MLC-Platinum Global Fund

QUARTERLY INVESTMENT MANAGER'S REPORT

PERFORMANCE

Fund Size: $1,039.1m	Last quarter	Last 12 months	5 years (compound pa)	Since inception (compound pa)
MLC-Platinum Global Fund	6.6%	25.4%	17.1%	11.5%
MSCI All Country World Net Index (A$)	6.1%	14.8%	17.3%	6.9%

After fees and expenses. Portfolio inception date: 30 June 1994
Source: MLC Investments Limited and Platinum Investment Management Limited for fund returns, and RIMES Technologies for MSCI index returns.
Past performance is not indicative of future performance. The value of an investment may rise or fall with the changes in the market.

For all the political news chatter around the Trump administration, Brexit negotiations, the 19th National Congress of the Communist Party of China, the supremacy of the Liberal Democratic Party under Shinzo Abe in the recent Japanese elections and, of course, the hysteria around missile launches by North Korea, **the year 2017 has been one of near perfection for most markets**: stocks, bonds and property. Underpinning the whole shebang has been the frantic purchasing of bonds, both government and corporate, by the US Federal Reserve, the European Central Bank (ECB), the Bank of Japan (BoJ) and the Bank of England (BoE) that has seen these four major central banks' balance sheets, in aggregate, blow out to **a new record of US$20 trillion** of assets and correspondingly to **oppress interest rates along the entire yield curve**. The effect should not be underestimated, because corporate issuers of subprime debt in Europe are raising term funding at a lower cost than the US Federal Government! One consequence of floating exchange rates is that the behaviour of an individual central bank impinges on the entire global system via currency swaps and the free movement of capital – it effectively cheapens money across the board.

This does matter, because quantitative easing (QE) has allowed the rebuilding of bank equity for those most affected following the Lehman crisis, it has allowed various industries to find cheap financing through the likes of private equity, to fund adventurous ideas, and indeed has encouraged the swapping of equity for debt, notably in the US, via share buy-backs. The overarching effect of forcing investors to reach for yield, be they life companies, pension funds or hapless retirees, is to **raise the risk threshold**, justified by **the view that it has obviated an otherwise likely contraction of economic activity.**

Evidently it is working and, as was suggested by the work of Kenneth Rogoff and Carmen Reinhart following the Lehman meltdown, cheap money would ultimately allow the system to **rebalance after about 10 years of sub-optimal growth**. Other factors have played their part, most notably the contribution of unremitting expansion of the Chinese economy, huge strides in alternative energy production and the power unleashed from the internet to serve a much broader purpose. No longer confined to e-mails and the like, there has been an explosion of on-line shopping and expedited fulfilment, fintech services, on-line games and entertainment, and now the industrial element with the internet of things (IoT). These developments were still in their infancy in 2007.

Some of **these changes have sidelined previously comfortable industries** with the subsequent costs of restructuring and mergers. These continued through the quarter with some mega deals revealing the changed circumstances of the players, notably the proposed acquisition of 21st Century Fox assets by Disney, the obstructed merger between AT&T with Time Warner, the combining of CVS and Aetna in health care, Unibail-Rodamco's takeover of Westfield in property, and in aerospace, Boeing's bid to acquire Embraer and Safran's bid for Zodiac.

The main show though was **Synchronised global growth**, early signs of returning pricing power in some industries, and yet the bonds refusing to hint at the return of inflation even though such chronic deflators such as Japan are seeing general price rises of over one percent. Topping off the year was the passing of the tax bill in the US which reduces corporate taxes, including to the benefit of foreign companies, and encourages capex via accelerated depreciation deductions. Despite generous commentary, the tax break for the median earner (US$59,000 p.a.) is pitiful, some US$1,000 p.a. versus US$3,000 for the so-called "middle class" with incomes of US$100,000 p.a. Despite a rise of the government deficit by an estimated US$1.5 trillion a year, the bond market barely took notice.

