

**Monthly Performance % - as at 31 May 2011**

|  | NAV     | May    | YTD    | Asset size |
|--|---------|--------|--------|------------|
| Offshore Feeder  | \$11.79 | -0.51% | -3.28% | \$86M      |
| Topix - <i>Topix Return is in USD unhedged using WM London 4pm close</i> |         | -1.69% | -6.87% |            |

Financial results for Japanese companies with a March year-end have now been aggregated and the results were strong. Sales for the 1187 company sample were up 6.2% while operating profits were up 46.9%. Quite a few companies have issued forecasts for lower profits in the current year (to March 2012), blaming this on the uncertainty and disruptions resulting from the Great Tohoku earthquake and the related damage. We aren't in a position to second guess just when Toyota will return to full production (let alone how many cars they will sell and at what profit margin) but knowing from experience how loathe the Japanese are to show any exuberance – rational or otherwise – these forecasts can be taken with a grain or two of salt.

In general, we have noted that there have been more surprises of a positive variety than otherwise when looking at company announcements relating to the recovery from March's disasters. Toyota has indicated that domestic car production should be back to 90% of full capacity in July and power shortages to industry and other organisations will be minimal. On a recent visit to Japan, it was abundantly clear that hotels and offices were doing their bit to minimise electricity consumption as air-conditioning was shunned and unessential lighting was avoided. The lack of illumination created an impression of being in a state of permanent dusk, but this has not had any effect of reducing productivity or access to amenities.

The Fukushima nuclear reactor explosions and leakage will nonetheless have profound effects on the generation of electricity and public opinion is clearly anti-nuclear. Prime Minister Kan - himself soon to be replaced it seems – has indicated that alternative energy sources will supply 20% of Japan's total needs by 2020 and Japan's foremost entrepreneur Masayoshi Son of Softbank fame will throw his formidable energies behind solar power farms. We were sceptical of Mr Son's ambitious plans to build a telecom network capable of competing with the behemoth NTT Docomo and giant KDDI, but he has achieved that through a combination of greenfield and acquisition strategies, and we will be less stand-offish if he moves seriously into the solar power industry. Adapting new technologies and materials to energy production plays to Japan's undoubted strengths and this area deserves serious investment research.

Much as we wish it weren't so, Japan continues to be hampered by an ineffectual and self-absorbed political system. As

mentioned above, Mr Kan is expected to resign his position within the next few months, having won a no-confidence vote on June 1st by announcing he would fall on his sword once he had put earthquake/tsunami/nuclear recovery policies in place. Part of this will be submitting draft unified tax and social security reforms which will incorporate a rise in the consumption tax rate from 5%. It is likely to be hiked to 10% and will be portrayed as a "temporary" measure, but whoever the prime minister is once the temporary conditions have normalised, we suspect that it won't revert to 5% ever again. A second supplementary budget for 2011 will go to the Diet in August and after that has been passed, Mr Kan might leave his post. All well and good, except that no one seems very enthusiastic about the various names that have been mentioned as possible successors. We think our politicians are vacuous and base all their efforts on clinging to power, but the Japanese must win that dubious prize hands down.

One result of poor policies in Japan has been persistent deflation in goods and wages. Admittedly both of these were absurdly high as Japan entered the 1990s, but in the two decades since Japan's bubble burst, things have certainly reversed to a startling extent. A recent economic piece from Mitsubishi UFJ Morgan Stanley shows that unadjusted wages in Japan are just two-thirds the level of those in Germany (\$24.95/hr versus \$36.14/hr), slightly below the rate in the US, and on a par with the rates in the UK and Italy. Adjusted for purchasing power using the IMF formula, Japan's average hourly rate falls to a level just above that of Spain's and in 31 of Japan's 46 prefectures, this rate is indeed lower than the Spanish average. "Wages in Tohoku are now lower than in Spain" is the heading of the research piece, and having been in Hokkaido in March, we can vouch for the fact that they are definitely cheap. More relevant is that Japan's wages (PP adjusted) are only 5% higher than those in South Korea. Policies that would bring about a weaker Yen, a lower company tax rate and more liberal work visas might even succeed in making Japan a viable place for manufacturing investment. Extreme overvaluation can be erased quickly (for example if Greece were to exit the Euro and revert to a devalued local currency) or over a long time (Japan), but eventually, relative economic attractiveness comes to bear. We are of the view that Japan has got to that point, but its politicians do not seem to have realised it yet.

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## Recent 3 month Fund Exposure

| % of NAV in         | Mar 11 | Apr 11 | May 11 |
|---------------------|--------|--------|--------|
| Long Stock Position | 89.81  | 92.50  | 90.29  |
| Index Futures       | -      | -      | -      |
| Net Exposure        | 89.81  | 92.50  | 90.29  |

## 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](http://www.optimalasia.com) or contact us at – [optimal@optimalasia.com](mailto:optimal@optimalasia.com)*

### Position Concentration

|                     | Top 5  | Top 10 |
|---------------------|--------|--------|
| Longs               | 25.57% | 43.39% |
| Shorts              | -      | -      |
| Total no. positions | 34     |        |

### Top Five Positions

Hitachi Ltd  
 JS Group Corp  
 Canon Inc  
 Mitsubishi Estate Co Ltd  
 Itochu Corp

### Winners

Yamada Denki Co Ltd  
 Hitachi Ltd  
 JGC Corp  
 Sumitomo Realty & Development Co Ltd  
 Canon Inc

### Losers

Mitsubishi Materials Corp  
 Softbank Corp  
 Fanuc Ltd  
 Asahi Kasei Corp  
 Toagosei Co Ltd

## Sector Exposure as at 31 May 2011

|                   | Longs  |                    | Longs  |
|-------------------|--------|--------------------|--------|
| Consumer Disc     | 13.76% | Industrials        | 17.53% |
| Consumer Non Disc | 6.11%  | Materials          | 13.90% |
| Energy            | 2.06%  | Technology         | 15.86% |
| Financials        | 15.06% | Telecommunications | 6.03%  |

## 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    | Topix <sup>1</sup><br>YTD |
|------|-------|--------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|---------------------------|
| 2004 |       |        |       |       |       |       |       |       | -1.6  | -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 |       |       |       |       |       |       |       | -3.28  | -6.87                     |

<sup>1</sup> Topix Return is in USD unhedged using WM London 4pm close