtitled his book about gold *The History of an Obsession*. But much as I admire these two great minds, such loaded phraseology implies there to be something irrational about owning gold and I think that's just plain wrong. The fact is that there is a fundamental need for a medium of exchange. Early civilisations used pebbles or shells. Prisoners have used cigarettes.

Having a medium of exchange makes life easier than under barter economy and societies have always organised themselves around the best monetary standard they could find. Until industrialisation of the paper printing process, that happened to be gold, which is small, malleable, portable and with no tendency to tarnish. Crucially, it's also relatively finite and this particular characteristic (in combination with the others) can be very useful in environments characterised by monetary mischief.

"There is nothing mystical about gold and I don't consider myself a gold bug"

— Dylan Grice

I view it primarily as insurance against such environments. It's a lump of metal with no cash flows and no earnings power. In a very real sense it's not intrinsically worth anything. If you buy it, you're forgoing dividend or interest income and the gradual accumulation over time of intrinsic value since a lump of cold, industrially useless metal can offer none of these things. That forgone accumulation of wealth is like the insurance premium paid for a policy which will pay out in the event of an *extreme* inflation event.

Is there anything else which will do that? Some argue that equities hedge against inflation because they are a claim on real assets, but most of the great bear market troughs of the 20th century occurred during inflationary periods. A more obvious inflation hedge is inflation linked bonds, but governments can default on these too. More exotic insurance products like sovereign CDSs, inflation caps, long-dated swaptions or upside yield curve volatility all have their intuitive merits. But they all come with counterparty risk. Physical gold doesn't.

Indeed, during the "6000 year gold bubble" no one has defaulted on gold. It is the one insurance policy which will pay out when you really need it to.

There is nothing mystical about gold and I don't consider myself a *gold bug*. In fact, I'm not sure I'd even classify gold as an 'investment' in the strictest sense of the word. Well chosen equities (not indices) will act as wealth-compounding machines and are likely to make many times the initial outlay in real terms over time. These are 'investments' because so long as the economics of each business remain firm, you don't want to sell. As they say in the textbooks, you 'buy to hold.' But gold isn't like that. Like all commodities, it's intrinsically speculative because you only buy it to sell it in the future.

The reason I own gold is because I'm worried about the long-term solvency of developed market governments. I know that Milton Friedman popularised the idea that inflation is "always and everywhere a monetary phenomenon" but if you look back through time at inflationary crises – from ancient Rome, to Ming China, to revolutionary France and America or to Weimar Germany – you'll find that uncontrolled inflations are caused by overleveraged governments which resorted to printing as the easiest way to avoid *explicit* default (whereas inflation is merely an *implicit* default). It's all very well for economists to point out that the cure for runaway inflation is simply a contraction of the money supply.

It's just that when you look at inflationary episodes you find that such monetary contractions haven't been politically viable courses of action.

Economists, we find, generally don't understand this because economists look down on disciplines which might teach them it, such as history, because they aren't *mathematical* enough. True, historians don't use maths (primarily because they don't have physics envy) but what they do use is common sense, and an understanding that while the economic laws might hold in the long run, in the short run the political beast must be fed.

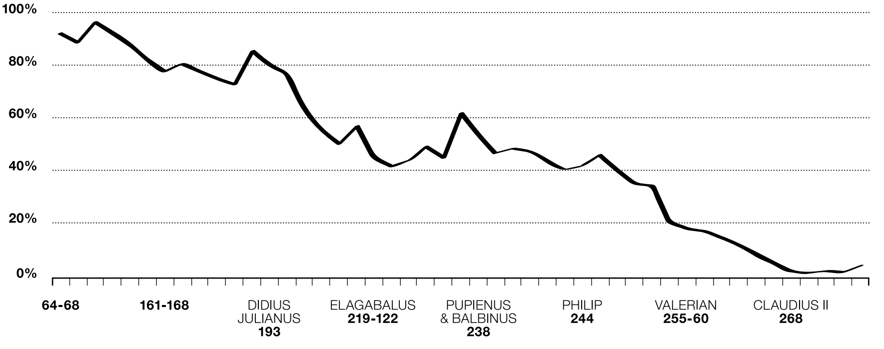
I wrote about the Weimar Hyperinflation a few weeks ago and showed, for example, that Rudolf von Havenstein (Reichsbank president) was terrified of pursuing such a monetary contraction because he was so fearful of the social consequences rising unemployment and falling output would elicit. But the agonizing dilemma he faced, identical in principle if not in magnitude to that faced by policy makers today, is as old as money itself.

In the 3rd century AD, as the Roman Empire became too large and unwieldy, its borders were consolidated and the great imperial expansion halted. Though necessary, this consolidation posed problems. While the Empire was in growth mode, driven by military conquest which strengthened public finances, the army paid for itself. It was an asset on the national balance sheet. But when that territorial growth was halted, a hole was created in the budget as while the army was still needed to defend the borders, it was no longer self-funding because there was no territorial expansion.

Roman emperors discovered that contracting expenditure to fit with new lower revenues was a difficult feat to pull off. So rather than contract military spending, public works or public entertainment – long-term necessities which were painful in the short run – they opted to buy time using successive currency debasements. Ultimately, this culminated in what would become the world's first of many *fiscally* driven inflation crises (see charts on following page).

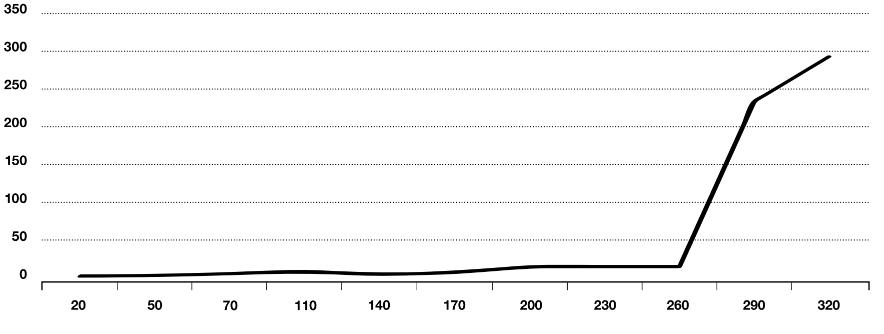
1 Silver content of a Roman denarius

Source: *http://www.tulane.edu/~august/handouts/601cprin.htm*



2 Egyptian wheat price, drachmas per artaba

Source: *http://www.tulane.edu/~august/handouts/601cprin.htm*



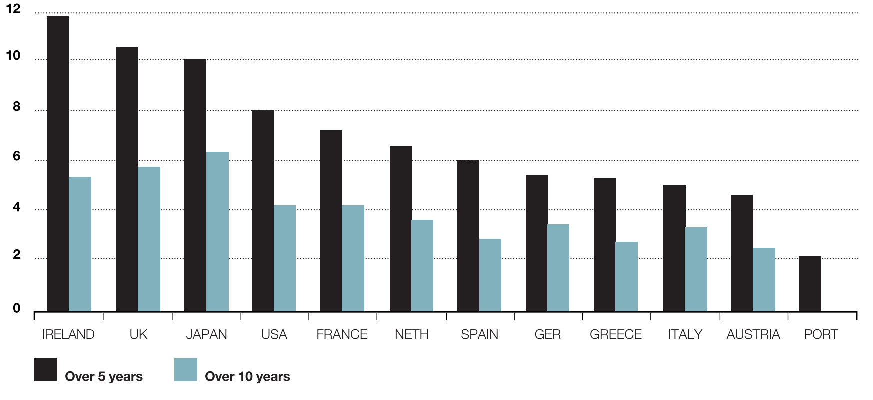
"Paring overstretched government balance sheets has never been easy"

— *Dylan Grice*

Two thousand years ago, the fiscal sobriety so clearly needed in the long run was subordinated to the short-run requirement to buy time. Hence the age-old short-term temptation to debase the currency and hope no one notices. Paring overstretched government balance sheets has *never* been easy. As the Romans should have done in the third century, developed market governments today will have to come clean to their citizens that since keeping the welfare promises they've made over the years will bankrupt them, those promises are going to have to be 'restructured' and government expenditure substantially tightened.

