Quarterly Letter to Investors
09/30/2019
MAGALLANES VALUE INVESTORS, S.A. SGIIC

Dear Investor,

Performance for the first nine months of 2019 and thus accumulated for the year has been **+1.4%** for the **Iberian** fund, **+14.3%** for the **European** fund and **+0.8%** for the **Microcaps** fund.

For Iberia and Europe, the funds that have surpassed a sufficiently representative time frame, the accumulated returns are **+44.3%** and **+35.7%** respectively[1] since their launch.

The market continues to be dominated by a growing amount of negative news. The trade war between the US and China has entered a decisive and complex phase, where today there are few signs of a satisfactory agreement for both parties, as evidenced by the numerous threats of new tariffs or the successive cancellations of meetings between the respective negotiating groups.

To this we can add calls to impeach the American president Donald Trump, initiated by the leader of the House of Representatives of Congress, due to claims that he "betrayed his oath to office" and that his actions "violated the American constitution" in talks with the president of Ukraine.

In Asia, violent clashes continue in Hong Kong, and in the Middle East a drone attack disabled some of the largest oil facilities in Saudi Arabia for several days, affecting 5% of the world's oil production.

In Europe, the request for the prorogation of the British Parliament by its Prime Minister Boris Johnson was significant, considering what appears to be an outcome of the United Kingdom leaving the European Union without an agreement.

As if that weren't enough, and on a more economic level, the OECD has lowered the global growth forecast to the lowest level in the last 10 years, specifically to +2.9% in 2019 from +3.2%, and +3% in 2020 from the previous +3.4%, weighed down by Europe and the US.

Growth in Europe is especially weak, barely exceeding +1% for 2019 and 2020 and very negatively affected by Germany. It is possibly already in a technical recession after a negative second quarter, and an estimated growth of just +0.5% for the year as a whole.

[1] Iberian: Magallanes Iberian Equity Class P in 2019 and Class E since the beginning. European: Magellan European Equity Class P in 2019 and Class E from the beginning. Microcaps: Magellan Microcaps Europe B. At the end of the letter you will find an annex with the detail of the performance of each class and investment vehicles managed and/ or advised by Magellanes.

With regard to investments, Bernstein Research published a report on September 23rd explaining that "investors are more out of stock market investments than ever." But perhaps the most striking is that, according to their analysis and for the last 12 months, "the outflow from stocks and inflow into bonds has been the largest in history."

This would make sense if stock performance were negative, but the reality is that it is positive, and very positive in the case of the US, with increases of + 20% so far this year and close to historical highs.

Extremes

It is true that not all stock markets are so buoyant, in fact many of them are still far from their highs. But the general trend is positive in terms of performance.

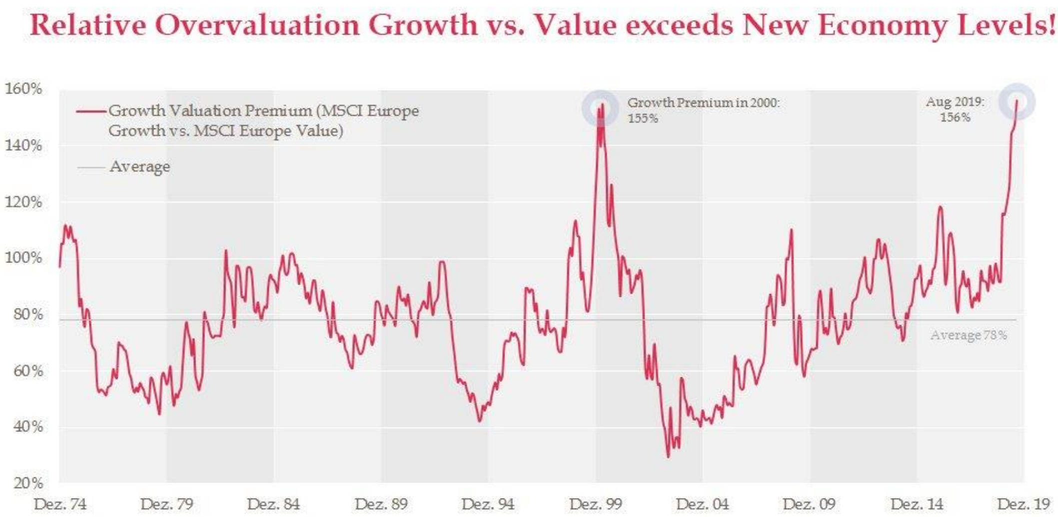
In our opinion the explanation lies in the valuation extremes that the market has reached. A trend that has been taking place for a long time but that has recently reached record levels never seen before.

