

**Performance % - as at 31 December 2010**

	NAV	Dec	Qtr	YTD	Asset size
Offshore Feeder	US\$12.19	8.26%	12.77%	16.65%	US\$170M
Topix (Return is in USD unhedged using WM London 4pm close)		7.83%	11.61%	13.67%	

*\*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.*

“A key to investment strategy is that price formation is steadily returning to fundamentals and moving away from investor sentiment and demand-supply, which determined prices in the wake of the GFC. Share price falls after 2008 were accompanied by selling of the euro and the currencies of resource-rich nations and emerging nations, and by falls in the price of low-rated bonds and commodities. For example, TOPIX displayed a clear correlation with the JPY/EUR rate. However, this extreme correlation between asset classes is now fading: TOPIX has risen since November 2010, even as the euro has fallen against the yen. We conclude that changes in investor risk avoidance have ceased to be the key determinant of prices in the currency and stock markets, and that prices are increasingly reflecting fundamentals again.”

Chisato Haganuma, MUFJ Morgan Stanley equity strategist from his “Strategy Monthly”, 5 January 2011.

We think that the paragraph above describes the past few years very well. Over the last couple of months, we have felt that investing in Japanese equities has indeed become more fertile ground for investment analysts whereas we believe that the previous three years were better for psychoanalysts and pattern-watchers. In the jargon of the industry, it was a trading market. We are hopeful that we have seen the end of that for some time. The dislocations that culminated with the global financial and economic crisis of 2007-2009 have yet to be put right, but a sense of stabilisation has grown in the past six months and this certainly creates a better investment environment for investment managers like us.

Despite the improvement and strong last two months of the year, 2010 was hardly a banner year for local investors in

Japanese equities. When measured in Yen the Topix index was down by almost 1% in local currency terms but for investors in most of the developed markets, the return was actually very good. A Euro investor saw the market rise 21%, a USD investor’s return was 11.9% and a investor in GBP saw a gain of 16.8%. Australian investors were less lucky as the AUD was strong, but with a AUD return of -1.0% from an unhedged investment in the Topix, at least their return was better than that of their local index which fell almost 3% in 2010.

We were pleased to have produced better returns in 2010 than we had for the previous couple of years and feel there is much about Japan at the end of 2010 that reminds us of how the market felt in 2003. The four years that followed 2003 were excellent years in Japanese equities in both the overall market sense (beta) and in terms of the ability to add value from stock selection (alpha). Our feeling - call it experience, or “gut-feel” - is supported by quantitative research which shows that the correlation between Japanese stock prices was high until the last quarter of 2010 and has been dropping since. In short, at high correlations, the skill of the stock picker is unrewarded, whilst at lower correlations, active stock picking can add more value. These are conditions that play to our strengths and are more representative of a normalised market.

Just to prove we are not totally cock-eyed optimists, the piece below comes from an AFP, Tokyo story reported on Yahoo! News over the weekend of Jan 15-16. We have confidence in our abilities to add value in research and portfolio management of Japanese equities, but are clueless as to what we can do to fix this problem:

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“TOKYO (AFP) – Young Japanese men are losing interest in sex, according to a study commissioned by the government, in a further warning sign for a nation notorious for its low birth rate, a doctor said Friday. The survey also found that more than 40 percent of married people said they have not had sex in the past month, said Kunio Kitamura, head of the clinic of the Japan Family Planning Association, who took part in the survey.

“This is directly linked with falling birth rate. Policy actions are necessary,” Kitamura told AFP. The data confirmed a wider social belief that younger men are becoming “herbivorous”, a label attached to passive men who do not actively seek women and sex.

The latest biennial survey found that 36.1 percent of Japanese males between the ages of 16-19 said they had no interest or even despised sex, a jump from 17.5 percent in the 2008 study. Compounding the issue was data that showed 59 percent of girls in the same age group felt the same way, up 12 percentage points from 2008.

The data is a worry for a government aiming to encourage couples to have children to reverse a falling birth rate and avert a potential economic calamity. Japan’s total fertility rate in 2009 was estimated by the government at 1.37 births per woman, one of the world’s lowest, compared with 2.06 in the United States and 1.97 in France.

The trend has been largely blamed on a widespread belief, especially in rural Japan, that women who give birth should quit their jobs, amid shortages of childcare centres and other systemic factors.

Japan’s population has already started to decline as younger people delay starting a family due to the perceived burden on their finances, lifestyles and careers. A growing population of elderly, known for their longevity, is meanwhile overwhelming a welfare system that is decreasingly supported by a shrinking workforce, meaning that tax revenue is declining.

