Platinum International Fund

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Performance

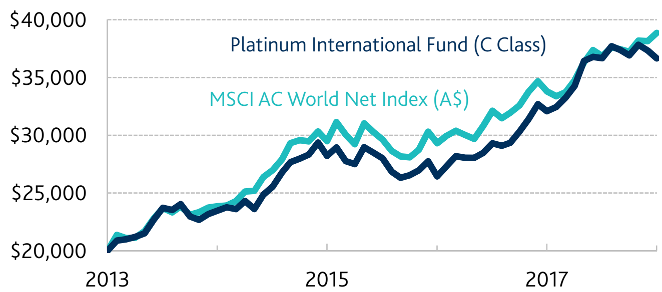
(compound pa, to 30 June 2018)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Int'l Fund*	-1%	14%	9%	13%	13%
MSCI AC World Index	4%	15%	10%	14%	7%

Net of accrued fees and costs. Refer to note 1, page 6.
*C Class – standard fee option. Inception date: 30 April 1995.
Source: Platinum Investment Management Limited, FactSet.
Historical performance is not a reliable indicator of future performance.

Value of $20,000 Invested Over Five Years

30 June 2013 to 30 June 2018



Fund returns are net of accrued fees and costs. Refer to note 2, page 6.
Source: Platinum Investment Management Limited, FactSet.
Historical performance is not a reliable indicator of future performance.

Disposition of Assets

REGION	30 JUN 2018	31 MAR 2018	30 JUN 2017
Asia	35%	37%	37%
Europe	21%	22%	19%
North America	18%	14%	18%
Japan	12%	14%	13%
Australia	<1%	<1%	0%
South America	<1%	1%	<1%
Russia	<1%	1%	1%
Cash	13%	11%	12%
Shorts	-15%	-14%	-9%

Source: Platinum Investment Management Limited. See note 3, page 6.

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/pif.

Top 10 Holdings

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Samsung Electronics	Korea	IT	2.8%
Alphabet Inc	USA	IT	2.8%
Ping An Insurance Group	China	Financials	2.6%
TechnipFMC	UK	Energy	2.4%
Glencore PLC	Switzerland	Materials	2.4%
Facebook Inc	USA	IT	2.3%
Siemens AG	Germany	Industrials	2.3%
Royal Dutch Shell PLC	UK	Energy	2.0%
Jiangsu Yanghe Brewery	China	Consumer Staples	2.0%
Intel Corporation	USA	IT	1.9%

As at 30 June 2018.
Source: Platinum Investment Management Limited. See note 4, page 6.

The features of the markets that we highlighted in the first quarter continued to be expressed in the second, namely, greater volatility in markets, tightening credit and a flattening of economic indicators like the PMIs. This caused a pronounced divergence in the performance of the emerging markets, perceived typically as being dependent on and the recipients of capital flows from the so-called developed markets.

The big change was the shift in perception about the US dollar. The blend of loose fiscal policy emanating from the tax cuts and tight monetary policy, together with the second federal funds rate rise this year, led to a rapid strengthening of the US currency. Further guidance from the Fed of two more rises likely later in the year reinforced this tendency. There were of course a diverse range of other factors. The US domestic economy showed no signs of slowing, the European Central Bank indicated that it was in no hurry to return to positive rates before mid 2019, and political intrigue reached fever pitch.

The home of Machiavelli put on a splendid performance of political theatre following the March election while not too far to the north, Frau Merkel was tussling with her alliances to deal with the European-wide consternation about illegal immigration. Hard-line anti-immigration legislation was passed in Hungary, threatening imprisonment for anyone found to have helped or legally represented asylum seekers. While Macron was trying to inveigle the Germans into closer European fiscal bonds, Brexit droned on with recalcitrant 'remainders' seeking stronger assurances from Theresa May about the terms of severance.

