Platinum Japan Fund

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Portfolio Manager

Performance

(compound pa, to 31 March 2018)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Japan Fund*	-1%	21%	12%	23%	15%
MSCI Japan Index	3%	19%	8%	16%	3%

*C Class – standard fee option. Inception date: 30 June 1998.
Net of accrued fees and costs. Refer to note 1, page 4.
Source: Platinum Investment Management Limited, RIMES Technologies.
Historical performance is not a reliable indicator of future performance.

Disposition of Assets

REGION	31 MAR 2018	31 DEC 2017	31 MAR 2017
Japan	86%	94%	94%
Korea	0%	2%	0%
Cash	14%	4%	6%
Shorts	-2%	-2%	-2%

Source: Platinum Investment Management Limited. See note 3, page 4.

Sector Breakdown

SECTOR	31 MAR 2018	31 DEC 2017
Information Technology	23%	25%
Industrials	16%	17%
Consumer Discretionary	13%	14%
Materials	11%	12%
Financials	10%	9%
Energy	7%	8%
Health Care	4%	4%
Telecommunication Services	1%	5%
Consumer Staples	-1%	-1%
TOTAL NET EXPOSURE	84%	94%

Source: Platinum Investment Management Limited. See note 5, page 4.

Currency Position

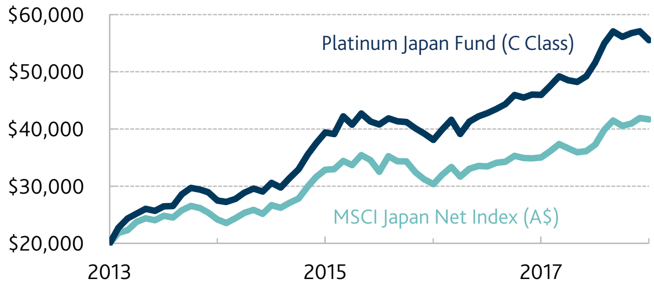
	31 MAR 2018	31 DEC 2017
Japanese yen	95%	71%
US dollar	4%	24%
Korean won	0%	2%
Australian dollar	1%	3%

Source: Platinum Investment Management Limited. See note 6, page 4.

The Fund (C Class) fell 1.0% for the quarter and rose 20.8% for the twelve months. A defining aspect of the Japanese stock market is the wide valuation dispersion between the most expensive stocks and the cheapest stocks, which reflects the price outperformance of growth versus value. This is a phenomenon seen in many global markets but it is particularly evident in Japan. From both a historical and a fundamental perspective, these trends eventually reverse, but the timing is difficult, if not impossible, to predict. Recent portfolio performance has been weighed down by this phenomenon and it would not be unexpected if this continues for an indeterminate period of time. The risk is that the valuation dispersion is reflecting, however unlikely, a fundamental change in both human behaviour and the underlying structure of the economy.

Value of $20,000 Invested Over Five Years

31 March 2013 to 31 March 2018



Net of accrued fees and costs. Refer to note 2, page 4.
Source: Platinum Investment Management Limited, RIMES Technologies.
Historical performance is not a reliable indicator of future performance.

Changes to the Portfolio

While it has been evident for more than a year that many high quality Japanese companies and those with obvious growth prospects were fully valued from a longer-term perspective, the recent domestic buying in the stock market has given rise to some valuations that are toward the absurd end of the spectrum. The longer-term prospects are undoubtedly bright for voice recognition, automated driving, artificial intelligence, quantum computing and the sharing economy, among others, but even on the most optimistic scenarios it is impossible to justify price-to-earnings (P/E) multiples above 300 and price-to-sales (P/S) multiples above 100. Academic studies have shown that future returns are negative for all time horizons when valuations rise above P/S multiples of 8, of which many examples can be found.

The portfolio has been gradually transitioning toward the cheaper parts of the market and this process has recently accelerated. The overall market remains attractively priced on both an absolute and relative analysis with roughly half of the 3,000 listed stocks selling below book value. The large cash holdings across the market (Nintendo and Keyence each have more than US$10 billion of cash) and the extensive cross-shareholdings mask the overall valuation and return metrics, thus it is not surprising that many cheap investments are visible upon closer inspection. Many companies are trading on their lowest valuations in five decades.

