Platinum European Fund

Nik Dvornak
Portfolio Manager

Performance

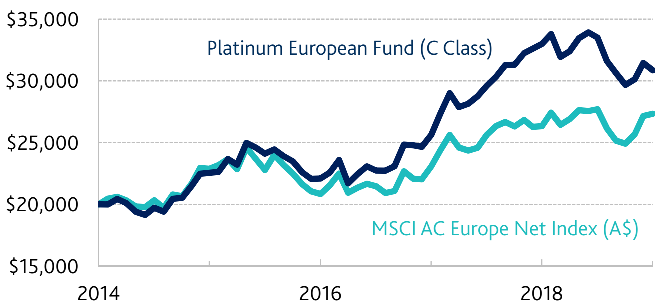
(compound pa, to 31 March 2019)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum European Fund*	4%	-6%	12%	9%	11%
MSCI AC Europe Index^	10%	4%	9%	6%	3%

* C Class – standard fee option. Inception date: 30 June 1998.
After fees and costs, before tax, and assuming reinvestment of distributions.
^ Index returns are those of the MSCI All Country Europe Net Index in AUD.
Source: Platinum Investment Management Limited, FactSet.
Historical performance is not a reliable indicator of future performance.
See note 1, page 5. Numbers have been subject to rounding adjustments.

Value of $20,000 Invested Over Five Years

31 March 2014 to 31 March 2019



After fees and costs, before tax, and assuming reinvestment of distributions.
Historical performance is not a reliable indicator of future performance.
Source: Platinum Investment Management Limited, FactSet.
See notes 1 & 2, page 5.

During 2018, investor concerns coalesced around two key issues: slowing economic growth in China and rising interest rates in the US. These concerns weighed heavily on stock prices, afflicting emerging markets in the first instance, then spreading to developed markets later in the year.

As we entered 2019, the US Federal Reserve surprised the market by signalling a halt to its tightening campaign. It indicated that interest rate increases would be put on hold and attempts to unwind Quantitative Easing (QE)[1] would be curtailed. This change in stance eradicated one of the two main concerns tormenting investors. Bond yields fell and stock markets rallied vigorously in response.

The Platinum European Fund (C Class) returned 4.0% over the first three months of 2019.

The best performing segments were those that are most sensitive to interest rates. This includes fast-growing businesses whose life-time earnings mostly accrue in the distant future, as well as slow-growing businesses with defensive earnings and high dividend payouts (the so-called bond proxies).

The worst performing segments were those with cyclical earnings. The data coming out of China were mixed, while the Federal Reserve's change in stance implied slower growth in the US, adding to investor concerns.

Our portfolio is increasingly skewed to businesses with cyclical earnings. We have modest exposure to fast-growing businesses and almost no exposure to the bond proxies. This largely explains why our performance lagged the broader market in recent months.

Commentary

But why have we invested so heavily in cyclical businesses?

As a starting point, we don't set out to construct the portfolio in a certain way. The investment process works the other way around. We investigate a broad range of investment ideas at the company level and invest in those we think have merit. Our portfolio positioning is a by-product of these decisions. It just so happens that the opportunities that

1 QE provides liquidity to the bond market, driving yields lower. The winding back of QE reduces the liquidity in the market and therefore drives yields higher.

are currently appealing to us are increasingly clustered in the cyclical category.

Investors today are assigning tremendous value to safety and predictability. The best example of this is the global bond market where some US$10 trillion worth of bonds are currently trading at negative yields. To be clear, if you buy these bonds, you are guaranteed to lose money. This is not so much investing as voluntary taxation. Yet investors are buying these bonds because they are so risk averse that a small loss with certainty is preferred to the wide range of possible outcomes that uncertainty can bring.

In the stock market, this phenomenon is reflected in the high valuations paid for businesses with defensive but growing earnings. Equally, it is evident in the very low valuations assigned to businesses whose earnings are subject to the vagaries of economic cycles.

Such polarisation creates great opportunities. The most tangible way to demonstrate this is through a real-life example. In the table below we show the growth and profitability of two well-known European companies over the period between 1998 and 2018.

