Pelargos Japan Alpha Fund
August 2017

pelargos capital

Fund Performance

The Pelargos Japan Alpha Fund Class B appreciated +0.46% in August. Since July 2008, inception-to-date (ITD), the fund is up +56.52% with a realized volatility of 7.0%, whilst the MSCI Japan is up +18% ITD with a realized volatility of 19%.

Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,364.34	0.42%	0.30%	36.43%
Class B EUR	1,565.20	0.46%	0.60%	56.52%

Market Environment

After a 4-month winning streak the MSCI Japan declined by just -0.5% in JPY terms in August. With yields declining globally, sectors such as Insurance and Banks massively underperformed. Whilst cyclical sectors in combination with Consumer Staples showed decent outperformance.

Global equities had an exceptional 9-month winning streak and August was down slightly . The decline in the US dollar is positive for global GDP growth. As the US dollar depreciates, global commodity prices appreciate and with it emerging markets, especially Asian equities perform well. For the same reason, Japanese equities are underperforming global markets. Due to the very high current account surplus the Japanese yen remains an appreciating currency despite the Bank Of Japan's effort to debase the currency through aggressive balance sheet expansion.
The long book outperformed again and appreciated by +1.3%, whilst the short book was also up by just +0.3%. This positive spread and the fact that we are net long with good stock selection resulted in +0.5% capital appreciation for the fund. Despite a weaker market the hit ratio in the long book was 67% and the majority of days, 13 to be precise, were up days.
This month the systematic hedge book declined by -0.7% contributing exceptionally well. The turnover continued to be low at 26% of NAV. Daily correlation remained stable at 0.6. We found the best value opportunities in the cyclicals space , which generally tends to have higher correlation with beta. Thus value stocks (except for financials) were positively correlated with beta.

Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Household Products	5.0%	31.1%	4.0	32.2
Energy	2.7%	1.0%	1.0	10.9
Transportation	2.1%	3.2%	1.2	15.3
Industry Group	**MTD**	**YTD**	**PB**	**PE**
Insurance	-6.1%	-4.2%	0.9	12.4
Banks	-4.1%	-8.1%	0.5	11.0
Div. Financials	-3.5%	-5.5%	1.0	14.4

Source: Bloomberg

General Statistics

% Return long book	1.3%
% Return short book	0.3%
# Long stocks	46
# Short stocks	13
% Long stocks ↑	67%
% Short stocks ↓	31%
# Up days / Down days	13 / 9
Daily Correlation with MSCI JP	0.60
Turnover as % NAV	26%

Source: Factset

Top 10 gross positions

Nishimatsu Con.	3.6%	Pola Orbis	2.9%
Maeda Road	3.5%	Heiwa Real Estate	2.9%
Toshiba Plant	3.4%	NBF	2.7%
Fuji Media	3.2%	HIS	2.6%
Fanuc	2.9%	Mitsui Chemicals	2.4%

Source: BNY Mellon Fund Services

Single Stock Activity

Largest Buy*	Largest Sell*
Ichigo Group	SMFG
Toray Industries	Terumo Corp
House Foods Corp	Nishimatsu Const
Pola Orbis	Japan Tobacco
Fuji Media	Tokyu Corp

** B = Buy; S = Sell* *Source: BNY Mellon Fund Services*

Investment Strategy

The top 3 names have not changed. The biggest conviction bets are placed on highly stock specific, extremely undervalued and mainly domestically oriented companies. We took some profits in Nishimatsu Construction as it spiked up early in the month. Because path matters we decided to step aside and come back later with even higher vengeance.
The most noticeable changes are that Sumco and SMFG are not present in the top 10 anymore. Both stock prices triggered our stop losses and we sold out. Last month we outlined why we re-entered Sumco after its 20% drop from the May high. We combine fundamentals and enhance position sizing with technical signals. The earnings announcement during the month was not poor, by no means, but it raised question marks with regards to the sustainability of wafer price hikes. Once the stock has taken this uncertainty into account we think there will be another great long opportunity, but for now we stay sidelined.
SMFG is one of the highest quality banks in Japan, and very inexpensive at a price-to-earnings ratio of 8.6 and a dividend yield of 4%. That said, despite its cheapness the stock trades as a bond market proxy and with yields collapsing globally the stock remains soft and dropped below our stop loss level. Except for small exposure in the systematic hedge we have no financials exposure in

