Platinum Asia Fund

Andrew Clifford Portfolio Manager

Disposition of Assets

REGION	DEC 2010	SEP 2010
China (Listed PRC)	6%	8%
China (Listed Ex PRC)	18%	18%
Hong Kong	3%	4%
Taiwan	6%	6%
Greater China total	**33%**	**36%**
Korea	18%	17%
India	11%	11%
Thailand	9%	11%
Malaysia	5%	6%
Singapore	5%	5%
Philippines	3%	3%
Indonesia	2%	3%
Vietnam	1%	1%
US/Canada	1%	0%
Cash	12%	7%
Shorts	9%	8%

Source: Platinum

Performance

Performance (compound pa, to 31 December 2010)

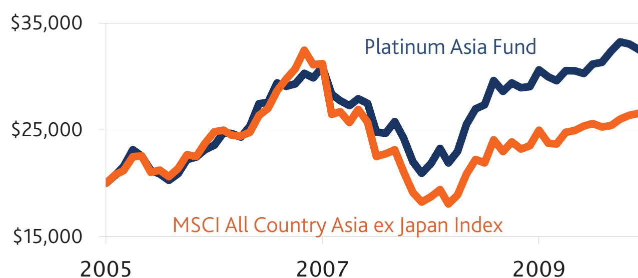
	QUARTER	1 YR	3 YRS	5 YRS	SINCE INCEPTION
Platinum Asia Fund	-4%	4%	1%	10%	20%
MSCI AC Asia ex Jp Index	1%	5%	-6%	6%	12%

Source: Platinum and MSCI. Refer to Note 1, page 4.

Asian stock markets had another bright quarter rising a little over 5% though this was reduced to only 0.8% due to an appreciating Australian dollar. The strongest regional markets were Korea (+9.5%) and Taiwan (+8.9%), both beneficiaries of improvement in the performance of the US economy as well as ongoing growth in China. The weakest markets were India (flat) where rising interest rates were a drag on the market and the China H shares (+2.3%) which were held back by concerns over rising inflationary pressures in China.

Value of $20,000 Invested Over Five Years

31 December 2005 to 31 December 2010



Source: Platinum and MSCI. Refer to Note 2, page 4.

Over the quarter, the Fund underperformed the market by almost 5%, offsetting the benefit of an equally good performance in the prior quarter. The Fund saw good returns from its holdings in a number of its Korean finance holdings including KB Financial Group (bank, +22%), Korean Investments (broker, +27%) and Dongbu Insurance (+27%), as the Korean domestic economy continued to perform well. Major exporters such as Samsung Electronics (+22%) and Taiwan Semiconductor (+15%) were also good contributors to performance. The main detractors were Guangzhou Auto (-20%) and our Indian property stocks, Housing Development and Unitech, both falling 25% over the quarter. The Fund's minimal exposure to the Australian dollar has meant the benefit of rising Asian stock prices over the last six months has been lost due to our appreciating currency.

Changes to the Portfolio

The main change has been to decrease the net invested position of the portfolio from 85% at the start of the quarter to 79%. This was achieved by increasing the cash position of the Fund through the sale of a number of our smaller holdings that performed well. Included in these sales were Sohu (Chinese internet portal) which had performed strongly since its initial purchase the prior quarter. Also sold was the holding in Ping An Insurance H shares, though an investment is still held in the A shares of that company. The short positions were also increased but more importantly refocused on China (primarily the H share index in Hong Kong) where we expect there to be weakness as policy is tightened in China as a response to rising inflationary pressures.

New additions to the portfolio included **China Mobile** where there have been promising developments with its local 3G technology that should see it able to stem its recent market share losses. **Franshion Properties** is a Chinese property developer and investor that to our eye appears significantly undervalued. **Manila Water** has a concession to operate part of Manila's water supplies that allows it to earn a real return of 9% on its investment. Considerable ongoing capital expenditures required to modernise the city's water and sewerage system should see the company grow its earnings for some time to come. The Fund also took advantage of weakness in **Unitech** (Indian property developer) to add substantially to this position.

Commentary

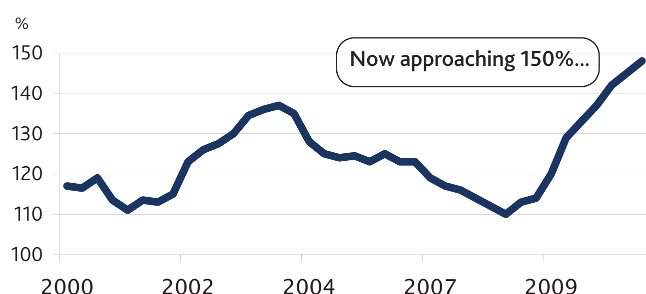
We return yet again to the topic of inflation in China, a subject that has been at the centre of a number of our past reports. Although we would prefer not to bore readers with a return to the familiar ground, it is in our view the issue for Asian stock markets in the year ahead.

Starting in mid-September food prices in China began increasing at an alarming rate pushing the rate of food inflation back over the 10% level for the first time since 2008. Although it is difficult to judge the significance of any given level of inflation, the anecdotal evidence from our contacts in China suggested that the drain on household budgets was not insignificant. Supporting this were the moves by various local governments to put in place food price controls and regulations against hoarding. Stories of school students trashing their school canteen in response to price increases also suggested that the on-ground experience was perhaps greater than suggested by the headline statistic.

