Platinum Unhedged Fund

Jacob Mitchell Portfolio Manager

Disposition of Assets

REGION	SEP 2010	JUN 2010
North America	29%	30%
Asia and Other	27%	24%
Japan	20%	22%
Europe	15%	13%
Australia	0%	1%
Cash	9%	10%

Source: Platinum

Portfolio Position

Changes in quarterly portfolio composition:

Sector Breakdown

SECTOR	SEP 2010	JUN 2010
BRICs* Consumption	22%	17%
Technology	12%	12%
Gold	10%	10%
Defensive	9%	6%
Consumer Cyclical	9%	10%
Healthcare	8%	10%
Japanese Domestic	8%	12%
Commodity	7%	5%
Capital Equipment	4%	4%
Alternative Energy	1%	2%
Other	1%	2%
Gross Long	91%	90%

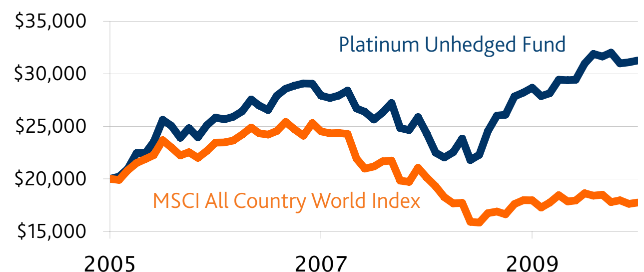
* Brazil, Russia, India and China

Source: Platinum

We have used the term "Consumer Cyclical" in a very broad sense; it includes technology, internet, transport, financials etc and similarly "Defensives" includes pharmaceutical, telecommunications, utilities etc.

Value of $20,000 Invested Over Five Years

30 September 2005 to 30 September 2010



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

Performance and Changes to the Portfolio

Over the last 12 months the Fund rose 9%, outperforming the MSCI All Country World Index (A$) benchmark by 10% and over the past quarter the Fund fell 2.3%, underperforming the benchmark by 2%.

The global stock market has experienced a 12 month trading range with turning points dictated by key "macro" climaxes but with a growing pattern of emerging markets rebounding to new highs as Western markets struggle to regain previous highs.

If we look back on our positions entering 2010, we had started to sell some of our more expensive "BRIC" (Brazil, Russia, India and China) investments in preference for Japanese and US equities that were offering a similar growth profile at lower valuation. In a sense, we were looking for some confirmation that the Chinese were in fact serious in their efforts to rebalance towards consumption via a de-pegging of the Renminbi from the US dollar. Further, our fundamental view was that the Yen was grossly overvalued and poised to enter a weakening phase. The strategy worked well until European sovereign debt concerns drove the Euro weaker and Yen stronger, once again delaying a rebound in Japanese equities. The Euro decline proved short-lived as the "macro" crowd refocused on the weakening US recovery with the US dollar now depreciating against almost all currencies and other "hard" assets.

The market has applauded the following aspects of the current uncertain environment:

- The collapse in US yields (even though it has not flowed into a decline in the conforming residential mortgage rate, as the majority of US mortgages no longer conform due to negative equity and/or decline in credit rating). This has fuelled speculation that US policy makers will change the rules to facilitate a refinancing cycle (from around 5% to 3.3%), representing a major shot in the arm for the US consumer. Whilst any change would represents a clear deterioration in the US sovereign credit rating, as roughly 25% of these mortgages are owned by foreigners (largely Asian Central Banks) and 25% by the Federal Reserve, the policy has obvious appeal to US politicians.
- The apparent stalling US recovery has fed market speculation that the Federal Reserve is about to embark on another round of monetised asset purchases, a currency devaluation policy dressed up as deflation fighting.
- Signs that natural demand for Chinese residential property is so strong that the market is rebounding from April's administratively enforced clamp down.
- A renewed crawling appreciation of the Renminbi against the US dollar (the forward market is currently pricing in 4-6% pa) with some signs that Asia, as a whole, may embrace an accelerated currency-trade rebalancing with the West.