3 **Fiscal contractions required over 5 year and 10 year periods to stabilise government debt ratios at 2007 levels (%PA)**

Source: *Cecchetti, Mohanty, Zampolli (BIS conference paper, 2010)*



"These draconian fiscal policies wouldn't have been possible five years ago"
— Dylan Grice

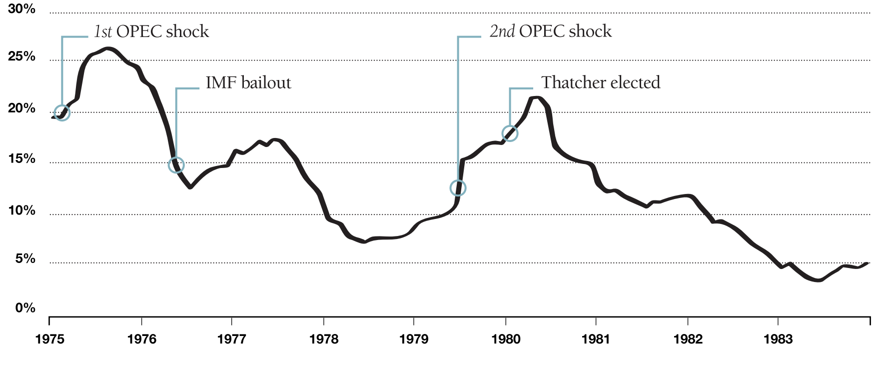
But governments aren't ready to take that step at the moment (the chart on the previous page shows just how painful the required measures could be). Indeed, the pressing fear among policy makers today remains that stimulus might be removed too soon. In the UK, policy makers refused to *"risk the recovery we've fought so hard for"* to quote PM Gordon Brown ("fought so hard for"!). In the US, lawmakers have just expanded the most inefficient health care system on the planet (according to Peter Peterson – ft.com there are five times as many CT scans per head in the US as there are in Germany, and five times as many coronary bypasses as in France). It has been promised that the increase will be deficit-neutral (which I doubt) but even if it is, current period deficits aren't the correct way to look at health and pension obligations which should be examined on an actuarial basis (and if expanding the program is so difficult, wait until they try contracting it!)

But they will face up to these problems one day, because they must. And the good news is that there are precedents for policy makers adopting the policy of short-term pain for long-term gain. In the UK in the 1970s, for example, the country tired of lurching from one crisis to the next, of militant trade unions and of high inflation. Eventually, they elected Margaret Thatcher who promised to control inflation and smash the unions even if the short-term pain would be severe. She did, and it was. But the rest (despite 364 economists petitioning her that such drastic measures threatened social stability – How 364 economists got it totally wrong – Telegraph) is history.

The key point to bear in mind is that she was elected with a mandate for short-term pain which hadn't existed five years earlier. *The political winds had changed.*

Ireland swallowing bitter fiscal medicine today offers a similar example. I've been over there a couple of times in the last few months and it's heartbreaking. Its economy has contracted by nearly 10% since the peak of the credit bubble and my friends in Dublin tell me that, unofficially, house prices are down 60-70% from their peak. Unemployment has spiked to around 15%. The striking thing about being there, though, is that while no one is happy about them, and there have been strikes in protest at the distribution of the pain (which, in passing seems to be a feature of the political climate during such crises) on the whole there seems to be an understanding that such measures are unavoidable. **These draconian fiscal policies wouldn't have been possible five years ago. *But the political winds have changed.***

4 **UK inflation in the 1970s**
Source: *SG Cross Asset Research*



What causes the political winds to change? A government crisis. In 2008, Ireland came very close to going the way of Iceland. They had their crisis. And historians today still refer to the "inflation fatigue" in Britain by the end of the 1970s. This was our crisis. So what we learn from these experiences and others like them is that a fiscal crisis is required to force a majority acceptance of the implications of an overleveraged government.

But the political winds in *countries with central banks* are a long way from blowing in the direction of fiscal rectitude. And while it's true that more people are at least talking about it, talk is very cheap and no one is yet close to walking the walk. Such steps remain politically unpopular because we haven't had our crisis yet. Given the clear unsustainability of government finances and the explosive path government leverage is on, a government funding crisis is both inevitable and necessary. Dubai and Greece are merely the first claps of thunder in what is going to be a long emergency.

Eventually, there will be a crisis of such magnitude that the political winds change direction, and become blustering gales forcing us onto the course of fiscal sustainability. Until it does, the temptation to inflate will remain, as will economists with spurious mathematical rationalisations as to why such inflation will make everything OK (witness the IMF's recent recommendation that inflation targets be raised to 4%: IMF Tells Bankers to Rethink Inflation – WSJ).

Until it does, the outlook will remain favorable for gold. But eventually, majority opinion will accept the painful contractionary medicine because it will have to. That will be the time to sell gold.

Dylan Grice *Société Générale Cross Asset Research from Global Strategy Document,* 23 March 2010, *Popular Delusions.*

