Quarterly Letter to Investors
06/30/2019
MAGALLANES VALUE INVESTORS, S.A. SGIIC

Dear Investor,

Performance during the first half of 2019[1] and thus accumulated for the year is **+ 7.24%** for the **Iberian** fund, **+ 19.14%** for the **European fund** and **+ 4.97%** for the **Microcaps fund**.

Despite the strong divergence between expensive and cheap assets, which are reaching historical levels (*growth* vs. *value* as defined by the financial industry), our funds, managed according to the strict criteria of the value philosophy, are showing strong performance in 2019. Additionally for Iberia and Europe, funds that have both passed a sufficiently representative time frame, accumulated returns[1] are **+52.44%** and **+41.17%** respectively.

Before going into more detail regarding these figures and other details about our portfolios, it's important to explain in the following paragraphs the main factors that are behind the current market fears and overall pessimism.

The global economy continues to slow down, with previous forecasts being revised downwards. The stagnation in trade negotiations between China and The United States is the main reason for the global economic slowdown.

Another reason for the modest growth is the high level of uncertainty that comes from the United Kingdom's possible 'no-deal' exit from the EU.

As a consequence of the aforementioned events, the European Central Bank has revised downwards its growth forecast for the Eurozone for this year from 1.7% to 1.1%. Similarly, the International Monetary Fund has cut global growth from 3.5% to 3.3% for 2019 in its latest publication.

This fall in activity has led central banks to carry out big changes to their monetary policy. The Federal Reserve has recognised at its latest meeting that "uncertainty in expectations for the economy of the United States has increased", and interpreted by the market as the first step to a possible reduction in interest rates, the first since the FED started to raise rates in December 2015.

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[1] Iberian: Magallanes Iberian Equity P in 2019 and E since its inception. European: Magallanes European Equity P in 2019 and E since its inception. Magallanes Microcaps Europe B. At the end of the letter please see an Addendum with details about the performance of each and every one of the classes and vehicles under Magallanes management and/or benefitting from advice from Magallanes.

The ECB announced at its latest meeting that it would delay increasing interest rates "at least until the first half of 2020." At the same time, it opened the door to more cuts in the deposit rate, currently at -0.40% to try to stimulate the European economy.

In this lower economic growth environment, profitability of the ten-year German bond has closed the quarter in negative territory at -0.33%.

There is a growing feeling of pessimism about the future prospects of the global economy. This is what is technically known as "fear of the end of the cycle." The cycle being understood as the path recovery to global economic growth, more or less balanced, from the financial crisis of 2007.

Pessimism feeds on data such as global PMIs, the main survey of company purchasing managers, which are beginning to show signs of falling business activity. Yet more telling is the monthly survey of investment portfolio managers, carried out by Bank of America Merrill Lynch[2]: the fear of a market correction is such that the exposure to equities in managed portfolios is at minimum levels, not seen since 2009. Again, the fear of a trade war between China and the United States, together with the possibility of an economic slowdown, are the main explanations behind such pessimism.

The investor chooses to "seek refuge" in assets perceived to be low risk, mainly in government or corporate bonds, the dollar, or in companies considered high quality, luxury or technology among others (the latter sector will be explained in more detail later).

The frenzy is such that more than half of European sovereign debt currently trades at negative yields[3]. The rest of the bonds are quoted at very low rates, for example Austria has issued a 100-year bond at a yield of 1.2%, with a demand from investors five times greater than the billion euros worth of bonds supplied to the market.

In terms of high-quality companies, we have companies from the luxury sector listed in France whose PE-ratio reach 50 times. In our opinion, more than risk-free investments, they are profitless investments (for more details, read the "Dispersion of returns" section from our previous letter.

As well we buy companies perceived to be riskier; "those that nobody likes", the cyclical ones, the complex ones, the cheap ones; in other words, all those that face known problems and so are priced low.

This is good news though for value investors like us. We buy companies that few people want to in order to sell them further down the line at a better price, probably to the same people that don't wish to buy them today. This is the story of value investing.

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2 https://www.ft.com/content/2d8d5392-91ab-11e9-b7ea-60e35ef678d2
3 https://www.elconfidencial.com/mercados/2019-07-05/bono-aleman-deuda-negativo-union-europea_2106711/

Non-natural monopolies and tech firms

We have been asked a lot lately why it is that we at Magallanes don't invest in tech companies. At the end of this section you will find the answer.

