PLATINUM JAPAN FUND

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Portfolio Manager

PERFORMANCE

Performance this quarter was entirely dominated by movements in the $A/yen cross rate which rose by 9.8% and caused a 7.0% decline in the value of the Fund in Australian dollar terms. This is an extraordinary move in such a short space of time and highlights both the extent of bullishness about global growth and the frenzy amongst Japanese seeking higher yielding assets overseas. We have clearly been very wrong, not just in failing to hedge our yen back to Australian dollars, but more widely in terms of our positive bias toward the emergence of a wider bull market in Japanese assets which to date has been primarily limited to CBD property. However we are reluctant to change our positioning significantly because there is no evidence that corporate Japan is losing strength, in fact the contrary is the case. In time this strength should be expressed in higher returns from Japanese assets whilst in a global downturn, the yen is likely to take on defensive qualities. In a world of expensive valuations Japan presents investors with an increasingly compelling investment opportunity!

CHANGES TO THE PORTFOLIO

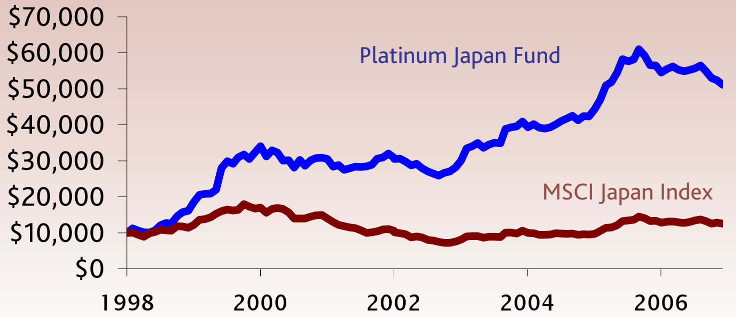
In the current mania for commodity cyclical stocks the valuations of true growth companies have been compressed toward market averages. This is an opportunity and we have been adding the likes of Tokyo Electron, Sumitomo Chemical and Credit Saison to the portfolio.

DISPOSITION OF ASSETS

REGION	JUN 2007	MAR 2007
JAPAN	96%	87%
KOREA	0.2%	6%
CASH	3.8%	7%
NET SHORTS	0%	0%

Source: Platinum

VALUE OF $10,000 INVESTED SINCE INCEPTION
1 JULY 1998 TO 30 JUNE 2007



Source: Platinum and MSCI. Refer to Note 2, page 41.

In the case of Tokyo Electron, a semiconductor production equipment supplier (SPE), it is hard to identify the specific catalyst which will move the stock, however the company leads its industry and yet trades on a lower than peer valuation. The SPE industry itself seems reasonably well placed, despite some near term concern over falling DRAM prices, because it is leveraged to global growth. The customer base, including the likes of Samsung Electronics and TSMC, remain financially quite robust. With Credit Saison and Sumitomo Chemical we have companies which have suffered short term setbacks for different reasons yet their competitive position has improved and growth prospects remain. Credit Saison is an interesting one because of the carnage caused by the government's illogical clamp down on money lenders. Essentially the government has adopted a heavy handed approach in setting interest rates, which is leading to a severe credit crunch and weeding out the weaker players. In time, Credit Saison (which has a strong franchise amongst the higher income spenders) should consolidate its position and it is a reality that Japanese spending on credit cards remains in a structural uptrend.

