

Monthly Performance % - as at 29 October 2010

	NAV	October	YTD	Asset size
Offshore Feeder	\$11.22	3.79%	7.37%	\$153M
Topix - <i>Topix Return is in USD unhedged using WM London 4pm close</i>		1.39%	3.26%	

“...Yet, between 1990 and 2009, planet Earth managed to chalk up average annual growth of 3.3%, despite multiple recessions, Long-Term Capital Management, the Tequila Crisis, the Asian Tiger Crisis and the Great Recession. As – in the world’s eyes – *Japan morphed from economic hegemon to a kind of national cigar butt*, other, non-Japanese sources of growth and demand and investment materialized.

Leverage, overinvestment and make-believe did, indeed, turn out to be important elements in the Japanese ascendancy. So too today with China.....”

From Grant’s Interest Rate Observer October 29, 2010 issue, discussing the wonder with which the world viewed Japan twenty years ago and possible similarities with the status which China enjoys today.

We want it known that we are bullish on Japanese equities and urge investors to act now and enjoy the ride. The typically pithy and laser-like Grant’s description of Japan as a kind of national cigar butt says more about investor sentiment towards the world’s second largest stock market than thousands of words from us. Anyone involved in global equity markets is familiar with the Icarus-like decline we have seen from Japanese equities since 1990, but to treat it like a worthless, ugly cigar butt is going to backfire

Why do we feel so positive? There are many reasons but the most vital ingredient in creating the environment in which a bull market can develop is an end to deflation. The Japanese government knows this and is working towards a joint approach with the Bank of Japan that will specifically target a certain annual inflation rate (1.5% perhaps). They have recently announced new measures which sanction the purchase of bonds other than JGBs and even shares in J-Reits, as a way of mopping up excess, unwanted assets. The scale is not large enough to slay the deflation hydra, but seen with the recent intervention to stop the Yen’s further appreciation, it is clear that the DPJ wants to cure Japan of this cancerous problem.

What else is there to like about things in Japan? In the past couple of days, we have seen no less than four announcements of corporate deals where one listed company is buying out all or some of the minority shareholders in companies they control. In one of these – Combi (code#7935) - the buy-out is being done by management and it all seems to make very good sense. This is a rare and welcome move for those

– like us - who have chosen to remain interested in Japanese equities and augurs well. In Combi’s case, the business is solid (Japan’s number two baby goods maker) and profitable and the balance sheet over-capitalised. With bank debt as cheap as it is, the deal appears to be highly attractive.

As we are in mid-year reporting season, it seems to be the time for companies to announce new initiatives along with their results. Yesterday, Japan’s telco giant NTT announced that it would be cancelling almost 8% of their treasury stock (they own over 15% of themselves) and that more of the same should be expected. NTT has most of the legacy problems of former monopoly telecom companies, but it also owns the world’s most extensive and high-spec fibre-optic network and is seeing enormous growth in digital content downloads. After this deal, NTT will trade at a PER of 10x, a PBR of 0.55x and carry a dividend yield of 3.5%. These are seriously cheap valuations – justified by the bears on account of the RoE of only 5% - and some 24 years after its partial privatisation and stock market listing, the shares are finally at a level where guardians can buy them for Widows and Orphans.

Successful investors buy stocks when they are cheap and sell them when they are not. Japan’s valuations are genuinely cheap, and with any whiff of inflationary expectations, leverage to rising profits will address the relatively modest RoEs that Japan currently suffers from. We urge readers to take a look at Hitachi as an example of a corporate turnaround that has received little attention from the financial media.

The company recently announced a big increase in forecast profits for the current year (ending March 2011) and the net profit of Y200bn will be their highest profit for twenty years. If Japan has been a sort of national cigar butt, Hitachi has certainly been a corporate one, but things are changing dramatically. Hitachi is strong in many fields and can be compared with Siemens AG in Germany and GE in the USA. Not only is Hitachi cheaper than both of these companies in terms of PER, PCFR and PBR, they are also generating a higher RoE than GE and one similar to Siemens, but with a shareholders equity ratio superior to GE’s and equal to Siemens. They are on track to earn Y55 in EPS for the next financial year and now trade at Y395, pricing it on just over 7x earnings. It is one of our largest positions and we expect that the shares will be over Y500 before long.

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Recent 3 month Fund Exposure

% of NAV in	Aug 10	Sep 10	Oct 10
Long Stock Position	92.12	84.90	91.88
Index Futures	-	-	-
Net Exposure	92.12	84.90	91.88

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

Position Concentration

	Top 5	Top 10
Longs	29.45%	50.90%
Shorts	-	-
Total no. positions	35	

Top Five Positions

Mitsubishi Estate Co Ltd
Chuo Mitsui Trust Holdings Inc
Hitachi Ltd
Fanuc Ltd
Fujifilm Holdings Corp

Winners

Fanuc Ltd
Mitsubishi Estate Co Ltd
Chuo Mitsui Trust Holdings Inc
Sumitomo Heavy Industries
Nidec Corp

Losers

Nippon Electric Glass Co Ltd
Itochu Corp
Kirin Holdings Co Ltd
T&D Holdings Inc
JS Group Corp

Sector Exposure as at 29 October 2010

	Longs	Shorts		Longs	Shorts
Materials	4.19%	-	Consumer Non Disc	7.77%	-
Industrials	23.74%	-	Consumer Disc	10.26%	-
Technology	12.50%	-	Telecom	4.67%	-
Financials	26.71%	-	Utilities	2.04%	-
Energy	-	-			

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 ¹ 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			7.37	3.26

¹ Topix Return is in USD unhedged using WM London 4pm close