Platinum Japan Fund

Leon Rapp
Portfolio Manager

Overview

- The first quarter of 2024 marked two important events for Japan investors. The first was the headline Nikkei 225 index surpassing its 1989 bubble high. The second was the BOJ's historic exit from a decade long experiment with ultra-loose monetary policy.
- The portfolio benefited from the excellent performance of holdings such as data company **SUNCORPORATION** (+50%), **MS&AD Insurance** (+44%) and **Toyota Motor** (+46%). We also captured healthy returns from newly initiated positions in real estate developers **Mitsui Fudosan** and **Mitsubishi Estate** (both up over 35%).
- We think a virtuous circle for Japan's economy – a clean break from the past three decades of low growth – is drawing near. As a result, the outlook for earnings growth – and for Japanese equities more generally – is particularly encouraging.

Leon Rapp became sole Portfolio Manager of the Platinum Japan Fund on 18 March 2024. He was previously Co-Portfolio Manager of the Platinum Japan Fund.

Performance

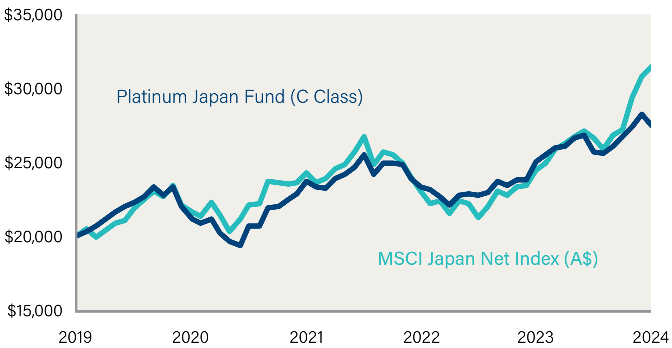
compound p.a.+, to 31 March 2024

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Japan Fund*	3%	10%	5%	7%	13%
MSCI Japan Index^	16%	29%	9%	10%	4%

+ Excludes quarterly performance.
* C Class – standard fee option. Inception date: 30 June 1998.
After fees and costs, before tax, and assuming reinvestment of distributions.
^ Index returns are those of the MSCI Japan Net Index in AUD.
Source: Platinum Investment Management Limited, FactSet Research Systems.
Historical performance is not a reliable indicator of future performance.
See note 1, page 5. Numerical figures have been subject to rounding.

Value of $20,000 invested over five years

31 March 2019 to 31 March 2024



After fees and costs, before tax, and assuming reinvestment of distributions.
Historical performance is not a reliable indicator of future performance.
Source: Platinum Investment Management Limited, FactSet Research Systems.
See notes 1 & 2, page 5.

Led by large caps, Japanese equities continued to perform strongly and were supported by continued inflows from global investors. Our portfolio lagged the market due to our higher exposure to smaller, domestically-focused firms. As we approached the end of the quarter we freed up some cash within the portfolio that we are looking to deploy in new opportunities.

During the quarter, technology stocks rallied further, driven by the AI thematic. Toward quarter-end the market rotated to stocks focused on the domestic economy, with strong performance from the real estate sector. The yen continued to steadily weaken versus the USD from the 140 to 150 level despite the long anticipated Bank of Japan (BOJ) exit from yield curve control (YCC) and negative interest rates.

Key contributors to the portfolio were **SUNCORPORATION** (+50%), **MS&AD Insurance** (+44%), **Toyota Motor** (+46%) as well as newly initiated positions in real estate developers **Mitsui Fudosan** and **Mitsubishi Estate** (both up over 35%).

Key detractors were **Shift** (-32%), which released disappointing Q4 earnings in January. **Toho Titanium** (-17%) and **Ship Healthcare** (-13%) also lagged.

Following recent research trips to Japan we continue to make changes to the portfolio to reflect an investing environment likely to be very different to the one seen in past decades in Japan.

During the quarter, we initiated positions in the two major real estate developers Mitsubishi Estate and Mitsui Fudosan, given still substantial Net Asset Value (NAV) discounts and improving outlook. We also initiated positions in **Mitsubishi Electric** and **Hitachi** which are well positioned for earnings growth and have been undertaking wide-reaching and meaningful reforms that should see higher returns on capital over time. Additionally, we bought **Daifuku**, a leading materials handling specialist, while raising our holdings in industrial automation specialist, **Keyence**. These companies are important enablers to the rebuilding of Japan's manufacturing footprint and should benefit from a potential multi-year boom in domestic capex. Following very strong performance, we lowered our exposure to semiconductor related businesses.

Commentary

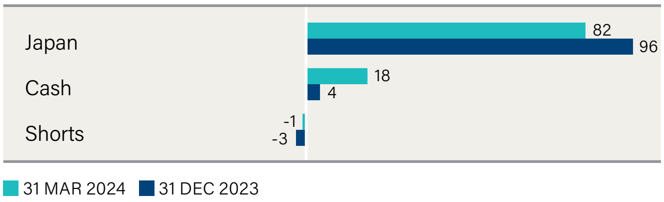
The first quarter of 2024 marked two important events for Japan investors. The first was the headline Nikkei 225 index surpassing its 1989 bubble high in February. The second was the BOJ's historic exit from the decade long experiment with ultra-accommodative monetary policy in March (albeit while still maintaining easy monetary conditions).