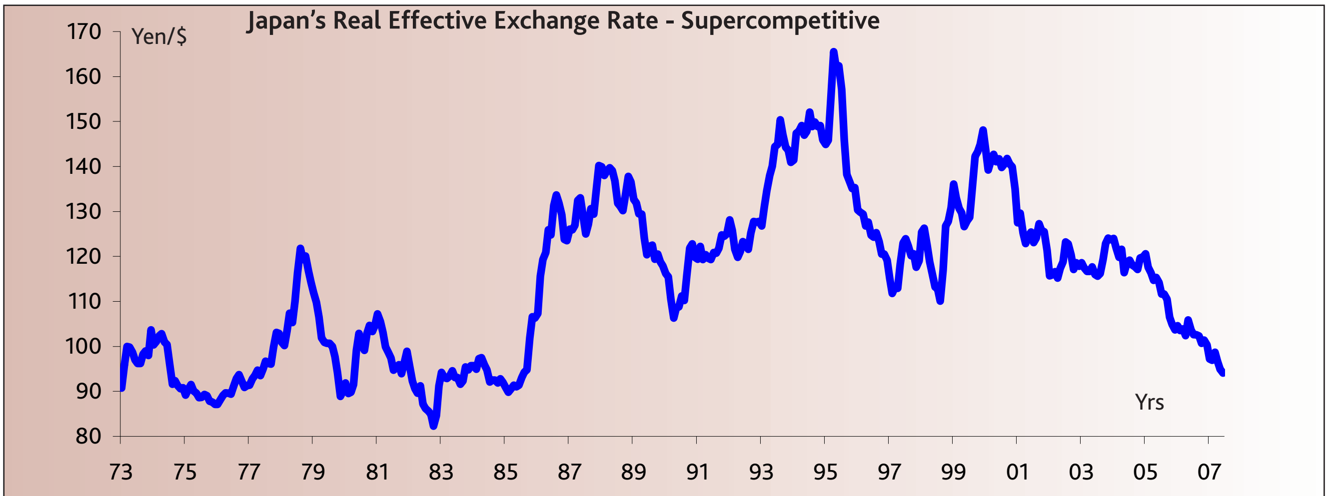
These purchases were funded by a combination of running down cash and selling of core positions with the result that the Fund was fairly fully invested at quarter end. This reflects our view that in the short term Japan seems poised for a move higher. The decision was taken to sell our positions in Mitsubishi Heavy and Sony both of which had been very good performers for the Fund. Additionally there was a continued reduction in the Korean exposure towards the eventual goal of zero weighting in line with the changing relative values of the two markets.

COMMENTARY

A new national sport – yield chasing!

Last quarter we spoke of the surge of outward Japanese investment in search of yield. What we failed to communicate fully was the extent of this activity. It is clearly becoming the "sport" of choice amongst local investors with approximately $US20bn per month of outflows dwarfing inflows from the current account surplus of about $US12bn per month. Initially this money found its way into such high quality investments as Indian stocks and Australian and NZ dollars. Being bored with this they have now moved onto Chinese stocks as well as minor currencies such as the South African Rand, Turkish Lira and Icelandic Krona! Lately they have arrived in Oman with the Omani Rial being played on thin spreads over $US interest rates (due to a currency peg) but with 50x leverage employed.

Our inherent conservatism makes us question the fervour with which "uneducated" investors are chasing these apparent risk free returns, because they are not without risk. History is littered with examples of these spread games being played. Long Term Capital Management springs to mind, where the game works very well until there is a discontinuity, most likely to be in the form of higher global interest rates. Yet timing is everything in the short run and with Japanese investors seemingly early on in their discovery of foreign currencies and having about 2% of their assets offshore there is potentially a long way to go. Perhaps more importantly what does this mania tell us about Japan? On the one hand animal spirits have returned to the Japanese investor which must be seen as a good thing. But on the other, he shuns the returns from his own markets. Is this telling us something about Japan, or is it just a phase as his risk appetite awakens? We think it is probably the latter.