	COMPANY A	COMPANY B
Growth (1998-2018)		
Sales growth (p.a.)	6%	19%
Profit growth (p.a.)	11%	20%
Profitability (1998-2018)		
Return on capital employed (p.a.)	21%	31%
Profit margin	12%	20%
Current valuation		
Price-to-earnings	36x	12x
Volatility of earnings growth		
1 standard deviation range	1% to 21%	-33% to +73%

Source: FactSet, Platinum Investment Management Limited.

Company A grew sales at an average compounded rate of 6% p.a. and earnings at 11% p.a. This is an impressive track record of growth. However, Company B has performed much better, growing sales at 19% p.a. and earnings at 20% p.a. To illustrate the difference, over a 20-year period, Company A grew earnings 7½-fold while Company B grew earnings 40-fold.

Company A averaged a 12% profit margin and a 21% return on capital employed (RoCE) over this period, testifying to the quality of this business. However, it was once again outshone by Company B, which averaged a 20% profit margin and a staggering 31% return on capital employed.

These statistics are backward looking and the future may well be different to the past. However, two decades are a sufficiently long time period to include many episodes of adversity and provide a good sense of the mettle of each business.

At this point most people would gravitate towards Company B. It has grown much more quickly and has been considerably more profitable over a long period of time. But this is not reflected in its valuation. Company A trades on 36x earnings, while company B trades on just 12x earnings. What's going on?

Company A is Lindt, the Swiss chocolatier. Demand for chocolate is considered recession-proof. Lindt has a strong brand and an excellent global distribution network, insulating it from competition and bestowing it with a degree of pricing power. Its earnings are highly defensive. They grow slowly but steadily each year. Over the last 20 years, the typical change in its earnings ranged between +1% and +21%. Lindt's earnings rarely fall.

Company B is Ryanair, a European airline. Airlines are notoriously difficult businesses. Demand is fickle. Supply regularly overshoots. Competition is fierce. Ryanair is a pure price taker with largely fixed costs, making earnings terribly volatile. Over the last 20 years, the typical change in its earnings fluctuated between -33% and +73%. This year, earnings are likely to fall by over 30% and this is not uncommon.

Knowing the identity of these companies will likely curtail enthusiasm for Company B. Instinctively, people will want to discount its higher growth and profitability to adjust for the higher risk. The market valuation may even begin to seem plausible. Yet, this is where one needs to tread carefully. The identity of the companies is new information and human beings have a natural urge to respond to new information. ***But is this new information actually relevant***? Or is it merely triggering a deeply ingrained bias?

Company B (Ryanair) is a great business with an outstanding track record. This remains true. It also happens to be an airline; a brutal business with volatile earnings. But it has always been an airline! Over the last 20 years, Ryanair has grown its earnings 20% p.a. and averaged a 31% return on capital employed, ***by being an airline***. During this period the industry was savaged by the World Trade Centre attacks, SARS (severe acute respiratory syndrome) and the global financial crisis. Yet, Ryanair did not once report an operating loss. Over the last decade, Europe experienced two recessions and a sovereign debt crisis. Yet, Ryanair's profitability matched that of the much lauded Coca Cola Company. Airlines may be terrible businesses, but nobody seems to have told Ryanair.

Nor is Lindt without its challenges. New brands face lower barriers to entry than ever, thanks to digital marketing and online retailing. Consumer tastes are skewing to products that are authentic, craft and artisan, sentiments which global mass market brands inherently struggle to evoke. Supermarkets are increasingly devoting premium shelf space to their own-label products. Promotions are becoming increasingly frequent to fend off competition, but risk eroding brand cachet. With a proliferation of flavours, Lindt must walk a fine line between being innovative and appearing ridiculous.

Lindt is a fine business that we've owned in the past. But its moat is shrinking, it is facing non-trivial threats and is valued on a multiple that means even a slight misstep can be very costly. Lindt is not a very risky business. But it may well prove to be a risky investment while the rewards seem slim.

Ryanair is a fantastic business that faces plenty of challenges. It is valued as if all manner of things will go wrong, which they mostly probably will. That's just business as usual. But if things go only a little right for them, investors stand to make handsome gains. Ryanair is a risky business. But it is not necessarily a very risky investment and the rewards are potentially very high.

So returning to the original question: Why are we so heavily invested in cyclical stocks? Today, investors are clamouring for safety and predictability. The Lindt and Ryanair examples showcase how this affects the opportunity set at the individual stock level. We think opportunities like Ryanair are quite attractive on a risk-reward basis. Conversely, on the same basis, we think Lindt is downright scary. The portfolio skew to cyclical stocks reflects many decisions like these at the individual stock level, rather than a preference for cyclicality or a macroeconomic view.

