

Monthly Performance % - as at 30 September 2016

	NAV	September	YTD	Strategy AUM
Offshore Feeder	US\$ 12.782	-0.09%	-16.06%	US\$42M
<i>Topix Return is in USD unhedged using WM London 4pm close</i>		1.62%	1.55%	

It must be due to the years of weak economic growth and the fact that the equity indices remain well below their 1990 high, but it nevertheless amazes us how heavily shorted Japanese equities are. It is possibly due to the fact that institutional owners of equity are so desperate for sources of added returns, that even the paltry amount they receive for lending their stock to short sellers is sufficient inducement to make the deal. If the borrow is cheap enough, the shorters will sell.

Whatever the reason, if there is an equity market anywhere that matches Japan's levels, we are not aware of it. The big jump in the short sell ratio to 35% of total selling coincided with the topping out of the Topix index at 1700 in the May-August period of 2015 and as Topix plumbed the depths at 1200 in June this year, the short sell ratio exceeded 40% and remained there through the next four months. Admittedly we are only a third of the way through the month, but the decline in the short sell ratio below 40% in October might signal the fact that for now, the bears are in retreat. They should be, as there are many other parts of the world and asset classes with less favourable valuations and outlooks than those for Japanese equities.

As we mentioned last month, we made a round of company visits in mid-September, just before the Bank of Japan made their comprehensive assessment of monetary policy. Not being active bond investors, we might be missing something in the details, but we thought the BoJ announcement was innocuous, and certainly was not the "catalyst" that so many participants seemed to be worried/excited about in the weeks preceding it. The 10Yr JGB yield today is pretty much where it sat at the end of August. Enough said.

After the respite in August when value sectors (including banks) did better, September saw some familiar defensive ("low vol") sectors back in the best performers while banks were down over 7% and the worst of the 33 Topix sectors. The Real Estate sector continued to bleed, despite getting ample evidence of strong underlying demand from our meetings in Japan, and we have not heard a convincing argument as to why it continues to be out of favour. Interestingly, shares in the three large developers

(Mitsubishi, Mitsui and Sumitomo) are all down by more than the Real Estate sector index so far this year, despite collectively representing almost 64% of the sector. Clearly this has been a sector where the least bad performance has come from the smaller stocks, as six of the ten largest sector component stocks have done worse than the -24% YTD decline, and the 11th largest stock has only a 2% weight in the sectoral index. Our best guess as to why the big three have been so poor is that they hoard cash and pay small dividends. That has always been the case, and has not stopped them performing well before, but perhaps this is one sign that investors are holding management to account for poor governance.

We had mixed feelings about our company visits, and believe that the market is – and will increasingly be – differentiating between companies with management who can demonstrate that they care about the share price and returns and those who do not. In the former camp, would be HIS - the travel agency with a highly profitable theme park near Nagasaki called "Huis Ten Bosch". In the latter camp would sit JR Central and perhaps Japan Airlines, neither overly surprising given their antecedents as government owned railway and flag carrier airline respectively. We have sold JR Central but retain JAL as it is egregiously cheap and should re-rate.

Hitachi has been a long-standing holding of ours and we felt that the good news there is far from over. They have a board of 13, out of which nine are external and five of those are foreigners, with careers in major companies including 3M, Anglo American and Bharat Forge. We expect ongoing corporate restructuring with an eye to better returns on capital and ultimately value creation for shareholders. Sekisui House, Isuzu and MUFJ are all very cheap. They did not exhibit the ambitions that Hitachi did, but management was solid, if not especially convincing.

The smaller, younger companies that we visited were impressive and exuded entrepreneurial ambition. In both Trust Tech and Nihon Chouzai, the founders retain significant equity stakes and drive the businesses' growth plans. Both have high RoEs, strong cash flow and yet trade at single-digit EV/EBITDA multiples. Each carries risk associated with their expansion plans, but in a market where ambition is sometimes hard to find, we rate their prospects highly.

