MONTHLY REPORT TO SHAREHOLDERS OF OPTIMAL JAPAN TRUST

Optimal FUND MANAGEMENT

Monthly Performance % - *as at 28 February 2017*				
	NAV	**February**	**YTD**	**AUM**
A$ Series 1	A$11.364	-0.12%	0.29%	A$8M

Notwithstanding the media's alarm at the many utterances and decisions of President Trump and other leading politicians, financial markets have been calm so far in 2017. Economic conditions – measured by such indicators as the Economic Surprise indices for each country - are improving in many regions, deflation is no longer front page news, and labour markets have also brightened in a number of countries. There was a long period of time in financial markets when poor economic news fed into higher bond markets, lower interest rates and firmer equity prices, but as short rates were progressively cut and bond yields headed below zero, this perverse state where "bad news is good for markets" has dissipated, and, arguably reversed. The better economic conditions have not yet tempted investors to wade back into markets with any enthusiasm, as evidenced by the cash levels at the large institutional investors which are closer to historic highs than lows.
Is the lack of bad news actually bad news for markets? Perhaps so, but with plenty of long-term issues (ageing demographics, job replacement by technology) that warrant worry, if not downright fear, exuberance for equities is difficult to find.

We have been following the progress of Japan and Japanese companies in improving governance and alignment with minority shareholders. Although there is still much scepticism, (and why wouldn't there be after such a long period of indifference?) we see more evidence of improvement as each month goes by and hold high conviction that this is a major positive factor in assessing the outlook for Japanese equities. In February we saw a number of high profile companies take actions that should lead to improvements in corporate performance and their share prices. Kirin Holdings bit the bullet and sold their struggling Brazilian brewing unit for over a $1bn less than they paid for it back in late 2011. The sale price is actually higher than the written-down valuation the assets are held at on their balance sheet, but having visited Kirin HQ only last week, we believe that selling the business and freeing management from the task of trying to turn it around will be a net plus for shareholders. It was clear to us that a painful and costly lesson has been learned.

Other announcements include the long-anticipated unwinding of cross shareholdings between Fuji Electric and Fujitsu and buy-backs from Rakuten and Nishio Rent All. Rakuten's shares have been poor performers over the past couple of years and their founder, Chairman and major shareholder Mr Mikitani has seen his wealth fall sharply since the shares peaked at over Y2300 just before the company issued Y190bn of new shares in July 2015 at a price of Y1905. With the shares below Y1050 on 21 February, the company announced a buy back of up to Y100bn of stock, so at least they are following the mantra of "buy low, sell high".

It will be interesting to watch how things track from here. While there are doubts about the operating business model Rakuten's management have in place, they would get a plus for capital management at least.

Years and years of inertia in Japan have led global investors to believe nothing will ever be done by government or companies to address the problems of low growth, inefficient allocation of capital and scant attention to shareholder returns. They would have lots of years of inactivity as supporting evidence of their view. We disagree. Having met with a dozen or more companies last week in Japan, we are convinced that there is real change underway and this process is both significant, durable and will inevitably be a shock to the sceptics. In most meetings, it becomes clear that organisation structures have been – and continue to be – simplified. Hitachi is one of our core positions, and despite still having nine (going to eight soon, as the IR man eagerly pointed out) business divisions, this is being simplified as the board force management to focus on returns, efficiency and justification for capital and management time. Panasonic is neater with four current divisions, although inside these divisions are numerous separate segments, and while not as developed as Hitachi in board composition, diversity and governance, they too are eager to simplify and boost returns. We believe the role of a good board cam make a huge difference to corporate performance and shareholder returns, and simplifying and focusing the business is one key aspect. A recent study by Daiwa Securities of the stock price performance of the largest 30 companies (ex-financials) in the index confirms that returns have been best at the companies where sales are concentrated in their biggest business segment and the next group was the companies with diverse segments but where there are few transactions between the segments. In this type of company, there were more spin-offs than in the diversified group with a large number of inter-segment transactions.

The survey was conducted only from 2002 and the classification methodology might be questioned, but to us, the results are in keeping with better management and governance that we witness more often now than in past years. The sceptics have history on their side, but we believe they are fighting the last war and risk missing the change underway. It is time to reassess the outlook for Japanese equities and we are bullish.