Collectively, the survey found all age categories showed a general lack of interest toward sex, except for men in their 30-34 years of age with just 5.8 percent of these respondents not interested, as opposed to 8.3 percent in 2008.

The survey also found that 40.8 percent of married people said they had not had sex in the past month, up from 36.5 percent in the 2008 survey and 31.9 percent in the 2004 survey. Nearly 50 percent of married people older than 40 years old said they have not had sex in the past month, the study said.

Among reasons for not having sex, survey participants cited vague reluctance after childbirth, that they could not be bothered, or that they were too tired after work, it said.

The survey, conducted by a team of experts commissioned by the health ministry, received valid answers from 671 men and 869 women in interviews. It was originally designed to gauge the success of Japan’s birth control education with an aim to reduce unwanted pregnancies, Kitamura said. But the falling abortion rate may be a result of a general indifference toward sex and not attributable to the success of sex education he said.”

Ideas anyone?

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## Recent 3 month Fund Exposure

% of NAV in	Oct 10	Nov 10	Dec 10
Long Stock Position	91.88	85.58	80.36
Index Futures	-	-	-
Net Exposure	91.88	85.58	80.36

## Performance Statistics

Last 12 Months	16.65%
3 Yr Annual Average Return	-3.37%
5 Yr Annual Average Return	-1.95%
Average Annual Return Since Inception	3.18%

## Position Concentration

	Top 5	Top 10
Longs	25.50%	43.73%
Shorts	-	-
Total no. positions	32	

## Top Five Positions

Chuo Mitsui Trust Holdings Inc  
Hitachi Ltd  
Fanuc Ltd  
JS Group Corp  
Nippon Telegraph & Telephone Corp

## Winners

Chuo Mitsui Trust Holdings Inc  
Hitachi Ltd  
Fanuc Ltd  
Mitsubishi Estate Co Ltd  
T&D Holdings Inc

## Losers

Mizuho Financial Group Inc  
Star Micronics Co Ltd  
Daihatsu Motor Co Ltd  
Otsuka Holdings KK  
Kirin Holdings Co Ltd

## Sector Exposure as at 31 December, 2010

	Longs	Shorts	Total
Materials	9.25%	-	9.25%
Industrials	18.14%	-	18.14%
Financials	19.71%	-	19.71%
Energy	0.18%	-	0.18%
Consumer Non-Disc	6.81%	-	6.81%
Consumer Disc	11.34%	-	11.34%
Health Care	1.59%	-	1.59%
Utilities	-	-	-
Telecom	4.44%	-	4.44%
Technology	8.90%	-	8.90%
Total Equity	80.36%	-	80.36%
Index Futures	-	-	-
Net Exposure	80.36%	-	80.36%

## December Qtr Sector Performance – P&L

	Longs	Shorts	Total
Materials	0.50%	-	0.50%
Industrials	2.71%	-	2.71%
Financials	3.88%	-	3.88%
Energy	0.02%	-	0.02%
Health Care	-0.09%	-	-0.09%
Telecom	0.01%	-	0.01%
Consumer Non-Disc	0.09%	-	0.09%
Consumer Disc	1.44%	-	1.44%
Utilities	-	-	-
Technology	1.24%	-	1.24%
Index Futures	-	-	-
FX and Others	-	-	2.97%
Total	9.80%	-	12.77%

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## Historical Returns

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

*Optimal Japan Absolute Long Fund Monthly Returns in USD (before Performance Fees) %*

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	Topix <sup>1</sup> YTD
2004									-1.6	-1.32	6.18	2.52	5.70	8.16
2005	1.61	2.05	-3.83	-0.47	-1.81	-0.58	1.17	6.66	9.32	-0.75	3.25	8.64	27.25	24.59
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	0.94
2007	1.50	3.69	-1.88	0.33	1.71	1.49	1.27	-4.97	2.18	-1.04	-5.37	-6.57	-7.97	-6.37
2008	-6.00	2.60	0.15	4.21	1.40	-9.57	-3.85	-7.26	-5.49	-5.14	-4.01	8.78	-22.95	-28.24
2009	-5.28	-11.56	3.78	4.75	9.49	2.12	3.11	4.76	-3.58	-2.26	-2.78	-0.38	0.38	2.85
2010	2.58	0.19	4.19	1.88	-8.25	-3.15	3.36	-2.39	5.77	3.79	0.36	8.26	16.65	13.67

<sup>1</sup> Topix Return is in USD unhedged using WM London 4pm close

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