Platinum®
WORLD PORTFOLIOS PLC

Quarterly Investment Manager's Report

Platinum World Portfolios - International Fund

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31 December 2017

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Macro Overview

by Andrew Clifford, CIO, Platinum Investment Management Limited

As we enter 2018, the global economy appears to be in as good a shape as it has been any time in the last decade. The US, Europe, China and Japan have each shown improving economic momentum over the course of 2017. Higher commodity prices should bring about stronger growth in many of the emerging economies in the year ahead. Interestingly, the trends in place today (excepting the run up in commodities) were obvious enough a year ago, though at the time investors and commentators were preoccupied with a range of concerns.

The US, which has led the global recovery since the Global Financial Crisis (GFC), continued to grow strongly in the final months of 2017. Consumers appear to be in good shape as employment markets remain strong which, together with the promise of tax cuts coming in 2018, saw consumer confidence reach levels not seen in almost 15 years, well before the GFC. New home sales, which have been relatively slow to recover in the current cycle, are now experiencing sturdy growth. To date, there has been little evidence of rising inflation and, as such, while interest rates are rising, they do not look to be a threat to economic momentum for the moment. While the delivery of the tax cuts is a new impetus for growth (though we suspect not a significant one), the picture is not very different to that of a year ago. A year ago, the great concern was the proposed policies of the newly elected President Trump: the roll-back of the Affordable Care Act (Obamacare) which threatened to leave potentially 20 million Americans without health insurance, a possible trade war with China, and a major revamp of the tax system that contained more sound and fury than legislative detail. Of course, little has come to pass other than a much reduced tax plan; meanwhile the economy has continued to motor along.

In Europe, employment growth is strong and consumer and business confidence is high and rising. Today, economic growth rates across Europe are back at pre-GFC levels. A year ago, the improvement in Europe's economic performance was already well established. The strength of the job market today is simply a continuation of the upward trajectory that had already started then. However, a year ago all were concerned with political instability in Europe post the Brexit vote and the defeat of the Italian constitutional reform referendum. There was much discussion about the possibility of Marine Le Pen winning the French presidential election and the implications that would have for the sustainability of the European Union (EU). Concerns also remained with regards to unresolved bad debts in the European banking systems, particularly within Italy. What came to pass was a surprisingly positive outcome in the French presidential race with pro-reform candidate Emmanuel Macron claiming victory. Bad debt issues have either been resolved or have faded to the background.

Throughout 2016 China staged an impressive economic recovery from its investment downturn, kick-started by government spending on infrastructure as part of its "One Belt One Road" program. The residential property market recovered and excess inventories were well on the way to being cleared. Despite this clear improvement in the economic environment, there remained much scepticism at the beginning of 2017 as to whether the recovery was sustainable, with most concerns focused on the level of indebtedness in the economy and the potential for a bad debt crisis in the banking system. While these were not unreasonable concerns, as we first discussed in our March 2017 quarterly report and then in more detail in the September 2017 report, China's supply side reforms were dealing with issues of excess capacity in industries such as coal and steel. The result was immediate improvement in profitability and, with that, the ability to service debt. Over the course of 2017 these supply side reforms have been extended, particularly with respect to enforcement of environmental standards, leading to further improved profitability across a wide range of industries both within and outside of China.

While the fears regarding China's indebtedness have receded somewhat in the second half of 2017, investors and commentators generally remain sceptical. Along with the supply side reforms, there have also been reforms of the financial sector, in part to address the reckless use of credit in the system. It is somewhat ironical that these changes, both of which act to limit the state's role in the economy, are viewed as evidence that President Xi is steering the economy back towards central planning and away from markets. Our observation is that all the signs point in the other direction. Indeed, if one looks at the electric vehicle (EV) market in China, the mechanism being used to encourage auto producers to sell EVs is essentially a simplified version of the mechanism employed by the EU, only that it will be implemented in China a year or two sooner. Besides, the auto industry, like most of the other fast growing industries in China, is dominated by private companies operating in a predominantly free market.

Finally, there is the world's third largest economy, one that is almost forgotten by investors after 25 years of deflation, slow growth, and falling asset prices. The list of woes that usually attract attention when Japan is mentioned includes massive government debt, the extraordinary printing of money by the Bank of Japan (BOJ), and a rapidly aging population, to name just a few. Yet, the country is currently enjoying record levels of employment, driven by rising participation in the work force by women, and rising wages. Corporate profit margins are at record highs. And, for the record, the economy has not seen such robust levels of growth for more than two decades!

The world has not seen this degree of synchronised growth across the major economies since 2008. Together with the supply side reforms in China, this growth has helped to drive a range of commodity prices higher during 2017. Over the next five years, an additional factor driving demand for various metals will be electric vehicles. Combined with a lack of investment in new supply in recent years, this should see commodity prices remain buoyant. While it may act as a tax on most of the developed world, this transfer of income to large emerging economies such as Indonesia, Brazil and Russia should be beneficial for overall global growth.

What are the key risks to this buoyant global outlook? The obvious risk, and one that the markets are focused on, is a return of inflation. In particular, labour markets are tight in the major economies, with the exception of Western Europe, so higher wage inflation is certainly possible if growth remains strong. Couple this with higher commodity prices (and the anecdotal evidence of shortages in a range of industrial and electronic components), a scenario of rising inflationary pressures cannot be dismissed. If central banks were to raise rates in a sustained and steady fashion in response to inflation, given the level of debt carried in all the major economies, it would certainly pose a threat to current rates of growth.

The other great unknown is the longer term ramifications of the money printing exercises by the US Federal Reserve, the European Central Bank and the BOJ. While the US, on face value, has extricated itself successfully from its quantitative easing (QE) program (i.e. it has stopped "printing money" via bond and other asset purchases), it is yet to attempt to unwind this policy in any meaningful way. For the moment, QE continues in both Europe and Japan.

Market Outlook

Global stock markets have recognised these improving prospects and rewarded investors with good returns over the last 12 months. The following table shows the 1-year and annualised 5-year returns in local currency terms for key global markets.

MSCI Regional Indices
Local Currency Returns as at 31 December 2017

REGION	1 YEAR	5 YEAR COMPOUND P.A.
World	19.8%	12.7%
United States	21.2%	15.0%
Europe	13.0%	9.9%
Japan	19.8%	17.2%
Asia ex Japan	35.6%	9.1%
China	55.0%	10.1%
India	30.5%	12.3%

Source: RIMES Technologies

The 1-year returns presented here would usually suggest that one should be cautious about the prospects of future returns. However, the 5-year returns, while solid, are not spectacular except in the case of Japan and the US. Japan, it must be remembered, started the period at the bottom of a 23 year bear market!

It is our assessment that, despite these good outcomes, most investors remain cautious when it comes to the prospects for future returns from owning shares. We see this in the frequent headlines carrying warnings from investment experts for overvalued stocks, stock market bubbles, and even the looming possibility of another GFC. We also see this caution in the actions of investors around the world where we still observe a strong preference for other asset classes, notably debt securities. This assessment, together with the fact that we continue to find new companies to buy at attractive valuations, makes us cautiously optimistic that we can continue to generate good returns for investors, if not in the next 12 months, certainly over the next three to five years.

Interestingly though, despite caution around share markets, the rise of Bitcoin and other cryptocurrencies shows that enthusiasm for speculation is far from dead! I would encourage anyone with an interest in this topic to read Sava Mihic's excellent article on the following pages. Certainly, some cryptocurrencies look on face value to be another old-fashioned bubble, though they may still have some way to go despite the daily predictions of their demise. Could an eventual burst of the bubble have the potential to cause disruptions to broader financial markets? Perhaps, particularly if significant amounts of debt are involved, though for the moment this appears unlikely. For every loser in this speculative game, there is an offsetting winner. Perhaps a more likely scene for a significant financial accident may be the debt markets, where the risk aversion of investors, together with the QE policies of central banks, has driven yields to extraordinarily low levels.

Bitcoin – A Primer

by Sava Mihic, Quant Analyst, Platinum Investment Management Limited

Bitcoin has recently captured popular attention by exceeding the US$10,000 per coin mental barrier. Discussion has been extremely polarised, with some claiming it is the biggest bubble since the Tulip while others claim we are seeing the start of a new paradigm.

This article will discuss what it is, some perspectives, and what the future may look like.

What is Bitcoin?

Bitcoin is the first of a new breed of digital tokens labelled "cryptocurrencies" (or simply "cryptos"). The core idea is that it has a public record of all transactions, called a "blockchain". New transactions are recorded by adding transaction record blocks to the existing chain, with specific rules around who can add blocks, how new blocks are recognised, the types of blocks and the rate at which they are *meant*[1] to be added.

