

**Performance % - as at 31 December 2009**

|              | NAV      | December | Qtr.   | YTD    | Asset size |
|--------------|----------|----------|--------|--------|------------|
| OJT Series 1 | A\$10.24 | 3.02%    | -2.94% | -5.01% | A\$40M     |

A quick glance at the report we wrote a year ago shows that the economic recession was foremost in our minds as we started 2009. We predicted that stock markets would nevertheless finish 2009 higher than where they started and in all major markets this proved the case. The gain in Japanese equities was less than that of most markets with the increase anywhere between 3% (Topix index return in USD) and 19% (the Nikkei 225 index in JPY) but had it not been for December's 8.05% gain in the Topix index, the year's return would have been negative. All in all, it was a banner year for equities after the horrors of 2008, but not so for Japan.

We have had a year that we are glad to leave behind and consign to history. The dispersion in returns amongst the 33 Topix industry sectors was very large. The best performer was Transport Equipment (autos) with a gain of 53% while the worst was Air Transport (mainly Japan Airlines) with a loss of 44%. We did well through our holding in Suzuki Motors but did not have enough support in that sector and while we avoided the damage in Japan Airlines, it was a year when we just had our stock picking wrong. Our large position in NTT has been a drag on performance while shorts in cyclicals such as securities companies and real estate have been amongst our worst.

Looking back over the past few years, we have found the period from the second half of 2007 very difficult in the Japanese market and tricky elsewhere in Asia as well. As someone else said, markets are far wiser than those that comment on them, and we would have to say wisdom has not been abundant in our stock selection for much of the past couple of years. Japan's position in Asia has changed in some aspects over the past six or seven years as less developed economies continue to move into more value-added industries. In some instances – such as ship-building – Japanese companies have lost their pole position and will almost definitely never reclaim it. In other areas, whilst competition has intensified, the Japanese companies continue to hold a significant lead over their Asian rivals. It is crucial to be able to determine when the performance of certain sectors and stocks is driven mainly by shorter-term cyclical factors and when it is in fact due to longer-term factors of a secular nature.

We believe that 2010 will be a year when a cyclical upturn is likely to be the main factor pushing Japanese equities higher. In addition to the similarities with late 2002, there is a new government that favours consumption over investment and is addressing some of the critical long-term problems facing Japan. The previous government had run out of ideas, and was rapidly running out of credible candidates to fill the

prime minister's role.

In terms of economic cycles, the domestic real estate market looks very similar to late 2002 with Tokyo office vacancy rates now at 8% (they peaked in mid 2003 at 8.5% and rents back to the levels they were at on 2005 and only 5% above the absolute recent lows of late 2004. Market experts expect greater clearances in the office real estate market in 2010 and domestic institutional interest has been evident for prime locations – particularly as interest rates are unlikely to offer much competition to rental yields for some time.

The recession has also pushed capital investment down to levels not seen since 1957 and it is very likely that this will spur increased capex in the coming year. According to Nomura Securities (see "Japanese equities: two focal points" 24 December 2009), the ratio of capex to nominal GDP fell to 13.1% in the September quarter of 2009 as companies have placed emphasis on optimising production structures as demand slumped.

There are a couple of positive outcomes one can expect from here. First, one would expect a cyclical pick-up in capex as demand recovers and companies need to both maintain and improve production equipment. Many of Japan's capital equipment companies and materials industries thus stand to benefit.

A more interesting aspect of this is that there might be more at play here than just swings in demand leading capex up or down. In an insightful analysis of Japan's plight, Andrew Smithers (see Financial Times, 8 Dec 2009) points out that Japan has over-invested for too long, suppressing not only company profits (through higher depreciation), but also wages and consumption. Due to the recession and plunge in profits, capital investment has been slashed and labour's share of output is now higher than that in the US. As Japan's household disposable income as a proportion to GDP is far lower than that of any other G5 country, this increase in wages' share of output should be positive for consumption.

Another positive aspect of this shift to lower depreciation is that tax revenues should rise given that depreciation is untaxed, while wages and spending are. More of the latter two means more tax revenue for Japan's government and a reduction in the Budget pressure so oft discussed.

