Performance % - *as at 28 September 2007*

	NAV	September	Qtr	YTD	Asset size
Offshore Feeder	US$15.44	2.18%	-1.66%	5.18%	US$665M
US Feeder	US$15.56	2.37%	-1.52%	5.99%	US$36M

** The NAV shown above is after expenses and management fees but before any performance fees. The Fund return may thus not be the same as the return of a discrete investment that might be subject to performance fees through equalisation.*

Have you ever been to a party where the music is so good, the drinks so delicious and the company so exciting that everyone crowds onto the dance floor and really believes that they are cool, dashing, alluring and more? Well that is what the financial markets had come to resemble by the middle of 2007. One can only imagine the holidays that had been booked and the plans for the new house that were being drafted as the northern Spring turned to Summer and equity markets reached new highs – day after day after day.

Even Japan's market had started the year well, caught severe hiccups in late February, then steadied, and was ready to rejoin summer's raging dance party when someone put Burl Ives on the turntable and all of a sudden, nobody looked quite so cool. The twinkle-toed men of gravitas became paunchy, awkward and stumbled on their two left feet, the sparkling ladies stared into the mirror and frantically tried to re-apply their mascara. Princes of Darkness (the private equity mavens) ordered fizzy water and ran their hands nervously through thinning hair, and Japan picked the wrong song and tried to breakdance to "Rambling Rose". The result was a humiliating and gut-churning couple of weeks as markets melted and as the party fizzled out, people staggered off to find refuge and hope they would wake from a nightmare. Well it wasn't a nightmare, and anyone unlucky enough to be long equities in the week that ended August 17th knew that someone had laced their punch with a modern version of Agent Orange. From Hero to Zero in three short weeks.

Japan's recovery in September was most welcome but certainly anaemic in comparison with that of other Asian markets. It is true that emerging markets everywhere did especially well as fears of a credit squeeze eased, but in the Asia-Pacific region, even the Australian market managed a 5.1% gain whilst the broader MSCI AC Asia Pac (ex Japan) Index gained an eye-watering 12.7%. Japan's Topix index squeezed out a rise of 0.5% but after a decline of almost 10% over July-August, we felt like we'd won the lottery. Foreigners – particularly European foreigners – were very big sellers of Japanese equities in August and although the selling was stemmed in September, the net result for the quarter was a large negative. Japanese investors have been steadily increasing their purchase of investment trust funds in the past three years, but only some of this is allocated to domestic equities while a good portion continues to find its way into India, China and other exotic equities whilst the charms of high yield currencies like the Kiwi, the Aussie and other decidedly non-exotic countries continue to attract a lot of buying as well.

The supply and demand of/for stock in Japan continues to be problematic. On the one hand we have the twin positives of retail buying through the investment trusts and corporate buy-backs. The investment trust managers have designed funds that pay out attractive income distributions at frequent intervals and these will continue to attract money from savings accounts that pay interest – but only at derisory rates. Corporate buy-backs have been accelerating as well and the total income return to shareholders is now well above 2%pa. If I were Japanese I think I would be happy to take this income and expect a capital gain over time. But I'm not.

The negatives are firstly the fact that foreigners now own 27% of the market and account for over 50% of turnover and secondly that the Japanese financial institutions do not seem to regard their own equities as an investment opportunity. Perhaps the latter is still an (understandable) legacy of the devastation caused to so many companies and individuals by the bear market in Japanese stocks that lasted over twelve long years until early 2003. It may also have something to do with the imperative for the Japanese government to ensure that domestic investors continue to lend them money through holdings of government bonds. Everyone will have heard quips along the lines that "the last communist country left in Asia is Japan" - often ascribed apocryphally to a visiting Chinese dignitary – but I think it is demeaning to Marx, Engels, Lenin, Stalin , Mao et al that people would dignify Japan's model of political governance with any underlying ideology at all.

Should a Mrs Thatcher-style prime minister ever take the reins in Japan, or more likely, a completely privatised Post Office decide that they did not wish to subscribe to another massive JGB refinance, the government of the day would have little problem in paying off the national debt by selling national assets to the private sector. It has happened to varying degrees in almost every developed economy and is happening in many developing countries, but in Japan the idea seems to remain beyond the realm of public debate.

