

Pelargos Japan Alpha Fund

September 2016



Fund Performance

The Pelargos Japan Alpha Fund Class B declined -0.29% in September. Since July 2008, inception-to-date (ITD), the fund is up +50.05% with a realized volatility of 7.3%, whilst the MSCI Japan is down -2.73% ITD with a realized volatility of 20.2%.

Fund Performance

Share Class	NAV	MTD	YTD	ITD
Class A EUR	1,310.68	-0.33%	-1.93%	31.07%
Class B EUR	1,500.48	-0.29%	-1.56%	50.05%

Market Environment

In September the MSCI Japan lost -1.3%, still deeply in the red to the tune of -14% for 2016.

The downside momentum from the first and second quarters seemed to exhaust itself in September and the market traded sideways in a narrow range. The price action in the equity market was a reflection of the US dollar - Japanese yen (JPY) currency cross. Despite some JPY weakness late August, the JPY again strengthened back to 100, a level at which US dollar strength reasserted itself on the Japanese equity market.

In stark contrast to the prior month, defensive sectors and tech related industries performed well, whilst yield sensitive sectors such as banks and insurance were down for the month.

The long book outperformed the MSCI Japan somewhat, whilst the short book was down 3.2% against the benchmark of -1.3%.

The core book consists of 60 positions. 48 long positions of which 13 positions are below 1%. We find plenty of great value opportunities in the small-/mid-cap space and therefore have a higher numbers of names in the long book. With regards to shorts we are rather hesitant to take liquidity risk, and so limit ourselves to large caps. The hit ratio was rather positive last month with 65% of the long stocks appreciating, whilst only 50% of the shorts ended the month higher. Turnover as % of NAV was rather low, with little directionality and plenty of rotation, we limited our activity.

Top & Bottom Industry Movers

Industry Group	MTD	YTD	PB	PE
Software & Serv.	9.7%	34.7%	2.0	19.9
Utilities	8.9%	-12.0%	0.8	15.5
Food & Staples	8.4%	17.7%	1.7	18.0
Industry Group	MTD	YTD	PB	PE
Insurance	-2.8%	-8.5%	0.9	12.6
Banks	-2.7%	-23.9%	0.4	9.1
Automobiles	-2.5%	-22.4%	0.9	13.1

Source: Bloomberg

General Statistics

% Return long book	-1.2%
% Return short book	-3.2%
# Long stocks	48
# Short stocks	12
% Long stocks ↑	65%
% Short stocks ↓	50%
# Up days / Down days	10 / 12
Daily Correlation with MSCI JP	0.58
Turnover as % NAV	19%

Source: Factset

Top 10 gross positions

Ichigo Group	3.6%	Nippon Building Fund	2.9%
Resona	3.2%	Mitsui Soko	2.9%
Hitachi High Tec	3.1%	Honda Motor	2.8%
Sumitomo Met Min	3.1%	Metawater	2.5%
Fuji Media	3.1%	Ryosan	2.5%

Source: BNY Mellon Fund Services

Single Stock Activity

Largest Buy & Buy Cover*	Largest Sell & Short Sell**
Oriental Land	BC
Fuji Media	B
Sumco Corp	B
Nissin Foods	BC
Sumitomo Heavy	B
Murata Mfg	S
Honda Motor	S
RELLA	S
Ube Industries	S
Hitachi High Tec	S

* B = Buy; BC = Buy Cover

Source: BNY Mellon Fund Services

** S = Sell; SS = Short Sell

Investment Strategy

Ichigo is once again the largest long position. Discussed many times in this newsletter, the story remains intact and after the recent correction the risk/reward is rather favorable again.

Last month we started to cover the short position in Oriental Land. The basic thesis of a significant slow-down in visitor numbers and lackluster earnings growth despite an outrageous valuation multiple has played out as expected.

