Quarterly Letter to Investors
12/31/2017
MAGALLANES VALUE INVESTORS, S.A. SGIIC

Dear Investor,

The performance in the fourth quarter was **+1.94%** in the **European** fund, **+3.84%** in the **Iberian** fund, and **+1.33%** in the **Microcaps** fund. Accumulated annual returns were **+20.13%**, **+16.04%** and **+12.38%** respectively, considerably higher than average market return levels[1].

When investing in the market, the time frame should be set in decades. However, after three years of activity, it makes sense to address long-term annualized returns. The performance obtained by our **European** and **Iberian** funds since their launch reach annual compound levels of **+12.76%** and **+13.45%** respectively, thus accumulated returns amount to **+42.04%** and **+43.23%** correspondingly.

Anniversary

2017 has been a special year, just as in 1522 the vessel *Victoria* commanded by explorer Ferdinand Magellan had circumnavigated the world in slightly over three years, so we at Magallanes have completed three years of activity since our establishment. The *Victoria* expedition was important not only because it was the first to circle the world, but also because it opened new horizons: science changed, as did our understanding of the Earth.

Our voyage is not over, however, we are determined to become a reference in management quality and excellence in service provided to clients in the asset management industry. We are convinced that success is reached when the client is the priority. At Magallanes, the client comes first.

Peter Lynch

Last December 12 was a landmark in the history of Magallanes: that was the day we met with Peter Lynch in his Boston office. A common investment in a particular company made the meeting possible.

By way of reminder, Peter Lynch managed the Fidelity Magellan Fund from 1977 until his retirement in 1990. During these years the fund achieved annualized returns of +29%, multiplying the initial investment by nearly thirty-fold.

[1]Iberian: Magallanes Iberian Equity P. European: Magallanes European Equity P. Microcaps: Magallanes Microcaps Europe B. An Annex to the Letter includes details on returns for each and every investment type and vehicle under management and/or advice by Magallanes.

Peter is doubtless one of the best investors of all time, not only because of the unequalled returns obtained, but also because he brings common sense to transmitting ideas. In our opinion he is the epitome of a value investor: bold, unemotional, patient, intelligent, open-minded, and, most of all, opposed to dogma regarding investments. For all of these reasons, we like to say he is the "Total Investor."

It is not by happenstance that our management firm's name is Magallanes. It is of course a clear tribute to the historic Ferdinand Magellan, Fernando de Magallanes in Spanish, and it is also a tribute to Peter Lynch and the fund he managed for more than a decade.

Throughout our conversation we had the opportunity to discuss investment ideas, to accept advice, and to recall some of the investment principles that have played such a major role in Magallanes' core philosophy. Following is a summary of some of the investment principles, comments and thoughts that were talked over during our meeting with Peter.

Before you invest in Equities

It is very possible that investing in stocks is not the best option for all audiences.

Shares are "volatile," which is just the market's euphemism to describe something that moves rapidly. The market occasionally drops, sometimes it plummets, but in the long-term results are always positive.

Peter always says looking to the past is helpful. If we analyze one century in the history of the stock exchange, we learn that every two-year period typically sees corrections of -10%. Every six years or so, these declines may be of -25% or more. During the 13 years of Peter's mandate, his fund experienced 9 drops of -10%, and one crash of over -40%. Even so, the fund delivered annualized returns of +29%. Shares are volatile, and this is the only thing an investor needs to know: if you can live with that, the market is definitely an option for you.

If, however, you are fearful of short-term swings, you will inevitably be a potential victim of market fluctuations. This will lead you to selling low and buying high. The impersonal nature of the market tends to punish the undecided while rewarding the committed.

But an overly aggressive approach to the market is not advisable either, because expectations of excessively high returns will typically lead to severe frustration if they are not met, and this is usually the case, especially if you have a short-term time horizon.

Market inefficiencies account for the unruly nature of shares. Most investors do not assimilate information rationally. When faced with bad news, people usually react by selling quickly, which is difficult, or even painful, as an entire herd of sheep trying to squeeze out from the sheepfold together.

Another consideration pertains to forecasting. Briefly put, forecasting is a total waste of time. But it could be argued that, after several years of bull markets, and based on statistical experience as outlined above, a market correction would appear inevitable, sooner rather than later, and so we wonder, how can we prepare for that event?

