MAGALLANES

VALUE INVESTORS

4th Quarterly Letter to Investors
31/12/2020
MAGALLANES VALUE INVESTORS, S.A. SGIIC

Dear Investor,

Performance during the fourth quarter of 2020 has been +17.1% for the European fund, +23.5% for the Iberian fund and +17.4% for the Microcaps fund. In 2020, the accumulated returns were -2.8%, -12.5% and -0.6%, respectively.

The recovery in performance of the funds is remarkable, which despite being negative, rose from March's lows by +62%, +46% and +58% respectively; well above the increases achieved by the European markets.

2020 will be remembered as the year in which the world economy almost came to a halt. The coronavirus outbreak (COVID-19) and the subsequent lockdowns in almost every country in the world caused a health and economic crisis never seen before. In addition to the human tragedy as a result of the large number of deaths, the crisis had a huge impact on economic activity causing mass unemployment in a short period of time. According to the OECD, the GDP of the OECD nations registered an unprecedented fall of -9.8% in the second quarter of 2020, which will go down in the annals of history as the largest and fastest decline ever recorded to date.

In a similar vein, the major stock exchanges fell by more than -35% from February to March, a new record. Only swift, coordinated and extraordinary actions taken by central banks and governments prevented economic activity and the stock market from declining even more dramatically.

However, the second half of the year revealed a very different scenario at least from a stock market perspective. Very significant rises even caused certain markets and stocks to close the year showing gains or practically without losses. Yet again an unusual and unprecedented record in the greatest peacetime humanitarian tragedy in memory.

According to the IMF, global fiscal support is approaching €12 trillion led by the United States, which launched a $2 trillion-dollar federal stimulus package in March and an additional $900 billion-dollar rescue package in December. In addition to that, the EU has closed an agreement to launch the so-called Next Generation Recovery Fund, worth €750 billion in addition to the long-term EU budget of €1.1 trillion. This recovery fund, which will come into effect in 2021, is a historic achievement for the EU as more than half of the amount will be provided as non-repayable grants.

There has also been strong support from central banks with a wide range of actions in order to limit the economic damage from the pandemic. The Federal Reserve (FED) intervened by supporting the financial markets through massive asset purchases, known as quantitative easing in an almost unlimited quantity. On the other side of the Atlantic, the European Central Bank (ECB) launched the Pandemic Emergency Purchase Program (PEPP) of public and private sector securities. In December it was increased by €500 billion to a total amount of €1.85 trillion.

The FED also cut its interest rates in the first months of 2020 by 150 basis points from the previous target range of 1.50% to 1.75% to 0% to 0.25%, while the ECB kept its official interest rate at 0%.

Positive news finally came to light as the year progressed. China recovered much faster and stronger than expected and according to the IMF, is the only major economy with positive growth expectations for 2020, estimated to be +1.9%.

China's strong recovery and that of other major economies during the year boosted commodity prices. Industrial metals ended 2020 strongly; iron ore was the one with the highest appreciation with a gain of +70%, followed by copper with a gain of +25.8%. On the negative side was the -21.5% drop in the price of Brent crude due to lower demand caused by severe lockdowns that strongly affected traffic data and the lack of an initial agreement between Saudi Arabia and Russia regarding how much oil to supply.

The recent approval and launch of the vaccine by the relevant health authorities to combat COVID-19, together with the last-minute agreement reached between the UK and the EU regarding Brexit have given cause for further optimism.

The latest manufacturing PMI data in the main economies are clearly in expansion territory (> 50), which is one more sign of the acceleration of economic activity.

In the IMF's latest outlook for the world economy in October 2020, it estimated a strong rebound in global growth for 2021. From an estimated drop of -4.2% for 2020, the recovery is estimated to be at +5.2 % by 2021.

With all the above taken into account, stock market performance was mixed depending on the geographical area and the type of asset. In North America, returns were excellent; the S&P 500 rose +16.3%, while the Nasdaq, mainly a tech-heavy index, increased by +43.6%. However, in Europe, the results were not so fantastic. The STOXX Europe 600 fell -4% and the IBEX 35 closed as one of the worst performing markets, with a drop of -15.5%.

The crystal ball

Is the ball that all 'market experts' are quick to say they don't have before they offer their predictions for the current year. Think for a moment what you would have been recommended to do with your investment portfolio if any of these experts had been in possession of such ball just a year ago, after visualizing the pandemic, the historic drop in world GDP, the unprecedented destruction of employment, the turbulent American elections including the storming of the Capitol building, in addition to the Brexit negotiations in extremis. Don't blame your financial advisor; the rational decision for everyone in the face of these events would have been to sell all shares, especially in the early days of the pandemic, when confirmation of the worst was becoming apparent.

