Made in Italy Fund

Bayes Investments

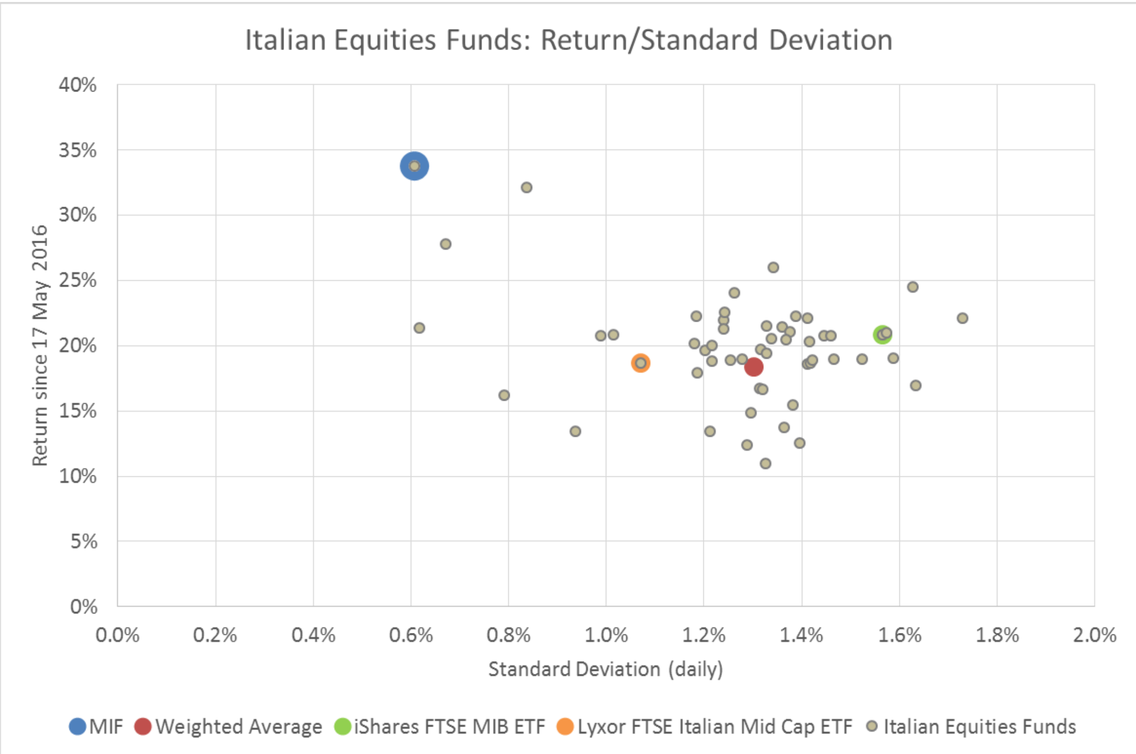
Investor letter – First Quarter 2017

Dear Fellow Investors,

The Made in Italy Fund (MIF) returned 20.5% in the first quarter of 2017. The return since 17 May 2016 – the fund's launch date – is 33.8%. Returns are net of all fees and administrative costs.

The fund is first among 54 Italian Equities funds, including ETFs, in the quarter and since inception, confirming the position already gained after six months from launch.

As shown in the graph below, the fund's superior return since inception combines with a decisively lower volatility compared to the average:



Source: Factset

In particular, the MIF's return is 15.3% higher than the average return, weighted by size, of the 54 Italian Equities funds, which in the same period has been 18.4%. The MIF's volatility has been less than half the other funds' average volatility.

In addition, 12.9% is the excess return versus the main Italian Equities ETF – the iShares FTSE MIB – which grew 20.9% in the same period, virtually in line with the total return (dividends included) of the FTSE MIB index, and 2.5% higher than the Italian Equities funds' average. The MIF's volatility was about a third of the volatility of the iShares fund and the MIB index.

Finally, 15.1% is the excess return versus the ETF which is most comparable to the MIF – the Lyxor FTSE Italy Mid Cap Fund – which grew 18.7% in the period, in line with the Italian Equities funds' average. The MIF's volatility is also notably lower than the volatility of the Lyxor fund.

First Quarter 2017

In the first quarter, the average return of Italian Equities funds has been 8.9% and the return of the MIB index and the iShares ETF has been 6.8%, while the Lyxor ETF grew 17.4%. Such significant difference has been influenced by the start, at the beginning of the year, of the Piani Individuali di Risparmio (PIR), a savings tax incentive scheme similar to UK's Individual Savings Accounts. The Lyxor fund was a major beneficiary, seeing a more than ten-fold increase in its assets from 42 million euro at the beginning of the year to 469 million at the end of the quarter.

