Platinum Japan Fund

Jacob Mitchell Portfolio Manager

Disposition of Assets

REGION	MAR 2011	DEC 2010
Japan	89%	98%
Korea	1%	5%
Cash	10%	-3%
Shorts	14%	15%

The Fund also has a 10% short position in Japanese Government Bonds.

Source: Platinum

Portfolio Position

Changes in the quarterly long portfolio composition:

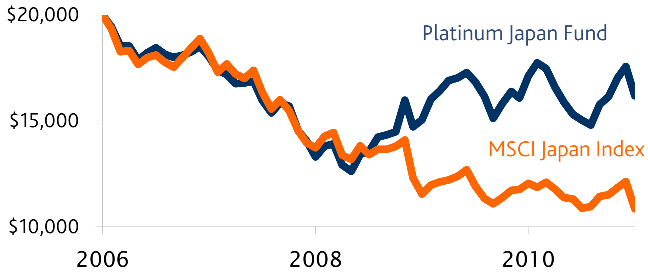
Sector Breakdown

SECTOR	MAR 2011	DEC 2010
DOMESTIC	41%	54%
Financials	12%	19%
Retail and Services	6%	14%
Telco, IT and Internet	10%	13%
Real Estate and Construction	13%	8%
EXPORT	49%	49%
Tech/Capital Equipment	12%	18%
Commodities	14%	12%
Autos and Machinery	13%	12%
Alternative Energy	10%	7%
Gross Long	90%	103%

Source: Platinum

Value of $20,000 Invested Over Five Years

31 March 2006 to 31 March 2011



Source: Platinum and MSCI. Refer to Note 2, page 5.

Performance

Over the past 12 months the Fund fell 5.5%, outperforming the MSCI Japan Index (AUD) benchmark by 4.5% and over the past quarter the Fund was flat, outperforming the benchmark by 6%. For the quarter the benchmark fell 5.8% in Australian dollar terms and 2.8% in Yen terms.

From the outset, we should put the recent geophysical events in perspective: the 9.0 magnitude earthquake that hit Japan's Tohoku region on Friday, 11 March represents one of the most powerful known earthquakes to have hit Japan and one of the five most powerful earthquakes in the world since modern record-keeping began in 1900. Similar to the 2004 Indian Ocean earthquake and tsunami (estimated +225,000 lives lost), the damage from surging water, though much more localised, was far more deadly and destructive than the actual quake.

Tohoku's toll (both human, +12,000 confirmed dead and +15,000 missing, and physical) was greatest in the Iwate, Miyagi, Fukushima and Ibaraki prefectures. This region accounts for 6-7% of the Japanese economy. Whilst there are inevitable comparisons being made to the January 1995 Kobe quake (Great Hanshin magnitude 7.3, impacting the Hyogo and Osaka prefectures, areas of similar economic importance), there are also some major differences and we address these in the Outlook section at the end of this report. Given this backdrop, unsurprisingly it has been a volatile quarter for Japanese equities.

Changes to the Portfolio

Fortunately, as the Topix approached 1,000 for the third time in as many years, we started to sell some of the relatively more expensive positions (including Credit Saison, T&D and Mitsubishi UFJ Financial call options, Nitto Denko, Kubota and Murata) such that we cut gross long exposure from 103.5% at beginning of the quarter to 92.2% by the end of February, just before the quake struck. Though the stocks sold were not overly expensive, we had learnt the hard way that it pays to book profits when prices are tending to run ahead of the story. In terms of overall portfolio composition, the reduction in gross exposure was concentrated in our domestic holdings, which has proven fortuitous as post-quake Yen weakness has supported the outperformance of exporters.

We had no exposure to the power utilities damaged by the earthquake as we have always viewed the sector as overvalued due to high gearing, low growth and challenged profitability.

Long Positions

We wrote a year ago after returning from a visit to Japan and South Korea that given the cheapness of the Korean won and the entrepreneurship demonstrated by Korean management, it made no sense to descend down the quality spectrum in Japan to second tier exporters/industrial conglomerates. We returned to Japan in February to visit companies, arriving back the week before the earthquake struck. In contrast with a year ago, there are now more signs that Yen strength, combined with the competitive threat posed by China, South Korea, Taiwan, et al, is forcing long overdue Japanese conglomerate restructuring. An example of one such stirring giant would be Hitachi. The first signs of reform and greater operational focus emerged in 2009 with the sale of the plasma display factory to Showa Shell Sekiyu (incidentally, it is now used to produce thin film solar cells). This was followed in 2010 by a scaling back of the LCD business and reduction of their investment in Renesas Electronics Corp, a company which was created via the 2001 merger of Hitachi and Mitsubishi Electric's semiconductor businesses, and subsequent 2010 merger with NEC Electronics. The reform news has continued with the March 2011 announced sale of the hard disk drive (HDD) business to Western Digital and merger of the hydroelectric power generation businesses of Hitachi, Mitsubishi Electric and Mitsubishi Heavy Industries. The HDD sale is significant as Hitachi bulked-up in 2003 by acquiring IBM's HDD business but have decided to sell, at what we believe is a favourable price, rather than tie-up capital in a market with questionable growth prospects. We are encouraged by the company's increasing focus on the core business (IT solutions and social infrastructure). Turning this battleship will take time and the market is unlikely to quickly forgive past sins. However, with the Yen finally looking as if it has entered a phase of structural weakness, some of these second tier industrials are looking more enticing, especially if we can see a globally relevant thematic hook.

