

**Platinum
International Fund**
(Quoted Managed Hedge Fund)

(ARSN 620 895 301 | ASX Code: PIXX)

**Quarterly Investment
Manager's Report**

31 March 2018

Investment Update

by Kerr Neilson, Portfolio Manager

Performance

(to 31 March 2018)

	QUARTER	6 MONTHS	SINCE INCEPTION
Platinum International Fund (Quoted Managed Hedge Fund)	0.8%	7.4%	9.4%
MSCI AC World Net Index (A\$)	1.0%	7.1%	10.2%

Net of accrued fees and costs. Inception date: 12 September 2017.

Refer to note 1, back cover.

Source: Platinum Investment Management Limited, RIMES Technologies.

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 31 March 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 slightly 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.

Markets

Alas, as the austral summer drew to a close, we witnessed the **return of market volatility**. This derivative, used to measure the likely turbulence of share prices and most widely monitored through the VIX index,¹ had been progressively falling since 2012. The longevity of its falling trend drew the inevitable response from the financial repackaging industry with the offer of an ETF to play this seemingly perfect trend bet. The irony is that volatility cannot incessantly drop (for obvious reasons). When the VIX index spiked in early February, the loss was almost total at an estimated cost of

US\$3 billion, though with only passing consternation from the media. How slow we seem to learn in this business! Eight years of rest and our memories fade.

Another question around extrapolation relates to the seeming absence of an acceleration of inflation. In the US, unemployment is plumbing the depths, yet the average hourly wage is still increasing very slowly at the current rate of 2.9% p.a. Yield on US 10 Year Treasuries has crept up, but towards the quarter end reversed somewhat to 2.74%, even though the Federal Reserve has declared its hand and raised short-term rates again in March, taking the federal funds rate to 1.75%, compared with 1% a year ago. Unlike earlier cycles, the LIBOR rate, at 2.3%, has moved ahead of the onshore rate. This move has caused some confusion which is partly explained by the 2016 rule changes for money market funds and the unintended consequences of the recent US tax changes. **Money is clearly tightening.**

While the **rate of improvement** in the synchronised global recovery, as represented by the PMIs,² **has lost some momentum** and the economic surprise indices are fading, evidence of a deteriorating growth outlook eludes us. At present there are the **rising fears about tariffs on trade and concern about tighter control over lending in China** and their adverse consequence for growth. The Chinese data is partly obscured by the timing of the Lunar New Year and the forced seasonal shutdowns of capacity on grounds of air pollution during the winter months. Our own interpretation is that China is quite as worried about the level of debt abroad as it is about that within its own system and is acting accordingly. Granting President Xi Jinping what will surely be a life tenure should be beneficial in the short term, particularly in view of the ministerial reshuffle around his inner circle and important administrative reforms. Some will be dismayed about the longer term implications about which history has a lot to say.

The Trump **tax reform package was well received by analysts who had a field day projecting that most of the value will accrue to shareholders** even though there is the need, and the will, to top up pension reserves and to meet rising minimum wage standards. The corresponding rise in

¹ The CBOE Volatility Index (VIX) quotes the expected annualised change in the S&P 500 Index over the following 30 days, priced off option data.

² The Purchasing Managers' Index (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.

the US fiscal deficit scarcely received a mention, and even the bond market appeared conspicuously unmoved at the prospect of a tidal wave of new bond supply (as Andrew Clifford elaborated on in the Macro Overview). The S&P 500 responded well to the tax legislation initially, but as the quarter came to a close, the misfortunes of Facebook, the presidential threats to Amazon and the malfunctioning of Uber's and Tesla's autonomous vehicles took the gloss off the important tech stocks in the US.

Unlike earlier periods, the elections in Europe caused barely a stir, mergers and acquisitions and share buybacks, some still funded by debt, continued apace and, surprisingly, even private equity found reason to buy into asset-heavy, low-variable cost businesses. At the same time, other indices were testing their 200-day moving averages as the tightening of money and tariffs were seen as a threat to the Panglossian outlook. The flip side is that companies are increasingly optimistic about the capital expansion programmes. Historically, **capex is sparked by improving corporate profitability**. Contrary to popular belief, capex in the **service sectors accounts for two-thirds of corporate capital spending** in the US. The manufacturing industry only accounts for about 22% of US capex while sectors like finance and insurance account for 9% and mining and oil 7%.

With these strong underpinnings, one might conclude the **high level of share ownership and crowding in hot areas of tech and biotech may have accounted for the weakness** at this quarter's end as investors, full of tech stocks and other 'invincibles', began to apply more caution. Europe and Japan have had the added burden of strong exchange rates to crimp profit growth which had lagged the US.

