

Monthly Performance % - as at 30 September 2014

	NAV	September	YTD	Strategy AUM
Offshore Feeder	US\$14.340	2.91%	-3.17%	US\$78M
<i>Topix Return is in USD unhedged using WM London 4pm close</i>		-1.72%	-2.42%	

In the world of 24/7 financial markets, September feels a long time ago. Caused by the Yen's weakness against the dollar – albeit at a time when the dollar strengthened against every major currency – Japanese equities rallied strongly through September while world equities faltered. Alibaba finally listed on September 19th and this seems to have marked a temporary top in equities, with the sell-off in most markets accelerating after that date. While Alibaba itself is down 5% from its close on Sept 19th, Japan's Softbank – which has a sizeable equity interest in Alibaba – is down almost 20%. It is impossible to say how much of this can be ascribed to the completion of the Alibaba float, and how much might be due to their rumoured interest in buying Dreamworks. The vast majority of analysts rate Softbank a buy but as the stock's gain (>150%) since Abe became PM is twice that of the sector's and almost three times that of the market, it strikes us that the shares have already digested a lot of good news.

October has begun in a dark mood and Japanese equities are down more than 6% as we write. As we mentioned last month, Japan's economic news has not been all good, but the market weakness over the past fortnight is more likely due to events outside Japan. The war in Syria and Iraq, China's slower economic growth prospects and bad loans in its banking system, weakness in the Eurozone and the possibility of rate hikes in the US are all issues or worries that investors have had to consider and the combined effect is currently overpowering the actions of the optimists. When asset consultants advise their clients to retain market weights in equities because the alternative assets are not attractive, you know the underpinnings of the equity market are imperfect.

Somewhere in a tropical jungle, a butterfly beats its wings and ensuing price changes then attract momentum investors who tend to believe that the price foretells all and jump aboard the trend. Sometime around September 19th, sellers became more active and markets have weakened, but not on any new news that we can identify.

News in Japan during the past month has been more positive and the release yesterday of September Machinery Orders up 35% yoy was much higher than expected. Domestic orders were up 17% (versus foreign up 48%) but as the September 2013 domestic order number was itself up 19% yoy, the latest increase is particularly positive. We have recently added exposure to equipment and machinery (Ebara & KHI) and expect strong earnings to continue – especially with the Yen around 107/\$.

We have mentioned the weakness in financials a number of times and realise that another mention risks comparison with the children's story "The Boy who cried Wolf". Mention it we must however, as this continues to be a very significant bet by us and represents a large part of the portfolio. Within the broad financials group, real estate stocks have performed worse than the banks and with limited exposure there, the portfolio has not suffered to a large extent. The Fund's exposure to the three mega-banks has however been a major, sorry, *the* major drag on performance in 2014. We will not go through the list of fundamental reasons why we like the banks but thought the chart below would tell a pretty powerful story. It shows the price-to-book ratio of SMFG (bank) relative to (divided by) the price-to-book ratio of the Topix index, going back ten years. The chart is more remarkable if you take it back further, but if we confine ourselves to the last decade, we are at least comparing valuations that pre-date and then follow from the global financial crisis of 2008. At a ratio of 0.64x, SMFG is trading at the bottom relative to the market over the period and yet it is a stronger and more profitable company than it has been throughout that time. We know that globally, banks are trading at low valuations, but we also know why the market would impose such a discount on banks in many other markets. Why is does so in Japan is another story, and we are frustrated to have cost the Fund money by continuing to hold almost 20% of the portfolio in banks shares this year. If we are wrong on this investment opportunity, I think it might speak to bigger problems than just Japan's banking system, but we find these compelling investments at current prices and intend to hold on to the positions.



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Recent 3 month Fund Exposure

	Jul 14	Aug 14	Sep 14
Long Stock Positions	92.70	92.54	89.90
Index Futures	-	-	-
Net Exposure	92.70	92.54	89.90

Performance Statistics

Last 12 Months	1.13%
3 Yr Annualised Return	8.91%
5 Yr Annualised Return	5.37%
Annualised Return Since Inception	3.64%

Position Concentration

	Top 5	Top 10
Longs	29.35%	49.74%
Total no. of positions	30	

Top Five Positions

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

Winners (Qtr)

Fujifilm Holdings Corp
Isuzu Motors Ltd
Hitachi Ltd
Sumitomo Mitsui Financial Group Inc
Komatsu Ltd

Losers (Qtr)

H.I.S. Co Ltd
Nomura Holdings Inc
Nippon Steel Corp
Jafco Co Ltd
Mizuho Financial Group Inc

Sector Exposure as at 30 September 2014

	Longs
Consumer Discretionary	20.86%
Consumer Non-Disc	-
Energy	3.39%
Financials	31.78%
Health Care	1.72%
Industrials	21.61%
Information Technology	8.66%
Materials	1.88%
Telecommunications	-
Net Exposure	89.90%

September Qtr Sector Performance – P&L

	Longs
Consumer Discretionary	0.04%
Consumer Non-Disc	-
Energy	0.09%
Financials	-0.61%
Health Care	0.27%
Industrials	1.25%
Information Technology	1.06%
Materials	-0.40%
Telecommunications	-
	1.70%
FX Forwards	8.01%
FX and Other	-7.65%
Total	2.06%

Performance Contribution

	Longs	FX Forwards	Other	Total
September 2014	2.53%	5.45%	-5.07%	2.91%

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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
(Inception September 2004)														
2014	-6.55	-3.03	-0.52	-3.07	3.71	4.69	0.57	-1.38	2.91				-3.17	-2.42
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

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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