The start of PIRs also benefitted the MIF, which outperformed the Lyxor fund by more than 3%. But it is important in this regard to clarify three essential points:

1. In contrast to the Lyxor, which invests indiscriminately in Mid Cap stocks, the MIF has a diametrically opposite approach, investing in about 30 stocks after a long and accurate selection process.

2. Many stocks in the MIF have had a good growth since the fund's inception, especially in the last three months. However, while the PIR has facilitated and accelerated the performance, the gap between intrinsic values and market prices remains ample.

3. The focus on PIR, and therefore on Italian Mid and Small Cap stocks, is important, has just started and will likely continue to have an influence in the months and years ahead, thus encouraging, among other things, the arrival on the market of new companies.

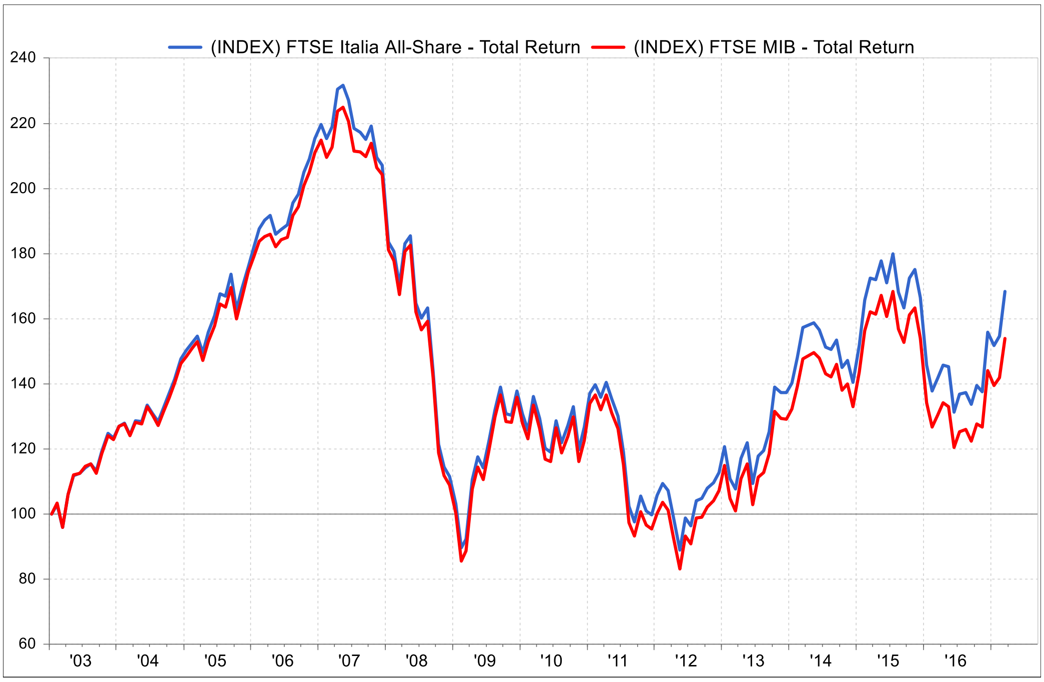
The Made in Italy Fund

The MIF invests in quoted Italian equities with a market capitalisation mainly below one billion euro. These stocks constitute three quarters of the approximately 320 stocks quoted on the Italian Stock Exchange, but they represent only 6% of the market value:

	All Shares			**Small Caps**		
	Number of companies	Market cap (m)	% Weight	Number of companies	Market cap (m)	% Weight
4800 Finance	61	169,295	30%	40	6,038	17%
4700 Utilities	26	87,009	15%	18	1,856	5%
2100 Energy Minerals	4	58,820	10%	1	132	0%
2400 Consumer Non-Durables	25	54,615	10%	17	2,434	7%
4600 Transportation	13	28,302	5%	8	1,419	4%
4900 Communications	7	15,801	3%	5	414	1%
1200 Producer Manufacturing	28	22,774	4%	22	4,617	13%
1400 Consumer Durables	17	35,108	6%	13	1,937	6%
2300 Health Technology	9	15,873	3%	5	658	2%
3400 Consumer Services	28	11,244	2%	25	3,146	9%
3100 Industrial Services	10	10,452	2%	6	986	3%
1300 Electronic Technology	12	12,439	2%	9	1,761	5%
1100 Non-Energy Minerals	7	25,225	4%	4	1,213	3%
3500 Retail Trade	4	2,437	0%	3	451	1%
3200 Commercial Services	15	3,203	1%	14	1,407	4%
3300 Technology Services	19	2,780	0%	18	1,391	4%
3250 Distribution Services	5	2,233	0%	4	859	2%
2200 Process Industries	9	2,469	0%	9	2,469	7%
3350 Health Services	2	213	0%	2	213	1%
6000 Miscellaneous	8	750	0%	8	750	2%
NA [Unassigned]	9	640	0%	9	640	2%
Total	318	561,681	100%	240	34,790	100%
Large Caps	78	526,891				
	25%	94%		75%	6%	

