M. M. WARBURG BANK SCHWEIZ   WARBURG INVEST LUXEMBOURG

WARBURG VALUE FUND

ISIN LU0706095410 (Class C)

MANAGER COMMENTARY 2nd quarter 2017

REVIEW

The Fund's net asset value (C-shares) fell by 4.47% and rose by 1.71% in 2Q17 and YTD, respectively. Since inception (11/11/11) through 06/30/17, the Fund has compounded at an annual net return rate 11.68%.

During the reporting we sold two holdings: the prices of two Japanese firms, namely meat processor Starzen Co. Ltd and industrial conglomerate Mitsubishi Electric Corp., have reached our conservative estimate of intrinsic value. On the buy side, we established a new position in a US-based energy equipment provider. Overall the cash balance remains low at less than 1% of AuM.

Most of the general stock market's performance so far this year has come from a handful of popular high-tech, social media and biotech firms. By contrast, providers of basic goods and services such as industrials, materials, energy, utilities and telecom have fallen back into struggling mode due to lower commodities prices as well as toned down expectations with regard to infrastructure spending and regulatory easing. Unsurprisingly then, the so-called "momentum-trade" in a small group of large, index-heavy stocks has been in vogue while "value investing" in arguably unexciting firms has been neglected.

OUTLOOK, THOUGHTS AND ISSUES

Value and momentum: two completely different animals

When academics theoretically backward test return figures on investment style, they usually reach the conclusion that "momentum" and "value" work best. From a practical perspective, however, the two could not be more different. We would like to point out some of the reasons why this is the case and what the implications for investors are.

Momentum basically stipulates that equities exhibiting recent up- or down moves in price will continue to go along the same path for some time to come. Essentially it is a pure trend following concept akin to technical analysis, perhaps with some economic analysis mixed in. A big share of the money management business is based either implicitly or explicitly on momentum ideas: these days it's the "FANGs" and "BATs" (dominating tech and social media companies); during the mid-2000's it was the "BRICs" (select emerging markets rich in natural resources whose prices were deemed to be in a "super-cycle"); at the end of the 1990s, there were the "TMTs" (exciting industry sectors riding the emerging internet wave); in the late 1960s, the "Nifty-Fifty" (far-flung conglomerates growing by means of financial engineering) were all the rage; and so on down history.

Value, on the other hand, cannot be that neatly categorized. It involves a conservative fundamental assessment of the net worth of specific firms. The chief goal is to identify mispriced equities, each evaluated and valued on a case-by-case basis. Every analyst independently works on his unique set of investment projects. Unlike momentum, value strictly revolves around tangible corporate considerations rather than uncontrollable stock price swings. Consequently, there are no catchy names, acronyms and fashionable trends. Long-only value, by definition targeting underappreciated equities, emerges in uneven intervals given the particular company's state of betterment. On a portfolio level, then, value realization occurs randomly over time, regardless of overall stock market conditions.

Consequently, crucial distinctions exist in terms of how the two strategies need to be handled in order to render fruitful results. For one, momentum may work only for traders, speculators or gamblers, but not for buy-and-hold investors. Simply put, momentum works until it stops working. As such, momentum is not a strategy capable of naturally compounding total return over time. The trader will always depend on the next great idea once momentum in the last position fades, cedes or even reverses. These characteristics induce timing risk in that the trader must always take a view based on popularity, or expected crowd behavior; a tricky undertaking given that mass psychology regularly causes market participants to bet on initially promising but ultimately failing trends.

In contrast, value is appropriate for patient long-term investors and savers only. It requires perseverance and operates in a timeless compounding context. That is, total return accrues over time in a slow, grinding, lumpy and unpredictable fashion. As a quintessentially contrarian approach, value tries to take advantage of irrational mass psychology instead of incurring the risk of falling prey to it.

To sum up, in practice momentum clearly is a transactional product which may be implemented through fintech-type automated tools or quantitative solutions as well as through ETFs and other passive vehicles. A momentum player is constantly forced to decide whether to buy or to sell. Value, on the other hand, embodies an enduring and hence relationship-driven buy-and-hold investment philosophy. It is entirely knowledge-based and therefore people-dependent. Thus it can only be effectively implemented by means of a fund or a separate mandate structure.

Momentum is not part of our skill-set; we gladly leave that field up to other people who may be better at it. It is value that we live and breathe. And we strive, on a continuing basis, to achieve an attractive long-term outcome for the benefit our loyal clientele.

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 Regulations, 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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