In the face of a complex environment like the one described above, investors choose to sell stocks and buy bonds (among other assets). But this description is too generic, so much so that it doesn't correctly reflect the anomalies we are seeing.

Leaving bonds aside and focusing on the stock market, its performance differs greatly depending on the type of stocks we are talking about.

Some of the main extremes among others are:

- Better performance of the US stock market compared to the European one.
- Better performance of large companies compared to small ones.
- Better performance of 'momentum' companies against value-style companies, reaching maximum historical levels, as can be seen in the following graph:



The chart shows the overvaluation of the MSCI Europe Growth Index compared to the MSCI Europe Value index since 1974. The overvaluation is measured by a composite factor of PE, PB, PC und Dividend Yield. Source: StarCapital, Datastream and MSCI as of 08/30/2019.

As followers of the value philosophy, we are of course interested in this latest divergence between expensive and cheap companies[2]. The reasons behind this will now be explained.

Why is value investing doing worse?

The question could be rephrased into the following: Why, in a complex environment such as the current one, is expensive becoming more expensive and cheap becoming cheaper?

Investors needs to know what will happen in the future. In other words, they are willing to pay (and a lot) to avoid having to deal with current uncertainty (which is very high). This leads them to buy long-term assets (to try to overcome the anguish of the short term) and known profitability (the certainty of making little is worth more than the uncertain probability of making a lot).

This usually translates into the purchase of bonds, but when so many bonds have been purchased thus making that profitability is negative, what else can be bought? Well, something that "looks like a bond"; you just have to ensure that its duration is long and that the return is certain, at least as certain as possible.

[2]A value-style company is understood as one whose fundamental valuation of the business is attractive, but that its price does not reflect its real potential for valuation. Whereas a "momentum" company is defined as the one whose stock price is well above an objective valuation based on the fundamentals of the company. That is why we define the first companies as *cheap* and the latter as *expensive*.

'Momentum' companies meet these requirements perfectly: infinite duration (equity, as an asset, does not have expiration date) and a relatively predictable source of future cash flows. So they are clear candidates, among others; companies of stable consumer goods, luxury goods or iconic brands; as well as certain businesses linked to technology. The more predictable and further away in time profit generation is, the more attractive (reassuring) these businesses will be for the (fearful) investor.

Something similar happens to the exorbitant valuations of some technology companies recently listed on the stock market. Companies that are currently burning through huge amounts of cash but with the enormous faith that these losses will be turned into big profits, trade at valuation multiples far beyond even the best possible scenarios, and sometimes, even beyond reality.

To summarise, in an uncertain world without growth, the investor is willing to pay a lot for something that transmits security; bonds and 'momentum' shares; and for what “can promise" future growth, mainly technology, giving little importance to the viability of their business models, which are in most cases unprofitable.

A case that demonstrates this paradigm is WeWork, which we analysed in the previous letter and whose outcome will be discussed later.

This causes a significant part of the market to be priced very high, compared to another part of the market that is priced very low. In the latter, the most “uncomfortable” businesses for the investor are found; those whose profit generation depends more on the moment of the current cycle. Industrial, manufacturing, capital goods and capital-intensive firms are undoubtedly the most affected as their short-term visibility is low, although their upside potential is very high.

