Platinum Japan Fund

Scott Gilchrist Portfolio Manager

Disposition of Assets

REGION	DEC 2016	SEP 2016	DEC 2015
Japan	95%	92%	71%
Korea	0%	0%	3%
Cash	5%	8%	26%
Shorts	0%	0%	-5%

Source: Platinum. Refer to note 3, page 5.

Top 10 Holdings

STOCK	COUNTRY	INDUSTRY	WEIGHT
Mitsubishi UFJ Financial	Japan	Financials	4.2%
Ushio	Japan	Industrials	4.0%
Sumitomo Mitsui Financial	Japan	Financials	3.9%
NTT	Japan	Telecom	3.5%
Inpex Corporation	Japan	Energy	3.5%
Nintendo	Japan	IT	3.5%
JSR Corporation	Japan	Materials	3.5%
Ibiden	Japan	IT	3.1%
JAPEX	Japan	Energy	3.1%
Kyocera Corp	Japan	IT	3.1%

Source: Platinum. Refer to note 4, page 5.

For further details of the Fund's invested positions, including country and industry breakdowns as well as currency exposures, updated monthly, please visit https://www.platinum.com.au/fund-updates/#MonthlyUpdatesForThePlatinumTrustFunds.

Portfolio Position

Sector Breakdown

SECTOR	DEC 2016
JAPANESE INTERNATIONAL FOCUS	50%
Electronics	26%
Industrials	10%
Autos	7%
Energy	7%
JAPANESE DOMESTIC FOCUS	45%
Internet	21%
Financials	13%
Health Care	4%
Property	4%
Consumer	3%
GROSS LONG	95%

Source: Platinum

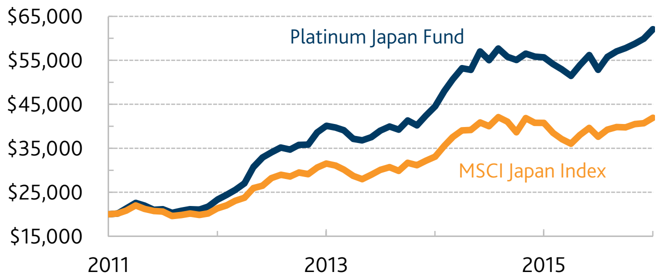
Currency Position

Japanese yen	71%
US dollar	20%
Australian dollar	9%

Source: Platinum

Value of $20,000 Invested Over Five Years

31 December 2011 to 31 December 2016



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

Performance

(compound pa, to 31 December 2016)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Japan Fund	7%	11%	16%	25%	15%
MSCI Japan Index	6%	3%	10%	16%	2%

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

Portfolio performance for the quarter was positive as the Japanese stock market moved up to levels last seen in 2015. This broad market strength was offset by a rapid depreciation of the Yen from around 100 to the US dollar to above 115. The Fund's currency hedges against the Yen into both the Australian dollar and US dollar were positive contributors to performance. The shift in the trajectory of the currency led to outperformance of cyclicals and low valuation stocks. The portfolio's recent purchases and longer-term holdings of energy producers, exporters, financials, low valuation stocks and electronics component manufacturers were strong contributors while a core portfolio of cheap defensive stocks in the telecommunication, gaming and healthcare sectors lagged the market. Nintendo and DeNA were both weak during the quarter.

Over the last two years since December 2014, the Fund has risen 39%. This is nearly 13% ahead of the MSCI Japan Index (in AUD terms).

Changes to the Portfolio

There were limited changes to the portfolio during the quarter except for a small increase in cash towards the end of the calendar year due to the trimming of one defensive stock and the sale of some cyclicals. A number of small new positions were initiated.

Commentary

Nintendo

Nintendo has been through many stages of development since it was founded in 1889. At various times it has sold playing cards, robotic toys and vacuum cleaners. It has also operated taxi fleets and hotels. There have been periods of great success, times of failure and periods when they struggled under a heavy debt load. Until recent decades, the Yamauchi family managed the company. For today's context, the key event was the release of their first video game in 1975. This was followed in 1981 by Donkey Kong, a new character developed by Shigeru Miyamoto, who is also known as the father of Mario. Since 1983, Nintendo has sold over 700 million hardware units and 4.5 billion software units across a wide range of Entertainment Properties including their prime positions of Pokémon, Legend of Zelda and Mario. Their overall – and arguably industry leading – success in the computer game market is despite a long list of mistakes both in hardware and software across their many console generations.

