

## Monthly Report to Unitholders of the

### Optimal Japan Trust

June, 2004

Date	NAV	Monthly % Return*
31 May 2004	A\$13.15	-1.20

\* 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

	Mar04	Apr04	May04
Topix %	8.94	0.60	-3.91
OJF longs %	21.35	-6.34	-2.16
OJF shorts %	-15.34	5.80	-0.83

*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.*

It could have been a lot worse but it was bad enough. As mentioned in last month's report, May began badly and continued to deteriorate all through the first half of the month. By the time we had finished work on Monday May 17<sup>th</sup>, the Topix index had fallen by 13.5% from the high reached on April 14<sup>th</sup>. More importantly for investors in Optimal Japan Trust, the Real Estate sector was down 23.4%, Banks -23.2, Steel -22.3, Shippers -18.9 and Wholesale (mainly trading companies) -20.3. As we write, the return since May 17<sup>th</sup> has been Topix +10.1%, Real Estate +19.4, Shippers +19.4, Steel +168, Banks +15.3 and Wholesale +15.1. The rest of Asia has been similarly unsettled and what had become a sure fire bet by early this year (the short US\$ and long reflating Asia trade) is now a more delicate proposition.

Whatever the reasons for the sell-off, one certainty is that foreigners were net sellers in May after thirteen consecutive months as buyers (totalling approximately Y12tn since end of March 2003). Countering this reversal by the foreign investor was a welcome return to net buying from the Japanese trust banks – the main managers of Japanese pension funds. Given both these groups are largely institutional, it is probably even more significant that Japanese individuals also found their buying

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# Optimal FUND MANAGEMENT

zeal again in May and turned net buyers. They have a better record in the equity market than their institutional counterparts and have plenty of fire-power. We hope – and believe – that they will rediscover their appetite for risk along with the recovery in real estate prices and the end of deflation.

In recent meetings with investors, we have been asked who had done the selling. For what it's worth, we do not think it was dedicated Japan long/short managers, nor does it appear to have been the institutional long-only managers. The apparent sellers would be the global hedge funds (perhaps including investment banks' prop trading desks) who had seen Japan as a simple "reflation trade" and have been flushed out. At the risk of causing offence, I think the market can live without them.

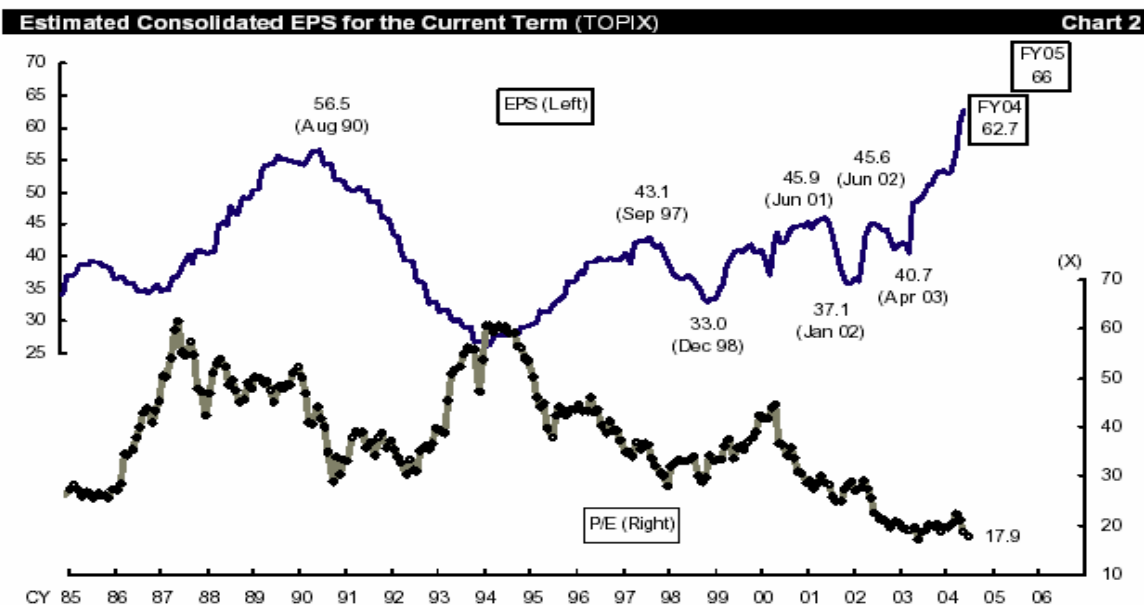
Although the table below (courtesy of Daiwa Securities using Toyo Keizai data and estimates) is a little difficult to read, the valuation argument in Japan remains convincing to us. TSE1 refers to the 1400 or so stocks listed on the Tokyo Stock Exchange's first section (larger caps). In the year ended March 04, sales for this group rose 1.6% yoy whilst recurring profits rose 24.4%. This year, they expect a 2.7% sales increase and 13.8% in profits, followed by a further 8.7% in 2005. The chart tells the story better than any words can. Bears will say we have reached a cyclical top and cast doubt on the profits outlook. We hold a different view, and believe the market is a buy.

