

Monthly Performance % - as at 31 December 2012

	NAV	December	YTD	AUM
Offshore Feeder	US\$10.97	5.68%	0.37%	US\$14M
<i>Topix Return is in USD unhedged using WM London 4pm close</i>		4.94%	5.01%	

Can Mr Abe's soufflé rise twice?

Participants in the equity markets tend to be optimists, and based on the 10% rise in the Topix index since the LDP election victory on December 16th, the response to the question posed above would seem to be strongly positive. The governing DPJ suffered a huge backlash from voters - albeit in an historically low voter turnout - who preferred the pro-growth platform that Mr Abe chose to push. Despite pre-election talk of a grand LDP-led coalition with Mr Noda and some senior DPJ Diet members, the huge swing to the LDP meant that Mr Abe did not need to make conciliatory moves and so Mr Noda leaves office with little but his dignity. Although his party was seen as a largely ineffectual government, he seems to have acquitted himself well in very difficult circumstances and whilst he has never looked for sympathy, one cannot help feeling sorry for him.

The market looks forward however, and lost no time celebrating his departure. The Yen's weakening versus the Dollar gathered momentum and is a further 5% lower now than it was prior to the election while financial stocks and cyclical sectors have soared. Sector analysts are generally raising their price targets but have not begun to increase earnings expectations. The higher targets are being set based on looking further out beyond the 2013 earnings numbers. With the weaker Yen however, it is very likely that export sectors will be the first area to have earnings upgrades and further target price hikes from analysts.

At this early stage it is futile to spend time adjusting profit forecasts based on a weaker exchange rate as the greatest variable in the calculation of Japan's fair value is certain to be the CPI and the outlook for inflation. If deflation is to turn to (modest) inflation in the years ahead, then as with a cyclical stock, Japan's equity market level is better measured by reference to its book value than by its PER. The earnings element in the PER contains a lot of leverage and the multiple afforded those earnings will rise with an exit from deflation. Both exporters and domestic sectors stand to benefit from this, and while (non-financial) domestics have lagged of late, we want to keep some exposure there as well.

As political leaders love to say, the path ahead will be hard, but in the case of Japanese equities, we do not think it will be as hard as it has been. Japanese industries that have been dismissed as no longer competitive will prove themselves relevant after all if the Yen's weakening persists and particularly so if the Korean Won strengthens further. Some companies like Sony and Panasonic need a lot more than a weak currency to flourish, and we do not see their road to success gleaming before us. Autos are a different matter. Already, in the past year we have seen the Won rise from 15/Yen to 12.1/Yen and in that time Hyundai Motor's shares have fallen from W223,000 to W206,000 while Toyota's have risen from Y2,644 to Y4,205. To put that Won strength into context, it was 7.5/Yen in the middle of 2007 before the Lehman crisis erupted so there is still some way to go before we can talk of a strong Won. Both Hyundai and Toyota are very good car makers and as cars are partly commodity consumer items and partly "image", the swings in currency rates tend to make a lot of difference to profits and share price.

We are pleased to have ended the year on a better note but disappointed not to have done better for the year overall. Our response to the question posed at the start of this letter is that given Mr Abe never managed to get his soufflé to rise in his first term as Prime Minister, we should look forward to better results this time.

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Recent 3 month Fund Exposure

% of NAV in	Oct 12	Nov 12	Dec 12
Long Stock Positions	89.38	93.91	93.80
Index Futures	-	-	-
Net Exposure	89.38	93.91	93.80

Performance Statistics

Last 12 Months	0.37%
3 Yr Annualised Return	1.63%
5 Yr Annualised Return	-4.08%
Annualised Return Since Inception	1.12%

Position Concentration

	Top 5	Top 10
Longs	31.59%	52.82%
Total no. of positions	27	

Top Five Positions

Mitsubishi UFJ Financial Group Inc
Sumitomo Mitsui Financial Group Inc
Mitsubishi Estate Co Ltd
Nissan Motor Co Ltd
Benesse Holdings Inc

Winners (Qtr)

Sumitomo Mitsui Financial Group Inc
Mitsubishi UFJ Financial Group Inc
Mitsubishi Estate Co Ltd
Mitsubishi Electric Corp
Nissan Motor Co Ltd

Losers (Qtr)

Benesse Holdings Inc
Ain Pharmaciez Inc
KDDI Corp
Nittoku Engineering Co Ltd
Aeon Delight Co Ltd

Sector Exposure as at 31 December 2012

	Longs
Consumer Discretionary	36.09%
Consumer Non-Disc	3.15%
Energy	-
Financials	28.62%
Industrials	15.45%
Information Technology	8.19%
Telecommunications	2.30%
Net Exposure	93.80%

December Qtr Sector Performance – P&L

	Longs
Consumer Discretionary	3.00%
Consumer Non-Disc	0.36%
Energy	-0.01%
Financials	6.45%
Industrials	3.90%
Information Technology	0.73%
Telecommunications	0.02%
	14.45%
FX and Other	-10.86%
Total	3.59%

Performance Contribution

	Longs	Futures	Other	Total
December 2012	10.38%	N/A	-4.70%	5.68%

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Optimal FUND MANAGEMENT

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)														
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

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.

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