

Performance % - as at 30 June 2009

	NAV	June	Qtr	YTD	Asset size
Offshore Feeder	US\$10.60	2.12%	17.13%	1.83%	US\$217M
US Feeder	US\$10.87	1.87%	16.26%	3.52%	US\$8M

**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.*

With half of 2009 behind us, the Japanese equity market is well up from the lows recorded in early March but still barely changed from the level it reached at the end of 2008. Last year was one of the worst years for investors on record, and the current price level is almost exactly where it was six years earlier and equal to the lowest level in well over twenty years. This bear market has been a traumatic end to six years of profits growth and rising equity prices and only the most trenchant misanthrope would want to put his fellow man through such an experience as we have all gone through over the past two years.

Whatever the consensus sees ahead for investors, the real outcome will most probably be something quite different. What appears immutable and permanent now, we will look back on as a turning point and what appears preposterous and unattainable today, we will reflect ruefully upon and wonder why we did not see it coming, and position our investments to profit from.

As we write, Japan's Prime Minister has just dissolved the parliament and an election is expected to be held on Sunday August 30th. Opinion polls predict the governing Liberal Democratic Party will lose power to the opposition Democratic Party of Japan. Like many opposition parties, the DPJ has not been rushing to detail its policies but there are signs that at least they understand the need to provide a clear set of principles for encouraging a more confident society. One does not need to conduct an extensive sociological study to conclude that Japanese people have a low level of expectations for their own and their country's future, and an even lower expectation that their government can achieve any positive change. If there was one aspect of former Prime Minister Koizumi's period in office that set him apart from his recent predecessors and successors it was his ability to

impart a sense that he had a vision for the future that would see improvement in peoples' lives. Much of his reputation as a reformer was based on perception rather than fact, but he did give the Japanese something to hope for. The DPJ seems to have taken its lessons in part from him, and no doubt in some part from the splendid campaign waged by Barack Obama in 2008, and have stated that a core policy is to "reduce people's current anxieties and increase their confidence in the future". Much of this is centred on family-friendly policies which entail more government subsidies in areas such as child support, education expenses and medical costs. Critics will argue that the DPJ has not outlined clearly just how they will fund their programmes, but given how much of Japan's fiscal budget has been wasted on unproductive spending on construction, I don't think the critics' argument will sway many voters. The DPJ has stated they will reduce spending on public works projects as part of their savings drive, as well as cutting the number of government-owned administrative bodies. Our belief is that a set of policies that focus on boosting the feeling of economic well-being of families is a path worth following, as nothing from the LDP over the past fifteen years has been introduced to make one believe that they ever sought to achieve that goal.

Investors in Japan should not lose sight of the fact that Japanese household financial assets amount to over US\$15trillion and that cash accounts for over half of it. Should new government policies create a greater sense of optimism, there is a lot of firepower at the individual level to lead to far higher consumption and investment. Some of it would even find its way into the equity market, and with a current market capitalisation of only \$2tn, small allocations could be meaningful (n.b. see comments in first para about consensus and what appears immutable). As we have pointed out a number of times in the past year, Japanese individuals have been net buyers since the start of 2008 and that year marked their first year of net buying since 1989. Something might well be changing as the man in the street ponders his investment options, and the consensus has certainly not

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factored sustained domestic buying into expectations.

Individual cash levels aside, corporate Japan is also cashed up. There are exceptions of course, and equity capital raisings in 2009 have been sizeable (\$25bn) – particularly from the financial sector (\$20bn) and the electronics companies. Looked at in aggregate however, Japanese companies have been reducing their dependence on bank borrowings for decades, with a corresponding decline in their return on equity. The “right” level of gearing is, of course, impossible to say, though it is possible to say that the easy, cheap money period of the last ten years or so led to levels of gearing in most countries that were certainly not “right”. Mediocre investment returns have been papered over by massive leverage used by private equity investors, property developers, hedge funds (though naturally, not all of them!) mortgagors and most of the world’s commercial banks and one effect of the financial crisis will be a move to deleverage balance sheets and investments. Japan, in common with many countries in Asia, does not need to reduce leverage, but arguably should increase borrowing.

One company we own is Kirin Holdings, a company best known as a maker of beer, but which has in recent years expanded into other countries and non-alcoholic drinks via acquisitions. These have been broadly successful and have added considerably to Kirin’s consolidated earnings. Now it appears that Kirin might be making a move to consolidate the domestic beer and soft-drinks market in Japan by announcing that they are in discussions with the unlisted Suntory to merge the two companies into one. Suntory has higher margins in its non-alcoholic drinks division while Kirin is more profitable in its beer division so putting them together should raise overall profit margins. Both have strong balance sheets and growing operations in Asia, Europe and the US. Importantly, a merger between the two would inevitably spur other companies in the overcrowded domestic food and drinks area to make similar moves, and fewer players would in all likelihood lead to less price competition and better profitability. Discussions might yet lead us nowhere, and we are a long way short of a confirmed deal here, but the signs are positive. We are not willing to abandon all hopes that Japan might see consolidation, higher margins, greater gearing, higher RoEs and better share price performance, but that position puts us in a small minority. A lot of perceived improvement has been factored into the rise in equities across the globe over the past four months, but a move to relatively higher returns from Japanese companies as they increase leverage is not in the mix yet. We would

suggest that this has the potential to shock investors, and is a notion not to be dismissed blithely.

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Recent 3 month Fund Exposure

% of NAV in	Apr 09	May 09	Jun 09
Long Stock Position	59.89	67.44	77.01
Index Futures	-	-	-
Net Exposure	59.89	67.44	77.01

Performance Statistics

Last 12 Months	-15.00%
3 Yr Annual Average Return	-9.18%
Average Annual Return Since Inception	1.21%

Position Concentration

	Top 5	Top 10
Longs	25.05%	44.03%
Total no. positions	26	

Top Five Positions

Mitsui Fudosan
Mitsubishi UFJ Lease & Finance Company Limited
Nippon Telegraph & Telephone Corp
Suzuki Motor CB
Tokyo Tatemono

Winners

Tokyo Tatemono
Mitsui Fudosan
Mitsubishi UFJ Lease & Finance Company Limited
Kubota Corp
Suzuki Motor

Losers

Shin-Etsu Chemical Co
Nintendo
Honda Motor Co
Shima Seiki Manufacturing
KDDI Corp

Sector Exposure as at 30 June, 2009

	Longs
Materials	12.01%
Industrials	12.65%
Financials	18.38%
Energy	-
Consumer. Non-Disc	2.18%
Consumer Disc	16.80%
Utilities	-
Telecom	4.83%
Technology	10.16%
Total Equity	77.01%
Index Futures	-
Net Exposure	77.01%

June Qtr Sector Performance – P&L

	Longs	Shorts	Total
Materials	-0.25%		-0.25%
Industrials	1.91%		1.91%
Financials	6.86%		6.86%
Telecom	0.17%		0.17%
Consumer Non-Disc	0.90%		0.90%
Consumer Disc	3.34%		3.34%
Utilities	0.12%		0.12%
Technology	0.44%		0.44%
Index Futures	-		
FX and Other	3.64%		3.64%
Total	17.13%		17.13%

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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
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	-4.97	2.18	-1.04	-5.37	-6.57	-7.97
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
2009	-5.28	-11.56	3.78	4.75	9.49	2.12							1.83

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

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