According to the principle of investing in companies and not in the market, the moment of entry becomes irrelevant. The question is not “How can I prepare for a possible drop?” but rather “Do I have the right temperament to invest in stocks, knowing that they may drop?”

Investors ought to forget the market’s daily fluctuations. Because shares go up and shares go down, sometimes they soar and sometimes they crash, this is a plain and simple fact. When one is desperate to sell, often one sells cheap. When one is eager to buy, one often buys at disproportionately high prices.

About his approach to decision taking, in Peter’s own words, “I don’t prepare, I’m just constantly analyzing companies.” Knowing that the market is volatile by definition and that from time to time it moves sharply should not be the key to positioning our portfolio. All we need to know is that downturns happen and do not last forever. Within a reasonable time frame we will recover and make profits. That leads Peter to remind us that the most important organ in the human body when investing is “the stomach, not the brain.” Accepting this fact leads us to focus on what is truly significant: analyzing companies.

There is always something to worry about, wars, monetary policy, populism, etc. Learning to single out what is truly important is crucial. We should sell our shares because fundamentals have worsened, not because Mario Draghi decides to raise interest rates.

Sir John Templeton recommended that the best time to invest is when you have money, and to not rely on forecasts concerning market upturns or downturns.

That being said, we are aware of the possibility of a drop in the market over the next weeks, months, or quarters. Our funds invest in publicly listed companies, and are therefore not immune to market drops. Fear of a potential correction will not lead us to stop searching for companies and investing in those which show a high potential for appreciation.

Just as a ship manned by a competent crew has better chances of weathering a storm than a ship with no crew, a portfolio composed of great companies will, in the long term, generate better returns than a portfolio not invested due to fear of a storm.

Know what you own

People usually behave rationally when deciding on an important outlay, such as the purchase of a new car. This entails visiting dealers, comparing and test-driving different models, discussing discounts and special offers. It is ultimately a research project and it takes time and effort. Now, think about how much time you devoted to deciding on the purchase of your first stock.

Peter Lynch reminds us that we should be capable, in less than two minutes, of explaining the decision to invest in a company in a way that a 10-year old could understand it.

A share is a unit of ownership that represents an equal proportion of a company's capital. Investing in shares is significant in that we purchase a percentage, usually small, of something real, i.e. a business. Stocks represent a fractional ownership of a business that generates profits.

If we hope to make profits, we should attempt to purchase shares of companies with the best earnings prospects. Stocks rise or fall for a reason; they are not lottery tickets. To paraphrase Warren Buffett, if the business does well, the stock eventually follows.

In-depth knowledge of one's portfolio is especially helpful when things go wrong. If you truly understand a business you will be likely to buy more shares when its share price drops, just as you would not think twice about buying your dream car in a stock clearance sale.

Concerning investment ideas

Peter insisted: "Never stop searching for ideas." It's true that good investment ideas, those which help you multiply your money several times over, are scarce, but the fact is, they are there. The more ideas we study, the more possibilities we have of finding one of these gems. If we consider 10 ideas we will be lucky to discover 1 that is worth our while, whereas if we study 100, we will probably find 10, which is a fair number.

One of the Magallanes's investment process distinctive features, in fact, is how we spot ideas. To this end we use different means.

Approximately one out of three ideas in the portfolio is the result of careful observation. We pay particular attention to the world around us. Professional bias is what leads us to constantly observe which products and services satisfy the needs and expectations of consumers and users. Some of our best ideas, past and present, are the result of observation, such as **Kapsch TrafficCom**, **Conzzeta**, **Temenos**, **Barón de Ley** or **Savencia**, among others. This method is both enjoyable and cheap. Enjoyable in that we become true "hands-on" analysts, testing the products and services provided by companies we have identified. Cheap in that we pay no one for these ideas: they are simply there. It is thought provoking to see that it is difficult for us to identify a winning stock when, very often, it is staring us in the face. This approach is actually one of the most profitable of all, because it allows us to act in advance of the market consensus, and the real economy is always one step ahead of the major institutional investors.

We also find many ideas through study, analysis, and reading anything within reach. This is actually what we devote our time to. Some good examples within this category are **Orkla**, **Porsche Holding** and **Renault.**

And some of our more controversial ideas have been outstandingly profitable as well. Controversial because we dared adopt a position contrary to the market consensus. A case in point was our decision to invest in the shipping companies **Euronav** and **Scorpio Tankers**.

