



Quarterly Investment Manager's Report

Platinum World Portfolios - International Fund
Platinum World Portfolios - Asia Fund
Platinum World Portfolios - Japan Fund

30 June 2018

Contents

Performance	3
Macro Overview by Andrew Clifford, CEO & CIO	4
Fund Updates	
PWP - International Fund	6
PWP - Asia Fund	11
PWP - Japan Fund	15

Performance

to 30 June 2018

SUB-FUND	PORTFOLIO VALUE (US\$ MIL)	QUARTER	6 MONTHS	1 YEAR	2 YEARS COMPOUND PA	SINCE INCEPTION COMPOUND PA	INCEPTION DATE
Platinum World Portfolios - International Fund							
Class A (USD)	\$46.3m	-3.1%	-3.6%	10.2%	16.0%	13.6%	27 Apr 2016
Class B (USD)	\$41.6m	-3.7%	-4.2%	9.6%	-	16.5%	2 Dec 2016
Class D (USD)*	\$14.5m	-3.7%	-4.2%	9.6%	15.6%	9.5%	16 Nov 2015
Class F (EUR)	\$8.1m	1.5%	-1.6%	7.3%	-	5.3%	4 Apr 2017
Class G (GBP)	\$9.9m	3.1%	-1.2%	8.9%	16.6%	18.9%	27 Apr 2016
Class H (GBP)	\$0.4m	2.4%	-2.0%	8.2%	-	14.4%	4 Aug 2016
MSCI All Country World Net Index (USD)		0.5%	-0.4%	10.7%	14.7%	11.4%	16 Nov 2015
Platinum World Portfolios - Asia Fund							
Class A (USD)	\$12.5m	-4.1%	-5.6%	13.5%	-	20.3%	10 Mar 2017
Class B (USD)	\$7.1m	-3.9%	-5.9%	13.8%	-	17.5%	20 Apr 2017
Class D (USD)*	\$17.6m	-3.9%	-5.9%	13.8%	19.1%	14.1%	16 Nov 2015
Class I (USD)	\$138.0m	-3.9%	-5.4%	14.1%	-	21.9%	19 Jan 2017
MSCI All Country Asia ex Japan Net Index (USD)		-5.4%	-4.8%	9.9%	18.0%	14.5%	16 Nov 2015
Platinum World Portfolios - Japan Fund							
Class A (USD)	\$10.6m	-4.3%	-7.9%	8.5%	17.0%	13.7%	11 Jan 2016
Class B (USD)	\$2.2m	-4.4%	-8.7%	8.5%	-	13.6%	23 Dec 2016
Class D (USD)*	\$20.1m	-4.5%	-8.7%	8.5%	17.8%	12.9%	16 Nov 2015
Class F (EUR)	\$0.3m	0.7%	-6.2%	-	-	-1.0%	18 Oct 2017
MSCI Japan Net Index (USD)		-2.8%	-2.0%	10.5%	14.8%	8.9%	16 Nov 2015

* Being the first share class activated, Class D is used as the reference class of the Fund and its inception date is used for the purpose of calculating the "since inception" returns of the Index.

Fund returns are net of accrued fees and expenses, are pre-tax, and assume the accumulation of net income and capital gains.

Historical performance is not a reliable indicator of future performance. Refer to note 1, page 20.

Source: Platinum Investment Management Limited for fund returns and FactSet for MSCI index returns.

Macro Overview

by Andrew Clifford, CEO & CIO, Platinum Investment Management Limited

We opened our March quarter Macro Overview with the following summary of issues that had led investors to return to a more cautious stance:

- rising interest rates in the US;
- the impact of China's financial system reform on that country's economy and on asset markets both inside and outside of China; and
- the potential for a trade war between the US and China.

Today, these issues continue to be at the forefront of investors' minds, and continue to drive a growing risk aversion by investors globally. As such, it is worth returning to these issues, even at the risk of repeating oneself.

Any analysis of the impact of a "trade war" is far from straightforward. Modelling by various economists suggests that China may lose up to 0.5% in economic growth in the more extreme outcomes. This may sound dramatic, but for an economy growing at around 6% to 7%, the potential impact is limited. In assessing the prospects of any given company, this macroeconomic effect is largely irrelevant. However, the tariffs that are being applied to imports by the US and by their trading partners in response most certainly will impact product prices, demand, and ultimately profits, which will be felt not only by the companies facing tariffs, but potentially also by their customers. A Chinese manufacturer may be hurt, but so will be a US retailer who potentially has to increase prices on the products it's selling. A US company now paying more for aluminium and steel faces a cost disadvantage against its competitors elsewhere in the world. US soybean farmers, whose production now attracts a tariff when sold to China, will most likely respond by selling their produce elsewhere, potentially suppressing prices for soybean growers in other countries. There will be many unintended consequences from the trade war. From the US perspective, one example is Harley-Davidson who have announced that they would move some production to Europe.

Exactly where the costs of these measures fall will become more apparent in the months ahead. Consumers will be paying higher prices for products, some companies will see an impact on their profitability and competitiveness, and jobs will be lost. Secondary effects such as the loss of business and lower consumer confidence impacting spending may also

become apparent in the US and elsewhere. What is not clear though is how severe and widespread these impacts will be. Nevertheless, it will be an interesting test of the US administration's resolve to maintain their trade policies once the costs are known. Changes to any system (for the better or worse) are usually very difficult to implement because entrenched interests are very effective at opposing them!

