



**Platinum  
International Fund**  
**(Quoted Managed Hedge Fund)<sup>®</sup>**

(ARSN 620 895 301 | ASX Code: PIXX)

**Quarterly Investment  
Manager's Report**

**30 June 2018**

# Investment Update

by Kerr Neilson, Portfolio Manager

## Performance

(to 30 June 2018)

	QUARTER	6 MONTHS	SINCE INCEPTION
Platinum International Fund (Quoted Managed Hedge Fund)	-0.5%	0.3%	8.9%
MSCI AC World Net Index (A\$)	4.4%	5.4%	15.0%

Fund returns are net of accrued fees and costs. Refer to note 1, page 11.

Inception date: 12 September 2017.

Source: Platinum Investment Management Limited, FactSet.

Historical performance is not a reliable indicator of future performance.

The Platinum International Fund (Quoted Managed Hedge Fund) (ASX code: PIXX) is a feeder fund that primarily invests into Platinum's flagship international equity fund, the Platinum International Fund ("PIF"), which was established on 4 April 1995.

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

## Market Review

The features of the markets that we highlighted in the first quarter continued to be expressed in the second, namely, greater volatility in markets, tightening credit and a flattening of economic indicators like the Purchasing Managers' Indices (PMIs). This caused a pronounced divergence in the performance of the emerging markets, perceived typically as being dependent on and the recipients of capital flows from the so-called developed markets.

The big change was the shift in perception about the US dollar. The blend of loose fiscal policy emanating from the tax cuts and tight monetary policy, together with the second federal funds rate rise this year, led to a rapid strengthening of the US currency. Further guidance from the Fed of two

more rises likely later in the year reinforced this tendency. There were of course a diverse range of other factors. The US domestic economy showed no signs of slowing, the European Central Bank indicated that it was in no hurry to return to positive rates before mid 2019, and political intrigue reached fever pitch.

The home of Machiavelli put on a splendid performance of political theatre following the March election while not too far to the north, Frau Merkel was tussling with her alliances to deal with the European-wide consternation about illegal immigration. Hard-line anti-immigration legislation was passed in Hungary, threatening imprisonment for anyone found to have helped or legally represented asylum seekers. While Macron was trying to inveigle the Germans into closer European fiscal bonds, Brexit droned on with recalcitrant 'remainders' seeking stronger assurances from Theresa May about the terms of severance.

Almost drowning out these developments were the much publicised negotiations between Donald Trump and the leader of North Korea, Kim Jong Un. These talks apparently ended the threat of a nuclear fallout with much acclaim being attributed to the American president. Inexplicably, no sign of gratitude was extended to China who, by closing almost all supply corridors to North Korea, essentially forced a positive outcome. Instead, there was a hardening of the position of the White House on trade with China in an attempt to enforce more favourable trade concessions and greater protection of intellectual property rights. These issues were far from resolved as we entered July and fears of tit-for-tat that targets individual companies is a relatively new development for the market to consider. The White House also chose to pick fights with its trading partners in NAFTA (the North American Free Trade Agreement). None of this gives any reassurance to markets in terms of supporting business confidence.

However, massive takeovers of the likes of 21st Century Fox and Time Warner, though fewer than in the first quarter, are still running at a frenetic pace and serve as a reminder of the inevitable restructuring of older industries in the face of fundamental change. This was underlined by huge raising of private equity, a record-breaking US\$453 billion in 2017 and a further US\$80 billion in the first quarter of 2018,<sup>1</sup> and impressive raisings by initial coin offerings (or ICOs)

<sup>1</sup> Source: Preqin

amounting to US\$12 billion year to date,<sup>2</sup> despite recent falls in the value of Bitcoin and other cryptocurrencies (as our December 2017 feature article suggested they might).

None of these perturbations were helpful to our position. Though we have virtually no exposure to the emerging markets of Latin America or others like Turkey, Russia or South Africa which were violently sold off on account of US dollar indebtedness, large trading nations like China, Japan and Korea were adversely affected by the turbulence. As the MSCI Regional Index Net Returns table below shows, Emerging Markets fell by 4.4% over the quarter while Japan was also weak relative to the stand-out performer which was the US, which rose by 7.4% in AUD terms. The resource plays that worked in our favour were energy producers which continue to benefit from tight supplies and solid demand. In addition to our heavy exposure to Asia, there were other casualties among our stocks, notably Pandora, the Danish purveyor of inexpensive jewellery, Bharti Airtel, the Indian mobile service provider, and Rakuten, Japanese e-commerce company, which we had been selling.