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Recent 3 month Fund Exposure

	Jul 16	Aug 16	Sep 16
Long Stock Positions	98.85	93.00	91.66
Index Futures	-	-	-
Net Exposure	98.85	93.00	91.66

Performance Statistics

Last 12 Months	-8.93%
3 Yr Annualised Return	-3.40%
5 Yr Annualised Return	2.86%
Annualised Return Since Inception	2.05%

Position Concentration

	Top 5	Top 10
Longs	33.10%	55.79%
Total no. of positions	25	

Top Five Positions

Mitsubishi Estate Co Ltd
Mitsubishi UFJ Financial Group Inc
Nishio Rent All Co Ltd
Hitachi Ltd
Sekisui House Ltd

Winners (Qtr)

Nishio Rent All Co Ltd
Komatsu Ltd
Nidec Corp
LIXIL Group Corp
Mitsubishi UFJ Financial Group Inc

Losers (Qtr)

H.I.S. Co Ltd
Open House Co Ltd
Japan Airlines Co Ltd
Nippon Steel & Sumitomo Metal Corp
Isuzu Motors Ltd

Sector Exposure as at 30 September 2016

	Longs
Consumer Discretionary	27.98%
Consumer Non-Disc	2.89%
Energy	-
Financials	21.96%
Health Care	-
Industrials	26.67%
Information Technology	7.41%
Materials	4.75%
Telecommunications	-
Net Exposure	91.66%

September Qtr Sector Performance – P&L

	Longs
Consumer Discretionary	-0.25%
Consumer Non-Disc	-0.06%
Energy	-
Financials	-0.06%
Health Care	-
Industrials	4.84%
Information Technology	0.66%
Materials	-0.35%
Telecommunications	-
	4.78%
FX Forwards	-1.61%
FX and Other	1.58%
Total	4.75%

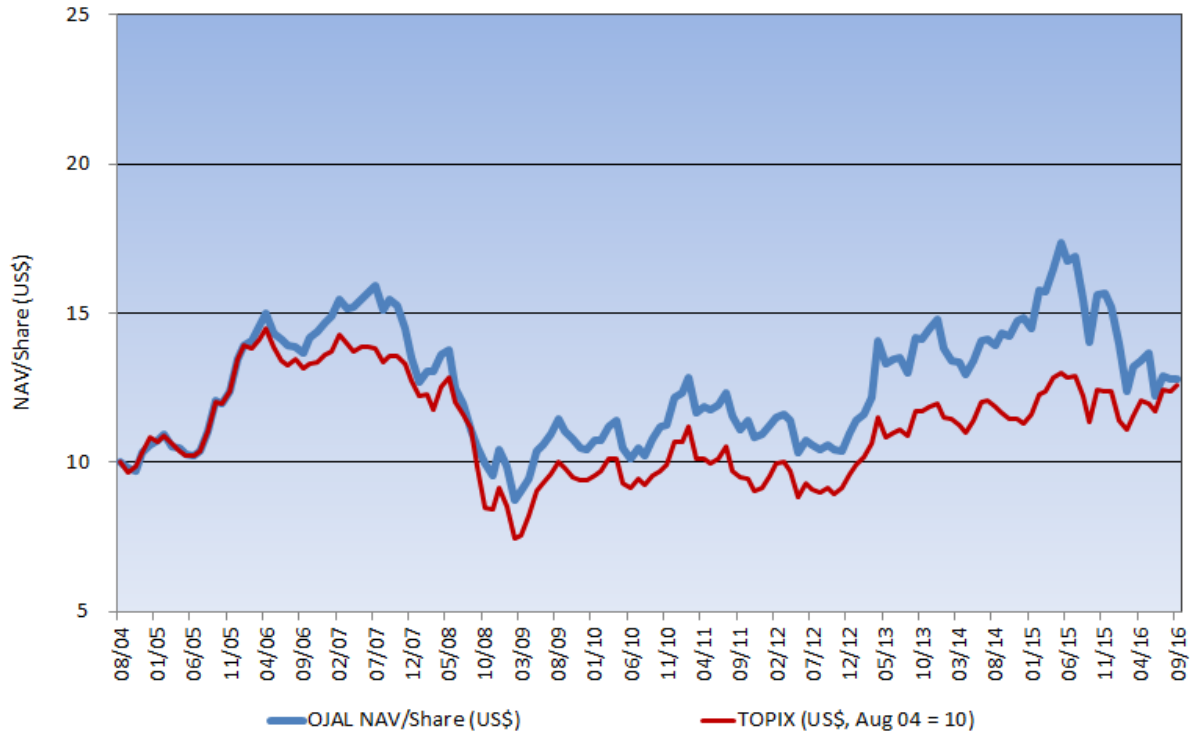
Performance Contribution

	Longs	FX Forwards	Other	Total
September 2016	-0.35%	-1.99%	2.25%	-0.09%

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Portfolio Performance as of 30 September 2016



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)														
2016	-8.33	-11.28	6.75	1.57	1.82	-10.75	5.75	-0.86	-0.09				-16.06	1.55
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

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