An acknowledgement of broad dependable growth, combined with the capacity reductions in several basic industries in China (supply side reforms), saw markets **reprice value stocks and cyclicals relative to growth stocks**. This was in stark contrast to the bidding-up for "certainty" that gripped the markets from 2011 through to early 2016. All this coalesced to produce a new record. 2017 was the first calendar year on record in which the MSCI All Country World Index had had no down month (in local currency terms)!

Platinum ASSET MANAGEMENT

MSCI REGIONAL INDEX PERFORMANCE TO 31.12.2017 (AUD)

Region	Quarter	1 year
Developed Markets	**6%**	**13%**
Emerging Markets	**8%**	**27%**
United States	**7%**	**12%**
Europe	**3%**	**16%**
Germany	3%	18%
France	2%	19%
United Kingdom	6%	13%
Japan	**9%**	**15%**
Asia ex Japan	**9%**	**31%**
China	8%	43%
Hong Kong	7%	26%
India	12%	28%
Korea	12%	36%
Australia	7%	11%

Source: RIMES Technologies.

MSCI ALL COUNTRY WORLD SECTOR INDEX PERFORMANCE TO 31.12.2017 (AUD)

Sector	Quarter	1 year
Information Technology	8%	31%
Materials	8%	20%
Consumer Discretionary	8%	16%
Energy	7%	-1%
Financials	6%	15%
Consumer Staples	6%	9%
Industrials	6%	16%
Telecommunication Services	2%	0%
Health Care	2%	11%
Utilities	0%	5%

Source: RIMES Technologies.

Note the variances of performance by sector and country in the tables above.

Even though the Fund runs cash and has been burdened with ineffectual short selling in strongly rising markets through the year, the broadening of market action has significantly rewarded our index-agnostic stock picking. For the quarter and the year, the Fund achieved respectively 6.6% and 25.4% while its benchmark MSCI AC World Net Index rose by 6.1% and 14.8% (in AUD). Over the last five years, a $100 investment in the Fund would have grown to $220 today.[1]

This year's strong performance, in both absolute and relative terms, is pleasing, but by no means surprising. Some of you may recall the detailed expositions in our March and June 2016 quarterly reports in which we took you through the characteristics of the portfolio of the Platinum International Fund ("PIF") which the MLC-Platinum Global Fund's portfolio closely resembled (and resembles), including numerous individual positions within it. On measures of growth, profitability, leverage and value, **PIF's portfolio was as attractive as it had ever been in the prior 17 years; yet, at the time it looked forlorn** next to the index-hugging funds chasing expensive consumer staples companies and other bond-proxy stocks. As it transpired over the last 18 to 24 months, those characteristics served us well and the investments unfolded largely as envisaged to generate handsome returns, once again attesting to the underlying method at work.

CHANGES TO THE PORTFOLIO

As a regular reader of this quarterly publication, you will be aware that we have been gradually raising the cyclical component of the portfolio. This has been motivated by the significant impact that the production rationalisation in China has had on prices across a wide range of industries. Broader global growth has also played a part in tightening supply and lacklustre capex has found many companies chasing to add capacity. Other emerging themes like battery-driven automobiles, the pollution clean-up in China, and factory automation are also influencing our preferences. To fund these investments, we have been reducing or eliminating the highly successful Chinese internet plays like **Baidu**, **Tencent** and **58.com**. We have also reduced some of the Fund's financials exposure in China and Europe, trimming companies like **China Pacific Insurance**.

An important addition was **Siemens**. This remarkable 170 year old company, which started out with a telegraph invention, has pioneered many innovations involving the use of electricity to find itself today as a leader in power generation and distribution, industrial and building automation, rail transport and healthcare equipment. Apart from heavy spending on research and development (R&D), Siemens has arrived at this point through a myriad of forward-looking acquisitions and disposals.

At present, the market is a little unsure about its near-term earnings power because of the need to downsize its large combined cycle gas turbine business (note that GE is afflicted by the same). There is also pressure on the profits of its wind power subsidiary Siemens Gamesa, and the local press are agitated about the CEO's decision to own partial stakes in former core businesses that have been recently merged with competitors to consolidate their industrial significance. Some of these mergers were not so well-timed. Early in 2018, the plan is to list a (minority) stake in its healthcare business. The press is flustering about this German national icon losing relevance as it sets on this new path.