These companies are the thermometer of the current market situation: the greater the risks of recession, of tension in the trade war or of a hard Brexit, the worse their performance and the better the bond and 'momentum' shares. And in turn, the greater the value we find in these companies compared to the overvaluation of bonds and similar-to-bond stocks.

Uncertainty and Risk

Sometimes we find situations in which the investor begins to seriously worry about the complexity of the current situation, with so much "recession noise around the corner" that one is not willing to "take so much risk" with their investments.

If we agree that risk is facing the possibility of losing money and not recovering it, then currently investing in bonds and 'momentum' companies (believing them to be safe) could be considered to be one of the riskiest decisions that exist.

People tend to confuse risk with uncertainty. The stock market is uncertain by nature; nobody knows what future events will hold. But not knowing how an event is going to develop does not have to affect the final result of the investment, in fact, it is irrelevant.

The investor suffers during the time of the investment, minute by minute, sometimes losing sight of the true goal which is to earn more money in the long term. When one goes to sleep at night I do not think one takes a risk thinking that the sun won't rise the next day, although the uncertainty of how the night will develop is absolute: it might or might not rain, it can be cold or hot, and you may not even sleep because your young son's ears hurt, but what is certain is that the sun will rise.

There are currently many examples in the bond market that illustrate the perception of these concepts. At the time of writing, the profitability of the two-year Spanish bond is -0.5%. You have read that correctly: 0.5% with a negative sign in front, for two years. What it means is that if we invested 1 million euros today, in two years they would give us 990,000 euros back; a certain loss of 10,000 euros. The risk of this investment is obvious, since the loss is already known; on the other hand its uncertainty is zero; we know for sure that we are going to lose money.

In this sense we can say that the stock market is uncertain, but not as risky as it might seem. The probability of losing money without options to recover it practically disappears if you invest with a long-term view in a diversified portfolio of shares.

For all the above, given an extreme divergence between the expensive and the cheap, at Magallanes we believe that the least risky and potentially most profitable in the future is a well-diversified portfolio of companies that are currently trading below their real value. They will bear fruit and they are low-risk; the price to pay is to travel along a road with many potholes.

Signals

A question that comes up immediately after reading this is, when will this change in trend happen?

Although there is no concrete answer, we can see different signs that historically remind us a lot of other situations of the past which marked a clear turning point:

- "The death of value": There are many reports that question the true usefulness of the value strategy as an effective asset management technique after its bad performance compared to other styles in recent times. So much so that the financial information company Factiva has counted more than 120 articles with express mentions to the words "value" and “death" so far this year, a level never seen since records began in the 80s. As a reference, in the year of the previous technological bubble of 2000, the number of mentions approached 100.

- Just three months till the end of the year, the amount of money raised by unprofitable companies; about $30 billion; has already exceeded levels from the year 2000. The last to join the club has been Peloton Interactive. In addition, practically all of them share the peculiarity of registering significant falls since their IPO (Uber and Lyft for example)[3].

- The recent avalanche towards passive management is distorting the true valuations of certain assets, specifically those that are more crowded. As was said before, bonds, 'momentum' companies, technology companies, etc... An excellent explanation of this issue can be found in the recent interview with Michael Burry, who compares the current passive asset management bubble with the bubble of American subprime mortgages in 2007[4].

- WeWork's case is particularly interesting due to the lack of value of the initial assessments that were raised and the development of events that have recently frustrated its IPO. From a valuation of $47 billion, to the risk of running out of cash at the beginning of 2020, according to the WSJ. Along the way, one of the founding partners and CEO has been dismissed, and the strategy has changed dramatically from growing at all costs to drastically reducing costs[5].

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[3] https://www.bloomberg.com/graphics/2019-unprofitable-ipo-record-uber-wework-peloton/

[4] https://www.bloomberg.com/news/articles/2019-09-04/michael-burry-explains-why-index-funds-are-like-subprime-cdos?srnd=premium-europe

[5] https://www.wsj.com/articles/wework-faces-cash-needs-as-botched-ipo-scuttles-planned-infusion-11569846537

The parallels with past situations in the markets are clear; one remembers the merger between AOL and Time Warner in January 2000 marked the end of the tech bubble. There are clear symptoms that suggest that the bubble of capital flows to companies that do not generate revenue may be coming to an end.

