Platinum International Fund

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Performance

(compound pa, to 30 June 2015)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Int'l Fund	1%	20%	25%	11%	13%
MSCI AC World Index	0%	24%	24%	14%	6%

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

There have been moments of high excitement within the last three months. Perhaps volatility in the bond markets takes first place with a final precipitous drop in interest rates, led by the German Bunds, and followed by an equally harrowing bounce with the 10-Year Bund yield moving through a 0.8% range. The cause of this change in sentiment has been the shift of perceptions away from deflationary fears to the evidence that indeed Europe is on a broadening recovery track with Greece being the one exception.

The realisation of Europe's recovery, greatly assisted by the relative weakness of the Euro versus the US dollar, drove earlier investment flows into Europe, but this was disrupted late in the quarter as Greece took an uncompromising line in negotiations with its lenders. At the time of going to press, there is a tense standoff post the "No" referendum outcome with the ball back in Greece's court to provide a resolution.

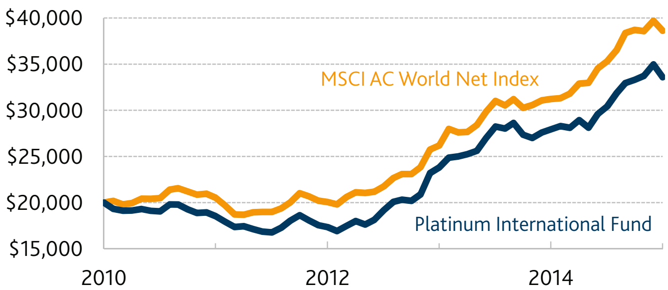
Disposition of Assets

REGION	JUN 2015	MAR 2015
Asia	37%	35%
North America	20%	23%
Europe	20%	22%
Japan	11%	11%
Russia	1%	1%
Australia	1%	1%
Cash	10%	7%
Shorts	8%	7%

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

Value of $20,000 Invested Over Five Years

30 June 2010 to 30 June 2015



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

The Chinese domestic A-share market continued its run with perceived government sponsorship. A strong reform agenda, accommodating monetary policies, an IPO allocation model that favours small investors and the potential inclusion of China A-shares in the MSCI global indices created an exhilarating concoction that drove crazy valuations in the Rmb6 trillion small-cap ChiNext sub-index of the Shenzhen Stock Exchange. The A-share market is by comparison relatively calm. Having already doubled in less than a year, one would expect at least a pause to refresh.

The penny has dropped among investors that Japan has, after all, embraced change and that it has probably seen the end of a trend of chronically weak consumer prices (aka deflation). The changes that these pages have tediously laboured over for several years are starting to bear fruit and, most importantly, earnings revisions are progressively adjusting higher to reveal the true competitiveness of companies at the current value of the Yen.

Progress of the US economy is discussed later but, having been in the vanguard of recovery, it seems that the market is losing some of its vigour even as there is broader cyclical confirmation of growth. Lack of compelling valuations and stalling earnings growth (exchange rates being a big factor) are being offset by a mergers and acquisitions cycle, supported by buybacks, to result in a tight range trading and very low volatility. Importantly, firms are tending to use the current low cost of borrowing to **replace** equity.

High levels of debt in the West will continue to retard growth prospects in those regions which, together with ample supplies of commodities, are keeping pressure on the prices thereof. Some commodity-rich emerging markets remain out of favour. A combination of slow growth, a strong US dollar, specific political or geo-political problems and large current account deficits have contributed to lacklustre market performance.

As the accompanying tables reveal, there has been some broadening of interest to hitherto dull sectors while defensives may be losing their charm for investors.

The MSCI AC World Index (A$) achieved -0.3% for the quarter and 23.7% for the 12 months to 30 June.

The Fund is gradually showing the benefits of seeing the world through different eyes and achieved 0.8% for the quarter and 20.2% for the last 12 months.

Currency

The portfolio remains heavily hedged back into US dollars (70%, including 10% in Hong Kong dollars), with 14% in European currencies, including the Norwegian krone and Swiss francs. There is virtually no exposure to the Japanese yen and very little to the Australian dollar.

