

# MLC-Platinum Global Fund

## QUARTERLY INVESTMENT MANAGER'S REPORT

### PERFORMANCE

Fund Size: 642.8m	Last quarter	Last 12 months	5 years (compound pa)	Since inception (compound pa)
MLC-Platinum Global Fund	2.0%	-1.5%	5.5%	10.2%
MSCI All Country World Net Index (A\$)	3.9%	3.9%	9.9%	7.1%

Fund returns are after fees and expenses and assume the reinvestment of distributions. Portfolio inception date: 30 June 1994.

Source: MLC Investments Limited and Platinum Investment Management Limited for Fund returns, and FactSet Research Systems for MSCI index returns. Past performance is not indicative of future performance. The value of an investment may rise or fall with changes in the market.

Over the quarter the Fund returned 2.0%.<sup>1</sup> Despite some strong gains in a number of our positions, these were offset by the strength in the Australian dollar and falls elsewhere.

The major positive contributors during the quarter included investments in:

- FedEx:** Still run by its founder Fred Smith, FedEx has a long history of willingness to prioritise long-term investment and success over chasing short-term results. In late 2018, the company embarked on a heavy investment phase in its US ground division (its most profitable business), both to significantly increase its capacity to deliver e-commerce packages, and lower their all-in delivery cost. In the short run, the cost of these investments had lowered profits, with the stock falling 40% as investors remained sceptical of the strategy. The boom in parcel demand post COVID now makes these investments look like a masterstroke, with FedEx well positioned to handle the extra volumes. Following the release of strong profit results, FedEx rose 79% over the quarter.

- LG Chem:** Highlighted in our June quarterly report, LG Chem is one of four major battery suppliers for electric vehicles globally. With consumer demand for electric vehicles gaining pace post COVID (aided by generous green initiative subsidies), there is a global shortage of electric vehicle battery capacity, which will aid the bargaining position and profitability of the battery makers. LG Chem's reported results in August confirmed this thesis, with the stock price rising 33% as the battery division grew 41% while delivering record levels of profitability.

Offsetting these gains were falls primarily in a number of our Chinese holdings. Our investment in Chinese property owner and developer **China Overseas Land & Investment** fell 17% as the government introduced new restrictions around debt financing for property development, while our holding in Chinese parcel express leader **ZTO Express** fell 18% as fierce price competition between the major players looks set to drag on, post several competitors raising additional capital to fund the fight.

<sup>1</sup> References to returns and performance contributions (excluding individual stock returns) in this MLC-Platinum Global Fund report are in AUD terms. Individual stock returns are quoted in local currency terms and sourced from FactSet Research Systems, unless otherwise specified.

## DISPOSITION OF FUND ASSETS (NET INVESTED POSITIONS) ^

Region	30 Sep 2020	30 Jun 2020
Asia	32.9%	30.9%
Europe	14.4%	12.9%
North America*	13.2%	29.9%
Japan	12.2%	10.0%
Australia	2.3%	2.3%
Africa	0.6%	0.5%
Cash	24.5%	13.5%

^ The geographic disposition of assets (i.e. other than "cash") shows the Fund's exposures to the relevant countries/regions through its long securities positions and long securities/index derivative positions, as a percentage of its portfolio market value.

\* At 30 September 2020, the Fund had a -16.3% short position against the Nasdaq E-Mini Future Dec 20. The Fund's -2.1% short position against the Russell Mini 2000 CME and -2.0% short position against the S&P 500 Index were closed during the quarter.

Source: Platinum Investment Management Limited.

## TOP 10 HOLDINGS ^

Company	Country	Industry	Weight
Samsung Electronics Co Ltd	Korea	Info Technology	5.0%
Microchip Technology	US	Info Technology	3.3%
Micron Technology In	US	Info Technology	3.2%
Sanofi SA	France	Health Care	3.1%
Takeda Pharma Co	Japan	Health Care	2.8%
Lixil Group	Japan	Industrials	2.8%
LG Chem Ltd	Korea	Materials	2.7%
Ally Financial Inc	US	Financials	2.7%
Amadeus IT Holdings	Spain	Info Technology	2.7%
Ping An Insurance	China	Financials	2.7%

^ As at 30 September 2020. The table shows the Fund's top ten positions as a percentage of its portfolio market value taking into account its long securities positions and long securities derivative positions. Numerical figures are subject to rounding adjustments.

