MARKET COMMENTS

After the October crash the Japanese market continued its volatile performance in November, dropping 5% intra-month and at the end closed the month in positive territory (+1%). Over the past several weeks the Japanese market closely followed the US market and needless to say, the price action looks terrible. Fundamentally, the global economic slowdown is well underway, and earnings downgrades have started to appear. The pockets of weakness are most apparent in the semiconductor industry, Chinese factory automation and car sales globally. Most importantly, credit growth in many countries is decelerating with negative repercussions for asset prices and risk of spillover effects. Throughout the year, the Chinese government is reigning in excess leverage with negative implications for asset prices in China and partially abroad. In Australia, Canada and the UK house prices are coming off as affordability and credit availability has started to impact those real estate markets. That said, the Japanese economy is still doing fine as the domestic demand situation remains solid. The only pockets of weakness are those related to global export sectors such as IT, automotive and Chinese capital expenditure, which are, admittedly, not insignificant.

SINGLE STOCK OBSERVATIONS

The biggest long position Toshiba Plant Systems reported earnings and the stock rallied +7.6% in November. Operating profits (OP) grew 39% y-o-y and OP margins improved to 9.3%. The company did a small upward revision to the full year, which leaves room for further upward revisions in Q3 (Oct-Dec) or Q4 (Jan-Mar).

Okamoto Industries rallied 18% last month after announcing reassuring results. 50-55% of its operating profits are generated in the condoms segments. This is a highly profitable business in a rather consolidated industry globally, with strong growth prospects in the Asian region, especially in China. The company keeps a low profile and proofed to be forthcoming to shareholders as it buys back and retires about 1% of outstanding shares per annum. Unfortunately, the stock is highly volatile for two reasons. Firstly, the other half of its OP comes from highly customized, but more cyclical rubber-product businesses.

Amongst the losing positions are shorts such as Coca Cola Japan (CCJ). This Coca Cola bottler has consolidate the highly fragmented bottlers' landscape in Japan and is streamlining its distribution footprint. This logistics realignment has turned into a logistical nightmare because of recent natural disasters, wiping out production and storage facilities. In addition, Suntory has introduced a new product; coffee in PET bottles. Why would one care about bottled coffee? Well, canned coffee has traditionally had a significant market share and is a highly profitable business for CCJ, because Japanese people are not so much into carbonated drinks. In addition, canned coffee is sold in high-margin vending machine, where the producer controls pricing. Suntory is the first mover in the bottled coffee business and is taking share from CCJ. Suntory has set the price at a much lower level on a per milliliter basis. CCJ has great management and recently announced a share buyback, which pushed up the share price, but we believe in the famous Warren Buffet quote "when a management with a reputation for brilliance, tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact".

RISK ALLOCATION

The gross and net exposure is unchanged from the prior month. The beta-adjusted net exposure around 20-25% and a gross exposure between 130-140% corresponds with a 8-9% volatility in the current market environment.

STYLE ANALYSIS

Our factor models show poor returns across all styles. In Japan, value was the worst performing style, only quality was barely up. The rather unsystematic behavior and high degree of randomness over the past 9-12 months seems to indicate that a lot of liquidity issues drive price behavior, such as deleveraging of quant strategies, unwind of crowded trades, fund closures and/or asset allocation driven flows.

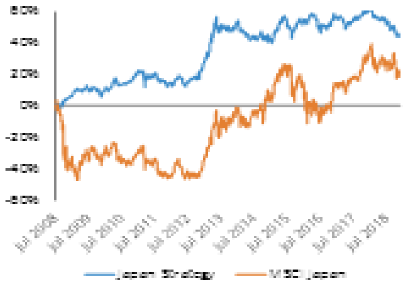
OUTLOOK

Against the backdrop of a slowing global economy, the liquidity situation seems to deteriorate rapidly. Yes, Japanese stocks are inexpensive and indeed the earnings growth outlook is fading, but earnings are still growing in aggregate and are far from disastrous. Share buybacks increased 38% y-o-y and reached an 11-year high, because Japanese corporates prefer to do buybacks when their share prices are down. This makes perfect sense, however, still only about 30% of TOPIX 500 companies conduct share buybacks and even worse the top 20 companies in terms of the size of the buybacks accounted for more than 70% of the total buyback value. Corporate governance is improving, however, the progress with regards to shareholder returns at the average Japanese corporate seems snail speed at best. Japan is once again a contrarian call, valuations are cheap and the Japanese market is as under-owned as it was in 2008.

