Platinum Japan Fund

Jacob Mitchell Portfolio Manager

Disposition of Assets

REGION	SEP 2014	JUN 2014
Japan	86%	90%
Korea	8%	7%
Cash	6%	3%
Shorts	9%	5%

The Fund has a 12% short position in Japanese Government Bonds.

Source: Platinum. Refer to Note 3, page 6.

Portfolio Position

Changes in the quarterly long portfolio composition:

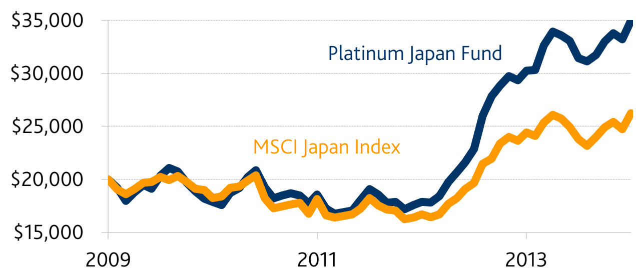
Sector Breakdown

SECTOR	SEP 2014	JUN 2014
DOMESTIC	45%	50%
Financials	13%	12%
Consumer and Retail	10%	13%
Healthcare	8%	9%
Services	8%	7%
Telco and Utilities	4%	6%
Property and Construction	2%	3%
EXPORT	49%	47%
Tech/Capital Equipment	18%	19%
Durables	16%	17%
Commodities	15%	11%
Gross Long	94%	97%

Source: Platinum

Value of $20,000 Invested Over Five Years

30 September 2009 to 30 September 2014



Source: Platinum and MSCI. Refer to Note 2, page 6.

Whilst we build the portfolio one idea at a time, prominent themes within the Fund include:

- Cheap exporters with leading global positions – Toyota.
- Corporate revitalisation – Panasonic.
- Potential policy change beneficiaries - KB Financial.
- Internet 2.0 and service sector growth opportunities – NTT.
- Emergent energy management opportunities – Rohm.
- Specific neglected cyclical stocks - Sumitomo Metal Mining, Asahi Glass.

Performance

(compound pa, to 30 September 2014)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Japan Fund	6%	16%	23%	12%	14%
MSCI AC Japan Index	5%	8%	13%	6%	1%

Source: Platinum and MSCI. Refer to Note 1, page 6.

Assisted by a weaker Yen, the Japanese market awoke from a 12 month slumber rising 5.8% in local currency terms and breaking to a new six year high. However, the sad news for investors fully exposed to the Yen i.e. most Japanese households, the market actually fell 2.3% in US dollar terms.

Outperformers included some of our automotive electrification/electronics suppliers, stocks including Rohm, Sumitomo Electric and Hitachi Chemical. A combination of greater adoption of electronic control and sensing throughout the automobile, and growing penetration of hybrid and EV drive-trains is driving demand for components such as electric motors, batteries, inverters, advanced cabling and power semi-conductors. But this is more than just a demand story, the model specific nature and high performance requirements of the automotive original equipment manufacturer is leading to better margins; for companies such as Rohm, that historically supplied into the hypercompetitive consumer electronics market, this is a welcome change.

Underperformers were concentrated in two areas:

1. Broadly across domestic service and consumer related areas where Yen weakness focused investor's minds on the potential cost of the Bank of Japan (BOJ's) reflationary policies i.e. a haircut to national wealth and purchasing power.
2. Commodity stocks, for example, Sumitomo Metal Mining and Nippon Electric Glass gave up some of their prior quarter gains.

Changes to the Portfolio

As investors can see from the table on page 17 and for the reasons discussed in the commentary below, we reduced our exposure to the domestic part of the market. In a nutshell, weaker retailers and the like are suffering margin pressure, the result of rising part-time service sector wage costs, imported product costs and customers suffering real income pressure. Hence, we have sold domestic stocks that have reached targets (retailer PAL) and also divested positions where the original case had weakened (Aeon, Hitachi Transport and other smaller service and property related companies).

At the same time our exposure to commodity related names increased via investments in Tokyo Steel, Nippon Electric Glass (NEG, LCD glass) and more recently, Asahi Glass (Asian and European float glass and LCD glass). For the sake of brevity, we will focus on the LCD glass aspect of these investments, a business with high technological barriers to entry and a consolidated industry where the top three players account for 95% of capacity (Corning 50%, Asahi Glass 25% and NEG 20%).

TFT-LCDs (Thin-Film-Transistor Liquid Crystal Display) dominate the flat panel display market (TVs, monitors, notebook PCs and tablets). A key input in the manufacture of TFT-LCD panels is the two sheets of display glass that act as a sandwich holding the liquid crystals in place with the rear panel also acting as substrate on which the TFT's are etched.