This shows once again that current news (both positive and negative events), macroeconomic shocks or socio-political shifts, among many other things, don't help us to understand short term market behaviour.

Moreover, at the worst point of the year towards mid-March, when markets fell at rates never seen before, one of the best moments in history to invest in the stock market was forged. Our European fund for example, as was mentioned at the beginning, suffered drops of -40% but recovering by the end of the year to +62%, reducing the year's final loss to around -3%. Once again, buying at the time of maximum pessimism was a good strategy.

A real impact on our portfolios almost a year after. Future potential

In March we conducted an analysis of the possible aggregate impact of the pandemic on our portfolios, taking into account the individual impact on each company. We classified investments according to the expected permanent loss of intrinsic value in the long term in the following way: neutral/positive (0% impact), moderate (-10%) and high (-20%).

Following this analysis, we estimated a reduction in our funds' potential of -4%, -4.2% and -3.3% for the European, Iberian and Microcaps funds respectively. This is not very far from the real declines that we saw in the year 2020 except for the Iberian fund, whose steeper fall is explained by the particular political and economic situation that our country is going through.

From this we can deduce that the real impacts have been quite aligned with the conservative estimates that we made, and of course very far from what the market reflected at that time. Another no less important observation is that those investors who remained in the funds still keep their chances of making money with their positions intact.

There are reasons to trust the statement above. As we have been saying in the last quarterly letters, the economic recovery in 2021, inflationary risks, fiscal and monetary

stimuli, and the rotation of portfolios from expensive stocks to cheap ones are strong arguments in favour of the good performance for Magallanes' funds.

In particular, the earnings growth of the companies that make up the fund's portfolios - most of them in the high double digits - provide a very solid fundamental support. This would justify the continuity in the appreciation of their shares until they reach levels more in line with their intrinsic valuations.

A reflection of the good earnings momentum of our companies is the attractive valuation of our three funds, with a significant upside potential, together with an expected dividend yield of 3%, which is not inconsiderable in a zero-interest rate environment.

We would also like to highlight the financial health of our portfolios. The robustness shown by the funds in mid-March has paid off as, to date, we have not had any bankruptcies or credit events for any of the portfolios' securities. Similarly, the funds' companies continue to show solid financial profiles with low leverage and high interest coverage. We must not forget that, in the possible event of further deterioration, the remaining resource is the companies' capacity to survive, something that is determined by their financial situation.

A world of extremes

The last quarter of the year 2020 will be remembered as one of the moments of greatest divergence of behaviour between 'expensive and cheap companies.' As we have commented in previous letters, the valuation and price divergences between both assets have reached record levels both in time and magnitude, especially heightened during the worst of the pandemic. This trend turned sharply in mid-November, coinciding with the announcement of the high effectiveness of the COVID-19 vaccines.

Some strategists agree in pointing out this event as the catalyst for the reversal of a large part of the valuation differential accumulated over so many years, being especially beneficial to companies categorized as 'value' stocks. This is what they call the 'great rotation'.

We are sceptical of these great changes. In fact, our portfolios remain practically the same as they were before the COVID-19 pandemic, a demonstration of consistency with our investment philosophy. Although it is no less true than an environment like the one that appears to open up now; with a return to normality, growth and reactivation of demand, after current-event constrained supply; is especially beneficial for certain industrial and cyclical companies such as the ones in our portfolio.

However, the world is still living through an extraordinary situation of extremes and certain imbalances, which makes diversification towards markets and companies with good fundamentals, little or no debt and away from the "hottest stocks" of the moment advisable.

In this sense, I would like to share with you the preface that we wrote in the special edition for Magallanes of the book ‘The Man Who Traded His Home for a Tulip’ by Fernando Trías de Bes (some market data has been updated compared to the original version):

> “*Investors queued up on Tuesday to buy the new Italian three-year bond, even though they won't receive anything until early 2024*”.
>
> The Financial Times, October 13th, 2020

Italy issued, with great success, its first three-year bond that will not pay a coupon. This is Italy, a country whose debt accounts for 150% of its gross domestic product. Things did not end here, as soon as it was placed on the market, the price of the bond rose in such a way that it had an implicit coupon of -0.14% per year until maturity. Yes, what you are thinking is right; for lending to a subject whose debt is 150% of its GDP, I will have to pay -0.14% every year until maturity. Difficult to understand, but real as life itself.

