Platinum Japan Fund

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Portfolio Manager

Performance

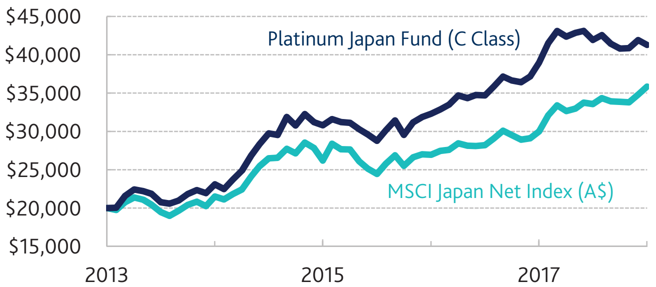
(compound pa, to 30 September 2018)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Japan Fund*	1%	6%	10%	16%	15%
MSCI Japan Index^	6%	20%	11%	12%	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 in AUD and are inclusive of net official dividends in AUD.
Historical performance is not a reliable indicator of future performance.
Source: Platinum Investment Management Limited, FactSet.
Refer to note 1, page 6. Numbers are subject to rounding adjustments.

Value of $20,000 Invested Over Five Years

30 September 2013 to 30 September 2018



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.
Refer to note 2, page 6.

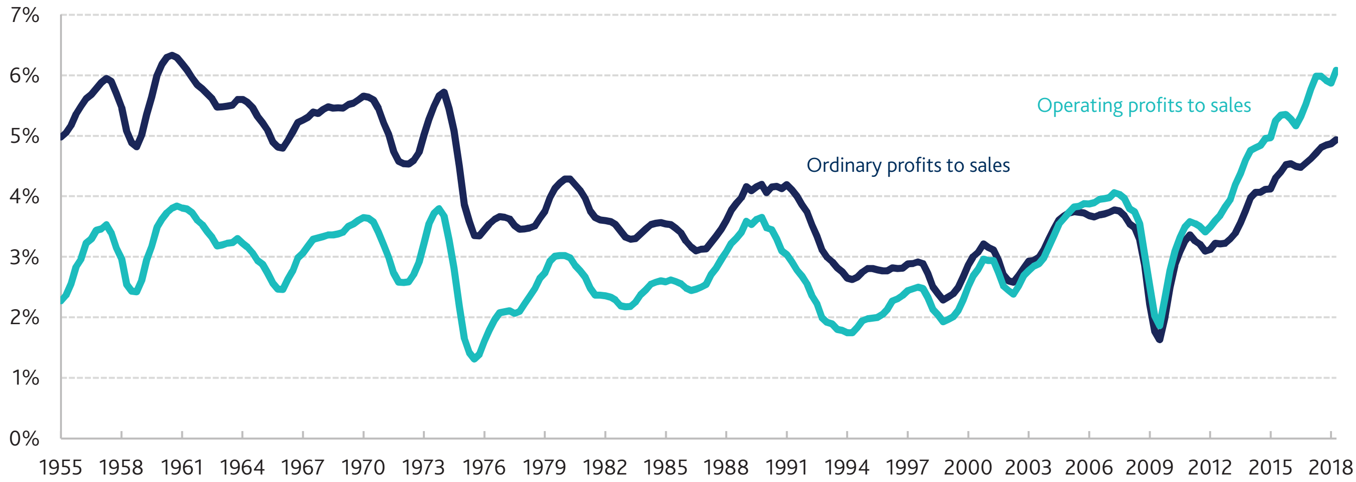
The Fund (C Class) rose 1.2% for the quarter and 5.9% for the year. The Fund has languished while some Japanese indices moved to 27 year highs. Although disappointing, this is not unexpected given the market's tendency towards momentum and quality, often from starting valuations that are difficult to rationalise. Some of these sectors, such as pharmaceuticals, stood out as expensive in terms of their absolute valuations. They were also expensive relative to global peers, even prior to their recent rapid gains. At the same time, the cheaper parts of the market have been shunned, including many companies selling at multi-decade low valuations. This has largely been under the guise of cyclicality, particularly for those sectors with exposure to the broader Chinese industrialisation theme, such as robotics, semiconductor production equipment, natural resources and machine tools. Driven by conservatism and risk management rather than greed and the fear of missing out, the portfolio's positioning has clearly been less than ideal for the current environment.

