

Pelargos Japan Alpha Fund

May 2015



Fund Performance

The Pelargos Japan Alpha Fund Class B increased +2.57% in May. Since July 2008, inception-to-date (ITD), the fund is up 56.78% with a realized volatility of 7.3%, whilst the MSCI Japan is up 26% ITD with a volatility of 20%.

Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,379.14	2.54%	9.19%	37.91%
Class A USD	1,015.67	2.62%	9.18%	1.57%
Class A JPY	100,616	2.88%	9.06%	0.62%
Class B EUR	1,567.82	2.57%	9.40%	56.78%

Market Environment

In May, the MSCI Japan appreciated 5% in Japanese Yen (JPY) terms. The JPY dropped 3.8% against the US dollar and 1.8% against the euro. After six months of sideways trading within a narrow range, the JPY broke down in the third week of May and rapidly depreciated. US dollar strength regained momentum globally across all major currencies as market participants assess how to factor in the start of the FED's tightening cycle.

The increased volatility in foreign exchange markets finally spilled-over into fixed income. Long dated sovereign bonds started to correct since the start of QE in Europe; classic 'buy the rumor, sell the news' behavior. Volatility in equities picked up in emerging markets, but remained muted in developed markets.

Our long book underperformed the MSCI Japan slightly (4.7% versus 5%), which is to be expected in a strong market rally as the long book has a low beta bias. The short book, admittedly we only have few shorts left, was down -0.5% for the month. April performance was similar, when the long book performed in-line with the market, despite its lower beta characteristics and the short book was down -0.8%.

5 out of the 10 shorts were down last month. The fund was up 13 days of the 20 trading days and the correlation was just 0.14. The turnover for the month was rather muted at 20%.

Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Utilities	11.5%	20.3%	1.2	18.5
Semiconductors	11.2%	3.2%	1.5	15.3
Insurance	9.0%	30.7%	1.0	16.6

Industry Group	MTD	YTD	PB	PE
Consumer Services	-0.8%	10.0%	1.9	20.3
Pharma	1.0%	25.7%	1.6	27.0
Household Prod.	1.7%	23.5%	2.2	33.7

Source: Bloomberg

General Statistics

% Return long book	4.7%
% Return short book	-0.5%
# Long stocks	51
# Short stocks	10
% Long stocks ↑	73%
% Short stocks ↓	50%
# Up days / Down days	13 / 7
Daily Correlation with MSCI JP	0.14
Turnover as % NAV	20%

Source: Factset

Largest Long & Short Holdings

Longs	Shorts
Moshi Moshi	Nippon Building Fund
Ichigo Group	Japan Real Estat
Ryosan	McDonald's Holding
Honda Motor	Nissin Foods
Yamada Denki	Nippon Express

Source: Citi Financial Services

Single Stock Activity

Largest Buy & Buy Cover*		Largest Sell & Short Sell**	
Yamada Denki	B	East Japan Rail	S
Daicel Corp	B	Honda Motor	S
Nippon Yusen	BC	Nippon Express	SS
Maruichi Stl Tub	B	Ichigo Group	S
Nishimatsu Const	B	Sumitomo Heavy	S

* B = Buy; BC = Buy Cover

Source: Citi Financial Services

** S = Sell; SS = Short Sell

Investment Strategy

A few small changes compared to last month; on the long side, we took profits in Ichigo and Honda. On the short side, we introduced Nippon Express.

Last month we highlighted the valuation extremes in the food sector and that the likes of Kikkoman (36x P/E), Meiji (26x P/E) and Yakult (38x P/E) were trading at excessive valuations.

Nippon Express is another stock for which expectations are at odds with fundamentals. This parcel delivery company has had no EPS growth in the past 10 years, trades at 25x trailing P/E, and with a P/B of 1.3x despite 2.5% operation profit margins and a RoE of just 5%. Future EPS growth is expected to come from better pricing and this will be, in our opinion, extremely difficult to achieve. The company is a second tier player and Japan Post is aggressively gaining market share in preparation for its IPO later this year. We re-established a long position in Nishimatsu Construction. After our recent company visit and a 20%+ correction from last year's highs the risk-reward is very attractive again.