MSCI Regional Index Performance to 31.3.2018 (AUD)

REGION	QUARTER	1 YEAR
Developed Markets	1%	13%
Emerging Markets	3%	24%
United States	1%	13%
Europe	0%	14%
Germany	-2%	13%
France	2%	20%
United Kingdom	-2%	11%
Japan	3%	19%
Asia ex Japan	3%	25%
China	4%	38%
Hong Kong	1%	18%
India	-5%	10%
Korea	1%	25%
Australia	-4%	1%

Source: RIMES Technologies.
Historical performance is not a reliable indicator of future performance.

From the Fund's perspective, this change of tone was only partly helpful. We have been moving to a more cyclical posture, believing that the current strong growth will support more vigorous capital spending and tighter commodity markets. We still believe this to be true and that the softer readings in China are partly seasonal. While the rate of change in the world's largest manufacturing economy may be tapering, there is no evidence that it will be more than a slowdown. In addition, when one compares the valuation of these cyclicals to their invested capital, they are still at remarkably low levels, in particular the hydrocarbon complex (oil companies and the extraction-related support industries), even though the prices of these commodities are well off the bottom.

Our relative performance is showing this uncertainty with a slight underperformance for the quarter, yet we are still far ahead over the last 12 months. PIF (C Class) achieved 0.7% for the quarter and 21.7% for the year (refer to note 1, back cover). The MSCI AC World Index (A\$) returns over these respective periods were 1.0% and 14.2%.

Changes to the Portfolio

We have been very active rotating out of the notably strong performing areas of the last three to six months into more neglected areas. In particular, we discarded **Wynn Resorts, Kering, Reliance Industries, The Coca-Cola Company, Oracle, Qingdao Haier** and most of **Intesa Sanpaolo**, and continued to reduce the Chinese internet names, like **Tencent, 58.com** and **Sina**. Purchases were made in existing **non-ferrous metal miner holdings, Intel** and **Siemens**. We also introduced **Facebook** to the portfolio.

MSCI All Country World Sector Index Performance to 31.3.2018 (AUD)

SECTOR	QUARTER	1 YEAR
Information Technology	5%	29%
Consumer Discretionary	3%	17%
Health Care	1%	9%
Financials	1%	16%
Utilities	1%	5%
Industrials	0%	14%
Materials	-2%	15%
Energy	-2%	6%
Consumer Staples	-3%	4%
Telecommunication Services	-4%	-1%

Source: RIMES Technologies.
Historical performance is not a reliable indicator of future performance.

The latter may surprise some for it is hardly an unloved company, though the recent publicity around Cambridge Analytica has seen the stock price fall from US\$190 to US\$155. There is no doubt that the **political environment facing the three big US internet names** (Facebook, Amazon and Google) **has darkened**. There are many questions about their information controls and the full nature of their earnings sources, as well as disquiet about their business models which depend on offering users free services in exchange for giving potential advertisers access to their personal data. In addition, there are other platforms trying to increase their share of the advertising pool, and even Amazon has succumbed to shifting its business model towards more advertising to exploit the power of its marketplace.

The central question remains **'what is the alternative?'** *Wired* magazine led with an article that proffered alternative apps to displace one's need for Facebook. The problem is that it requires most users to download 10 standalone apps to do the job. Worse still, it requires one's friends to do the same. To date, the consumer response to the 'leak' of one's Facebook friends' data has been remarkably tame. The #DeleteFacebook movement does not seem to be getting traction and the reported change of personal privacy settings has been insignificant. Only 14% of users seem to have made changes since the incident erupted with the majority placidly accepting the notion of an exchange of value. The company has for some time been experiencing defections in North America and the UK with the 12 to 24 age group tending to abandon the platform in favour of alternatives such as Snapchat. Importantly, these are the high value customers in North America and Europe who respectively provide annual revenue-per-user of US\$84 and US\$27.

The **core social network effect of Facebook remains intact** even if its users are becoming less willing to fully engage and there may be a tendency for new users to be somewhat less valuable, being older users and consumers from lower income

countries. The overall network has kept expanding and Facebook claims over 2 billion average monthly users and 1.4 billion daily active users worldwide. In the developed world, it is estimated that users are spending over one hour per day on the platform and it **remains a gateway to other internet applications**. A hint of the longer-term earnings potential may be given by the fact the annual revenue per monthly user in North America is US\$84 while that from Europe is US\$27 and the Asia Pacific US\$8.7 per user!

By the nature of such a phenomenon, the glory days are presumably past. But, like Google, anticipatory acquisitions have been made to broaden the longer-term revenue sources of the company. Facebook's acquisitions of Instagram and WhatsApp are only now starting to contribute revenues. There are also e-commerce initiatives that can still potentially be harvested. The company itself had been warning of the need for greater investment and a tightening of procedures. In some cases there will be some pressure on revenues and regulation is bound to reduce the efficacy of their offer to advertisers as the melding of bought-in data becomes restricted.

