MONTHLY REPORT TO SHAREHOLDERS OF OPTIMAL JAPAN TRUST

Monthly Performance % - *as at 31 October 2016*	NAV	October	YTD	AUM
A$ Series 1	A$10.221	4.76%	-8.83%	A$9M

Are we in the first stage of the Great Rotation out of bonds and into equities or is just a temporary blip in the 34 year mega-bull market in bonds? Topix is up almost 12% since early July when the 10 year JGB yield flirted with a yield of -0.3% (now -0.06%) and the three worst performing sectors since then are the "low-vol" bond proxies railways, foods and drugs. All three sectors had been massive outperformers in the preceding two and a half years during which time Topix had fallen 5% and financials fared a lot worse. On valuations alone, the switch out of the defensives should have a lot more room to run.

Over the same period the US10 year bond yield has jumped from 1.35% to 1.82%, but a year ago it was at 2.35%, so it is hard to draw a conclusion from the evidence. It strikes us as far-fetched to hope for conclusive evidence however, because surely if we had it, the bond yield would be considerably higher and the opportunity for profitable investment would have passed. As has ever been the case, investors are left to rely on conjecture, hope and solid analysis.

Foreign investors have been large net sellers in 2016 as their hopes for a "catalyst" have been disappointed. During October's strong rally in the index however, foreigners turned to net buyers, joining Trust Banks (pension funds) on the positive side while individuals resumed their habitual role of sellers into strength. Japan specialists and value investors are unlikely to want to sell at the current valuation levels and with positive signs from companies as indicated by buy-backs, mergers and other improvements in corporate governance. The more market agnostic, macro-driven opportunistic investors have decamped from Japan and moved to newer pastures, leaving the supply-demand outlook for equities very favourable. Japan's institutional investors might not be frothing at the mouth to buy more domestic equities, but they have been consistent net buyers over the past year, whereas it would seem that they have little in the way of demand for domestic bonds. Late in the month, there was a day when there was no trading at all in the 10 year JGB and while not the first time this had occurred, it is still an extreme rarity and an unusual state of affairs. We would not want to buy a bond yielding -0.06% either, so we find the lack of interest at these prices from Japan's institutions to be indicative of a welcome, if belated, change of attitude.

Companies are midway through the results for the 2nd quarter (and thus 1st half) of FY3/17 and positive surprises outnumber negative ones by a modest margin. The stronger Yen has hurt profits – especially the manufacturers – and companies are being cautious with their revised forecasts for the second half, but analysts' expectations are higher and we would tend to agree. Having been overly optimistic with the FX assumptions coming into FY16, companies have opted to go conservative for the coming six months with many using Y100/$ and Y110/EUR as the bases for their profit forecasts. We don't expect we will get back to Y120/$ in the next six months, but see Y110 as more likely than Y100 and expect company forecasts to be proven overly cautious.

It is always a welcome change to read an FT article on Japan which is positive. In last weekend's edition, the FT carried a piece on the nascent boom in M&A in Japan, most recently highlighted by the announcement that the big three Japanese shipping companies would merge their container ship operations. The thrust of the piece is that after decades of bitter rivalry and competition, Japanese companies are finding it more palatable to team up and cooperate with one of their own, rather than risk going out of business, or being prey to foreign predators. Sharp's corporate decline and subsequent takeover by Taiwan's Hon Hai would have sent a massive wake-up call to many Japanese companies still believing they could remain independent and compete in a world of larger global rivals. Domestic competition in Japan is more fierce than anything they find outside, so by joining forces with - or at least stopping relentless competition against – old domestic rivals, companies stand a far better chance of boosting revenues and, importantly, returns on capital.

Although corporate earnings can never be immune to competition and the business cycle, it seems clear to us that income-hungry Japanese pension funds and insurers should be able to find higher yields and overall returns from their equity investments in Japan than they will find by buying IOUs written by the Japanese government. Now that they have a vested interest to see that happen, they will be a more powerful agent for change in Japanese corporate attitudes than any number of foreign activist investors and editorials in the foreign financial press.