PELARGOS JAPAN ALPHA FUND
NOVEMBER 2018 | monthly return -0.13%

pelargos capital

FUND CHARTS AND FACTS



TOP 5 GROSS POSITIONS

Toshiba Plant Sy
Ichigo Hotel REIT Investment C
Alpine Elec
Taihei Dengyo
Maeda Road Const

TOP 5 MOVERS

Toshiba Plant Sy	0.59%
Okamoto Inds	0.49%
Creo	0.40%
Tokyo Ohka Kogyo	0.33%
Maeda Road Const	0.31%

TOP 5 SHAKERS

Pepper Food Serv	-0.36%
Nippon Building Fund	-0.34%
Sbi Holdings	-0.30%
Coca Cola West C	-0.30%
Toshiba Tec Corp	-0.26%

FUND FACTOR

	Long	Short
Price to Earnings (PE)	16.0	19.8
EV/EBITDA	10.6	13.8
Price to Book (PB)	1.5	3.1
Dividend Yield	2.4	1.9
EV/IC	1.2	2.8
1 month momentum	5.3	6.0
12-1 month momentum	-1.3	-13.7

FUND PERFORMANCE*

Month to date performance	-0.13%
Year to date performance	-9.71%
Inception to date performance	44.99%

*based on share class B EUR

FUND FACTS*

Fund size in mln EUR	94.87
Fund size in mln USD	107.42
Firm size in mln EUR	222.96
Firm size in mln USD	252.46

RISK STATISTICS

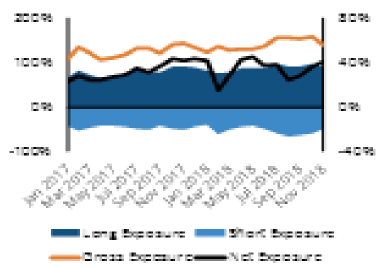
Net Exposure	41%
Gross Exposure	138%
Volatility (ex-ante; 3 months daily data)	5.5%
Beta (ex-ante)	0.29
Sharpe Ratio	0.53
Sortino Ratio	0.98
Sterling Ratio	0.43
Max Drawdown (monthly)	-8.4%
Annualized Return	3.6%

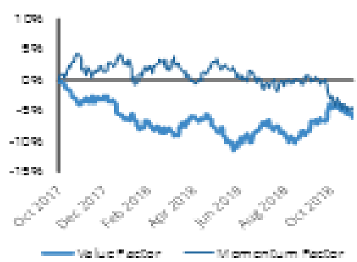
SECTOR EXPOSURES (IN PERCENT)

	Long	Short	Net	Gross
Consumer Discretionary	5	-2	4	7
Consumer Staples	4	-2	2	6
Energy	0	0	0	0
Financials	1	0	1	1
Health Care	19	-7	13	26
Industrials	7	-9	-2	16
Information Technology	8	-4	5	12
Materials	1	0	1	1
Real Estate	36	-11	25	46
Telecommunication Services	4	-9	-4	13

GENERAL STATISTICS

% Return long book	2.57%
% Return short book	4.22%
# Long stocks	48
# Short stocks	20
% Long stocks ↑	65%
% Short stocks ↓	30%
# Up days / Down days	11 / 11
Turnover as % NAV	62%





FUND PERFORMANCE: CLASS B EUR

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	ITD
2018	-0.26%	-1.77%	-1.03%	-0.63%	-0.06%	-0.36%	-0.87%	-1.66%	0.36%	-3.69%	-0.13%		-9.71%	44.99%
2017	0.56%	-0.92%	-1.63%	-0.57%	0.23%	1.32%	1.18%	0.46%	0.99%	1.25%	0.20%	0.14%	3.22%	60.59%
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%	55.58%
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%	52.42%
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%	-6.52%	43.31%
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%	53.31%
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%	27.15%
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%	14.60%
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%	19.97%
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%	9.39%
2008							0.96%	-1.35%	1.40%	3.44%	0.52%	1.39%	6.46%	6.46%

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