Platinum ASSET MANAGEMENT

Platinum Asia Fund

(Quoted Managed Hedge Fund)®

(ARSN 620 895 427 | ASX Code: PAXX)

Quarterly Investment Manager's Report

30 June 2018

Platinum ASIA FUND (QUOTED MANAGED HEDGE FUND)

Investment Update

by Joseph Lai, Portfolio Manager

Performance

(to 30 June 2018)

	QUARTER	6 MONTHS	SINCE INCEPTION
Platinum Asia Fund (Quoted Managed Hedge Fund)	-0.7%	-1.0%	10.2%
MSCI AC Asia ex-Japan Net Index (A$)	-1.8%	0.8%	10.6%

Fund returns are net of accrued fees and costs. Refer to note 1, page 7.
Inception date: 12 September 2017.
Source: Platinum Investment Management Limited, FactSet.
Historical performance is not a reliable indicator of future performance.

The Platinum Asia Fund (Quoted Managed Hedge Fund) (ASX code: PAXX) is a feeder fund that primarily invests into Platinum's flagship Asian equity fund, the Platinum Asia Fund ("PAF"), which was established on 3 March 2003.

The following is the 30 June 2018 Quarterly Investment Manager's Report prepared for PAF by its Portfolio Manager. Please note that in this report, the "Fund" refers to PAF and portfolio details, such as portfolio disposition, top 10 holdings and currency exposure, pertain to PAF's portfolio. Please be aware that PAXX and PAF (C Class - standard fee option) have different fee structures and therefore different returns. PAXX's returns may also vary from PAF's performance fee (P Class) returns due to different cash holdings as well as gains and losses arising as a result of PAXX's market making activities.

Market Review

Rising interest rates in the US and the uncertainties created by trade friction continued to weigh on the Asian markets over the quarter, with the Philippines (-10%), Malaysia (-9%), Indonesia (-6%) and Korea (-5%) all posting weak returns.[1] PAF (C Class) was down -1.0% over the quarter and returned +16.5% over the last 12 months.

Although performance was weakened by a sell-off towards the end of the quarter, some stocks contributed positively to the Fund's returns. Unsurprisingly, the key contributors were once again the companies that are benefiting from the secular consumer trends of China's rising middle class. Healthcare stocks, such as Guangzhou Baiyunshan (pharmaceuticals and herbal tea manufacturer) rose +43% (H-share) and MicroPort Scientific Corporation (maker of heart stents, pacemakers and orthopaedic prostheses) was up +11%. A strong beneficiary of China's booming e-commerce market, ZTO Express (logistics) was up +33%, while Baidu (search engine) gained +9%. Consumer stocks Jiangsu Yanghe Brewery and Anta Sports (dominant Chinese sportswear) were up +22% and +5% respectively.

Mining stocks also performed well as China's economic recovery and expansion continued to support commodity prices. MMG (copper) was up +15%, CNOOC (oil) gained +17% and PT Vale Indonesia (nickel) rose +45%. Our Indian banking stocks displayed better form than last quarter, with Yes Bank up +11%.

Our Philippines and Korean holdings generally detracted from performance, with Ayala Land (Philippines developer) down -8% and Naver (Korean internet search portal) down -4%. Despite this recent price weakness, the fundamentals have not changed and we continue to believe that these are quality businesses that will do well in the long run.

Changes to the Portfolio

Weakness in the share market over the quarter gave us an opportunity to further reposition our portfolio towards more domestically-focused champions, cushioning the Fund against the impact of the ongoing trade friction. The repositioning also aims to maximise the Fund's exposure to the benefits flowing from the economic recovery and reform in the Asian region.

The Fund has upped its cash holdings (with a net invested position at around 81% as at the end of June) and kept its Australian dollar exposure to a minimal level, both of which helped to lessen the impact of the overall market weakness experienced during the quarter. We also have very limited exposure to the regions that are most susceptible to a strong US dollar and rising oil prices (Indonesia, Malaysia, Philippines). To the extent that the Fund is exposed to these headwinds, particularly in India, we have put in a 3% short

1 Referencing respectively the PSEI, JCI, KOSPI and KLCI indices in local currency terms for the quarter of 31 March 2018 to 30 June 2018. All other references in this report to index or individual stock performance are in local currency terms for the quarter of 31 March 2018 to 30 June 2018, unless otherwise specified.

position on the market for protection. India appears to be on a gradual economic ramp-up and it would be remiss not to invest in some of the well-managed and growing businesses that are trading on extremely attractive valuations.

