Platinum Japan Fund

Jacob Mitchell Portfolio Manager

Disposition of Assets *

REGION	JUN 2013	MAR 2013
Japan	90%	96%
Korea	5%	4%
Cash	5%	0%
Shorts	11%	14%

The Fund also has a 12% 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:

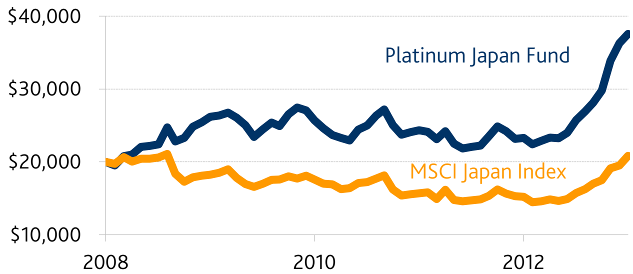
Sector Breakdown

SECTOR	JUN 2013	MAR 2013
DOMESTIC	51%	56%
Consumer and Healthcare	21%	23%
Financials	16%	13%
Telco, IT and Internet	10%	8%
Real Estate and Infrastructure	4%	12%
EXPORT	44%	44%
Tech/Capital Equipment	24%	24%
Autos	9%	10%
Commodities	8%	7%
Alternative Energy	3%	3%
Gross Long	95%	100%

Source: Platinum

Value of $20,000 Invested Over Five Years

30 June 2008 to 30 June 2013



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

Performance

(compound pa, to 30 June 2013)

	QUARTER	1 YR	3 YRS	5 YRS	SINCE INCEPTION
Platinum Japan Fund	26%	61%	13%	13%	14%
MSCI Japan Index	19%	37%	6%	1%	0%

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

The past quarter in Japanese equities has been one of the more surreal on record (and that is from a market that does surreal well). We started to position the Fund late last quarter for a correction in the Index as it seemed expectations for Kuroda's, the Bank of Japan's (BOJ) new Governor, first policy announcement were set too high. As it turned out, Kuroda massively exceeded expectations and at the high of the quarter the market had rallied 23%, though by quarter-end the market was up only 10%.

The immediate reaction to Kuroda's "big bang" monetary easing announcement was felt not only in the obvious reflation beneficiaries e.g. property and financial stocks, but broadly with global investors rushing to gain exposure to the Kuroda liquidity party via Nikkei futures, Exchange Traded Funds (ETFs) and structured products, and Japanese retail traders ramping smaller "concept" stocks as evidenced by the rise in the "Mothers" Index (generously described as the market of high-growth and emerging stocks).

At one level, the demand for equity index derivatives (futures, ETF's and structured products as a liquid alternative to just buying shares) simply reflected that most global investors and brokers had cut their Japanese teams to the bone and when the order came to buy, there was no one left to select the stocks. But as the recent rally grew more and more extended, one suspects the marginal buyer was very fast money. The Pavlovian rally response to the Federal Reserve's quantitative easing (QE)1, QE2 and QE infinity are well ingrained in the investor psyche but over the quarter, volatility in Japanese equities, currency and bonds steadily built and this wasn't meant to be part of the playbook. The origins of the 23 May "flash crash" where the Nikkei fell 7% on the day somewhat reflected the dysfunctional scale of market turnover associated with equity derivatives relative to the normal cash market. Rising Japanese Government Bonds (JGB) volatility was potentially the straw that broke the camel's back. The subsequent fall seems to have reset speculative expectations in a healthy manner and volatility has retraced to more normal levels; we suspect that stock picking may once again come to the fore.

Examining 12 month performance, the key stock contributors ranked by sector were: real estate/utilities, financials, autos, consumer/healthcare, telecommunications/internet and tech/capital equipment. The key underperformers were our commodity related stocks. Over the year, the Fund averaged a 9% short equity position and whilst this lost money, this was relatively immaterial given the 61% move upwards in the Fund. The result from the JGB short was also immaterial, though our currency positioning (i.e. hedging out of Yen and shorting the Australian dollar) produced significant returns.

Changes to the Portfolio

Longs

We opportunistically invested in four of the Japanese electric utilities that were suffering under the post Fukushima shut-down of all Japanese nuclear reactors. Whilst the debt of these companies was trading close to par, implying little financial stress, the equity was priced at a greater than 40% discount to book – an appropriate estimate of fair value. With potential for restart an obvious re-rating trigger, we protected our downside by investing in the companies that owned the youngest reactors located in the least seismically challenged parts of Japan. The frothiness of the market has meant the discount to book value was more than closed and we have been able to sell the stocks without any restarts actually announced – having experienced the bear market, one must enjoy the bull-market.

In terms of longer-term core holdings, following the correction we acquired Nippon Telegraph and Telephone (cheap yield play), Aeon (driving the reform of the mass market retail supply chain), SK Hynix (same rationale as Micron, consolidation of the memory chip industry) and Canon, funding this from complete sales of stocks that had surpassed valuation targets: Shin-Etsu Chemical, Nitto Denko, Yamato Holdings, Astellas Pharma and Japan Exchange Group. We also added to our financial holdings.