There is likely to be further bloodletting in the days ahead, but the initial reaction had seen the company de-rate to a level that makes it look attractive in relation to the quality of its earnings. It is still growing at probably over 20% p.a., has a clean balance sheet and continues to provide a useful social function. While we recognise that fashion, with all its foibles, is an important adjunct to any social medium, we believe that Facebook's 2018 GAAP P/E of 21 times offers an attractive initiation level.

Shorting

Apart from raising cash by reducing exposure to some of the strong performers noted above, we also added to our short positions. These comprised the NASDAQ index, the Biotech index and a company-specific short position. As at this

PIF Portfolio Disposition

REGION	31 MAR 2018	31 DEC 2017
Asia	37%	39%
Europe	22%	22%
North America	14%	16%
Japan	14%	14%
Russia	1%	1%
South America	1%	<1%
Australia	<1%	<1%
Cash	11%	7%
Shorts	-14%	-12%

Refer to note 2, back cover.

Source: Platinum Investment Management Limited.

Top 10 Holdings of PIF

STOCK	COUNTRY	INDUSTRY	WEIGHT
Samsung Electronics	Korea	IT	3.0%
Ping An Insurance Group	China	Financials	2.8%
Alphabet Inc	USA	IT	2.6%
Inpex Corporation	Japan	Energy	2.6%
Glencore PLC	Switzerland	Materials	2.4%
TechnipFMC	UK	Energy	2.2%
Siemens AG	Germany	Industrials	2.2%
Royal Dutch Shell PLC	UK	Energy	1.9%
Lixil Group Corporation	Japan	Industrials	1.9%
China Overseas Land & Invt	China	Real Estate	1.8%

As at 31 March 2018. Refer to note 4, back cover.

Source: Platinum Investment Management Limited.

quarter's end, the Fund's overall short exposure was 14%, up from 12% in December 2017. These positions gave us positive returns that partly offset the weakness in high beta cyclicals that we have been tending to accumulate. Our view remains that, while the growth rate may have peaked and interest rates will gradually tighten credit, **there is a more attractive geographic balance to world growth than has been for some time.**

Currency

The US dollar was conspicuous for its weakness. Close to the end of the quarter, we closed our long position on the Norwegian krone to go longer US dollars. The Australian dollar has also been weak and may be bottoming-out on the bilateral rate versus the US dollar given the prospect for improving export receipts, led by natural gas.

CURRENCY	31 MAR 2018	31 DEC 2017
US dollar (USD)	22%	22%
Euro (EUR)	14%	14%
Hong Kong dollar (HKD)	14%	14%
Japanese yen (JPY)	12%	10%
Korean won (KRW)	8%	8%
Chinese yuan (CNY)	7%	7%
Indian rupee (INR)	5%	6%
British pound (GBP)	5%	5%
Norwegian krone (NOK)	3%	5%
Australian dollar (AUD)	3%	3%

Refer to note 3, back cover.

Source: Platinum Investment Management Limited.

Commentary

While very cognisant of the problems of excessive debt in the West and China, and hence **the system's greater sensitivity to interest rates**, we cannot become unduly negative. Earlier this year the *Wall Street Journal* described an alarming surge of credit card charge-offs by the smaller US banks, having now reached the same level as in 2006/07. Historically the small banks have been the first to experience this reversal of credit worthiness, being possibly more exposed to those lower down the economic pecking order of credit customers. While the larger banks have started to see an upturn of delinquencies, their experience to date has been subdued. Yes, there is a lot of US consumer debt outstanding: US\$1 trillion on credit cards, US\$1.3 trillion in auto loans and a further US\$1.5 trillion in student loans. But in our experience, the last cause of a crisis, while receiving lots of coverage, is seldom the catalyst for the subsequent economic 'event'.

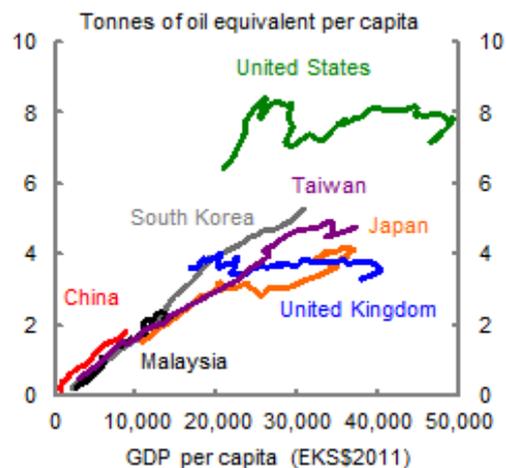
Earlier we commented on the change in the weight of economic activity globally. It is easy to lose sight of the reweighting of activity over the last 20 years. For example, the traditional economic powers of the West and Japan have

seen their share of world activity shrink from 58% in 1996 to 42% in 2016.

