Pelargos Japan Alpha Fund
January 2016

Fund Performance

The Pelargos Japan Alpha Fund Class B appreciated 1.27% in January. Since July 2008, inception-to-date (ITD), the fund is up +54.36% with a realized volatility of 7.4%, whilst the broader market is up 5.93% ITD with a volatility of 20.2%.

Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,354.53	1.35%	1.35%	35.45%
Class B EUR	1,543.62	1.27%	1.27%	54.36%

Market Environment

In January, the MSCI Japan declined -7.7% and was down -16% year-to-date at its lowest point on the 21st of January. For many developed equity markets, it turned out to be the worst start-to-the-year ever.

We were well prepared for the market turmoil and the fund gained 1.3%. We operate under the thesis that last year's sell-off in August was the start of a cyclical bear market. In our opinion, the FED's rate hike into a severely slowing global economy served to accelerate the global US dollar liquidity crunch. In the first week of December, we bought significant out-of-the-money put options at very reasonable prices. The US FED utterly misjudged the self-sustaining strength of the asset price driven US economy.

Of course, the biggest headline making news in January was the Bank of Japan (BOJ) intervention on the last day of the month. The BOJ aims to do what Europe has established a while ago, negative interest rates. The monetary intervention gave a decisive boost to risk assets, although with a notably negative impact on interest rate sensitive stocks such as Insurance and Banks. With very limited exposure to interest rate sensitive stocks, the long book only declined by 4.6%. Unfortunately, the short book performed even better as a) value performed rather poorly and b) the short positions in high-price momentum, high-valuation stocks bounced aggressively into month-end.
The daily correlation of the fund with the MSCI Japan was -0.47 and the number of up-days outnumbered the down-days.

Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Food Beverage	-4.2%	19.5%	1.2	21.3
Household Products	-4.4%	30.7%	2.2	25.8
Commercial Services	-5.1%	22.0%	1.4	17.0
Industry Group	**MTD**	**YTD**	**PB**	**PE**
Insurance	-14.4%	2.2%	0.7	14.5
Tech Hardware	-14.3%	-10.4%	0.8	13.2
Banks	-13.7%	-5.6%	0.4	7.4

Source: Bloomberg

General Statistics

% Return long book	-4.6%
% Return short book	-3.9%
# Long stocks	46
# Short stocks	15
% Long stocks ↑	28%
% Short stocks ↓	73%
# Up days / Down days	11 / 9
Daily Correlation with MSCI JP	-0.47
Turnover as % NAV	35%

Source: Factset

Largest Long & Short Holdings

Longs	Shorts
Ryosan	Hino Motors
Chiyoda	Kikkoman Corp
Moshi Moshi (Relia)	Komatsu
Ichigo Group	Kose Corp
Pola Orbis	All Nippon Airways

Source: BNY Mellon Fund Services

Single Stock Activity

Largest Buy & Buy Cover*		Largest Sell & Short Sell**	
THK	BC	All Nippon Airways	SS
Nikon Corp	B	Kose Corp	SS
Kenedix Realty	B	Advantest Corp	SS
Nissin Foods	BC	Megmilk Snow	SS
Sanrio Co	BC	Hino Motors	SS

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

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

Investment Strategy

Ryosan remained number our largest long position and in the January panic we added to the long position in Chiyoda, the shoe retailer, after it dropped 30% from the end of last year. With regards to the short book, we covered the entire short position in THK. The short thesis on this stock played out as expected and target price was achieved. We increased the short position in Kose. This high-price momentum market darling fits the inbound tourist theme. We recognized the strong earnings momentum and positive sentiment, but 24x FY15 PE looks oddly rich. No premium seems too high for its perceived stability and exposure to the inbound tourist theme, but we expect this to normalize in the foreseeable future. Another stock that ticks the inbound theme box is All Nippon Airways (ANA). Airlines in general are sub-cost of capital business models and tend to destroy value in the long run. ANA is a decent quality company and its stock valuation held up quite well due to the tail winds of lower fuel costs. The benefit from lower oil prices will eventually fade due to competitive pressure and the global slowdown will effect cargo as well as business travel and lofty earnings expectations need to be cut.

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Investment Strategy

Ichigo Group was again amongst the top five contributors. Our multi-year high conviction position. The stock traded well throughout January and got another boost from the BOJ intervention, returning 8.8% in January.

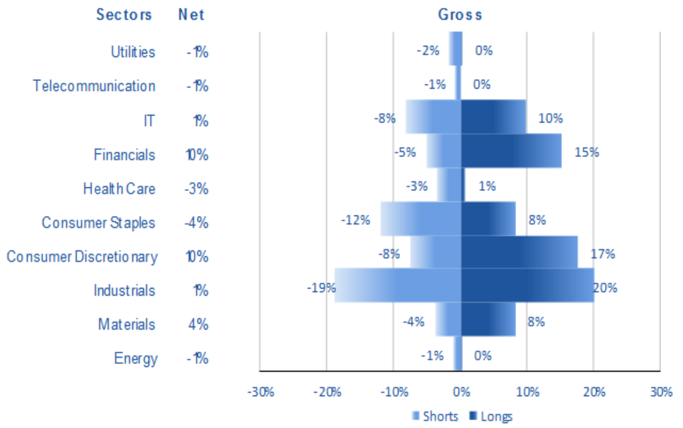
The other top contributors are short positions. Komatsu is a commodity bust and construction deceleration story. Despite the management doing an excellent job at restoring earning the bust of the commodity super cycle poses a multi year head wind.

