

# Pelargos Japan Alpha Fund

## August 2016



### Fund Performance

The Pelargos Japan Alpha Fund Class B declined -1.05% in August. Since July 2008, inception-to-date (ITD), the fund is up +50.48% with a realized volatility of 7.4%, whilst the MSCI Japan is down -1.5% ITD with a realized volatility of 20.3%.

### Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,315.01	-1.09%	-1.61%	31.50%
Class B EUR	1,504.83	-1.05%	-1.27%	50.48%

### Market Environment

In August, the MSCI Japan advanced +1.3%. The bounce continued after the June crash but lost momentum last month as only the last trading day lifted the market into positive territory.

Despite the broader market trading sideways in August, sector rotation was quite extreme. Banks appreciated 10% whilst defensive sectors such as Food & Beverages declined by 7%. Sectors and stocks with very low 1-year price momentum performed well in August. Thus, cyclical sectors were amongst the winners and defensives underperformed. This style performance is a continuation of July, when the rotation started. Cyclical stocks are inexpensive and very cheap compared to defensives.

The market continued to exhibit very systematic behavior based on our factor return analysis, which indicates a persistent top-down approach to risk allocation rather than rewarding single stock picking.

In August, the long book significantly outperformed the short book but the long book underperformed the market itself. Only 40% of our 47 long positions were up last month. Over the long run, the long book outperformed the market by a wide margin. Last month banks performed very well and historically we have had little exposure to banks as the analytical value added is limited. The only bank exposure is a long position in super-regional bank Resona. With a 4% dividend yield, 7x P/E, 0.65x P/B and aggressive shareholder returns policy, we think the attractiveness of low risk/high reward outweighs worries relating to margin compression from negative interest rates.

### Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Banks	10.7%	-20.4%	0.4	9.0
Materials	6.3%	-17.1%	0.8	13.0
Semiconductors	6.1%	-6.9%	1.1	17.1
Industry Group	MTD	YTD	PB	PE
Transportation	-8.0%	-5.4%	1.0	14.3
Food Beverage	-7.2%	11.6%	1.3	22.7
Pharma	-7.0%	13.3%	1.5	22.2

Source: Bloomberg

### General Statistics

% Return long book	-1.2%
% Return short book	-3.2%
# Long stocks	47
# Short stocks	13
% Long stocks ↑	40%
% Short stocks ↓	62%
# Up days / Down days	9 / 13
Daily Correlation with MSCI JP	0.66
Turnover as % NAV	23%

Source: Factset

### Largest Long & Short Holdings

Longs	Shorts
Honda Motor	Nippon Building Fund
Resona	Oriental Land
Ichigo Group	All Nippon Airways
Hitachi HT	House Food Corp
Murata	Kikkoman Corp

Source: BNY Mellon Fund Services

### Single Stock Activity

Largest Buy & Buy Cover*		Largest Sell & Short Sell**	
Ube Industries	B	Kikkoman Corp	SS
THK	BC	House Foods Corp	SS
Honda Motor	B	Sumitomo Met Min	S
Sumitomo Heavy	B	Acom	S
Ichigo Group	S	Melco Holdings	S

\* B = Buy; BC = Buy Cover

Source: BNY Mellon Fund Services

\*\* S = Sell; SS = Short Sell

### Investment Strategy

The core value book consists of 47 long positions and 13 short positions. The Honda long position was increased to the largest long position. Risk-reward improved as confirmation of the fundamental turn-around strengthened, the currency stabilizes and the sell side started to realize the enormous value in the Honda stock. Sumitomo Metal Mining was the largest long position in the prior month. The stock rallied 21% in July and 5.5% in August. We took profits as we expected a lengthy bottoming process. The fundamentals continued to improve and valuations remain supportive, thus a matter of timely position size management. With the 'buy cover' in THK we exited the linear motion guide short position, because the company's exposure to the semiconductor equipment capex cycle has stabilized. We re-initiated UBE Industries long position. In our opinion, the stock is significantly mispriced as analysts focus too much on the poor performance of the chemicals business and neglect the value from specialty tech materials and its cement business. Earnings downward revisions have stabilized and its price-to-book valuation dropped below 2008 levels.