[1] Net of fees, pre-tax, and assuming the reinvestment of distributions.

Having followed the twists and turns that Siemens has taken over the decades, we feel these **uncertainties give an excellent buying opportunity** to own one of the great industrial enterprises of our times. The evolution of Industry 4.0, which is essentially a digital transformation of manufacturing and other activities to enable data to be manipulated, shared and used to control processes to ultimately have self-ordering systems, has come a long way since the vision was unveiled by the German government at the Hannover Fair in 2011. Siemens is indubitably the leader in the field. Of course, the majority of factories are burdened with massive legacy investments and the task ahead is to persuade, facilitate and profit from this inevitable shift in the way things are made or controlled.

We run the risk of being too early in entering this investment because of downward pressure on 2018 earnings from the divisions that are restructuring and from a further rise in R&D in the Digital Factory division, but finding a company of this quality selling on 15 times earnings is rare in these markets.

SHORTING

Our index shorts were expensive in a record year on 12 solid months of unremitting advances.

CURRENCY

The main change was a further reduction of the holding of US dollars in favour of the Japanese yen, the Korean won and the Norwegian krone. Regarding the Australian dollar, we were inclined to remove this long position early in 2017 as we built further positions in cyclical stocks and did not wish to double the 'bet'. See table below:

FUND'S CURRENCY EXPOSURE

Currency	31 Dec 2017	30 Sep 2017
US dollar (USD)	24%	34%
Euro (EUR)	16%	15%
Hong Kong dollar (HKD)	15%	12%
Japanese yen (JPY)	11%	9%
Korean won (KRW)	9%	8%
Norwegian krone (NOK)	7%	3%
British pound (GBP)	5%	5%
Indian rupee (INR)	4%	5%
Chinese yuan (CNY)	4%	4%
Australian dollar (AUD)	1%	1%

Source: Platinum Investment Management Limited

FUND'S DISPOSITION OF ASSETS (NET INVESTED POSITION)^

Region	31 Dec 2017	30 Sep 2017
Asia	36.1%	36.1%
Europe	23.2%	22.1%
Japan	18.5%	16.4%
North America*	7.6%	7.6%
Russia	0.9%	0.9%
Cash	13.7%	16.9%

Source: Platinum Investment Management Limited

^ The net invested positions represent the Fund's exposure to physical holdings and both long and short derivatives as a percentage of the Fund's net asset value.

* At 31 December 2017, the Fund had a short position in the US against the S&P 500 Index of -9.0% (30 September 2017: -8.8%).

TOP 10 HOLDINGS

Stock	Country	Industry	Weight
Samsung Electronics	Korea	IT	3.4%
Alphabet Inc	USA	IT	3.2%
Inpex Corporation Ltd	Japan	Energy	3.0%
Royal Dutch Shell PLC	UK	Energy	2.8%
Lixil Group Corporation	Japan	Industrials	2.6%
Sina Corp	China	IT	2.5%
Glencore PLC	Switzerland	Materials	2.4%
Ping An Insurance Group	China	Financials	2.4%
Nexon	Japan	IT	2.2%
Jiangsu Yanghe Brewery	China	Consumer Staples	2.1%

As at 31 December 2017. The table shows the Fund's top 10 long stock exposure (through physical holdings and long derivative positions) as a percentage of the Fund's net asset value.

Source: Platinum Investment Management Limited.

COMMENTARY

On account of the surplus capacity that came with the Global Financial Crisis, inflation has been absent, except, one could argue, in the price of tangible assets, nominal and real. More recently one can spot this effervescence boiling over into new 'asset' concepts like #Bitcoin and the host of emulators that have caught the popular imagination. The important point to grasp is that **the concept of a public register, called a 'blockchain'**, and the way entries are verified and recorded by users across the network, rather than depending on a central authority, **are sound and clever.** Building on this kernel, the idea that it is tamper-proof from government intervention has created a mystique. The **distributed** nature of a public blockchain and the **traceability of every entry** gives the technology particular appeal from a **security standpoint**. This is increasingly important in a world where everything from bank accounts to smart cars is at the mercy of hackers. Further, the trade in already-mined

