

Pelargos Japan Alpha Fund

July 2016



Fund Performance

The Pelargos Japan Alpha Fund Class B increased 2.12% in July. Since July 2008, inception-to-date (ITD), the fund is up +52.08% with a realized volatility of 7.4%, whilst the MSCI Japan is down -2.72% ITD with a realized volatility of 20.4%.

Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,329.57	2.08%	-0.52%	32.96%
Class B EUR	1,520.80	2.12%	-0.23%	52.08%

Market Environment

In July, the MSCI Japan bounced +6.4%. After the June crash (-9.9%) the market had a decent, although unconvincing, bounce. Market participants in Japan continued to be extremely top-down and macro driven. On a daily basis, systematic basket-driven behavior dominated price action. The recent volatility in daily factor returns and the extent to which leveraged quant strategies influence single stock price action is fundamentally different from 3-4 years ago.

We run a bottom-up, fundamental stock picking strategy and track quant factors to understand market dynamics and risk. In the current market environment stock specific news, valuation and company fundamentals were, once again, of little importance as quant and ETF flows dominated. In June, expensive stocks with relative high price momentum and solid earnings revisions performed extremely well, irrespective of valuation. In July, we observed a significant reversal of the momentum style as value factors started to perform very well. Cyclical sectors started to outperform and with it value stocks, and as such stocks with higher beta characteristics.

Most important, despite the distraction of being caught up in spurious correlations to macro/quant factors introduced by the machines, the current volatility in factor returns offers some interesting opportunities. In July, the long book significantly outperformed the market and the short book's return was similar to the 'benchmark'. The number of up-days was 11, and down days 10.

Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Insurance	14.4%	-11.0%	0.8	12.4
Software & Services	12.7%	21.0%	1.7	17.4
Automobiles	12.1%	-23.7%	0.8	11.7
Industry Group	MTD	YTD	PB	PE
Food & Staples	-3.4%	11.5%	1.4	16.9
Telco	-2.4%	12.3%	2.1	15.8
Household Prod.	-2.3%	31.2%	2.6	23.7

Source: Bloomberg

General Statistics

% Return long book	7.3%
% Return short book	6.5%
# Long stocks	45
# Short stocks	13
% Long stocks ↑	78%
% Short stocks ↓	23%
# Up days / Down days	11 / 10
Daily Correlation with MSCI JP	0.44
Turnover as % NAV	28%

Source: Factset

Largest Long & Short Holdings

Longs	Shorts
Sumitomo Met Min	Nippon Building Fund
Resona	Oriental Land
RELIA	All Nippon Airways
Metawater	Nippon Express
Ichigo Group	THK

Source: BNY Mellon Fund Services

Single Stock Activity

Largest Buy & Buy Cover*		Largest Sell & Short Sell**	
Sumitomo Met Min	B	Amada	S
Murata Mfg	B	Komeda Holdings	SS
Kose Corp	BC	Takara Leben	S
Resona	B	Gulliver	S
Nishimatsu Const	B	Ichigo Group	S

* B = Buy; BC = Buy Cover

Source: BNY Mellon Fund Services

** S = Sell; SS = Short Sell

Investment Strategy

The total number of stocks in the portfolio declined by just 1 in July. The core long book consisted of 45 long positions and just 13 short positions. The stocks in the long book are to a large extent long term holdings. However, in July the top 5 position in the long book changed significantly. We increased the position size in Sumitomo Metal and Mining as well as in Resona. These stocks are extremely inexpensive as stock prices undershot to the downside in the June top-down, macro sell-off. Historically we held only a few bank stocks, but Resona is too cheap to ignore. With a 4% dividend yield, 7x P/E, 0.65x P/B and further increase in shareholder returns to come, we think the attractiveness of low risk/high reward outweighs worries relating to margin compression from negative interest rates. The regular reader might notice that we reduced our favorite long term holdings Takara Leben and Ichigo. We remain convinced that these high price momentum stocks will continue to deliver superior returns. However, for tactical and portfolio construction reasons we wanted to have less exposure in a period when long-term price reversal in combination with low price-to-book cyclicals started to perform well.

Investment Strategy

Our multi-year long position Ryosan showed stellar returns last month, the stock price appreciated +31%. The company announced a 10bn JPY buyback, whilst its market capitalization is only 90bn JPY. Furthermore, the company announced to pay a special dividend and to increase the regular dividend. With investor sentiment depressed, this news was welcomed with the biggest jump in Ryosan's stock price since 1987.

The other cash rich companies, Hitachi High Tech, Melco and Tokyo Ohka showed equally strong returns. Tokyo Ohka's stock price, which can be rather volatile, jumped 23% in July. Hitachi High Tech appreciated 27% and Melco jumped a whopping 40%. What a difference just one month can make. Melco announced a buy back of 15% of its outstanding shares and Hitachi High Tech reported very strong numbers. High conviction long position Metawater finally started to deliver. In prior editions, we have outlined how orders were pushed out from last fiscal year into this fiscal year due to regulatory changes. This issue has finally been resolved and visibility of the earnings growth trajectory is better understood after the recent earnings announcement.