Activity in our fund portfolios

Within our **European strategy**, position increases have been made in certain companies in the industrial sector such as **ArcelorMittal**, and the energy sector, with an increase in our position in **The Drilling Company of 1972**.

The level of investment remains at high levels close to 98.1%, due to the high upside potential that we are seeing in the different companies that make up the portfolio. The number of securities in the fund is 33.

In terms of purchases in our **Iberian strategy**, exposure to the industrial sector has been increased through position increases in **Miquel y Costas** and **Gestamp**.

On the selling side, exposure to the consumer sector has been reduced with the reduction in our **INDITEX** position, to the pharmaceutical sector after position decreases in **Almirall** and **Faes Farma**, in telecommunications with the decrease in our **NOS** position and finally exposure to the energy sector has also been reduced after reducing our positions in **Naturgy** and **Siemens Gamesa**.

The level of investment remains at high levels close to 97.7%, due to the high appreciation potential that we are observing in the different companies that make up the portfolio. The number of securities in the fund is 28.

In the **Microcaps fund**, exposure to the energy and industrial sectors has increased through increases in companies such as **Ferronordic**, **IPCO**, **Enel Russia** and **Kongsberg Automotive**.

In terms of selling, the fund has offset this increase in the energy sector with a reduction in our **Avance Gas** position. Additionally, we have sold off our **SCS Group** and **Natuzzi** positions completely, reducing exposure to the consumer sector.

The level of investment remains at high levels close to 88.9% due to the strong upside potential that we are observing in the different companies that make up the portfolio. The number of securities in the fund is 51.

I am fully convinced of the composition of each of the portfolios that make up our three investment funds. The potential for future gains is very high.

Thanks to our investors

During the third quarter we participated in different events and conferences related to value investment in Europe such as *SmartVienna*, held in Austria. On a national level we also participated in the *Buscando Valor Valencia 2019* forum, which is specialised in Value Investing.

During the month of September we participated in the first edition of the INDEPENDENTS' DAY meeting of independent Spanish asset management companies, where we had the opportunity to share and discuss different aspects, challenges and opportunities that characterise the asset management industry in the current environment. You can take a look at our website www.magallanesvalue.com to see these and other conferences.

In a complicated environment like the one that has been described, I want to personally thank each and every one of our co-investors for trusting the management of their wealth along with ours.

Yours sincerely,

Iván Martín Aránguez, CFA
Chief Investment Officer

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ANNEX. RETURNS BY FUND AND CLASS as of 09/30/19

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"	136,1427	**0,27%**	**-5,61%**	**-5,95%**	**-12,81%**	**0,97%**	**-9,22%**	**15,45%**	**15,48%**	**8,04%**	**32,03%**	97,7%
Iberian benchmark		4,32%	0,14%	1,28%	0,64%	10,44%	-11,59%	12,13%	0,52%	-5,73%	3,99%	
Magallanes Iberian Equity FI "P"	139,3469	**0,31%**	**-5,49%**	**-5,72%**	**-12,37%**	**1,35%**	**-8,76%**	**16,03%**	**16,09%**	**6,32%**	**32,43%**	97,7%
Iberian benchmark		4,32%	0,14%	1,28%	0,64%	10,44%	-11,59%	12,13%	0,52%	-11,27%	-2,34%	
Magallanes Iberian Equity FI "E"	144,3429	**0,37%**	**-5,31%**	**-5,36%**	**-11,71%**	**1,92%**	**-8,07%**	**16,91%**	**16,91%**	**12,72%**	**44,34%**	97,7%
Iberian benchmark		4,32%	0,14%	1,28%	0,64%	10,44%	-11,59%	12,13%	0,52%	2,57%	13,47%	

