

**Monthly Performance % - as at 31 October 2017**

	<b>NAV</b>	<b>October</b>	<b>YTD</b>	<b>Strategy AUM</b>
Offshore Feeder	US\$ 17.458	4.67%	17.07%	US\$48M
<i>Topix Return is in USD unhedged using WM London 4pm close</i>		4.46%	19.36%	

We wrote in last month’s letter about the lid on the Japanese equities market (referred to as the “Ama no Iwato” or the Iron Coffin Lid) which had prevented Japan’s Topix index breaching 1800 since November 1991. October was an unusually strong month - following an excellent September – and although Topix rose almost 5.5%, it did finish shy of the “lid” at 1766. Four trading days into November as Topix closed at 1813.3 on November 7<sup>th</sup>, a small but devoted group of grizzled fund managers crept out into the bright sunlight of territory not chartered since the early days of Japan’s “Post Bubble” era. In the 26 long years since we were last here, a whole generation of investors has grown middle aged believing that both Japan’s economy and equity market were destined for terminal decline and that one could find better investment options elsewhere. Anywhere else.

These analysts, fund managers and commentators – typically ranging in age from 25 to 50 – had many good reasons - and even more implausible ones - to believe the apocalyptic view of Japan, but for those interested enough, there were signs of change, and eventually, improvement. The first big changes had begun in Japan from the late 90s when the banking sector began to crumble, accelerated during the Koizumi era when certain vested interests began to be tackled and then became more obvious under PM Abe’s second go as Prime Minister from late 2012. The conditions for equity investors are certainly far better today, with profit margins stronger, RoEs and dividends higher and governance practices generally better than they were in 1991. They are not where we would like them to be, but investment is at least as much about the direction you head in rather than the destination itself, and Japan has been charting a path – invariably a winding one – away from the rocky shoals over the past 15-20 years.

Japan’s strong equity market has not occurred in isolation of course, and much of the world also has enjoyed rising equity markets. For many in financial markets, it has been a joyless bull market since the Lehman Crisis in 2008, and the better known and more oft-quoted expert commentary has been guarded, sceptical, or just pessimistic. It is difficult to think of any large country where government policy has been popular, approved of, or praised. In the main however, governments have been

hands-off when it comes to industrial policy, taxation or anti-monopoly concerns, and companies have been cautious about expansion capex and have focused their efforts on achieving higher margins.

Looking back at sectoral performance over the period since the Lehman Crisis, the clear laggards holding the Topix index back have been banks and other financial sectors, autos and real estate. Smaller cyclical sectors such as steel, shipping and airlines have been weak too, but their weight in the index is small and their impact overall is limited. The better performing sectors have seen earnings growth move more or less in line with the share price gains so valuations are not excessive, while the defensive sectors of food, drugs, J-REITs and railways, which had become wildly over-priced by mid 2016, have been big laggards since then and are now more moderately valued.

In our portfolio, a number of stocks we added following our meetings in Japan in August have done very well in a short time. Tokai Carbon, SMC, Hazama Ando, Idemitsu and Horiba have all done well and been major contributors to the Fund’s return. The lean times since 1990 have conditioned investment managers to take profits when prices have risen quickly, and we have had our fingers poised over the sell button a few times in the past month. We are not willing to sell yet however, as economic momentum both domestically and overseas is still positive and valuations attractive. Our portfolio currently sits on a PER for FY18 of 13.4x, with an RoE of 11% and a weighted average profit margin of 8%. If anything, we suspect the earnings forecasts are too low.

We plan to adjust our eyes to the unaccustomed bright light and gather our bearings in the unfamiliar territory we find ourselves in, and then try and determine what the prospects are for the market. Foreigners have turned net buyers in the recent months and Japanese individual investors have continued to sell. Foreign buying has been a good contrary indicator for the past decade or more, but in conditions which might signal a break from the past, we need to try and look at the market ahead with fresh eyes. It is always tempting to be pessimistic – it makes you sound smarter for one – but is it hard to spot changes other than with hindsight, and we believe change is accelerating in Japan.