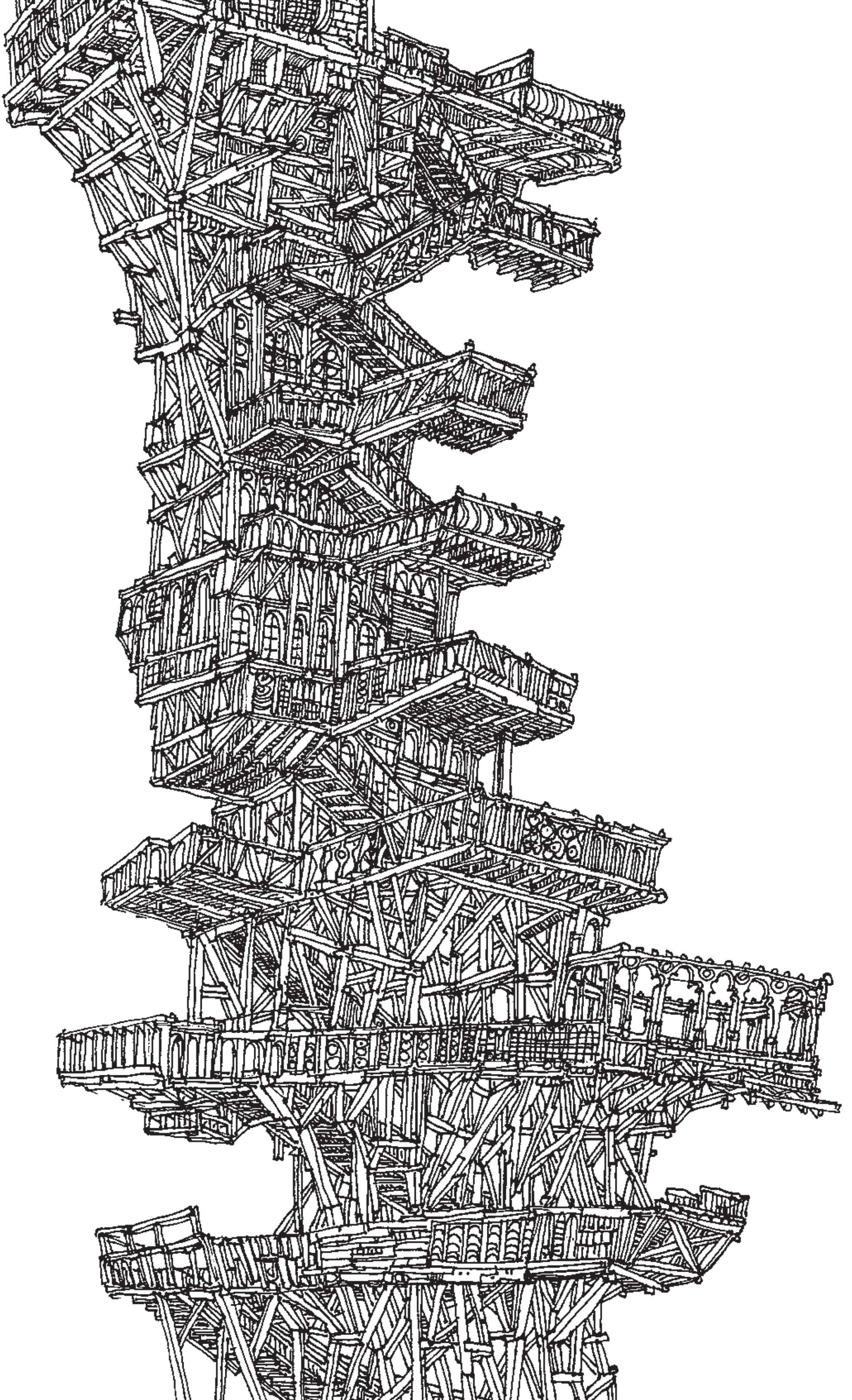
What causes the political winds to change? A government crisis.

— *Dylan Grice*

THE big short

TV interview
Erik Schatzker
with Michael Lewis

Interviewee: Michael Lewis
Title: Author *The Big Short*
Channel: Bloomberg US **Date:** March 15, 2010
Time: 9 PM ET **Duration:** 41 minutes 35 seconds
Interviewer: Erik Schatzker



ES **Hi, I'm Eric Schatzker here in the Bay area talking to author, Michael Lewis. The man behind *Liar's Poker*, *Moneyball* and *The Blind Side*. For his newest book, *The Big Short*, Michael spent a year in hedge fund land looking for the small handful of people who anticipated the subprime mortgage collapse. He wanted to know why – why they spotted the catastrophic bubble that everyone else missed.**

ML This is one of the great mysteries of the last few years in finance and there emerges on the scene this really, really smart trade: buying credit default swaps on subprime mortgage bonds. With a limited downside, you're buying insurance on subprime mortgage bonds. Limited downside – you're paying a couple percent premium a year for a bet that maybe it's not sure to pay out, but the odds are better than 50:1 they will. It's a really obvious smart bet and many thousands of investors could have made this bet. Not individual investors, for the most part, but a lot of institutional investors could have made this bet. In the end, only about a dozen make it in a huge way. Most of them are outsiders, are people who are kind of on the fringe of, certainly on the fringe of, the credit markets. They're not people who are bond market people. They are people who, for the most part, were stock market people, who sort of craw-fished into it because they could see that the stocks that they were trying to understand were going to be driven by this event that was going on in the subprime mortgage market.

So they had to understand the subprime mortgage market and then the more they came to understand it, the more appalled they were about how that market worked; and the more appalled they became, the more they began to think, well, I really ought to bet against it. In each case, I mean, I learned something about investing from this book because I've always thought of it as kind of an antiseptic event and kind of a purely intellectual event and it was pretty clear to me in each case these characters had an emotional/psychological dimension to them that enabled them to get where they are.

ES **You note early on in the book that John Paulson made more money than anyone had ever made so quickly on Wall Street, so why not make him more a part of the story?**

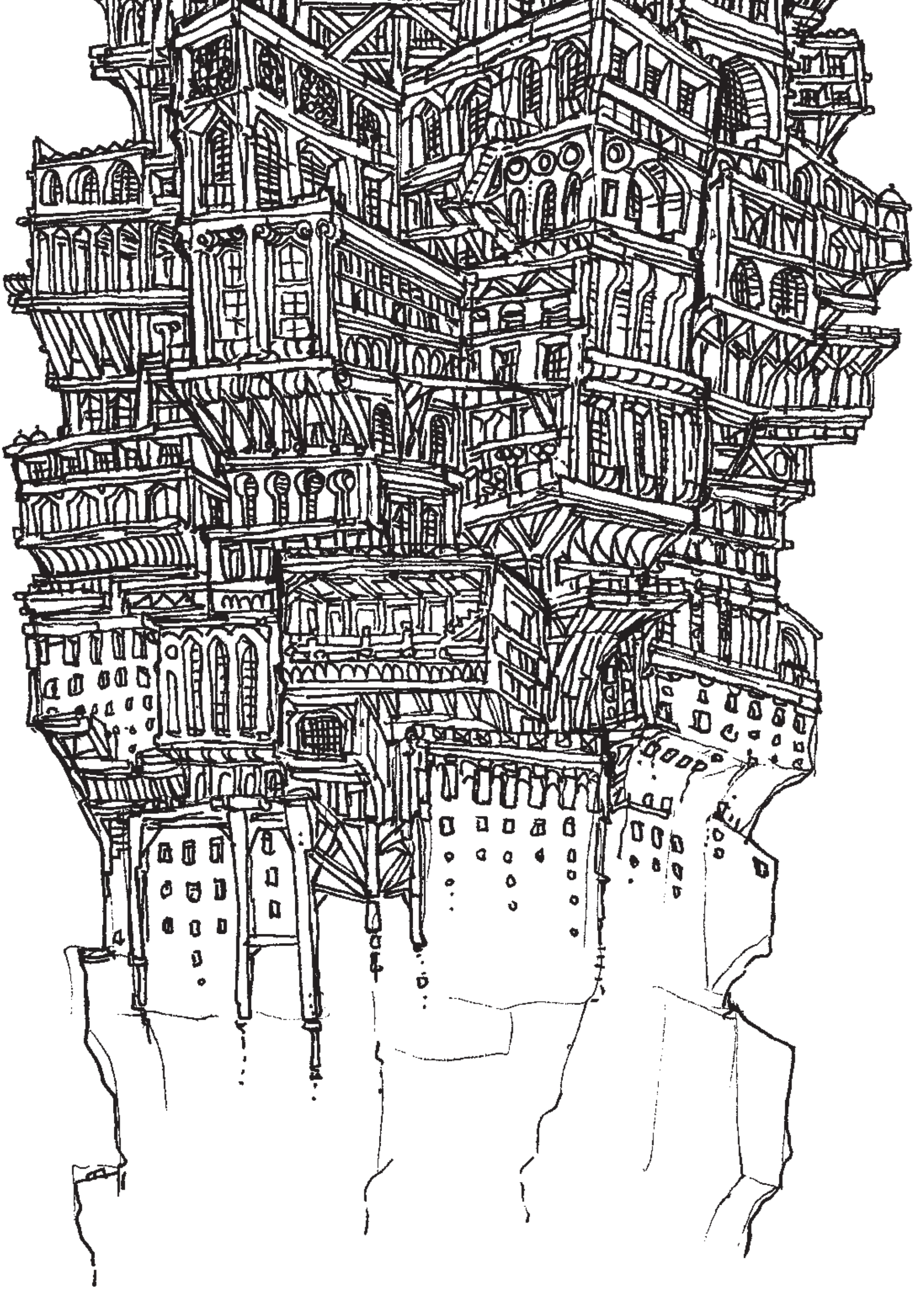
ML I spent time with him and he's very, he was very friendly. I mean, I could have made him part of the story very easily, but I had a purpose for this story and the purpose was I wanted to explain to the reader what on earth had happened; and to do that, it helped that the characters themselves had to learn about these markets, that they didn't understand these markets to begin with. So the reader could learn with them.

