Monthly Report to Shareholders of the Optimal Japan Absolute Long Fund – *July 2007*

Optimal FUND MANAGEMENT

Monthly Performance % - *as at 31 July 2007*

	NAV	July	YTD	Asset size
Offshore Feeder	$15.90	1.27%	8.31%	$624M
US Feeder	$15.99	1.20%	8.92%	$37M

As mentioned in last month's report, we spent the last week of July in Japan. The rainy season had just ended and the weather was hot, and mercifully dry. Our visit coincided with the final week of electioneering before the upper house poll took place and came on the heels of a large typhoon that had drenched Kyushu. As it turned out, we did not need our gumboots or sou'westers on our tour of cement plants, but with markets under siege as we write, some protective clothing now would be more appropriate. The less we say on Japanese politics, the wiser we will all be.

July's market was pretty ugly, with the Topix index down almost 4% to close the month a mere 1.5% above the level at the end of 2006. August has been even more dramatic with the market off a further 3.5% as we write, and experiencing wild intra-day moves on very large volume. There are many rumours which will turn out to be true in some measure, and many more that will be totally false, but our strong feeling is that the large selling and buying in Japan this past week or so has been driven by foreigners and not by domestic institutions. In most developed markets there are financial institutions with strong balance sheets and investment horizons long enough to take bold decisions and buy when prices are falling. In Japan, there is no such "buyer of last resort" and so price falls can be steeper and more violent that you might expect. In a world of increasingly correlated equity markets, the problems behind the decline in US markets quickly flow over into other countries and the most liquid markets become a source of funding as the race to raise cash plays out. The Japanese stock market – whilst not as deep as it once was – is still far larger than any other Asian market, so when funds need to liquidate positions to meet collateral calls or redemptions, Japan's equity market takes the first wave of sell orders. But all this is little more than educated guesswork, speculation and gut feelings formed over the years and impossible for us to either validate or quantify. For the moment, we will finish this discourse by confirming that we have been using the weakness in certain stocks to cover some short positions (one never has enough of these when you really need them) and to add to some of our favoured longs. For clarity's sake, we also can assure investors that we do not invest in CDOs or other exotic plays on subprime mortgages, and hope we never meet one in a dark alley.

The Kyushu cement plant visits were highly interesting and something I would urge everyone to try some time – but perhaps best done in winter. The crushed limestone is heated in long cylindrical kilns at a temperature of 1,450 degrees Celsius so our plant walkabout was a noisy and cosy affair – not helped by the fact that the midday temperature in north Kyushu was hovering around 35 degrees. Most impressive to us - and we believe not well known in the marketplace – is the huge advances the Japanese cement makers have made in substituting industrial and household waste as both a fuel source and an input into the cement itself. Since the early 1990s, the Japanese cement makers have all had great success in increasing the use of waste products as a way of reducing their fuel costs and also their overall production costs. With coal prices high and rising, any fuel substitute is a boon, but particularly when the user (cement co) is paid to take the refuse. The economic benefits to the cement companies from accepting and using these waste products are even greater than the effects of a price rise in the cement itself. We expect the operating margins of the big Japanese cement companies to rise as their use of waste products continues to increase, and with more attention on waste issues and emissions in China (the Beijing Olympics starts in only 363 days after all) the potential to profit from the successful adoption of these production methods by other Asian cement companies is vast. Taiheiyo Cement's shares have fallen 22% in the last week and now trade on 1.3x book value. We have been building a bigger position in the stock and believe the share's fall gives us a great entry point.

First quarter (June) earnings have been released for most companies now and year-on-year profits are up almost 13%. This run rate is well ahead of the companies' full year forecast growth rate and if we achieve that level of growth in the full year, Japanese equities would be trading on a PER of close to 15-16x. Right now, market participants are more interested in "overseas stock and bond markets" than in "economy and corporate earnings" (from the August QSS Report mentioned in the JP Morgan Equity Strategy piece dated 7 August). It does not take much imagination to see that at some point, Japanese investors might find a Japanese equity earnings yield of 6.5% attractive in a world of volatile FX rates and credit market turmoil. Tokyo Stock Exchange data shows that in the last week, Japanese individuals were large net buyers of stocks while foreigners sold. This bears watching as individuals have been better market timers than foreigners in recent years.

Our football coaches always told us to keep our eyes on the ball and not on the man. In this instance we think that the outlook for profits (the ball) is good and valuations very enticing. Everyone is watching US subprime and related credit market action (the man), but you can't win the game if you don't get the ball. We trust and hope we are watching the right ball!

SYDNEY: Level 5, Wyoming, 175 Macquarie St, Sydney NSW 2000 **Phone:** 61 2 8239 3300 **Fax:** 61 2 8239 3333 **Email:** optimal@optimalasia.com

TOKYO: 5F Izumikan Kioicho, 4-3 Kioicho, Chiyoda-ku, Tokyo 102-0094 **Phone:** 81 3 3238 1671 **Fax:** 81 3 3238 1687

Optimal FUND MANAGEMENT

Recent 3 month Fund Exposure

% of NAV in	May 07	Jun 07	Jul 07
Long Stock Position	90.50	88.13	92.31
Index Futures			
Net Exposure	90.50	88.13	92.31

Optimal FUND MANAGEMENT

*Should you wish to make an investment or further enquiry about the Optimal Japan Absolute Long Fund, please see our website – **www.optimalasia.com** or contact us at – **optimal@optimalasia.com***

Position Concentration

	Top 5	Top 10
Longs	25.19%	44.45%
Total no. positions	36	

Top Five Positions

Komatsu
Toyota Motor
Sumitomo Corp
Fanuc
Mizuho Financial Group

Winners

Komatsu
Hitachi Construction Machinery
JFE
Star Micronics
Sumitomo Corp

Losers

Tokyu Corp
Ushio
Toyoto Motor
Mitsui Fudosan
Mitsubishi UFJ Financial Group

Sector Exposure as at 31 July, 2007

	Longs
Materials	15.2%
Industrial	32.3%
Futures	
Financials	19.0%
Energy	

	Longs
Consumer. Non Disc	
Consumer Disc	19.9%
Utilities	
Telecom	
Technology	6.3%

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
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	6.66	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	1.71	1.49	1.27						8.31