Platinum Japan Fund

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Performance

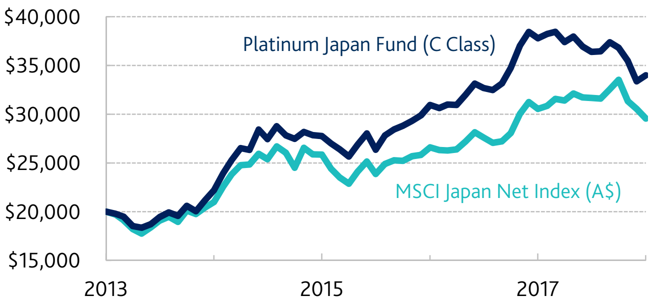
(compound pa, to 31 December 2018)

	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Japan Fund*	-8%	-10%	7%	11%	14%
MSCI Japan Index^	-12%	-3%	5%	8%	3%

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

Value of $20,000 Invested Over Five Years

31 December 2013 to 31 December 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.
See notes 1 & 2, page 5.

Portfolio performance for the last 12 months was negative as cyclical sectors and companies reliant on global economic growth were weak. The Yen was strong relative to most currencies, which offset the equity market falls to some extent. The weakest parts of the portfolio were companies with indirect exposure to Chinese growth and some stocks which had performed well over the last few years, often a combination of both. Valuation has not been good protection from market declines as many stocks of seemingly good value got cheaper. Towards the end of the year, cash holdings and short positions partly protected the portfolio against a quarterly index decline of more than 17% (in local currency).

Commentary

We view the following as the defining aspects of the Japanese stock market over the next five years:

1. The 30th anniversary of the 1989 stock market bubble is coming up. The multi-decade bear market that ensued the burst of the bubble has been one of the longest in modern financial market history.
2. Valuation dispersion across the Japanese stock market is at historical highs. Market participants have shunned any company exposed to cyclical growth or any type of uncertainty.
3. Absolute valuations for a wide range of high quality businesses are at or approaching the low end of their multi-decade trading range.
4. The external economic environment is still an important factor due to Japan's wide-ranging interactions with global trading partners, particularly Asia.

The latter attributes, particularly the absolute valuations and dependence on the external environment, also apply to Korea. This highlights the low valuations evident across North Asian stock markets.

The current portfolio positioning reflects the relative short-term importance of the last of the above four points. While the Japanese market remains very attractive from a medium-term perspective, the current backdrop is not encouraging, as discussed below. Cash holdings of 26% will be used to add to existing holdings or initiate new positions when very attractive opportunities become available. In the interim, a

16% short exposure is concentrated in three areas: 1) spuriously cheap cyclicals where growth is slowing and margins are under pressure, 2) expensive momentum stocks, and 3) expensive domestic companies experiencing margin pressure.

Implications of a Strong Yen

The Japanese Yen has strengthened in bursts over the last three years. It is currently at 108 Yen to the US Dollar, having bottomed around 125 in 2015. At today's exchange rate, it remains competitive globally.

As Japan is a large importer of energy and other basic materials, the domestic focus is to ensure that it remains a net exporter of complex manufactures and high-end materials for the long-term future of the nation. A co-ordinated approach to this end across all parts of the country has been successful despite significant headwinds, particularly the rise of China's manufacturing base. The current weakness in raw material prices, particularly oil, is an overall positive for Japanese and Korean consumers, but also contributes to strength in the Yen. The market's assessment appears to be that global shale oil production is a latent reservoir of significant size which, if correct, will be very positive for Japan's energy trade balance.

Last cycle, the Yen peaked at around 80 Yen to the Dollar in 2011 and 2012 before the advent of Abenomics changed the psychology. The ensuing period of windfall in Yen-denominated profits for owners of foreign assets induced a system-wide complacency and further capital outflows. The level of complacency is such that many foreign assets held by pension funds, insurance companies and the banking system are now unhedged and thus exposed to currency fluctuation. As the Yen strengthens and foreign asset values fall, the compounding effect on domestic balance sheets has led to a reversal of the outflows seen over the last five years, and this return of capital is further strengthening the currency.

Over the medium-term, there are two offsetting influences to Yen strength: potential further selling of Japanese equities by foreigners, and a fundamental desire by Japanese firms to augment their global footprints of investment portfolios and corporates. On the first topic, 40% of the Japanese share market is owned by foreigners and their trading makes up 60% of activity. Over the last few years, the market has worried about the trajectory of the Chinese economy. Rather than making any strong statements, the attitude seems to have been to avoid uncertainty and opaqueness. If this wariness continues, one of its possible expressions would be to sell shareholdings in companies listed in Japan, particularly those that are susceptible to China's slowdown.

As discussed above, there has been a desire by Japanese firms to shift assets overseas in search of higher returns. Through discussions with market participants over the last year, it is becoming clearer to us that the Japanese economy remains stuck in a classic liquidity trap, as exemplified by deposits rising faster than loans across the banking system. The system is becoming ever more liquid. The probability of large scale overseas investments and purchases by Japanese corporates and households is rising, especially as the currency strengthens.

Balancing the above four factors on the Japanese currency is difficult; at times it moves to extremes and presents attractive opportunities.

***Great Wave*, Hokusai, 1803.** Source: https://mag.japaaan.com/archives/62662

Disposition of Assets

REGION	31 DEC 2018	30 SEP 2018	31 DEC 2017
Japan	67%	74%	94%
Korea	7%	3%	2%
Cash	26%	23%	4%
Shorts	-16%	-10%	-2%

See note 3, page 5. Numbers have been subject to rounding adjustments.
Source: Platinum Investment Management Limited.

