

# Pelargos Japan Alpha Fund

## March 2015



### Fund Performance

The Pelargos Japan Alpha Fund Class B declined -0.27% in March. Inception-to-date (ITD) the fund is up 48.04% with a realized volatility of 7.3%, whilst the MSCI Japan is up 16.2% ITD with a volatility of 20.1%.

### Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,303.15	-0.32%	3.17%	30.32%
Class A USD	956.51	-0.51%	2.82%	-4.35%
Class A JPY	94,849	-0.51%	2.81%	-5.15%
Class B EUR	1,480.38	-0.27%	3.30%	48.04%

### Market Environment

In March, the MSCI Japan appreciated 1.2% in Japanese Yen (JPY) terms. The JPY advanced significantly (+3.9%) against the euro and depreciated slightly against the US dollar (-0.4%). In March, foreign exchange markets were less directional, most commodities stabilized and bond markets traded sideways with sizeable swings. In the last week of March the Japanese market sold off 1.6%, ending its 9-week winning streak.

The month of March was the fiscal year end for most Japanese companies. High dividend and high price momentum stocks performed especially well into fiscal year end. At the same time, market breadth declined in March, and despite a marginally higher equity index, investors took profits on a wider scale.

The market darlings were (again) the household product names and pharma stocks. As the pension fund system in Japan rebalances its bond/equity exposure we observe a clear preference for low variance themes such as low beta, high dividend, high earnings revisions and, in our opinion, expensive stocks.

On our measures the crowding into high price momentum stocks is at extremes. We monitor reversal behavior carefully on a daily basis in order to assess whether this trend is finally exhausted.

### Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Software & Serv.	12.6%	21.9%	1.8	19.9
Household Prod.	8.7%	24.4%	2.1	27.4
Pharma	7.2%	24.7%	1.7	24.9

Industry Group	MTD	YTD	PB	PE
Energy	-5.7%	-1.0%	0.8	18.2
Banks	-3.8%	7.5%	0.6	12.4
Transportation	-2.7%	10.3%	1.1	18.3

Source: Bloomberg

### General Statistics

% Return long book	0.9%
% Return short book	2.1%
# Long stocks	49
# Short stocks	7
% Long stocks ↑	39%
% Short stocks ↓	43%
# Up days / Down days	12 / 9
Daily Correlation with MSCI JP	0.57
Turnover as % NAV	25%

Source: Factset

### Largest Long & Short Holdings

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

Source: Citi Financial Services

### Single Stock Activity

Largest Buy & Buy Cover*		Largest Sell & Short Sell**	
Komori Corp	B	Terumo Corp	S
Seven & I	B	JVC Kenwood	S
Daiwa Secs Grp	B	Dai Ichi Life	S
Ichigo Group	B	LIXIL Group	S
Hirose Electric	BC	Fujifilm	S

\* B = Buy; BC = Buy Cover

Source: Citi Financial Services

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

### Investment Strategy

Our top 5 long positions are the same as last month, only the ranking has changed. We aggressively bought Ichigo Group during February and it is now the largest position. We reduced the position sizes of Ryosan and Moshi Moshi. Both stocks have substantial upside; however in a portfolio context these positions became too large.

With regard to the top 5 short positions, we covered Hirose very timely. This stock was a massive underperformer, however the demand side for Hirose's business seems to be bottoming out and Hirose has a fortress like balance sheet. In the current market environment it is too risky to structurally short high cash-to-market capitalization stocks as buy backs are on every corporate's agenda. In Japan, buy back announcements are rewarded with instant price spikes.

We closed our long position Terumo; bought around 2200 JPY and sold at 3200 JPY as we sensed the undervaluation has been corrected for the time being. This was a classic investment case of 'buying a great company at a fair price' rather than 'buying a fair company at a great price'.

**Investment Strategy**

Our high conviction call on Ichigo Group finally started to deliver. We have written too many times about Ichigo in this newsletter and this time we simply want to re-emphasis that the best is still to come. We diligently analyze management execution with regards to solar / real estate projects and remain excited about the valuation upside. After gaining 18% in February the stock added another 9% in March.

