

# Pelargos Japan Alpha Fund

## February 2015



### Fund Performance

The Pelargos Japan Alpha Fund Class B appreciated 4.89% in February. Inception-to-date (ITD) the fund is up 48.45% with a realized volatility of 7.3%, whilst the MSCI Japan is up 12.95% ITD with a volatility of 20.2%.

### Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,307.33	4.85%	3.50%	30.73%
Class A USD	961.40	4.79%	3.35%	-3.86%
Class A JPY	95,333	4.80%	3.33%	-4.67%
Class B EUR	1,484.46	4.89%	3.59%	48.45%

### Market Environment

In February, the MSCI Japan appreciated +8% in Japanese Yen (JPY) terms, and rallied significantly in euro and US dollar terms as well. The market advanced without further Japanese Yen weakness driving it. While January was all about macro developments, in February, earnings announcements drove single stock activity and pension fund buying, as well as BOJ buying, supported the entire market.

The bond to equity shift by domestic pension funds is the most important demand factor currently. Interestingly, retail investors seem largely absent and therefore little margin debt has been built during the recent advance. Foreign investors have been largely sidelined as the focus of the global investment crowd shifted to Europe post the ECB's quantitative easing.

The macro environment is dominated by 'policy divergence'. The US FED's intention to tighten by summer contrasted with the BOJ's and the ECB's aggressive easing. However, Japan has a few more dimensions going for it. The stewardship code and corporate governance initiatives are for real; these are very powerful in terms of investment return drivers and still not taken seriously by investors. Japanese corporates are ramping up payout ratios and/or share buy backs at still very favorable valuations. Shares of companies which announce more favorable shareholder return policies get handsomely rewarded and those stocks continue to outperform rather than fade immediately thereafter.

### Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Pharma	16.5%	16.5%	1.7	25.1
Household Prod.	14.4%	14.4%	1.9	27.1
Transportation	13.3%	13.3%	1.2	18.4

Industry Group	MTD	YTD	PB	PE
Utilities	2.0%	2.0%	1.0	18.0
Real Estate	2.7%	2.7%	1.5	20.1
Automobiles	4.1%	4.1%	1.1	11.7

Source: Bloomberg

### General Statistics

% Return long book	8.8%
% Return short book	10.2%
# Long stocks	49
# Short stocks	8
% Long stocks ↑	88%
% Short stocks ↓	0%
# Up days / Down days	11 / 9
Daily Correlation with MSCI JP	0.56
Turnover as % NAV	44%

Source: Factset

### Largest Long & Short Holdings

Longs	Shorts
Ryosan	Park24 Co
Honda Motor	Mcdonald's Holding
Moshi Moshi	Familymart
Fujifilm Holding	Hirose Electric
Ichigo Group	Kikkoman Corp

Source: Citi Financial Services

### Single Stock Activity

Largest Buy & Buy Cover*		Largest Sell & Short Sell**	
Fujifilm Holding	B	Kenedix Realty	S
Sumitomo Heavy	B	JVC Kenwood	S
East Japan Rail	B	Nippon Telegraph	S
Kenedix Retail	B	Moshi Moshi	S
Acom	B	Takara Leben	S

\* B = Buy; BC = Buy Cover

Source: Citi Financial Services

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

### Investment Strategy

With regards to the largest long positions it is worth noting that we reduced Ichigo REIT and Takara Leben after their stellar performance. Takara more than doubled and Ichigo REIT gained 50% over the past 12 months.

FujiFilm made it to the top 5 longs, it is a lower beta conglomerate; the eternal turnaround story which is finally returning cash to shareholders. In our opinion, it is not so much about the fact that shareholders need to be rewarded than the mechanics of it. It introduces internal competition for capital and leads to more efficient capital allocation. FujiFilm's future will be one of higher return-on-equity and the stock still trades with a discount to book value.

We added to long positions East Japan Railway and Sumitomo Heavy. We sold Kenedix Realty, which reached our price target, and reallocated those funds to Kenedix Retail. At the same time, we took profits in high-flyers such as JVC Kenwood. The stock doubled from October lows and is a multi-year turn around story. After this rally the first leg of operational turnaround seems reflected in the share prices, in our opinion.