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Recent 3 month Fund Exposure			
% of NAV in	**Aug 16**	**Sep 16**	**Oct 16**
Long Stock Positions	86.52	86.35	96.11
Short Stock Positions	-3.15	-6.22	-6.47
Index Futures	-65.75	-28.77	-18.49
Index Options	-	-	-
Net Exposure	17.62	51.36	71.15

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	31.77%	54.28%
Shorts	-6.47%	-
Total no. of positions	29	

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

Winners
Hitachi Ltd
Mitsubishi Estate Co Ltd
Mitsubishi UFJ Financial Group Inc
H.I.S. Co Ltd
Mitsubishi Electric Corp

Losers
Nikkei Index Futures (short)
Marubeni Corp (short)
Japan Post Bank Co Ltd (short)
Mitsui Fudosan Co Ltd
Trust Tech Inc

Sector Exposure *as at 31 October 2016*	**Longs**	**Shorts**	**Net**
Consumer Discretionary	33.06%	-	33.06%
Consumer Non-Discretionary	2.85%	-	2.85%
Energy	-	-	-
Financials	24.23%	-3.17%	21.06%
Futures	-	-18.49%	-18.49%
Health Care	-	-	-
Industrials	24.07%	-3.30%	20.77%
Information Technology	7.13%	-	7.13%
Materials	4.77%	-	4.77%
Telecommunications	-	-	-

Performance Contribution	Longs	Shorts	Futures	Other	FX Forwards	Total
October 2016	6.43%	-0.35%	-1.48%	-3.31%	3.47%	4.76%

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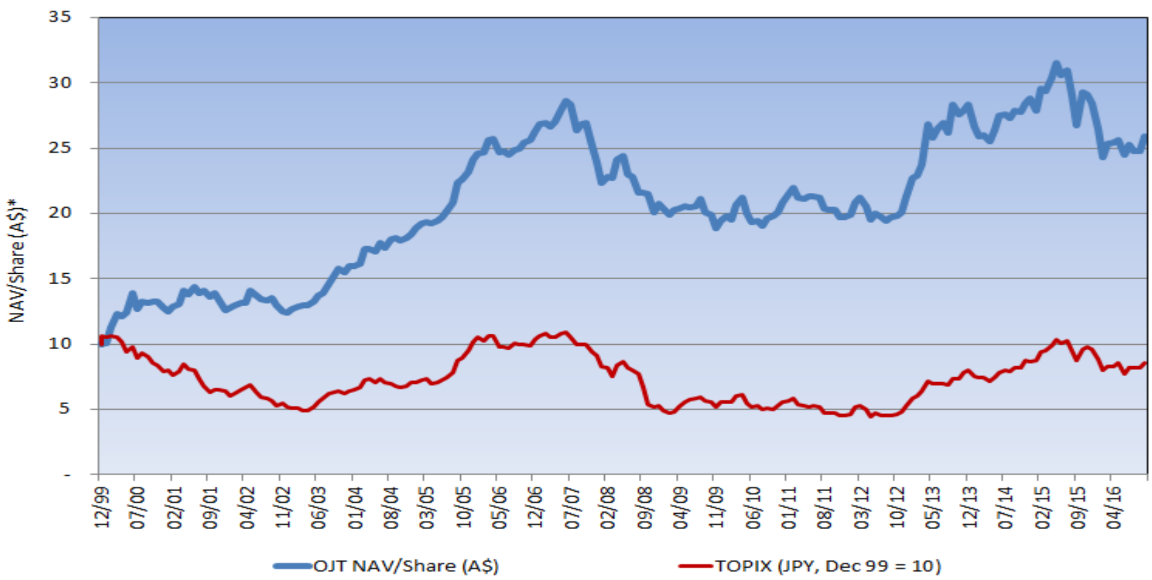
Portfolio Performance as of *31 October 2016*



* Total Return - NAV grossed up to include reinvestment of Distributions

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)													
2016	-6.82	-8.23	4.34	0.12	0.80	-4.38	2.94	-1.87	0.07	4.76			-8.83
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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