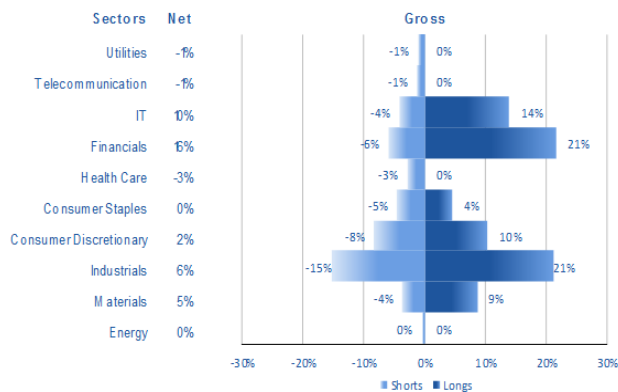
The top 5 losers are a mixture of 3 shorts and 2 long positions. The low beta REIT index did not participate in the July rally and more illiquid names such as Ichigo Hotel REIT were even down for the month. The losses in the shorts THK (+18%) and Kose (+11%) were due to short term price reversals as THK declined -17% and Kose -14% in the prior month.

Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Ryosan	L	0.8%	THK	S	-0.4%
Hitachi HT	L	0.7%	Ichigo Hotel REIT	L	-0.3%
Melco	L	0.6%	Nippon Express	S	-0.3%
Metawater	L	0.5%	RELIA	L	-0.3%
Tokyo Ohka	L	0.4%	Kose Corp	S	-0.2%

*CTR = Contribution

Source: Factset

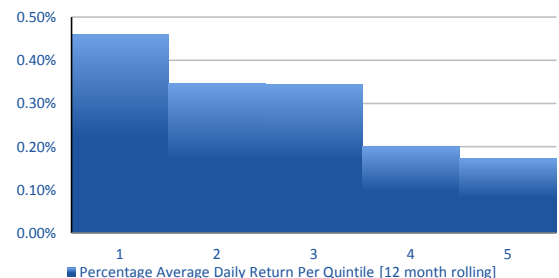
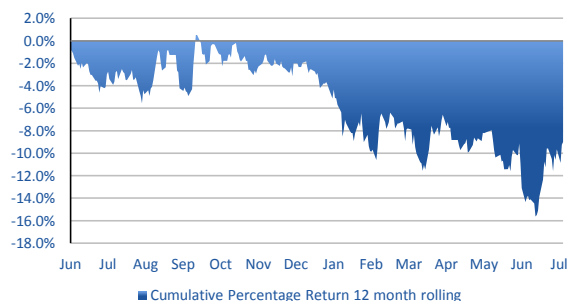


Source: UBS PAS

Value Factor Performance*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MoM	5.0%	6%	5%	3.3%	4.6%	3.9%
YoY	-12.6%	-5%	-4%	0.5%	-3.7%	5.1%

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.

As bad as value performed in June, July saw one of the largest reversals on record. The volatility in the value factor was extreme for every underlying factor.

The best performing factor was EV/EBITDA followed by price-to-earnings (P/E) and price-to-book (P/B). Dividend Yield as a style bounced only 3.3% after declining -5.1% in a risk off month.

The P/E of the long book is 14.7x compared to 20.4x for the short book. The EV/EBITDA of the long book is 7.3x compared to 9.8x for the short book. The dividend yield of the long book is 2.4% compared to 1.9% in the short book.

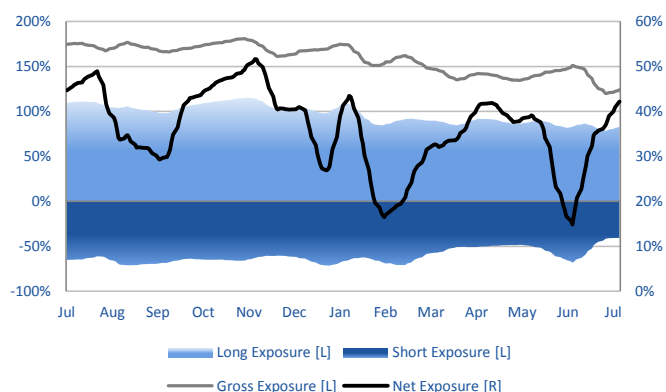
The weighted average P/B of the long book is 1.4x compared to 1.8x for the short book. Our circle of competence, our fundamentally restricted investment universe, includes only a few financials. Our own investment universe has a median P/B of 1.2x and average P/B of 1.6x, largely due to our limited interest in banks, what are currently very inexpensive stocks.

