

**Monthly Performance % - as at 31 December 2014**

	<b>NAV</b>	<b>December</b>	<b>YTD</b>	<b>AUM</b>
A\$ Series 1	A\$12.24	1.32%	1.87%	A\$23M

Being equity investors we naturally pay most attention to equity matters such as index levels, allocations, sector performance and outstanding stocks. A quick look back at Japan in 2014 however, shows that greater price volatility was found in assets other than equities.

Whereas the Topix index gained 8% over the year, the Yen weakened from Y105/\$ to almost Y120/\$, crude oil (WTI) fell sharply from \$98/bbl to \$53/bbl and the 10 year JGB yield fell from 0.74% to 0.33%, its decline not unconnected to the fall in the oil price. While many people felt the Yen would weaken in 2014, the plunge in oil was not widely predicted and likewise, a decline in the 10 year JGB yield to below 0.30% was certainly unexpected.

To some extent, the return from Japanese equities was a disappointment given earlier high expectations and the range of positive factors that should have helped push prices higher. Economic policy was supportive, the government has decided to begin cutting corporate taxes, the GPIF (public pension fund) made an aggressive change in asset allocation to raise the weighting in equities at the expense of JGBs and companies have been raising dividends and increasing share buy-backs. In addition, the weaker Yen provides a strong boost to profits and makes Japanese made products so much more competitive against those from countries (mainly Asian) where their currencies are closely aligned with the USD.

The general election held on December 14<sup>th</sup> resulted in a boost for Prime Minister Abe, with his LDP returned to government with a clear majority. As evidenced by the very low turnout, it seems Japanese voters were as unimpressed/confused by his decision to call an election as we were, but the more plugged-in observers of Japanese politics explain the election as one which PM Abe called to shore up his position and policies from opposition within his own party and particularly from within the bureaucracy. With such an emphatic mandate in the polls, Mr Abe has every reason to push ahead with any regulatory and legal reforms he wants, and policy announcements on this agenda are due early in the new year. He should be bold, or risk losing credibility with those who have been willing to support his proposed Three Arrows strategy.

We start 2015 with an improved risk-return profile after the modest PER multiple contraction of the past year. The lacklustre equities return last year has thus built a firm platform for a better year in 2015, as earnings have risen more than stock prices and

left the market priced cheaper now than it was a year ago. The opposite (rising equities from PER expansion) has been more common in other markets in recent years and, ceteris paribus, one can make a good case for preferring Japanese equities to those of other developed markets. In investing, other things are, of course, never equal, but investment returns do depend on the valuation at the beginning of the period, and at present, Japan is offering good value as well as a positive outlook for profits.

For the past few years, analysts have forecast a decline in the profits of the major city banks in Japan, citing lower trading gains on bond holdings as one of the major reasons. The banks have continued to surprise on the upside when reporting their profits and although it is true that net interest margins on domestic loans have not widened as we'd hoped, the banks have defied the sceptics and have been successful in growing profits from various sources – not the least of which has been overseas lending. As we have mentioned before, the Fund's return has been held back by the large weighting in banks and other financials and once again the consensus prediction for bank profits is modest to say the least. The consensus has long been too negative and nothing seems more convincing this time around, the valuations are very cheap, and they are returning capital to shareholders via higher dividends and (in the case of MUFJ) through share buybacks.

The banks are now a major part of the "value" half of the market – trading at massive discounts to the market PER & PBR – and unsurprisingly, value has again underperformed growth in 2014. The cumulative excess return from growth (expressed by the MSCI Japan Growth index) over value in the past three years is 32% and is the longest period of such outperformance since the mid 1960s. Remembering the experience of the value managers in the late 1990s as they suffered in a roaring growth (TMT) market, we are loath to believe explanations for growth's success that "this time is different". The abandonment of their value strategy after years of underperformance and business pressure was a disaster for value-based managers as it locked in poor performance in the subsequent value market to add to the pain of the poor performance in the period when growth out-gunned value. Some companies can command higher multiples because of a dominant industry position and high returns on investment, but on the whole, stretched valuations eventually come back to (or below) the mean, and undervalued businesses get a re-rating. We expect the latter is nigh for the Japanese banks and financials.

**SYDNEY:** Level 5, Wyoming, 175 Macquarie St, Sydney NSW 2000 **Phone:** 61 2 8239 3300 **Fax:** 61 2 8239 3333 **Email:** [optimal@optimalasia.com](mailto:optimal@optimalasia.com)

**DISCLAIMER:**

This material is for your private information and we are not soliciting any action based upon it. Opinions expressed are our opinions only. The material is based upon information, which we consider reliable, but we not represent that it is accurate or should not be relied upon as such. Past performance is not an indication of future performance. This material is not intended for distribution in Japan or for Japanese domiciled entities.