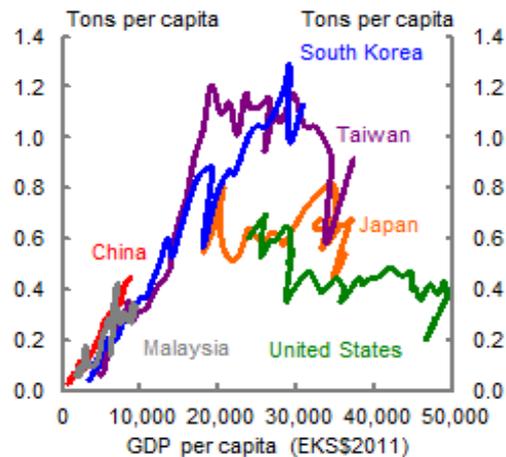
A visit to the World Bank website will reveal that while the developed countries have been dawdling along, the so-called developing countries have been galloping. High-income countries have typically experienced a 2.5 fold increase in national income (whether measured in current or purchasing power parity (PPP) terms) from 1990 to 2016, while some large-population countries like India and China have excelled with national income per head rising respectively by 5.8 fold and 15.6 fold. Even populous countries like Pakistan (population of 193 million) and Iran (80 million), with all their conflicts, unhelpful directives from on high and so on, have outshone the West in these terms, admittedly off a low base, to achieve a 2.7 fold improvement. These are not dry numbers. They refer to **the progressive reduction of global poverty** and in particular, are **a forewarning of a further change in the allocation of global physical resources.**

The important statistic seems to be a national income of \$5,000 per head at purchasing power parity (PPP). At that point, the broad population is no longer scrambling to survive and discretionary spending begins to show. In particular, the use of fossil fuel and metals takes off. Consider the number of people involved here. If we focus only on the lower-income, high-population countries of Asia, comprising Indonesia, India, Pakistan, the Philippines, Vietnam and Myanmar, we find some 2 billion people on this threshold. Now observe the charts overleaf showing this S-curve at work in the rise of the use of crude oil and steel (the same pattern goes for copper and aluminium) for places like Japan, Korea and Taiwan once PPP income per head exceeded \$5,000. There will obviously be specific differences relating to each country's consumption, export intensity and other characteristics, but your imagination will likely draw you to the conclusion of a massive impending rise in the demand for these commodities. By way of example, India consumes an average of 1.2 barrels of oil per capita per year. This is similar to China in 2000 when its annual income per head was \$940 (current US\$). Today China is consuming 12 million barrels per day or 3.2 barrels per capita per year. The charts also reveal the drop-off in usage in developed countries which obviously offsets some of this competition for resources.

We have written before of the impending tightening of the markets for metals like copper, nickel and cobalt and the market is alive to these prospects, though probably underestimating the magnitude of this tightness three years hence. The commodity that is conspicuously set up for a surprise is crude oil. Here investors can conjure up stories of substitution, thanks to the electric car or the frugality of new automobiles and the boundless capacity of shale oil. This misses the base case of usage growth caused by the S-curve in developing countries and endorses the observed chronic

Per Capita Energy Consumption vs. Income (1965-2010)

Source: BP Statistical Review of World Energy 2011; The Conference Board Total Economy Database, January 2012; and CIEC Asia Database. Chart by Brendan Coates and Nghi Luu, the Australian Treasury.

Per Capita Steel consumption vs. Income (1971-2010)

Source: ABARES Australian Commodities; World Steel Association Steel Statistical Yearbooks; World Metal Statistics; United Nations World Population Prospects: The 2010 Revision; The Conference Board Total Economy Database, January 2012. Chart by Brendan Coates and Nghi Luu, the Australian Treasury.

under-estimation of consumption growth forecasts by the International Energy Agency. While fracking has changed the dynamics of oil supply, the ability of US production to grow exponentially is limited. Already some of the important unconventional basins like the Bakken and the Eagle Ford are showing characteristics of reserve exhaustion while the Permian remains highly productive with significant remaining resources. However, the limits of increasing fracking intensity and endless down-spacing (the idea of decreasing the space between wells) appears to have peaked. Even though US unconventional production will continue to grow, the need to replace conventional production is challenging against the backdrop of a natural field decline rate of close to 5% and a halving of capex from peak levels in 2014. While Brent oil prices have recovered to US\$70 per barrel, this is only slightly above the average real level seen over the last 35 years. This theme gives us some interesting investment candidates!

