MLC-Platinum Global Fund

QUARTERLY INVESTMENT MANAGER'S REPORT

PERFORMANCE

Fund Size: $693.8m	Last quarter	Last 12 months	5 years (compound pa)	Since inception (compound pa)
MLC-Platinum Global Fund	0.0%	11.0%	9.2%	10.6%
MSCI All Country World Net Index (A$)	6.0%	25.8%	14.3%	7.9%

Fund returns are after fees and expenses and assume the reinvestment of distributions. Portfolio inception date: 30 June 1994.
Source: MLC Investments Limited and Platinum Investment Management Limited for Fund returns, and FactSet Research Systems for MSCI index returns.
Past performance is not indicative of future performance. The value of an investment may rise or fall with changes in the market.

The Fund returned 0% for the quarter and 11.0% for the year.[1]

Looking at the contributors and detractors for the quarter, a main driver on the positive side was the strength in a number of our semiconductor and technology hardware companies, namely **Micron Technology** (+31% over the quarter), **Lam Research** (+26%), **Microchip Technology** (+13%) and **Ciena** (+50%).

Ciena is a leading player in the field of optical networking and transport, producing equipment that is essentially used to transmit large amounts of data across distances. We started building our position in March 2021, with the investment case to buy Ciena underpinned by two key factors:

1. The competitive environment for this equipment had improved via both consolidation (the Alcatel, Lucent, Siemens and Nokia assets were all brought together under one roof) and the fact that Chinese giant Huawei had been blacklisted from a number of Western markets.
2. Ciena was about to enjoy a large spending cycle as major telecommunication companies around the world roll out 5G, which had slowed due to COVID disruptions.

The return of 5G spending was always a matter of when, not if, and Ciena's recent results confirmed the rollout by the operators was back on, with revenue up 25% and their backlog of orders doubling vs. 2020.

1 References to returns and performance contributions (excluding individual stock returns) in this MLC-Platinum Global Fund report are in AUD terms. Individual stock returns are quoted in local currency terms and sourced from FactSet Research Systems, unless otherwise specified.

The major stocks that detracted over the quarter fell into two categories, travel and a couple of our small cap positions. Our travel positions retraced (**Trip.com** -20%, **MTU Aero Engines** -8%) with the emergence of the Omicron variant. On the small positions, there were two notable falls, Chinese orthopaedic device manufacturer **AK Medical** (-39%) and Japanese baby products maker **Pigeon** (-15%).

The Fund's index short positions (Russell, Nasdaq) also detracted from performance over the quarter (-0.8% contribution overall).

AK Medical is the largest domestic manufacturer of orthopaedic products (mainly hip and knee) in China. Founded by prominent surgeon Li Zhi Jiang and businessman Zhang Chao Yang in 2015, AK has been the most research and development (R&D) focused of the domestic players, building roughly 20% market share[2] and being the first to get approvals for a number of 3D printed implants.

The stock has been weighed down by the short-term impact on profits from the new 'volume-based procurement' system, which is essentially a form of centralised buying/bidding aimed at reducing costs for the health system. AK was very successful in both rounds of bidding, which will see it gain further market share, but at lower pricing/profit levels than in the past.

2 Source: Company reports.

DISPOSITION OF FUND ASSETS (NET INVESTED POSITIONS) ˆ

REGION	31 DEC 2021	30 SEP 2021
Asia	32.9%	34.5%
Europe	15.9%	17.0%
Japan	15.8%	16.2%
North America*	11.7%	13.4%
Australia	2.9%	3.5%
Other	1.1%	1.0%
Cash	4.5%	4.6%

ˆ The geographic disposition of assets (i.e. other than 'cash') shows the Fund's exposures to the relevant countries/regions through its long securities positions and long securities/index derivative positions, as a percentage of its portfolio market value.

* As at 31 December 2021, the Fund had a -10.2% short position against the Nasdaq E-Mini Future Mar 22 and a -4.9% short position against the Russell Mini 2000 CME Mar 22. The Fund's -5.0% short position against the Nasdaq E-Mini Future Dec 21 and a -4.9% short position against the Russell Mini 2000 CME Dec 21 were closed during the quarter.

Source: Platinum Investment Management Limited.