Last quarter we discussed the reforms in the Chinese financial system. To briefly recap, the regulator has required the banks to bring the assets and liabilities of the shadow banking system back onto their balance sheets. One of the goals in doing so is to ensure compliance with the lending restrictions that have been put in place. For example, following the GFC, regulators banned banks from lending to developers for land acquisition, but the shadow banking system provided a way around these rules. As the amount of loans a bank can issue is limited by its level of shareholders' funds, bringing these "shadow" loans back onto the balance sheet reduces the banks' capacity to issue additional loans, and some may even look to recover outstanding loans. As such, the availability of bank credit has been much reduced, and credit growth has fallen to just over 8%, a level much in line with the nominal growth of the economy.

While these reforms are undoubtedly a long-term positive for the Chinese financial system, the immediate question is whether this tightness in credit availability impacts the growth of the economy. Clearly, it has impacted the Chinese stock market, with the A share market down 22% from the highs reached in January, but indicators such as construction equipment, auto, and property sales still suggest robust levels of activity through to the end of May. Of course, the impact on the broader economy may yet become apparent, but policy makers in China certainly have the ability to respond if and when this happens. The People's Bank of China (PBOC) cut reserve requirements for banks in June, which freed up their ability to lend, and further cuts can certainly be made, if necessary.

In the US, the Federal Reserve raised interest rates again this quarter. As we have noted numerous times in our reports, rising interest rates will eventually bring about a slowing in the economy and a fall in stock prices. The difficulty is assessing exactly at what point interest rates will have risen far enough for their impact to be felt. One indicator often

used is the steepness of the yield curve. This refers to the difference in short-term and long-term interest rates. When short-term rates rise up towards the level of long-term rates, referred to as a flattening of the yield curve, it is usually indicative that the economy will soon start to slow. During the last quarter, the yield difference between the 10-year and 2-year US government bonds continued to narrow, reaching levels last experienced between 2005 and 2007.

The flattening of the yield curve certainly supports the view that we are starting to enter the final stages of the current US expansion. Nevertheless, for the moment, economic indicators in the US point to ongoing robust growth, undoubtedly buoyed by this year's tax cuts. One should also expect that at some point President Trump will announce his infrastructure initiatives which would add further fuel to the economy and reinforce upward pressure on interest rates.

Market Outlook

Fears around trade wars, tightening credit in China and rising rates have resulted in increased risk aversion and significant divergence in stock price performance over the last six months. Asian markets have been particularly weak with the China A share market down 22% from its high point earlier in the year, Japan down 10% and Korea down 11%.¹ Emerging markets also performed poorly during this period. While the US market was flat over the last six months, within this market, performance varied dramatically across sectors with investors favouring a narrow group of growth stocks in the technology and biotech sectors while financial and industrial stocks generally performed poorly. While in aggregate the MSCI All Country World Net Index indicates that global stock markets are up slightly year to date in local currency (+0.8%), though down -0.4% in USD terms, this narrowing of markets where a smaller number of stocks are responsible for holding up returns is often a signal that higher interest rates may be starting to impact the markets.

The Chinese A share market, as noted above, has been particularly hard hit by the issues outlined in our commentary. Of particular concern for local investors in this market has been the tightness in credit availability as a result of the financial reforms. The topic has been part of daily news and commentary in China for the last six months and the fear has been well and truly expressed for some time, though it has only recently been reported in the foreign financial press. Similarly, given that China is the prime target of President Trump's trade war and it has become clear that there wouldn't be a negotiated outcome, the trade tension weighed

heavily on the Chinese market towards the end of the quarter.

Currently the Shanghai A share index is back to the lows reached in January 2016. As you may recall, at that point the country had just been through a period of capital flight, heavy industry was plagued by excess capacity and many companies were loss making, and there loomed the possibility of non-performing loans triggering a banking crisis. Today, while the economy may be experiencing some slowdown as a result of changes in the financial system, supply side reforms have resolved the issue of excess capacity, profitability of heavy industry is much improved, and while the banking system is likely to have to work through some problem loans, the likelihood of a fully blown banking crisis is much lower. Risks have been reduced substantially, profits are higher, yet stock prices in aggregate are at the same level as they were two years ago. At an individual stock level, we see extraordinary value in a wide range of companies.

Of course, it is hard to know when these various fears will subside, allowing the market to move higher. One would expect the credit tightness created by the financial reforms to recede in time and it is likely that PBOC will take measures such as further cutting reserve requirements to ease the problem. The impact of tariffs at a company level should start to become obvious in the weeks ahead, although one can't predict future moves by the US administration. Overall, a combination of negative sentiment and attractive valuations are indicative of strong future returns from this market in coming years.

In other markets such as Japan, the divergence between the most highly valued and the least valued stocks in the market is at a record level. Elsewhere, outside of the much loved high growth technology and biotech stocks we are finding companies at interesting valuations. All this, we believe, bodes well for future returns. However, it is possible that before these returns can materialise, we may first see a correction in the prices of the high flying stocks, potentially precipitated by rising US interest rates.

¹ Referencing respectively the CSI 300, TOPIX and KOSPI indices, from their respective peaks in January 2018 to 28 June 2018.