Lastly, we lost about -0.5% on our short positions over the quarter, while contribution from currencies was flat. The result was a very disappointing quarter where we lost ground and surrendered part of the strong performance we had enjoyed over the last 12 months. For the quarter, PIF (C Class) recorded a loss of -0.7%, and for the year we achieved +14.2%. This was slightly shy of the performance of the MSCI AC World Net Index (A\$) for the year.

<sup>2</sup> Source: [www.coinschedule.com/stats/html](http://www.coinschedule.com/stats/html)

**MSCI Regional Index Net Returns to 30.6.2018 (AUD)**

REGION	QUARTER	1 YEAR
<b>Developed Markets</b>	<b>6%</b>	<b>15%</b>
<b>Emerging Markets</b>	<b>-4%</b>	<b>12%</b>
<b>United States</b>	<b>7%</b>	<b>18%</b>
<b>Europe</b>	<b>2%</b>	<b>9%</b>
Germany	0%	6%
France	3%	14%
United Kingdom	7%	14%
<b>Japan</b>	<b>1%</b>	<b>15%</b>
<b>Asia ex Japan</b>	<b>-2%</b>	<b>14%</b>
China	0%	26%
Hong Kong	3%	13%
India	3%	11%
Korea	-6%	7%
Australia	9%	13%

Source: FactSet. Numeric figures are subject to rounding. Total returns over time period, with net official dividends in AUD. Historical performance is not a reliable indicator of future performance.

**Changes to the Portfolio**

As the quarter progressed we began to raise more cash, both to capture some strong price rises and also to make way for the large impending year-end distribution. The positions in **Hyundai Motor**, **Inpex** and **Norilsk Nickel** were sold as was most of the holding in potash producer, **K+S**. Both Norilsk and K+S gave reasonable returns while Hyundai has been disappointing because of boycotts in China and its slow response to meet the market trend towards SUVs. The return from Inpex was enhanced by our additions during periodic setbacks, but as a long-term holding, it fell short of our anticipated return. Delays and capex overruns on the giant US\$40 billion Ichthys LNG project were to be expected, but the disappointment lay in the management's guidance regarding the degree to which shareholders will participate in future cash flows from this massive Browse Basin LNG project.

The important buys for the quarter were further additions of **Facebook** and initial purchases of **Kasikornbank** in Thailand, the shale gas producer **Seven Generations** in Canada and the regional bank **Suruga** in Japan. We described the case for Facebook last quarter, and while there are ongoing issues with data privacy, the case stands.

**Kasikornbank** remains a family owned and managed bank and is among the 'big 4' in Thailand with around 15% of the system's deposits and loans. **The arbitrage is principally boredom.** There seems to be nothing remarkable happening. The Thai economy is growing with a hint of acceleration. There is very little inflation and the current account surplus is running at close to 10% of GDP. Foreign exchange reserves are US\$200 billion and the memories of the 1997-98 melt-down have barely faded.

**MSCI All Country World Sector Index Net Returns to 30.6.2018 (AUD)**

SECTOR	QUARTER	1 YEAR
Energy	14%	29%
Information Technology	8%	31%
Consumer Discretionary	7%	20%
Health Care	6%	9%
Utilities	5%	7%
Materials	4%	18%
Consumer Staples	2%	3%
Industrials	1%	10%
Telecommunication Services	-1%	-1%
Financials	-2%	9%

Source: FactSet. Numeric figures are subject to rounding. Total returns over time period, with net official dividends in AUD. Historical performance is not a reliable indicator of future performance.

