Pelargos Japan Alpha Fund
June 2016

Fund Performance

The Pelargos Japan Alpha Fund Class B declined -4.33% in June. Since July 2008, inception-to-date (ITD), the fund is up +48.92% with a realized volatility of 7.4%, whilst the MSCI Japan is down -8.54 ITD with a realized volatility of 20.3%.

Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,302.47	-4.52%	-2.54%	30.25%
Class B EUR	1,489.20	-4.33%	-2.30%	48.92%

Market Environment

In June, the MSCI Japan dropped -9.9%. After January's drop of -7.6% and February's -9.4% crash, June delivered the worst month of 2016. It was the worst month since May 2012. Having managed the volatility in the first quarter well, June dealt a blow to our strategy. The relentless strength in the Japanese Yen (JPY) led to a top-down, macro-driven panic in risk assets. The JPY appreciated 7.3% in June and 16.6% year-to-date. Brexit and the Bank of Japan's (BOJ) inaction were blamed for the extreme avoidance of risk assets. Stock specific news, valuation and company fundamentals did not matter at all. ETFs and 'smart beta' type flows dominated price action. Expensive stocks with high relative price momentum and solid earnings revisions performed extremely well again, irrespective of valuation. The valuation spread, between the cheapest and most expensive stocks in Japan, reached its highest point since the infamous IT bubble. Relative price-to-book (P/B) valuation of cyclicals versus defensives exceeded the lows of the Lehman crisis, which, in our opinion, is far from justified. That said, central banking induced market manipulation blurs noise and signal. Logic and reasoning are only second best to outguessing policy tinkering. Obviously, an increased risk premium for Japanese equities is warranted and with that the entire market dropped below replacement value of 1x price-to-book.

Pair-wise correlation (average single stock correlation across the market) reached its highest level in years, an indication for 'everything gets treated the same'. In such an environment extracting alpha and especially hedging is made even more difficult than 'normal'.

Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Telecom	-2.0%	15.1%	2.2	15.5
Household Prod.	-2.8%	34.3%	2.8	28.0
Consumer Serv.	-3.6%	2.5%	1.7	18.8
Industry Group	**MTD**	**YTD**	**PB**	**PE**
Div. Financials	-18.0%	-32.0%	0.8	12.2
Insurance	-16.2%	-22.2%	0.8	9.4
Banks	-14.4%	-31.6%	0.4	7.5

Source: Bloomberg

General Statistics

% Return long book	-9.8%
% Return short book	-7.7%
# Long stocks	46
# Short stocks	13
% Long stocks ↑	7%
% Short stocks ↓	77%
# Up days / Down days	8 / 13
Daily Correlation with MSCI JP	0.51
Turnover as % NAV	36%

Source: Factset

Largest Long & Short Holdings

Longs	Shorts
Relia	Oriental Land
Takara Leben	Nippon Building Fund
Ichigo Group	All Nippon Airways
Hitachi High Tech	Kose
Honda Motor	Nissin Foods

Source: BNY Mellon Fund Services

Single Stock Activity

Largest Buy & Buy Cover*		Largest Sell & Short Sell**	
Mitsui Fudosan	B	Tokyu Corp	S
Takara Leben Infra	B	Nippon Building Fund	SS
Ichigo Group	B	All Nippon Airways	SS
Hino Motors	BC	Seven & I	S
RELIA	B	Honda Motor	S

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

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

Investment Strategy

The long book declined -9.8%, in-line with the broader market, while the short book outperformed and only declined -7.7%. The number of stocks in the long and short book was unchanged from May. The spike in pair-wise correlation led to a further increase in daily correlation with the overall benchmark (0.5 in June), up significantly from May (0.4) and April (-0.2).

The largest long and short holdings are all familiar names. With regards to single stock activity, Mitsui Fudosan and Nippon Building Fund (NBF) warrant further comments. The valuation spread has reached the widest levels since NBF's listing in 2001. Investor's and the BOJ's hunt for yield led to extreme dislocation only witnessed in an 'Armageddon'-like environment. However, the end of the world only happens once and the valuation discrepancy between the stocks was/is utterly misplaced and therefore we bought long Mitsui Fudosan (with a put protection) and shorted Nippon Building Fund. With regards to the remaining real estate exposure, we have a barbell approach and continue to hold Takara Leben and Ichigo as 'reflation' trades in combination with specialty REITs in the hotel, office and retail space.

