



**Platinum
Capital[®] Limited
Quarterly Investment
Manager's Report**

31 March 2019



Investment Update

by Andrew Clifford, Portfolio Manager

Performance

(compound pa, to 31 March 2019)

	QUARTER	1 YR	3 YRS	5 YRS	SINCE INCEPTION
Platinum Capital Limited	7.9%	-1.3%	10.7%	8.7%	12.0%
MSCI AC World Index [^]	11.2%	10.8%	13.7%	12.3%	7.0%

PMC's returns are calculated using PMC's pre-tax net tangible asset (NTA) backing per share as released to the ASX monthly. PMC's returns are calculated after the deduction of fees and expenses, have been adjusted for taxes paid and any capital flows, and assume the reinvestment of dividends. **PMC's returns are not calculated using PMC's share price.**

Portfolio inception date: 29 June 1994.

[^] Index returns are those of the MSCI All Country World Net Index in AUD.

Historical performance is not a reliable indicator of future performance.

Source: Platinum Investment Management Limited for PMC's returns;

FactSet for MSCI Index returns. See note 1, page 11.

Net Tangible Assets

The following net tangible asset backing per share (NTA) figures of Platinum Capital Limited (PMC) are, respectively, before and after provision for tax on both realised and unrealised income and capital gains.

	PRE-TAX NTA	POST-TAX NTA
31 December 2018	\$1.5025	\$1.4857
31 January 2019*	\$1.4893	\$1.4604
28 February 2019*	\$1.5514	\$1.5049
31 March 2019	\$1.5570	\$1.5095

* Ex-dividend. Adjusted for the 31 December 2018 interim dividend of 6 cents per share, declared on 19 February 2019 and paid on 19 March 2019. Source: Platinum Investment Management Limited.

PMC returned 7.9% for the quarter and a loss of 1.3% over the last 12 months. These returns lagged the performance of global equity markets, which were up 11.2% for the quarter and 10.8% for the 12 months.¹

It is worth noting the underlying components of PMC's performance. The portfolio's long positions gained 12.3% over the quarter, which compares favourably with the broader market. However, given their 87% average weighting

in the portfolio (PMC held an average cash position of around 13% through the quarter), this only translated into a contribution of about 10.6% towards portfolio performance.

Looking at the underlying companies, our Chinese holdings returned around 23% and contributed 4.9% to PMC's portfolio performance. The strongest contributors amongst our Chinese holdings included Ping An Insurance (insurance and banking, up 39%), Weichai Power (diesel engine manufacturer, up 51%), and Jiangsu Yanghe Brewery (white spirits producer, up 40%). The other significant contributor to performance came from our US holdings, which rose 17%, well ahead of the US market, and contributed 2.3% to portfolio returns.

Detracting from performance were losses on short positions which reduced PMC's returns by 1.6%, as well as the minor appreciation of the Australian dollar over the period.

It is worth noting the gains made by our oil-exposed holdings in the year to date, in particular, **TechnipFMC** (up 19%) and **Transocean** (up 24%). In our December 2018 quarterly report, we mentioned that our offshore oil service companies were part of a sector of the market that had been deeply discounted and out-of-favour.

Over the course of the December quarter, the Brent oil price had collapsed from US\$80 to US\$50 due to a sharp ramp-up in US shale oil production out of the Permian Basin, which drove a rebuild in US oil inventories (signalling oversupply), and Saudi Arabia's move to boost its production to 11 million barrels per day in expectation of additional US sanctions on Iran (which were subsequently delayed).

Since then, the picture has improved. In response to lower oil prices, US shale producers reduced their spending, with shale production capex now expected to fall by 10% in 2019, while the Saudis throttled back their production to 9.8 million barrels per day. This led the oil price to a quick rebound from US\$50 back to US\$69.

More importantly, we are seeing increasing evidence of a pick-up in offshore activity. Over the past three months, TechnipFMC won a number of new offshore contracts (including the Petrobras Mero project in Brazil and Eni's Merakes field in Indonesia), and Transocean has continued to raise the tender rates for its deep-water drill ships.

¹ References to returns and performance contributions in this report are in AUD terms, unless otherwise specified.