Bitcoin follows a "proof-of-work" requirement in order to add a block to the blockchain. This means that the right to record the next block is attained by doing work – also known as "mining". The work required, in the case of Bitcoin, is testing a large number of random numbers until you happen upon one that produces a specific outcome. By making the numbers random, the playing field is levelled, with anybody able to jump in and mine. The more miners there are testing random numbers, and the more computing power they use, the faster somebody finds the correct random number. Miners that control more computing power are more likely to be the first to find the solution, with their rate of success being proportional to their share of computing power. Making mining simple means it isn't dominated by any one party, preventing a malicious party from consistently adding fraudulent transaction blocks.

Once a new block is mined, the miner will broadcast it to the network. The network will confirm that the random number the miner chose does indeed generate the required outcome, and will append it to all the other blocks in the Bitcoin blockchain. One Bitcoin block is meant to be added every 10 minutes – the idea being that prescribing 10 minute intervals makes it less likely for two miners to independently find and broadcast competing solutions to the network at the same time. If mining activity increases and blocks start to be added faster, the difficulty of mining will increase in order to keep the rate at one block per 10 minutes.[2] Conversely, the difficulty will decrease if there is less mining. Each block can at present accommodate around 2,000 transactions.

Of course, people need to be incentivised to do the work required to record transactions, so Bitcoin has an incentive system to encourage mining. There are two parts to the incentive system, and both go to the miner that solves the block first:

1. The first part is the block reward. Currently set at 12.5 Bitcoin and halving every four years, it will increase Bitcoin supply up to a maximum of 21 million Bitcoin and will therefore end in 2140 if all goes to plan. This amount isn't paid by anybody in particular, but rather is inflationary. Essentially, it is partially funded by everybody that owns Bitcoin.

2. The second part is the transaction fee, which is a variable amount and depends on how much Bitcoin users are willing to pay in order to have their transaction included in the next block. Users bid a transaction fee, and miners then decide which transactions to include in the block they are mining. As Bitcoin has risen in popularity, transaction fees have moved from being around 0.1 Bitcoin to 2 Bitcoin per block, with this cost borne by the parties initiating transactions.

Chart 1 on the following page shows the price of Bitcoin on a log scale, and puts into perspective just how extreme the initial boom in 2013 was. While it got a lot of attention then, it didn't get the same level of attention as the latest boom, primarily because the total value of all outstanding Bitcoin peaked at US$10 billion at the time, whereas we are now looking at US$250 billion. See our commentary in *The Journal* on the 13th of January 2014 for further thoughts at the time.[3]

A lot has changed since the early days of Bitcoin. Nobody thought Bitcoin prices would reach the stratosphere when it first started, and there were so few miners at the time that mining could be done by a home PC. Today, mining has become so intense that it requires specially designed hardware, huge amounts of electricity and heavy cooling. Bitcoin has been able to rise through a combination of

1 Bitcoin blocks require testing random numbers to process, so a block can take more or less than the 10 minute target depending on miner luck. That is why processing time is *meant* to be 10 minutes, rather than *is* 10 minutes.

2 Difficulty is increased by requiring more random numbers to be tested by miners before a solution can be found.

3 https://www.platinum.com.au/Insights-Tools/The-Journal/The-Fantastic-Rise-of-Bitcoin

Chart 1 – Bitcoin Price History

BitStamp (USD) – Closing Price – Daily (Log Scale)

Source: https://bitcoincharts.com

fulfilment of needs, strong promotion, and a healthy dose of speculative exuberance. Some of these are discussed in the following sections. The price of US$15,000, which is current at the time of writing, will be used in numbers quoted below.

Bitcoin as a Medium of Exchange?

One of the early hopes was the idea that Bitcoin could be used as a cheap means of transaction that circumvents the banking system. As things stand today, however, this is not a realistic proposition unless some significant changes are made to the Bitcoin protocol. The reason is that transaction costs on the Bitcoin network are simply too high – today the block reward, i.e. the socialised cost of a transaction, is about US$100 at the 2,000 transactions per block rate (see Chart 2). Additionally, the specific transaction cost borne by the transacting parties is about US$15. Add to this the fact that each block takes 10 minutes to process,[4] and you will be waiting quite a while to confirm your $25 coffee order. The Bitcoin blockchain simply cannot be used to process small transactions as it is currently configured.

Bitcoin as a Store of Value?

With the reality that it cannot be used as a medium of exchange recognised, the narrative has shifted to Bitcoin being a store of value, with gold being used as an analogue. Proponents argue that the limited total supply of Bitcoin creates scarcity value, and that the mining of Bitcoin, similar to the mining of gold, takes work. In the case of gold, the price is often underpinned to some extent by the cost of mining it, and mining costs generally increase over time as the geology becomes more difficult. In contrast, no such analogue can be drawn in Bitcoin, because the difficulty of mining is proportional to the amount of processing power being expended. High Bitcoin prices incentivise more processing power and therefore higher costs, but the reverse is also true, which implies that there is little pricing support when Bitcoin prices fall.

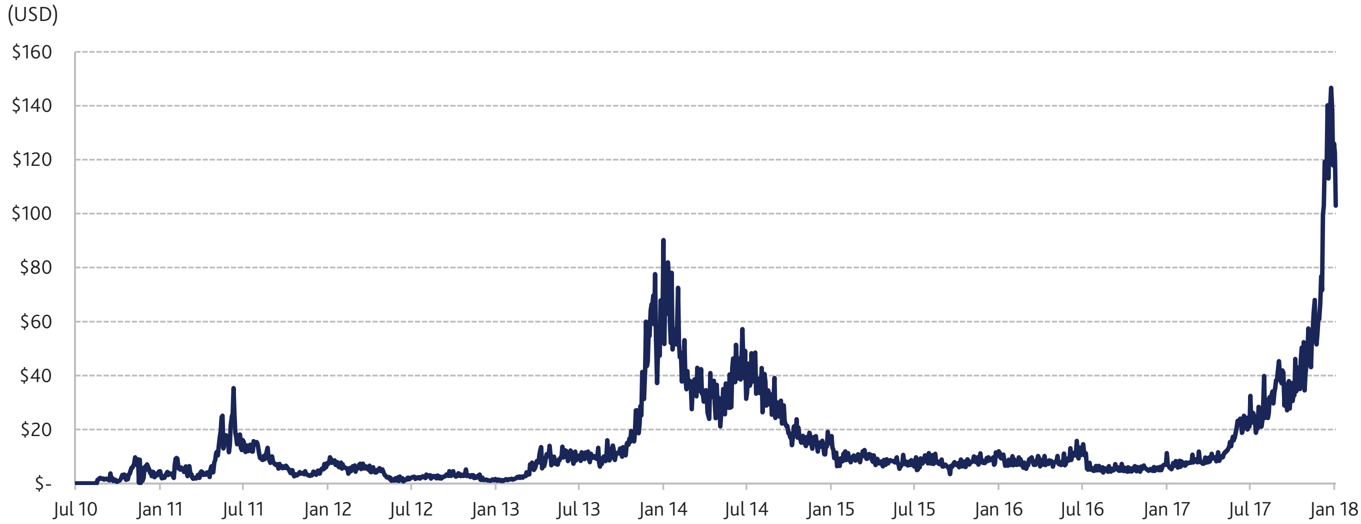
ICOs and "Forks"

But what about scarcity value? While Bitcoin supply is limited (unless the code is changed), there has been an enormous proliferation of copycats[5] – the count of recognised cryptocurrencies stands at 1324 as of today. Coinschedule.com indicates that in 2016 a total of US$96 million was raised in 46 “Initial Coin Offerings” (ICOs), and in 2017 the number has jumped to 235 ICOs, raising a total of US$3.7 billion – a 39 fold increase in money raised.

4 There is a backlog, which varies in size, but currently has over 100,000 unconfirmed transactions, which would take over 8 hours to process assuming no further transactions are recorded. Even with no backlog, one would generally require several blocks to be added after the block processing one’s transaction, to ensure that the transaction is embedded in the blockchain.

5 An example of a copycat is Ether, which is similar to Bitcoin, but has the added use of being able to pay for “smart contracts” on the Ethereum network, which are payment contracts that are executed automatically. For example, a smart contract may have an address, and when something is paid into that address, it may be split among two different addresses automatically in a certain share, like a royalty. The Ethereum network can also be used to issue ICOs. Another example is Ripple, which, instead of using proof of work like Bitcoin and Ether, relies on consensus among trusted parties to approve transactions, thereby removing the costs of proof of work, but also to some extent the decentralisation. If Ripple, which has some institutional backing, were to advance from concept to a fully functioning network, it may represent an efficient payment system. Among the many less popular tokens is UET, the “Useless Ethereum Token”. The "ICO disclosure" of UET, “the world’s first 100% honest Ethereum ICO”, says that it has “no value, no security and no product. Just me, spending your money.”