Commentary

Reality and perception are often diametrically opposed when trying to reconcile today's Japan against its recent decades and the dominant template of western performance and behaviours. It is often hard to isolate the reality even within Japan. **Chart 1** shows the movement of Japanese corporate margins over the last six decades. From a more recent perspective, it highlights the dramatic improvement in the last 20 years. Similar charts and statistics of female workplace participation, overall workplace participation rates, earnings-per-share (EPS) growth, real per capita GDP and immigration levels also highlight the slow but persistent change. After traversing the post-Bubble decades since 1989, there is a burgeoning domestic understanding and agreement on the path forward. This is not expressed as external confidence or strong statements, but can be seen in the Japanese people's actions, behaviours and outcomes.

On September 20th, Shinzo Abe was re-elected as leader of the governing Liberal Democratic Party and will serve a third consecutive term as the Prime Minister of Japan, thereby becoming the longest serving prime minister in Japan's history. This is in parallel with the appointment of Kuroda-san for a second term as the Governor of the Bank of Japan, a position he has held since 2013. Continuity and stability, rather than dislocation and uncertainty, are almost certain to be expressed as continued "soft money" nominal GDP

Chart 1 – Profit Margins of Japanese Companies



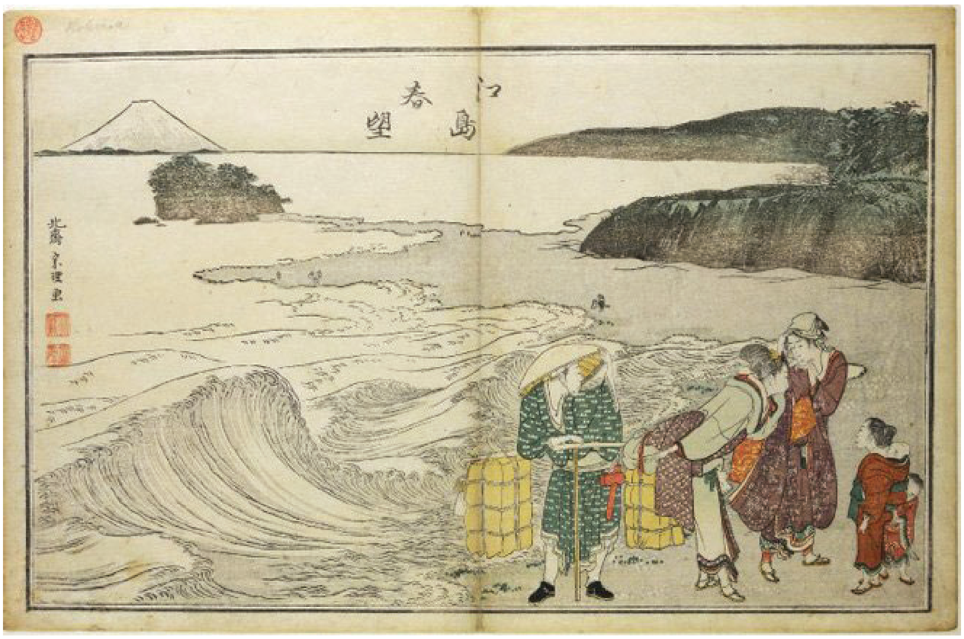
Source: Japan Ministry of Finance

targeting led by Kuroda-san's two newly appointed deputy governors. Similarly, the political path is likely to be more of the same with perhaps a renewed and reinvigorated "Three Arrows" program. There is some concern that the focus on the economy and reform might be waylaid by Abe-san's insistence on changing the 1947 Constitution to recognise Japan's right to self-defence by legitimising the existing Self-Defence Forces. His relentless quest to effect this change stems from Japan's reliance on imported food and fuel, which are dependent on clear trade routes currently presided over by a dominant foreign blue water navy. This reality explains many aspects of the Japanese psyche and the nation's interactions with the Asian sphere and the wider world.