We do expect capex to pick-up, but there is certainly evidence that many companies that previously were extravagant investors are looking for ways to reduce their asset heavy business models. This could be as simple as increasing

**SYDNEY:** Level 5, Wyoming, 175 Macquarie St, Sydney NSW 2000 **Phone:** 61 2 8239 3300 **Fax:** 61 2 8239 3333 **Email:** optimal@optimalasia.com

**TOKYO:** KS Building 10th Floor, 2-9 Minami Aoyama 6-chome, Minato-ku, Tokyo 107-0062 **Phone:** 81 3 5774 6507 **Fax:** 81 3 5774 6508

**DISCLAIMER:**

This Material is for your private information and we are not soliciting any action based upon it. Opinions expressed are our opinions only. The material is based upon information, which we consider reliable, but we do not represent that it is accurate or should not be relied upon as such. Past performance is not an indication of future performance. This material is not intended for distribution in Japan or for Japanese domiciled entities.

production facilities in countries where costs are lower - and indeed Panasonic has announced only today that they would double LCD TV output at their Malaysian factory – or outsourcing production to companies with lower costs and/or critical mass. This is evident in semiconductor chips where Japanese makers have moved to outsource manufacturing of memory chips to Taiwan's TSMC due to the huge ongoing capex demands. Capital investment will certainly pick-up from the 40 year lows it has reached, but it will not go back to levels of the past, and that should have a net positive outcome for most companies and their shareholders.

And finally, we leave you with the following article which appeared in the Lex column of the FT on December 31st.

“...Almost nobody is interested in investing now. Hard work and stashing one's money under the mattress, ....., is considered the road to wealth in the west these days.

Few should be surprised at this change. Japan went through a similar decade after its own market bubble burst at the end of the 1980s. From loving equities, Mrs Watanabe barely touched a share again for 20 years. It is fitting then that, while the S&P 500 trades at exactly the same level that it finished 2009, Japanese stocks have more than doubled. It took the Great Recession for the likes of Sony and Kirin finally to embrace “shareholder value”. But once they did, boy – returns on equity have skyrocketed.

Yet while the teens marked the return of Japan, it has been a decade that emerging wonder-markets of yesteryear would rather forget. Bubbles bursting are nothing new. But investors underplayed the importance of western consumers to developing world economies. The big lesson they learnt is that embryonic, rapidly evolving markets should never have traded with risk premiums barely above stable, mature ones. And what is left to say about poor China? Historians will be digging through the rubble of that economic and political experiment for years.”

We like the sound of the middle paragraph, but certainly not all else that is stated or implied in this piece entitled “Looking back from 2019”.

**DISCLAIMER:**

This Material is for your private information and we are not soliciting any action based upon it. Opinions expressed are our opinions only. The material is based upon information, which we consider reliable, but we do not represent that it is accurate or should not be relied upon as such. Past performance is not an indication of future performance. This material is not intended for distribution in Japan or for Japanese domiciled entities.

## Recent 3 month Fund Exposure

| % of NAV in          | Oct 09 | Nov 09 | Dec 09 |
|----------------------|--------|--------|--------|
| Long Stock Position  | 77.71  | 81.15  | 74.05  |
| Short Stock Position | -10.68 | -13.84 | -10.89 |
| Index Futures        | -18.38 | -18.73 | -19.14 |
| Equity Derivatives   |        |        |        |
| Net Exposure         | 48.65  | 48.58  | 44.02  |

## Performance Statistics

|  |        |
|--|--------|
| Last 12 Months                         | -6.14% |
| 3 Yr Annual Average Return             | -1.53% |
| 5 Yr Annual Average Return             | 3.22%  |
| Average Annual Return Since Inception* | 6.92%  |

\* Initial Series Used

## Position Concentration

|                     | Top 5   | Top 10 |
|---------------------|---------|--------|
| Longs               | 23.39%  | 39.72% |
| Shorts              | -10.05% | -      |
| Total no. positions | 39      |        |