Our worst quarterly underperformers were in the technology area (capital equipment suppliers, Cisco and Applied Materials and component suppliers, LG Display and Shin-Etsu) and our Japanese domestic stocks (Obic and T&D Holdings). The outperformers were largely confined to our emerging world consumption stocks (Guangzhou Automobile - the merger of the erstwhile Denway, the Honda China JV partner with its parent company's Toyota, Hino and Fiat JV operations, Kangwon Land, Genting and Bangkok Bank), as well as mid-cap gold stocks (CGA Mining and Great Basin Gold).

In the March quarterly report, we outlined the rationale behind some of our technology holdings and we also noted the risks to the story ie. exposure to a "challenged" Western world consumer. Though in the short-term our view that our downside was protected by valuation has proven incorrect, each of our holdings is underpinned by a strong stock specific investment case. As for our Japanese domestic holdings, we have previously acknowledged our view was mistimed with regard to the Bank of Japan (BOJ) acting to weaken the Yen and reflate the domestic economy. Thus, we have progressively cut exposure to this area from a peak of 15% at the end of March to a current level of 8% by selling holdings with waning conviction levels (eg. Yamato Holdings) and stocks that had reached valuation targets (PAL and Itochu Techno Solutions).

We also sold our last shares in China Resources Enterprise (China's leading beer and mass market retailer) on a current year PE of 36 times. Clearly, in certain parts of the market,

euphoria is back and the relative strength of investor flows into emerging markets suggests we are overdue for a correction. Notwithstanding, in aggregate emerging market equities are trading inline with Western valuations (see chart below) suggesting we are a long way from the "irrational exuberance" moment. We are still finding neglected gems and used the pull-back early in the quarter to accumulate new positions (deploying the cash raised from Japan), including:

- CFAO, a stock that readers of the Platinum European Fund quarterly reports would be familiar with; an African new car dealership and pharmaceutical distribution business with trading operations dating back 160 years. Along with the endogenous growth inherent in the new frontier of globalisation, the commodity price boom is driving African foreign direct investment, boosting pitifully low rates of car ownership and pharmaceutical use. In the current European Fund quarterly report, currency moves gifted us an opportunity to buy the stock cheaply, that is at around 12 times PE for a company that we believe will experience a high rate of growth.

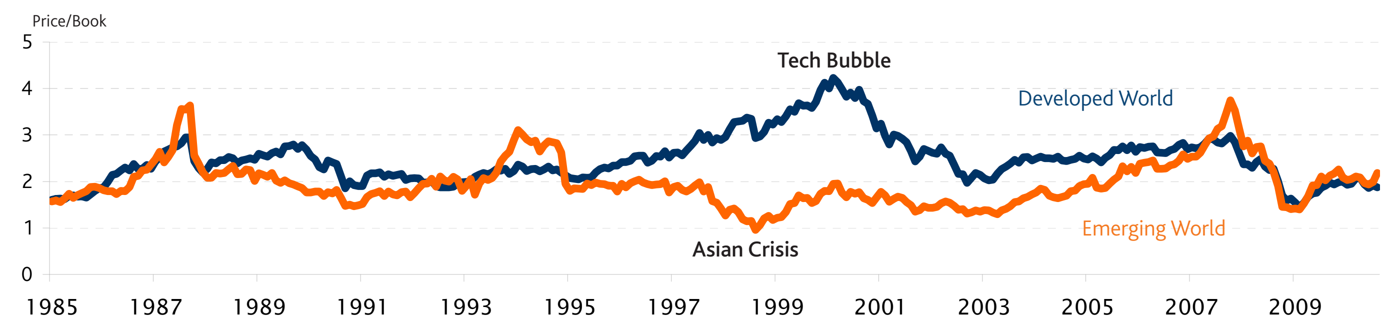
- China Telecom is China's leading fixed-line telecommunications company (180 million subscribers in a two player 300 million subscriber market) and the number three mobile operator (75 million subscribers, 9% share in a three player market with China mobile dominant with 71% share). Along with the global sector, the stock has fallen out-of-favour due to ongoing revenue declines from fix-to-mobile substitution. However, we think the market is missing some points that differentiate the company, including:

  - A high growth broadband business with 55 million ADSL subscribers (dominant player in a 100 million subscriber market) growing customers at 10 million pa and with revenues already larger than the legacy fixed line business.