In response to the positive trends in activity and the higher oil price, the stock prices of Transocean and TechnipFMC have risen 40% and 25% (in local currency) from their respective lows.

Over the 12-month period, the portfolio's long equity exposure provided only a small positive return, which was offset by small losses on short positions. Within the portfolio, Chinese holdings were up an average of 11% and contributed 2.7% to performance. However, it should be noted that these returns were boosted by a weak Australian dollar over this period. Across the portfolio, strong contributors over the 12 months included Ping An Insurance (up 25%), Schibsted (online classifieds, up 53%) and Alphabet (owner of Google, up 23%). Our Japanese holdings were the major detractors from performance, reducing returns by 3.6%.

One question that naturally arises from consideration of the above results is the merit of running short positions² in the portfolio. In a 12-month period where markets sold off sharply before rebounding, one would have perhaps expected a greater contribution from shorting.

As we have outlined in this quarter's Macro Overview, the uncertainty in markets created by China's slowdown and its trade dispute with the US resulted in many stocks being sold down to very attractive valuations. These stocks represent a significant opportunity for investors. On the other hand, the extraordinarily high valuations that have resulted from investors crowding into high-growth companies represent a very real risk.

Since PMC was established nearly 25 years ago, we have seen numerous examples of financial excesses across a broad range of geographies and assets. Many have unwound with the damage relatively contained to the particular asset involved. The crash in cryptocurrencies is one such example, the current account crisis in Turkey during 2018 being another. However, as was experienced in the tech wreck of 2000/01 and the global financial crisis (GFC) in 2008, in some cases the unwinding of the financial excesses in one area can have broader ramifications for all markets. Today, we can see numerous areas that give cause for concern. Besides the mania for high-growth stocks, other examples include the enthusiasm for debt securities despite very low yields, the

² Short-selling or "shorting" is a transaction aimed at generating a profit from a fall in the price of a particular security, index, commodity or other asset. To enter into a short sale, an investor sells securities that are borrowed from another. To close the position, the investor needs to buy back the same number of the same securities and return them to the lender. If the price of the securities has fallen at the time of the repurchase, the investor has made a profit. Conversely, if the price of the securities has risen at the time of the repurchase, the investor has incurred a loss.

Disposition of Assets

REGION	31 MAR 2019	31 DEC 2018
Asia	38%	36%
North America	20%	15%
Europe	19%	21%
Japan	9%	12%
Australia	1%	1%
Africa	1%	1%
Cash	12%	14%
Shorts	-10%	-14%

Numbers have been subject to rounding adjustments.

See note 2, page 11. Source: Platinum Investment Management Limited.

Net Sector Exposures

SECTOR	31 MAR 2019	31 DEC 2018
Financials	16%	14%
Communication Services	13%	16%
Materials	13%	13%
Industrials	11%	11%
Information Technology	7%	6%
Consumer Discretionary	6%	5%
Energy	6%	6%
Health Care	3%	4%
Real Estate	3%	2%
Consumer Staples	1%	1%
Other*	-2%	-6%
TOTAL NET EXPOSURE	77%	73%

* Includes index short positions.

Numbers have been subject to rounding adjustments.

See note 3, page 11. Source: Platinum Investment Management Limited.

Top 10 Holdings

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Ping An Insurance	China	Financials	4.1%
Samsung Electronics	Korea	Info Technology	3.4%
Glencore PLC	Switzerland	Materials	3.1%
Alphabet Inc	USA	Communication Serv.	3.0%
Facebook Inc	USA	Communication Serv.	2.7%
China Overseas Land	China	Real Estate	2.6%
Jiangsu Yanghe Brewery	China	Consumer Staples	2.3%
PICC Property & Casualty	China	Financials	2.2%
Tencent Holdings	China	Communication Serv.	2.0%
TechnipFMC	UK	Energy	2.0%

As at 31 March 2019. See note 5, page 11.

Source: Platinum Investment Management Limited.

For further details of PMC's invested positions, including country and industry breakdowns and currency exposure, updated monthly, please visit www.platinumcapital.com.au.

popularity of risk parity strategies,³ and a frenzied FoMo (fear-of-missing-out) over unlisted investments such as private equity and infrastructure.

