Optimal FUND MANAGEMENT

Monthly Report to Unitholders of the
Optimal Japan Trust

January 11th, 2002

DATE	NAV	Monthly % Return*
31/12/01	A$10.39	-5.46

- After all fees
- NAV is ex-distribution of A$ 0.8989 (for Yr to 6/01) and A$1.4158 (for Yr to 6/00)

Trailing 3 months NAV

10/01	11/01	12/01
A$11.44	A$10.99	A$10.39

Calendar year 2001 return: -0.25% against Topix (AUD) index return: -23.55%

It was a nasty end to a difficult year and a month we would certainly hope is not repeated any time soon – preferably ever. We mentioned in the conclusion to the November report that we expected the market conditions to remain hostile to value investing, but have to admit that in spite of this correct prediction, we did not manage to cope with it as well as we had hoped. Before discussing things in more detail, I wish to reproduce a quote from a famous Australian golfer who almost reached great heights:

"There's no question that I've had a lot of great things happen to me *at Augusta* – and some not so great things," Norman said. "But they're all just memories now, and I know that everything that has happened *at Augusta* has made me a better person. I don't think there is *an event* anywhere that has brought me more enjoyment or shaped my development as *a player* as much."

The golfer is Greg Norman who won two British Open titles but almost won many other major championships and most famously let a commanding final round lead disappear in the 1996 Masters at Augusta. The quote shows the interesting approach he took in dealing with the pain of that experience. I could substitute the words in italics with "in the Japanese market", "a period" and "investment manager" in addressing our poor returns in the last few months of 2001 but that would be disingenuous – to put it mildly. Let me try and give a more realistic account.

Exacerbated by the corporate bankruptcies of November & December (Taisei Marine & Fire Insurance, Niigata Engineering and Aoki Corp) investors became increasingly preoccupied with the question of credit-worthiness. Any company with high debt levels became a target for sellers – both existing institutional shareholders desperate to avoid holding a stock that goes bust and short-sellers looking for the next momentum play. It was not until late in the month that the more rational and diligent researchers began publishing analysis that assessed debt levels *and* the company's ability to meet

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interest and principal payments from their reserves and cash flow. We agonised over a number of our stocks that were wrongly put into the "credit risk" basket and sold heavily (Tokyu Land, Japan Energy, Kawasaki Shipping) and rather than capitulate with the momentum sellers, we have maintained and added to these favourites. Where we had positions in stocks that we felt less sure about we cut positions and in a couple of cases, we added new shorts from the same sector to provide a hedge while credit fears remained extreme. The credit fears seem to have abated – for now – and the market has evened out in the past two weeks, albeit without many signs of energy.

The consensus view on the Yen/Dollar has been for more declines in the Yen – usually rationalised as the most effective tool of monetary easing in the face of a central bank which still fears inflation. The consensus has been eerily correct as the Yen fell by over 6% against the dollar in December alone and no one seems to mind all that much. Companies that benefit from a weaker currency have performed well (autos and office automation) but it is not a theme that we are going to take a large bet on. We do not try to add value with currency bets (leaving the Yen positions hedged back into $) and am wary of pushing our luck too far by stacking the portfolio's long side with car companies and fax makers for currency reasons alone.

We approach the peak month for selling by the banks with a market in poor shape and confidence levels low. Daiei, the supermarket operator, is allegedly close to folding but it has been regarded as one of the walking dead for some years now. The company's main banks were reported ready to waive a significant part of their outstanding loans to Daiei and had an immediate haircut as investors threw up their hands in despair. The official comment from the parties involved was that no decision had been reached. Being short of a denial, this prompted further selling in the banks and a sudden surge in Daiei's shares. More positive was the news that MEI would be buying out the minority stakes in its main listed subsidiaries and making a share buy back with some of its enormous pile of cash. Economic forces have not been suspended in Japan, they just take longer to reach their inevitable conclusions. We will see more bankruptcies, consolidations and share buy-backs in Japan and a steady rise in return on equity. Eventually – perhaps sooner than the gloomy consensus view holds - this will lead to steadily rising share prices.

<u>Positive contributors</u>	(long)	Canon; Ricoh; Central Glass
	(short)	Oracle Japan; Don Quijote; UFJ Holdings; Mizuho Holdings
<u>Negative contributors</u>	(long)	Kawasaki Shipping; Tokyu Land; Japan Energy; Takagi Securities
	(short)	Tokyo Seimitsu; Ito-Yokado

Major Positions

<u>Long</u>

Kawasaki Shipping; Canon; Central Glass; Rohm; Japan Energy

<u>Short</u>

Acom; Tokyo Seimitsu; Hoya; Takefuji

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Returns Snapshot	
Period	**% (AUD)**
Year to Date Return:	-0.25
Return since inception: ***Inception 20 Dec, 1999**	27.08

Portfolio Composition at Month End			
%of NAV in:	Oct 2001	Nov 2001	Dec 2001
Long Stock Position	56.24	66.42	71.24
Short Stock Position	(36.48)	(34.96)	(35.57)
Index Futures			
Equity Derivatives	4.35	2.64	2.86
Net Exposure	24.11	34.10	38.53

Historical Returns

Below we provide a table detailing the monthly returns of the Trust since its inception in December 1999.

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

- Trust Inception 20 December, 1999

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