

### Fund Performance

The Pelargos Japan Alpha Fund Class B appreciated +0.14% in December. Since July 2008, inception-to-date (ITD), the fund is up +60.59% with a realized volatility of 6.9%, whilst the MSCI Japan is up +31% ITD with a realized volatility of 19%.

### Market Observations

The Japanese market appreciated another +1.3% in December. The bull market is in full swing and the year-end rally lifted the MSCI Japan to a 10-year high.

The Japanese equity market performed very well in the fourth quarter of 2017. Higher interest rates globally against a backdrop of strong global economic growth are very supportive for Japanese equities.

Cyclical stocks and interest rate sensitive stocks showed strong performance in December. The best performing sectors were Energy and Banks followed by Materials.

We are not heavily exposed to macro trades such as banks and therefore the long book slightly lagged the broader market and appreciated by +1.0%.

In December, the short selection in the fundamental core book was disappointing, especially in Industrials. The short book appreciated +3.5% last month.

This month the spread between the long and the fundamental short book was negative. However, with the long book up +1% and our systematic hedge book only increasing +0.5% last month, we squeezed out a small positive return to end the year at +3.2%.

The turnover in December was just 27% with in total 66 positions.

### Top 10 gross positions

Toshiba Plant	4.4%
Tokyu Corp	4.0%
Maeda Road	3.8%
Ichigo Group	3.2%
Japan Tobacco	3.0%
Nishimatsu Construction	3.0%
Pola Orbis	2.8%
Taihei Dengyo	2.7%
Heiwa Real Estate	2.7%
Fuji Media	2.7%

Source: BNY Mellon Fund Services

### Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,395.81	0.10%	2.61%	39.58%
Class B EUR	1,605.87	0.14%	3.22%	60.59%

### Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Energy	11.5%	38.3%	1.1	14.3
Banks	4.7%	7.0%	0.5	12.3
Materials	4.5%	31.7%	1.1	15.2
Industry Group	MTD	YTD	PB	PE
Telecommunication	-8.1%	9.8%	1.8	12.9
Software & Services	-2.2%	48.3%	2.5	22.4
Utilities	-2.1%	-5.1%	0.9	16.9

Source: Bloomberg

### General Statistics

% Return long book	1.0%
% Return short book	3.5%
# Long stocks	54
# Short stocks	12
% Long stocks ↑	63%
% Short stocks ↓	25%
# Up days / Down days	10 / 9
Daily Correlation with MSCI JP	0.45
Turnover as % NAV	27%

Source: Factset

### Investment Strategy

We construct the exposures bottom-up looking for undervalued, misperceived and easy to understand business models.

The list of names in the table on the left is a reflection of the opportunities we strongly believe in. This set of opportunities is heavily exposed to domestic factors and less to global growth or themes. With the current set of high conviction stocks we have a strong tilt towards smaller capitalization stocks. As a result fewer sell-side analyst cover our holdings, the consequence being that it is easier to establish an informational edge and that fewer foreigners are involved in these stocks.

In addition, our domestic exposure tends to have a very strong corporate governance angle. We aim for stable, high return-on-investment business models with overcapitalized balance sheets. We see ample of opportunities for those companies to return cash to shareholders, and through share buy-backs compound earnings-per-share even faster.

**Investment Strategy**

Post the earnings announcement in November Taihei Dengyo dropped -9%. Because only one sell side analyst covers the stock the market just reacted on the headlines, which looked disappointing. The underlying business is doing pretty well and Taihei Dengyo delivered a big increase in its order intake. In addition, senior leadership at the company acquired shares, which we considered a positive. As market participants came to understand the real dynamics at Taihei Dengyo the stock bounced back +9.9% in December, adding 30bps to the fund performance.

Last month we exited H.I.S. long position. The stock price appreciated 60% from April lows and the most recent earnings announcement did not justify any further upside to our target price.

The gross as well as the net exposure is concentrated in the Industrials sector. The Industrials gross exposure stood at 43% and its net exposure at +18%. Exposure in this sector ranges from robots to heavy machinery, from road construction and staffing companies to private rail operators. These are a very diverse set of business models with very different earnings drivers. We had almost no exposure in Utilities, Telecommunication and Energy.