Unfortunately, Metawater turned out to be the biggest losing position last month. Metawater was listed in December 2014. It is an water treatment equipment/solution company selling its services to local municipalities. The multi-year replacement cycle provides good visibility. However, in the short-run the company faced unexpected order delays. The postponement of orders is due to a new law aiming to smooth government expenditure across the year and de-emphasize one particular quarter in which orders usually get placed. With a newly listed stock and the global market rout, investors sell first and ask questions later, thus Metawater ended -17% lower in January.
Due to very poor position timing we lost 30bps each in Kose and Advantest. With regards to Kose we are rather confident that eventually investors realize that even perceived defensives can be too risky if the price is too lofty.

Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Komatsu	S	0.5%	Metawater	L	-0.5%
Kikkoman Corp	S	0.3%	Honda Motor	L	-0.4%
Ichigo Group	L	0.2%	Alpine Elec	L	-0.4%
THK	S	0.2%	Kose Corp	S	-0.3%
Keyence Corp	S	0.2%	Advantest Corp	S	-0.3%

**CTR = Contribution* *Source: Factset*

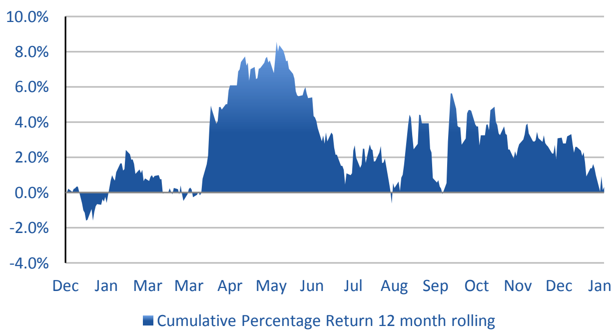


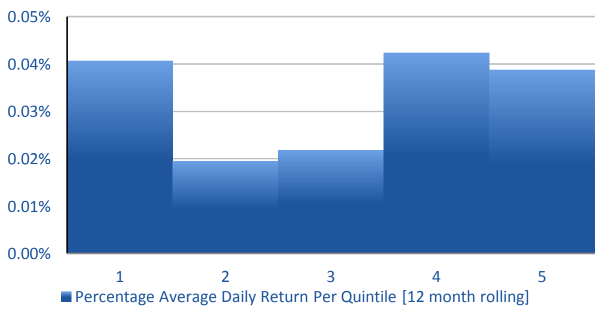
Source: UBS PAS

Value Factor Performance*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MTD	-3.9%	-0.8%	-2.1%	0.6%	-0.2%	-1.7%
YTD	-3.9%	-0.8%	-2.1%	0.6%	-0.2%	-1.7%

*Source: Factset**





*Source: Factset**

Style Performance

On a daily basis we track a number of style factors based on 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.

January was a bad month for value factor performance. High price-to-book and high price-to-earnings stocks clearly outperformed. All value factors were negative, except for dividend yield. Dividend stocks performed extremely well on the last day of January as the BOJ announced its intention to move towards negative rates, high dividend stocks got a strong boost. The dividend yield of the long book is 1.9% compared to 1.6% in the short book.

The poor performance of the value factor is partly to be blamed on the Financial sector. Within financials, banks and insurance, which are already very inexpensive, collapsed whilst property and non-bank finance performed very well. We consider banks outside of our circle of competence. The degree of complexity of a banking business makes it difficult for us to achieve an informational edge. We appreciate the simplicity of REITs and the 8% net long REIT exposure contributed nicely in January.
The momentum exposure is slightly negative. The short book's 9-month price momentum is +4.9% compared to +1.1% for the long book.
The price-to-book spread widened somewhat with the long book's P/B of 1.6x compared to 2.1x for the short book. Given our value approach we have a strong preference for cash rich companies. The long book has 32% cash-to-market cap and its debt-to-equity is just 2%.

