

Pelargos Japan Alpha Fund

February 2016



Fund Performance

The Pelargos Japan Alpha Fund Class B appreciated 0.92% in February. Since July 2008, inception-to-date (ITD), the fund is up +55.78% with a realized volatility of 7.3%, whilst the broader market is down -3.98% ITD with a volatility of 20.4%.

Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,366.45	0.88%	2.24%	36.65%
Class B EUR	1,557.76	0.92%	2.20%	55.78%

Market Environment

In February, the MSCI Japan delivered another jaw-dropping -9.4% as the Japanese Yen (JPY) appreciated +7% against the US dollar. The Bank of Japan (BoJ) intervention utterly backfired and led to massive strengthening of the JPY. Volatility in equities was extremely high with the MSCI Japan selling off -18.5% from its intra-month high to intra-month low.

In February, our long book continued its outperformance and only declined -6.8% whilst the shorts in the core book declined by -10.2%. The global economy is in bad shape and the only game in town seems to be activist central banking. Unfortunately, central banking tools seem rather ineffective, but instead of questioning their monetary weaponry, Kuroda-san and Draghi aim to do more of the same. As such, the grand experiment continues and policy divergence aggravates as Japan and Europe move in opposite direction to the US.

We operate under the thesis, that last year's sell-off in August was the start of a cyclical bear market. In our opinion, the FED's rate hike into a severely slowing global economy served to accelerate the global US dollar liquidity crunch.

Our exposure to banks is rather limited. Financial exposure in the books is predominately Real Estate Investment Trusts (REITs), property developers and non-bank consumer credit.

The daily correlation of the fund with the MSCI Japan was 0.05 and the number of up-days was close to equal the number of down-days.

Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Telecommunication	1.5%	10.6%	2.0	15.5
Consumer Services	-2.5%	8.6%	1.8	17.0
Pharma	-3.3%	26.0%	1.4	21.6
Industry Group	MTD	YTD	PB	PE
Banks	-20.1%	-26.0%	0.4	8.3
Automobiles	-17.8%	-22.8%	0.8	10.9
Div. Financials	-15.5%	-17.8%	1.0	14.7

Source: Bloomberg

General Statistics

% Return long book	-6.8%
% Return short book	-10.2%
# Long stocks	48
# Short stocks	13
% Long stocks ↑	21%
% Short stocks ↓	85%
# Up days / Down days	10 / 11
Daily Correlation with MSCI JP	0.05
Turnover as % NAV	25%

Source: Factset

Largest Long & Short Holdings

Longs	Shorts
Ryosan	Hino Motors
Ichigo Group	Nippon Express
Takara Leben	Komatsu
Relia	Kose Corp
Nikon Corp	All Nippon Airways

Source: BNY Mellon Fund Services

Single Stock Activity

Largest Buy & Buy Cover*		Largest Sell & Short Sell**	
Nikon Corp	B	Toray Industries	SS
LaSalle Logiport	B	Ryohin Keikaku	SS
Kikkoman Corp	BC	Nippon Express	SS
Advantest Corp	BC	Hino Motors	SS
Sumitomo Met Min	B	Pola Orbis	S

* B = Buy; BC = Buy Cover

Source: BNY Mellon Fund Services

** S = Sell; SS = Short Sell

Investment Strategy

Ryosan is still the largest long position. Ichigo Group and Takara Leben notched higher in the ranking. It is partly due to performance and us having added to the position in midst of the recent turmoil. With resilient overall performance we preserved sufficient mental capital to act and add to high conviction names.

High conviction shorts did not change much. We manage risk levels very tightly in this high volatility environment and partially covered Advantest and Kikkoman.

We participated in the LaSalle Logiport REIT IPO and bought a small position in Sumitomo Metals Mining, one of the few Japanese mining companies with exposure to gold, copper and nickel.

Our selling activity focused on cyclical shorts such as Toray, a specialist materials company which historically fails to cover its cost-of-capital but trades at 1.5x price-to-book. Toray has a consistent track record of overspending on capital expenditure and underachieving on return-on-capital.

