

Monthly Performance % - as at 31 December 2017

	NAV	December	YTD	Strategy AUM
Offshore Feeder	US\$ 18.911	3.96%	26.81%	US\$50M
<i>Topix Return is in USD unhedged using WM London 4pm close</i>		0.75%	23.92%	

In the first week of a new year, it is somewhat unsatisfying to look back and review the market for the last month of the year just passed. For cricket fans, it feels akin to watching a batsman making runs in the second innings of a 5th (dead) test match. It matters for their batting average (performance) but has minimal relevance in assessing what lies ahead. Equity markets are meant to be a forward looking discounting mechanism, and like a batsman getting runs in a dead rubber, it does not tell you much about future returns. The Topix index 1.4% gain in December rounded off a good year for Japanese stocks with the annual gain of almost 20% making it the second best year of the past 10. Only 2013, flush with the early optimism of Abenomics, did better with a Yen return of 51.5%, although in USD terms (unhedged), 2017 was slightly better. More on this below.

Much has been made of the positive effects of a weaker Yen, both as a way to help Japan escape from long-lasting deflation and also as a condition precedent to higher equity prices. On the deflation question, trade is a small part of Japan's GDP and although a weaker Yen has an impact on input costs for certain industries (steel comes to mind), its effect on overall price levels is less than that brought on by a reduction of the output gap.

As for equity prices, the causal link between a weak Yen and strong equities has been a phenomena of recent years – arguably starting from the onset of the deflation era in the latter 1990s – and while the link was strong from the start of Abe's second stint as PM in late 2012 through until the end of 2016, there has been a break in the link since then. The market (Topix) return in Yen was 19.7% in 2017 while the stronger Yen meant the USD return was 24%. The past five years is traced in the chart below showing the Topix index and the Yen/\$ rate. If prices are stable and rising, and company profits at record levels while the equity market climbs to a 26 year high, it is odd that so many people continue to bet on a weaker Yen. We doubt that Toyota, Hitachi, Sony et al are lobbying Abe's ministers and bureaucrats for a weaker currency, so can only question why currency traders and investors seem to believe it will happen.

TOPIX AND THE YEN/\$ RATE OVER 5 YEARS



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The final quarter of the 2017 was filled with a regular flow of positive news on the global economy. While not as vigorous as the coordinated global growth that preceded the Lehman Crisis, there is a sense of relief that after such a catastrophic collapse in trade and confidence in 2008-9, the world appears to once more be doing rather well - at least according to economic indicators. We focus on Japan and specifically Japanese equities, but financial and mainstream media reports have carried regular reports of stronger jobs growth, higher consumer confidence levels, better pricing power and of course, rising stock markets – in all the major countries. In this environment, the Japanese market tends to do well as it has many companies with global footprints that benefit from rising consumer and industrial demand.

In our portfolio the positive contributors were many and widespread. All but two of our holdings were positive in the quarter and the two that were not summed to a 3bps negative. It was satisfying that our two largest positive contributors were stocks added following our August round of company visits (Idemitsu Kosan and Tokai Carbon). In fact, 5 of our best 10 contributors were stocks bought in the second half of 2017 while the other 5 were all long held, including Izumi, MUFJ, Hitachi and HIS. By GICS classification, the consumer discretionary sector provided almost 4% of our 13.38% return for the December quarter, followed by materials, energy and industrials – all adding more than 2% to the return.

2018 is only three days old in the Japanese equity market and the year has begun in a bright fashion, in common with other markets. We are optimistic on the outlook for Japanese equities this year (admittedly not for the first time) and expect 2018 to provide further evidence of the quiet revolution in corporate governance that we believe is in its infancy.

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Recent 3 month Fund Exposure

	Oct 17	Nov 17	Dec 17
Long Stock Positions	96.55	95.90	91.03
Index Futures	-	-	-
Net Exposure	96.55	95.90	91.03

Performance Statistics

Last 12 Months	26.81%
3 Yr Annualised Return	8.35%
5 Yr Annualised Return	11.51%
Annualised Return Since Inception	4.89%

Position Concentration

	Top 5	Top 10
Longs	29.11%	48.72%
Total no. of positions	26	

Top Five Positions

Mitsubishi UFJ Financial Group Inc
Hitachi Ltd
Mitsui OSK Lines Ltd
SMC Corp
Hazama Ando Corp

Winners (Qtr)

Idemitsu Kosan Co Ltd
Tokai Carbon Co Ltd
Izumi Co Ltd
Mitsubishi UFJ Financial Group Inc
Kyoritsu Maintenance Co Ltd

Losers (Qtr)

