M. M. WARBURG BANK SCHWEIZ WARBURG INVEST LUXEMBOURG

WARBURG VALUE FUND

ISIN LU0706095410 (Class C)

MANAGER COMMENTARY 2nd quarter 2016

REVIEW

The Fund's net asset value (C-shares) rose by 4.77% during 2Q16 and by 0.01% YTD, respectively. Since inception (11/11/11) through 06/30/16, the Fund has compounded at an annual net return rate of 9.19%.

During the reporting period we sold one holding which has reached our conservative estimate of intrinsic value, namely Italian diversified utility group Hera S.p.A. On the other side we established two new positions, a large French industrial and services conglomerate and a Japanese home and housing products manufacturer. Overall the cash balance remains low at less than 1% of AuM.

Unexpected recent political disruptions, notably in Europe, as well as an ongoing series of lacklustre economic indicators in some of the leading global economies have pushed long-term yields of hard currency government bonds to all-time lows. If one compares expected returns of prime quality fixed-income securities and equities, it appears evident that, generally-speaking, the latter entail a much more enticing payoff profile than the former. Under this light, below we would like to discuss the particular benefits the Fund may offer to long-term savers.

OUTLOOK, THOUGHTS AND ISSUES

Growing dividend streams + long-term capital appreciation = countermeasure against low-yielding nominal assets

The prevailing ultra-low interest rate environment has become known in macroeconomics as "financial repression." The term tries to describe how deflationary tendencies and the consequent loose monetary policies in place around the world pose an ever rising challenge to private savers' ability to get a decent return profile from public retirement programs, private pension plans and insurance savings schemes. To make matters worse still, we shouldn't forget that people's basic means of income such as salaries and fringe benefits are also growing harder and harder to adjust upwards. For example, average real wage growth statistics in the US and other developed economies have been decidedly flat for years now.

How is one to remedy the situation? In the case of unconstrained long-term investment programs, the asset allocation of choice between fixed-income and equity should lean towards real-yield assets (e.g., equities) while deemphasizing nominal yield ones (e.g., fixed-coupon bonds).

The Fund obtains its total return from two main sources: dividends and capital appreciation from its portfolio companies. In the context of our deep value approach, within those generic categories we aim to generate performance in two ways: (1) growing dividend streams as a result of improving future free cash flows accruing to our firms and (2) appreciating equity prices as our companies' depressed current market valuations eventually rise towards their true intrinsic worth.

First, as far as growing dividends are concerned, the Fund distinguishes itself from the strategies of most dedicated dividend funds available in the market place, whose usual objective is to maximize current dividends. Our portfolio firms, however, often struggle with current cash flow generation because of an adverse business environment, company-specific management problems or major capital spending programs that are undertaken to assure competitiveness in the future. Thus, true to our long-term investment philosophy, analytically we prioritize future real income growth over current nominal payout. Even with that clear focus in mind, we should nevertheless mention that the current aggregate dividend yield accruing to the Fund approximates 3% per year, which is not too shabby compared to what dedicated dividend funds are currently achieving.

Second, with respect to appreciating equity prices, the Fund stands in clear contrast compared to conventional equity funds such as growth, momentum or index funds, which place their emphasis on currently rising equity valuations. Evidently, as deep value investors we take the contrarian route by investing in select equities whose current prices reflect big discounts to their true economic value because of a variety of stock market-driven obstacles such as neglect, fear, complexity or misunderstanding. Again, the aim is to achieve above-par long-term investment results by patiently deferring payback to the future rather than falling for the easier, short-term-minded solution of "instant gratification."

For what it's worth, we can assure that your portfolio managers believe in what they preach: they "eat their own cooking" by having their own savings invested in the Fund. They are willing to tolerate short-term market fluctuations in order to let the return-compounding mechanism do its work over the long horizon, which should represent the appropriate stance of any investor in the Fund.

Gregor Trachsel, Portfolio Manager

THE INVESTMENT APPROACH

We buy equities that trade at significant discounts to our estimate of intrinsic value, where we define intrinsic value as the company's worth to a strategic buyer / long-term owner able to exert full control over the business. We sell (1) when the price catches up to intrinsic value, (2) if we realize that we made a mistake in our analysis or that our assumptions underlying the investment case no longer hold true, or (3) if we find a better alternative to an existing portfolio position.

Our investment process is exclusively designed to evaluate the business, operating and financial risk taken by the firms we analyse. In contrast to the vast majority of other investment funds, *we do not attempt at all* to estimate or anticipate risks that are beyond the realm of corporate finance, such as the general movements in the equity, fixed-income and currency markets. Typically, to make it worthwhile to purchase and hold a particular equity position, our valuation analysis must indicate a potential doubling in price over the ensuing five years. Our objective for the Fund is, *over time*, to achieve compound annual returns after all fees of ca. 10% in EUR-terms.

DISCLAIMER

The WARBURG VALUE FUND has been established under Part I of the Luxembourg law of 20 December 2002 on undertakings for collective investment. From now on the fund is subject to Part I of the Law of 17 December 2010 and complies with the changed provisions set forth by the directive of the Council of the European Communities no 2009/65/EG of 13 July 2009.
The fund is registered for distribution in Luxembourg, Germany, Austria and Switzerland. It is not admitted for distribution in the U.S. The prospectus with the Management Regu-

lations, the Key Investor Information Document (KIID) and the annual and semi-annual reports of the Fund are available free of charge at the investment company (Warburg Invest Luxembourg S.A., 2 Place François-Joseph Dargent in L-1413 Luxembourg) or from the Paying- and Representation Agents (M.M.Warburg Bank Luxembourg S.A., 2 Place François-Joseph Dargent in L-1413 Luxembourg, M.M.Warburg & CO KGaA, Ferdinandstr. 75 in D-20095 Hamburg, Erste Bank der österreichischen Sparkassen AG, Graben 21 in A-1010 Vienna or M.M.Warburg Bank (Schweiz) AG, Parkring 12 in CH-8027 Zurich).

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