Investment Strategy

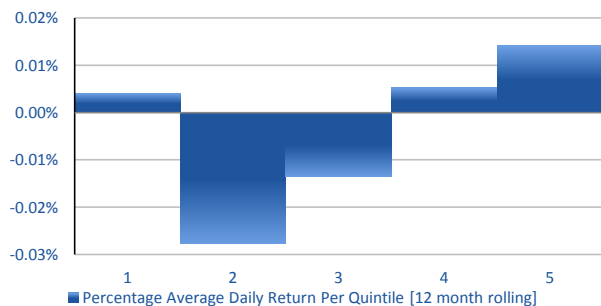
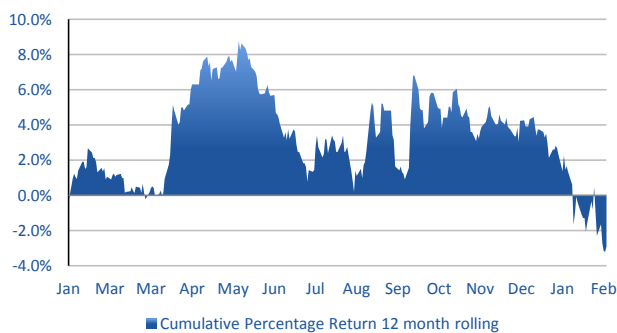
Our shorts are concentrated in two style/market segments. On the one hand, in high price momentum, high earnings momentum consumer staples stocks which are trading at outrageous multiples. On the other hand, shorts in cyclical stocks where investors, buy and sell side, underappreciate the earnings deterioration. Kose, despite being a defensive cosmetics company dropped 12% in February. Likewise, Megmilk Snow, a milk and dairy producer, dropped 14% last month. These stocks are members of the low-variance-at-any-price smart beta theme, bought by institutional investors aiming to replace low yielding fixed income with perceived defensive equity exposure.

The top gainers included even one long position, Kenedix Retail REIT. This real estate investment trust appreciated 13% last month, high dividend stocks performed extremely well as 10 year Japanese government bonds dropped below 0%. The losers this month had little to nothing in common, a specialty chemical stock (Kaneka), a extremely cash rich tech company (Tokyo Ohka Kogyo), a large regional bank (Resona), a shoe retailer (Chiyoda) and a chip distributor (Ryosan).

The largest net long position remained in the Financials sector. This allocation is almost all boring, good old-fashioned real estate investment trust exposure, which we picked for high dividends and solid prospective dividend growth at attractive valuations.

Value Factor Performance*						
	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MTD	-6.5%	-5.4%	-4.1%	0.6%	-3.0%	1.6%
YTD	-5.8%	-6.6%	-4.9%	4.0%	-3.0%	5.1%

Source: Factset*



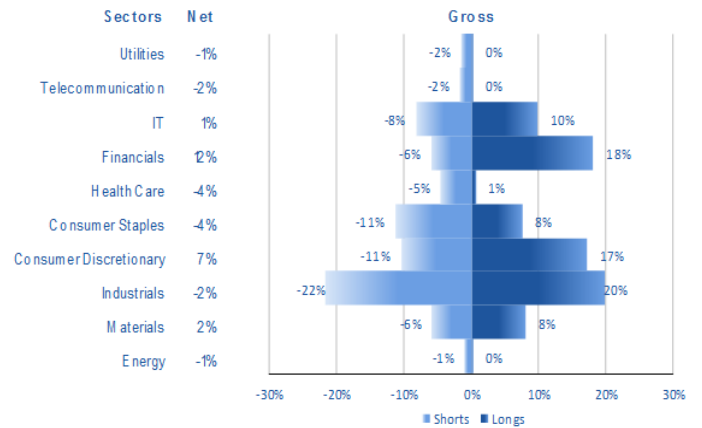
Source: Factset*

Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Hino Motors	S	0.5%	Kaneka Corp	L	-0.6%
Kose Corp	S	0.3%	Tokyo Ohka Kogyo	L	-0.5%
Nippon Express	S	0.3%	Ryosan	L	-0.4%
Megmilk Snow	S	0.3%	Resona Holdings	L	-0.4%
Kenedix Retail	L	0.3%	Chiyoda Co	L	-0.4%

*CTR = Contribution

Source: Factset



Source: UBS PAS

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.

The value factor turned decisively negative for the year and February was yet another bad month for value stocks. High price-to-book and high price-to-earnings stocks outperformed by a wide margin.

All value factors were negative, except for dividend yield and free cash flow yield. Dividend stocks performed extremely well on the last day of January as the BOJ announced its intention to move towards negative rates, high dividend stocks got a strong boost. The dividend yield of the long book is 1.9% compared to 1.6% in the short book.

The poor performance of the value factor is partly to be blamed on the Financial sector. Within financials, banks and insurance, which are already very inexpensive, collapsed whilst property and non-bank finance performed very well. Resona, a 1% long position, is the only banking exposure in the books. We tend to avoid bank stocks. We find that complexity in asset valuation on the balance sheets as well as regulatory and monetary intervention diminishes our ability to have an informational edge. We appreciate the simplicity of REITs and its 8% net long exposure contributed nicely to performance.