The price momentum exposure has increased somewhat. On a 9-month basis, the long book is down -2.2% and the short book -7.2%.

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 July the gross exposure stood at 127%, the delta adjusted gross exposure was 150%. The net exposure stood at 44%. Including the long Nikkei225 put option strike 16500, the delta adjusted net exposure stood at much lower 29%. The REIT exposure, consisting of Ichigo Hotel, Ichigo Office, Kenedix Office, Kenedix Retail, Takara Leben Infrastructure Fund amounted to 8.7%.

The ex-ante volatility based on daily data was 8.3% with an ex-ante beta of 0.2. Because of the elevated spot volatility, short-term ex-ante volatility measure is significantly higher. Based on 5 year monthly data the ex-ante volatility is 6.7%.



Source: BNY Mellon Fund Services*

Fund Overview

	Long	Short
Price to Earnings (PE)	14.7	20.4
EV/EBITDA	7.3	9.8
Price to Book (PB)	1.4	1.8
Dividend Yield	2.4	1.9
EV/IC	0.9	1.7
1 month momentum	9.6	4.8
6 month momentum	1.8	-6.5
9 month momentum	-2.2	-7.2
Earnings momentum (1M)	-11.8	-10.2
Earnings momentum (3M)	-5.2	-3.3
CFROI	7.1%	9.0%
Cash/MarketValue	35.1%	23.7%

Source: Factset

Style Exposure

	Long	Short
Beta	0.85	0.83
Volatility	19.4%	19.0%
Debt-to-equity	-3%	48%

Source: UBS PAS

Risk Statistics Delta Adjusted

Volatility (ex-ante; 3 months daily data)	8.3%
Volatility (ex-ante; 5yr monthly data)	6.7%
Var (99%, 5 days)	1.7%
Beta (ex-ante)	0.21

Source: GS and Nomura

Outlook

Strategic Framework - Outlook 2nd half of 2016

During the first half of 2016 we operated under the assumption of a cyclical bear market. The three year bull run completed in August 2015. We argued for a cyclical bear market due to tightening conditions in global dollar liquidity. We correctly anticipated that the FED would not be able to normalize interest rates, because it is built on the faulty assumption of a self-sustaining US economic growth cycle. This thesis has materialized to a large extent and Japanese equities had the deepest correction since the global financial crisis, correcting 30% peak-to-through. In June, we witnessed a full fledged panic with Japanese equities in free fall and broad based capitulation. Our strategy is contrarian in nature, thus buying cheap assets and shorting overpriced assets. Every once in a while 'mister market' is handing out gifts for those willing to go against the crowd and those who have the patience to hold them for a prolonged period. Easier said than done, the market is far from acting 'rationally' and although 80% of the time assets are efficiently priced, certainly at this moment in time, market participants are highly distracted by non-fundamental issues. Dislocation within the market is at multi-decade highs and the potential alpha source an obvious one. However, price action remains tightly correlated to currency moves and swings in liquidity conditions. The BOJ's inaction is partly excusable as the last two interventions had adverse reactions. However, investors realize that the Kuroda-put is increasingly ineffective, which only heightens investors' anxiety. That said, Kuroda and Draghi are marginal players, it is all about the trajectory of the US dollar and Yellen's confidence in her forecast. The Yellen Fed has missed its forecasts every single year for the past 5 years, every time overestimating growth by a substantial margin. In our opinion a rate hike remains unlikely this year and a weaker US dollar our base case scenario.

Tactical assessment - monthly outlook

In July the broader index continued with rather soft price action and attempted to re-test the June lows. As world equity markets ripped higher, investor sentiment, even in Japan, finally improved as selling depleted. Japanese equities dared to participate in the risk-on mode with an unconvincing, though not insignificant bounce. Valuation is supportive, however as long as the Japanese Yen refuses to hold ground it will be difficult to see a sustained beta rally. Nevertheless, intra-market dynamics are shifting and smart beta type stocks (expensive quality defensives with strong earnings revisions) started to underperform and, in our opinion, will continue to do so. With the relative price-to-book of cyclicals versus defensives at 2008 Lehman-crisis lows, and understanding the dynamics why defensives are outrageously expensive, being long cheap cyclicals and short expensive defensives is a relatively straight forward call for a patient investor.

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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%	0.88%	1.08%	-0.20%	-1.03%	-4.52%	2.08%					
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%	0.92%	1.18%	-0.19%	-1.06%	-4.33%	2.12%					
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	-0.52%	5.81%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
Class B EUR	-0.23%	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	€ 208,337,150
Firm AUM in USD	\$232,795,931

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	€ 88,216,183
Fund Size in USD	\$98,572,763
Participations Outstanding Class A	236
Participations Outstanding Class B	57,800
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.
Depository	Bank of New York Mellon

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