Platinum Japan Fund

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Portfolio Manager

Disposition of Assets

REGION	30 JUN 2018	31 MAR 2018	30 JUN 2017
Japan	91%	86%	95%
Korea	0%	0%	1%
Cash	9%	14%	4%
Shorts	-2%	-2%	-2%

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

Sector Breakdown

SECTOR	30 JUN 2018	31 MAR 2018
Information Technology	26%	23%
Industrials	17%	16%
Consumer Discretionary	13%	13%
Materials	11%	11%
Financials	9%	10%
Energy	8%	7%
Health Care	5%	4%
Telecommunication Services	1%	1%
Consumer Staples	-1%	-1%
TOTAL NET EXPOSURE	89%	84%

Source: Platinum Investment Management Limited. See note 5, page 6.

Currency Position

	30 JUN 2018	31 MAR 2018
Japanese yen	94%	95%
US dollar	4%	4%
Australian dollar	2%	1%

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

Performance

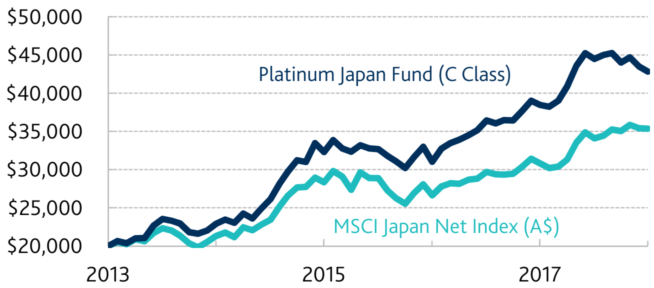
(compound pa, to 30 June 2018)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Japan Fund*	-3%	11%	10%	16%	15%
MSCI Japan Index	1%	15%	8%	12%	3%

Net of accrued fees and costs. Refer to note 1, page 6.
*C Class – standard fee option. Inception date: 30 June 1998.
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.

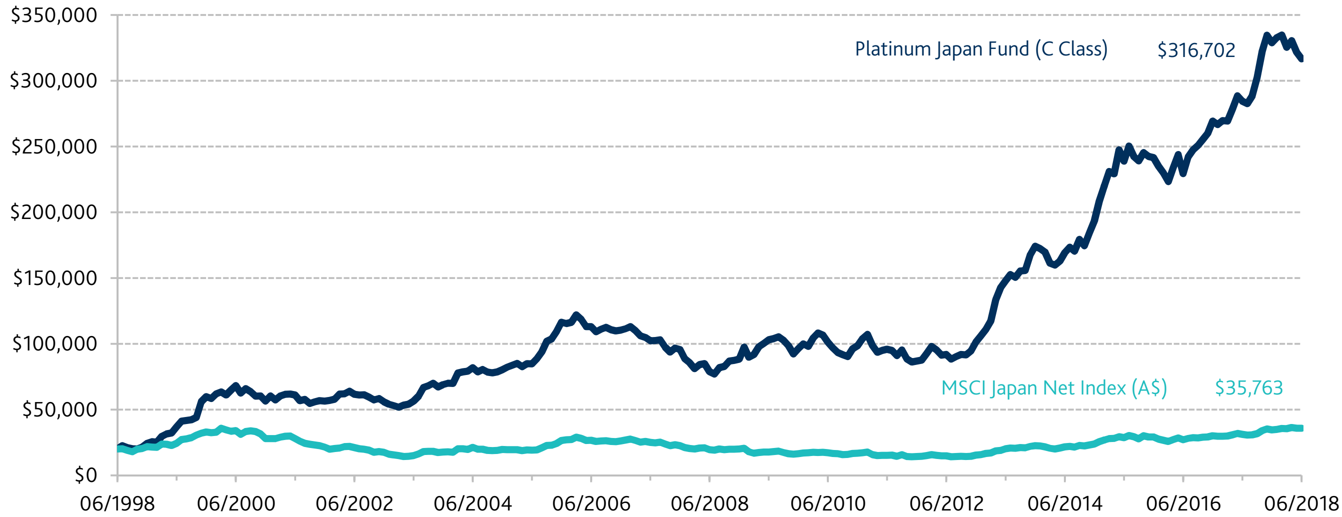
Top 10 Holdings

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Nexon	Japan	IT	4.0%
Murata Manufacturing Co	Japan	IT	3.4%
Nintendo	Japan	IT	3.4%
Itochu Corporation	Japan	Industrials	3.4%
Sumitomo Mitsui Financial	Japan	Financials	3.3%
Inpex Corporation	Japan	Energy	3.0%
Mitsubishi UFJ Financial	Japan	Financials	2.8%
Kyocera Corp	Japan	IT	2.6%
Sumitomo Metal Mining Co	Japan	Materials	2.6%
JAPEX	Japan	Energy	2.5%