This investment approach is what Platinum has consistently practised for 25 years. It does occasionally result in periods of significant underperformance. However, Platinum's long-term track record testifies to the enduring merits of this approach.

Changes to the Portfolio

During the last three months we have trimmed a number of our better performing positions. These included **Roche** (Swiss multinational healthcare company), **Scout24** (digital marketplace operator specialising in real estate and automobiles) and **Schibsted** (international media group). We also added to a number of existing positions, mostly in Eastern Europe, and initiated a couple of new positions such as **Ryanair**.

Disposition of Assets

REGION	31 MAR 2019	31 DEC 2018	31 MAR 2018
Germany	19%	19%	23%
Switzerland	11%	11%	9%
UK	10%	9%	15%
Norway	9%	9%	4%
Spain	8%	7%	5%
Austria	7%	8%	8%
France	6%	4%	2%
Romania	5%	4%	1%
US*	5%	3%	2%
Poland	3%	3%	0%
Ireland	3%	2%	1%
Italy	2%	2%	3%
Russia	2%	2%	6%
Denmark	2%	2%	3%
Hungary	1%	1%	2%
Netherlands	1%	0%	1%
Cash	7%	13%	15%
Shorts	-8%	-8%	-2%

* Stocks that are listed on US exchanges, but whose businesses are predominantly conducted in Europe.
See note 3, page 5. Numbers have been subject to rounding adjustments.
Source: Platinum Investment Management Limited.

Net Sector Exposures ^

SECTOR	31 MAR 2019	31 DEC 2018	31 MAR 2018
Industrials	23%	21%	17%
Financials	18%	18%	25%
Health Care	11%	10%	9%
Consumer Discretionary	9%	7%	10%
Energy	8%	8%	6%
Communication Services	7%	7%	7%
Materials	5%	4%	7%
Information Technology	4%	4%	4%
Other	2%	2%	0%
Consumer Staples	-2%	-1%	-1%
TOTAL NET EXPOSURE	85%	79%	84%

^ A major GICS reclassification was implemented during the December 2018 quarter. The changes affected the Information Technology, Communication Services (previously Telecommunication Services) and Consumer Discretionary sectors. Historical exposures have been updated for continuity.
See note 4, page 5. Numbers have been subject to rounding adjustments.
Source: Platinum Investment Management Limited.

For further details of the Fund's invested positions, including country and industry breakdowns and currency exposures, updated monthly, please visit https://www.platinum.com.au/our-products/pef.

Net Currency Exposures

CURRENCY	31 MAR 2019	31 DEC 2018	31 MAR 2018
Euro (EUR)	41%	36%	33%
Swiss franc (CHF)	15%	11%	6%
Norwegian krone (NOK)	13%	13%	9%
British pound (GBP)	12%	13%	17%
Czech koruna (CZK)	8%	13%	12%
US dollar (USD)	3%	5%	13%
Polish złoty (PLN)	3%	3%	0%
Romanian leu (RON)	3%	2%	6%
Danish krone (DKK)	2%	2%	3%
Hungarian forint (HUF)	1%	3%	3%
Australian dollar (AUD)	<1%	<1%	-2%

See note 5, page 5. Numbers have been subject to rounding adjustments.
Source: Platinum Investment Management Limited.

Top 10 Holdings

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Schibsted ASA	Norway	Comm Services	4.2%
Glencore PLC	Switzerland	Materials	4.2%
Raiffeisen Bank International	Austria	Financials	4.0%
TechnipFMC	UK	Energy	3.6%
Roche Holding AG	Switzerland	Health Care	3.4%
Siemens AG	Germany	Industrials	3.3%
RELX PLC	UK	Industrials	3.1%
Applus Services SA	Spain	Industrials	3.0%
Siemens Gamesa Renewable	Spain	Industrials	3.0%
IHS Markit Ltd	USA	Industrials	2.9%

As at 31 March 2019. See note 6, page 5.
Source: Platinum Investment Management Limited.