So while we are optimistic about the prospects for our portfolio, we remain cautious about the environment that we are investing in. As such, we believe it makes good sense to retain a conservative net invested position in the portfolio through the use of cash and short positions.

Changes to the Portfolio

The net invested position of the portfolio rose from 72.6% to 77.4% over the quarter, with cash holdings falling from 13.9% to 12.4% and short positions reduced slightly from 13.5% to 10.2%. As we reported last quarter, the change in the portfolio positioning was more significant than these aggregate numbers reveal, as there were substantial sales across the portfolio of companies that were either at or approaching full valuations as well as purchases in both new and existing holdings.

³ A risk parity strategy (also known as risk premia parity) is an approach to portfolio management that allocates capital across multiple asset classes based on risk (usually defined as volatility), rather than expected returns. Unlike most traditional multi-asset portfolios in which equities, rather than bonds, tend to determine returns as well as carry more of the risk, risk parity strategies generally aim to build diversified portfolios in which each group of assets contributes an equal amount of risk.

Net Currency Exposures

CURRENCY	31 MAR 2019	31 DEC 2018
US dollar (USD)	36%	34%
Japanese yen (JPY)	17%	22%
Hong Kong dollar (HKD)	14%	14%
Euro (EUR)	13%	14%
Chinese yuan (CNY)	10%	7%
Indian rupee (INR)	6%	6%
Korean won (KRW)	5%	6%
British pound (GBP)	5%	5%
Norwegian krone (NOK)	3%	3%
Swiss franc (CHF)	2%	3%
Canadian dollar (CAD)	2%	2%
Australian dollar (AUD)	1%	1%
Thai baht (THB)	<1%	<1%
Danish krone (DKK)	<1%	<1%
Chinese yuan offshore (CNH)	-15%	-16%

Numbers have been subject to rounding adjustments.
See note 4, page 11. Source: Platinum Investment Management Limited.

Of particular note was the addition to our semiconductor holdings in **Samsung Electronics**, **Intel** and **Skyworks Solutions**, as well as a new position in **Micron Technology**. These companies had been impacted by weaker smartphone sales and a slowdown in the investment in data centres in the second half of 2018. Micron is a US competitor to Samsung Electronics in memory chips, both DRAM and flash memory (NAND). Historically, the memory chip business has displayed erratic profitability as manufacturers raced to the next generation of chips to drive down costs, often moving supply well ahead of demand. In recent years the competitive landscape has changed as the industry consolidated down to three players in DRAM and five in flash memory, and profitability has significantly improved. While 2019 will likely see profits fall for these memory companies, their long-term prospects remain bright in our view. A return to data centre investment, and with it a pick-up in demand for memory chips, will be required to support the ongoing roll-out of e-commerce, software-as-a-service (SaaS), and artificial intelligence (AI) applications. At recent lows, both Micron and Samsung Electronics were trading slightly above book value, a very attractive valuation for businesses operating in an industry where the accumulated intellectual property and industrial know-how represent enormous barriers to entry.

Another new addition to the portfolio this quarter was **Booking Holdings**. Booking is the world's largest hotel-focused⁴ online travel search and booking platform, controlling brands and websites such as Booking.com, Agoda, Kayak and OpenTable.

Hotels are a product that is well suited to be sold via online search portals and marketplaces. There are many reasons for this. For example, the hotels market is very fragmented and each hotel is easily substitutable for another, but the offerings are also differentiated enough that users want to compare them. However, what truly makes an online aggregator of hotels an attractive business is that **hotel pricing is dynamic**. Hoteliers are constantly adjusting pricing to fill unsold rooms. While booking directly with a chain might get you the best price for that particular hotel, users know that they will often find a better deal on an aggregator site like Booking.com, as some hoteliers will discount their prices to fill vacancies.

On the 'supply' side, independent hotels represent 80% of the rooms sold on Booking's websites. These operators face a challenging mix of high fixed costs, huge marginal profitability for each extra guest, and inventory that expires on a daily basis. They also don't usually have the internal capability to build booking apps and conduct extensive direct response advertising to fill their excess inventory themselves.

⁴ In 2018, Booking sold 760 million room nights for a total value of US\$92 billion through its websites.

