Made in Italy Fund

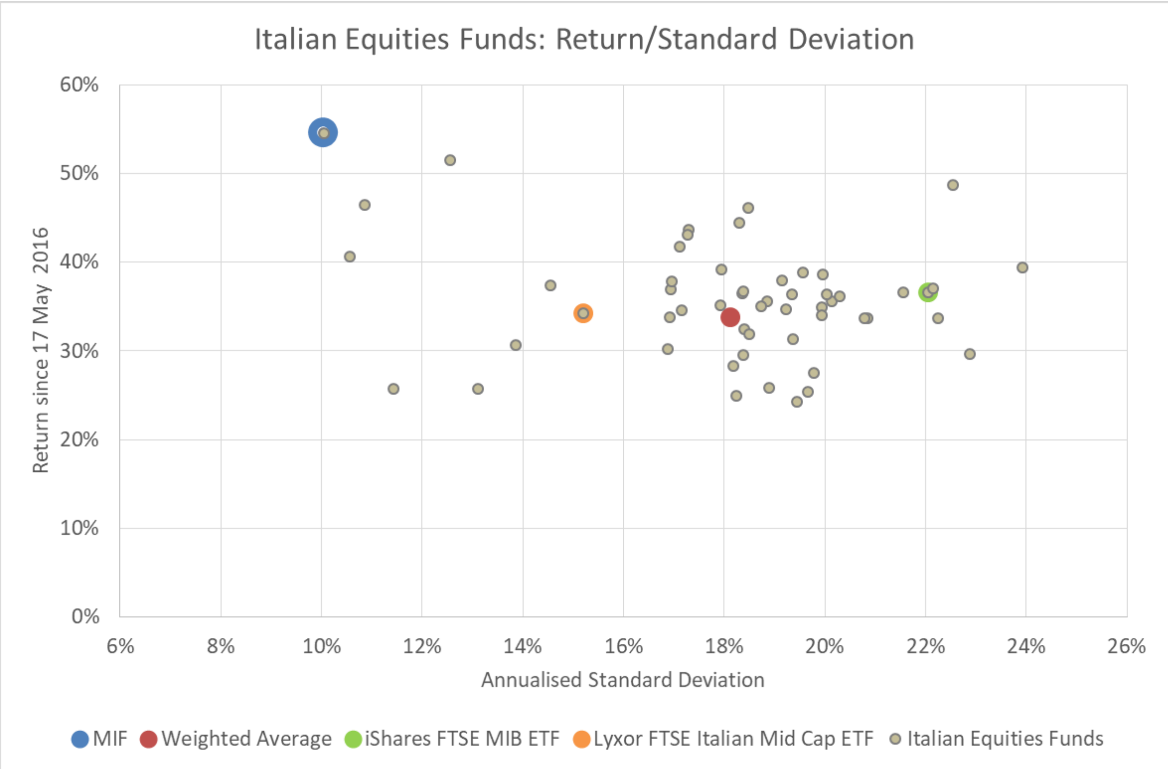
Bayes Investments

Investor letter – Third Quarter 2017

Dear Fellow Investors,

The Made in Italy Fund (MIF) returned 10.5% in the third quarter of 2017. The return since inception (17 May 2016) is 54.6%. Returns are net of all fees and administration costs.

During the quarter, the MIF continued to increase its advantage over the Italian Equities fund universe, whose weighted average return since MIF's inception is 33.8%:



Source: Factset

The MIF return is also substantially above the 36.6% return of the main Italian Equities ETF – the iShares FTSE MIB – as well as the 34.6% return of the ETF most comparable to the MIF – the Lyxor Mid Cap Fund.

The MIF's return continues to be accompanied by low volatility. The annualised standard deviation of its daily returns is 10.0%, compared to 18.1% for the weighted average fund, 22.1% for the iShares ETF and 15.2% for the Lyxor ETF.

Third Quarter 2017

Our 10.5% return for the quarter compares with a weighted average return of 9.2% for Italian Equities universe, 10.7% for the iShares ETF and 8.9% for the Lyxor ETF.

In the nine months to September, the MIF returned 39.2%, versus 23.3% for the weighted average fund, 20.7% for iShares ETF and 33.2% for the Lyxor ETF.