Outlook

The trade conflict and tightening money point to lower valuations. On the trade issue, research reveals that the imbalance is much lower than it first appears if account is taken of the level of activity by American firms in the Chinese domestic economy. When this large American footprint is taken into account, one can see that the negotiating position

of the Americans is less secure than the headline trade deficit numbers suggest. Moreover, the newly crowned emperor may prove to be equally sensitive to his constituents' delight in China's re-emerging global status, and this could account for the surprisingly swift rebuttal on the part of the Chinese. Unsettling volatility on Wall Street and possible consumer boycotts will test the resolve of the negotiators!

While we have raised our cash and short positions, we are unable to be particularly negative. Some companies' prices have retracted meaningfully and, in addition, many of our holdings look like they will have strong multi-year growth ahead. Valuations are compelling and enhanced earnings growth from buybacks is generally not part of our equation. An interesting calculation by Evercore ISI shows that had US companies not engaged in buybacks since 2000, S&P earnings would be more like US\$81 than the current level of US\$124. The point is that, prospectively, this aspect of the investment scene may prove to be a weaker driving force than hitherto as capital is repriced. On the other hand, our high exposure to Asia may expose us to greater market volatility as foreign flows are an important constituent of stock market activity there. Some protection is however offered by much lower starting valuations and growth prospects that are arguably superior to those of other markets.

Macro Overview

by Andrew Clifford, CIO

Over the course of the first quarter of 2018, a number of issues have arisen that gave investors reason to return to a more cautious stance despite the global economy continuing to grow robustly. Among these concerns are:

- 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.

Over the last year, we have highlighted that rising US interest rates are the most likely source of a setback for the economic outlook and for markets. In developed economies, historically the pattern has been that initial increases in rates have little impact on growth, but as rates continue to rise, they will eventually act as a handbrake on the economy. As for whether the next rate hike will be the straw that breaks the camel's back, it is difficult to foretell even at the best of times. After a period of quantitative easing and near zero interest rates, the task is perhaps even more challenging. That debt levels remain elevated across most of the major economies adds further complexity to the problem!

For the moment though, it is clear that the US economy continues to travel well. Employment is strong, with initial unemployment claims (an indicator of new job losses) at the lowest level in 45 years. Wage growth remains healthy (average hourly earnings growing at 2.5% annually), and workers continue to be attracted back into the workforce with the participation rate¹ gradually rising. While the concern is that higher wages will ultimately be passed along through higher prices, for now, inflation in the US remains subdued at 1.9%.² The current scenario of steady gains in employment with wages rising and little evidence of inflationary pressures to date appears to be a very positive one.

We would think investors faced with this scenario would remain relatively optimistic about their prospects, and through January they appeared to be so. Of course, the environment can change quickly, and the big change was President Trump's tax cuts which were passed by Congress in December. The stock market's first reaction was clearly

welcoming of the change as US companies would see a significant lift in their after tax profits. However, there are other impacts to be considered. Firstly, as tax cuts flow through to US corporates and households in the months ahead, one would expect them to boost the economy to some degree as a result of either increased consumption or more investment. The risk is that these cuts will add fuel to an economy that is already growing strongly, thus causing greater inflationary pressure and possibly an acceleration of interest rate hikes.

The secondary issue is that the consequential increase in the country's fiscal deficit – which is expected to rise from 3.7% of GDP currently to around 6% of GDP in 2020 as a result of the tax cuts – will see a significant increase in the amount of government bonds that need to be issued, with the potential to move long-term interest rates higher. In some respects, this increase in the supply of government bonds looks even more dramatic when one considers that there was a *net negative supply* not very long ago – the bond purchases made by the Federal Reserve in 2012-13 under their quantitative easing policy were greater than the new bonds issued. Viewed in this light, the net supply of new bonds will effectively have moved from less than zero to over 6% of GDP in the space of six years. And all this is without taking into account how President Trump's other policy initiatives (such as infrastructure spending) might further stretch the deficit and add to the bond-issuing task!

It is easy to start envisaging both long- and short-term interest rates moving much higher than previously expected, in the process upsetting economic growth prospects and indeed equity and debt markets. We will address the issues for markets later in this report, but first it is worth noting that in the period prior to the tax cuts being passed, the 10 Year US Treasury Note was trading at a yield of around 2.35%, and subsequently ran up through the first months of the year to just below 3%, before settling back at 2.8%. It is easy to see why some commentators are excited about bond yields going much higher even though the US government's bond-issuing task hasn't even started.

The problem with this analysis is that while we have an approximate idea of the future government deficit, there are many variables that no one can fully predict. As an example, to what extent will consumers spend their tax cut or save it,

¹ Of 25 – 54 year olds.