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

Value of $20,000 invested in Platinum Japan Fund (C Class) from inception on 30 June 1998 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.

The Platinum Japan Fund opened in June 1998. The chart above illustrates the performance of the Fund (C Class) over the subsequent two decade period.

An investment of $20,000 in 1998 has grown at 15% per annum over twenty years and is now worth close to $320,000.

One estimate of the long-term nominal returns from 1900 to 2017, or more than a hundred years of global growth and dynamism, is tabulated below.

Developed world equities	8.4% per annum
Bonds	4.9% per annum
Real estate	4.2% per annum
Gold	3.6% per annum

Source: Blended estimates compiled by Dimson, Marsh and Staunton, published in the Credit Suisse Investment Returns Yearbook 2018.

Outlook

Unemployment rates in Japan are at multi-decade lows, corporate profitability has broken above the previous range, corporate behaviour is trending in the right direction and the political environment is stable. It is difficult to envision a more positive domestic environment, especially relative to the post-bubble decades following 1989. By contrast, the Japanese stock market is trading at roughly half its level in 1989. This has been one of the longest bear markets in modern financial market history. The current market valuation implies that today's unlevered Japanese corporate cashflows are far less valuable than the indebted position thirty years ago.

Yet, despite all the changes of the last decades, Japan still hasn't broken the domestic shackles, nor its interdependence with the rest of the world. This is reinforced by a recent anecdote. In almost all banking markets, deposits are precious. In Japan, it's the opposite. A senior executive at a mega bank recently hinted that one of the reasons for branch rationalisation is to reduce their deposit base. Across the broader system, deposits are still growing faster than loans and thus the system is becoming ever more liquid. Japanese inter-bank borrowing rates, which reflect the interest rates charged between banks, recently turned negative at the short end. This reflects both the excess liquidity in the system and participants' assessment of the robustness of the collateral in the financial system. After almost thirty years, Japan remains stuck in a liquidity trap.

Recent assessments of the actions taken by the Bank of Japan (BOJ) since 2012 have been generally positive. However, most large scale monetary interventions are made with both imperfect knowledge due to the complexity of the systems and acknowledgement of potential unintended consequences. Kuroda-san almost certainly targeted foreign exchange rates with his various actions. This focus on the exchange rate channel incentivised both hedged and unhedged overseas investment which was very profitable as the Yen weakened and global asset prices rose. However, there are many barriers to further overseas transfers, but none more so than the elevated price of high quality asset classes and the relative weakness of the Japanese yen. Future purchases might drop down the foreign asset quality spectrum, thereby increasing the opportunity set, but this entails taking long-tailed risks. If the post 2012 changes were to reverse, leading to a stronger currency, it would clearly show Japan's interdependence with the global economy and financial markets.

With the above context in mind, it is worrying that some recent market signals have started to show mounting global concerns. Such discussions are notoriously ephemeral. It is possible to reach very different conclusions from the same set of data. At the core of the current debate is the influence of debt and its contribution to stability and growth. The evidence from Japan's recent decades is that high asset prices fuelled by debt leads to instability. There is also a broad body of academic work leading to a similar conclusion. Asia's relative rise, in particular China's ambitions in the region and globally, together with the degradation of the mercantilist principle which has underpinned the post Bretton Woods economic system, adds further instability. Some see the recent rise in the oil price and US dollar strength as likely temporary, but the resultant ructions do highlight the fragility of some parts of the global economy.

While the Japanese stock market remains well placed for the medium- to longer-term, it is almost inconceivable that it would be immune to external disruptions, especially if the currency were to strengthen as capital returns home despite no need for it there.