Confounding predictions of a summer decline, Italian equities and the MIF advanced in each of the three months of the quarter, accelerating in September. During the quarter, the fund sold out of one position which, after more than doubling in price since the first purchase last October, had closed a large portion of the gap vis-à-vis our estimate of intrinsic value; and acquired two new positions, one of which is another IPO: Neodecortech, a manufacturer of printed décor paper, laminate, melamine film and other materials for the furniture and flooring industries (see pictures from our recent visit of their plant in Filago, near Bergamo, on our Instagram account).

Our market outlook remains unchanged. Stocks in the portfolio continue to be priced at a discount to their intrinsic value. If and when the gap is reduced, through appreciation or a change in valuation, they get replaced by new stocks that are more attractively priced. We continue to find and assess many new investment opportunities.

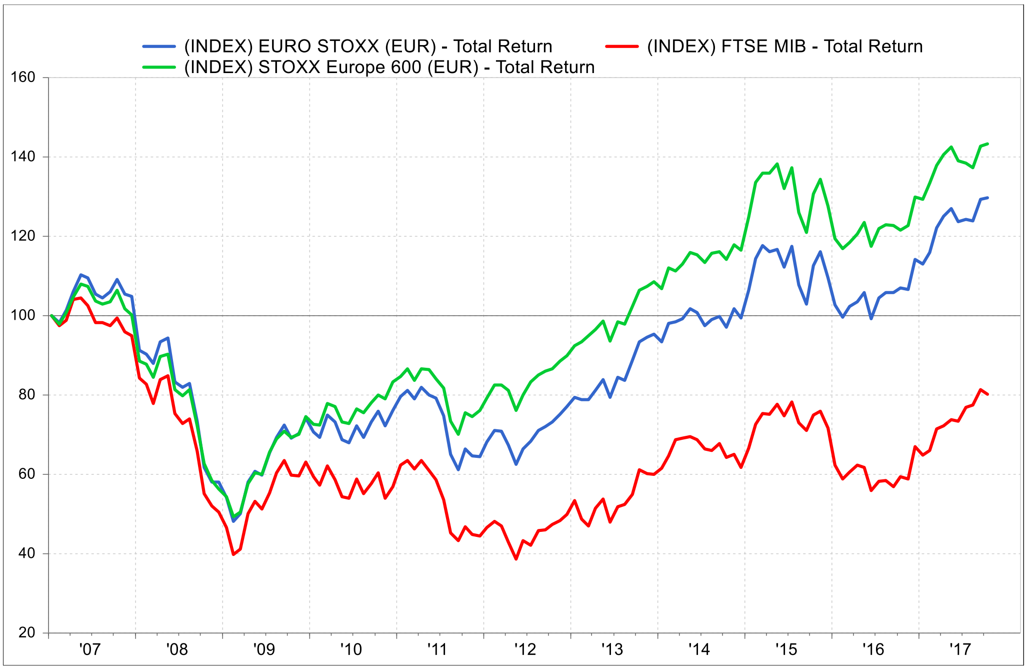
The sector composition of the fund at quarter end is the following:

	Number of companies	% Weight
Producer Manufacturing	6	20.0%
Electronic Technology	4	15.8%
Process Industries	4	11.6%
Consumer Non-Durables	2	6.2%
Commercial Services	4	13.3%
Distribution Services	1	3.0%
Technology Services	4	9.0%
Consumer Durables	2	6.7%
Finance	3	9.8%
Retail Trade	1	2.2%
Total	31	97.6%
Cash		2.4%