Platinum World Portfolios - International Fund



Kerr Neilson
Portfolio Manager

Market Review

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

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

The home of Machiavelli put on a splendid performance of political theatre following the March election while not too far to the north, Frau Merkel was tussling with her alliances to deal with the European-wide consternation about illegal immigration. Hard-line anti-immigration legislation was passed in Hungary, threatening imprisonment for anyone

Performance

(compound pa, to 30 June 2018)

	QUARTER	1 YEAR	2 YEAR P.A.	SINCE INCEPTION P.A.
PWP Int'l Fund Class A USD	-3.1%	10.2%	16.0%	13.6%
PWP Int'l Fund Class B USD	-3.7%	9.6%	–	16.5%
PWP Int'l Fund Class D USD	-3.7%	9.6%	15.6%	9.5%
PWP Int'l Fund Class F EUR	1.5%	7.3%	–	5.3%
PWP Int'l Fund Class G GBP	3.1%	8.9%	16.6%	18.9%
PWP Int'l Fund Class H GBP	2.4%	8.2%	–	14.4%
MSCI AC World Index (USD)	0.5%	10.7%	14.7%	11.4%

Fund returns are net of accrued fees and costs. Refer to note 1, page 20.

Source: Platinum Investment Management Limited, FactSet.

Historical performance is not a reliable indicator of future performance.

found to have helped or legally represented asylum seekers. While Macron was trying to inveigle the Germans into closer European fiscal bonds, Brexit droned on with recalcitrant 'remainders' seeking stronger assurances from Theresa May about the terms of severance.

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

However, massive takeovers of the likes of 21st Century Fox and Time Warner, though fewer than in the first quarter, are still running at a frenetic pace and serve as a reminder of the inevitable restructuring of older industries in the face of

fundamental change. This was underlined by huge raising of private equity, a record-breaking US\$453 billion in 2017 and a further US\$80 billion in the first quarter of 2018,¹ and impressive raisings by initial coin offerings (or ICOs) amounting to US\$12 billion year to date,² despite recent falls in the value of Bitcoin and other cryptocurrencies (as our December 2017 feature article suggested they might).

None of these perturbations were helpful to our position. Though we have virtually no exposure to the emerging markets of Latin America or others like Turkey, Russia or South Africa which were violently sold off on account of US dollar indebtedness, large trading nations like China, Japan and Korea were adversely affected by the turbulence. As the MSCI Regional Index Net Returns table below shows, Emerging Markets fell by -8.0% over the quarter while Japan was also weak relative to the stand-out performer which was the US, which rose by +3.4% in USD terms. The resource plays that worked in our favour were energy producers which continue to benefit from tight supplies and solid demand. In addition to our heavy exposure to Asia, there were other casualties among our stocks, notably Pandora, the Danish purveyor of inexpensive jewellery, Bharti Airtel, the Indian mobile service provider, and Rakuten, Japanese e-commerce company, which we had been selling.

Lastly, we lost about -0.5% on our short positions over the quarter, while contribution from currencies was flat. The

1 Source: Preqin

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

MSCI Regional Index Net Returns to 30 Jun 2018 (USD)

REGION	QUARTER	1 YEAR
Developed Markets	2%	11%
Emerging Markets	-8%	8%
United States	3%	14%
Europe	-2%	5%
Germany	-4%	3%
France	0%	10%
United Kingdom	3%	10%
Japan	-3%	11%
Asia ex Japan	-5%	10%
China	-4%	21%
Hong Kong	-1%	9%
India	-1%	6%
Korea	-9%	3%
Australia	5%	9%

Source: FactSet. Numeric figures are subject to rounding. Total returns over time period, with net official dividends in USD. Historical performance is not a reliable indicator of future performance.

result was a very disappointing quarter where we lost ground and surrendered part of the strong performance we had enjoyed over the last 12 months. For the quarter the Fund (Class D) recorded a loss of -3.7%, and for the year we achieved +9.6%.

Changes to the Portfolio

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

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

Kasikornbank remains a family owned and managed bank and is among the 'big 4' in Thailand with around 15% of the system's deposits and loans. **The arbitrage is principally boredom**. There seems to be nothing remarkable happening.

MSCI All Country World Sector Index Net Returns to 30 Jun 2018 (USD)

SECTOR	QUARTER	1 YEAR
Energy	10%	24%
Information Technology	4%	26%
Consumer Discretionary	3%	16%
Health Care	3%	5%
Utilities	1%	3%
Materials	0%	14%
Consumer Staples	-1%	-1%
Industrials	-3%	6%
Telecommunication Services	-4%	-4%
Financials	-6%	5%

Source: FactSet. Numeric figures are subject to rounding. Total returns over time period, with net official dividends in USD. Historical performance is not a reliable indicator of future performance.

The Thai economy is growing with a hint of acceleration. There is very little inflation and the current account surplus is running at close to 10% of GDP. Foreign exchange reserves are US\$200 billion and the memories of the 1997-98 melt-down have barely faded.