(Continued)

Bitcoin has exploded as exchanges have sprung up to meet and promote this burgeoning activity. Right now there is massive turnover in the existing stocks of the token, earning spreads that are creating huge wealth for the operators of these exchanges. As you will see from the excellent article by our Quant Analyst, Sava Mihic, ***Bitcoin – A Primer,*[2] *gross annual fees* generated are likely greater now than those on the New York Stock Exchange!**

This massive cash flow provides motivation and funding for highly promotional web-directed activities to perpetuate this apparent gravity-defying money-making machine. **Why one might not fight the trend at present is that it's got many of the qualities of a good story** for new-age millennials and disparaged voters in a world that is readily embracing new digital payment systems and, in addition, money is very cheap. Long gone is any discussion about its inherent worth (a store of value) or as a medium of exchange, a value attributed to traditional money, which might even earn interest to those who are so old-fashioned as to care. The gamblers are having the time of their lives and it is all about buying-the-dips and getting involved. Of course, this desperate participation **forewarns of the likely bust**, but for now, punters (as a group!) are reckoning on their greater agility than the crowd. The leader, Bitcoin, may eventually falter and lose favour, and its recent exponential rise from US$1,000 at the beginning of 2017 to a peak of US$19,000 in mid-December suggests **its parabolic rise is close to climax, dwarfing even the Tulip fever** that gripped Amsterdam in the 17th century. However, if and when that happens, others like Ripple (XRP), which facilitates the exchange of cryptos into hard cash and offers cheap and speedy processing, might be expected to take up the running.

With the cost of money being so low, the danger lies in **the use of debt to play** and as of December both the Chicago Board Options Exchange (CBOE) and the Chicago Mercantile Exchange (CME) offered futures contracts on Bitcoin. **If debt is used to fuel the flames**, the consequence of a bust could be felt across all asset classes as **the liquidity squeeze** forces the sale of other assets to meet the collapsing crypto phenomenon.

"But what is likely to change the cost of money?" you ask. It was mentioned earlier that some industries are regaining their pricing power, some of which is due to the muted capex cycle and unexpected strength in demand. Traditional measures of productivity show weakness, yet still labour in markets as far apart as the US and Japan seems bereft of pricing power in aggregate. However, pressure from rising unit labour costs – and note the confidence of middle income workers has fallen since the US tax bill was announced – could turn the tide. It is not as if prices on average haven't been rising. The change in the CPI in the US did after all get down to zero in 2015 and is now rising by between 1.5% and 2.0% p.a. while in Japan it may be running at an annual rate of 1.5%.

Based on our experience from field trips and company visits, and with the prospect of India and China growing yet again by above 6% in 2018 (remember, such growth in China is tantamount to adding an economy the size of the Philippines on a purchasing power parity basis with its population of 105 million), **we are inclined to back growth forcing changes in the cost of money**. This is against a backdrop of tightening by the US Federal Reserve and other central banks likely being shamed into desisting from their market manipulation. In the meantime the **cryptos** may serve as the proverbial **canaries of financial market health**. As an interesting gauge, we see that Google search trends for Bitcoin have dropped below those for gold!

OUTLOOK

High valuations and long bull runs do not by themselves cause the onset of a bear market. The key is earnings growth and on that score the markets still look satisfactory. We like the companies we are finding in Asia in particular, as they typically offer above average growth prospects and yet are valued on lower multiples of earnings than those in the western hemisphere. While acknowledging that historically these markets have been prone to the influence of foreign flows, the weakening pattern of the US dollar suggests that this factor may be less significant in future. As we have highlighted over the last 18 months, Asia is creating its own ecosystem with ever diminishing dependence on the large Western economies. The likely repricing of borrowing caused by US Fed tightening is an evident obstruction, but, like earlier tightening cycles, the relative pace of earnings growth could be the deciding factor for individual investment opportunities. Some of the growth themes with which we tag individual stock ideas are almost immune from broader economic influences and this gives one confidence that they can deliver strong earnings almost independent of their host economies.