While both events are significant, we need to ask whether the recent strong gains in Japanese equities, up some 43% in local terms over the past 12 months (Nikkei 225), can be sustained. Is there a risk that higher inflation means the BOJ pulls away the punchbowl too quickly, leading to a sharp rise in the Yen and then a broad equity market selloff? Are we witnessing another false dawn for Japanese equities?

To answer these questions – and thinking about the Japanese equity market more broadly – there are a few key points to digest.

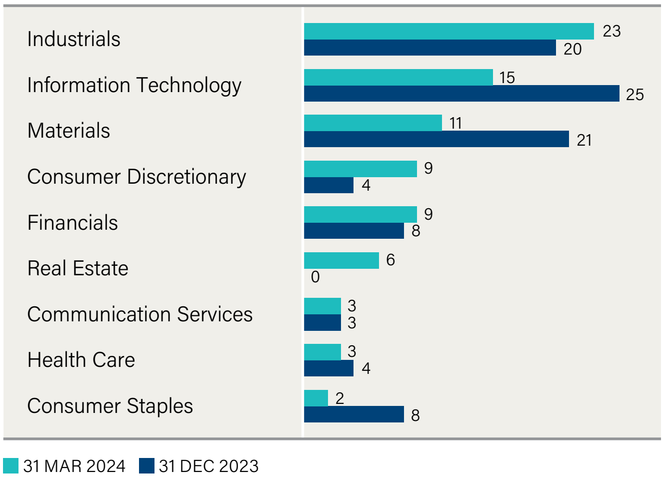
Firstly, after three decades of off and on deflation, inflation at both the consumer and producer level is now establishing itself across the Japanese economy and becoming embedded in expectations. This was initially partly the result of a weaker currency raising producer prices. However, passing through price increases is now becoming commonplace. At long last, this gives corporates the confidence to invest in their own economy and gives consumers a stronger expectation of the wage growth and job security that lead to higher consumption. This is the long-awaited virtuous circle of higher prices and higher wages that the BOJ needed to see before monetary policy settings could be normalised.

Disposition of Assets %



See note 3, page 5. Numerical figures have been subject to rounding.
Source: Platinum Investment Management Limited.

Net Sector Exposures %



See note 4, page 5. Numerical figures have been subject to rounding.
Source: Platinum Investment Management Limited.

Top 10 Holdings

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Toyo Seikan Group	Japan	Materials	4.3%
GMO Payment Gateway Inc	Japan	Financials	4.1%
Toyota Industries Corp	Japan	Industrials	3.7%
Toyota Motor Corp	Japan	Cons Discretionary	3.6%
Taisei Corp	Japan	Industrials	3.6%
Hirano Tecseed Co Ltd	Japan	Industrials	3.4%
Mitsubishi Estate Co Ltd	Japan	Real Estate	3.2%
Mitsui Fudosan Co Ltd	Japan	Real Estate	3.2%
Keyence Corp	Japan	Info Technology	3.2%
Sony Corp	Japan	Cons Discretionary	3.2%

As at 31 March 2024. See note 5, page 5.
Source: Platinum Investment Management Limited.

The widely followed 2024 *Shunto* annual wage negotiations between labour unions and employers saw a headline rise in salaries of 5.3% YoY, the fastest rise for 33 years. While encouraging, real wages in Japan have been negative and real household spending still remains below pre-COVID levels. The BOJ knows Japan is a two-speed economy still emerging from a deflationary mindset. Thus any normalisation of policy is likely to be slow, which we believe is supportive of further economic expansion.

Secondly, we see a steady but profound shift in corporate mindsets away from the self-defeating battles for market share that historically undermined margins and entrenched deflation. Now there is a focus on prioritising profitability and returns on capital – and therefore protecting and rewarding shareholders.

Mid-term corporate growth strategies are widely used in Japan, detailing corporate priorities over a rolling 3~5 year horizon. Traditionally, these plans would be kept broad brush, with only basic quantitative targets such as sales growth and absolute profits. They were more talking points than deliverables and the *achievement* of these plans appeared a secondary priority.

Recently, however, we've seen much more granularity and realism in these plans. Capital efficiency targets have become commonplace with such metrics as ROE, ROIC and margin ratios being used as well as the introduction of quantifiable shareholder return policies. This is the new standard and is welcome news for investors who for too long have been low on the list of corporate priorities in Japan.

