

**Monthly Performance % - as at 29 February 2016**

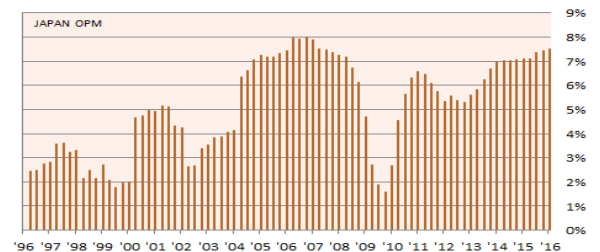
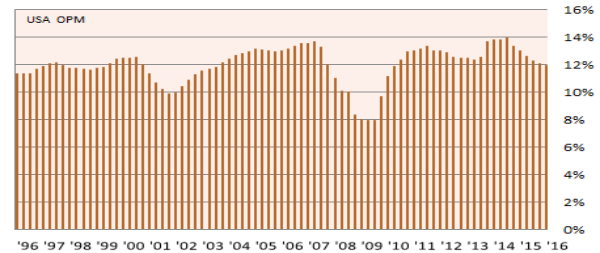
	NAV	February	YTD	Strategy AUM
Offshore Feeder	US\$12.383	-11.28%	-18.68%	US\$48M
<i>Topix Return is in USD unhedged using WM London 4pm close</i>		-2.80%	-10.61%	

These days, investors are never short of commentary, opinion and data to help explain why markets move up, sideways or down. In our opinion, most of it does not help to bring clarity to the issues at hand and in many instances probably muddies the water instead.

A case in point is the surprise decision taken by the Bank of Japan to charge interest to banks on any increase to their deposit balance held at the BoJ. Many market commentators have jumped to declare this NIRP to be a failure, despite the fact that less than six weeks have passed since the decision was announced. This is clearly premature, but what most agree upon is that it will have a small negative impact on the Japanese banking sector's profits. The real effect might be small, but since the BoJ announcement on January 29<sup>th</sup>, the Topix bank index is down over 15%, which is a severe reaction and has not helped our Fund's performance. It was worse. On February 12<sup>th</sup> – just after we sent our last letter – the Bank index was 26% lower than its close on "NIRP Day", but despite the rally, it is the worst performing Topix sector year-to-date.

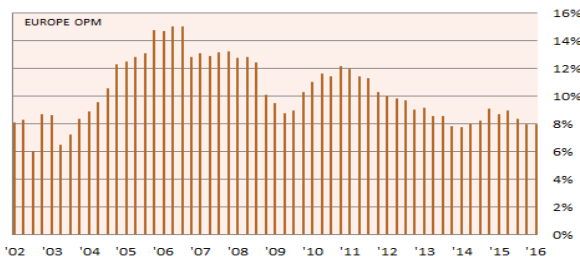
It is difficult to see cashed up Japanese companies or individuals suddenly rediscovering a passion for borrowing just because interest rates have gone negative, but already mortgage refinancing seems to have taken off. The Nikkei reported last week that February refinancing applications were 2.5 times the number recorded in February 2015 and overall home loan applications were up 50% from a year earlier. Although Mr Kuroda and his supporters at the BoJ would not be too pleased with the stock market's response to the NIRP, they would be delighted to see Japanese households taking advantage of extremely good borrowing terms to buy houses. Perhaps the policy will be judged a success once enough time has elapsed to make an informed judgement.

We have made mention in previous letters that Japanese stock valuations now stack up well against most developed markets. It has taken many years of weak stock prices to get to that point, but it is not all just a matter of prices falling. While other markets have seen profit margins halve since the mid-2000s, Japan's margins have recovered to the levels they reached pre-Lehman. The stand out market is the USA, where the S&P 500 Operating Profit Margin is 12% and only just below its high of 13.7% reached in December 2014. In Europe and the UK, margins have fallen from the mid-teens in 2006 to 8% and below 6% respectively while Japan's margins are almost back to their mid-2006 high of 8%.



In some Japanese sectors such as tyres, operating margins have soared to record levels and we see more risk of downside than further upside, but in other areas where margins have also reached new highs such as Food and Construction, pricing power and solid domestic demand should enable companies to boost profitability further. Both of these sectors have an OPM below that of the market as a whole, and having achieved higher profit margins in spite of the deflationary period, we expect plenty of potential upside to their margins from here in a firmer pricing environment. As value investors, we have found it very difficult to justify buying many of these domestic "defensive" sectors, but there is no doubt that in some of them at least, there has been a clear improvement in profitability taking place over a number of years.

Financials (banks, brokers and real estate included) have been our Fund's major drag on performance over the past year, followed by what GICS classify as "Industrials". This is a broad catch-all category but includes DMG Mori, Nishio Rent All, Fanuc, Shinmaywa, Komatsu, Nidec and Mitsubishi Electric. Our decision to hold these has cost the Fund dearly, but with signs that the OECD Leading indicator is bottoming out, history would tell us that so too are global equities, Japan relative to the world and Japanese industrials. If we are avoiding another 2008-style catastrophe – and we believe that we are – these underperformers should become our best performers from here.



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**Recent 3 month Fund Exposure**

% of NAV in	Dec 15	Jan 16	Feb 16
Long Stock Positions	87.60	96.14	99.11
Index Futures	-	-	-
Net Exposure	87.60	96.14	99.11

**Optimal** FUND MANAGEMENT

Should you wish to make an enquiry about the Optimal Japan Absolute Long Fund, please see our website [www.optimalasia.com](http://www.optimalasia.com) or contact us by email at [optimal@optimalasia.com](mailto:optimal@optimalasia.com).

**Position Concentration**

	Top 5	Top 10
Longs	31.66%	54.01%
Total no. of positions	30	

**Top Five Positions**

Mitsubishi Estate Co Ltd  
Sumitomo Mitsui Financial Group Inc  
Japan Airlines Co Ltd  
Mitsubishi UFJ Financial Group Inc  
Mitsubishi Electric Corp

**Winners**

Mitsubishi Electric Corp  
Fanuc Corporation  
Sun Frontier Fudousan Co Ltd  
H2O Retailing Corp  
Zenkoku Hosho Co Ltd

**Losers**

Sumitomo Mitsui Financial Group Inc  
Nomura Holdings Inc  
Mitsubishi UFJ Financial Group Inc  
Hitachi Ltd  
Mitsubishi Estate Co Ltd

**Sector Exposure as at 29 February 2016**

	Longs		Longs
Consumer Discretionary	20.86%	Health Care	-
Consumer Non-Discretionary	-	Industrials	37.66%
Energy	1.67%	Information Technology	4.39%
Financials	34.53%	Materials	-

**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)														
2016	-8.33	-11.28											-18.68	-10.61
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

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

**SYDNEY:** Level 5, Wyoming, 175 Macquarie St, Sydney NSW 2000 **Phone:** 61 2 8239 3300 **Fax:** 61 2 8239 3333 **Email:** [optimal@optimalasia.com](mailto:optimal@optimalasia.com)

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