### Investment Strategy

Volatility in February was much more subdued and investor's attention shifted from macro uncertainties to earnings announcement and increasingly important: shareholder return policy events.

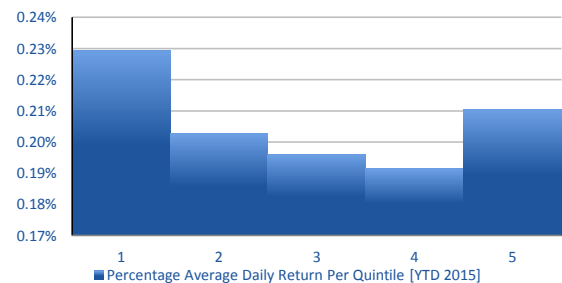
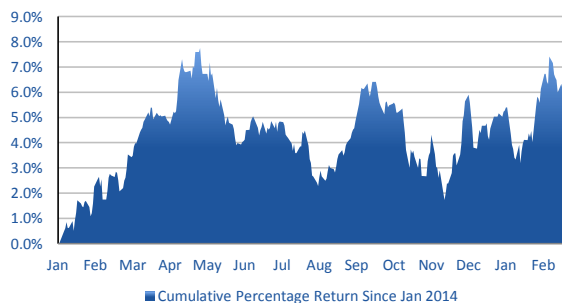
We have been holding Ryosan for many years and discussed this long term, high conviction position several times in this newsletter. We emphasized the business model transition and the growth that lies ahead. The company, which is not covered by the sell side, presented great numbers for a few quarters. In February the company announced another dividend increase and buyback. Despite its stellar performance the stock still trades below book.

There were only minor losers last month. Start Today, a fashion e-retailing platform, had a 20% move last month. We already reduced the position size in prior months, but were not convinced to fully close the position. The company's growth profile is diminishing and its valuation seems too stretched.

With regards to sector exposure; it is our intention to build sector exposure bottom up and invest where we find opportunities. It is not often the case, however last month the net exposure in Financials reached 18%. This sector is extremely underappreciated in Japan and for that matter globally. We see very, very inexpensive stocks in this space.

Value Factor Performance*						
	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MTD	1.1%	-0.3%	0.5%	0.5%	-1.5%	2.0%
YTD	-2.6%	1.8%	0.1%	0.5%	1.8%	-1.7%

Source: Factset\*



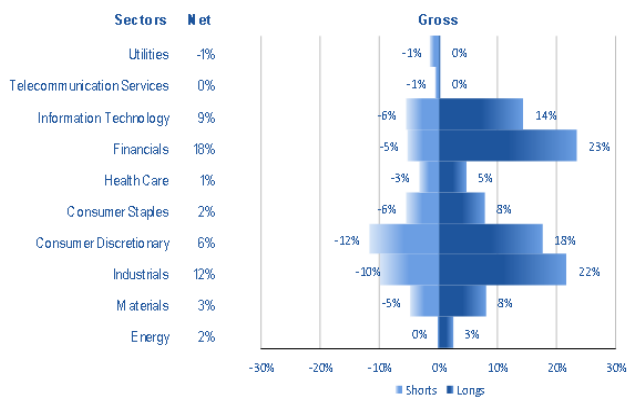
Source: Factset\*

### Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Ryosan	L	1.0%	Start Today	S	-0.3%
JVC Kenwood	L	0.7%	Park24 Co	S	-0.2%
Ichigo Group	L	0.6%	Fancl Corp	L	-0.1%
Honda Motor	L	0.4%	Oji Paper	S	-0.1%
Terumo Corp	L	0.3%	Hirose Electric	S	-0.1%

\*CTR = Contribution

Source: Factset



Source: UBS PAS

### Style Performance

On a daily basis we track numerous style factors based on our proprietary quant model, in order to help our understanding of style trends and investor's behavior in Japan.

Finally we see a pick-up in price-to-book (P/B) spread performance, which is our favorite value measure. Not only did P/B as a style perform well last month, price-earnings (P/E) also contributed nicely.

This combination greatly supports our stock picking. We have plenty of cheap stocks in the long book and catalysts start to emerge as payout ratios and share buybacks are top of the agenda for our holdings.

