Platinum Japan Fund

Jacob Mitchell Portfolio Manager

Disposition of Assets

REGION	SEP 2010	JUN 2010
Japan	88%	87%
Korea	7%	5%
Cash	5%	8%
Shorts	14%	25%

The Fund also has a 12% short position in Japanese Government Bonds.

Source: Platinum

Portfolio Position

Changes in quarterly portfolio composition:

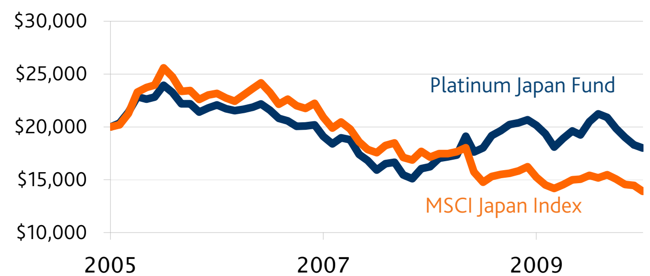
Sector Breakdown

SECTOR	SEP 2010	JUN 2010
DOMESTIC	47%	52%
Retail and Services	15%	16%
Financials	14%	14%
Telco, IT and Internet	13%	14%
Real Estate and Construction	5%	8%
EXPORT	48%	40%
Tech/Capital Equipment	19%	17%
Commodities	9%	9%
Alternative Energy	8%	8%
Autos and Machinery	12%	6%
Gross Long	95%	92%

Source: Platinum

Value of $20,000 Invested Over Five Years

30 September 2005 to 30 September 2010



Source: Platinum and MSCI. Refer to Note 2, page6.

Performance

Over the past 12 months the Fund fell 10.7%, underperforming the MSCI Japan Index (A$) benchmark by 2%, and over the past quarter the Fund fell 9.4%, underperforming the benchmark by 1.7%. For the quarter the benchmark fell 7.7% in A$ terms and 0.1% in Yen terms.

Currencies continue to play a heavy role in markets. The US dollar counter-rally triggered when Greece's sovereign issues went front page in April, proved short-lived. For the moment, the European Central Bank (ECB) has restored some semblance of order without resorting to significant new asset purchases allowing the "macro" crowd to refocus on the US debt sustainability issue. As readers would be aware, the US dollar is now depreciating against almost all currencies. Hence, whilst the Yen continues to appreciate against the US dollar, 5% for the quarter, at least the currencies of most of its export competitors are now appreciating alongside it (ie. for the quarter, the Korean won and Euro appreciated 1.2% and 5.2% respectively against the Yen). However, these small moves make little difference in the context of how overvalued the Yen remains and this is impeding Japan's export performance. Unsurprisingly, the Japanese Topix Index remains anchored to the low-end of the post March 2009 trading range.

There were few places to hide with both domestic/export sectors and defensives/cyclicals declining. Sector and stock price correlation within the market remains very high reflecting a fairly indiscriminate liquidation of Japanese equities as investors allocate assets to outperforming emerging markets (in A$ terms over last 12 months, emerging markets have outperformed developed markets by 12.3%). Hence, in regard to quarterly performance attribution, outside of some very specific mid-cap stocks, our longs tracked the market, whilst our shorts cost money and currency was neutral.

In terms of the nine months year-to-date attribution relative to the benchmark (the Fund -4.9%, benchmark -4.4%), being less than fully exposed to the Yen has cost 3.4%, stock and index shorts cost 1.2%, the Japanese Government Bonds short cost 0.5% and we were just above break-even on our longs ie. our longs outperformed by 4.6%. Importantly, towards the end of the quarter the trade weighted Yen finally started to weaken – the biggest drag on our portfolio may be starting to unwind.

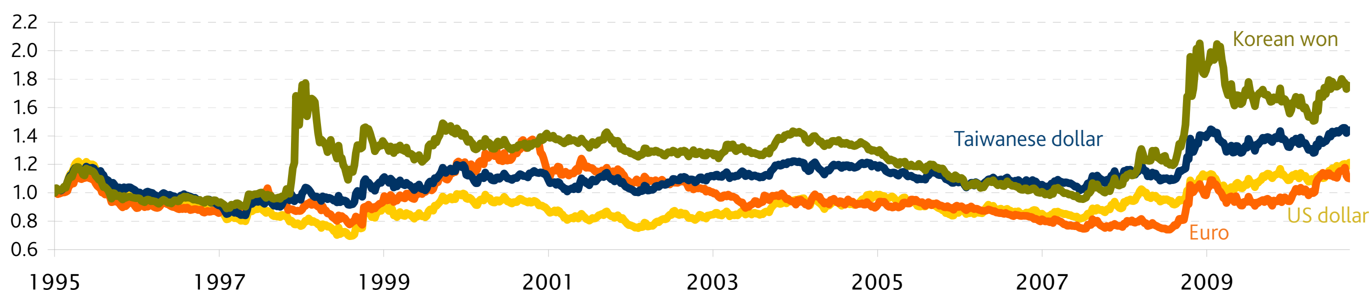
Changes to the Portfolio

Long Positions

We reduced domestic holdings in preference for more interesting export stories as the strong Yen (especially against the Euro) provided an attractive entry point to some thematically appealing global leaders. In total, we cut domestic exposure by 5.6% (eg. outright sales of Daiwa Securities and Sekisui House) and increased export exposure by around 8% including the addition of NGK Insulator and Kubota.