It is easy to see how a marketplace that can fill rooms on a success-based fee is an attractive channel. The value provided to both the customer and the hotelier results in attractive economics for the platform, with Booking enjoying a long history of making 30% or more in operating margins.

So, if Booking's business is so attractive, why was the stock recently sold down by investors? It was for two main reasons:

1. Slower growth – Booking's revenue growth has slowed from a trend rate of 20% p.a. to 14% in 2018. Booking's business is heavily weighted to Europe (65% of the transactions conducted on its platforms are from European customers) and management estimates that the economic slowdown in the region will taper growth further to 6-8%.
2. Higher investments – Booking's management team has said that it is seeing good opportunities to increase investments in countries like the US and China to drive long-term growth, but this will be at the expense of slower profit growth in 2019.

The uncertain near-term outlook for revenue and profit growth has prompted investors with short-time horizons to flee the stock. However, those with a longer-term perspective should find the future prospects for Booking more appealing. One can see multiple factors driving the global travel industry to continue to grow: the rise of outbound tourism in China, the trend of consumers shifting more spending to experiences from physical goods, as well as the increasing affordability of international travel driven by the rise of budget airlines focusing on international long-haul routes (such as Air Asia and Norwegian Air).

Booking, valued at a starting P/E of 16x, is overall a good example of a high-quality company trading at a reasonable price, and we believe it will be a sound long-term investment for the portfolio.

Re-introduced into the portfolio early in the quarter was **Kweichow Moutai**, a stock which PMC had previously held in its portfolio and had sold after strong appreciation. Moutai-branded 'baijiu' (white liquor made from sorghum) is one of China's few home-grown luxury brands, with its brand heritage reinforced by being the drink of choice at state banquets.

Moutai's brand positioning gives the company immense pricing power, with a bottle carrying a retail price of RMB1,700 (A\$350). We have long argued that Moutai has historically given its distributors an overly generous share of the margin relative to the value that they bring. Of the RMB1,700 retail price, Moutai earns RMB970 (A\$200), while the distributor captures RMB730 (A\$150) in mark-up, which is

considerably higher than the RMB200 (A\$40) distributors typically earn from selling other luxury brand baijiu.

This situation is now changing following Moutai's appointment of a new chairman, Baofang Li, last year. Moutai has announced it will limit the volume of liquor sold via distributors and sell more via its direct channels through which the company will be able to capture more than the RMB970 that it currently earns through indirect sales, which should provide a significant boost to its future profits. This news, along with the rebound in general sentiment towards China, saw Moutai's stock price rise 48% (in local currency) over the quarter.

Stocks sold out from the portfolio included **Scout24** (German, online real estate and auto marketplace), **Nexon** (Japan, computer games) and **Asahi Group** (Japan, brewery). Positions were trimmed in **Weichai Power** (China, diesel engines), **Roche** (Swiss, pharmaceuticals) and **Axis Bank** (Indian bank).

Commentary

Lixil and Corporate Governance in Japan

The need for corporate governance reform has long been well recognised in Japan. Progress over the last three decades has been slow, but real. Stock buybacks by listed companies are at 15-year highs and dividend payouts are at record levels. Arguably these actions are driven as much by some of these companies' extraordinarily high cash balances as they are by behavioural changes on the part of management. At a deeper level, there is clear government support for ongoing improvements. This is reinforced by widely available databases listing multifactor corporate governance rankings. These have increasingly been used proactively in discussions with management teams, leading to positive outcomes.

Of particular importance to PMC are the dramas at Lixil, which has been a significant underperformer in the portfolio.

Lixil in its current form is the roll-up of a large number of businesses which have been slowly integrated by former owner management and external hires. This process has not been easy, and there have been significant missteps including failed international acquisitions. The former CEO, Seto-san, had been very successful at his previous start-up business MonotaRO⁵ and accepted the top job at Lixil with a view to

⁵ Seto-san's involvement in this story is important for a number of reasons, as MonotaRO under his leadership stood out as a disruptive technology success. MonotaRO is an internet-based distributor of industrial goods and consumables founded jointly by Sumitomo and US company W. W. Grainger. It disrupted the incumbent multi-tiered Japanese distribution systems with a more efficient network. MonotaRO's financial performance and growth rates have far outpaced the Japanese market and rank in the top league globally. This success was built on disruption, energy and speed.

reforming an existing company with a global footprint and strong brands in sanitary ware and housing materials.