We increased the long position in Fuji Media with its incredible amount of 'hidden' real estate value which is happily ignored by market participants and we revisited the long position in wafer producer Sumco. For many years we shorted Sumco because of excessive valuation in combination with poor demand/supply fundamentals in the wafer industry. But while fundamentals have improved, the stock traded at the 2008 financial crisis price-to-book ratio lows. The stock tends to be rather currency sensitive with high beta characteristics therefore a limited position with tight stop losses it will be.

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The size of the individual gainers is rather small this month. The top 5 gainers contributed 0.2% each. We highlight Mitsui Soko and Sumitomo Metal Mining which were both in the top gainers last month and continued to show strong price momentum. Mitsui Soko gained 5% on no news and Sumitomo Metal Mining (SMM) was up another 6% because rumors on the closure of nickel mines in the Philippines were intensifying. The long position in SMM was based on the extreme cheapness of the stock and a somewhat stabilizing demand/supply environment. The news out of the Philippines clearly accelerated the unfolding of this thesis, while the stock is still too cheap.

Resona and Honda both retraced most of last month's gains. Resona added 50bps in August and gave back 30bps, whilst Honda contributed 30bps and gave back all of it. Out of experience we know that stocks with long term negative price momentum tend to churn for a long term before an uptrend can reassert itself.

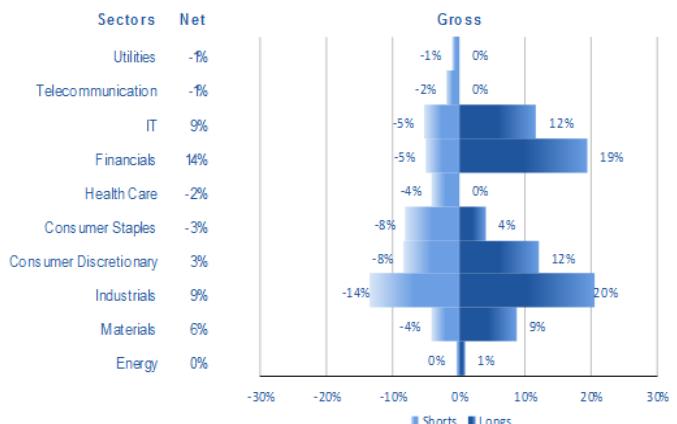
Honda's fundamentals are clearly improving and management is executing well. Resona's profitability is more hostage to central banking's pipedream of negative interest rates, however with very strong shareholder return policies and high dividend in place, the stock is well supported at current price levels.

Top Gainers & Losers

Gainers	CTR*	Losers	CTR*
Fuji Media	L 0.2%	Resona	L -0.3%
Mitsui Soko	L 0.2%	Honda Motor	L -0.3%
Sumitomo Met Min	L 0.2%	RELLA	L -0.2%
Technopro	L 0.2%	Murata Mfg	L -0.2%
Ichigo Group	L 0.2%	Metawater	L -0.1%

*CTR = Contribution

Source: Factset



Source: UBS PAS

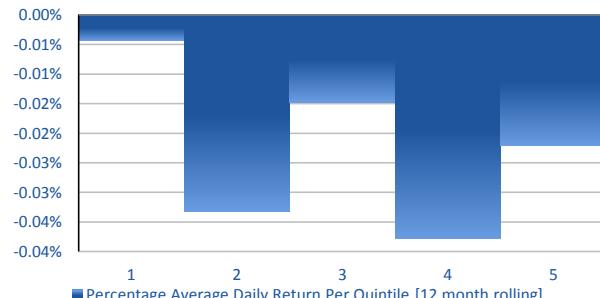
Value Factor Performance*

	P/E	EV/EBITDA	P/B	Div Yld	EV/IC	FCF
MoM	0.0%	0%	1%	-0.3%	0.1%	1.3%
YoY	-0.5%	2%	6%	7.7%	1.3%	7.5%

Source: Factset*



■ Cumulative Percentage Return 12 month rolling



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 July we observed one of the largest style reversals on record and in August the value factor continued its strong performance. The rotation into value stocks slowed down in September and value was more or less flat for the month.