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

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

Central to the case is a highly contiguous 500,000 acre position in the over-pressured, liquids-rich sweet spot of the Montney Kakwa River area of Alberta. We believe the economics are as good as those in the Permian Basin, supported by the very **high condensate yields**. This product is an ideal diluent and faces growing demand from Alberta's fast expanding oil sands production. While over 60% of well economics are driven by liquids revenues, 7G has underpinned its future production growth **by locking in long haul pipeline capacity to the US**. (It was this take-or-pay agreement that partly explained the helter-skelter growth

Disposition of Assets

REGION	30 JUN 2018	31 MAR 2018
Asia	34%	36%
Europe	20%	22%
North America	17%	12%
Japan	15%	17%
Australia	1%	1%
Russia	0%	1%
Cash	13%	11%
Shorts	-16%	-15%

Refer to note 2, page 20. Numeric figures are subject to rounding.
Source: Platinum Investment Management Limited.

For monthly updates of the Fund's invested positions, including country and industry breakdowns as well as currency exposure, please visit www.platinumworldportfolios.ie/Funds/InternationalMonthlyUpdates.

Sector Breakdown

SECTOR	30 JUN 2018	31 MAR 2018
Information Technology	23%	20%
Industrials	12%	12%
Financials	11%	12%
Materials	9%	11%
Energy	8%	9%
Consumer Discretionary	7%	9%
Health Care	6%	6%
Consumer Staples	2%	1%
Telecommunication Services	2%	1%
Real Estate	1%	2%
Utilities	1%	1%
Other*	-11%	-10%
TOTAL NET EXPOSURE	71%	74%

* Includes short positions of indices.

Refer to note 4, page 20. Numeric figures are subject to rounding.
Source: Platinum Investment Management Limited.

drive initiated by the former management which led subsequently to above-average well decline rates and other operational problems.) As the company drills more wells – it has only sunk 200 to date, with the potential of over 1000 – the pre-investment in above ground handling will provide considerable leverage to free cash flow which we estimate will exceed US\$1 billion by 2022 at current hydrocarbon prices. The company is capitalised at just under US\$4 billion.

Shorting

This has not been our finest quarter. One or two of the individual stock positions made positive returns but the volatility of the more daring shorts cost us, as did the index positions. As noted above, shorts subtracted -0.5% from our returns this quarter and -0.9% over the last 12 months.

Currency

The principal change was to increase the exposure to the US dollar while reducing our exposure to the Euro, the Korean won and the Australian dollar.

CURRENCY	30 JUN 2018	31 MAR 2018
US dollar (USD)	23%	19%
Japanese yen (JPY)	16%	16%
Hong Kong dollar (HKD)	15%	15%
Euro (EUR)	11%	18%
British pound (GBP)	10%	4%
Korean won (KRW)	6%	8%
Indian rupee (INR)	5%	5%
Chinese yuan (CNY)	3%	3%
Norwegian krone (NOK)	2%	2%
Australian dollar (AUD)	1%	4%

Refer to note 5, page 20. Numeric figures are subject to rounding. Source: Platinum Investment Management Limited.

Top 10 Holdings

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Alphabet Inc	USA	IT	3.1%
Siemens AG	Germany	Industrials	3.0%
Samsung Electronics	Korea	IT	3.0%
Intel Corporation	USA	IT	2.7%
Royal Dutch Shell PLC	UK	Energy	2.5%
Glencore PLC	Switzerland	Materials	2.4%
TechnipFMC	UK	Energy	2.3%
Facebook Inc	USA	IT	2.2%
Jiangsu Yanghe Brewery	China	Consumer Staples	2.2%
Murata Manufacturing	Japan	IT	2.2%

As at 30 June 2018. Refer to note 3, page 20. Numeric figures are subject to rounding. Source: Platinum Investment Management Limited.

Commentary

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

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

(1) Excludes cross-shareholdings and investments.

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

Source: FactSet, MSCI, IMF and CEIC.

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

Now, we know that the US economy is booming and that there has just been a huge fiscal transfer, thanks to the tax cuts. But why should we be particularly optimistic about the US economy relative to others? The government's funding requirement is huge, with the need to find buyers in the next

three years for some US\$3 trillion of federal debt to meet refinancing and new issuance. This at a time when the traditional buyers of US government debt from the Middle East, Japan and China are, if anything, looking to reduce their exposure. In addition, corporate debt in the US is now over 57% higher than in 2007, and remember, with all the cash sitting on the balance sheets of the 'FANG'-like companies, implying considerable concentration of debt elsewhere.³

We are intrigued that high corporate debt levels as well as underfunded pension schemes do not receive more sanction in the light of rising interest rates.

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

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

Other regulations restricting **automobile emissions** have implications for the speed of adoption of electric vehicles (EVs) and hybrid drives, pointing to additional demand for metals such as copper, nickel and cobalt. This is not just a dream, because traditional auto companies are launching pure electric models, starting with Jaguar in the third quarter of 2018 and various German manufacturers next year. Chinese auto manufacturers are also launching EV products spurred on by government incentives. Adding to this demand

for raw materials is the burgeoning demand from **stationary batteries** which are partly the product of the solar power boom that has continued to grow on account of rising efficiency and which has seen panel costs nose dive.

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

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

Outlook

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

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

Platinum Asia Fund



Joseph Lai
Portfolio Manager

Disposition of Assets

REGION	30 JUN 2018	31 MAR 2018
China [^]	48%	45%
Hong Kong	6%	5%
Taiwan	1%	2%
India	12%	12%
Korea	11%	10%
Thailand	4%	4%
Philippines	2%	2%
Singapore	1%	1%
Indonesia	<1%	<1%
Malaysia	<1%	<1%
Vietnam	<1%	0%
Cash	15%	19%
Shorts	-3%	-2%

[^] Inclusive of all mainland China-based companies, both those listed on exchanges within mainland China and those listed on exchanges outside of mainland China.

