

Monthly Report to Unitholders of the Optimal Japan Trust August 10th, 2004

Date	NAV	Monthly % Return*
30 July 2004	A\$12.89	-2.26

* After all fees

* NAV is ex-distribution of 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

Success – Longs & Shorts

	May04	June04	Jul04
Topix %	-3.91	4.36	-4.23
OJF longs %	-2.16	7.95	-7.56
OJF shorts %	-0.83	-2.78	3.72

Important: The Optimal Japan Fund and Optimal Japan Trust are both soft-closed. The administrator (BTFE) will request any applicant for investment to contact the manager and require Directors' consent before acceptance.

In recovering from the depths of 2002 and early 2003, the Topix index first breached the 1100 level in early March this year and has since spent five months trapped between 1200 and 1100. Having only just digested the FY2003 results - announced between mid-April and late May 2004 – we have been badgered by companies reporting their results for Q1 FY2004. This newly adopted practice of Japanese companies announcing quarterlies is most unwelcome, and will render the publications of the sell-side even more ineffectual than hitherto. No doubt it is meant to keep the market better informed but I fear it will not have the impact hoped for. Individual investors are not likely to read quarterly announcements with any great interest and investment managers should not be worried into changing their opinion of a company's shares based on a running three-month update. Adopting western market practices in this area at least is not a reason to be cheerful.

There are reasons to be cheerful however as Japan has worked hard to turn vices into virtues. In some cases, this is only a recent improvement but in the case of dependency on oil, it has been a work in progress for thirty years. Having been hit hard by the oil shocks of the 1970s, Japanese industry has been successful in cutting the amount of oil needed for a unit of real GDP by more than 50%. Daiwa Securities calculates that a 10% annual rise in crude oil will have a -1.7% effect on All Industries recurring profits and that materials input costs (including inputs from mining, pulp/paper, oil & coal products, chemicals and glass/ceramics) to have fallen as a % of production value from 10.9% in 1985 to 7.7% in 2002. As a percentage of the total "value-added", these material inputs fell from 20.2% to 14.0% over the same period. It is only a hunch, but I suspect that the same numbers are not as impressive for many of the larger OECD economies.

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Bears contend that the impression of structural change in Japan is just that – and that the same old web of vested interests remains in place to thwart equity investors. I would rather avoid the hair-splitting in defining structural from cyclical and point out that in a number of important areas, Japan's excesses have been largely worked off.

First, debt as a multiple of EBITDA has fallen from a peak of 6.5x in 1994 to 4.3x in 2004. Over the same time, operating profits plus interest received has risen to almost 7x that of interest paid from a low in 1994 of only 2x.

In employment, the Bank of Japan's Tankan survey reveals that after 11 consecutive years where manufacturers responded that they had an excess of employees, the latest survey shows the balance of responses to be almost back to neutral. As labour costs are such a massive proportion of total costs for Japanese companies, this is compelling evidence of the labour adjustments that have taken place in recent years.

Excess capacity would also appear to be largely worked off as METI's production capacity index has fallen from a peak of 102 in 1998 to 92 this year. This level was last seen in 1988.

Excess bad loans - whilst not behind us – have also returned to what may be described as a stable position. Outstanding bad debts as a percentage of all major banks' loans peaked at over 8% in 2002 and should be back below 4% this fiscal year. Given the size of the Japanese banks loan books, a 1% change in this figure represents trillions of yen.

On more immediate matters, earnings of the listed companies are on track to see another year of profit growth (somewhere between 12-20% looks likely) and the market gets cheaper. The Topix EPS number this fiscal year should hit 65, which puts the market on a PER multiple of 17x – the lowest level since 1982. As long as global interest rates look set to rise, it is hard to see a multiple expansion in Japan, but at least one can be confident that Japanese rates will remain at zero until deflation is long dead. Once this occurs, Japanese earnings may be capitalised at a somewhat more generous rate than they are now – and we should see earnings yields stable to falling while long rates rise. Under such a scenario, the Topix index should regain the 1700 level – but this is at least a year away, and that's an investment horizon that very few investors seem willing to work with these days.

Positive contributors (long) Nichiiko Pharm Co., Tokyo Basis, NHK Spring, Pigeon Co,
(short) Matsui Securities, Isetan Co, UFJ Holding, Fujitsu Ltd

Negative contributors (long) Sumitomo Trust Banking, Tokyo Tatemono, NEC Electronics
(short) Nitori, Daiichi Pharm, Yakult, Saizeriya

Major Positions

Toyota Motor, Mitsui OSK, Fuji Photo Film, Tokyo Tatemono, Mitsubishi Co

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Optimal FUND MANAGEMENT

Return Snapshot	
Period	%(AUD)
Year to Date Return	8.63
Return since inception Inception 20 Dec, 1999	65.74

Portfolio Composition at Month End			
% of NAV	May 04	June 04	July 04
Long Stock Position	80.90	88.20	78.48
Short Stock Position	(33.63)	(40.42)	(36.73)
Index Futures	(13.69)	(15.65)	(21.14)
Equity Derivatives	3.35	4.09	3.55
Net Exposure	36.93	36.22	24.16

Historical Returns

Below we provide a table detailing the monthly returns of the Fund since its inception in mid-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	1.47	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						8.63

* Trust inception 20 December, 1999

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