> *"From Standard Oil to the railroads to AT&T, the United States has a long history of breaking up big conglomerates. My plan is to continue with this tradition."*

Senator Elizabeth Warren

This was the statement made by Senator Warren in March at the SXSW technology conference held annually in Austin, where she also specifically added that companies such as "**Amazon**, **Google** and **Facebook** have accumulated too much power over the economy, society and democracy."

Although I disagree with the senator's reasons, I would like to discuss the substance of the matter. I believe that the risk of government intervention in large technology companies is higher than ever. Not for being too big or for having accumulated too much power, but rather for breaking the rules of free competition, that is, for the adopted model used to achieve its objectives.

Inspired by Amazon's success, the current preferred way in Silicon Valley to succeed is to gain size over profitability, although this implies burning through huge amounts of cash over a long period of time, as long as the goal is met: eliminate the competition completely.

It involves the creation of non-natural monopolies (as opposed to natural ones such as highways, communications, electricity generation ...) at the cost of violating the basic rule of business competition: selling below production cost, or 'dumping' as it is sometimes known.

It is public knowledge that the average loss of **Uber** per trip was 58 cents in 2018. In the IPO prospectus, it could be read that the company lost 3 billion dollars in the 5.2 billion trips it made throughout the year.

This model, based on "losing to make the competitor fall" is what has elegantly come to be known as 'disruption'. Professor Arun Sundararajan of the Stern business school at the University of New York sums up **Uber's** position perfectly: "I think the correct strategy would be to continue losing money for at least five years."[4] **Uber** managed to go public during the month of May, with a market capitalization close to 80 billion dollars.

[4] https://www.cbsnews.com/news/uber-ipo-uber-losing-an-average-of-58-cents-per-ride-and-says-its-ready-to-go-public/

As a result of the above, it is a worrying fact that according to Bernstein Research, the percentage of technology companies that have gone public this year and that lose money at the level of cash flow exceeds 50%, levels not seen in more than 10 years and not far from the dot-com bubble in the year 2000.

There is so much enthusiasm for going public before profit is being made, that when traditional valuation metrics do not work, others are sought. I do not remember seeing a case as striking as the new concept of operating profits called "community-adjusted EBITDA", invented by **WeWork** in an effort to get a valuation close to 50 billion dollars to go public. To sum it up, the "creativity" of this new invention causes operating losses of -1.4 billion in 2018 to become a gain of +467 million[5].

In Spain, we also have some telltale signs. Some fund management companies have begun to distribute investment funds for retailers whose investment policy is to invest exclusively in technology companies.

Human nature does not change, and there are too many familiar signs that remind us of the dot-com bubble of 20 years ago.

For these reasons, we do not invest in technology companies, specifically in this type of tech companies, whose business model and valuation go beyond reasonable or understandable. But we do invest in other technology companies whose businesses we are able to understand and whose valuation is appropriate, such was the case of **Temenos AG**, where we have doubled our money, or currently **Kapsch TrafficCom**, **Nokia** or **Signify** among others.

It is not about saying "yes" to tech companies or "no" to tech companies, it is about "cheap companies or expensive companies": clearly we prefer the former to the latter, regardless of whether or not they belong to the technology, pharmaceutical or car manufacturing sector.

Activity in our funds' portfolios

At Magallanes, we try to invest in companies whose future depend to a large degree on their capacity for internal improvement without depending too much or as little as possible on external factors, mainly the economic cycle. We also invest in those businesses that, while being cyclical, the price of their shares reflects to a high degree the possibility of a very negative scenario.

Our recent trip to France to meet with companies that we have in our portfolio is a good example to explain this.

[5] https://ftalphaville.ft.com/2019/04/10/1554885754000/Revealed--the-cash-cost-of-WeWork-s-global-expansion/

We were able to talk long and hard with the management team of **Savencia** about their internal improvement opportunities in terms of gaining greater efficiency in their production process, including the closure of some plants and other operational improvements. Of course the fact that the economy is improving or worsening will affect business, but a large part of the intrinsic value of **Savencia** has to do with the ability of its management team to continue managing the company correctly and make improvements wherever necessary.