Finally, to a lesser degree we also contemplate companies undergoing difficulties, or which are involved in either complex restructuring processes or other special situations, such as spin-offs. The **E.ON-Uniper** case would fit this concept.

When to buy, when to sell? Classifying ideas

There is no single rule governing buying or selling, beyond the "always buy cheap" mantra. The time to buy or sell depends on the type of company. At the same time, the appreciation potential for each is diverse.

To this end, in his book "*One Up On Wall Street,*" Peter provides an extremely useful classification of companies according to growth, cyclicality, and risk. He defines six categories of companies: slow growers (**Orange Polska**), stalwarts (**Savencia**), fast growers (**Aker BP**), cyclicals (**Renault**), asset-backed (**Pargesa Holding**) and turnarounds (**Metro AG**)[2].

We implemented this classification when we established Magallanes. It helps us understand the companies in which we invest. This open, flexible approach allows us to say we are open-minded in our value investing philosophy. While occasionally it will be more appropriate to invest in cyclicals, different conditions may make it preferable to invest in fast growers. The takeaway message here is that there is no such thing as a hard-and-fast rule. The single red line we will never, ever cross is to pay in excess.

A combination of different intrinsic risks, depending on the type of company, provides added and effective portfolio diversification to a greater degree than the mere ownership of a large number of shares does. In other words, an apparently diversified portfolio, because many companies are involved, is not really that diversified if all the stock belongs to the same investment category. It is better to concentrate the best investment ideas in unrelated companies that, at the same time, are at different stages within the cycle.

[2]Please see Chapter 7 of "One Up On Wall Street" for details on categories.

The decision to buy must be analyzed in accordance with each company's category. So, Peter reminded us that he preferred to buy into cyclical companies when the situation within the cycle turned from "ugly to semi-ugly," while the time to sell is exactly when the situation goes "from good to excellent." What's more, our experience indicates that the best time to buy into a heavily penalized company is exactly when you're embarrassed to do so, because the general market opinion is just the opposite. A company featuring a stable business profile should be bought into by profiting from any short-term market correction, while the sale of that same company should be subject to good operating performance.

This being said, Peter insists that it isn't necessary to always abide by set rules and, especially, that it's important to avoid making the double mistake of selling winners and keeping losers. The disastrous result of that would be being doomed to bear the burden of mediocre portfolios for the rest of your life. In Peter's words, that would be like "pulling out the flowers while watering the weeds in your garden."

Keeping in mind the reason for the purchase is a good lead when considering selling, if there is no change, it is not time to sell. Selling only makes sense if the potential for appreciation is exhausted.

Disruptive and Unicorn: Winners and Losers

Two of the most popular words in 2017 were **disruptive** and **unicorn**. The former is used to define the effects of sudden change, of a break, the result of a new technology that overhauls the traditional way of doing things. The latter, besides naming a mythological animal, is used to describe, due to scarcity and rarity, recently created companies that rapidly reach a market valuation of more than 1 billion dollars. The mushrooming of the Internet and lightning-fast technological progress have fostered the exponential growth of these type of companies, and disruptive effects on traditional businesses have followed.

The world progresses thanks to transformational events. One of the greatest disruptions of all times took place at the beginning of the 20th century, in 1906, when determined businessman Henry Ford declared that he would build a car for the people, the "universal automobile."[3] In a short time the Ford Model T would forever change transport for millions.

Jeff Bezos, Larry Page, Sergey Brin, Mark Zuckerberg, Steve Jobs and others may well be some of the 21st century's Henry Fords. Their disruptive companies have no doubt facilitated the technological and economic advances of the modern world.

We believe that the unavoidable market dynamics that establish the difference between winners and losers are bringing about significant distortions between value and price. This deserves analysis.

[3]We recommend "Henry Ford: My Life and Work".

The market, driven by high expectations from businesses that are perceived to be disruptive, tends to price them generously. On the contrary, those businesses perceived in general as failures are penalized with excessively depressed valuations, sometimes at a great discount to their intrinsic values.

Subsequently, one of our last purchases in 2017 was **Carrefour**, the world's second largest retailer after **Wal-Mart.**

Amazon's ubiquitous threat in all areas susceptible to online distribution has given rise to the generalized opinion that the bricks-and-mortar shop model is dead. As a result, the share price of businesses deemed to be "dead" has suffered, in our opinion, far beyond those companies' fundamentals, even in an environment of strong competition. This is the case of **Carrefour**.

