

# Optimal FUND MANAGEMENT

## Monthly Report to Shareholders of the Optimal Japan Absolute Long Fund Feb 13<sup>th</sup>, 2007

31 January 2007	Offshore Feeder	US Feeder
NAV*	\$14.90	\$14.89
Monthly return %	1.50	1.43

*\*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.*

We were in Tokyo last November at the time of the Goldman Sachs Japan Hedge Fund Conference and the mood was dark. Investors were “disappointed” after a tough year following 2005’s abnormally strong return and fund managers were hesitant. 2006 turned out to be a poor year for Japanese equities in the relative world of borderless capital markets but it was hardly cataclysmic – especially coming after the 40% gain of 2005 – and in terms of the competing Japanese asset classes it was quite respectable. Yen deposits would have returned 0.1%, JGB 10 year yields averaged 1.5%, and the Topix index in Yen rose by 1.9% - before factoring in dividends. We would hate investors to think we’d be satisfied with a 3% annual return from the Fund but it did strike us as a touch melodramatic to witness such hand wringing and despair. Rather than selling one’s investments after leaving the conference, a good contrarian should have bought call options, as the months of December and January have seen the Topix index rise 10% from November 13<sup>th</sup> (when we gathered in Tokyo). We did neither, but, as we mentioned last month, at least the Fund benefited from renewed interest in steel and autos and this trend continued in January with foreigners big buyers and both Nippon Steel and JFE up significantly.

Japan’s recovery from the 1990s malaise and the stock market crash has been slow, steady and is far from over in our view. The stock market recovery began when the weak domestic holders of equity unloaded the last large parcels of their cross-holdings, coinciding with aggressive buying by foreign investors. On the corporate front (at least in the listed segment), the return on capital has been rising since 2002 and an understanding of the cost of capital and the notion of an acceptable return has become evident – if not universal. Mitigating these positives is the fact that economic growth has been hampered by weak private consumption and with inescapable ageing of the population to consider, the modest GDP growth of recent years may well be the norm rather than the exception. With this as a background to our investment approach, we are sometimes tempted to reduce positions where a sharp upward move in the price looks to be a product of (transient) improvement in sentiment rather than being due to a shift in the business outlook for the company in question. We have faced this again recently with the example of the steel stocks. From the share price lows of 2006, JFE has risen 94% and Nippon Steel 95%. Earnings, meanwhile, are expected to be slightly lower

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 do 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

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

# Optimal FUND MANAGEMENT

in the year ending March 2007 versus the actual profits of March 2006. We have previously said (only slightly tongue-in-cheek) that the big Japanese blast furnace companies constitute the true technology sector in Japan and lamented that they were afforded such measly multiples of cashflow and earnings when compared with the truly unimpressive electronics sector - which is still referred to as “tech” and afforded a farcically high share price rating as a result. Just to be clear: we love the steel sector. Given the huge gains in from the lows of 2006 , we decided to reduce our positions in late December but still hold over 5% of the Fund’s assets in these stocks.

**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.**

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 do 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

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

# Optimal FUND MANAGEMENT

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

**Equity Long: 82.40%**

**Net exposure: 82.40%**

**Fund size: US\$ 350 mil**

**Total number of positions: 31**

**Top 5 positions:**

	% of NAV
Toyota Motor Corp	5.75 %
Tokyu Corp	5.21 %
Mitsui Fudosan	4.57 %
Tokyo Tatemono	4.49 %
Suzuki Motor	4.39 %
<b>Total</b>	<b>24.41%</b>

**Best Performers:** Tokyo Tatemono, Mitsui Fudosan, Komatsu

**Worst Performers:** Teijin, JSR, Bosch Co

## *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												1.50

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 do 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

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