Chart 2 – Cost per Transaction



Source: https://blockchain.info

In an ICO, the promoter profits by selling tokens to the public. Generally the promoter will start by publishing a "whitepaper" to explain the token and getting backing from a few high net worth investors that are willing to fund the advertising of the token. Then the promoter will selectively groom some initial investors, for example, by setting up a Slack channel in which he chats with them directly, convincing this group that they are "in the know". This "special" group will take a pre-ICO placement of tokens to distribute ownership and some will then proceed to spread the word on the ICO and how great it is. Finally, after a strong burst of advertising, and once interest is judged to be at peak, the promoter will issue as many tokens as there is demand for while cashing out, usually significantly.

The other angle is "forking", which involves creating a new cryptocurrency and issuing the tokens to the owners of an existing cryptocurrency. Fork promoters tend to be involved in cryptocurrency mining and/or the running of cryptocurrency exchanges. They bet that the more widely distributed a token is the more valuable it is likely to be. So, instead of staging an ICO, which is likely to attract only a limited number of investors, they freely give the new tokens to everyone who is listed as an owner of Bitcoin (or some other well-known token) at a certain point in time, hoping to profit by being the trading hub where their token is traded, earning transaction fees. There have been two significant forks using the Bitcoin blockchain – Bitcoin Cash and Bitcoin Gold. While the names may give the impression that these tokens are somehow the offshoots of Bitcoin, in reality they are not – these are entirely unrelated cryptocurrencies created by those seeking to take advantage of Bitcoin's popularity and wide ownership base.

Some argue that these ICOs and forks will fade over time, and that people will refocus on Bitcoin, thereby retaining its scarcity value. For now, the proliferation is massive.

Black Market Demand

One of the initial use cases of Bitcoin was black market activity, because Bitcoin addresses[6] have no identifying information, allowing criminals to stay anonymous. While there is no doubt that underground activity remains a significant part of the actual transactions using Bitcoin, which is considered the currency of the dark web, it is probably not playing as large a part in Bitcoin's recent run as it may have done previously.

The Miners

Around 300,000 Bitcoin transact each day using the blockchain, representing US$3.5 billion at the moment. Of that, miners are earning around 2,200 Bitcoin per day, for revenues of about US$33 million per day or US$12 billion per year. There are estimates that mining electricity costs are around 16% of mining revenues today, with total power consumption up 25% in December alone and approaching one-seventh of Australia's national energy consumption.[7] Currently miners are very profitable, but in the past they have suffered large losses when the price fell, as they were unable to recoup the significant capital outlay for the custom mining chips they operate. The chips used for mining are called ASICs (application-specific integrated circuits), and they have no use

6 Bitcoin addresses are digital keys that represent the location at which Bitcoin are held by an individual, similar to a bank account number, and are usually in the format of a string of random letters and numbers.

7 https://powercompare.co.uk/Bitcoin/ has great data.

outside of mining Bitcoin, resulting in Bitcoin miners being unable to sell them during the last crash. The most popular Bitcoin mining ASICs, Antminers, are developed by the biggest Chinese crypto mining company, a privately held firm called Bitmain.

The Exchanges

A cryptocurrency exchange is an entity through which a customer can exchange Dollars for Bitcoin or another cryptocurrency, or exchange one cryptocurrency for another. This is how most Bitcoin are bought. When a customer buys Bitcoin on an exchange, it does not go to their private wallet immediately; rather, it is held in custody by the exchange, where the customer can sell it. Moving Bitcoin between an exchange and one's private wallet, in either direction, will incur the blockchain fee. This means that customers holding Bitcoin in a private wallet run the risk of not being able to return their Bitcoin to the exchange in a timely manner if they wish to sell it, as there tends to be a large backlog to process transactions through the blockchain during times of heavy trading. Regulation on Bitcoin exchanges is currently minimal – the market has grown too fast for legislation to catch up.[8]

Impressively, the exchanges bear no mining costs but are, in aggregate, trading around US$10 billion[9] in Bitcoin per day, more than double the daily transaction volume on the blockchain itself. Taking a 1% clip (0.5% on each side) of that US$10 billion means that the Bitcoin exchanges are pulling in US$100 million per day at the current pace – annualising fees of US$36.5 billion,[10] with relatively low overheads. If one adds the exchange trading of other cryptocurrencies to the mix, total annualised fees exceed US$60 billion. To put this in perspective against conventional exchanges, Intercontinental Exchange, a group that operates the New York Stock Exchange among other regulated exchanges and clearing houses and has a market capitalisation of US$46 billion, is expected to produce revenue of US$4.6 billion in 2017.

If you ever wondered who funded all of the Bitcoin and cryptocurrency ads that you saw, now you know – the crypto exchanges are the true winners in the Bitcoin phenomenon, bearing none of the risk and earning outsize profits. It is somewhat ironic that these exchanges, which have none of the proof of work or decentralisation features that give Bitcoin its appeal, actually transact twice as much Bitcoin as the blockchain!

8 The government of South Korea has indicated concern around unsophisticated investors being too involved in cryptocurrency trading and is therefore considering regulating their exchanges. China has banned the exchange of Renminbi for cryptocurrency on exchanges.

9 https://coinmarketcap.com/ has aggregation data regarding trading on all of the popular crypto exchanges.

10 This annualises current turnover with the current elevated Bitcoin price. If the price falls, their annual take would fall proportionally.

Bitcoin as Gambling Arbitrage

So how did the exchanges get so big? Part of the answer is gambling arbitrage. In Japan and South Korea gambling is heavily regulated. Japan has no casinos and pachinko parlours, the traditional gambling outlets, have been curtailed by regulation over time. The extreme volatility that has occurred in Bitcoin, coupled with its unregulated nature and high turnover, makes it an ideal avenue for gambling. A large Japanese cryptocurrency exchange plays the sound of pachinko machines as the prices of cryptocurrencies move up and down, as well as when trades are done, triggering all the necessary endorphins.

Bitcoin as a Tool to Circumvent Capital Controls

China has strict capital controls. It also dominates the crypto mining industry, having the largest share of mining as well as of the market for designing custom mining chips. The initial driver of the recent boom in Bitcoin occurred in China – Bitcoin, with its anonymity, allowed some capital to circumvent the traditional currency controls and flee the country. Seeing this, the Chinese government banned ICOs from being sold to Chinese nationals and shut down domestic crypto exchanges by preventing the exchange of Renminbi for cryptocurrencies.[11] Volumes observably related to China are now a tiny fraction of what they used to be.

Bitcoin and Decentralisation

Another of the initial hopes for Bitcoin was its potential to be a decentralised system, with a frequent argument being that it can disintermediate transactions by removing the need for "trusted" centralised institutions such as banks. To date, Bitcoin has not realised this decentralisation, and is becoming more rather than less centralised. For example, a small group of programmers, known as Bitcoin Core, still write the software that the network runs. Bitcoin mining, which was supposed to be democratised by the brute force "proof-of-work" that anybody can do, is instead being dominated by a few Chinese mining pools as institutionalised ASIC-based mining makes individual PC-based mining unprofitable. Mining ASIC design itself is also dominated by Chinese mining pool operator Bitmain, and Bitcoin trading is dominated by cryptocurrency exchanges, which are centralised institutions. Even Bitcoin ownership is highly centralised, with 1500 addresses (of a 28 million total) owning 38% of all Bitcoin. The number of parties that must be trusted therefore makes the argument that Bitcoin can be used for "trustless" disintermediation difficult.

11 Not all regulation has been negative – Japan has taken the most positive stance, approving Bitcoin as a means of payment.

Bitcoin as a Ponzi Scheme

Some argue that the structure of Bitcoin is an exact replica of a Ponzi Scheme. Nobody can see Bitcoin or make anything out of it and there is no utility value to holding Bitcoin (unlike, say, gold, which is used to make jewellery and has some limited industrial uses). Bitcoin generates no income, and an owner of Bitcoin can only make money by selling the Bitcoin at a higher price to another investor. Bitcoin buyers are attracted by the very high appreciation apparently on offer, and the continuation of the scheme is dependent upon current holders[12] continuing to hold! Encouraging holding, there are some barriers to moving Bitcoin held off an exchange onto an exchange, such as slow transaction time and high transaction costs, making selling more difficult. To cap things off, the whole process is facilitated by the exchanges, which act as the cashed-up manager of the scheme, pumping out unregulated advertising promoting the wonderful returns on offer.

The Future of Bitcoin

The future of Bitcoin is unclear, but it is unlikely to become a medium of exchange in its current form, and further regulation is likely on the horizon. Whether that regulation removes demand for some of the uses of Bitcoin, and whether it stifles unregulated advertising, is yet to be seen, and its ultimate future will depend on that.

Telling also is the fact that long discussions among enthusiasts on the future uses of Bitcoin have given way to hopes and dreams around how soon one can become rich – one is told to resist the "fud" (fear, uncertainty, doubt), be one with the "fomo" (fear of missing out) and just "hodl" (hold). Amongst many buyers understanding of how Bitcoin works and whether it can be used for anything is minimal. People questioning the long-term value of Bitcoin are promptly banned from online crypto forums, although predictions around short-term declines are allowed. With Bitcoin having made the front cover of Barron's, there is no doubt that things are very frothy today, and while the madness of crowds has taught us that bubbles can persist for some time, ultimately, like every euphoria before it, Bitcoin will come crashing down.

