Platinum Japan Fund

Jacob Mitchell Portfolio Manager

Disposition of Assets

REGION	SEP 2012	JUN 2012
Japan	88%	89%
Korea	5%	4%
Cash	7%	7%
Shorts	8%	8%

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

Source: Platinum

Portfolio Position

Changes in the quarterly long portfolio composition:

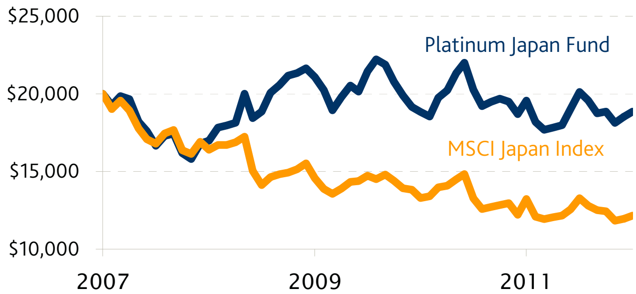
Sector Breakdown

SECTOR	SEP 2012	JUN 2012
DOMESTIC	53%	52%
Retail and Services	21%	19%
Financials	12%	14%
Telco, IT and Internet	12%	12%
Real Estate and Construction	8%	7%
EXPORT	40%	41%
Tech/Capital Equipment	18%	19%
Autos and Machinery	16%	16%
Alternative Energy	4%	5%
Commodities	2%	1%
Gross Long	93%	93%

Source: Platinum

Value of $20,000 Invested Over Five Years

30 September 2007 to 30 September 2012



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

Performance

Over the past 12 months the Fund fell 3.6%, outperforming the MSCI Japan Index (A$) benchmark by 4.5% and over the past quarter the Fund was flat versus a 2.3% decline in the benchmark. Our star performers comprised retail/consumer (PAL, Ain Pharmaciez, Ryohin Keikaku, Calbee), telecommunications/Internet (KDDI, So-Net Entertainment, Namco Bandai) and property sector exposures (Arnest One). The Fund's large financial and auto exposures tracked sideways. Most of the quarterly performance was generated by mid-capitalisation stocks; our large capitalisation holdings continue to languish.

So-Net was subject to a takeover offer from the major shareholder Sony Corporation at a +150% premium to our average acquisition price. We acquired our holding in early 2010 as the company was trading at a significant discount to underlying assets including strategic stakes in Internet gaming company Dena and online medical portal M3. As one of the few domestic Japanese merger and acquisition actions of the recent past, it was satisfying to be on the winning end of this transaction.

Over the past 12 months, on a common currency basis, the Japanese Index has underperformed the Global Index by a very large 21% and over the past ten years by 3.9% pa. In the short-term, one could attribute this to the troika of Great Tohoku Earthquake/Tsunami/Nuclear emergency, the Thai Floods (large base for outsourced manufacturing by Japanese corporates) and the rise in Sino-Nipponese tensions – and in this sense, it is difficult to imagine what could go wrong next. However, at a deeper level, the underperformance reflects longer-term issues that could be neatly described as the Japanese culture of inflexibility.

Whilst Japanese society may not be experiencing a crisis, Japanese manufacturing is, with the pain being felt by shareholders rather than employees. We see a common pattern across some of the major exporters of using balance sheets to absorb the pricing pressure created by the very strong currency i.e. extending more attractive working capital terms to keep their domestic supply chains afloat and maintain global market share via vendor finance. This is well illustrated by a cursory comparison of the working capital management of Hitachi Construction Machinery and Komatsu versus Caterpillar. From this already vulnerable position, the slow-down in Chinese infrastructure investment and the rise of regional tensions could not have happened at a worse time for the typical Japanese exporter.

The one part of industry that is on a different cycle is the auto sector where the rebound in Toyota's North American market share has happened against a backdrop of record low inventories (the direct result of the Great Tohoku Earthquake and Thai flood disruptions).

Changes to the Portfolio

Once again changes to the portfolio were minor in nature and our preference for owning the US dollar over the Yen also remains unchanged. Whilst additional easing from the Bank of Japan would accelerate Yen weakness, there is sufficient terms of trade headwinds and pressure on the domestic corporate earnings to support a gradual decline in the currency.