Italian equities

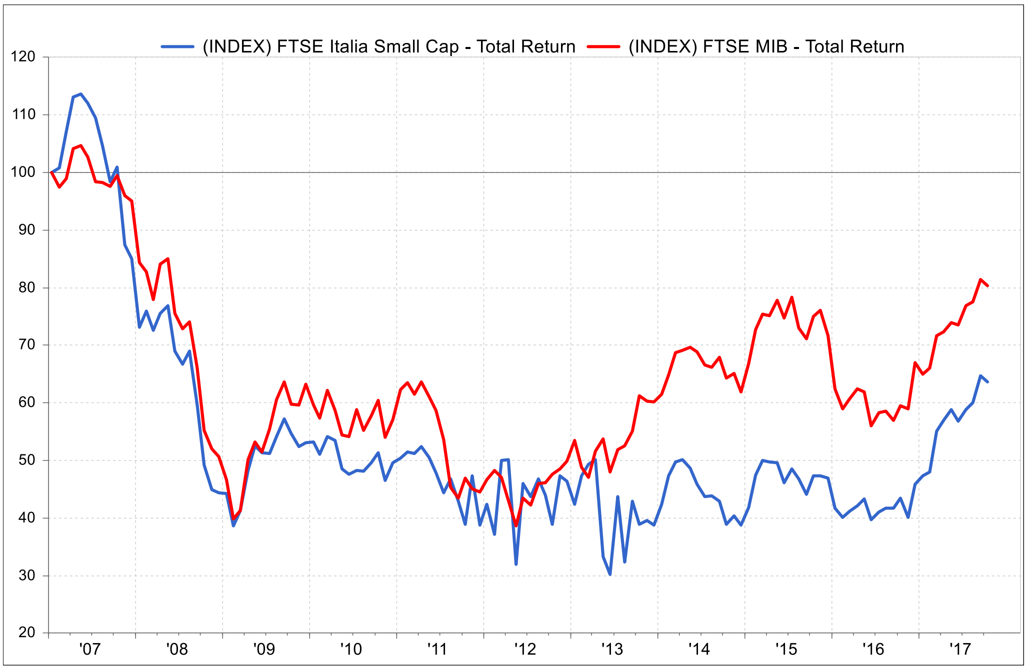
The Italian stock market has been strong this year, helped by an improved European macro environment and the introduction of PIR legislation. But we think it would be wrong to conclude – as some commentators have done – that it is now in overvalued territory.

Unlike most other European markets, Italian equities have yet to regain their pre-2008 level, and their gap vis-à-vis the rest of Europe remains substantial:



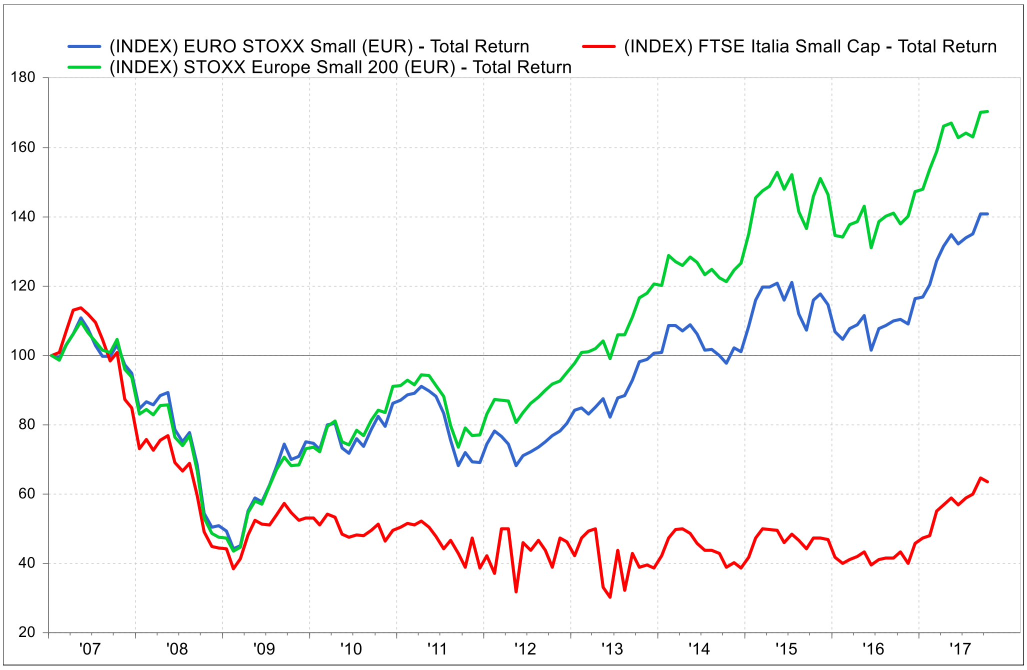
Source: Factset

Small caps have done better than the main market this year, supported by PIR-related demand. But they have done even worse than large caps over the longer period:



