Optimal FUND MANAGEMENT

Monthly Report to Unitholders of the

Optimal Japan Trust

6 August, 2000

DATE	NAV	Monthly % Return*
31/7/00	A$12.6412	-9.05

* After all fees

Timing may not be everything when it comes to investing, but it certainly casts a big shadow in the shorter term. Whilst making judgements on a company's business outlook and valuing the shares is difficult enough, making predictions about the behaviour of other investors is far harder. In this sense, July was a stark reminder to us that the difference between being early and being wrong is only discernible with the benefit of hindsight and offers no comfort to investors who have suffered in the meantime. We had enjoyed abnormally strong returns from our stock selection in June but found the situation dramatically reversed in July and the Fund suffered its worst monthly result since inception as a result. The Topix index (in AUD) fell 8.84% for July but despite maintaining net market exposure of around 50% for the month, our return was slightly worse than that of the index.

Looking back at the events of July, we clearly underestimated the build up of negative sentiment towards Japan in the USA and in Europe. Foreign selling was not as great as it had been in the Spring but buying interest really dried up as Japanese institutions sat on their hands. There is clearly a body of opinion which perceives corporate reform as being insufficient – or at best, to have lost momentum.
We tend to think that this perception is coincident with falling share prices and not wholly justified. On recent company visits we have been pleasantly surprised at management's description of their attempts to improve profitability and believe that the need to achieve a higher return on investment is accepted by many companies. Sadly, however, there is no

short term mechanism to scare the complacent or incompetent managers into action so rather than resolving their problems with an aggressive takeover or through shareholder dissent, we are left waiting for market forces to take effect as sources of capital dry up. Whether one wants to invest in undervalued companies in the belief that sooner or later the value will be realised for shareholders through liquidation and capital returns depends on your patience. We believe there are many alternatives one can invest in which should provide capital appreciation - where management are willing and able to generate higher returns – without waiting for hostile M & A to take root in Japan. It would however be much more enjoyable and profitable if that were to happen sooner rather than later. We sense that it may be not all that far away.

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What mistakes did we make in July? Until the fall in price of many electronic/technology stocks since March, we had found it impossible to justify buying shares in many companies in these areas. We could agree with analysts that Rohm, Murata, Advantest et. al. were high quality companies with good long term prospects but felt that as everyone knew that and had long since bought the story, the share prices were unattractive – indeed were extremely over-valued at their peak. With their prices 30-50% lower than their late March-peak, we began buying some of these higher quality companies during June and July on the assumption that world growth was looking resilient through the year and that demand for their products was still strong and likely to remain so. Valuations had fallen back to modest levels and we felt it was right to accumulate good businesses at cheap prices. So far so good. What we failed to predict however, was the ongoing selling of these shares by both foreigners – capitulating and either cutting their losses or realising profits if they'd been invested early enough – and by domestic mutual fund managers. In one instance, we bought Taiyo Yuden some 30% from its peak only to see it fall a further 25% in a matter of weeks. In the short-term at least, we had sorely underestimated the deterioration in the supply-demand equation for Japanese equities.

In the short term, we have confidence that refreshed from a summer break, investors will acknowledge economic conditions and the corporate profit recovery warrant allocating money again to Japanese equities. In the longer term there needs to be more credible political and administrative management if Japan is to leave the mistakes of the 1980s and 1990s behind and punch its weight on the world stage. The growing sense of unease amongst ordinary Japanese that the pilot is asleep on the bridge and their ship is drifting off course is ultimately of more importance to investors than debating whether this bank merges with that or arguing the process through which a retail company's demise is managed.

Performance

Positive contributors (long) M.E.I. ; Denso; Kajima
(short) Advantest; Takashimaya

Negative contributors (long) Mitsubishi Electric; Nikko Securities; Daito Electron; Harmonic Drive; Taiyo Yuden; Hitachi Maxell; Nippon Mining & Metals (short) Toyoda Gosei; Ito Yokado; JR West

Major Positions

Long

Arrk; Central Glass; Sanwa Bank; M.E.I.; Kawasaki Shipping

Short

Ito Yokado; Advantest; Meitec; Furukawa Electric

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Returns Snapshot	
Period	**% (AUD)**
Year to Date Return:	25.69
Return since inception: ***Inception 20 Dec, 1999**	26.41

Portfolio Composition at Month End			
%of NAV in:	May 2000	June 2000	July 2000
Long Stock Position	102.26	98.22	108.19
Short Stock Position	(22.11)	(27.05)	(27.93)
Index Futures	(23.35)	(21.12)	(31.07)
Equity Derivatives	5.14	3.74	4.53
Net Exposure	61.94	53.79	53.72

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						25.69

- Trust Inception 20 December, 1999

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