Prior month's star performer Ryosan correct somewhat, -2.9%, and our exit from long position JVC Kenwood was well timed (-5.6%); at least in the short run.

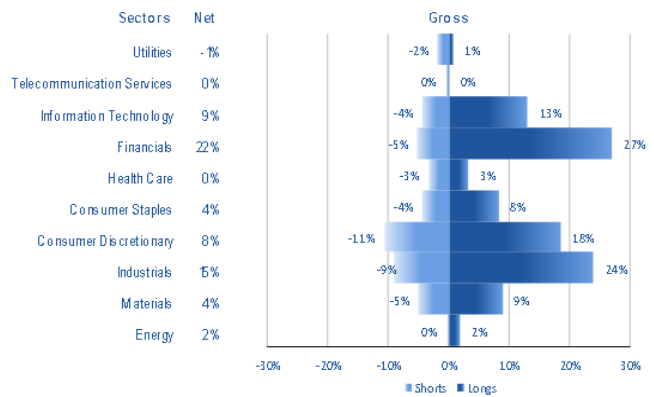
Resona had the biggest negative contribution in March. The bank index was down 3.8% and Resona underperformed, dropping -11% on what might be perceived as a disappointing mid-term plan. The management is taking the right measures at the right pace and markets are just impatience and short sighted. It will take time and currently no short term catalyst seems apparent.

**Top Gainers & Losers**

Gainers		CTR*	Losers		CTR*
Ichigo Group	L	0.5%	Resona	L	-0.2%
Pola Orbis	L	0.3%	Tonen General	L	-0.1%
Acom	L	0.2%	Iida Home	L	-0.1%
Invincible REIT	L	0.2%	Fancl Corp	L	-0.1%
Fujifilm	L	0.2%	Park24 Co	S	-0.1%

\*CTR = Contribution

Source: Factset

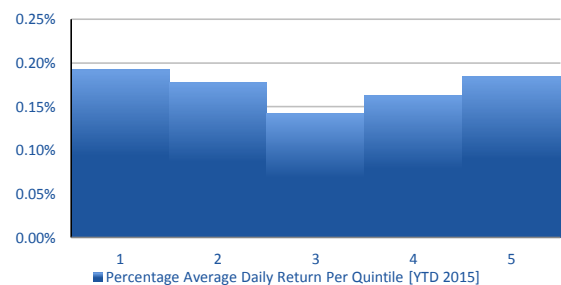
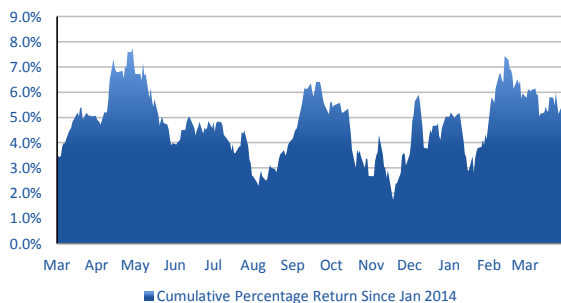


Source: UBS PAS

**Value Factor Performance\***

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MTD	-0.4%	0.7%	-0.7%	-0.7%	0.2%	1.0%
YTD	-2.0%	2.8%	-1.7%	1.8%	-0.5%	-0.8%

Source: Factset\*



Source: Factset\*

**Style Performance**

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

The improvement in price-to-book (P/B) factor performance turned out to be short lived. Our favorite value measure declined last month, however earnings based factors such as P/E and EV/EBITDA were flat for the month.

Our books are neutral with regards to short term and medium term price momentum. However, on a 9 month basis our long book has significantly higher price momentum characteristic compared to the short book.

Admittedly, we do not have many short positions left, however the P/B of the long book is 1.6x and the short book 4.7x. The EV/EBITDA of the long book a mere 5.7x whilst the short book trades at an aggregated 39.1x.