LCD glass is distinguished by a couple of key properties to maintain picture quality; it must be:

- Extremely smooth and of uniform thickness (standard is now around 0.5mm).
- Free of charge-carrying particles that could migrate into the thin-film-transistor (TFT) structure.

As a consequence, the glass must be alkali-free which significantly increases the temperature required for the process. Melting tanks, refining channels and stirring cells must be capable of withstanding temperatures of up to 1,650ºC, hence, the hottest parts of the tanks must be platinum coated. Corning and NEG use the fusion process where molten glass is fed into a trough called an "isopipe", overfilling until the glass flows evenly over both sides. It then re-joins, or fuses, at the bottom, where it is drawn down in a continuous flat sheet which is then cooled in a way that prevents warping and cut into panels in one continuous high-speed process. Technological barriers to entry have been built-up based on the ongoing requirement to make ever purer glass, at ever thinner dimensions and ever greater speed. Accordingly, despite their best efforts and billions of dollars of investment, Schott, Saint Gobain and most recently LG Chemical have all failed to break in.

As a result of these characteristics, the industry has experienced periods of high profitability. For instance, NEG's return on capital employed (RoCE) peaked at 30% in 2008 despite ASP declining at roughly 15% pa over the past ten years. In the early years, the reduction in selling price was necessary to drive customer adoption. This was facilitated by substantial cost reductions from improved technology, efficiency and more recently, thinning of the glass.

In a perfect storm, cost reductions have stalled in recent years whilst glass selling price declines have accelerated due to discounting by the Japanese and also due to the weaker Yen. LCD glass is priced in Yen, whereas TV's are priced in US dollars, hence the 40% Yen depreciation of the past two years has led to LCD glass prices falling much faster than LCD panel/TV prices. Hence, the glass content as a proportion of the overall panel cost has fallen from 12% back in 2010 to a record low 7% today. By way of reference, a 42 inch TV contains 1m^2 of glass costing around $20. As a result, NEG and Asahi's profitability and share prices have declined significantly since the 2008 peak (NEG's RoCE fell to 4%). Stocks are trading at over 30% discounts to invested capital and 4-5x historical peak profits.

The market seems keen to extrapolate the industry's near-term malaise; in contrast we see the pre-conditions for rebalancing back towards a more rational pricing environment falling into place. Since Corning gained full control of its Samsung joint venture, ALL players have a stated commitment to capacity discipline whilst glass demand continues to grow at 5-7% pa driven by emerging market demand, replacement demand and increasing screen size. Accordingly, industry "end-to-end" utilisation should come close to the maximum effective level in the next 12-18 months. Whilst we can't identify the exact trigger for industry recovery, we still have some faith in the operation of the market economy and given how depressed valuations are, we are willing to be patient.

Shorts and Currency

Whilst our equity hedges detracted from performance, this was more than made up for by our currency hedges as the Yen fell just under 8% against the US dollar. We increased the total equity market hedge from 2% to 9% by adding to the Nikkei short.

As it becomes more evident that the fast money shorts associated with the 2013 Yen depreciation had been washed out by 12 months of sideways volatility, we started rebuilding the Fund's shorts in the currency. The other headwind to a weaker Yen was the potential for a worse than expected growth scare from China. However, given how negative expectations for most things Chinese had been reset, we took a view that the risk of a safe-haven Yen rally was much diminished. Further, the fundamental logic for hedging out much of the Fund's Yen exposure hadn't changed and the pre-conditions for the next leg-down in the currency were falling into place - that, is:

- BOJ balance sheet expansion continuing at a rapid rate relative to the Federal Reserve's tapering and the European Central Bank's (ECB) dithering.
- A relatively weak Japanese economy with the consumption tax hike and general inflation weighing on consumer demand.
- A relative weak export/import replacement and domestic investment response to the initial 30% Yen depreciation. Even before the GFC, Japanese corporates were investing heavily offshore, and post-crisis, the combination of a strong Yen and Tohoku Earthquake-Fukushima disruption, left Japanese corporates in no mood to increase domestic exposure.

- The ongoing shut-down of the nuclear reactor fleet adding some $40 billion pa or 0.7% of GDP to Japan's energy import bill and 30% higher power price forcing intensive industries to relocate outside Japan, for example, NEG relocating LCD glass operations to China and South Korea.

Commentary and Outlook

Enough time has passed since the advent of "Abenomics" to justify a mid-term report card. Clearly the wins from a market perspective have been the reversal of a BOJ strong currency policy and subsequent relief rally in Japanese reflation and export sensitive equities. On the direction of future monetary policy, we expect Kuroda and Abe's "grand bargain" to result in additional BOJ stimulus in return for the Liberal Democratic Party's (LDP) implementation of the scheduled October 2015 consumption tax hike from 8% to 10%. Additional measures would likely involve more exchange traded fund purchases and a clarification of the open-ended nature of the current program.

