Platinum Japan Fund

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Portfolio Manager

Performance

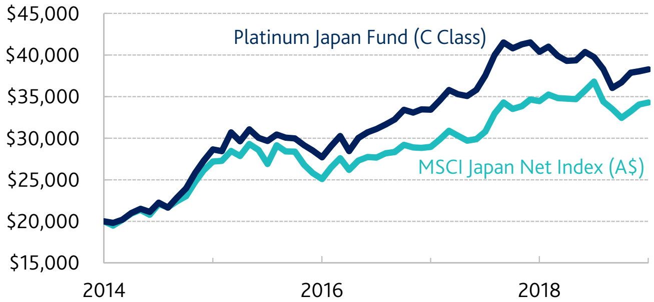
(compound pa, to 31 March 2019)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Japan Fund*	4%	-5%	11%	14%	14%
MSCI Japan Index^	6%	0%	11%	11%	3%

* C Class – standard fee option. Inception date: 30 June 1998.
After fees and costs, before tax, and assuming reinvestment of distributions.
^ Index returns are those of the MSCI Japan Net Index in AUD.
Source: Platinum Investment Management Limited, FactSet.
Historical performance is not a reliable indicator of future performance.
See note 1, page 5. Numbers have been subject to rounding adjustments.

Value of $20,000 Invested Over Five Years

31 March 2014 to 31 March 2019



After fees and costs, before tax, and assuming reinvestment of distributions.
Historical performance is not a reliable indicator of future performance.
Source: Platinum Investment Management Limited, FactSet.
See notes 1 & 2, page 5.

The Fund (C Class) returned -5.2% over the past 12 months, a disappointing result in a weak market. Recent performance has been more encouraging with the Fund's health care and technology holdings being the strongest contributors to the 4.3% gain over the quarter. Cyclical sectors, while having rebounded from the steep declines of late last year, continued to underperform the so-called growth stocks.

The Japanese stock market shifted mode during the year. In summary, many high-quality companies with longer duration cashflow streams were further de-rated to valuations which in some cases are the lowest in many decades. At the same time, prices rose for high-growth and high-valuation stocks. This is not a style which has historically worked in Japan, nor one that is sustainable for the medium to longer term, in our view. It's certainly not a behaviour that we practise and is a key factor weighing down the Fund's performance. A broad range of studies show that large parts of the Japanese market now trade at valuations which have low future return profiles.

The portfolio has been positioned cautiously in the last six months, with a low net invested position. This benefited the Fund during the market weakness towards the end of 2018, and has not been a major detractor from performance during the market's rebound in the first three months of 2019. In hindsight, the missed opportunity of not buying some assets which reached low valuations in December is now clear.

Commentary

While the topic of corporate governance is often couched in dry and procedural rhetoric, the reality is very different. In Japan, the issue has been visited many times over the last three decades of slow but steady progress. At a recent meeting with the CFO of a large pillar of the Japanese corporate establishment, I received laughter in response to raising the topic. He gleefully reminded me that corporate governance is often skin-deep and ineffective. However, the changes, both in the mood towards, and through the implementation of, improved corporate governance, are deepening and becoming ever more pervasive.

On the surface, the indications are positive. Stock buybacks by listed companies are at 15-year highs and dividend payouts are at record levels. Some recent high-profile decisions by Nintendo, Shin-Etsu and the Bank of Kyoto show

Disposition of Assets

REGION	31 MAR 2019	31 DEC 2018	31 MAR 2018
Japan	75%	67%	86%
Korea	6%	7%	0%
Cash	19%	26%	14%
Shorts	-20%	-16%	-2%

See note 3, page 5. Numbers have been subject to rounding adjustments.
Source: Platinum Investment Management Limited.

