MONTHLY REPORT TO SHAREHOLDERS OF OPTIMAL JAPAN ABSOLUTE LONG FUND

Optimal FUND MANAGEMENT

Monthly Performance % - *as at 30 April 2014*				
	NAV	**April**	**YTD**	**Strategy AUM**
Offshore Feeder	US$12.94	-3.07%	-12.63%	US$82M
Topix Return is in USD unhedged using WM London 4pm close		-2.57%	-8.16%	

Four months into 2014 and the Topix index is down almost 11%. Not many experts predicted that Japanese equities would start 2014 so poorly, which no doubt goes some way in explaining why they have. Mr Market has a habit of making the consensus look foolish, and we too squirm with the others who looked out at 2014 and predicted a strong performance from Japan. We are nevertheless bullish and want to be buying here given prices are lower, earnings are better and valuations even more attractive that they were. We remain very confident that the Topix index will finish 2014 comfortably above where it was at the start of the year.

In the last couple of manager reports we have written at some length about Abenomics, policy and economic progress. As our view has not changed and we see no evidence that the outlook is worsening (quite the contrary), we will focus this time on some of the stocks that have been hurting our performance year-to-date.

By far the biggest sectoral damage has been done in the financials, which account for over half of the negative return. SMFG – the Fund's largest position – was the biggest culprit, followed by MUFJ and then **Nomura Holdings**. The two banks will report FY13 (ending March 2014) results on May 14th but Nomura has already announced its numbers and saw net profit double in the year. Nomura's management have made it clear that they wish to capitalise on their position as largest adviser to individual investors in Japan and are boosting revenue and profits from their retail businesses at long last. The shares trade at 0.9x book value and a PER of just over 10x. This is below the market average despite being geared to greater investor activity and being a beneficiary of the growth of the recently created tax-effective NISAs.

SMFG and **MUFJ** are both generating strong growth in loans outside Japan and have finally begun to experience loan demand from Japanese borrowers as well. The Bank of Japan's aggressive JGB purchase programme has also helped the banks to accelerate the de-risking of their assets to a rise in bond yields and with their much smaller JGB portfolios concentrated in shorter duration bonds, their exposure is now very limited. Foreign loans are growing strongly, and contrary to perception, the customers are mainly non-Japanese borrowers. Loan spreads are still thin, but are stabilising, so volume growth falls directly through to profits. SMFG has been more active than MUFJ in its investor relations in recent years and has made a commitment to maintaining an RoE of at least 10%. Unless they increase dividend pay-outs considerably, this will be very hard to achieve without share buy-backs and we expect this to be a regular feature of their capital management in future years. On consensus earnings estimates for FY13, SMFG has an RoE of 11%, is on a PER of 7x and carries a 3% dividend yield. With deflation a fading memory, the big banks will be clear beneficiaries and we maintain a large position in all the three majors.

Other stocks that have hurt the Fund in 2014 so far are home builder **Iida Holdings** and auto major **Honda Motor**. We have talked about Iida before, around the time that the company was formed from the merger of six related house builders in November 2013. Because of the merger, year-on-year comparisons are not possible - or at least not simple – and we believe that analysts have been reluctant to take up formal coverage until the new holding company has passed its first anniversary. Of the four analysts with profit forecasts for Iida, the lowest price target is 25% above the current share price while the highest is more than 60% higher. We think the housing sector has been sold off in advance of the rise in the consumption tax to 8% and that not only will this prove excessively pessimistic, but that Iida's discount in valuation to some of its peers will narrow as well and provide significant upside.

Honda has been a poor performer - along with Nissan – when compared to Toyota over the past couple of years. The car makers' profits depend on a number of issues and the product cycle is certainly a big factor. Honda has been investing heavily in developing new models in their standard petrol motors but in particular in alternative power sources such as hydrogen fuel cell and electric/hybrid models. As a result, depreciation and amortization at Honda exceeded operating profits whereas at Toyota, D&A expenses were barely 50% of operating profits. This will inevitably reverse as the companies enter different stages of capex and as new models are released, and while we are disappointed by Honda's own forecast for broadly flat profits for the year ahead, it is cheaper on EV/EBITDA than its giant rival and sells for just 10x earnings.

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Recent 3 month Fund Exposure

% of NAV in	Feb 14	Mar 14	Apr 14
Long Stock Positions	94.48	96.38	97.29
Index Futures	-	-	-
Net Exposure	94.48	96.38	97.29

Optimal FUND MANAGEMENT

Should you wish to make an enquiry about the Optimal Japan Absolute Long Fund, please see our website www.optimalasia.com or contact us by email at optimal@optimalasia.com.

Position Concentration

	Top 5	Top 10
Longs	29.55%	51.02%
Total no. of positions	29	

Top Five Positions

Sumitomo Mitsui Financial Group Inc
Mizuho Financial Group Inc
Mitsubishi UFJ Financial Group Inc
Itochu Corp
H.I.S Co Ltd

Winners

Komatsu Ltd
Tsukui Corp
Nippon Meat Packers Inc
Iida Group Holdings Co Ltd
Maeda Road Construction Co Ltd

Losers

Sumitomo Mitsui Financial Group Inc
Nomura Holdings Inc
Mitsui OSK Lines Ltd
Hoya Corp
Mitsubishi Estate Co Ltd

Sector Exposure *as at 30 April 2014*

	Longs		Longs
Consumer Discretionary	27.80%	Industrials	20.71%
Consumer Non-Discretionary	1.91%	Information Technology	7.66%
Financials	28.58%	Materials	8.90%
Health Care	1.73%	Telecommunications	-

Historical Returns- *Optimal Japan Absolute Long Fund Monthly Returns in USD (before Performance Fees) %*

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	Topix* YTD
(Inception September 2004)														
2014	-6.55	-3.03	-0.52	-3.07									-12.63	-8.16
2013	4.19	1.40	5.18	15.67	-5.74	1.13	0.45	-3.56	8.91	-0.35	2.62	2.14	35.00	24.60
2012	2.84	2.31	1.04	-1.81	-9.47	3.97	-1.30	-1.79	1.73	-1.42	-0.57	5.68	0.37	5.01
2011	1.31	3.89	-9.20	1.72	-0.51	1.02	3.69	-6.40	-3.98	2.70	-4.91	0.83	-10.34	-14.55
2010	2.58	0.19	4.19	1.88	-8.25	-3.15	3.36	-2.39	5.77	3.79	0.36	8.26	16.65	13.67
2009	-5.28	-11.56	3.78	4.75	9.49	2.12	3.11	4.76	-3.58	-2.26	-2.78	-0.38	0.38	2.85
2008	-6.00	2.60	0.15	4.21	1.40	-9.57	-3.85	-7.26	-5.49	-5.14	-4.01	8.78	-22.95	-28.24
2007	1.50	3.69	-1.88	0.33	1.71	1.49	1.27	-4.97	2.18	-1.04	-5.37	-6.57	-7.97	-6.37
2006	3.57	1.22	3.55	2.74	-4.40	-1.32	-1.55	-0.29	-1.51	3.73	1.48	1.94	9.14	0.94
2005	1.61	2.05	-3.83	-0.47	-1.81	-0.58	1.17	6.66	9.32	-0.75	3.25	8.64	27.25	24.59
2004									-1.60	-1.32	6.18	2.52	5.70	8.16

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