### Recent 3 month Fund Exposure

% of NAV in	Oct 14	Nov 14	Dec 14
Long Stock Positions	89.44	87.25	93.24
Short Stock Positions	-5.95	-5.73	-2.13
Index Futures	-10.55	-10.51	-10.93
Equity Derivatives	-	-	-
Net Exposure	72.94	71.01	80.18

### Position Concentration

	Top 5	Top 10
Longs	29.02%	50.38%
Shorts	-2.13%	-
Total no. of positions	32	

### Winners (Qtr)

HIS Co Ltd  
Kawasaki Heavy Industries Ltd  
Japan Airlines International Co Ltd  
Toyo Tire & Rubber Co Ltd  
Kawasaki Kisen Kaisha Ltd

### Performance Statistics

Last 12 Months	1.87%
3 Yr Annualised Return	13.27%
5 Yr Annualised Return	7.99%
Annualised Return Since Inception *	6.18%
* Initial Series Used	

### Top Five Positions

Sumitomo Mitsui Financial Group Inc  
Mitsubishi UFJ Financial Group Inc  
H.I.S. Co Ltd  
Mitsubishi Electric Corp  
Mizuho Financial Group Inc

### Losers (Qtr)

Takata Corporation  
Ebara Corp  
Inpex Corporation  
Nikkei Index Futures (short)  
Tokyo Steel Manufacturing Co Ltd (short)

### Sector Exposure as at 31 December 2014

	Longs	Shorts	Net
Consumer Discretionary	18.33%	-	18.33%
Consumer Non-Disc	-	-2.13%	-2.13%
Energy	2.97%	-	2.97%
Financials	38.15%	-	38.15%
Health Care	2.17%	-	2.17%
Industrials	25.93%	-	25.93%
Information Technology	3.67%	-	3.67%
Materials	2.02%	-	2.02%
Telecommunications	-	-	-
Total Equity	93.24%	-2.13%	91.11%
Index Futures	-	-10.93%	-10.93%
Net Exposure	93.24%	-13.06%	80.18%

### December Qtr Sector Performance – P&L

	Longs	Shorts	Total
Consumer Discretionary	0.39%	0.66%	1.05%
Consumer Non-Disc	-	-0.20%	-0.20%
Energy	-0.47%	-	-0.47%
Financials	1.13%	0.07%	1.20%
Health Care	-0.07%	-	-0.07%
Industrials	1.80%	0.14%	1.94%
Information Technology	0.28%	0.21%	0.49%
Materials	0.42%	-0.38%	0.04%
Telecommunications	-	-	-
Index Futures	-	-0.38%	-0.38%
	3.48%	0.12%	3.60%
FX Forwards	-	-	0.84%
FX and Other	-	-	-0.80%
Total	-	-	3.64%

### Performance Contribution

	Longs	Shorts	Futures	FX Forwards	Other	Total
December 2014	1.57%	0.07%	-0.04%	-0.98%	0.70%	1.32%

#### DISCLAIMER:

This material is for your private information and we are not soliciting any action based upon it. Opinions expressed are our opinions only. The material is based upon information, which we consider reliable, but we not represent that it is accurate or should not be relied upon as such. Past performance is not an indication of future performance. This material is not intended for distribution in Japan or for Japanese domiciled entities.

**Historical Returns – Distribution Reinvested**

**Annual Distributions**

*Optimal Japan Trust Net Monthly Returns in AUD %*

<b>Year to Jun 00</b> A\$1.4158	<b>Year to Jun 01</b> A\$0.8989	<b>Year to Jun 02</b> A\$0.8983	<b>Year to Jun 04</b> A\$0.4713
<b>Year to Jun 05</b> A\$1.4218	<b>Year to Jun 06</b> A\$1.2446	<b>Year to Jun 07</b> A\$2.4179	<b>Year to Jun 14</b> A\$2.8013