NGK Insulator is a company with a 100-year history in fine ceramic materials that has deftly applied this artisanal

Japanese Yen Indexed to Currencies of Major Export Competitors



Source: Factset

knowledge to industrial applications. There are two areas of particular interest to us - exhaust filter substrates for vehicles and sodium-sulphur (NAS) batteries, which may play an important role in solving the electrical grid storage problem.

Ceramic material is notoriously hard to work with. Not only does the subtle blend of ingredients affect its characteristics, so too do particle sizes and consistency of firing. Compounding this is the very harsh operating environments the end products are expected to operate in. The result is a situation where just two or three companies globally supply the entire automotive industry for catalytic converter and exhaust filter substrates.

Whilst the Western car market remains depressed, the trend towards tighter emission standards, not only in Western markets but in emerging markets such as China and Brazil, works in the company's favour. Emission standards are also being tightened for much larger vehicles such as trucks, agricultural and construction equipment. While in exhaust filter unit terms, the three million or so trucks/heavy machinery sold globally are only a fraction of the 70 million cars sold, it represents a largely untapped market and the very large engine displacements mean unit prices can easily be many multiples of a passenger vehicle. We think that the market for these exhaust filter substrates can potentially grow from $1.5 billion today to US$4 billion over the next five years and that NGK might reasonably expect to capture 40-50% of that.

The other opportunity is not as easily quantifiable but exciting nonetheless. NGK has used its ceramic material technology to develop what is essentially a very large rechargeable battery that can be used to store electricity on a grid scale. It has the potential to store wind and solar energy for use in peak demand periods or to make existing grids more reliable and efficient. Grid storage is in some ways the holy grail of electricity transmission and as such there are many lofty claims being made, but we put more faith in NGK largely because it's shipping commercial systems today. The stock became a hot story in 2009 when the company received a rash of large NAS battery orders (and we successfully shorted the over-hyped valuation) but has now returned to an attractive valuation as the hype has moved elsewhere (ie. outside Japan).

Now turning to Kubota and what on the surface looks like a boring manufacturer of small farm machinery. In the US and locally, the company is well-known for its strong position in the hobby farm/recreational segment selling small tractors/lawn movers and excavators – a segment that has been hit hard by the US housing wreck. Possibly, less well-understood, is its strong position in the high growth Asian small tractor, rice planting/harvesting machinery market. Asian agriculture has features that play to Kubota's strengths. Wet paddy farming is the predominant rice farming method throughout Asia and it requires very light equipment that is also reliable while working in mud and/or water for many months of the year.

Japanese demand for agricultural machinery boomed in the late 1960s, early 1970s for two principal reasons:

- Due to shortages, global agricultural commodity prices rose, driving-up farm income and new equipment purchases.
- Japanese industrialisation and urbanisation reduced agricultural labour surpluses (the young workers move to the city for higher wages) forcing farm labour productivity via mechanisation.

From our work back in 2005 on the global grain/cereal market, we know global food inventories remain tight. To a certain extent, low inventory just reflects the modernisation of the farming supply chain; however, it also reflects the growing affluence of the six billion people living in developing countries and the fundamental shortage of arable land relative to this population base. Accordingly, any weather or politically inspired supply chain disruption has the potential to feed into much higher commodity prices.

China may be on the cusp of an agricultural machinery boom similar to that experienced by Japan 40 years ago. That is, urbanisation levels are similar to Japan's (40 years ago) and industrial wage growth is accelerating, a function of government directives to lift minimum wages and a diminishing surplus of rural labour. But rather than an absolute shortage of workers, the real issue in China is a very low level of agricultural productivity and, hence, the government is encouraging higher levels of mechanisation as both an enhancement to farmer "quality of life" and to free-up labour resources for industrial jobs.

Japan is a relatively small rice producer with only 1.7 million ha of land under cultivation compared with Thailand (Kubota's largest Asian ex-Japan market) at 10 million ha and China at 28 million ha. In the 1960-70s, Japanese growth rates of rice planter and combined sales averaged 30-75% pa ie. rice planter sales went from 20k units in 1968 to 350k in 1974. If China is close to a Japan-like inflection point, then over the next five or so years the Chinese rice machinery market could expand five-fold to over $3 billion in sales. For market leader Kubota, this is a sizable opportunity given its total global machinery business has sales of around $6 billion. The US housing wreck and strong Yen has provided the opportunity to buy Kubota at an attractive valuation as we are paying very little for a claim on potential rapid Asian agricultural mechanisation.

