

# Pelargos Japan Alpha Fund

## October 2015



### Fund Performance

The Pelargos Japan Alpha Fund Class B appreciated +1.88% in October. Year-to-date (YTD) the fund is up +5.71%. Since July 2008, inception-to-date (ITD), the fund is up +51.50% with a realized volatility of 7.4%, whilst the benchmark is up 16.0% ITD with a volatility of 20.3%.

### Market Environment

The Japanese market dropped 20% from its August high to the September low and bounced 11% in October. The Japanese Yen (JPY) was more or less unchanged over the month.

All industry groups increased last month with semiconductors, telecoms and consumer discretionary outperforming. Food & Staples, Retailing and Consumer Services underperformed last month. Cheap stocks outperformed expensive stocks by a significant margin.

Volatility across global equity markets peaked in late August and declined throughout October. Uncertainty in equity markets remained elevated as macro-economic data in Japan continued to disappoint in face of a global growth slow down.

In October, the long book significantly underperformed the market. Not much of a surprise, because in September the long book only declined - 2.5% whilst the market dropped by -8.5%. Our long book tends to consist of lower beta stocks and of companies with strong balance sheets. In October, the correlation with the MSCI Japan picked up to 0.29 compared to 0.09 during prior month's sell-off.

45 out of 50 long positions gained last month. With regards to the short book, only 2 out of the 12 short positions declined in October. The turnover of the core value book was a mere 20%.

### Largest Long & Short Holdings

Longs	Shorts
Ichigo Group	Nissin Foods
Ryosan	Nippon Express
Honda Motor	Kikkoman Corp
Pola Orbis	Keyence Corp
Chiyoda Co	Hino Motors

Source: Citi Financial Services

### Single Stock Activity

Largest Buy & Buy Cover*		Largest Sell & Short Sell**	
Dai Ichi Life	B	Kenedix Retail	S
Sumco Corp	B	Honda Motor	S
Kaneka Corp	B	Chiyoda Co	S
Kikkoman Corp	BC	Daiwa Office	S
Komatsu	BC	Nippon REIT	S

\* B = Buy; BC = Buy Cover

Source: Citi Financial Services

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

### Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,329.69	1.83%	5.27%	32.97%
Class B EUR	1,514.96	1.88%	5.71%	51.50%

### Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Semiconductors	21.6%	-17.2%	1.0	14.0
Telecom	16.9%	-18.2%	2.0	16.3
Consumer Dur.	13.7%	20.5%	1.0	17.0

Industry Group	MTD	YTD	PB	PE
Food & Staples	0.4%	27.7%	1.8	21.3
Retailing	1.5%	19.8%	1.0	17.0
Consumer Serv.	3.8%	-30.6%	1.9	18.5

Source: Bloomberg

### General Statistics

% Return long book	7.2%
% Return short book	10.8%
# Long stocks	50
# Short stocks	12
% Long stocks ↑	90%
% Short stocks ↓	17%
# Up days / Down days	13 / 8
Daily Correlation with MSCI JP	0.29
Turnover as % NAV	20%

Source: Factset

### Investment Strategy

Last month Ichigo Group entered the top five long positions. This company has been amongst our core holdings for many years. The stock performed poorly over the summer months and we increased the position in September and October.

On the other hand, Moshi Moshi Hotline, which recently changed its name to Relia, continued to underperform and therefore dropped out of the top five holdings. More than 20% of its market capitalization is net cash with a dividend yield of 2.7% and the earnings cycle is close to bottoming out. Therefore, the stock remains in our core book, but with no apparent near-term catalyst, the position size is just average.

In October, we covered some Komatsu and reduced the REIT exposure somewhat. We reduced Kenedix Retail, Daiwa Office REIT and Nippon REIT. The positions in Ichigo Office REIT and Invincible REIT were unchanged. We re-entered a long position in Dai-ichi Life. This extremely cheap life insurance company benefits from higher interest rates. Its business model is a good balance to the inversely correlated REIT exposure.

### Investment Strategy

Honda was the top contributor last month. The stock price appreciated 14.3% in October and quickly recovered from the August, September sell-off. It still trades at just 1x price-to-book.

Tokyo Ohka Kogyo, a 2% long position, jumped 23% last month. This specialty chemical company is heavily exposed to the semiconductor industry and has a market capitalization of just 1.3bn US dollar. 30% of its market cap consists of cash and with operating margins of 15% the company has plenty of capacity to buy back its stock at and even below book value. Last quarter the company cancelled 3.3% of outstanding shares.