MSCI World Index Regional Performance (AUD)

REGION	QUARTER	1 YEAR
Developed Markets	**0%**	**25%**
Emerging Markets	**0%**	**17%**
United States	**0%**	**31%**
Europe	**0%**	**13%**
Germany	-6%	11%
France	0%	11%
United Kingdom	2%	13%
Japan	**3%**	**33%**
Asia ex Japan	**0%**	**28%**
Korea	-4%	5%
China	5%	53%
Hong Kong	5%	38%
India	-4%	27%
Australia	-7%	5%

Source: MSCI

MSCI World Index Sector Performance (AUD)

SECTOR	QUARTER	1 YEAR
Telecommunication Services	2%	23%
Financials	1%	25%
Health Care	1%	44%
Consumer Discretionary	0%	33%
Consumer Staples	-1%	26%
Energy	-1%	-9%
Materials	-1%	9%
Information Technology	-2%	33%
Industrials	-2%	21%
Utilities	-3%	12%

Source: MSCI

Shorting

Biotechs strike us as epitomising the effects of Fed-derived cheap funding. We have consequently taken out a short position in a Biotech ETF. The other positions are principally shorts on the S&P Index.

Changes to the Portfolio

Small residual positions continue to be sold alongside the strongly performing pharmaceutical companies like Sanofi and Novartis. We completed our exit from the short-lived hope for the aluminium sector with a smaller profit than last quarter, and exited Oracle and Bharti Airtel to make way for new holdings. These include **Reliance Industries**, **LIXIL Group**, **Fujitsu** and **JSR Corp**.

The bull market in India has completely eluded **Reliance Industries**. Being one of the world's largest refiners and processors of hydrocarbons (into fuel, textile yarns and plastics) is hardly considered "sexy" in today's service-led markets. Hurting sentiment has been the lack of profit growth in the last four years after a stunning fivefold rise in profits in the first 10 years of this century. The company is now in the midst of a new investment cycle where it is upgrading its petrochemical capacity and launching into new fields.

The activity at its Jamnagar refining complex, the world's biggest, processing 67.9 million tonnes of crude a year, involves the introduction of a *petcoke gasifier* and an *offgas cracker*. These are gigantic undertakings with over 100,000 construction workers presently on site. Their returns will be somewhat **compromised by the present low oil price** but will nevertheless produce 10-15% on new investment. There are other transient implications regarding the current low cost of naphtha on the expansion of the petrochemical complex (+65% in capacity). However, these are unlikely to damage this entity's ability to earn, on its expanded asset base, its traditional RoCE of around 15% because of the entire complex's scale, feed versatility, remarkable operating KPIs and dominant supply position to a fast expanding local customer base.

The more challenging conundrum is to **appraise the company's bold entry into telecommunications**. Investor sentiment is already weak because of Reliance's expensive foray into shale gas exploration in the US and disappointing levels of production from its Indian offshore KG-D6 gas field. They question the company's ability as a newcomer to break into a crowded market and point to the problems that Hutchison faced in similar circumstances. We tend to take the other side of the argument and **point to the opportunity**, and the fact that few companies in India have standing and free cash flow of US$6 billion a year to force their entry.

To spare readers all the intricate detail about the ownership and use of spectrum, the ability to deliver voice over LTE and the willingness of users to pay for handsets and data, we can **truncate the argument to that of need**. With only 2.5 land lines per head of population in India versus 20 in China[1], wireless allows a leapfrogging of technology. As it happens, dense mobile networks need laid optic fibre connections to base stations and Reliance, through its telco start-up, Reliance Jio Infocomm Limited, has already laid 250,000 km of optic fibre with plans to double that over the next three years. While the market frets about the losses that will be incurred, we suspect that the usage of digital may be underestimated. Cisco predicts that by 2018 mobile traffic per connected device in India will increase to 1.1 GB per month from 60 MB in 2013[2]. If Mukesh Ambani has his way, there will not be an Indian user who is unaware of the broader offering he has in mind for Jio. They are doubling their hosting capacity to one million square feet with the plan to offer *Jio Drive* (video-on-demand with hundreds of channels and news) and *Jio Chat*, a powerful app that integrates voice, video, conferencing, file sharing as well as introducing digitised payments. Existing fibre already has capacity to connect 100 million broadband customers end-to-end as well as 20 million fibre-to-the-home customers.