Along these lines, major new investments included: Showa Shell Sekiyu (see the Platinum Unhedged Fund Quarterly Report on page 9) and Sumitomo Electric Industries. The case for Sumitomo Electric Industries is a simple one: the company has built a leading global position in auto wire harnesses with a 25%

share by winning over key original equipment manufacturers such as Hyundai Motors and VW – this is not that Yen sensitive as plants are located in low-cost labour zones close to auto production and represent only a third of sales. Company-wide margins and return on capital employed (RoCE) are on target to reach the 2006 high which is impressive given the other two-thirds of sales (power and telecommunications cables, optical components, specialised materials) are much more Yen sensitive. The company is focused on lifting the profitability of the less dominant businesses and does not seem wedded to the weaker businesses that are detracting from overall profitability. In terms of valuation, we are paying 0.9x book, PE 11x, for a business that has had a poor 10 year average RoCE of only 7%, which seems to have lifted this to around 14% today. That alone would be insufficient reason to own the stock; where the story becomes more interesting is that the trend towards car electrification, where a full electric vehicle has 2-5x more wire harness content than the equivalent internal combustion vehicle, places the stock on the cusp of higher growth trajectory that isn't factored into the valuation.

Short Positions

No significant changes.

Currency

In keeping with our view that the Yen is overvalued, we cut our exposure from 39% to 37%; whilst on the Tuesday after the earthquake struck the Yen spiked to an all time high against the US dollar of 77 as investors feared offshore capital repatriation (to fund rebuilding efforts). This remained short lived with the currency weakening to 83 by quarter end. Whilst the headline reason for the currency weakness was the coordinated G7 intervention, the longer-term reasons for a trend reversal discussed in previous quarterlies may also be in play. At least for the quarter our currency allocation added an estimated 2% to performance.

Commentary and Outlook

Following the 1995 Kobe Earthquake, economic activity rebounded relatively quickly with industrial production back to its pre-quake level within two months. The direct economic cost of the quake was estimated at ¥10 trillion - ¥15 trillion (2.0-2.5% of GDP) and the government responded with three supplementary budgets totalling ¥3.2 trillion. The Tohoku quake released approximately 355x more energy[1] than Kobe with a tsunami spreading its destructive reach much wider, damaging power plants, and with the situation further complicated by the unresolved Fukushima nuclear incident, the economic impact will be somewhat more drawn out than Kobe with a slower rebound in industrial production, exports, tourism and consumer spending.

For those interested in understanding more about the nuclear situation we would direct you to our website – http://www.platinum.com.au/images/market-update_15032011.pdf

The power situation is exacerbated by the existence of two separate East and West grids with a difference in frequency making interconnection problematic (this dates back to 1886 when East Japan installed German equipment and West Japan, General Electric equipment). The 87GW Eastern grid has sustained significant damage: 7.0GW of nuclear capacity was shut for maintenance prior to the quake and an additional 9.6GW of nuclear and 15.5GW of thermal capacity was either shut-down because of, or was damaged by, the quake. Adding all that up and West Japan has operating capacity of only 55GW versus average peak demand of 60GW and a typical summer spike in peak demand to 70GW i.e. it is short peak demand of 15GW (the Western grid has approximately 22GW in spare capacity but frustratingly this can't be accessed).

1 Magnitude helps to measure the amount of seismic energy released by an earthquake. The first stage is to calculate the shaking amplitude, which is m in the equation M = 10m. This means that a M5 earthquake shakes 10 times more than an M4 one. The second stage is to calculate the energy release, which raise 10m to the power of 3/2. So the energy release in an earthquake with m=4 is e = (104)3/2 = 106. The Hanshin quake was M7.3, and the Tohoku quake was estimated at M9.0. Therefore, the ratio of energy released by the Tohoku quake to that of the Hanshin quake was (10 9.0) 3/2 / (10 7.3)3/2 = 10 13.50 – 10.95 = 355 times greater. See http://earthquake.usgs.gov/learn/topics/measure.php

Clearly, Japan is facing some tough decisions:

