

Fund Performance

The Pelargos Japan Alpha Fund Class B appreciated +0.23% in May. Since July 2008, inception-to-date (ITD), the fund is up +51.98% with a realized volatility of 7.1%, whilst the MSCI Japan is up +14% ITD with a realized volatility of 20%.

Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1.326,00	0,19%	-2,52%	32,60%
Class B EUR	1.519,75	0,23%	-2,32%	51,98%

Market Environment

Against all seasonal odds, May turned out to be the strongest month of 2017 as the MSCI Japan appreciated +2.1%. The month of May is earnings season and Japanese companies delivered very strong numbers. The majority of companies beat estimates and stocks reacted positively as expectations were generally low. Nevertheless, despite the reacceleration in the overall market, the best performing sub-segment was low beta Household Products. Expensive stocks did again very well in May, which is not supportive for our style. With government yields declining globally, low beta, bond-proxies such as Consumer Staples performed extremely well. Valuations in this sector are far beyond reasonable. Investor's attention is extremely concentrated in this sub-segment of the market and other opportunities, such as good-old machinery, were completely ignored.

Yield sensitive stocks, such as banks, and reflation trades, such as real estate, continued to underperform. Especially, in the REIT sector a lot of value opportunities have emerged. The fundamental core long book performed very well, +3.7% in May. Whilst the short book nicely underperformed for the month with just +0.7%. A decent spread indeed. Unfortunately, due to the systematic hedge book we gave back quite a large part of the positive spread. In order to manage the level of net exposure we use a hedge basket. In our case, the systematic basket consists of the most expensive stocks in our universe. In the long run, shorting these crowded, glamour stocks delivers additional alpha in the form of pure factor premium.

Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Household Products	15,3%	25,3%	3,8	34,0
Software & Services	13,1%	22,1%	2,2	20,7
Semiconductors	9,8%	27,0%	1,7	23,2

Industry Group	MTD	YTD	PB	PE
Banks	-3,5%	-8,7%	0,5	10,7
Energy	-3,5%	-5,6%	0,8	10,3
Media	-3,1%	-1,8%	1,6	18,1

Source: Bloomberg

General Statistics

% Return long book	3,7%
% Return short book	0,7%
# Long stocks	42
# Short stocks	8
% Long stocks ↑	62%
% Short stocks ↓	38%
# Up days / Down days	12 / 10
Daily Correlation with MSCI JP	0,77
Turnover as % NAV	25%

Source: Factset

Top 10 gross positions

Nishimatsu Con.	5,4%	Familymart	2,3%
Pola Orbis	4,1%	Toshiba Plant S.	2,3%
Heiwa Real Est.	2,6%	Toray Industries	2,3%
Relia	2,5%	Nippon Gas	2,3%
Mitsui Fudosan	2,5%	NBF	2,2%

Source: BNY Mellon Fund Services

Single Stock Activity

Largest Buy*		Largest Sell*	
Maeda Road Const	B	Familymart	S
Nishimatsu Const	B	Resona Holdings	B
Pola Orbis	B	Toray Industries	S
East Japan Rail	B	Sumitomo Met Min	S
Kikkoman Corp	B	Nabtesco	S

* B = Buy; S = Sell

Source: BNY Mellon Fund Services

Investment Strategy

The turnover in the fund was very low in May, as it tends to be during earnings season. We do not trade short-term earnings events. Therefore we use this period to step aside and digest incoming newsflow and assess its implications for the company's longer-term outlook and valuation.

Currently, the biggest positions are Nishimatsu Construction and Pola Orbis, both long positions. With regards to Nishimatsu Construction, we increased the position size from 3.8% last month to 5.4% end of May. We have been writing about both companies in prior newsletters.

Last month we initiated a long position in Maeda Road Construction. We have monitored this Road Construction company for a long time, and without apparent catalyst we were hesitant to engage as its growth outlook is rather anemic. Mid-May Obayashi Corp announced the buy out of its consolidated subsidiary Obayashi Road. This consolidation move seemed to us a reasonable template for Maeda Road. The cross-shareholding with Maeda Corp is reasonably high and with an activist shareholder ranking number 2 in the shareholder register, we expect corporate action to happen within a reasonable time frame.

Investment Strategy

Pola Orbis contributed another 60bps in May. The stock rallied throughout the month, appreciating +18%. The company revised earnings upwardly due to the new blockbuster product 'Wrinkle Shot', which added 6bn JPY (60mn US) in revenues in just the first quarter.

Nippon Gas' stock finally appreciated +13% in May. The market liberalization in the Tokyo area is the biggest growth driver for this company. The stock only recently started to react positively to the number of newly acquired customers. The initial reaction was muted as new customer acquisition costs disappointed, but in the re-rating of low beta stocks this one certainly participated.