Carrefour is another example of a company whose future depends on its own management capabilities. The meeting helped us to reaffirm the idea that the optimization and transformation plans are being carried out correctly and in a timely manner. Its dominant position in the countries in which it operates together with the capillarity of its extensive distribution network gives it a competitive advantage in the food retail sector.

Renault with whom we also held a meeting, is one of our main positions in the European fund and was recently punished by a series of doubts including the slowdown and transformation of the car sector, in particular for its quarrels with its Japanese partner **Nissan**. We are convinced of **Renault**'s great revaluation potential and after a very constructive talk with them, it became even clearer that the reality of the company's fundamentals does not correspond to other investors’ current pessimism regarding the automobile manufacturer. In our opinion, its share price already discounts a catastrophic scenario, and will disappear from the business in the coming years.

At Magallanes we continue to do things as we have done from the first day, we buy companies that we are able to understand, that are cheap and most important of all, that we understand the reasons behind such undervaluation. Sometimes a low multiple is not enough to buy a business. We know that **Savencia**, **Carrefour** or **Renault** are cheap, but we also know the motives of each of them very well, as we do with the rest of our portfolio.

Specific factors such as the general pessimism of the investment community, the anticipation of a downward cycle, the lack of credibility of the management team, or simply the loss of patience, among others, make some of these businesses temporarily to be listed below their true, long-term intrinsic values.

Within our **European strategy**, position increases have been carried out in certain companies in the energy sector, such as **Shelf Drilling** or the incorporation in the portfolio of **Drilling Company of 1972**, spin-off of **A.P. Moller-Maersk**, and in the industrial sector with the increase in our **ArcelorMittal** position.

On the other hand, we have partially sold **Metro AG**, following the takeover news about the company by Czech-born businessman Daniel Kretinsky.

In terms of purchases in our **Iberian strategy**, exposure to the industrial and consumer sectors has been increased, by increasing the positions of **ArcelorMittal** and **Melia Hotels** respectively.

In regards to selling, we have reduced exposure to the energy sector by partial selling of **Naturgy**, **Repsol** and **Siemens Gamesa**, and reduced our position in **NOS** in the telecommunications sector. We also sold all of our **Inmobiliaria Colonial** position, thus reducing exposure to the real estate sector.

In the Microcaps fund, exposure to the energy, industrial and consumer sectors has been increased through purchases in companies such as **Ferronordic Machines, Recticel, Reno de Medici** and **Elegant Hotels**.

On the selling side, the fund has compensated such increases in the consumer and energy sectors after the partial sales of **SCS Group** and **Rottneros** respectively.

Thanks to our investors

In the second quarter we held our most important event of the year, the Investor Day. Taking place in Madrid and Barcelona, we had the opportunity to present and explain first-hand everything related to your investments at Magallanes.

In addition, we have participated in various value investment events and conferences in Spain such as the ValueSpain and the Iberian Value conference held by El Confidencial and Finect. You can take a look at our YouTube channel to view these and other conferences.

In a complicated period I want to personally thank each and every one of our nearly 20,000 investors for trusting us in managing their assets.

Our commitment is 100%, as well as our passion and dedication to taking care of your savings, along with ours.

Yours sincerely,

Iván Martín Aránguez, CFA
Chief Investment Officer

ANNEX 1. STRUCTURE OF THE FUNDS

MAGALLANES IBERIAN EQUITY FI

The fund closes the quarter with an investment level of 97.3% and a total of 28 companies.

The fund maintains its exposure towards the industrial, services and energy sectors. May we highlight, among others, holdings like Gestamp, Inditex, NOS, Almirall and Siemens Gamesa. Top ten holdings account for 50.7% of the fund.

Spain accounts for 74.6% of the total investment of the fund and Portugal represents 22.7%.

A 63.5% of the fund is invested in large and mid-cap companies. The remaining 33.8% is invested in small-cap companies.

Current investment level of the fund seems to be appropriate for us. The number of companies in the fund will not significantly change in the medium term.

MAGALLANES EUROPEAN EQUITY FI

The fund closes the quarter with an investment level of 96.1% and a total of 33 companies.