During the quarter we spent two weeks visiting roughly 60 companies in Tokyo and Kyoto as the country was beset by winds, waves, storms and quakes. This served as a reminder of the origin of the conservative underlying nature of the Japanese people. A severe earthquake struck Hokkaido in the north of the archipelago and cut off power supplies to most of the island. A typhoon made a landing around Osaka and inundated the airport, closing it completely. At the same time, a large ship crashed into the airport bridge, dislodging some of the road girders.

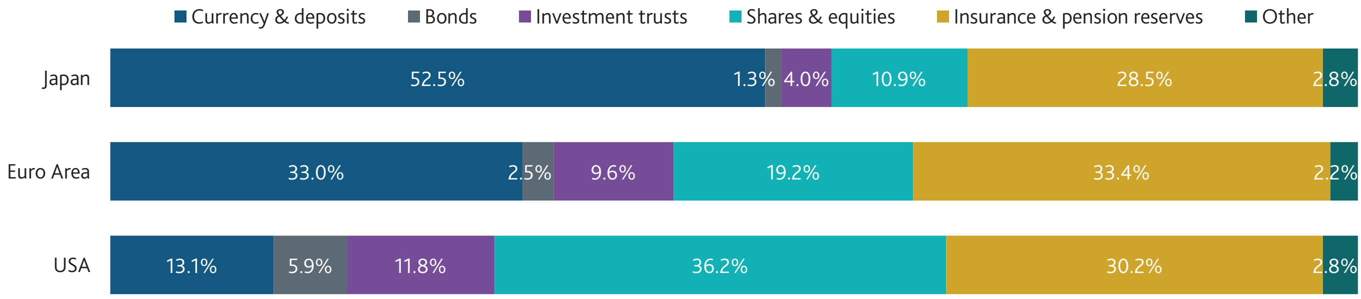
It might be a tenuous connection, but the financial management of the country somewhat reflects this acceptance of inevitable variability. Japan has a large foreign asset position, which is now earning a significant return. While the country has large ongoing expenses for food, fuel and low-end manufactured goods, their exports of high quality steel, sophisticated manufactures and high-end equipment roughly lead to a balanced trade position. The balance obviously fluctuates with key commodity prices and global trade cycles. However, the large foreign investment position continues to grow as earnings are reinvested in plant and equipment, and are augmented by acquisitions.

It was remarkable how quickly the disaster recovery occurred across the damaged areas of the country, as a cohesive effort repaired the airport and power supply grids and returned the system to full operation.



Great Wave, Hokusai, 1792. Source: https://mag.japaaan.com/archives/62662

Chart 2 – Breakdown of Household Assets



Source: CLSA, Bank of Japan, European Central Bank, US Federal Reserve Board

Japan's large foreign investment position is mirrored by large domestic household cash holdings and strong corporate balance sheets. Its household asset mix differs from other developed markets as shown in **Chart 2**. This large cash position has been highlighted in the past by traders and brokers with the hope that assets would shift towards the stock market and other higher yielding assets. In the last year, however, the opposite has happened as cash holdings have continued to grow.

Our company visits witnessed Japan's strengths in many areas, notably against tough, even brutal, Korean and Chinese competition. Companies like Yushin Precision, Komatsu, Toyota, Nitto Denko, Minebea, Murata, and Toyota Industries have been able to prosper in this environment. Softbank, Rakuten, Lixil, Takeda, Monotaro and Daikin are accelerating their overseas efforts. Domestic restructuring efforts continue in many parts of the market.