² CPI ex Food and Energy.

and will companies invest more or simply pass it through to shareholders in the form of dividends and buybacks? The degree to which this happens will not only have an impact on the strength of the economy and on inflation, but also on the amount of savings in the economy available to purchase the bonds. In addition, the move in the US 10 Year Treasury yield to 2.8% may already be sufficiently attractive for investors to fund the deficit, especially for the European and the Japanese whose equivalent rates in their home markets vary between zero and around 1.5%. Ultimately, the economic and financial systems we are dealing with are dynamic and the simplistic predictions are often wrong.

The other important development is the ongoing reform of the Chinese financial system, a topic that has received relatively little coverage in the Western media. The key change that has been causing concern is a directive that requires the assets and liabilities of the shadow banking system be brought back onto the balance sheet of the sponsoring financial entity. The issue is that banks and other financial institutions are required to have a minimum level of shareholders' funds (or equity capital) for a given level of lending, and bringing these shadow banking assets back onto the balance sheet will lead to many banks breaching these capital adequacy requirements. The solution is relatively straightforward: limit new lending and seek repayments of loans where possible.

There is, however, the additional complication that the loans funnelled to the shadow banking system and kept off balance sheet were loans that the banks would have otherwise been restricted from making. Also, the regulator has tightened up on the use of Chinese banks' balance sheets to fund the purchase of offshore assets. The result is a forced deleveraging by companies, particularly those that have taken on significant debt to acquire assets both at home and overseas. An example well publicised here in Australia is the divestment by Wanda, a Chinese shopping mall developer, of a major residential project at Sydney's iconic Circular Quay. Other names impacted include HNA Group (airline operator turned real estate and hospitality conglomerate) which now has a stake in Virgin Australia, and Anbang Insurance, whose vast portfolio of assets includes the Waldorf Astoria in New York.

In conjunction with these changes, China is looking to further develop its domestic bond market in order that companies and local governments can borrow money in a more transparent fashion. The issue is that this mechanism will take time to replace the shadow banking system as it is today, and as a result the availability of loans will be much reduced. Indeed if we look at the broadest measure of credit growth in China, it has now slowed to 12.9% year-on-year, a relatively

subdued level by Chinese standards. The question then is what impact this tightness in credit availability will have on the Chinese economy and asset prices both inside and outside of China.

On the economic front, our expectation is that there will be relatively little impact. The dynamic, growing part of China's economy is predominantly the private sector which has traditionally had relatively poor access to credit. Another area of growth has been government sponsored infrastructure spending, an area to which we expect credit will remain readily available. While we may well see ongoing forced divestitures of assets by some groups, they remain as much an opportunity for those that are in a position to buy as they are a problem for the sellers. Simply, we don't see this as a problem for the economy, and as investors, you want to be an owner of the companies buying, not those selling. Finally, we would note that as a result of these concerns the Shanghai A-share market has retreated over 10% from recent highs and remains at levels reached in late 2016 when the economy was still in relatively early stages of recovery.

President Trump's decision to apply tariffs on US\$50 billion of Chinese imports and China's response to do likewise for a comparable amount of US imports have sparked concerns of trade wars and potentially a broader decline in free trade. It should be noted that these announcements are of *intentions*, and there will be months of deliberation domestically in the US and opportunities for negotiation between the two countries. Most commentators assume that negotiations will yield some compromise on starting positions as well as some concessions granted by China to US demands for removing existing trade and investment barriers. We consider such a compromise the most likely outcome. But even if these tariffs end up coming into force, their broad economic impact on both sides will probably not be particularly significant.

The greater risk here is the political environment, present in much of the Western world, which makes the idea of such policies politically appealing. At the core of the issue, we believe, is that low income households have shared relatively little of the prosperity of the last 30 years and, as such, see no great downside from the end of ideals such as free trade. As governments continue to fail to address the issue of income disparities, it is likely that populist policies will remain part of the landscape across the developed world. The other issue that is unlikely to fade away is the instability of the Trump administration. A particularly concerning move by President Trump was to allow reciprocal visits between senior US and Taiwanese officials. While China's initial response to the announcement of import tariffs was measured and constructive, the response from President Xi on the Taiwan announcement was much stronger.

Market Outlook

While interest rates rarely make for a particularly enthralling discussion, at times they are critical for outcomes in markets. The reason is that the rate of return from owning cash or government bonds is the anchor off which all other assets are priced. The higher the yield on a government bond, the greater the return investors will demand from any given stock (all else being equal³), which in turn means a lower share price. A significant increase in interest rates therefore can be a catalyst for equity markets to move lower.

We think this is particularly true today, as many of the popular or fashionable investments of the moment will likely be very sensitive to interest rate moves. As we have stated over the last year, if there is an accident in financial markets waiting to happen, we suspect it is most likely to happen in the debt markets. Many investors in an attempt to avoid risk in recent years have crowded into bond funds, and the room for disappointment there is significant.⁴ Other popular investment strategies such as risk parity funds,⁵ we suspect, will also be susceptible to higher interest rates. Some observers attributed the initial sell-off in February to activity by risk parity funds.