The fund has a bias towards the industrial, consumer and energy sectors. Such sectors are mainly represented through holdings like Carrefour, OCI, Porsche, Renault and Nutrien. Top ten holdings account for 43.5% of the fund.

As a result of the holdings in the fund the exposure to France, Germany and Netherlands is greater compared to other countries. These three countries represent 47.2% of the fund.

A 45.1% of the fund is invested in companies with market cap below €5 billion. The remaining 51.0% is invested in companies whose size is over €5 billion.

Current investment level of the fund seems to be appropriate for us. The number of companies in the fund will not significantly change in the medium term.

MAGALLANES MICROCAPS EUROPE FI

The fund closes the quarter with an investment level of 91.7% and a total of 53 companies.

The fund has a bias towards the industrial, consumer and energy sectors, mainly represented through holdings like Orsero, KRKA, Avance Gas, SOL and Italian Wine Brands. Top ten holdings account for 30.7% of the fund.

As a result of the holdings in the fund the exposure to Italy, United Kingdom and Germany is greater compared to other countries. These three countries represent 53.8% of the fund.

A 72.5% of the fund is invested in companies with an adjusted market cap below 100 million euros. The remaining 19.2% of the fund is invested in companies with size over 100 million euros.

Current investment level of the fund seems to be appropriate for us. The number of companies in the fund will not significantly change in the medium term.

MAGALLANES

VALUE INVESTORS

ANNEX 2. RETURNS BY FUND AND CLASS as of 06/30/19

MAGALLANES IBERIAN EQUITY, FI

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2019	2018	2017	2016	2015 [1]	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes Iberian Equity FI "M"	144,2366	**1,57%**	**-0,36%**	**6,97%**	**-8,61%**	**6,97%**	**-9,22%**	**15,45%**	**15,48%**	**8,04%**	**39,88%**	97,3%
Iberian benchmark		2,69%	1,15%	10,29%	-1,62%	10,29%	-11,59%	12,13%	0,52%	-5,73%	3,84%	
Magallanes Iberian Equity FI "P"	147,4453	**1,61%**	**-0,24%**	**7,24%**	**-8,15%**	**7,24%**	**-8,76%**	**16,03%**	**16,09%**	**6,32%**	**40,13%**	97,3%
Iberian benchmark		2,69%	1,15%	10,29%	-1,62%	10,29%	-11,59%	12,13%	0,52%	-11,27%	-2,48%	
Magallanes Iberian Equity FI "E"	152,4432	**1,67%**	**-0,05%**	**7,64%**	**-7,46%**	**7,64%**	**-8,07%**	**16,91%**	**16,91%**	**12,72%**	**52,44%**	97,3%
Iberian benchmark		2,69%	1,15%	10,29%	-1,62%	10,29%	-11,59%	12,13%	0,52%	2,57%	13,32%	

[1] *Class M 29/01/2015; Class P 26/02/2015; Class E 09/01/2015. Returns net of fees. Iberian benchmark: 80% Ibex35 Net TR + 20% PSI20 Net TR.*

MAGALLANES VALUE INVESTORS UCITS IBERIAN EQUITY - LUXEMBOURG

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2019	2018	2017	2016 [1]	2015	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes Iberian Equity Lux "R"	128,9613	**1,56%**	**-0,49%**	**6,84%**	**-8,92%**	**6,84%**	**-9,61%**	**14,79%**	**16,33%**	**-**	**28,96%**	96,9%
Iberian benchmark		2,69%	1,15%	10,29%	-1,62%	10,29%	-11,59%	12,13%	0,52%	-	8,74%	
Magallanes Iberian Equity Lux "I"	131,4103	**1,60%**	**-0,37%**	**7,11%**	**-8,46%**	**7,11%**	**-9,14%**	**15,42%**	**16,99%**	**-**	**31,41%**	96,9%
Iberian benchmark		2,69%	1,15%	10,29%	-1,62%	10,29%	-11,59%	12,13%	0,52%	-	8,74%	

[1] *Class R 31/12/2015; Class I 31/12/2015. Returns net of fees. Iberian benchmark: 80% Ibex35 Net TR + 20% PSI20 Net TR.*

