

Platinum International Fund



Kerr Neilson Portfolio Manager



Andrew Clifford Portfolio Manager

Disposition of Assets

REGION	DEC 2016	SEP 2016	DEC 2015
Asia	32%	34%	32%
Europe	22%	20%	20%
North America	21%	24%	21%
Japan	13%	13%	10%
Australia	1%	1%	1%
Russia	1%	1%	1%
Cash	10%	7%	15%
Shorts	-16%	-15%	-11%

Source: Platinum. Refer to note 3, page .

For further details of the Fund's invested positions, including country and industry breakdowns as well as currency exposures, updated monthly, please visit <https://www.platinum.com.au/fund-updates/#MonthlyUpdatesForThePlatinumTrustFunds>.

Performance

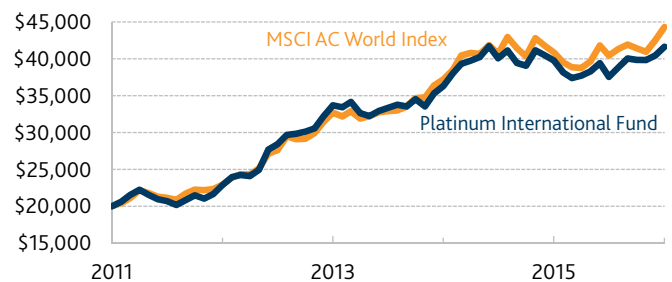
(compound pa, to 31 December 2016)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Int'l Fund	4%	5%	7%	16%	13%
MSCI AC World Index	7%	8%	11%	17%	6%

Source: Platinum and MSCI. Refer to note 1, page .

Value of \$20,000 Invested Over Five Years

31 December 2011 to 31 December 2016



Source: Platinum and MSCI. Refer to note 2, page .

Top 10 Holdings

STOCK	COUNTRY	INDUSTRY	WEIGHT
Samsung Electronics	Korea	IT	3.5%
Alphabet Inc	USA	IT	3.2%
Tencent Holdings	China Ex PRC	IT	2.4%
Sanofi SA	France	Health Care	2.4%
PICC Property & Casualty Co	China Ex PRC	Financials	2.2%
AstraZeneca Plc	UK	Health Care	2.1%
Lixil Group Corporation	Japan	Industrials	2.0%
Intesa Sanpaolo SpA	Italy	Financials	2.0%
KB Financial Group	Korea	Financials	1.9%
Baidu.com	China Ex PRC	IT	1.9%

Source: Platinum. Refer to note 4, page .

It has been a highly eventful quarter. Matters that received the most attention in the world press were the **unorthodox election campaign of Donald Trump** and his subsequent win, the tragic **loss of civilian lives in Syria**, and the protracted negotiations among **OPEC members** and their subsequent agreement, which was reinforced later by promises of **production cuts** by some non-OPEC countries. This is the first time the Organization of the Petroleum Exporting Countries (OPEC) agreed to cut production since December 2008.

The other surprise was the decision of Prime Minister Modi of **India to suspend the convertibility of higher value Rupee notes**. The abruptness of the decision, driven by concerns about the black economy, counterfeiting and vote-buying in upcoming elections, has caused its fair share of disruption, but could carry the longer-term benefits of greater tax compliance, albeit perhaps at the cost of yet more delays in the implementation of the newly passed goods and services tax (GST) legislation. Lastly, concerns around **the Italian referendum and bank solvency turned out to be a damp squib** with Prime Minister Renzi resigning when the motion was defeated, and the stock market recovered!

Behind these headlines there is **clear evidence of improving economic activity almost across the globe**. This has somewhat diminished concerns around deflation, as has been

reflected in bond yields finally starting to rise, with the US 10-Year Treasury yield moving from 1.6% at the beginning of the quarter to 2.5%. Similarly, German 10-Year Bunds moved from -0.10% to 0.3%, somewhat retarded by aggressive buying by the European Central Bank (ECB) as part of its ongoing quantitative easing (QE) program. Even in Japan, where the Bank of Japan's intervention has been very determined, bonds have weakened in price and yields have risen, indicating perhaps a return of price stability or even mild inflation.

