

Fund Performance

The Pelargos Japan Alpha Fund Class B appreciated +1.25% in October. Since July 2008, inception-to-date (ITD), the fund is up +60.04% with a realized volatility of 7.0%, whilst the MSCI Japan is up +28% ITD with a realized volatility of 19.3%.

Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1.392,26	1,14%	2,35%	39,23%
Class B EUR	1.600,40	1,25%	2,87%	60,04%

Market Environment

The bull market in Japanese equities continued in October with the MSCI Japan surging another 5.6%. Indeed, we expected Japan would catch-up with the US at some point. However, the magnitude and speed of the recent move has been quite remarkable. Japan has been trading at a discount to global developed markets but with the best earnings revisions momentum globally. It seems the price momentum of the past few months suddenly created its own demand, as most global investors were underweight Japan and had to close that pain trade.

The long book outperformed the short book by 0.7%. However, the long book was lagging the market this month. Whilst in prior months the long book outperformed or participated to the same extend, in October the bull move in the index was highly concentrated in several mega-caps and we were not involved in those.

The short book was rather effective, the defensive expensives continued to lag. The hit ratio in the long book achieved 86%, which is a reflection of the broad participation in the Japanese market.

The hit ratio in the short book was quite supportive with 1-in-4 short positions actually declining in this bullish market environment. This month, the systematic hedge book reversed last month's underperformance and outperformed the MSCI Japan by 0.5%. The turnover was at a normal run rate of 40% of NAV and the daily correlation dropped to 0.22.

Top 10 gross positions

Nishimatsu Con.	5,2%
Maeda Road	4,5%
Fuji Media	3,8%
Mitsui Fudosan	3,6%
Toshiba Plant	3,6%
Central JR	3,3%
Nippon Building Fund	3,2%
Heiwa Real Estate	3,2%
HIS	3,1%
Ariake Japan	3,0%

Source: BNY Mellon Fund Services

Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Semiconductors	13,4%	56,6%	2,3	22,9
Telecommunication	7,4%	15,5%	1,9	13,7
Insurance	6,9%	7,1%	0,9	15,3

Industry Group	MTD	YTD	PB	PE
Energy	1,5%	14,7%	1,0	13,3
Consumer Services	2,2%	20,5%	2,2	22,2
Commercial Services	2,2%	12,6%	1,8	21,4

Source: Bloomberg

General Statistics

% Return long book	4,2%
% Return short book	3,5%
# Long stocks	50
# Short stocks	12
% Long stocks ↑	86%
% Short stocks ↓	25%
# Up days / Down days	13 / 8
Daily Correlation with MSCI JP	0,22
Turnover as % NAV	40%

Source: Factset

Investment Strategy

We construct the portfolio bottom-up looking for undervalued, misperceived and easy to understand business models, that, with a high degree of confidence, can replicate historic execution.

The long book continued to be heavily exposed to domestic themes such as domestic civil engineering, road construction as well as real estate assets with promising rent development or underappreciated in terms of asset value. Companies such as Nishimatsu Construction, Maeda Road, Fuji Media, Mitsui Fudosan and Heiwa Real Estate all qualify on these measures. These stocks are greatly underappreciated for various reasons. The most common pushback from investors and the reason why these stocks trade at steep discounts to intrinsic value is the lack of shareholder returns. We continue to have a constructive view that the change in corporate governance is for real.

Capital allocation is improving and we are highly convinced that 3 years from now all these companies will have a higher payout ratio and/or significantly returned cash to shareholders through buybacks.

Investment Strategy

Sumco surged 40% last month and we captured 40bps for the fund in October. We have written about the stock extensively in the past. As the wafer cycle, in terms of volume and prices, is far better than expected, the stock has plenty of room to appreciate.

Alpine contributed another 30bps in October as the stock jumped 22.8%. We first bought the stock in summer of 2009 and followed the company ever since. The stock has always traded at a massive discount to its intrinsic value and finally in July this year Alps decided to buy out the minority shareholders. During the last month an activist investor acquired a 10% position in Alpine and requested a higher premium, which we expect will eventually force Alps to pay a more reasonable price to minority shareholders.

With global industrial production continuing to show signs of strength Toshiba Machine was finally re-rated as it rallied some 100%+ from last year's lows and even now is valued at just 1.1x price-to-book.