The brilliant essay by Fernando Trías de Bes, ‘The Man Who Traded His Home for a Tulip’ *in view of these events, maintains the same validity that it had when it was published more than 10 years ago. Fool's syndrome, which Fernando introduces and describes in these pages so well is more alive than ever; different assets, different protagonists, different countries but basically the same script as always, a situation in which low or practically zero-percent interest rates work like petrol that fuels a fire.*

In a simple and enjoyable way, this book presents a good summary of the main bubbles of the modern era by impact and notoriety. From Tulip mania in the Netherlands in the seventeenth century to the Great Financial Crisis of 2007, through to Japanese and Spanish real estate, or the very interesting South Seas Company where a man even of the intellectual level of Isaac Newton lost a large part of his savings in the early 18th century. It was a long time ago but has a chilling parallel in the 21st century when Spanish banks offered preferred equity products to their customers on the street with a guaranteed coupon and without any apparent risk. But as Fernando states in one of his passages, “it is foolish to believe that there is no risk. What varies is perceived risk, but real risk never disappears”, and what a real risk there was with these products.

One of the main reasons that you have this example right now is none other than to have a good defence mechanism against the appearance of bubbles. Personally, I do not think that the occurrence of bubbles can be avoided, in fact I would even say that they are healthy due to the purgative effect they have on economies, but I am convinced that a manual like this will help you protect yourself in time from the first symptoms of Fool's syndrome.

Even paying close attention to the magnificent decalogue of symptoms presented in these pages, you may not be able to avoid falling into a bubble during your life. In this case, my recommendation is that you never get into debt as you may have got it wrong, although

to a certain extent it is normal to make mistakes in life sometimes. What you have to avoid at all costs is to bankrupt yourself with the mistake.

The world is experiencing an anomalous financial situation. Nominal interest rates are at their lowest level in 4,000 years according to historians Sidney Homer and Richard Sylla. The concept of risk-free assets, traditionally a government bond, have ceased to make sense. They should be renamed as 'yield-free bonds', since they offer none, and sometimes even you have to pay as we saw in the case of the Italian bond. It is estimated that more than $17 trillion in bonds are currently trading at negative yields across the globe. Although not at negative yield, the 100-year bond issued by the Austrian government is well-known, offering a return below 1% per year. Seeing is believing.

An ultra-lax monetary policy orchestrated by the main central banks is behind this situation. Specifically, through the constant injection of liquidity into the system via the anchoring at almost 0% interest rates at which banks lend and a permanent asset purchase program, mainly of government and corporate bonds.

This is causing a distortion in asset valuations never seen before as a result of financial repression. The saver who is zealous with their wealth and worried about the erosion of purchase power due to the passage of time, looks for a way to preserve their money by looking for different ways to invest it. With 'risk-free' interest rates at zero or negative, you have no choice but to climb the risk ladder, in search of other assets that can offer you a return. This is where the problems begin; in the exercise of assimilating some assets with others 'as if they were the same', although in essence they are not.

The saver who has always invested in saving deposits today is forced to leave their comfort zone in terms of risk. They may start by jumping into real estate investments, because someone has told them that "it is the closest thing to a saving account, and also very safe." But to the extent that many people do the same, the returns on this asset will go down, as is currently the case.

The next step is to buy shares in companies whose profit profile is 'predictable, safe and risk-free'. Luxury companies, consumer staples companies and large brand names would, among others be in this category. But remember, 'as if it were the same' is not necessarily the same. Logically, these stocks also begin to offer potentially low returns, given that many investors are pushed to buy them. Another step could lead us to not only buy what 'gives me security and what seems calm' but also to test the waters in those sectors that in addition to appearing safe, are said to change the world as 'they are the future, with a whole range of growth and opportunities'. This is the case with technology companies of the moment, specifically those whose price is very far from its fundamentals or simply still don't earn any money.

This is how a savings deposit owner could end up – and it is in fact happening already - buying a fund of technology companies quoted on the American Nasdaq exchange, calmly

and thinking that they are safe and that they have high expectations of returns in the medium and long term 'as if it were a deposit'.

This way, the bond bubble, as a result of zero interest rates, brings with it the making of another bubble in other assets; those 'that are trying to replicate' the expected return from bonds, but that have nothing to do with the real assumed risk. Going further into this last part, the passage that Fernando comments on in his book regarding the bubble in Japan is worth noting when at the end of the 80's the Japanese telephone company NTT Corporation had a stock market value that equalled that of AT&T, IBM, Exxon, General Electric and General Motors together. Today, thirty years later, history rhymes again (alluding to Mark Twain's phrase "history does not repeat itself, but it often rhymes"). Tesla, the American electric carmaker, with a market capitalization of more than 700 billion dollars, exceeds the combined size of Volkswagen Group (which includes brands such as Porsche, Audi, Seat, Skoda, Lamborghini, Bugatti and Volkswagen itself), Ford, General Motors, Fiat Chrysler, BMW, Daimler, Peugeot and Renault, all of them together with sales close to 40 million cars in 2019 compared to less than 400,000 for Tesla.

