



Platinum  
World Portfolios  
Japan Fund

Quarterly Investment  
Manager's Report

30 September 2016

# Platinum World Portfolios - Japan Fund



**Scott Gilchrist** Portfolio Manager

## Disposition of Fund Assets

REGION	SEP 2016	JUN 2016
Japan	91%	88%
Cash	9%	12%
Shorts	0%	-1%

Source: Platinum. Refer to note 2.

## Sector Breakdown

SECTOR	SEP 2016	JUN 2016
JAPANESE INTERNATIONAL FOCUS	46%	43%
Electronics	23%	24%
Industrials	11%	8%
Autos	6%	7%
Energy	6%	4%
JAPANESE DOMESTIC FOCUS	45%	45%
Internet	23%	22%
Financials	10%	11%
Health Care	5%	5%
Property	5%	4%
Consumer	2%	3%
GROSS LONG	91%	88%

## Currency Position

	SEP 2016	JUN 2016
Japanese yen	73%	88%
US dollar	27%	12%

Source: Platinum

## Performance

(compound pa, to 30 September 2016)

	QUARTER	6 MONTHS	SINCE INCEPTION
PWP Japan Fund (Class D USD)	11.6%	11.7%	10.6%
PWP Japan Fund (Class A USD)	11.3%	11.7%	11.6%
MSCI Japan Net Index	8.6%	9.7%	3.1%

Source: Platinum and MSCI. Refer to note 1.

Portfolio performance for the quarter was positive with a significant contribution from stock selection, especially some larger holdings in the games industry plus a range of low valuation stocks. Early in the quarter, the Japanese stock market moved back towards the top end of its recent trading range, adding to performance. Short positions were a minor positive for performance. The relevant currencies were roughly flat for the quarter.

## Changes to the Portfolio

The portfolio remains fully invested in Japanese equities. During the quarter, some defensive holdings were trimmed. A range of low valuation and cyclical stocks were purchased. In sum, this resulted in a smaller cash position. The short equity positions were closed. Exposure to the Japanese yen was reduced by purchasing US dollars.

## Top 10 Holdings

STOCK	COUNTRY	INDUSTRY	WEIGHT
Nintendo	Japan	IT	3.8%
DeNA	Japan	IT	3.5%
Ushio	Japan	Industrials	3.2%
JSR Corporation	Japan	Materials	3.0%
Inpex Corporation	Japan	Energy	3.0%
NTT	Japan	Telecom	2.9%
JAPEX	Japan	Energy	2.9%
NTT DoCoMo	Japan	Telecom	2.9%
Sumitomo Mitsui Financial	Japan	Financials	2.8%
Mitsubishi UFJ Financial	Japan	Financials	2.8%

Source: Platinum. Refer to note 3.

## Commentary

### Nintendo

Platinum has followed Nintendo's progress for many years and through a few cycles. Currently, the Fund has a large investment in a group of companies associated with Nintendo, including DeNA, MegaChips and Minebea. Recent performance of this group has been positive as the mobile game Pokemon Go became a major hit and the launch event for Apple's iPhone 7 included both Nintendo's Creative Director, Miyamoto, and the CEO of Niantic, the developer of Pokemon Go. After a long period of opacity, Nintendo's actions are speaking clearly as they adapt their industry-leading Entertainment Properties to the two key smartphone operating systems, Apple and Android. This could potentially lead to a positive cycle of reinforcement as past and new gamers engage with Mario, Pokemon and Zelda feeding through to a console cycle. The market is bipolar in its assessment of Nintendo, which is understandable given the lack of clarity on key aspects of the investment case and the lack of details on upcoming games and hardware launches.

### Japanese Pharma

We recently spent a week in Tokyo, mainly on a pharmaceutical tour with a group of global investors visiting the leading ethical drug, generic drug and medical device companies. In the last five years, Japanese scientists have won three Nobel Prizes in Medicine, reflecting the country's commitment to long term fundamental science. This is reflected in the Japanese pharmaceutical industry's past success and current undertakings. However, in general, it was hard to identify new investment opportunities for a few reasons. The headline issue is the lack of growth in the domestic market as long listed drugs face increasing price pressure from generics. Somewhat surprisingly for a developed market, new innovative drugs also face price cuts if they are successful. The nation's overall drug budget is likely to fall slightly over the next decade according to GlaxoSmithKline (GSK), despite an ageing society. Secondly, the valuations across the sector reflect the somewhat defensive nature of the pharmaceutical industry for which investors are willing to pay a premium. Thirdly, the innovation is currently occurring outside the incumbents who are thus forced into a string of expensive acquisitions to maintain their position. They seem reluctant to admit that their past success is perhaps not repeatable. Companies with new drugs trade at large premiums to both their peers and the overall market.