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Investment Strategy

Pola Orbis is steaming ahead and appreciated another 15% in August. The holding period is almost 6 years and management continues to deliver. Nichirin also stands out. This is a small capital goods company with a very specific niche market in which the company has acquired a globally dominant market position. As is the case with many Japanese companies, managements tend to be reluctant to use pricing to drive earnings. This aspect resulted in outstanding earnings for Nichirin and the stock appreciated 33% last month and the price-to-earnings ratio now stands at 8x for this year.

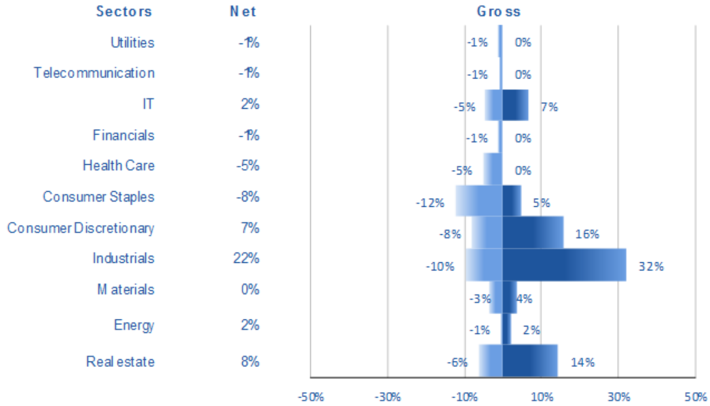
The top losing position Sumco has been explained above and the other four top losers account for 0.2% each. Fanuc and Mitsui Fudosan continue to show very disappointing price performance. Mitsui Fudosan's valuation has reached 'pre-Abenomics' levels and historically at that valuation level the stock is a buy with massive upside. However, our downward trend exhaustion measures and technical signals are not in place to be aggressive in terms of position sizes.
Without any news out from Fanuc the stock is just driven by being a large benchmark weight and the flows tied to those indices.

With regards to sector exposure, our bottom-up process resulted in a close-to-maximum long exposure in Industrials (+22%) and the biggest net short position remains in Consumer Staples (-7%).

Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Pola Orbis	L	0.3%	Sumco Corp	L	-0.4%
Nichirin	L	0.3%	Fanuc Corp	L	-0.2%
Heiwa Real Estat	L	0.2%	Nishimatsu Const	L	-0.2%
H I S	L	0.2%	Mitsui Fudosan	L	-0.2%
Nabtesco	L	0.2%	House Foods Corp	S	-0.2%

**CTR = Contribution* *Source: Factset*

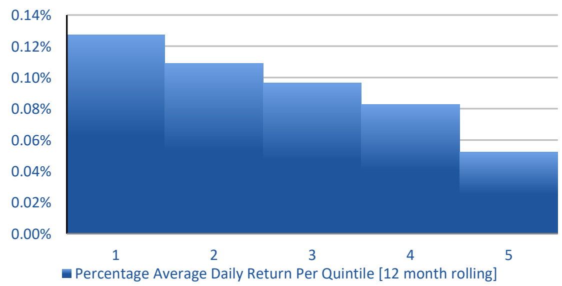


Source: UBS PAS

Value Factor Performance*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MoM	2%	1%	2%	1%	1%	-1%
YoY	16%	10%	20%	10%	10%	7%

*Source: Factset**



*Source: Factset**

Style Performance

On a daily basis, we track a number of style factors through 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.