John Paulson happened to be just oddly positioned inside the financial markets, in that he was one of the few people who made his living shorting bonds and looking for bonds to short – and he was also, his motives were, to me, less interesting. He's much more of a purely economic animal and so he didn't have a great distance to travel to get to the trade. The people who I was interested in were the people who had kind of laid it all on the line: where they'd start off thinking, yeah, nice little trade and it ended up, essentially if this didn't work out, their careers were over. And Paulson had very cleverly, but from a characterological point of view less interestingly, structured his financial life so that he was going to kind of win either way.

ES **They're not protagonists, but you do identify some of the people on Wall Street who figured out the subprime bubble early: Greg Lippmann from Deutsche Bank, for example; Gene Park at AIG Financial Products. I'm curious, why no central character from Goldman Sachs, because it was Goldman that created the synthetic CDO in the first place.**

ML That's right. I mean Goldman's in the book in a big way. I suppose if they would have let me speak honestly to Jonathan Egol, the trader there, or Andy Davilman, the salesman who bought credit default swaps from AIG, but put AIG into the subprime mortgage market, I might have developed them further as characters. But Goldman – the last thing they want is someone like me writing about Goldman Sachs. They're very careful about what they'll divulge.

The people inside the Wall Street firms who are more interesting to me were the people who had first tried to – seen the opportunity and there weren't many. I mean, Greg Lippmann is the exception. Goldman Sachs was shrewd in finding AIG to be the turkey at the table and shrewd in getting them to insure subprime mortgage bonds, but Goldman Sachs was not set up, when they were doing that, to make money if the subprime mortgage bond market collapsed. If the subprime mortgage bond market had done what it was supposed to do and it collapsed maybe a year or a year and a half earlier than it did, Goldman would have been buried. They were long. So they were the dumb money too.



So they weren't that interesting for that reason. The one guy who was really interesting as kind of smart money inside a Wall Street firm was Greg Lippmann. I mean Lippmann was a Deutsche Bank asset-backed trader, who was at war with his own firm, because the whole rest of the firm is long in the market and he's saying this is going to be a disaster and Lippmann was the proselytizer of the trade. I mean, the bond market is the Wild West. What goes on in the bond market would never be allowed to go on in the stock market. Investors in the bond market know that if Goldman Sachs or Deutsche Bank come to you and wants to sell you something, you don't want to buy it. And so that Greg Lippmann is running around selling the single greatest trade in the history of the bond market and nobody believes him, it tells you something about the bond market. They don't, he can't get the message across because of where he comes from.

Then the other, broadly-speaking, character on Wall Street who was interesting to me was – who was in a big way the dumb money on the other side. Nowhere else on Wall Street was there a single trader, I don't think, making a directional bet on the subprime mortgage market who lost as much as Howie Hubler did at Morgan Stanley. He lost $9.4 billion. Now, I don't think anybody's ever done that on Wall Street and that this guy had done it and he was basically anonymous was amazing to me.

ES **Michael Lewis says it's just wrong how a single Wall Street firm could do so much to fuel the subprime bubble. Find out which one when we come back.**

[BREAK]

ES **When it comes to picking the biggest villain in the mortgage meltdown, there's a lot to choose from. Michael Lewis narrows it down to one firm.**

ML If I had to put my finger on one person or one kind of person, one role player in this crisis, who I would like to string up or rather I'd like to have him just have to answer questions honestly to the public, I think it would be the people who I know knew better. It would be – I would like for the people who designed synthetic CDOs at Goldman Sachs and persuaded AIG to insure them, to essentially take all the risk in the subprime mortgage market in 2005. I would like for them to explain what they thought they were doing. There was nothing illegal about what they did. It was just exploitative. It was just wrong, but they were smart enough and their position in the society was elevated enough that you would have thought that they would have paused and said – I have some responsibility here not to do this or to prevent this from happening, not to actually make it happen.

So I hold there is a very obvious status structure on Wall Street. Ratings agencies aren't even in it, but at the very top of the status structure is Goldman Sachs – certain traders at Goldman Sachs and hedge funds – and when the people at the top set such a bad example, everything else in a weird way follows from it. And I'd like the genuine elites to explain why they behaved in the way they did, because I think in the end, if you're going to get back to a saner relationship between our financial system and the rest of the economy, the rest of the society, you have to have people at the very top of that structure who have some sense of social obligation. And they don't right now. It's a question of how do you restore that. I think you restore it with shame, with a sense of you should be ashamed that you did not behave in the way you should have behaved.

ES **Does that make Goldman evil?**

ML Evil's too strong a word. I think the system is evil and the system is capable of, now obviously capable of, and likely to do great wrong and the rules in the system need to be changed. One of the things I learned writing the book and it just reinforced what I kind of always expected was how amazingly powerful incentives are. And you just can't ignore them and you've got to be very careful about the incentives that you give people and people are just badly incentivized and they're badly incentivized inside Goldman Sachs and I'm sure individually they're all great. They're all smart. I'm sure they're…

ES **In some cases, delightful.**

ML Absolutely. Maybe not at the end of their careers, but certainly at the beginning. And so it's not that these are bad people and it's a mistake to say – oh what you need to do is get rid of some bad people and put some good people in – because if you put the good people into the same system, they'll become bad people. They're badly incentivized.