12 Or, as they like to refer to themselves, "HODLers" – a famous misspelling of "hold" by a drunk Bitcoin user trying to calm people down during a crash.

Platinum World Portfolios - International Fund

Kerr Neilson
Portfolio Manager

Performance

(to 31 December 2017)

	QUARTER	6 MTHS	1 YEAR	SINCE INCEPTION P.A.
PWP Int'l Fund Class A USD	5.4%	14.3%	31.7%	20.6%
PWP Int'l Fund Class B USD	5.2%	14.4%	32.2%	30.0%
PWP Int'l Fund Class D USD	5.2%	14.4%	32.1%	14.2%
PWP Int'l Fund Class F EUR	3.7%	9.0%	–	8.4%
PWP Int'l Fund Class G GBP	4.6%	10.2%	20.5%	26.1%
PWP Int'l Fund Class H GBP	4.5%	10.4%	20.8%	21.7%
MSCI AC World Index (USD)	5.7%	11.2%	24.0%	14.5%

Refer to note 1, page 23.
Source: Platinum Investment Management Limited, RIMES Technologies.
Historical performance is not a reliable indicator of future performance.

Markets

For all the political news chatter around the Trump administration, Brexit negotiations, the 19th National Congress of the Communist Party of China, the supremacy of the Liberal Democratic Party under Shinzo Abe in the recent Japanese elections and, of course, the hysteria around missile launches by North Korea, the year **2017 has been one of near perfection for most markets**: stocks, bonds and property. Underpinning the whole shebang has been the frantic purchasing of bonds, both government and corporate, by the US Federal Reserve, the European Central Bank (ECB), the Bank of Japan (BoJ) and the Bank of England (BoE) that has seen these four major central banks' balance sheets, in aggregate, blow out to **a new record of US$20 trillion** of assets and correspondingly to **oppress interest rates along the entire yield curve**. The effect should not be underestimated, because corporate issuers of subprime debt in Europe are raising term funding at a lower cost than the US Federal Government! One consequence of floating exchange rates is that the behaviour of an individual central bank impinges on the entire global system via currency swaps and the free movement of capital – it effectively cheapens money across the board.

This does matter, because quantitative easing (QE) has allowed the rebuilding of bank equity for those most affected following the Lehman crisis, it has allowed various industries to find cheap financing through the likes of private equity, to fund adventurous ideas, and indeed has encouraged the swapping of equity for debt, notably in the US, via share buy-backs. The overarching effect of forcing investors to reach for yield, be they life companies, pension funds or hapless retirees, is to **raise the risk threshold**, justified by **the view that it has obviated an otherwise likely contraction** of economic activity.

Evidently it is working and, as was suggested by the work of Kenneth Rogoff and Carmen Reinhart following the Lehman meltdown, cheap money would ultimately allow the system to **rebalance after about 10 years of sub-optimal growth**. Other factors have played their part, most notably the contribution of unremitting expansion of the Chinese economy, huge strides in alternative energy production and the power unleashed from the internet to serve a much broader purpose. No longer confined to e-mails and the like, there has been an explosion of on-line shopping and expedited fulfilment, fintech services, on-line games and entertainment, and now the industrial element with the internet of things (IoT). These developments were still in their infancy in 2007.

Some of **these changes have sidelined previously comfortable industries** with the subsequent costs of restructuring and mergers. These continued through the quarter with some mega deals revealing the changed circumstances of the players, notably the proposed acquisition of 21st Century Fox assets by Disney, the obstructed merger between AT&T with Time Warner, the combining of CVS and Aetna in health care, Unibail-Rodamco's takeover of Westfield in property, and in aerospace, Boeing's bid to acquire Embraer and Safran's bid for Zodiac.

The main show though was **synchronised global growth**, early signs of returning pricing power in some industries, and yet the bonds refusing to hint at the return of inflation even though such chronic deflators such as Japan are seeing general price rises of over one percent. Topping off the year was the passing of the tax bill in the US which reduces corporate taxes, including to the benefit of foreign companies, and encourages capex via accelerated depreciation deductions. Despite generous commentary, the tax break for the median earner (US$59,000 p.a.) is pitiful, some US$1,000 p.a. versus US$3,000 for the so-called "middle class" with incomes of US$100,000 p.a. Despite a rise of the government deficit by an estimated US$1.5 trillion a year, the bond market barely took notice.

An acknowledgement of broad dependable growth, combined with the capacity reductions in several basic industries in China (supply side reforms), saw markets **reprice value stocks and cyclicals relative to growth stocks**. This was in stark contrast to the bidding-up for "certainty" that gripped the markets from 2011 through to early 2016. All this coalesced to produce a new record. 2017 was the first calendar year on record in which the MSCI All Country World Index had had no down month (in local currency terms)!

Note the variances of performance by sector and country in the accompanying tables below.

Even though the Fund runs cash and has been burdened with ineffectual short selling in strongly rising markets through the year, the broadening of market action has significantly rewarded our index-agnostic stock picking. For the quarter and the year, the Fund (Class D) achieved respectively 5.2% and 32.1% while its benchmark MSCI AC World Net Index rose by 5.7% and 24.0% (in USD).

This year's strong performance, in both absolute and relative terms, is pleasing, but by no means surprising. Some of you may recall the detailed expositions in our March and June 2016 quarterly reports in which we took you through the characteristics of the portfolio of our Australian-domiciled Platinum International Fund ("PIF") as a proxy for the Platinum World Portfolios - International Fund (the "Fund") but with a much longer track record, including numerous individual positions within it. On measures of growth, profitability, leverage and value, **PIF's portfolio was as attractive as it had ever been in the prior 17 years; yet, at the time it looked forlorn** next to the index-hugging funds chasing expensive consumer staples companies and other bond-proxy stocks. As it transpired over the last 18 to 24 months, those characteristics served us well and the investments unfolded largely as envisaged to generate handsome returns, once again attesting to the underlying method at work.

MSCI Regional Index Performance to 31 Dec 2017 (USD)

REGION	QUARTER	1 YEAR
Developed Markets	**6%**	**22%**
Emerging Markets	**7%**	**37%**
United States	**6%**	**21%**
Europe	**2%**	**25%**
Germany	3%	28%
France	2%	29%
United Kingdom	6%	22%
Japan	**8%**	**24%**
Asia ex Japan	**8%**	**42%**
China	8%	54%
Hong Kong	7%	36%
India	12%	39%
Korea	11%	47%
Australia	7%	20%

Source: RIMES Technologies.

MSCI All Country World Sector Index Performance to 31 Dec 2017 (USD)

SECTOR	QUARTER	1 YEAR
Information Technology	8%	42%
Materials	8%	30%
Consumer Discretionary	8%	25%
Energy	7%	7%
Financials	6%	24%
Consumer Staples	6%	18%
Industrials	5%	25%
Telecommunication Services	2%	8%
Health Care	1%	20%
Utilities	0%	14%

Source: RIMES Technologies.

Changes to the Portfolio

As a regular reader of this quarterly publication, you will be aware that we have been gradually raising the cyclical component of the portfolio. This has been motivated by the significant impact that the production rationalisation in China has had on prices across a wide range of industries. Broader global growth has also played a part in tightening supply and lacklustre capex has found many companies chasing to add capacity. Other emerging themes like battery-driven automobiles, the pollution clean-up in China, and factory automation are also influencing our preferences. To fund these investments, we have been reducing or eliminating the highly successful Chinese internet plays like **58.com** and **Baidu**. We have also reduced some of the Fund's financials exposure Europe, trimming companies like **Raiffeisen Bank**.

An important addition was **Siemens**. This remarkable 170 year old company, which started out with a telegraph invention, has pioneered many innovations involving the use of electricity to find itself today as a leader in power generation and distribution, industrial and building automation, rail transport and healthcare equipment. Apart from heavy spending on research and development (R&D), Siemens has arrived at this point through a myriad of forward-looking acquisitions and disposals.

At present, the market is a little unsure about its near-term earnings power because of the need to downsize its large combined cycle gas turbine business (note GE is afflicted by the same). There is also pressure on the profits of its wind power subsidiary Siemens Gamesa, and the local press are agitated about the CEO's decision to own partial stakes in former core businesses that have been recently merged with competitors to consolidate their industrial significance. Some of these mergers were not so well-timed. Early in 2018, the plan is to list a (minority) stake in its healthcare business. The press is flustering about this German national icon losing relevance as it sets on this new path.

Having followed the twists and turns that Siemens has taken over the decades, we feel these **uncertainties give an excellent buying opportunity** to own one of the great industrial enterprises of our times. The evolution of Industry 4.0, which is essentially a digital transformation of manufacturing and other activities to enable data to be manipulated, shared and used to control processes to ultimately have self-ordering systems, has come a long way since the vision was unveiled by the German government at the Hannover Fair in 2011. Siemens is indubitably the leader in the field. Of course, the majority of factories are burdened with massive legacy investments and the task ahead is to persuade, facilitate and profit from this inevitable shift in the way things are made or controlled.

