

Monthly Performance % - as at 31 May 2012

	NAV	May	YTD	AUM
Offshore Feeder	US\$10.33	-9.47%	-5.49%	US\$14M
Topix - <i>Topix Return is in USD unbedged using WM London 4pm close</i>		-8.91%	-3.11%	

We invest in a bull market in fear. The fear can be measured – I am told – by the high prices investors are willing to pay to protect their portfolios from a deflationary melt-down. It is evident in the curious fact that investors are willing to pay to lend money to the German government for two years. It is also evident in the depths that equities in Japan plumbed during the awful month of May.

We have found the market conditions very tough and are not pleased with the Fund's performance. It is not just because the market has fallen since the late March high, but with macro issues dominating the news and damaging investor confidence, dispersion amongst stock returns has fallen and bottom-up stock analysis becomes less effective. The Topix declined 10.5% in May and up until June 1st, had fallen for nine consecutive weeks – the longest such period on record. As we write, it looks likely that this week is going to break that losing streak.

The fate of the Japanese equity market seems tightly entwined with the Japanese currency. The inverse relationship has been clear this year as the weaker Yen during February and the first half of March coincided with the market's 20% rise to March 27th. On that date, the Yen still traded at 83 to the dollar, but as the Yen climbed alongside rising European fears, so the Topix index fell. From its high on March 27th, the Topix fell just over 20% to June 4th, more than erasing the positive gains of the first quarter. In 2011, Japan's early market recovery was cut off by the Eastern Japan earthquake and tsunami whereas this year it has been Greece, Italy, Spain and Europe's issues in general combined with more anxiety of slower growth in China. Japan meanwhile has delivered positive surprises in economic growth led by private consumption and capex, has seen the CPI turn positive and real wages rise along with company forecasts for strong earnings growth in 2012 and 2013.

We wrote of the opportunities that have arisen for Japanese banks through the misfortune of their European competitors and already we are seeing stark evidence of this in Asia-Pacific region trade financing. In the first five

months this year, Japan's share of the region's trade financing has jumped from 13% to 32% (of a total of \$8.4bn) while the portion of the market provided by the European banks fell from 41% in 2011 to just 23% in 2012. MUFJ alone accounted for 19.3% and has seen its share of the market quadruple in the past year. Despite this happy news, and a general improvement in demand for bank loans in Japan, the Topix banks sub-index hit its lowest level ever on June 4th - probably driven by short selling as much as selling by long-only funds. One broker told us that 40% of their sell orders were short sales, and the banks generally are prime short-seller targets because they are big, liquid, easy to borrow and....banks.

MUFJ shares trade at Y345, and at that price are on 7x earnings, a price-book ratio of 0.5x and a dividend yield of 3.5%. You could pay the German government to lend them Euros for two years, or buy MUFJ and get 7-8% in dividends in Yen. Given everyone seems to fear deflation and economic disarray in Europe, and no-one seems to believe that the sky is not falling in, there might be logic in this, but it strikes us that holding MUFJ over the next two years does not pose great risk of capital destruction. It is one of our largest holdings.

The world's major economies are growing, as are global purchasing managing indices and even the timorous Bank of Japan is boosting its balance sheet while Japanese inflation and wages nudge into positive territory. We think the global bearish consensus has had its day in the sun (or should that be shade?) and feel that equities in Japan are outstandingly attractive. Our portfolio carries an average dividend yield of 3% while earning a 12% RoE on a PBR of 1x. That looks like a bargain to us.

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Recent 3 month Fund Exposure

% of NAV in	Mar 12	Apr 12	May 12
Long Stock Positions	91.54	92.61	89.74
Index Futures	-	-	-
Net Exposure	91.54	92.61	89.74

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.

Position Concentration

	Top 5	Top 10
Longs	23.54%	43.01%
Total no. of positions	33	

Top Five Positions

Aeon Co Ltd
Mitsubishi Electric Corp
Canon Inc
Toyota Motor Corp
Mitsubishi UFJ Financial Group Inc

Winners

Seria Co Ltd
Nippon Ceramic Co Ltd
Sumitomo Electric Industries
Daiichikosho Co Ltd
Aeon Delight Co Ltd

Losers

Yamada Denki Co Ltd
Sumitomo Mitsui Trust Holdings Inc
Canon Inc
Terumo Corp
Mitsubishi Electric Corp

Sector Exposure as at 31 May 2012

	Longs		Longs
Consumer Discretionary	27.07%	Industrials	17.49%
Consumer Non-Discretionary	5.13%	Information Technology	9.22%
Energy	3.56%	Materials	3.74%
Financials	20.73%	Telecommunications	2.80%

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
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								-5.49	-3.11

* Topix Return is in USD unbedded using WM London 4pm close

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