ES **So what happens though if the rules of the game aren't changed?**

ML The popular thing to say is – oh it's all going to happen again – but if it does all happen again, it's going to happen in such a different way: it's going to require an elaborate explanation to show people how it all connects up. But it will all happen again.

But the bigger problem is what is Wall Street supposed to do? It is not a creator of wealth. It is a handmaiden to creators of wealth. It occupies essentially a parasitic, but usefully parasitic, relationship with the rest of the society. It's totally out of control. It is not making America a great place. It's making America a worse place right now and so that's the problem, that finance needs to occupy a healthier, more productive relationship with the rest of society and it isn't just an economic relationship.

It's also – it's got the social cultural component to it that it is not healthy: that our financial system has rules in it that enable the returns to individual traders that it enables. And it leads half the smartest kids from the best schools wanting to be more than anything else in their lives bond traders or investment bankers. It's a waste of talent. The wrong economic signals are being sent by the system that's in place. I think if the rules are changed in some obvious ways, the returns to the finance sector would decline and the talent would find more useful avenues of endeavor.

ES **Michael Lewis knows as much about trader psychology as any author, but even he was surprised about what he learned writing *The Big Short*. We'll have that when we come back.**

[BREAK]

ES **Writing *The Big Short*, Michael Lewis got close to the most toxic trades in history. They taught him something critical and frightening about the culture of Wall Street.**

ML In the Wall Street firms, I should have known it, but I didn't know it. I didn't know quite how cynical they could become, just how detached from their original purpose they could get and this surprised me because the Solomon Brothers I left in 1989 was a fractious, violent, bawdy, interesting place, but there was a personal attachment that people felt to the institution.

People were angry with me for writing the book because they thought I had betrayed Solomon Brothers. The Wall Street that I walked back into to do *The Big Short*, it wouldn't occur to anyone that you could betray your Wall Street firm because there isn't that relationship: that relationship doesn't exist anymore. Everybody's a free agent.

There's no sense of loyalty to an institution or a cause greater than yourself or all that stuff. And so what I learned was just how purely financial and commercial the place had become and how denuded of essentially what it was denuded of is the partnership sentiment. There was the residue of the partnership sentiment that was still hovering around Solomon Brothers when I got there because it had been a partnership not that long ago. And that had been completely replaced by this new antiseptic, raw financial relationship and it was curious to see that people could function in that environment and feel like that was a satisfying thing to be doing with their lives.

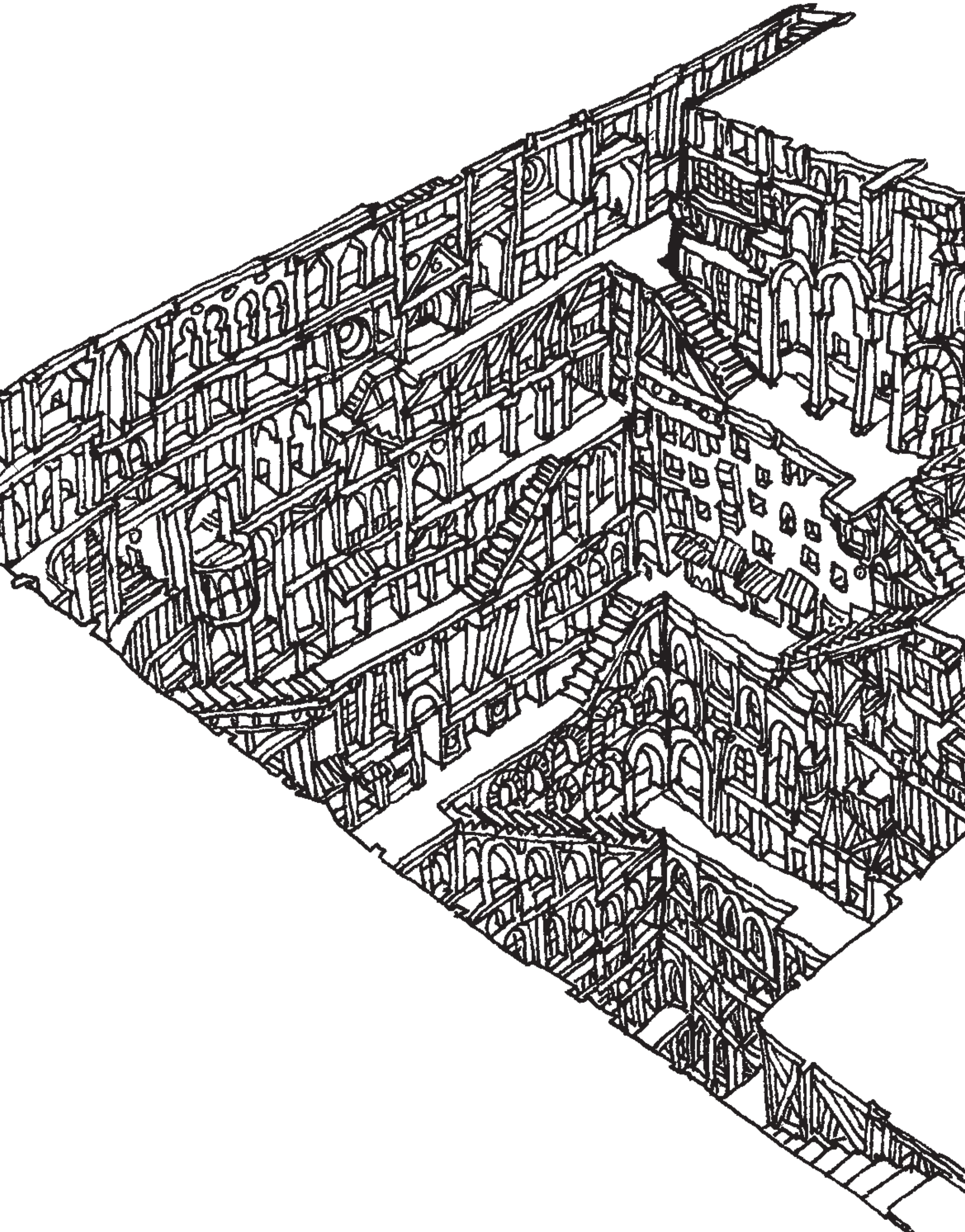
ES **A lot of people would say the most jaded, the most cynical, out there would say that there never ever was a golden age of investment banking even when the firms were privately held. It was all partners' capital inside. Do you agree with that?**

ML Well, golden age might be a bit strong, but I think there were much saner structures.

ES **The incentives were organized.**

ML The incentives were organized much more properly. The right incentive now is the hedge fund incentive. It's the, I mean there are things that are screwed up about it, but typically the person who runs the hedge fund has all his money in his own hedge fund and that's kind of how it's got to be and he's on the hook for losses.

The problem now is there's no long-term greed. It's all short-term greed. It's not institution building or career building. It's quick kills. And so I do think that that aspect of the business, that approach to finance, is a healthier, more golden age-like approach than what we have now. I'm not arguing that investment banks were ever perfect institutions. That's silly. I'm just saying that there's a smarter way to organize them.