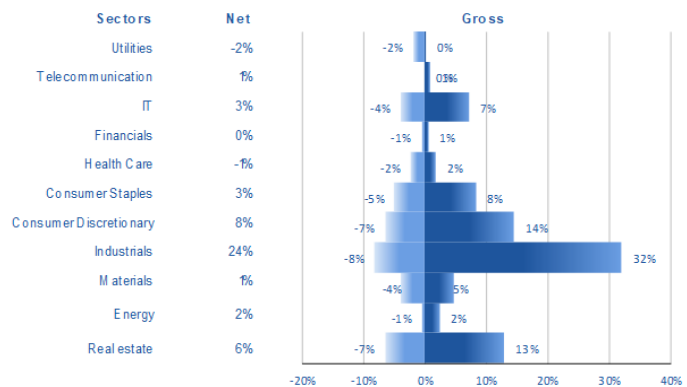
The losses this month were rather muted on a single stock level. Resona Holdings with -0.2% ranks number 1 and indeed the business suffers from declining net interest margins due to negative short term rates. Nevertheless, earnings downgrades have bottomed out as most negative scenarios are already taken into account by sell side analysts.

Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Pola Orbis	L	0,6%	Resona Holdings	L	-0,2%
Nippon Gas	L	0,3%	Toshiba Plant Sy	L	-0,2%
Nishimatsu Const	L	0,3%	Fuji Media	L	-0,2%
RELIA	L	0,2%	Mitsui Chemicals	L	-0,1%
Fuji Machine Mfg	L	0,2%	Mitsui Soko	L	-0,1%

*CTR = Contribution

Source: Factset

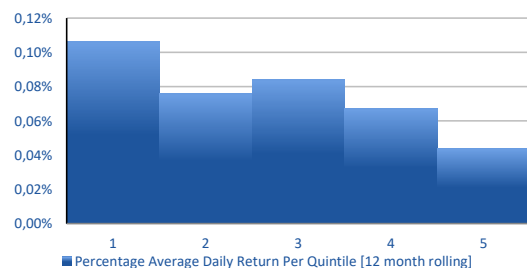
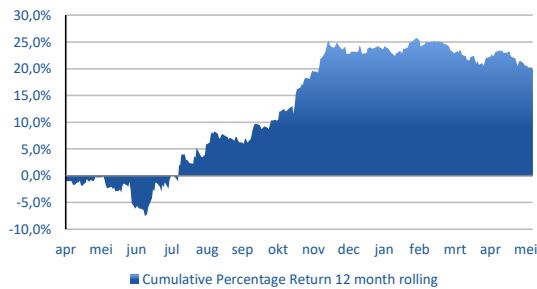


Source: UBS PAS

Value Factor Performance*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MoM	-2%	-1%	-3%	-4%	-1%	-2%
YoY	11%	8%	15%	2%	6%	8%

Source: Factset*



Source: Factset*

Style Performance

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

The outperformance of the value factor started in the summer of last year and peaked in December. The strong performance of value was very consistent across different types of definitions and sectors. Since December, the strong performance of value stocks has stalled.

The value factor closely correlates with global yields as well as the Japanese yen.

The drawdown in value accelerated to downside and in May, price-to-book (P/B) recorded another negative -3% spread return. Unfortunately, all value factors had a negative spread return last month.

The weighted average P/B of the long book is 1.5x compared to 1.9x for the short book. Price momentum exposure continues to be elevated. On a 9-month basis, the long book's price momentum is +24% and the short book's price momentum was just flat with -1%.

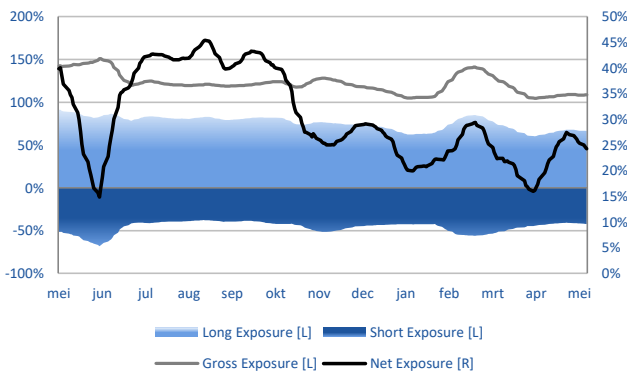
The P/E of the long book was 16.9x compared to 23.3x for the short book. The EV/EBITDA of the long book is 8.2x compared to 10.6x for the short book. The dividend yield of the long book is 2.3% compared to 1.9% in the short book.

Risk Measurement and Management

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

At the end of the May, net exposure was about 25% and gross exposure 110%. The ex-ante volatility based on daily data stood at 5.5% with an ex-ante beta of 0.31. The beta of the long book is about the same as the beta of the short book.

The current risk in terms of gross exposure is lower than historically as our style has insufficient support in the current macro environment. Valuations in low beta stocks are at extremes. Once fund flow driven investors refuse to carry those stocks to even higher levels and buying exhausts itself we will aggressively increase risk budgeting.