**DISCLAIMER:**

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**Recent 3 month Fund Exposure**

% of NAV in	Aug 17	Sep 17	Oct 17
Long Stock Positions	87.81	90.27	96.55
Index Futures	-	-	-
Net Exposure	87.81	90.27	96.55

**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	32.99%	55.23%
Total no. of positions	24	

**Top Five Positions**

Mitsubishi UFJ Financial Group Inc  
Hitachi Ltd  
Panasonic Corp  
Izumi Co Ltd  
Toray Industries Inc

**Winners**

Hitachi Ltd  
Hazama Ando Corp  
Sekisui House Ltd  
Mitsubishi UFJ Financial Group Inc  
SMC Corp

**Losers**

Sumitomo Mitsui Financial Group Inc  
Hitachi Metals Ltd  
Kasai Kogyo Co Ltd  
S Foods Inc  
Pressance Corp

**Sector Exposure as at 31 October 2017**

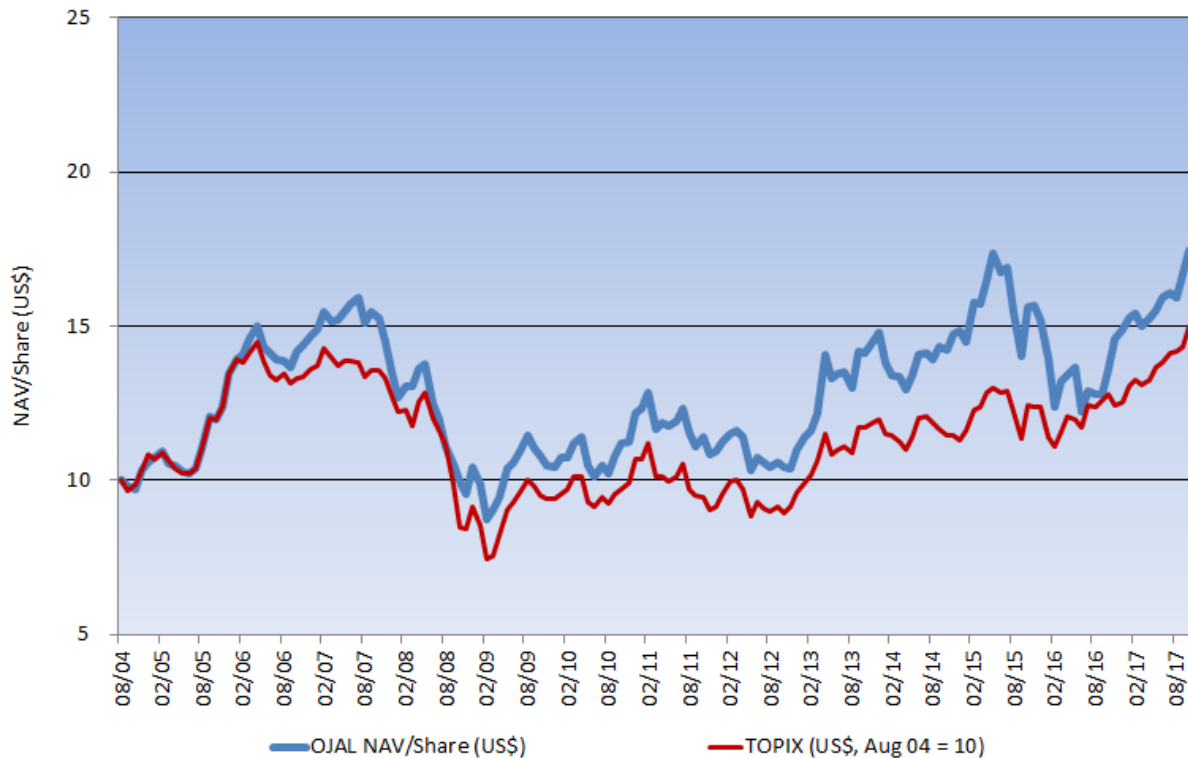
	Longs
Consumer Discretionary	32.44%
Consumer Non-Discretionary	2.45%
Energy	4.47%
Financials	11.08%
Health Care	3.16%
Industrials	16.46%
Information Technology	11.83%
Materials	14.66%
Telecommunications	-

Performance Contribution	Longs	Futures	FX Forwards	Other	Total
October 2017	5.01%	-	0.57%	-0.91%	4.67%

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**Portfolio Performance as of 31 October 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 <sup>*</sup> YTD
(Inception September 2004)														
2017	2.13	1.08	-2.46	1.55	1.61	2.76	0.95	-0.82	4.63	4.67			17.07	19.36
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

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

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