On the back of higher yields and the expectations of potential tax reform that would benefit US domestic production over imports, the **US dollar is seen as a big beneficiary**. The US Dollar Index (DXY) has strengthened by 7% from the beginning of the quarter, or 6% since the presidential election took place in early November. Commodities have also been running strongly on the back of speculative price action, but this is now slowly subsiding.

In **China**, the work by the government to rebalance the economy continues. **Economic activity has been accelerating resolutely**, but there has been no let-up in the loss of foreign exchange reserves as the Chinese government intervenes to guide the glide of the Renminbi downwards against a basket of currencies that themselves have been weak against the US dollar. Expatriating funds has become

MSCI World Index Regional Performance (AUD)

REGION	QUARTER	1 YEAR
Developed Markets	8%	8%
Emerging Markets	1%	12%
United States	9%	11%
Europe	6%	1%
Germany	7%	3%
France	9%	5%
United Kingdom	5%	0%
Japan	6%	3%
Asia ex Japan	-1%	6%
China	-2%	1%
Hong Kong	-4%	3%
India	-3%	-1%
Korea	0%	9%
Australia	6%	12%

Source: MSCI

MSCI World Index Sector Performance (AUD)

SECTOR	QUARTER	1 YEAR
Financials	19%	13%
Energy	14%	28%
Materials	9%	24%
Industrials	7%	12%
Consumer Discretionary	7%	3%
Information Technology	5%	13%
Telecommunication Services	3%	6%
Utilities	2%	6%
Health Care	0%	-6%
Consumer Staples	-1%	2%

Source: MSCI

increasingly difficult and restrictions even apply to foreign-owned companies wishing to remit their profits. (These restrictions have interesting implications for the Australian residential market as a large number of properties bought off-the-plan are now approaching settlement. High-cost bridging and deposit forfeiture are the order of the day.)

From the stock market point of view, there has been a dramatic shift in flows. After a protracted leakage of funds out of equities, the past quarter saw a significant reversal with some evidence of a growing preference for equities over bond funds. Along with Financials, Cyclical, for which investors had had little appetite until recently, bounced strongly ahead of earnings which investors hope will recover next year.

Strong contributors to the Fund's performance this quarter included the European banks (Mediobanca +34%, Raiffeisen Bank +28%, Intesa Sanpaolo +23%), our energy holdings (Inpex +29%, Eni +21%) as well as luxury goods group Kering (+19%) and Samsung Electronics (+13%). Weak performers included our Chinese stocks (Tencent -11%, Sina -18%, PICC -6%) and pharmaceutical group AstraZeneca (-11%).

Our stock selection is paying off, however, given our focus on absolute performance, 'insurance' has been a cost to relative performance, which we feel is justified by the uncertainties and high valuations. Even so, the Fund has returned nearly 16% per year over the past five turbulent years, versus 17% by the MSCI AC World Index (\$A). **The Index, as we have frequently alluded to, is heavily weighted to the US market (54%) which also tilts it to being expensive by traditional measures.** There are, however, signs that the pattern has begun turning in favour of less index-obsessed funds in the second half of the year.

Shorting

We shifted around the index shorts to the Russell 2000, once it had outrun the S&P 500 by a 10% margin, and closed our puts on the S&P for a small benefit amidst the confusion of the Trump election win. In the late days of 2016 we have been buying puts on the S&P on the basis of their low cost in the face of the huge bullish repositioning in the US market that has taken place since the election. There is broad consensus that fewer regulations, lower taxes and more infrastructure spending will be beneficial. However, as you will read later in this report, there will be a time lag before implementation and some of the proposals may be difficult to drive into legislation. Very little concern about international repercussions from these changes seems to be priced into the market and, to the extent there are dangers, they are being seen principally as a cost to China.

Currency

We increased our position in the Australian dollar on the view that the improvement of Australia's terms of trade is significant and likely to be more enduring. This implies a bottoming of our interest rate cycle. However, the nature of the Republican US tax proposals caused us to partially reverse our position late in the quarter as those moves may result in the Australian dollar remaining out of favour and discourage natural foreign inflows. We remain hedged out of the Japanese yen and the Chinese yuan, and are long the Norwegian kroner which we bought at mid-year in anticipation of a stronger oil price.

