Pelargos Japan Alpha Fund
June 2017

Fund Performance

The Pelargos Japan Alpha Fund Class B appreciated +1.32% in June. Since July 2008, inception-to-date (ITD), the fund is up +53.98% with a realized volatility of 7.1%, whilst the MSCI Japan is up +17% ITD with a realized volatility of 20%.

Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,342.93	1.28%	-1.27%	34.29%
Class B EUR	1,539.79	1.32%	-1.03%	53.98%

Market Environment

June turned out to be another strong month for Japanese equities as the MSCI Japan appreciated 2.6% in Japanese yen (JPY) terms. Finally, value stocks outperformed by a significant margin. The long book performed roughly in line appreciating by +2.2%. On the other hand, the short book drastically underperformed and declined by 0.7%. A good spread indeed. The hit ratio was outstanding in June with 66% of long stock appreciating and 60% of short positions declining.

Low price-to-book cyclicals performed best last month whilst Consumer Staples underperformed. With government bond yields and the yen stabilizing, money flows into low-beta, bond-proxies diminished. With incremental buying depleting the expensive defensives declined under their own weight of absurdly high valuations. The Food & Beverage segment trades at 21x price-to-earnings (P/E) ratio and Household Products at 33x P/E. In comparison, several of our long positions in the industrials sector trade below break-up level.

This month the systematic hedge book, with which we manage the level of net exposure, contributed positively as well. Last month it was a significant drag on the performance, but this month the basket only appreciated +0.7% and thereby nicely underperforming the market by a wide margin. The turnover this month was rather low with 23%. The correlation with the market seems elevated. Most appealing undervaluation can be found in the cheap cyclicals, which tend to be higher correlated with beta. Thus value stocks in June were positively correlated with beta.

Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Software & Services	7.8%	33.2%	2.2	19.8
Banks	7.5%	-1.2%	0.5	10.6
Materials	7.0%	6.1%	1.0	14.7
Industry Group	**MTD**	**YTD**	**PB**	**PE**
Semiconductors	-1.6%	23.7%	1.8	22.8
Food Beverage	-1.1%	10.6%	1.5	21.2
Utilities	0.0%	4.0%	0.9	16.7

Source: Bloomberg

General Statistics

% Return long book	2.2%
% Return short book	-0.7%
# Long stocks	47
# Short stocks	10
% Long stocks ↑	66%
% Short stocks ↓	60%
# Up days / Down days	11 / 10
Daily Correlation with MSCI JP	0.79
Turnover as % NAV	23%

Source: Factset

Top 10 gross positions

Nishimatsu Con.	5.2%	Heiwa Real Est.	2.4%
Mitsui Fudosan	2.9%	Relia	2.4%
Maeda Road	2.8%	Familymart	2.3%
NBF	2.6%	Mitsui Chem.	2.1%
Toshiba Plant	2.5%	Pola Orbis	2.1%

Source: BNY Mellon Fund Services

Single Stock Activity

Largest Buy*	Largest Sell*
Tokyu Corp	Pola Orbis
Maeda Road Const	Yamato Holdings
Murata Mfg	Fancl Corp
IDOM	Megmilk Snow
JVC Kenwood	Kao Corp

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

Investment Strategy

Nishimatsu Construction remained the largest long position. We trimmed the Pola Orbis long position during last month down to 2.1%. The earnings impact from the blockbuster product is largely understood and with recent upward revision the stock's valuation is still elevated and with that we risk of overstaying our welcome.

In the same context we took profits in long position Fancl. A multi-year turnaround story in the functional nutrition industry. The stock appreciated 30% over the past 3 months and with close proximity to our target price and taking into account lofty valuation we took action. In the same line of thinking, we increased the shorts in the expensive defensives such as Megmilk Snow and Kao.

We wrote about Maeda Road last month and as the stock price pulled back somewhat during June we were able to increase the position size. We re-initiated a long position in private railroad operator Tokyu.