Out of all the major economies, Japan's money printing efforts are the most extreme and whilst it is difficult to normalise the impact of last April's consumption tax hike, both realised inflation and future inflationary expectations seem to be rising. Clearly, the "tail-risk" associated with the BOJ's "reflationary" policy would be a larger than expected currency devaluation, after-all, the BOJ is buying around 85% of the annual net issuance of Japanese government bonds and expanding its balance sheet at an annual rate equivalent to around 13% of GDP. If the Japanese household in true group-think like fashion wakes-up one day slighting spooked by this reality, the domestic move out of Yen assets could be interesting. Paradoxically, individual Japanese equities that represent a true inflation hedge or a call on foreign assets should do reasonably well, at least in local currency terms (and we're hedging out a lot of the local currency exposure).

It's this "tail-risk" that should have the Abe administration fully focused on productivity-related reforms and whilst the sound bites and atmospherics remain encouraging, there's been distinct lack of progress on key issues such as:

- Agricultural reform and a Transpacific Partnership trade deal, though this isn't just a Japanese issue.
- Facilitation of a more flexible and dynamic full-time workforce via employment law reform.
- Linked to this, polices designed to encourage Japanese companies to merge and deal with fixed cost duplication and recycle redundant full time labour into more productive roles.

The slow pace of labour reforms is leading to the paradoxical outcome of Japan suffering labour shortages AND poor income growth. The labour shortages are occurring generally in the more lowly skilled/paid service sector as part-time workers seek higher paying full time roles as the economy recovers, whilst more highly skilled/paid full time workers don't seem to have sufficient bargaining power to drive real wage growth, an issue in common with other major developed world economies.

Where the administration has made some progress is in the area of corporate accountability. These reforms include:

- Modernisation of Government Pension Investment Fund's (GPIF) asset allocation and governance policies.
- Promotion of the JPX-Nikkei 400 return on equity (RoE) based index.
- Launch of the Japanese Stewardship Code covering institutional investor engagement with investee companies.

Of these reforms, GPIF's now seemingly inexorable move to decrease exposure to domestic bonds by approximately 20% (and allocate towards domestic equities and foreign bonds) is clearly the most relevant in the short-term for the Japanese stock market and currency.

We have discussed the positive aspects of the JPX-Nikkei 400 Index in previous quarterlies; the weak part of this initiative is that 60% of the quantitative factors are size based, with RoE a secondary consideration. Clearly the JPX-Nikkei 400 sponsors were pressured to set the bar low enough for most major large-capitalisation companies to make the cut including some companies with extremely poor profitability records. Inclusion won't make an ounce of difference to the good companies as shareholder focus is part of their DNA rather than their "balanced scorecard". However, for the bottom quartile of performers we think the threat of index exclusion at quarterly recalculation time will lead to better shareholder outcomes - don't underestimate the sense of shame that such an exclusion may trigger.

The more esoteric Japanese Stewardship Code draws heavily on the "comply-or-explain" regime adopted in the UK and obligates institutional shareholders to engage with their investee companies by challenging them on anything that could threaten long-term value. The GPIF quickly signed-up to the code in April prompting a further 130 institutions to follow suit. However, whilst the UK Code requires institutional investors to ultimately act in "*concert*" to resolve conflict with a recalcitrant board, the Japanese requirement has been watered down to "*individually*" reach a "*common understanding*" with the board. This represents another missed opportunity by the regulators to lend teeth to the RoE campaign by compelling Japanese institutions to use their collective voting power to remove a recalcitrant board. Notwithstanding, the very fact that these issues are now part of the official narrative is a massive improvement on the once typical, blank stare approach to shareholder issues.

Regardless of the hit-and-miss nature of many "third arrow" polices, we are generally encouraged by Japanese corporates' greater focus on profitability and shareholder returns. Company buybacks are rising and based on announcements year-to-date, should be up 43% on last year and almost double that of 2012. Further, most Japanese Prime Ministers of the past twenty odd years have experienced a predictable and rapid decline in popularity within months of their election – the two exceptions are Junichiro Koizumi (2001-06 and fifth longest serving) and Shinzō Abe's in his second and current term. Notably, both of these PM's were elected with a strong mandate for change. It would seem Abe still has sufficient political capital to push through third arrow reforms if he chooses to spend it this way. In the meantime, valuations within our portfolio are still reasonably attractive and any serious reforms would represent upside to our base case.

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$20,000 invested in the relevant Fund over five years from 30 September 2009 to 30 September 2014 relative to their Index (in A$) 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. Invested position represents the exposure of physical holdings and long stock derivatives.

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