## Top Five Positions

Nippon Telegraph & Telephone Corp  
Mitsui & Co Ltd  
  
Toyota Motor Corp  
Nippon Steel Corp  
  
Mitsui Trust Holdings Inc

## Winners

Nippon Steel Corp  
Mitsubishi Estate Co Ltd  
  
Nomura Holdings Inc  
Mitsui & Co Ltd  
  
Toyota Motor Corp

## Losers

Nikkei Index Future (Short)  
Nippon Telegraph & Telephone Corp  
Tokuyama Corporation  
Hitachi Construction Machinery Co Ltd (Short)  
Sumitomo Mitsui Financial Group Inc

## Sector Exposure as at 31 December, 2009

|                    | Longs  | Shorts  | Net     |
|--------------------|--------|---------|---------|
| Materials          | 8.97%  | -       | 8.97%   |
| Industrials        | 13.04% | -4.18%  | 8.86%   |
| Financials         | 13.13% | -0.84%  | 12.29%  |
| Energy             | -      | -       | -       |
| Consumer. Non-Disc | 2.80%  | -       | 2.80%   |
| Consumer Disc      | 21.35% | -       | 21.35%  |
| Utilities          | -      | -       | -       |
| Telecom            | 5.72%  | -3.80%  | 1.92%   |
| Technology         | 9.04%  | -2.07%  | 6.97%   |
| Total Equity       | 74.05% | -10.89% | 63.16%  |
| Index Futures      |        | -19.14% | -19.14% |
| Net Exposure       | 74.05% | -30.03% | 44.02%  |

## December Qtr Sector Performance – P&L

|                   | Longs  | Shorts | Total  |
|-------------------|--------|--------|--------|
| Materials         | -0.20% | -      | -0.20% |
| Industrials       | 0.33%  | -0.49% | -0.17% |
| Financials        | -0.23% | -0.20% | -0.43% |
| Telecom           | -0.88% | -0.22% | -1.10% |
| Consumer Non-Disc | 0.20%  | -      | 0.20%  |
| Consumer Disc     | 0.35%  | -0.37% | -0.02% |
| Utilities         | -      | -      | -      |
| Technology        | -0.34% | 0.12%  | -0.21% |
| Fx and Others     | -0.11% | -      | -0.11% |
| Index Futures     | -      | -0.90% | -0.90% |
| Total             | -0.87% | -2.07% | -2.94% |

### DISCLAIMER:

This Material is for your private information and we are not soliciting any action based upon it. Opinions expressed are our opinions only. The material is based upon information, which we consider reliable, but we do not represent that it is accurate or should not be relied upon as such. Past performance is not an indication of future performance. This material is not intended for distribution in Japan or for Japanese domiciled entities.

## Historical Returns - Distributions Reinvested

### Optimal Japan Trust Net Monthly Returns in AUD %

The table below outlines the monthly returns of the Fund's Series 1 since its inception in August 2002.

| Year to | Jul   | Aug   | Sep   | Oct   | Nov   | Dec   | Jan   | Feb   | Mar   | Apr   | May   | Jun   | YTD    |
|---------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|
| 2002    |       |       |       |       |       |       |       |       |       |       |       |       |        |
| 2003    |       |       | 1.68  | -4.38 | -3.66 | -0.42 | 1.80  | 1.98  | 0.41  | -0.10 | 2.55  | 3.48  | 3.06   |
| 2004    | 1.54  | 5.20  | 3.86  | 3.55  | -1.67 | 3.06  | -0.33 | 1.24  | 7.11  | 0.15  | -1.14 | 3.93  | 29.47  |
| 2005    | -2.14 | 4.01  | 0.23  | -1.21 | 1.30  | 1.51  | 2.74  | 2.02  | 0.07  | -0.14 | 0.99  | 1.47  | 11.24  |
| 2006    | 1.81  | 3.68  | 6.81  | 1.36  | 2.41  | 4.38  | 1.82  | 0.43  | 3.86  | 0.35  | -4.05 | 0.18  | 25.14  |
| 2007    | -0.79 | 1.43  | 0.13  | 2.10  | 0.77  | 2.49  | 1.99  | 0.55  | -1.03 | 1.35  | 3.45  | 2.28  | 15.66  |
| 2008    | -0.87 | -6.98 | 1.88  | 0.35  | -6.70 | -4.69 | -6.67 | 2.21  | -0.67 | 6.20  | 1.34  | -5.91 | -19.57 |
| 2009    | -0.83 | -5.34 | -0.09 | -0.44 | -6.38 | 3.22  | -1.74 | -2.15 | 1.91  | 0.47  | 0.84  | -0.46 | -10.84 |
| 2010    | 0.28  | 2.59  | -4.87 | -0.66 | -5.15 | 3.02  |       |       |       |       |       |       | -5.01  |