CURRENCY	DEC 2016	SEP 2016	DEC 2015
US dollar (USD)	33%	32%	50%
Australian dollar (AUD)	19%	16%	10%
Euro (EUR)	13%	15%	8%
Hong Kong dollar (HKD)	11%	12%	9%
Norwegian krone (NOK)	9%	9%	3%
Indian rupee (INR)	6%	6%	6%
Korean won (KRW)	6%	6%	3%
British pound (GBP)	5%	4%	4%
Japanese yen (JPY)	4%	3%	11%
Chinese yuan (CNY)	-3%	-3%	-2%
Chinese yuan Offshore (CNH)	-6%	-6%	-6%

Source: Platinum

Changes to the Portfolio

We used some strong price moves to raise our cash holdings as the quarter progressed. Notably, we sold the Palladium-miner **Stillwater** after its price spiked 30% on a take-over offer. We also trimmed our largest holding, **Samsung Electronics**, whose share price incidentally barely budged on the Galaxy 7 battery fiasco and has subsequently reached new highs on the basis of strong demand for OLED and memory devices, which was part of our well-documented investment thesis. In the US we exited **McDonald's** for a good return, sold out of mortgage insurer **MGIC** after a long but profitable wait. We reduced our positions in the online payment intermediary **PayPal**, the Internet infrastructure facilitator **Level 3 Communications**, and **Carnival** cruise lines. All are good companies, but their share prices are now pricing in relatively optimistic earnings growth. In Asia, we took further profits on Internet play, **Sina**, and the Chinese white spirits purveyor **Kweichow Moutai**. Both have

appreciated ahead of strong earnings expectations. We also reduced Japanese hydrocarbon producer **Inpex**, which has rallied strongly with the oil price.

Significant new entries were **FMC Technologies**, **K+S AG** and **Daimler AG**.

As part of our expectation of a higher oil price, we acquired two energy producers early in 2016, Inpex and Eni, and then broadened our search for those companies that would benefit from the eventual recovery in exploration and development expenditure. Prospects are hardly encouraging when the price of a commodity is weak, but with due reflection on other factors, one might identify the silver lining.

In the case of **FMC Technologies** there have been several important changes in the deep-sea hydrocarbons business that give rise to optimism. Technological advancements and plant integration procedures are changing which favour hydrocarbons to be processed on the sea floor instead of on rigs, and this is encouraging the tying-back of new wells to existing infrastructure, thereby obviating the need for production platforms. This will save capital outlays, which is significant for the private oil companies whose subsea reserves exceed those onshore. At the same time the number of equipment suppliers is diminishing following numerous mergers, and this helps restore some negotiating balance in a market where there are relatively few oil company buyers.

In the case of **FMC**, it is merging with **Technip** and will, together with the merged entity of Schlumberger/Cameron, dominate the subsea production systems (SPS) and subsea umbilicals, risers and flowlines (SURF) market with a market share exceeding 65%. Profits are still heading downwards, but are likely to bottom out in 2017 before recovering. The amplitude of the downturn will, however, be attenuated by the anticipated cost savings from the merged entity.

K+S AG is another cyclical company that has seen its share price collapse in the face of declining commodity prices and several one-off problems. K+S is the world's largest listed salt producer and Europe's largest potash supplier, with a granular-grade potash capacity of 7 million tonnes per annum (mtpa) across six German mines and 32 mtpa of salt capacity across regional subsidiaries. An eight-year decline in global potash prices, together with a six-month delay in commissioning its new potash mine in Saskatchewan, Canada – the first in 40 years – and curtailment of German potash production due to water disposal restrictions, has left the business challenged. A milder northern hemisphere winter has further weakened demand for de-icing salt with the concerns weighing on the company's share price.

However, a credit rating downgrade left the shares unaffected, supporting our assessment that the worst has passed. K+S's competitors' share prices have run up in anticipation of improving potash prices even though the mineral is still in surplus. However, it is not entirely a fungible market on account of transport costs and other considerations. Under our base forecast, which assumes a potash spot price of US\$240/tonne, earnings can recover strongly, implying a P/E multiple of under 8 times, and this is before the benefits accrue from its new Canadian mine which is rated at 2 million tonnes a year. The North American producers, Potash Corp and Mosaic, are priced considerably higher on like mineral price forecasts.