Kerr Neilson
Chief Executive Officer
Platinum Asset Management

[2] Available on our website at https://www.platinum.com.au/Insights-Tools/The-Journal/Bitcoin-A-Primer.

MACRO OVERVIEW

By Andrew Clifford, CIO, Platinum Asset Management

As we enter 2018, the global economy appears to be in as good a shape as it has been any time in the last decade. The US, Europe, China and Japan have each shown improving economic momentum over the course of 2017. Higher commodity prices, we believe, should bring about stronger growth in many of the emerging economies in the year ahead. Interestingly, the trends in place today (excepting the run up in commodities) were obvious enough a year ago, though at the time investors and commentators were preoccupied with a range of concerns.

The US, which has led the global recovery since the GFC, continued to grow strongly in the final months of 2017. Consumers appear to be in good shape as employment markets remain strong which, together with the promise of tax cuts coming in 2018, saw consumer confidence reach levels not seen in almost 15 years, well before the GFC. New home sales, which have been relatively slow to recover in the current cycle, are now experiencing sturdy growth. To date, there has been little evidence of rising inflation and, as such, while interest rates are rising, they do not look to be a threat to economic momentum for the moment. While the delivery of the tax cuts is a new impetus for growth (though we suspect not a significant one), the picture is not very different to that of a year ago. A year ago, the great concern was the proposed policies of the newly elected President Trump: the roll-back of Obamacare which threatened to leave potentially 20 million Americans without health insurance, a possible trade war with China, and a major revamp of the tax system. Of course, little has come to pass other than a much reduced tax plan; meanwhile the economy has continued to motor along.

In Europe, employment growth is strong and consumer and business confidence is high and rising. Today, economic growth rates across Europe are back at pre-GFC levels. A year ago, the improvement in Europe's economic performance was already well established. The strength of the job market today is simply a continuation of the upward trajectory that had already started then. However, a year ago all were concerned with political instability in Europe post the Brexit vote and the defeat of the Italian constitutional reform referendum. There was much discussion about the possibility of Marine Le Pen winning the French presidential election and the implications that would have for the sustainability of the European Union (EU). Concerns also remained with regards to unresolved bad debts in the European banking systems, particularly within Italy. What came to pass was a surprisingly positive outcome with pro-reform candidate Emmanuel Macron winning the French presidential race. Bad debt issues have either been resolved or faded to the background.

Throughout 2016 China staged an impressive economic recovery from its investment downturn, kick-started by government spending on infrastructure as part of its "One Belt One Road" program. The residential property market recovered and excess inventories were well on the way to being cleared. Despite this clear improvement in the economic environment, there remained much scepticism at the beginning of 2017 as to whether the recovery was sustainable, with most concerns focused on the level of indebtedness in the economy and the potential for a bad debt crisis in the banking system. While these were not unreasonable concerns, as we first discussed in our March and September 2017 Macro Overviews, China's supply side reforms were dealing with issues of excess capacity in industries such as coal and steel. The result was immediate improvement in profitability and, with that, the ability to service debt. Over the course of 2017 these supply side reforms have been extended, particularly with respect to enforcement of environmental standards, leading to further improved profitability across a wide range of industries both within and outside of China.

While the fears regarding China's indebtedness have receded somewhat in the second half of 2017, investors and commentators generally remain sceptical. Along with the supply side reforms, there have also been reforms of the financial sector, in part to address the reckless use of credit in the system. It is somewhat ironic that these changes, both of which act to limit the state's role in the economy, are viewed as evidence that President Xi is steering the economy back towards central planning and away from markets. Our observation is that all the signs point in the other direction. Indeed, if one looks at the electric vehicle (EV) market in China, the mechanism being used to encourage auto producers to sell EVs is essentially a simplified version of the mechanism employed by the EU.

Finally, there is the world's third largest economy, one that is almost forgotten by investors after 25 years of deflation, slow growth, and falling asset prices. The list of woes that usually attract attention when Japan is mentioned includes massive government debt, the extraordinary printing of money by the Bank of Japan (BOJ), and a rapidly aging population, to name just a few. Yet, the country is currently enjoying record levels of employment, driven by rising participation in the work force by women, and rising wages. Corporate profit margins are at record highs. And, for the record, the economy has not seen such robust levels of growth for more than two decades!