Japan is hosting the Rugby World Cup in 2019 and the Olympic Games in 2020. Thus there is a buzz of construction and restoration around the country in preparation for a wave of tourists atop the ongoing seemingly inexorable rise of inbound tourists from around Asia. The Tokyo real estate wealth and the first nationwide increase in land prices in 27 years has increased high-end discretionary spending in conjunction with IT sector wealth and profits accrued by business owners. However, the recent experience by the majority of the population is that costs are rising faster than wage increases, thus their finances have been squeezed, particularly families with children. Japanese wages are now low relative to most competitors. Thus over time there should be a positive flow across to the broader economy and a change of mindset. In the meantime, high asset prices relative to stagnant disposable incomes have led to instances of mortgage fraud. While Japanese asset prices seem cheap relative to global equivalents, they are often expensive relative to local wages, hence there is a domestic reluctance to bid up asset prices, a somewhat Pavlovian response to historical cycles.

Portfolio Review

The Fund owns three Japanese financials, which together comprise 9.3% of the portfolio. This group of companies, including Sumitomo Mitsui Financial, Mitsubishi UFJ and Orix, has an average price-to-earnings (P/E) multiple of 8.6x, a price-to-book (P/B) ratio of 0.7x and a dividend yield (DY) of 3.5%. The Fund owns three automobile industry stocks centred around Toyota. Together they comprise 3.5% of the portfolio and have an average P/E of 11x, a P/B of 0.9x, a DY of 2.7% and a price-to-sales (P/S) ratio of 0.8x. The Fund owns four businesses with utility style characteristics with an average P/E of 11.5x, a P/B of 1.5x and a DY of 3.5%. These valuations do not reflect the significant cash holdings and strong balance sheets of these companies, nor do they reflect the often significant treasury shareholdings resulting from ongoing buy-backs.

By way of contrast, the Fund has a 4% short position in two retailers which are among the largest employers in their respective sectors, particularly for part-time labour. The average valuation of these two companies is 30x P/E, 2.6x P/B and 1.8% in DY. Wage pressure, rising input costs, market saturation and consumer sensitivity to price increases are contributing to a difficult retail operating environment.

The Fund owns positions in three computer gaming companies, including Nintendo, totalling 9% of the Fund. On average, and adjusted for their significant cash holdings and treasury stock ownership, this group is on 10.7x P/E, 2.4x P/B and 2.6x P/S. The Fund also owns a portfolio of growing internet stocks, including Rakuten, with an average P/E of 19x and a DY of 1.5%. The Fund's healthcare holdings have an average P/E of 22.5x and a DY of 2.3%. These three groups of companies, comprising gaming, internet and healthcare, are expected to grow earnings faster than the overall market.

Again, by way of contrast, the Fund has a 5.5% short position in a portfolio of several companies across a variety of industries, including cosmetics, distribution, tourism and manufacturing. This group of stocks has an average P/E of 57x, a P/B of 13.8x, a DY of 0.4% and a P/S of 11x.

The Fund also owns groups of stocks in the energy sector, smartphone display industry, commodities, semiconductors and components. The valuations of these companies range from attractive to very attractive, but obviously have cyclical exposure. In some cases these companies have almost as much cash and investments as their current market capitalisation.

Investments are always made on a stock specific basis and the brief company discussions below attempt to illustrate the complexity of each case, the subtleties of market psychology and the broad dispersion in valuations across the market.

Inpex recently announced the first shipment of condensate from their Ichthys LNG mega-project located in the Browse Basin, 220 kilometres off the northwest coast of Western Australia. This is the start of the 40 year operational phase following the discovery of hydrocarbons in 2000 and commencement of project construction in 2012. The project is expected to produce 8.9 million tonnes of LNG, 1.6 million tonnes of LPG and 100,000 barrels per day of condensate at peak production. The total cost of the project is approximately US$40 billion, including the key components of the central processing facility, the floating, production, storage and offtake (FPSO) facility, and the underwater pipeline to Darwin, each of which was among the largest ever built by an industry renowned for engineering feats.