Nintendo's revenues have fallen for eight straight years from their peak in 2009. In early 2015, Nintendo announced a partnership and cross-shareholding with DeNA, a Japanese gaming and platform company. This was the first and most visible in a list of changes that they had been planning for a while. Changes accelerated following the death of widely admired CEO Iwata-san from bile duct cancer at age 55. Iwata had been the first external President of Nintendo. Incoming President Kimishima previously worked at The Pokémon Company and Nintendo of America, but is an outsider relative to the Board members who are lifetime employees. The ongoing organisational changes range from wholesale merging of internal divisions under new, younger leaders to more prosaic shifts such as Nintendo of Europe's office move from rural Germany to Frankfurt, near the airport. The sale of their long-held shareholding in the Seattle Mariners baseball franchise seems to indicate an ongoing focus on the core business.

Left: Pikachu from Pokémon GO. Source: Reddit

Right: Pokémon GO Plus worn on a wrist. Source: Cnet.com

Nintendo's recent string of successes has been impressive. Pokémon GO has been the most visible, but Super Mario Run has also been a success. A small piece of gaming hardware associated with Pokémon GO, called the Pokémon GO Plus, remains sold out. Nintendo also released a retro miniaturised version of their 1990 NES (Nintendo Entertainment System) which also remains sold out. A groundswell is building which has flowed through to their licensed products including coffee mugs, t-shirts and books. Packaged game sales of the latest Pokémon release have sold faster than any previous version. Christmas shopping trips showed empty shelves at toy stores for a wide range of Nintendo products including Pokémon playing cards. One Internet research firm found that the growth in Nintendo's search traffic increased by a factor of 60 over calendar year 2016. The overarching strategy of tapping into prior experiences with Nintendo products in addition to accessing a wider audience has been a resounding operational and branding success.

Pokémon GO is by some metrics the most successful mobile phone app ever developed. Since July 2016 it has been downloaded 900 million times and grandparents have reportedly been the demographic group responsible for the most in-app purchases as they spoil their grandchildren with virtual gifts. It is not yet possible to clearly delineate the limits of the game, but recent sponsorship deals with businesses like McDonald's in Japan, Sprint and Starbucks gives some hint at the opportunity. Super Mario Run was an eagerly awaited game with tens of millions of pre-notifications for its exclusive launch with Apple following an extensive advertising effort. The final product quality and gameplay is excellent, in keeping with the history of the franchise, and reviews from the industry have been glowing. Reviews from the broader community, however, have been lukewarm at best. The app became the fastest download in the history of the App Store and reached 90 million downloads within three weeks of its launch in mid-December. However, only three million of those users have actually paid $10 to purchase the full game after playing the initial three free levels. Nintendo has always prided itself on doing things differently, and in parallel has fought a long-running battle against piracy. The App Store has an unknown amount of pirates, perhaps approaching ten percent, but the real problem is the culture that has developed around "free apps". This system has existed for many decades, but has risen to prominence with the proliferation of smartphones. In a modern version mix of capitalism and socialism, a small number of players are paying for the majority to enjoy free entertainment. This system elicits both delight and revulsion from various parts of the gaming community which is generally not known for calmness and balance. Nintendo and Apple seem to want to change the culture of payment and piracy in the Apple ecosystem. Their initial attempt has failed, but there will undoubtedly be repeated attempts. The well-suited partnership between Nintendo and Apple could develop further in quite unexpected ways.

Lingering concerns remain that Nintendo has neither accepted the realities of the current marketplace nor agreed to fully engage with it. In this context, Nintendo's work with Hon Hai (also known as Foxconn), Apple, Google, Bethesda, Epic Games (Tencent) and Nvidia/TSMC shows a willingness to engage with industry leaders. The relationship with Nvidia is intriguing as Nintendo has switched from AMD to Nvidia as integrated chip supplier for the upcoming Nintendo Switch console. This is not a decision taken lightly after working with AMD for decades. Nvidia is the leading global high performance graphics chip designer and has a manufacturing

The evolution of Super Mario and the seriation typology of Nintendo Gaming Systems. Source: Nintendo arrangement with TSMC, reflecting their common Taiwanese heritage. This choice by Nintendo puts them squarely in the middle of the current maelstrom of Intel's x86 architecture against ARM which is supported by an extensive ecosystem that includes Softbank, Apple and TSMC. The choice of Hon Hai as assembler reflects the scale of the Chinese manufacturer and the significance of their acquisition of Sharp and their transition towards automation and robotics as Chinese labour costs rise.