Pressance Corp
Daiwa Securities Group Inc
Astellas Pharma Inc
Isuzu Motors Ltd
Nintendo Co Ltd

Sector Exposure as 31 December 2017

	Longs
Consumer Discretionary	24.05%
Consumer Non-Disc	3.87%
Energy	6.39%
Financials	14.38%
Health Care	2.86%
Industrials	13.51%
Information Technology	11.10%
Materials	14.87%
Telecommunications	-
Net Exposure	91.03%

December Qtr Sector Performance – P&L

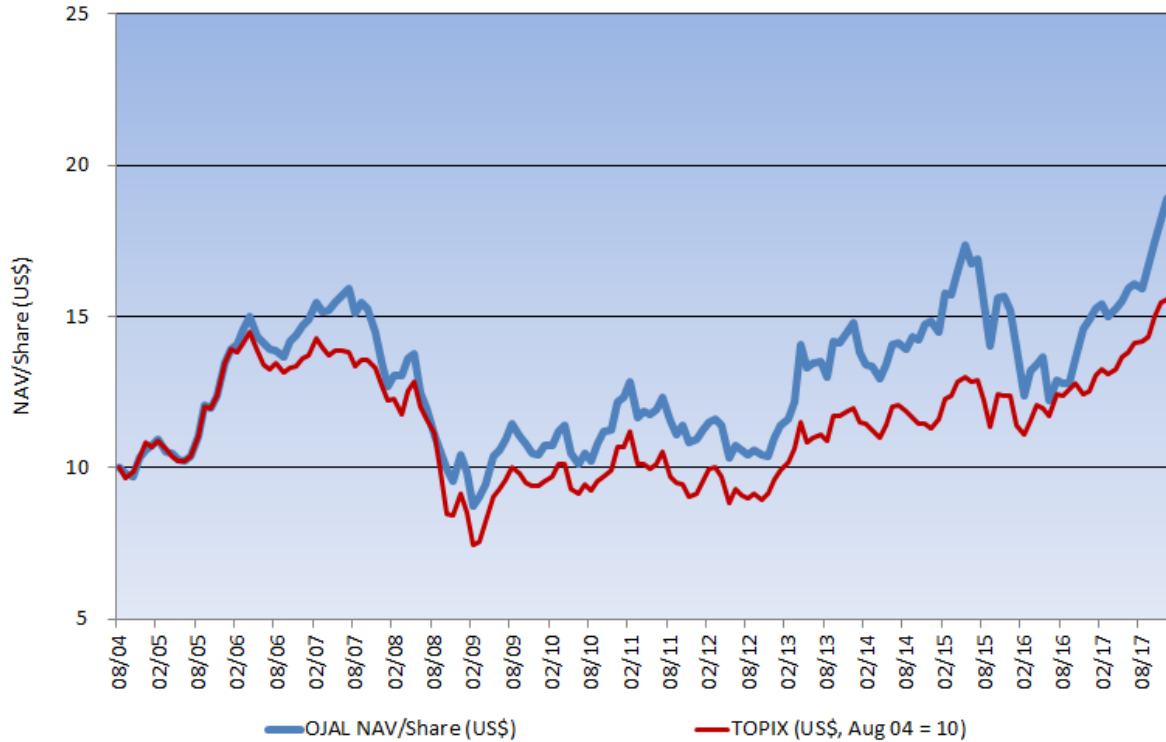
	Longs
Consumer Discretionary	3.76%
Consumer Non-Disc	0.65%
Energy	2.15%
Financials	1.23%
Health Care	0.01%
Industrials	2.10%
Information Technology	1.14%
Materials	2.36%
Telecommunications	-
Total Equity	13.40%
FX Forwards	0.26%
FX and Other	-0.28%
Total	13.38%

Performance Contribution

	Longs	FX Forwards	Other	Total
December 2017	4.19%	0.40%	-0.63%	3.96%

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Portfolio Performance as of 31 December 2017



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)														
2017	2.13	1.08	-2.46	1.55	1.61	2.76	0.95	-0.82	4.63	4.67	4.19	3.96	26.81	23.92
2016	-8.33	-11.28	6.75	1.57	1.82	-10.75	5.75	-0.86	-0.09	6.68	6.84	2.36	-2.06	1.23
2015	-2.45	8.82	-0.37	4.95	5.27	-3.54	0.70	-8.52	-9.08	11.21	0.39	-2.82	2.41	9.57
2014	-6.55	-3.03	-0.52	-3.07	3.71	4.69	0.57	-1.38	2.91	-0.65	3.38	0.96	0.40	-5.25
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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