Source: Platinum Investment Management Limited.

## NET SECTOR EXPOSURES ^

Region	30 Sep 2020	30 Jun 2020
Industrials	21.1%	18.5%
Information Technology	18.1%	20.5%
Financials	12.9%	11.5%
Materials	11.2%	7.5%
Consumer Discretionary	9.1%	8.6%
Health Care	8.8%	9.8%
Communication Services	7.1%	10.4%
Energy	2.0%	1.9%
Real Estate	1.6%	2.0%
Consumer Staples	0.0%	0.0%
Utilities	0.0%	0.0%
Other	-16.3%	-4.1%
TOTAL NET EXPOSURE	75.5%	86.5%

^ The table shows the Fund's net exposures to the relevant sectors through its long securities positions and long securities/index derivative positions, as a percentage of its portfolio market value. Index positions (whether through ETFs or derivatives) are only included under the relevant sector if they are sector specific, otherwise they are included under "Other". Numerical figures are subject to rounding adjustments.

Source: Platinum Investment Management Limited.

## NET CURRENCY EXPOSURES ^

Currency	30 Sep 2020	30 Jun 2020
US dollar (USD)	20.8%	15.9%
Euro (EUR)	20.2%	18.1%
Chinese yuan (CNY)	17.2%	19.5%
Australian dollar (AUD)	10.3%	13.9%
Japanese yen (JPY)	9.4%	13.6%
Korean won (KRW)	7.7%	7.9%
Indian rupee (INR)	3.5%	1.9%
Hong Kong dollar (HKD)	2.9%	3.6%
Canadian dollar (CAD)	2.8%	2.7%
British pound (GBP)	2.1%	1.5%
Taiwan dollar (TWD)	1.8%	0.0%
Thai baht (THB)	0.7%	0.9%
Zambian kwacha (ZMK)	0.6%	0.5%

^ The table shows the Fund's net exposures to the relevant currencies through its long securities positions, cash at bank, cash payables and receivables, currency forwards and long securities/index derivative positions, as a percentage of its portfolio market value.

Source: Platinum Investment Management Limited.

## Commentary

When assessing potential investment opportunities, we would argue that there are two stock markets at the moment.

The 'growth' and 'safety' stocks, generally typified by technology companies and the Nasdaq Composite Index, are in a **huge bull market**. Here, there are many stocks at record high prices and valuations, well above their pre-COVID levels. The rationalisation for the high valuations usually comes back to the theory that low interest rates justify higher prices for equities.<sup>2</sup> Other signs of enthusiasm include the rapid pace of new initial public offerings (IPOs) in the space (along with swathes of listed companies raising extra cash via secondary issues) and rampant participation by retail investors using options.

The picture in the rest of the market looks very different. Here, stocks often with a cyclical edge to their business look much like you would expect six months after a worldwide recession, with many stock prices down 20-40% due to the uncertainty around the recovery. The valuation-boosting effects of low interest rates are seemingly not being applied to these companies, resulting in a valuation difference between these two camps at historical extremes.

### With this backdrop, the key question is how should one invest in this environment?

One scenario is that the low interest rate environment could last for a long time. This is the consensus scenario held by investors today, but not without good reason. Central banks around the world are holding rates low as economies are weak, and they want to both facilitate and encourage governments to spend and create employment and activity.

The clear winners from the low interest rate environment have been the 'quality growth' stocks, with huge investor demand for businesses that can steadily grow, earn high returns on capital and have strong barriers to entry. The task for us, is not to buy the current batch of loved growth stocks, but to identify companies that will be the growth stocks of tomorrow, and are not priced for it today.

A good example of this, is our investment in **Trip.com Group** (formerly called Ctrip). Trip.com is China's largest online travel agency, with the business making the bulk of its money via commissions from selling hotel rooms and flights. A simple illustration of the growth potential for Trip.com is the trend in Chinese outbound travel. Today, China is the largest outbound tourist market in the world, which if we exclude Hong Kong and Macau, recorded 75 million outbound flights in 2019,

growing at 15% p.a.<sup>3</sup> The potential for growth becomes apparent when you realise China has achieved this growth despite less than 15% of Chinese nationals holding a passport.<sup>4</sup>

With the tailwind of market growth, it is clear Trip.com has the potential to grow strongly for many years to come, but due to the COVID crisis we were able to buy this stock at a valuation of 13x 2019 earnings.