The world has not seen this degree of synchronised growth across the major economies since 2008. Together with the supply side reforms in China, this growth has helped to drive a range of commodity prices higher during 2017. Over the next five years, an additional factor driving demand for various metals will be electric vehicles. Combined with a lack of investment in new supply in recent years, this should see commodity prices remain buoyant. While it may act as a tax on most of the developed world, this transfer of income to large emerging economies such as Indonesia, Brazil and Russia should be beneficial for overall global growth.

What are the key risks to this buoyant global outlook? The obvious risk, and one that the markets are focused on, is a return of inflation. In particular, labour markets are tight in the major economies, with the exception of Western Europe, so higher wage inflation is certainly possible if growth remains strong. Couple this with higher commodity prices, a scenario of rising inflationary pressures cannot be dismissed. If central banks were to raise rates in a sustained and steady fashion in response to inflation, given the level of debt carried in all the major economies, it would certainly pose a threat to current rates of growth.

The other great unknown is the longer term ramifications of the money printing exercises by the US Federal Reserve, the European Central Bank and the BOJ. While the US, on face value, has extricated itself successfully from its quantitative easing (QE) program (i.e. it has stopped "printing money" via bond and other asset purchases), it is yet to attempt to unwind this policy in any meaningful way. For the moment, QE continues in both Europe and Japan.

MARKET OUTLOOK

Global stock markets have recognised these improving prospects and rewarded investors with good returns over the last 12 months. The following table shows the 1-year and annualised 5-year returns in local currency terms for key global markets.[3]

MSCI REGIONAL INDICES
LOCAL CURRENCY RETURNS TO 31.12.2017

Region	1 year	5 years (compound pa)
World	19.8%	12.7%
United States	21.2%	15.0%
Europe	13.0%	9.9%
Japan	19.8%	17.2%
Asia ex Japan	35.6%	9.1%
China	55.0%	10.1%
India	30.5%	12.3%

Source: RIMES Technologies

The 1-year returns presented here would usually suggest that one should be cautious about the prospects of future returns. However, the 5-year returns, while solid, are not spectacular except in the case of Japan and the US. Japan, it must be remembered, started the period at the bottom of a 23 year bear market!

It is our assessment that, despite these good outcomes, most investors remain cautious when it comes to the prospects for future returns from owning shares. We see this in the frequent headlines carrying warnings from investment experts for overvalued stocks, stock market bubbles, and even the looming possibility of another GFC. We also see this caution in the actions of investors around the world where we still observe a strong preference for other asset classes, notably debt securities. This assessment, together with the fact that we continue to find new companies to buy at attractive valuations, makes us cautiously optimistic that we are well positioned to continue to generate good returns for investors over the next three to five years, if not in the next 12 months.

Interestingly though, despite caution around share markets, the rise of Bitcoin and other cryptocurrencies shows that enthusiasm for speculation is far from dead! I would encourage anyone with an interest in this topic to read Sava Mihic's excellent article *Bitcoin – A Primer*. Certainly, some cryptocurrencies look on face value to be another old-fashioned bubble, though they may still have some way to go despite the daily predictions of their demise. Could an eventual burst of the bubble have the potential to cause disruptions to broader financial markets? Perhaps, particularly if significant amounts of debt are involved, though for the moment this appears unlikely. For every loser in this speculative game, there is an offsetting winner. Perhaps a more likely scene for a significant financial accident may be the debt markets, where the risk aversion of investors, together with the QE policies of central banks, has driven yields to extraordinarily low levels.

If you have any questions about your investment in the MLC-Platinum Global Fund, please contact the MasterKey Service Centre on

132 652 from anywhere in Australia or
+61 3 8634 4721 from overseas

[3] For Australian investors, the returns in most cases would have been significantly better over 5 years due to a weak Australian dollar, but weaker over the 1 year period as the Australian dollar has appreciated against most currencies over the last 12 months.

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