### Investment Strategy

The banks sector appreciated 11% last month on an equally weighted basis. Resona outperformed and jumped 14% last month. Honda contributed 30bps last month. Its stock climbed 11.6%, because brokers started to warm up to the idea of Honda being a genuine turn-around story now that news relating to the Takata airbag saga is fading.

August was a low price-to-book, long term price reversal month and stocks such as Mitsui Soko (0.6x P/B with a dividend yld of 3.3%) and Sumitomo Metal Mining (0.7x P/B) contributed positively.

On the other side however, high price momentum stocks such as Takara Leben, Pola Orbis and Melco were hit last month. In Mid-July Takara Leben was up +41% year-to-date and since then the stock gave back most of the gains, dropping 28% in August. The stock corrected despite strong positive newsflow and valuations at 7x price-to-earnings.

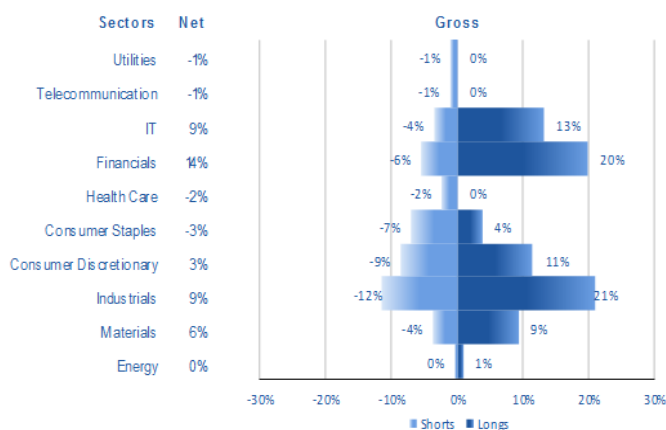
The financials net long position was 14% and basically consisted of long Resona plus net long REIT exposure, which consisted of a blend of specialist situations such as Ichigo Hotel REIT, Ichigo Office, Kenedix Retail, Kenedix Office and Takara Leben Infrastructure Fund. The net long in Industrials and IT increased substantially over the past several months. Earnings revisions for stocks in these sectors are stabilizing and valuations are appealing, especially compared to the expensive defensives.

### Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Resona	L	0.5%	Takara Leben	L	-0.5%
Honda Motor	L	0.3%	Pola Orbis	L	-0.4%
Mitsui Soko	L	0.3%	Ichigo Hotel REIT	L	-0.3%
Hitachi HT	L	0.3%	Melco Holdings	L	-0.3%
Sumitomo Met	L	0.2%	Toshiba Plant	L	-0.3%

\*CTR = Contribution

Source: Factset

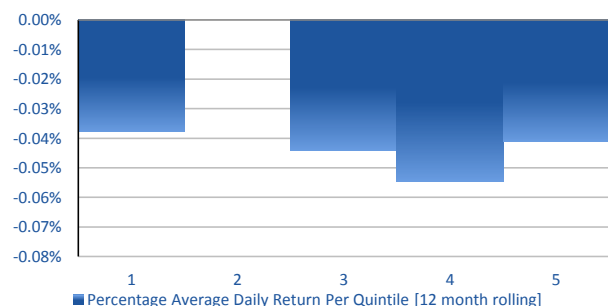
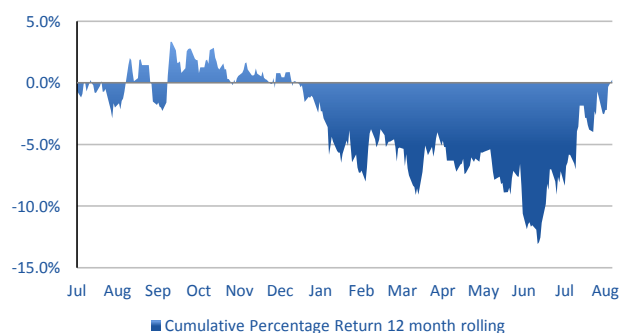


Source: UBS PAS

### Value Factor Performance\*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MoM	7.8%	4%	5%	6.4%	2.6%	0.8%
YoY	-3.7%	3%	4%	9.0%	-0.2%	4.9%

Source: Factset\*



Source: Factset\*

### Style Performance

On a daily basis we track a number of style factors based on our proprietary quant model. This helps us to detect dislocation within the market. In addition, it helps our understanding of style trends and investor's behavior in Japan.