MAGALLANES EUROPEAN EQUITY, FI

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2019	2018	2017	2016	2015 [1]	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes European Equity FI "M"	133,5437	**8,25%**	**4,61%**	**18,84%**	**-0,50%**	**18,84%**	**-19,19%**	**19,52%**	**12,89%**	**3,47%**	**34,07%**	96,1%
European benchmark		4,43%	3,01%	16,24%	4,46%	16,24%	-10,57%	10,24%	2,58%	0,42%	18,05%	
Magallanes European Equity FI "P"	136,5609	**8,29%**	**4,74%**	**19,14%**	**0,00%**	**19,14%**	**-18,78%**	**20,12%**	**13,45%**	**4,23%**	**37,44%**	96,1%
European benchmark		4,43%	3,01%	16,24%	4,46%	16,24%	-10,57%	10,24%	2,58%	0,43%	18,06%	
Magallanes European Equity FI "E"	141,1700	**8,36%**	**4,94%**	**19,58%**	**0,76%**	**19,58%**	**-18,17%**	**21,02%**	**14,31%**	**4,29%**	**41,17%**	96,1%
European benchmark		4,43%	3,01%	16,24%	4,46%	16,24%	-10,57%	10,24%	2,58%	9,77%	29,04%	

[1] *Class M 27/01/2015; Class P 29/01/2015; Class E 09/01/2015. Returns net of fees. European benchmark: MSCI Europe Net TR.*

MAGALLANES VALUE INVESTORS UCITS EUROPEAN EQUITY - LUXEMBOURG

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2019	2018	2017	2016 [1]	2015	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes European Equity Lux "R"	126,5400	**8,10%**	**4,43%**	**18,57%**	**-0,81%**	**18,57%**	**-19,43%**	**19,11%**	**18,30%**	**-**	**34,61%**	96,3%
European benchmark		4,43%	3,01%	16,24%	4,46%	16,24%	-10,57%	10,24%	9,39%	-	25,36%	
Magallanes European Equity Lux "I"	128,8771	**8,15%**	**4,56%**	**18,86%**	**-0,31%**	**18,86%**	**-19,00%**	**19,76%**	**27,76%**	**-**	**47,31%**	96,3%
European benchmark		4,43%	3,01%	16,24%	4,46%	16,24%	-10,57%	10,24%	19,66%	-	37,14%	
Magallanes European Equity Lux "P"	130,3901	**8,18%**	**4,66%**	**19,08%**	**0,07%**	**19,08%**	**-18,70%**	**20,16%**	**12,08%**	**-**	**30,39%**	96,3%
European benchmark		4,43%	3,01%	16,24%	4,46%	16,24%	-10,57%	10,24%	2,58%	-	17,56%	
Magallanes European Equity Lux "ING"	94,9000	**9,45%**	**8,57%**	**18,49%**	**0,86%**	**18,49%**	**-19,91%**	**-**	**-**	**-**	**-5,10%**	96,3%
European benchmark		4,43%	3,01%	16,24%	4,46%	16,24%	-10,57%	-	-	-	1,65%	

[1] *Class R 29/01/2016; Class I 12/02/2016; Class P 31/12/2015; Class ING 17/01/2018. Returns net of fees. European benchmark: MSCI Europe Net TR.*

MAGALLANES MICROCAPS EUROPE, FI

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2019	2018	2017 [1]	2016	2015	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes Microcaps Europe, FI "B"	92,0285	**-0,17%**	**-2,13%**	**4,97%**	**-13,43%**	**4,97%**	**-21,98%**	**12,37%**	**-**	**-**	**-7,97%**	91,7%
European benchmark		0,27%	2,74%	11,36%	-5,79%	11,36%	-13,38%	8,14%	-	-	4,31%	
Magallanes Microcaps Europe, FI "C"	91,5402	**-0,19%**	**-2,17%**	**4,86%**	**-13,62%**	**4,86%**	**-22,18%**	**7,81%**	**-**	**-**	**-12,02%**	91,7%
European benchmark		0,27%	2,74%	11,36%	-5,79%	11,36%	-13,38%	7,22%	-	-	3,41%	

[1] *Class B 17/03/2017; Class C 31/03/2017. Returns net of fees. European benchmark: MSCI Europe Micro Cap Net Total Return.*