

# Pelargos Japan Alpha Fund

## December 2015



### Fund Performance

The Pelargos Japan Alpha Fund Class B declined -1.42% in December. 2015 the fund ended up +6.36%. Since July 2008, inception-to-date (ITD), the fund is up +52.42% with a realized volatility of 7.4%, whilst the broader market is up 14.7% ITD with a volatility of 20.1%.

### Market Environment

In December, the Japanese equity market declined -2.2%. Yellen, the Federal Reserve Chair, telegraphed with much confidence her intention to raise rates, and so she did. As the FED implemented its first rate hike in a decade, investors remained highly skeptical of the FED's confidence in a strong US economy. By raising rates in December the FED completely ignored the poor liquidity situation in global markets especially during the festive season. The market sold off aggressively prior to the FED meeting, declining by more than 6%, followed by a shallow Santa Clause rally. Despite the bounce during Christmas the market ended the month down.

In this risk-off environment, investors stuck to high price momentum stocks with strong earnings momentum. Value stocks, which tend to do well in December, performed in line with the broader universe. Defensive sectors, such as Food and Pharma, outperformed whilst cyclical sectors, such as semi conductors and retailing, performed poorly. The core book consisted of 46 long positions at the end of December and 11 short positions.

2015 was a strong year for the Japanese market, solidly outperforming most developing and emerging markets. 2015 marked the fourth consecutive up-year. Even in US dollar terms the market was up 7% whilst the Pelargos Japan Fund achieved 6.4% with single-digit volatility.

### Largest Long & Short Holdings

Longs	Shorts
Ryosan	Komatsu
Ichigo Group	Kikkoman Corp
Kaneka Corp	THK
Moshi Moshi	Nissin Foods
Honda Motor	Hino Motors

Source: BNY Mellon Fund Services

### Single Stock Activity

Largest Buy & Buy Cover*		Largest Sell & Short Sell**	
Acom	B	Dai Ichi Life	S
Zuiko	B	THK	SS
Nippon Building Fund	BC	Ichigo Group	S
Nippon Express	BC	Nippon REIT	S
Ichigo Hotel REIT	B	Kikkoman Corp	SS

\* B = Buy; BC = Buy Cover

Source: BNY Mellon Fund Services

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

### Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,336.48	-1.62%	5.81%	33.65%
Class B EUR	1,524.25	-1.42%	6.36%	52.42%

### Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Consumer Services	2.8%	15.1%	1.8	16.6
Food Beverage	2.2%	24.8%	1.3	22.6
Pharma	1.5%	39.7%	1.6	22.5
Industry Group	MTD	YTD	PB	PE
Semiconductors	-8.1%	-15.2%	0.8	13.1
Retailing	-7.5%	18.9%	0.9	15.7
Household Prod.	-5.0%	36.6%	2.3	28.9

Source: Bloomberg

### General Statistics

% Return long book	-1.7%
% Return short book	-0.4%
# Long stocks	46
# Short stocks	11
% Long stocks ↑	39%
% Short stocks ↓	64%
# Up days / Down days	7 / 14
Daily Correlation with MSCI JP	0.27
Turnover as % NAV	40%

Source: Factset

### Investment Strategy

The largest long position, Ichigo Group had a stellar run and reached our intermediate price target at which risk/reward appeared less appealing and therefore we reduced the position size.

Pola Orbis is not amongst the top five positions anymore. We remain long-term bulls on the company, however the stock price got ahead of itself and we took profits. The position size in Ryosan remained unchanged and we added two new long positions, Zuiko and Ichigo Hotel REIT.

Ichigo Hotel REIT, a recent IPO, had extremely muted price action on its first trading days. We took advantage and bought this inbound-tourist proxy at very low prices. The other newcomer in the long book is Zuiko. The stock has been on our radar screen for the past 12 months. Zuiko is a small, family owned machinery company supplying the likes of Unicharm with diaper production machines. On the short side, it is worth noting that Nippon Express was our largest short position last month and is not in the top five anymore. The stock dropped 11% in November and contributed 0.3%, as our thesis played out. Risk/reward diminished at lower prices and we decided to take profits on this short.

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### Investment Strategy

In December Ichigo Group was again the best contributor. In the fourth quarter of 2015 the stock rallied 37%, and +65% from its September lows, and contributed about 120bps in the last quarter.

The very timely purchase of Ichigo Hotel REIT added some 20 basispoints as the stock rallied 26% despite the market declining by 2%.