TOP 10 HOLDINGS ˆ

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Micron Technology Inc	US	Info Technology	5.2%
Microchip Technology Inc	US	Info Technology	5.2%
Samsung Electronics Co	South Korea	Info Technology	4.6%
MinebeaMitsumi Co Ltd	Japan	Industrials	3.5%
ZTO Express Cayman Inc	China	Industrials	3.5%
UPM-Kymmene OYJ	Finland	Materials	3.5%
Lixil Group Corp	Japan	Industrials	3.3%
China Overseas Land & Inv	China	Real Estate	3.1%
Tencent Holdings Ltd	China	Comm Services	3.0%
Glencore PLC	Australia	Materials	2.6%

ˆ As at 31 December 2021. The table shows the Fund's top ten positions as a percentage of its portfolio market value taking into account its long securities positions and long securities derivative positions. Numerical figures are subject to rounding adjustments.

Source: Platinum Investment Management Limited.

NET SECTOR EXPOSURES ˆ

SECTOR	31 DEC 2021	30 SEP 2021
Industrials	20.9%	20.0%
Information Technology	18.9%	16.0%
Financials	16.8%	17.0%
Materials	14.7%	15.7%
Communication Services	7.8%	7.2%
Consumer Discretionary	6.8%	7.6%
Health Care	3.9%	7.0%
Real Estate	3.7%	3.5%
Consumer Staples	1.5%	0.8%
Energy	0.6%	0.6%
Other	-15.2%	-9.9%
TOTAL NET EXPOSURE	80.3%	85.6%

ˆ The table shows the Fund's net exposures to the relevant sectors through its long securities positions and long securities/index derivative positions, as a percentage of its portfolio market value. Index positions (whether through ETFs or derivatives) are only included under the relevant sector if they are sector specific, otherwise they are included under 'Other'. Numerical figures are subject to rounding adjustments.

Source: Platinum Investment Management Limited.

NET CURRENCY EXPOSURES ˆ

CURRENCY	31 DEC 2021	30 SEP 2021
United States Dollar (USD)	32.2%	24.0%
Chinese Renminbi (CNY)	20.7%	22.0%
Euro (EUR)	11.1%	13.0%
Japanese Yen (JPY)	10.9%	16.3%
South Korean Won (KRW)	6.4%	7.2%
UK Pound Sterling (GBP)	6.3%	4.7%
Australian Dollar (AUD)	3.3%	4.0%
Hong Kong Dollar (HKD)	3.0%	2.5%
Indian Rupee (INR)	2.1%	2.5%
Canadian Dollar (CAD)	1.3%	1.3%
Brazilian Real (BRL)	1.1%	1.0%
Thai Baht (THB)	1.0%	0.9%
Kazakhstani Tenge (KZT)	0.6%	0.6%

ˆ The table shows the Fund's net exposures to the relevant currencies through its long securities positions, cash at bank, cash payables and receivables, currency forwards and long securities/index derivative positions, as a percentage of its portfolio market value.

Source: Platinum Investment Management Limited.

To us, the appeal in AK is longer term. The government clearly wants to encourage domestic capability and innovation in medical devices (it's currently doing so via R&D tax incentives to the manufacturers and preferential insurance rebates to encourage use of the domestic brands) and as a R&D focused player, AK stands to benefit here. Also, the potential for AK to grow unit volume long term is immense. With roughly 600,000 primary knee and hip implants per year, the Chinese market is tiny compared to its population, and as China's standard of living rises over time, you would expect procedure rates to trend higher. Using procedure rates in Japan (the lower end) or Europe (the higher end) as a guide would indicate the market can grow to be five to ten times its current size over time.

Changes to the Portfolio

During the quarter, we sold out of our positions in **Louisiana-Pacific** and **Merck KGaA** as both reached prices we deemed as fair value. We also halved our positions in **Bank of Ireland** and **Raiffeisen Bank International**, with the reduction in Raiffeisen in response to the tail risk around the brinksmanship between Russia and the West over Ukraine's future involvement with the North Atlantic Treaty Organization (NATO).

We used these funds to increase our holdings in travel-related names **InterGlobe Aviation** and **Trip.com** post the sell-off due to Omicron, and started a new position in UK banking group **Barclays**.

In our June 2021 quarterly report, we mentioned that the global push to decarbonise is of interest to us for potential investment ideas. Indeed, if the world only achieves half of its goal, it will still represent one of the largest capital works programs of the last 100 years. The issue from an investment perspective is finding companies not engulfed in hype, with investors now willing to pay huge prices for 'environmental' stocks.