MSCI Regional Index Net Returns to 30.6.2018 (AUD)

REGION	QUARTER	1 YEAR
Developed Markets	**6%**	**15%**
Emerging Markets	**-4%**	**12%**
United States	**7%**	**18%**
Europe	**2%**	**9%**
Germany	0%	6%
France	3%	14%
United Kingdom	7%	14%
Japan	**1%**	**15%**
Asia ex Japan	**-2%**	**14%**
China	0%	26%
Hong Kong	3%	13%
India	3%	11%
Korea	-6%	7%
Australia	9%	13%

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

Almost drowning out these developments were the much publicised negotiations between Donald Trump and the leader of North Korea, Kim Jong Un. These talks apparently ended the threat of a nuclear fallout with much acclaim being attributed to the American president. Inexplicably, no sign of gratitude was extended to China who, by closing almost all supply corridors to North Korea, essentially forced a positive outcome. Instead, there was a hardening of the position of the White House on trade with China in an attempt to enforce more favourable trade concessions and greater protection of intellectual property rights. These issues were far from resolved as we entered July and fears of tit-for-tat that targets individual companies is a relatively new development for the market to consider. The White House also chose to pick fights with its trading partners in NAFTA (the North American Free Trade Agreement). None of this gives any reassurance to markets in terms of supporting business confidence.

However, massive takeovers of the likes of 21st Century Fox and Time Warner, though fewer than in the first quarter, are still running at a frenetic pace and serve as a reminder of the inevitable restructuring of older industries in the face of fundamental change. This was underlined by huge raising of private equity, a record-breaking US$453 billion in 2017 and a further US$80 billion in the first quarter of 2018,[1] and impressive raisings by initial coin offerings (or ICOs) amounting to US$12 billion year to date,[2] despite recent falls in the value of Bitcoin and other cryptocurrencies (as our December 2017 feature article suggested they might).

1 Source: Preqin

2 Source: www.coinschedule.com/stats/html

MSCI All Country World Sector Index Net Returns to 30.6.2018 (AUD)

SECTOR	QUARTER	1 YEAR
Energy	14%	29%
Information Technology	8%	31%
Consumer Discretionary	7%	20%
Health Care	6%	9%
Utilities	5%	7%
Materials	4%	18%
Consumer Staples	2%	3%
Industrials	1%	10%
Telecommunication Services	-1%	-1%
Financials	-2%	9%

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

None of these perturbations were helpful to our position. Though we have virtually no exposure to the emerging markets of Latin America or others like Turkey, Russia or South Africa which were violently sold off on account of US dollar indebtedness, large trading nations like China, Japan and Korea were adversely affected by the turbulence. As the MSCI Regional Index Net Returns table on the preceding page shows, emerging markets fell by 4.4% over the quarter while Japan was also weak relative to the stand-out performer which was the US, which rose by 7.4% in AUD terms. The resource plays that worked in our favour were energy producers which continue to benefit from tight supplies and solid demand. In addition to our heavy exposure to Asia, there were other casualties among our stocks, notably Pandora, the Danish purveyor of inexpensive jewellery, Bharti Airtel, the Indian mobile service provider, and Rakuten, Japanese e-commerce company, which we had been selling.

Lastly, we lost about -0.5% on our short positions over the quarter, while contribution from currencies was flat. The result was a very disappointing quarter where we lost ground and surrendered part of the strong performance we had enjoyed over the last 12 months. For the quarter the Fund (C Class) recorded a loss of -0.7%, and for the year we achieved +14.2%. This was slightly shy of the performance of the MSCI AC World Net Index (A$) for the year.

Changes to the Portfolio

As the quarter progressed we began to raise more cash, both to capture some strong price rises and also to make way for the large impending year-end distribution. The positions in **Hyundai Motor**, **Inpex** and **Norilsk Nickel** were sold as was most of the holding in potash producer, **K+S**. Both Norilsk and K+S gave reasonable returns while Hyundai has been disappointing because of boycotts in China and its slow response to meet the market trend towards SUVs. The return from Inpex was enhanced by our additions during periodic setbacks, but as a long-term holding, it fell short of our anticipated return. Delays and capex overruns on the giant US$40 billion Ichthys LNG project were to be expected, but the disappointment lay in the management's guidance regarding the degree to which shareholders will participate in future cash flows from this massive Browse Basin LNG project.

The important buys for the quarter were further additions of **Facebook** and initial purchases of **Kasikornbank** in Thailand, the shale gas producer **Seven Generations** in Canada and the regional bank **Suruga** in Japan. We described the case for Facebook last quarter, and while there are ongoing issues with data privacy, the case stands.

Kasikornbank remains a family owned and managed bank and is among the 'big 4' in Thailand with around 15% of the system's deposits and loans. **The arbitrage is principally boredom.** There seems to be nothing remarkable happening. The Thai economy is growing with a hint of acceleration. There is very little inflation and the current account surplus is running at close to 10% of GDP. Foreign exchange reserves are US$200 billion and the memories of the 1997-98 melt-down have barely faded.