We run the risk of being too early in entering this investment because of downward pressure on 2018 earnings from the divisions that are restructuring and from a further rise in R&D in the Digital Factory division, but finding a company of this quality selling on 15 times earnings is rare in these markets.

Disposition of Assets

REGION	31 DEC 2017	30 SEP 2017
Asia	37%	36%
Europe	21%	20%
Japan	17%	16%
North America	12%	12%
Australia	2%	1%
Russia	1%	1%
Cash	10%	14%
Shorts	-9%	-8%

Refer to note 2, page 23.
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	31 DEC 2017	30 SEP 2017
Information Technology	20%	21%
Financials	14%	13%
Consumer Discretionary	12%	12%
Industrials	10%	7%
Materials	10%	9%
Energy	9%	8%
Health Care	7%	8%
Consumer Staples	0%	0%
Real Estate	2%	2%
Telecommunication Services	1%	1%
Utilities	1%	1%
Other*	-5%	-5%
TOTAL NET EXPOSURE	81%	78%

* Includes short positions of indices.
Refer to note 5, page 23.
Source: Platinum Investment Management Limited.

Shorting

Our stock specific shorts, which relate mainly to consumer brand names that are fighting valiantly to hold sales and/or margins against a changing retail environment, recovered slightly this quarter. These consumer companies remain expensive and growth challenged. The index shorts were expensive in a record year on 12 solid months of unremitting advances.

Currency

The main change was a further reduction of the holding of US dollars in favour of the Japanese yen, the Euro and the Norwegian krone. See table below:

CURRENCY	31 DEC 2017	30 SEP 2017
US dollar (USD)	19%	32%
Euro (EUR)	17%	13%
Hong Kong dollar (HKD)	15%	13%
Japanese yen (JPY)	13%	12%
Korean won (KRW)	8%	8%
Norwegian krone (NOK)	7%	3%
British pound (GBP)	5%	5%
Indian rupee (INR)	4%	5%
Australian dollar (AUD)	3%	3%
Chinese yuan (CNY)	3%	3%

Refer to note 4, page 23.
Source: Platinum Investment Management Limited.

Top 10 Holdings

STOCK	COUNTRY	INDUSTRY	WEIGHT
Samsung Electronics	Korea	IT	3.5%
Alphabet Inc	USA	IT	2.8%
Inpex Corporation Ltd	Japan	Energy	2.8%
Sina Corp	China	IT	2.5%
Royal Dutch Shell PLC	UK	Energy	2.4%
Glencore PLC	Switzerland	Materials	2.4%
Lixil Group Corporation	Japan	Industrials	2.2%
Nexon	Japan	IT	2.1%
TechnipFMC	UK	Energy	2.0%
Siemens AG	Germany	Industrials	1.9%

As at 31 December 2017. Refer to note 3, page 23.
Source: Platinum Investment Management Limited.

Commentary

On account of the surplus capacity that came with the Global Financial Crisis, inflation has been absent, except, one could argue, in the price of tangible assets, nominal and real. More recently one can spot this effervescence boiling over into new 'asset' concepts like #Bitcoin and the host of emulators that have caught the popular imagination. The important point to grasp is that **the concept of a public register, called a 'blockchain'**, and the way entries are verified and recorded by users across the network, rather than depending on a central authority, **are sound and clever**. Building on this kernel, the idea that it is tamper-proof from government intervention has created a mystique. The distributed nature of a public blockchain and the **traceability of every entry** gives the technology particular appeal from a **security standpoint**. This is increasingly important in a world where everything from bank accounts to smart cars is at the mercy of hackers. Further, the trade in already-mined Bitcoin has exploded as exchanges have sprung up to meet and promote this burgeoning activity. Right now there is massive turnover in the existing stocks of the token, earning spreads that are creating huge wealth for the operators of these exchanges. As you will see from the accompanying feature article, *Bitcoin – A Primer*, by Sava Mihic, ***gross annual fees* generated are likely greater now than those on the New York Stock Exchange**!

This massive cash flow provides motivation and funding for highly promotional *web-directed* activities to perpetuate this apparent gravity-defying money-making machine. **Why one might not fight the trend at present is that it's got many of the qualities of a good story** for new-age millennials and disparaged voters in a world that is readily embracing new digital payment systems and, in addition, money is very cheap. Long gone is any discussion about its inherent worth (a store of value) or as a medium of exchange, a value attributed to traditional money, which might even earn interest to those who are so old-fashioned as to care. The gamblers are having the time of their lives and it is all about buying-the-dips and getting involved. Of course, this desperate participation **forewarns of the likely bust**, but for now, punters (as a group!) are reckoning on their greater agility than the crowd. The leader, Bitcoin, may eventually falter and lose favour, and its recent exponential rise from US$1,000 at the beginning of 2017 to a peak of US$19,000 in mid-December suggests **its parabolic rise is close to climax, dwarfing even the Tulip fever** that gripped Amsterdam in the 17th century. However, if and when that happens, others like Ripple (XRP), which facilitates the exchange of cryptos into hard cash and offers cheap and speedy processing, might be expected to take up the running.

With the cost of money being so low, the danger lies in **the use of debt to play** and as of December both the Chicago Board Options Exchange (CBOE) and the Chicago Mercantile Exchange (CME) offered futures contracts on Bitcoin. **If debt is used to fuel the flames**, the consequence of a bust could be felt across all asset classes as **the liquidity squeeze** forces the sale of other assets to meet the collapsing crypto phenomenon.

"But what is likely to change the cost of money?" you ask. It was mentioned earlier that some industries are regaining their pricing power, some of which is due to the muted capex cycle and unexpected strength in demand. Traditional measures of productivity show weakness, yet still labour in markets as far apart as the US and Japan seems bereft of pricing power in aggregate. However, pressure from rising unit labour costs – and note the confidence of middle income workers has fallen since the US tax bill was announced – could turn the tide. It is not as if prices on average haven't been rising. The change in the CPI in the US did after all get down to zero in 2015 and is now rising by between 1.5% and 2.0% p.a. while in Japan it may be running at an annual rate of 1.5%.

Based on our experience from field trips and company visits, and with the prospect of India and China growing yet again by above 6% in 2018 (remember, such growth in China is tantamount to adding an economy the size of the Philippines on a purchasing power parity basis with its population of 105 million), **we are inclined to back growth forcing changes in the cost of money**. This is against a backdrop of tightening by the US Federal Reserve and other central banks likely being shamed into desisting from their market manipulation. In the meantime the **cryptos** may serve as the proverbial **canaries of financial market health**. As an interesting gauge, we see that Google search trends for Bitcoin have dropped below those for gold!

Outlook

High valuations and long bull runs do not by themselves cause the onset of a bear market. The key is earnings growth and on that score the markets still look satisfactory. We like the companies we are finding in Asia in particular, as they typically offer above average growth prospects and yet are valued on lower multiples of earnings than those in the western hemisphere. While acknowledging that historically these markets have been prone to the influence of foreign flows, the weakening pattern of the US dollar suggests that this factor may be less significant in future. As we have highlighted over the last 18 months, Asia is creating its own ecosystem with ever diminishing dependence on the large Western economies. The likely repricing of borrowing caused by US Fed tightening is an evident obstruction, but, like earlier tightening cycles, the relative pace of earnings growth could be the deciding factor for individual investment opportunities. Some of the growth themes with which we tag individual stock ideas are almost immune from broader economic influences and this gives one confidence that they can deliver strong earnings almost independent of their host economies.

Platinum Asia Fund

Joseph Lai
Portfolio Manager

Performance

(to 31 December 2017)

	QUARTER	6 MTHS	1 YEAR	SINCE INCEPTION P.A.
PWP Asia Fund Class A USD	8.9%	20.3%	–	34.9%
PWP Asia Fund Class B USD	8.9%	20.9%	–	28.8%
PWP Asia Fund Class D USD	8.9%	20.9%	47.4%	21.1%
PWP Asia Fund Class I USD	9.0%	20.6%	–	40.6%
MSCI AC Asia ex Jp Index (USD)	8.2%	15.4%	41.7%	20.9%

Refer to note 1, page 23.
Source: Platinum Investment Management Limited, RIMES Technologies.
Historical performance is not a reliable indicator of future performance.

The Fund (Class D) rose 8.9% over the quarter and 47.4% over the year. The MSCI Asia ex-Japan Index (in USD) returned 8.2% and 41.7% over the same respective periods.

Markets across Asia took a slight breather to digest the gains from the last few quarters, nonetheless, still delivering positive performance. The Hong Kong market was up 6% (in local currency) and the domestic Chinese A share market was up 5%, as the market gradually starts to appreciate China's reform efforts. The Indian market rose 9% for the quarter (in local currency), as economic activity continues to pick up.

