Pelargos Japan Alpha Fund
February 2017

pelargos capital

Fund Performance

The Pelargos Japan Alpha Fund Class B declined -0.92% in January. Since July 2008, inception-to-date (ITD), the fund is up +55.02% with a realized volatility of 7.2%, whilst the MSCI Japan is up +12.2% ITD with a realized volatility of 20%.

Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,354.23	-0.93%	-0.44%	35.42%
Class B EUR	1,550.15	-0.92%	-0.36%	55.02%

Market Environment

The global bull market was roaring ahead and lifted the MSCI World Equities index in local currency by yet another 3.1%. The MSCI Japan underperformed significantly adding just +0.5% in Japanese yen (JPY) terms.

Risk assets globally showed very strong trend persistence. However, last month defensive sectors in Japan staged a strong comeback as Pharma, Beverage and Media outperformed. Sectors with lower price-to-earning (PE) and price-to-book (PB) ratios, such as banks and transportation, as displayed on the right, performed poorly. The revival phase of value stopped outperforming since December 2016. We monitor the stabilization of the value factor closely. Once the multi-month consolidation period has come to an end we expect value stocks to regain strength again.

The earnings season, which peaked in February, showed a very favorable trend for Japanese equities. Listed companies are doing well and return-on-equity is decisively improving due to a better operating environment as well as higher shareholder return policies. With earnings season behind us investors attention towards macro related factors will increase again. The JPY has been trading sideways for the past few months. With the Japanese bond prices basically set by the Bank of Japan (BOJ) the key determinate to drive the JPY is the US 10-year yield, which started to increase again recently. Volatility continued to compress as the market traded in a very narrow range. As pair-wise correlation declined, the daily correlation of the fund with the overall benchmark was 0.45 last month.

Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Pharma	3.7%	2.9%	1.6	24.8
Media	3.6%	2.3%	1.6	18.4
Food Beverage	2.7%	1.1%	1.5	22.4
Industry Group	**MTD**	**YTD**	**PB**	**PE**
Telecommunication	-3.6%	3.1%	2.0	14.7
Banks	-2.7%	-0.7%	0.5	10.3
Transportation	-2.6%	-1.1%	1.1	16.5

Source: Bloomberg

General Statistics

% Return long book	-1.1%
% Return short book	0.0%
# Long stocks	49
# Short stocks	10
% Long stocks ↑	41%
% Short stocks ↓	40%
# Up days / Down days	8 / 12
Daily Correlation with MSCI JP	0.45
Turnover as % NAV	35%

Source: Factset

Top 10 gross positions

Resona	4.6%	Nippon Gas	3.3%
Honda Motor	4.1%	Azbil	3.2%
Pola Orbis	3.5%	Toshiba PS	2.8%
Mitsui Fudosan	3.4%	Nabtesco	2.8%
Fanuc	3.3%	Kikkoman	2.8%

Source: BNY Mellon Fund Services

Single Stock Activity

Largest Buy & Buy Cover*		Largest Sell & Short Sell**	
Honda Motor	B	Shin-Etsu Chemical	S
Daicel	B	Pola Orbis	S
Sumitomo MM	B	Kikkoman	SS
Fanuc	B	Fuji Media	S
Mitsui Fudosan	B	Nippon Building Fund	SS

** B = Buy; BC = Buy Cover* — *Source: BNY Mellon Fund Services*

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

Investment Strategy

As volatility collapsed and pair wise correlation declined we increased single stock positions. Pola Orbis was the largest position in January and as the stock appreciated after the introduction of its innovative 'wrinkle-short' product we sold into strength. We increased position sizes in Honda, Resona and Fanuc. The share prices of these long term core positions finally broke out to the upside and with price momentum reasserting itself we tactically increased position sizes against a back drop of improving fundamentals for each of those companies.

The top 10 positions account for 34% of gross exposure and is a well-balanced collection of domestic, very company specific business models and stocks exposed to the global cycle without being overly dependent on either interest rates or the Japanese yen.

Over the past few months we took profits on cyclical low price-to-book (PB) stocks and increased position sizes in higher return-on-assets franchises. Examples for the later are the likes of Nabtesco, Fanuc and Azbil.