Embracing the spirit of reform

The outlook for meaningfully higher and growing shareholder returns stands in stark contrast to the poor returns of Japan's "lost decades". While much of the credit can go to the introductions of shareholder friendly policies such as the governance and stewardship codes begun during Abenomics and the more recent Tokyo Stock Exchange cost-of-capital initiatives, we think the real difference between corporate reform attempts of the past and now is the recognition that the limitations of traditional cost cutting has been reached and that the only way for Japan to thrive in the face of chronic labor shortages is to implement reforms that substantially raise firm productivity.

Tokyo property

Of the many themes we look at, we believe the return of inflation could see a Japanese real estate boom, led by the prime central Tokyo office leasing market. The traditional narrative is that real estate equities perform poorly during inflationary times, as credit is tight and higher rates raise debt servicing costs. Yet despite the BOJ raising rates, Japanese real estate developers have rallied strongly. This could be due to the market being less concerned about the pace of rising interest rates, but we think it is more likely due to strong property fundamentals such as limited supply of desirable office locations with high demand from strong corporate earnings leading to low single digit vacancy rates for well-located office space.

We think these conditions provides scope for Mitsui Fudosan and Mitsubishi Estate (who own and lease diversified prime properties in central Tokyo) to raise office rents while also benefitting from higher realised property values. This implies robust earnings ahead. Yet both stocks trade at discounts to their Net Asset Value, due to significant unrealised gains on their properties. A more proactive stance on capital efficiency and increasing shareholder returns is beginning to address this discount.

The quality of Japanese life

Japan has steadily deindustrialised over the past three decades. On a clear day in the late 80's and early 90's one could see Mount Fuji from central Tokyo only in the very early morning. By mid-morning it would disappear in smog, the result of air pollution from industry. Transport infrastructure in the Kanto region had not kept up with the economy, resulting in chronic traffic jams.

Today Mount Fuji, some 100kms from central Tokyo, can regularly be seen throughout the day and traffic through the capital flows (mostly) smoothly. While deflation and weak wage growth during the drift decades were negative, the quality of life steadily improved for most Japanese.

The return of value chains

We think conditions are also ripe for a sustained domestic capex boom thanks to a substantially weaker currency, policy support aimed at getting value chains moving back to Japan and a flurry of domestic capacity expansion announcements by leading tech firms.

In the recent quarterly Ministry of Finance (MoF) corporate survey, Japanese corporates raised spending on plant and equipment by a strong 16.4% YoY in Oct-Dec 2023. Notably, spending was up 20% YoY for manufacturing firms, with Information and Communication Electronics Equipment up 67% YoY.

The return of value chains should underpin higher levels of physical capex which we expect to be enhanced by productivity investments such as software spending and automation. With this, we should also expect a pickup in real wage growth that supports a stronger recovery in consumption.

We think a virtuous circle for Japan's economy – a clean break from the past three decades of low growth – is drawing near. Thus the outlook for earnings growth – and for Japanese equities more generally – remains particularly encouraging.

Notes

Unless otherwise specified, all references to "Platinum" in this report are references to Platinum Investment Management Limited (ABN 25 063 565 006, AFSL 221935).

Some numerical figures in this publication have been subject to rounding adjustments. References to individual stock or index performance are in local currency terms, unless otherwise specified.

1. Fund returns are calculated by Platinum using the net asset value unit price (i.e. excluding the buy/sell spread) of the stated unit class and represent the combined income and capital returns over the specified period. Fund returns are net of fees and costs, pre-tax, and assume the reinvestment of distributions. The MSCI index returns are in AUD, are inclusive of net official dividends, but do not reflect fees or expenses. [The gross MSCI index was used prior to 31/12/98]. MSCI index returns are sourced from FactSet Research Systems. Platinum does not invest by reference to the weightings of the specified MSCI index. As a result, the Fund's holdings may vary considerably to the make-up of the specified MSCI index. MSCI index returns are provided as a reference only. The investment returns shown are historical and no warranty is given for future performance. Historical performance is not a reliable indicator of future performance. Due to the volatility in the Fund's underlying assets and other risk factors associated with investing, investment returns can be negative, particularly in the short term.
2. The investment returns depicted in the graph are cumulative on A$20,000 invested in C Class (standard fee option) of the Fund over the specified period relative to the specified MSCI index in AUD.
3. The geographic disposition of assets (i.e. other than "cash" and "shorts") shows the Fund's exposures to the relevant countries/regions through its long securities positions and long securities/index derivative positions, as a percentage of its portfolio market value. Country classifications for securities reflect Bloomberg's "country of risk" designations. "Shorts" show the Fund's exposure to its short securities positions and short securities/index derivative positions, as a percentage of its portfolio market value. "Cash" in this table includes cash at bank, cash payables and receivables and cash exposures through derivative transactions.
4. The table shows the Fund's net exposures to the relevant sectors through its long and short securities positions and long and short securities/index derivative positions, as a percentage of its portfolio market value. Index positions (whether through ETFs or derivatives) are only included under the relevant sector if they are sector specific, otherwise they are included under "Other".
5. The table shows the Fund's top ten positions as a percentage of its portfolio market value taking into account its long securities positions and long securities derivative positions.

Disclaimers

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