

Performance % - as at 31 December 2011

	NAV	December	YTD	AUM
Offshore Feeder	US\$10.93	0.83%	-10.34%	US\$15M
Topix - <i>Topix Return is in USD unhedged using WM London 4pm close</i>		0.92%	-14.55%	

“2011 has been a terrible year for the Japanese economy and stock market, which were wracked by a series of crises. These included the Great East Japan Earthquake, the subsequent nuclear accident and power shortages, sharp yen appreciation triggered by the European debt crisis, damage from the Thai floods, and the scandal at Olympus. Japanese stocks are trending at the lowest levels seen during this 20-year bear market and close to levels 30 years in the past. The Japanese market is unpopular among major stock markets at this time.”

From Daiwa’s Monthly Investment Strategy – January 2012 (of 15 December 2011)

Although Japan faced a number of specific disasters in 2011, global equity investors would all agree that the best thing that can be said about the year is that it has ended. The great Bond Bull Market (Bubble?) continued while the revulsion of equities gathered strength throughout the year. Most equity indices are down 15-25% while government bond holders cling to yields well below those of market dividends. The world faces some big economic challenges in 2012, but surely it won’t be as poor a year for stock markets as 2011 was. Surely?

The authors of the Daiwa strategy piece (Kazuhiro Miyake and Yuichi Sano) go on to say that foreign institutional investors – especially North American ones – complain that Japanese RoEs are too low. US stocks (represented by the MSCI USA ex-financials) carry an RoE of 16.5% while Japan (Topix constituents) manages just 6.1%. The gap between the two is not explained by differences in financial leverage or asset turnover. It is solely due to the US average net income margin being significantly higher than that of Japan. Over the years, we have commented many times on the relatively low profitability of Japanese companies. At the level of gross operating profits (before SG&A costs), Japan compares reasonably well with other countries that we have looked at. It is the next level where Japan stands out – though not in a way that shareholders would want to see. SG&A costs are way higher than in other countries, partly due to the “social contract” that leads Japanese companies to maintain employment at levels not necessary for maximum efficiency. Other than costs, it has been tough for Japanese companies to grow revenue in a deflationary environment and where there are too many participants fighting over a pie that has grown only minimally since the 80s Bubble burst. For reasons that we won’t detail here, but which are reasonable in our view, the

Daiwa strategists predict that Japan’s RoE will rise to between 8-12% within a few years – bearing in mind that it had reached 9.5% in 2007 before the Great Global Recession. At those levels, it is unlikely that 71% of TSE First Section stocks will still be trading below book value – as is the case today.

Notwithstanding the fact that 2011 has been “a terrible year” for Japan, there are some very positive signs in the MBO area. Up until early December, there had been 19 announcements of MBOs of listed companies, marking a new record. The value of these is still small at Y263bn, but even this is only slightly below the value of announced MBOs in 2007 (Y318bn) and two thirds of that consisted of just two companies, Tsubaki Nakashima (6477) and TOC (8841) – the latter of which subsequently failed to complete. This year’s crop is headed by Culture Convenience Club (4756) but notably includes Tachihi Enterprise (8821) and New Tachikawa Aircraft Co (5996). These two have long been among Japanese value investors’ favourites, and it was satisfying to see them finally “taken out”. Both had a common major shareholder (a Japanese activist fund) that also appears as TOC’s second largest shareholder. Maybe there will be a second MBO attempt at TOC in 2012? MBOs are sure to become more common, and both dividends and share buy-backs look set to recover in 2012 to levels approaching the record levels reached in both in 2007.

Another thing to look forward to about 2012 (and not just to say farewell to 2011) is that 2012 is a “Tatsu Doshi” - Year of the Dragon in the Chinese zodiac. This has been a positive zodiac sign for the Japanese stock market and would be a welcome change after the disappointment of The Year of the Rabbit this year. As 2011 draws to a close, market volumes are derisory, the Topix index is lower than it was when the market began to rally in early 2003, and valuations are the cheapest in 30 years. European indebtedness continues to dominate the daily financial news, but markets are reasonable discounting mechanisms and investors have had every opportunity to sell, short or otherwise hedge their investments.