More specifically, we have cut positions that we believed to have reached their fair value and took advantage of the market volatility over the quarter to deploy the cash into the following key positions:

- **China Merchants Bank** – in our view, the best bank in China, with a strong wealth management arm that has a dominant industry position and is well placed to take advantage of the burgeoning wealth management needs of the country's growing middle class.
- **AIA Group** – the leading and, in our view, most well-run life insurer in Asia, with a dominant position in the huge Chinese market.
- **ZTO Express** – one of the most competitive low-cost parcel delivery operators in China, ZTO emerged a winner as it rode the waves of the country's e-commerce boom and is now consolidating the market.

Commentary

India

During the quarter, several members of our team visited India and China, and we came away from both countries with positive but different observations.

In India, we were pleasantly treated to superfast mobile internet service. The upload and download speed is similar, if not superior, to what we are used to in Australia. Reliance Jio entered the mobile network business only several years ago. Its efforts to ramp up a gold-plated 4G network in a vast country like India from scratch were dismissed by many as a daft idea. We disagreed with this assessment because we believed the country, hitherto under-served by poor fixed line services and slow mobile networks, would see significant demand unleash with an efficient and affordable internet offer. We first invested in Reliance Industries, the parent company of Reliance Jio, in the second quarter of 2015, when the Jio mobile network was yet to launch. 18 months after launch, Reliance Jio has accumulated a gargantuan 180 million 4G subscribers, enticing users with offers of virtually unlimited data usage for US$2 a month! This is a boon to consumers who are getting ready access to the full gamut of online activities and services literally at their fingertips 24 hours a day. As mobile internet becomes increasingly affordable, Indians are buying about 120 million smartphones a year.

Faced with an aggressive competitor with a deep pocket, some smaller operators are exiting the market. With the number of mobile network providers in India having reduced from half a dozen to effectively just three players, the level of competition will eventually ease, restoring profitability for the remaining big operators like Bharti Airtel (in which we have a position).

Another encouraging sign observed in India is that for the first time in half a decade, some construction-related sectors are running high on rising utilisation rates. Some steel makers are operating at 85% utilisation rates and cement producers are starting to ramp up too. Commercial truck and passenger car sales are also running hot. All this while the rate of credit

PAF Portfolio Disposition

REGION	30 JUN 2018	31 MAR 2018
China^	45%	45%
Hong Kong	6%	5%
Taiwan	1%	2%
India	12%	13%
Korea	11%	10%
Thailand	4%	5%
Philippines	2%	2%
Vietnam	1%	1%
Singapore	1%	1%
Indonesia	1%	<1%
Malaysia	<1%	<1%
Cash	16%	16%
Shorts	-3%	-2%

^ Inclusive of all mainland China-based companies, both those listed on exchanges within mainland China and those listed on exchanges outside of mainland China.

Refer to note 2, page 7. Numeric figures are subject to rounding.

Source: Platinum Investment Management Limited.

Top 10 Holdings of PAF

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Samsung Electronics	Korea	IT	3.4%
Ping An Insurance Group	China	Financials	3.4%
Axis Bank Ltd	India	Financials	3.1%
Alibaba Group	China	IT	3.0%
Kasikornbank PCL	Thailand	Financials	2.8%
China Overseas Land & Invt	China	Real Estate	2.7%
Yes Bank Ltd	India	Financials	2.7%
China Oilfield Services	China	Energy	2.6%
CNOOC Ltd	China	Energy	2.4%
Naver Corporation	Korea	IT	2.3%

As at 30 June 2018. Refer to note 3, page 7.

Source: Platinum Investment Management Limited.

growth is only beginning to recover from some of the lowest levels since the times of Indira Gandhi. As the utilisation rates continue to increase, corporates are starting to add capacity. India appears to be on the cusp of the long-awaited revival of a private sector capital expenditure cycle. Business confidence is high.

What has been driving demand so far are government-led infrastructure programs which are bearing fruit. India needs infrastructure improvements to reduce the cost of transporting goods around the country. The authorities have approved 13,000 km of road construction for two consecutive years, a doubling of length compared to just a few years ago. Other infrastructure projects, such as airports, railway and social housing, also continue apace.