In July we observed one of the largest style reversals on record and in August the value factor continued its strong performance. 'Value' almost recovered its year-to-date drawdown in excess of 10%. In August all value factors were up with price-to-earnings leading followed by dividend yield and price-to-book.

The P/E of the long book is 14.7x compared to 20.4x for the short book. The EV/EBITDA of the long book is 7.3x compared to 9.8x for the short book. The dividend yield of the long book is 2.4% compared to 1.9% in the short book.

The weighted average P/B of the long book is 1.4x compared to 1.8x for the short book. The cheapest P/B stocks can be found in the financials sector. However, because we restrict our investment universe to what we deem knowable and comprehensible we only follow a few banks and insurance companies. Therefore, our own investment universe has a median P/B of 1.2x and average P/B of 1.6x, largely due to our limited interest in banks, which are currently very inexpensive stocks.

The price momentum exposure has increased further. On a 9-month basis, the long book is down -2.2% and the short book -7.2%.

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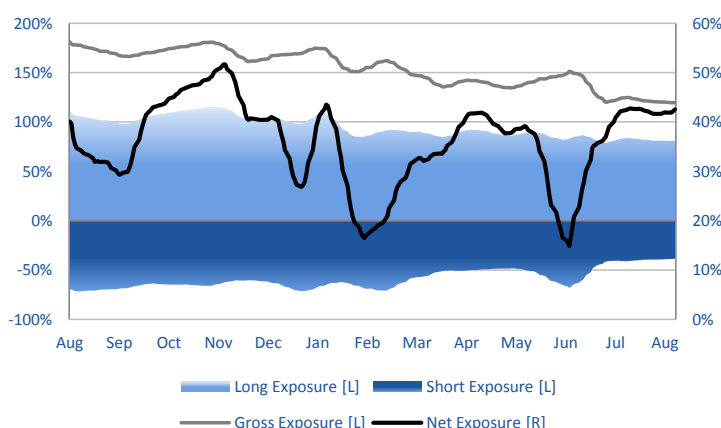
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### Risk Measurement and Management

The chart below shows the rolling 12-month net and gross exposure for the fund. The exposures are shown as 10 (trading) days moving averages. At the end of August, the gross exposure stood at 122%, the delta adjusted gross exposure was 140%. The net exposure stood at 45% and including the long Nikkei 225 put option strike 16500, the delta adjusted net exposure stood at much lower 36%.

The ex-ante volatility based on daily data was 10.3% with an ex-ante beta of 0.35. As we covered a few cyclical shorts the beta of the short book dropped from 0.83 to 0.72 and as a result the overall beta has increased. Because of the elevated spot volatility, the short-term ex-ante volatility measure is significantly higher. Based on 5 year monthly data the ex-ante volatility is 7.8%.



Source: BNY Mellon Fund Services\*

### Fund Overview

	Long	Short
Price to Earnings (PE)	14.7	20.4
EV/EBITDA	7.3	9.8
Price to Book (PB)	1.4	1.8
Dividend Yield	2.4	1.9
EV/IC	0.9	1.7
1 month momentum	9.6	4.8
6 month momentum	1.8	-6.5
9 month momentum	-2.2	-7.2
Earnings momentum (1M)	-11.8	-10.2
Earnings momentum (3M)	-5.2	-3.3
CFROI	7.1%	9.0%
Cash/MarketValue	35.1%	23.7%