Refer to note 2, page 20. Numeric figures are subject to rounding.
Source: Platinum Investment Management Limited.

For monthly updates of the Fund's invested positions, including country and industry breakdowns as well as currency exposure, please visit www.platinumworldportfolios.ie/Funds/AsiaMonthlyUpdates.

Performance

(compound pa, to 30 June 2018)

	QUARTER	1 YEAR	2 YEAR INCEPTION P.A.	SINCE INCEPTION P.A.
PWP Asia Fund Class A USD	-4.1%	13.5%	-	20.3%
PWP Asia Fund Class B USD	-3.9%	13.8%	-	17.5%
PWP Asia Fund Class D USD	-3.9%	13.8%	19.1%	14.1%
PWP Asia Fund Class I USD	-3.9%	14.1%	-	21.9%
MSCI AC Asia ex Jp Index (USD)	-5.4%	9.9%	18.0%	14.5%

Fund returns are net of accrued fees and costs. Refer to note 1, page 20.

Source: Platinum Investment Management Limited, FactSet.

Historical performance is not a reliable indicator of future performance.

Rising interest rates in the US and the uncertainties created by trade friction continued to weigh on the Asian markets over the quarter, with the Philippines (-10%), Malaysia (-9%), Indonesia (-6%) and Korea (-5%) all posting weak returns.¹ The Fund (Class D) was down -3.9% over the quarter and returned +13.8% over the last 12 months.

Although performance was weakened by a sell-off towards the end of the quarter, some stocks contributed positively to the Fund's returns. Unsurprisingly, the key contributors were once again the companies that are benefiting from the secular consumer trends of China's rising middle class. Healthcare stocks, such as Guangzhou Baiyunshan (pharmaceuticals and herbal tea manufacturer) rose +43% (H-share) and MicroPort Scientific Corporation (maker of heart stents, pacemakers and orthopaedic prostheses) was up +11%. A strong beneficiary of China's booming e-commerce market, ZTO Express (logistics) was up +33%, while Baidu (search engine) gained +9%. Consumer stocks Jiangsu Yanghe Brewery and Anta Sports (dominant Chinese sportswear) were up +22% and +5% respectively.

¹ Referencing respectively the PSEI, JCI, KOSPI and KLCI indices in local currency terms for the quarter of 31 March 2018 to 30 June 2018. All other references in this report to index or individual stock performance are in local currency terms for the quarter of 31 March 2018 to 30 June 2018, unless otherwise specified.

Mining stocks also performed well as China's economic recovery and expansion continued to support commodity prices. MMG (copper) was up +15%, CNOOC (oil) gained +17% and PT Vale Indonesia (nickel) rose +45%. Our Indian banking stocks displayed better form than last quarter, with Yes Bank up +11%.

Our Philippines and Korean holdings generally detracted from performance, with Ayala Land (Philippines developer) down -8% and Naver (Korean internet search portal) down -4%. Despite this recent price weakness, the fundamentals have not changed and we continue to believe that these are quality businesses that will do well in the long run.

Changes to the Portfolio

Weakness in the share market over the quarter gave us an opportunity to further reposition our portfolio towards more domestically-focused champions, cushioning the Fund against the impact of the ongoing trade friction. The repositioning also aims to maximise the Fund's exposure to the benefits flowing from the economic recovery and reform in the Asian region.

The Fund has upped its exposure to the US dollar and further reduced its Australian dollar exposure, both of which helped to lessen the impact of the overall market weakness experienced during the quarter. We also have very limited exposure to the regions that are most susceptible to a strong US dollar and rising oil prices (Indonesia, Malaysia, Philippines). To the extent that the Fund is exposed to these headwinds, particularly in India, we have put in a 3% short position on the market for protection. India appears to be on a gradual economic ramp-up and it would be remiss not to invest in some of the well-managed and growing businesses that are trading on extremely attractive valuations.

More specifically, we have cut positions that we believed to have reached their fair value and took advantage of the market volatility over the quarter to deploy the cash into the following key positions:

- **China Merchants Bank** – in our view, the best bank in China, with a strong wealth management arm that has a dominant industry position and is well placed to take advantage of the burgeoning wealth management needs of the country's growing middle class.
- **AIA Group** – the leading and, in our view, most well-run life insurer in Asia, with a dominant position in the huge Chinese market.
- **ZTO Express** – one of the most competitive low-cost parcel delivery operators in China, ZTO emerged a winner as it rode the waves of the country's e-commerce boom and is now consolidating the market.

Sector Breakdown

SECTOR	30 JUN 2018	31 MAR 2018
Financials	23%	22%
Information Technology	18%	17%
Energy	9%	5%
Industrials	8%	8%
Consumer Discretionary	7%	7%
Real Estate	5%	6%
Materials	5%	6%
Health Care	3%	4%
Consumer Staples	3%	3%
Utilities	2%	2%
Telecommunication Services	2%	1%
Other*	-3%	-2%
TOTAL NET EXPOSURE	82%	79%

* Includes short positions of indices.

