

Monthly Performance % - as at 31 July 2012

	NAV	July	YTD	AUM
Offshore Feeder	US\$10.60	-1.30%	-3.02%	US\$14M
Topix - <i>Topix Return is in USD unhedged using WM London 4pm close</i>		-2.32%	-0.44%	

Although the Topix index return for 2012 is only 1.1% as at end of July, the monthly moves have been pretty wild with July's decline of 4.4% the smallest since March when the market rose a mere 2.2%. In the first seven months of the year, we have had two monthly moves greater than 10%, one of 7% and another of almost 6% and this is a year without either a man-made or natural disaster to speak of. It keeps us on our toes.

On the subject of disasters, ever since the Fukushima nuclear accident last March, the once staid and predictable utilities sector has been on a volatile trajectory – ultimately downwards - with sector heavyweights Kansai Electric and Chubu Electric both very weak in July. It is inconceivable that anyone actually sees Tokyo Electric Power's shares as investible at this point, especially with nuclear power policy still far from settled. In a poor month for Japanese equities, it is no surprise, however, that the other traditional defensive sectors all feature amongst the best performers with rail, food and pharma all making positive returns.

The rail sector is dominated by the three companies spun out of the former state-owned Japan National Railways Corp – JR East, JR Central and JR West – which to varying degrees have created a business model reliant on train travel, retail and property rental income. The laggard of these three has been JR Central, which operates the lucrative Shinkansen lines between Tokyo and Osaka. The reason for the lowly valuation is down to their plans to build a new super high-speed train using Maglev technology which will initially link Tokyo with Nagoya – the auto industry hub and Japan's third largest city. The capital requirement is so enormous that it has spooked investors who are naturally fearful that there will be an endless series of capital raisings. The irony is that their Shinkansen lines were largely built when the railway was a national public asset and JNR debt was government guaranteed. When the JNR was broken up into the three listed entities, the outstanding debt was parcelled out amongst the three companies and the steady revenue and cashflow has serviced this easily. We expect that for the new Maglev project to proceed, there will have to be a sizeable government contribution to the costs and were this to occur, it would make the shares of JR Central a good investment. We do not own it, as we are not sure how much the return to shareholders features in the thinking of JR Central's board and management, but it is a subject that warrants further investigation.

As we have mentioned in previous reports our portfolio is biased towards domestic demand with most of the companies we own earning well over half their revenue in Japan. Amongst these are our holdings in the banks, which are domestic plays with an important growing exposure to lending and trade finance outside Japan.

Our non Japanese exposure is a mixture of auto-related, trading companies and heavy Electricals (Hitachi & Mitsubishi Electric) and we have just initiated a position in Shin-Etsu Chemical. Shin-Etsu is dominant in all its major products being number 1 globally in PVC (from its US subsidiary), number 1 in silicon wafers and number 2 in silicon resins. At a share price 20% off the 2012 high and less than half the level they reached in 2007 – despite maintaining net profits of more than \$1bn throughout the period – we believe they are a good buy below Y4,000.

Although the Fund's return in July beat the index, it was held back by the weakness in Canon's shares (down 16% for the month) and by another large (-26%) fall in the shares of the airline Skymark. Canon shares were under pressure as other laser printer companies announced weaker earnings and they eventually revised their full year earnings down based on the ongoing strength of the Yen against the Euro and the USD and poor demand in Europe. They did however announce yet another Y50bn share buyback – the fourth in the past year – and their shares have bounced more than 5% since the end of July. Whatever one's view of the economic outlook, there is no denying Canon's strong commitment to its shareholders. A little Yen weakness would certainly help too.

The current June quarter earnings reporting season is nearing its end and it is clear that the strong Yen has hurt profits in a number of industries. Most companies have left their full year estimates unchanged, but on balance our impression is that profits have not quite met analyst expectations for the first quarter. While Japanese analysts will be aggregating the data over the next couple of weeks, outside Japan the real interest is just what is happening at Sharp, Sony and Panasonic. Their shares have plunged as losses mount and their combined market capitalisation is now less than one fifth of that of Samsung Electronics. They will need more than just a bit of Yen weakness.

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Recent 3 month Fund Exposure

% of NAV in	May 12	Jun 12	Jul 12
Long Stock Positions	89.74	91.07	93.12
Index Futures	-	-	-
Net Exposure	89.74	91.07	93.12

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	24.98%	46.09%
Total no. of positions	33	

Top Five Positions

Benesse Holdings Inc
Sumitomo Mitsui Financial Group Inc
Aeon Co Ltd
Mitsubishi UFJ Financial Group Inc
Mitsubishi Electric Corp

Winners

Benesse Holdings Inc
Unipres Corp
Shin-Etsu Chemical Co Ltd
Toshiba Plant Systems & Services Corp
Sumitomo Realty & Development Co Ltd

Losers

Canon Inc
Skymark Airlines Inc
JVC Kenwood Corp
Mitsubishi Electric Corp
JX Holdings Inc

Sector Exposure as at 31 July 2012

	Longs		Longs
Consumer Discretionary	29.71%	Industrials	19.11%
Consumer Non-Discretionary	4.98%	Information Technology	8.38%
Energy	3.33%	Materials	2.46%
Financials	25.15%	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
2004									-1.60	-1.32	6.18	2.52	5.70	8.16
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
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
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
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
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
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
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
2012	2.84	2.31	1.04	-1.81	-9.47	3.97	-1.30						-3.02	-0.44

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

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