



## Quarterly Letter to Investors

31/03/2017

MAGALLANES VALUE INVESTORS, S.A. SGIC

Dear Investor,

The performance of our funds for the quarter was +6.1% for the Iberian strategy and +7.3% for the European strategy. Since inception more than two years ago the funds accumulate returns of +40.1% and 28.1%, respectively<sup>1</sup>.

A series of events considered to be high-risk and unlikely to happen have featured the financial agenda over the last quarters: Trump's victory in the US elections, the Brexit, the result of the referendum in Italy or the outcome of the expansive monetary policy, among others.

In this complex environment global stock markets, mainly led by the United States and Europe, continued to rise during the first months of the year making it eight straight years of upward market trend. Some indexes, like the S&P 500, reached new all-time highs and the Spanish Ibex-35 Index registered one of its best starts to the year with a performance of +12% for the quarter.

The opposite happened just a year ago, during the first quarter of 2016, which will be remembered as one of the worst stock market beginnings in history.

Predictions proven to be wrong and unexpected outcomes demonstrate how decisions based upon geopolitical and macroeconomic events turn out to be sterile in the investment management field. Not only do you run the risk of being wrong on the prediction but also on the way of how to carry out such prediction.

On the other hand, the value investing philosophy is based upon the identification of businesses that trade at a discount. The success of this strategy does not depend on guessing the prediction right but on the discount at which the business trades versus its fundamental value. It is simple but not easy. This process requires discipline, working capacity and long-term investment horizon.

In the last 50 years, the investment horizon of investors has gone from being 8 years to 4 months. In this context patience and a long-term horizon are competitive advantages which allow us to continue searching for investment ideas.

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<sup>1</sup>Iberian strategy: Magallanes Iberian Equity P. European strategy: Magallanes European Equity P. At the end of the Letter you will find an Annex with a detailed performance for each and every investment vehicle and fund class managed and/or advised by Magallanes. Performance since inception corresponds to class E as for being the first active class on 09/01/2015.



Despite the sharp stock market appreciations and new highs, we keep finding good investment opportunities as a result of our feverish research activity which in the last 12 months may be translated into 250 meetings with companies, more than 100 valuation models quarterly updated and participation in seminars and conferences such as the *Ira Sohn* in London or *ValueSpain* in Madrid.

The first quarter of 2017 was one of the most active in terms of portfolio activity.

In the Iberian fund, we may highlight the purchase of the Portuguese telecom operator NOS, a company that has been able to consistently gain market share over the past few years. The telecom market in Portugal is one of the most attractive in Europe due to its high degree of concentration, being dominated by three operators which is leading to a gradual increase in prices. NOS trades well below its fundamental value with an excellent financial situation which may turn into higher returns for shareholders.

Regarding the European fund, we took advantage of the rally of one of our main historical stocks at Magallanes, Buzzi Unicem, to sell the whole position at levels of over €24, accumulating gains of more than +80%. This is a clear example of the irrationality and short-termism of the market. Buzzi is an Italian cement company with presence in Italy, Germany, United States and Eastern Europe. Two years ago the market exclusively focused on the difficult situation in Italy and Eastern Europe and overlooked their presence in Mexico via its participation in Corporación Moctezuma. Today the focus is on the strong presence and high growing perspectives of its business in the United States. Our valuation of the company is roughly the same today than two years ago, the only thing that has changed is the perception of the market. Once again, value investing requires research and patience.

On new additions to the European fund we would highlight, among others, the incorporation of Aurubis AG, world leader in the processing and recycling of copper and other metals. The unstoppable residential development, the emergence of electric cars and the degree of progress of new and bigger infrastructures has generated a demand which exceeds the available supply of necessary metals for these processes. This situation is aggravated due to the continuous deterioration of the quality of extracted ore.

Within the search for value we have increased our investment frontiers with two new purchases in Poland and Brazil.

Recent boom of passive management<sup>2</sup> deserves a reflection. A recent study by Merrill Lynch indicates this investment strategy currently represents more than 30% of total assets globally managed, which turns into an accumulated assets under management increase close to \$2 tn over the past 15 years.