Expectations are so low that **Carrefour**'s market valuation, including the value of its debt, is barely 30% of its total sales revenue, some 80 billion euros. This valuation is approaching historically low levels.

Of course, **Carrefour** faces vast difficulties, particularly digitization and the hypermarket format in France. However, thanks to its size, both in terms of sales and of its global position in more than 30 countries, **Carrefour** is in a privileged position to tackle those challenges.

As often happens, the market seems to focus only on the difficulties. Ignoring the multiple options available for business improvement, it is driving share prices far below our fundamental valuation. Thus, our estimated upside potential is close to +50%.

European Regulation: MiFID II Effective Date

January 3, 2018 saw the coming into force throughout the EU of Directive 2014/65/EU, commonly known as MiFID II[4], which deals with financial instruments markets and is based on improving the rules and operation of investment services companies. In brief, the aim of MiFID II is both to ensure improved transparency in financial markets and to bolster investor protection.

Magallanes' investment process, which relies on profound knowledge of the companies in which we invest, drives us to draft in-house research and valuation reports. As a strong conviction active fund manager, our internal research is paramount to add value for our clients. We also consider other sources of information like selected research generated by external parties. The purpose of MiFID II is to improve the level of transparency around the cost of external research, and we believe that the more ethical and natural option, with our investors´ best interest in mind, is that Magallanes bear the total cost of external research.

[4]http://www.boe.es/doue/2014/173/L00349-00496.pdf

Equity, shareholders and investment strategies

Based on end-of-year data, Magallanes has a total of 1.8 billion euros under management and advises more than 15,000 clients. These assets are distributed among three strategies:

Europe: 1,296 million euros
Iberia: 422 million euros
Microcaps: 82 million euros

One of our guiding principles is our firm commitment to quality management, which we believe matters more than size. When the time comes and depending on market conditions, this commitment might require total or partial closure of some of the investment strategies. For instance, both the **Iberian** and the **Microcaps** strategies are not too far from their optimum amount of manageable size.

There has been a notable increase in the number of our foreign clients: 40% in the case of the **European** fund domiciled in Luxembourg. In this regard and for said fund, during the last quarter of 2017 we created a new share class denominated in pounds sterling.

Firmly committed as we are to disclosure, in 2017 we published a listing of recommended reading material[5], one hundred books in total. Additionally, we have participated as speakers in several value conferences, among them *Value Spain* in Madrid, *Acatis Value Conference* in Frankfurt, and the first *International Value Investor Conference* in Luxembourg.

We believe our annual meeting with investors is a tradition to uphold and will shortly announce the details of our Investors' Days, one in Madrid and another in Barcelona. In the meantime, please do not hesitate to contact us. We will be pleased to respond to any query or consultation you may wish to pursue.

Best regards,

Iván Martín Aránguez, CFA
Chief Investment Officer

[5]https://magallanesvalue.com/wp-content/uploads/2017/07/MAGALLANES-BIBIOGRAFIA-0517.pdf

ANNEX 1. STRUCTURE OF THE FUNDS

MAGALLANES IBERIAN EQUITY FI

The fund closes the quarter with an investment level of 92.8% 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, holdings like Sociedade de Investimento y Gestao, Sonae, Fluidra, Gas Natural e Inmobiliaria Colonial. Top ten holdings account for 49.8% of the fund.

Spain accounts for 64.2% of the total investment of the fund and Portugal represents 28.6%.

An 80.0% of the fund is invested in large and mid-cap companies. The remaining 12.8% is invested in small-cap companies.

Current investment level of the fund seems appropriate to be 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 86.4% and a total of 39 companies.

The fund has a bias towards the industrial, consumer and energy sectors. Such sectors are mainly represented through holdings like Porsche, Renault, Aker BP, Nutrien and Metro AG. Top ten holdings account for 34.7% of the fund.

As a result of the holdings in the fund the exposure to Germany, France and Austria is greater compared to other countries. These three countries represent 46.4% of the fund.

A 76.4% of the fund is invested in large and mid-cap companies, with a 41.5% of such weight in companies with market cap of over €5 billion. A 10.0% of the fund is invested in small-cap companies (market cap below €1 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 87.2% and a total of 51 companies.

The fund has a bias towards the industrial, consumer and financial services sectors. Such sectors are mainly represented through holdings like Orsero, EDAG Engineering, Camellia, Banca Sistema and Mutares AG. Top ten holdings account for 33.0% of the fund.