Unfortunately, Ryosan gave back some of its strong gains from last month. In November, the stock jumped 11% due to the buy back announcement which we considered a very strong vote of confidence by management. However, in the recent market related sell-off the stock participated and declined 4%.

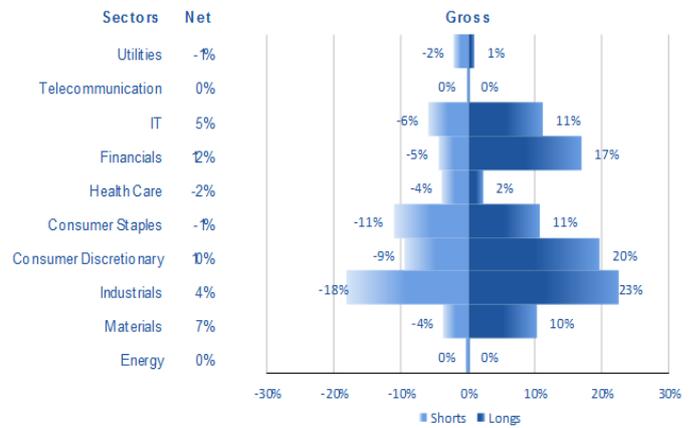
The worst stock in December was Sumco. Our investment thesis was rejected, at least in the short term, and with the stock declining below our stop loss we decided to exit. Sumco, together with Shin Etsu, dominates 200mm and 300mm wafer production, which is a capital intensive, cyclical business with commodity type character. The two players became very disciplined in terms of capacity addition, however both companies have failed so far to achieve price increases. With the stock down 60% from last years high and after having met the company to discuss our thesis we found the risk/reward attractive. The stock dropped another 45% from its December highs.

### Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Ichigo Group	L	0.4%	Sumco Corp	L	-0.5%
Ichigo Hotel REIT	L	0.2%	Moshi Moshi	L	-0.3%
Alpine Elec	L	0.1%	Chiyoda Co	L	-0.3%
Ibiden Co	S	0.1%	Pola Orbis	L	-0.2%
Kaneka Corp	L	0.1%	Ryosan	L	-0.2%

\*CTR = Contribution

Source: Factset



Source: UBS PAS

### Value Factor Performance\*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MTD	0.1%	0.6%	1.1%	0.4%	1.2%	-0.9%
YTD	0.0%	1.6%	0.6%	2.2%	1.9%	4.0%

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.

In December, value factor performance was just flat. The price-to-book factor had a bit of a bounce, but overall 2015 turned out to be a lackluster year for value. The best performing value factor was Free-Cash flow Yield (FCF), followed by dividend yield (Div Yld).

In December, price momentum continued to perform strongly as did earnings revisions. It seemed investors are agnostic to valuation and, with so much government involvement distorting market based signals, investors invest in what has worked and extrapolate earnings trends.

The long book's 9-month price momentum is 10.2%, whilst the short book's 9-month price momentum is -5%. A rather distinct momentum spread, nevertheless the P/B of the long book is 1.7x compared to 2.0x for the short book. Dividend yield of the long book is equal to the short book and EV/EBITDA of the long book is 8.2x compared to 10.9x for the short book.

The beta and volatility of the long book is significantly lower compared to the short book.

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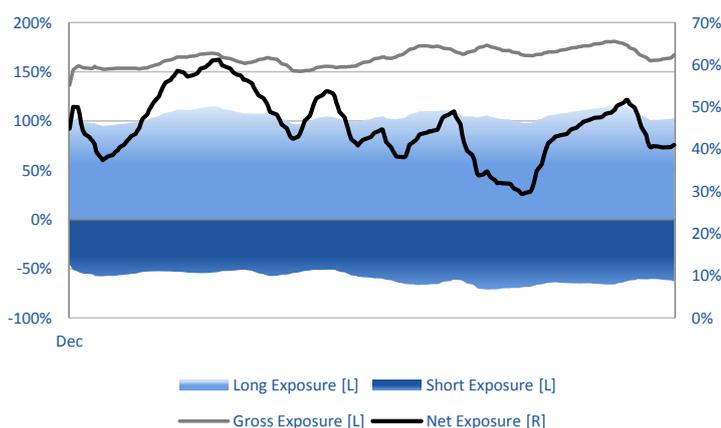
### Risk Measurement and Management

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.