What separates Kasikornbank from the others is its preference for small company lending (63%) and **a strong and cheap deposit base** comprising current and savings accounts that represent 79% of funding. Over the cycle it has earned spreads of about 1% higher than competitors because of its preference for small business lending, but offsetting this have been credit costs that are above industry average by about 0.5% a year. The net effect is that the *ex post* 'realised' return on equity over the last 10 years has been about 15% per annum, of which 2% p.a. has been distributed to shareholders as dividends. The capital position is extraordinarily strong with Tier 1 capital of 15.4%, and this is after a rather protracted and difficult credit cycle starting with the floods in 2011, the slowing of growth in the region led by China in 2013, and the coup in 2014. Non-performing loans tripled between 2013 and 2016 and are now declining. This **sets up the system and Kasikornbank nicely for the next credit growth cycle** and **even if it is muted, a slight improvement in loan growth and falling provisions should accelerate earnings growth** to high single or even low double digits. Starting with a price-to-book ratio of 1.3x and a prospective price-to-earnings ratio of under 11x, this seems like a great bargain for a well-funded bank in a relatively stable home market.

As a producer of natural gas, natural gas liquids and condensate (a light oil used as a diluting agent to blend with oil sands bitumen to improve flow in pipelines), **Seven Generations Energy** is an interesting opportunity to participate in the unfashionable Canadian exploration and production sector. Pipeline capacity constraints are the concern for Canadian producers, as evacuation difficulties tend to suppress regional hydrocarbon prices. 7G didn't help its case by tending to over promise, and after ramping up from a very small base to become Canada's largest condensate producer at nearly 200,000 BOE/d (barrels of oil equivalent per day), it is **now going through a production reset**. The leadership has changed, technical issues addressed and projections lowered, but which still suggest volume growth of some 7% to 14% p.a. over the next five years. Free cash flow begins in the second half of this year as above-ground investment stabilises and the company's gas processing plant comes on line.

Central to the case is a highly contiguous 500,000 acre position in the over-pressured, liquids-rich sweet spot of the Montney Kakwa River area of Alberta. We believe the economics are as good as those in the Permian Basin, supported by the very **high condensate yields**. This product is an ideal diluent and faces growing demand from Alberta's fast expanding oil sands production. While over 60% of well economics are driven by liquids revenues, 7G has underpinned its future production growth **by locking in long haul pipeline capacity to the US**. (It was this take-or-pay agreement that partly explained the helter-skelter growth drive initiated by the former management which led subsequently to above-average well decline rates and other operational problems.) As the company drills more wells – it has only sunk 200 to date, with the potential of over 1000 – the pre-investment in above ground handling will provide considerable leverage to free cash flow which we estimate will exceed US$1 billion by 2022 at current hydrocarbon prices. The company is capitalised at just under US$4 billion.

Shorting

This has not been our finest quarter. One or two of the individual stock positions made positive returns but the volatility of the more daring shorts cost us, as did the index positions. As noted above, shorts subtracted -0.5% from our returns this quarter and -1.3% over the last 12 months.

Currency

The principal change was to increase the exposure to the US dollar by 4% out of the Korean won and the Euro.

CURRENCY	30 JUN 2018	31 MAR 2018	30 JUN 2017
US dollar (USD)	26%	22%	30%
Hong Kong dollar (HKD)	13%	14%	11%
Euro (EUR)	12%	14%	14%
Japanese yen (JPY)	11%	12%	10%
Chinese yuan (CNY)	7%	7%	4%
Korean won (KRW)	6%	8%	7%
British pound (GBP)	6%	5%	3%
Indian rupee (INR)	5%	5%	7%
Australian dollar (AUD)	5%	3%	4%
Norwegian krone (NOK)	2%	3%	6%

Source: Platinum Investment Management Limited. See note 6, page 6.

Commentary

With the tightening that we noted last quarter and the more recent political disharmony in Europe as well as between the US and its principal trading partners, one can certainly see the need for caution. In general, **our research reveals that the areas of greatest value lie in Japan, Korea and Taiwan**, but indeed they are each open trading economies. In Japan the contrasts are stark. The entire listed corporate sector has a market capitalisation of US$6 trillion, yet in aggregate its cash and deposits sit at US$2.3 trillion. This is remarkable given that it was the excessive use of debt that led to their downfall and now the boot is on the other foot, yet stock prices barely endorse this! The following table highlights some of these ratios versus the world average for listed companies.