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Investment Strategy

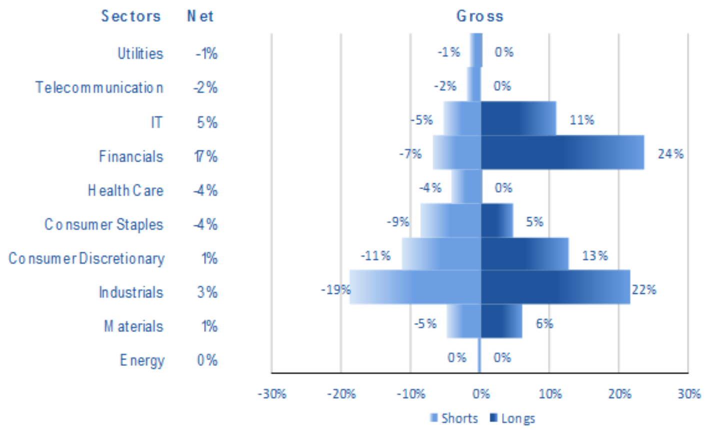
The positive contributor were short positions in Kose (-13%), THK (-17%), Oriental Land (-9%), All Nippon Airways (-10%) and Itochu (-10%). Only Kose and THK significantly underperformed the market and in that sense added value. On average the short book was down 7.7% in June.
The heavy losses occurred in the long book with Honda (-18%), Acom (-19%), Hitachi High Tech (-14%), Fuji Media (-15%) and Resona (-12%). Our conviction bets all underperformed the overall market. News on the individual stocks was minimal and the cheapness of the stocks was insufficient to limit their downside.
Honda Motor accounts for -70bps, and fundamentally the underlying thesis continues to be validated. Nevertheless, a low P/B stock in a cyclical, currency exposed sector was certainly not the flavor of the month.

The biggest disappointment is the fact that our high exposure towards domestically exposed companies with high stock specific characteristics participated in the macro-led sell-off. Amongst the biggest losers Acom, Fuji Media and Resona are close to 100% domestic businesses. In addition, we held long positions in Doutor Nichires, Chiyoda (shoe retailer), Pola Orbis, Seven & I, Fancl, Heiwa Real Estate, Takara Leben, Ichigo, Metawater, Technopro, Chudenko, Relia. Unfortunately, in June 2016 our bottom up portfolio construction was superseded by global macro concerns comparable to what we experience in 2008.

Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Kose	S	0.3%	Honda Motor	L	-0.7%
THK	S	0.3%	Acom	L	-0.6%
Oriental Land	S	0.3%	Hitachi High Tech	L	-0.5%
All Nippon Air	S	0.2%	Fuji Media	L	-0.4%
Itochu	S	0.2%	Resona	L	-0.4%

**CTR = Contribution* *Source: Factset*

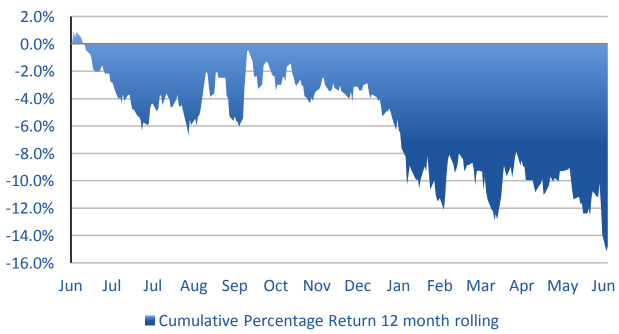


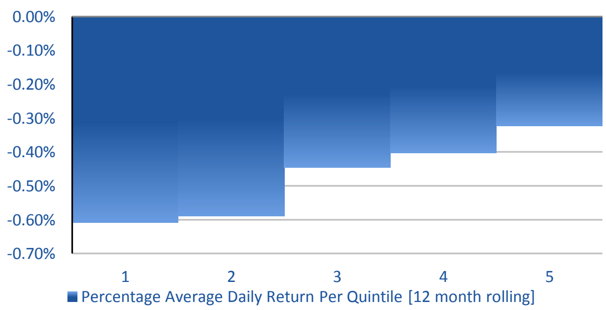
Source: UBS PAS

Value Factor Performance*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MoM	-6.2%	-4%	-4%	-5.1%	-4.4%	-1.4%
YoY	-17.5%	-12%	-11%	-4.5%	-10.3%	0.3%

*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.
Simply said, June was a disaster for value based factors. June was as bad as February and the year-over-year losses accumulate to one of the largest value draw-downs in decades.
In the February melt-down at least dividend showed a small positive contribution, but not in June. All factors had significant declines. Price-to-earnings (P/E) lost a whopping -6.2%, followed by dividend yield (Div. Yld.) - 5.1%. Despite a decline in long dated bond yields globally, high dividend stock were negatively correlated and contributed to our poor performance.

The P/E of the long book is 13.7x compared to 20.1x for the short book. The EV/EBITDA of the long book is 7.2x compared to 10.7x for the short book. The dividend yield of the long book is 2.6% compared to 1.9% in the short book. Our value composite has peaked in May 2015 and has been declining ever since.