Condensate from Ichthys is a very attractive product with an API of 50, indicative of a relatively light hydrocarbon mixture which could yield 50-60% naphtha as feedstock for chemical industry steam crackers and 35% middle distillates for diesel and jet fuel. Exports of LNG and LPG from the project should commence towards the end of calendar year 2018.

The Fund has owned Inpex at various times, but built a large investment in 2016 as the oil price fell below US$40 per barrel and concerns of cost overruns at Ichthys returned. At the time, Inpex was selling at a valuation equivalent to roughly half of what they had spent to build their assets, with Ichthys being the key asset, giving very little credit for Inpex's long duration resource base.

Today, the oil price has risen above US$85 per barrel and the market is taking a more positive view of LNG markets, as highlighted by Royal Dutch Shell's recent approval of the next major greenfield LNG export facility on the west coast of Canada. The valuation of Inpex has risen and now appears reasonable. The return from three years of ownership has been attractive, but is rather disappointing given the risk profile and the rise in the oil price. Oil prices in local currencies in many parts of the developing world are now at record levels, which is likely to act as a significant headwind to overall global oil demand. This is important as demand growth is higher in less developed economies.

Disposition of Assets

REGION	30 SEP 2018	30 JUN 2018	30 SEP 2017
Japan	74%	91%	93%
Korea	3%	0%	2%
Cash	23%	9%	5%
Shorts	-10%	-2%	-2%

See note 3, page 6. Numbers are subject to rounding adjustments.
Source: Platinum Investment Management Limited.

Net Sector Exposures

SECTOR	30 SEP 2018	30 JUN 2018	30 SEP 2017
Information Technology	15%	26%	27%
Industrials	13%	17%	17%
Consumer Discretionary	11%	13%	15%
Financials	9%	9%	9%
Materials	8%	11%	10%
Energy	5%	8%	7%
Health Care	5%	5%	4%
Telecom Services	3%	1%	5%
Real Estate	1%	0%	0%
Consumer Staples	-2%	-1%	-1%
TOTAL NET EXPOSURE	67%	89%	93%

See note 4, page 6. Numbers are subject to rounding adjustments.
Source: Platinum Investment Management Limited.

Net Currency Exposures

CURRENCY	30 SEP 2018	30 JUN 2018	30 SEP 2017
Japanese yen (JPY)	94%	94%	69%
US dollar (USD)	12%	4%	28%
Korean won (KRW)	3%	0%	2%
Australian dollar (AUD)	-10%	2%	1%

See note 5, page 6. Numbers are subject to rounding adjustments.
Source: Platinum Investment Management Limited.

Top 10 Holdings

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Nintendo	Japan	IT	4.0%
Sumitomo Mitsui Financial	Japan	Financials	3.5%
Itochu Corporation	Japan	Industrials	3.5%
Mitsubishi UFJ Financial	Japan	Financials	3.2%
Kangwon Land Inc	Korea	Consumer Discretionary	3.1%
Takeda Pharmaceutical	Japan	Health Care	3.0%
Nexon	Japan	IT	2.9%
Rakuten Inc	Japan	Consumer Discretionary	2.7%
Ebara Corp	Japan	Industrials	2.7%
Orix Corp	Japan	Financials	2.6%

As at 30 September 2018. See note 6, page 6.
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/pjf.

Rakuten has been a frustrating investment for the Fund. While the business has developed mostly as expected with the exception of weakening margins in the core e-commerce business, CEO and founder Mikitani's decision to build a mobile phone network in competition with the three strong incumbents recently caused a significant drop in the share price. This presented an opportunity and a significant position was purchased. Since it was founded in 1997, Rakuten has grown into a business with annual revenue of around US$10 billion across e-commerce, communication, financial services, advertising and investments. Over the last 10 years, revenues have grown 16% per annum and the future opportunity looks similarly attractive. At the recent Rakuten Optimism conference in California, Mikitani reiterated his plans for future growth in combination with his renewed global ambitions.