ES **Did you learn anything about Wall Street that you didn't know before in the course of reporting this book?**

ML Yes, I did. I mean if I hadn't learned a lot, I wouldn't have been interested in doing it, but I learned first about investing. It was very interesting to me to see just how personal investing decisions can be, just how in the end a lot of it comes back to who you are as a person, that you're guided by all sorts of things that I wouldn't have thought would have informed investment decisions. So just how human the financial markets were on the buy side was really interesting to me.

There were several layers to the interest, but I can remember the first thing that grabbed me was I was shocked that these big firms that used to essentially be the smart money at the poker table had become the dumb money and I was really curious how that had happened. I was curious, I had watched them change over the years and adapt to the world in ways that enabled people to continue to get paid large sums of money in them. The outrageous behavior that I describe in *Liar's Poker*, that didn't exist. The places got much more corporate, much more sanitized, all in the service of preserving the paychecks.

ES **Next, Wall Street subprime's strategy finds a new home, overseas.**

[BREAK]

ES **The story of toxic derivatives didn't end with subprime mortgages. It's still unfolding today, in Greece.**

ML The parallel gets even more elaborate because Goldman Sachs appears to advise the Greek government on how to disguise its level of indebtedness. So it feels as if Wall Street went into entire countries and persuaded them to take out subprime mortgage loans, in effect, or help them, enable them in taking out subprime mortgage loans.

So, yes, we're living through this period where we're reckoning with the real consequences of financial engineering: financial engineering gone wrong. And the very small bore version of this was the financial engineering that enabled some poor schmuck in Chico, California, who had no income, to buy a $1 million house and the big version of this is Greece.

ES **To what degree should we point the finger at derivatives? Would any of this have happened if derivative contracts did not offer unlimited opportunities to take risk?**

ML I have a friend who says derivatives are like guns. Guns don't kill people, people do. It's not the derivatives. It's the way people use them and that is true. It's true that in better hands there's no reason derivatives by themselves would cause problems. Derivatives are just ways of carving up the risk and redistributing it. It's also true that there is no way the misallocation of capital that occurred in the last few years would have occurred without derivatives. That you need – the only way it happens is it's so complicated, people can't understand it. And so they were a necessary ingredient to this catastrophe.

ES **But not single-handedly responsible.**

ML But not single-handedly responsible. So I do think that more generally, not just derivatives, but financial innovation now needs to be regarded with skepticism. That we've come through an age where people just assume that anything that was invented on Wall Street must be good for the rest of the society because someone was making money from it; that all innovation led to great efficiency. We can now see examples of innovation that led to greater inefficiency.

So the question is how do you parse this innovation and decide what's good and what's bad. It was insane, the credit default swaps were not regulated as insurance and that they aren't. It's insane that they're not, that everything, every new security that's created is not traded on screens with a clearing house so people can see what the prices should be. The problem is it's totally hidden, that nobody knows, people could tell you who owns the subprime mortgage loans. They can't tell you who's on the other side of the credit default swaps. No one knows which firms are on the wrong side of this bet. There's no exchange. They're private transactions between consenting adults and no one knows how much of it there is. This creates uncertainty.

If you want to know why the panic happened in 2008, it was because no one knew who had what losses and the reason no one knew who had what losses is there were all these private transactions of enormous, indeterminate size that were undisclosed.

ES **It wasn't so long ago that Wall Street was a hidden world where what traders bought and sold didn't matter to the rest of us. Not any more. When we come back, Michael Lewis explains why.**

[BREAK]

ES **Welcome back. Michael Lewis started his career at Solomon Brothers in the 1980s. I wanted to know, 25 years later, how did Wall Street become so dangerous?**

ML I think the seeds of this catastrophe go back to the '80s and that the source of a lot of the problems are peoples' incentives being screwed up. It's not right or it's certainly not satisfying to say – oh Wall Street's just greedy, got too greedy and that was the problem. Wall Street's always greedy. People who go to work on Wall Street are greedy. That's why they go to Wall Street. They don't go to Wall Street because they have a calling in finance. I mean a handful of people do, but for the most part, people go there because that's where the money is and they want money. You're not going to change that.

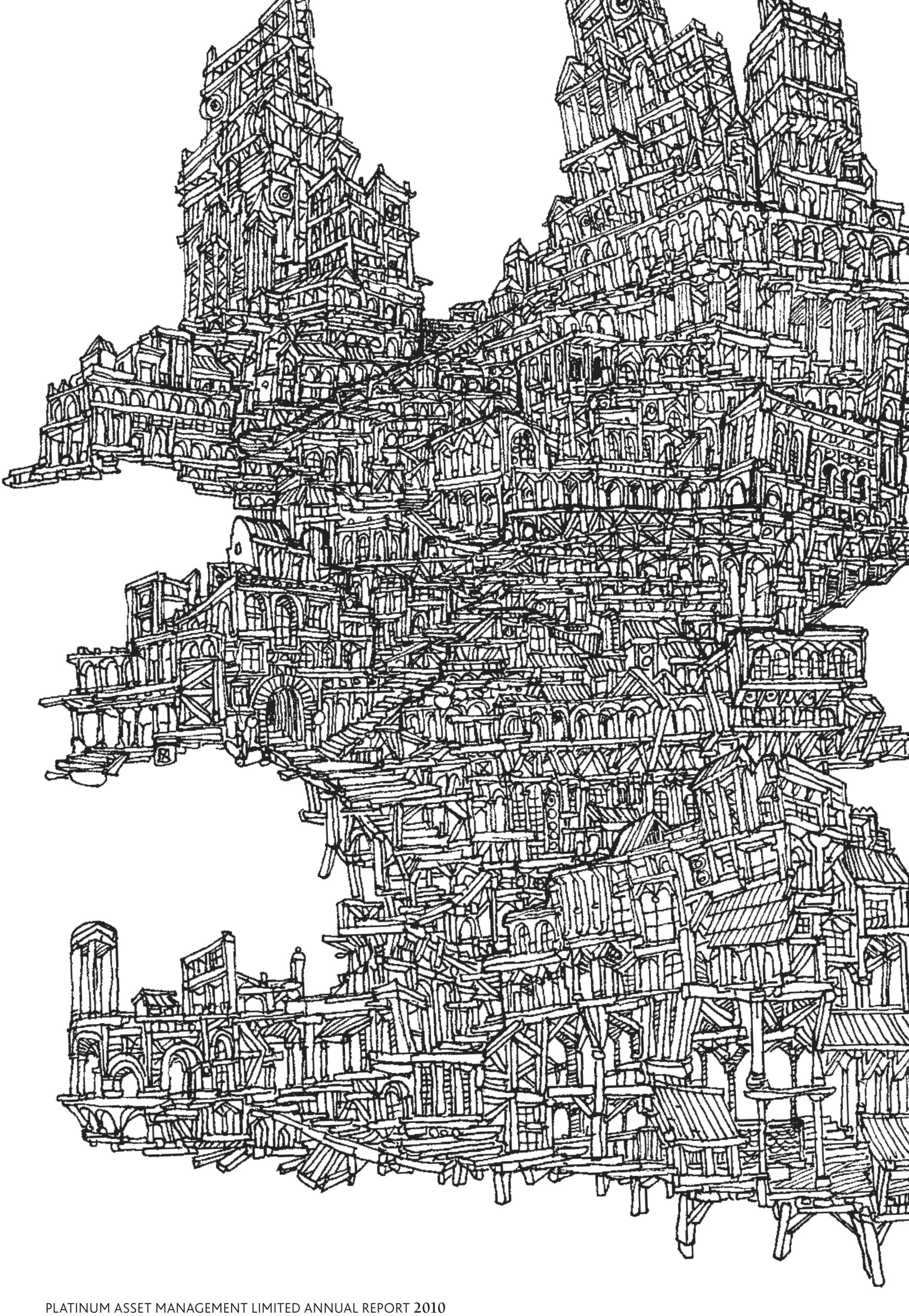
What changes are the rules that channel the greed or the system that channels the greed. So the greed came to be channeled in very short-term ways. So people became very short-term greedy, greedy for the next quarter, greedy for the next bonus rather than greedy for a long and lucrative career. What caused that? Firms ceasing to be partnerships is the beginning of it. That a Wall Street firm that is investing its own money, the people inside it – it's their money that's at stake – are going to behave very differently from people who are a public corporation who are using shareholders' money. No partnership would have ever allowed itself to own billions of dollars of triple A rated CDOs backed by subprime, just wouldn't have happened because they would have scrutinized it in a different way. Nobody will say that on Wall Street or say that's true. They'll say we behaved just as we would have as if it was our own money, but they don't, nor would you expect them to.