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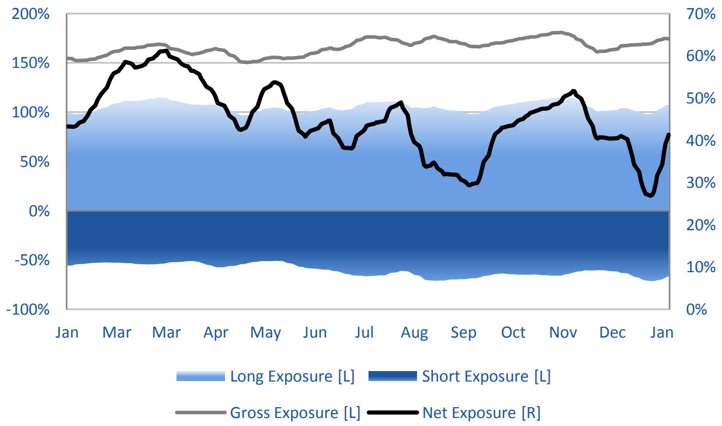
Risk Measurement and Management

The chart below shows the rolling 12-month net and gross exposure for the fund. The exposures are shown as 10 (trading) days moving averages. At the end of January the gross exposure stood at 163%, the delta adjusted gross exposure was 187%. As we indicated in the December newsletter we bought Nikkei puts February strike 19500 early December. As the market declined, the option's delta increased close to 1, decreasing the net exposure from 36% to 12% adjusted for the option.
At the very extreme on January 21st we closed one quarter of the put and extended the maturity at a lower strike, taking some profits on the insurance as the house was already burning and buying some for an even more extreme outcome.
In this extremely risky environment the ex-ante volatility dropped from 11.3% at the end of November to 5.4% at the end of January. The ex-ante beta was close to 0.



*Source: BNY Mellon Fund Services**

Fund Overview

	Long	Short
Price to Earnings (PE)	17.7	20.3
EV/EBITDA	8.1	10.7
Price to Book (PB)	1.6	2.1
Dividend Yield	1.9	1.6
EV/IC	1.0	1.8
1 month momentum	-3.2	-3.2
6 month momentum	-0.9	-1.5
9 month momentum	1.1	4.9
Earnings momentum (1M)	-1.9	-11.2
Earnings momentum (3M)	9.4	0.6
CFROI	7.0%	8.4%
Cash/MarketValue	32.2%	18.6%

Source: Factset

Style Exposure

	Long	Short
Beta	0.97	0.98
Volatility	21.3%	23.0%
Debt-to-equity	2%	40%

Source: UBS PAS

Risk Statistics Delta Adjusted

Volatility (ex-ante; 1yr daily data)	5.4%
Volatility (ex-ante; 5yr monthly data)	4.6%
Var (99%, 5 days)	1.5%
Beta (ex-ante)	-0.01

Source: GS and UBS PAS

Outlook

Strategic Framework - Outlook 1st half of 2016

The six year bull cycle in global equities is over. Last year's correction was the initial leg down in a cyclical bear market. The FED induced policy divergence resulted in universal US dollar strength and drain on global US dollar liquidity. With such drastic tightening, commodity prices collapsed and commodity related credit suffered. This cycle is only mid-way and will end with a major liquidity event. Investors across asset classes are in the process of re-pricing risk, not only economic risk but also liquidity risk. The period of central banks suppressing risk premia/volatility through monetary activism came to a halt. The price we pay for ultra low interest rates is capital mis-allocation and the current withdrawal of liquidity will show 'who is swimming naked'.
In our opinion, the US FED's 'normalization' of interest rates is built on the faulty assumption that the US economy can stand on its own feet. Due to central banks' monetary activism it is impossible to distinguish noise from signal. The US recovery seems asset price led and therefore a phony construct which easily unravels once asset prices revert. 2016 has all the hallmarks of a proper cyclical bear market. For the time being, the FED does not come to the rescue. Getting off the zero bound is easier said than done, as the Japanese found out a decade ago. Japan remains caught in the crosshairs of improving micro stories while being treated as a global, leveraged growth proxy.

Tactical assessment – Outlook February 2016

That's an impressive start of the year. Most equity markets had their worst first week of a year ever. One might argue a long overdue correction might be healthy after an engineered bull market with an extended period of suppressed volatility. The FED took the punch bowl away whilst the global economy was already decelerating and the impact on the US, Europe and Japan was only a matter of time. The US is in a manufacturing recession already, and in our opinion, the odds of a full recession occurring this year are greatly underestimated. Thus, we remain cautious when determining our entry prices for long positions and more aggressively pursue short opportunities. We focus on stock specific, very domestic businesses such as coffee shops, water treatment equipment, REITs and labor scarcity in the long book. With regards to the short side, we pursue shorting opportunities in extremely overpriced, highly crowded momentum stocks in the consumer staples space. Nevertheless, January turned out to be a great reminder of how difficult it is to make money in bear markets. Central banking engineered bull traps can be vicious and costly, therefore nimble position sizing will be paramount in the coming months.

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Historic Fund Performance (Monthly)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Class A EUR												
2016	1.35%											
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												
2016	1.27%											
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)

	2016	2015	2014	2013	2012	2011	2010	2009	2008
Class A EUR	1.35%	5.81%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
Class B EUR	1.27%	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	€ 213,012,889
Firm AUM in USD	$230,714,260

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

Fund Facts

Fund Size in EUR	€ 91,762,377
Fund Size in USD	$99,387,830
Participations Outstanding Class A	236
Participations Outstanding Class B	59,239
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
Legal	De Brauw Blackstone Westbroek N.V.
Title Holder	SGG Netherlands N.V.
Depositary	Bank of New York Mellon

Pelargos Japan Alpha Fund
January 2016

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