Commentary

It is a tantalising idea that thunderous news coverage about *the economy* actually has *predictive value* or that the growth of an economy directly determines the prospect for a country's stock market. We are of the view that these apparent linkages are mostly random and a distraction, but in a world of loose anchorages, most assume they are better than nothing.

In case you feel this is being rather esoteric, consider the fact that operating profits of companies in China have doubled since 2007/08 and yet the stock market has declined by 40%. Its rating has deteriorated from 40 times to 20 times, yet the economy has grown at more than twice the rate of the best performing economy in the Western hemisphere. By contrast, annual operating profits in North America, excluding Financials, have risen by some US\$300 billion since the last peak in 2007 to US\$1.6 trillion (+23%), and yet the S&P index now stands at over 2200 versus 1500 in November 2007, a rise of 46%. This outperformance of the market relative to profits has been caused by a re-rating of earnings, from about the long-term average (16 times GAAP¹ earnings) to a solid premium of 20 times GAAP earnings.

Consider further the negative press coverage of the Japanese economy and the endless coverage of its shrinking population. Yet, profits are at an all-time high – nearly 10% of Japan's GDP, and in stark contrast to the US, its market rating is close to the lows of the last 30 years! In a similar vein, operating profits in Europe are currently at the same level as those reached in 2007 (US\$ 1300 billion), yet the Stoxx index is 30% below the peak of 4500 reached in March 2007. Yes, agreed, too many numbers to ingest. But the message is

¹ Generally Accepted Accounting Principles.

clear: **the relationship between economies, profits and stock markets can diverge immensely, and yet many regard them as synonymous.**

So what? We are pretty clear that evidence of an improvement in the world economy started to appear at the end of the first quarter of 2016, with a rise in sentiment indicators, a recovery in Asian exports and, by mid-year, broad geographical improvements in Purchasing Managers' Indices (PMIs). Even though central banks in Europe and Japan have continued to suppress interest rates by buying debt and even equity instruments, the **underlying indicators for demand** and, importantly, producer prices, **have been rising for about half a year.** Most important of all, in our view, is the **bottoming of interest rates globally from mid-year to end a 36-year bull market in bonds,** the starting point of which traces back to the measures taken by the then US Federal Reserve Chair, Paul Volcker, in 1980 to break the back of persistent inflation!

Much is made of the turn of the US economic tide with the election of Donald Trump as the next President of the United States of America. There has been some excitement about the prospect of refined regulation and greater investment in infrastructure, but we believe **the more telling change will come from improved sentiment and tax reform.** There is a growing realisation of its magnitude as we write pre-New Year, but in all likelihood, it will be **the central focus of markets in the months ahead.** The proposals, which are based on a manifesto by Paul Ryan, the Republican Speaker of the House of Representatives, are vague and contestable. However, if the newly elected legislature does manage to turn the tentative proposals into concrete, implementable policies, there would be a complete overhaul of the current system:

- **Companies are to be taxed on their destination-based cash flow** where the 'border adjust' concept disallows the imported content, both goods and services, as a cost while excluding cash flows from exports, of both goods and services, as taxable revenue.
- **It leans heavily on the theoretical construct that the US dollar should appreciate strongly,** which will cut the cost of imports, as expressed in US dollars, while implying that exporters will adjust their selling prices downwards to reflect their tax free revenue treatment.
- **There will be a standard tax rate applied at perhaps 20%, from the current effective rate of around 27%,** with very few special deductions, and instead of depreciation, capex will be deductible against cash flow as incurred.

- **Interest costs** will not be deductible from taxable income.
- **The anomaly of taxation on global income will be solved by the consequential changes in company recognition of income** – foreign sourced being tax exempt. (This addresses the multi-nationals' past behaviour of shifting profits and is seen as one of the benefits of these reforms rather than supposedly promoting fairer trade! A transition proposal is to have an 8.75% tax on one-off remittances on income currently stored abroad.)

One's thoughts immediately turn to the prospect of such a gigantic step ever being implemented. And what will be the response from trading partners and business interests?

