

Monthly Performance % - as at 31 December 2013

	NAV	December	YTD	Strategy AUM
Offshore Feeder	US\$14.81	2.14%	35.00%	US\$91M
<i>Topix Return is in USD unhedged using WM London 4pm close</i>		0.77%	24.60%	

Writing a mere hour or so before the last trade on the last market day of 2013, it seems certain that we will end with a positive return, just as we did on the first trading day of 2013. On January 4th 2013, the Topix rose 3.3% from 860 to close at 888.51 and will close today very near 1300, finally surpassing the high set in mid-May.

The Yen ended 2012 at 85.9/US\$ and is now at 105.3/\$, which goes a long way to explain why the equity market is up so much over the year. It is also a very stark reminder of what a major effect forex moves have on the total investment return. While the 2013 local currency Topix return is 51%, the unhedged USD investor has seen that dwindle to less than 24% - still a wonderful year from Japanese equities but uncannily similar to the USD return from both US equities and European markets (Euro Stoxx).

Less wonderful has been the return from emerging market equities, with the MSCI Emerging Markets index down 5.5% and MSCI Asia-ex Japan largely flat. For all that, emerging markets' stocks have still lost you less than being in bonds. For over thirty years, bond investors have usually had the last laugh over their equities counterparts, so one can't feel too much sympathy for the bond-lovers, unless you see it as the first year of a longer-term change between the two dominant securities classes. There are very smart people who will convincingly argue their side of this debate so we will not bother guessing, but in the case of Japan, the outlook is pretty clearly in favour of equities.

Topix has thirty three sectors and this year's performance has ranged from Topix Mining at the bottom with +19.9% to Topix Info & Communications at the top with +90%. More instructive is that sixteen sectors have beaten the Topix return while seventeen have failed to match it, leaving a nice distribution of returns with the overall market right in the middle. In 1999 by contrast, when we launched our first fund and the Internet Bubble was at its manic height, only seven of the Topix sectors beat the market's 58% with sixteen actually generating negative returns. In 1999, with such a distorted market, the Topix was really not representative of the return of the average stock whereas this year it is.

Value investing – which has usually been a successful strategy in Japan – has been a big underperformer in 2013 following on from a small margin of underperformance in 2012. Over the past two years, the MSCI Japan Growth Index has returned +92% against Value's +70% and in 2013 alone, the Value return of +43% is more than 15% adrift of the +58% return from Growth.

A contrarian investor – and we will admit we find this appealing – would be tilting their portfolio heavily to Value at this point, but it is worth considering whether there is a fundamental change in investor expectations and preferences that might explain Growth's success and argue for it to continue.

Looking down the list of better performing sectors it is difficult to identify a common theme among the major stocks within each of these disparate industrial sectors. In a world of limited and uneven economic growth, there is an argument that investors will pay up for both top-line growth and more certainty and stability of earnings, but when the second best sector is securities houses, the third best is shipping, the fifth is rubber (tires) and the seventh is steel, it is hard to find evidence of stability and certainty across these sectors. Perhaps it is better to adopt the contrarian's tilt to value after all.

In 2014, we have high expectations again, notwithstanding the big move already seen in 2013. We believe the actions of Japanese individuals will be highly significant in terms of their consumption and also their investments. In 2013, they have been much more active in their equity market, but have finished the year as sizeable net sellers. They have been enthusiastic supporters of IPOs however and with greater confidence in the corporate profits outlook, they will surprise by their willingness to look for investments in risk assets that also carry decent income yields. Payments of income by Japanese mutual funds this year have exceeded Y5 trillion – equal to 1% of GDP – and with companies raising dividends in line with – or in excess of their profits – the figure will jump again in 2014.

Consumption trends will depend to a large extent on wages and asset prices, and again we are confident that compensation will increase in 2014. Large Japanese companies hoard too much capital and would do better to either pay their workers more or pay their shareholders more. It would be better still if more of their workers were also their shareholders, and we expect to see this trend become more evident, but corporate governance and capital management will be very much in the spotlight in the years ahead and we continue to look for companies that do care about their shareholders (and workers) more than they care about their management and their "relationships". If we can identify these companies at the right price, we are sure it will bear fruit for our investors.

Best wishes to everyone in 2014.

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Recent 3 month Fund Exposure

% of NAV in	Oct 13	Nov 13	Dec 13
Long Stock Positions	92.76	93.13	92.83
Index Futures	-	-	-
Net Exposure	92.76	93.13	92.83

Performance Statistics

Last 12 Months	35.00%
3 Yr Annualised Return	6.70%
5 Yr Annualised Return	7.31%
Annualised Return Since Inception	4.30%

Position Concentration

	Top 5	Top 10
Longs	33.21%	52.63%
Total no. of positions	29	

Top Five Positions

Mitsubishi UFJ Financial Group Inc
Sumitomo Mitsui Financial Group Inc
Iida Group Holdings
Itochu Corp
Nomura Holdings Inc

Winners (Qtr)

Sumitomo Mitsui Financial Group Inc
Mitsubishi UFJ Financial Group Inc
Honda Motor Co Ltd
Fujifilm Holdings Corp
Hitachi Ltd

Losers (Qtr)

Nissan Motor Co Ltd
Komatsu Ltd
H.I.S. Co Ltd
Sanrio Co Ltd
Tomy Co Ltd

Sector Exposure as at 31 December 2013

	Longs
Consumer Discretionary	29.14%
Consumer Non-Disc	0.85%
Energy	-
Financials	28.22%
Health Care	-
Industrials	16.25%
Information Technology	10.16%
Materials	8.21%
Telecommunications	-
Net Exposure	92.83%

December Qtr Sector Performance – P&L

	Longs
Consumer Discretionary	-0.39%
Consumer Non-Disc	-0.04%
Energy	-
Financials	2.27%
Health Care	-0.05%
Industrials	0.40%
Information Technology	1.07%
Materials	0.46%
Telecommunications	0.30%
	4.02%
FX Forwards	6.63%
FX and Other	-6.21%
Total	4.44%

Performance Contribution

	Longs	FX Forwards	Other	Total
December 2013	2.00%	2.56%	-2.42%	2.14%

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Optimal FUND MANAGEMENT

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)														
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

** Topix Return is in USD unhedged using WM London 4pm close*

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.

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