

Fund Performance

The Pelargos Japan Alpha Fund Class B appreciated +0.39% in December. Since July 2008, inception-to-date (ITD), the fund is up +55.58% with a realized volatility of 7.2%, whilst the MSCI Japan is up +11.7% ITD with a realized volatility of 20.1%.

Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,360.27	0.38%	1.78%	36.03%
Class B EUR	1,555.82	0.39%	2.07%	55.58%

Market Environment

The global bull market in risk assets continued in December. The MSCI World appreciated +2.3% and the MSCI Japan increased by +3.2%. Against the backdrop of a global bond market sell off, the yield differential between Japan and the US widened further and led to additional weakness in the Japanese Yen (JPY).

After the Fed meeting mid-December the JPY stabilized together with global bond markets. Since this stabilization phase, cyclical value started to underperform and investors rotated back into bond-like defensives. We gave back some performance in the last two weeks of the month and ended the month of December at +0.4%. For the year of 2016 the NAV gained 2.1%.

The great rotation of 2016 from high price momentum, high earnings momentum, expensive 'bond-proxy-like-equities' into cheap cyclicals and business models that benefit from higher rates started in late June and thus peaked in December.

In stark contrast to prior months the long book lagged the market in December appreciating by just +2.9%. The short book appreciated +4.6%. In 2016 the long book gained +5.3% against the short book of -1.6%. The daily correlation in December was 0.5. Elevated but a steep drop from 0.9 in November. The correlation is higher compared to prior years, because the long book was heavily tilted towards cheap cyclicals, which are positively correlated to the overall market. Turnover declined to below normal run-rate of 32%.

Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Energy	9.2%	-1.6%	0.9	14.8
Utilities	9.1%	-1.0%	0.8	16.6
Telecommunication	8.2%	26.9%	2.0	15.0

Industry Group	MTD	YTD	PB	PE
Software & Services	-2.8%	35.9%	2.0	20.5
Capital Goods	1.3%	5.8%	1.0	13.9
Real Estate	1.4%	-4.7%	1.2	14.6

Source: Bloomberg

General Statistics

% Return long book	2.9%
% Return short book	4.6%
# Long stocks	47
# Short stocks	11
% Long stocks ↑	74%
% Short stocks ↓	18%
# Up days / Down days	9 / 11
Daily Correlation with MSCI JP	0.50
Turnover as % NAV	32%

Source: Factset

Top 10 gross positions

Pola Orbis	4.2%	Mitsui Soko	2.3%
Sumco	3.0%	Ichigo Group	2.2%
Relia	2.6%	Fuji Media	2.2%
Sumitomo MM	2.4%	Kose Corp	2.1%
Mitsui Fudosan	2.3%	Ryosan	2.1%

Source: BNY Mellon Fund Services

Single Stock Activity

Largest Buy & Buy Cover*		Largest Sell & Short Sell**	
Pola Orbis	B	Ube Industries	S
Oriental Land	BC	Tokyo Ohka Kogyo	S
Nippon Building Fund	BC	Hitachi High Tec	S
Azbil Corp	B	Nishimatsu Const	S
Nippon Express	BC	Honda Motor	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 11 short positions. With political event risk subsiding investors attention shifted from macro to micro news. Pair-wise correlation had its biggest drop in years. Declining, as well as low levels of, intra-market correlation is a positive for our bottom-up stock picking strategy.

After the stellar performance of many of our cheap, cyclical long positions we started to reduce and take profits where appropriate in a very disciplined manner. At the same time we covered some of the bond-like, expensive defensives after the multi-month underperformance.

We closed the long position in Ube Industries. We initiated the position in August at a price-to-book (P/B) ratio of 0.7x. Once the stock traded closer to 1x P/B we closed the position. In this case the holding period was just 4 months with an average cost price of 189 JPY and an average selling price of 230 JPY. In the long run Ube Industries is a RoE=CoC (return of equity equal to its cost of capital) business with fair value at 1x P/B. Significant deviation from that level are always attractive opportunities for us.