With regards to price-to-book (P/B), the weighted average P/B of the long book is 1.3x compared to 2.1x for the short book. Our circle of competence, our fundamentally restricted investment universe, includes only few financials. Our own investment universe has a median PB of 1.2x and average PB of 1.6x, largely due to our limited interest in, currently very inexpensive, banks.
The price momentum exposure (spread between long and short book) is rather limited. On a 9-month basis, the long book is flat 0.0% and the short book down -2.3%.

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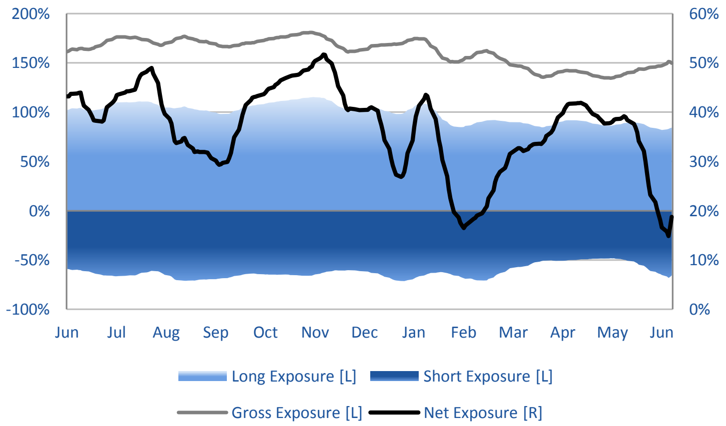
Risk Measurement and Management

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 June the gross exposure stood at 139%, the delta adjusted gross exposure was 162%. The net exposure stood at 37%. Including the long Nikkei225 put option strike 17000, the delta adjusted net exposure stood at 18%. The REIT exposure, consisting of Ichigo Hotel, Ichigo Office, Kenedix Office and Kenedix Retail, amounted to 8% in total.

The ex-ante volatility based on daily data over the past 1 year was just 6% with an ex-ante beta of just 0.1. Partly because of the REIT exposure, and the fund's lack of bank exposure, the beta of the long book was 0.82. Historically, we have had a preference for being long low beta stocks. Unfortunately, as experienced many times in the past, risk measure are snapshots and worth nothing in times of distress with correlation spikes.



*Source: BNY Mellon Fund Services**

Fund Overview

	Long	Short
Price to Earnings (PE)	13.7	20.1
EV/EBITDA	7.2	10.7
Price to Book (PB)	1.3	1.9
Dividend Yield	2.6	1.9
EV/IC	0.9	1.9
1 month momentum	-7.9	-6.0
6 month momentum	-9.4	-12.4
9 month momentum	0.0	-2.3
Earnings momentum (1M)	-3.5	-6.6
Earnings momentum (3M)	-2.7	-2.3
CFROI	6.8%	9.2%
Cash/MarketValue	34.5%	22.2%

Source: Factset

Style Exposure

	Long	Short
Beta	0.82	0.85
Volatility	21.2%	21.8%
Debt-to-equity	-1%	44%

Source: UBS PAS

Risk Statistics Delta Adjusted

Volatility (ex-ante; 3 months daily data)	6.0%
Volatility (ex-ante; 5yr monthly data)	5.5%
Var (99%, 5 days)	1.7%
Beta (ex-ante)	0.08

Source: GS and Nomura

Outlook

Strategic Framework - Outlook 2nd half of 2016
During the first half of 2016 we operated under the assumption of cyclical bear market. The three year bull run completed in August 2015, and 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 its 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 from investors. 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 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 is very unlikely this year and a weaker US dollar our base case scenario.

Tactical assessment - July 2016
June had all hallmarks of a proper panic in Japan. The Japanese Yen rallied into heavy resistance at 100 Yen to the US dollar. Policy makers are on high alert and strain in capital markets will force the BOJ's hand eventually. Newly introduced terminology, such as confetti and helicopter money, are telling additions to the so called unconventional monetary vocabulary. Valuation is again very supportive for long positions as cheapness puts in a price floor notwithstanding undershoots from liquidity mismatches. Investors positioning is rather cautious and partly at extremes indicating further downside in the short run is limited. However, we doubt that beyond a short term relief we can re-test the highs any time soon. The only sustainable rock bottom will be a level of cheapness at which investors refuse to sell and strong hands regain control. The Japanese market trading at replacement value is an excellent starting point and we find quality stocks trading at multiples below 2008 levels.

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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%						
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%						
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	-2.54%	5.81%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
Class B EUR	-2.30%	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	€ 203,557,667
Firm AUM in USD	$226,071,146

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	€ 86,383,181
Fund Size in USD	$95,937,160
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.
Depositary	Bank of New York Mellon

Pelargos Japan Alpha Fund
June 2016

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