This is indeed a bold dream involving an investment thus far of US$14 billion and potential losses of around US$1.8 billion in the first full year of operation in 2016. However, even with this burden, we can see Reliance's P/E down to 13x by March 2018[3]. This may appear to be of limited appeal for some, but in a market where some consumer companies sell on a P/E of

1 The **trajectory** of wireless data usage in China versus the US is remarkably similar, with current monthly usage in the US running at about 1.8 GB versus 117 MB in China.

2 The number put forward by Cisco may be ambitious on account of the much lower level of disposable income per head in India – at US$1,500, it is about one quarter of that of China. The intriguing notion though is that with quality broadband, Indian rural (and urban) users may well be persuaded to use mobile devices to consume Reliance's entertainment, news and other networking apps.

3 We believe telco losses will continue past this date, but the returns from the new investment in Reliance's traditional business plus the roll-out of petrol stations, 400 already, and general retail, which is already a US$3 billion turnover business, will see the company's EPS progressively rise.

30x, we are happy to take an initial stake with the hope of being able to raise our position on probable setbacks in what will be seen subsequently as a company representing a 'call option' on India.

The Japanese companies, **LIXIL Group** (manufacturer and distributor of housing subcomponents from bathroom and kitchen plumbing to windows and sidings), **Fujitsu** (supplier of principally IT integration solutions as well as IT hardware) and **JSR Corp** (supplier of microchip coatings, photo-resists and synthetic rubbers) all share misapprehension in their share prices owing to transient factors. Each has a leading position in its field, generates good returns on capital and faces a period of rising demand. Space constraints limit our ability to fully explore their cases. We shall perhaps unfurl them in coming months.

Commentary

We have mentioned in the past the surprising **search for certainty** among fund managers and the consequent emphasis on global brand companies and the like. This has been accompanied by systematic selling of equities in favour of bonds and alternative investments such as private equity. The phenomenon both troubles and baffles us as we think it is tantamount to driving with one's eyes on the rear view window. The expressed concerns relate to the slowing in China, and Asia in general, and the supposed weak recovery in the West.

We often need to remind ourselves that the **US economy** is well **into its sixth year of recovery**, the nation's wealth, as expressed in the valuation of equities, is 35% above those levels prevailing before the Lehman Brothers' bust, employment is approaching the normal inflection point where wages tend to break above the current subdued level of 2.8% year-on-year, and the mortgage cycle may well be on the cusp of expansion.

Let's dwell for a moment on the **US labour market**. It is correct that globalisation has penalised the average working person in the West and in real terms wages have barely kept pace with inflation, and, net of rising tax bands, they have probably lagged behind. However, closer scrutiny of the US labour market shows that **new jobs available (openings)** are both outrunning and **now exceeding the speed at which workers are being hired**. This is corroborated further by the number of days taken to fill vacancies, which is the slowest in 15 years (it is taking longer to fill these roles). The health of the labour market is also manifested in the willingness of workers to trade jobs. Starting from a low in 2009, this ratio of voluntary job switching is approaching the strong levels seen in 2005-06. Moreover, the number of people who are out of the workforce but looking for jobs, combined with the number of unemployed, are now at a smaller proportion to the number of available jobs. Compared to some 10 such people for each job opening in 2009, this ratio is now below three. Lastly, the rise in the yield curve is telling us that fixed interest investors are girding themselves for higher rates. **Far from fearing a rise in the federal funds rate, which has been suppressed at 0.1% for six years, we are fearful of the Federal Reserve Bank losing credibility as it loiters with indecision.**

In Europe we can point to the surge in the **current account surplus** across the continent and economically sensitive indicators like retail sales, unemployment trends and the like which have, on balance, much improved over the last 18 months.

Turning to Asia which has seen slowing growth, it is our view that **both India and China are about to turn**. India for reasons enunciated before (clear leadership, deregulation and falling interest rates) and China on account of the loosening of credit and the improving lending capacity of the large banks. The reserves that Chinese banks are required to hold with the Central Bank, the so-called reserve requirements ratio (RRR), has started to drop, and we can see why the Central Bank will progressively free the banks from such onerous requirements which presently immobilise nearly a fifth of the banks' lending capacity. Secondly, some months back, the People's Bank of China (PBoC), the country's Central Bank, started to guide down the short-term cost of borrowing to help with the transition of China's economy away from its high dependency on investment towards greater reliance on the consumer. This is showing up in what seems to be a bottoming in the property market and continued buoyancy in the labour market with wages running well ahead of general prices at around 10% per annum.