Online apartment management service platform **Tateru** proved to be a bad investment despite high founder ownership and a reasonable starting valuation, especially relative to its historical growth rates. During the quarter it was discovered that some employees had been falsifying loan documents, similar to the behaviour discovered at Suruga Bank. While this doesn't seem to have been as systemic as at some other institutions, this fundamentally changes the perception of the organisation.

Itochu's valuation stands out as quantitatively cheap in a global context. CEO Okafuji took over in 2010 and focused on the daily activities of the business and the turnaround of its weaker subsidiaries. The strategy has been a success, though offset by some weak results from the company's major investments, such as Dole and CITIC. Itochu is a complex business to understand as there are some 300 subsidiaries, so the market at times focuses on commodity prices which are obviously variable. However, the core of the company is non-resource activities which were the foundation of the company and are performing better than expected. Itochu's share price is at record high levels. The valuation is 8 times earnings and a 3.7% dividend yield.

Pigeon is the dominant Japanese manufacturer of baby bottles and other child-rearing essentials. While the Japanese business is stagnant, their Chinese business has grown quickly and is almost half of corporate sales. Sales have grown 7% per annum over the last decade while profits have grown at 25% as margins expanded. The current valuation is the highest in the company's 60 year history – at 7 times sales and 45 times earnings. The company estimates its free cash flow yield at 1.6% from which they pay a 1% dividend yield. The Fund opened a short position in Pigeon after quarter end.

Nissan is currently valued at a level similar to other low points in the company's long history. Toyota Motors and the wider automobile sector, including the global comparatives, are similarly depressed. This is a broadly discussed phenomenon as the fear of disruption from Silicon Valley under the slogan of "Mobility as a Service" permeates the view into the future. There is no sign of this impact today. In fact, more readily available and convenient transport services such as Uber and Lyft have increased vehicle demand. Through this period of surging demand for SUVs and light trucks, the Japanese have retained their exposure to fuel efficient sedans and developed alternative drivetrains such as hybrids and electric cars which position them relatively well for a higher oil price environment. For context, the following table shows Nissan's current and historical valuations:

	DIVIDEND YIELD	PRICE-TO-BOOK RATIO
1987	2.5%	0.96x
1992	1.3%	0.95x
1998	2.0%	0.86x
2008	12.6%	0.49x
Today	5.5%	0.76x

Source: FactSet; estimates by Platinum Investment Management Limited.

The portfolio shifted towards higher cash levels, more conservative sectors and lower overall equity exposure during the quarter. A small short position on the Australian Dollar against the US Dollar was used to hedge some core holdings. This shift to more liquidity provides flexibility as and when opportunities present themselves.

Outlook

While global growth momentum remains positive, there are some signs of weakness, such as the declining Japanese machine tool sales for the first time in two years, declining semiconductor production equipment orders, and highly price elastic consumer behaviour. Against a backdrop of rising oil prices, rising interest rates, emerging market dislocations, loose financial conditions and high asset prices, it seems prudent to take a somewhat conservative stance. Some parts of the financial system are exhibiting behaviours consistent with highly optimistic outlooks. In fact, many indicators are so good that they likely cannot get better and are consistent with previous peaks in the cycle. This optimism is not irrational, given the widespread availability of cheap commodities and, in particular, cheap energy. The disruptive and educational impact of an amazing storage and compute device in the hand of every human should not be underestimated either. It's always hard to separate the structural from the cyclical, especially today as the solution to the financial problems faced late last decade has been more of the same, rather than slogging through a fundamental reassessment. The lesson from Japan's post Bubble decades was to heed the cyclical nature of the aftermath rather than emphasise the structural. This feels like the conservative and rational path especially against a background of trade dislocations and fundamental US Dollar funding imbalances.

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 long 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 effective net exposures 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).

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

6. 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.

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

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