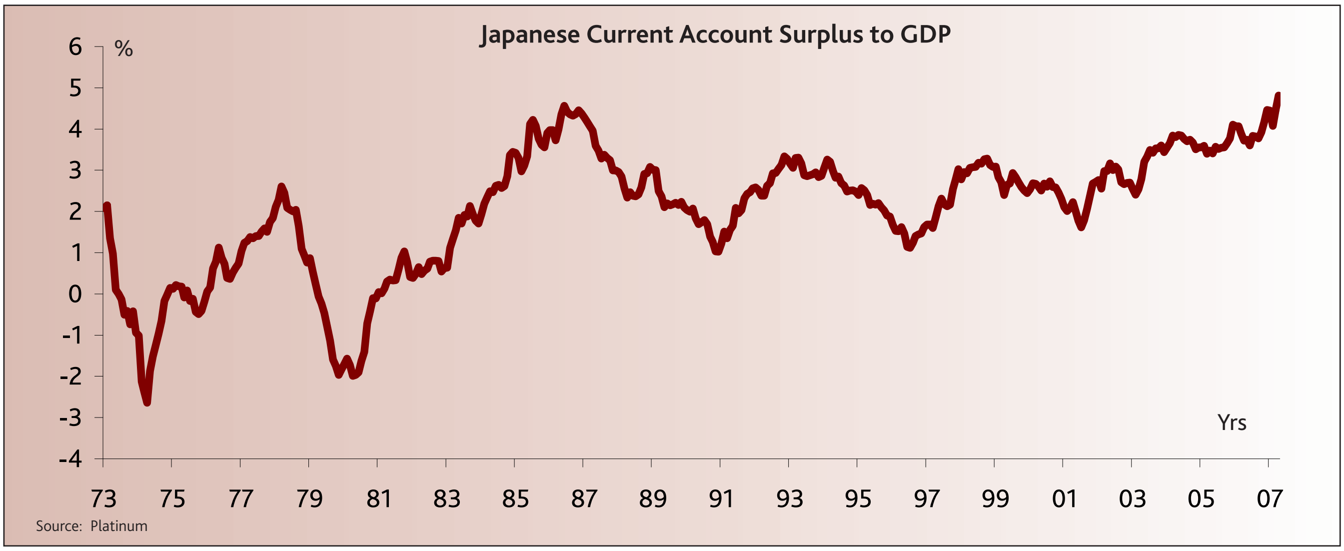


Source: Bank of Japan

On the surface the problem with the Japanese stock market appears evident. Whilst Japanese economic growth is doing well and corporate profits have never been better, companies are not recycling those profits to individuals through either wages or shareholder payouts. In turn Japanese domestic investors, despite being more confident about the employment situation, still suffer from low interest rates and stagnant wages and so feel less confident in terms of borrowing to invest in risk assets. Rather they have chosen to convert a portion of their fixed bank deposits to foreign currency to supplement income. In a real sense this mentality is very much consistent with the early stages of recovery for a patient that has been on the critical list for some time and we should not be totally surprised by it. If you examine market recoveries from deep depressions it is quite common to find a relatively long period of backfilling as investors question the sustainability of the advance in light of their recent memory!

The charts we have presented really highlight the fact that rarely has Japan been a more competitive country with surpluses continuing to build and growth which does not pale compared to the US or Europe. So with the growth fundamentals appearing solid, what is going to shift in order to make individuals come back to their own market? Clearly it must be an improvement in local return prospects either via a rise in interest rates, recognition of the improving returns companies are providing to shareholders, or a large, hostile takeover attempt which will force companies to change their attitude. While we are generally moving in a forward direction on these issues, very recently the courts and various annual meetings of companies have tended to uphold the approach of companies to implement poison pills to protect latent assets. This is yet another setback which is unlikely to embolden foreigners especially with the returns on offer across the seas in China! Elsewhere and perhaps more importantly, the BOJ is making increasing noises about getting on with the job of raising rates which would be a very big positive development if they are "allowed" to do so.

If all looks solid for now on the economic front, is it possible that the Japanese investor is alerting us to something under the surface? Clearly politics will be an unfavourable feature of the market but this seems well understood. It is even possible that we may lose Abe as he falls on his sword after the election to take responsibility. More importantly perhaps we should look to the way the authorities (BOJ and MOF) deal over the next two years with the looming maturities of short term government debt which amounts to about



100% of GDP. Will the Japanese investor be prepared to roll this debt over at the current one year interest rates of 0.8%? The answer is probably yes but what if the current weakness of the yen is really a recognition by the individual that because of this high level of government debt the BOJ is effectively prevented from raising rates sharply and that therefore the currency is a "one way trade". In this scenario the weakness of the yen could snowball causing clumsy policy responses that smack of desperation. There is a hint of this possibility in interference by the MOF in recent BOJ policy setting as well as hints at FX intervention. Our view is that proactive BOJ action on this score could help alleviate the issue by presenting higher rates as a gift to consumers rather than being forced into such a solution. Interesting times are ahead as inevitably markets test the resolve of the authorities.

OUTLOOK

Whilst we share the frustration of many investors with the performance of the Japanese stock market there are some signs of an improvement. The indices appear to be testing the upside of recent trading ranges despite continued redemption selling from the hedge fund community, and small stocks, a bell weather of local sentiment, are starting to outperform larger stocks. Additionally the yen seems to have found a base at least for the time being. Further out the real issue for Japan remains the confidence of the local investors to play in their own market instead of overseas but with corporate attitudes still miserly in their approach to rewarding shareholders it is likely to be a slow process save for some catalyst such as could be provided by a successful hostile takeover. If that all sounds like too much for readers to bear we leave you with a reminder of our experience in Germany which experienced similar disinterest from domestic investors only to see them eventually return and bid stocks to record levels as confidence in the domestic situation finally filtered through. The Japanese market seems to be taking a similar path.