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<sup>2</sup> We understand passive management as the investment strategy that replicates the main market indexes, such as the Spanish Ibex 35 Index, at a low cost. The aim is to achieve exposure to certain sectors or countries without the need to search or pay for an active management strategy able to outperform the market. Passive management strategies tend to be articulated through index funds or ETFs.



We are convinced this phenomenon is good for the asset management industry for two reasons:

- 1) Passive management mainly focuses on the most representative indexes of certain sectors and countries. The more a stock appreciates (the more expensive it turns) the more representative it will be and thus more probabilities of belonging to an index it will have. The opposite happens with small cap companies or heavily penalized stocks. The increase of these index funds makes the big even bigger (and more expensive) and the small even smaller (and cheaper).
- 2) The market will polarize into two types of strategies: passive management at lower cost and active management where the client is willing to pay for the proven ability of the investment team to add higher value than indexes in the long-term. Strategies in-between the two mentioned that imply high costs and doubtful value generation will be doomed to disappear.

We are happy with our current portfolios and we see important value potential. It is true that the aggregated valuation of markets is demanding, very high in the case of the American market. However it is also a reality that valuation discrepancies between sectors, countries and types of assets make good investment opportunities possible. The above-mentioned passive management increase contributes to enlarge even more such difference.

During March, we launched the fund Magallanes Microcaps Europe. It is an investment fund managed under value investing principles which invests in companies whose market price trades below its long-term fundamental value, with the feature that its investment universe focuses on listed European companies of less than €200M market cap, without excluding securities from other OECD countries.

After many years of activity, we have found a real value opportunity in an illiquid and inefficient market where discrepancies between value and price last longer over time and at the same time are larger. Analyzing the universe of listed stocks we observe that some of the best investment ideas come from medium and small companies which tend to be unknown and overlooked, commonly referred to as “invisible companies” which due to their specific characteristics trade at a wide discount versus their fundamental value.

The fund will have a limited capacity of around €100M. Its launching has nothing to do with growing purposes but with the desire to be loyal to our vocation: searching for value. It is an innovative fund due to its restricted investment universe where the majority of institutional investors, passive management or index funds and ETFs find difficult to invest in.



In the upcoming 24<sup>th</sup> of April we will hold our Investor's Day in Madrid at the Rafael del Pino Auditorium. As last year it will be a great opportunity to talk about our investment philosophy, portfolios and other issues you may be interested in. Pat Dorsey, member of the Advisory Board of Magallanes and founder of the American Dorsey Asset Management company will be with us for the day to give us a presentation on competitive advantages of companies.

Magallanes faces its third year of life thanks to the trust and support of our more than 8,000 investors: individuals, families, entrepreneurs, religious institutions, foundations, big investment institutions and universities. Blanca, Mónica and myself, as founding partners, would like to thank each and every one of you.

The biggest privilege and honor for the Investment Team of Magallanes, Otto, Diogo, Miguel and myself, is to manage your savings. It is a responsibility we make on a daily basis with passion and exclusive dedication. Thank you for entrusting us with the management of your savings.

Please do not hesitate to contact us through any of the communication paths available or directly through Mercedes, responsible for Investor Relations purposes, for any queries you may have.

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 84.9% and a total of 28 Spanish and Portuguese companies.

The fund maintains its exposure towards the services and industrial sectors. May we highlight among others stocks like Gas Natural, Sonae, ENCE, Mapfre and NOS. Top ten positions account for 44.7% of the fund.

Spain accounts for 58.3% of the total investment of the fund and Portugal represents the remaining 26.6%.

The prevailing size of the companies in the fund does not exceed a market cap of €3 bn, accounting for 63.9% of the fund. A 21.1% of the fund is invested in companies with market cap of over €3 bn.

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 87.7% and a total of 37 companies.

The fund is biased towards the industrial, manufacturer and consumer sectors. Such sectors are mainly represented through stocks like Bouygues, Orkla, Savencia, Hornbach and E.ON. Top ten holdings account for 37.1% of the fund.

