MONTHLY REPORT TO SHAREHOLDERS OF OPTIMAL JAPAN ABSOLUTE LONG FUND

Optimal FUND MANAGEMENT

Monthly Performance % - *as at 30 June 2017*

	NAV	June	YTD	Strategy AUM
Offshore Feeder	US$ 15.921	2.76%	6.76%	US$44M
Topix Return is in USD unhedged using WM London 4pm close		1.15%	10.18%	

It has not felt like a bull market so far in 2017 but in USD, most markets have reached the 2017 half way mark with gains in excess of 10%, propelled in no small way by the weakness in the Dollar against almost every major currency. Against the basket of currencies that are used in calculating the DXY US Dollar Index, the Dollar has fallen more than 6% this year, with gains in the Yen of 3.9%, in Sterling of 5.4% and in the Euro of 8.7%. In the case of Japan, the Topix index was up just over 6% for the half in Yen terms, but gained 10.4% in USD (unhedged).

From the parochial perspective of a value investor in Japan, the period since the US election on November 8, 2016 has been a mixed bag. The initial period up to New Year 2017 was an excellent time with increased expectations for a steeper yield curve helping economic cyclicals and financial stocks, but the following six months have been tough, with only the final month of June giving value investors any respite. The ascendancy of value stocks in June coincides with a rise in the yield on government 10 year bonds in all the major markets but unlike the second half of 2016 when this happened, the main drivers of heightened growth expectations are now Europe and China - *and Japan* - whereas last year it was a US recovery story.

Japan's economy, while never going to feature as the world's hottest growth story, has been recovering from the mild slowdown which troughed around the middle of 2016 and is now showing strength in a number of hard and soft measures. The Bank of Japan's June Tankan report on corporate conditions and intentions showed that all corporations - regardless of whether they are large, middle sized, small, manufacturers or in the service sector – responded that current conditions had improved noticeably, and were at a three year high. Even more stunning is the continued rise in the jobs-to-applicants figure which has reached its highest level since the 1970s. Nearly all industries report that they are now short of capacity and that workers are hard to find. Eventually, even the grateful Japanese worker will realise that he – and increasingly she – has a good case for a wage rise, but the tight labour market is not yet evident in the official wage figures. We think rising wages are inevitable, and imminent, although the reluctance of the Japanese worker to ask for more is legendary.

As mentioned above, the Yen has been stronger this year at the same time that equities have rallied. Neither movement has been particularly strong, but the break from the perceived nexus of "weaker Yen=stronger Nikkei" is a welcome change and reflects a broader based recovery in the economy and across sectors with stronger domestic demand coinciding with improved exports. In the same way that it is hard to imagine a prolonged bull market in Japanese equities without buying from domestic investors, we cannot expect to see anything more than trading rallies occurring if the only source of growth is from exports. In our portfolio, the broader economic recovery is reflected in major positions in both companies dependent on overseas sales (Toyota, Panasonic and Hitachi) and those more focused on domestic demand (MUFJ, JAL, Izumi and Mitsubishi Estate).

We have mentioned in previous reports the prolonged and bewildering poor stock performance of Mitsubishi Estate. It is a significant - though reduced - position in the Fund (almost 4.5%) and has been a drag on the overall return for some years, and we find it amongst our most frustrating investment decisions. The shares trade at a historically large discount to adjusted net asset value and offer a great way to get a liquid exposure to real estate at an implied cap rate well above that of the blue riband buildings which constitute the asset base. Despite that, Mitsubishi Estate's shares have lagged both the real market, and their listed peers. Given their strong balance sheet and access to ready finance, management's unwillingness to either boost dividends or buy-back shares is frustrating to us – and the market. It is a case that perhaps best illustrates that alignment with shareholders and good governance more generally is increasingly important to investors in Japan – foreign and domestic alike.

Investing in Japanese equities over the past two decades (and more) has involved believing that low valuations are temporary and these will revert to a higher mean. There have been plenty of other factors that have made that journey more erratic than theory would hold, and strangely enough, low real interest rates have been put forward as one such factor. In the GMO Q1 2017 letter to investors, legendary value investor Jeremy Grantham commits value investing heresy by suggesting that elevated US equity valuations will not revert to a lower mean as long as real interest rates remain low. It is a thoughtful argument and is typically well written, but it is also worth reading Jim Grant's response entitled "The Apostasy of Jeremy Grantham" in the June 16 edition of Grant's Interest Rate Observer. Grant is an even better writer than Grantham and believes that "this time is never different", and his concluding paragraph is surprisingly (to us) uncharitable in assessing Grantham's motivation. It would be a great debate if someone can get the two of them to agree to do one.

Whether US equities are too expensive and will fall is not a subject for our monthly report. If real rates remain low however, and in Japan the combination of inflationary forces and BoJ policy will ensure they do for some time yet, then the better bet is that Japanese equities will be supported by low rates and investors will benefit from valuation expansion. Grantham might well be right and US equities do not plummet, but Japanese equities offer a better way to capitalise on the main factor behind his bull (at least non-bear) outlook. Low real rates and corporate governance reform makes for strong tail winds for Japanese equities.

