

Performance % - as at 28 September 2012

| | NAV | September | YTD | AUM |
|---|-----------|-----------|--------|---------|
| Offshore Feeder | US\$10.59 | 1.73% | -3.11% | US\$14M |
| Topix - Topix Return is in USD unhedged using WM London 4pm close | | 1.44% | 0.09% | |

In the second last week of September we visited Japan and caught the last of the summer heat. Temperatures reached the mid-30s in Tokyo and in Niigata we were fortunate to travel there a day after a sweltering 37°C and enjoyed slightly cooler conditions. As part of Japan's laudable approach to energy saving, companies are encouraged to set air conditioning no lower than 25°, so meeting rooms were "close" but dress codes have been relaxed and most company spokesmen had dispensed with neckties and jackets. The mood was generally positive, but no one was willing to suggest good times were just around the corner. Twenty-plus years of grinding deflation and cost controls has entrenched caution in the DNA of Japanese business managers and only a few will concede that their business is doing rather well.

The few optimists one meets at companies in Japan totally outnumber those who claim to be optimistic about the national political situation. The expected change in the party that forms government at the next election is not so much a case of actually liking the current opposition but more one of rejecting the current DPJ government. Since our trip, the main opposition party (the LDP) has chosen Shinzo Abe to be its new leader – almost five years to the day since he resigned as Prime Minister. Abe was the successor to the popular Junichiro Koizumi but lasted just under one year in the role before resigning due to "ill-health". Since the popular Koizumi stepped down in September 2006 after five years as PM, Japan has had three LDP premiers and three DPJ premiers and none of these could be regarded as leaving much of a mark. Mr Noda, the incumbent premier, has struck a more determined figure than any of the five preceding ones but with his popularity at dangerously low levels, there is mounting pressure for him to dissolve the Diet and call an election. The forgettable Mr Abe might well get a second chance at PM, and one hopes that the embarrassment of his first attempt might bring about an improvement. He surely can't be doing it for the money.

One of the companies we visited was JR Central, the operator of the Shinkansen ("Bullet") trains that run between Osaka and Tokyo. We mentioned this company in our July report and this was our first opportunity to meet with the management since then.

The company generates cash from operations of between Y450-550bn each year and is steadily paying down the debt it inherited from the government-owned Japan National Railways when it was privatised in the early 1990s. Between Tokyo and Osaka, nearly all travel is by Shinkansen as it is not only more convenient than air travel, but also price competitive. JR Central will pay down the

vast bulk of its long-term debt by 2017 and thus would be in a very good position to increase profits and dividends, but for one matter. They have decided to build a Maglev train line between Tokyo and Nagoya (first stage) and then Nagoya and Osaka (second stage) with the first stage projected to cost Y5.4tn and be completed in 2027 and the second leg to be finished in 2042 at a further cost of Y3.6tn. All free cash flow will thus be used to retire existing debt and then service the new debt as it is taken on when construction begins. Once completed, travellers will enjoy a 40 minute train trip from Nagoya to Tokyo (quicker than the current commuting time of most Tokyo-ites) and this should make all sorts of new business opportunities possible.

Prior to the visit, we had been tempted by the cheap valuations and strong cash flow of this mature business. We left the meeting with rather less optimism on the share price outlook. The shares do trade at cheap levels but shareholders are not going to benefit from the strong cashflow now that debt will once again increase – reversing a twenty year trend. The infrastructure and standard of living in Japan – especially Tokyo - continues to improve with each passing year, but it is consumers rather than shareholders who often get the most benefit.

We believe great investments are available in Japanese equities and that despite the succession of faceless leaders, Japan's policy-makers are getting closer to solutions to alleviate pressing macroeconomic issues. Investors do need to be discerning however, as many Japanese companies are run with little regard for the return for shareholders. Aversion to debt is endemic, and banks have certainly been willing to flex their muscles in getting their debtor companies to dilute equity holders and reduce leverage. Meeting company management helps us in judging whether we as shareholders will enjoy our fair share of profits. We continue to believe we can generate good long-term investment returns for our investors with critical analysis of the potential opportunities - both the real and the false.

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Recent 3 month Fund Exposure

| % of NAV in | Jul 12 | Aug 12 | Sep 12 |
|----------------------|--------|--------|--------|
| Long Stock Positions | 93.12 | 93.27 | 89.29 |
| Index Futures | - | - | - |
| Net Exposure | 93.12 | 93.27 | 89.29 |

Performance Statistics

| | |
|-----------------------------------|--------|
| Last 12 Months | -4.59% |
| 3 Yr Annualised Return | -1.38% |
| 5 Yr Annualised Return | -7.26% |
| Annualised Return Since Inception | 0.71% |

Position Concentration

| | Top 5 | Top 10 |
|------------------------|--------|--------|
| Longs | 24.83% | 46.32% |
| Total no. of positions | 30 | |

Top Five Positions

Benesse Holdings Inc
 Sumitomo Mitsui Financial Group Inc
 Mitsubishi Estate Co Ltd
 Sumitomo Mitsui Trust Holdings Inc
 Aeon Co Ltd

Winners (Qtr)

Shin-Etsu Chemical Co Ltd
 Benesse Holdings Inc
 Mitsubishi Estate Co Ltd
 JX Holdings Inc
 Daito Trust Construct Co Ltd

Losers (Qtr)

Sumitomo Electric Industries Ltd
 Mitsubishi Electric Corp
 Yamada Denki Co Ltd
 Aeon Co Ltd
 Nissan Motor Co Ltd

Sector Exposure as at 28 September 2012

| | Longs |
|------------------------|--------|
| Consumer Discretionary | 31.59% |
| Consumer Non-Disc | 4.69% |
| Energy | 3.76% |
| Financials | 23.63% |
| Industrials | 21.39% |
| Information Technology | 4.23% |
| Materials | - |
| Net Exposure | 89.29% |

September Qtr Sector Performance – P&L

| | Longs |
|------------------------|--------|
| Consumer Discretionary | -0.70% |
| Consumer Non-Disc | -0.54% |
| Energy | 0.23% |
| Financials | 0.16% |
| Industrials | -2.16% |
| Information Technology | -1.03% |
| Materials | 0.48% |
| FX and Other | 2.16% |
| Total | -1.40% |

Performance Contribution

| | Longs | Futures | Other | Total |
|----------------|-------|---------|-------|-------|
| September 2012 | 1.21% | N/A | 0.52% | 1.73% |

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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 |
|---|-------|--------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|---------------|
| Below we provide a table detailing the monthly returns of the Fund since its inception in September 2004. | | | | | | | | | | | | | | |
| 2004 | | | | | | | | | -1.60 | -1.32 | 6.18 | 2.52 | 5.70 | 8.16 |
| 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 |
| 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 |
| 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 |
| 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 |
| 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 |
| 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 |
| 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 |
| 2012 | 2.84 | 2.31 | 1.04 | -1.81 | -9.47 | 3.97 | -1.30 | -1.79 | 1.73 | | | | -3.11 | 0.09 |

* 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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