In the meantime, we expect the surprise to investors in Japan in the year ahead to be a surge in corporate consolidation – largely driven by Japanese companies themselves. Discussion we have had lately have been very encouraging as senior management at a number of companies we've met has talked freely about the need for over-crowded domestic sectors to rationalise and undergo consolidation. It is as plain as night and day to see that the industries that are competing internationally have higher profit margins, better asset utilisation, higher RoEs, better corporate governance and currently stronger growth. They are also less crowded. The domestic sectors are the antithesis of this and need consolidation. We have seen a number of attempts to coerce management to restructure their businesses – usually little more than a demand to pay out capital or profits – but little success. We believe there will be mergers and alliances formed in the next year that will begin to address the inefficiencies in the domestic areas. The agents for change will not likely be activists – at least not foreign ones – but will be led by the stronger and more outward-looking leading companies in these areas. Japan's Fair Trade Commission will need to relax its stringent anti-trust stance, but if the protagonists are leading lights in corporate Japan, their opposition will be diluted considerably.

Performance report

The September quarter was not a good one for our Fund and losers outnumbered winners by five to one. Worst of our long positions were the domestic sectors with Mizuho Bank, Mitsubishi UFJ Financial and Mitsubishi UFJ Lease each contributing about -0.8% to the Fund's return. The stocks with exposure to the "Global (and especially-Asian) Growth" theme were all hit hard in early August but many managed a good recovery along with the other Asian markets and mining stocks. Investors are fearful that Japanese banks and financial institutions have not been sufficiently transparent about their exposure to RMBS/Sub Prime investments and expect that sooner or later the dreaded mea culpa will be forthcoming. As there was a period when every single financial mess involving complex structures had a Japanese bank at the epicentre, it is understandable that people still expect bad news. Our sense – and it is no more than that – is that along with the waning power of the Japanese consumer electronics brands, there has been a corresponding waning in their appetite for opaque financial products. We hear more rumours of these problems in Taiwanese financial groups than in Japanese ones and believe that the sell-off in the Japanese banks has created a buying opportunity. Up to the end of September, the 2007 return of the Topix Banks index was -21.6%, making it the second worst sector after "Other Financials". If the Japanese equity market is to recover from the current low levels as we expect, the Banks will have to play their part. Mizuho Bank is trading right on book value and around 10 times earnings. If you have to wait for a lower price to buy a Japanese bank, you'd have to be deeper into value investing than Graham & Dodd.

During the quarter we added three new names to the Fund at the expense of three that we decided to cut. There was little change to the portfolio's make up as a result as we sold one materials company (JSR) whilst adding one (Sumitomo Metal Industries), exchanged a retailer (Mitsukoshi) for another (Izumi) and bought a diversified electronics company (Mitsubishi Electric) in the place of a devices maker (Topcon). The total number of holdings remained at thirty five.

Recent 3 month Fund Exposure

% of NAV in	Jul 07	Aug 07	Sept 07
Long Stock Position	92.31	91.14	90.33
Index Futures			
Net Exposure	92.31	91.14	90.33

Performance Statistics

Last 12 Months	12.87%
3 Yr Annual Average Return	15.78%
Average Annual Return Since Inception	15.18%

Position Concentration

	Top 5	Top 10
Longs	24.54%	44.06%
Total no. positions	35	

Top Five Positions

Komatsu
Sumitomo Corp
Toyota Motor
Fanuc
Suzuki Motor

Winners

Komatsu
Star Micronics
JFE Holdings
Hitachi Const Machinery
Mitsubishi Electric Corp

Losers

Mitsubishi UFJ Financial
Mizuho Financial Group
Mitsubishi UFJ Lease
Toyota Motor
Taiheiyo Cement

Sector Exposure *as at 28 September, 2007*

	Longs
Materials	14.85%
Industrials	34.11%
Financials	16.42%
Energy	
Consumer. Non-Disc	
Consumer Disc	19.44%
Utilities	
Telecom	
Technology	5.51%
Total Equity	90.33%
Index Futures	
Net Exposure	90.33%

September Qtr Sector Performance – P&L

	Longs
Materials	-0.40%
Industrials	-1.26%
Financials	-2.60%
Energy	
Consumer Non-Disc	
Consumer Disc	-1.22%
Utilities	
Technology	-0.01%
Index Futures	
FX	3.83%
Total	-1.66%

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
2004									-1.6	-1.32	6.18	2.52	5.70
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
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
2007	1.50	3.69	-1.88	0.33	1.71	1.49	1.27	-4.97	2.18				5.18

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***