The value rally continued into August. With a lack of stock specific news post the earnings season and limited macro flows the market behaved rather systematic. Momentum, Value, Quality, Size and Low Volatility were all up. Most of the time value and momentum tend to be negatively correlated but not so in August.

The outperformance of the value factor started in the summer of last year and peaked in December. The strong performance of value was very consistent across different types of definitions and sectors. Since December, the strong performance of value stocks has reversed somewhat and finally in July our value composite posted new highs. The value factor remained closely tied to global bond yields and the JPY.

The weighted average P/B of the long book was 1.7x compared to 2.1x for the short book. Price momentum exposure continued to be very high. On a 9-month basis, the long book's price momentum was +15% and the short book's price momentum was just +2%.

The P/E of the long book increased from last month's 16.3x to 16.7x which compared to 22x for the short book. The EV/EBITDA of the long book stood at 10.5 x compared to 13.4x for the short book. The dividend yield of the long book is 2.1% compared to 1.9% in the short book.
The CFROI's are quite similar despite the fact that our long holdings are almost debt free and the cash-to-market value amounts to 35%.

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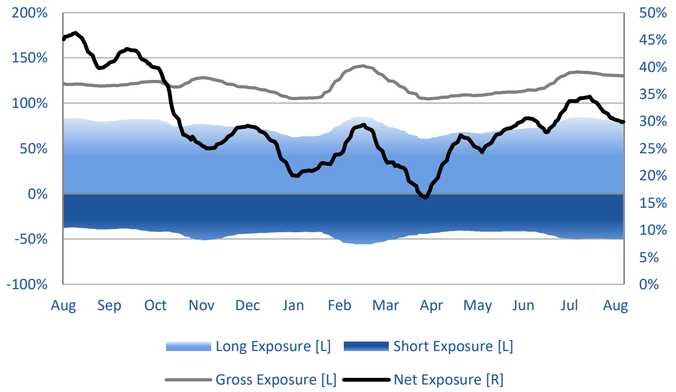
Risk Measurement and Management

The chart below shows the rolling 12-month net and gross exposure as 10 (trading) days moving averages.
For several months we increased the risk budget as our style was rewarded and with that net as well as gross exposure increased. During August, several larger long positions hit stop loss levels as well as target prices. Thus we sold out of several long positions and at the same time as style continued to be favorable we kept the gross exposure fairly constant.

The ex-ante beta dropped to 4.3%. This number of course is rather meaningless as it is just a reflection of globally depressed volatility. Even the long term volatility measure stands at 6% which seems more adequate representation of risk taken in a more adverse environment.
An ex-ante beta of 0.22 is a good level to enter the seasonally weak autumn period.



*Source: BNY Mellon Fund Services**

Fund Overview

	Long	Short
Price to Earnings (PE)	16.7	22.0
EV/EBITDA	10.5	13.4
Price to Book (PB)	1.7	2.1
Dividend Yield	2.1	1.9
EV/IC	1.2	1.8
1 month momentum	1.9	1.3
6 month momentum	8.9	2.7
9 month momentum	15.3	2.4
Earnings momentum (1M)	14.8	3.7
Earnings momentum (3M)	7.3	2.5
CFROI	8.8%	9.4%
Cash/MarketValue	35.5%	15.1%

Source: Factset

Style Exposure

	Long	Short
Beta	1.02	0.96
Volatility	10.3%	9.9%
Debt-to-equity	-2%	47%

Source: UBS PAS

Risk Statistics Delta Adjusted

Volatility (ex-ante; 3 months daily data)	4.3%
Volatility (ex-ante; 5yr monthly data)	6.0%
Var (99%, 5 days)	1.0%
Beta (ex-ante)	0.22