Refer to note 4, page 20. Numeric figures are subject to rounding.

Source: Platinum Investment Management Limited.

Currency

CURRENCY	30 JUN 2018	31 MAR 2018
Hong Kong dollar (HKD)	36%	39%
US dollar (USD)	29%	21%
Korean won (KRW)	11%	11%
Indian rupee (INR)	9%	12%
Chinese yuan (CNY)	7%	5%
Thai baht (THB)	4%	4%
Philippine peso (PHP)	2%	2%
Australian dollar (AUD)	0%	4%

Refer to note 5, page 20. Numeric figures are subject to rounding.

Source: Platinum Investment Management Limited.

Top 10 Holdings

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Ping An Insurance Group	China	Financials	3.6%
Samsung Electronics	Korea	IT	3.4%
Axis Bank Ltd	India	Financials	3.1%
Alibaba Group	China	IT	3.0%
China Overseas Land & Invt	China	Real Estate	2.9%
Yes Bank Ltd	India	Financials	2.9%
Kasikornbank PCL	Thailand	Financials	2.8%
CNOOC Ltd	China	Energy	2.4%
China Oilfield Services	China	Energy	2.4%
Naver Corporation	Korea	IT	2.3%

As at 30 June 2018. Refer to note 3, page 20. Numeric figures are subject to rounding. Source: Platinum Investment Management Limited.

Commentary

India

During the quarter, several members of our team visited India and China, and we came away from both countries with positive but different observations.

In India, we were pleasantly treated to superfast mobile internet service. The upload and download speed is similar, if not superior, to what we are used to in Australia. Reliance Jio entered the mobile network business only several years ago. Its efforts to ramp up a gold-plated 4G network in a vast country like India from scratch were dismissed by many as a daft idea. We disagreed with this assessment because we believed the country, hitherto under-served by poor fixed line services and slow mobile networks, would see significant demand unleash with an efficient and affordable internet offer. We first invested in Reliance Industries, the parent company of Reliance Jio, in late 2015 (shortly after the Fund's inception), when the Jio mobile network was yet to launch. 18 months after launch, Reliance Jio has accumulated a gargantuan 180 million 4G subscribers, enticing users with offers of virtually unlimited data usage for US\$2 a month! This is a boon to consumers who are getting ready access to the full gamut of online activities and services literally at their fingertips 24 hours a day. As mobile internet becomes increasingly affordable, Indians are buying about 120 million smartphones a year.

Faced with an aggressive competitor with a deep pocket, some smaller operators are exiting the market. With the number of mobile network providers in India having reduced from half a dozen to effectively just three players, the level of competition will eventually ease, restoring profitability for the remaining big operators like Bharti Airtel (in which we have a position).

Another encouraging sign observed in India is that for the first time in half a decade, some construction-related sectors are running high on rising utilisation rates. Some steel makers are operating at 85% utilisation rates and cement producers are starting to ramp up too. Commercial truck and passenger car sales are also running hot. All this while the rate of credit growth is only beginning to recover from some of the lowest levels since the times of Indira Gandhi. As the utilisation rates continue to increase, corporates are starting to add capacity. India appears to be on the cusp of the long-awaited revival of a private sector capital expenditure cycle. Business confidence is high.

What has been driving demand so far are government-led infrastructure programs which are bearing fruit. India needs infrastructure improvements to reduce the cost of transporting goods around the country. The authorities have approved 13,000 km of road construction for two

consecutive years, a doubling of length compared to just a few years ago. Other infrastructure projects, such as airports, railway and social housing, also continue apace.

Various reform measures are starting to have a meaningful impact. The implementation of a national goods and services tax has reduced the complexity of state-based taxes. India's new bankruptcy law is getting tested and it is evidently working. For the first time, assets are being transferred from insolvent founders to new owners through bankruptcy proceedings. The significance of this new law is that it prevents founders of companies from getting out of their debt repayment obligations by dragging out the court process and wearing out the creditors, which had traditionally been the norm. Instead, the new law forces defaulting founders to either fix the problem or face the loss of their assets to the banks or new owners. This is beginning to have a profound impact on the behaviour of founders, some of whom might have chosen in the past to wilfully default on their debt given how powerless the banks were at recovering it. This is no longer the case! The new bankruptcy law represents an important structural change to Indian banks (including several of the Fund's holdings), and we cannot overstate the significance of its benefits. Our holdings in the Indian banking sectors are what we believe to be the best-in-class operators, and we expect them to reap additional rewards if the Indian capital expenditure cycle finally launches into full swing.

China

Our visit to Beijing, Shanghai and Hong Kong was literally a "breath of fresh air"! China's infamous air pollution truly has improved. Although we concede that air quality can and does fluctuate daily, it was nevertheless impressive to be able to enjoy five consecutive days of blue sky, a first in many years since our Asia team started visiting China.

China's relentless ascendance along the technology ladder has primarily been driven by an energetic private sector. Meeting with various industry heads shone a light on how ambitious the Chinese electric car makers are. In the near future, we will see many local competitors to Tesla, retailing at affordable prices of US\$30,000 to US\$60,000. These cars are designed from the ground up for electrification. With the battery pack situated at the bottom of the chassis, the centre of gravity is extremely low, allowing the electric motor to bring the vehicle into exhilarating acceleration from a standing start.

