Optimal FUND MANAGEMENT

Monthly Report to Unitholders of the Optimal Japan Trust

13th July, 2004

Date	NAV	Monthly % Return*
30 June 2004	A$13.67	3.95

* 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 of the initial series

Success – Longs & Shorts

	Apr04	May04	June04
Topix %	0.60	-3.91	4.36
OJF longs %	-6.34	-2.16	7.95
OJF shorts %	5.80	-0.83	-2.78

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 the arbitrary world in which we operate where success and failure are sometimes measured from month-end to month-end, June was a good month for Japanese equities and for the Fund. The Topix index recovered all of the losses of May and closed at the highest level since July 2001 whilst the Optimal Japan Fund US$ also hit a closing high. The Fund has risen 11.1% in 2004 and 30.6% over the past year whilst the respective numbers for Topix are 14% and 31.7% (in Yen). Measured in Australian dollars, the Topix returns are higher as the Yen has climbed from 81/A$ to 76/A$ over the twelve months but as we have maintained our agnostic stance on Forex and hedged all net Yen back into base currency, the Fund has not benefited from the Yen's gain. Despite this opportunity cost, we are satisfied with the success of our stock picking over the year and hope for ourselves and investors alike that this good fortune continues in the year ahead.

Since the Japanese market bottomed at the end of 2002, the best returns have come from lower price stocks that combined weaker balance sheets with recovering earnings. Our investors would recall our long-held conviction that this would be an area of excellent investment returns and we have certainly enjoyed the recovery of many stocks in this category. Marubeni, Haseko and sectors such as steel, real estate and shipping have been major sources of profit for the Fund and we continue to hold large positions in selected companies in these industries. It is apparent to us, however, that the easy money has largely been made in the recovery stories and this is illustrated both collectively and individually by recent data and events. A recent strategy piece from Nomura Securities (No 04-1406 of 12th July) points out three favourable factors that, in combination, propelled the low-price shares to best performers over the past year and a half. First, despite very cheap valuations (often with PERs below

Level 32, The Chifley Tower
2 Chifley Square
Sydney NSW 2000
Phone: 61 2 9229 1863
Fax: 61 2 9223 2920
optimal@optimaljapan.com

5F Izumikan Kioicho
4-3 Kioicho, Chiyoda-ku
Tokyo 102-0094
Phone: 81 3 3238 1671
Fax 81 3 3238 1687

10x), low priced shares were shunned for perceived credit risk. Second, due to fears that banks would pull credit lines or raise lending rates, these companies undertook aggressive and effective cost-cutting and restructuring. Third, banks were in fact willing to extend credit to these leveraged companies at low interest rates to help them recover rather than declare their loans non-performing and exacerbate their own balance sheet problems. To illustrate the extent of the success of these measures – at least in stock-market terms – the number of TSE1 listed companies (of Y50 par value) that trade below Y100 has fallen from 200 at the end of 2002 to just 9 as at July 9th.
Equally illustrative is the fact that sorted by share price, the bottom quintile of TSE1-listed companies now trade on an average PBR of 1.61x which is the same level as the TSE 1 average. Over 30 years of such analysis, this low-price group has only rarely traded on a PBR level equal to (or above) the market average PBR.

During June, we reluctantly sold our position in Haseko. Haseko, a construction company specialising in Tokyo-based apartment buildings, is a quintessential example of the low price stock referred to above. We first visited it in early 2003 when broker coverage of the company had disappeared. In September 2002 the company had made a debt-for-equity swap with its three main creditor banks and in return for retiring Y150bn of debt, their banks had been issued with convertible preference shares. The stock's shareholders' equity thus went from Y-122bn in 3/02 to Y31bn in 3/03 and Y45bn in 3/04. Net profits went from Y-122bn to Y5bn and Y15bn in the same period. At the low at the start of 2003, the shares reached Y41 and when we saw the company, the stock had risen to Y80. With an improved balance sheet, supportive banks and improving earnings, the stock was trading on a forward PER of just 1.6x when we began buying. Along with the recovery of the market, sentiment towards the economy and apartment demand, Haseko's shares rose to Y400. Their success was a double-edged sword for investors however as the banks have clearly begun to regard their stake in Haseko more as equity, rather than as debt, and the likelihood that they will wish to convert the prefs to ordinary stock rather than accept redemption by Haseko has grown. In addition to this likely dilution (admittedly not possible before September 2006 at the earliest), we believe their banks are behind the recent decision by Haseko to issue a Y30bn convertible bond to Daiwa SMBC. By doing so, Haseko's capital base is shored up so that the expected write-offs they'll need to take on marking-to-market some land purchased during the Bubble era will mean their bank lenders do not have to reclassify their loans to them as troubled. Although we like much of what the company is doing and have confidence in the business outlook and execution skills, the final analysis is that their future is controlled by their banks, and that may not lead to a result beneficial to us. Now that the banks are beginning to focus on improving their operating earnings I expect that we will see a lot of these leveraged recovery stocks raising capital through equity and convertible bond issues. Whilst optimistic on the market and the earnings outlook, we are thus more cautious on some of the companies that have performed so well since late 2002.

<u>Positive contributors</u>	(long)	Kawasaki Kisen, Yumeshin, Teijin, Mitsui Trust Holdings
	(short)	NTT Data, Sumitomo Realty, Misawa Home
<u>Negative contributors</u>	(long)	Tokyo Tatemono, Marubeni Co, Godo Steel, Haseko
	(short)	Matsui Securities, Nippon Yusen, Tostem Inax

Major Positions

Toyota Motor, Mitsui Trust Holdings, Mitsubishi Tokyo Financial, Mitsui OSK

Level 32, The Chifley Tower
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Fax 81 3 3238 1687

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Return Snapshot	
Period	**%(AUD)**
Year to Date Return	11.14
Return since inception **Inception 20 Dec, 1999**	68.83

Portfolio Composition at Month End			
% of NAV	Apr 04	May 04	June 04
Long Stock Position	75.80	80.90	88.20
Short Stock Position	(38.06)	(33.63)	(40.42)
Index Futures		(13.69)	(15.65)
Equity Derivatives	3.25	3.35	4.09
Net Exposure	40.99	36.93	36.22

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							11.14

* Trust inception 20 December, 1999

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