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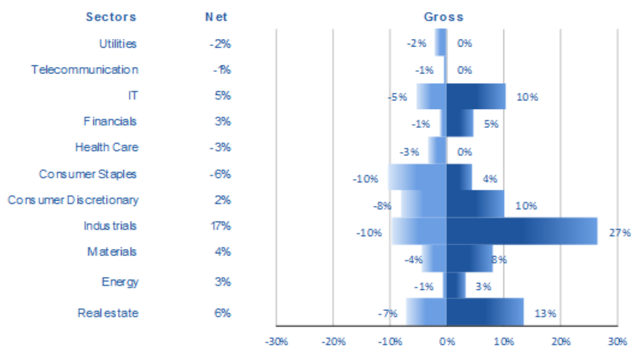
Investment Strategy

Equity volatility declined across the globe, as such the magnitude of single stock moves was limited. Therefore neither on the gainers nor the losers side there are no significant outliers this month. The top two gainers were Azbil and Nabtesco; we timely increased position sizes and both stocks added 0.1% each. Even one short position, Kikkoman, made it into the top gainers ranking. With regards to the losers Toshiba Plant System subtracted -0.2% from the overall performance. The stock traded at exactly the same level as 10 months ago, trading in a rather narrow range of just 10%. January's +0.2% positive contribution was lost again in February. Sumco added 40bps in January and in total more than +1.3% since we initiated the position in October last year. We already trimmed the position in January and were looking to re-size the position after a decent correction. So we did, however the correction went somewhat further and took longer than we anticipated resulting in a loss of 0.2% in February.
Most of the gross exposure is allocated in the sectors Industrials, Real Estate, Consumer Staples and Consumers Discretionary. There is little to no exposure in Utilities, Telecom, Health Care and Energy. The net exposure end of February stood at 28%, of which the bulk (17%) relates to Industrials and (6%) Real Estate.

Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Azbil	L	0.1%	Toshiba PS	L	-0.2%
Nabtesco	L	0.1%	Sumco	L	-0.2%
Chiyoda Co	L	0.1%	Mitsui Fudosan	L	-0.2%
Kikkoman	S	0.1%	RELIA	L	-0.1%
Resona	L	0.1%	Sumitomo MM	L	-0.1%

**CTR = Contribution* *Source: Factset*

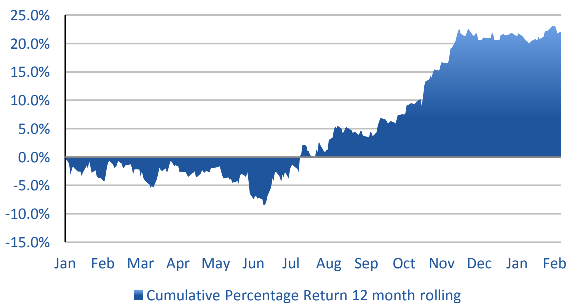


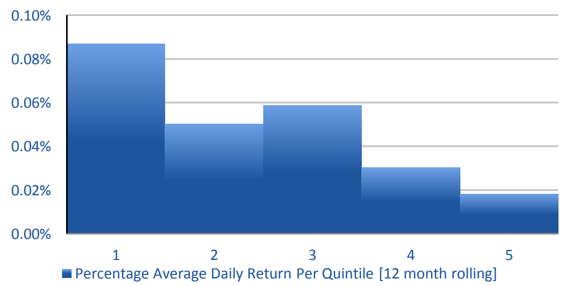
Source: UBS PAS

Value Factor Performance*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MoM	-0.4%	1%	2%	0.9%	-0.1%	-0.6%
YoY	6.6%	8%	21%	15.8%	5.9%	10.3%

*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 July and peaked in December. The strong performance of value was very consistent across different types of definitions and sectors. The strong performance of value stocks has stalled. However, value stocks on an absolute basis still exhibit strong momentum, but expensive defensive started to catch up indeed.

The P/E of the long book increased was 17x compared to 25x for the short book. The EV/EBITDA of the long book is 7.9x compared to 11.7x for the short book. The dividend yield of the long book is 2.2% compared to 1.7% in the short book.