What separates Kasikornbank from the others is its preference for small company lending (63%) and **a strong and cheap deposit base** comprising current and savings accounts that represent 79% of funding. Over the cycle it has earned spreads of about 1% higher than competitors because of its preference for small business lending, but offsetting this have been credit costs that are above industry average by about 0.5% a year. The net effect is that the *ex post* 'realised' return on equity over the last 10 years has been about 15% per annum, of which 2% p.a. has been distributed to shareholders as dividends. The capital position is extraordinarily strong with Tier 1 capital of 15.4%, and this is after a rather protracted and difficult credit cycle starting with the floods in 2011, the slowing of growth in the region led by China in 2013, and the coup in 2014. Non-performing loans tripled between 2013 and 2016 and are now declining. This **sets up the system and Kasikornbank nicely for the next credit growth cycle and even if it is muted, a slight improvement in loan growth and falling provisions should accelerate earnings growth** to high single or even low double digits. Starting with a price-to-book ratio of 1.3x and a prospective price-to-earnings ratio of under 11x, this seems like a great bargain for a well-funded bank in a relatively stable home market.

As a producer of natural gas, natural gas liquids and condensate (a light oil used as a diluting agent to blend with oil sands bitumen to improve flow in pipelines), **Seven Generations Energy** is an interesting opportunity to participate in the unfashionable Canadian exploration and production sector. Pipeline capacity constraints are the concern for Canadian producers, as evacuation difficulties tend to suppress regional hydrocarbon prices. 7G didn't help its case by tending to over promise, and after ramping up from a very small base to become Canada's largest

condensate producer at nearly 200,000 BOE/d (barrels of oil equivalent per day), it is **now going through a production reset**. The leadership has changed, technical issues addressed and projections lowered, but which still suggest volume growth of some 7% to 14% p.a. over the next five years. Free cash flow begins in the second half of this year as above-ground investment stabilises and the company's gas processing plant comes on line.

**Central to the case is a highly contiguous 500,000 acre position in the over-pressured, liquids-rich sweet spot of the Montney Kakwa River area of Alberta.** We believe the economics are as good as those in the Permian Basin, supported by the very **high condensate yields**. This product is an ideal diluent and faces growing demand from Alberta's fast expanding oil sands production. While over 60% of well economics are driven by liquids revenues, 7G has underpinned its future production growth **by locking in long haul pipeline capacity to the US**. (It was this take-or-pay agreement that partly explained the helter-skelter growth drive initiated by the former management which led subsequently to above-average well decline rates and other operational problems.) As the company drills more wells – it has only sunk 200 to date, with the potential of over 1000 – the pre-investment in above ground handling will provide considerable leverage to free cash flow which we estimate will exceed US\$1 billion by 2022 at current hydrocarbon prices. The company is capitalised at just under US\$4 billion.

## Shorting

This has not been our finest quarter. One or two of the individual stock positions made positive returns but the volatility of the more daring shorts cost us, as did the index positions. As noted above, shorts subtracted -0.5% from our returns this quarter and -1.3% over the last 12 months.

## PIF Portfolio Disposition

REGION	30 JUN 2018	31 MAR 2018
Asia	35%	37%
Europe	21%	22%
North America	18%	14%
Japan	12%	14%
Australia	<1%	<1%
South America	<1%	1%
Russia	<1%	1%
Cash	13%	11%
Shorts	-15%	-14%

Refer to note 2, page 11. Numeric figures are subject to rounding.  
Source: Platinum Investment Management Limited.

## Top 10 Holdings of PIF

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Samsung Electronics	Korea	IT	2.8%
Alphabet Inc	USA	IT	2.8%
Ping An Insurance Group	China	Financials	2.6%
TechnipFMC	UK	Energy	2.4%
Glencore PLC	Switzerland	Materials	2.4%
Facebook Inc	USA	IT	2.3%
Siemens AG	Germany	Industrials	2.3%
Royal Dutch Shell PLC	UK	Energy	2.0%
Jiangsu Yanghe Brewery	China	Consumer Staples	2.0%
Intel Corporation	USA	IT	1.9%

As at 30 June 2018. Refer to note 4, page 11.

Source: Platinum Investment Management Limited.

## Currency

The principal change was to increase the exposure to the US dollar by 4% out of the Korean won and the Euro.

CURRENCY	30 JUN 2018	31 MAR 2018
US dollar (USD)	26%	22%
Hong Kong dollar (HKD)	13%	14%
Euro (EUR)	12%	14%
Japanese yen (JPY)	11%	12%
Chinese yuan (CNY)	7%	7%
Korean won (KRW)	6%	8%
British pound (GBP)	6%	5%
Indian rupee (INR)	5%	5%
Australian dollar (AUD)	5%	3%
Norwegian krone (NOK)	2%	3%

Refer to note 3, page 11. Numeric figures are subject to rounding.  
Source: Platinum Investment Management Limited.