People are very – it's amazing how powerful incentives are. Two, the business got intellectualized in the 1980s. The proximate cause of the intellectualization was the Black-Scholes' option pricing model, but just generally it got more complicated and so as it got more complicated, it got harder and harder for normal people to understand it and easier and easier for smart people to persuade dumb people to do things they shouldn't do and easier and easier for smart traders to disguise what they were doing from their bosses because it's so complicated. That was absolutely necessary.

One of the signature traits of this crisis is that the people on the top of the firms clearly didn't know what their firms were doing; that they were buffaloed by people underneath them. And they all feel betrayed by their employees when they're speaking privately about them. But this is why they could be because the business got too complicated for the people who ran them. Finally and this is a really big one and related to the other two. The relationship between Wall Street and its customers, the legitimate business of Wall Street is to allocate capital. The traditional businesses on Wall Street, the traditional capital allocation businesses have gotten less and less profitable. All these new markets, these financial innovations is a response, in part, to Wall Street's need for profits and profits drying up and say old-fashioned stock broking because you can now go on the internet and buy a stock and pay a tiny commission rather than call your guy at Merrill-Lynch and pay a fat one.

So Wall Street, if you look at how firms make their money, especially if you have been inside one of them, you realize that increasingly, especially in the bond markets where more of the profits are than in the stock markets, Wall Street has come to increasingly trade against its customers rather than on their behalf. It's acting not as an intermediary, but essentially as a big proprietary trading fund. It is using its customers to get itself out of the positions it doesn't want to be in, to take the stupid side of a smart trade they want to do, so on and so forth. There is a poisonous interface between these big firms and their customers in the bond market and everybody now takes it for granted. It shocked me when I saw it in 1987, 86-87, but it's now just normal. It's thought to be normal and that is the minute you're starting to think – the way I make money is exploiting the idiocy of my customers – is the minute you start creating securities that are designed to explode, that you could be on the other side of.

The minute you're thinking less like a handmaiden to productive enterprise and a useful allocator of capital, you're becoming the jerk in the zero sum game and they become the jerks in the zero sum game. So you back away from it all and you say – look at what these people did. And the shocking thing is is what they did was legal – and you say how do you change the rules? What do you do here?



One of the things you obviously do is you have to destroy this notion that it's okay to trade against your customers. You have to say maybe what you say is you can be a firm like Schwab that has customers, but you don't trade in anything for yourself or you can be a hedge fund, but you can't be both. Because the minute you start to trade against the customers is the minute you start designing things that aren't good for the customers. And the minute you start designing things that aren't good for the customers, you start designing CDOs filled with subprime mortgage bonds. You start to misallocate capital. You're trying to misallocate capital and that's crazy.

It's insane. But it is the normal on Wall Street and so breaking it up, as you can see, changing it is going to be a violent act because it's become so assumed, it's so deeply embedded as the assumption of this is how the business is.

ES **Want to know what gets Michael Lewis really worked up?**

ML It's outrageous. If the markets had been allowed to function, if the government had not stepped in to rescue these firms, they'd all be out of business, all of them.

[BREAK]

ES **I'm getting a sense of Michael Lewis right now and what he thinks and there's quite a bit of you in the epilogue to this book. You talked about the fantastic handouts given to the TARP recipients, how they were unnaturally selected for survival and how it was shocking for the Fed to buy mortgage-backed securities. Are you personally outraged?**

ML Yes. Because it's outrageous. And absolutely, you know, well they are, if the markets had been allowed to function, if the government had not stepped in to rescue these firms, they'd all be out of business, all of them. They're all failed. There are different degrees of idiocy. Maybe Goldman Sachs doesn't fail because it has lots of subprime mortgage bonds on its books. It fails because it's got credit default swaps with people who do. But, nevertheless, it fails. Because of the position they occupy in the financial system, they can't be allowed to fail. I think that, all right you can forgive. That step I can forgive. I completely understand. I can understand the way, how the decisions that were made in the midst of the crisis were necessarily self-contradictory, ad hoc, hard to understand in retrospect, all the rest, but now we're out of that.

What I find outrageous is that the people who were in positions of influence and power, when the crisis occurred were, by definition, people who didn't see it coming. They were, by definition, ignorant at what was going on right under their noses and that they are, that there's been so little change in that regime, is a little outrageous to me.

I think it's outrageous that essentially the US government took the position, unlike say the UK government, that these firms were so central to our way of life that not only could we not let them fail, but we can't even suggest their creditors take a hit; that essentially they're failed institutions that we need to prop up so we are going to gift them money until they get out of their problems, which they appear to be doing now. That's what we've done though, we've gifted the money.

In the beginning, we gifted the money in very overt ways, direct investment in the firms or buying their securities or whatever at inflated prices or whatever, those obvious ways, but now their ability to tap the Fed for money at 0% and reinvest the money in agency bonds and take the spread is a form of the gift. So it's outrageous that they are essentially being gifted out of their problems and that their view is that their employees deserve a large chunk of the rewards of those gifts. I think that, but it's outrageous.

On the other hand, it's understandable because they have a way of life that has existed for 30 years on Wall Street. It's very hard to change peoples' habits especially if they don't have to change and they've proved that they don't have to change. I think that the end result of this, however, is just to stoke the political anger. It is going to change the system. So I think that in the end, in a weird way, the behavior of the Wall Street firms currently is the best friend that reform has because they're not doing a very good job of disguising their interest in the rest of the world.