The P/E of the long book is 14.7x compared to 20.4x for the short book. The EV/EBITDA of the long book is 7.3x compared to 9.8x for the short book. The dividend yield of the long book is 2.4% compared to 1.9% in the short book.

The weighted average P/B of the long book is 1.4x compared to 1.8x for the short book. The cheapest P/B stocks can be found in the financials sector. However, because we restrict our investment universe to what we deem knowable, we only follow a few banks and insurance companies. Therefore, our own investment universe has a median P/B of 1.2x and average P/B of 1.6x, largely due to our limited interest in banks, which are currently very inexpensive.

The price momentum exposure has increased further. On a 9-month basis, the long book is down -2.2% and the short book -7.2%.

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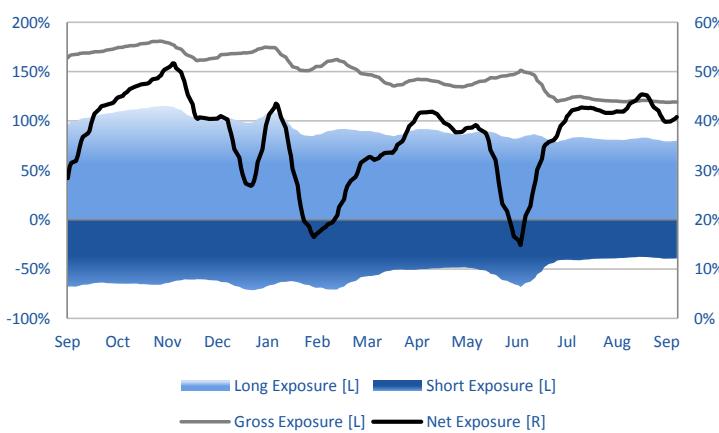
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Risk Measurement and Management

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. At the end of September, the gross exposure stood at 119%, the delta adjusted gross exposure was 136%. The net exposure stood at 42% and including the long Nikkei 225 put option strike 16500, the delta adjusted net exposure stood at much lower 25%.

The ex-ante volatility based on daily data was 6.8% with an ex-ante beta of 0.21. Both dropped significantly compared to prior month, partly due to net exposure reduction but also a step decline in realized market volatility.



Source: BNY Mellon Fund Services*

Fund Overview

	Long	Short
Price to Earnings (PE)	14.7	20.4
EV/EBITDA	7.3	9.8
Price to Book (PB)	1.4	1.8
Dividend Yield	2.4	1.9
EV/IC	0.9	1.7
1 month momentum	9.6	4.8
6 month momentum	1.8	-6.5
9 month momentum	-2.2	-7.2
Earnings momentum (1M)	-11.8	-10.2
Earnings momentum (3M)	-5.2	-3.3
CFROI	7.1%	9.0%
Cash/MarketValue	35.1%	23.7%

Source: Factset

Style Exposure

	Long	Short
Beta	0.88	0.77
Volatility	15.7%	14.5%
Debt-to-equity	11%	46%

Source: UBS PAS

Risk Statistics Delta Adjusted

Volatility (ex-ante; 3 months daily data)	6.8%
Volatility (ex-ante; 5yr monthly data)	6.4%
Var (99%, 5 days)	1.6%
Beta (ex-ante)	0.21