## Commentary

With the tightening that we noted last quarter and the more recent political disharmony in Europe as well as between the US and its principal trading partners, one can certainly see the need for caution. In general, **our research reveals that the areas of greatest value lie in Japan, Korea and Taiwan**, but indeed they are each open trading economies. In Japan the contrasts are stark. The entire listed corporate sector has a market capitalisation of US\$6 trillion, yet in aggregate its cash and deposits sit at US\$2.3 trillion. This is remarkable given that it was the excessive use of debt that led to their downfall and now the boot is on the other foot, yet stock prices barely endorse this! The following table highlights some of these ratios versus the world average for listed companies.

	JAPAN	KOREA	TAIWAN	WORLD AVERAGE
Net debt-to-equity ratio <sup>(1)</sup>	34%	24%	7%	50%
Return on capital employed	13.4%	13.5%	17.8%	12.0%
Trailing P/E	15.6x	11.0x	15.8x	21.0x
Trailing weighted EPS growth in USD - 5 years	11.8%	8.7%	12.4%	5.0%
Trailing weighted EPS growth in USD - 10 years <sup>(2)</sup>	3.8%	5.8%	2.9%	2.1%
Foreign exchange reserves - months' imports	19	9	20	11
Current account surplus to GDP	4%	5%	13%	0%

(1) Excludes cross-shareholdings and investments.  
(2) This measures earnings from the pre-GFC peak levels.

Source: FactSet, MSCI, IMF and CEIC.

These measures hardly suggest that these Asian countries are economic cripples or that their companies in aggregate have performed particularly badly against the global average. The fact is that they have surpassed the world average on each measure, yet their stocks are more modestly priced. The common thread is that these are relatively open economies with massive exchange reserves and evidently competitive economies. **Along with China, these markets have been punished of late. Is this because of the changing perceptions about global trade which is no longer expanding faster than the world economy in aggregate?** Even if we are at the early stages of the demise of mercantilism, we feel comfortable that we can still identify very interesting individual companies!

Now, we know that the US economy is booming and that there has just been a huge fiscal transfer, thanks to the tax cuts. But why should we be particularly optimistic about the US economy relative to others? The government's funding requirement is huge, with the need to find buyers in the next three years for some US\$3 trillion of federal debt to meet refinancing and new issuance. This at a time when the traditional buyers of US government debt from the Middle East, Japan and China are, if anything, looking to reduce their exposure. In addition, corporate debt in the US is now over 57% higher than in 2007, and remember, with all the cash sitting on the balance sheets of the 'FANG'-like companies, implying considerable concentration of debt elsewhere.<sup>3</sup> **We are intrigued that high corporate debt levels as well as underfunded pension schemes do not receive more sanction in the light of rising interest rates.**

Moving from the general to the particular, we can find industries with **growth prospects that are to a high degree independent of their host economies**. These originate from either the **regulatory environment or the inevitable evolution of technology**. Sometimes these are niche opportunities, others are tangentially related. For example, a lot of threads can be drawn from the impending International Maritime Organisation regulation that requires ships worldwide to **cut sulphur emissions** from 3.5% m/m (mass on mass) currently to 0.5% by 2020. Designated emission control areas (ECAS) such as the Baltic Sea area, the North Sea area and the coastal areas off North America are subject to an even stricter limit of 0.1% m/m. To achieve these much reduced levels of pollution, shipowners will need to consider replacing old style bunker fuel with low sulphur fuel oil blends, replacing or converting propulsion units to dual fuels incorporating LNG, installing 'scrubbers' (exhaust gas cleaning systems), or even scrapping uneconomic vessels. Among other things, this has huge ramifications for the increased demand for refined diesel fuel – perhaps as much as

<sup>3</sup> Aggregate market cap of the Russell 2000 Index is US\$2.6 trillion. Net debt is around US\$1.1 trillion. Debt-to-equity ratio is approximately 41%.

4 million barrels *per day* (4% of primary oil production). This is great news for certain refineries, storage facilities, and perhaps also some shipyards.