Source: Factset

### Style Exposure

	Long	Short
Beta	0.88	0.72
Volatility	18.7%	17.1%
Debt-to-equity	16%	51%

Source: UBS PAS

### Risk Statistics Delta Adjusted

Volatility (ex-ante; 3 months daily data)	10.3%
Volatility (ex-ante; 5yr monthly data)	7.8%
Var (99%, 5 days)	1.7%
Beta (ex-ante)	0.35

Source: GS and Nomura

### Outlook

#### Strategic Framework - Outlook 2nd half of 2016

During the first half of 2016 we operated under the assumption of a cyclical bear market. The three year bull run completed in August 2015. We argued for a cyclical bear market due to tightening conditions in global dollar liquidity. We correctly anticipated that the FED would not be able to normalize interest rates, because it is built on the faulty assumption of a self-sustaining US economic growth cycle. This thesis has materialized to a large extent and Japanese equities had the deepest correction since the global financial crisis, correcting 30% peak-to-through. In June, we witnessed a full fledged panic with Japanese equities in free fall and broad based capitulation. Our strategy is contrarian in nature, thus buying cheap assets and shorting overpriced assets. Every once in a while 'mister market' is handing out gifts for those willing to go against the crowd and those who have the patience to hold them for a prolonged period. Easier said than done, the market is far from acting 'rationally' and although 80% of the time assets are efficiently priced, certainly at this moment in time, market participants are highly distracted by non-fundamental issues. Dislocation within the market is at multi-decade highs and the potential alpha source an obvious one. However, price action remains tightly correlated to currency moves and swings in liquidity conditions. The BOJ's inaction is partly excusable as the last two interventions had adverse reactions. However, investors realize that the Kuroda-put is increasingly ineffective, which only heightens investors' anxiety. That said, Kuroda and Draghi are marginal players, it is all about the trajectory of the US dollar and Yellen's confidence in her forecast. The Yellen Fed has missed its forecasts every single year for the past 5 years, every time overestimating growth by a substantial margin. In our opinion, a rate hike remains unlikely this year and a weaker US dollar our base case scenario.

#### Tactical assessment - monthly outlook

Following conventional wisdom September and October tend to be volatile months; especially when volatility is as mispriced as it is now, due to central bankers suppressing risk premia. Economic growth will remain anemic in Japan and disappointing in the US. Central bankers monetary magic is counterproductive and partly accountable for deflationary tendency. The conclusion is that Kuroda-san at the BOJ will continue to do more of what does not work; printing more money, meddling with capital markets to set the price of risk with the intention to weaken the JPY and push up risk assets. From current valuation level it is time to get more constructive on Japanese equities from a long beta perspective and the best risk/reward opportunity lies in going long cheap cyclical assets and short expensive, defensive yield proxies, preferable stocks fitting the low volatility theme.

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### Historic Fund Performance (Monthly)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<b>Class A EUR</b>												
2016	1.35%	0.88%	1.08%	-0.20%	-1.03%	-4.52%	2.08%	-1.09%				
2015	-1.28%	4.85%	-0.32%	3.21%	2.54%	-1.63%	-3.07%	-3.05%	2.42%	1.83%	2.16%	-1.62%
2014	-3.21%	-0.64%	-0.59%	-1.03%	-2.28%	1.40%	0.19%	-0.64%	2.01%	-1.94%	-1.28%	0.92%
2013	4.99%	-0.58%	6.55%	6.10%	-1.05%	-0.78%	0.26%	-0.91%	1.08%	-0.79%	1.35%	1.61%
2012	-1.43%	3.77%	1.31%	-1.26%	-3.88%	1.72%	0.79%	0.89%	1.28%	0.54%	2.53%	3.78%
2011	0.84%	-0.06%	-1.56%	0.10%	-0.19%	0.38%	-0.01%	-3.68%	0.64%	-0.41%	-2.64%	1.64%
2010	0.65%	-0.25%	3.27%	3.16%	-2.71%	-1.27%	1.12%	-0.39%	0.82%	1.03%	1.28%	1.75%
2009	0.35%	1.62%	-0.76%	-0.71%	0.98%	1.03%	-1.84%	2.07%	-1.61%	-0.40%	-3.37%	3.19%

