

Pelargos Japan Alpha Fund

June 2015



Fund Performance

The Pelargos Japan Alpha Fund Class B decreased -1.67% in June. Since July 2008, inception-to-date (ITD), the fund is up 54.16% with a realized volatility of 7.3%.

Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,356.66	-1.63%	7.41%	35.67%
Class A USD	998.37	-1.70%	7.32%	-0.16%
Class A JPY	98,682	-1.92%	6.96%	-1.32%
Class B EUR	1,541.59	-1.67%	7.57%	54.16%

Market Environment

In June, the MSCI Japan declined -3.2% in Japanese Yen (JPY) terms. Volatility in the fixed income market remained high and over the month the 10-year JGBs traded between 0.42% and 0.52%. With regards to currencies, the euro-JPY was flat for the month and the JPY appreciated 1.3% in June.

The hot topic of June was the parabolic up-move in the Shanghai market followed by its inevitable bust. The Shanghai composite corrected 17% from its intra-month highs to the end of June.

In addition to the equity woes in China, the Greek drama continued to weigh on market sentiment, although it received much more attention than is economically justified.

The long book (-2.3%) performed somewhat better than the market (-3.2%) and the fundamental short book declined -3.6%, which is a bit worse than the MSCI Japan itself. Most of the negative performance this month derived from the overall net long exposure.

Expensive, high price momentum consumer staples related industries performed very well, as can be seen in the table on the right. Cyclical semiconductors and discretionary consumer spending basket continued to perform poorly despite its low valuation.

The up- versus down-days were evenly balanced, with 11 up days and 10 down days. 7 of the 9 short positions were down. 16 of the 53 long positions were up. Turnover as % NAV was 42%, which is higher than average.

Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Household Prod.	5.3%	30.0%	2.4	35.5
Retailing	3.9%	31.8%	1.1	20.0
Food & Staples	3.7%	25.7%	1.9	22.8

Industry Group	MTD	YTD	PB	PE
Semiconductors	-7.6%	-4.6%	1.4	14.4
Consumer Durables	-7.1%	17.3%	1.0	18.8
Automobiles	-6.5%	5.5%	1.1	12.6

Source: Bloomberg

General Statistics

% Return long book	-2.3%
% Return short book	-3.6%
# Long stocks	53
# Short stocks	9
% Long stocks ↑	30%
% Short stocks ↓	78%
# Up days / Down days	11 / 10
Daily Correlation with MSCI JP	0.87
Turnover as % NAV	42%

Source: Factset

Largest Long & Short Holdings

Longs	Shorts
Ryosan	Nissin Foods
Moshi Moshi	Japan Real Estat
Ichigo Group	THK
Chiyoda Co	Kikkoman Corp
Pola Orbis	Nippon Express

Source: Citi Financial Services

Single Stock Activity

Largest Buy & Buy Cover*		Largest Sell & Short Sell**	
SMFG	B	Yamada Denki	S
Chiyoda Co	B	Fujifilm Holding	S
Metawater	B	Ube Industries	S
Daicel Corp	B	Nippon Telegraph	S
Maruichi Stl Tub	B	Ushio	S

* B = Buy; BC = Buy Cover

Source: Citi Financial Services

** S = Sell; SS = Short Sell

Investment Strategy

The largest long positions are mainly unchanged except for Chiyoda. Chiyoda is the second largest shoe retailer in Japan. We met the company for the first time 6 years ago and have watched the management's execution from the sidelines ever since. The stock always traded at steep valuation discounts and the market cap for this 2nd largest shoe retailer is just about 1bn US. The turnaround management in the past was too slow for our liking, and way too modest. The management's attitude is changing on many layers including the appointment of a foreigner as independent board member. The earnings power tremendously improved and the quality of execution vastly different from when we first assessed the business case many years back.

We closed long position Ushio, Yamada Denki and Ube Industries. All three stocks were bought at steep discount to intrinsic value and sold at or even below our fair value price targets.

Nissin Foods was promoted to the largest short position, and having increased the short in THK early in the month, this

Investment Strategy

Moshi Moshi Hotline contributed +60bps last month and unfortunately gave back 30bps in June. Ichigo Group (-30bps) continues to drift down for no obvious reason. Fundamentals at Ichigo remain very strong with little apparent reason for the stock's weakness. Ichigo is considered a reflation trade and the whole cohort performed poorly and underwent significant multiple contraction. We can be patient and think this stock will deliver great returns eventually, in the meantime we actively manage the position size.