A new addition to the Fund that both benefits from this trend and is sensibly priced is **Longshine Technology**.

Longshine is a Chinese software company that specialises in software for demand and supply monitoring, customer relationship management (CRM) and billing systems for the electricity and gas utilities in China. A growing, profitable software company in its own right, Longshine is currently benefiting from a large grid upgrade program.

In China today, a large amount of electricity is still billed via flat-rate tariffs. This means you are charged the same 10–12 cents per kilowatt-hour (Kw/h) regardless if you are consuming electricity during a high- or low-demand period.

As part of the government's CO_2 reduction and energy efficiency targets, they are mandating a move to a market-based pricing system, more akin to what we have in the West. Under this system, the price corporates pay will move up and down depending on the level of demand, and this will incentivise both better energy usage planning and investment in more power-efficient equipment. This move requires a large upgrade to the supply/demand monitoring and response software, along with the billing software capability, with Longshine powering these upgrades.

With Longshine's core software business growing 40%,[3] with high visibility for that to continue, our initial purchase price of the company on a low 20x multiple of earnings was a good example of growth at a reasonable price. However, as a demonstration of the market's current enthusiasm for decarbonisation beneficiaries, other investors have recently jumped on the opportunity in Longshine, with its share price rallying strongly in the last two months.

3 Source: Company reports.

OUTLOOK

A lost opportunity for the Fund over the past decade was not adjusting enough to the low-rate environment and how that could completely change what investors would pay for businesses with stable and growing cashflows. Holdings such as Kweichow Moutai, PayPal and IHS Markit are good examples, where in keeping with our valuation discipline, we either sold out or heavily reduced our position at valuations we deemed a rich 30–50x earnings, only to watch the stocks double again.

However, today the adjustment required may be in the opposite direction as evidence builds that the zero-interest rate environment of the past decade is coming to an end. As we detailed in our last quarterly report, the new factor driving rates is inflation, and over the quarter we saw global central banks begin to lift interest rates and the most expensive and speculative parts of the market start to fall.

In this regard, our message remains the same. While we could be wrong on the outlook for rates and inflation, we think the risk is asymmetric because huge swathes of the stock market are still pricing in a low interest rate environment. We continue to stand firm on our discipline that price matters, avoiding the 'hot' areas of the market and positioning the portfolio into companies where starting relative valuations are favourable.

Clay Smolinski
Co-Chief Investment Officer & Portfolio Manager
Platinum Asset Management

Macro Overview: A Case of Catch-22 for Policymakers in 2022?

by Andrew Clifford, Co-Chief Investment Officer

In late December, CEO and co-CIO Andrew Clifford sat down with Investment Specialist Douglas Isles to discuss inflation, labour market pressures, interest rates, China, decarbonisation, and Omicron – and the challenges these pose for policymakers and markets in 2022. An edited transcript of the conversation is below.*

DI: Andrew you've been talking about the risks of inflation since June 2020 and now everyone's talking about it. Can you give us an update on your thoughts?

AC: The way the inflation story has progressed is really quite interesting. A few months ago, many still regarded it as being 'transitory' – citing the lumber price, and a whole series of prices for that matter, moving up, down and back up again. We've always maintained that the underlying cause of inflation is the amount of money that's been printed. As a result, you're not going to be able to track it by looking at used car prices, copper prices or the like. What's happening in labour markets is a much more important indicator to focus on now, particularly in the US.

The US economy is booming and currently there are about 10 million job vacancies, give or take. There are around seven million people who identify as being unemployed, so we have more jobs than people who are unemployed. Small, medium and large companies are all finding it hard to fill jobs and there's anecdotal evidence of companies needing to increase wage rates to attract staff. I would also add that in our discussions with companies, many have commented that in the past, when copper prices and steel prices rose, pressuring margins for those companies that use these as inputs, they couldn't really increase prices and needed to find cost savings elsewhere. Today, there's a very relaxed attitude from corporates – they're just putting up prices. I think these factors will create a potentially self-perpetuating cycle of inflation.

DI: Would you say these labour shortages are emboldening workers' sense of self?

AC: Lower-income households have really struggled over the past few decades, their real living standards have not improved, particularly in places like the US. Their real living standards have actually worsened over the last couple of years, because they suffered the most from the COVID lockdowns and subsequent job losses. They may have been given some financial assistance along the way with the various government benefit schemes around the world, but as always, it's these groups that are impacted the most by inflation. They don't have the big stock or property portfolios, which is where the money has been made.