Various reform measures are starting to have a meaningful impact. The implementation of a national goods and services tax has reduced the complexity of state-based taxes. India's new bankruptcy law is getting tested and it is evidently working. For the first time, assets are being transferred from insolvent founders to new owners through bankruptcy proceedings. The significance of this new law is that it prevents founders of companies from getting out of their debt repayment obligations by dragging out the court process and wearing out the creditors, which had traditionally been the norm. Instead, the new law forces defaulting founders to either fix the problem or face the loss of their assets to the banks or new owners. This is beginning to have a profound impact on the behaviour of founders, some of whom might have chosen in the past to wilfully default on their debt given how powerless the banks were at recovering it. This is no longer the case! The new bankruptcy law represents an important structural change to Indian banks (including several of the Fund's holdings), and we cannot overstate the significance of its benefits. Our holdings in the Indian banking sectors are what we believe to be the best-in-class operators, and we expect them to reap additional rewards if the Indian capital expenditure cycle finally launches into full swing.

China

Our visit to Beijing, Shanghai and Hong Kong was literally a "breath of fresh air"! China's infamous air pollution truly has improved. Although we concede that air quality can and does fluctuate daily, it was nevertheless impressive to be able to enjoy five consecutive days of blue sky, a first in many years since our Asia team started visiting China.

China's relentless ascendance along the technology ladder has primarily been driven by an energetic private sector. Meeting with various industry heads shone a light on how ambitious the Chinese electric car makers are. In the near future, we will see many local competitors to Tesla, retailing at affordable prices of US$30,000 to US$60,000. These cars are designed from the ground up for electrification. With the battery pack situated at the bottom of the chassis, the centre of gravity is extremely low, allowing the electric motor to bring the vehicle into exhilarating acceleration from a standing start.

Observations from the trip also reinforced our view that there is enormous demand for life insurance products. Despite the authorities' ongoing efforts to improve the quality of healthcare, access to publicly funded medical care remains limited for patients suffering from serious illnesses such as cancer and coronary heart disease. As the cost of healthcare rises and the average life expectancy increases, the issue is becoming more acute. This has made insurance policies for "critical illnesses" extremely attractive. These policies cover a range of major illnesses and will pay out a lump sum (say US$30,000) in the event of the insured contracting one. The overall penetration of life insurance remains very low in China vis-à-vis the developed world. Products are immature and highly profitable. We can see this industry continue to grow for years to come. Ping An and AIA, two of the Fund's holdings, are the leaders in this market. They have what we believe to be the most experienced sales force and the most advanced IT system in the industry, which will play a crucial role in getting their products into the hands of the eager consumers.

Indeed, the Chinese economy continues to recover and expand despite the difficult job of cleaning up the shadow banking sector. The authorities are not afraid of pulling the many levers that they have to ensure that a decent level of economic activity is maintained. China is not blindly following the US Fed's move to raise interest rates. Its government continues to push ahead with its infrastructure programs, from the inter-state high-speed rail network to metropolitan underground metro systems, water treatment plants, and new healthcare facilities. In the property market, despite the authorities' draconian measures to curb demand and limit purchase, the market is holding up. We continue to witness a shortfall in supply and new construction starts are supporting economic activity.

Outlook

Given the market volatility, we have increased the Fund's net exposure to China as it tends to be more resilient against the impact of rising US interest rates and oil prices than ASEAN economies. India holds promise, particularly if and when the long-awaited capital expenditure cycle truly kicks off.

We are encouraged by the number of attractive long-term opportunities that we are finding, and many of these businesses are not expected to be directly impacted by the trade friction. The Fund will continue to invest in reasonably valued companies with strong growth prospects.

Macro Overview

by Andrew Clifford, CEO & CIO

We opened our March quarter Macro Overview with the following summary of issues that had led investors to return to a more cautious stance:

- rising interest rates in the US;
- the impact of China's financial system reform on that country's economy and on asset markets both inside and outside of China; and
- the potential for a trade war between the US and China.

Today, these issues continue to be at the forefront of investors' minds, and continue to drive a growing risk aversion by investors globally. As such, it is worth returning to these issues, even at the risk of repeating oneself.