**Value Factor Performance\***

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MoM	0%	0%	1%	0%	1%	-1%
YoY	4%	-3%	4%	0%	0%	0%

Source: Factset\*



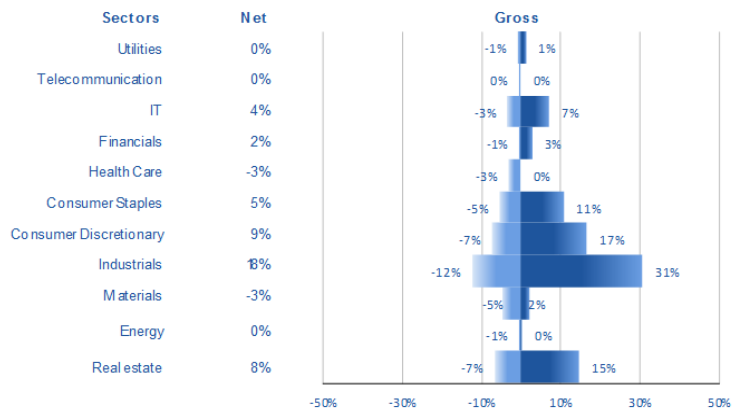
Source: Factset\*

**Top Gainers & Losers**

Gainers	CTR*	Losers	CTR*
Taihei Dengyo	L 0.3%	Alpine Elec	L -0.3%
Resona Holdings	L 0.2%	H I S	L -0.2%
Fuji Media	L 0.1%	Ariake Japan	L -0.1%
Technopro	L 0.1%	Megmilk Snow	S -0.1%
Ichigo Group	L 0.1%	Nishimatsu Const	L -0.1%

\*CTR = Contribution

Source: Factset



Source: UBS PAS

**Style Performance**

On a daily basis, we track a number of style factors using 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.

Value as a style has been really struggling throughout 2017. In Japan, price momentum delivered stellar performance.

High price momentum stocks continued to accelerate higher whilst low price momentum stocks continued to underperform. This is certainly not only a Japanese phenomenon, because this behavior can be observed in all major equity markets.

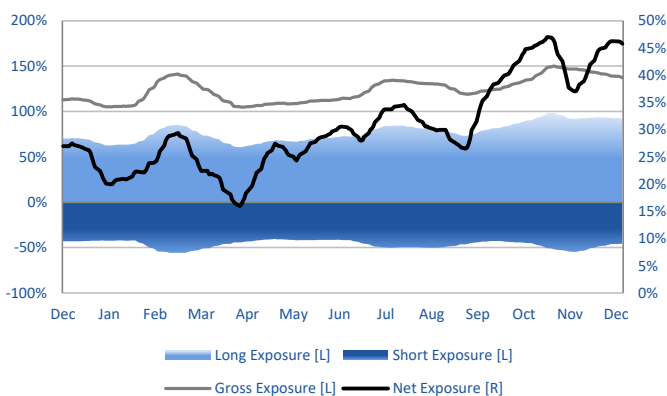
It is not so much that investors disliked value stocks, it much more that investors were buying price momentum for the sake of price momentum. None of the other factors in our model, be it earnings momentum, earnings surprises, share buy-backs or quality displayed any systematic behavior during 2017.

**Risk Measurement and Management**

The chart below shows the rolling 12-month net and gross exposure as 10 (trading) days moving averages.

The risk budget has steadily increased during 2017 with the gross- and net-exposure at the high end of its historical range.

Despite the substantial increase in net exposure the ex-ante volatility stood at 5.8% despite significant capital being deployed. This is rather remarkable and these numbers are not a good reflection of the underlying risk involved because risk premia globally are extremely depressed.



Source: BNY Mellon Fund Services\*

**Fund Overview**

	Long	Short
Price to Earnings (PE)	18.1	19.8
EV/EBITDA	10.2	12.5
Price to Book (PB)	1.8	1.9
Dividend Yield	2.0	1.7
EV/IC	1.1	1.5
1 month momentum	2.1	3.4
6 month momentum	18.6	5.1
9 month momentum	26.3	4.9
Earnings momentum (1M)	14.7	3.5
Earnings momentum (3M)	17.5	5.6
CFROI	8.2%	9.8%
Cash/MarketValue	32.8%	20.2%

