

Monthly Performance % - as at 31 October 2014

	NAV	October	YTD	Strategy AUM
Offshore Feeder	US\$14.247	-0.65%	-3.80%	US\$62M
<i>Topix Return is in USD unhedged using WM London 4pm close</i>		-1.61%	-3.99%	

Last month's report began:

"October has begun in a dark mood and Japanese equities are down more than 6% as we write."

A week later (on October 17th), the Topix index closed at 1177 and at that point had fallen over 11% for the month, but by the October 30th, had recovered to 1286 and had cut the MTD decline to 3.5%. All Saint's Eve (31st October) saw a reprise of April 4th 2013 when Mr Kuroda of the Bank of Japan had first announced his aggressive monetary policy (dubbed QQE). In the early afternoon of Halloween, Mr Kuroda stunned investors by announcing that a 5-4 majority of the BoJ's board had voted to expand the Bank's buying of JGBs (and ETFs and J-REITs) in a further example of his willingness to use whatever monetary tools were needed to break Japan free from deflationary expectations and return it to a more "normal" state of affairs. As with the rites of Halloween, here was a monetary policy move that was meant to "confront the power of deflation" (death) and it took everyone by surprise.

The reaction was immediate and violent with the Topix index jumping from 1299 to close at 1333 and the Yen falling from 109/\$ to 112/\$ in a matter of hours. As the following Monday was a public holiday in Japan, November 4th was again a strong day for equities – accompanied by further weakness in the Yen – but the follow through has been muted since with the market slightly down from its closing level on the 4th. The instinctive reaction was to buy equities, but there are certainly sections of the investor universe that see the BoJ actions more as an act of desperation than the guiding hand of a central bank in control. Investors will see the actions of the BoJ as supportive of the theory that they already adhere to, but anyone who has observed Japanese policy-making (including that of the Bank of Japan) over the past couple of decades will have to admit that Mr Kuroda is cut from a different cloth and is not about to fade quietly into grey anonymity the way that most of them have.

The sectors that have recovered most since the market low of mid October are a combination of weak Yen beneficiaries such as autos, precision equipment and shipping and domestic deflation sectors such as real estate and financials. The real estate developers – who are benefitting from the fall in office vacancy rates and improving rents – have been dreadful performers this year and despite rising 19% since October 17th, are still down 14% YTD while their dreary J-REIT cousins are up 15% in 2014. We view the J-REITs as reasonable alternatives to holding Yen cash for an income seeking Japanese investor but while their Price/NAVs are well above 1x, they are inevitably trading cum-equity issuance. As long as they can more or less maintain their

distribution per share, this remains a path for them to expand their assets and in the process, become more investible to the large local pension funds. Despite their good returns this year, we feel there are better ways to play an improving property market than investing in a relentlessly dilutive structure, and hope that the outperformance of developers over REITs has a long way to go yet.

Whether it counts as a "Third Arrow" or not, the other noteworthy announcement made on Friday October 31st was that Japan's GPIF (the \$1.2tn government pension fund) would re-design their asset allocation benchmark and lift the neutral allocation to both Japanese and foreign equities to 25% and reduce domestic bonds to 35% from around 60%. Apart from the effect this will have on the Yen, equities and other pension funds in Japan, it is nice to see this become a reality rather than remain an expectation, and shows that although things do take time to implement in a system that seeks consensus, Mr Abe can effect change, and not just tell a good story. It is undoubtedly good news for equities.

The Fund's worst performer in October was the airbag and seat-belt maker Takata – which has been in the news for the wrong reasons as some of their airbags have been shown to have had defects leading to recalls by their customers. When judged with the benefit of hindsight, these cases are usually shown to be opportunities to buy at depressed share prices, and we expect Takata is a strong buy for those with patience. Unfortunately, dealing with a safety device like an airbag and thus deep into the highly politicised world of consumer protection, it is impossible to know when the situation bottoms out and the market reassesses the longer-term prospects for Takata. The company has already made provisions of over Y47bn, is looking for operating profits growth of 10% for the current year and trades on an EV/EBITDA ratio of 2.5x. As a dominant global provider of air-bags and seat belts, Takata has a bright future and we believe the right investment approach is to sit tight while there is so much uncertainty and look for longer-term evaluations to support the shares before long. Information is patchy and conflicting however, and before we add – or exit - we need to sort the wheat from the chaff. It is unlikely to be that easy.

Earnings for the September half year are now well underway and have been progressing well, with a majority of companies beating their own forecast. Despite this, few are raising their full year forecasts but with many companies basing their profit outlook on a Y100/\$ rate, the prospects for better earnings in the year to March 2015 are good. In a world full of uncertainties and worries, Japanese equities seem a good bet to us.

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Optimal FUND MANAGEMENT

Recent 3 month Fund Exposure

% of NAV in	Aug 14	Sep 14	Oct 14
Long Stock Positions	92.54	89.90	91.86
Index Futures	-	-	-
Net Exposure	92.54	89.90	91.86

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	32.62%	54.09%
Total no. of positions	28	

Top Five Positions

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

Winners

Mitsubishi Estate Co Ltd
Orix Corp
Nomura Holdings Inc
Mizuho Financial Group Inc
Jafco Co Ltd

Losers

Takata Corp
Inpex Corp
Isuzu Motors Ltd
Itochu Corp
Hitachi Zosen Corp

Sector Exposure as at 31 October 2014

	Longs		Longs
Consumer Discretionary	18.77%	Health Care	2.11%
Consumer Non-Discretionary	-	Industrials	23.43%
Energy	3.02%	Information Technology	5.29%
Financials	37.36%	Materials	1.88%

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	4.69	0.57	-1.38	2.91	-0.65			-3.80	-3.99
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

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