The case for Canon is relatively straightforward. The stock has been out of favour, tarred by the perception that in the smartphone and tablet era, the camera and copier/printer businesses are ex-growth. This looks misguided as volumes in key end markets (printers, copiers and cameras) are still growing at double digit rates. Canon is well-run and with the headwinds of the uber strong Yen receding, remains dominant in its key markets; importantly, over 25% of sales are derived from consumables. The company continues to make a very respectable return on capital employed (RoCE) even after expensing 8% of sales on research and development, and given that more than 80% of sales and less than half of production is derived from overseas, the weakening Yen will flow through to profits. The valuation is attractive at a March 2014 expected P/E of 12x and with a fortress-like balance sheet (net cash of $7 billion), the current dividend yield of 4% and buy-backs of 1~2% of stock outstanding are sustainable.

Shorts

In anticipation of a backup in global yields, we had put in place some Index and single stock shorts concentrated in the yield sensitive real estate area prior to and during the correction phase. Post the correction we have rolled some of this short into unjustifiably expensive stocks that are more directly exposed to the China investment growth slow-down.

Currency

The first stage of what longer-term is likely to be a much greater Yen devaluation is close to conclusion. However, the timing of the next stage is tricky. In isolation the BOJ's flagrant printing should see the currency continue to depreciate and even more so given the relative vitality of the US recovery (and related tapering discussion) and ever so green-shoots in the Euro-zone periphery. What makes timing the next leg to this devaluation difficult is the China infrastructure investment slow-down. Accordingly, whilst we still prefer the US dollar over Yen, we retain some ownership of Yen in case a worsening China growth scare triggers a major unwind of emerging market debt carry trades funded from US dollar and Yen.

The decision to short the Australian dollar in May based on significant over-valuation relative to purchasing power, with the break-down in the terms of trade a clear trigger for reassessment, was timed well. Whilst we have covered this position, we will consider reopening on any bounce in the Australian dollar.

Commentary and Outlook

Given the historic nature of Kuroda's 2% inflation targeting policy, it is worth revisiting the details of the related QE program. This is not because we believe QE or inflation targeting is a panacea, rather it represents a country's choice to take a hair-cut to its wealth (via currency debasement) for the sake of improving its nominal growth rate and perceptions of debt sustainability via an improvement in competitive position and claim on global trade.

In a quantitative and qualitative sense, what Kuroda has committed to exceeds that of any of his predecessors (and any QE program that we know of). Whilst Hayami, Fukui and Shirakawa all conducted QE, this was restricted to the short-end of the curve (so not to be confused with government debt monetisation). By doubling the duration of the JGB portfolio while increasing it from ¥94 trillion to ¥190 trillion, Kuroda has committed to buy ¥160 trillion of 7-8 year bond equivalent over the next 21 months. This is more than twice what the net JGB issuance is likely to be. Just to add some spice, Kuroda also threw in a commitment to buy ¥2 trillion of equity ETFs and Real Estate Investment Trusts (REITs) over 2013-14 – more than doubling the BOJ's then exposure.

Kuroda has committed to doubling the BOJ balance sheet to reach ¥290 trillion by end 2014 or 60% of current nominal GDP. The People's Bank of China (PBoC) is the only major Central Bank with a balance sheet of this size and Kuroda is effectively committed to match it. In terms of base money, this is equivalent to 50% growth in 2013 and 25% in 2014, with a peak in expansion at 60% year-on-year in late November this year.

It is inevitable that as China slows and global growth potentially becomes scarce, the chorus of opposition against the BOJ's inflation targeting will grow. However, keep in mind the following – the level of Japanese industrial production is still 17% below the 2007 peak compared to Germany down 3%, US down 2%, Taiwan down 11% and South Korea up 19% – don't expect the newly invigorated BOJ to back away from the task at hand.

Given the success of the Liberal Democratic Party (LDP) at the recent Tokyo prefecture election, the July national Upper House election is shaping up as a landslide win for the LDP. Importantly, the LDP's current popularity seems linked to reform. In installing Kuroda, Abe and the LDP coalition have achieved real change, not because QE will necessarily work, but because it represents a clear break from 20 years of Ministry of Finance/BOJ inertia and policy passivity. The six months following the July election will represent the next test for Abe. This is when we'll know whether he intends to move to deliver long-lasting free market reforms, the wildcard for Japan.

In the meantime, encouraging signs of domestic recovery across the economy are emerging even without a rebound in exports: retail sales rose 1.5% sequentially in May, and housing starts and auto sales are recovering, whilst broad money growing at just under 3% is the fastest rate since the late 1990s. The pricing data is also consistent with a domestic recovery. In the past, the Japanese CPI has only risen in response to global supply shocks, which the BOJ mistook for inflation. This time, underlying inflation appears to be returning of its own accord. With the stock market in aggregate only priced on 1.3x trailing book (pre-currency and market gains) and a recovering economy, outside of a major disruptive external event, it is difficult to be too negative on the outlook for Japanese equities.

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$20,000 invested in the relevant Fund over five years from 30 June 2008 to 30 June 2013 relative to their Index (in A$) 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.

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