Net Sector Exposures ^

SECTOR	31 MAR 2019	31 DEC 2018	31 MAR 2018
Communication Services	17%	17%	11%
Consumer Discretionary	13%	10%	12%
Information Technology	11%	12%	13%
Industrials	9%	7%	16%
Materials	7%	5%	11%
Energy	4%	5%	7%
Health Care	3%	3%	4%
Financials	3%	3%	10%
Real Estate	<1%	<1%	<1%
Consumer Staples	-5%	-4%	0%
TOTAL NET EXPOSURE	61%	58%	84%

^ A major GICS reclassification was implemented during the December 2018 quarter. The changes affected the Information Technology, Communication Services (previously Telecommunication Services) and Consumer Discretionary sectors. Historical exposures have been updated for continuity.
See note 4, page 5. Numbers have been subject to rounding adjustments.
Source: Platinum Investment Management Limited.

widespread behavioural changes, even in the core of the corporate system. However, it's important to note that the highest absolute amount of stock buybacks was in 2003, near the bottom of the market cycle. This was arguably far too early, but shows the system's willingness to act in the pursuit of profit when the time and conditions are correct.

It's easy to argue that recent share buybacks, dividends, Treasury stock cancellations and other behaviours by managements are typical for this stage of the cycle. Cash balances have built up significantly across the corporate system. In many cases, the level of cash is now at unjustifiable levels, even using the often contorted logic that corporate offices employ as resistance, and thus massive amounts of pressure have been applied to many companies.

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. There have also been important linkages shown between corporate governance and corporate performance, closing the loop and removing one of the pillars upon which the recalcitrants resist change.

After three decades of slow and undulating progress, there is undoubtedly still a journey ahead for corporate governance improvement in Japan. What's clear is that the worst is far behind us and the ongoing substantial changes will be an incremental positive tailwind for the whole economy and the stock market.

Net Currency Exposures

CURRENCY	31 MAR 2019	31 DEC 2018	31 MAR 2018
Japanese yen (JPY)	98%	85%	95%
US dollar (USD)	29%	41%	4%
Korean won (KRW)	-7%	-6%	0%
Australian dollar (AUD)	-20%	-20%	1%

See note 5, page 5. Numbers have been subject to rounding adjustments.
Source: Platinum Investment Management Limited.

Top 10 Holdings

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Kangwon Land Inc	Korea	Consumer Discretionary	4.6%
Takeda Pharmaceutical	Japan	Health Care	4.5%
Nippon Telegraph	Japan	Communication Services	3.9%
Itochu Corporation	Japan	Industrials	3.8%
Rakuten Inc	Japan	Consumer Discretionary	3.6%
KDDI Corporation	Japan	Communication Services	3.4%
Nintendo Co Ltd	Japan	Communication Services	3.3%
Kyocera Corp	japan	Information Technology	3.3%
Canon Inc	Japan	Information Technology	3.1%
Nexon Co Ltd	Japan	Communication Services	3.1%

As at 31 March 2019. See note 6, page 5.
Source: Platinum Investment Management Limited.

For further details of the Fund's invested positions, including country and industry breakdowns and currency exposures, updated monthly, please visit https://www.platinum.com.au/our-products/pjf.

Lixil

It's hard to discuss corporate reform without highlighting Toshiba and Lixil. In brief, it's important to note Toshiba's shareholder structure, portfolio changes and implicit societal and government approval as it reforms itself. It's a very important signal for large parts of the Japanese economy and for Japanese listed companies. However, of more importance to the Fund 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 MonotaRO and accepted the top job at Lixil with a view to 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 offsider. 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.[1] It's worth highlighting that this process is occurring at a major Japanese company with political and societal significance.

Seto-san's involvement in this story is important for a myriad 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.

1 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.

A similar culture is evident at Rakuten, where recent developments have the potential to change investor sentiment. At the 2019 Mobile World Congress in Barcelona, Mikitani-san, CEO of Rakuten, announced details of its new mobile phone network. It's a next generation platform, along the lines of cloud internet services with large data centres, edge computing and virtualised, packet-based network communication. It promises to deliver lower capex, reduced operating costs and freedom from legacy network costs. A similar model worked very well for Reliance in India, and a key member of Rakuten's team worked on that network. Japan presents very different challenges, but the global industry has been waiting for this type of mobile network innovation and at this stage it seems likely to be a technical breakthrough. The core team is strong, including Cisco, Intel, Red Hat, Qualcomm, Altiostar, Ciena, Tech Mahindra and Nokia. Whether it is a commercial success will depend on global applicability and the rapid identification of 5G use cases requiring large volumes of data, video or the base case of wireless home internet pipes.

