

Merrill Lynch Investment Managers  
Sub-fund of Luxembourg domiciled Sicav - Part 1  
Report Issued: June 2006

**Peer Group:**

Japan Small and Mid Cap

**Fund Manager/Adviser:**

Hiroshi Tateda (since January 2000)

**Location:**

Tokyo

**Launch Date:** May 1987

**Fund Size (March 2006):**

US\$1.9bn, ¥223.5bn

**Group Contact No:**

+352 342 0101

**Website:**

www.mlinternational.com

**S&P ID Number:** OS359861

**Underlying share class:**

ADS £

For additional details see Fund

Charges and Group Profile

information.

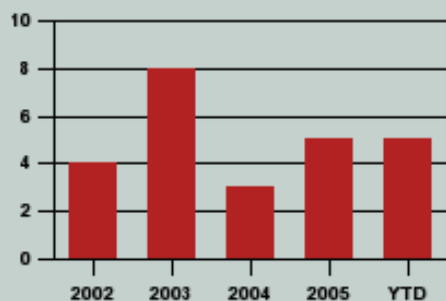


### INVESTMENT STYLE

	Value	Blend	Growth
Large-Cap			
Mid-Cap			
Small-Cap			

**AS THE FUND IS UNDER THREE YEARS OLD THERE IS INSUFFICIENT PERFORMANCE DATA FOR RISK/RETURN ANALYSIS.**

### CALENDAR YEAR DECILE RANKS



Decile ranking in discrete annual periods. 1st decile shown as rank 10, 2nd decile as rank 9, etc. to 10th decile as Rank 1.

All statistical data on this report has been run to 28/02/2006 on NAV to NAV basis, with gross income reinvested, in Japanese Yen.

### STANDARD & POOR'S OPINION (MAY 2006)

This is one of the largest mid-/small-cap funds in the Japan equity sector. Being over US\$1.9bn in size places a constraint on the manager's ability to take meaningful positions in sub-\$300m companies and in turn, has hindered performance, most noticeably in the second quarter of 2005.

Merrill Lynch has a team of five Japanese equity specialists based in Tokyo, led by the highly experienced, Hiroshi Tateda. Changes, if any, resulting from the proposed merger of Merrill Lynch's asset management arms with those of BlackRock will not be known until September at earliest.

The other team members are far less experienced (typically five to seven years) and while three of them only joined the team within the last 18 months, the investment approach is team-focused and highly disciplined. Research responsibilities are organised

by top-down themes, rather than by sector, with each theme covered by a lead and a support analyst. The same lead/support approach is applied to individual company research which, unlike for most funds in the peer group, follows a pure quality growth philosophy with the primary focus on earnings growth. Most managers in the sector tend to be either value-oriented, or rather more pragmatic in their style biases.

As stated previously, we are concerned that the size of the fund may have dulled its competitive edge, already restricted by the manager's strict pure growth approach. Returns in 2005 were again disappointing, but were confined largely to a strong second-quarter rally in small-caps. Although under pressure, the fund retains its single A status.

### FACT FILE

**Group:** Merrill Lynch Investment Managers (MLIM), the integrated investment management business of Merrill Lynch & Co., Inc, is being sold to BlackRock on the 1 October, 2006. Merrills will retain a 49% stake in the merged entity.

**Team:** Hiroshi Tateda heads the specialist team of five manager/analysts focusing on Japanese mid-/small-cap stocks. Their research is organised along thematic lines, rather than sectors.

**Fund Manager:** Tateda has 18 years' experience, including nine on Japanese mid-/small-caps. He has

managed this fund since joining Merrill Lynch in 1997 and has been the team head since 2000.

**Style:** The fund is run in a thematic, bottom-up style. Risk controls are pragmatic with a maximum 5% position in any one stock. Focus is on companies likely to benefit from the "new growth" areas in Japan.

**Performance:** Since launch to 28/02/2006, the fund has returned 68.2%, compared with 74.9% for the sector median and 146.0% for the index, ranking 49/72.

### FUND MANAGER & TEAM

Merrill Lynch has a team of five Japanese equity specialists based in Tokyo and led by Hiroshi Tateda. Assets under management are around US\$4bn with a focus on mid-/small-cap mandates. With the exception of Tateda, most team members have five years' or less experience in the Japanese mid-/small-cap market.

Research is organised along investment themes, rather than by sector. Each analyst has lead responsibility for one theme and a support role on another. There is a similar lead/support pairing of analysts for fund holdings. The team conducts over 600 company meetings a year. Additional input is taken from the large-cap team in Tokyo and from across the ML group.

Hiroshi Tateda - head of small-cap team - law (Keio University), began his career in 1998 at Meiji Life Insurance where he worked in Japanese and US fixed income and then US equities, before moving to MLIM in 1997 to manage Japanese smaller company funds.

