Optimal FUND MANAGEMENT

Monthly Report to Unitholders of the Optimal Japan Trust December 10th, 2004

Date	NAV	Monthly % Return*
30 November 2004	A$13.53	1.65

* After all fees
* NAV is ex-distribution of 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

Contribution – Longs & Shorts

	Sept04	Oct04	Nov04
Topix %	-2.43	-1.51	1.23
OJF longs %	-0.10	0.71	5.91
OJF shorts %	0.85	-0.28	-2.75

Important: The Optimal Japan Fund and Optimal Japan Trust are both hard-closed. The administrator (HSBC Institutional Trust Services) will request any applicant for investment to contact the manager and require Directors' consent before acceptance.

Starting at the end of July, an investor in the Topix index could have lost a maximum of 4.6% had he bought the highest close and sold at the lowest close (weekly basis). Annualised, that is of course a large loss, but in the modern world of borderless securities trading and 24/7 analysis, it is a very tight band indeed. So tight that one gets a strong sense that global investors are becoming a bit tired of waiting for Japanese equities to deliver the profits that they were expecting. Broker strategists are reporting that European and US investors are now saying they are "neutral to underweight" Japan whereas in March they had been "overweight" and proud of it. This cooling towards Japan has been caused in part by a consensus that 2005 will see slower world growth and in part by recent economic releases from Japan that have been mildly disappointing. Given the deficits and savings shortfall in the USA and the modest outlook for growth in Europe, the expected slowdown in global growth looks plausible.

In the area of economic forecasting however, I am firmly in the camp of our favourite Japan commentator who noted in his Wednesday daily piece that he had given up the academic study of economics in the summer of 1974 and that the release of Japan's revised Q3 GDP numbers that day had underlined the wisdom of his decision. I cannot claim to have ever studied economics in an academic manner, but I too decided to give up all study of it in the summer of 1976 – about the time the Sex Pistols released the song "Vacant" off the album "Never mind the Bollocks". I remember the words of that song (there were only seven I believe) a lot better than I can recall the economics, but that is more a reflection on me than of the subject. The problem is that despite the enormous relevance of economics to investment, I do not believe there is any proven correlation between

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economic forecasting and successful investment. For that reason alone, I am reluctant to set our portfolio strategy based on macro forecasts – particularly global ones. What concerns me far more are the components of demand (and growth) and the change in prices and pricing power. In Japan, there have been few economic signs to make me more pessimistic about the outlook for equities whereas anecdotal evidence and empirical data (if empirical can be used in relation to Japanese GDP numbers) has been encouraging. In the latest GDP revision for Q3, all of the private sector components were positive contributors – with a surprisingly large jump in housing – whilst public sector capex continues to drag the overall number down. Anecdotally, we have good evidence that demand for real estate is very strong and that the source of the buying is increasingly Japanese domestic investors in addition to the foreigners who have been making good money in this area for some years now. If real estate is stabilising and investors are willing to buy it for yields in excess of debt, then the same will eventually happen with equities.

Recent analysis by Deutsche Securities of the return on invested capital shows that in 2004, Japanese listed companies - as a whole – will produce a cash return on invested capital in excess of their imputed cost of capital for the first time in well over a decade. This is the sort of big picture data which should be of interest to asset allocators and entrepreneurial capitalists and supports our own research at the company level which has been uncovering an increasing number of this "value add" over the past four or five years. A simpler (and admittedly simplistic) method of highlighting the disparity between the returns on debt and equity in Japan is to invert the PER of listed Japan (1/16*100) and compare that yield with the yield on debt. Equities have an earnings yield this year of 6.25% whilst 10 year JGBs yield 1.5%. If Japanese companies would raise their dividend pay-out ratios to European or Asian levels (around 45%), even risk averse Japanese institutions might be tempted by dividend yields of almost 3% - twice the return from fixed income. We recently heard from one respected strategist that large Japanese companies are planning to raise pay-out ratios as part of a defensive move to thwart off possible take-overs. Although thoroughly reasonable and rational for a company to do this, it would be almost revolutionary in Japan. I do not think this is mere wishful thinking, but it will still be a most welcome surprise when it starts happening.

Positive contributors	(long)	Tokyo Tatemono, Mitsubishi Corp, Sumitomo Trust & Banking, Mizuho Financial Group
	(short)	Funai Elec, KHI, Sumitomo Osaka Cement
Negative contributors	(long)	Toyota Motor, Kitamura, Starmicronics Co, Niichiiko Co,
	(short)	Shimizu, Nippon Yusen, Teijin, Nomura Holdings

Major Positions

Toyota Motor, Mitsubishi Co, Tokyo Tatemono, Fuji Photo , Mizuho Financial

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Return Snapshot	
Period	**%(AUD)**
Year to Date Return	13.83
Return since inception **Inception 20 Dec, 1999**	72.14
Fund size at 30 Nov 04	AUD 35mil

Portfolio Composition at Month End			
% of NAV	Sept 04	Oct 04	Nov 04
Long Stock Position	75.26	77.08	83.85
Short Stock Position	(28.46)	(25.03)	(21.23)
Index Futures	(19.20)	(19.04)	(9.36)
Equity Derivatives	1.77	1.78	1.41
Net Exposure	29.37	34.79	54.67

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	-2.26	4.03	0.82	-1.55	1.65		13.83

* Trust inception 20 December, 1999

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