Commentary and Outlook

A relevant question for the remaining Japanese equity investor is: when does the manufacturing crisis transition to a social crisis and how will the political elite respond? As we have discussed in the past, it will take a rise in unemployment via the bankruptcy of a major industrial to trigger a realignment of interests in the favour of equity owners.

In this sense, the arrival of Hashimoto Toru, the current Mayor of Osaka City, on the national political scene has some interest. Hashimoto's landslide win for Osaka City mayor in November 2011, after resigning as the sitting Osaka Prefectural governor, was a key turning point, campaigning on the basis of electoral and administrative reform, smaller government and deregulation. Most would understand that Japan suffers from weak national governments, effectively run by bureaucrats since the departure of Koizumi in 2006. Unlike Prime Ministers, city and prefectural governors in Japan are directly elected by voters. Beginning with Ishihara in Tokyo in 1999, Japan has elected a string of populist governors, primarily running on anti-establishment platforms, tapping into dissatisfaction with national politics.

Until now, local and national politics have remained largely separate. However, Hashimoto is now in the process of launching a national party (Japan Restoration Party or JRP) based on similar policies to his existing Osaka based party (One Osaka Movement or OOM). Several sitting Diet members from other parties have defected to the JRP, allowing it to be officially recognised and thus able to receive public funds. JRP intends to field 300~350 candidates in the next lower and upper house election, which invest to be called before September 2013. Given the current dysfunctionality of the Democratic Party of Japan (DPJ) -led government, it is looking likely that an earlier election may be called.

JRP/OOM recently launched their policy platform, and has called it 'Senchu Hassaku'. This is deliberately named after a proclamation issued by Ryoma Sakamoto, a widely admired and key historical figure involved in the overthrow of the Tokugawa shogunate and the push to modernise Japan. The policy offers a radical, but sensible solution to Japan's stasis. The key points are set out below.

1. Abolish the Upper House of Japanese parliament.
2. Cut the number of Lower House seats by half to 240.
3. Implement direct elections for Prime Minster.
4. Cut Diet member donations and perks by 30%.
5. Put revision of Article 9 (i.e. the pacifist article) to a national referendum.
6. End reliance on nuclear power.
7. Shift away from central government power to 9~12 semi-autonomous regions.
8. Entry into the Trans-Pacific Partnership, a multilateral free trade agreement that claims to aim to further liberalise the economies of the Asia-Pacific region.
9. Increased control over bureaucratic appointments.
10. Simplified tax system based on flat tax principle.
11. Free market economy based on competition.
12. Industrial policy based on freedom to fail.

The above reads like a Thatcherite call to arms. There were similar hopes for reforms and change when the DPJ came into to power in 2009, benefiting from voter disappointment with the Liberal Democratic Party (LDP) after Koizumi. Fast forward to 2012 and the DPJ are now widely derided, having backtracked on nearly every electoral pledge they made.

Hashimoto has far more substance. Apart from the usual media hyperbole about his controversial statements, right wing stance etc there has been very little analysis of what he has achieved since becoming Osaka governor. This is because most of what he has done delves too deep into the structure of public finances to draw interest from the casual observer. His policy has focused on the elimination of administrative waste centering on the overlap between separate administrations of Osaka Prefecture, Osaka City, and neighbouring Sakai. Thus the push has been for the creation of a single Osaka prefecture, similar to Tokyo.

Because the nature of reform that is required in Japan is rather fundamental, it will be difficult to implement. JRP is unlikely to achieve an outright majority but a coalition or independent swing outcome is possible. The incumbent political, bureaucratic and business elite have much to lose from the rise of alternatives such as JRP. The question remains though, with unemployment low and the generation X and Y politically apathetic, where is the will for change? In the meantime, we will continue to hunt for interesting companies to add to our collection of undervalued opportunities.

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$20,000 invested in the relevant Fund over five years from 30 September 2007 to 30 September 2012 relative to their Index (in A$) 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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