Japan undoubtedly has a strong ongoing position as a global centre for innovation in robotics, novel compounds, and drug development. One unanswered puzzle is Japan's lack of success in the area of biologic drugs despite a high level of research spending. Recent changes to the development and approval process, highlighted by the Health Ministry's "Strategy of SAKIGAKE" (or Strategy of Pioneering), will likely change this. Japan's regulatory approach to stem cell leads the global industry and could be a major new industry for the country.

M3 is a Japanese software company that has developed an innovative communication platform for dissemination of drug efficacy and safety information to doctors that is extremely successful in Japan and is now spreading around the world. This channel will eventually lead to improved sales efficiency, but structural rigidity means that Japanese medical representative numbers remain static despite their loss of relative effectiveness. M3's massive future revenue opportunity plus their geographical and new business ambitions are reflected in the current valuation at the high end of market multiples.

Sosei is a Japanese drug development company which Platinum funded during its early phases of corporate development last decade. Revisiting the company after some time, it was intriguing to see the latest developments. The current CEO, Peter Bains, is ex-GSK and recently was CEO of Syngene when it listed in Mumbai. While the core of Sosei is Japanese, it seems as though they have looked worldwide for talent rather than restricting themselves to the local market. Over the last decade, Sosei has purchased a series of drug discovery companies including Arakis, Activus, Jitsubo and Heptares. The first products are now on the market: Seebri and Ultibro, developed in collaboration with Novartis and Vectura. These provide a small but very useful royalty stream for Sosei. However, it is the last of these acquisitions that seems the most promising.

Heptares was founded in Cambridge seven years ago and the early years consisted of two industry and academic veterans doing basic science in a demountable shed on the outskirts of the city where Francis Crick and James Watson delineated the structure of DNA. Malcolm Weir and Fiona Marshall founded Heptares and have subsequently built a team and a pipeline of prospective drugs which looks both substantial and tantalising. Their key breakthrough was stabilisation of key molecules called G Protein-coupled receptors, located on the outsides of human cells. These receptors have been targeted by over 40% of current pharmaceuticals, yet only roughly one quarter of potential targets has been addressed. Once the

### Diamond Light Source, the synchrotron x-ray beam facility located in the County of Oxfordshire, England



Source: [www.diamond.ac.uk](http://www.diamond.ac.uk)

stable proteins are isolated, they are crystallised, imaged in a 600 metres-in-diameter synchrotron x-ray beam facility, and their structure analysed by supercomputers, then drugs are designed to interact with the specific receptors while not interfering with other pathways. Each step in the above process is not trivial and the successful identification of each opportunity requires both luck and brilliance. The wider industry seems to have recognised the opportunity for structure-based drug design and development based on this approach and recent collaborations coming with hard cash include Allergan, AstraZeneca, Teva, Pfizer, Medimmune and MorphoSys. Peter Bains and his team scoured acquisition targets all over the world and rejected fifty others before purchasing Heptares. The initial purchase price of US\$400 million has already paid for itself. The current valuation of Sosei reflects a reasonable amount of success despite the early stage of their efforts.

Eisai is a drug discovery company that has been managed by the Naito family since it was founded in 1941. They have had an international presence since the 1970s and a global footprint since the 1990s. Their research laboratories are located in Japan, the USA and the UK and have led a series of novel drug developments. Currently the company is passing through a performance trough but their science and management appear as strong as ever and the pipeline has potential. The key focus of the moment is their work on Alzheimer's Disease where they have three compounds in clinical trials – internally developed compounds E2609 and BAN2401 plus a Biogen compound Aducanumab B1B037, licensed from a Swiss company, Neurimmune. All three drugs are being developed through an agreement with Biogen, and the success of just one would fundamentally change the outlook for Eisai.

While the Fund does not currently own M3, Sosei or Eisai, we find these companies interesting not only in their own respective ways, but also as being indicative of the prospects for Japan's broader biotech sector. These represent excellent examples of the types of companies we would look to invest in if and when valuations become sufficiently attractive.

### Abenomics and BOJ Revisited

Abenomics commenced in late 2012, thus there has been much reflection on the success or otherwise of Prime Minister Abe's namesake policy following the recent renewal of his political mandate. It seems rather early for such an assessment when the plan is long term and the proponent's energy and desire is undaunted. Similarly, the Governor of the Bank of Japan (BOJ), Haruhiko Kuroda's energy levels seem undiminished. His key speech in early 2013 talked of "unconventional policy" "for as long as necessary". The practical effect of Kuroda's activities was to reduce interest rates across the yield curve indirectly through large scale purchases of Japanese Government Bonds (JGBs). Recently, he renewed his commitment to further policy action for an extended duration. A brief summary of his latest policy is that the BOJ will now effectively set interest rates along the curve until inflation rises sustainably above their 2% target. They also increased their purchase of ETFs listed on the Japanese stock market. The outlook is for an extended period of negative real interest rates in Japan.