Over the past 12 months the gross exposure ranged between 150-180%, and stood again at 170% gross exposure at the end of December. Early December we bought Nikkei puts February strike 19500. Including this sizeable put option to hedge out market risk, the delta adjusted gross exposure was 193%.

The net exposure stood at 36.5% at the end of December, markedly lower compared to 52% the prior month. On a delta adjusted basis, thus including the put option, the net exposure was a mere 13%.

The ex-ante volatility dropped from above 11.3% at the end of November to 8.0% at the end of December. The ex-ante beta was just 0.2.



Source: BNY Mellon Fund Services\*

### Fund Overview

	Long	Short
Price to Earnings (PE)	18.8	21.1
EV/EBITDA	8.2	10.9
Price to Book (PB)	1.7	2.0
Dividend Yield	1.8	1.8
EV/IC	1.0	1.8
1 month momentum	0.2	-2.4
6 month momentum	2.1	-2.3
9 month momentum	5.6	-7.4
Earnings momentum (1M)	6.5	-9.3
Earnings momentum (3M)	12.7	-12.9
CFROI	7.2%	8.6%
Cash/MarketValue	31.5%	22.1%

Source: Factset

### Style Exposure

	Long	Short
Beta	0.9	1.0
Volatility	20.2%	21.3%
Debt-to-equity	8%	26%

Source: UBS PAS

### Risk Statistics Delta Adjusted

Volatility (ex-ante; 1yr daily data)	8.0%
Volatility (ex-ante; 5yr monthly data)	6.8%
Var (99%, 5 days)	1.8%
Beta (ex-ante)	0.20

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 collapse 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 '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 your 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 and being treated as a global, leveraged growth proxy.

#### Tactical assessment – Outlook January 2016

For the past 12 months we have continuously highlighted the devastating effects of misguided central banking activism. Zero interest rate policy has led to an 'to be expected' capital misallocation and now that the US FED attempted to start a rate hiking cycle, global liquidity tightened. The Japanese market reacts as it always did, as 'a warrant on global growth'. We remain cautious on all fronts and favor to be long domestic defensive businesses and short global cyclical in addition to extremely overpriced, high crowded momentum plays in the consumer staples space. Cyclical bear markets are difficult to trade as high volatility regimes means velocity down and back-up. In such an environment, investors get easily whipsawed and nimble position sizes becomes increasingly important. We are working on the shopping list in order to pick up the pieces once the sellers are in full panic.

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### Historic Fund Performance (Monthly)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<b>Class A EUR</b>												
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%
<b>Class B EUR</b>												
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)

	2015	2014	2013	2012	2011	2010	2009	2008
<b>Class A EUR</b>	5.81%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
<b>Class B EUR</b>	6.36%	-6.52%	20.57%	10.95%	-4.48%	9.67%	2.75%	6.46%

#### Fund Facts

<b>Investment Manager</b>	Pelargos Capital
<b>Legal Status</b>	FGR (fund for joint account)
<b>Fiscal Status</b>	VBI (tax exempt)
<b>Dividend Policy</b>	Reinvestment
<b>Base Currency</b>	EUR
<b>ISIN Class A EUR</b>	NL0009051887
<b>ISIN Class B EUR</b>	NL0001118015
<b>Inception Date Class A EUR</b>	January 2009
<b>Inception Date Class B EUR</b>	July 2008

#### Company Facts

<b>Firm AUM in EUR</b>	€ 212,661,278
<b>Firm AUM in USD</b>	\$230,992,681

#### Fund Facts

<b>Fund Size in EUR</b>	€ 90,622,724
<b>Fund Size in USD</b>	\$98,434,403
<b>Participations Outstanding Class A</b>	236
<b>Participations Outstanding Class B</b>	59,247
<b>Minimum Subscription Class A</b>	EUR 10,000
<b>Minimum Subscription Class B</b>	EUR 10,000
<b>Dealing Day</b>	First business day of each month
<b>Subscription</b>	Any dealing day, 5 business days notice
<b>Redemption</b>	15 business days notice
<b>Management Fee Class A</b>	1.5%
<b>Management Fee Class B</b>	1.0%
<b>Performance Fee Class A</b>	20% subject to High Watermark
<b>Performance Fee Class B</b>	15% subject to High Watermark
<b>Early Redemption Fee</b>	max 1% (accrues to Fund)
<b>Lock-up Class B</b>	1 year

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### 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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