Investment Strategy

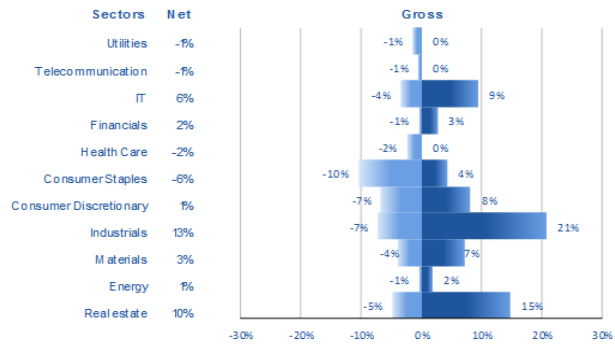
The long position in Sumco added another 0.5% in December after having contributed 0.4% in November. The capacity shortage in wafer and the price increase thesis in this capital intensive, commodity type business is playing out as expected. Sumco turned out to be highest contributor of 2016, adding 1.25% in total. Our timely position increase in Pola Orbis contributed 0.4% last month. The visibility of earnings contribution for the new blockbuster product has greatly increased. Company guidance for the product launch seems extremely conservative and analysts will have to increase estimates during the coming months. The largest negative contributor was Toshiba Plant System. The stock declined by 10% in December. The stock is extremely inexpensive, however the negative headline news at parent company Toshiba dragged down the stock price. As described above in the second half of December Consumer Staples started to perform better and the shorts in the expensive defensives Kose (-0.2%), House Food (-0.1%) and Nissin Food (-0.1%) accounted for small losses, but still add up to 40bps. In terms of sector allocation, the net long position in Industrials accounts for 13% of NAV and the biggest short position in Consumer Staples for 6% of NAV.

Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Sumco Corp	L	0.5%	Toshiba Plant Sy	L	-0.2%
Pola Orbis	L	0.4%	Kose Corp	S	-0.2%
Resona	L	0.2%	Acom	L	-0.2%
Shin-Etsu Chemical	L	0.2%	House Food	S	-0.1%
Chudenko	L	0.1%	Nissin Foods	S	-0.1%

*CTR = Contribution

Source: Factset

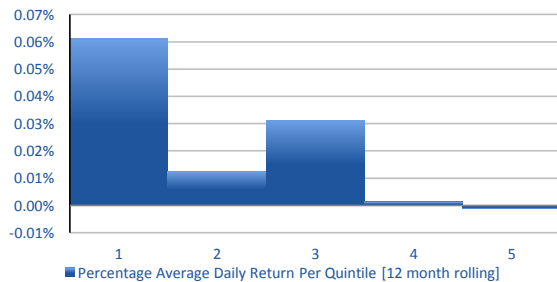
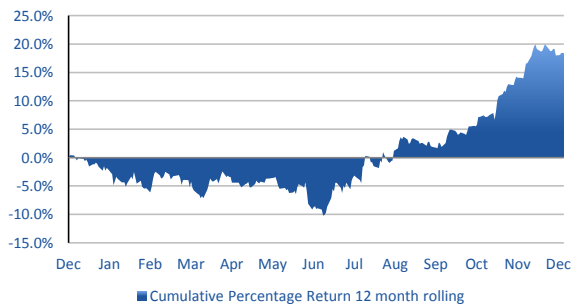


Source: UBS PAS

Value Factor Performance*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MoM	0.3%	3%	3%	2.1%	1.8%	0.6%
YoY	4.7%	7%	17%	13.5%	6.6%	8.6%

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 outperformance of the value factor started in June and peaked in mid-December. The reversal in value coincided with the peak in the bond market. The performance of value was very consistent across different types of definitions and sectors. Most value factors are now showing strong momentum.

Early 2016 we highlighted extensively the gross mispricing of cyclicals versus defensives. This reversal was the biggest trade of 2016 and whilst the most obvious mispricing was undone there is plenty more to go for further strong outperformance of cheap cyclicals.

The P/E of the long book is 17.9x compared to 24.5x for the short book. The EV/EBITDA of the long book is 7.5x compared to 11.2x for the short book. The dividend yield of the long book is 2.2% compared to 1.6% in the short book.

The weighted average P/B of the long book is 1.6x compared to 2.3x 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.

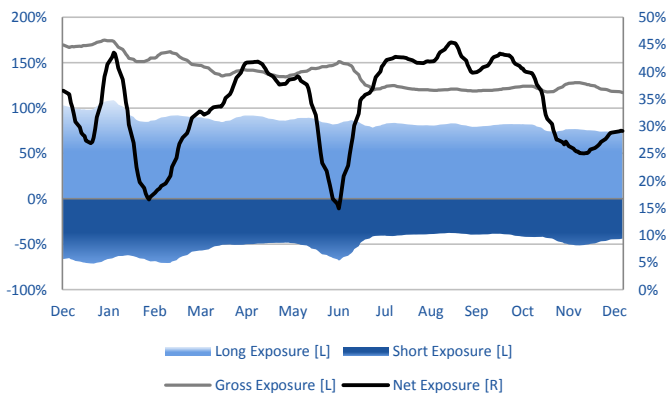
Price momentum exposure has increased significantly. On a 9-month basis, the long book's price momentum is 17.8% and the short book's price momentum is 1.0%.