Any analysis of the impact of a "trade war" is far from straightforward. Modelling by various economists suggests that China may lose up to 0.5% in economic growth in the more extreme outcomes. This may sound dramatic, but for an economy growing at around 6% to 7%, the potential impact is limited. In assessing the prospects of any given company, this macroeconomic effect is largely irrelevant. However, the tariffs that are being applied to imports by the US and by their trading partners in response most certainly will impact product prices, demand, and ultimately profits, which will be felt not only by the companies facing tariffs, but potentially also by their customers. A Chinese manufacturer may be hurt, but so will be a US retailer who potentially has to increase prices on the products it's selling. A US company now paying more for aluminium and steel faces a cost disadvantage against its competitors elsewhere in the world. US soybean farmers, whose production now attracts a tariff when sold to China, will most likely respond by selling their produce elsewhere, potentially suppressing prices for soybean growers in other countries. There will be many unintended consequences from the trade war. From the US perspective, one example is Harley-Davidson who have announced that they would move some production to Europe.

Exactly where the costs of these measures fall will become more apparent in the months ahead. Consumers will be paying higher prices for products, some companies will see an impact on their profitability and competitiveness, and jobs will be lost. Secondary effects such as the loss of business and lower consumer confidence impacting spending may also become apparent in the US and elsewhere. What is not clear though is how severe and widespread these impacts will be. Nevertheless, it will be an interesting test of the US administration's resolve to maintain their trade policies once the costs are known. Changes to any system (for the better or worse) are usually very difficult to implement because entrenched interests are very effective at opposing them!

Last quarter we discussed the reforms in the Chinese financial system. To briefly recap, the regulator has required the banks to bring the assets and liabilities of the shadow banking system back onto their balance sheets. One of the goals in doing so is to ensure compliance with the lending restrictions that have been put in place. For example, following the GFC, regulators banned banks from lending to developers for land acquisition, but the shadow banking system provided a way around these rules. As the amount of loans a bank can issue is limited by its level of shareholders' funds, bringing these "shadow" loans back onto the balance sheet reduces the banks' capacity to issue additional loans, and some may even look to recover outstanding loans. As such, the availability of bank credit has been much reduced, and credit growth has fallen to just over 8%, a level much in line with the nominal growth of the economy.

While these reforms are undoubtedly a long-term positive for the Chinese financial system, the immediate question is whether this tightness in credit availability impacts the growth of the economy. Clearly, it has impacted the Chinese stock market, with the A share market down 22% from the highs reached in January, but indicators such as construction equipment, auto, and property sales still suggest robust levels of activity through to the end of May. Of course, the impact on the broader economy may yet become apparent, but policy makers in China certainly have the ability to respond if and when this happens. The People's Bank of China (PBOC) cut reserve requirements for banks in June, which freed up their ability to lend, and further cuts can certainly be made, if necessary.

In the US, the Federal Reserve raised interest rates again this quarter. As we have noted numerous times in our reports, rising interest rates will eventually bring about a slowing in the economy and a fall in stock prices. The difficulty is assessing exactly at what point interest rates will have risen far enough for their impact to be felt. One indicator often

used is the steepness of the yield curve. This refers to the difference in short-term and long-term interest rates. When short-term rates rise up towards the level of long-term rates, referred to as a flattening of the yield curve, it is usually indicative that the economy will soon start to slow. During the last quarter, the yield difference between the 10-year and 2-year US government bonds continued to narrow, reaching levels last experienced between 2005 and 2007.

The flattening of the yield curve certainly supports the view that we are starting to enter the final stages of the current US expansion. Nevertheless, for the moment, economic indicators in the US point to ongoing robust growth, undoubtedly buoyed by this year's tax cuts. One should also expect that at some point President Trump will announce his infrastructure initiatives which would add further fuel to the economy and reinforce upward pressure on interest rates.

Market Outlook

Fears around trade wars, tightening credit in China and rising rates have resulted in increased risk aversion and significant divergence in stock price performance over the last six months. Asian markets have been particularly weak with the China A share market down 22% from its high point earlier in the year, Japan down 10% and Korea down 11%.[1] Emerging markets also performed poorly during this period. While the US market was flat over the last six months, within this market, performance varied dramatically across sectors with investors favouring a narrow group of growth stocks in the technology and biotech sectors while financial and industrial stocks generally performed poorly. While in aggregate the MSCI All Country World Net Index indicates that global stock markets are up slightly year to date in local currency (+0.8%), though down -0.4% in USD terms, this narrowing of markets where a smaller number of stocks are responsible for holding up returns is often a signal that higher interest rates may be starting to impact the markets.