His style and action-oriented approach, however, was at odds with the needs of the vested interests of some of the founding families and he was unceremoniously ejected and replaced by the son of one of them. A subsequent investigation by an external legal firm found irregularities in the dismissal process, but no action was taken. In a startling development, an Extraordinary General Meeting has been called by a group of shareholders, including the members of another founding family. The aim of the meeting is to remove the newly-appointed CEO and his key offside. While the outcome is uncertain, the structure of Lixil's shareholder register means that there is a reasonable chance of success which should lead to a positive outcome for the company.⁶

It's worth highlighting that this process is occurring at a major Japanese company with political and societal significance. After three decades of slow and undulating progress, there is undoubtedly still a long journey ahead for corporate governance improvement in Japan. We are hopeful, however, that the worst may be behind us and that the ongoing substantial changes will be an incremental positive tailwind for the Japanese economy and the stock market.

Outlook

While the portfolio's net invested position has increased from last quarter, it remains moderately conservative. As we stated in the past two quarters' reports, this relatively low net exposure is not an expression of a particularly bearish outlook on markets, but is the result of the significant divergence in valuation between the crowded stocks and markets in which we are short, and the unloved and under-appreciated companies in which we are invested.

While a number of PMC's holdings have performed strongly over the first three months of 2019, the valuations of our holdings give us reason to be optimistic regarding the portfolio's prospective returns. At quarter end, the average price-to-earnings and price-to-book multiples of the long positions in PMC's portfolio compare favourably with market averages, and our quantitative and qualitative indicators continue to show that our portfolio companies are both more profitable and growing faster than the average.

While significant uncertainties and risks remain in the macroeconomic and market environment, an improving outlook for China and a halt to the interest rate rises in the US have assuaged some of the pessimism. Further signs of stabilisation in China and a resolution to the US-China trade dispute would augur well for markets over the rest of 2019.

⁶ Platinum issued a press release on 4 April 2019 in support of the action to remove Mr Ushioda (CEO) and Mr Yamanashi (COO) from Lixil's Board of Directors. The press release, together with a letter from Platinum to Lixil's Board dated 22 February 2019, is available at www.platinum.com.au/Platinum_Supports_Action_to_Remove_Lixil_CEO_and_COO.

Macro Overview

by Andrew Clifford, CIO, Platinum Investment Management Limited

A tale of two yield curves – what interest rates tell us about the world's two largest economies

Investors have been preoccupied with US interest rates in recent months as the Federal Reserve changed its stance on the likelihood of future rate increases. The resulting inversion of the US yield curve¹ has garnered significant attention as this is widely seen as a harbinger of a recession and weaker stock markets. And of course, where the US goes the world follows! There is no question that not only are interest rates an important variable for economic growth, they are also a key factor in driving stock market performance. As such, it is neither surprising nor inappropriate that the discussion around interest rates receives so much attention.

However, while the US economy is important for the global economy and financial markets, the lesson of 2018 was that China is now equally important. As we sought to explain in previous reports, China's financial sector reforms which commenced in 2017, reduced the availability of credit and precipitated a significant economic slowdown in the following year. The situation was exacerbated by the trade war with the US. While China's economy is only around two-thirds of the size of the US economy,² its impact on the markets for many physical goods is often the world's largest due to the scale of its demand. While this is well appreciated when it comes to iron ore and copper, of which China consumes about half of the world's output,³ some may find it hard to believe that China is also the world's largest market⁴ for autos (more than 23 million passenger vehicles sold in 2018 versus 17 million for the US),⁵ smartphones (454 million handsets shipped in

2017 versus 201 million for North America),⁶ and just about any other physical good one might nominate. As such, the result of China's credit tightening, compounded by its trade disputes with the US, was a slowdown not only in China's economic activity, but also in Europe, Japan, and many emerging economies which had otherwise been growing well until the latter half of last year.