Shorts are hard to find in a bull market. In June the shorts Nippon Express and THK contributed 20bps each. Nippon Express was down 12% in June; as discussed last month, the full year earnings guidance was set too high and the company will eventually revise down. In the meantime market participants continue to adjust the stock price to a more realistic valuation multiple.

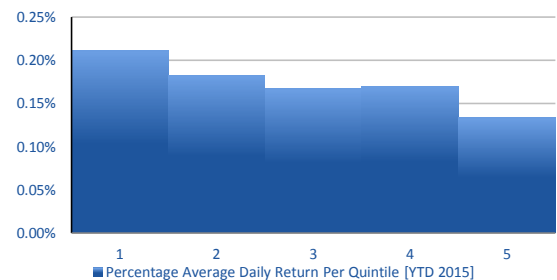
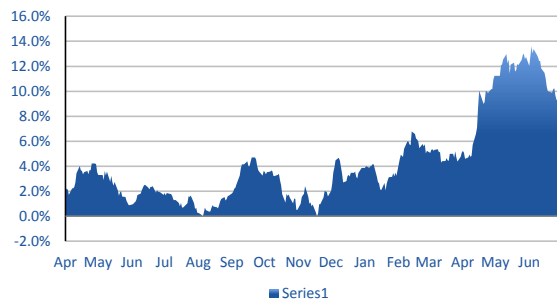
THK also dropped 12% in June; the product cycle rolled over as THK's clients, Chinese handset producers, continued to slow down. THK has short cycle fundamentals and its stock tends to be rather volatile.

The net exposure in financials declined further to 16% from 19% last month. Several financials positions appreciated beyond target prices and we reduced the position sizes, whilst it was too early to re-enter the lagging REITs.

Value Factor Performance*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MTD	-1.1%	-2.5%	-2.2%	-1.7%	-1.6%	0.1%
YTD	5.4%	2.1%	2.1%	2.0%	2.3%	1.9%

Source: Factset*



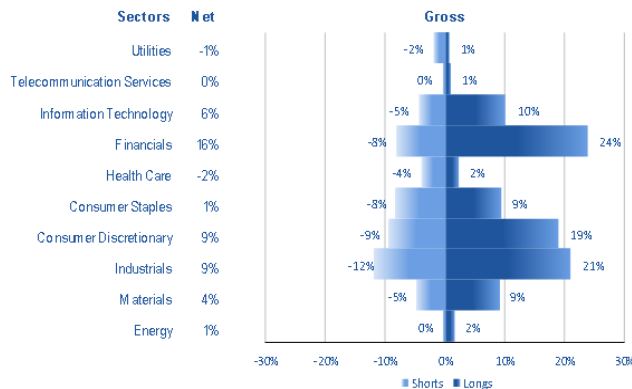
Source: Factset*

Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Acom	L	0.3%	Ichigo Group	L	-0.3%
Fancl Corp	L	0.2%	Moshi Moshi	L	-0.3%
Nippon Express	S	0.2%	Honda Motor	L	-0.2%
THK	S	0.2%	Alpine Elec	L	-0.2%
Dai Ichi Life	L	0.1%	Fujifilm Holding	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.

Value was very strong earlier this year, which was very supportive in our approach to capturing alpha. Last month price-earnings-ratio (P/E) was weak and price-to-book (P/B) was very weak. Dividend yield as a style suffered as well. The fund is long dividend exposure mainly through the REIT space. The REIT index peaked out in January this year, in absolute terms and relative to the broader market. As indicated in earlier newsletter we reduced REIT exposure and look to re-enter at lower prices/higher dividend yields.

The current exposure characteristics in the fundamental book are shown on the next page. With regards to the value factors the biggest spread is in P/E, P/B and EV/EBITDA.

The long book has significantly higher price momentum as well as earnings momentum exposure compared to the short book.

We mentioned this in last month's newsletter but want to reiterate that the numbers displayed below 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 27x, this compares to a median P/E of 15x for the long book.

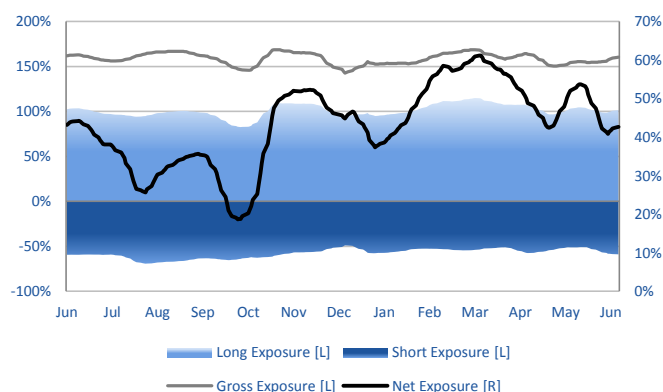
Risk Measurement and Management

The chart below shows the rolling 12-month net and gross exposure for the fund. In order to improve readability of the chart, the exposures are shown as 10 (trading) days moving averages.