Source: Factset

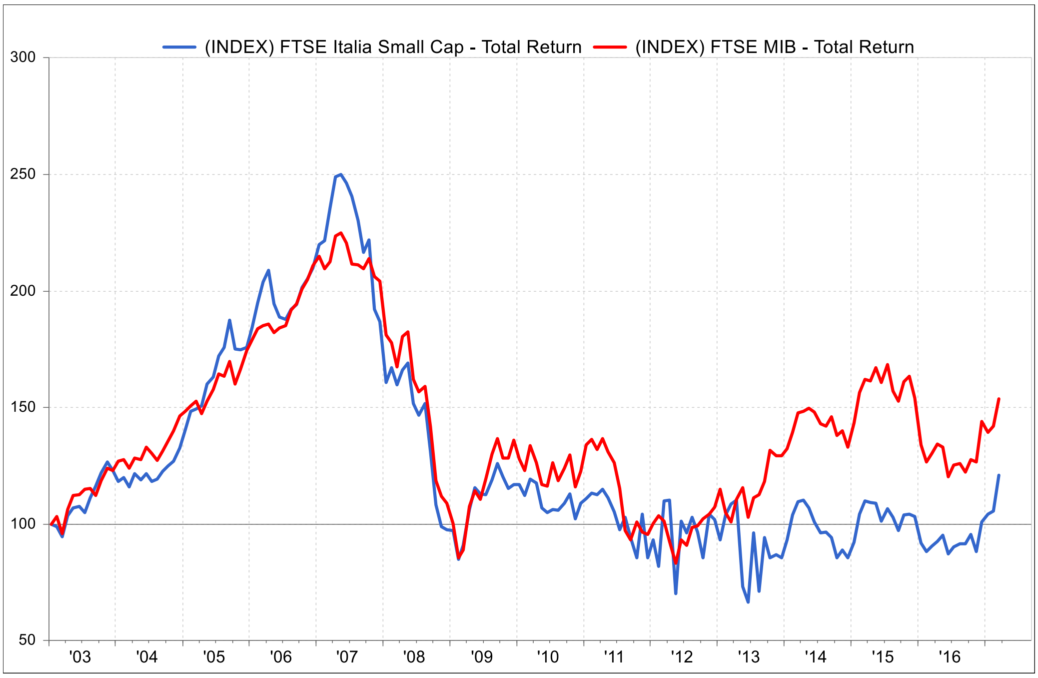
As shown in the table, the Italian stock market is heavily exposed to four sectors, which together amount to two thirds of the entire market value and include most of the large capitalisation stocks. The FTSE MIB index, which includes the first 40 companies, represents to a large extent the totality of the market:



Source: Factset

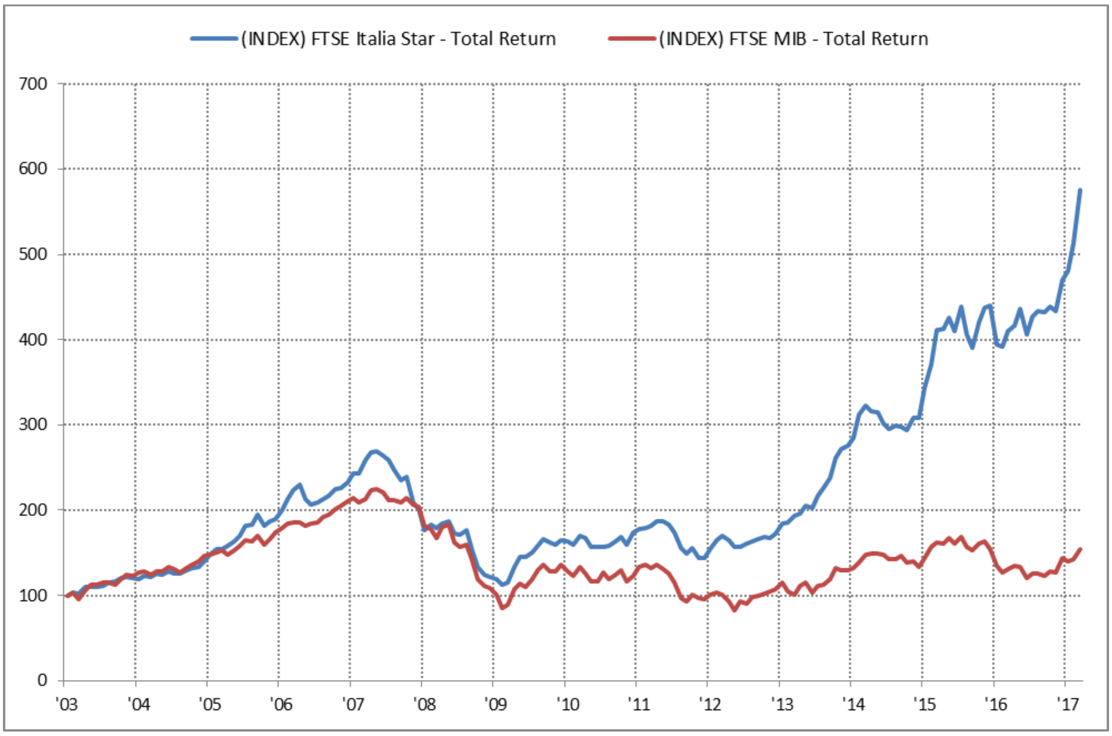
As a consequence, those who invest in 'Italy' through an ETF such as the iShares, or through one of the Italian Equities funds which are almost entirely managed around the FTSE MIB index, are to a large extent buying those four sectors, and therefore substantially underinvesting in the small and medium industrial, manufacturing and service companies which constitute the backbone of the Italian economy.