The idea that China plays a large and important role in the global economy is hardly a controversial one, yet few participants in financial markets direct a proportionate amount of attention to what is going on in China and most remain focused firmly on the US. By way of illustration, many readers are likely to be well aware of the recent inversion of the US yield curve, and while some may not know exactly what the yield is on the US 10-year Treasuries, most probably have an approximate idea. (For the record, as of the end of March, the US 10-year rate was 2.39%, marginally lower than the 1-year rate at 2.40%⁷). Keener followers of markets may also know that the German 10-year bunds and the Japanese 10-year government bonds currently have a yield close to or even below zero! However, how many market participants know where the Chinese 10-year government bonds are trading at, let alone the shape of the Chinese yield curve?

One may well gain some insights from China's yield curve, and investors might not have been caught completely off guard by last year's downturn had they paid nearly as much attention to China's interest rates in the year before as they typically do to every statement made by members of the US Fed.

At the end of 2017, as can be seen from the chart on the following page, Chinese interest rates had risen significantly from the lows of 2016, with the 1-year Chinese government bond yield just 0.1% below the 10-year rate. Not quite an inverted yield curve, but close. While the People's Bank of China (PBoC) does not manage interest rates in the same manner as the central banks of developed economies, these market-set rates should provide a reasonable indicator of the credit conditions in China. In the second half of 2018, the PBoC, together with China's banking regulator, implemented

1 A yield curve plots the interest rates (or yields) of comparable debt instruments with different maturities. Starting on the left with the yields of shorter-term instruments, the curve typically slopes upwards to the right, reflecting investors' desire to be compensated for the uncertainty associated with locking their money away for longer periods of time. An inverted yield curve occurs when longer-term debt instruments have a lower yield than short-term debt instruments, reflecting expectations of weaker economic conditions – and hence lower interest rates – in the future.

2 Based on 2018 (estimate) nominal GDP, US Dollars. Source: IMF World Economic Outlook Database.

3 <https://www.businessinsider.com.au/china-global-commodity-demand-rank-gdp-2018-10>

4 Typically in volume terms, though this may be very different in value terms.

5 Source: VDA and <https://www.best-selling-cars.com/international/2018-full-year-international-worldwide-car-sales/>

6 <https://www.gfk.com/nl/insights/press-release/smartphone-unit-sales-rose-6-in-north-america-in-4q17-highest-growth-in-two-years/>

7 Source: US Treasury. 29 March 2019 rates.

1-Year versus 10-Year Chinese Government Bond Yields



Source: China Central Depository & Clearing (CCDC), Platinum Investment Management Limited.

a number of policy measures to ease liquidity conditions and loosen credit availability, and as a result, interest rates fell significantly.

In addition to lower interest rates, the Chinese government also introduced a range of corporate and personal tax cuts, as well as increased its spending on infrastructure. In developed economies, budget estimates published by the government would typically disclose the nature and scale of the various fiscal policy initiatives. While no such official numbers exist in China, estimates of this year's fiscal stimulus are as high as 3% or more of GDP, not dissimilar in size to the stimulatory measures put in place during the 2015/16 slowdown.

So, while the recent inversion of the US yield curve may be indicative of a potential slowdown or even a recession in that country, it is important to note also that fiscal and monetary policies in China are firmly set on an expansionary path.

The other positive development during the quarter is the deferral of the imposition of additional tariffs on Chinese imports into the US, as the two sides work towards a new trade agreement.

Global Macroeconomic Outlook

Indeed, there are signs of stabilisation in China's economy, though these remain inconclusive for the moment. There has been a pick-up in credit demand, car retail sales volume for the first two months of 2019 were only down slightly (2.9%⁸) from the peak a year ago, the Purchasing Managers' Index

(PMI)⁹ has improved, and at least anecdotally, the numbers of bidders at government land auctions have substantially increased. On the other hand, import and export numbers have been very weak. This is most likely the result of US and Chinese importers having brought forward their orders at different points last year, ahead of the imposition of tariffs, and may take some time to recover even if a successful trade deal transpires in the near future.

In the US, interestingly, despite (or perhaps because of) the Fed halting interest rate hikes, citing weaker economic growth, the data actually suggests that the economy remains relatively robust, with employment and wage growth remaining buoyant. Housing, the area that had been impacted most heavily by last year's rate increases, saw a strong rebound in new and existing home sales this quarter as lower bond yields fed through to lower mortgage rates.