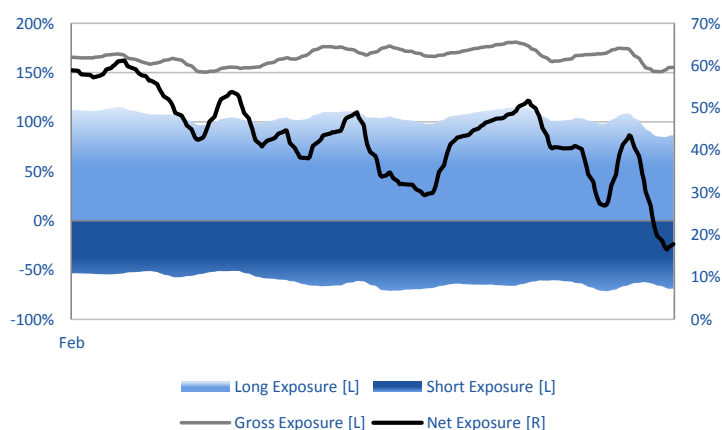
The momentum exposure (spread between long and short book) is close to non-existent on a 9-month basis and on a 6-month basis -0.9% for the long book and -10% for the short book. The price-to-book spread remained the same with the long book's P/B of 1.5x compared to 2.0x for the short book. Given our value approach we have a strong preference for cash rich companies.

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 February the gross exposure stood at 157%, the delta adjusted gross exposure was 184%.

The net exposure stood at 19%. Having bought cheap protection in early December last year, we took off part of the hedges as our extreme downside scenario materialized. Including the option protection the delta adjusted net exposure stood at 11%.

The ex-ante volatility, based on daily data over the past 1 year, was just 5.7% with an ex-ante beta of close to 0%. Partly because of the REIT and lack of bank exposure the beta of the long book was 0.89. Historically, we have a preference for being long low beta stocks.



Source: BNY Mellon Fund Services*

Fund Overview

	Long	Short
Price to Earnings (PE)	16.5	17.4
EV/EBITDA	8.2	10.2
Price to Book (PB)	1.5	2.0
Dividend Yield	2.1	1.8
EV/IC	1.1	1.8
1 month momentum	-6.0	-10.0
6 month momentum	-0.9	-10.4
9 month momentum	-7.5	-8.0
Earnings momentum (1M)	-17.4	-6.7
Earnings momentum (3M)	-1.8	-3.0
CFROI	7.0%	8.8%
Cash/MarketValue	31.7%	17.7%

Source: Factset

Style Exposure

	Long	Short
Beta	0.89	0.98
Volatility	23.2%	25.0%
Debt-to-equity	-1%	37%

Source: UBS PAS

Risk Statistics Delta Adjusted

Volatility (ex-ante; 1yr daily data)	5.7%
Volatility (ex-ante; 5yr monthly data)	4.8%
Var (99%, 5 days)	1.9%
Beta (ex-ante)	-0.01

Source: GS and UBS PAS

Outlook

Strategic Framework - Outlook 1st half of 2016

The six year bull cycle in global equities is over. Last year's correction was the initial leg down in a cyclical bear market. The FED induced policy divergence resulted in universal US dollar strength and a substantial drain on global US dollar liquidity. With such drastic tightening, commodity prices collapsed and related credit suffered. We think, this cycle is only mid-way and it will end with a major liquidity event. Investors across asset classes are in the process of re-pricing risk, not only economic risk but also liquidity risk. The period of central banks suppressing risk premia through monetary activism has come to a halt and the price we pay for ultra low interest rates is capital mis-allocation. In our opinion, the US FED's 'normalization' of interest rates is built on the faulty assumption that the US economy can stand on its own feet. Due to central banks' intervention it is impossible to distinguish noise from signal. For us, it seems that the US recovery is asset price led and therefore a phony construct, which easily unravels once asset prices revert. 2016 has all the hallmarks of a proper cyclical bear market. For the time being, the FED does not come to the rescue. Getting off the zero bound is easier said than done, as the Japanese found out a decade ago.

Tactical assessment – Outlook March 2016

The Japanese market nose dived in February. At some point Japanese equities were down -23% for the year and down -30% from last year's high. This is proper bear market territory and sentiment turned extremely negative. With investors throwing in the towel, downside exhaustion morphs into short covering. The nature of the ensuing rally provides insight into whether the bears regain control or central bankers underwrite another, increasingly costly, put option. It all hinges on the guardians of the global reserve currency who took the punch bowl away despite a developing manufacturing recession. We remain long caution and common sense, leading us to pursue opportunities in boring, unloved, stable and dividend paying stocks. Insanity, manifesting itself in outrageously high valuations, can be best identified in highly crowded momentum stocks. It seems fundamental bottom-up investing with a cautious top down macro overlay is working in our favor. Upside is capped with deteriorating fundamentals and downside is protected by central bankers stetting up bear traps.

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Historic Fund Performance (Monthly)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Class A EUR												
2016	1.35%	0.88%										
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%										
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	2.24%	5.81%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
Class B EUR	2.20%	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	€ 215,516,972
Firm AUM in USD	\$234,331,603

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

Fund Facts

Fund Size in EUR	€ 92,603,168
Fund Size in USD	\$100,687,425
Participations Outstanding Class A	236
Participations Outstanding Class B	59,239
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.
Depository	Bank of New York Mellon

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