The weighted average P/B of the long book is 1.6x compared to 2.4x for the short book. Price momentum exposure has increased significantly. On a 9-month basis, the long book's price momentum is +21% and the short book's price momentum is just a mere +2%.

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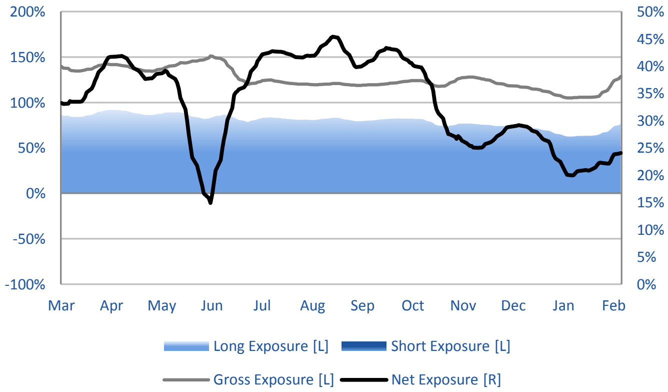
Risk Measurement and Management

The chart below shows the rolling 12-month net and gross exposure as 10 (trading) days moving averages.
We were well positioned for the strong revival in cyclical value and in a very disciplined manner we took profits during the October to January period. Therefore the net exposure dropped down to +20% and gross exposure to 100% by mid February.

The ex-ante volatility based on daily data stood at 5.9% with an ex-ante beta of 0.24. The beta of the long book exceeds that of the short book as value opportunities are concentrated in perceived higher beta situations.



*Source: BNY Mellon Fund Services**

Fund Overview

	Long	Short
Price to Earnings (PE)	16.8	25.0
EV/EBITDA	7.9	11.7
Price to Book (PB)	1.6	2.4
Dividend Yield	2.2	1.7
EV/IC	1.0	2.0
1 month momentum	-0.1	-1.8
6 month momentum	20.9	6.0
9 month momentum	21.0	2.3
Earnings momentum (1M)	18.0	14.1
Earnings momentum (3M)	16.3	18.3
CFROI	8.5%	10.4%
Cash/MarketValue	31.2%	15.6%

Source: Factset

Style Exposure

	Long	Short
Beta	0.97	0.87
Volatility	14.0%	12.8%
Debt-to-equity	11%	51%

Source: UBS PAS

Risk Statistics Delta Adjusted

Volatility (ex-ante; 3 months daily data)	5.9%
Volatility (ex-ante; 5yr monthly data)	6.6%
Var (99%, 5 days)	1.2%
Beta (ex-ante)	0.24

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 2016 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
We viewed the August 2015 – June 2016 as a cyclical bear market after which the structural bull market will reassert itself. From the bottom of the cyclical bear market in summer last year cyclical value had a great run and the mispricing of cyclicals relative to defensives has corrected to some extent. In our opinion there is more to go. For the last 3 months our value long positions are trading sideways and the shorts in expensive defensive started to slowly move higher. On an absolute basis our long positions are consolidating and we expect a reacceleration after this consolidation period. With regards to the shorts we are convinced the price other investors pay for these low volatility consumer staples is excessive and our long positions offer much better risk-reward.

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Historic Fund Performance (Monthly)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Class A EUR												
2017	0.49%	-0.93%										
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												
2017	0.56%	-0.92%										
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)

	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Class A EUR	-0.44%	1.78%	5.81%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
Class B EUR	-0.36%	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	€ 219,192,583
Firm AUM in USD	$231,818,076

Portfolio Managers

Richard Dingemans

Michael Kretschmer

Fund Facts

Fund Size in EUR	€ 93,258,495
Fund Size in USD	$98,630,185
Participations Outstanding Class A	236
Participations Outstanding Class B	59,955
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

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Fund Description		Legal	De Brauw Blackstone Westbroek N.V.
Investment Strategy	Equity Long/Short	**Title Holder**	SGG Netherlands N.V.
Investment Style	Value with a twist	**Depositary**	Bank of New York Mellon
Investment Objective	Capital appreciation through investing in long/short positions in Japanese securities		

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