But bubbles create opportunities, referring specifically to the period during which these bubbles are created. A necessary ingredient to create a bubble is that many people want the same thing at the same time. Now, as we saw, it seems that all buyers are concentrated in one part of the market: bonds, the American stock market, technology companies with little or no profit at all, and in general those assets that are reminiscent of bonds in one way or another. Money flows almost exclusively to this area. But there is another part of the market in which interest has been lost, or orphaned. And I speak of real, tangible businesses, of the old economy if you will. Businesses that no matter how old-fashioned they are today in the eyes of the modern investor, it is difficult to imagine life without them for the next few years. It is possible to buy chemical, steel, copper, paper, pharma, car, fertilizer, food, distribution, DIY or components companies, among others, at very low valuations. It is also ironic to think that many of the companies that today stand as true protagonists of the future could not exist or sell their services if it weren't for the supply of products or services from distributors classified as traditional; those not currently wanted by the market.

The collateral effect of the frenzy for those assets that are popular and expensive is that in these traditional stocks the competition to buy them is low or zero. It is that part of the market that today is known by the name of value investing. The low interest in these businesses, at a minimum, has originated an event never seen before: value stocks are at historical lows in terms of valuation, both in absolute terms and compared to the most demanded and expensive part of the market. This is a truly unique opportunity; it is the fruit of a bubble.

All of the above makes the current moment ideal, almost historical, for active management based on a value investing philosophy, characteristic of our way of working at Magallanes. This is why a book like the one you are holding in your hands will help you not only to be aware of the risk of getting pulled into bubbles, but especially how to take advantage of them.

Activity in the final quarter of the year

We have continued with a high level of activity in our funds. Movements have been made in order to increase the upside of the funds.

In Europe, we have increased weight in companies such as **ArcelorMittal**, **Serco Group**, **Aker BP**, **OCI NV** and **Covestro AG**, among others.

In our Iberian fund, we have taken advantage of the declines in certain stocks to continue increasing our exposure in **Iberpapel**, **Ibersol**, **Repsol**, **Catalana Occidente** and **Mapfre**, among others.

Finally, in the Microcaps fund, we have newly incorporated companies that due to their small size, high degree of knowledge and very high upside potential, deserve to be in this fund's portfolio. We have bought shares in **Catalana Occidente**, **Iberpapel**, **Miquel y Costas** and **Ibersol**. Additionally, we have increased our positions in **KSB**, **Waberer's**, **Camellia** and **Orsero** among others.

On the sell side, our activity has focused on stocks whose potential has been reduced thanks to good stock market performance, with most of them reaching record highs. Specifically, in Europe we have fully sold off our position in **Hornbach Holding**, and partially sold our positions in **A.P. Moller Maersk**, **Signify** and **Husqvarna**. In our Iberian fund we have sold off completely our positions in **Siemens-Gamesa** and **Sonae Capital** (after accepting the improvement in the initial takeover bid) and partially sold **Fluidra**. In the Microcaps fund, it is worth noting the total sale of **Sonae Capital** due to the takeover received, but it was not the only one. **Massimo Zanetti** also joins the takeover club together with the already acquired **Gunnebo**, and the recent take-over bids received on **Centrotec**, **Netia** and **Q - Free**. The high number of takeover bids received continues to draw attention, specifically in the Microcaps fund, exceeding 10% of the securities in the portfolio. It shows that good businesses at attractive prices do not last long in the market.

Thank you and Happy New Year

After an unprecedented year, the entire Magallanes Team wishes you a year full of health, hope and excitement in 2021. As always, we are at your service in relation to your wealth invested with us, helping you in everything you need and being available through any of the Magallanes contact channels.

Thank you very much as always for your continued trust in the management of your investments together with ours in an environment as complicated as the current one.