As a result of the stocks in the fund the exposure to Germany, France and Austria is greater compared to other countries. These three countries represent the 48% of the fund.

The prevailing size of the companies in the fund does not exceed a market cap of €5 bn, accounting for 58.1% of the fund. A 29.6% of the fund is invested in companies with market cap of over €5 bn.

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.



### ANNEX 2. RETURNS BY FUND AND CLASS as of 31/03/2017

#### MAGALLANES IBERIAN EQUITY, FI

| FUND                                    | NAV      | 1 MONTH      | 3 MONTHS     | 6 MONTHS      | 12 MONTHS     | 2017         | 2016          | 2015 <sup>1</sup> | SINCE INCEPTION <sup>1</sup> | INVESTMENT LEVEL |
|---|----------|--------------|--------------|---------------|---------------|--------------|---------------|-------------------|------------------------------|------------------|
| <b>Magallanes Iberian Equity FI "M"</b> | 136,3168 | <b>3,42%</b> | <b>5,97%</b> | <b>14,10%</b> | <b>20,63%</b> | <b>5,97%</b> | <b>15,48%</b> | <b>8,04%</b>      | <b>32,20%</b>                | 84,9%            |
| Iberian benchmark                       |          | 9,37%        | 11,91%       | 19,76%        | 21,97%        | 11,91%       | 0,52%         | -5,73%            | 6,05%                        |                  |
| <b>Magallanes Iberian Equity FI "P"</b> | 137,7908 | <b>3,46%</b> | <b>6,10%</b> | <b>14,39%</b> | <b>21,27%</b> | <b>6,10%</b> | <b>16,09%</b> | <b>6,32%</b>      | <b>30,95%</b>                | 84,9%            |
| Iberian benchmark                       |          | 9,37%        | 11,91%       | 19,76%        | 21,97%        | 11,91%       | 0,52%         | -11,27%           | -0,18%                       |                  |
| <b>Magallanes Iberian Equity FI "E"</b> | 140,0750 | <b>3,53%</b> | <b>6,29%</b> | <b>14,81%</b> | <b>22,12%</b> | <b>6,29%</b> | <b>16,91%</b> | <b>12,72%</b>     | <b>40,08%</b>                | 84,9%            |
| Iberian benchmark                       |          | 9,37%        | 11,91%       | 19,76%        | 21,97%        | 11,91%       | 0,52%         | 2,57%             | 15,38%                       |                  |

<sup>1</sup> Class M 29/01/2015; Class P 26/02/2015; Class E 09/01/2015. Returns net of fees. Iberian benchmark: 80% Ibox35 Net TR + 20% PSI20 Net TR.

#### MAGALLANES VALUE INVESTORS UCITS IBERIAN EQUITY – LUXEMBOURG

| FUND                                     | NAV      | 1 MONTH      | 3 MONTHS     | 6 MONTHS      | 12 MONTHS     | 2017         | 2016 <sup>1</sup> | 2015 | SINCE INCEPTION <sup>1</sup> | INVESTMENT LEVEL |
|--|----------|--------------|--------------|---------------|---------------|--------------|-------------------|------|------------------------------|------------------|
| <b>Magallanes Iberian Equity Lux "R"</b> | 122,9364 | <b>3,45%</b> | <b>5,68%</b> | <b>13,50%</b> | <b>18,86%</b> | <b>5,68%</b> | <b>16,33%</b>     |      | <b>22,94%</b>                | 85,5%            |
| Iberian benchmark                        |          | 9,37%        | 11,91%       | 19,76%        | 21,97%        | 11,91%       | 0,52%             |      | 12,49%                       |                  |
| <b>Magallanes Iberian Equity Lux "I"</b> | 123,7988 | <b>3,50%</b> | <b>5,82%</b> | <b>13,81%</b> | <b>19,52%</b> | <b>5,82%</b> | <b>16,99%</b>     |      | <b>23,80%</b>                | 85,5%            |
| Iberian benchmark                        |          | 9,37%        | 11,91%       | 19,76%        | 21,97%        | 11,91%       | 0,52%             |      | 12,49%                       |                  |

<sup>1</sup> Class R 31/12/2015; Class I 31/12/2015. Returns net of fees. Iberian benchmark: 80% Ibox35 Net TR + 20% PSI20 Net TR.

