

Monthly Report to Shareholders of the Optimal Japan Absolute Long Fund 10 June, 2005

	OJAL NAV*	Performance
31 May 2005	\$10.30	-1.81%

* Price is NAV after performance fee at the Fund level but is subject to equalisation at the investor level.

Those who follow the Japanese equity market closely (I know, we should get out more) are familiar with the widely-held view that Japanese institutional fund managers are perennial under-achievers whilst foreigners have a preternatural understanding of the workings of the market. Given our position, we feel it unseemly to express a view one way or the other, but data – hard, objective, and impersonal that it is – does not necessarily support the common view. Japanese pension funds - corporate and public - are mainly managed by the domestic trust banks and so the actions of this group of investment professionals is most representative of “institutional investors” in Japan. Tracking net buying and selling by trust banks over the past four years leads one to a rather different conclusion. Through the difficult years 2001 & 2002 (when the Topix index fell by about 40%), the trust banks were net buyers for all but a few weeks- arguably buying into weakness as institutional investors with long term time horizons are supposed to do. (Remember when that was the case?) By way of contrast, in 2003 and 2004, when the index rose by 40%, trust banks were net sellers as the market recovered and volumes picked up. That is history, but what of the present, and most importantly, the future. Sadly we have no data for the latter – the future not being what it used to be – but recent figures imply a change in attitude from Japan’s custodians of the pension funds. For six consecutive weeks ending June 3rd, trust banks were net buyers - the longest bullish period since 2002 – and interestingly, foreign investors were sellers in much of that same period. Six weeks of data does not signal an iron-clad trend. Moreover, this is a period that happens to be the start of a new fiscal year when managers are feeling they can start with a clean slate and set their sails with confidence they know where the land lies ahead. But being bullish on valuations and believing domestic confidence to be on the rise, we are willing to see this as a glimmer of hope.

Our largest position is Toyota. Everyone knows that Toyota is the greatest auto maker on the planet and soon will command market share dominance everywhere it wishes to. It has plenty of cash on the balance sheet (Y6 trillion in cash and other current assets) and produced a 9% EBIT margin in the year just ended. Therein lies the reason why it just won’t go up – namely, that everyone knows about it. Over two years the price is up 26% (Topix +30%), over one year it is down 7% (Topix -1%) and YTD it is down 8% (Topix flat). The company will earn Y360/share this year and trades on just over 10x PER. The dividend however is just Y65 for the year ended March 2005. This is a payout ratio of 18% - exactly the same as the weighted average for non-financial stocks in Japan. As holders, we believe that the company should (and could) triple the dividends and still continue to fund expansion in the US, Asia and Europe without a hiccup. The next buyer has to be domestic – and we would suggest that Japanese individuals and institutions should be tempted even with the current dividend yield of 1.6%. Over the past three years, Toyota has increased its dividend by 132% - from Y28/share

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Level 32, The Chifley Tower
2 Chifley Square
Sydney NSW 2000
Phone: 61 2 9229 1863
Fax: 61 2 9223 2920
optimal@optimaljapan.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 to March 2002 to Y36, then Y45 and now Y65 for the year ended March 2005. Over the past three years, they have also bought back Y1trillion (about US\$9.5bn) of their own stock so added to the approximately Y620bn paid out in cumulative dividends in the same period, they have returned around 12% of current market capitalisation (Y13.9trillion) to their shareholders. I imagine Toyota's board would argue that Y1.62trillion is a significant amount to have paid out over three years. We believe they will keep raising the dividends – as stock buy-backs are less necessary now than they were – and that this yield will attract Japanese individuals and fund managers alike. The wait for higher dividends from Toyota is a simple metaphor for much in Japan – it is heading in the right direction and will eventually pay off. It is just a question of time – and patience.

Major Positions

Toyota Motor, Mizuho Financial, Mitsubishi Co, Mitsui Fudosan

Month-end investments (as % NAV): 86.31%

Fund size: US\$ 15.7mil

Total number of positions: 26

Top 5 positions:

	% of NAV
Toyota Motor	5.88%
Mizuho Financial	5.42%
Mitsubishi Co	5.11%
Mitsui Fudosan	4.9%
Tokyo Tatemono	4.42%
Total	25.73%

Best Performers: Kubota Co, Star Micronics, Tokyo Tatemono, Diamond Lease, Mizuho Financial

Worst Performers: Nippon Mining, JFE Holdings, Ajinomoto

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 Net Monthly Returns in USD													
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								-2.55

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