The outlook for Nintendo remains uncertain as they attempt to return from chasing the ghost of their wildly successful 2006 Wii console. Some more of the fog will lift on January 12 when their latest console, the Nintendo Switch, is formally unveiled. Consumers will have the opportunity to interact with the game line-up for seven hours a day in one of Tokyo's largest convention centres and on a subsequent global roll-out. Pre-orders will be available shortly thereafter in North America. Fans are eagerly awaiting a refresh of favourite games such as The Legend of Zelda, Mario Kart, Smash Brothers, Metroid and Mother 3. Of greater import, they are hopeful that a full suite of third party games, such as Skyrim and Dragon Quest, will be ported to the console. This event will not totally eliminate the path dependency for the investment case, but it will remove a significant uncertainty for both the profit outlook and investor perception.

Nintendo Switch. Source: Nintendo

Japan

There have been a few recent visitors to Japan who travel there expecting to see a somewhat dowdy and backward nation. Upon return they talk of a clean, modern, safe nation with many intriguing cultural aspects. The Japanese stock market reached current levels a few times during the 1990s, roughly two decades ago, and first reached these levels in 1987. Almost thirty years later, Japan is still emerging from the aftermath of a bubble of such immense magnitude that the financial system write-offs were estimated at three times the GDP by some accounts. Given the recent struggles at Toshiba following ongoing scandals at Asahi Kasei, Takata, etc., it is clear that there is still a lot of corporate restructuring to be done. There has been a broad, consistent push towards improved corporate governance and capital allocation in recent years, and an extended period of low interest rates will accelerate this as shareholders push for improved corporate performance and higher payouts.

There has been worryingly extensive analysis of central banker behaviour and writings in recent times. The story emanating from the Bank of Japan remains comprehensive and responsive, but for the moment the message can be distilled down into a simple statement: interest rates will be pinned near zero for the whole yield curve for the duration of almost all investment time horizons. This is in stark contrast to elevated and rising interest rates in many other parts of the world. This is occurring while Japanese unemployment rate pushes down below the lowest point in decades. As discussed previously, there is significant under-utilisation of labour combined with low productivity in many domestic sectors, but unless elements of labour force flexibility develop further, there is likely to be upward pressure on wages in many parts of the Japanese economy.

Outlook

As the world struggles to analyse Trump's intentions and understand the reasons why he was elected, financial markets have decided that the upcoming shift in US policy will be positive. On a more basic level, the focus of the market has returned to company and industry specifics as central banker discussions and election concerns faded somewhat.

It is widely acknowledged that the global financial system is burdened by large amounts of debt across many geographies and sectors of the economy. Further, the imbalances that have developed over the last decades have not been resolved and have perhaps worsened as improved communications and low cost transport enable hundreds of millions to enter the modern global marketplace. This is offset by the astounding rise out of poverty by hundreds of millions of people over the last decade and the paradigm shift of a supercomputer in the hands of every human. On a daily operating basis, it is difficult to identify regions or industries where conditions are currently deteriorating beyond expectations, allowing for ongoing business disruption and dislocation. On the contrary, it seems as though a minor cyclical upswing is underway as the long expansion matures and Chinese economic growth responds to incentives. Japan is likely to be a major beneficiary of this change in sentiment and global growth trajectory, both directly through a weak Yen and the consequent demand for their manufactures and indirectly through the broad effect on consumer behaviour.

Notes

1. The investment returns are calculated using the relevant Fund's unit price and represent the combined income and capital return for the specified 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 in the 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: 28 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

   (NB: The gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist.)

2. The investment returns depicted in this graph are cumulative on A$20,000 invested in the relevant Fund over the specified five year period relative to the relevant benchmark index (in A$) as per below (the "Index"):

   - 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

   The investment returns are calculated using the relevant 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. Regional exposures (i.e. the positions listed other than "cash" and "shorts") represent any and all physical holdings, long derivatives (stock and index), and fixed income securities as a percentage of net asset value.

4. The table shows the relevant Fund's top ten long stock positions as a percentage of net asset value as at 31 December 2016. Long derivative exposures are included. However, short derivative exposures are not.

Disclaimer

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