

Platinum International Fund



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Performance

(compound pa, to 30 September 2015)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Int'l Fund	-3%	13%	22%	11%	13%
MSCI AC World Index	-1%	16%	22%	14%	6%

Source: Platinum and MSCI. Refer to Note 1, page 6.

Rather like a successful TV series, Game of Thrones comes to mind, stock markets keep churning through the same motions, yet in the excitement of the moment, every episode seems unique. In the last three months the tempo seemed to speed up with a procession of new actors.

Starting in June, the **bubble burst in the margin-assisted hysteria of the Chinese stock markets**. In its eagerness to use equity markets to assist in the refinancing of the state-owned enterprises (SOEs), the 'regulators' intervened with some profoundly silly tactics that allowed the canny to escape at the cost of those directed to support the market. As usual, this tended to drag out the adjustment in levels rather than arresting a natural clearing at lower prices.

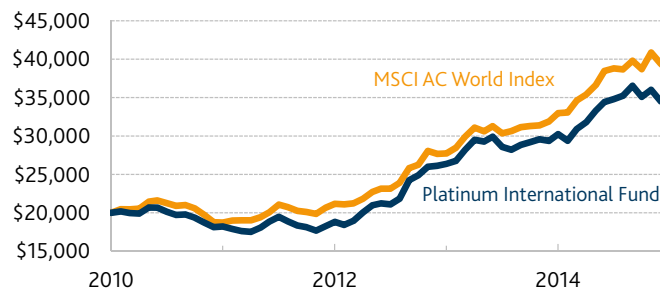
Disposition of Assets

REGION	SEP 2015	JUN 2015
Asia	32%	37%
Europe	23%	20%
North America	21%	20%
Japan	9%	11%
Russia	1%	1%
Australia	1%	1%
Cash	13%	10%
Shorts	-12%	-8%

Source: Platinum. Refer to Note 3, page 6.

Value of \$20,000 Invested Over Five Years

30 September 2010 to 30 September 2015



Source: Platinum and MSCI. Refer to Note 2, page 6.

The People's Bank of China (PBoC) nearly trumped this error when it notified the foreign exchange markets of a **change of policy in managing the price of the Renminbi** to more accurately reflect market forces. The relatively small devaluation and subsequent intervention confused most participants, particularly in the light of falling exchange reserves. **Capital flight** is evident, partly facilitated by the gradual opening of the country's capital account. This was significant to the extent that the market had come to believe that the role of strong currency was equally shared between the US dollar and the Renminbi and that without this linkage, there is a danger of China embarking on a competitive exchange rate-driven export push, to create further downward pressure on traded goods prices. All the while the economic indicators have flashed warnings of the difficulties facing the Chinese economy as it **transitions from investment to consumption** and services – a process made no easier by the **intensification of the anti-graft campaign and evidence of tightening credit conditions**.

The prospect of much lower growth emanating from China translated into **weak commodity prices and washed across the emerging markets**. Those that had done least with economic reforms (Brazil, Turkey and Russia) felt the full brunt of this wash-out, but Asia in general felt the chill from its powerful neighbour, and share prices have tumbled.

MSCI World Index Regional Performance (AUD)

REGION	QUARTER	1 YEAR
Developed Markets	0%	18%
Emerging Markets	-10%	1%
United States	2%	23%
Europe	0%	12%
Germany	-2%	13%
France	2%	15%
United Kingdom	-2%	10%
Japan	-3%	22%
Asia ex Japan	-9%	9%
China	-15%	18%
Hong Kong	-8%	21%
Korea	-3%	2%
India	2%	17%
Australia	-7%	-2%

Source: MSCI

The developed markets were not immune to this unfolding scene, with the added drama of the **Greek election and subsequent debt bail-out**, and the **refugee influx** as a consequence of the turmoil in the Middle East. In the US, the realisation spread as to the effect of weaker world growth with manufacturing companies selling off hard and some announcements of down-sizing. There was also evidence of **money leaving equities** as crowded trades, such as biotechs, unwound at extremely high valuations. In addition, the loss of foreign exchange reserves by central banks in the Middle East and other commodity-dependent countries saw redemptions of bond and equity holdings, adding to the selling pressure. As the quarter came to a close, the US Federal Reserve chose to defer raising interest rates and there was fallout from the Volkswagen emissions test trickery and Glencore's high leverage in a commodity-glutted world. The summary of this three-month drama is shown in the tables below.

With our large exposure to Asia, we have suffered from this repricing, though we did raise cash earlier in the quarter and also augmented our short positions. Even so, the low exposure to the strongest market, the US, has taken its toll on our relative performance. Compared to the returns from the MSCI AC World Index (A\$) of 16.3% for 12 months and -0.9% for three months, the Fund has lagged at respectively 13.1% and -2.5%.