Most commentators remain unconcerned about inflation in China. They would argue that food prices are a function of external factors such as weather (indeed this appeared to be behind the rise in vegetable prices, which are now falling back) and that the vast supply of low cost labour means the prospect of food inflation morphing into broader price pressure via wages is unlikely. While typically they would agree with our proposition that an undervalued exchange rate will lead to inflation, the expectation (and hope) is that this will reveal itself in the price of assets such as property (which of course it has) and stocks (which in the case of China's domestic stock markets hasn't been so easily observed). The People's Bank of China (PBOC) seems to share a similarly relaxed position having made only some minor adjustments to interest rates and banking reserve requirements while most focus has to date been on administrative measures regarding lending to the property sector.

There are a number of developments that cause us to be far more concerned. Most importantly, as revealed by *Fitch* in their report on China's banking system, there has been a significant disintermediation of the banking system over the last year. The result is that growth in credit is occurring at much higher rates than had generally been understood or intended by the PBOC. Simply, there is more fuel being thrown on the fire when the reverse is required. Meanwhile wage increases would appear to be accelerating and although

China - Credit as a % of GDP



Source: Wigram Capital Advisors and CEIC

annual increases of the order of 20% are not yet out of line with history, the recent rate of increase suggest they soon will be. Indeed our meetings with companies operating in China suggest wage increases of up to 50% are not unusual. Finally, many of the controls Chinese authorities have used in the past appear to be breaking down. Loan quotas for the banking system no longer appear relevant and in the property market individuals have learnt to ignore measures aimed at pushing prices down. Indeed some measures such as price controls tend to make the situation worse with producers resorting to various tactics such as hoarding.

Ultimately though, the Western notion that food price inflation is not relevant for policy makers is wrong. Food makes up a significant part of household budgets and thus prices are politically sensitive. The last two occasions in 2004 and 2007 when food prices moved up, action was taken to cool the economy, primarily through increasing interest rates and a tightening of the banks ability to lend. Unless inflationary pressures dissipate (and we can't see why they will given the rate of lending growth in the last year), we would expect no difference this time. Although bankers may have been able to skirt the lending quotas to date, once action is deemed necessary we would expect lenders, which are primarily still government controlled, to be brought back into line. Our long held hope that the Chinese authorities would allow a stronger Yuan exchange rate to mitigate inflation seems an unlikely prospect at this stage and even if pursued would probably make little difference.

Outlook

We would expect that initially the domestic Chinese stock market (A share market) to be the weakest of the regional markets in a period of rising inflation as the prices anticipate the potential for a tightening of policy. Indeed this has been the pattern in the past two inflationary episodes of the last decade when the A shares have entered bear markets while the rest of the world continued to enthuse about the prospects for China's growth.

Across the range of Chinese companies there is likely to be highly divergent performances depending on their ability to pass on labour cost increases. Indeed one might expect that state controlled entities will be reluctant to (or be directed not to) increase prices and profitability will suffer as a result. Many of the larger H share companies will fit this category and as a result we expect the Hong Kong H share market to be a relatively poor performer.

If China is forced into more extreme action to slow down growth then this will have negative implications for all of the regional stock markets, commodity markets and commodity plays such as the Australian dollar. However, the building inflationary pressures that we expect, may well in the initial stages, bring forward activity and exaggerate China's growth prospects which will most likely be greeted with enthusiasm by the usual suspects.

Until there is a clear change in China's outlook we would expect a continuation of the trends of the last three or so months with China's markets weak and the rest of the region outperforming. There are numerous other factors that may yet come into play such as the effects of policies including US quantitative easing but for the moment this remains our base case. The difficulty as a stock picker is that we continue to find the best value across the region primarily within Chinese stocks. Our approach has been to continue to buy those companies whose valuations we find most appealing and to try and reduce the Fund's market exposure through short sales of the H share index and other instruments.

Notes

1. The investment returns are calculated using the Fund's unit price and represent the combined income and capital return for the specific period. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), are pre-tax, and assume the reinvestment of distributions. The investment returns shown are historical and no warranty can be given for future performance. You should be aware that historical performance is not a reliable indicator of future performance. Due to the volatility of underlying assets of the Funds and other risk factors associated with investing, investment returns can be negative (particularly in the short-term).

   The inception dates for each Fund are as follows:
   Platinum International Fund: 30 April 1995
   Platinum Unhedged Fund: 31 January 2005
   Platinum Asia Fund: 4 March 2003
   Platinum European Fund: 30 June 1998
   Platinum Japan Fund: 30 June 1998
   Platinum International Brands Fund: 18 May 2000
   Platinum International Health Care Fund: 10 November 2003
   Platinum International Technology Fund: 18 May 2000

2. The investment returns depicted in this graph are cumulative on A$20,000 invested in the relevant Fund over five years from 31 December 2005 to 31 December 2010 relative to their Index (in A$) as per below:
   Platinum International Fund - MSCI All Country World Net Index
   Platinum Unhedged Fund - MSCI All Country World Net Index
   Platinum Asia Fund - MSCI All Country Asia ex Japan Net Index
   Platinum European Fund - MSCI All Country Europe Net Index
   Platinum Japan Fund - MSCI Japan Net Index
   Platinum International Brands Fund - MSCI All Country World Net Index
   Platinum International Health Care Fund - MSCI All Country World Health Care Net Index
   Platinum International Technology Fund - MSCI All Country World Information Technology Net Index
   (nb. the gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist).

   The investment returns are calculated using the Fund's unit price. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), pre-tax and assume the reinvestment of distributions. It should be noted that Platinum does not invest by reference to the weightings of the Index. Underlying assets are chosen through Platinum's individual stock selection process and as a result holdings will vary considerably to the make-up of the Index. The Index is provided as a reference only.

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