Source: GS and Nomura

Outlook

Strategic Framework - Outlook 2nd half 2017

The most important variable in global markets are the US dollar together with the 10-year treasury rate. A weak dollar, a reflection of more US dollar supply than demand, provides easier access to liquidity. In such an environment, commodity prices denominated in US dollar perform well together with equities in commodity producing nations. Thus more liquidity in the global reserve currency is growth positive and emerging market equities perform as well.
This describes the current state of the world. Global growth is better than expected due to a depreciating US dollar. On the other side is Japan, with a very strong trade account which puts upward pressure on its currency despite the Bank of Japan's effort to aggressively expand its balance sheet to counterbalance the depreciating US dollar.
Despite a globally, synchronized growth spurt and very strong earnings in Japan and fortress like balance sheets, the Japanese equity market is amongst the worst performing markets. Market participants continue to focus on yields heading lower and crowd into bond-like equity , but this trade is coming to an end. Not so much because yields are heading higher, but because growth is boosting earnings in the cyclicals as well as more structural growth sectors such as IT. Bottom-up research coverage in Japan remains anemic and a lot of those opportunities are missed by the majority of investors.

Tactical assessment - monthly outlook

We remain very bullish on alpha generation in the Japanese equities space. The interest for single stock opportunities in Japan dropped to multi-year lows. Sentiment is, once more, rather depressed, despite strong earnings and cash pouring into Japanese companies that benefit from global capex . The currency as always is the wild card and causes the obvious swing in the larger cap, benchmark related stocks. However, the number of good, small, domestically oriented business models are countless and, in general, balance sheets are extremely strong with tremendous buy-back potential . The shorts continue to be concentrated in a space where pricing power remains elusive and valuation at extreme levels. The global economy seems to be on a better footing than last year. As long as the global macro situation does not derail, in the sense of extreme US dollar weakness and collapsing yields, the Japan story will just tick along. With that, investors will re-emphasize bottom-up value oriented strategies and move away from top-down orchestrated smart-beta buying. We monitor the smart-beta flows closely and it becomes increasingly the clear that this space is starting to underperform and investors who bought into it are lagging the market.

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Historic Fund Performance (Monthly)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
Class A EUR													
2017	0.49%	-0.93%	-1.67%	-0.61%	0.19%	1.28%	1.17%	0.42%					0.30%
2016	1.35%	0.88%	1.08%	-0.18%	-1.05%	-4.52%	2.08%	-1.09%	-0.33%	2.38%	0.99%	0.38%	1.78%
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%	5.81%
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%	-6.99%
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%	18.86%
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%	10.24%
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%	-4.96%
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%	8.66%
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%	0.36%
Class B EUR													
2017	0.56%	-0.92%	-1.63%	-0.57%	0.23%	1.32%	1.18%	0.46%					0.60%
2016	1.27%	0.92%	1.18%	-0.16%	-1.08%	-4.33%	2.12%	-1.05%	-0.29%	2.38%	0.88%	0.39%	2.07%
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%	6.36%
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%	-6.52%
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%	20.57%
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%	10.95%
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%	-4.48%
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%	9.67%
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%	2.75%
2008							0.96%	-1.35%	1.40%	3.44%	0.52%	1.39%	6.46%

Fund Facts

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

Company Facts

Firm AUM in EUR	€ 231,942,920
Firm AUM in USD	$275,790,923

Portfolio Managers

Richard Dingemans

Michael Kretschmer

Fund Description

Investment Strategy	Equity Long/Short
Investment Style	Fundamental Value
Investment Objective	Capital appreciation through investing in long/short positions in Japanese securities

Fund Facts

Fund Size in EUR	€ 92,954,979
Fund Size in USD	$110,527,794
Participations Outstanding Class A	236
Participations Outstanding Class B	56,173
Minimum Subscription Class A	EUR 10,000
Minimum Subscription Class B	EUR 10,000
Dealing Day	First business day of each month
Subscription	Any dealing day, 3 business days notice
Redemption	15 business days notice
Management Fee Class A	1.5%
Management Fee Class B	1.0%
Performance Fee Class A	20% subject to High Watermark
Performance Fee Class B	15% subject to High Watermark

Service Providers

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

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