MONTHLY REPORT TO SHAREHOLDERS OF OPTIMAL JAPAN ABSOLUTE LONG FUND

Optimal FUND MANAGEMENT

Monthly Performance % - *as at 30 May 2014*

	NAV	May	YTD	Strategy AUM
Offshore Feeder	US$13.42	3.71%	-9.39%	US$82M
Topix Return is in USD unhedged using WM London 4pm close		3.76%	-4.70%	

An old saying goes "a stopped clock is right twice a day" and after four consecutive negative months for Japan's Topix index, our bullish forecasts finally came to fruition in May with a Topix gain of 3.3%. Anyone who reads our monthly letters would know that we have generally been optimistic on developments in Japan and especially so since Mr Abe's second stint as Prime Minister began in late 2012. We have been disappointed with the weak market since early January and have struggled to square the pessimism in equities with the improving tone of economic and corporate news. On the economic front, Q1 2014 GDP was revised up from 5.9% (q/q annualised) to 6.7%, largely due to a greater contribution from private capex. Japanese GDP numbers are normally subject to at least three of four revisions so this is likely to change again, but whatever the final figure is, growth is expected to decline in Q2 due to the effects of the increase in consumption tax in April. This should not be a surprise, but "poor" numbers, even when expected, still seem to push sentiment and equity prices down. Our impression however, is that following the front-loaded surge in demand in Q1 the decline in demand in April and May has been muted and as we had hoped, the fears that a 3% increase in consumption tax would send the economy into a tail spin have been greatly exaggerated.

We spent last week in Japan and met with a number of companies and analysts. The biggest change was the fact that all the companies we met – ranging from cardboard box makers to nursing home operators – were positive about the boost to confidence, prices and consumption that has been engendered by the Government's policies and attitude. Confidence is a fragile thing, whether one talks of a football team or consumers, and when there is a lot of it about anything seems possible. The mood in Japan is hardly exuberant (it is too early for that) but it is better than at any time since 2006 and while consumers and companies are clearly feeling better, the misanthropes in the financial markets have remained generally gloomy.

Negative commentary has been either that the Bank of Japan is resting on its laurels and should be more aggressive on monetary policy, or that the Third Arrow of policy – the growth strategy – has not left the quiver and might not be real. As for the first criticism, this strikes us as unreasonable as the Bank of Japan is buying Y7*trillion* of JGBs every month and thus boosting the balance sheet by an amount equal to 17% of GDP each year that this continues. That is very aggressive monetary policy, and moreover gives holders of JGBs a very big opportunity to reduce their holdings in advance of the targeted 2% CPI. The BoJ is aggressive enough in our view!

The other criticism that there has been insufficient detail on the growth strategy is one that we do have sympathy for, but here the answer may be at hand. The current session of the Diet ends on June 22nd and Mr Abe is meant to be making an important policy speech soon after to flesh out the details of what have been rather general strategies for growth. The evidence is that this government knows it has to keep its constituents – and I would include international investors in that group – on side and buying into their vision and policies. Whether it is Mr Abe himself, or his colleagues and advisors such as Mr Ishiba (secretary general of the LDP), Prof Heizo Takenaka or Prof Takatoshi Ito (economic policy advisors) or Mr Kuroda (BoJ Governor), they are all in sales mode, traveling widely to attend conferences and presenting their views to a wide audience directly or through the media. We find this a welcome change after years of inarticulate and introverted Japanese governments and are keen to see what Mr Abe's forthcoming growth strategy will contain.

To finish, we have selected a passage from the "Ito Review of Competitiveness and Incentives for Sustainable Growth" which was produced under the supervision of the eponymous Professor Ito (of GPIF reform fame). It is a clear indication that there is a genuine desire on the part of Abe's government to see Japanese companies manage themselves better for longer term value-creation and thereby investment returns. Anyone wanting to see the full report - which we commend for its brevity and clarity – can get it from the following link http://www.meti.go.jp/english/press/2014/0425_02.html

Under "Recommended Directions and Issues for further investigation" it says:

3) Corporate Value Management Based on Capital Efficiency and not on "Short-Termism"

The sustainable growth of a company is the result of cooperative value creation with long-term investors, and should be evaluated using capital efficiency measures such as ROE and ROIC. In order to promote global management of a business, companies must adopt internationally recognized management metrics such as ROE as target performance indicators and commit to managing to such measures. It is important that ROE is not viewed from a short-term perspective, and rather should be understood that an increase of ROE over the long-term contributes to the accumulation of resources necessary for increasing corporate value, and that this in turn increases value for all stakeholders including a rise in long-term shareholder value. While on the one hand the importance of ROE has been recognized, there is strong concern that some companies may aim to raise ROE in the short-term through excessive financial leverage. There is evidence suggesting that some European and American companies have done this. However, this should not be reason to deny the important need for Japanese companies to manage to ROE. It should also be noted that there is considerable difference between the levels and maturity of ROE management conducted in Japan, Europe and the US. US companies (with an average ROE of 15%) and Japanese companies (with an average ROE of 5%) are at very different stages with respect to ROE management. Japanese companies must adopt ROE into their business management and in the right way. Investors, on the other hand, must fairly assess companies which continuously generate returns above their cost of capital.

The most important concept in assessing an appropriate level of ROE is the cost of capital. Many Japanese companies lack an understanding of their cost of capital….Due to the positive effects of the macroeconomic policies of Abenomics, the ROE of Japanese companies is on the rise…..

We concur, and believe that this trend has a long way to go yet.

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Recent 3 month Fund Exposure

% of NAV in	Mar 14	Apr 14	May 14
Long Stock Positions	96.38	97.29	96.27
Index Futures	-	-	-
Net Exposure	96.38	97.29	96.27

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	29.97%	52.06%
Total no. of positions	28	

Top Five Positions

Sumitomo Mitsui Financial Group Inc
Mitsubishi UFJ Financial Group Inc
Mizuho Financial Group Inc
Itochu Corp
H.I.S Co Ltd

Winners

Nomura Holdings Inc
Toyo Tire & Rubber Co Ltd
Mitsubishi UFJ Financial Group Inc
Resorttrust Inc
Mitsubishi Estate Co Ltd

Losers

Tsukui Corp
Teijin Ltd
Hitachi Ltd
Komatsu Ltd
Mizuho Financial Group Inc

Sector Exposure *as at 30 May 2014*

	Longs		Longs
Consumer Discretionary	28.66%	Industrials	20.88%
Consumer Non-Discretionary	-	Information Technology	7.06%
Financials	29.44%	Materials	8.77%
Health Care	1.46%	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
(Inception September 2004)														
2014	-6.55	-3.03	-0.52	-3.07	3.71								-9.39	-4.70
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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