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
<b>Series 1 (Inception August 2002)</b>													
2014	-5.91	-2.71	0.37	-1.68	3.12	4.40	0.22	-1.02	1.90	-0.08	2.37	1.32	1.87
2013	6.42	0.75	3.82	12.97	-3.76	2.58	1.72	-2.82	8.21	-2.62	1.03	1.57	32.71
2012	1.16	4.87	1.46	-2.87	-4.99	2.53	-1.80	-1.06	1.17	0.39	1.73	6.05	8.41
2011	3.38	2.12	-3.46	-0.54	0.90	0.09	-0.36	-3.94	-0.74	-0.09	-2.54	-0.29	-5.57
2010	1.95	-1.53	5.74	2.76	-5.91	-3.24	0.49	-1.96	2.89	0.97	1.34	3.89	7.03
2009	-1.74	-2.15	1.91	0.47	0.84	-0.46	0.28	2.59	-4.87	-0.66	-5.15	3.02	-6.14
2008	-6.67	2.21	-0.67	6.20	1.34	-5.91	-0.83	-5.34	-0.09	-0.44	-6.38	3.22	-13.41
2007	1.99	0.55	-1.03	1.35	3.45	2.28	-0.87	-6.98	1.88	0.35	-6.70	-4.69	-8.76
2006	1.82	0.43	3.86	0.35	-4.05	0.18	-0.79	1.32	0.13	2.10	0.77	2.49	8.73
2005	2.74	2.02	0.07	-0.14	0.99	1.47	1.81	3.68	6.81	1.36	2.41	4.38	31.13
2004	-0.33	1.24	7.11	0.15	-1.14	3.93	-2.14	4.01	0.23	-1.21	1.30	1.51	15.24
2003	1.80	1.98	0.41	-0.10	2.55	3.48	1.54	5.20	3.86	3.55	-1.67	3.06	28.63
2002									1.68	-4.38	-3.66	-0.42	-6.73

**Initial Series (Inception December 1999)**

2014	-5.74	-2.71	0.35	-1.66	3.10	4.44	0.14	-0.96	1.86	-0.08	2.46	1.24	2.03
2013	6.42	0.71	3.86	12.97	-3.76	2.51	1.77	-2.81	7.91	-2.42	1.11	1.36	32.43
2012	1.10	4.89	1.47	-2.89	-4.99	2.49	-1.71	-1.10	1.11	0.37	1.73	6.09	8.33
2011	3.37	2.09	-3.44	-0.51	0.85	0.17	-0.42	-3.90	-0.79	-0.09	-2.49	-0.27	-5.53
2010	1.94	-1.54	5.81	2.70	-5.94	-3.25	0.47	-1.86	2.84	1.01	1.36	3.86	7.03
2009	-1.74	-2.21	1.90	0.53	0.79	-0.44	0.26	2.54	-4.79	-0.72	-5.15	3.05	-6.16
2008	-6.62	2.17	-0.71	6.19	1.42	-5.97	-0.78	-5.37	-0.08	-0.42	-6.38	3.23	-13.38
2007	1.96	0.58	-0.99	1.35	3.47	2.23	-0.89	-6.99	1.85	0.40	-6.68	-4.73	-8.77
2006	1.82	0.42	3.79	0.34	-4.04	0.24	-0.77	1.46	0.13	2.72	0.99	2.62	9.91
2005	2.83	2.05	0.00	-0.14	1.04	1.37	2.38	4.15	6.71	1.31	2.39	4.30	32.12
2004	-0.33	1.22	7.01	0.23	-1.20	3.95	-2.26	4.03	0.82	-1.55	1.65	1.92	16.21
2003	1.80	1.98	0.41	-0.20	2.65	3.97	1.91	5.90	3.81	3.58	-1.73	3.02	30.43
2002	1.10	1.47	2.07	-0.26	7.13	-2.92	-1.46	-1.39	2.04	-4.47	-3.65	-0.44	-1.30
2001	-2.34	3.13	1.36	8.47	-2.14	3.96	-2.87	1.49	-3.58	1.77	-3.89	-5.46	-1.00
2000	-0.32	12.76	8.99	-1.53	2.45	11.82	-9.05	4.02	-0.37	0.90	-0.18	-3.86	26.13
1999												0.58	0.58

**Optimal** FUND MANAGEMENT

Should you wish to make an enquiry about the Optimal Japan Trust, please see our website [www.optimalasia.com](http://www.optimalasia.com) or contact us by email at [optimal@optimalasia.com](mailto:optimal@optimalasia.com).

SYDNEY: Level 5, Wyoming, 175 Macquarie St, Sydney NSW 2000 Phone: 61 2 8239 3300 Fax: 61 2 8239 3333 Email: [optimal@optimalasia.com](mailto:optimal@optimalasia.com)

**DISCLAIMER:**

This material is for your private information and we are not soliciting any action based upon it. Opinions expressed are our opinions only. The material is based upon information, which we consider reliable, but we not represent that it is accurate or should not be relied upon as such. Past performance is not an indication of future performance. This material is not intended for distribution in Japan or for Japanese domiciled entities.