It appears that the Australian dollar is poised to weaken, given escalating concerns about the external funding situation and questionable banking system collateral. It's worth highlighting that this is the opposite of the Japanese situation. It feels discordant that the total value of Australian residential real estate at A$7 trillion is roughly equivalent to the value of all gold ever mined, at US$7 trillion.

The Three Body Problem has been well explored recently in both the alternative financial press and literature. Simply, when three bodies orbit each other, there is no discrete formula to predict their paths. An iterative process is required to solve the problem. Given the complexity of global financial markets and the concept of reflexivity, it's clear that absolute answers are both unproductive and incorrect.

While the above discussion highlights uncertainty, the markets have acted with certainty. Investors have pushed the valuation dispersion to levels seen at previous peaks in 1987 and 2000. They have reacted to uncertainty by being certain about particular groups of companies, in particular those with earnings clarity, earnings growth and long-term opportunities. While this is indeed sensible, when any idea is taken to an extreme, it becomes dangerous. This behaviour has been evident for some time, but has likely now been taken to an extreme.

The Japanese equity market has been in a long bear market and is now valued attractively in an absolute sense. Combined with extreme valuation dispersion, it is easy to identify low valuations and attractive medium-term investments across broad parts of the market. Conversely, many stocks are valued with unbridled optimism. While this combination presents many opportunities, the complexity of the system and basic human psychological characteristics[1] make it both difficult and unhelpful to have delusional clarity of the timing of reversion.

Performance

The Fund fell -2.7% for the quarter and rose +11.3% for the year. This is somewhat surprising given the extension of the valuation dispersion which widened through the quarter and over the year. In brief, the "cheap stocks" got cheaper and the "expensive" or "defensive" stocks became more expensive. While recent portfolio performance is certainly not ideal, the alternative of a potential loss of capital by overpaying for "certainty" would be unpalatable.

Changes to the Portfolio

The shift highlighted in prior quarters towards the cheaper parts of the market continued. Cash positions also increased. The Fund remains invested in Japanese equities with zero weighting to Korea and a consequently high exposure to the Yen. The only notable change in portfolio constituents was the increased allocation to the discrete electronic components sector focused on MLCCs (see below commentary on the MLCC industry). Small short positions in a portfolio of expensive stocks have been added.

Commentary

The three defining aspects of the Japanese stock market at the moment are:

1. A 30 year bear market following the bursting of the bubble in 1989.
2. The low absolute valuation of the market when accounting for cross-shareholdings and cash and investment balances.
3. The valuation dispersion which is now approaching historical peaks.

The trading range of the last 25 years has led to a Pavlovian conditioning of the market, selling at the top of the range, buying towards the bottom. This behaviour won't change

1 See, for example, *Extraordinary Popular Delusions and the Madness of Crowds*, an early study of crowd psychology by Scottish journalist Charles Mackay, first published in 1884.

easily. Japan's households have 11% of their US$16.4 trillion financial assets invested in the stock market while their US counterparts have 36% invested in equities. The aggregate market capitalisation of all listed companies in Japan is roughly US$6 trillion with 15% or more cross-shareholdings, 4% BOJ ownership and US$2 trillion of surplus corporate cash. A small shift in asset allocation could have a large impact on the stock market! Sales of the latest edition of the *Japanese Company Handbook* are up 50% compared with last year, so perhaps interest is increasing at the end of a string of six years of gains.

These characteristics are evident in the individual stocks. A recent IPO of an artificial intelligence company listed at a valuation of 500 times sales. It was the biggest opening day for an IPO in the history of the Japanese market. In the same week, Itochu announced record earnings and gave projections for record earnings and dividends. Itochu's share price responded by falling. Itochu is now on an estimated current year P/E ratio of 6.6x, a dividend yield of 3.6% while generating a return on equity of 16.5%. This valuation is near historical lows. By contrast, GMO Payment is on an earnings multiple of 113 times this year's earnings. While this reflects their high growth rate, there are many capable competitors. Keyence, a true global champion is trading at 15.5 times sales, approaching its historical extremes. Many market participants are willing to pay a high price for growth.

This valuation dispersion has been evident for a few years. It may continue. However, our track record has been built on a foundation of patience and rigour. The current market is sorely testing these strengths.