Our Chinese holdings made a significant contribution to performance. Strong companies positioned to service the burgeoning Chinese middle class consumers fared well, with China Merchants Bank (a premier retail bank) up 13% (H-share), Tencent up 21%, Jiangsu Yanghe (Chinese liquor producer) up 13%, and Midea (home appliance maker) up 25%. Healthcare stocks also performed well, with 3SBio (biologics company) up 22% and Shanghai Fosun Pharmaceutical Group (healthcare conglomerate) up 55% (H-share). Other strong performers include Tingyi (instant noodle maker) up 29%, BAIC (large auto maker with joint ventures with Mercedes and Hyundai, among others) up 37%, and Ping An Insurance up 36% (H-share). Elsewhere, banks across the Asian region are starting to pick up steam as economic recovery takes hold in India, Thailand and Korea.

Commentary

China

All eyes were on the Chinese National Congress during the quarter, which takes place once every five years. As per usual, Western press coverage focused on the consolidation of power and leadership succession plans (or, in this particular instance, the apparent lack thereof). While political intrigue may be of interest to some, what we are more interested in, as investors, is China's economic goal and the path it decides to adopt in order to reach it.

China's per capita GDP has grown from US$200 almost 40 years ago to US$8,500 today.[1] The "Reform and Opening-up" of its economy, coupled with the entrepreneurialism of its people, has already lifted hundreds of millions of people out of poverty. Deng Xiaoping's initial goal for the country in the 1980s was to grow the economy and ensure enough food and clothing for all. That goal was achieved within 10 years! His longer term goal was to achieve the level of prosperity of moderately developed countries by 2050.

In contrast, China's current leader, President Xi Jinping, appears more ambitious. He aims for China to become a "moderately prosperous society" by 2020 and a "modern socialist country" by 2035. The path which he laid out for China's development focuses on managing key risks, fighting

1 Gross domestic product per capita, current prices (US$). Source: IMF, World Bank, The Guardian.

poverty and pollution, and investing in technological innovation. We are pleased to find the Fund's China exposure broadly in sync with the direction the country is taking, with the major themes being consumption upgrade, robotics, fintech, healthcare and the emergence of industry champions.

You may find our upbeat pitch at odds with much of what you have read and heard in the media about the 19th National Congress. Some suggested that President Xi wants to steer the country back to the old (and failed) planned economy. We find this unduly pessimistic. Given Xi's aspirations for the country and the fact that the country's prosperity today is indisputably the result of market-oriented reforms, why would he want to backtrack?

Speculations that economic activity would drastically slow down post the Congress also proved to be ill-founded. Rather, we are seeing construction activity rebounding, with new construction starts measured by floor area growing by nearly 19% in November from a year ago, after falling 4.3% in October.[2] (Remember, as we have written in previous reports, China's property demand in fact outweighs supply.) Building machinery and equipment sales were very robust, with November's excavator and truck crane sales jumping more than 100% year-on-year.[3] This is not to suggest that we expect a dramatic pick-up in activity, but rather, that investors should not let their judgment be clouded by exaggerated fear and bias so as to lose sight of the real opportunities on offer.

Vietnam & Thailand

Several members of our investment team took a field trip to Thailand and Vietnam in November, visiting a number of companies.

Vietnam's economic growth has been picking up pace, with its GDP running at more than 6% p.a. and income growing at more than 5% p.a.[4] The reality is perhaps more nuanced than these headline numbers reveal. Vietnam can be thought of as a dual-economy. There is an uncompetitive domestic economy which still employs many people and runs a trade deficit. The more interesting part is a very competitive, fast-growing export economy that has no debt and is generating a sizeable trade surplus with very high profitability. This is the result of improving infrastructure, cheap labour, and foreign investment from countries like South Korea and China where labour costs are higher and continue to rise. Samsung Electronics, for instances, accounts for some 25% of Vietnam's exports which grew close to 20% in the first nine months of 2017 from a year earlier while foreign direct investment rose more than 13%.[5]

We were able to identify several fast-growing, well-managed companies in Vietnam which have healthy balance sheets and are trading at attractive valuations. Vietnam's ongoing privatisation is not dissimilar to what some other Asian countries have undergone in the past where outsize returns were available to stock pickers who were willing to perform diligent investigation.

Coming to the second leg of our trip, the valuations of most Thai stocks are reasonable, but their growth prospects are understandably less exciting than those in less-developed Vietnam. This is also why Thai companies have been looking for foreign opportunities to grow and expand, mostly in the Indochina region (Vietnam, Laos and Cambodia). For example, ThaiBev recently paid US$5 billion to acquire a majority stake in Vietnam's largest brewer, outbidding Anheuser-Bush InBev and Kirin.

There has been little investment in infrastructure in Thailand since former Prime Minister Thaksin Shinawatra was ousted in 2006, owing in no small part to the fact that subsequent governments struggled to stay in power for more than two years and that they favoured populist shotgun policies that focused on boosting consumption. However, the current military government does seem to have a genuine interest in reform.

Investors are sceptical of whether the government's promised investments will materialise, but from our meetings with Thai companies we did see signs of change:

- We learned from contractors that the tendering process for some government mega-infrastructure projects is well underway. Businesses like Siam Cement (a major construction material producer) are making preparations to meet growing demand ahead.
- Big companies and foreign corporations are starting to invest more.
- Factory utilisation rates are picking up.
- Retail sales are starting to rise after prolonged stagnation.

The most puzzling observation from our trip was a paradoxical expectation by most managements that we met with in both countries that inflation and interest rates would remain low while hiring and retaining staff are becoming increasingly difficult. The former assumption is unlikely to hold if the latter continues.

2 Source: Reuters.

3 Source: CICC Research; Citigroup.

4 Source: World Bank.

5 Source: Bloomberg.

Thailand's banking sector is in good shape. Thai banks have in recent years suffered from tepid loan growth, low interest rates which depressed margins, and ongoing provisioning charges for bad loans made half a decade ago. There are signs that all three metrics are beginning to improve as the economy steadies and gradually rebounds, which bodes well for the Fund's exposure to the Thai banking sector.

Changes to the Portfolio

The economic reforms that are taking place in China and India, together with the cyclical recovery across the Asian region, are producing rich pickings of investment ideas that are currently out of favour, hence cheap, but highly attractive over the longer term.

Given our Chinese stocks' strong performance over the past year, the Fund has trimmed some positions while deploying some of the cash to take advantage of the sectoral price weakness emanating from the excessive concerns over the slow-down of China's economy, mostly in the financials and other cyclical sectors.

Outlook

With the market having consolidated around the current levels, the outlook is perhaps becoming more sanguine. With an abundance of prospective ideas generated by the team, we are busy making risk-reward evaluations to prioritise the most attractive opportunities for the Fund.

Top 10 Holdings

STOCK	COUNTRY	INDUSTRY	WEIGHT
Alibaba Group	China	IT	3.3%
Ping An Insurance Group	China	Financials	3.3%
Axis Bank Ltd	India	Financials	3.1%
Kasikornbank PCL	Thailand	Financials	3.0%
China Merchants Bank	China	Financials	3.0%
Tencent Holdings	China	IT	2.8%
Samsung Electronics	Korea	IT	2.8%
China Overseas Land & Invt	China	Real Estate	2.5%
Jiangsu Yanghe Brewery	China	Consumer Staples	2.5%
CNOOC Ltd	China	Energy	2.3%

As at 31 December 2017. Refer to note 3, page 23.
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.

Disposition of Assets

REGION	31 DEC 2017	30 SEP 2017
China^	52%	57%
Hong Kong	3%	3%
Taiwan	2%	2%
Korea	12%	10%
India	10%	9%
Thailand	4%	4%
Philippines	2%	4%
Vietnam	1%	2%
Indonesia	1%	1%
Singapore	1%	1%
Malaysia	<1%	1%
Cash	12%	6%

^ Inclusive of all China-based companies, both those listed on exchanges within China and those listed on exchanges outside of China.
Refer to note 2, page 23.
Source: Platinum Investment Management Limited.

Sector Breakdown

SECTOR	31 DEC 2017	30 SEP 2017
Financials	21%	18%
Information Technology	17%	21%
Consumer Discretionary	11%	15%
Industrials	8%	6%
Materials	6%	7%
Consumer Staples	6%	7%
Real Estate	6%	7%
Energy	5%	5%
Health Care	4%	3%
Telecommunication Services	2%	2%
Utilities	2%	3%
TOTAL NET EXPOSURE	88%	94%

Refer to note 5, page 23.
Source: Platinum Investment Management Limited.

Currency

CURRENCY	31 DEC 2017	30 SEP 2017
Hong Kong dollar (HKD)	42%	41%
US dollar (USD)	19%	19%
Korean won (KRW)	12%	10%
Indian rupee (INR)	10%	9%
Chinese yuan (CNY)	6%	7%
Thai baht (THB)	4%	4%
Philippine peso (PHP)	3%	4%

Refer to note 4, page 23.
Source: Platinum Investment Management Limited.