Net Sector Exposures ^

SECTOR	31 DEC 2018	30 SEP 2018	31 DEC 2017
Communication Services	17%	13%	16%
Information Technology	12%	6%	15%
Consumer Discretionary	10%	10%	14%
Industrials	7%	13%	17%
Energy	5%	5%	8%
Materials	5%	8%	12%
Health Care	3%	5%	4%
Financials	3%	9%	9%
Real Estate	<1%	1%	0%
Consumer Staples	-4%	-2%	-1%
TOTAL NET EXPOSURE	58%	67%	94%

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

Net Currency Exposures

CURRENCY	31 DEC 2018	30 SEP 2018	31 DEC 2017
Japanese yen (JPY)	85%	94%	71%
US dollar (USD)	41%	12%	24%
Korean won (KRW)	-6%	3%	2%
Australian dollar (AUD)	-20%	-10%	3%

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

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

Political and Macroeconomic Uncertainty

Recent global economic numbers have been weak. Considering Japan's strong currency in conjunction with the weak signals from across the Asian region, in particular China, it is not unreasonable to take a conservative view on Japanese asset prices. However, there are a wide range of further complications which make the outlook for asset prices uncertain. It's a long list of concerns that have been building over the last decade, but some are more important than others.

The global political environment is turning, as reflected in the protests in France, the protracted Brexit process, and ongoing hints of a presidential impeachment in the US. These are perhaps in part expressions of the underlying dislocations and tension resulting from the influence of China on the global manufacturing economy and its growing political influence across the world. The changing relationship between China and the US introduces a level of uncertainty, which is bad for asset prices generally.

While it has been unproductive and distracting over the last few decades to think about the historical context of events such as the Bretton Woods Agreement in 1944 and Nixon's closing of the gold window in 1971, the time for another significant adjustment to the global system seems to be coming closer as the stress in the system builds. It is unclear what and how changes would be made, and there is limited clarity on the likely outcome. But, needless to say, the myriad of implications on asset pricing would be significant.

The last decade of central bank intervention has resulted in an extended period of low market volatility and led some to conclude that the underlying problems had been addressed.

Top 10 Holdings

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Kangwon Land Inc	Korea	Consumer Discretionary	3.9%
Takeda Pharmaceutical	Japan	Health Care	3.9%
Itochu Corporation	Japan	Industrials	3.7%
Nexon	Japan	Communication Services	3.5%
KDDI Corporation	Japan	Communication Services	3.5%
Samsung Electronics	Korea	IT	3.5%
Nintendo	Japan	Communication Services	3.3%
NT&T	Japan	Communication Services	3.0%
Kyocera	Japan	IT	2.9%
JXTG Holdings	Japan	Energy	2.9%

As at 31 December 2018. See note 6, page 5.
Source: Platinum Investment Management Limited.

However, global debt levels and many asset prices are close to record levels, and many of the fundamental weaknesses that caused the disruptions in 2000 and 2008 have not been addressed. It's a complex system, in which equity prices are merely one expression of the overall situation. Behind the scenes, there is a large, perhaps even massive, derivatives position which has been of some concern for many years. This is not a new revelation. However, when volatility is low, the margin required to be held against those notional obligations – perhaps in the tens of trillions of dollars – is also low. The increasing volatility is itself an implicit margin call in a global environment of central bank tightening, Eurodollar system tightness, low global trade growth, low monetary base growth, and high asset valuations.

Changes to the Portfolio

Against what appears to be a difficult backdrop, there are still interesting opportunities presenting themselves. The challenge is to find enough unique opportunities.

Takeda recently completed its acquisition of Shire, which gives Asia's largest pharmaceutical company a global footprint and additional therapeutic areas for their aggressive collaborative R&D efforts. Takeda's share price fell as some shareholders, who received Takeda shares as part of the Shire deal, were forced to sell their holdings for reasons of jurisdictional restrictions under mandates, which provided an attractive purchase price for the Fund.

Rakuten's share price rose as the market came to accept that its entry into mobile network operations had advanced further than previously thought. This presented an opportunity to reduce our holding while maintaining a core position for the medium-term.

M3 is a fast growing medical services provider with low capital intensity. It sometimes describes itself as 'Facebook for doctors'. In mid-2018, M3's valuation was on an exorbitant trailing price-to-earnings (P/E) multiple of 78x and a price-to-sales (P/S) ratio of 14x. The company's share price has subsequently collapsed and our short position provided a good gain.

A visit to Bachem in Switzerland and Sosei outside Cambridge, England in late 2016 was a reminder of the long-term opportunities in the healthcare sector. A few years ago, **Sosei** was the most highly traded stock in Japan, trading more than even Toyota on a daily basis. We wrote about Sosei and its very interesting structure-based approach to drug design in the Fund's September 2016 quarterly report, but at the time the share price more than reflected the company's prospects, appealing as they were. Subsequently, Sosei's share price has fallen by more than 80%. While it's still early, a small position has been purchased for the Fund.

Outlook

The portfolio remains conservatively positioned with 26% in cash and 16% in shorts for a net exposure of 58%. Similarly, the currency positioning is conservative. While there are undoubtedly many very attractively valued companies, the political, economic and cyclical backdrop is a major concern.

Natural ecosystems exhibit variations and regular systemic dislocations. The actions of global central banks over the last decade, as they attempted to normalise the system, have had the unintended consequence of reducing variability and perceived risk. This unnatural state is unsustainable and the return to a more natural state will have many second and third order effects, some of which have clearly not been anticipated.

Nevertheless, experience has shown that owning a portfolio of serious companies that are already priced for a high degree of uncertainty, tends to provide above average long-term returns.

Notes

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

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

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

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

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

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