Platinum Japan Fund

Jacob Mitchell Portfolio Manager

Disposition of Assets *

REGION	MAR 2014	DEC 2013
Japan	88%	90%
Korea	7%	9%
Cash	5%	1%
Shorts	5%	14%

The Fund also has a 11% short position in Japanese Government Bonds.

* The invested position represents the exposure of physical holdings and long stock derivatives.

Source: Platinum

Portfolio Position

Changes in the quarterly long portfolio composition:

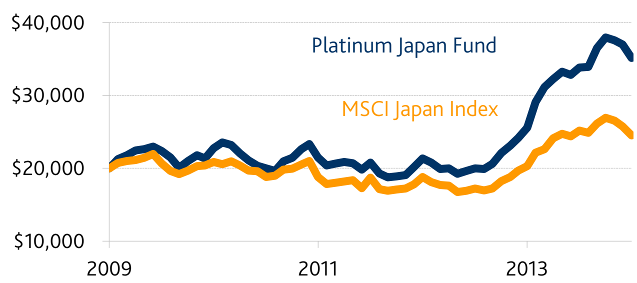
Sector Breakdown

SECTOR	MAR 2014	DEC 2013
DOMESTIC	52%	61%
Consumer and Retail	14%	15%
Financials	12%	15%
Healthcare	10%	8%
Services	7%	13%
Telco and Utilities	6%	6%
Property and Construction	3%	4%
EXPORT	43%	38%
Tech/Capital Equipment	22%	22%
Durables	15%	13%
Commodities	6%	3%
Gross Long	95%	99%

Source: Platinum

Value of $20,000 Invested Over Five Years

31 March 2009 to 31 March 2014



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

Some themes that are represented prominently within the Fund include:

- Emergent industrials with leading global positions.
- Corporate revitalisation, industry reorganisation and potential merger and acquisition targets.
- Potential policy change beneficiaries (e.g. industry deregulation, labour market reform, tax reform, new business incubation incentives).
- Internet 2.0 and service sector growth opportunities.
- Emergent energy management opportunities (smart cities/grids, smart buildings).
- Cheap real asset exposures that domestic investors will seek as inflation hedges.

Performance

(compound pa, to 31 March 2014)

	QUARTER	1 YR	3 YRS	5 YRS	SINCE INCEPTION
Platinum Japan Fund	-7%	38%	18%	12%	14%
MSCI Japan Index	-9%	21%	9%	4%	0%

Source: Platinum and MSCI. Refer to Note 1, page 5.

The Japanese market experienced a poor quarter, best described as indigestion, with record inflows from foreigners over the past 12 months leaving the market vulnerable to perceived policy disappointments. Some express disappointment that the Bank of Japan (BOJ) in not pre-emptively easing prior to the 1 April consumption tax rise (from 5% to 8%), whilst others are just losing patience with the apparent slowness of Abe's so called "Third Arrow" reforms. Our interpretation, given the large move over the prior 12 months, is that many investors are just looking for an excuse to sell the market.

The weakness in the market was also felt broadly across our portfolio with only a few exceptions, though our index and individual stock shorts did provide some protection as did a higher weighting in the Yen. Importantly, portfolio hedging strategies (via individual stock and index shorts, and currency hedging) have generated just over a quarter of the Fund's total returns over the past six years, with our long stock picking generating the residual. In practice we do not see these as separate strategies, but as one inter-related approach where the macro and stock/industry specific work is inextricably linked.

Changes to the Portfolio

There was some turnover in the portfolio as we attempted to concentrate around higher conviction ideas. This meant selling stocks that had reached valuation levels which made them less interesting as investments (e.g. Naver, Cyberagent, Obic and Mitsubishi Electric) and stocks where our original thesis had become less certain (e.g. Kurita Water and our two large bank holdings). We added to existing positions that had pulled back to attractive levels (Samsung Electronics, Toyota Industries and Pola Orbis) and initiated new investments in extremely neglected parts of the market such as energy and materials (more on that at a later date).