Top 10 Holdings

STOCK	COUNTRY	INDUSTRY	WEIGHT
Nintendo	Japan	IT	4.3%
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Itochu Corporation	Japan	Industrials	3.6%
Inpex Corporation	Japan	Energy	3.4%
Sumitomo Mitsui Financial	Japan	Financials	3.3%
Mitsubishi UFJ Financial	Japan	Financials	3.0%
Hogy Medical	Japan	Health Care	2.8%
Sumitomo Metal Mining Co	Japan	Materials	2.7%
Lixil Group Corporation	Japan	Industrials	2.5%
Ebara Corp	Japan	Industrials	2.5%

As at 31 March 2018.

Source: Platinum Investment Management Limited. See note 4, page 4.

For further details of the Fund's invested positions, including country and industry breakdowns and currency exposure, updated monthly, please visit https://www.platinum.com.au/Investing-with-Us/Investment-Updates.

Commentary

The news and trends in Japan continue along surprising trajectories, especially relative to the external consensus. In summary, many indicators show an economy that is stronger than any time post bubble. Strong employment gains have reduced unemployment to the lowest level in decades. This is due to rising participation rates, especially among female and older workers. Retirement is perhaps a curse for civil societies, rather than the promised nirvana. The Japanese female worker participation rate is now higher than the OECD average and higher than the USA. The absolute number of workers across Japan is now at record levels, delaying the much discussed demographic demise of the country. Recent legislative and cultural efforts further address the birth rate which is now rising perhaps for timing reasons, but is certainly helped by rising wages and underlying economic optimism. Dating apps are surging in popularity. The impact of these employment trends is seen in both wage growth and higher consumer spending, but the most important point to watch will be productivity gains should decades of socialising unemployment become unwound. Improved productivity is part of the explanation for the rise in corporate operating margins, which have shifted higher from a multi-decade range around 3% and are now approaching 6%.

Gambling in Japan is often associated with the unique sound of ball bearings cascading through neon-lit Pachinko parlours immune to change through the decades. Astoundingly, the political process seems to have agreed to proceed with three integrated resort casinos in Japan after an exhaustive and exhausting negotiation. This is against the backdrop of rising inbound tourism which is causing strain on some city infrastructure, but also highlights the spare capacity across rural Japan. New electronic pocket translators with wireless connections to a cloud-based application allow fifty languages to be translated in real time with particular focus on the needs of Chinese, Korean, English/American and ASEAN visitors.

The Japanese Corporate Governance Code was published in early 2015. It provided guidance, but was not enforceable. Adherence has been patchy, but it certainly provided cover for those who wished to adjust, or merely signal. Recently announced draft revisions to the Code contain stronger and more specific language in many areas, reflecting the government's frustration with the rate of progress over the last three years. Of particular note are the details related to cross-shareholdings. By some estimates, surplus corporate cash holdings are more than a quarter of the current market valuation which, when combined with cross-shareholdings of similar magnitude, give some idea of the enormity of the opportunity being addressed and why it is of particular relevance to equity owners. In an environment of low cash deposit rates, high bond prices and elevated asset prices generally, it seems inevitable that external pressure on corporate management teams will increase across a wide range of areas, including underlying business improvement and financial management.

It has been five years since Abenomics commenced. Amidst the bustle of daily life, it is easy to forget that this dramatic change in direction followed two decades of post-bubble economic recovery during which the Ministry of Finance enforced its preference for tight monetary conditions. The details of Prime Minister Abe's “Three Arrows” (monetary easing, fiscal stimulus and structural reforms) and their associated actions are well documented and there is much debate about the success or failure of this primary tenet of Abe’s second period as leader. However, what is of primary importance is the narrative now being disseminated, comparing the outcomes of the two preceding decades with those of the five years of Abenomics. This is important as Abe now has a political mandate and Kuroda has been reappointed to the Bank of Japan with two deputies who strongly advocate a continuation of the current approach. This team was seemingly appointed against the wishes of the Ministry of Finance. The propaganda clearly stresses the structural changes in the economy resulting from Abenomics. With a renewed mandate, it is almost impossible to believe that more of the same and perhaps stronger medicine won’t be applied. This is contrary to the prevailing market consensus which, while hoping for more of the same, has settled into a narrative which implies the end of the experiment and a return to the prior conditioning.