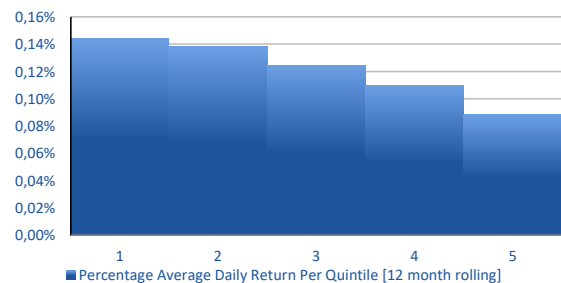
The losses last month were minor, Enplas' stock encountered some profit taking and declined 7.7% after its stellar performance of 40% year-to-date.

With several stocks reaching the target prices in the Industrials sectors the net sector exposure declined from 24% to 22%. For the first time in a long time we had positive net long position in

Value Factor Performance*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MoM	2%	-2%	-1%	-1%	0%	-1%
YoY	13%	5%	14%	6%	8%	6%

Source: Factset*



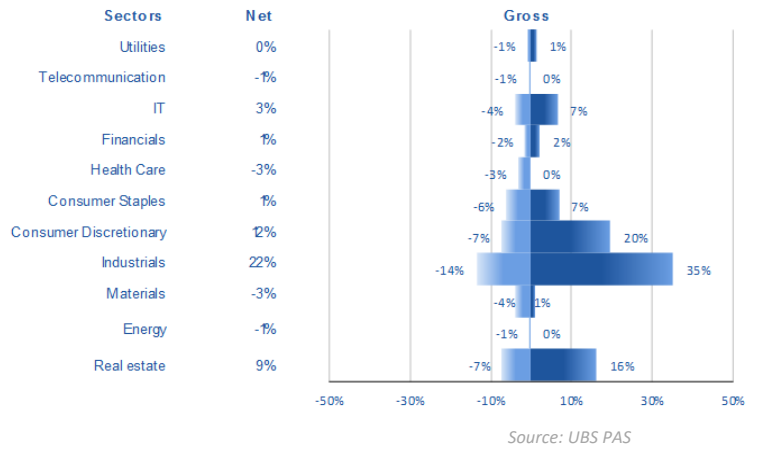
Source: Factset*

Top Gainers & Losers

Gainers		CTR*	Losers		CTR*
Sumco Corp	L	0,4%	Enplas Corp	L	-0,1%
Alpine Elec	L	0,3%	Familymart	S	-0,1%
Toshiba Machine	L	0,3%	Megmilk Snow	S	-0,1%
Fuji Media	L	0,3%	Kikkoman Corp	S	-0,1%
Nishimatsu Constr.	L	0,2%	Kenedix Retail	L	-0,1%

*CTR = Contribution

Source: Factset



Source: UBS PAS

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.

Our proprietary model shows that in October value as a style stalled. Almost all underlying factor had negative performance except for low price-to-earnings stocks which outperformed last month.

Price momentum performed well again. Thus in October expensive, large cap stocks with strong earnings and price momentum outperformed.

As our long stocks performed very well the weighted price-to-book (P/B) of the long book has increased to 1.7x and is now equal to the P/B of the short book. On a PE and EV/EBITDA basis the cheapness of the long book is much more obvious.

The Enterprise Value/Invested Capital ratio, which is comparable to P/B, but takes cash and liabilities into account, is a much better measure than P/B and still shows a massive valuation gap between the longs and the shorts.

The P/E of the long book increased from last month's 16.6x which compares to 21.1x for the short book. The EV/EBITDA of the long book stood at 9.8 x compared to 14.7x for the short book. The dividend yield of the long book is almost equal to the short book.

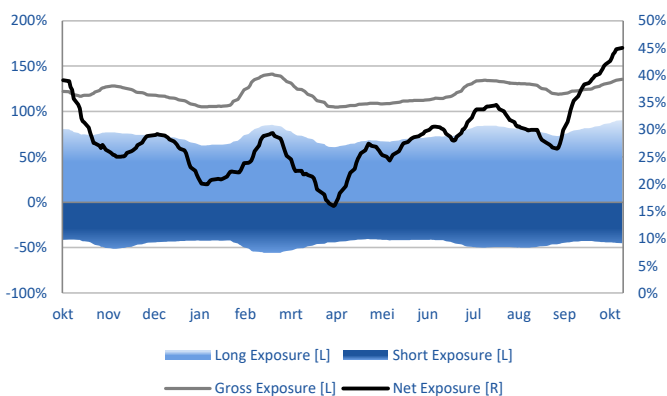
Despite the extremely high cash positions on the balance sheet in the long book the CFROI's of the long positions is 9.2% whilst the short book stands at 7.7% with higher leverage.