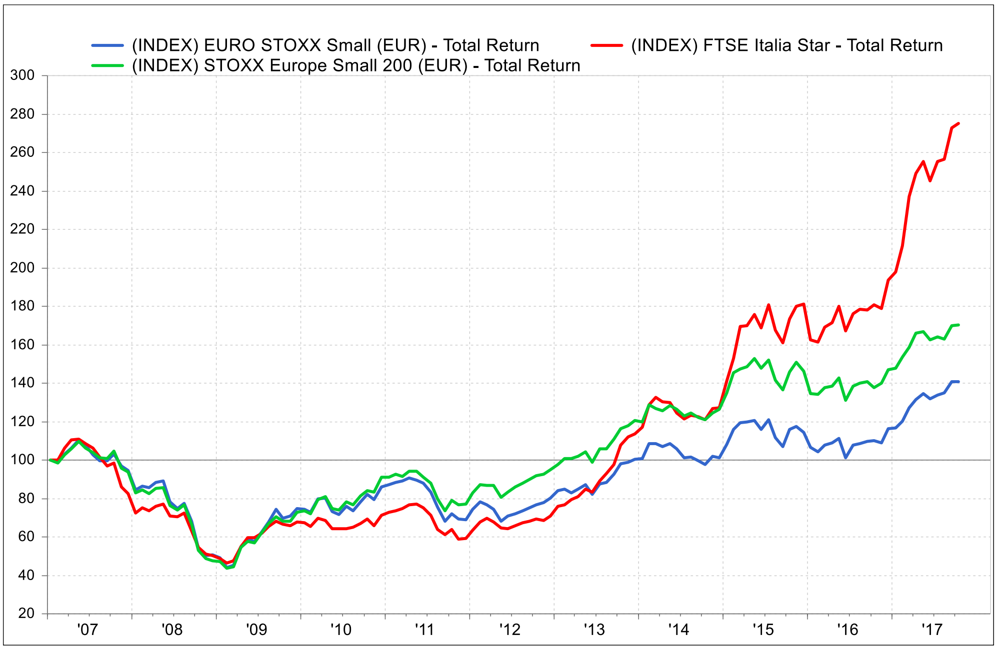
Source: Factset

and their gap versus European small caps is still very large:



Source: Factset

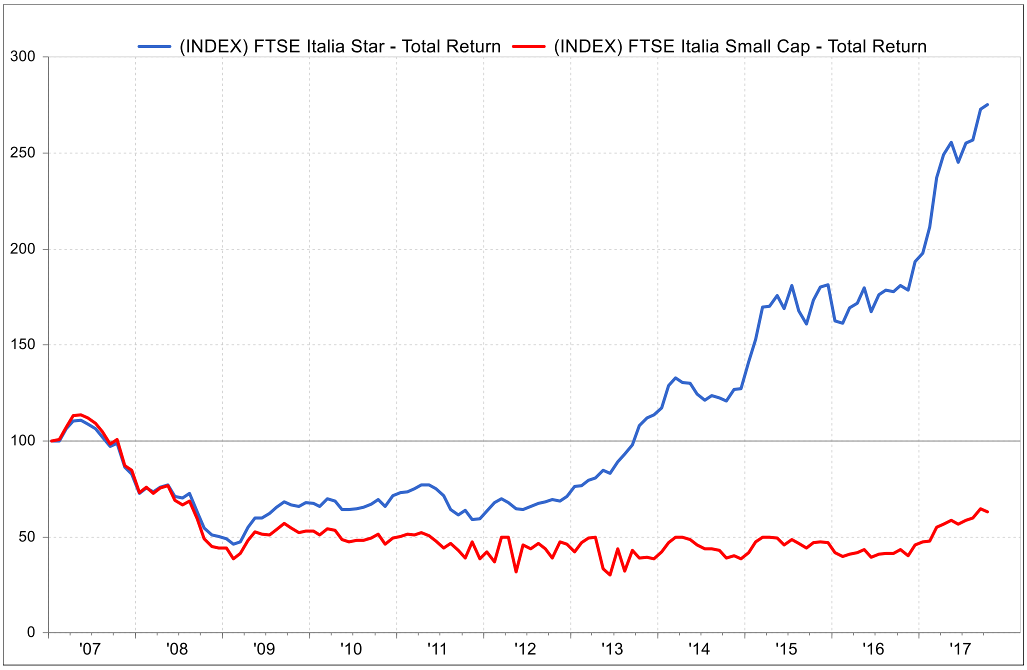
While this gap would seem to support indiscriminate buying, e.g. through the Lyxor ETF, it is important to bear in mind that the small cap universe, in Italy as in other countries, is markedly heterogeneous. It contains great companies, as attested by the stellar performance of the STAR segment, which has done much better even relative to European small caps, especially in the recent past:



Source: Factset

but it also includes many other companies whose complex mixture of risks and opportunities needs to be carefully assessed case by case.