In addition, the rise in shale liquids has further changed the **slate available to refineries**, which has implications for relatively obscure areas such as the production of needle coke. The shortages of this product, which goes into the fabrication of graphite electrodes (that require a very low coefficient of thermal expansion) for electric arc furnaces used in the steel industry, have been reflected in soaring prices, exacerbated by the Chinese beginning to ramp up scrap-fed electric-arc steel production.

Other regulations restricting **automobile emissions** have implications for the speed of adoption of electric vehicles (EVs) and hybrid drives, pointing to additional demand for metals such as copper, nickel and cobalt. This is not just a dream, because traditional auto companies are launching pure electric models, starting with Jaguar in the third quarter of 2018 and various German manufacturers next year. Chinese auto manufacturers are also launching EV products spurred on by government incentives. Adding to this demand for raw materials is the burgeoning demand from **stationary batteries** which are partly the product of the solar power boom that has continued to grow on account of rising efficiency and which has seen panel costs nose dive.<sup>4</sup>

The supply of more **wind power** has similarly been the product of falling costs borne on the wings of technical advances and cheap financing. The industry has seen its economics improve exponentially with electrical energy now being delivered to the grid in the US at US\$40-50 per megawatt hour (MWh), which is on par with highly efficient coal-burning plants in low cost locations.<sup>5</sup> The emergence of financial intermediaries as the owners of these wind farms has incidentally enhanced the quality of the turbine manufacture businesses by virtue of granting **long duration service agreements**. We benefit from these various opportunities directly through our exposure to several companies in the portfolio.

We are also finding **interesting companies that are applying their product know-how to new applications**. For example, Murata, who have been progressively moving up the difficulty curve in making multilayered ceramic capacitors, can barely keep up with demand from the auto industry. Another Japanese company is finding new applications for its flexible printed circuits, such as LED lights in automobiles. Both companies have imminent growth generators derived from technical innovation and importantly, little exposure to demand destruction in their traditional activities. On the other side of the spectrum, the normally tame demand from gaming applications for graphic processing units (GPUs) has been disrupted by a surge of usage to mine cryptocurrency tokens such as Bitcoin. We believe the recent setback in this activity will lead to a likely de-stocking cycle to reward us on the short side of a very optimistically priced producer.

## Outlook

There has been some fierce repricing of companies in Asia and the emerging markets in general. Trade disputes are damaging sentiment, but above all, the tightening of credit causes the most damage to valuations. After such a painful re-calibration of prices, we are inclined to believe that the Asian markets have adjusted to this new scenario. All indicators for the underlying economies of Asia are very solid, with scant evidence of slowing. While there is unlikely to be any near term let-up in the liquidity squeeze, we believe that valuations are extremely attractive, with, for example, the Chinese market on a prospective P/E of around 11 times. The portfolio is very attractively set at these levels. We would expect to see some upward price spikes as the fear around the trade disputes dissipate. We are maintaining shorts on the most aggressively priced segments of markets in the belief that if there is no relief to tighter money, these well-owned and extraordinarily highly priced sectors will also succumb to a reappraisal by investors.

<sup>4</sup> Solar Choice suggests that solar prices in Australia have fallen from about \$2.40 per Watt in 2012 to about \$1.40 now.

<sup>5</sup> A 4 July 2018 article in the Australian Financial Review suggests that solar and wind augmentation is starting to drive down prices in Australia from last year's panic levels. Yet, wholesale prices are still high by world standards at between \$72 and \$101 per megawatt hour.

# 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%.<sup>1</sup> 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.

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



# The Journal

Visit [www.platinum.com.au/Our-Products/PIXX](http://www.platinum.com.au/Our-Products/PIXX) to find a repository of information about the Platinum International Fund (Quoted Managed Hedge Fund) (PIXX), including:

- NAV history and intra-day iNAV
- distribution history and the Distribution Reinvestment Plan
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- monthly updates on PIXX's performance, portfolio positioning and top 10 holdings

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Recent highlights include:

- **Video - Platinum Health Care Update<sup>1</sup>** – Investing in health care isn't just about targeting the ageing population. Dr Bianca Ogden explains the key trends in health care today and how data is driving innovation.
- **Video - Investment Update<sup>2</sup>** – Clay Smolinski discusses where we are at in the economic cycle for the world's major markets, and where we are finding the most opportunities.