Yours sincerely,

Iván Martín Aránguez, CFA
Chief Investment Officer

MAGALLANES

VALUE INVESTORS

ANNEX. RETURNS BY FUND AND CLASS as of 12/31/20

MAGALLANES IBERIAN EQUITY, FI

FUND	NAV	1 MONTH	6 MONTHS	2020	2019	2018	2017	2016	2015 [1]	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes Iberian Equity FI "M"	124,4773	4,61%	21,20%	-12,92%	6,02%	-9,22%	15,45%	15,48%	8,04%	20,71%	96,9%
Iberian benchmark		1,60%	12,95%	-11,07%	15,38%	-11,59%	12,13%	0,52%	-5,73%	-3,38%	
Magallanes Iberian Equity FI "P"	128,2071	4,65%	21,50%	-12,48%	6,55%	-8,76%	16,03%	16,09%	6,32%	21,85%	96,9%
Iberian benchmark		1,60%	12,95%	-11,07%	15,38%	-11,59%	12,13%	0,52%	-11,27%	-9,26%	
Magallanes Iberian Equity FI "E"	134,0567	4,72%	21,96%	-11,83%	7,35%	-8,07%	16,91%	16,91%	12,72%	34,06%	96,9%
Iberian benchmark		1,60%	12,95%	-11,07%	15,38%	-11,59%	12,13%	0,52%	2,57%	5,43%	

[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	6 MONTHS	2020	2019	2018	2017	2016 [1]	2015	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes Iberian Equity Lux "R"	109,7754	4,53%	20,28%	-13,94%	5,68%	-9,61%	14,79%	16,33%	-	9,78%	98,3%
Iberian benchmark		1,60%	12,95%	-11,07%	15,38%	-11,59%	12,13%	0,52%	-	1,17%	
Magallanes Iberian Equity Lux "I"	112,7028	4,58%	20,58%	-13,51%	6,21%	-9,14%	15,42%	16,99%	-	12,70%	98,3%
Iberian benchmark		1,60%	12,95%	-11,07%	15,38%	-11,59%	12,13%	0,52%	-	1,17%	

[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	6 MONTHS	2020	2019	2018	2017	2016	2015 [1]	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes European Equity FI "M"	132,0138	5,09%	25,41%	-3,30%	21,48%	-19,19%	19,52%	12,89%	3,47%	32,54%	97,1%
European benchmark		2,37%	10,91%	-3,32%	26,05%	-10,57%	10,24%	2,58%	0,42%	23,76%	
Magallanes European Equity FI "P"	136,0155	5,14%	25,73%	-2,81%	22,09%	-18,78%	20,12%	13,45%	4,23%	36,89%	97,1%
European benchmark		2,37%	10,91%	-3,32%	26,05%	-10,57%	10,24%	2,58%	0,43%	23,77%	
Magallanes European Equity FI "E"	142,2014	5,20%	26,20%	-2,08%	23,01%	-18,17%	21,02%	14,31%	4,29%	42,20%	97,1%
European benchmark		2,37%	10,91%	-3,32%	26,05%	-10,57%	10,24%	2,58%	9,77%	35,28%	

[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	6 MONTHS	2020	2019	2018	2017	2016 [1]	2015	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes European Equity Lux "R"	124,0940	5,03%	25,12%	-3,82%	20,89%	-19,43%	19,11%	18,30%	-	32,01%	95,3%
European benchmark		2,37%	10,91%	-3,32%	26,05%	-10,57%	10,24%	9,39%	-	31,42%	
Magallanes European Equity Lux "I"	127,3417	5,08%	25,44%	-3,33%	21,50%	-19,00%	19,76%	27,76%	-	45,55%	95,3%
European benchmark		2,37%	10,91%	-3,32%	26,05%	-10,57%	10,24%	19,66%	-	43,76%	
Magallanes European Equity Lux "P"	129,5892	5,11%	25,68%	-2,96%	21,96%	-18,70%	20,16%	12,08%	-	29,59%	95,3%
European benchmark		2,37%	10,91%	-3,32%	26,05%	-10,57%	10,24%	2,58%	-	23,24%	
Magallanes European Equity Lux "ING"	93,8600	4,98%	23,55%	2,15%	14,72%	-19,91%	-	-	-	-6,14%	95,3%
European benchmark		2,37%	10,91%	-3,32%	26,05%	-10,57%	-	-	-	6,57%	

[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	6 MONTHS	2020	2019	2018	2017 [1]	2016	2015	SINCE INCEPTION	INVESTMENT LEVEL
Magallanes Microcaps Europe, FI "B"	96,3670	5,14%	26,35%	-0,61%	10,59%	-21,98%	12,37%	-	-	-3,63%	96,1%
European benchmark		8,16%	34,49%	18,66%	22,39%	-13,38%	8,14%	-	-	36,04%	
Magallanes Microcaps Europe, FI "C"	94,9977	5,10%	25,97%	-1,16%	10,10%	-22,18%	7,81%	-	-	-8,70%	96,1%
European benchmark		8,16%	34,49%	18,66%	22,39%	-13,38%	7,22%	-	-	34,87%	

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