FOCUS Japan

CAT FUND

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May 2008

The Turnaround in Japan?

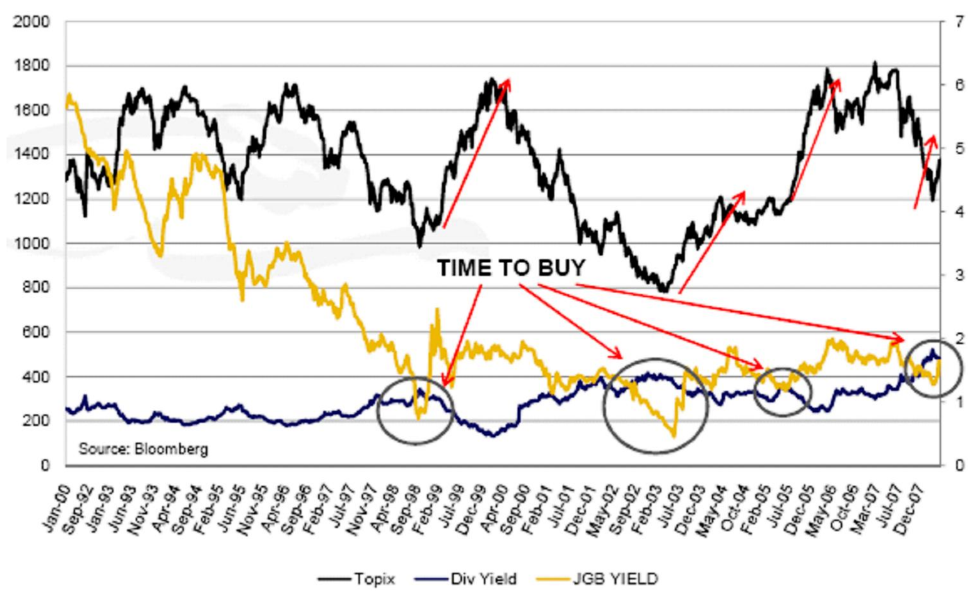
From Deflation to Inflation

CPI in March was announced at +1.2% yoy, the highest number in 10 years. The BOJ is now expecting FY08 CPI at 1.1% and FY09 at 1%. The expectations for GDP are now at 1.5% for FY08 and 1.7% for FY09. At last inflation is back in Japan. This represents a major change after a 20 year period of deflation.

Japanese Government Bond yields have risen substantially in the last 10 days (10 year JGB yield moved from 1.33 to 1.63 in just over 2 weeks). Over the long term we expect interest rates to rise gradually and this would be very positive for consumer spending as Japanese households hold over US$ 7.5 trillion on accounts that would earn some interest. Inflation can also stimulate consumer spending if it translates into expectations of wage growth later in the year.

Topix dividend yield versus 10 year Japanese Government Bond yield

Another supporting factor is that the Topix dividend yield has been until recently higher than the 10 year Japanese Government Bond yield which in the past signaled a bottom in the market. This situation occurred in 1998, 2003, 2005 and was followed by a rising market in the following months.



Corporates

Corporates are buying back more of their own shares and increasing their dividend payout. Over 55% of all listed stocks trade below their book value. We have seen US value investors coming back recently as they are finding value in Japan after 20 years.

Japan benefits from ongoing Asian economic growth. Exports to US accounts now only 20% of total exports while Asia is still on the rise at around 50%. Exports to US showed some weakness largely compensated by strong figures to EU and Asia. While we expect near-term weakness in exports due to a slowdown in the US, we do not project a sharp deterioration as exports increasingly go to Asia and emerging markets. In these countries, led by domestic demand, economic growth appears more sustainable.

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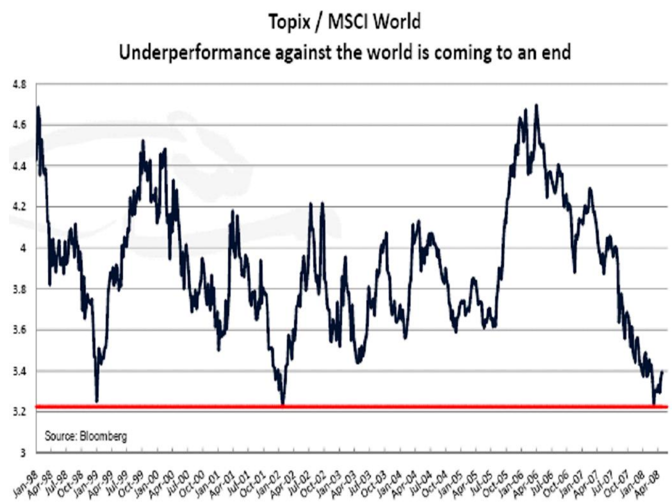
Technicals

The Japanese market has marked a major bottom in mid-March when it rebounded at its 61.8% retracement point from the 2003/2007 bull-run. At the same time the USD/YEN marked an important bottom. The April monthly closing reading also confirmed the break of the September 2007 downward trend. Moreover the Topix has confirmed its 1999 and 2002 relative cycle low against the MSCI World index. This leads us to believe that the Japanese market is ready for a rally in absolute terms as well as an outperformance to major Western peers.

Major investors have a massive underweight allocation in Japan compared to other markets. This can only translate in a positive supply and demand situation particularly if the relative outperformance of the Japanese market continues as we expect.



Investment Ideas

- The **Cat Nippon Convert**, which is a long only convertible bond fund, would be the ideal investment for more conservative portfolio profiles. Convertible bonds generate a higher risk-adjusted return compared to a combination of bonds and equities thanks to their asymmetrical risk/reward profile.
- **Catam Japan Advantage** is a long only equity fund which invests in large and mid caps.
- The **FIT Japan** is a long only equity fund which invests in the small cap universe. Average price to book of the portfolioȏs holdings is currently 0.45 x.

For more information about these funds, please do not hesitate to contact us or visit our website **www.cat-fund.ch**

Cat Fund AG
Member of the Cat Group AG
info@cat-fund.ch
www.cat-fund.ch
www.cat-group.ch

Geneva +41 22 311 35 25
Zurich +41 43 311 26 11
Liechtenstein +423 384 40 00