

Monthly Report to Unitholders of the Optimal Japan Trust

February 14, 2002

| DATE | NAV | Monthly % Return |
|----------|----------|------------------|
| 31/01/02 | A\$10.51 | 1.10 |

- 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)

Monthly return composition

| Topix % | OJT longs % | OJT shorts % |
|---------|-------------|--------------|
| -5.85 | -4.96 | 11.86 |

Trailing 3 months NAV

| 11/01 | 12/01 | 1/02 |
|----------|----------|----------|
| A\$10.99 | A\$10.39 | A\$10.51 |

Japanese equities continued to fall and plumbed 18 year lows during January. There cannot be a business magazine or broadsheet newspaper in the world that has not carried apocalyptic stories about Japan's economy during the past few months. According to hearsay, foreign asset-allocators have cut their portfolio exposure in Japan and as we are constantly reminded, domestic institutions are ongoing forced sellers. In light of all this, the equity market and the Yen have both been surprisingly resilient.

Most interesting to us has been the return of some degree of risk appetite after the panic run for safety during November and December. As we mentioned in the last report, we were hit hard in December by the selling of stocks with more geared balance sheets and bankruptcy fears were most evident in the enormous implied yields on many of these companies' convertible bonds. Although the macro news has been anything but cheerful since then, most of these bonds have recovered strongly and yields, whilst still high, have fallen. The weakness in the credit market of late has been in the Japanese government bond market and in the corporate bonds of Japan's erstwhile bluechips. The ten year JGB yield has risen by 20bps (from 1.30 to 1.50%) since late December while yields on the CBs of NEC and Fujitsu, for example, have also been rising. The yield spread between the bonds of these corporate bellwethers and those of the "basket cases" has contracted dramatically. Considering the disastrous earnings outlook for Japan's major integrated electronics stocks and their recent downgrades, this narrowing in spreads seems entirely rational to us. Indeed market talk of balance sheet risk and economic redundancy of late has shifted to many stocks that until recently were core positions for foreigner and Japanese institution alike. Sacred cows are looking less like safe havens than they once did but we see this as part of the trend towards a more critical assessment of risk and return in Japan's capital markets.

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Looking at our portfolio during January, we saw a slightly better-than-market return from our long positions as value stocks stabilised but the major factor in achieving a positive overall return was the success of our shorts. This was partly linked to the fall in Nasdaq in the latter part of the month as some shorts in the tech area did well, but more of the gains were from domestic sectors such as retail, services and consumer finance. The latter have been great performers for many years as they grew assets (small-lot loans) and grabbed a huge spread between their cost of funds and their lending rates. We believe that the good times have largely passed as asset growth has either slowed right down or has been achieved through looser credit assessment. Rising default rates have eaten into profits and with unemployment rising and incomes likely to decline we see these as being a case of “yesterdays’ heroes”.

A week spent in Japan recently was instructive in a number of ways – perhaps best illustrated by one day of company visits in the Kansai (Osaka) area. The first company we saw was doing many things right (expanding production into China, selling unnecessary real estate and integrating a number of distribution sited into one) and appears very cheap. The problem is that they are yet to see any pick-up in orders and so earnings are poor. We like it and believe patience will pay off.

The next was a third tier electronic component maker that appears to be happy to remain so – and so will inevitably disappear. One wondered whether the world would notice their passing.

The last was a cash rich, cash generative, overly capitalised company in a low growth industry. They will not pay out cash to their shareholders and have a pathological dislike of borrowings. When we put it to them that they really might be better served by delisting from the stock exchange the spokesmen agreed and laughed. We felt that despite the sense, it was unlikely that they would bother.

All three visits were useful and give us more faith in the outlook for long/short investment in Japan. There are good companies subject to economic cycles, poor companies with no future, and solid companies with no need of the stock market. With more to come from new investor groups looking to persuade management to pay out some of their cash reserves, the complacent companies might just start to care about their shareholders. We certainly feel that pressure is building and the year ahead will see change – for the better.

| | | |
|------------------------------|---------|---|
| <u>Positive contributors</u> | (long) | Toyota; Japan Foods; Mitsui OSK; Daidoh Limited |
| | (short) | Sanix; Takefuji; Ito Yokado; Net One Systems |
| <u>Negative contributors</u> | (long) | Central Glass; Benesse; Kao; Sanki Engineering |
| | (short) | Nidec; Kyorin Pharmaceutical; Keihin Railway |

Major Positions

Long

Kawasaki Shipping; Canon; Central Glass; Toyota; Mitsui OSK

Short

Acom; Tokyo Seimitsu; Hoya; Mitsubishi Motors

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| Returns Snapshot | |
|--|---------|
| Period | % (AUD) |
| Year to Date Return: | 1.10 |
| Return since inception: *Inception 14 Oct, 1999 | 28.2 |

| Portfolio Composition at Month End | | | |
|------------------------------------|----------|----------|----------|
| % of NAV in: | Nov 2001 | Dec 2001 | Jan 2002 |
| Long Stock Position | 66.42 | 71.24 | 68.64 |
| Short Stock Position | (34.96) | (35.57) | (34.85) |
| Index Futures | | | |
| Equity Derivatives | 2.64 | 2.86 | 2.75 |
| Net Exposure | 34.10 | 38.53 | 36.54 |

Historical Returns

Below we provide a table detailing the monthly returns of the Fund 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 |
| 2002 | 1.10 | | | | | | | | | | | | 1.10 |

- Trust Inception 20 December, 1999

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