

Performance % - as at 30 September 2011

	NAV	September	YTD	AUM
Offshore Feeder	US\$11.10	-3.98%	-8.94%	US\$81M
Topix - <i>Topix Return is in USD unhedged using WM London 4pm close</i>		-2.01%	-10.89%	

Japan outperformed most markets in the September quarter but that is tempered by the fact that the hurdle it had to beat was not high. The MSCI World Index plunged 17.9% to eclipse the decline seen in the September quarter of 2008 when Lehman Brothers went bust (-17.1%) and ranks as the third worst quarter of the past decade behind the December quarter of 2008 when the fall was 22.8% and the September quarter of 2002 (-18.6%).

Japan's Topix index fell 6.4% (in USD) and 10.4% in local currency. The damage was pretty much all done in August (-8.4%) but that is not to say that July and September were a barrel of laughs. The extent of the decline was clearly a lot less in Japan than many markets – especially the European ones – but as Japan has round tripped back to the lows reached in March 2009, the downside should be less. This relative attractiveness of Japan is supported by expectations of faster economic growth from Japan than most of the developed countries as it recovers from the natural disasters of earlier this year and benefits from the stimulatory effects of the supplementary budgets for reconstruction work.

The faster economic growth expected in 2012 (a consensus estimate of real GDP growth of 2.5%) has implications for investors comparing global markets and also for Japanese investors like us when considering sector and stock selection. We have had more of a domestic sector bias in our funds for the past year as we felt that expectations had become unduly pessimistic and valuations had been driven down to good entry levels. This has generally worked, although the domestic cyclical (real estate & finance) have not performed well in 2011. Now it has become more of a consensus view to favour domestics and, if anything, the classic cyclical sectors (e.g. shipping, steel, paper) are now attractive on relative valuations – even if the outlook is far from rosy. The better outlook for the economy was the subject of a Lombard Street Research daily note of October 11 entitled “Japan's economy – domestic strength, external weakness”. I find the argument for domestic strength pretty clear, but pessimism on the global economy might be a touch too commonly held to be much use as a basis for investment decision-making. A prediction of a

dire future for the developed world is the received wisdom of the day, and as the wonderful Blah! puts it in the October 13th daily: “To suggest otherwise is, of course, a symptom of intellectual superficiality, if not actual mental illness.” More than once we have felt that suggesting that Japanese equities might be worth buying has produced a similar reaction.

We will say it again however as we reckon that the main thing stopping Japanese equities from a considerable advance is the persistence of deflation. It affects the desire to spend, invest and borrow and makes economic growth difficult and reduces tax revenues. Japan entered the 1990s with grossly overvalued real estate and equities and a highly indebted financial system. All three problems have now been dealt with, but in the process, public debt has accumulated at a steady rate and is now at an elevated level. Other developed economies entered the 2000s with overvalued equities, and then as equities declined, pushed real estate too far and created another asset bubble. Financial institutions are struggling to deal with the marking down of their asset values and public debt is growing as the private sector cuts back. Some countries are pursuing policies that will devalue their currencies and might be inflationary. Japan has chosen not to do so and has thus prolonged the process of recovery. In the FT of October 14<sup>th</sup>, Martin Wolf argues the case for an inflationary monetary policy for the UK:

“If debt destruction were desired, the least damaging policy would be inflation. At the least, no sane policymaker would choose deflation in an over-indebted economy. Yet one government – that of Japan – did just that.”

Prices in Japan are now broadly stable, bank lending (September) has stopped declining and domestic investors are buying real estate. The new government under Mr Noda has shown a steadier hand on the tiller of policy and one or two good decisions and a less-than-disastrous global economy might just see the interest in domestic real estate spread over into the world of cheap Japanese equities.

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### Recent 3 month Fund Exposure

% of NAV in	Jul 11	Aug 11	Sep 11
Long Stock Positions	92.50	92.67	95.93
Index Futures	-	-	-
Net Exposure	92.50	92.67	95.93

### Performance Statistics

Last 12 Months	2.68%
3 Yr Annualised Return	1.84%
5 Yr Annualised Return	-4.09%
Annualised Return Since Inception	1.48%

### Position Concentration

	Top 5	Top 10
Longs	25.96%	45.39%
Total no. of positions	33	

### Top Five Positions

JS Group Corp  
Asahi Kasei Corp  
Canon Inc  
Mitsubishi Estate Co Ltd  
Itochu Corp

### Winners (Qtr)

Aeon Co Ltd  
JS Group Corp  
Ryohin Keikaku Co Ltd  
Park24 Co Ltd  
Benesse Holdings Inc

### Losers (Qtr)

Softbank Corp  
Nintendo Co Ltd  
Asahi Kasei Corp  
Sumitomo Realty & Development  
Mitsubishi Materials Corp

### Sector Exposure *as at 30 September 2011*

	Longs
Consumer Discretionary	26.68%
Consumer Non-Disc	3.80%
Energy	2.85%
Financials	18.43%
Industrials	17.85%
Information Technology	11.04%
Materials	9.36%
Telecommunications	5.92%
Net Exposure	95.93%

### September Qtr Sector Performance – P&L

	Longs
Consumer Discretionary	-2.26%
Consumer Non-Disc	0.34%
Energy	-0.63%
Financials	-2.62%
Futures	0.46%
Industrials	-0.79%
Information Technology	-2.63%
Materials	-2.13%
Telecommunications	-0.99%
FX and Other	4.45%
Total	-6.80%

### Performance Contribution

	Longs	Futures	Other	Total
September 2011	-3.46%	0.45%	-0.97%	-3.98%

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## 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
Below we provide a table detailing the monthly returns of the Fund since its inception in September 2004.														
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				-8.94	-10.89

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

## Optimal FUND MANAGEMENT

*Should you wish to make an enquiry about the Optimal Japan Absolute Long Fund, please see our website – [www.optimalasia.com](http://www.optimalasia.com) or contact us by email at [optimal@optimalasia.com](mailto:optimal@optimalasia.com).*

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