Source: GS and Nomura

Outlook

Strategic Framework - Outlook 2nd half of 2016

During the first half of 2016 we operated under the assumption of a cyclical bear market. The three year bull run completed in August 2015. We argued for a cyclical bear market due to tightening conditions in global dollar liquidity. We correctly anticipated that the FED would not be able to normalize interest rates, because it is built on the faulty assumption of a self-sustaining US economic growth cycle. This thesis has materialized to a large extent and Japanese equities had the deepest correction since the global financial crisis, correcting 30% peak-to-through. In June, we witnessed a full fledged panic with Japanese equities in free fall and broad based capitulation. Our strategy is contrarian in nature, thus buying cheap assets and shorting overpriced assets. Every once in a while 'mister market' is handing out gifts for those willing to go against the crowd and those who have the patience to hold them for a prolonged period. Easier said than done, the market is far from acting 'rationally' and although 80% of the time assets are efficiently priced, certainly at this moment in time, market participants are highly distracted by non-fundamental issues. Dislocation within the market is at multi-decade highs and the potential alpha source an obvious one. However, price action remains tightly correlated to currency moves and swings in liquidity conditions. The BOJ's inaction is partly excusable as the last two interventions had adverse reactions. However, investors realize that the Kuroda-put is increasingly ineffective, which only heightens investors' anxiety. That said, Kuroda and Draghi are marginal players, it is all about the trajectory of the US dollar and Yellen's confidence in her forecast. The Yellen Fed has missed its forecasts every single year for the past 5 years, every time overestimating growth by a substantial margin. In our opinion, a rate hike remains unlikely this year and a weaker US dollar our base case scenario.

Tactical assessment - monthly outlook

September was rather uneventful for this time of the year. Realized volatility remained surprisingly low globally, despite plenty of risk catalysts arising. The global economy remains stubbornly slow as excessive debt levels and government meddling stifles economic activity. Japan's growth will remain slow but we find plenty of attractively priced assets that can deliver positive returns in a slow growth world. Earnings season is around the corner and little positive news can be expected. It will be instructive to see how share prices of stocks that benefited from the rotation into cyclicals react to earnings misses. For a long time we have argued to short low mean-variance type expensive defensives and it seems the thesis is playing out according to plan as volatility has picked up in the low volatility space!

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	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Class A EUR												
2016	1.35%	0.88%	1.08%	-0.20%	-1.03%	-4.52%	2.08%	-1.09%	-0.33%			
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%
Class B EUR												
2016	1.27%	0.92%	1.18%	-0.19%	-1.06%	-4.33%	2.12%	-1.05%	-0.29%			
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%
							0.96%	-1.35%	1.40%	3.44%	0.52%	1.39%

	2016	2015	2014	2013	2012	2011	2010	2009	2008
Class A EUR	-1.93%	5.81%	-6.99%	18.86%	10.24%	-4.96%	8.66%	0.36%	
Class B EUR	-1.56%	6.36%	-6.52%	20.57%	10.95%	-4.48%	9.67%	2.75%	6.46%

Fund Facts

Investment Manager	Pelargos Capital	Fund Facts	
Legal Status	FGR (fund for joint account)	Fund Size in EUR	€ 90,256,092
Fiscal Status	VBI (tax exempt)	Fund Size in USD	\$101,402,719
Dividend Policy	Reinvestment	Participations Outstanding Class A	236
Base Currency	EUR	Participations Outstanding Class B	59,945
ISIN Class A EUR	NL0009051887	Minimum Subscription Class A	EUR 10,000
ISIN Class B EUR	NL0001118015	Minimum Subscription Class B	EUR 10,000
Inception Date Class A EUR	January 2009	Dealing Day	First business day of each month
Inception Date Class B EUR	July 2008	Subscription	Any dealing day, 5 business days notice
Company Facts		Redemption	15 business days notice
Firm AUM in EUR	€ 218,250,624	Management Fee Class A	1.5%
Firm AUM in USD	\$245,204,576	Management Fee Class B	1.0%
Portfolio Managers		Performance Fee Class A	20% subject to High Watermark
Richard Dingemans		Performance Fee Class B	15% subject to High Watermark
Michael Kretschmer		Early Redemption Fee	max 1% (accrues to Fund)
Service Providers		Lock-up Class B	1 year
Prime Brokers		Accountant	UBS AG, Goldman Sachs International
Administrator		Legal	BNY Mellon Fund Services
Accountant		Title Holder	PricewaterhouseCoopers
Legal		Depository	De Brauw Blackstone Westbroek N.V.
Investment Strategy	Equity Long/Short		SGG Netherlands N.V.
Investment Style	Value with a twist		Bank of New York Mellon
Investment Objective	Capital appreciation through investing in long/short positions in Japanese securities		
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