Observations from the trip also reinforced our view that there is enormous demand for life insurance products. Despite the authorities' ongoing efforts to improve the quality of healthcare, access to publicly funded medical care remains limited for patients suffering from serious illnesses such as cancer and coronary heart disease. As the cost of healthcare rises and the average life expectancy increases,

the issue is becoming more acute. This has made insurance policies for “critical illnesses” extremely attractive. These policies cover a range of major illnesses and will pay out a lump sum (say US\$30,000) in the event of the insured contracting one. The overall penetration of life insurance remains very low in China vis-à-vis the developed world. Products are immature and highly profitable. We can see this industry continue to grow for years to come. Ping An and AIA, two of the Fund’s holdings, are the leaders in this market. They have what we believe to be the most experienced sales force and the most advanced IT system in the industry, which will play a crucial role in getting their products into the hands of the eager consumers.

Indeed, the Chinese economy continues to recover and expand despite the difficult job of cleaning up the shadow banking sector. The authorities are not afraid of pulling the many levers that they have to ensure that a decent level of economic activity is maintained. China is not blindly following the US Fed’s move to raise interest rates. Its government continues to push ahead with its infrastructure

programs, from the inter-state high-speed rail network to metropolitan underground metro systems, water treatment plants, and new healthcare facilities. In the property market, despite the authorities’ draconian measures to curb demand and limit purchase, the market is holding up. We continue to witness a shortfall in supply and new construction starts are supporting economic activity.

Outlook

Given the market volatility, we have increased the Fund’s net exposure to China as it tends to be more resilient against the impact of rising US interest rates and oil prices than ASEAN economies. India holds promise, particularly if and when the long-awaited capital expenditure cycle truly kicks off.

We are encouraged by the number of attractive long-term opportunities that we are finding, and many of these businesses are not expected to be directly impacted by the trade friction. The Fund will continue to invest in reasonably valued companies with strong growth prospects.

Platinum Japan Fund



Scott Gilchrist
Portfolio Manager

Disposition of Assets

REGION	30 JUN 2018	31 MAR 2018
Japan	94%	87%
Korea	0%	<1%
Cash	6%	13%
Shorts	-1%	-1%

Refer to note 2, page 20. Numeric figures are subject to rounding.
Source: Platinum Investment Management Limited.

Top 10 Holdings

COMPANY	COUNTRY	INDUSTRY	WEIGHT
Nintendo	Japan	IT	3.5%
Murata Manufacturing Co	Japan	IT	3.3%
Itochu Corporation	Japan	Industrials	3.3%
Sumitomo Mitsui Financial	Japan	Financials	3.2%
Nexon	Japan	IT	3.1%
Mitsubishi UFJ Financial	Japan	Financials	2.7%
Lixil Group	Japan	Industrials	2.6%
Orix Corp	Japan	Financials	2.6%
Kyocera Corp	Japan	IT	2.5%
JAPEX	Japan	Energy	2.4%

As at 30 June 2018. Refer to note 3, page 20. Numeric figures are subject to rounding. Source: Platinum Investment Management Limited.

Performance

(compound pa, to 30 June 2018)

	QUARTER	1 YEAR	2 YEAR INCEPTION P.A.	SINCE INCEPTION P.A.
PWP Japan Fund Class A USD	-4.3%	8.5%	17.0%	13.7%
PWP Japan Fund Class B USD	-4.4%	8.5%	-	13.6%
PWP Japan Fund Class D USD	-4.5%	8.5%	17.8%	12.9%
PWP Japan Fund Class F EUR	0.7%	-	-	-1.0%
MSCI Japan Index (USD)	-2.8%	10.5%	14.8%	8.9%

Fund returns are net of accrued fees and costs. Refer to note 1, page 20.
Source: Platinum Investment Management Limited, FactSet.
Historical performance is not a reliable indicator of future performance.

Sector Breakdown

SECTOR	30 JUN 2018	31 MAR 2018
Information Technology	28%	22%
Industrials	20%	20%
Consumer Discretionary	14%	13%
Materials	10%	11%
Financials	9%	9%
Energy	6%	5%
Health Care	6%	4%
Telecommunication Services	1%	1%
Consumer Staples	<1%	1%
TOTAL NET EXPOSURE	94%	86%

Refer to note 4, page 20. Numeric figures are subject to rounding.
Source: Platinum Investment Management Limited.

Currency

CURRENCY	30 JUN 2018	31 MAR 2018
Japanese yen	99%	96%
US dollar	1%	4%
Korean won	0%	<1%

Refer to note 5, page 20. Numeric figures are subject to rounding.
Source: Platinum Investment Management Limited.

For monthly updates of the Fund's invested positions, including country and industry breakdowns as well as currency exposure, please visit www.platinumworldportfolios.ie/Funds/JapanMonthlyUpdates.

Market Review and Outlook

30 June 2018 marked the 20th anniversary of our Australian-domiciled Platinum Japan Fund. An investment of A\$20,000 in 1998 has grown at 15% per annum over the subsequent two decades and is now worth A\$316,702, compared to A\$35,763 by the MSCI Japan Net Index (A\$).¹

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.