As for Japan and Europe, as both regions have been impacted by the trade issues, there may well be a delay in the return of stronger momentum in economic growth. Having said that, domestic indicators such as employment and household expenditures remain strong in Japan and in key economies within Europe.

⁹ The PMI is an indicator of the economic health of the manufacturing sector. It is derived from monthly surveys of purchasing executives at private sector companies and is based on five major indicators: new orders, inventory levels, production, supplier deliveries and employment environment. A PMI reading of greater than 50 indicates expansion of the manufacturing sector when compared to the previous month, while a reading of under 50 represents a contraction and a reading at 50 indicates no change.

⁸ Source: CAM and Bernstein.

Looking ahead, our expectation is that China's economy will respond positively to the monetary and fiscal stimulus measures that the government has instituted. A resolution to the trade dispute with the US would also help considerably. Even if the recent inversion of the US yield curve is of significance, there can often be a lag before the economy and stock markets peak. The housing market's response to lower mortgage rates is quite supportive of the possibility that the cycle may yet have a little way to run in the US.

However, some caution is due. Given the size of the Chinese economy, it is to be expected that growth rates will steadily decline over time and, as such, the recovery may not be as spectacular or as impactful for the rest of the world as similar episodes have been in the past. Another risk to the relatively benign outlook is that a rebound in both the US and China could see the Fed change tack once again to raise rates. In addition, clearly, any stumble in the US-China trade negotiations would also be very detrimental.

Market Outlook

Markets have run strongly in the first three months of 2019 in response to the Fed's signalling that interest rate rises are on hold for the moment. Amongst developed markets, the US once again led the way (up 13.7%), then Europe (up 11.4%), followed by Japan (up 7.6%) (each in local currency terms).¹⁰ These divergences are not particularly notable on a three-month basis, though they continue a pattern of the US outperforming the rest of the world.

As we have repeatedly observed over the past year, there has been a significant divergence within markets, with a strong preference for stocks with certainty and growth, as investors sought to avoid or reduce risk. This has most notably been manifested in the extraordinary performance of high-growth

¹⁰ Local currency quarterly returns of the MSCI USA Net Index, the MSCI All Country Europe Net Index, and the MSCI Japan Net Index respectively.

MSCI Regional Index Net Returns to 31.3.2019 (USD)

REGION	QUARTER	1 YEAR
All Country World	12.2%	2.6%
Developed Markets	12.5%	4.0%
Emerging Markets	9.9%	-7.4%
United States	13.7%	8.8%
Europe	10.7%	-3.9%
Germany	6.9%	-13.7%
France	10.7%	-3.7%
United Kingdom	11.9%	-0.1%
Italy	14.6%	-10.6%
Spain	7.0%	-8.8%
Russia	12.2%	2.2%
Japan	6.7%	-7.8%
Asia ex-Japan	11.4%	-5.2%
China	17.7%	-6.2%
Hong Kong	15.6%	8.0%
Korea	4.9%	-16.7%
India	7.2%	6.8%
Australia	11.4%	4.5%
Brazil	8.1%	-4.2%

Source: FactSet.

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 31.3.2019 (USD)

SECTOR	QUARTER	1 YEAR
Information Technology	18.8%	8.5%
Energy	14.1%	2.9%
Industrials	13.8%	-1.0%
Consumer Discretionary	13.2%	2.7%
Consumer Staples	11.4%	4.8%
Communication Services	11.1%	4.7%
Materials	11.1%	-3.1%
Utilities	9.5%	12.4%
Financials	8.2%	-7.8%
Health Care	8.0%	10.9%

Source: FactSet.

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

Historical performance is not a reliable indicator of future performance.

technology stocks, best represented by the new software-as-a-service (SaaS) businesses. Examples include Salesforce, Workday and ServiceNow. Each of these companies provides cloud-based software applications that help companies run their business. During the quarter, many of these SaaS companies (easily in excess of 50 in the US alone, plus more listed elsewhere) not only rebounded, some even proceeded to reach significant new highs. While many of these companies hold great promise and some have the capability to execute, it is not uncommon for their stock prices to be trading at **15 to 25 times sales**. These are extraordinarily high valuations, and while the future success of some of these companies may ultimately justify their current stock prices, it is unlikely that all of them will. It should be noted that the performance of high-growth areas such as information technology and healthcare explains much of the US market's outperformance over the rest of the world, reflecting its higher weighting in these sectors.