As a result of the holdings in the fund the exposure to Italy, Germany and United Kingdom is greater compared to other countries. These three countries represent 53.5% of the fund.

A 70.1% of the fund is invested in companies with an adjusted market cap below 100 million euros, of which 29.5% below 50 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.

ANNEX 2. RETURNS BY FUND AND CLASS as of 31/12/17

MAGALLANES IBERIAN EQUITY, FI

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2017	2016	2015 [1]	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes Iberian Equity FI "M"	148,5368	1,11%	3,71%	2,55%	15,46%	15,46%	15,48%	8,04%	44,05%	92,8%
Iberian benchmark		-0,92%	-2,03%	-1,16%	12,13%	12,13%	0,52%	-5,73%	6,50%	
Magallanes Iberian Equity FI "P"	150,7054	1,15%	3,84%	2,80%	16,04%	16,04%	16,09%	6,32%	43,23%	92,8%
Iberian benchmark		-0,92%	-2,03%	-1,16%	12,13%	12,13%	0,52%	-11,27%	0,02%	
Magallanes Iberian Equity FI "E"	154,0656	1,21%	4,03%	3,19%	16,91%	16,91%	16,91%	12,72%	54,07%	92,8%
Iberian benchmark		-0,92%	-2,03%	-1,16%	12,13%	12,13%	0,52%	2,57%	16,22%	

[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	2017	2016 [1]	2015	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes Iberian Equity Lux "R"	133,5439	1,02%	3,58%	2,29%	14,79%	14,79%			33,54%	92,7%
Iberian benchmark		-0,92%	-2,03%	-1,16%	12,13%	12,13%			11,52%	
Magallanes Iberian Equity Lux "I"	135,0312	1,07%	3,73%	2,57%	15,42%	15,42%			35,03%	92,7%
Iberian benchmark		-0,92%	-2,03%	-1,16%	12,13%	12,13%			11,52%	

[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	2017	2016	2015 [1]	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes European Equity FI "M"	139,0677	1,91%	1,81%	6,82%	19,53%	19,53%	12,89%	3,47%	39,62%	86,4%
European benchmark		0,79%	0,63%	3,34%	10,24%	10,24%	2,58%	0,42%	13,56%	
Magallanes European Equity FI "P"	141,1405	1,95%	1,94%	7,09%	20,13%	20,13%	13,45%	4,23%	42,04%	86,4%
European benchmark		0,79%	0,63%	3,34%	10,24%	10,24%	2,58%	0,43%	13,57%	
Magallanes European Equity FI "E"	144,2704	2,01%	2,12%	7,49%	21,03%	21,03%	14,31%	4,29%	44,27%	86,4%
European benchmark		0,79%	0,63%	3,34%	10,24%	10,24%	2,58%	9,77%	24,13%	

[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	2017	2016 [1]	2015	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes European Equity Lux "R"	132,4560	1,89%	1,74%	6,71%	19,11%	19,11%			40,90%	86,6%
European benchmark		0,79%	0,63%	3,34%	10,24%	10,24%			20,59%	
Magallanes European Equity Lux "I"	133,8623	1,94%	1,88%	7,00%	19,76%	19,76%			53,01%	86,6%
European benchmark		0,79%	0,63%	3,34%	10,24%	10,24%			31,92%	
Magallanes European Equity Lux "P"	134,6787	1,97%	1,97%	7,19%	20,16%	20,16%			34,68%	86,6%
European benchmark		0,79%	0,63%	3,34%	10,24%	10,24%			13,08%	

[1] 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.

MAGALLANES MICROCAPS EUROPE, FI

FUND	NAV	1 MONTH	3 MONTHS	6 MONTHS	12 MONTHS	2017 [1]	2016	2015	SINCE INCEPTION [1]	INVESTMENT LEVEL
Magallanes Microcaps Europe, FI "B"	112,3850	2,64%	1,33%	2,35%	-	12,38%			12,38%	87,2%
European benchmark		1,25%	-0,24%	2,63%	-	8,14%			8,14%	
Magallanes Microcaps Europe, FI "C"	112,1806	2,62%	1,26%	2,22%	-	7,82%			7,82%	87,2%
European benchmark		1,25%	-0,24%	2,63%	-	7,22%			7,22%	

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