Another scenario is to consider the end goal of all the fiscal stimulus and central bank action. It's clear the mandate of the US Federal Reserve and European Central Bank has moved away from inflation control, towards restoring full employment and activity. Governments are embracing higher fiscal spending, with even the fiscally disciplined Germans opening the purse strings and actively encouraging other European Union nations to join them in spending more.

The end goal of full employment clearly helps more cyclical businesses, and when the valuation difference between these stocks is at historical extremes we feel it makes sense to have a decent portion of the portfolio invested in these areas.

An example of an investment that fits this mould is **Carrier Global**. Carrier is a predominately US-based manufacturer of air-conditioning and transport refrigeration equipment, with its Carrier (air-conditioning) and Transicold (truck refrigeration) brands being the leader in their respective markets.

Carrier is a classic quality industrial business. The US market is consolidated and the major players have locked up the distribution and after-sales service networks, which are key to winning market share. The difficulty of entry is evident in the failure of the Japanese and Chinese manufacturers to make inroads into the market despite 20 years of trying. The business also has a nice regulatory driver in the form of tighter standards around the use of chlorofluorocarbons (CFCs) and energy efficiency, which provides a persistent technology upgrade cycle and the ability to charge for it. These industry characteristics allow Carrier to make high-teen returns on capital and operating margins of around 15%.

The uncertainty around the pace of residential and commercial construction during the lockdowns gave us the opportunity to buy Carrier on 11x earnings, which was a deep discount to businesses of similar quality.

<sup>2</sup> We have no issue with the theory that long-term lower interest rates (and hence discount rates) should justify higher valuations. The issue is that markets rarely behave in a perfectly rational manner and stock prices are heavily influenced by human psychology. The current market conditions are a great example of this, theoretically low interest rates should boost the value of all equities, not just a select group, but this is clearly not happening today.

<sup>3</sup> Source: Morgan Stanley.

<sup>4</sup> Chinese National Immigration Administration and JP Morgan.

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## OUTLOOK

As at October, the economic data has recovered far faster than the post-global financial crisis period, particularly in China and the US. The strength of the data is broad based, with both the Chinese and US services and manufacturing purchasing managers' indices (PMIs) in firm expansion territory, with a very strong recovery seen in retail sales, auto demand and rail and trucking freight.<sup>5</sup> The strength in some industries is surprising, with no better example than the US housing market, which is currently booming.

Aided by governments' willingness to spend, we feel there are enough positive drivers to ensure the recovery continues. While the cyclical tilt in the portfolio reflects the relative value on offer rather than a macro view, we believe these holdings should perform well if investor confidence in the environment grows.

**Clay Smolinski**  
Portfolio Manager  
Platinum Asset Management

<sup>5</sup> Source: FactSet Research Systems, Evercore ISI.

# Macro Overview

by Andrew Clifford, Chief Investment Officer, Platinum Investment Management Limited

Over the last three months, stock markets have continued to rally strongly as economic activity started to recover from the depths of the COVID-induced recession. As a result of the lockdowns that have been put in place to control the spread of the virus, there have been significant changes in spending and working patterns across economies.

These changes, together with rapid and large increases in money supply, have unleashed a speculative mania in 'high growth' companies and other beneficiaries of the changing environment, while the balance of the market remains mired in a traditional bear market. **We believe extreme caution is warranted in regards to the market's current 'high flyers', while opportunities abound elsewhere.**