But perhaps these high-growth sectors will continue to rise, you might say. Why should one expect the strong price ascent of these well-loved companies to stall, or even reverse, at some point? Firstly, when interest rates ultimately move higher, the stock prices of highly-valued companies tend to be more sensitive. We saw a preview of this in the fourth quarter last year when, faced with the prospect of further interest rate hikes, the high-growth tech and healthcare stocks finally had a setback. However, with the Fed's now more dovish stance on rates, a similar sell-off appears to be off the agenda for the moment. Another possible trigger for a correction is the supply of new "growth stock investment opportunities". On this front, there is reason to be cautious as there is a substantial pipeline of new IPOs coming to market.

These include Lyft (Uber's competitor in ride-sharing, listed in the last week of March), Pinterest (web application for sharing images), and Uber. Ultimately, the very high valuations of growth stocks will likely attract a steady supply of new listings which, once reaching enough volume, will at some point potentially suppress the share price performance of companies already listed.

Outside of these expensive pockets of "growth", the end of 2018 saw many other stocks sold down to very attractive valuations. Broadly speaking, these out-of-favour companies all had elements of uncertainty or cyclicalities in their businesses. Afflicted by apprehensions of a global recession, investors were unwilling to look through the cycle to a potential recovery. These included many semiconductor, energy, metals, banking, auto, and industrial stocks, as well as much of the Chinese market. In many cases, the stocks were already trading at or close to the valuations reached at the bottom of prior economic and market downturns. In such cases, the likelihood of a recession had become a moot point as the stock valuation had already priced in a substantial discount as if a major recession was already occurring. Some of these companies had a strong recovery this quarter, most notably Chinese stocks (up 17.9%).¹¹ Easier monetary conditions in China, fiscal expansion, and relief on the trade front were all contributors to the rebound in the Chinese market. Despite this move, however, sentiments of both Chinese and foreign investors remain cautious and valuations are still highly attractive. Similarly in the other depressed areas (such as semiconductor, energy and industrials), while there has been a broad lift, valuations remain attractive and prospective returns promising.

11 MSCI China Net Index (local currency).

Notes

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1. PMC's returns are calculated using PMC's pre-tax net tangible asset (NTA) backing per share (as released to the ASX monthly). PMC's returns are calculated after the deduction of fees and expenses, have been adjusted for taxes paid and any capital flows, and assume the reinvestment of dividends. **PMC's returns have not been calculated using PMC's share price.**

PMC's returns have been provided by Platinum. The MSCI All Country World Net Index (A\$) returns have been sourced from FactSet. Index returns are in Australian Dollars and are inclusive of net official dividends, but do not reflect fees or expenses. The gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist then. For the purpose of calculating the "since inception" returns of the Index, PMC's portfolio inception date (29 June 1994) is used. Platinum does not invest by reference to the weightings of the Index. PMC's underlying assets are chosen through Platinum's bottom-up investment process and, as a result, PMC's holdings may vary considerably to the make-up of the Index. Index returns are provided as a reference only.

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2. The geographic disposition of assets (i.e. the positions listed other than "cash" and "shorts") represents, as a percentage of PMC's portfolio value, PMC's exposures to the relevant countries/regions through direct securities holdings and long derivatives of stocks and indices.
3. The table shows, as a percentage of PMC's portfolio value, PMC's exposures to the relevant sectors through direct securities holdings as well as both long and short derivatives of stocks and indices.
4. The table shows the effective net currency exposures of PMC's portfolio as a percentage of PMC's portfolio value, taking into account PMC's currency exposures through securities holdings, cash, forwards, and derivatives. The table may not exhaustively list all of PMC's currency exposures and may omit some minor exposures.
5. The table shows PMC's top 10 long equity positions as a percentage of PMC's portfolio value, taking into account direct securities holdings and long stock derivatives. 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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