[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"	121,6910	**0,23%**	**-5,64%**	**-6,10%**	**-13,03%**	**0,82%**	**-9,61%**	**14,79%**	**16,33%**	**-**	**21,69%**	97,0%
Iberian benchmark		4,32%	0,14%	1,28%	0,64%	10,44%	-11,59%	12,13%	0,52%	-	8,89%	
Magallanes Iberian Equity Lux "I"	124,1585	**0,27%**	**-5,52%**	**-5,87%**	**-12,60%**	**1,20%**	**-9,14%**	**15,42%**	**16,99%**	**-**	**24,16%**	97,0%
Iberian benchmark		4,32%	0,14%	1,28%	0,64%	10,44%	-11,59%	12,13%	0,52%	-	8,89%	

[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"	127,9463	**3,48%**	**-4,19%**	**0,23%**	**-5,26%**	**13,86%**	**-19,19%**	**19,52%**	**12,89%**	**3,47%**	**28,45%**	98,1%
European benchmark		3,76%	2,58%	5,67%	5,74%	19,24%	-10,57%	10,24%	2,58%	0,42%	21,09%	
Magallanes European Equity FI "P"	131,0021	**3,52%**	**-4,07%**	**0,48%**	**-4,79%**	**14,29%**	**-18,78%**	**20,12%**	**13,45%**	**4,23%**	**31,84%**	98,1%
European benchmark		3,76%	2,58%	5,67%	5,74%	19,24%	-10,57%	10,24%	2,58%	0,43%	21,11%	
Magallanes European Equity FI "E"	135,6798	**3,58%**	**-3,89%**	**0,86%**	**-4,07%**	**14,93%**	**-18,17%**	**21,02%**	**14,31%**	**4,29%**	**35,68%**	98,1%
European benchmark		3,76%	2,58%	5,67%	5,74%	19,24%	-10,57%	10,24%	2,58%	9,77%	32,37%	

[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"	121,0687	**3,44%**	**-4,32%**	**-0,08%**	**-5,54%**	**13,44%**	**-19,43%**	**19,11%**	**18,30%**	**-**	**28,79%**	98,2%
European benchmark		3,76%	2,58%	5,67%	5,74%	19,24%	-10,57%	10,24%	9,39%	-	28,59%	
Magallanes European Equity Lux "I"	123,4604	**3,48%**	**-4,20%**	**0,17%**	**-5,06%**	**13,86%**	**-19,00%**	**19,76%**	**27,76%**	**-**	**41,12%**	98,2%
European benchmark		3,76%	2,58%	5,67%	5,74%	19,24%	-10,57%	10,24%	19,66%	-	40,67%	
Magallanes European Equity Lux "P"	125,0307	**3,51%**	**-4,11%**	**0,36%**	**-4,70%**	**14,19%**	**-18,70%**	**20,16%**	**12,08%**	**-**	**25,03%**	98,2%
European benchmark		3,76%	2,58%	5,67%	5,74%	19,24%	-10,57%	10,24%	2,58%	-	20,59%	
Magallanes European Equity Lux "ING"	89,9000	**1,25%**	**-5,27%**	**2,85%**	**-5,69%**	**12,25%**	**-19,91%**	**-**	**-**	**-**	**-10,10%**	98,2%
European benchmark		3,76%	2,58%	5,67%	5,74%	19,24%	-10,57%	-	-	-	4,27%	

[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"	88,3867	**2,15%**	**-3,96%**	**-6,01%**	**-14,20%**	**0,81%**	**-21,98%**	**12,37%**	**-**	**-**	**-11,61%**	88,9%
European benchmark		2,33%	-2,52%	0,15%	-8,04%	8,55%	-13,38%	8,14%	-	-	1,68%	
Magallanes Microcaps Europe, FI "C"	87,8466	**2,12%**	**-4,03%**	**-6,12%**	**-14,41%**	**0,63%**	**-22,18%**	**7,81%**	**-**	**-**	**-15,57%**	88,9%
European benchmark		2,33%	-2,52%	0,15%	-8,04%	8,55%	-13,38%	7,22%	-	-	0,81%	

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