

## Monthly Report to Unitholders of the Optimal Japan Trust 16<sup>th</sup> June, 2006

| Date        | NAV       | Monthly % Return* |
|-------------|-----------|-------------------|
| 30 May 2006 | A\$ 16.87 | -4.04%            |

\* After all fees

\* NAV is ex-distribution of **A\$ 1.4218 (for Yr to 6/05)** 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

***Important: With effect from July 1<sup>st</sup>, 2006, the Fund's administration agreement with HSBC Institutional Trust Services (Asia) will cease and a new agreement with EFA of Luxembourg will become effective. A new Private Placing Memorandum has been created and is available on our website ([www.optimalasia.com](http://www.optimalasia.com)) or can be emailed by the manager upon request.***

Had we been writing this on June 1<sup>st</sup> rather than June 16<sup>th</sup>, we would have been feeling a little shaken but relieved that we had come through May with a fall of “only” 4%. By the end of the second week of June, we were feeling less smug. From 30<sup>th</sup> May (our May month “end”) to 13<sup>th</sup> June, Topix fell a further 10% as the world's investors suddenly rediscovered fear after three years of greed.

We have been conditioned to see emerging markets such as India, Brasil or Turkey fall suddenly and sharply and think of it as no more unusual than a passing Spring squall, but when a market as mature and large as Japan's does likewise, it throws up more questions. One can pore over the weekly list of buyer and seller activity (as produced by the Tokyo Stock Exchange) to try and find answers but the inescapable fact is that in Japan there is no buyer of last resort. The Japanese pension funds – whether private or public – are suffering from the aging of Japanese society and are unlikely to see any growth in their assets. This fact, coupled with years of poor performance and subsequent chronic risk aversion, leaves them unwilling or unable to buy when the equities fall so the heavy momentum selling of foreigners and forced selling of leverage individuals can lead to the sharp declines that we have witnessed of late.

Apart from the general weakness in other equity markets, the biggest shock in Japanese financial circles has been the admission of insider trading by Mr Murakami of MAC Fund fame. For those unfamiliar with MAC, this is a high profile fund manager that has raised a considerable sum to invest via “activist” funds that target cheap companies that could do more to benefit their shareholders. Through the use of sensible advice and gentle persuasion, the MAC funds had built a big reputation - not necessarily justified by their performance we gather – and were seen as a force of change in the comfortable world of Japanese corporate (non) governance. That MAC's high profile leader was charged for insider trading has been a jolt to the market as there are those who fear that the charges are yet another example of “revenge of the dinosaurs”. We can't add much to this but obviously hope that it is merely a case of better regulatory policing and that the accused's high profile is no more than a coincidence. Time will tell.

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# Optimal FUND MANAGEMENT

As equities fell, JGBs rose, with the 10 year bond yield retreating from 2% to 1.8%. JREITs – seen as the equity market’s closest proxy to bonds – performed well over the period from end April to early June but have since had a sharp fall. With a solid pipeline of new REIT deals waiting for the right timing to come to the market, it seems that investors will demand better yields from the existing REIT group than they have offered of late. With limited growth through development or management of their properties, we see little attraction in the REIT market. By contrast, one can buy top quality real estate developers with premium location land banks at far cheaper valuations (on a like-for-like basis). We continue to like Tokyo Tatemono and Mitsui Fudosan in this group, and have increased our stake in railway/property company Tokyu Corp as an undervalued play on high-end Tokyo suburban real estate.

To finish on an administrative matter, we wish to stress that any applications for redemptions or subscriptions in our funds that come in to EFA (administrator) after the dealing deadline will be rejected. Please visit our website [www.optimalasia.com](http://www.optimalasia.com) for related information and we encourage you to contact us through the web-site.

Positive contributors (long) JFE Holdings Inc, Nippon Steel , Nichi-iko Pharmaceutical  
(short) Mitsubishi UFJ, Kaneka, Advantest

Negative contributors (long) Kubota, Sumitomo Corp, Mitsubishi Corp  
(short) Mabuchi Motor, Asahi Breweries, Nippon Building Fund

## Major Positions

Sumitomo Trust & Banking, JFE Holdings Inc, Mitsubishi Co, Kubota, Toyota Motor

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# Optimal FUND MANAGEMENT

| Return Snapshot                                  |              |
|--|--------------|
| Period   | %(AUD)       |
| Year to Date Return                              | 2.18         |
| Return since inception<br>Inception 20 Dec, 1999 | 119.76       |
| Fund size at 30 May 06                           | AUD 66.4 mil |

| Portfolio Composition at Month End |         |         |         |
|------------------------------------|---------|---------|---------|
| % of NAV                           | Mar 06  | Apr 06  | May06   |
| Long Stock Position                | 83.76   | 81.09   | 77.12   |
| Short Stock Position               | (21.22) | (19.31) | (20.57) |
| Index Futures                      |         |         |         |
| Equity Derivatives                 |         |         |         |
| Net Exposure                       | 62.54   | 61.78   | 56.55   |

## Historical Returns

Below we provide a table detailing the monthly returns of the Fund since its inception in December 1999. The returns are of the Trust's Initial Series

| 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 | 4.03  | 0.82  | -1.55 | 1.65  | 1.92  | 15.95 |
| 2005   | 2.83  | 2.05  | 0.0  | -0.13 | 1.04  | 1.37  | 2.38  | 4.15  | 6.71  | 1.31  | 2.39  | 4.30  | 30.03 |
| 2006   | 1.82  | 0.42  | 3.79 | 0.34  | -4.04 |       |       |       |       |       |       |       | 2.18  |

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