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

Recent 3 month Fund Exposure

	Apr 17	May 17	Jun 17
Long Stock Positions	94.50	93.89	97.50
Index Futures	-	-	-
Net Exposure	94.50	93.89	97.50

Performance Statistics

Last 12 Months	30.48%
3 Yr Annualised Return	4.26%
5 Yr Annualised Return	8.19%
Annualised Return Since Inception	3.69%

Position Concentration

	Top 5	Top 10
Longs	35.02%	59.27%
Total no. of positions	25	

Top Five Positions

Mitsubishi UFJ Financial Group Inc
Hitachi Ltd
Panasonic Corp
Sekisui House Ltd
H.I.S. Co Ltd

Winners (Qtr)

H.I.S. Co Ltd
Izumi Co Ltd
Panasonic Corp
Hitachi Ltd
Mitsubishi UFJ Financial Group Inc

Losers (Qtr)

Zojirushi Corp
Baroque Japan Ltd
Toray Industries Inc
Isuzu Motors Ltd
Kyoritsu Maintenance Co Ltd

Sector Exposure *as at 30 June 2017*

	Longs
Consumer Discretionary	45.57%
Consumer Non-Disc	3.17%
Energy	-
Financials	18.98%
Health Care	-
Industrials	11.55%
Information Technology	9.22%
Materials	9.01%
Telecommunications	-
Net Exposure	97.50%

June Qtr Sector Performance – P&L

	Longs
Consumer Discretionary	4.00%
Consumer Non-Disc	0.00%
Energy	-
Financials	1.11%
Health Care	-
Industrials	0.18%
Information Technology	1.54%
Materials	-0.24%
Telecommunications	-
Total Equity	6.59%
FX Forwards	0.46%
FX and Other	-1.02%
Total	6.03%

Performance Contribution	Longs	FX Forwards	Other	Total
June 2017	3.44%	0.88%	-1.56%	2.76%

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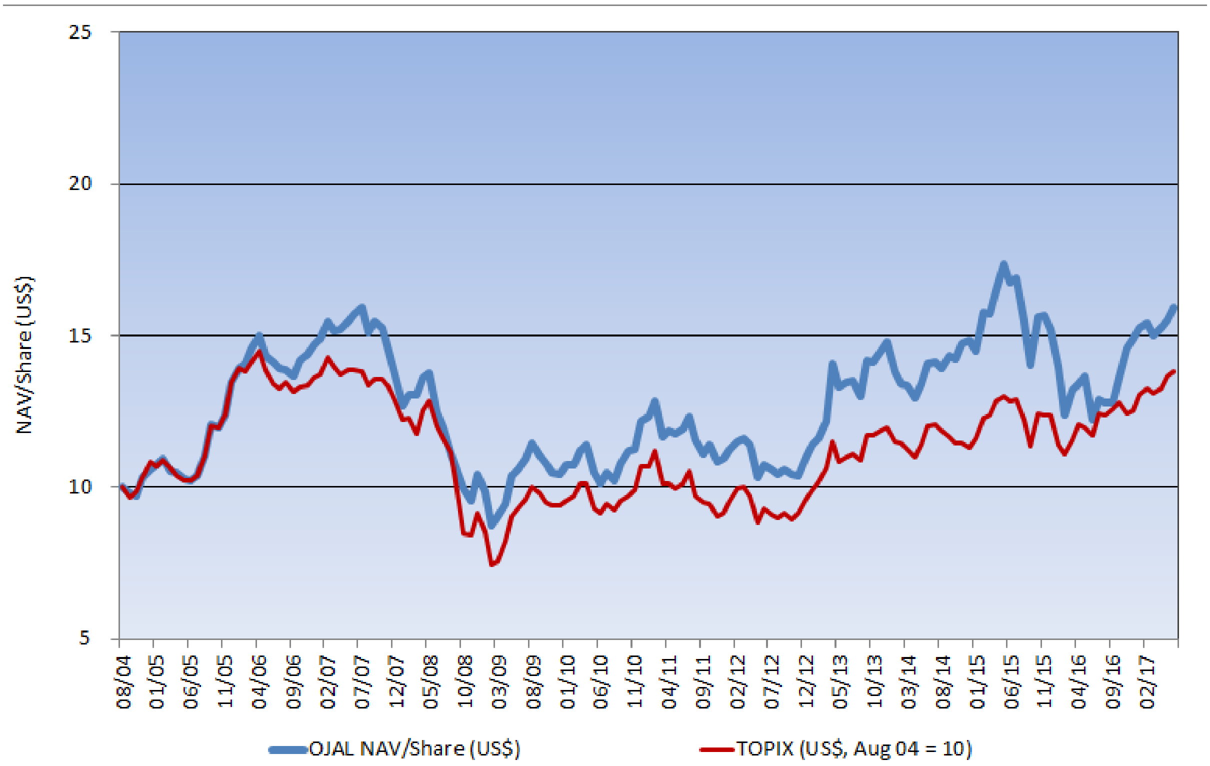
Portfolio Performance *as of 30 June 2017*



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							6.76	10.18
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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