2011 has been a spectacularly bad year for equities across the globe, and as correlations within the markets rose in the latter half of the year, stock picking has proven difficult again. We are not satisfied with the returns we have produced for our investors this year, but with pessimism levels where they are now, we feel confident – and are determined - that we shall do better in 2012.

**SYDNEY:** Level 5, Wyoming, 175 Macquarie St, Sydney NSW 2000 **Phone:** 61 2 8239 3300 **Fax:** 61 2 8239 3333 **Email:** [optimal@optimalasia.com](mailto:optimal@optimalasia.com)  
**TOKYO:** KS Building 10<sup>th</sup> Floor, 2-9 Minami Aoyama 6-chome, Minato-ku, Tokyo 107-0062 **Phone:** 81 3 5774 6507 **Fax:** 81 3 5774 6508

**DISCLAIMER:**

This material is for your private information and we are not soliciting any action based upon it. Opinions expressed are our opinions only. The material is based upon information, which we consider reliable, but we not represent that it is accurate or should not be relied upon as such. Past performance is not an indication of future performance. This material is not intended for distribution in Japan or for Japanese domiciled entities.

### Recent 3 month Fund Exposure

% of NAV in	Oct 11	Nov 11	Dec 11
Long Stock Positions	86.02	85.88	91.79
Index Futures	-	-	-
Net Exposure	86.02	85.88	91.79

### Performance Statistics

Last 12 Months	-10.34%
3 Yr Annualised Return	1.64%
5 Yr Annualised Return	-5.73%
Annualised Return Since Inception	1.22%

### Position Concentration

	Top 5	Top 10
Longs	24.08%	44.12%
Total no. of positions	33	

### Top Five Positions

Aeon Co Ltd  
Asahi Kasei Corp  
JS Group Corp  
Hitachi Ltd  
Itochu Corp

### Winners (Qtr)

CyberAgent Inc  
Benesse Corp  
Itochu Corp  
Nippon Television Network Corp  
Nippon Telegraph & Telephone Corp

### Losers (Qtr)

JS Group Corp  
Mitsui OSK Lines Ltd  
Sumitomo Mitsui Trust Holdings Inc  
Mitsubishi Estate Co Ltd  
Eagle Industry Co Ltd

### Sector Exposure *as at 31 December 2011*

	Longs
Consumer Discretionary	24.40%
Consumer Non-Disc	5.47%
Energy	4.06%
Financials	15.70%
Industrials	13.76%
Information Technology	10.02%
Materials	12.48%
Telecommunications	5.90%
Net Exposure	91.79%

### December Qtr Sector Performance – P&L

	Longs
Consumer Discretionary	0.19%
Consumer Non-Disc	0.04%
Energy	0.00%
Financials	-1.46%
Industrials	-2.59%
Information Technology	0.07%
Materials	-0.47%
Telecommunications	0.49%
FX and Other	2.20%
Total	-1.53%

### Performance Contribution

	Longs	Futures	Other	Total
December 2011	0.04%	N/A	0.79%	0.83%

#### DISCLAIMER:

This material is for your private information and we are not soliciting any action based upon it. Opinions expressed are our opinions only. The material is based upon information, which we consider reliable, but we not represent that it is accurate or should not be relied upon as such. Past performance is not an indication of future performance. This material is not intended for distribution in Japan or for Japanese domiciled entities.

## Historical Returns

*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* YTD
Below we provide a table detailing the monthly returns of the Fund since its inception in September 2004.														
2004									-1.60	-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
2011	1.31	3.89	-9.20	1.72	-0.51	1.02	3.69	-6.40	-3.98	2.70	-4.91	0.83	-10.34	-14.55

\* Topix Return is in USD unhedged using WM London 4pm close

## Optimal FUND MANAGEMENT

*Should you wish to make an enquiry about the Optimal Japan Absolute Long Fund, please see our website – [www.optimalasia.com](http://www.optimalasia.com) or contact us by email at [optimal@optimalasia.com](mailto:optimal@optimalasia.com).*

### DISCLAIMER:

This material is for your private information and we are not soliciting any action based upon it. Opinions expressed are our opinions only. The material is based upon information, which we consider reliable, but we not represent that it is accurate or should not be relied upon as such. Past performance is not an indication of future performance. This material is not intended for distribution in Japan or for Japanese domiciled entities.