The gross exposure continued to be rather stable in a range between 150-160%.

The net exposure at the end of June stood at 43%, this is 10% lower compared to the prior month. In May our long book performed very well and during early June we started to trim position sizes.

The ex-ante volatility estimate stands at 7.9%.



Source: Citi Financial Services*

Fund Overview

	Long	Short
Price to Earnings (PE)	17.7	61.2
EV/EBITDA	6.8	19.4
Price to Book (PB)	1.5	1.9
Dividend Yield	2.0	1.6
EV/IC	1.0	1.6
1 month momentum	0.2	-4.2
6 month momentum	19.8	0.7
9 month momentum	28.7	16.1
Earnings momentum (1M)	5.8	-40.7
Earnings momentum (3M)	1.1	-19.7
CFROI	6.2%	5.1%
Cash/MarketValue	36.8%	22.2%

Source: Factset

Style Exposure

	Long	Short
Beta	0.9	0.9
Volatility	15.7%	15.6%
Debt-to-equity	8.00	52.00

Source: UBS PAS

Risk Statistics Delta Adjusted

Volatility (ex-ante; 1yr daily data)	7.9%
Volatility (ex-ante; 5yr monthly data)	7.9%
Var (99%, 5 days)	1.3%
Beta (ex-ante)	0.31

Source: GS and UBS PAS

Outlook

Strategic Framework - Outlook 2nd half of 2015

Economic data is normalizing after last years VAT hike. Finally underlying trends are meaningful again. The Japanese economy is not in great shape, and neither is the global economy. Nevertheless, at least the Japanese data has stopped disappointing. The weak Japanese Yen continues to be a support for a rather dull economy. The most interesting development is the volatility spill over from currency markets, commodity markets into fixed income markets and as of mid June finally into equities. Central banks aimed to suppress risk premia/volatility through monetary activism and 'achieved' the lowest long dated bond yields in centuries. A healthy financial system can cope with volatility. Accepting price swings yields most efficient capital allocation, it rewards savvy market participants and punishes misjudgement as well as overly leveraged risk taking. The manipulation of market segments by central bankers results in underestimating risk and introduces second/third layer of unintended consequences. Not all prices can be controlled all the time, ultra low interest rates did not matter for a long time and now that the US Fed wants to 'normalize' interest rates currency markets need to re-price for policy divergence. The single most important economic variable for the second half of 2015 is the US dollar. As long as the US dollar depreciation and sell-off in long dated bonds is gradual, the repercussion for the US economy remain limited and the Japanese market can continue its ascent. A lot of 'IFs' indeed, nevertheless a useful roadmap to keep in mind.

Tactical assessment – Outlook July 2015

After the strong value performance earlier this year, expensive quality stocks made a come back in June and our thesis of shorting the outrageously expensive smart beta bubble has been seriously tested. The systematic smart beta buying is an institutional trend supported by trust/pension funds increasing semi-passive equity exposure. That said, Japanese pension re-allocation to equities is running its course and the incremental buying is diminishing. In our opinion, the market as a whole is fair value. The current buyers are too obsessed with realized return-on-equity and paying a lofty premium for it whilst we find plenty of inexpensive domestic businesses which have the potential to deliver superb RoEs. Indeed, cost turnaround stories carry execution risk and inefficient balance sheet are a reflection of poor corporate governance, but investors are being compensated for those risks by paying cheap prices. And not to be forgotten, not all share buy backs are equal. A share buy back by a company at steep discount to intrinsic value is a good thing and a buy back of a 'best-of-breed' company trading at 40x price-earning can not be a good thing.

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%	-1.63%						
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%	-1.70%						
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%	-1.92%						
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%	-1.67%						
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	7.41%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
Class A USD	7.32%	-7.38%	0.43%					
Class A JPY	6.96%	-8.06%	0.35%					
Class B EUR	7.57%	-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	€ 96,649,860
Fund Size in USD	\$107,735,599
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

June 2015



Company Facts

Firm AUM in EUR € 240,047,054
Firm AUM in USD \$267,580,451

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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