Platinum Japan Fund

Scott Gilchrist
Portfolio Manager

Performance

(to 31 December 2017)

	QUARTER	6 MTHS	1 YEAR	SINCE INCEPTION P.A.
PWP Japan Fund Class A USD	8.2%	17.9%	31.5%	22.5%
PWP Japan Fund Class B USD	8.1%	18.8%	34.0%	32.1%
PWP Japan Fund Class D USD	8.1%	18.8%	33.9%	21.3%
PWP Japan Fund Class F EUR	_	_	_	5.5%
MSCI Japan Index (USD)	8.5%	12.8%	24.0%	12.1%

Refer to note 1, page 23.
Source: Platinum Investment Management Limited, RIMES Technologies.
Historical performance is not a reliable indicator of future performance.

The Fund (Class D) rose 8.1% for the quarter and 33.9% for the twelve months. Portfolio performance contribution was broad based for both periods.

Over the last two years, the Fund (Class D) appreciated 22.2% per annum. Indeed, a compound return of 21.3% p.a. since the Fund's inception in November 2015 is pleasing both on an absolute basis and relative to the MSCI Japan Net Index (USD) which returned 12.1% p.a. over the same period. Against this backdrop it is appropriate to consider future returns. As outlined below, there are many reasons why current opportunities are just as attractive as those seen in recent years and our assessment is that the investments currently in the portfolio will generate good medium to long term returns.

Disposition of Assets

REGION	31 DEC 2017	30 SEP 2017
Japan	91%	90%
Korea	2%	2%
Cash	7%	8%
Shorts	-1%	-1%

Refer to note 2, page 23.
Source: Platinum Investment Management Limited.

Sector Breakdown

SECTOR	31 DEC 2017	30 SEP 2017
Information Technology	22%	23%
Industrials	20%	19%
Consumer Discretionary	15%	16%
Materials	13%	12%
Energy	9%	8%
Financials	7%	7%
Health Care	3%	4%
Telecommunication Services	2%	3%
Consumer Staples	1%	-1%
TOTAL NET EXPOSURE	92%	91%

Refer to note 5, page 23.
Source: Platinum Investment Management Limited.

Currency

CURRENCY	31 DEC 2017	30 SEP 2017
Japanese yen	74%	70%
US dollar	24%	28%
Korean won	2%	2%

Refer to note 4, page 23.
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.

Changes to the Portfolio

New opportunities continue to be identified which are more attractive than current holdings. There are many businesses in Japan which have been fallow for almost a decade and are now showing signs of renewal.

Top 10 Holdings

STOCK	COUNTRY	INDUSTRY	WEIGHT
Nexon	Japan	IT	4.3%
Nintendo	Japan	IT	3.4%
Itochu Corporation	Japan	Industrials	3.4%
Inpex Corporation	Japan	Energy	3.4%
Japan Petroleum Exploration	Japan	Energy	3.2%
JSR Corp	Japan	Materials	3.0%
Lixil Group	Japan	Industrials	2.9%
Sumitomo Metal Mining	Japan	Materials	2.9%
Murata Manufacturing Co	Japan	IT	2.5%
Nitto Denko Corp	Japan	Materials	2.4%

As at 31 December 2017. Refer to note 3, page 23.
Source: Platinum Investment Management Limited.

Commentary

There are widespread concerns about Japan, both subliminal and widely discussed. At a group dinner in Tokyo late last year, a loud and opinionated American confidently told the whole group repeatedly about the failings of the country. It reminded me of a site visit to Mount Isa Mines fifteen years ago where I witnessed a raucous local fund manager laying accusations at management in an embarrassing manner. MIM was subsequently purchased for a song at the start of the commodity super-cycle.[1]

Some major concerns about Japan and a brief comment follow, most of which are backward-looking:

- Corporate governance – there has been a multi-decade process of improvement which is now finally accelerating.
- Demographics – this is a well understood issue at many levels in Japan and steps are being taken to address it.
- Nominal GDP – after decades of deflation, signs of inflation are emerging. The price of goods and services in Japan often seems cheap relative to leading developed countries, especially when adjusted for quality.
- Geopolitics – There are many concerns about China, especially military activities in their adjoining oceans. North Korean missile launches are a headline topic of debate. Russia and the irritation of the Magnitsky Act[2] are surely lurking beneath the surface. These are complicated relationships with millennia of history.
- Government debt levels – the Bank of Japan now owns the majority of the outstanding Japanese Government Bonds. There is no clear plan for the resolution of what looks like an extreme experiment in monetary policy. The outcome will be very path dependent.
- Fiscal deficit – the government deficit has been decreasing through a combination of increased sales tax and broad based economic improvement. There has been a long-term focus on fixing this situation, and more changes are expected in a stable political environment.

Other concerns about Japan’s future include:

- Low R&D productivity
- Lack of innovation and fast growth companies
- Limited global brands
- Labour immobility and inflexibility
- Depopulation of regional centres
- Low labour productivity
- Energy and commodity import dependence
- Aging corporate leadership

Some of these concerns are real; many are mere distractions.

What is new is old. The Romans poisoned themselves with lead pipes and polluted their air with smelters across the Empire. The Chinese seem to have read *Silent Spring* (Carson, 1962) and are focused on remedying the environmental degradation resulting from decades of helter-skelter development. There were 9,000 windmills in the Netherlands in the 1800s, a precursor to the spread of wind and solar installations across the world today. The British Pound has devalued consistently since the Sun set on the British Empire, and the current hegemony is following their footsteps. With actual or potential regime changes in Zimbabwe, Russia, Saudi Arabia, Iran and Venezuela, the treadmill of tyranny seems to be accelerating despite the delightful misunderstanding that it’s too early to assess the impact of the 1789 French Revolution.[3]

1 Platinum was at the time a shareholder in MIM, a company listed on the Australian Securities Exchange. We vociferously opposed its takeover by Xstrata in 2003, arguing that the bid grossly undervalued the company’s long-term potential. But there was no stopping the short-sighted institutional holders.

2 A law passed by the US Congress in 2012 intended to punish Russian officials who were thought to have been responsible for the death of Russian tax accountant Sergei Magnitsky by prohibiting their entrance to the US and their use of US banks. Magnitsky died in a Moscow prison after investigating fraud involving Russian tax officials.

3 During Richard Nixon's historic visit to Beijing in 1972, the then Chinese premier, Zhou Enlai, was asked about the impact of the "French Revolution", to which he answered "too early to say". What was once thought a diplomatic quip was in fact a misunderstanding by Zhou – he had in mind the events of 1968 while the question referred to the Revolution of 1789.

On a recent visit to GS Yuasa, a lead acid and lithium ion battery maker in Kyoto, the display in their office lobby was an electric car from 1917 with the following description: “The history of the electric vehicle dates back to 1873 when the first electric vehicle was assembled in England. In 1915, 2,000 vehicles were in use in New York and around 1926 29,000 electric vehicles were being used in various fields all over the USA. The electric vehicle 'DETROIT' was imported from the USA in 1917 by GS Yuasa. Powered by the company’s lead acid battery, it was used for nearly 30 years until 1946.” Detroit had a range of 33 km propelled by an 11 kWh battery at 24 volts with a kerb weight of 1,440 kg.

A 1917 electric vehicle named 'DETROIT' on display in GS Yuasa's Kyoto office lobby. Source: author

Yet, the modern world is full of wonder and amazement. Would the intrepid intercontinental traders of prior millennia puzzle over the instant connectivity possible between the globe’s five billion adults? Would ancient Chinese retailers recognise a GPU accelerated data centre as a modern abacus? Is the nascent blockchain just a shiny shell or a piece of gold? Global development enabled by technology and communication is seemingly inexorable despite the many diversions and depredations. World poverty has been in clear decline for decades and again reached a new low last year. 2017 was the first year in the history of modern aviation with no commercial air deaths.

Our assessment is that Japan is reasonably well positioned for both the new and the old of the coming decades.

- E-commerce – Japan has been slower than leading countries to migrate to online shopping. However, the current environment feels like 2005 in North America and there are a wide range of Japanese companies with B2C (business-to-consumer) and C2C (consumer-to-consumer) platforms in place, which are growing exponentially.
- Quantum computing – NF Corp and Fixstars are Japanese companies which supply software and components to a Canadian company selling quantum computers today. Japanese companies are using quantum computers to optimise advertising networks and develop new polymers. In both cases, better real world solutions are being found.
- Artificial Intelligence/Machine Learning – Japanese companies are neither the software nor hardware leaders, but are fast followers across multiple industries.
- Self driving cars – The Japanese auto OEMs have been building safety and self driving features for many years. The industry is moving so fast that it’s not yet clear which components, solutions, processors or software will prevail, but it seems likely that the Japanese will be in the leading group.
- Cloud computing – Software-as-a-service (SaaS) and other cloud computing services are widespread across the Japanese economy.
- 5G networks – NTT is one of the global leaders; capex starts in March 2019 with a full rollout across the 23 wards of central Tokyo in preparation for the 2020 Olympics.
- EVs – Toyota is the largest electric car company in the world. There are supply chains for cathode, anode, separator and electrolyte materials across the country, including for Tesla and the Gigafactory.
- Robots – Japan is the undisputed global leader in the area of joints, controls, motors, integration and software. The full list of Japanese robotics companies is extensive.
- Blockchain – the largest blockchain investor is a Japanese company and significant amounts of cryptocurrency trading occur in Japan. Japan is at the forefront of nations embracing the dawn of the Internet of Value. Real world uses of the blockchain are only just beginning as Patrick Byrne of Overstock turns from e-commerce to new ventures that include a blockchain-based global property registry.

