

Optimal FUND MANAGEMENT

Monthly Report to Unitholders of the Optimal Japan Trust

December 10th, 2002

DATE	NAV	Monthly % Return
29 November 2002	A\$9.47	-3.65

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)

Monthly return composition

	September	October	November
Topix %	-2.19	-6.39	3.53
OJF longs %	-3.26	-9.72	1.77
OJF shorts %	7.77	6.79	-11.33

Trailing 3 months NAV

September	October	November
A\$10.29	A\$9.83	A\$9.47

Having fallen more than 5% at the low point on November 19th, the Topix index recovered 9.3% to finish November with a gain of 3.5%. Despite November's recovery, the market remained 14% below the end-2001 level and trading on 22 times this year's earnings (based on Nomura's NRI 400 index). Much has improved over the past six months but investors remain risk averse and sceptical.

On the positive side of the ledger, macro indicators have generally recovered. Industrial production has risen from the worst decline since the mid-1970s and inventories to shipments ratio is at its lowest since the 1980s. Corporate profits in the first half (ended September) rose between 40-50% and the full year forecast is for a gain in recurring profit of 56% (NRI 400) on sales increase of only 0.2%. This

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demonstrates that cost controls are being put in place in a growing number of companies with declining labour costs being the most important element.

Share buy backs have been implemented at an annual rate of Y3trillion (more than 1% of total market cap.) which is far in excess of the market's earlier expectations and an important new source of demand. Despite much media and analyst focus on Japan Inc's precarious balance sheet, the equity to total assets ratio was at its lowest level in 1975 and has risen steadily since then to 40% now. Many companies are under-leveraged and will continue to buy back stock to boost their RoE. There is also growing evidence that banks are charging more for loans to weaker borrowers and as this trend continues, management will need to boost profitability and cash-flow to avoid higher funding costs. As for government policy, the debate on tax concessions seems to be entering the final stages (of the first stage) and we should soon see a 10% tax rate for individuals whether receiving dividend income or a capital gain. Importantly, any losses will be able to be offset against either income or capital gains.

On the negative side, these, and other, developments would normally be associated with a bullish environment for equity investors, but as this is Japan, 2002, we have to consider other issues. After so many prime ministers, so many fruitless and circuitous arguments and so many bad debts, the population has seemingly become inured to bad news and, what's more, totally risk averse. The bond/dividend yield ratio is now below 1 for the first time in almost 50 years and yet equities are regarded as toxic waste. Short selling as a share of total turnover on the Tokyo Stock Exchange has exceeded 20% since March and it would appear that in October, over 35% of all sales by foreigners were short sells. In short, no-one has confidence in areas such as the setting of policy, job security, retirement benefits or most of the major elements of a capitalist democracy. Confidence is the missing ingredient and it is difficult to see how it returns without a major shake-up at the political level. Two right leaning politicians have recently edged closer into the debate and all should watch closely the actions of Tokyo Governor Shintaro Ishihara and Liberal Party leader Ichiro Ozawa. Both have many enemies, but are seemingly single-minded enough to overcome objections and pursue more radical policies than the current coalition led by Mr Koizumi. A change in the political jigsaw seems inevitable.

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Were this to be achieved, the long-standing and much analysed problem of the banking system would become a hurdle, rather than an impassable road-block. Most of the bad loans that grew out of the bubble-era lending spree have now been written off (Y90tn or 80% of the new loans) and the new NPLs have more to do with Japan's inevitable structural change from a diversified manufacturing base to a more concentrated economy where services dominate. These changes are not bad per se but need to be dealt with in a more competent manner than we've seen to date. That will require a major political realignment that the existing players are unlikely to embrace.

Our performance in November was hurt by the shorts. A wild swing in sentiment from a focus on earnings & valuations to the balance sheets took place in October and ran through most of November. Indicators, in particular the convertible bond market, which we watched for early warning signs of trouble ahead for equities did not sound any alarms this year and in fact eventually acted as a lagging indicator. Although the market has not recovered to any great extent, the fear of bankruptcies has receded for now and we are working to limit the damage from the short but severe swings in market mood that we have seen in both late 2001 and 2002. We will be introducing a stop-loss for longs with similar limits to those we apply to shorts, but remain confident that the stock-picking success we have had since inception will capture the upside when the market stabilises. In the meantime, we look to employ tighter risk-control and an understanding of both value and swings in sentiment.

<u>Positive contributors</u>	(long) Omron; Kawasaki Shipping; Shin-Etsu Chemical; Toyota
	(short) Sumitomo Realty; Ono Pharmaceutical; Bellsystem 24
<u>Negative contributors</u>	(long) Sumitomo Trust; MTFG; Fuji Television; Mitsui Fudosan
	(short) Aiful; Alps; Net One Systems; Fanuc; Sharp

Major Positions

Nippon Mining; Toyota; Mitsui Fudosan; Mitsui OSK; Central Glass

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Returns Snapshot	
Period	% (AUD)
Year to Date Return:	-0.23
Return since inception: *Inception 14 Oct, 1999	26.84

Portfolio Composition at Month End			
% of NAV in:	Sept 2002	Oct 2002	Nov 2002
Long Stock Position	70.62	72.20	62.47
Short Stock Position	(30.94)	(37.17)	(37.91)
Index Futures		(23.26)	
Equity Derivatives	2.01	2.07	1.04
Net Exposure	41.69	13.84	25.60

Historical Returns

Below we provide a table detailing the monthly returns of the Fund since its inception in 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		-0.23

- Trust Inception 20 December, 1999

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