Pola Orbis has steadily crept up our holdings list and is now a sizable position. This is a family-owned, high quality company with two well-positioned skin-care brands in Japan; Pola, premium focus and Orbis, aspirational (code for more affordable). The company realised early on, given Japan's historical deflationary bias, that channel control would be important to managing the customer experience and ultimate price points, hence, almost all of the company's products are sold directly to the customer, either door-to-door, in company owned clinics or via the Internet. This has resulted in a highly focused product-portfolio rather than following retailer demands to broaden the number of stock keeping units. Further, the sales force of clinicians is paid on a contract commission basis in stark contrast with competitors such as Shiseido with job-for-life type obligations. This has its complications when the product on offer is eternal youth. Taking advantage of the Yen's strength, the company acquired two foreign skin-care brands in 2012, Jurlique and H20, to complement the existing focus on natural treatments. The focus is now on growing the affordable Orbis brand through

South East Asia and the premium Pola brand in China via a multi-channel strategy. Management have stated a clear commitment to lifting the return on equity (RoE) via both higher profitability and shareholder distributions which we find enticing given a starting P/E multiple of 15x ex-cash (normalising for goodwill amortisation).

Late last quarter and into this quarter we progressively took advantage of some of the euphoria around the broad Japan reform story (which at a corporate level is selectively real) to partially hedge the portfolio via the Nikkei Index and some stock specific shorts where we thought market expectations were running significantly ahead of reality – post the recent correction, these have been profitably closed (though we have retained a small residual Nikkei hedge). We also shorted the Topix Property Index, as investors had crowded into the space to gain exposure to the BOJ's reflationary policies, without any regard for valuation and the reality of what is a relatively slow, though persistent, recovery.

Commentary and Outlook

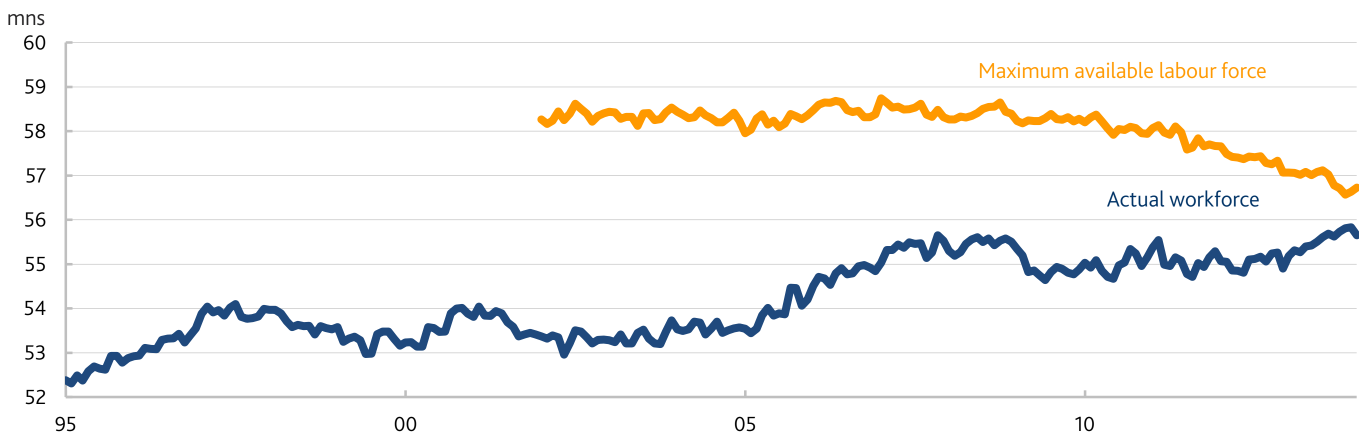
Most of the current weakness in the Japanese economic data seems related via the export channel to the slow-down in Asia ex Japan, the destination of some 50% of Japanese exports. For those with long memories, the parallels to 1997 are a bit too obvious i.e. the Japanese raised the consumption tax rate on the eve of the Asian currency crisis which went a long way to embedding Japanese deflationary expectations for the better part of the next two decades.