So, this divide is getting wider, but interestingly, they now have the upper hand with labour being in such short supply. As a result, we are seeing labour strikes, such as the well-publicised ones at Deere and Kellogg's that have gone on for some time. In the case of Deere, the workforce has been awarded some pretty healthy wage increases.

Perhaps symbolically, large parts of the US labour force have not been unionised, but now the first Starbucks store (out of around 9,000) has been unionised – and that's just one store in New York. Amazon workers at different warehouses are trying to unionise, and we also have teacher strikes. Things are changing, which again, links back to the potential for a self-perpetuating inflation cycle.

DI: Is there a deep social problem emerging? How does this factor into your thinking?

AC: Well, there is an issue here and I think one of the most interesting social phenomena's is on the Reddit discussion platform, where 'anti-work' is the fastest-trending thread. Rather than during the 1970s, 1980s or communism era, where people were agitating for everyone to be paid the same, the anti-work thread is that none of us should have to work. Now, that might sound appealing, but we shouldn't underestimate the strength of this movement and it poses a real problem for governments to solve. I believe it actually points the way to some very fundamental changes, one of which I think is going to be interest rates.

*The full interview is available in audio format on The Journal page of our website https://www.platinum.com.au/Insights-Tools/The-Journal

DI: The US Federal Reserve is now talking about rate rises in 2022 of around three-quarters of a percent, how does that impact things and what is the outcome from that?

AC: The first thing to note is that we're now talking about rate hikes in 2022 – previously, they were meant to be somewhere far off, in 2023 or 2024. I don't think this should surprise anyone though, and we've been focused on this for quite some time. The issue again, comes back to the impact of inflation across the economy. The higher-income groups will probably be relatively immune to it if their grocery bill goes up 10%–15%, but for others it's very damaging. Of course, in terms of politicians who fundamentally want to be re-elected, solving inflation is more important. Ultimately, what history showed through the 1960s, 1970s and 1980s, is that governments need to deal with inflation or they will lose the next election.

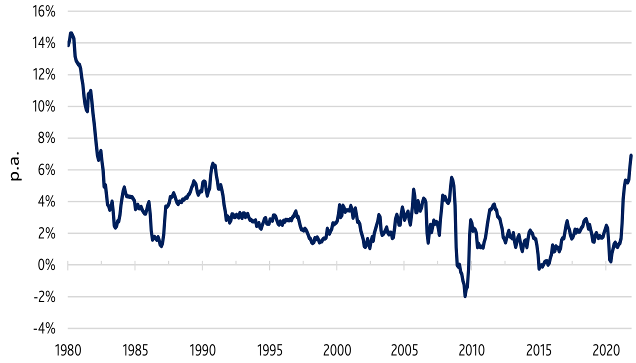
I think we're on the cusp of changing the way we think about interest rates. It's really interesting that the market had predicted this change in interest rates, with yields on the US two-year Treasury edging higher in the closing weeks of 2021. If you think about it though, if interest rates increase to 1% or 2% and inflation is 6%, with a strong economy, 1% or 2% is not going to make a whole lot of difference. Indeed, there's a huge incentive for the private sector to continue to borrow money at still very low rates and essentially, in one way or another, speculate on inflation. That's how these cycles really take hold – it just creates more monetary growth when we already have too much money. These are the things investors need to be thinking about.

Monetary policy changes, whether it's interest rates or quantitative easing, impact the economy with long lags – traditionally 12–18 months. So, regardless of whether inflation moves beyond 6% or not, we should expect that it's going to be at elevated levels for some time to come, and the ultimate end to deal with that, will be much higher interest rates than people are expecting.

DI: Is this a pattern that is starting to emerge in other economies as well, or is it still primarily a US phenomenon?

AC: If you look at the monetary expansions we had in Europe, money supply is up roughly 30% on two years ago, while in the US, it's closer to around 40–45% and the monthly rates continue to be quite strong. In China, it's less so, let's call it in the mid-20s.[1] This is very clearly US led, but we are seeing inflation numbers at the highest levels in decades in many economies and rate increases in much of the emerging world already. So, I think the US is the centrepiece, but it is something that we're seeing pretty much everywhere.