ES **The firms that survive may be even stronger now than they were before and a whole lot of the people, the traders, for example, who lost their jobs, are back, employed by the firms that survived, so where is the justice?**

ML It's not over. We're living through this big transition right now, I think, but Wall Street has changed dramatically and Wall Street's relationship to the rest of the world has changed dramatically and the way people view Wall Street has changed dramatically. These firms have gone from being unquestioned masters of the universe and unquestioned kind of upper class that everyone aspired to be, to being essentially enemies of the people, inside of the last two years.

I mean, they do have a lot of political influence and there is natural resistance and impediment to changing the rules of their road, but there is also on the other side of that, enormous anger and cynicism that is going to find a political expression and you can't expect democracy to move as quickly as finance. Financial markets panic. They change very rapidly. Democracy moves very slowly. In 1929, the markets collapsed. It wasn't until 1933 that Glass-Steagall is introduced. It took several years to have proper hearings in Congress. The reason for that is that the engine for democratic change is elections and elections don't happen every day.

ES **There's something about Michael Lewis that sets him apart from other writers. When we come back, the author tries to handicap his own success.**

[BREAK]

ES **What is it about Michael Lewis that makes him different? What's the thread he followed from Wall Street to Silicon Valley to baseball and football and back to Wall Street again? I wanted to know.**

ML My own explanation for why I've always been interested in this and interested in why anybody would pay me a lot of money to advise people what to do with their money. That was the beginning of *Liar's Poker*. I think it's that I grew up in a city, in a culture in New Orleans that had experienced enormous status collapse and it was experiencing it and things that I cherished and valued were no longer valued or being less and less valued by the world and things that made for a happy life were less and less valued in the world and I think that as I enter adulthood when I'm in my late teens, early 20s, I am perplexed by what people think is important and valuable – so I'm probably drawn to that subject in part for that reason. But other than that, I don't have a self-conscious obsession with the subject.

ES **If you had to handicap it, what would you say has been the key to your success?**

ML Sloth, let me tell you, this is not completely a joke. Indolence more than sloth, that I think the fact that I am inherently a little lazy. And you may not believe this, but if you just ask my wife she will tell you that it means that I have to be really roused to do anything. I have to be really interested. I don't write a book because I need to write a book – because I really don't need to write a book. I write a book because I'm really interested in it. So that really helps. It really helps that it's not exactly a lack of ambition, but a kind of – I'd rather be laying in bed reading a book or watching TV or playing with my kids. It helps to have to be roused to action rather than just be always ready for action. I think it's helped me that I have a pretty low threshold of boredom and if I'm not humored and interested by it, then I just drop it.

ES **Were you surprised by the commercial success of *The Blind Side* both as a book and now as an Oscar-winning movie?**

ML I was so taken with the story that I couldn't believe it took so long for the movie industry to be interested in it and it did and it only got made accidentally. It got made because of the intercession of Fred Smith – the head of FedEx has a movie company. He knew the story personally. He lives in Memphis and he made it happen, I think is what happened. So I can't say – I wish I could – I was really surprised. I'll say this about it: that when I wrote it, it was very different from anything I had written and I was surprised my publisher didn't give me more grief about writing it. They were wonderful about it and they probably shouldn't have been and we found it, in the first instance, a hard book to sell. It did not sell well as a hardback. It's sold well now because of the movie, but, if anything, I was surprised I didn't do a better job selling it when it came out. I thought it would be better than it did.

ES **Well, nobody expected Michael Lewis to write a tearjerker.**

ML Me neither and I still cry when I see it, so how does that work? But it's also very, I mean, the movie may be a little less so, but there's a lot of humor. It's a pretty funny story. At the same time, and funny enough.

ES **Tragic-comic in a way.**

ML Well, but this is actually, I think, something that's basically universally true, is that in some weird way, all emotions are the same; that the presence of humor makes it even easier to evoke tears; that crying and laughing, you're feeling something – and this is a story in which you felt so much, which is why I thought it would be a movie because Hollywood's naturally attracted to that sort of story. But I felt so much of it when I was writing.

Sandra Bullock from the movie: This team is your family, Michael. When you look at him…

ES **With the Oscar success of his book, *The Blind Side*, Hollywood beckons. Coming up, Michael Lewis and I talk about his other movie prospects.**

[BREAK]

ES **Michael Lewis wrote *Liar's Poker*, *Moneyball*, and *The Blind Side*. More now from our conversation about his newest book. You hope *The Big Short* gets made into a movie?**

ML Well it got bought. Paramount and Brad Pitt bought it. This is what I've learned about the movie business so far. It is pointless to hope it does anything because you have no control over it. I'm not even sure it has control over itself, so it's like this raving lunatic wandering the street. You don't want to hope things for it because your hopes are just going to be dashed. I try to keep my emotions detached from it and not get too worked up about it. Of course, it's better if it gets made into a movie than not because even if it is made into a crappy movie, more people will read the book. So, sure, and I actually don't care whether it's a crappy, I mean I'd like it to be, of course, it's better if it's a good movie than a crappy movie, but I'd rather make a crappy movie than no movie at all because it drives traffic to the book.

ES **If it did get made into a movie, have you given any thought to whom you'd like to see play certain characters?**

ML I have, I think, Philip Seymour Hoffman should play Steve Eisman. That he's so perfect for it that it's just not true. I think Matt Damon should play Michael Burry. They even look a little alike, but Matt Damon, I think he could do Asperger's well and he hasn't done it yet and everybody should do Asperger's once.

ES **At least once in your career.**

ML Right, then there are these three – essentially kids that they're in their early 30s – but they're sort of young men with a Schwab account and I think I would cast them out of the Judd Apatow universe of actors.

ES **Seth Rogen?**

ML Yeah, Seth Rogen in the super bad guy and Jonah Hill and I would cast essentially comic actors in that role.

ES **Would you want to go back to writing about things that people never saw before, people never heard of before and, as a result, gave your audience kind of a strategic roadmap for what was going to happen?**

ML Yes, it bothered me about *The Big Short* that it wasn't – that the greatest financial crisis in the history of the world was not a secret. I would like it to have been a secret. But, on the other hand, it's nice that the subject is obviously important. I can't generalize about where I'm going to find a story. It just so happened that I found what I thought was a really riveting story inside this big event. So it wasn't the whole event. It was this very narrow story inside the event and having said that, it still bothers me a little bit that the event's so obvious. Any idiot can write a book about the financial crisis. So I would like to, all things being equal, I'd rather nobody had ever heard what I'm writing about because there's a freshness to that and you feel like you can invent the world in some way that you can't do if everybody, your reader comes with so much baggage to a story about the financial crisis that they don't bring to a story about a poor boy no one's ever heard of. So all things being…

ES **They talk to you and nobody was paying attention.**

ML That's right. So all things being equal, I'd rather farm land that's not being farmed, but all things are never equal and I actually don't know exactly what I'm going to do next.

ES **Michael Lewis started his latest book, *The Big Short*, with a mixture of fascination, curiosity and awe. How could so few people have spotted the financial meltdown and made so much money doing it? He walked away with a sense of outrage and a conviction that something on Wall Street has to change or we'll surely end up with another crisis. I'm Erik Schatzker, thanks for watching.**

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