  - A high growth mobile business, adding customers at a rate of 30 million pa and taking 30% incremental market share. The company is succeeding in winning high-end 3G smartphone customers from the somewhat technologically disadvantaged China Mobile (the regulator enforced an experiment with the untested indigenous TDS CDMA (code division multiple access) 3G technology). We think the mobile telephony market will continue to grow in line with a Western saturation benchmark implying 300 million more subscribers up for grabs ie. the business is far from ex-growth. Clearly, there are competitive risks, however, our thesis is that the threat of asymmetrical regulation (in terms of interconnect) will keep the incumbent China Mobile on the leash.

We acquired our position on a current year un-geared cash flow yield of around 10% and this includes zero contribution from the mobile operation which has just passed through break-even; on our reckoning, we are getting the mobile business for free.

Developed versus Emerging World Price to Book



Source: Factset

Commentary and Outlook

We started the year proposing that for the current equity market cycle to gain durability, we needed a currency led, trade rebalancing between the six billion hyper-competitive consumers in the developing world (average GDP per capita of $3k) and the 800 million over-leveraged, uncompetitive Western consumers (average GDP per capita of $51k). We have certainly embarked on a "rebalancing" journey, but possibly along a somewhat different route to that envisaged 12 months ago. It has become clearer that before the Chinese consider a major de-pegging of the Renminbi from the US dollar, they wish to minimise losses on their existing estimated $1.6 trillion holdings of US dollar by aggressive reserve diversification. They first started to accumulate Euro only to be hit by the European sovereign debt concerns and then accumulating Yen only to be hit by Ministry of Finance (MOF) intervention. Clearly, Western economies are grappling with a lack of export competitiveness and too much leverage and the last thing they want is a strong currency reinforcing deflationary tendencies (so even the Japanese have started a tentative fight back – see the current Platinum Japan Fund quarterly report).

But in addition to the Yen, there is now evidence that the Chinese are accumulating the currencies of their Asian and emerging market export competitors. This is a fascinating development and could be described as the mercantilists starting to eat each other. When one considers that the developing world in total only accounts for 20% daily foreign exchange market turnover, you can see how disruptive China's diversification actions could become. Understanding and capitalising on the unintended consequences of this dynamic will remain a focus of the Fund.

The Chinese are encouraging the appreciation of their Asian export competitors' currencies against the US dollar, so instead of China rebalancing with the West, it is forcing it upon the rest of the emerging world. In a way, it is forging potential new markets for its exports to replace the Western consumer.

Whilst there is a risk that these countries respond with greater currency/capital controls, for the following reasons this may not occur just yet:

- In 1997 the non-Japan Asian currencies devalued heavily against the Renminbi; China could make a convincing argument that these countries should revalue first, especially the more affluent ones like Taiwan, South Korea, Singapore, Malaysia etc.
- The commodity price boom represents an Asian terms of trade shock as the region is generally a commodity importer; a strong currency can help offset commodity price inflation.
- The sterilisation of Asian Central Bank intervention now has a real cost as US dollar yields (and in fact all G7 yields) have fallen below most Asian domestic yields.

Clearly, the implicit contradiction in US and Chinese monetary policies is heightening risks, such as:

- Administrative controls that dampen developing world domestic demand may exacerbate Western deflationary tendencies, potentially triggering a major sovereign credit event (PIGS (Portugal, Italy, Greece and Spain) or a large US State like Illinois or California).
- US-China trade spat balloons out of control.
- US dollar crisis triggered by excess liquidity from Federal Reserve easing policies driving up commodity prices to the point where not just foreigners, but US citizens, start to question the US dollar as a store of value.

As we witnessed in the great Western world credit bubble that burst in 2008, whilst the risks had been apparent to many of us for years, it didn't pay to be that pre-emptive and the "Minsky moment" proved allusive (though we were reasonably well prepared when it finally did arrive). If we see Japan and Europe (re)join in the currency devaluation game, many of these concerns may well be blasted away by a new abundant source of liquidity.

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$20,000 invested in the relevant Fund over five years from 30 September 2005 to 30 September 2010 relative to their Index (in A$) 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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