Risk Measurement and Management

The chart below shows the rolling 12-month net and gross exposure as 10 (trading) days moving averages.

June was our worst month since inception and we acted in a disciplined manner and reduced risk. Once the great rotation kicked-in and we made back our losses we were comfortable to carry 40% net until late October. Prior to US election and into year-end we started to take profits in long positions where target prices had been met and at the end of 2016 the net exposure stood at 27%. The gross exposure stood at 113%.

The ex-ante volatility based on daily data was 7.1% with an ex-ante beta of 0.31.



Source: BNY Mellon Fund Services*

Fund Overview

	Long	Short
Price to Earnings (PE)	17.9	24.5
EV/EBITDA	7.5	11.2
Price to Book (PB)	1.6	2.3
Dividend Yield	2.2	1.6
EV/IC	1.0	2.0
1 month momentum	3.4	3.7
6 month momentum	25.7	6.0
9 month momentum	17.8	1.0
Earnings momentum (1M)	12.2	19.6
Earnings momentum (3M)	6.7	13.0
CFROI	7.7%	10.3%
Cash/MarketValue	33.8%	14.9%

Source: Factset

Style Exposure

	Long	Short
Beta	0.99	0.76
Volatility	16.4%	14.1%
Debt-to-equity	9%	48%

Source: UBS PAS

Risk Statistics Delta Adjusted

Volatility (ex-ante; 3 months daily data)	7.1%
Volatility (ex-ante; 5yr monthly data)	6.1%
Var (99%, 5 days)	1.4%
Beta (ex-ante)	0.31

Source: GS and Nomura

Outlook

Strategic Framework - Outlook 1st half of 2017

The cyclical bear market from August 2015 into June 2016 took the broader index down -30% peak-to-trough. 2016 was another year of heightened macro event risk. Perceived low probability outcomes caused major surprises. January was one of the worst 'start-of-the-years' on record. In June, Brexit risk aversion upset markets globally and the outcome of the US presidential election led to further elevation of political uncertainty. The Japanese market bottomed together with global bond yields, and with that the greatest rotation from defensives into cyclicals for the past decade occurred. We correctly anticipated that the Fed would not be able to normalize interest rates as projected, because trend growth is too anemic. However, supply/demand balance shifted drastically in the bond market and with higher yields in the US the Japanese JPY weakened and with it value stocks finally performed well. For the first half of 2017 we expect the value trade to continue as yields need to adjust higher globally, be it due to better economic growth or central banks tapering. However, leverage in the global economic system is too high, therefore much higher yields can not be absorbed and eventually disinflation will return. For the immediate future Japanese equities look attractive as valuations are not stretched, earnings revisions are trending upwards and buyback programs are accretive for shareholders and supportive from a flow perspective.

Tactical assessment - monthly outlook

Cyclical value had a great run since the summer last year and the mispricing of cyclicals relative to defensives has corrected to some extent. In our opinion there is more to go. Because expensive, low-volatility stocks are highly correlated to bond yields, volatility in that space has returned with a vengeance. Investors realize that paying too high a price and herding into the low-volatility themes has introduced heightened risk. And indeed, for the past few months, the realized volatility of the low-volatility ETF surpassed the volatility overall market ETF. We consider the discrepancy between price and value our guiding principle in how to think about risk. We are looking forward to further de-rating of this market segment. Maybe this will be a good hunting ground for longs in the second half of 2017 when investors finally throw in the towel on their 'search-for-yield' and much loved low volatility positioning. For the time being we remain short the expensive defensives and continue to take profits on cyclical value.

Historic Fund Performance (Monthly)												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Class A EUR												
2016	1.35%	0.88%	1.08%	-0.20%	-1.03%	-4.52%	2.08%	-1.09%	-0.33%	2.38%	0.99%	0.38%
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%	-0.29%	2.38%	0.88%	0.39%
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
Class A EUR	1.78%	5.81%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
Class B EUR	2.07%	6.36%	-6.52%	20.57%	10.95%	-4.48%	9.67%	2.75%	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	€ 219,343,133
Firm AUM in USD	\$230,683,173

Portfolio Managers

Richard Dingemans
Michael Kretschmer

Fund Description

Investment Strategy Equity Long/Short

Fund Facts

Fund Size in EUR	€ 93,584,787
Fund Size in USD	\$98,423,121
Participations Outstanding Class A	236
Participations Outstanding Class B	59,945
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, 5 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
Early Redemption Fee	max 1% (accrues to Fund)
Lock-up Class B	1 year
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.

Pelargos Japan Alpha Fund

December 2016



Investment Style	Value with a twist	Depository	Bank of New York Mellon
Investment Objective	Capital appreciation through investing in long/short positions in Japanese securities		

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