Undoubtedly, low interest rates have played a significant role in bringing about the very high valuations currently attributed to fast growing companies. While the share prices of Facebook, Amazon, Netflix and Google (now Alphabet) – the so called 'FANG' stocks – are mentioned in almost every financial news report, the reality is that these companies represent just one part of the extreme market valuations reached in recent months.⁶ We have seen similarly high valuations across a range of companies in biotech, medical devices, artificial intelligence, autonomous vehicles, and even some in the consumer sector. Companies on such inflated valuations are very susceptible to a setback, should rates move higher.

Our problem, as stated earlier, is that the art of predicting where interest rates will go and when the moves will happen is a highly imprecise one. The broad statement we can make is that we are in an environment where interest rates are rising and that this will act as a dampener on markets. Ultimately our outlook for the next three to five years is guided by the returns implied in the valuations of the stocks we hold in our portfolios and the ease with which we find new ideas to buy. On this front, we are optimistic on future investment returns over the medium-term.

In the next 12 months or so, besides the question of interest rates, the trade policies of President Trump are likely to be a major focus for markets. We think trying to predict outcomes on this front is even more problematic than forecasting interest rates. Our approach to managing the associated risk is to simply ensure that we have cash reserves in our portfolios to take advantage of any trade war-inspired sell-off.

3 Which, of course, it never is! On a day to day basis, higher bond yields might mean better economic growth and thus better profits for a company.

4 As bond yields rise, the prices of bonds fall. So the investor expecting bonds to be a safe haven may be disappointed.

5 A risk parity strategy is one that is focused on the allocation of risk (usually defined as volatility) across different asset classes, rather than allocation of capital.

6 We would argue that Google and Facebook have been quite reasonably valued.

Letter to Investors

As announced to the Australian Securities Exchange on 22 February 2018, the portfolio management responsibilities for the Platinum International Fund (the underlying fund of Platinum International Fund (Quoted Managed Hedge Fund)) will change from 1 July 2018.

Below is Mr Neilson's letter to investors which accompanied the ASX release by Platinum Asset Management Limited (ASX code: PTM), the ultimate holding company of Platinum Investment Management Limited, the responsible entity and investment manager of the Platinum International Fund.

22 February 2018

Dear clients and shareholders

The Platinum Asset Management Limited (ASX: PTM) Board has endorsed my decision to hand over the role of Chief Executive Officer (CEO) of the Platinum Group¹ to Andrew Clifford from 1 July 2018. I will continue as a full time executive director of the Platinum Group and a member of Platinum's investment team, continuing to work on the generation of investment ideas and company research. I will also provide additional support to Platinum's client diversification initiatives in Europe and the US.

As you will be aware, Andrew co-founded the company in 1994 and has over 30 years of investment experience. He took over the role of Chief Investment Officer (CIO) in 2013 and led the implementation of the highly successful sector-based investment team structure. Andrew will continue to lead the investment team as CIO.

I formerly held the positions of CIO and CEO concurrently, and found that with the strong support of the other executive directors my time was essentially focused on investing. More important still is that in an investment performance-driven organisation like Platinum, it is essential that the direction of the firm is controlled from the perspective of investing rather than from that of money gathering.

Andrew Clifford, along with Clay Smolinski, will take full portfolio management responsibility for the flagship fund, the Platinum International Fund,² and my portfolio management responsibilities for Platinum's other global equity funds and mandates will be allocated between Andrew Clifford and Clay Smolinski. Both Andrew's and Clay's long-term individual performance records are exceptionally strong.

The investment team has grown significantly over the years and now comprises 31 individuals including nine portfolio managers who have an average tenure at Platinum of 13 years. These portfolio managers run a range of highly successful global, regional and sector funds, each with strong long-term performance records.

It is with delight that the years of training and gradual elevation in responsibility has allowed our flat organisational structure to bring through and reward a growing number of the team to enjoy the recognition they have earned.

I look forward to continue to tussle around with investment ideas and to spread more broadly the word about our global investment capability.

These changes will take effect from 1 July 2018.

Yours sincerely



Kerr Neilson
CEO & Managing Director
Platinum Asset Management Limited

¹ Platinum Group means Platinum Asset Management Limited and its subsidiaries. Platinum means Platinum Investment Management Limited.