Sporadically, a public commentator would talk about the relevance of Japan’s post-bubble economic experience to the current global environment. This is often part of a wider search for historical analogies to the present day situation. They question whether the post-depression template of the 1940s or the inflation foothills of the 1960s are more appropriate than the post 1989 Japanese experience. Certainly, the entry into the global economy of billions of smartphone users climbing the economic ladder should exert pressure on Mother Nature to provide raw materials which are naturally limited. However, this is offset by the extent of global debt and the financialisation of many economies. The debate continues. As China increasingly asserts primacy in global events amid those unfolding on the Korean Peninsula and the trade, tax and treasury turmoil emanating from Washington DC, it is perhaps appropriate to quote Lenin: “There are decades where nothing happens; and there are weeks where decades happen.” Along this line of thinking, reminders have been resurfacing of Roosevelt’s Executive Order 6102 of 1933, which forbade the hoarding of gold, and Nixon’s closure of the gold window in 1971, which led to the collapse of the Bretton Woods system and indirectly to the Plaza Accord of 1985. Some talk about the fall of the Berlin Wall in 1989 as context for the current North Korean negotiations. As the Federal Reserve continues its concurrent path of higher interest rates and balance sheet “normalisation” while China also attempts to rein in credit growth, there are many in Japan who would caution against a repeat of their own decades of mistakes. Perhaps they should follow Ben Bernanke’s recommendation to use the *Lords of Finance* as a primary reference and heed the book's key lesson of “devalue hard and devalue early”.

Tesla’s ongoing travails are perhaps distracting the debate away from the overall energy discussion, especially in the context of robust global demand. With this in mind, it is worth noting three recent developments. Firstly, after a few years of oversupply, many are now coming to the conclusion that eventual LNG deficits are unavoidable due to the long-duration nature of new projects. Chinese and other Asian demand has been robust, leading to winter shortages of seaborne LNG despite large new capacity additions. This supply surge ends next year and the hiatus of new projects is now becoming alarming for end consumers. Second, the projected surge of unconventional Permian oil supply has recently bumped up against two soft barriers. Shale oil is lighter than the global average, so it struggles to easily find a place in the global refining system and, once refined, it produces lower quality products than conventional crude oil. This complex problem is exacerbated by OPEC’s production restraints and Venezuela’s travails as their economy descends further into disarray. After many years of reduced upstream oil and gas spending, low exploration success and consistently growing demand, there is a strong argument to be made that oil prices will be firm in the absence of a major global economic disruption or distortion. As an aside, global lithium ion battery production capacity is projected to increase from 33 GWh to over 400 GWh by early next decade, which remind us of the solar industry experience both as a warning for the battery industry and in terms of the multi-decade timeframe required for energy system transitions.

Notes

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

   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, the inception date of C Class of the fund is used. Where applicable, the gross MSCI indices were used prior to 31 December 1998 as the net MSCI indices did not exist then. Fund returns have been provided by Platinum Investment Management Limited; MSCI index returns have been sourced from RIMES Technologies.

   Platinum does not invest by reference to the weightings of any index or benchmark, and index returns are provided as a reference only. A fund's underlying assets are chosen through Platinum's bottom-up investment process and, as a result, the fund's holdings may vary considerably to the make-up of the index that is used as its reference benchmark.

   The stated portfolio values of C Class and P Class of the Platinum International Fund (PIF) do not include funds invested in PIF by the Platinum International Fund (Quoted Managed Hedge Fund), a feeder fund that invests primarily in PIF. The stated portfolio values of C Class and P Class of the Platinum Asia Fund (PAF) do not include funds invested in PAF by the Platinum Asia Fund (Quoted Managed Hedge Fund), a feeder fund that invests primarily in PAF.

2. The investment returns depicted in this graph are cumulative on A$20,000 invested in C Class (standard fee option) of the fund over the specified five year period relative to the relevant net MSCI index in Australian dollars.

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

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3. The geographic disposition of assets (i.e. the positions listed other than "cash" and "shorts") represents the fund's exposure to physical holdings and long derivatives (of stocks and indices) as a percentage of the fund's net asset value.
4. The table shows the fund's top 10 long stock positions (through physical holdings and long derivatives) as a percentage of the fund's net asset value.
5. Sector breakdown represents the fund's net exposure to physical holdings and both long and short derivatives (of stocks and indices) as a percentage of the fund's net asset value.
6. The table shows the fund's major currency exposure as a percentage of the fund's net asset value, taking into account currency hedging.

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Some numerical figures in this publication have been subject to rounding adjustments. References to individual stock performance are in local currency terms, unless otherwise specified.

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