MSCI World Index Sector Performance (AUD)

SECTOR	QUARTER	1 YEAR
Utilities	7%	17%
Consumer Staples	7%	28%
Information Technology	2%	23%
Consumer Discretionary	2%	30%
Health Care	-1%	28%
Industrials	-1%	15%
Telecommunication Services	-1%	14%
Financials	-3%	15%
Energy	-11%	-18%
Materials	-12%	-5%

Source: MSCI

Currency

Our exposure to the US dollar has risen as we entered hedges against the Chinese Renminbi. However, we have increased our position in Euros and have partly removed hedges on the Yen. In summary, the key exposures are as follows:

CURRENCY	SEP 2015
US dollar (USD)	77%
Hong Kong dollar (HKD)	7%
Indian rupee (INR)	6%
Euro (EUR)	5%
Norwegian krone (NOK)	4%
Japanese yen (JPY)	3%
Pound sterling (GBP)	3%
Swedish krona (SEK)	2%
Australian dollar (AUD)	2%
Swiss franc (CHF)	2%
Korean won (KRW)	2%
Canadian dollar (CAD)	1%
Chinese Renminbi Offshore (CNH)	-7%
Chinese Renminbi (CNY)	-7%

Source: Platinum

Shorting

We came and went on shorting the German DAX and the Nikkei Index of Japan through the quarter and ended with a position of shorting the S&P 500, the Russell 2000 and the Nikkei with respectively -6%, -3% and -2%.

Changes to the Portfolio

Concerns regarding policy errors (bungling of stock and foreign exchange market interventions) caused us to reduce several of our Chinese positions and to sell most of **Ping An Insurance**, **China Life** and **Gree**. At low valuations this is always difficult, but given the cross currents within the Chinese market, it is believed to be prudent. We were also active in Japan where a gush of hot foreign buying caused us to reduce **Mitsubishi Heavy Industries** and remove **Hitachi** early in the quarter, notwithstanding their reform credentials. We also sold **Denso**, a long-standing and highly profitable holding at good prices, as the auto market seems over-owned. Likewise, we cut **Toyota Industries** after a strong run while selling **Fujitsu** at a loss. The latter is further behind the reform curve than we had understood and more down-sizing is required.

The divergence of stock prices within related industries gave some interesting opportunities to swap holdings: we re-introduced **Oracle** and added opportunistically to **Ericsson** in exchange for some **Intel**, **Cisco** and most of the holding in **Ciena**; added **Roche** and **Fresenius** and more to **AstraZeneca** at the expense of **Novartis**, **Qiagen** and **Daiichi Sankyo**; and added to **Corning** while cutting **Asahi Glass** which had run ahead of itself on good results. Among the Internet names we initiated a position in **PayPal** and added to **Tencent** after its recent fall.

Lloyds Banking Group has been languishing for the last two years as it has acknowledged and paid the price (with some £13 billion set aside) for mis-selling certain payment protection insurance (PPI) products. This is a company we bought in the dark days following the Global Financial Crisis (GFC) and subsequently sold on a re-rating. But its time may have come again as all its operating ratios have returned to that of a prosperous, well-financed and significant financial intermediary¹. The concerns now are whether it can grow much and where the business will go from here. These are indeed real issues as historically banks have a tendency to 'divorsify' when they run out of growth. We acknowledge this as an issue as indeed is the threat of the UK leaving the European Union.

However, the British economy is growing, lending is rising and, importantly, non-performing assets keep shrinking. There is a **very high likelihood** that Lloyds will earn 9 pence a share in the years ahead and management has been very clear that much of this will be paid out as dividends. Banks are particularly susceptible to inflation and if indeed it remains low, a leading bank, representing some 20% of the system, yielding say 8% on our entry price of under 75 pence, will attract a horde of new owners now that Lloyds has begun to pay dividends and the UK Government's holding is all but sold back into private hands.

¹ Risk weighted tier 1 equity 13.3% (7.6% at 12/2011). Loan to deposit ratio 109% (135% at 12/2011). Loan to value of mortgage book 46% (56.4% at 12/2012). Impaired loan ratio 2.7% (10.1% at 12/2011). Net interest margin targeting 2.6% for 2015. Best in class cost to income ratio of 48% (versus competitors at 56% to 67%). Return on equity 16.2% (9.7% at 12/2013). Active digital users 11 million, with 6 million on mobiles (compared to 6.8 million in total in 12/2010).

Commentary

Having side-stepped earlier challenges so adroitly, it has come as a surprise how poorly the Chinese Government has dealt with the stock market wash-out (and indeed the rampaging margin lending that preceded it) and the realignment of the Renminbi. The *schadenfreude* displayed by some commentators should be examined against the proportion of world growth that has emanated from China since the Lehman melt-down – nearly 60%.

As time passes, it will become clearer as to the effect of the officially sponsored doubling of bank credit that occurred from 2009 to 2011 in response to the threat that 20 to 30 million 'migrant workers' might lose their jobs. In retrospect, we may believe that there was an over-shoot of growth that tricked commodity producers and investors into believing that the growth trajectory of China was steeper and longer than was plausible. By way of illustration, in 2008 China produced 502 million tonnes (mt) of steel, five times more than the USA. We in Australia celebrated this as the entrée to the feast that would follow, as indeed it did with a new record being achieved in 2014 at 823 mt. Had it grown from this 502 mt base by, say, 6% (its average rate of growth in the late 1990s) and a level that would have represented about twice the world's economic growth rate, production would now be of the order of 712 mt. This figure incidentally broadly corresponds with current domestic consumption with a surplus of some 100 mt now flooding out of China as direct exports.