Source: BNY Mellon Fund Services*

Fund Overview

	Long	Short
Price to Earnings (PE)	16,9	23,3
EV/EBITDA	8,2	10,6
Price to Book (PB)	1,5	1,9
Dividend Yield	2,3	1,9
EV/IC	1,1	1,5
1 month momentum	5,7	-0,4
6 month momentum	10,5	-0,4
9 month momentum	24,7	-1,1
Earnings momentum (1M)	-0,2	-19,4
Earnings momentum (3M)	16,3	-3,3
CFROI	8,6%	10,1%
Cash/MarketValue	35,9%	16,0%

Source: Factset

Style Exposure

	Long	Short
Beta	0,87	0,86
Volatility	11,3%	11,9%
Debt-to-equity	1%	73%

Source: UBS PAS

Risk Statistics Delta Adjusted

Volatility (ex-ante; 3 months daily data)	5,5%
Volatility (ex-ante; 5yr monthly data)	6,8%
Var (99%, 5 days)	0,8%
Beta (ex-ante)	0,31

Source: GS and Nomura

Outlook

Strategic Framework

We firmly believe that 2012 was THE bottom in the Japanese equity market and in Q4 of that year a secular bull market started. The initial bull leg lasted three years, and the cyclical bear market from August 2015 into June 2016 took the broader index down -30% peak-to-trough. 2016 was another year of heightened macro event risk. Perceived low probability outcomes caused major surprises. Brexit related risk a version upset markets globally and the outcome of the US presidential election led to further elevation of political uncertainty. In June 2016, the Japanese market bottomed together with global bond yields, and with that the greatest rotation from defensives into cyclicals for the past decade occurred.

After a brief consolidation we expected the reflation trade to continue and value stocks, not only interest rate related bank stocks, but also heavily discounted Japanese cyclicals to accelerate. So far the contrary happened as yields declined and especially in Japan expensive, defensives roared higher and the absurd valuation spread has been taken to extremes again.

We wrote many times that in a highly levered global economic system, the upside for yields is limited as higher yields are difficult to absorb. Nevertheless, we are surprised to see that yields continue to drift lower globally. The BOJ has basically 'fixed' the yield curve up until 10 years and 'monetary' policy is basically outsourced to the FED. However, as the FED increased short rates, long rates did not respond, even more worrisome the yield curve flattened. Why is this important to mention here? This macro dynamic has tremendous impact on the currency and style performance. In the current investment world we operate in, passive took over from active, and through indexation, themes were bundled and macro factors got correlated to the extent of absurdity. Smart beta is not smart if factor exposure is bought irrespectively of underlying value. We do not know when and what will act as a catalyst, but extreme valuation always indicates poor future returns. The dispersion in Japan is extreme, maybe most extreme globally. This offers tremendous opportunities and we are well positioned for it.

On the short-term basis, we expect Japanese equities to participate in the global bull run and remain very constructive on a multi-year basis. Everything seems to work in favor of the Japan equity trade, cheap valuation excluding the distorted bond like proxies, balance sheets are extremely healthy and the corporate governance revolution is only just starting. Completely disregarded but more true than ever, Japan is a stable place. In the past, this was frowned upon, but stable, steady progress is worth a premium in a world of political instability and elevated geopolitical risk.

Historic Fund Performance (Monthly)													YTD
Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec		
Class A EUR													
2017	0,49%	-0,93%	-1,67%	-0,61%	0,19%								-2,52%
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%
Class B EUR													
2017	0,56%	-0,92%	-1,63%	-0,57%	0,23%								-2,32%
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

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	januari 2009
Inception Date Class B EUR	juli 2008

Company Facts

Firm AUM in EUR	€ 222.857.497
Firm AUM in USD	\$250.580.970

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

Contact Details

WTC The Hague, Tower E 7th floor
Prinses Margrietplantsoen 43

Fund Facts

Fund Size in EUR	€ 85.668.760
Fund Size in USD	\$96.325.953
Participations Outstanding Class A	236
Participations Outstanding Class B	56.164
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

2595 AM, The Hague

The Netherlands

+31 (70) 7568030

www.pelargoscapital.com

Disclaimer

Pelargos Capital B.V. has compiled this publication. Pelargos Capital B.V. is a management company and in that capacity avails of a license pursuant to section 2:65 of the Act on Financial Supervision of the Netherlands (Wft) as that section reads following the incorporation of the AIFM Directive in the Wft).

Although the information contained in this publication is composed with great care and although we always strive to ensure the accuracy, completeness and correctness of the information, imperfections due to human errors may occur, as a result of which presented data and calculations may vary. Therefore, no rights may be derived from the provided data and calculations. All information is provided "as is" and is subject to change without prior notice.

Pelargos Capital B.V. does not warrant the adequacy, accuracy or completeness of any information and expressly disclaims any liability for errors or omissions therein. The recipients of this publication are responsible for evaluating the accuracy, completeness or usefulness of this information.

The information contained in this publication does not constitute any recommendation, investment proposal, offer to provide a service, nor a solicitation to buy or sell any security or other investment product.

The publication of this information may be subject to restrictions imposed by law in some jurisdictions. Pelargos Capital B.V. requests any recipient of this publication to become acquainted with, and to observe, all restrictions. Pelargos Capital B.V. accepts no liability for infringement of such restrictions.

The recipient shall not distribute, forward or publish this information. No rights may be derived from the provided information, data and calculations. Also by risks inherent to this investment fund, the value of the investments may fluctuate. Past performance is no guarantee or guide to future performance.

