

## Monthly Report to Unitholders of the

### Optimal Japan Trust

July 3, 2003

Date	NAV	Monthly % Return*
30 June 2003	A\$10.47	3.97

\* After all fees

\* NAV is ex-distribution of 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

### Success – Longs & Shorts

	Apr03	May03	June03
Topix %	1.09	5.16	7.85
OJF longs %	0.80	5.75	11.20
OJF shorts %	-1.90	-3.98	-9.10

There is too much good news to list in this report but we must say that it was a rare treat for Japan investors to have their market climb 7.9% after a 5.2% rise the previous month. So rare, and so intoxicating in fact, that one needs to do a bit of historic data mining to put the 14.7% Q2 2003 Topix index gain into context. A rolling 12 month return from Japanese equities was in fact *minus* 11.9% to the end of June whilst the loss since December 1999 is 47.5%. The quarterly rise we saw in Japan, moreover, undershot the 14.9% gains in the S&P500 index and begs the question what would happen to Japanese equities were the US market to roll over again? Based on recent experience, one is tempted to say that the downside in Japanese stocks would be at least as large as that in the US market, but that would be to ignore some facts that argue that Japan's economic outlook is improving faster than that of either Europe or the United States.

I place little stock in economic forecasts but occasionally there are figures that give one cause to reflect. The recently released June PMI data shows Japan at 50.4 (+1.4 from May), the US at 49.8 and Europe at 46.4. The Japanese "Tankan" diffusion index for large manufacturers (released July 1<sup>st</sup>) also showed an improvement to -5 and reinforces the recent positive momentum. Of more interest - to me at least - is the Japanese June labour data which showed the number of people in employment rose by 40,000 yr/yr for the first annual increase in 26 months. Labour costs are falling as Japanese workers accept lower wages/bonuses and perhaps we are seeing new jobs increase faster than jobs are shed. Call me optimistic, but I believe this is hardly deflationary.

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# Optimal FUND MANAGEMENT

As noted in our last report, Optimal was busy visiting companies in June with two of the Sydney team spending time in Japan during the month. One week was focused on revisiting real estate companies – a sector that we have been bullish on for some time. The story was unequivocally positive from the companies with strong land banks in and near Tokyo and with the willingness to access cheap loans to fund developments. Most of these companies are using off-balance sheet financing (non-recourse) to fund projects that are yielding 6-7% in annual income with equity contributing between 25-40%. The returns on equity are large. It is not necessary to take a long term positive view on land prices in Japan to see that the well-chosen development will offer a short pay-back of equity. We believe that many investors and analysts are missing the point when analysing real estate companies in Japan, and a re-rating is inevitable.

The other week was spent visiting a diverse group of companies encompassing banks, advertising, software, communication and housing. Whilst the level of profit growth is varied, the overall impression is one of steadily improving returns. The interesting opportunities are in areas where balance sheet fears have pushed share prices down to levels that make for juicy investments based on analysis of earnings. The risk with this type of investment has been clear – but is perhaps less imminent now that interest rates are bottoming with the easing of deflation and the ongoing corporate recovery.

Our report ends with a tale that should warm the long-frozen heart of investors who have been hibernating through Japan's dreadful bear market. It is a tale of animal spirits and a lesson in the merits of compounding returns. The Kyodo news service reports that on the 28<sup>th</sup> of June, someone described as “a middle aged man resembling a salary man” was seen at the Shinbashi off-course betting outlet collecting his winnings from the “Yasuda Kinen” horse race. He promptly placed the entire Y12 mn booty on horse number 10 in the “Takarazuka Kinen” race to be staged the following day at the Hanshin track in Takarazuka city. Number 10 – appropriately named “Hishi Miracle” - was the 6<sup>th</sup> favourite horse and duly won the gala race at odds of over 16-to-1. The apparent salary man turned his Y12 mn into Y200mn with his bold and decisive act. The “Takarazuka Kinen” is also known as the Spring Dream Race. The stock market buyers in the recent run since April have been foreigners and individual speculators on margin. Perhaps the latter have had enough of postal savings after all.

Positive contributors (long) Nippon Steel, Marubeni Co, TOC  
Nomura Holdings, Sparx Asset Management

(short) Lawson, Lion Co, Promise Co, Dentsu,

Negative contributors (long) Takeda Chemical, Daido Life, Chiyoda Integre, Zojirushi

(short) Fujitsu, Tokyo Electron, Sharp, Net One Systems

## Major Positions

Toyota Motor, Kawasaki Kisen, Nippon Steel, Mitsubishi Co, Mitsui OSK

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# Optimal FUND MANAGEMENT

Return Snapshot	
Period	%(AUD)
Year to Date Return	11.03
Return since inception Inception 20 Dec, 1999	36.83

Portfolio Composition at Month End			
% of NAV	Apr 2003	May 2003	June 2003
Long Stock Position	58.10	60.48	68.36
Short Stock Position	(33.60)	(29.10)	(43.78)
Index Futures			
Equity Derivatives	2.08		
Net Exposure	26.58	31.38	24.58

## 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							11.03

\* Trust inception 20 December, 1999

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