Outlook

Following the global financial crisis, Europe has addressed a range of economic and financial vulnerabilities. Competitiveness has been restored, as evidenced by current account surpluses across the region. Private sector indebtedness has been reduced. Government budgets are generally drifting from a deficit position to a surplus. These changes leave the European economy much more resilient to shocks than was the case a decade ago.

European economic growth is currently slowing. However, the weakness is largely confined to exports and manufacturing. This is consistent with experiencing a large external shock, namely slower economic growth in China. Now the world's second largest economy, China is an important trading partner for Europe.

Yet this shock has had minimal impact on the broader economy. Domestic-facing sectors remain resilient. The services sector remains comfortably in expansion territory. Unemployment continues to fall, while labour force participation rates are high and continue to rise. Wages continue to grow and this growth is accelerating, not slowing. House prices are rising. Construction activity remains robust. Private sector credit is expanding again. While both consumer and business confidence have retraced, they remain at high levels.

We continue to see the greatest risks as being on the political front. Populist and nationalist sentiment continues to build across the region. Britain is set to leave the European Union imminently with receding hopes of an accord being reached. Europe is likely to be next in the firing line with respect to possible trade sanctions, should the US reach a deal with China. However, asset prices are increasingly reflecting these concerns.

The most encouraging phenomenon for us is that markets are becoming ever more polarised. Companies with certain traits are held in extremely high regard while others are deeply out-of-favour. Such divergence will inevitably create opportunities and we have been finding plenty of them.

Notes

1. Fund returns are calculated using the net asset value (NAV) unit price (which does not include the buy/sell spread) of the stated unit class of the Fund and represent the combined income and capital returns of the stated unit class over the specified period. Fund returns are net of fees and costs, are pre-tax, and assume the reinvestment of distributions. Returns for P Class are net of any accrued investment performance fee.

   The MSCI Index returns are in Australian Dollars and are inclusive of net official dividends, but do not reflect fees or expenses. For the purpose of calculating the "since inception" returns of the MSCI Index, the inception date of C Class of the Fund is used. Where applicable, the gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist then. Fund returns are provided by Platinum Investment Management Limited; MSCI index returns are sourced from FactSet.

   Platinum does not invest by reference to the weightings of the Index. A Fund's underlying assets are chosen through Platinum's bottom-up investment process and, as a result, the Fund's holdings may vary considerably to the make-up of the Index that is used as its reference benchmark. Index returns are provided as a reference only.

   The investment returns shown are historical and no warranty can be given for future performance. Historical performance is not a reliable indicator of future performance. Due to the volatility in the Fund's underlying assets and other risk factors associated with investing, investment returns can be negative, particularly in the short-term.

   The stated portfolio values of C Class and P Class of the Platinum International Fund (PIF) do not include funds invested in PIF by the Platinum International Fund (Quoted Managed Hedge Fund), a feeder fund that invests primarily in PIF. The stated portfolio values of C Class and P Class of the Platinum Asia Fund (PAF) do not include funds invested in PAF by the Platinum Asia Fund (Quoted Managed Hedge Fund), a feeder fund that invests primarily in PAF.
2. The investment returns depicted in this graph are cumulative on A$20,000 invested in C Class (standard fee option) of the specified Fund over the specified period relative to the specified net MSCI Index in Australian Dollars.
3. The geographic disposition of assets (i.e. the positions listed other than "cash" and "shorts") represents, as a percentage of the Fund's net asset value, the Fund's exposures to the relevant countries/regions through direct securities holdings and long derivatives of stocks and indices.
4. The table shows, as a percentage of the Fund's net asset value, the Fund's exposures to the relevant sectors through direct securities holdings as well as both long and short derivatives of stocks and indices. In the case of the Platinum Unhedged Fund, the Fund does not undertake any short-selling. Its net exposures are therefore the same as its long exposures.
5. The table shows the effective net currency exposures of the Fund's portfolio as a percentage of the Fund's net asset value, taking into account the Fund's currency exposures through securities holdings, cash, forwards, and derivatives. The table may not exhaustively list all of the Fund's currency exposures and may omit some minor exposures.
6. The table shows the Fund's top 10 long equity positions as a percentage of the Fund's net asset value, taking into account direct securities holdings and long stock derivatives. The designation "China" in the "Country" column means that the company's business is predominantly based in mainland China, regardless of whether the company's securities are listed on exchanges within mainland China or on exchanges outside of mainland China.

Disclaimers

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