We are constantly reminded by investors about the excessive lending by banks in China. Indeed, we can point to examples in other countries where unbridled credit growth led to sharp rises in loan defaults. We believe this is happening in China. But here is the interesting surprise.

When we look at the residential property market, the recovery in sales activity and the stabilisation of prices in the larger east-coastal cities suggest that **the damage will not come to the banks from the hitherto super-hot housing sector**. What we find is that housing prices in the secondary market (used properties) in the top 5 to 10 cities have fallen variously by 2-7% and, more importantly, the *sales volume (proportion)* of used homes have risen and now accounts for between 35-45% of all housing transactions. The fine point is that volumes of second-hand properties have increased and such is the strength of demand that **the market is clearing on relatively modest price falls** from *their supposed peak levels of one or two years ago.* This gives us confidence that the **collateral value of houses in the large cities**, which account for some 40% of overall transaction volume and which are often used by small traders and the like to secure business loans, are rock solid. In any case, residential loan-to-value ratios across the country are under 50%!

The dangerous area has been lending to shopping mall builders or highly speculative borrowers who have been careless in the small developing cities or over-supplied industries. This will be an area of oversupply for several years. That building activity will play a smaller role in contributing to growth in China is without doubt. This will keep pressure on the building supply chain. Notably, cement and steel and capacity closures are likely to come at some cost to their lenders.

The banks have so far revealed conspicuously low provisions for non-performing loans at under 1.5%. This can be partly explained by technical factors: the base effect, onerous capital provisioning rules and, importantly, the use of interbank entrusted payments and "investments" which are disclosed separately on bank balance sheets. **The real area of concern is the activities of the unlisted banks.** According to work by UBS, these institutions, which are many and varied, account for 38% of the total banking sector's assets, or US$11 trillion! **It is likely to be here that the carnage will be revealed with substantial write-downs and where capital deficiencies will emerge.** This is likely to come at some cost to the listed banks and we would be **surprised if the system experiences non-performers of less than, say, 6-7% of loans** as the new consumption-led model for the economy emerges. Apart from the deregulation measures noted above, the Chinese central government is effectively underwriting the quality of outstanding borrowings at the municipal government level by initiating an Rmb2 trillion swap that enables local governments to refinance their funding vehicles (LGFVs). There is a cost to the banks in terms of lower spreads, but to the benefit of their capital adequacy.

Outlook

As noted above, it is not tightening we fear, though several Central Banks have admittedly needed to retreat from such moves as their currencies immediately strengthened. For the other immediate fear, that of the impasse with Greece, we believe that harsh reality will force both sides to compromise with resolution still distant.

A more pressing underlying concern is that for the first time since the Global Financial Crisis (GFC), the earnings forecasts for the S&P 500 Index are being revised downwards. This may be a passing phase, but sales growth has indeed been anaemic. The currency is reducing the contribution of foreign earnings and, if we are correct about wages continuing to outrun productivity, the pressure on profits will mount.

More broadly, we are seeing evidence that there is more latitude for stock-picking after several years of trending and converging valuations. As emphasised in the last quarterly report, we have placed our faith in the opportunities of Asia with countries such as Japan achieving strong profit growth. We sense there will be a turn-up in profitability among Indian companies as the economy begins to expand. The case for our Chinese holdings rests on the reform agenda and the opportunities the economy now offers with services contributing a greater share of activity than traditional manufacturing. We feel the current sell-off is a necessary adjustment after such a strong move. A liquidation wash-out should offer a good buying opportunity.

The remaining 40% of the portfolio – in the Western hemisphere – relies on each company's valuations and specific growth prospects. Conditions in the Eurozone are now very different - with low contagion prospects.

Notes

1. The investment returns are calculated using the relevant 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: 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$20,000 invested in the relevant Fund over five years from 30 June 2010 to 30 June 2015 relative to its benchmark index (in A$) 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

   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 benchmark 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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