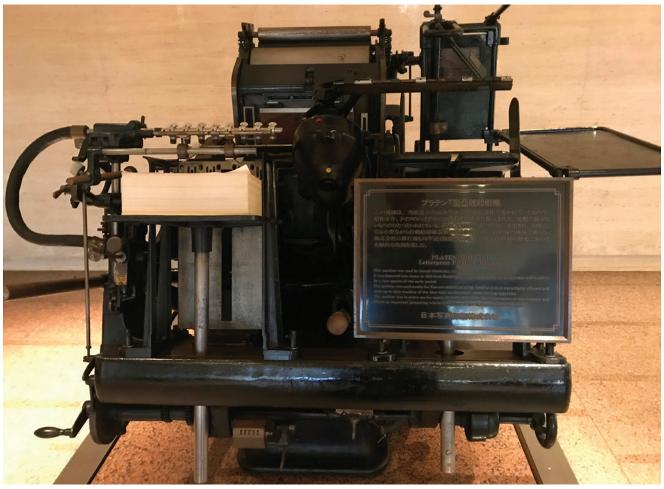
- Internet of Things (IoT) – SoftBank bought ARM and is building a global platform which will be integrated with their mobile networks to provide hardware and services with increased bandwidth, lower latency and orders of magnitudes more allowable connections. Japan excels at passive components essential for the trillion connected devices enabled by 5G.
- 3D printing – Japanese machine tool companies have many active development paths.
- Virtual reality (VR)/augmented reality (AR) – Nintendo developed commercial VR products in 1995 and launched the mobile AR game Pokémon GO in 2016.
- Environmental protection – Japanese companies excel across the full range of water and air pollution prevention machinery and chemicals.
- Distributed services – Japan has embraced car sharing, micro delivery networks and home sharing, where appropriate.

In the context of a long bear market and wide value dispersion, some aspects relevant to the Japanese stock market are worth mentioning:

- The domestic economy is strong. Surprisingly to many, employment in Japan is at all time record highs. Corporate confidence and snug labour markets are resulting in higher wages.
- Profit margins are rising. After six decades oscillating between 2% and 4%, Japanese profit margins have risen above 6%, a combination of low interest expense, higher domestic margins and record foreign profits. Japanese corporate profits are at record levels, twice the previous peak, while the Nikkei is half of its previous peak.
- Domestic competition is easing. Game Theory, in particular Nash's Equilibrium, makes predictions of market behaviour. The practical world experience tends toward the theoretical construct, but with a delay. Decades of rough competition in Japan are now transitioning to a more benign environment. The beer industry is in the early stages of this: "the chain of communication between the four players is open and working well".
- Both retail and institutional domestic investors continue to sell the stock market, extending a 25-year trend. The only significant buyer of the market in recent decades has been foreigners. The balance sheet of the Japanese consumer is strong, with US$8 trillion of cash and US$1 trillion of equities relative to an overall market valuation of US$5 trillion. In combination with a large set of domestic pension funds and insurers who have low equity holdings, it would not be hard for a small shift in asset allocation to change the tone of the stock market.
- Valuation dispersion is currently a defining feature of the Japanese stock market with many indicators of dispersion near the widest seen in the last few decades. Many stocks have P/E ratios above 50x, some approaching 100x, but there are also whole swathes of the market with single digit P/E ratios.
- The overall market valuation is not extended. While nominally on a P/E multiple around 15 times, this ignores the extensive Treasury shareholdings, the widespread cross-holdings and large amounts of cash. These are perhaps almost 30% of the total market capitalisation.
- Post the 1989 bubble, Japan has experienced a 30 year bear market. This is perhaps the longest stock market bear run in modern financial market history. A lot of the indicators that one would expect are clearly evident: very cheap companies, low stock market participation, widespread corporate problems and early signs of rejuvenation.
- Interest rates in Japan for most deposits are effectively zero. There is clear demand for products with yield, including financial products linked to the share market. The need for higher dividends is pushing real improvements in corporate behaviour – it's a true economic incentive.
- Asian and global integration – inbound tourist numbers to Japan are growing rapidly, leading to intermittent hotel shortages and pressure in some areas of the economy. This is just one aspect where Japan's integration into Asia becomes apparent – the future of Japan is tied to and intertwined with Asia broadly. Imagine the scenario where China bridges the middle income gap and India shows even part of its true potential. ASEAN growth is currently robust and Japanese companies have strong businesses across Vietnam, Burma, Thailand and Indonesia.
- Many areas of the global production system are reaching limits. THK's lead time for linear guides and other complex machine parts has recently increased from three to more than eight months. Many greenfield expansion plans are being considered; but thwarted by lack of available machinery. In many ways, the current global macro situation seems strong, perhaps as strong as any stage of the last decade.

Late in 2017 we visited 35 companies in Tokyo and Kyoto and checked in with some of our many contacts in the country. In some ways, Japan is a "solution looking for a problem" and, while for the moment there is no resolution to this conundrum, much of the country seems to have found enough activity to keep itself busy. There was a sense of calm and focus that has not been as evident over the last three years. The capacity expansion and the resulting capex has driven machine tool backlogs to record highs. The world is leaning towards Japan's strengths of precision and quality across semiconductor production equipment, miniature electronic components and mass automation of production capacity.

Nissha Printing is a Kyoto based business which is currently in the third generation of family management. They have been in the printing business for one hundred years and have been making touch panels for electronic devices for thirty years. They started working with Apple in 2010 and since 2013 have been the sole source supplier of the touch panel for the iPad, a monopoly position. With Apple's transition to OLED screens, Nissha is the sole supplier of the touch sensor and pressure sensor for the new iPhone X. We have been identifying many such opportunities in addition to the usual deep-value cyclicals and global leaders that are ever present in Japan.



A rare letterpress printing machine imported by Nissha from Germany in 1933. Source: author

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   - Platinum World Portfolios - Asia Fund — MSCI All Country Asia ex Japan Net Index (US$)
   - Platinum World Portfolios - Japan Fund — MSCI Japan Net Index (US$)

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   The portfolio inception dates for each active share class of the relevant Fund are as follows:
   - Platinum World Portfolios - International Fund:
     Class A USD (Accumulating) (ISIN: IE00BYRGQX37): 27 April 2016
     Class D USD (Accumulating) (ISIN: IE00BYRGQZ50): 16 November 2015
     Class G GBP (Accumulating) (ISIN: IE00BYRGR290): 27 April 2016
     Class B USD (Accumulating) (ISIN: IE00BYRGR076): 2 December 2016
     Class F EUR (Accumulating) (ISIN: IE00BYRGR183): 4 April 2017
     Class H GBP (Accumulating) (ISIN: IE00BYRGR308): 4 August 2016
   - Platinum World Portfolios - Asia Fund:
     Class A USD (Accumulating) (ISIN: IE00BYRGR522): 10 March 2017
     Class D USD (Accumulating) (ISIN: IE00BYRGRD06): 16 November 2015
     Class B USD (Accumulating) (ISIN: IE00BYRGR639): 20 April 2017
     Class I USD (Accumulating) (ISIN: IE00BYMJ5524): 19 January 2017
   - Platinum World Portfolios - Japan Fund:
     Class A USD (Accumulating) (ISIN: IE00BYRGRF20): 11 January 2016
     Class D USD (Accumulating) (ISIN: IE00BYRGRJ67): 16 November 2015
     Class B USD (Accumulating) (ISIN: IE00BYRGRH44): 23 December 2016
     Class F EUR (Accumulating) (ISIN: IE00BYRGRL89): 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.

2. The geographic disposition of assets (i.e. the positions listed other than "cash" and "shorts") represents the Fund's exposure to physical holdings and long derivatives (of stocks and indices) as a percentage of the Fund's net asset value.

3. The table shows the Fund's top 10 long stock positions (through physical holdings and long derivatives) as a percentage of the Fund's net asset value.

4. The table shows the Fund's major net currency exposure as a percentage of the Fund's net asset value, taking into account currency hedging.

5. Sector breakdown represents the Fund's net exposure to physical holdings and both long and short derivatives (of stocks and indices) as a percentage of the Fund's net asset value.

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