# Platinum International Fund

**Kerr Neilson**
Portfolio Manager

**Andrew Clifford**
Portfolio Manager

**Clay Smolinski**
Portfolio Manager

## Performance

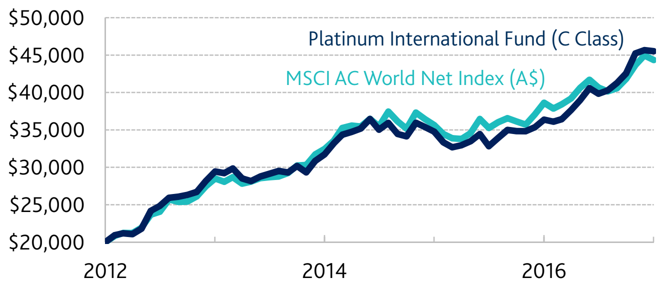
### (compound pa, to 31 December 2017)

| | QUARTER | 1YR | 3YRS | 5YRS | SINCE INCEPTION |
|---|---|---|---|---|---|
| Platinum Int'l Fund* | 7% | 25% | 13% | 18% | 13% |
| MSCI AC World Index | 6% | 15% | 11% | 17% | 7% |

*C Class – standard fee option. Inception date: 30 April 1995.
Refer to note 1, page ↓.
Source: Platinum Investment Management Limited, RIMES Technologies.
Historical performance is not a reliable indicator of future performance.

### Value of $20,000 Invested Over Five Years

31 December 2012 to 31 December 2017




Refer to note 2, page ↓.
Source: Platinum Investment Management Limited, RIMES Technologies.
Historical performance is not a reliable indicator of future performance.

## Disposition of Assets

| REGION | 31 DEC 2017 | 30 SEP 2017 | 31 DEC 2016 |
|---|---|---|---|
| Asia | 39% | 38% | 32% |
| Europe | 22% | 22% | 22% |
| North America | 16% | 17% | 21% |
| Japan | 14% | 13% | 13% |
| Russia | 1% | 1% | 1% |
| South America | <1% | <1% | 0% |
| Australia | <1% | <1% | 1% |
| Cash | 7% | 9% | 10% |
| Shorts | -12% | -11% | -16% |

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

For further details of the Fund's invested positions, including country and industry breakdowns and currency exposure, updated monthly, please visit https://www.platinum.com.au/Investing-with-Us/Investment-Updates.

## Top 10 Holdings

| STOCK | COUNTRY | INDUSTRY | WEIGHT |
|---|---|---|---|
| Samsung Electronics | Korea | IT | 3.1% |
| Ping An Insurance Group | China | Financials | 3.1% |
| Inpex Corporation | Japan | Energy | 2.8% |
| Alphabet Inc | USA | IT | 2.7% |
| Glencore PLC | Switzerland | Materials | 2.4% |
| TechnipFMC | UK | Energy | 2.2% |
| Lixil Group Corporation | Japan | Industrials | 2.2% |
| Royal Dutch Shell PLC | UK | Energy | 2.1% |
| PICC Property & Casualty Co | China | Financials | 1.9% |
| Tencent Holdings Ltd | China | IT | 1.9% |

As at 31 December 2017.
Source: Platinum Investment Management Limited. See note 4, page ↓.

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.

**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

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)!

Note the variances of performance by sector and country in the accompanying tables on the previous page.

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 (C Class) achieved respectively 7.0% and 25.1% 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 $228 today.[1]

This 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, including numerous individual positions within it. On measures of growth, profitability, leverage and value, **the 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.

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

## 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** and **Raiffeisen Bank**.

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 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.

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 stock specific shorts, which relate mainly to consumer brand names that are fighting valiantly to hold sales and/or margins against a changing retail environment, recovered slightly this quarter. These consumer companies remain expensive and growth challenged. The 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:

| CURRENCY | 31 DEC 2017 | 30 SEP 2017 | 31 DEC 2016 |
|---|---|---|---|
| US dollar (USD) | 22% | 28% | 33% |
| Euro (EUR) | 14% | 16% | 13% |
| Hong Kong dollar (HKD) | 14% | 12% | 11% |
| Japanese yen (JPY) | 10% | 9% | 4% |
| Korean won (KRW) | 8% | 8% | 6% |
| Chinese yuan (CNY) | 7% | 7% | -3% |
| Indian rupee (INR) | 6% | 6% | 6% |
| British pound (GBP) | 5% | 5% | 5% |
| Norwegian krone (NOK) | 5% | 4% | 9% |
| Australian dollar (AUD) | 3% | 2% | 19% |
| Chinese yuan offshore (CNH) | 0% | 0% | -6% |

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

## 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 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 this issue's feature article, *Bitcoin – A Primer*, by Sava Mihic, ***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.

## 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. 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 is 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 RIMES Technologies.

   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 fund over the specified five year period relative to the relevant 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. 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 exposure to physical holdings and long derivatives (of stocks and indices) as a percentage of the fund's net asset value.
4. The table shows the fund's top 10 long stock positions (through physical holdings and long derivatives) as a percentage of the fund's net asset value.
5. Sector breakdown represents the fund's net exposure to physical holdings and both long and short derivatives (of stocks and indices) as a percentage of the fund's net asset value.
6. The table shows the fund's major currency exposure as a percentage of the fund's net asset value, taking into account currency hedging.

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Some numerical figures in this publication have been subject to rounding adjustments. References to individual stock performance are in local currency terms, unless otherwise specified.

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