#### MAGALLANES EUROPEAN EQUITY, FI

| FUND                                     | NAV      | 1 MONTH      | 3 MONTHS     | 6 MONTHS      | 12 MONTHS     | 2017         | 2016          | 2015 <sup>1</sup> | SINCE INCEPTION <sup>1</sup> | INVESTMENT LEVEL |
|--|----------|--------------|--------------|---------------|---------------|--------------|---------------|-------------------|------------------------------|------------------|
| <b>Magallanes European Equity FI "M"</b> | 124,6652 | <b>3,60%</b> | <b>7,15%</b> | <b>14,54%</b> | <b>23,99%</b> | <b>7,15%</b> | <b>12,89%</b> | <b>3,47%</b>      | <b>25,16%</b>                | 87,7%            |
| European benchmark                       |          | 3,34%        | 5,96%        | 12,44%        | 16,95%        | 5,96%        | 2,58%         | 0,42%             | 9,15%                        |                  |
| <b>Magallanes European Equity FI "P"</b> | 126,0510 | <b>3,64%</b> | <b>7,28%</b> | <b>14,82%</b> | <b>24,61%</b> | <b>7,28%</b> | <b>13,45%</b> | <b>4,23%</b>      | <b>26,86%</b>                | 87,7%            |
| European benchmark                       |          | 3,34%        | 5,96%        | 12,44%        | 16,95%        | 5,96%        | 2,58%         | 0,43%             | 9,16%                        |                  |
| <b>Magallanes European Equity FI "E"</b> | 128,1255 | <b>3,71%</b> | <b>7,48%</b> | <b>15,25%</b> | <b>25,55%</b> | <b>7,48%</b> | <b>14,31%</b> | <b>4,29%</b>      | <b>28,13%</b>                | 87,7%            |
| European benchmark                       |          | 3,34%        | 5,96%        | 12,44%        | 16,95%        | 5,96%        | 2,58%         | 9,77%             | 19,31%                       |                  |

<sup>1</sup> 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     | 2017         | 2016 <sup>1</sup> | 2015 | SINCE INCEPTION <sup>1</sup> | INVESTMENT LEVEL |
|---|----------|--------------|--------------|---------------|---------------|--------------|-------------------|------|------------------------------|------------------|
| <b>Magallanes European Equity Lux "R"</b> | 119,0192 | <b>3,57%</b> | <b>7,03%</b> | <b>13,97%</b> | <b>21,57%</b> | <b>7,03%</b> | <b>18,30%</b>     |      | <b>26,61%</b>                | 86,5%            |
| European benchmark                        |          | 3,34%        | 5,96%        | 12,44%        | 16,95%        | 5,96%        | 9,39%             |      | 15,90%                       |                  |
| <b>Magallanes European Equity Lux "I"</b> | 119,7936 | <b>3,62%</b> | <b>7,17%</b> | <b>14,28%</b> | <b>22,24%</b> | <b>7,17%</b> | <b>27,76%</b>     |      | <b>36,93%</b>                | 86,5%            |
| European benchmark                        |          | 3,34%        | 5,96%        | 12,44%        | 16,95%        | 5,96%        | 19,66%            |      | 26,79%                       |                  |
| <b>Magallanes European Equity Lux "P"</b> | 120,2086 | <b>3,65%</b> | <b>7,25%</b> | <b>14,45%</b> | <b>22,61%</b> | <b>7,25%</b> | <b>12,08%</b>     |      | <b>20,10%</b>                | 86,5%            |
| European benchmark                        |          | 3,34%        | 5,96%        | 12,44%        | 16,95%        | 5,96%        | 2,58%             |      | 8,69%                        |                  |

<sup>1</sup> Class R 29/01/2016; Class I 12/02/2016; Class P 31/12/2015. Returns net of fees. European benchmark: MSCI Europe Net TR.