# Platinum International Brands Fund

**James Halse**
Portfolio Manager

## Performance

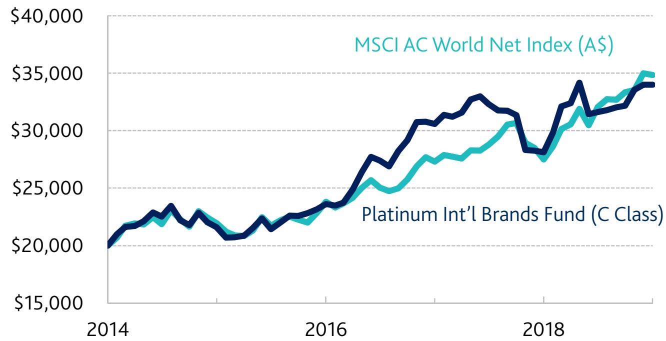
### (compound p.a.⁺, to 31 December 2019)

| | QUARTER | 1YR | 3YRS | 5YRS | SINCE INCEPTION |
|---|---|---|---|---|---|
| Platinum Int'l Brands Fund* | 6% | 21% | 13% | 11% | 12% |
| MSCI AC World Index^ | 5% | 27% | 14% | 12% | 4% |

+ Excludes quarterly returns.
* C Class – standard fee option. Inception date: 18 May 2000.
After fees and costs, before tax, and assuming reinvestment of distributions.
^ Index returns are those of the MSCI All Country World 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. Numerical figures have been subject to rounding.

### Value of $20,000 Invested Over Five Years

31 December 2014 to 31 December 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.

Global equity markets continued their strong run in the final quarter of the calendar year, and this was reflected in the Fund's performance, which returned 5.8% (C Class). This compared favourably with the global index return of 4.5%, which is especially pleasing given the Fund's short and cash positions meant we maintained an average net market exposure of around 72% during the quarter.

The December quarter saw strong performance from our long positions (contributing 8.5% in AUD terms to performance, pre fees), but our short positions meaningfully detracted from overall performance (-2.3%).

A key contributor to performance was online gaming firm, **Stars Group** (+71% over the quarter in local currency terms), which agreed to an all-stock merger at a premium price with UK-listed Flutter Entertainment (formerly Paddy Power-Betfair). The businesses are highly complementary, with the merger giving the combined entity a very strong position in the nascent US sports betting market. This market is growing very quickly and will likely become the world's largest in the medium term.

Other contributors to performance included online apparel retailer **ASOS** (+36%), which reported a better-than-feared earnings result, and UK real estate brokerage, **Foxtons** (+76%), which benefited from improving sentiment on Brexit and the increasing prospect of the Conservative Party winning the general election.

Several Chinese names, including **58.com** (+31%), **Alibaba** (+27%), **Meituan Dianping** (+27%), and **Guangzhou Automobile** (+29%), benefited from solid earnings results and/or improving investor sentiment toward China and the potential for resolution of the trade conflict with the US.

Key detractors from performance on the long side, included **American Eagle Outfitters** (-9%), which disappointed investors with its fourth quarter earnings guidance, **Ally Financial** (-8%), as yields on its mortgage and corporate loan books fell, and **Asahi Group** (-7%) as its domestic results worsened.

The key driver of the weak performance on the short side was our **Tesla Motors** position. Tesla is our highest conviction short position,[1] but rose 74% during the quarter. The stock initially rallied after reporting a small quarterly profit. It then gained further momentum after the market became excited by talk of Tesla opening a factory in Berlin, and prospects for sales in China.

We remain comfortable with our negative view on the stock's prospects. US sales are now declining for all Tesla models, with the product pipeline somewhat bare (the "Model Y" and the "Cybertruck" do not look likely to replicate the Model 3's sales success). The company has struggled to be consistently profitable, despite running its US plant at close to 100% utilisation, and slashing research and development spend. Despite this, the current stock price values the company at almost US$90 billion, which is more than the value of Ford and General Motors combined! For context, Tesla is producing vehicles at an annualised run rate of around 400,000 units. Volkswagen produces around 11 million vehicles annually (i.e. almost 28x Tesla's production) to justify its US$98 billion market capitalisation.

1 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.

Our short positions against 'defensive' consumer packaged goods companies made a positive contribution to performance, with a number of the stocks weakening following the upward move in interest rates, as well as earnings results that could not support the elevated market valuations of several of these companies. As discussed in detail in the September 2019 quarterly report, these companies are experiencing ongoing market share losses, which we believe will result in future earnings decay as they are forced to cut prices and/or increase marketing to stem the bleeding. As a group, these stocks fell by an average of -1.9% in the quarter.

