

Monthly Report to Unitholders of the Optimal Japan Trust

October 8th, 2001

DATE	NAV	Monthly % Return*
28/9/01	A\$11.24	-3.58

- After all fees
- NAV is ex-distribution of A\$ 0.8989 (for Yr to 6/01) and A\$1.4158 (for Yr to 6/00)

Trailing 3 months NAV

7/01	8/01	9/01
A\$11.49	A\$11.66	A\$11.24

Given that we described August as “a month for misanthropes and short-sellers” it is difficult to describe September – so I won’t try. While the Dow fell 11.1%, Japan’s Topix fell by 7.3% and is now down 17% for the year (17.4% in AUD terms) – perversely making it one of the best performing markets of 2001. Continuing the very risk-averse nature of the market from late August, early September saw a continued decline in our Fund’s NAV so that approximately half of the month’s loss of 3.58% was incurred in the first third of the month and the balance coming after the US attacks. By the end of the first week of October, the Topix index had recovered all of the post-Sept 11th losses and happily so had the Fund. Conditions remain trying but we sense that brokers and fund managers alike are finding fresh sell ideas hard to come by. For now, we are maintaining relatively low net market exposure (approx. 25%) but admit we have an urge to be adding rather than reducing.

Is there any rational explanation for this urge? To quote James Grant from the September 14

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edition of Grant's Interest Rate Observer: "A proposition: Where the "action" isn't, is often where the prospective returns are. The outcome depends on valuation, a subject of identical apparent irrelevance both at epochal bottoms and towering tops." I'll admit that there are many old favourites in Japan that currently trade at valuations anything but epochal, but one rarely gets to identify these points without hindsight. Sony's shares have fallen from Y16,000 at the end of 1999 to Y4,000 last week but on Toyo Keizai's "official" profit forecast for March 2003, is still trading on 100 times expected earnings. Based on peak earnings (3/98) they are on a PER of 15. When the shares hit Y2,000 in 1995, the Yen was at 80/1US\$ - both are safely described as epochal - and the EPS achieved that year would put it on a PER of 60 at today's price. We seem to be close to a bottom but needing strong earnings growth to warrant buying Sony shares today. Honda has also fallen a long way from its peak (reached as recently as July this year) of Y5,700 to last month's low of Y3,300 but is still three times higher than its epochal low of Y1,150 in June '95. One needs to track the impressive growth in profits at Honda since 1995 to understand how vital a weaker currency and strong US auto market is for their business. Using the depressed "low" earnings of 3/96, Honda also now trades on a PER of 60, whilst using Toyo Keizai's 3/03 forecast, it is on a PER of 12. With auto companies trading far cheaper than this in the USA and in Europe, and with a slowing US economy, it is difficult to state with confidence that Honda is a buy now. These examples illustrate the dilemma that large investors face when looking at Japan. The favourites that they want to own are attractive from some angles but do not scream out to be gobbled up. The really enticing investments tend to be in the smaller index components: to repeat Grant's phrase - where the action isn't. The dilemma for asset allocators is that although one can build an exciting portfolio of stocks bottom up, it is also quite easy to see how the index may not move much despite this. In our view, it is still a poor environment for market-timing long-only investors.

Performance

Positive contributors (long) Parco '04 CB
 (short) Sanix; Advantest; Matsushita Communication; Suzuki

Negative contributors (long) Nomura Securities; Kawasaki Shipping; Japan Energy; Wowow
 (short) Seven-Eleven; NTT Data; Asatsu DK; NTT Docomo

Major Positions

Long

Kawasaki Shipping; Japan Energy; Sumitomo Chemical; Tokyu Land Nippon Television

Short

Seven-Eleven; Oracle Japan; NTT Docomo; Takeda; Fuji Television

Returns Snapshot	
Period	% (AUD)
Year to Date Return:	7.24
Return since inception: *Inception 20 Dec, 1999	35.55

Portfolio Composition at Month End			
%of NAV in:	Jul 2001	Aug 2001	Sept 2001
Long Stock Position	71.88	72.05	61.69
Short Stock Position	(31.40)	(30.09)	(39.34)
Index Futures			
Equity Derivatives		2.67	4.37
Net Exposure	40.48	44.63	26.72

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Historical Returns

Below we provide a table detailing the monthly returns of the Trust 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				7.24

- Trust Inception 20 December, 1999

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