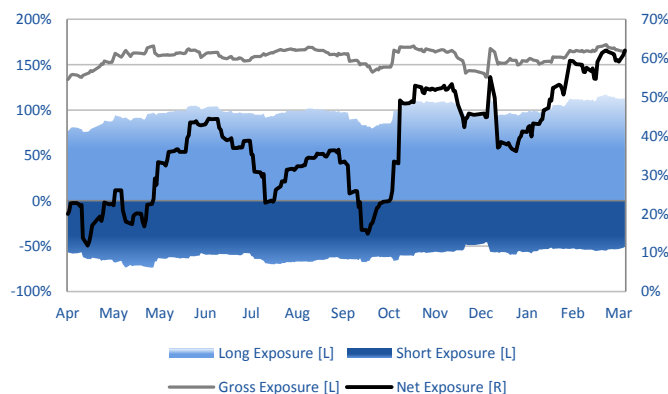
Our long book consists of companies holding a significant amount of cash, which depresses the CFROI on the long side versus that of the short book.

**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.

Throughout February the net exposure was stable and elevated at 60%. Most importantly, as spot volatility has dropped we added inexpensive put protection to the tune of 15% effectively lowering downside exposure of the net to 45%.

Our net exposure is highly stock specific with limited exposure to crowded, high momentum trades. We still observe plenty of days on which our net exposure is negatively correlated with the market despite the significant net exposure.



Source: Citi Financial Services\*

Fund Overview		
	Long	Short
Price to Earnings (PE)	18.1	117.0
EV/EBITDA	5.7	39.1
Price to Book (PB)	1.6	4.7
Dividend Yield	1.7	1.4
EV/IC	0.9	3.6
1 month momentum	1.7	0.0
6 month momentum	22.7	24.0
9 month momentum	25.3	17.8
Earnings momentum (1M)	4.5	-0.3
Earnings momentum (3M)	9.1	3.8
CFROI	6.5%	10.7%
Cash/MarketValue	39.5%	19.5%

Source: Factset

Style Exposure		
	Long	Short
Beta	1.0	0.9
Volatility	15.7%	14.7%
Debt-to-equity	15.00	73.00

Source: UBS PAS

Risk Statistics Delta Adjusted	
Volatility (ex-ante; 1yr daily data)	11.1%
Volatility (ex-ante; 5yr monthly data)	11.1%
Var (99%, 5 days)	3.4%
Beta (ex-ante)	0.51

Source: GS and UBS PAS

**Outlook**

*Strategic Framework - Outlook 1st half of 2015*

The VAT hike in 2014 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 April 2015*

The Japanese market had a massive run from the January lows and is up double digits for the year. It is tempting to call for a break, more caution and it is fair to assume that the market will be trading sideways for a while. A few segments of the market are unsustainably high and spill-over effects might cause a wobble. That is why we took out some insurance in terms of a sizeable put option. Nevertheless, our high conviction positions in the long book enjoy sound fundamentals at very inexpensive valuations. Based on valuation there are plenty of short opportunities. Why are Japanese pharma stocks trading at 25x PE or staples at 28x PE, Kikkoman at 50x PE? Pharma is not our play ground, but the big valuation dispersion within the overall Japanese equity market provides interesting long/short opportunities.

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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%	-0.32%									
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%	-0.51%									
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%	-0.51%									
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%	-0.27%									
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>	3.17%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
<b>Class A USD</b>	2.82%	-7.38%	0.43%					
<b>Class A JPY</b>	2.81%	-8.06%	0.35%					
<b>Class B EUR</b>	3.30%	-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>	€ 92,849,795
<b>Fund Size in USD</b>	\$99,637,115
<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% (accrues to Fund)

# Pelargos Japan Alpha Fund

## March 2015



### Company Facts

**Firm AUM in EUR** € 233,345,267  
**Firm AUM in USD** \$250,402,806

### 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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