	JAPAN	KOREA	TAIWAN	WORLD AVERAGE
Net debt-to-equity ratio(1)	34%	24%	7%	50%
Return on capital employed	13.4%	13.5%	17.8%	12.0%
Trailing P/E	15.6x	11.0x	15.8x	21.0x
Trailing weighted EPS growth in USD - 5 years	11.8%	8.7%	12.4%	5.0%
Trailing weighted EPS growth in USD - 10 years(2)	3.8%	5.8%	2.9%	2.1%
Foreign exchange reserves - months imports	19	9	20	11
Current account surplus to GDP	4%	5%	13%	0%

(1) Excludes cross-shareholdings and investments.

(2) This measures earnings from the pre-GFC peak levels.

Source: FactSet, MSCI, IMF and CEIC.

These measures hardly suggest that these Asian countries are economic cripples or that their companies in aggregate have performed particularly badly against the global average. The fact is that they have surpassed the world average on each measure, yet their stocks are more modestly priced. The common thread is that these are relatively open economies with massive exchange reserves and evidently competitive economies. **Along with China, these markets have been punished of late. Is this because of the changing perceptions about global trade which is no longer expanding faster than the world economy in aggregate?** Even if we are at the early stages of the demise of mercantilism, we feel comfortable that we can still identify very interesting individual companies!

Now, we know that the US economy is booming and that there has just been a huge fiscal transfer, thanks to the tax cuts. But why should we be particularly optimistic about the US economy relative to others? The government's funding requirement is huge, with the need to find buyers in the next three years for some US$3 trillion of federal debt to meet refinancing and new issuance. This at a time when the traditional buyers of US government debt from the Middle East, Japan and China are, if anything, looking to reduce their exposure. In addition, corporate debt in the US is now over 57% higher than in 2007, and remember, with all the cash sitting on the balance sheets of the 'FANG'-like companies, implying considerable concentration of debt elsewhere.[3] **We are intrigued that high corporate debt levels as well**

3 Aggregate market cap of the Russell 2000 Index is US$2.6 trillion. Net debt is around US$1.1 trillion. Debt-to-equity ratio is approximately 41%.

as underfunded pension schemes do not receive more sanction in the light of rising interest rates.

Moving from the general to the particular, we can find industries with **growth prospects that are to a high degree independent of their host economies**. These originate from either the **regulatory environment or the inevitable evolution of technology**. Sometimes these are niche opportunities, others are tangentially related. For example, a lot of threads can be drawn from the impending International Maritime Organisation regulation that requires ships worldwide to **cut sulphur emissions** from 3.5% m/m (mass on mass) currently to 0.5% by 2020. Designated emission control areas (ECAS) such as the Baltic Sea area, the North Sea area and the coastal areas off North America are subject to an even stricter limit of 0.1% m/m. To achieve these much reduced levels of pollution, shipowners will need to consider replacing old style bunker fuel with low sulphur fuel oil blends, replacing or converting propulsion units to dual fuels incorporating LNG, installing 'scrubbers' (exhaust gas cleaning systems), or even scrapping uneconomic vessels. Among other things, this has huge ramifications for the increased demand for refined diesel fuel – perhaps as much as 4 million barrels *per day* (4% of primary oil production). This is great news for certain refineries, storage facilities, and perhaps also some shipyards.

In addition, the rise in shale liquids has further changed the **slate available to refineries**, which has implications for relatively obscure areas such as the production of needle coke. The shortages of this product, which goes into the fabrication of graphite electrodes (that require a very low coefficient of thermal expansion) for electric arc furnaces used in the steel industry, have been reflected in soaring prices, exacerbated by the Chinese beginning to ramp up scrap-fed electric-arc steel production.