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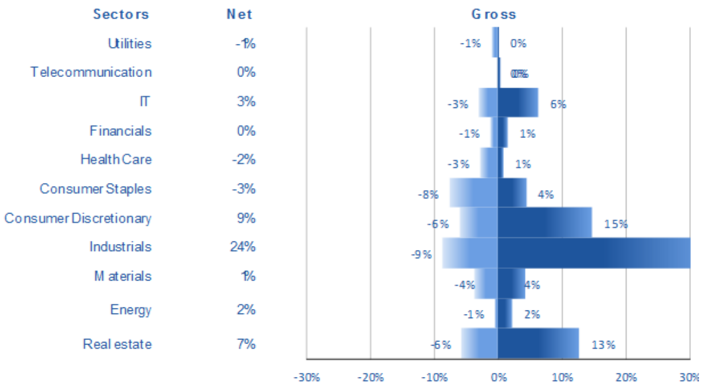
Several smaller positions made it into the top five contributors this month. Fujitec is a company which we visited for the first time 12 years ago and initiated a small long position in September 2014. This elevator company has tremendous earnings potential. Looking simply at current multiples, 1.3x P/B and 14x P/E for a 10% return-on-equity the stock does not look extremely mispriced. However, 40% of market capitalization consists of net current assets (meaning current assets - total liability). The company already bought back 13.5% of outstanding shares which makes perfect sense at such low valuations. As a reference point, the leading competitor Kone has a RoE of 50% without leverage. The upside is tremendous, but clearly slow and path dependent.

Losses this month were again very muted. Biggest single stock loss was only 0.1% and to a large extend price-reversal driven without much news of any significance.
Due to bottom-up position sizing the sector allocation has shifted. Whilst last month the net exposure in Consumer Staples was +3%, as of end of June the exposure declined to -3%. As explained above, profit taking and swiftly increasing the shorts in expensive defensives drove the sector exposure. Exposure in Utilities and Telcos as well as in Energy remains negligible. These highly regulated sector pose challenges to extract alpha therefore we do not allocate research effort to those sectors.

Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Fujitec Co	L	0.2%	Nishimatsu Const	L	-0.1%
Gulliver	L	0.2%	Pola Orbis	L	-0.1%
Toshiba Plant Sy	L	0.2%	Familymart	S	-0.1%
H I S	L	0.2%	Takara Leben Infra	L	-0.1%
Mitsui Chemicals	L	0.2%	Fuji Machine Mfg	L	-0.1%

*CTR = Contribution *Source: Factset*

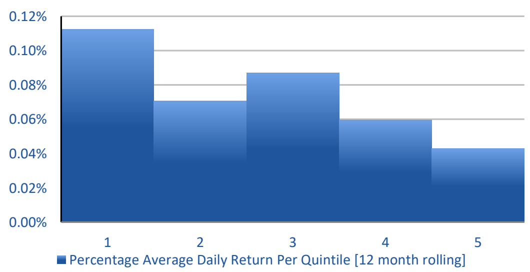


Source: UBS PAS

Value Factor Performance*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MoM	2%	-1%	1%	1%	1%	2%
YoY	13%	8%	17%	8%	8%	10%

*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.

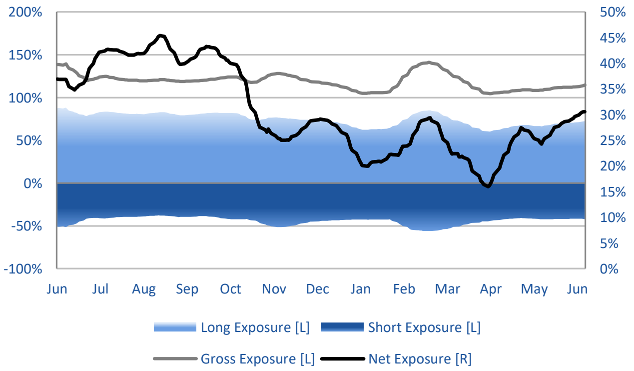
The outperformance of the value factor started in the summer of last year and peaked in December. The strong performance of value was very consistent across different types of definitions and sectors. Since December, the strong performance of value stocks has largely reversed, but finally June posted a positive month.
The value factor remained closely tied to global bond yields and the Japanese yen. In June, price-to-book (P/B) posted a small gain and price-to-earnings a more solid gain of +2%. We track many more value factors other than shown on the left and the majority of them were slightly higher for the month of June. We have good reason to believe that value will have a bit of a run just because the intra-market dispersion of cheap versus expensive reached extremes again.

The weighted average P/B of the long book is 1.5x compared to 1.9x for the short book. Price momentum exposure continues to be very high. On a 9-month basis, the long book's price momentum is +26.5% and the short book's price momentum was just +4.5%.

The P/E of the long book was 15.6x compared to 23.7x for the short book. The EV/EBITDA of the long book is 7.9x compared to 11.1x for the short book. The dividend yield of the long book is 2.2% compared to 1.7% in the short book.

