

Monthly Report to Unitholders of the Optimal Japan Trust 13 September, 2006

Date	NAV	Monthly % Return*
31 August 2006	A\$15.78	1.46

* After all fees

* NAV is ex-distribution of A\$ 1.24 (for Yr to 6/06) A\$1.4218 (for Yr to 6/05), A\$0.4713 (for Yr to 6/04) A\$ 0.8983 (for Yr to 6/02) A\$0.8989 (for Yr to 6/01) and A\$ 1.4158 (for Yr to 6/00)

* Returns are based on the redemption price of the initial series

Important: With effect from July 3rd, 2006, the Trust's administrator is EFA of Luxembourg. A new Private Placing Memorandum has been created and is available on our website (www.optimalasia.com) or can be emailed by the manager upon request.

The Topix index had a gain of 3.97% in August to mark the second largest monthly gain this year – so far. Because the Yen was quite weak against the AUD, the return in dollars was only 2.05%, but even with that lower hurdle, our funds struggled overall. It was not an investment style issue – as the MSCI Japan Value index return exceeded that of the Growth index in August – but reflects a more cautious tone to the global economic outlook and for the demand for resources and capital goods. The Machinery and Wholesale (mainly trading companies) sectors both performed poorly in August whilst Mining and Oil & Coal Products both had negative returns. We had reduced our position in Kubota over the past few months, but were hurt nevertheless by the 8% drop in the stock price, while other machinery plays we hold such as Makino Milling, Komatsu and Hitachi Construction Machinery also fell.

The largest percentage decline amongst our stocks was in the mid-cap stock Arrk. This was offered at the daily limit down on both August 14th & 15th after which it was changing hands 33% below the previous traded price. Our colleagues in Tokyo have already met with a director of Arrk to discuss the disappointing revision down and on September 21st, we travel to Arrk's head office in Osaka to meet their President and senior management. From discussions to date it appears that the bulk of the shortfall is expected from their Asian operations and 90% of that is due to Korean subsidiaries. We will assess our options after the meeting but at the current price it trades at just over 1x book value so would not appear to have too much downside. Fortunately our position at the start of August was only 1% so the portfolio's loss was significant, but not disastrous.

We have written before about the attractions of some Japanese companies with large market shares in businesses that have seen global consolidation. The autos, the steels, the metal refiners and precision equipment areas all come to mind but the problems come when we search the domestic sectors for similar stories of industry consolidation and better profit margins. Daiwa's strategist has compared companies with at least 30% of sales coming from overseas with those that have less than 30% external dependency. The results are interesting and paradoxical – at least to us. As a group, the “international” companies have significantly higher profit margins than the “domestic” ones, and yet they trade at lower multiples of earnings, cash-flow and book value. The logic in this escapes us, unless you believe that the market is so prescient and long-term in nature, that it is pricing in 1) a

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significant slowdown in global economic growth and/or loss of market share by the Japanese, or 2) a major boom in M&A and consolidation in the domestic sectors that will lead to greatly improved profitability. We would love to believe that scenario 2) is imminent, but we do not think this would make us much money – or at least not much any time in the next couple of years. The potential is certainly there for consolidation as evidenced by the following data. These are Nikkei sector classifications and show, in brackets, the number of listed companies in a selection of domestic-focused industries:

Electrical machinery trading companies (89)
Textile trading companies (46)
Food trading companies (39)
Construction materials trading companies (21)
Machinery & metal trading companies (70)
Chemical trading companies (28)

When evidence emerges that consolidation is occurring in these sector, we will be waiting to identify the acquirers, but for now, our sense is that these companies do not deserve a premium valuation.

Optimal visits Nachi-Fujikoshi's Toyama Plant in August 2006



(L-R) Warwick Johnson, Hideo Takagi, Hiroshi Maeda, Hisashi Yatsuo

To finish on an administrative matter, we wish to stress that any applications for redemptions or subscriptions in our funds that come in to EFA (administrator) after the dealing deadline will be rejected. Please visit our website www.optimalasia.com for related information and we encourage you to contact us through the web-site.

Positive contributors (long) Tokyu Corp, Nippon Steel, Showa Denko
(short) Nippon Paper, Dainippon Printing

Negative contributors (long) Arrk, Kubota, Makino Milling
(short) Topix Index Futures, Nippon Suisan, Sharp

Major Positions

Sumitomo Trust & Banking, JFE Holdings Inc, Tokyu Corp, Toyota

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Return Snapshot	
Period	%(AUD)
Year to Date Return	3.12
Return since inception Inception 20 Dec, 1999	121.3%
Fund size at 30 Jun 06	AUD 64.4 mil

Portfolio Composition at Month End			
% of NAV	Jun06	Jul06	Aug06
Long Stock Position	83.52	82.08	82.28
Short Stock Position	(18.82)	(23.93)	(21.12)
Index Futures	(12.57)	(12.16)	(11.60)
Equity Derivatives			
Net Exposure	52.13	45.99	49.56

Historical Returns

Below we provide a table detailing the monthly returns of the Fund since its inception in December 1999. The returns are of the Trust's Initial Series

Optimal Japan Trust Net Monthly Returns in AUD													
Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
1999												0.58*	0.58
2000	-0.32	12.76	8.99	-1.53	2.45	11.82	-9.05	4.02	-0.37	0.90	-0.18	-3.86	26.63
2001	-2.34	3.13	1.36	8.46	-2.14	3.96	-2.88	1.49	-3.58	1.77	-3.89	-5.46	-0.25
2002	1.10	1.47	2.07	-0.26	7.2	-2.9	-1.43	-1.47	2.04	-4.47	-3.65	-0.42	-0.59
2003	1.80	1.98	0.41	-0.20	2.55	3.97	1.91	5.90	3.81	3.58	-1.73	3.02	30.43
2004	-0.33	1.22	7.01	0.23	-1.20	3.67	-2.26	4.03	0.82	-1.55	1.65	1.92	15.95
2005	2.83	2.05	0.0	-0.13	1.04	1.37	2.38	4.15	6.71	1.31	2.39	4.30	30.03
2006	1.82	0.42	3.79	0.34	-4.04	0.24	-0.77	1.46					3.12

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