Corporate Visits

A series of recent corporate visits highlighted the ongoing development of a start-up and innovation culture in Japan. The core of this extends from Japan's gaming industry and has been augmented by Softbank's multi-decade success and models such as MonotaRO. These new companies, of which there are many hundreds, have a range of business models and target industries. Software, network effects and AI feature prominently, facilitated by cheap high-speed internet and low-cost handsets. The productivity gains from products such as Robot Process Automation (complex business process macros) are nothing short of amazing and, in combination with a myriad of other factors, illustrate the difficulty that central banks globally are having with their inflation targeting.

Corporate and economic news for the last six months has been weak with negative indicators from a broad range of industries globally. It appears as though many companies have built quite significant inventories as their expectations for demand growth led them to expand capacity, only to find themselves in a weaker-than-expected environment. This is not an isolated situation, but a widespread phenomenon.

At the same time, there are interesting developments on the supply side of many industries. Having lived in Indonesia with a deep connection to the country, it is amazing to me that Tsingshan has been able to build a US$4 billion integrated stainless steel plant in Central Sulawesi. The commissioned capacity is 1.5 million tonnes p.a. of nickel pig iron with a contained nickel content of 150,000 tonne p.a., the largest in the world. They are now building a similar but much larger project on the site of one of the world's largest nickel ore deposit in Halmahera, Maluku. While natural resources are depleting assets, human ingenuity continually discovers substitutes and alternative process routes which, combined with consumption efficiency, will cap many prices through elastic production growth.

Outlook

The rebound from the lows of last December has been rapid, despite ongoing weak economic, corporate and political news. The narrative is dominated by a range of hopes such as the possibility of a strong second-half economic recovery, an enduring Chinese monetary reflation and a delayed signal from the US yield curve inversion. The overriding assumption is that central banks have a complete understanding of the varied influences on the global economy and are in firm control. Similar narratives in the past have been proven to be based on hope rather than reality. In an era of significant disruption and change, it's hard for leaders to balance the many signals.

Against this difficult backdrop, the Fund will continue to invest in assets that we believe offer good long-term prospects but are selling at historically low valuations. This opportunity set continues to grow. At the same time, the very high valuations of a significant part of the market are vulnerable to disappointment from investors' very high expectations. The present issue for some of the portfolio's core holdings is that short-term earnings growth is scarce, temporarily masking the true long-term value of the assets.

Overall market sentiment remains weak. This is reflected by the renewed focus on corporate governance as a cover-all. This phenomenon is real, but is unlikely to be a true panacea if recent weak economic indicators and earnings don't reverse rapidly. Nevertheless, the Fund's cash position provides the flexibility to invest in what is undoubtedly one of the major global markets with multiple structural tailwinds and longer-term opportunities.

***Great Wave,* Hokusai, 1805.** https://mag.japaaan.com/archives/62662

Notes

1. Fund returns are calculated using the net asset value (NAV) unit price (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. Fund returns are net of fees and costs, are pre-tax, and assume the reinvestment of distributions. Returns for P Class are net of any accrued investment performance fee.

   The MSCI Index returns are in Australian Dollars and are inclusive of net official dividends, but do not reflect fees or 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 Index was used prior to 31 December 1998 as the net MSCI Index did not exist then. Fund returns are provided by Platinum Investment Management Limited; MSCI index returns are sourced from FactSet.

   Platinum does not invest by reference to the weightings of the Index. 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. Index returns are provided as a reference only.

   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.

   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 specified Fund over the specified period relative to the specified net MSCI Index in Australian Dollars.
3. The geographic disposition of assets (i.e. the positions listed other than "cash" and "shorts") represents, as a percentage of the Fund's net asset value, the Fund's exposures to the relevant countries/regions through direct securities holdings and long derivatives of stocks and indices.
4. The table shows, as a percentage of the Fund's net asset value, the Fund's exposures to the relevant sectors through direct securities holdings as well as both long and short derivatives of stocks and indices. In the case of the Platinum Unhedged Fund, the Fund does not undertake any short-selling. Its net exposures are therefore the same as its long exposures.
5. The table shows the effective net currency exposures of the Fund's portfolio as a percentage of the Fund's net asset value, taking into account the Fund's currency exposures through securities holdings, cash, forwards, and derivatives. The table may not exhaustively list all of the Fund's currency exposures and may omit some minor exposures.
6. The table shows the Fund's top 10 long equity positions as a percentage of the Fund's net asset 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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