Fig. 1: US Inflation Soars to Highest Level Since the Early 1980s



Source: Federal Reserve Bank of St. Louis, US Consumer Price Index, annual rate, as at November 2021.

DI: Last time we spoke, we talked a lot about China's reform program. Perhaps you could give us an update on what's happening on the ground there?

AC: As we discussed last time, what's most important in China, in terms of downside risk, are the reforms in the property sector. It's not about Evergrande and the indebted developers, it is about the fall-off we've seen in the sale of new apartments, which will then flow through to much lower construction activity in the months ahead. This is the one clear negative for global economic growth. The property sector is a very important part of the Chinese economy and thus the global economy. We haven't seen any improvement there yet, but we have clearly seen a change in approach from the government. For instance, there has been a change in rules for how the better-managed developers, the ones who have strong balance sheets, can access money and potentially acquire the good projects from those in trouble. We have also seen better mortgage terms for buyers, as well as cuts in the reserve requirement ratio for the banking system to ease liquidity. The Chinese policymakers are aware that there's an issue here, and they are starting to act, as one would expect. The market's response? By and large, stocks in the areas that have been the most impacted by these reforms bottomed in July/August, with stock prices for the good property developers up roughly 15–20% by year end. That's not to say that it's all over, but the market is indicating that we've probably seen the worst of it in China.

DI: The Chinese government has a pattern of going hard, the market reacts and then the government eases off a little through a number of years of reform, do you agree?

AC: Absolutely. China is the one government that actually does implement reform – they do it aggressively and there's always the chance of policy mistakes and overreach. We saw exactly the same thing occur at the end of 2018 with the banking system, and they had to step back and relax their measures. I think we have a similar situation here, they've recognised the issue and are talking about measures to help regain some momentum in the economy.

1 Source: FactSet Research Systems, Federal Reserve Bank of St. Louis.

DI: You touched on stock price reactions, let's turn to markets more broadly. Are you seeing any parallels with the technology boom in 2000, where everyone wanted to own a narrow collection of stocks?

AC: I think the tech boom in 2000 is a very good model to look at. There are a number of measures we look at. There's a very high concentration of big companies in the indices now. On the Nasdaq for example, the big 10 names, including the FANGs, Microsoft, Nvidia and Tesla, account for roughly over half of the market, which is very substantial – and most of them are trading on very high valuations of 40, 50, or 70 times earnings. Here's the other thing though, if you look at Nasdaq's performance for 2021, it's up around 17% in US dollar terms for the year to date, but if you exclude the best five of those big 10, the market is actually down c. 20%.[2]

Interestingly, a lot of the speculative, very highly valued growth names have been selling off, but not in a straight line up and down. Another measure we look at is 'advance decline', which measures the number of companies that are going up on any day versus the number going down, and steadily over time, less and less stocks are going up. There's also been a fall-off in the number of stocks making new highs versus those making new lows. These are classic patterns that have historically pre-empted a bear market. It is all very similar to 2000, so yes, it's a very interesting parallel.

DI: So, this might not have much longer to run then?

AC: Well, I think we have to go back to interest rates. We've been in an environment of falling inflation and interest rates for three or four decades. Particularly during the last decade, it has been the predominant financial variable propelling stock markets and driving investors into high-growth stocks and these big tech names. It looks like the end of that era is fast approaching and we're already seeing many of the companies that benefited from that, falling. It's not the first interest rate increase that really knocks a stock market down though, and it looks like we're going to have numerous ones. On that basis, I would say that there's very little value in these big-favoured names. We are looking elsewhere in the market and finding that all those other stocks people didn't want to know about are actually pretty good value, and we expect them to be beneficiaries of this stronger growth environment we're in.

DI: During the December quarter, we had COP26 and there was a lot of talk about net zero emissions, how are you thinking about that from an investment perspective?