Admittedly, we do not have many short positions left, however the P/B of the long book is 1.5x and the short book 4.3x. The EV/EBITDA of the long book a mere 5.8x whilst the short book trades at an aggregated 28.2x.

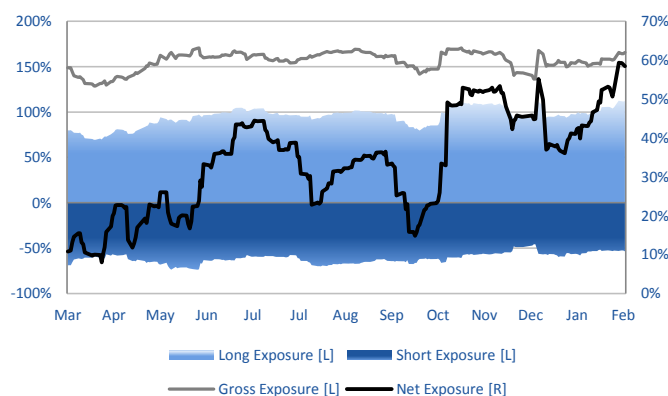
With regards to the momentum tilt, it is worth noting that we are momentum neutral on a 1-month and 6-months basis. We have a significant momentum tilt on a 12-month basis as shown in the table on the next page.

Our long book consists of companies holding a significant amount of cash and the CFROI on the long side is in excess of the short book.

**Risk Measurement and Management**

The chart below shows the rolling 12-month net and gross exposure for the fund. For the past 12 months the gross exposure ranged between 130-160%. The net exposure increased substantially from January lows, partly due to performance and buy covers of shorts exceeding stop loss levels.

Finally, several of our long term core holdings started to perform, but the upside is still plentiful in the long book. We start to find pockets of excessive valuation in the market, especially in the Consumer Staples sector. Unfortunately, at this stage it remains difficult to short those stocks. The net exposure at the end of February stands at 59% and consists mainly of low beta stocks. The ex-ante volatility based on our 1 year model increased to 10.2% and 8.9% using longer term reference data. At the end of February the fund's beta was 0.44. Style wise, the fund remains heavily tilted towards value factors.



Source: Citi Financial Services\*

Fund Overview		
	Long	Short
Price to Earnings (PE)	19.7	40.5
EV/EBITDA	7.0	14.1
Price to Book (PB)	1.6	3.6
Dividend Yield	1.6	1.2
EV/IC	1.0	2.3
1 month momentum	2.7	3.9
6 month momentum	21.3	26.0
9 month momentum	30.1	30.3
Earnings momentum (1M)	8.6	8.9
Earnings momentum (3M)	7.7	8.9
CFROI	7.0%	9.0%
Cash/MarketValue	24.0%	16.0%

Source: Factset

Style Exposure		
	Long	Short
Beta	0.9	0.9
Volatility	15.4%	15.2%
Debt-to-equity	10.00	38.00

Source: UBS PAS

Risk Statistics Delta Adjusted	
Volatility (ex-ante; 1yr daily data)	10.2%
Volatility (ex-ante; 5yr monthly data)	8.9%
Var (99%, 5 days)	3.1%
Beta (ex-ante)	0.44

Source: GS and UBS PAS

**Outlook**

*Strategic Framework - Outlook 1st half of 2015*

2014 was a difficult year. The VAT hike increased real economic volatility and distorted underlying fundamentals. The Japanese equity market was very directional; large cap, weak Yen beneficiaries and REITs performed very well, whilst valuations did not really matter. 2014 was all about price momentum in combination with earnings revisions. This rather one dimensional behavior was exacerbated by the BOJ's aggressive intervention, as it increased its stake in the global competition for monetary activism. The BOJ, and for that matter the FED and ECB, continue to distort market prices and price signals in general. The reason why capitalism used to work and enabled tremendous wealth creation is due to the very importance of price signaling. Price fluctuations due to constraints, be it oversupply or excessive demand, creates incentives for economic agents to correct for it. If at the very core, the price of money is distorted, everything is distorted and unintended consequences will (not 'might') arise. Despite all the fear mongering about the Japanese government debt, the 10-year JGB is trading at close to 30bps. 0.3% p.a. for the next 10 years just does not make any sense. The system is broken and central bankers are desperately trying to fix it. In the process of driving yields down even further, central banks are crowding out collateral from an already weak financial system. Good luck with all that. Admittedly, it is difficult to make sense of all of this, but one thing is for sure, the perceived stability and engineered suppression of volatility will have unintended consequences as central bankers can not control all prices all the time. One of these unintended consequences is the US dollar bull market which started in mid 2014. Most likely the US dollar strength will pause at some point, but when it reaccelerates an outright deflation scare in the face of collapsing commodities will re-introduce systematic risk and markets will challenge central banks to open the magic tool box once again.