Investment Strategy

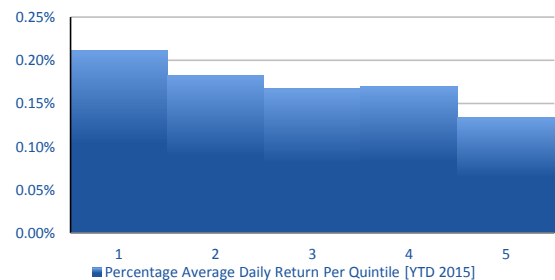
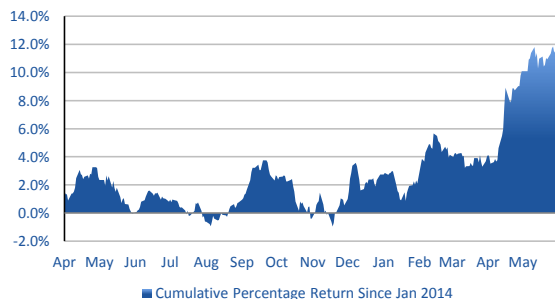
Moshi Moshi's share price continued its move higher after a pause in April. The high conviction position appreciated 14% last month as the company presented strong results and confidence in its outlook. We have followed the company for many years, there is no analyst coverage and we are confident the management continues to deliver. The majority shareholder Mitsui appointed a new CEO one year ago and he presented a new medium-term growth strategy. The balance sheet is debt free with plenty of excess cash to support future dividend increases.

After a minor pull back in March and April, Ryosan reaccelerated higher +12% for the month. The company presented great results and especially the dividend increase and a generally more positive stance towards share holders acted as a catalyst. Iida Home Group rallied strongly after its earnings announcement. The stock performed poorly for the past year as this detached house developer carried too much land inventory which worried market participants. Iida has cleared the inventory more aggressively than anticipated and promised to implement stricter guidelines for this 6-way merged entity.

The Financials net exposure is steadily declining for the past few months. Resona and Dai Ichi Life had massive rallies, which we sold into and as mentioned in last month's newsletter we hedged part of the REIT exposure.

Value Factor Performance*						
	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MTD	4.7%	0.0%	0.7%	-1.1%	0.7%	-1.6%
YTD	6.9%	4.6%	4.6%	3.6%	4.2%	1.8%

Source: Factset*



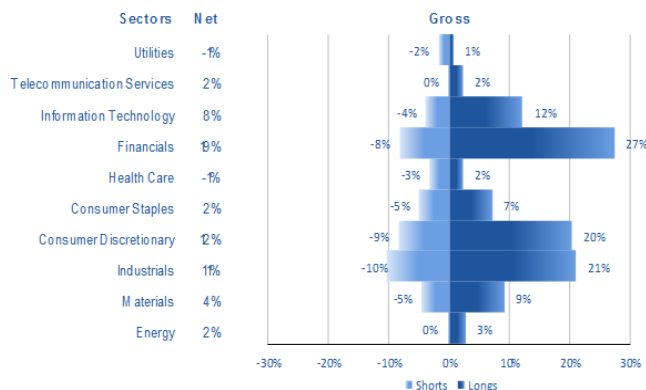
Source: Factset*

Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Moshi Moshi	L	0.6%	Fuji Machine Mfg	L	-0.2%
Ryosan	L	0.5%	Mitsui Soko	L	-0.1%
Iida Home Group	L	0.3%	Start Today	S	-0.1%
Resona Holdings	L	0.2%	Ichigo Group	L	-0.1%
Pola Orbis	L	0.2%	Fancl Corp	L	-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; this helps us to detect misallocation and helps our understanding of style trends and investor's behavior in Japan.

The value performance in April was extremely strong and we expected a bit of a pause or even a rotation back into expensive quality. The value performance continued, P/E was very strong and P/B up slightly. Only dividend yield and free cash flow-to-equity was down. The global sell off in long dated bonds had some repercussions in equity markets, as high dividend yielding stock underperformed.