By way of further example, the Fund currently owns a small position in NOK Corporation. The valuation is a P/E of 10x, P/S of 0.5x and P/B of 0.8x which is at the bottom of the five decade range. Half the balance sheet is cash and investments in addition to a large receivables balance. NOK is connected to Freudenberg, the large German industrial company with family direction and ownership, and together they produce 50% of the world's oil seals. NOK's other market position is the largest share of the global flexible printed circuit business. Apple has been a difficult customer, but there are some signs that this is abating.

The overall market is acting as though the currency is going to strengthen imminently. This is a major contributing factor to the valuation dispersion. Given the widening interest rate differentials, central bank attitudes and relative financial system structure, it would indicate that the Yen should weaken. The impediment to this is the current news vacuum. After twenty years of tight money led by the Ministry of Finance, the subsequent five years of Abenomics have been assessed as a success. Governor Kuroda and two like-minded deputies have been appointed to the BOJ, thus likely extending to Abenomics 2.0 and a new quiver of arrows. The final piece of the puzzle is the re-election of Prime Minister Abe who has recently seen a surge in popularity and is thus likely to go on to become Japan's longest serving prime minister. Interestingly, there has recently been a surge in overseas M&A activity outbound from Japan, perhaps indicating their belief that the success of the past five years will be extended to 2023.

While Korean valuations look very attractive, the main concern about the country is that its companies have a developed world cost structure but have not upgraded their product quality and composition to avoid low cost competition from China and other emerging areas. Their institutions and societal structures are reminiscent of a less developed market. These transitions are always difficult and the country has attempted to facilitate the shift with higher debt levels rather than undertake fundamental reforms. Many stocks in Korea are now approaching their historical low valuations.

While the focus of our portfolio construction has been on the valuation dispersion in Japan, an attempt has been made to identify where positive changes are occurring. Topics of interest include Chinese environmental tightening (LNG, chemicals, electric vehicles), automobile electrification and safety (components, OEMs), energy supply constraints, gaming (digital transactions, eSports, mobile), Apple supply chain (displays, wireless, FPC), SPE, silicon wafers, e-commerce, cloud computing.

The latest change to the Japanese tax code allows tax-free scrip acquisitions which has led to a flurry of deals. While it is glacial relative to Anglo expectations, corporate governance reform continues and will benefit many of the Fund's investments.

Discrete Components

Acronyms are an irritation. They exclude outsiders: ADAS, EV, HEV, LTE, SAW, IoT, HD, OLED, 5G, MIMO, OTT, 4k/8k, VR, ML, AI, LPWA, IaaS, PaaS. Other common words with novel meanings also create barriers: cloud, hyperscale servers, quantum computing, mobility as a service, sharing economy. At the end of this long economic expansion, acronyms are multiplying as many move from worrying about the past to scoping the future. Masayoshi Son, the CEO of SoftBank, exemplifies this shift. He is selling his stolid cash generating mobile phone businesses in Japan and the US. He is buying global unicorns and future growth businesses. The acquisitions have been backstopped by SoftBank's US$100 billion Vision Fund, itself based on a commitment of US$45 billion from Saudi Arabian Crown Prince Mohammed bin

Salman al-Saud. The Vision Fund has invested in Uber, ARM, Nvidia, WeWork, Flipkart, GM Cruise, Roivant and tens of other "visionary" companies.

It's a time of dreams and new realities.

Nevertheless, behind this miasma is a solid base of reality facilitated in part by another acronym, MLCC or multilayer ceramic capacitors. 300 billion of these tiny components are made each month, 3.6 trillion units per year! Capacitors are passive electrical components. They store potential energy in an electric field. Ceramic capacitors use nano-sized particles of titanium and barium oxide as a dielectric storage. These powders are applied to very thin nickel electrode foils and stacked hundreds of layers high. The final product is smaller than the head of a pencil. This industry exemplifies Japanese characteristics of persistence, long-term thinking and relentless pursuit of a project, often to the detriment of efficiency, but often with outstanding results. The capability of an individual MLCC chip has improved 50-fold over the last two decades!

