Monthly Report to Unitholders of the Optimal Japan Trust – *July 2010*

Optimal FUND MANAGEMENT

Monthly Performance % - *as at 30 July 2010*			
NAV	July	YTD	Asset size
A$10.22	0.49%	0.49%	A$40M

A gain is a gain - even when it is only 0.96% - and after two months of hefty falls, the small rise in the Topix index was welcome. Other markets found some real mojo in July with the US and Europe both up by almost 7% but this was not the case in Japanese equities. The economic and, especially, the corporate backdrop have not been such as to warrant more pessimism, so one is left searching for reasons to be cheerless. The likely reason – if market movements can be traced to a reason – was the poor showing in the mid-term Upper House election that took place on July 11th. Prime Minister Kan's DPJ failed to win the small number of new seats needed to take an absolute majority and has been searching for compromise with minor parties in order to ensure legislation gets through the house of review with minimum delay. We are still waiting to see how this will be resolved, but confess that we were hoping for a different result and so, it would seem, was the market.

Everything - except bonds – is becoming cheaper. A combination of strong earnings and falling share prices has put Japanese stocks (using the Topix index constituents) on below 15x PER (12 month forward estimates) and almost 70% of these trade at book value or below. These ratios imply a return on equity of about 6% for the average company and this is certainly low by comparison with the rest of Asia (where the average is more like 14%) and also in comparison with other developed markets. Raising the RoE is the big task for Japanese companies and all three factors that comprise the RoE could be better (we use that word with some reservations). Japanese companies have already paid back most of their debt and have unleveraged balance sheets. Lazy assets are still plentiful - although recent action by the large electronics companies has been positive so asset turnover is low and profit margins are modest, but improving sharply.

Aggressive cost cutting by Japanese companies has been a large factor in dragging the average Operating Profit Margin up to 5.5% for the companies that have reported their June quarter results. While not high enough, it is noteworthy that this level exceeds the level the market reached in the quarter prior to the onset of the GFC in mid-2008 and yet demand is well below the level at that time and the Yen is much stronger (now 85 versus 105 vs the USD). While the strong Yen hurts profitability of the exporters, the domestic sectors have not been helped by persistent price deflation exacerbated by the failure to consolidate in crowded industries. In a world where no government seems to want to see their currency strengthen, it is difficult to see a global consensus forming to weaken the Yen so Japan's manufacturers will continue to lower costs to deal with the Yen's strength.

Changes in demographic trends are slow to take effect so we won't dwell on the fact that Japan's birth rate has been rising in the past four years. It is another positive factor that has been largely overlooked, but more important in the near term is the coming boost in the proportion of the population in the high consuming age group of 40-49. This age group comprises the children of the post WW2 baby-boomer generation and as their share of the total population expands in the years ahead, it comes at the expense of the age group with the lowest propensity to consume – those aged 30-39 and particularly those in the 30-34 age bracket. Last year saw the share of the 40-44 group overtake the 30-34 group for the first time since 1997. This high spending group (40-44) "peaked" in 1991 at the end of the domestic demand-led "Bubble" period, while the miserly 30-34 age group peaked in 2004 and has just crossed below their spendthrift compatriots ten years their senior. We note that the consumption items that get the greatest share of their spending are "homes", "education", "entertainment" and "transport, telecom" and believe that we can profit by investing in leading companies in these sectors. We have other positive trends to highlight and will write more on these trends that offer interesting investment opportunities in the next monthly letter.

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Recent 3 month Fund Exposure

% of NAV in	May 10	June 10	July 10
Long Stock Position	92.61	87.91	86.05
Short Stock Position	-7.02	-7.08	-11.14
Index Futures	-28.97	-38.54	-39.47
Equity Derivatives	-	-	-
Net Exposure	56.62	42.29	35.44

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Position Concentration

	Top 5	Top 10
Longs	22.90%	38.79%
Shorts	-10.45%	-
Total no. positions	45	

Top Five Positions

- Chuo Mitsui Trust Holdings Inc
- Mitsubishi Estate Co Ltd
- Hitachi Ltd
- Nippon Telegraph & Telephone Corp
- Fanuc Ltd

Winners

- Hitachi Ltd
- Bridgestone Corp
- Daihatsu Motor Co
- Nippon Electric Glass Co Ltd
- Fujifilm Holdings Corp

Losers

- Nikkei Index Futures (Short)
- Ryohin Keikaku Co Ltd
- Daikin Industries Ltd (Short)
- Chuo Mitsui Trust Holdings Inc
- Nippon Paper Group Inc

Sector Exposure as at 30 July 2010

	Longs	Shorts	Net
Materials	8.95%	-	8.95%
Industrials	17.22%	-4.68%	12.54%
Technology	11.20%	-	11.20%
Financials	22.24%	-	22.24%

	Longs	Shorts	Net
Consumer Non Disc	4.53%	-2.02%	2.51%
Consumer Disc	17.56%	-4.43	13.13%
Telecommunication	4.33%	-	4.33%
Futures	-	-39.47%	-39.47%

Performance Contribution	Longs	Shorts	Futures	Other	FX Forwards	Total
July 2010	1.82%	-0.20%	-0.77%	-0.36%	NA	0.49%

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.

Annual Distributions

Year to 6/07 *A$2.4179*	**Year to 6/05** *A$1.4218*	**Year to 6/02** *A$ 0.8983*	**Year to 6/00** *A$1.4158*
Year to 6/06 *A$ 1.24*	**Year to 6/04** *A$0.4713*	**Year to 6/01** *A$0.8989*	

Year to June	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	1.95	-1.53	5.74	2.76	-5.91	-3.24	-5.66
2011	0.49												0.49

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

Year to June	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	YTD
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	1.94	-1.54	5.81	2.70	-5.94	-3.25	-5.71
2011	0.47												0.47

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