Risk Measurement and Management

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

The risk budget has steadily increased over the past few months and despite elevated levels of net exposure, due to the collapse in spot volatility, the ex-ante beta only stood at 5.2%. This is rather remarkable. Despite significantly more capital deployed this month, the beta on a fund level reached only 0.28.

These numbers are not a good reflection of the underlying risk involved as risk premia globally are extremely depressed. Even the long term volatility measure stands at just 5.8%, which seems a more adequate representation of risk taken in a more adverse environment.



Source: BNY Mellon Fund Services*

Fund Overview

	Long	Short
Price to Earnings (PE)	16,6	21,1
EV/EBITDA	9,8	14,7
Price to Book (PB)	1,7	1,7
Dividend Yield	2,0	1,9
EV/IC	1,1	1,4
1 month momentum	5,4	1,5
6 month momentum	21,3	1,2
9 month momentum	22,7	0,2
Earnings momentum (1M)	18,6	0,7
Earnings momentum (3M)	17,1	0,1
CFROI	9,2%	7,7%
Cash/MarketValue	36,3%	18,8%

Source: Factset

Style Exposure

	Long	Short
Beta	0,94	0,93
Volatility	9,8%	9,4%
Debt-to-equity	6%	46%

Source: UBS PAS

Risk Statistics Delta Adjusted

Volatility (ex-ante; 3 months daily data)	5,2%
Volatility (ex-ante; 5yr monthly data)	6,6%
Var (99%, 5 days)	1,2%
Beta (ex-ante)	0,28

Source: GS and Nomura

Outlook

The catch-up trade with global market is in full swing. With an astonishing sequence of low volatility, up-ward drifting daily price moves the Japanese market appreciated 5.6% last month. Japan is defying its sceptics and with very strong earnings momentum, reasonable valuation and an increased willingness to return more of this earnings to shareholders the bulls took full control.

In contrast to most global markets the price-to-earnings multiple of the Japanese market has not expanded. The equity rally was solely driven by the earnings cycle and even Abenomics has not resulted in a valuation premium.

Indeed, buying begets buying and as stocks appreciated attention was drawn to the strong fundamentals. We called the structural bull market at the lows in 2012, we warned of a cyclical bear in 2015 and understood that the bottom in 2016 was the continuation of the structural bull market. We find plenty of exciting value situation as Japan still tends to be ignored by most global market participants. The most striking feature of 2017 is the return of the activist fund. Nowadays, with institutional domestic support the notion of activists and engagement provides tremendous downside support as those market participants are like minded when it comes to identifying value situations. Corporates understand that just hoarding cash because 'it is mine to keep', is an insufficient argument to defend poor capital allocation.

That said, sharp up-moves in the broader indices are an indication of top-down, futures driven panic buying and certainly not conducive for our investment style. Sharp-down as well as sharp-up moves are an expression of sentiment, with Fear and Greed taking decisions rather than the conscious mind discounting future earnings and marking assets to fair value.

The top down investment processes are obvious at this point. As Abe -san has won the election, the Abenomics trade will continue and BOJ policy remains in place. This means, doing more of the same in the coming 6 months with a sit and wait approach, whilst monetary policy is basically outsourced to the FED. Thus, the leadership change at the US FED is the most significant event for Japanese beta in the coming 6 months. From an alpha perspective, we expect leadership to narrow and thereby the hit ratio of the long book to diminish but we remain extremely enthusiastic about our high conviction longs in the domestic oriented space.

Pelargos Japan Alpha Fund

October 2017



Historic Fund Performance (Monthly)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
Class A EUR													
2017	0,49%	-0,93%	-1,67%	-0,61%	0,19%	1,28%	1,17%	0,42%	0,90%	1,14%			2,35%
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%	1,32%	1,18%	0,46%	0,99%	1,25%			2,87%
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	€ 240.038.738
Firm AUM in USD	\$279.865.434

Portfolio Managers

Richard Dingemans
Michael Kretschmer

Fund Description

Investment Strategy	Equity Long/Short
Investment Style	Fundamental Value
Investment Objective	Capital appreciation through investing in long/short positions in Japanese securities

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Fund Facts

Fund Size in EUR	€ 98.659.411
Fund Size in USD	\$115.028.762
Participations Outstanding Class A	236
Participations Outstanding Class B	56.178
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, 3 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

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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