In October, all the losing positions were short positions. Kikkoman contributed 0.6% in September, and despite buying part of the short position back the loss still accounted for 0.4% as Kikkoman rallied 16% in October. The short positions in Komatsu and Unicharm lost 0.3% each, which is equal to the profit those stocks contributed in September.

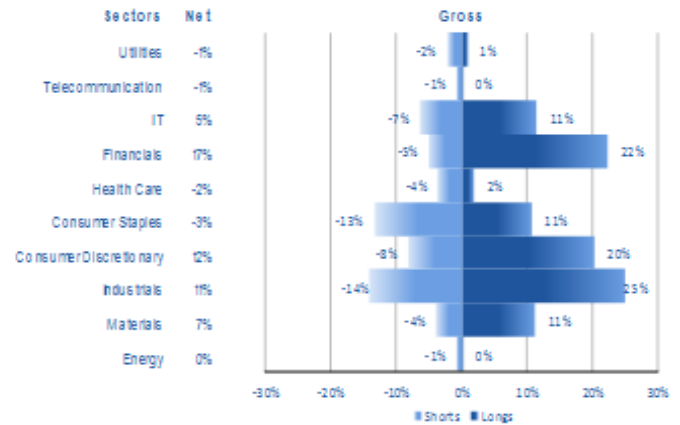
On a sector basis, the largest net exposure is still in Financials (+17%) of which 10% are REITs.

### Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Honda Motor	L	0.5%	Kikkoman Corp	S	-0.4%
Ichigo Group	L	0.5%	Keyence Corp	S	-0.3%
Fujitec Co	L	0.4%	Hino Motors	S	-0.3%
Tokyo Ohka	L	0.4%	Komatsu	S	-0.3%
Shin-Etsu	L	0.4%	Unicharm	S	-0.3%

\*CTR = Contribution

Source: Factset

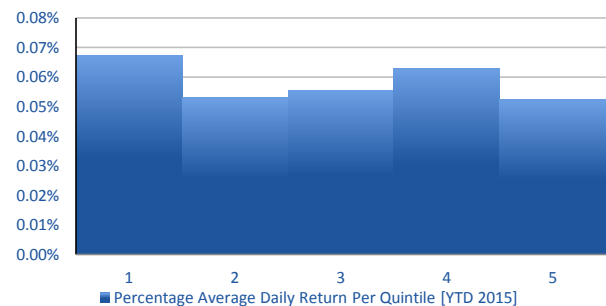
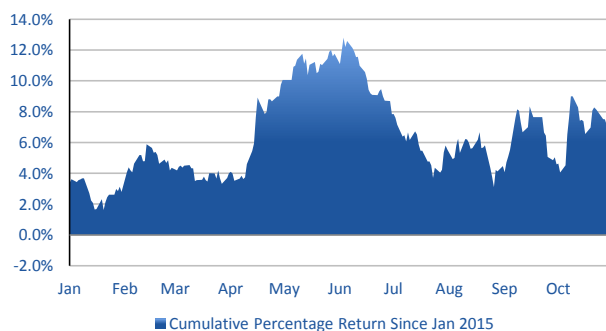


Source: UBS PAS

### Value Factor Performance\*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MTD	5.2%	0.1%	2.4%	0.0%	0.3%	1.3%
YTD	3.2%	0.8%	2.1%	2.7%	1.9%	2.5%

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.

October turned out to be a reasonable good month for our value style. The value composite was up +1%. Amongst the underlying value factors, price-to-earnings (P/E) and price-to-book (P/B) were strong. P/E delivered 5.2%, on the other hand the dividend yield factor was just flat. P/B performed well adding 2.4%. The mentioned returns are based on sector neutrality.

Our biggest dividend exposure is the 10% net long position in REITs. Though the REIT index underperformed in October, it still appreciated +3.3% and year-to-date the REIT index is down by -7.1%.

The market environment remains highly volatile with central banking induced uncertainty. In August volatility spiked to the highest level since the global financial crisis. Value factors were holding up pretty well, but are just not yet upward trending.

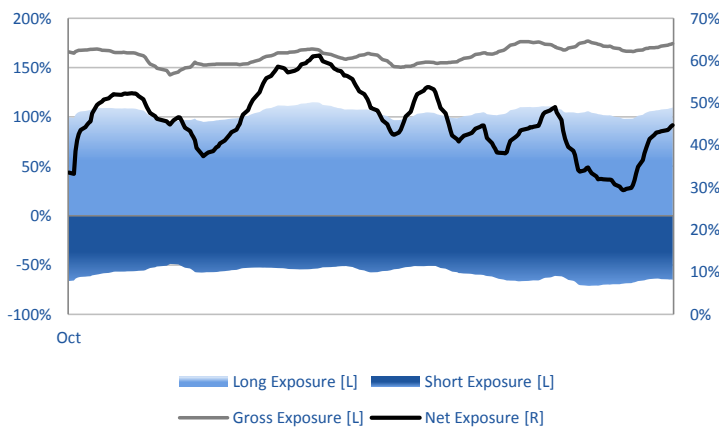
The P/B of the long book is 1.6x and 2.2x for the short book. Dividend yield of the long book is somewhat higher and EV/EBITDA of the long book is 8.9x compared to 11.7x for the short book.