Risk Measurement and Management

The chart below shows the rolling 12-month net and gross exposure as 10 (trading) days moving averages.
Last summer we were well positioned for the strong revival in cyclical value and in a disciplined manner took profits during the October to January period. Therefore, the net exposure dropped to +20% and gross exposure to 100% by mid-February. Late February we re-introduced a higher risk allocation and expanded the long as well as the short book. As our approach was not rewarded, we quickly withdrew. During May and June our indictors continued to support a higher risk budget, and at the end of June, gross exposure stood at 117% with net exposure at 29%.
Despite the higher risk budget, but because of collapsing spot volatility the ex-ante volatility declined to just 4.9%. The ex-ante beta remained at 0.29 despite the higher net exposure.



*Source: BNY Mellon Fund Services**

Fund Overview

	Long	Short
Price to Earnings (PE)	15.6	23.7
EV/EBITDA	7.9	11.1
Price to Book (PB)	1.5	1.9
Dividend Yield	2.2	1.7
EV/IC	1.0	1.5
1 month momentum	2.9	-1.4
6 month momentum	5.1	-2.0
9 month momentum	26.5	4.5
Earnings momentum (1M)	-13.3	-16.5
Earnings momentum (3M)	-13.5	-9.0
CFROI	8.8%	7.9%
Cash/MarketValue	36.8%	18.7%

Source: Factset

Style Exposure

	Long	Short
Beta	0.88	0.82
Volatility	10.5%	10.5%
Debt-to-equity	5%	43%

Source: UBS PAS

Risk Statistics Delta Adjusted

Volatility (ex-ante; 3 months daily data)	4.9%
Volatility (ex-ante; 5yr monthly data)	6.3%
Var (99%, 5 days)	0.9%
Beta (ex-ante)	0.29

Source: GS and Nomura

Outlook

Strategic Framework - Outlook 2nd half 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. In June 2016, the Japanese market bottomed together with global bond yields , and with that the greatest rotation from defensives into cyclicals for the past decade occurred. In our opinion, the June to December rally was the initial up-leg in the continuation of the structural bull. In 2017 volatility in Japan on an index level collapsed, which is a global phenomenon. Japan traded in a very narrow range from December until end of March. In April, Japanese equities had a bit of a hick-up, which was much less than the usual 20% drop, and quickly rebounded. This low volatility is rather atypical for a historically extremely volatile market. Within that framework, value strategies underperformed significantly during the first half of 2017 and expensive, low volatility strategies outperformed.
For the first half of 2017 we expected that value stocks would continue to outperform as yields needed to adjust higher globally, be it due to better economic growth or central banks tapering. The timing of this thesis was certainly off and finally in June we saw a distinct improvement in our indicators and somewhat higher yields ignited the long overdue rally in our 'too-cheap-to-be-true' long positions.
Yes, global economic growth is far from buoyant, to say the least. We expect sub-par growth for the coming years and this continues to put pressure on yields. By association, through indiscriminately designed ETF baskets, bond-like equity outperforms cyclicals as yields head lower. However, this phenomenon offers a great opportunity as we find plenty of long stocks, which are outrageously inexpensive especially compared to the excessive valuation paid for the recession-proof consumer stocks. Even within the Japanese context there are pockets of structural growth. Global IT capex is booming driven by Internet-of-Things and increased chip penetration in everything, most noteworthy cars. The bottom-up research coverage in Japan remains anemic and therefore little attention is paid to the great earnings potential those companies have.
Tactical assessment - monthly outlook
With regards to the immediate future it is worth repeating that our long book has tremendous upside. Valuations are still cheap, earnings revisions are trending upwardly and buyback programs are accretive for shareholders, which is supportive from a flow perspective. This is more or less a sweet spot for Japanese equities and despite that Japan is still amongst the worst performing developed equity markets globally. With the headwinds, such as lower yields and strong yen, stabilizing the re-rating potential on a short term basis is great. In earlier newsletters we mentioned that we stuck to low risk budgets as our style was not working. Now that value has bottomed out and the performance has recovered, we have started to increase gross and net exposure again.

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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%							-1.27%
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%							-1.03%
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	€ 224,768,774
Firm AUM in USD	$256,360,019

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

Contact Details

WTC The Hague, Tower E 7th floor

Prinses Margrietplantsoen 43

Fund Facts

Fund Size in EUR	€ 86,798,258
Fund Size in USD	$98,997,750
Participations Outstanding Class A	236
Participations Outstanding Class B	56,164
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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