AC: The move to decarbonise the world is a key thematic that we've been researching and investing in for a long time. A good example is LG Chem, one of the leading providers of electric vehicle (EV) batteries, which has delivered us strong returns over the last couple of years. A lot of the obvious themes are very expensive and there are plenty of other more interesting ways to play it. Let's look at EVs for example, we have Tesla obviously, but there's also Rivian, an electric truck maker that has barely sold a truck and can scarcely make trucks yet. It recently peaked with a market capitalisation of around US$120 billion. Now, even when Tesla was in its exciting days and everyone thought it was expensive, its market cap was US$20 billion not US$120 billion, and it was actually making quite a lot of cars back then.[3]

But let's think about how we're really going to decarbonise our transportation fleet, it's a big task and we have lots of companies out there that have invested heavily in the electrification of vehicles, Toyota is the leader and BMW is right up there. These companies have been investing in this area for a long time, but everything can't just go electric, that's not a feasible outcome. Even if the developed markets are fully electrified in a decade from now, there'll still be large parts of the world that don't have the infrastructure or the generation capacity for that. Companies like BMW and Toyota are thus very focused on reducing the carbon emissions from their traditional internal combustion engines and hence we believe these companies are a very good play. Companies like Valeo, who have a lot of componentry in the exciting areas in auto, but most notably the electric drive train, is another potential play. They're not the obvious 'buy' on the electric vehicle theme, but we're buying companies that stand to benefit from that very same trend. Another one is copper, a material that's seen very little investment of substance for years now. We need it for EVs, renewable energy and charging stations. We've had big investments there and done well, but again, it's not always the obvious 'buy the wind farm' or 'buy the wind turbine maker', there are other ways of playing this theme and that's very much our focus.

DI: You mentioned some successes; another big success was the vaccine producers. How is COVID factoring into your thinking as we enter 2022?

AC: It's been such an uncertain environment for the last couple of years and we now have the Omicron variant. What does that mean exactly? There are as many different opinions, as there are articles written about it. I think the thing for investors, and answering in that context, is that when we're buying companies, we're buying them for the next 10 and 20 years of their earnings, not the next six months. Now, the market might fluctuate around those concerns, but we are of the view that we will move beyond COVID – simply because you can see how populations just want to do that, even with the risk that entails. While there will be short-term fluctuations around concerns and stocks will go up and down depending on what investors think is going on, the way to navigate through this, again as an investor, is to look at the longer-term potential of your investments.

2 Source: https://realmoney.thestreet.com/markets/just-5-stocks-are-the-difference-between-a-bull-market-and-a-bear-market-15854516.

3 Source: FactSet Research Systems.

DI: Is there any final comment you would like to share?

AC: I think we're in an interesting market, and we've talked about this many times over recent years, where we have some parts that are extraordinarily expensive and we have focused on that here. However, there is the other side of the market, the real companies that have been ignored that are valued sensibly, that are in a position to benefit from the economic environment we're in. Again, going back to 2000, that's exactly what we had back then, where people at that time, only had eyes for the tech sector. It's very similar and the lesson from that time, was not to just avoid the over-hyped and expensive stocks, but to buy the other stocks that people wanted to ignore.

MSCI Regional Index Net Returns to 31.12.2021 (USD)

REGION	QUARTER	1 YEAR
All Country World	6.7%	18.5%
Developed Markets	7.8%	21.8%
Emerging Markets	-1.3%	-2.5%
United States	10.0%	26.5%
Europe	5.1%	16.2%
Germany	0.8%	5.3%
France	7.1%	19.5%
United Kingdom	5.6%	18.5%
Italy	5.6%	15.0%
Spain	-1.4%	1.4%
Russia	-9.2%	19.0%
Japan	-4.0%	1.7%
Asia ex-Japan	-1.2%	-4.7%
China	-6.1%	-21.7%
Hong Kong	-3.5%	-3.9%
Korea	-0.9%	-8.4%
India	-0.2%	26.2%
Australia	2.1%	9.4%
Brazil	-6.5%	-17.4%

Source: FactSet Research Systems.
Total returns over time period, with net official dividends in USD.
Historical performance is not a reliable indicator of future performance.

MSCI All Country World Sector Index Net Returns to 31.12.2021 (USD)

SECTOR	QUARTER	1 YEAR
Information Technology	12.6%	27.4%
Utilities	10.2%	10.1%
Real Estate	8.9%	22.8%
Consumer Staples	8.3%	11.1%
Materials	7.1%	14.8%
Health Care	6.7%	17.5%
Consumer Discretionary	6.1%	9.0%
Industrials	5.5%	16.1%
Financials	3.1%	24.4%
Energy	2.8%	36.0%
Communication Services	-1.6%	10.4%

Source: FactSet Research Systems.
Total returns over time period, with net official dividends in USD.
Historical performance is not a reliable indicator of future performance.

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

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