

Performance % - as at 29 June 2012

	NAV	June	YTD	AUM
Offshore Feeder	US\$10.74	3.97%	-1.74%	US\$14M
Topix - <i>Topix Return is in USD unhedged using WM London 4pm close</i>		5.19%	1.92%	

Japan's equity market performance in the June quarter was disappointing after a great start to 2012 and in percentage terms, fell by around the same amount as the European index (9%) while in the US and UK, equities weathered the conditions better with declines of just over 3%. There are some similarities between western Europe and Japan – stagnant population growth and low birth rates, zero interest rates and excellent food – but there are very clear differences as well. Japan is a sovereign country with its own currency and a central bank which can print as much paper as it wants to. It is a source of great frustration to many that the Bank of Japan does not flood the market with newly minted Yen, but if it wishes to it can do so with only its own government to answer to.

Japan also has major banks which have gone through the long and painful experience of writing down assets and shoring up their capital base. They are yet to generate attractive returns on assets, but the returns are improving as they look to expand where others are not able to and the market is growing more interested in this sector.

In the first half of 2012, the four financial sectors in the 33 sector Topix index all made the top 8 sectors by return, and their sister sector "Real Estate" came first with a return of almost 30%. This is not to say it was all beer and skittles for investors in the banking sector however as June 4th 2012 marked the lowest level recorded in at least thirty years but a strong rally in June took the banks sector return for the year to 11% against a Topix index return of 5.7%.

In a period when the market rose by over 5%, the Fund held significant positions in both Mitsubishi Estate and Sumitomo Realty which were amongst the markets better performers, but still the total return was held back by a disappointing performance from some of the Fund's long positions. This was not a matter of being in the wrong sectors but in holding positions in certain stocks that had very poor returns in the first half of the year. We continue to hold a position in Skymark Airlines which is Japan's leading low coast carrier, generating an RoE in the most recent year of almost 20%. Skymark's shares declined by 49% in the first half as a combination of perceived challenges encouraged selling. First, there were new LCC start-ups announced that will have some impact on their competitive situation. Secondly, Japan Airlines (JAL) has emerged from bankruptcy and restructuring in much better situation and plans to re-list on the Tokyo stock exchange later in 2012. Lastly, there are fears that Skymark's plans to acquire a number of long-haul jets for international routes will drive the company to raise equity from the market.

After a stellar return from 2009-2011 and with investors inclined to sell their winners, the stock has been hit hard. We have met the company and feel the share price discounts a worst case scenario and more, and continue to find more reasons to be long than not.

After an agonisingly long period of inaction, the Japanese lower house finally passed Prime Minister Noda's bills to increase the consumption tax rate from 5% to 8% and then to 10% over the coming three years. When compared with levels of such taxes in other advanced countries, it is hard to fathom why these increases were so difficult to get through. Spanish tax payers would certainly wonder what the fuss was about, but nevertheless, Mr Noda is to be commended for sticking to his policy despite widespread opposition. The increased revenue will not solve Japan's fiscal deficit but will narrow it considerably, assuming that is that other sources of tax revenue do not shrink. With GDP growth expected at 2.5% for 2012 and 1.5% next year, tax revenue should be higher, especially as the CPI is expected to nudge into positive territory this year. Politics in Japan is not conducive to bold policy moves however and it would not be surprising if Mr Noda paid the price for his success in raising consumption tax with a general election later this year and a loss at the polls. It is a problem shared by many countries unfortunately.

Corporate profits are on track to generate strong gains this year and next and Japanese companies are certainly looking to invest excess cash and cashflow into new acquisitions – mainly outside Japan. We have commented in earlier monthlies on the high rate of return that Japanese companies are generating on their direct investment overseas and especially in Asia. In recent announcements, Dentsu, Japan's largest advertising agency, has just made an agreed bid for Aegis of the UK which will take it into the big league of global ad companies and Sumitomo Corp has expanded its minerals exposure in Australia with the acquisition of coal assets. In an uncertain investment world where nothing can be taken for granted, we think it is a safe bet that we will see a lot more overseas acquisitions from Japan's cashed up companies. It might not be such good news for workers in Japan, but investors should see improving returns on equity from corporate Japan as a result.

Notwithstanding some similarities with Europe, we see plenty of positives on the horizon for Japanese investors and are looking for a much better second half to 2012 for the Fund.

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Recent 3 month Fund Exposure

% of NAV in	Apr 12	May 12	Jun 12
Long Stock Positions	92.61	89.74	91.07
Index Futures	-	-	-
Net Exposure	92.61	89.74	91.07

Performance Statistics

Last 12 Months	-9.82%
3 Yr Annualised Return	0.44%
5 Yr Annualised Return	-7.31%
Annualised Return Since Inception	0.92%

Position Concentration

	Top 5	Top 10
Longs	24.70%	46.33%
Total no. of positions	32	

Top Five Positions

Sumitomo Mitsui Financial Group Inc
Benesse Corp
Aeon Co Ltd
Mitsubishi Electric Corp
Sumitomo Mitsui Trust Holdings Inc

Winners (Qtr)

Sumitomo Mitsui Financial Group Inc
Sumitomo Electric Industries Ltd
Seria Co Ltd
Bridgestone Corp
Daito Trust Construction Co Ltd

Losers (Qtr)

Canon Inc
Yamada Denki Co Ltd
JX Holdings Inc
Skymark Airlines Inc
Inpex Corp

Sector Exposure *as at 29 June 2012*

	Longs
Consumer Discretionary	26.54%
Consumer Non-Disc	5.06%
Energy	3.46%
Financials	27.59%
Industrials	19.34%
Information Technology	9.08%
Materials	-
Telecommunications	-
Net Exposure	91.07%

June Qtr Sector Performance – P&L

	Longs
Consumer Discretionary	-3.04%
Consumer Non-Disc	-0.44%
Energy	-1.49%
Financials	-0.78%
Industrials	-1.40%
Information Technology	-1.81%
Materials	-0.69%
Telecommunications	-0.34%
FX and Other	2.42%
Total	-7.57%

Performance Contribution

	Longs	Futures	Other	Total
June 2012	6.12%	N/A	-2.15%	3.97%

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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
2012	2.84	2.31	1.04	-1.81	-9.47	3.97							-1.74	1.92

* 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 or contact us by email at optimal@optimalasia.com.

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