The table below outlines the monthly returns of the Fund's Initial Series since its inception in December 1999.

|      |       |       |       |       |       |       |       |       |       |       |       |       |        |
|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|
| 2000 |       |       |       |       |       | 0.58  | -0.32 | 12.76 | 8.99  | -1.53 | 2.45  | 11.82 | 39.0   |
| 2001 | -9.05 | 4.02  | -0.37 | 0.90  | -0.18 | -3.86 | -2.34 | 3.13  | 1.36  | 8.47  | -2.14 | 3.96  | 2.82   |
| 2002 | -2.88 | 1.49  | -3.58 | 1.77  | -3.89 | -5.46 | 1.10  | 1.47  | 2.07  | -0.26 | 7.13  | 2.92  | -4.55  |
| 2003 | -1.46 | -1.39 | 2.04  | -4.47 | -3.65 | -0.44 | 1.80  | 1.98  | 0.41  | -0.20 | 2.65  | 3.97  | 0.89   |
| 2004 | 1.91  | 5.90  | 3.81  | 3.58  | -1.73 | 3.02  | -0.33 | 1.22  | 7.01  | 0.23  | -1.20 | 3.95  | 30.56  |
| 2005 | -2.26 | 4.03  | 0.82  | -1.55 | 1.65  | 1.92  | 2.83  | 2.05  | 0.00  | -0.14 | 1.04  | 1.37  | 12.22  |
| 2006 | 2.38  | 4.15  | 6.71  | 1.31  | 2.39  | 4.30  | 1.82  | 0.42  | 3.79  | 0.34  | -4.04 | 0.24  | 26.09  |
| 2007 | -0.77 | 1.46  | 0.13  | 2.72  | 0.99  | 2.62  | 1.96  | 0.58  | -0.99 | 1.35  | 3.47  | 2.23  | 16.82  |
| 2008 | -0.89 | -6.99 | 1.85  | 0.40  | -6.68 | -4.73 | -6.62 | 2.17  | -0.71 | 6.19  | 1.42  | -5.97 | -19.60 |
| 2009 | -0.78 | -5.37 | -0.08 | -0.42 | -6.38 | 3.23  | -1.74 | -2.21 | 1.90  | 0.53  | 0.79  | -0.44 | -10.82 |
| 2010 | 0.26  | 2.54  | -4.79 | -0.72 | -5.15 | 3.05  |       |       |       |       |       |       | -5.01  |

## Annual Distributions

|                           |                           |                            |                           |
|---------------------------|---------------------------|----------------------------|---------------------------|
| Year to 6/07<br>A\$2.4179 | Year to 6/05<br>A\$1.4218 | Year to 6/02<br>A\$ 0.8983 | Year to 6/00<br>A\$1.4158 |
| Year to 6/06<br>A\$ 1.24  | Year to 6/04<br>A\$0.4713 | Year to 6/01<br>A\$0.8989  |                           |

# Optimal FUND MANAGEMENT

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

#### DISCLAIMER:

This Material is for your private information and we are not soliciting any action based upon it. Opinions expressed are our opinions only. The material is based upon information, which we consider reliable, but we do not represent that it is accurate or should not be relied upon as such. Past performance is not an indication of future performance. This material is not intended for distribution in Japan or for Japanese domiciled entities.