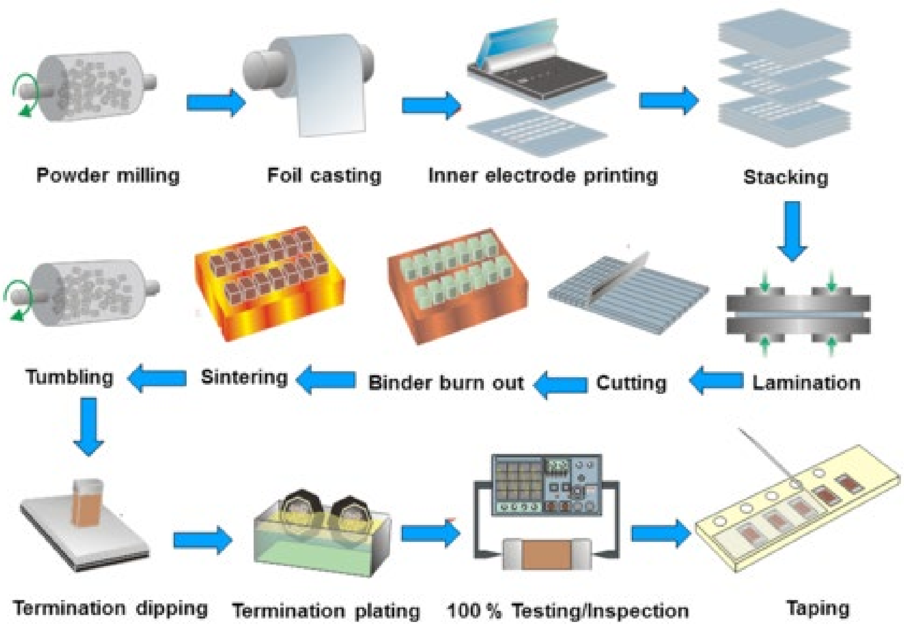
The first shortages of MLCCs were noted in early 2017. The Taiwanese were the first to raise prices through their distributors and were followed by the Koreans. A letter to customers from Berkshire Hathaway subsidiary TTI Inc, an MLCC distributor, describes the current market environment: "Now that we are in 2018, conditions are even worse than we anticipated", and "It is not unusual right now to see true demand increases (not artificial as a result of hedging) from customers of 30% or more year on year". Murata has a 40% market share of the global MLCC industry while Taiyo Yuden, TDK and Kyocera also produce high-end products. The Japanese have now started talking to their direct customer base about price rises. Industry operating rates are 100% and waiting times have extended out to many months.

The industry bottlenecks extend to the equipment suppliers and materials manufacturers, most of which are Japanese. The backlog at Hirano Tecseed has more than doubled in the last twelve months and extends well into the future.

While it's hard to see exactly where the broad increase in MLCC demand is occurring, Nissan's pioneering electric car, the Leaf, uses more than five times as many passive components as an internal combustion engine powered car. High-end mobile phones act as Veblen goods[2] and signallers of success but also use more and more components in the wireless modules and circuit boards.

Data consumption/generation is growing exponentially and there is no plateau in sight. But it seems that the acronyms are in the implementation phase and capacitor demand is being pulled through in a myriad of goods. Peering into the future, it's possible to envisage ubiquitous data, electric vehicles with dense electronification, connected devices with embedded artificial intelligence and immersive displays.

TTI describes the last decade thus: "production of MLCCs doubled but the value of the market remained flat". This implies 7% annual price declines. It also implies 7% annual production growth. This grinding road to a breaking point caused the current supply demand imbalance in the MLCC market which is now extending further and further into the electronics markets to include resistors, aluminium capacitors, resistors, inductors and power semiconductors. The Fund has a roughly 11% position in MLCCs (Murata, Taiyo Yuden, Kyocera), components (Rohm, Nichicon, Renesas) and equipment (Hirano Tecseed). This is also a wider phenomenon and bottlenecks can increasingly be seen across many real world product groups following a decade of under-investment.



MLCC manufacturing process. Source: Wikimedia Commons

2 Named after the American economist and sociologist Thorstein Veblen, "Veblen goods" are luxury goods for which demand rises as price rises, contrary to the usual laws of supply and demand, because of their exclusive nature and perceived value and appeal as a status symbol.

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.

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