### Commodities and OPEC

The term "commodity super-cycle" was coined a decade ago as the building crescendo of Chinese industrialisation pushed the global raw material supply chains to their limits and scarcity pricing prevailed. Current market conditions are at the opposite end of the spectrum with pervasive oversupply and pricing constrained at the lower bound by falling cost curves. Valuations across the energy, agricultural, mining, shipping and other basic industries reflect the somewhat dire backdrop of oversupplied markets, ongoing capacity addition and the lack of a major source of demand. Clearly the above description is well understood by the various industries, but generally the supply side is fragmented and disorderly and thus unable to respond. There are a few exceptions to this. One example has been nickel where the Indonesian sovereign banned raw ore exports, thereby putting the Philippines in the position of prime marginal supplier to the Chinese nickel processing industry. Recent actions by the newly elected Philippine government appear to be following the Indonesian example and the large nickel stockpile overhang could

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perhaps drop quickly after allowing for seasonal shipments. In the case of coal, both thermal for power generation and coking for steel making, Beijing imposed a 276 day per annum operating regime on the country's massive production base. Coking coal prices have doubled from the trough. There are a few other scattered examples of supply side cohesion, however, the most important one is OPEC's recent change of stance. The oil market is well into the process of rebalancing, and any further management of supply by the key seaborne suppliers while demand continues to grow will be influential despite the positive outlook for North American shale oil production. Recent global oil discovery rates are at sixty year lows and the spare production buffer is approaching the lowest level on record.

## Outlook

Recent months have seen a frenzy of central bank analysis. Every utterance of the Bank of Japan, the European Central Bank, the US Federal Reserve, etc. received detailed scrutiny and dissection. It seemed like an endless loop of questions such as "does Quantitative Easing work?", "is tapering

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imminent?", "are the hawks or doves ascendant?"... It reminds one of a statement made by Alan Greenspan, who served as the Chairman of the US Federal Reserve for almost twenty years: "Since becoming a central banker, I have learned to mumble with great incoherence. If I seem unduly clear to you, you must have misunderstood what I said". Certainly, attempts at deciphering the many convoluted messages from the developed world's financial centres have been a major distraction for the markets, which have seemingly lost some focus on the economic backdrop, corporate valuation and underlying business performance. The imminent election in the US has caused additional turbulence. Looking back to the market gyrations earlier in the year, it is quite unexpected that the Japanese equity markets are today at roughly the same level as they were in January, nine months ago. The sense garnered from our recent trip to Japan is that most market participants are weary and disinterested after nine months of directionless trading. This seems like a decent backdrop for a continuation of the outlook described last quarter: reasonable equity returns based on a portfolio of high-quality, cheap stocks with attractive medium term prospects.

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An umbrella fund with segregated liability between sub-funds  
Company Registration Number: 546481

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## Notes

1. The Fund's total returns are calculated using its net asset value attributable to the relevant share class (where applicable) and represent its combined income and capital returns for the specified period. The Fund's total returns are pre-tax and are net of fees and expenses (excluding investment performance fees, if any). The investment returns shown are historical and no warranty can be given for future performance. You should be aware that historical performance is not a reliable indicator of future performance. Due to the volatility in the underlying assets of the Fund and other risks associated with investing, investment returns can be negative (particularly in the short-term).

The index represented is the MSCI Japan Net Index (US\$) (the "Index"). Index data has been sourced from MSCI Inc. Index returns include dividends but, unlike the Fund's returns, do not reflect fees or expenses. It should be noted that the Investment Manager does not invest by reference to the weighting of the Index. Underlying assets of the Fund are chosen through the Investment Manager's individual stock selection process and, as a result, holdings vary considerably to the make-up of the Index. The Index is provided as a reference only.

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

Class D USD (Accumulating) (ISIN: IE00BYRGRJ67): 16 November 2015

Class A USD (Accumulating) (ISIN: IE00BYRGRF20): 11 January 2016

The inception date for the purpose of calculating Index returns, as contained in this publication, is taken to be the inception date of Class D of the Fund.

2. Regional exposures (i.e. the positions listed other than "cash" and "shorts") represent any and all physical holdings, long derivatives (stock and index), and fixed income securities.
3. The table shows the Fund's top ten long stock positions. Long derivative exposures are included. However, short derivative exposures are not.

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