1 <https://www.platinum.com.au/Insights-Tools/The-Journal/Video-Platinum-Health-Care-Update>

2 <https://www.platinum.com.au/Insights-Tools/The-Journal/Video-Investment-Update>

# Glossary

## Debt to equity ratio

Also known as the net debt to book value ratio or the gearing ratio, the debt-to-equity ratio is calculated by dividing a company's total liabilities by its shareholders' equity. It is a measure of how much debt or leverage a company is using to increase returns and shows the relationship between funds provided by creditors and funds provided by shareholders.

## Dividend yield

A ratio that indicates how much a company pays out in dividends each year relative to its share price (adjusted for any share splits).

## Earnings per share (EPS)

An indicator of a company's profitability, EPS equals to profit, net of tax and dividends to preferred shareholders, divided by the total number of ordinary shares outstanding.

## Price to book ratio (P/B)

The ratio of a company's current share price to its book value (total assets minus intangible assets and liabilities). It is an indicator of the value of a company by comparing its share price to the amount of the company's assets that each share is entitled to.

## Price to earnings ratio (P/E)

The ratio of a company's current share price to its per-share earnings, P/E is used as an indicator of the value of a company by comparing its share price to the amount of per-share earnings the company generates. A high P/E ratio suggests that the company's share price is expensive relative to the company's profits, which usually implies that investors are expecting the company's future profits to grow quickly.

## Price to sales ratio (P/S)

The ratio that compares a company's current share price to its revenue, P/S is an indicator of the value placed on each dollar of a company's sales and is typically calculated by dividing the company's market capitalisation by its total sales over a 12 month period.

## Purchasing Managers' Index (PMI)

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.

## Return on Capital Employed (RoCE)

RoCE is a measure of a company's profitability and the efficiency with which its capital (which includes both equity and long-term debt) is employed. It is calculated as earnings before interest and tax (EBIT) divided by capital employed, where "capital employed" represents the sum of shareholders' equity and the long-term liabilities. The higher a company's RoCE ratio, the more efficient its use of capital.

## Return on Equity (ROE)

ROE is a measure of a company's profitability and the efficiency with which it generates earnings from every unit of the funds that shareholders have invested in it. It is calculated as profit (or net income after taxes) divided by shareholders' equity. The higher a company's ROE ratio, the more efficient its use of shareholders' money.

## Volatility

Volatility is a statistical measure of the variation in returns for a given investment over a given time period. It is the same as standard deviation. High volatility implies bigger and more rapid swings in price or valuation over a relatively short period of time, while low volatility implies smaller and less frequent fluctuations.

Volatility is an indicator of the degree of uncertainty or risk involved in achieving a target return from an investment. The higher the volatility, the riskier the investment is generally considered to be.

## Yield

Yield refers to the income generated from an investment (such as the interest from cash deposits, the dividends from a shareholding, or the rent from a property investment), usually expressed as an annual percentage rate based on the cost of the investment (known as cost yield) or its market price (known as current yield).

For bonds, the yield is the same as the coupon rate (assuming the bond is purchased at par or is trading at par). Any increase or decrease of the yield relative to the coupon rate is approximately inversely proportional to any change in the bond price (yields fall as prices rise, and vice-versa).

## Notes

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1. PIXX's returns are calculated using PIXX's net asset value per unit (which does not include the buy/sell spread) and represent PIXX's combined income and capital returns over the specified period. PIXX'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 PIXX's underlying assets and other risk factors associated with investing, investment returns can be negative, particularly in the short-term.

PIXX's returns have been provided by Platinum Investment Management Limited. The MSCI All Country World Net Index (AS) 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, PIXX'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. PIXX's underlying assets are chosen through Platinum's bottom-up investment process and, as a result, PIXX'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 PIF's effective exposures to the relevant countries/regions as a percentage of PIF's net asset value, taking into account direct stock holdings and long derivative positions (stocks and indices).
3. The table shows PIF's effective exposures to the relevant currencies as a percentage of PIF's net asset value, taking into account stocks holdings, cash and the use of derivatives.
4. The table shows PIF's top 10 long stock positions as a percentage of PIF'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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