	Sales and Recurring Profit Growth Rates by Market (Issues with March-ending FYs; %)																			No. of issues	
	Sales										Recurring profit										
	FY00	01	02	03	04 F		05 F		00	01	02	03	04 F		05 F						
				1H	2H	1H	2H	1H	2H				1H	2H	1H	2H					
TSE 1	4.6	-2.2	2.5	1.6	1.4	1.8	2.7	2.4	2.9	2.9	37.3	-47.6	78.4	24.4	15.4	32.5	13.8	8.9	19.2	8.7	978
TSE 2	4.8	-4.6	2.1	3.5	5.0	2.1	3.5	3.1	3.9	3.2	13.9	-35.3	27.8	33.7	42.3	28.9	14.3	12.4	15.5	9.8	308
JASDAQ	7.7	-5.9	2.0	2.8	3.2	2.5	5.6	5.0	6.1	4.6	4.7	-38.1	24.0	5.6	21.3	-3.4	24.8	8.6	36.4	14.3	414
Total	4.6	-2.4	2.4	1.6	1.5	1.8	2.7	2.5	3.0	2.9	35.5	-47.0	74.6	24.2	16.0	31.3	14.0	7.1	19.4	8.9	1,956

Source: Toyo Keizai; compiled by DIR.

Note: Data limited to issues with March-ending FYs that have not been subject to mergers, stock splits, or irregular FYs since 1999, and whose parent companies are not listed. Total data include issues listed on local market alone.

F: Forecasts as of 2 June.



Source: Toyo Keizai; compiled by DIR.

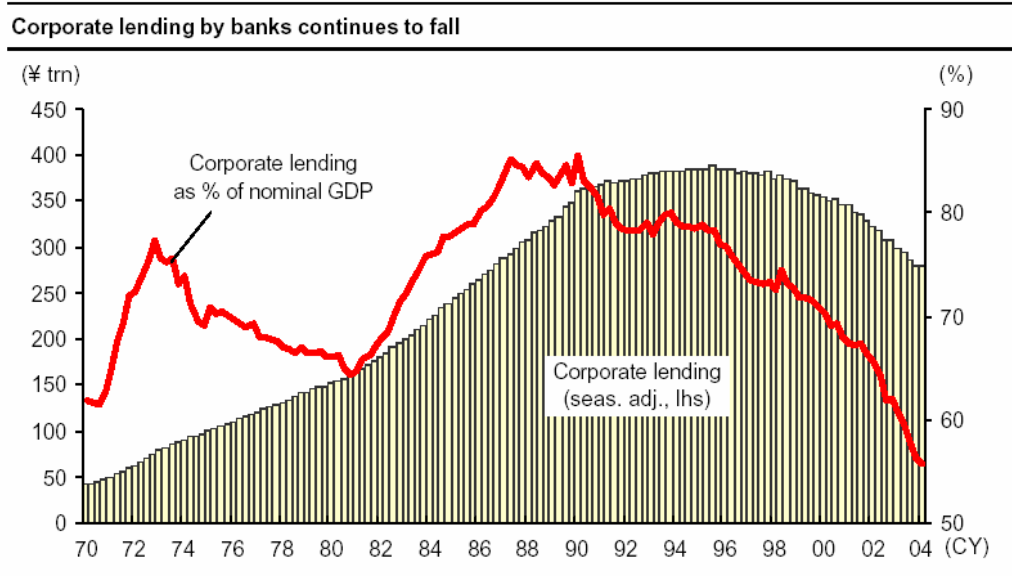
Note: Data limited to issues with March-ending FYs that have not been subject to mergers, stock splits, or irregular FYs since 1999, and whose parent companies are not listed. Total data include issues listed on local market alone. Data up to 3 June closing price.

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Japan offers rich pickings for the data-miners. There are many ways to demonstrate the extent (and scale) of the boom and bust we have experienced (in a personal context, since 1984) over the past few decades. The chart below (from Nomura Securities) caught our eye and is a staggering tale of the problems experienced by the banking sector. As a percentage of GDP, bank lending to the corporate sector has fallen from 85% at the peak (1990) to 55% at present. In nominal terms, loans have fallen by about Y100tn since their mid-90s highs. That is 20% of GDP. At the very least, it leads us to conclude that any bank left standing after that sort of retrenchment is worth casting an eye over.



Sources: Bank of Japan, "Loans and Discounts Outstanding by Sector" "Loans to Individuals", Cabinet Office, Japan "National Accounts"

Notes: (1) 'Corporate lending' is extended to 1970 by NRI, after adjustment for discontinuities in statistics in 1993 and again in 1975. (2) For GDP statistics before 1979, 68 SNA is used.

Positive contributors (long) Kawasaki Kisen, Yumeshin, Teijin, Mitsui Trust Holdings  
(short) NTT Data, Sumitomo Realty, Misawa Home

Negative contributors (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

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# Optimal FUND MANAGEMENT

Return Snapshot	
Period	%(AUD)
Year to Date Return	6.91
Return since inception Inception 20 Dec, 1999	63.63

Portfolio Composition at Month End			
% of NAV	Mar 04	Apr 04	May 04
Long Stock Position	78.04	75.80	80.90
Short Stock Position	(34.28)	(38.06)	(33.63)
Index Futures			(13.69)
Equity Derivatives	3.34	3.25	3.35
Net Exposure	47.1	40.99	36.93

## 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								6.91

\* Trust inception 20 December, 1999

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