It would be a mistake, however, to think that the alternative to the FTSE MIB is simply investing in the indistinct Small Cap universe which, if anything, has underperformed the index in the last fifteen years:



Sourcee: Factset

Especially in the Small Cap universe, selection and discernment are of the essence. Proof of this is the performance of the FTSE Italia STAR index – the Italian Stock Exchange segment where companies are required to submit to stricter standards of corporate governance, transparency and communication – which in the same period has greatly surpassed the main market:



Source: Factset

The MIF is invested in many companies in the STAR segment, but investment has nothing to do with index inclusion. To buy a stock because it is part of an index is markedly contrary to the investment principles which animate the MIF. In particular, there are at the moment 11 companies in the STAR index with a market cap above one billion, which together represent more than 60% of the index value. The largest is Brembo, which is worth 4.7 billion and represents about 11% of the STAR value, followed by BB Biotech, 3.1 billion and 7% of the index, which is, in any case, a Swiss company, quoted also in Zurich and Frankfurt, with little to do in Italy. The MIF does not invest in either company, not because they are not worthy but because the fund's explicit mandate is to invest mainly in companies with a market cap below one billion. The MIF's goal is to invest in tomorrow's Brembo.

The sector composition of the MIF is currently the following:

	Number of companies	% Weight
Producer Manufacturing	5	16.3%
Electronic Technology	3	11.7%
Process Industries	3	8.6%
Consumer Non-Durables	2	7.0%
Commercial Services	2	8.3%
Distribution Services	2	5.3%
Technology Services	6	15.4%
Consumer Durables	2	7.0%
Finance	5	14.7%
Total	30	94.2%
Cash		5.8%

The main sectors are Producer Manufacturing, with companies which are leaders in their sectors, such as Biesse, which designs and produces machines for cutting wood and other materials, and Cembre, a producer of electrical connectors; Electronic Technology, with El.En., a producer of industrial and medical laser machines, and Datalogic, which produces machines for Automatic Data Capture and Industrial Automation; Technology Services, with Reply and BE TSE, two leaders in the field of corporate consulting on information technology and communication; and Financial Services, with Banca Ifis, specialised in the financing of small and medium enterprises, and Mutui on Line, a distributor of credit and insurance products and supplier of outsourcing services to financial companies.

Banca Ifis, Datalogic and Reply, which at inception had a market cap lower than a billion but have subsequently appreciated over the period, are the only three exceptions to the MIF's capitalisation rule. In particular, Banca Ifis, which has an average acquisition cost of 19, is today worth 37; Datalogic, acquired at 16, is worth 24; and Reply, bought at 120, is at 150. In these as well as in other cases, the revaluation has not extinguished the potential of the stocks, which we believe will continue to do well in the future.

These are the reasons why we believe that an investment in the MIF, which at first sight may appear 'risky' after the strong performance, is as valid as in the beginning. No stock in the portfolio is overvalued and, should it become so, would be promptly replaced – although it goes without saying that the MIF does the opposite of 'trading': on the contrary, it takes advantage of volatility to increase positions in its selected stocks.

Moreover, we believe that, especially in the complex and intricate universe of small stocks, the MIF's highly selective investment criterion will continue to reward investors, compared to the generic ETF approach. For those who, attracted by PIRs, have hurriedly bought the Lyxor fund, this could be the right time to move to a more judicious and farsighted investment.

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