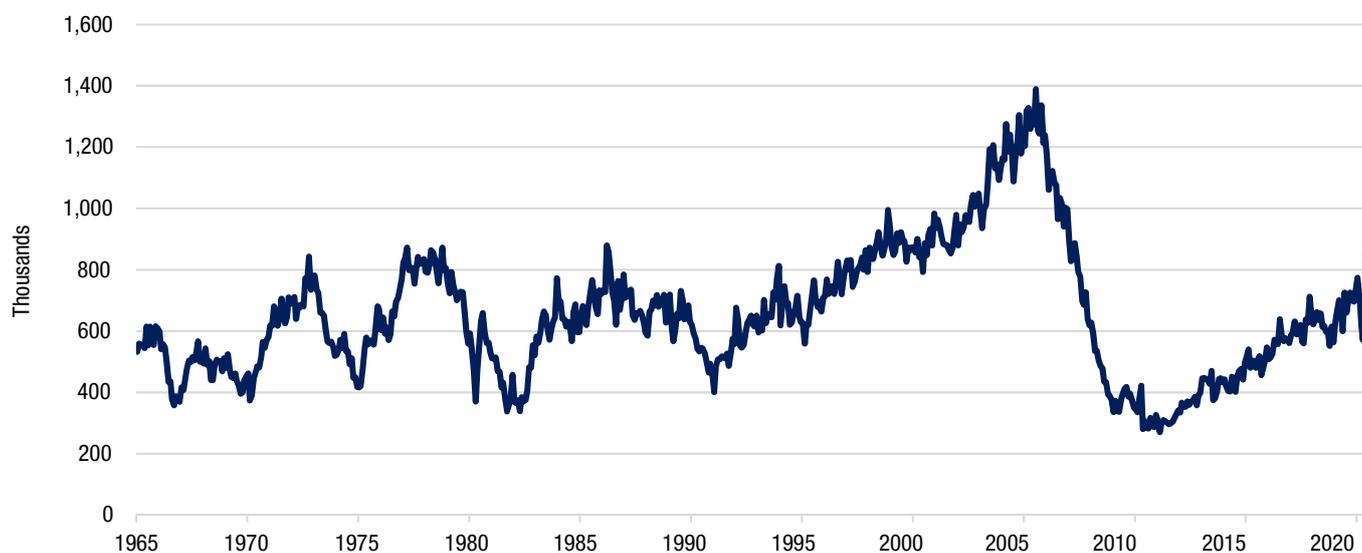
**Not all changes in spending patterns will be sustained.**

Many changes in our patterns of behaviour make entire sense given the circumstances. Faced with being either unable or not wanting to leave the house to shop, many consumers have taken to ordering groceries online for the first time. In many locations there is evidence of new adopters continuing to use such services, even as restrictions have eased. There are numerous examples that fit into this category, including video streaming services, such as Netflix or video conferencing products, such as Zoom.

Other changes have perhaps been somewhat more surprising. For example, in the US, we have seen extraordinarily strong new home sales (see Fig. 1). In one sense, the lift in home sales is understandable, as people opt for a different location and type of residence in an era of more flexible working arrangements, particularly the ability to work from home. The cost of financing major purchases, such as homes and cars, has fallen with lower interest rates. However, for households to be taking on such major financial commitments in the midst of a deep recession and extraordinary uncertainty is concerning.

What is often overlooked when observing these changing spending patterns is that they have been funded by the collapse in spending elsewhere, such as travel and restaurants. In a post-COVID environment, when people can once again spend money on such activities, the boost in spending in other areas will likely wane. For some areas, where activity has simply transferred from offline to online, such as grocery shopping, this may hold up, but even here, growth rates are likely to fade, as these businesses will have moved closer to maturity.

**Fig. 1: New One-Family Houses Sold: United States**



Source: Federal Reserve Bank of St Louis.

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One area of changed spending that will likely persist for some time, is government spending. However, the emphasis of government spending will likely shift from shorter-term support measures, such as the JobKeeper Payment scheme in Australia, to longer-term projects, such as infrastructure and incentives for investment. Environmental initiatives to reduce the use of fossil fuels and plastics for instance, are likely to be an ongoing part of government spending in much of the world.

**Changes in spending patterns have often reinforced investors' views of different sectors held prior to the pandemic.**

Businesses that have benefited from changes in consumer behaviour were in many cases ones that were already growing quickly. Examples include most forms of e-commerce from online shopping to food delivery services, online computer games, and video streaming services. Other favoured investments prior to the pandemic included defensive investments, such as consumer staples, that have seen sales grow not only from stocking up pantries as the lockdowns came into effect, but from greater consumption as people spent more time at home. On the other side, more cyclical businesses that were already struggling as a result of the US-China trade war and low growth, such as commodity producers, have suffered even further due to the collapse in economic activity.

Over the last two years, we have discussed on numerous occasions how investors, faced with low interest rates, have sought better returns from asset classes that they might otherwise have avoided, such as equities. As this has come at a time when there was already great uncertainty, such as rising geopolitical tensions and with many traditional businesses disrupted by e-commerce and other technology, investors have shown a strong preference for perceived 'low-risk' businesses. Predominantly, these were in high-growth areas (i.e. e-commerce, payment systems and software as a service), as well as defensive businesses (i.e. consumer staples, real estate, utilities and infrastructure). At the same time, investors were avoiding businesses with any degree of uncertainty or cyclicity.