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Recent 3 month Fund Exposure			
% of NAV in	**Dec 16**	**Jan 17**	**Feb 17**
Long Stock Positions	81.32	68.24	96.09
Short Stock Positions	-9.24	-11.11	-10.39
Index Futures	-17.31	-12.70	-17.46
Index Options	-	-	-
Net Exposure	54.77	44.43	68.24

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	33.65%	57.88%
Shorts	-10.39%	-
Total no. of positions	29	

Top Five Positions
Mitsubishi UFJ Financial Group Inc
Mitsubishi Estate Co Ltd
H.I.S. Co Ltd
Sekisui House Ltd
Panasonic Corp

Winners
DMG Mori Co Ltd
Izumi Co Ltd
Kasai Kogyo Co Ltd
Panasonic Corp
Toray Industries Inc

Losers
Hitachi Ltd
Baroque Japan Ltd
Nichii Gakkan Co Ltd (short)
Voyage Group Inc (short)
Marubeni Corp (short)

Sector Exposure *as at 28 February 2017*			
	Longs	**Shorts**	**Net**
Consumer Discretionary	47.16%	-	47.16%
Consumer Non-Discretionary	-	-	-
Energy	-	-	-
Financials	20.04%	-3.30%	16.74%
Futures	-	-17.46%	-17.46%
Health Care	-	-3.11%	-3.11%
Industrials	14.31%	-3.98%	10.33%
Information Technology	7.22%	-	7.22%
Materials	7.36%	-	7.36%
Telecommunications	-	-	-

Performance Contribution	Longs	Shorts	Futures	Other	FX Forwards	Total
February 2017	0.71%	-0.71%	-0.13%	-1.03%	1.04%	-0.12%

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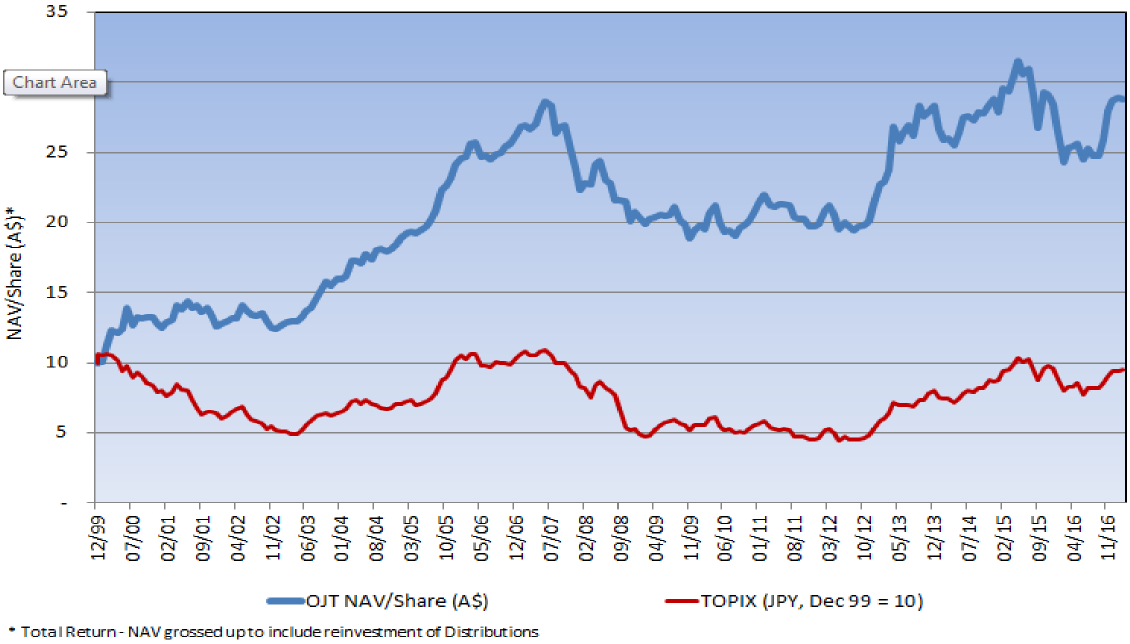
Portfolio Performance as of *28 February 2017*



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 to Jun 14*** *A$2.8013*
Year to Jun 15 *A$0.2631*	***Year to Jun 16*** *A$0.5317*		

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
Series 1 (Inception August 2002)													
2017	0.41	-0.12											0.29
2016	-6.82	-8.23	4.34	0.12	0.80	-4.38	2.94	-1.87	0.07	4.76	7.73	2.91	1.08
2015	-3.51	6.35	-0.72	3.61	3.41	-2.69	1.03	-6.01	-7.96	9.34	-0.53	-2.30	-1.37
2014	-5.91	-2.71	0.37	-1.68	3.12	4.40	0.27	-1.02	1.90	-0.08	2.37	1.32	1.92
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	-1.01	-6.98	1.88	0.35	-6.70	-4.69	-8.88
2006	1.82	0.43	3.86	0.35	-4.05	0.18	-0.79	1.43	0.13	2.10	0.77	2.49	8.85
2005	2.74	2.02	0.07	-0.14	0.99	1.47	2.01	3.68	6.81	1.36	2.41	4.38	31.38
2004	-0.33	1.24	7.11	0.15	-1.14	3.93	-2.22	4.01	0.23	-1.21	1.30	1.51	15.15
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

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