## PORTFOLIO CHARACTERISTICS

No. of holdings	72
Turnover ratio (%)	N/A
% in top 10	38

## TOP 10 HOLDINGS (01/03/06)

	%
Taiheiyo Cement *	4.9
OMC Card *	4.6
Misumi	4.1
Sky Perfect Communications	4.1
Suruga Bank *	3.9
Nachi-Fujikoshi	3.8
Sanken Electric *	3.5
Goldcrest	3.4
Japan Aviation Electronics *	3.2
Sumitomo Wiring Systems	3.0

\* In top 10 holdings a year ago

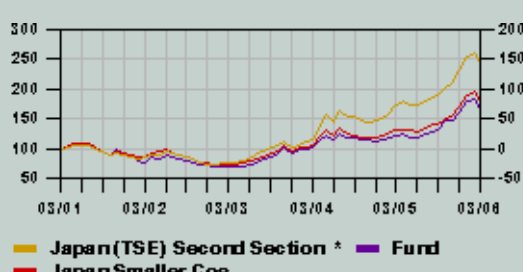
## ALLOCATION BREAKDOWN (01/03/06)

	Fund %
Consumer Discretionary	28
Consumer Staples	2
Energy	-
Financials	9
Industrials	24
Materials	13
Utilities	-
Telecoms	-
Healthcare	-
Information Technology	18
Others	1
Cash	5

## PERFORMANCE STATISTICS

	Launch
Fund	68.2%
Standard & Poor's Peer Median	74.9%
Index**	146.0%
Fund Rank	49/72
Standard Deviation	-
Relative Standard Deviation	-
Volatility Adjusted Ranking	-

## CUMULATIVE PERFORMANCE



# MERRILL LYNCH INVESTMENT FUNDS JAPAN OPPORTUNITIES FUND

Peer Group: Japan Small and Mid Cap



## MANAGEMENT STYLE

The fund is run in a bottom-up manner, emphasising quality growth stocks within a thematic framework. The aim is to beat the S&P EMI Japan index from a diversified portfolio that is not constrained to benchmark stocks.

The average market-capitalisation of the portfolio tends to be higher than in many competitor funds due to the higher exposure to mid-cap stocks.

Tateda defines his investable universe as the now 1,160 companies capitalised at between \$300m and \$3bn. All of these companies are analysed within the context of the team's top-down view on global trends and Japanese investment themes such as

the "New Japan" growth industries, outsourcing, changing demographics, the new media, health services and IT.

Stock selection within these themes is bottom-up, focusing on management quality and its ability to adapt quickly to change, apply good corporate governance and manage cashflows. Strong earnings growth and pricing power are also key criteria.

Tateda targets 50/80 holdings, the top end of the range, reflecting IPO activity and small positions in less liquid ideas. Most positions are built gradually from around 0.5% to a maximum of 5%.

The fund is usually fully invested.

## PORTFOLIO REVIEW

The manager's disciplined approach has been reflected in the way that he has maintained the broad shape of this portfolio despite significant cash inflows that have taken the fund to above \$1.9bn over the last 12 months.

Having cut back on the number of holdings in 2004, Tateda has since stayed in the lower 70s and kept the top-10 concentration at around 38% of total portfolio assets.

The capitalisation split has held at around 25% mid-caps and 75% small-caps throughout most of the year, edging closer to 30% mid-caps towards the year-end.

Cash has at times hit 10% as Tateda has waited for appropriate investment ideas, but has been down to the 3% mark for several months.

Thematic exposures, although modest, have evolved in favour of health services, new media services and IT, at the expense of niche growth stocks, financial services and outsourcing. Stock selection has focused on companies with strong earnings growth, rather than value plays and momentum-driven re-ratings.

## PERFORMANCE ANALYSIS (MARCH 2006)

After two years of disappointing returns relative to the peer group the fund's three- and five-year cumulative returns are now below the sector median.

However, returns over 12 months to March 2006 were only marginally below the sector median and largely a result of a poor Q2 2005 when small-caps, then relatively low in this fund, and low quality value plays, outperformed.

In sharp contrast, Q3 was particularly strong, with the fund regaining all of Q2's losses and adding a little bit more. Success came from

strong stock selection, notably financial service companies OMC Card, Suruga Bank and HS Securities; niche growth stocks Fast Retailing and Zensho; and "old economy" Taiheiyo Cement.

Since October 2004 relative gains have been given back as both OMC Card and HS Securities have turned down sharply, along with the likes of Uniden and Goldcrest. First quarter 2006 returns have held up through stock successes including Nachi-Fujikoshi, Taiheiyo Cement, Gulliver and Tokai Carbon.

	2002		2003		2004		2005		YTD 28/02/2006	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
Fund	-20.9	51/81	41.2	27/90	16.7	73/99	56.9	60/105	-6.8	58/109
Index**	-12.8		43.9		40.9		71.4		-3.8	
Median	-17.1		39.1		20.8		57.6		-6.6	

\*\* Japan TSE Second Section

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