While some businesses (e.g. those in the travel-related sector including infrastructure such as airports, real estate such as CBD offices and shopping malls) have changed sides from being in the loved 'high growth and certainty' grouping to the neglected 'cyclical and uncertainty' grouping, by and large the economic impacts of the pandemic have reinforced investors' pre-existing views and preferences.

**This is a particularly dangerous environment for investors as our cognitive biases come to the fore.**

It is well documented that our cognitive biases<sup>1</sup> play a major role in our decision making, and when it comes to investing we are deeply exposed to the role these biases play. Our short summary is that investors tend to over-emphasise and over-extrapolate the short-term trends and events - both the good and the bad.

This makes the current moment in time particularly worrisome. Prior to the pandemic, investors already held enthusiastic views of the prospects of many of the fast-growing companies. These views have now been reinforced even further by the additional boost to revenues they have received. As share prices move rapidly higher, this further reinforces the idea that these companies make great investments.

Ultimately, the value of a business is determined by the entirety of its future profits, for 10 years and beyond. The question is whether the boost to the short-term picture justifies the significant share price rises that have occurred? In some cases, it may well do. We have seen some companies that were expected to be lossmaking for a number of years turn profitable far sooner. However, there is plenty of complexity in assessing the prospects of fast-growing companies, especially when one must make assessments of revenues and profits into the distant future.

<sup>1</sup> Cognitive biases are the systematic ways in which we frame and process information, which can lead to irrational judgements and decision making. For a comprehensive read on the topic, please see Daniel Kahneman's *Thinking Fast and Slow*. Or for a much briefer overview, see our publication *Curious Investor Behaviour* as well as various other articles and materials at: <https://www.platinum.com.au/Insights-Tools/Investment-Fundamentals/Curious-Investor-Behaviour>.

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**The role of excess money creation provides an alternate story for why share prices of growth stocks are running hard.**

While there is much discussion around the potential of the 'new economy' at the moment, the other factor at play in the rebound in markets is the rapid growth in money supply. As we discussed in our last quarterly update,<sup>2</sup> this increase in money circulating in the economy reflects the way governments have funded their monetary and fiscal policy initiatives. When the growth in money supply exceeds economic output, it will necessarily result in inflation. Although inflation has not yet appeared in goods and services (or the consumer price index), it has appeared in asset prices, such as bonds and some parts of the stock market. Is it the bright prospects of the growth stocks that have driven markets or the inflationary effects of the printing presses?

We would answer this question by looking at valuations. What we see across many of the much-loved stocks of the moment are valuations that are hard to justify no matter how bright their prospects are. As one example, the market value of Tesla today is around US\$400 billion and the company is expected to sell in the order of 480,000 vehicles this year. This compares with Toyota, which is valued at just under US\$200 billion and will likely sell around 9.5 million vehicles i.e. around 20 times more than Tesla.<sup>3</sup>

Of course, this simple comparison doesn't do justice to Tesla's achievements in leading the electric vehicle revolution and the developments they are driving in battery technology. Still it could be argued that Toyota, having launched the first hybrid electric vehicle, the Prius, in 1997, knows a thing or two about making and selling electric cars. The prospects for Tesla are most certainly bright in our view and ultimately, they may achieve enough to justify this lofty valuation. However, the company must still jump a huge hurdle just to meet current market expectations.

The run-up in the market is not just about the valuations of one or two hot stocks that are inconsequential in size. There are many stocks, and in aggregate the market capitalisations of these high flyers readily run into hundreds of billions, even trillions of dollars. This phenomenon is of course well understood and splashed across the front pages of the financial press, and yet it continues. Perhaps equally disturbing, is that the safe and comfortable option to invest in growth has been in companies such as Microsoft, Facebook, Alphabet and Apple. These are fine companies with good prospects (ignoring any anti-trust concerns), however, they have steadily revalued over time and now trade at generous valuations, though nowhere near as challenging as Tesla.

This brings us back to the question of money printing. If it is the inflationary effects of money printing that has driven stocks to these lofty levels, then it probably needs to continue to keep the market rally going. At the time of writing, additional stimulus measures are being debated in the US. Whether there is an agreement before the 3 November US election or not, it is probably a reasonable assumption that over the course of the next 18 months, governments around the world will continue to increase their spending, and it will probably be funded by borrowing from the banking system. However, as economies start growing again, the excess of money creation over economic output will most likely reduce.