## Changes to the Portfolio

We sold a number of stocks during the quarter, reflecting the strong performance of many of our positions amid buoyant market conditions. We trimmed our holding of Stars Group early in the quarter, following the stock's strong gains on its merger announcement. Other stocks that were trimmed included Meituan Dianping, Anta Sports (+8% in the quarter), Kweichow Moutai (+3%), Callaway Golf (+9%) and ASOS. In each of these cases, we felt that some of the opportunity initially identified had played out through stock appreciation and smaller position sizes were warranted.

We exited our position in US big-box retailer, At Home in November, following a strong rebound from its precipitous sell-off between June and August. We exited as we saw signs of the competitive environment deteriorating further, an assessment which was confirmed as the stock declined close to 40% after releasing its earnings result in December.

### Disposition of Assets

| REGION | 31 DEC 2019 | 30 SEP 2019 | 31 DEC 2018 |
|---|---|---|---|
| Asia | 36% | 42% | 41% |
| North America | 27% | 27% | 23% |
| Europe | 22% | 17% | 17% |
| Japan | 8% | 8% | 8% |
| South America | 0% | 0% | 2% |
| Cash | 7% | 6% | 9% |
| Shorts | -19% | -20% | -16% |

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

### Net Sector Exposures

| SECTOR | 31 DEC 2019 | 30 SEP 2019 | 31 DEC 2018 |
|---|---|---|---|
| Consumer Discretionary | 41% | 37% | 29% |
| Communication Services | 21% | 23% | 20% |
| Financials | 10% | 9% | 10% |
| Industrials | 4% | 4% | 4% |
| Real Estate | 1% | 1% | 1% |
| Consumer Staples | -2% | 0% | 9% |
| Information Technology | 0% | 0% | 1% |
| TOTAL NET EXPOSURE | 74% | 73% | 76% |

See note 4, page 5. Numerical figures have been subject to rounding.
Source: Platinum Investment Management Limited.

We also closed our position in WW International (Weight Watchers), which more than doubled from our entry price in June to our December exit price. WW had sold off heavily as it faced declining subscribers, with the market fearing a continuation of that trend. As trends stabilised, the stock rebounded. However, the latest marketing campaign starring Oprah Winfrey (who has a stake in the business) does not appear to be gaining the traction the market was hoping for, so we elected to take our profits.

## Outlook

The very strong market rebound from the nadir in December 2018 has lifted (nearly) all boats, which means we need to work harder to continue to uncover attractive opportunities on the long side. In doing so, we rely heavily on the in-depth industry knowledge the Platinum investment team has built up over many decades of combined investing experience.

The bifurcation in valuations between perceived winners and losers in the broader consumer sector is perhaps stronger than in any other area of the market, and this continues to provide us with opportunities to deploy capital. The key is effectively utilising our experience and understanding of the stocks in our universe to ensure we are buying businesses on sensible valuations relative to their potential for long-term cash flow generation.

We will continue to manage our net exposure with a view to the overall buoyancy of market conditions, and the continued opportunities that unbridled investor optimism provides us with on the short side.

### Net Currency Exposures

| CURRENCY | 31 DEC 2019 | 30 SEP 2019 | 31 DEC 2018 |
|---|---|---|---|
| US dollar (USD) | 47% | 48% | 40% |
| Euro (EUR) | 24% | 23% | 25% |
| Hong Kong dollar (HKD) | 14% | 12% | 13% |
| British pound (GBP) | 5% | 4% | 1% |
| Japanese yen (JPY) | 4% | 4% | 6% |
| Indian rupee (INR) | 2% | 2% | 6% |
| Turkish lira (TRL) | 2% | 2% | 1% |
| Canadian dollar (CAD) | 2% | 1% | 1% |
| Chinese yuan (CNY) | 2% | 6% | 6% |
| Norwegian krone (NOK) | 2% | 4% | 3% |
| Danish krone (DKK) | 2% | 1% | 0% |
| Korean won (KRW) | 0% | 0% | 1% |
| Sri Lankan rupee (LKR) | 0% | 0% | 1% |
| Chinese yuan offshore (CNH) | -6% | -6% | -6% |

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

### Top 10 Holdings

| COMPANY | COUNTRY | INDUSTRY | WEIGHT |
|---|---|---|---|
| Tencent Holdings | China | Comm Services | 4.6% |
| Alibaba Group Holding | China | Cons Discretionary | 4.5% |
| Facebook Inc | US | Comm Services | 4.5% |
| Alphabet Inc | US | Comm Services | 4.4% |
| 58.com Inc | China | Comm Services | 3.9% |
| Meituan Dianping | China | Cons Discretionary | 3.9% |
| Lixil Group | Japan | Industrials | 3.7% |
| China ZhengTong Auto | China | Cons Discretionary | 3.6% |
| Stars Group Inc | Canada | Cons Discretionary | 3.3% |
| ASOS PLC | UK | Cons Discretionary | 3.1% |

As at 31 December 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/pibf.