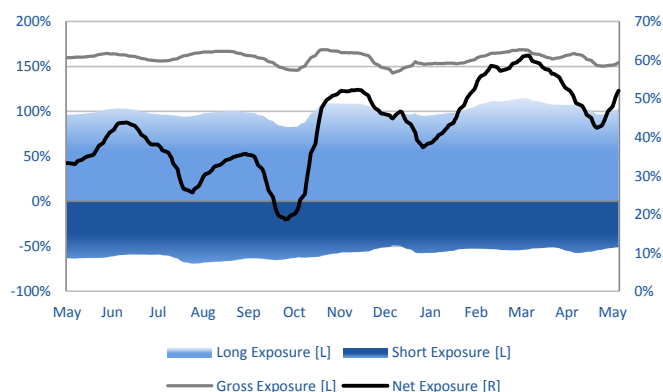
The current exposure in terms of value factors is shown on the next page. The dividend in the long book is actually same as in the short book. The biggest spread is in P/E, P/B and EV/EBITDA.

The numbers displayed are weighted averages. In the short book McDonalds Japan is an extreme outlier with a forward P/E ratio of 500x and currently the company is loss making. The median P/E for the short book is still 24.7x, this compares to a median P/E of 16.7 for the long book.

Risk Measurement and Management

The chart below shows the rolling 12-month net and gross exposure for the fund. As of this month we will show the exposures as 10 (trading) days moving averages. This, we think, gives a better representation and is less noisy as market moves tend to influence net- and gross exposure significantly. The gross exposure continues to be rather stable in a range between 150-160%.

Due to the strong performance over the past few months the price momentum exposure has increased. That said, the net exposure is highly stock specific and we refrain from owning crowded, expensive, 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)	17.5	63.4
EV/EBITDA	6.5	21.8
Price to Book (PB)	1.4	1.9
Dividend Yield	1.9	1.9
EV/IC	1.0	1.5
1 month momentum	4.8	-3.3
6 month momentum	20.7	3.8
9 month momentum	32.6	16.5
Earnings momentum (1M)	0.2	-19.8
Earnings momentum (3M)	2.2	-7.2
CFROI	5.4%	5.0%
Cash/MarketValue	39.9%	16.9%

Source: Factset

Style Exposure		
	Long	Short
Beta	0.9	0.9
Volatility	15.3%	14.6%
Debt-to-equity	10.00	48.00

Source: UBS PAS

Risk Statistics Delta Adjusted	
Volatility (ex-ante; 1yr daily data)	9.3%
Volatility (ex-ante; 5yr monthly data)	9.9%
Var (99%, 5 days)	2.8%
Beta (ex-ante)	0.42

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. 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 markets will challenge central banks to open the magic tool box once again.

Tactical assessment – Outlook June 2015

April and May delivered very strong performance in value related strategies. After years of lackluster value performance a turning point seems to have been reached. The smart beta bubble finally burst and the valuation gap between the cheapest and the dearest is still at multi-year extremes. The JPY depreciation is less directional, 10-year JGB's are less directional as bonds sell off and the BOJ support is very strong, but at diminishing growth rates. Macro economic data is still patchy, but on a micro level we observe a lot of positives. The shareholder return revolution is for real, and Japan is in the process of reorganizing its capital allocation process and freeing up idle capital resources. If it were to achieve the same with human resources a productivity boom will ensure. For the time being, we continue to focus on cheap assets with conservative balance sheets, that are ready to improve shareholder returns. On the short side we found a number of outrageous overvaluation situations which we closely follow.

Pelargos Japan Alpha Fund

May 2015



Historic Fund Performance (Monthly)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
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Class A EUR

2015	-1.28%	4.85%	-0.32%	3.21%	2.54%							
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%	3.48%	2.62%							
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%	3.11%	2.88%							
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%	3.25%	2.57%							
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
Class A EUR	9.19%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
Class A USD	9.18%	-7.38%	0.43%					
Class A JPY	9.06%	-8.06%	0.35%					
Class B EUR	9.40%	-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 A USD	NL0010545570
ISIN Class A JPY	NL0010545588
ISIN Class B EUR	NL0001118015
Inception Date Class A EUR	January 2009
Inception Date Class A USD	July 2013
Inception Date Class A JPY	July 2013
Inception Date Class B EUR	July 2008

Fund Facts

Fund Size in EUR	€ 98,296,235
Fund Size in USD	#N/A
Participations Outstanding Class A	436
Participations Outstanding Class B	62,382
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

Pelargos Japan Alpha Fund

May 2015



Company Facts

Firm AUM in EUR € 245,760,209
Firm AUM in USD \$269,992,166

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

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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