**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 at 178% gross exposure at the end of October.

The net exposure increased with the market rally and in addition we took off the put option hedge. At the end of the month the net exposure stood at 46% and with that the ex-ante volatility based on 5 year monthly data reached 8.1%.



Source: BNY Mellon Fund Services\*

**Fund Overview**

	Long	Short
Price to Earnings (PE)	18.1	22.9
EV/EBITDA	8.9	11.7
Price to Book (PB)	1.6	2.2
Dividend Yield	1.8	1.5
EV/IC	1.1	2.0
1 month momentum	9.2	8.4
6 month momentum	4.0	-1.0
9 month momentum	17.5	5.8
Earnings momentum (1M)	14.0	0.7
Earnings momentum (3M)	17.7	1.3
CFROI	7.0%	8.6%
Cash/MarketValue	31.4%	21.8%

Source: Factset

**Style Exposure**

	Long	Short
Beta	0.9	1.0
Volatility	20.2%	21.6%
Debt-to-equity	15%	38%

Source: UBS PAS

**Risk Statistics Delta Adjusted**

Volatility (ex-ante; 1yr daily data)	10.0%
Volatility (ex-ante; 5yr monthly data)	8.1%
Var (99%, 5 days)	1.8%
Beta (ex-ante)	0.27

Source: GS and UBS PAS

**Outlook**

*Strategic Framework - Outlook 2nd half of 2015*

Economic data is normalizing after last year's VAT hike. Finally underlying trends are meaningful again. The Japanese economy is not in great shape, neither is the global economy. The Japanese economic data remains lackluster though the weak Japanese Yen continues to be a support for this rather dull economy. The most interesting development is the volatility spill-over from currency and commodity markets into fixed income, 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 the most efficient capital allocation. It rewards savvy market participants and punishes misjudgment as well as excessively leveraged risk taking. The manipulation of market segments by central bankers results in underestimating risk and introduces second and third order effects 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 appreciation and sell-off in long-dated bonds is gradual, the repercussion for the US economy remains limited and the Japanese market can continue its ascent.

*Tactical assessment – Outlook November 2015*

Our base case is for a gradual climb higher in share prices into year end. Sentiment indicators have recovered from extremely bearish levels in September and the ensuing bounce in risk assets played out as expected. Post the impulsive bounce a period of consolidation will most likely be followed by gradually higher share prices. The FED seems utterly lost in its short-termism. By being data dependent the FED admitted its failure to forecast and short term noise will determine the timing of the first rate increase. Market participants again expect a rate hike in December and the FED will have to deliver it with a very dovish message as liquidity in the month of December tends to be very poor. In the meantime, the trading mantra is 'bad news is good news'. In the US, valuations are at extremes, corporate profits to GDP are at extremes, revenue growth has turned negative as did earnings growth despite massive share buybacks. In addition, FED support for risk assets is diminishing. The aim to normalize rates led to tight global liquidity through the US dollar appreciation, therefore a bear market in risk assets becomes increasingly likely.

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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%		
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%		
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>	5.27%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
<b>Class B EUR</b>	5.71%	-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	€ 236,345,347
Firm AUM in USD	\$260,121,689

### Fund Facts

Fund Size in EUR	€ 94,981,334
Fund Size in USD	\$104,536,456
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

## October 2015



### Portfolio Managers

Richard Dingemans  
Michael Kretschmer

### Fund Description

<b>Investment Strategy</b>	Equity Long/Short
<b>Investment Style</b>	Value with a twist
<b>Investment Objective</b>	Capital appreciation through investing in long/short positions in Japanese securities

### Service Providers

<b>Prime Brokers</b>	UBS AG, Goldman Sachs International
<b>Administrator</b>	BNY Mellon Fund Services
<b>Accountant</b>	PricewaterhouseCoopers
<b>Legal</b>	De Brauw Blackstone Westbroek N.V.
<b>Title Holder</b>	SGG Netherlands N.V.
<b>Depository</b>	Bank of New York Mellon

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