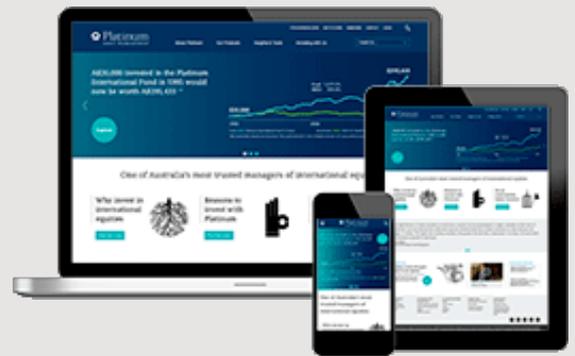
² The flagship fund, the Platinum International Fund, is currently co-managed by Kerr Neilson 50%, Andrew Clifford 40% and Clay Smolinski 10%. From 1 July 2018, the Fund will be co-managed by Andrew Clifford 70% and Clay Smolinski 30%.

The Journal

You can find a range of thought-provoking articles and videos on our new website. For in-depth commentary on the latest market trends and investment themes, look up **The Journal** under **Insights & Tools**.

Recent highlights include:

- [2018 Platinum Roadshow Presentation \(Video & Slides\)¹](#) – The 2018 Platinum Trust investor and adviser roadshows were held in major Australian capital cities during the quarter. A full video recording of the Sydney session held on 21 March is now available on our website. In it:
 - Dr Joseph Lai discusses why China is, in our view, an investment opportunity that no one should miss,
 - Clay Smolinski shares his insights on the opportunities presented by the advent of electric vehicles, some well-known, others not so much,
 - Andrew Clifford reflects on why Platinum's investment approach has delivered good results over the years, and why we believe that it will continue to do so in the years to come.
- [Investing in the Fast-Changing World of Digitisation²](#) – Autonomous driving, additive or 3D manufacturing, generative design, and the smart factories of Industry 4.0... Creative destruction is in full force. We all know that change is coming, but the challenge is to grasp the immediacy of the new and the scale of change.



¹ <https://www.platinum.com.au/Insights-Tools/The-Journal/2018-Roadshow-Presentation>

² <https://www.platinum.com.au/Insights-Tools/The-Journal/Investing-in-the-Fast-Changing-World-of-Digitisati>

Level 8, 7 Macquarie Place
Sydney NSW 2000

GPO Box 2724
Sydney NSW 2001

Telephone

1300 726 700 or +61 2 9255 7500
0800 700 726 (New Zealand only)

Facsimile

+61 2 9254 5590

Email

invest@platinum.com.au

Website

www.platinum.com.au/Our-Products/All-Products/PIXX-Quoted-Managed

Notes

Unless otherwise specified, all references to "Platinum" in this report are references to Platinum Investment Management Limited (ABN 25 063 565 006 AFSL 221935). "PIXX" refers to the Platinum International Fund (Quoted Managed Hedge Fund) (ARSN 620 895 301 ASX Code: PIXX). "PIF" refers to the Platinum International Fund (ARSN 089 528 307), the underlying fund into which PIXX invests primarily.

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. 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 (A\$) returns have been sourced from RIMES Technologies. 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 represents PIF's exposure to physical holdings and long derivatives (of stocks and indices) as a percentage of PIF's net asset value.
3. The table shows PIF's major currency exposure as a percentage of PIF's net asset value, taking into account currency hedging.
4. The table shows PIF's top 10 long stock positions (through physical holdings and long derivatives) as a percentage of PIF's net asset value.

Disclaimers

This publication has been prepared by Platinum Investment Management Limited ABN 25 063 565 006 AFSL 221935 trading as Platinum Asset Management (Platinum[®]). Platinum is the responsible entity and issuer of units in the Platinum International Fund (Quoted Managed Hedge Fund) (ARSN 620 895 301 ASX Code: PIXX). This publication contains general information only and is not intended to provide any person with financial advice. It does not take into account any person's (or class of persons') investment objectives, financial situation or particular needs, and should not be used as the basis for making investment, financial or other decisions.

This publication may contain forward-looking statements regarding our intent, belief or current expectations with respect to market conditions. Readers are cautioned not to place undue reliance on these forward-looking statements. Platinum does not undertake any obligation to revise any such forward-looking statements to reflect events and circumstances after the date hereof.

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.

You should read the entire Product Disclosure Statement for the Platinum Quoted Managed Funds ("PDS") and consider your particular investment objectives, financial situation and needs prior to making any investment decision to invest (or divest) in PIXX. You should also obtain professional advice prior to making an investment decision. You can obtain a copy of the current PDS from Platinum's website, www.platinum.com.au or by phoning 1300 726 700 (within Australia), 02 9255 7500 or 0800 700 726 (within New Zealand), or by emailing to invest@platinum.com.au.

No company or director in the Platinum Group[®] guarantees the performance of PIXX, the repayment of capital, or the payment of income. To the extent permitted by law, no liability is accepted by any company in the Platinum Group or their directors for any loss or damage as a result of any reliance on this information. The Platinum Group means Platinum Asset Management Limited ABN 13 050 064 287 and all of its subsidiaries and associated entities (including Platinum).

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