A more considered view would pay heed to some of the differences in both the macro and micro economic backdrop. Apart from a banking system that is in better shape, the most compelling of these is that just 18 months into an economic recovery in Japan, the workforce is showing signs of clear tightness (unemployment rate is 3.7%) and arguably this is happening much earlier than in previous recoveries (see the third chart on page 3). When one considers the longer-term trends, the tightness shouldn't surprise as the available workforce has simply been shrinking (see chart below) as Japan ages.

Notwithstanding that the emerging wage growth will help offset the consumption tax hike, the data could be interpreted negatively on a number of counts:

- Wage growth can negatively impact profit share (one reason US profit share has been rising is the lack of wage growth).
- Reflects a fundamental lack of **full-time** labour mobility (caveat to this is that the approximate 35% of the workforce that is employed on either a part-time or contract basis, a steadily rising proportion, has never experienced the "benefits" of guaranteed lifetime employment).

Japan's Available Labour Force



Source: National Institute of Population and Social Security Research, MIC, Bloomberg; compiled by SMBC NIKKO. Maximum available labour force = Population over 15 multiplied by participation rate minus structural unemployment. Actual Workforce = Current permanent employees plus contractors & part time staff.

It's a good thing we invest in companies not economies. At the Japanese corporate level, the labour tightness is potentially quite positive as a catalyst for ongoing full-time workforce reorganisation. Importantly, the shame associated with making a long-serving full-time employee redundant is clearly less when that person has other worthwhile employment opportunities available. The impact on productivity and profitability is potentially significant.

During the quarter we visited a range of Japanese pharmaceutical companies with Bianca Ogden to discuss some of these issues (for a more extensive analysis of this see the current Health Care Fund quarterly report). It is interesting that M3 (founded in Japan), an on-line information and marketing portal through which large pharmaceutical companies can communicate with doctors and specialists is so successful in Japan. The paradox is that widespread adoption of this productivity tool has not actually led to any improvement in Japan's pharmaceutical sector sales force productivity with benchmarks indicating more than twice as many sales representatives per doctor than in the West. When challenged some of the corporates are surprisingly open about the issue and simply conceded that they have too many sales reps and that outside of natural attrition, workforce reduction was difficult.

From a broader perspective, these companies are lagging reform initiatives in the industrial sector where memories of the truly life threatening nature of Yen strength are still fresh. Interestingly, the largest company in the sector, Takeda Pharmaceutical, is changing having appointed French executives into the key management positions with an announced plan to cut global costs by around $1 billion over three years with no exception made for the Japanese cost base; we think others will follow.

Trends in Japanese corporate willingness to distribute profits to shareholders are also an important indicator of corporate health and the signs are encouraging with the big-end of town taking the lead with buybacks (e.g. NTT, Hitachi, Mitsui and Toyota). In the case of Toyota, the company consistently bought back an average just over 2% pa of shares outstanding prior to the 2008 credit crisis and has just announced a resumption of this program, an important indicator of growing confidence.

Whilst there is always a long list of so-called "tail" risks that we have on our watch-list and we don't wish to down-play the structural issues facing many of the large economies (China's ageing credit binge, US long-term addiction to other people's savings, Japan's twin-deficits and high level of government debt and the real risk of deflation within the European periphery), it is also important to gauge these risks relative to starting valuations. In the case of Japan, a trailing multiple of 1.2x book for the entire market and a P/E discount (forward basis) relative to the world close to the all-time high, there remains some margin for error. However, as always, the stock specific remains far more interesting that the aggregate and on this count, not only do we remain comfortable with the stocks we own, we are also finding worthy new candidates. The issues facing the market more technically relate to the overhang of foreign buying and though we are approaching the point, at least from a sentiment perspective, where most foreigners have given up hope of any "Third Arrow" reforms, there may still be bouts of buyer remorse. As we have stated in earlier quarterlies, such "Third Arrow" success was never part of our base case for Japan and though we will keep a watching brief, our primary focus will remain actual change at the corporate level.

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$20,000 invested in the relevant Fund over five years from 31 March 2009 to 31 March 2014 relative to their Index (in A$) 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.

3. Long invested position represents the exposure of physical holdings and long stock derivatives. The net invested position represents the exposure of physical holdings and both long and short derivatives.

Disclaimer

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