Other regulations restricting **automobile emissions** have implications for the speed of adoption of electric vehicles (EVs) and hybrid drives, pointing to additional demand for metals such as copper, nickel and cobalt. This is not just a dream, because traditional auto companies are launching pure electric models, starting with Jaguar in the third quarter of 2018 and various German manufacturers next year. Chinese auto manufacturers are also launching EV products spurred on by government incentives. Adding to this demand for raw materials is the burgeoning demand from **stationary batteries** which are partly the product of the solar power boom that has continued to grow on account of rising efficiency and which has seen panel costs nose dive.[4]

The supply of more **wind power** has similarly been the product of falling costs borne on the wings of technical advances and cheap financing. The industry has seen its economics improve exponentially with electrical energy now being delivered to the grid in the US at US$40-50 per megawatt hour (MWh), which is on par with highly efficient coal-burning plants in low cost locations.[5] The emergence of financial intermediaries as the owners of these wind farms has incidentally enhanced the quality of the turbine manufacture businesses by virtue of granting **long duration service agreements**. We benefit from these various opportunities directly through our exposure to several companies in the portfolio.

We are also finding **interesting companies that are applying their product know-how to new applications**. For example, Murata, who have been progressively moving up the difficulty curve in making multilayered ceramic capacitors, can barely keep up with demand from the auto industry. Another Japanese company is finding new applications for its flexible printed circuits, such as LED lights in automobiles. Both companies have imminent growth generators derived from technical innovation and importantly, little exposure to demand destruction in their traditional activities. On the other side of the spectrum, the normally tame demand from gaming applications for graphic processing units (GPUs) has been disrupted by a surge of usage to mine cryptocurrency tokens such as Bitcoin. We believe the recent setback in this activity will lead to a likely de-stocking cycle to reward us on the short side of a very optimistically priced producer.

Outlook

There has been some fierce repricing of companies in Asia and the emerging markets in general. Trade disputes are damaging sentiment, but above all, the tightening of credit causes the most damage to valuations. After such a painful re-calibration of prices, we are inclined to believe that the Asian markets have adjusted to this new scenario. All indicators for the underlying economies of Asia are very solid, with scant evidence of slowing. While there is unlikely to be any near term let-up in the liquidity squeeze, we believe that valuations are extremely attractive, with, for example, the Chinese market on a prospective P/E of around 11 times. The portfolio is very attractively set at these levels. We would expect to see some upward price spikes as the fear around the trade disputes dissipate. We are maintaining shorts on the most aggressively priced segments of markets in the belief that if there is no relief to tighter money, these well-owned and extraordinarily highly priced sectors will also succumb to a reappraisal by investors.

4 Solar Choice suggests that solar prices in Australia have fallen from about $2.40 per Watt in 2012 to about $1.40 now.

5 A 4 July 2018 article in the Australian Financial Review suggests that solar and wind augmentation is starting to drive down prices in Australia from last year's panic levels. Yet, wholesale prices are still high by world standards at between $72 and $101 per megawatt hour.

Notes

1. Fund returns are calculated using the net asset value per unit (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 accrued fees and costs, are pre-tax, and assume the reinvestment of distributions. 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.

   Index returns are in Australian dollars and assume the reinvestment of dividends from constituent companies, but do not reflect fees and expenses. For the purpose of calculating the "since inception" returns of the MSCI index, the inception date of C Class of the Fund has been used. Where applicable, the gross MSCI indices were used prior to 31 December 1998 as the net MSCI indices did not exist then. Fund returns have been provided by Platinum Investment Management Limited; MSCI index returns have been sourced from FactSet.

   Platinum does not invest by reference to the weightings of any index or benchmark, and index returns are provided as a reference only. 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.

   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.

   Fund returns are calculated using the net asset value per unit (which does not include the buy/sell spread) of C Class of the Fund and represent the combined income and capital returns of C Class over the specified period. Fund returns are net of accrued fees and costs, are pre-tax, and assume the reinvestment of distributions. 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.

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3. The geographic disposition of assets (i.e. the positions listed other than "cash" and "shorts") represents the Fund's effective exposures to the relevant countries/regions as a percentage of the Fund's net asset value, taking into account direct stock holdings and long derivative positions (stocks and indices).

4. The table shows the Fund's top 10 long stock positions as a percentage of the Fund's net asset value, taking into account direct stock holdings and long derivative positions. 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.

5. The table shows the Fund's effective net exposure to the relevant sectors as a percentage of the Fund's net asset value, taking into account direct stock holdings and both long and short derivative positions (stocks and indices).

6. The table shows the Fund's effective exposures to the relevant currencies as a percentage of the Fund's net asset value, taking into account stocks holdings, cash and the use of derivatives.