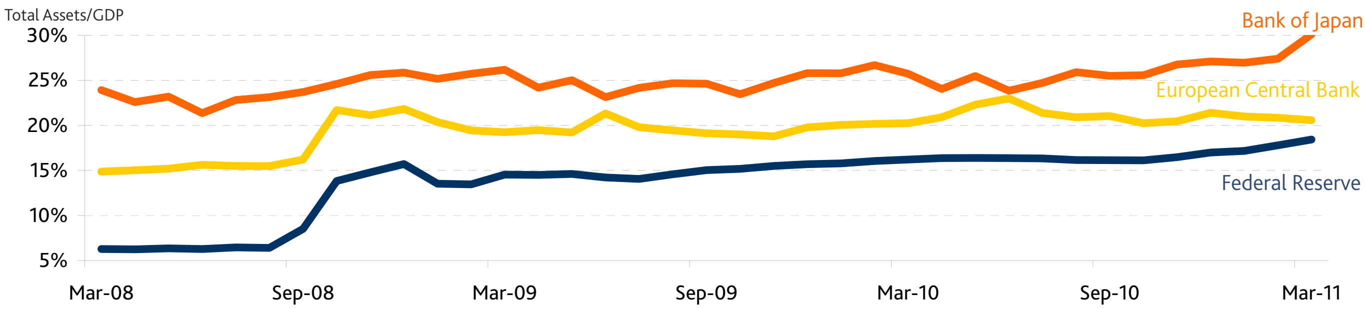
- As a mercantilist nation, one assumes that METI (Ministry of Economy, Trade and Industry) will favour power supply to globally competitive export industries, with households bearing the brunt of peak load shedding; the alternative is major auto and technology supply chain disruption and a weakening of Japan's global export position.
- There appears to be around 6.5GW in nuclear capacity that could be restarted relatively quickly, however, local populations/provincial governments that have the power to stop such restarts, may resist this on safety concerns.
- Clearly the repair of the 15.5GW in thermal capacity needs to be expedited.

Based on very early assessments, the Tohoku quake's economic cost is likely to be well in excess of Kobe's ¥15 trillion and we would also expect a government fiscal response larger in scale to Kobe's – however, the key difference is that in 1995 government debt to GDP was only 70% versus 184% today (on a net basis these numbers are 24% and 140%, respectively). Whilst the cost of recovery and rebuilding will be largely absorbed by domestic government debt issuance, it is difficult to see how this can be funded without some assistance from the Bank of Japan (BOJ) by way of debt monetisation, which is supportive of a weaker Yen. The BOJ, under its credit easing policy (expanding the Central Bank balance sheet via asset purchases), made it clear that they would do more when required and on the Monday following the quake doubled the size of its credit easing program from ¥5 trillion to ¥10 trillion (equivalent to 2% of GDP or an 8% balance sheet expansion). Also, post-quake the BOJ injected roughly ¥10 trillion in shorter term liquidity which is referred to as a temporary measure. Whilst Governor Shirakawa continues to resist use of the BOJ's balance sheet for reflation, the magnitude of the economic shock is confronting him with some stark choices. Expressed as a percent of GDP, the recent balance sheet expansion is roughly similar to the Federal Reserve's much vaunted Quantitative Easing 2 program.

We would argue that the Tohoku quake and consequent economic disruption bring forward the moment of truth when the politicians and bureaucrats finally realise that the current policy of high real rates is unsustainable. Regardless of whether the Japanese public is willing to pay higher taxes, unless the BOJ starts to actively target a weaker currency and higher inflation, it will be very difficult for Japan to bring its government debt position under control.

More specifically for our portfolio, before the market correction we assessed that many of our stocks were extremely cheap relative to their global peers. The recent market sell-off hasn't changed our view and the quake may act as much needed catalyst for the Yen depreciation and a general "reflation" of Japan.

Central Bank Balance Sheets



Source: Factset

Notes

1. The investment returns are calculated using the Fund's unit price and represent the combined income and capital return for the specific period. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), are pre-tax, and assume the reinvestment of distributions. The investment returns shown are historical and no warranty can be given for future performance. You should be aware that historical performance is not a reliable indicator of future performance. Due to the volatility of underlying assets of the Funds and other risk factors associated with investing, investment returns can be negative (particularly in the short-term).

   The inception dates for each Fund are as follows:
   Platinum International Fund: 30 April 1995
   Platinum Unhedged Fund: 31 January 2005
   Platinum Asia Fund: 4 March 2003
   Platinum European Fund: 30 June 1998
   Platinum Japan Fund: 30 June 1998
   Platinum International Brands Fund: 18 May 2000
   Platinum International Health Care Fund: 10 November 2003
   Platinum International Technology Fund: 18 May 2000

2. The investment returns depicted in this graph are cumulative on A$20,000 invested in the relevant Fund over five years from 31 March 2006 to 31 March 2011 relative to their Index (in A$) as per below:
   Platinum International Fund - MSCI All Country World Net Index
   Platinum Unhedged Fund - MSCI All Country World Net Index
   Platinum Asia Fund - MSCI All Country Asia ex Japan Net Index
   Platinum European Fund - MSCI All Country Europe Net Index
   Platinum Japan Fund - MSCI Japan Net Index
   Platinum International Brands Fund - MSCI All Country World Net Index
   Platinum International Health Care Fund - MSCI All Country World Health Care Net Index
   Platinum International Technology Fund - MSCI All Country World Information Technology Net Index
   (nb. the gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist).

   The investment returns are calculated using the Fund's unit price. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), pre-tax and assume the reinvestment of distributions. It should be noted that Platinum does not invest by reference to the weightings of the Index. Underlying assets are chosen through Platinum's individual stock selection process and as a result holdings will vary considerably to the make-up of the Index. The Index is provided as a reference only.

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