The case being made in the manifesto is that the US has effectively imposed a penalty on itself whereby its foreign trading partners levy value-added taxes (VAT) on exports received from the US and equally, the US effectively grants a subsidy on imports received from such VAT-driven countries.

In the face of **likely obstruction from the World Trade Organisation (WTO)**, which allows the imposition of indirect taxes at borders like VAT, but not direct taxes like company tax, which is levied after deduction of domestic labour costs, the US may attempt to argue that the cash flow concept creates a base equivalent to that of VAT. This would be highly contentious.

There is also likely to be noise from the business lobbies that are highly import-dependent regarding the passing-on of non-deductible import costs.

From a US legislative view point, the hurdle lies in the assumptions adopted by the Joint Committee on Taxation (JCT) which is now required to incorporate GDP impact when assessing the effects of the proposed changes in a tax bill. So long as the verdict is that the proposals are **tax neutral**, the legislation cannot be obstructed by filibusters in the Senate.

However, this system has other imperfections, such as the effect on imports by individuals, and non-tax-paying entities may require rebates for their exports. There is also the all-important and well-represented case for financial entities where destination-based cash flows are questionable.

Taxes on individuals are slated to drop, but closely interwoven in this is the removal of almost all special deductions.

As one can see, there are plenty of obstacles to these reforms, but the important point is that **they bring uncertainty to**

markets and, in the months ahead, one can expect a strong-willed business-orientated Cabinet team to play hard-ball. Of course, the notion of interest costs being non-deductible carries the other trap of **raising the theoretical cost of capital to US enterprises**, with the likely effect of reducing the attraction of share buy-backs.

Outlook

Some key points of likely issues in the year ahead:

- We might expect significant coverage and speculation around the **proposed changes to US company and personal tax regimes**. This will be complicated by both legislative procedures and matters of international trade.
- The **implications for the US dollar** are far-reaching with the Eurozone, China and Japan already receiving measurable benefits (growing trade surpluses) since the bottoming of the trade-weighted Dollar at 80 in mid-2014 (currently 103).
- The challenge for the US to lift growth in the face of relatively high employment and a strong Dollar suggests the need for **an investment surge** to augment productivity, rather than the less probable contributors of migration or an extended working age.
- The likely unfolding of **tensions between the US and some of its principal trading partners**, notably China, and the consequential **tit-for-tat** requires a close watch. This will reveal winners and losers in stock markets, though risk premiums seem lopsided.
- **China's credit boom**, which has **accelerated production and retail sales**, will continue to be closely watched and this will have important implications for real and perceived **demand for metals and minerals**.
- The global picture of continuing improvement in sentiment and rising producer prices will likely **remove references to deflation** with the consequence of bond yields being more attractive than they have been in 2016.
- The tensions between **political issues** (such as Brexit negotiations and elections on the European Continent), **company earnings and valuations** suggest selective opportunities rather than a uni-directional market.
- **Emerging technologies continue apace**, led by Artificial Intelligence, autonomous driving, improved battery storage capacity, robotic surgery, biotechnology, comprehensive IT security, the speed promise of 5G, and the list goes on as the full potential of computing power, sometimes hosted remotely and linked to sensors, unlocks the extraordinary potential of the Internet. The point here being that for all the wringing of hands about the dearth of conventional investment and weak productivity statistics, the **technological revolution is as potent as ever and probably under-measured**.

We are finding **considerable differences in valuations across markets** which are **at odds with the growth prospects of companies**. We believe this should allow us to make solid returns in the year ahead.

Notes

1. The investment returns are calculated using the relevant Fund's unit price and represent the combined income and capital return for the specified 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 in the 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.)

2. The investment returns depicted in this graph are cumulative on A\$20,000 invested in the relevant Fund over the specified five year period relative to the relevant benchmark index (in A\$) as per below (the "Index"):
 - 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 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.

3. Regional exposures (i.e. the positions listed other than "cash" and "shorts") represent any and all physical holdings, long derivatives (stock and index), and fixed income securities as a percentage of net asset value.
4. The table shows the relevant Fund's top ten long stock positions as a percentage of net asset value as at 31 December 2016. Long derivative exposures are included. However, short derivative exposures are not.

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