### Class B EUR

2016	1.27%	0.92%	1.18%	-0.19%	-1.06%	-4.33%	2.12%	-1.05%				
2015	-1.24%	4.89%	-0.27%	3.25%	2.57%	-1.67%	-2.94%	-3.01%	2.46%	1.88%	2.06%	-1.42%
2014	-3.16%	-0.60%	-0.56%	-0.99%	-2.24%	1.44%	0.23%	-0.60%	2.06%	-1.89%	-1.24%	0.96%
2013	5.35%	-0.58%	6.98%	6.48%	-1.07%	-0.78%	0.31%	-0.92%	1.18%	-0.80%	1.46%	1.73%
2012	-1.38%	3.81%	1.35%	-1.21%	-3.83%	1.76%	0.84%	0.93%	1.32%	0.58%	2.50%	4.06%
2011	0.93%	-0.03%	-1.55%	0.14%	-0.14%	0.42%	0.03%	-3.63%	0.69%	-0.38%	-2.60%	1.68%
2010	0.73%	-0.23%	3.52%	3.39%	-2.83%	-1.31%	1.23%	-0.37%	0.91%	1.13%	1.40%	1.89%
2009	2.07%	1.67%	-0.73%	-0.67%	1.34%	1.13%	-1.93%	2.24%	-1.68%	-0.39%	-2.99%	2.84%
2008							0.96%	-1.35%	1.40%	3.44%	0.52%	1.39%

### Historic Fund Performance (Yearly)

	2016	2015	2014	2013	2012	2011	2010	2009	2008
<b>Class A EUR</b>	-1.61%	5.81%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
<b>Class B EUR</b>	-1.27%	6.36%	-6.52%	20.57%	10.95%	-4.48%	9.67%	2.75%	6.46%

#### Fund Facts

<b>Investment Manager</b>	Pelargos Capital
<b>Legal Status</b>	FGR (fund for joint account)
<b>Fiscal Status</b>	VBI (tax exempt)
<b>Dividend Policy</b>	Reinvestment
<b>Base Currency</b>	EUR
<b>ISIN Class A EUR</b>	NL0009051887
<b>ISIN Class B EUR</b>	NL0001118015
<b>Inception Date Class A EUR</b>	January 2009
<b>Inception Date Class B EUR</b>	July 2008

#### Company Facts

<b>Firm AUM in EUR</b>	€ 217,601,971
<b>Firm AUM in USD</b>	\$242,800,279

#### Portfolio Managers

Richard Dingemans  
Michael Kretschmer

#### Fund Description

<b>Investment Strategy</b>	Equity Long/Short
<b>Investment Style</b>	Value with a twist
<b>Investment Objective</b>	Capital appreciation through investing in long/short positions in Japanese securities

#### Fund Facts

<b>Fund Size in EUR</b>	€ 90,517,379
<b>Fund Size in USD</b>	\$100,999,291
<b>Participations Outstanding Class A</b>	236
<b>Participations Outstanding Class B</b>	59,945
<b>Minimum Subscription Class A</b>	EUR 10,000
<b>Minimum Subscription Class B</b>	EUR 10,000
<b>Dealing Day</b>	First business day of each month
<b>Subscription</b>	Any dealing day, 5 business days notice
<b>Redemption</b>	15 business days notice
<b>Management Fee Class A</b>	1.5%
<b>Management Fee Class B</b>	1.0%
<b>Performance Fee Class A</b>	20% subject to High Watermark
<b>Performance Fee Class B</b>	15% subject to High Watermark
<b>Early Redemption Fee</b>	max 1% (accrues to Fund)
<b>Lock-up Class B</b>	1 year

#### Service Providers

<b>Prime Brokers</b>	UBS AG, Goldman Sachs International
<b>Administrator</b>	BNY Mellon Fund Services
<b>Accountant</b>	PricewaterhouseCoopers
<b>Legal</b>	De Brauw Blackstone Westbroek N.V.
<b>Title Holder</b>	SGG Netherlands N.V.
<b>Depository</b>	Bank of New York Mellon

# Pelargos Japan Alpha Fund

## August 2016



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