## Luxury Brands' Dilemma: Growth and Exclusivity?

By Nicholas Markiewicz, Investment Analyst

Trade in luxury goods dates back five millennia to the route between the Indus Valley and Mesopotamia. Later, much of the spending of the elite of ancient Rome went toward the importation of exotic products like silk, precious stones, spices and Ivory from the Far East. Perhaps the most storied item in the ancient world though, was purple dye, owing to the extreme difficulty of its manufacture. Each ounce of Tyrian dye required the mucus of 250,000 Phoenician sea snails, which had to be delicately extracted and then aged in vats. The final dye was worth three times its weight in gold, and its production and sale was monopolised by the State. Alexander the Great's motivations in pursuing a seven-month siege to take Tyre likely included the capture of this resource. Later, purple silk robes became the hallmark of Roman Emperors, and unauthorised use of the colour was punishable by death!

While the nobility managed to keep a stranglehold on purple, other exotic goods were freely available to anyone with enough money. Much to the chagrin of the remaining elites, this increasingly included the newly minted bourgeoisie (e.g. merchants, financiers). As aspirational consumption became widespread, the word 'lusso' (luxury) entered the Italian lexicon to denigrate the vulgar spending habits of these nouveau riche.

Today's luxury brands are still trying to manage these same contradictory forces, as they seek to accommodate new waves of Chinese middle class consumers and generate billions of dollars of new sales, whilst also maintaining a facade of exclusivity. **Louis Vuitton, Chanel**, and **Hermes** have written today's luxury playbook, collectively accounting for US$30 billion of consumer spending. The tactics they utilise are as follows:

- **Price discipline:** These brands have created a sense of steady value through rigid price controls, never discounting unpopular products, and raising prices on iconic lines each year. Like the Tyrians, they have maintained a monopoly on sale of their key products in order to limit exposure to wholesale partners that could discount product in an attempt to drive sales volumes.
- **Artificially restricting supply**: While the Tyrians actually possessed a scarce resource, luxury brands create an illusion of scarcity by mildly restricting the volume of their lowest priced iconic products. For example, the cheapest Hermes Birkin bag (US$10,000) is not available to walk-ins off the street. To buy a Birkin, one must work for it through spending some time on a mandatory waiting list, while buying other peripheral items (e.g. silk ties) in the meantime. While not quite equivalent to building a Tyrian causeway under constant bombardment[1], this small hardship makes the ultimate prize seem a rare object of desire, despite the reality that Hermes likely sells tens of thousands of units per year!
- **Ancillary categories:** Instead of reducing prices on core products to target a wider audience, most luxury brands sell more mass-produced products in tangential categories that feature lower price-points. Although the price-point is lower, brands maintain the illusion of luxury through pricing at a significant premium to the category average. For example, Chanel has a booming cosmetics business that sits comfortably alongside its couture/leather goods business at significantly lower price points, while branded sunglasses are one of the most commonly purchased 'luxury' items.
- **Style proliferation:** Brands that do become large can avoid ubiquity by offering a multitude of styles. Louis Vuitton for example has nearly 900 handbag varieties across 10 distinct styles.

Consumers have so far accepted these tactics from the leading Italian and French luxury houses, with desirability and profitability both touching all-time highs. However, the long-term success of these brands is dependent on how the concept of luxury and exclusivity evolves through time. Social media and the lifestyle-selfie phenomenon have given rise to demand for ultra-exclusive 'experiences' that existing luxury houses may not be able to provide. Online marketplaces for new and pre-owned products have significantly increased price and product transparency, which is potentially dangerous for an industry that achieves product margins as high as 90%.

In 1856, a UK laboratory created a synthetic purple for the first time in history, which smashed the purple cartel overnight by allowing the dramatic expansion of supply at lower price points, and thus widespread adoption by the masses. Equally, the large luxury brands cannot afford for their signature products to become 'common', lest the consumer perceptions of the marque's exclusivity deteriorate. Balancing this with the brand's growth aspirations is essential for long-term brand health, thus investors in the major brand houses should temper their expectations for ongoing rapid profit expansion.

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1 Alexander's successful conclusion of the siege of Tyre necessitated the engineering feat of building a kilometre-long causeway to the island-city's walls from which to launch a frontal attack. A mind-boggling expenditure of resources for a conquering army in the days before construction machinery.

## 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 market value of the Fund's positions, the Fund's effective exposures to the relevant countries/regions through direct securities holdings and long derivatives of stocks and indices. "Shorts" relates to the effective exposures to short securities and short securities/index derivative positions.
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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