

# Optimal FUND MANAGEMENT

## Monthly Report to Shareholders of the Optimal Japan Absolute Long Fund May 15<sup>th</sup>, 2007

30 April 07	Offshore Feeder	US Feeder
NAV*	\$15.21	\$15.31
Monthly return %	0.33	0.46

*\*The NAV shown above is after expenses and management fees but before any performance fees. The Fund return may thus not be the same as the return of a discrete investment that might be subject to performance fees through equalisation.*

**At the end of December 2006, we reorganised the Optimal Japan Absolute Long Fund into a Master-Feeder structure and as a result, the existing Fund becomes the Offshore Feeder. A new Feeder Fund for US tax paying investors has been created and will produce K-1 forms for US tax purposes. As a result, there will be no more PFIC reports produced. Anyone interested in investing should contact [optimal@optimalasia.com](mailto:optimal@optimalasia.com) to make sure they get the relevant documents and application forms.**

The Japanese market was unable to shake itself into life in April. Perhaps it was the imminent reporting season that kept everyone sitting on the fence, or maybe it was the sloth produced by too much carousing under the cherry trees for the domestic investors. For foreigners, it was more likely a case that there was so much fun to be had elsewhere in Asia. The MSCI Asia Pacific (ex-Japan) Free Index was up almost 5% in April led by the barnstorming markets of Malaysia, Indonesia, India and Korea. Only Taiwan – perhaps the market that has more similarities to Japan than either country would care to admit – produced a return worse than Japan’s as their index fell 0.1% and lags the region with a YTD gain of less than 1%.

As the company profit results for the year to March 2007 began to come through, the market in Japan has changed in nature with high-beta sectors that did poorly in April rocketing ahead. The big gains seen in the first two weeks of May in sectors such as Shipping, Other Finance, Securities and Banks may be partly down to sectorial rotation (a Japanese favourite play on reversion to the mean) but is also due in some part to great results and strong forecasts. As anyone investing in Japan would know, the pattern of the past few years has been for companies to announce painfully modest forecasts at the time they release their financial results and then spend the year revising up and beating “forecasts”. Although it is too early to generalise, we have noticed some forecasts from Japanese companies that show a bit of the old (distinctly un-Japanese) swagger is back. Mitsui Fudosan – a real estate major that we have had a long and beneficial love affair with – announced a new three year plan two years earlier than expected. The reason for the haste was that they had reached the targets of their existing three year plan two years earlier than “planned” so now we have a plan that takes us to March 2010 and that includes annual growth of operating profits of 12%. Given that they have achieved average OP growth of 15% in the past three years, this may seem anaemic, but the implicit doubling of profits in a six year period beginning in April 2004 is no mean feat when the economy is growing at between 1.5-2.5%. They are by no means the only company we own that has given us some cause for hope. Topcon – added quite recently to our portfolios – has announced a good result for March 2007 with

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Level 5  
175 Macquarie Street  
Sydney NSW 2000  
Phone: 61 2 8239 3300  
Fax: 61 2 8239 3333  
[optimal@optimalasia.com](mailto:optimal@optimalasia.com)  
[www.optimalasia.com](http://www.optimalasia.com)

6F Izumikan Kioicho  
4-3 Kioicho, Chiyoda-ku  
Tokyo 102-0094  
Phone: 81 3 3238 1671  
Fax 81 3 3238 1687

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OP up 16% on the previous year. Better still, they are expecting further OP growth to March 2008 of over 20%. This would take already healthy operating profits margins from 13.5% to 15.5% and given the demand for their positioning devices, we share their confidence.

Apart from the good results coming through and the encouraging tone to forecasts, there is still much to be done for Japan's share market to attract the concerted interest of the domestic individual investor. As long as the current yield attainable in overseas assets such as government bond funds is far superior to that from investing in similar assets at home, it is very likely that the trend for investment in overseas assets will come to an end.

Too many Japanese companies are indifferent to the interests of their shareholders and continue to pay down debt to levels where their balance sheets are grossly inefficient to equity interests. The private equity stormtroopers have yet to make any real advances in Japan – admittedly something we do not shed many a tear for – but it would be massively positive if we saw evidence that Japan Inc still had some fire in the belly and cared about its relative place in the world of corporate endeavour. It was a shame that the attempted takeover by Oji Paper of Hokuetsu Paper ended in failure last year as that was a purely Japanese affair based on sound arguments of market share and capacity in the paper industry. Investors in Japan need something similar to the success that Porsche has had in Germany with its holding (to control levels) in VW. It is ironic that Porsche's chief executive openly talks about "stealing" from Toyota's example and is disdainful of the capital markets and yet is prepared to take control of a rival German car maker. In our view, should a more aggressive corporate culture take hold in Germany, Japan is likely to follow. Already Germany has cut company tax and there are strong rumours that the same will happen in Japan in 2008. The downside in Japan is negligible in our opinion. The upside depends on Toyota and its fellow corporate leaders to determine through their actions.

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**Month-end investments (as % NAV):**

**Equity Long: 95.18%**

**Index Future: (44.10%)**

**Net exposure: 51.08%**

**Fund size: US\$ 527 mil**

**Total number of positions: 37**

**Top 5 positions:**

	% of NAV
Toyota Motor	5.29 %
Tokyo Tatemono	5.16 %
Komatsu	4.66%
Tokyu Corp	4.61 %
Sumitomo Corp	4.58 %
<b>Total</b>	<b>24.30%</b>

**Best Performers:** Hitachi Construction Machinery, Komatsu, Suzuki Motor

**Worst Performers:** Mitsubishi UFJ Lease, Showa Denko, Mitsubishi UFJ FG

## *Historical Returns*

Below we provide a table detailing the monthly returns of the Fund since its inception in September 2004.

<b>Optimal Japan Absolute Long Fund Offshore Feeder Net Monthly Returns in USD</b>													
<b>Year</b>	<b>Jan</b>	<b>Feb</b>	<b>Mar</b>	<b>Apr</b>	<b>May</b>	<b>Jun</b>	<b>Jul</b>	<b>Aug</b>	<b>Sep</b>	<b>Oct</b>	<b>Nov</b>	<b>Dec</b>	<b>YTD</b>
2004									-1.6	-1.32	6.18	2.52	5.70
2005	1.61	2.05	-3.83	-0.47	-1.81	-0.58	1.17	6.76	9.32	-0.75	3.25	8.64	27.25
2006	3.57	1.22	3.55	2.74	-4.40	-1.32	-1.55	-0.29	-1.51	3.73	1.48	1.94	9.14
2007	1.50	3.69	-1.88	0.33									3.61

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