*Tactical assessment – Outlook March 2015*

Our strategic outlook above reads bearish on systemic issues, but the not so inconvenient truth is that deflation equals money printing equals higher equity prices. It seems this simple mechanism, misleadingly coined wealth creation while it truly is wealth redistribution, works and its logic holds until we reach extremely distortive valuations. The US equity market entered the danger zone based on normalized valuation metrics, whilst Japan is still far from what can be considered expensive. In Japan, one still finds the cheapest stocks globally. Our thesis of a structural bull is still in place and the newly embraced shareholder return policies is the most powerful driver. As long as BOJ's Kuroda remains reasonably 'trustworthy', and does not feel the urge to act, micro efforts and second round effects from JPY weakness will support the equity trade.

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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>												
2015	-1.28%	4.85%										
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 A USD

2015	-1.37%	4.79%										
2014	-3.16%	-0.74%	-0.68%	-1.11%	-2.26%	1.30%	0.21%	-0.63%	1.88%	-1.89%	-1.36%	0.92%
2013							-1.92%	-1.15%	1.29%	-1.04%	1.58%	1.74%

### Class A JPY

2015	-1.40%	4.80%										
2014	-3.24%	-0.80%	-0.71%	-1.19%	-2.27%	1.26%	0.19%	-0.65%	1.86%	-1.97%	-1.60%	0.87%
2013							-1.82%	-1.26%	1.23%	-1.06%	1.59%	1.73%

### Class B EUR

2015	-1.24%	4.89%										
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)

	2015	2014	2013	2012	2011	2010	2009	2008
<b>Class A EUR</b>	3.50%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
<b>Class A USD</b>	3.35%	-7.38%	0.43%					
<b>Class A JPY</b>	3.33%	-8.06%	0.35%					
<b>Class B EUR</b>	3.59%	-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>	Fund for Joint Account
<b>Fiscal Status</b>	Tax Exempt
<b>Dividend Policy</b>	Reinvestment
<b>Base Currency</b>	EUR
<b>ISIN Class A EUR</b>	NL0009051887
<b>ISIN Class A USD</b>	NL0010545570
<b>ISIN Class A JPY</b>	NL0010545588
<b>ISIN Class B EUR</b>	NL0001118015
<b>Inception Date Class A EUR</b>	January 2009
<b>Inception Date Class A USD</b>	July 2013
<b>Inception Date Class A JPY</b>	July 2013
<b>Inception Date Class B EUR</b>	July 2008

### Fund Facts

<b>Fund Size in EUR</b>	€ 93,099,493
<b>Fund Size in USD</b>	\$104,234,192
<b>Participations Outstanding Class A</b>	436
<b>Participations Outstanding Class B</b>	62,402
<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
<b>Redemption</b>	20 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% (accrued to Fund)

# Pelargos Japan Alpha Fund February 2015



## Company Facts

**Firm AUM in EUR** € 232,824,340  
**Firm AUM in USD** \$260,670,131

## Portfolio Managers

Richard Dingemans  
 Michael Kretschmer

## Fund Description

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

## **Lock-up Class B**

1 year

## Service Providers

**Prime Brokers** UBS AG, Goldman Sachs International  
**Administrator** Citibank Europe Plc.  
**Accountant** PricewaterhouseCoopers  
**Legal** De Brauw Blackstone Westbroek N.V.  
**Title Holder** SGG Netherlands N.V.  
**Depositary** Citibank International Plc.

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