Source: Factset

**Style Exposure**

	Long	Short
Beta	0.35	1.01
Volatility	4.7%	9.9%
Debt-to-equity	-5%	60%

Source: UBS PAS

**Risk Statistics Delta Adjusted**

Volatility (ex-ante; 3 months daily data)	3.4%
Volatility (ex-ante; 5yr monthly data)	5.8%
Var (99%, 5 days)	1.8%
Beta (ex-ante)	-0.11

Source: GS and Nomura

**Outlook**

After a healthy shake out in November, when the market dropped close to -6% in five trading sessions, the market quickly turned around and accelerated higher. The Japanese market ended 2017 close to its November high and did not manage to put in a new closing high. The sentiment turned more constructive, but was not outright bullish as can be observed in US equities. Global investors continue to be underweight Japan and foreigners as well as retail investors are reluctant to participate in the rally.

The global economy continues to show a solid performance. After a decade of underinvestment we are witnessing a capital expenditure boom, especially in technology, which is supported by "close-to-nothing" cost-of-capital. On the other hand, labor markets in the US and Japan are already tight, but wage inflation has not really shown up yet. As the global financial system is still awash in liquidity, risk assets continue to sky-rocket despite obvious valuation concerns. Equities in the US are very expensive and the rest of world looks more attractively valued. The Japanese market is trading above mid-cycle valuations, but has not reached peak valuations yet. Central banks globally were explicitly or implicitly targeting animal spirits and clearly succeeded as US equities moved into blow-off phase. We are at the point of the cycle that the US FED wishes to put the genie back in the bottle and normalize interest rates, without crushing asset prices. This will be a tightrope act. Investors happily ignore the multi-decade high in political as well as geopolitical risk. The FED can remove the punch bowl, but nobody knows at what level of interest rates the tipping point will be.

For the time being, strong growth and higher interest rates are extremely positive for Japanese equities. In the multi-year transition phase from deflation to inflation it seems we are at the inflection point now and Japanese risk assets started to discount such a positive scenario. Needless to say, if inflation expectation nudge up even further the Japanese market will be a stellar performer for quarters to come. Having met BOJ officials recently, we doubt the central bankers in Japan will try to slow down the asset acceleration phase.

# Pelargos Japan Alpha Fund

## December 2017



### Historic Fund Performance (Monthly)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
<b>Class A EUR</b>													
2017	0.49%	-0.93%	-1.67%	-0.61%	0.19%	1.28%	1.17%	0.42%	0.90%	1.14%	0.15%	0.10%	2.61%
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%
<b>Class B EUR</b>													
2017	0.56%	-0.92%	-1.63%	-0.57%	0.23%	1.32%	1.18%	0.46%	0.99%	1.25%	0.20%	0.14%	3.22%
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

<b>Investment Manager</b>	Pelargos Capital
<b>Legal Status</b>	FGR (fund for joint account)
<b>Fiscal Status</b>	VBI (tax exempt)
<b>Dividend Policy</b>	Reinvestment
<b>Base Currency</b>	EUR
<b>ISIN Class A EUR</b>	NL0009051887
<b>ISIN Class B EUR</b>	NL0001118015
<b>Inception Date Class A EUR</b>	January 2009
<b>Inception Date Class B EUR</b>	July 2008

#### Company Facts

<b>Firm AUM in EUR</b>	€ 239,540,455
<b>Firm AUM in USD</b>	\$287,929,563

#### Portfolio Managers

Richard Dingemans  
Michael Kretschmer

#### Fund Description

<b>Investment Strategy</b>	Equity Long/Short
<b>Investment Style</b>	Fundamental Value
<b>Investment Objective</b>	Capital appreciation through investing in long/short positions in Japanese securities

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#### Fund Facts

<b>Fund Size in EUR</b>	€ 98,759,430
<b>Fund Size in USD</b>	\$118,709,634
<b>Participations Outstanding Class A</b>	236
<b>Participations Outstanding Class B</b>	56,178
<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, 3 business days notice
<b>Redemption</b>	15 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

#### Service Providers

<b>Prime Brokers</b>	UBS AG, Goldman Sachs International
<b>Administrator</b>	BNY Mellon Fund Services
<b>Accountant</b>	PricewaterhouseCoopers
<b>Legal</b>	De Brauw Blackstone Westbroek N.V.
<b>Title Holder</b>	SGG Netherlands N.V.
<b>Depository</b>	Bank of New York Mellon

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