The Chinese A share market, as noted above, has been particularly hard hit by the issues outlined in our commentary. Of particular concern for local investors in this market has been the tightness in credit availability as a result of the financial reforms. The topic has been part of daily news and commentary in China for the last six months and the fear has been well and truly expressed for some time, though it has only recently been reported in the foreign financial press. Similarly, given that China is the prime target of President Trump's trade war and it has become clear that there wouldn't be a negotiated outcome, the trade tension weighed heavily on the Chinese market towards the end of the quarter.

Currently the Shanghai A share index is back to the lows reached in January 2016. As you may recall, at that point the country had just been through a period of capital flight, heavy industry was plagued by excess capacity and many companies were loss making, and there loomed the possibility of non-performing loans triggering a banking crisis. Today, while the economy may be experiencing some slowdown as a result of changes in the financial system, supply side reforms have resolved the issue of excess capacity, profitability of heavy industry is much improved, and while the banking system is likely to have to work through some problem loans, the likelihood of a fully blown banking crisis is much lower. Risks have been reduced substantially, profits are higher, yet stock prices in aggregate are at the same level as they were two years ago. At an individual stock level, we see extraordinary value in a wide range of companies.

Of course, it is hard to know when these various fears will subside, allowing the market to move higher. One would expect the credit tightness created by the financial reforms to recede in time and it is likely that PBOC will take measures such as further cutting reserve requirements to ease the problem. The impact of tariffs at a company level should start to become obvious in the weeks ahead, although one can't predict future moves by the US administration. Overall, a combination of negative sentiment and attractive valuations are indicative of strong future returns from this market in coming years.

In other markets such as Japan, the divergence between the most highly valued and the least valued stocks in the market is at a record level. Elsewhere, outside of the much loved high growth technology and biotech stocks we are finding companies at interesting valuations. All this, we believe, bodes well for future returns. However, it is possible that before these returns can materialise, we may first see a correction in the prices of the high flying stocks, potentially precipitated by rising US interest rates.

1 Referencing respectively the CSI 300, TOPIX and KOSPI indices, from their respective peaks in January 2018 to 28 June 2018.

Notes

Unless otherwise specified, all references to "Platinum" in this report are references to Platinum Investment Management Limited (ABN 25 063 565 006, AFSL 221935). "PAXX" refers to the Platinum Asia Fund (Quoted Managed Hedge Fund) (ARSN 620 895 427, ASX Code: PAXX). "PAF" refers to the Platinum Asia Fund (ARSN 104 043 110), the underlying fund into which PAXX invests primarily.

1. PAXX's returns are calculated using PAXX's net asset value per unit (which does not include the buy/sell spread) and represent PAXX's combined income and capital returns over the specified period. PAXX's returns are net of accrued fees and costs, are pre-tax, and assume the reinvestment of distributions. The investment returns shown are historical and no warranty can be given for future performance. Historical performance is not a reliable indicator of future performance. Due to the volatility in PAXX's underlying assets and other risk factors associated with investing, investment returns can be negative, particularly in the short-term.

   PAXX's returns have been provided by Platinum Investment Management Limited. The MSCI All Country Asia ex-Japan Net Index (A$) returns have been sourced from FactSet. Index returns are in Australian dollars and assume the reinvestment of dividends from constituent companies, but do not reflect fees and expenses. For the purpose of calculating the "since inception" returns of the MSCI index, PAXX's inception date is used. Platinum does not invest by reference to the weightings of any index or benchmark, and index returns are provided as a reference only. PAXX's underlying assets are chosen through Platinum's bottom-up investment process and, as a result, PAXX's underlying assets may vary considerably to the make-up of the index.
2. The geographic disposition of assets (i.e. the positions listed other than "cash" and "shorts") represents PAF's effective exposures to the relevant countries/regions as a percentage of PAF's net asset value, taking into account direct stock holdings and long derivative positions (stocks and indices).
3. The table shows PAF's top 10 long stock positions as a percentage of PAF's net asset value, taking into account direct stock holdings and long derivative positions. The designation "China" in the "Country" column means that the company's business is predominantly based in mainland China, regardless of whether the company's securities are listed on exchanges within mainland China or on exchanges outside of mainland China.

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