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, or 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

¹ Cumulative on A\$20,000 invested in C Class (standard fee option) of the Australian-domiciled Platinum Japan Fund and the MSCI Japan Index (A\$) respectively from 30 June 1998 to 30 June 2018. Fund returns are calculated using the net asset value per unit (which does not include the buy/sell spread) and represent the combined income and capital returns over the specified period. Fund returns are net of accrued fees and costs, are pre-tax, and assume the reinvestment of distributions. Index returns are in Australian dollars and assume the reinvestment of dividends from constituent companies, but do not reflect fees and expenses. The gross MSCI Japan Index (A\$) is used for the period prior to 31 December 1998 as the net index did not exist then. Fund returns have been provided by Platinum Investment Management Limited ("Platinum"); MSCI index returns have been sourced from FactSet. Historical performance is not a reliable indicator of future performance. Returns of the Platinum Japan Fund are provided here solely for the purpose of illustrating the rigour of Platinum's investment approach and long-term focus. This is not an invitation to invest in the Platinum Japan Fund which is registered in Australia and may not be available to foreign residents.

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.

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 characteristics² make it both difficult and unhelpful to have delusional clarity of the timing of reversion.

Performance

The Fund (Class D) fell -4.5% for the quarter and rose +8.5% 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. 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.

² 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.

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 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.

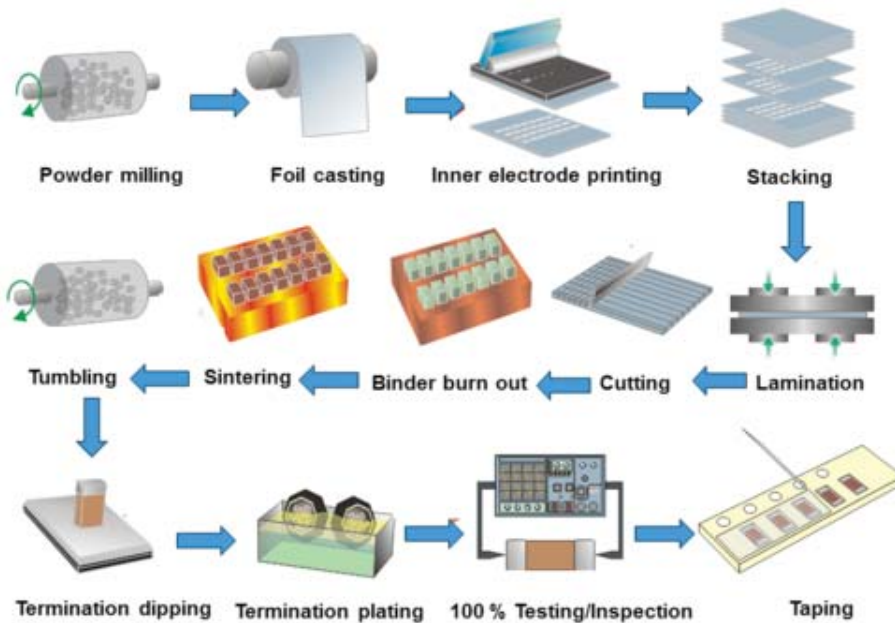
While it's hard to see exactly where the broad increase in MLCC demand is occurring, Nissan's pioneering electric car, the Leaf, uses more than five times as many passive components as an internal combustion engine powered car. High-end mobile phones act as Veblen goods³ and signallers of success but 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

³ 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.

being pulled through in a myriad of goods. Peering into the future, it's possible to envisage ubiquitous data, electric vehicles with dense electrification, 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

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Fund returns have been provided by Platinum Investment Management Limited; MSCI index returns have been sourced from FactSet. Index returns are in US dollars and assume the reinvestment of dividends from constituent companies, but do not reflect fees and expenses. Platinum does not invest by reference to the weighting of the Index. The Fund's underlying assets are chosen through Platinum's individual stock selection process and, as a result, the Fund's holdings may vary considerably to the make-up of the Index. Index returns are provided as a reference only.

The portfolio inception dates for each active share class of the relevant Fund are as follows:

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Class A USD (Accumulating) (ISIN: IE00BYRGQX37): 27 April 2016	Class B USD (Accumulating) (ISIN: IE00BYRGR076): 2 December 2016
Class D USD (Accumulating) (ISIN: IE00BYRGQZ50): 16 November 2015	Class F EUR (Accumulating) (ISIN: IE00BYRGR183): 4 April 2017
Class G GBP (Accumulating) (ISIN: IE00BYRGR290): 27 April 2016	Class H GBP (Accumulating) (ISIN: IE00BYRGR308): 4 August 2016
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Class A USD (Accumulating) (ISIN: IE00BYRGR522): 10 March 2017	Class B USD (Accumulating) (ISIN: IE00BYRGR639): 20 April 2017
Class D USD (Accumulating) (ISIN: IE00BYRGRD06): 16 November 2015	Class I USD (Accumulating) (ISIN: IE00BYMJ5524): 19 January 2017
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Class A USD (Accumulating) (ISIN: IE00BYRGRF20): 11 January 2016	Class B USD (Accumulating) (ISIN: IE00BYRGRH44): 23 December 2016
Class D USD (Accumulating) (ISIN: IE00BYRGRJ67): 16 November 2015	Class F EUR (Accumulating) (ISIN: IE00BYRGR189): 18 October 2017

For the purpose of calculating the "since inception" returns of the Index, the inception date of Class D of the Fund, being 16 November 2015, is used (as Class D was the first share class activated).

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3. 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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