MONTHLY REPORT TO SHAREHOLDERS OF OPTIMAL JAPAN TRUST

Monthly Performance % - *as at 28 February 2014*

	NAV	February	YTD	AUM
A$ Series 1	A$13.63	-2.71%	-8.46%	A$23M

The weak start to 2014 by Japanese equities continued into February with the market falling sharply at the start of the month before climbing from the early lows to finish down just under 1% in Yen terms. Japanese individuals have continued to feature on the buy side while foreigners have been sellers until changing course late in the month. The term "investor tourists" has gained currency in recent times and describes well those who manage the large pools of money that move to and fro seeking quick and sizeable returns across the globe and across the varying asset classes. The money is "unhinged" in the sense that it does not take reference from any index and is often leveraged to maximise the gains. These "tourists" were all over the Japanese market in early 2013 and their fingerprints could be found on the huge tally of Nikkei index futures contracts bought by foreigners at that time. They have also left their mark in 2014 in the heavy selling of these same Nikkei contracts. In CY2013, the Nikkei rose almost 57% while the less arbitraged and less liquid Topix index rose by 51%. So far in 2014, the Topix is outperforming as the tourist money leaves via the Nikkei futures.

Are they right to be selling? Reasons given to exit Japanese equities in search of better investments include: Abe's 3rd arrow has misfired and nothing is happening on regulatory reform; the trade deficit shows weak Yen is not working; Bank of Japan is not doing enough; consumption tax hike will dampen any recovery on the domestic front; vested interests will prevent Japan joining the TPP, just to name a few. There are kernels of truth in some of the criticism, and it is absolutely understandable that investors are sceptical of success after so many lean years, but most of it is evidence of investment short-termism and an addiction to central bank spoon-feeding that has become widespread over the past decade or two. We think the results since Mr Abe began his second term as Prime Minister are impressive, that policies are sufficiently stimulatory, that the Diet has been active already in passing legislation to deregulate and that the new bills coming to the Diet over the next few months will only further the momentum for reform. Foreign perception of the attractiveness of Japanese equities is very important, but ultimately, what all of us want is to see domestic investors (individual and pensions) regain some confidence in the investment outlook and redress their bias away from Japanese equities. Time will tell.

We were in Japan last week and spent time at a conference organised by one of the big Japanese brokers. It was well attended – as had been a similar event run by a foreign broker the week before – and the line-up of speakers and presenting companies was extensive and impressive. Optimistic was the tone struck by Prof Heizo Takenaka, economic adviser to former Prime Minister Koizumi, but he made mention of a recent lunch he'd shared with Mr Kuroda of the BoJ, whose optimism on inflation and the economy dwarfed his own. The BoJ's estimate of trend GDP growth is only 0.7% and as GDP is currently expanding at around 1.5%, Mr Kuroda sees the output gap closing rapidly and thereby helping to offer support for firmer pricing.

We also heard a speech by Mr Ishiba, Secretary General of the ruling LDP, which struck a very forthright and confident tone about the changes that Mr Abe's government is introducing. Mr Ishiba gave the air of a man who would not brook dissent and who was committed to the task of raising Japan from the mire and reinstating it in the league of successful countries as it once was. His speech touched on the need for wages to rise to boost domestic demand, claimed that exports were not rising as strongly as some expected because Japanese companies were now producing so much outside Japan in locations near their end-consumers, and that by raising consumption tax, Japan would have the latitude to lower corporate tax and offer tax incentives for companies who invest. He said there was excessive competition in many industries (singling out whitegoods) and that they had to reach a successful conclusion to the TPP talks so that they could revitalise agriculture and attract new (corporate) entrants to the sector.

For someone who had written Japan off as an irrelevance, these presentations would have come as a jolt to their senses. To those of us who do believe that positive change is under way, the impression was reinforced and redoubled. The investor tourists might have decided that they can make more money in other places for now, but this story has legs and they will return.

The Fund has had a poor start to the year as our bias to financials and domestic sectors such as real estate has been a drag. Banks, where the Fund has almost 21% of its assets, have fallen 12.6% YTD while the Topix is down by 7%. Real estate, where we are similarly well represented, has fared even worse with a decline of almost 21% to the end of February. Aside from holdings in external demand-led stocks like Honda, Mitsui OSK, Fuji Film, Komatsu and Hitachi, the portfolio has more of a bet on domestic demand sectors such as retail, real estate, financials, construction and leisure. Quite a few of these are small & mid cap stocks and not covered by a lot of analysts but they are well placed to lead their sectors and grow revenue and profits from the recovery in domestic consumption. Examples of these that were among the best contributors for us in February were infrastructure/ construction firm Kyowa Exeo and travel agency H.I.S. We hold these positions with more conviction than ever, believing that they are well managed and well placed to see pricing and profitability improve. The portfolio trades on a 12 month forward PER of less than13x and has an average RoE of 11%. A positive, and patient investment stance will pay off for investors.

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

Recent 3 month Fund Exposure			
% of NAV in	**Dec 13**	**Jan 14**	**Feb 14**
Long Stock Positions	103.63	113.04	105.66
Short Stock Positions	-6.91	-7.72	-8.14
Index Futures	-14.48	-19.75	-19.69
Equity Derivatives	-	-	-
Net Exposure	82.24	85.57	77.83

Optimal FUND MANAGEMENT

Should you wish to make an enquiry about the Optimal Japan Trust, please see our website www.optimalasia.com or contact us by email at optimal@optimalasia.com.

Position Concentration	Top 5	Top 10
Longs	39.88%	62.89%
Shorts	-8.14%	-
Total no. of positions	33	

Top Five Positions
Mitsubishi UFJ Financial Group Inc
Sumitomo Mitsui Financial Group Inc
Itochu Corp
Nippon Steel & Sumitomo Metal Corp
Nomura Holdings Inc

Winners
Sanrio Co Ltd
Kyowa Exeo Corp
Mitsui & Co Ltd
Hoya Corp
H.I.S Co Ltd

Losers
Sumitomo Mitsui Financial Group Inc
Mitsubishi UFJ Financial Group Inc
Iida Group Holdings Co Ltd
Nippon Steel & Sumitomo Metal Corp
Nomura Holdings Inc

Sector Exposure ***as at 28 February 2014***

	Longs	Shorts	Net
Consumer Discretionary	26.76%	-2.51%	24.25%
Consumer Non-Discretionary	-	-2.84%	-2.84%
Energy	-	-	-
Financials	31.20%	-	31.20%
Futures	-	-19.69%	-19.69%
Health Care	-	-	-
Industrials	23.42%	-	23.42%
Information Technology	13.02%	-	13.02%
Materials	11.26%	-	11.26%
Telecommunications	-	-2.79%	-2.79%

Performance Contribution	Longs	Shorts	Futures	Other	FX Forwards	Total
February 2014	-3.18%	-0.02%	-0.04%	-0.42%	0.95%	-2.71%

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

Historical Returns – Distribution Reinvested

Optimal Japan Trust Net Monthly Returns in AUD %

Annual Distributions

Year to Jun 00 *A$1.4158*
Year to Jun 01 *A$0.8989*
Year to Jun 02 *A$0.8983*
Year to Jun 04 *A$0.4713*
Year to Jun 05 *A$1.4218*
Year to Jun 06 *A$1.2446*
Year to Jun 07 *A$2.4179*

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
Series 1 (Inception August 2002)													
2014	-5.91	-2.71											-8.46
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											-8.29
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

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