Short Positions

We reduced our total short position from 25% to 14% by closing winners such as Samsung Electro-mechanics (falling as the LED mania cooled in the face of looming over-supply), GS Yuasa, Komatsu and Nidec (all hit by the strong Yen), and reducing positions where our thesis has proven mistimed (Hyundai Steel, Hyundai Motors, Sysmex and the Korean Kospi index). Whilst it was a poor quarter for our shorts, in different market conditions, shorting has added considerable performance to the Fund.

Currencies

After adding considerable value in calendar year 2009 (roughly 9%), our 2010 currency positioning has been less than optimal. However, we have invested considerable effort over the last 12 months improving our currency framework and remain convinced that whilst our timing has been off, that the Yen is significantly over-valued and that it makes sense to own currencies such the Australian dollar, Korean won and Taiwanese dollar as alternatives (our reasoning for this can be found in the current Platinum International and Platinum Unhedged reports). Hence, over the quarter our holdings of these three currencies increased from 29% to 47%, largely at the expense of the Yen.

Commentary and Outlook

It remains a dull fact that developed markets, including Japan, remain currency and policy driven.

In late September, there was some excitement as the Ministry of Finance (MOF) spent $25 billion "intervening" in the currency – the effect lasted a few days with the Yen weakening from Y83 to Y86, before promptly returning to Y83. Leaving the fishing boat incident aside, the final straw would seem to have been China's continuing accumulation of the Yen as part of its diversification of foreign reserves away from the US dollar (as at July roughly $27 billion in total, buying the Yen at a rate of around $5 billion per month). As a mercantilist country competing against China, Japan has no interest in the Yen becoming a reserve currency for China. The MOF's decision to start selling the Yen against the US dollar marks the first skirmish of what will likely be a prolonged currency war, where the real objective is to devalue the Yen against its major Asian trade competitors that remain largely US dollar pegged ie. China, South Korea and Taiwan.

In early October, the Bank of Japan (BOJ) also created some excitement by announcing an additional asset buying program worth up to ¥5 trillion, or 1% of GDP or a 4% expansion of the BOJ's balance sheet. Importantly, they will target assets other than Japanese Government Bonds, a necessary first step to ultimately adopting an inflation targeting regime that focuses on restoring a yield curve and risk appetite. Whilst these measures help, they do not address the fundamental problem of Japan's lack of structural reform, and in a monetary sense, are equivalent to using a pop-gun to bring down a bull elephant (the Federal Reserves active policy of devaluing the US dollar and the inherent inconsistency the Chinese remaining ostensibly pegged to the US dollar, though diversifying reserves away from the US dollar).

The third source of excitement was Ozawa's challenge against Kan for the Prime Ministership. Even though crusty old Ozawa lost the challenge, his faction remains at war with Kan, splitting the parliamentary party down the middle. Under indictment for certain "questionable" deals, Ozawa is fighting for survival. In itself, this is not interesting. What is interesting, is the rising influence of a new party, "mina-no-to" ie. "Your Party". Whilst their presence in the Parliament is minor (5/480 seats Lower House and 11/242 seats Upper House), they hold the Upper House balance of power and the minimum 10 seats required to introduce legislation. Your Party has heavy-weight leadership and a well-articulated policy platform, the over-riding goal of which is to end deflation and reduce debt to GDP ratios. This will be done via high nominal GDP growth by cutting corporate taxes (to aid competitiveness), deregulation, privatisation, and more importantly, changing the BOJ law to force the Central Bank to target a specific inflation rate ie. buy assets (public and private) and weaken the currency until structural inflation re-emerges. Fiscal consolidation via a consumption tax hike would be deferred until after nominal growth had been kick-started. For the policy free zone of Japanese politics this is radical stuff, a frontal assault on the bureaucratic status quo.

Whilst we are a long-way from the wholesale adoption of the "Your Party" policy manifesto, this month the party plans to introduce a bill that will require the BOJ to actively pursue policies to end deflation and then the question becomes "will the Democratic Party of Japan (or the Liberal Democratic Party + DPJ rebels) support the bill, if only to marginalise the new upstart by co-opting its policies"? We are following this closely as we see pro-reform Koizumi's resounding win in the 2005 Postal Reform election as a key catalyst for Japan's 2005-2006 brief return to global stock market relevance.

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$20,000 invested in the relevant Fund over five years from 30 September 2005 to 30 September 2010 relative to their Index (in A$) 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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