The same pattern of over-abundance occurred across many industries: cement, glass, heavy trucks and earth moving equipment. In most cases, China had reached the exalted position of being responsible for manufacturing almost half of the world's output of these products. Consolidation and restructuring of ownership and capacity seems inevitable as losses, by the least efficient, mount.

Apart from the drag this will impose on Chinese growth, there are also implications for the banking sector. From a starting point of US\$9 trillion of assets controlled by the banks at the end of 2008, this figure is likely to pass US\$30 trillion (CNY192 trillion) by year end! Autonomous Research has tried to assess the degree of over-lending by comparing the historic increase of GDP associated with a measure of credit growth. Their calculations suggest that the **excess (unproductive) credit granted from 2008 to 2015 was in the order of CNY73 trillion (US\$11.4 trillion)**. When they then compare the experiences of other countries that have experienced credit boom and busts², they conclude that banks could incur losses of 45% of their share of *excess credit granted* to non-government and central SOEs. This translates into possible losses of CNY24 trillion (US\$4 trillion) for the banks and nonbanks, or 14% of total 2015 outstanding credit, in an US\$11 trillion economy!

While one can envisage interest rates coming down and the amount of reserves held by banks (the so-called reserve requirement ratio) also dropping from the current level of 18%, the environment of deteriorating credit will likely

2 Excess credit and loss experience across countries

Country	Credit/GDP			Excess credit			Bank losses as % of banks' excess credit
	Start	End	Change	% Credit lent in boom	% Total credit o/w banks' share		
Mexico, 88-94	14%	38%	24pp	49%	34%	28pp	77%
Norway, 85-90	114%	134%	20pp	42%	16%	7p	70%
Korea, 92-98	126%	166%	40pp	41%	24%	20pp	*50%
Sweden, 85-90	119%	175%	56pp	42%	24%	18pp	34%
US, 00-07	168%	207%	39pp	58%	25%	8pp	31%
Japan, 85-97	181%	240%	60pp	45%	24%	11pp	67%
Greece, 00-08	54%	118%	64pp	81%	59%	55pp	**44%
Spain, 02-07	118%	207%	89pp	75%	50%	40pp	33%
Ireland, 00-07	137%	222%	85pp	78%	50%	38pp	52%
Portugal, 96-07	104%	193%	89pp	83%	60%	45pp	24%
Thailand, 89-97	59%	174%	114pp	81%	70%	66pp	*32%
Average				60%	40%	31pp	47%

Source: Bank for International Settlements, International Monetary Fund, bank financial statements, local regulators, Autonomous Research.

* Figures represent total financial institution losses as a share of total excess credit.

** Revised up from 27% in July 2015.

impede the willingness of banks to expand credit. There are other options open to the Chinese Government, but the lesson from Japan was that 'extend and pretend' is not the answer.

With world trade barely growing in volume terms, there is pressure on prices as firms **intensify their hunt for foreign sales opportunities to take care of their surplus capacity**. Does this now bring the long-standing trend of **rising profits that accrue to capital to an inflexion point**? Having long obsessed about this – too early as usual – we suspect this is now in the offing, slow growth globally being an important contributor to pressure on prices and hence profits.

None of this is very helpful at a stock-picking level other than to caution one to build in greater variances for those businesses exposed to recent investment binges. At the country level, there is the cross-play of the disruption of the Internet and e-commerce, and in the case of China, the extra dimension of a country re-aligning its economy away from fixed investment towards services and the consumer. In an environment of low inflation where incomes are rising, the prospects for consumer-focused companies are still favourable. The art is to correctly price each individual opportunity.

Outlook

As the quarter came to a close, one could observe the concerns emanating from the realisation that China was no longer the reliable growth locomotive it once was. However, share prices have adjusted fiercely in the case of cyclical and the emerging markets. There have been massive outflows from emerging markets since July, around US\$45 billion, of which about 40% came out of Hong Kong and China. We cannot know whether they have reached a bottom, but we do know that the markets are no longer presuming the best of outcomes and the fierceness of the sell-off of highly cyclical stocks and commodities world-wide **looks very much like capitulation of a bear trend**.

We are pleased with the buying opportunities the sell-off has given us and feel confident that the portfolio is well balanced for the months ahead. (Subsequent to month end, we have reduced the shorts further.)

Notes

- The investment returns are calculated using the relevant 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: 28 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

(NB: The gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist.)

- The investment returns depicted in this graph are cumulative on A\$20,000 invested in the relevant Fund over five years from 30 September 2010 to 30 September 2015 relative to its benchmark 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

The investment returns are calculated using the relevant 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 benchmark 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.

- Invested position represents the exposure of physical holdings and long stock derivatives.

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