**The risk for investors in equity markets today is the highly valued growth stocks. The opportunity is in companies that will benefit as we move into the post-COVID environment.**

There is much discussion about a new world for investing, or a new paradigm if you will, marked by interest rates at or around zero for the foreseeable future and the never-ending march of new technology continually changing the business landscape. This new environment renders all the old rules of investing null and void. Perhaps? Or is this just another version of the four most expensive words in investing: This time is different? Alternatively, it may just be a good old-fashioned bull market, driven by a great story and excess money supply, reinforced by our cognitive biases that lead us to emphasise recent events and trends.

<sup>2</sup> [https://www.platinum.com.au/PlatinumSite/media/Reports/mlcqr\\_0620.pdf](https://www.platinum.com.au/PlatinumSite/media/Reports/mlcqr_0620.pdf)

<sup>3</sup> Source: FactSet Research Systems, company reports, Platinum Investment Management Limited.

There are plenty of warning signs to suggest what we have here is simply a speculative mania:

- A buoyant market for new listings with companies often debuting on the market at prices as high as 50% or more above their issue price.
- High levels of retail investor activity, not just in shares but also in the options market.
- The stories of fortunes made and lost overnight by small investors that are regularly shared on internet blogs and even in the traditional financial press.
- And every good bull market needs an innovative financing vehicle and this time we have Special Purpose Acquisition Companies (SPACs). The premise here is that investors invest their cash in a SPAC and the promoters will find a great company to buy from the private markets with the funds. For those who have been around long enough, it sounds very similar to the 'cash box' listings in the bull market of the 1980s, and most of these didn't end well for investors.

What brings it to an end and when that happens are the great unanswerable questions, as has been the case in past speculative markets. One thing we do know though, is that manias tend to end suddenly and abruptly. The significant bull markets of the last 40 years have come to an end when monetary conditions tightened. Typically, this has been marked by rising interest rates, which for the moment seems inconceivable. Perhaps a slowing of money creation at a time when economic activity is rising will represent the tightening in liquidity, even if interest rates do not budge significantly. Perhaps it will simply be when we are clear of the lockdowns and restrictions and the level of permanent business closures and job losses is much greater than thought and prospects for listed companies are much bleaker than expected. Despite these unusual times, it is important to remain committed to our long-standing and consistent investment approach. We will focus on companies that others prefer to avoid, assess their potential over the medium term, and buy where their stock price implies an attractive return.

#### MSCI REGIONAL INDEX NET RETURNS TO 30.9.2020 (USD)

Region	Quarter	1 Year
All Country World	8.1%	10.4%
Developed Markets	7.9%	10.4%
Emerging Markets	9.6%	10.5%
United States	9.5%	16.4%
Europe	4.2%	-1.5%
Germany	8.3%	10.0%
France	2.8%	-6.2%
United Kingdom	-0.2%	-15.8%
Italy	1.3%	-10.1%
Spain	-3.8%	-21.0%
Russia	-4.7%	-16.0%
Japan	6.9%	6.9%
Asia ex-Japan	10.7%	17.8%
China	12.5%	33.6%
Hong Kong	1.6%	-1.6%
Korea	12.8%	18.6%
India	15.0%	0.5%
Australia	2.8%	-7.7%
Brazil	-3.3%	-32.5%

Source: FactSet Research Systems.

Total returns over time period, with net official dividends in USD.

Historical performance is not a reliable indicator of future performance

#### MSCI ALL COUNTRY WORLD SECTOR INDEX NET RETURNS TO 30.9.2020 (USD)

Sector	Quarter	1 Year
Consumer Discretionary	17.9%	29.2%
Information Technology	12.7%	44.8%
Materials	11.7%	11.7%
Industrials	11.2%	3.3%
Communication Services	7.3%	16.5%
Consumer Staples	7.2%	3.3%
Health Care	4.6%	21.6%
Utilities	4.0%	-3.7%
Real Estate	2.0%	-11.2%
Financials	1.4%	-15.5%
Energy	-12.8%	-39.0%

Source: FactSet Research Systems.

Total returns over time period, with net official dividends in USD.

Historical performance is not a reliable indicator of future performance.

**If you have any questions about your investment in the MLC-Platinum Global Fund, please contact the MasterKey Service Centre on**

**132 652** from anywhere in Australia or  
**+61 3 8634 4721** from overseas

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