Naturally, given the striking gap between the STAR and the small cap indices:



Source: Factset

it would be tempting to conclude that all one needs to do is to buy STAR companies and track the index – as a few funds trailing the MIF are apparently doing. As we wrote in the first quarter letter, however, this is very far from being our approach. The MIF does own many STAR companies, but we have a principled aversion to indexing and believe that the MIF will do much better in the long run by investing in tomorrow's success stories, irrespective of which index they happen to belong to.

Patience

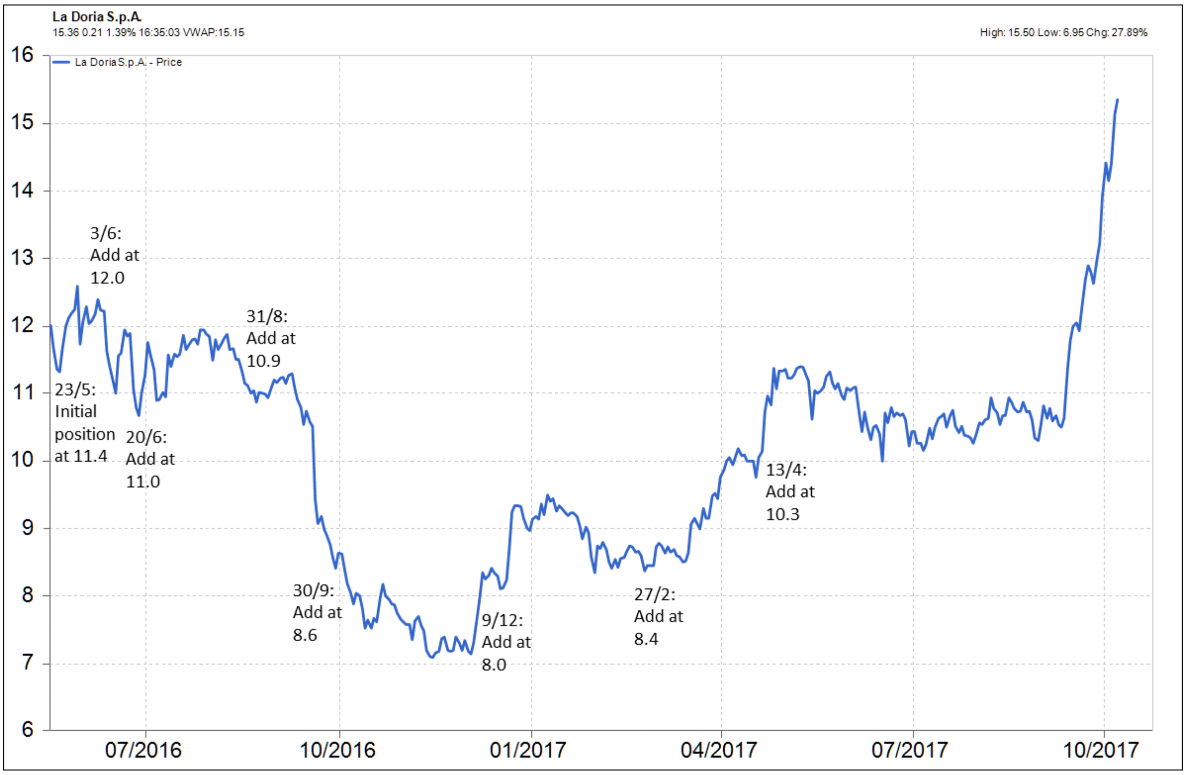
One of the STAR companies that has been in the MIF portfolio since inception is La Doria, a producer of private label canned food – tomato, baked beans, pulses – as well as fruit juices and ready-made sauces and soups. We visited the company twice before the fund launch, in their headquarters in Angri, near Salerno, in the southern region of Campania. La Doria, headed by CEO Antonio Ferraioli, the son of the founder who started the business in 1954, has been quoted on the Milan Stock Exchange since 1995 and has been one of the earliest members of the STAR segment.

An essential element of our investment approach is low turnover. We do no short-term trading. Stocks are not bits of an online game: they represent a fractional ownership of a real company – with its management, workers, plants, strategies, markets, competition, balance sheets. We buy a company because we believe it is a good long-term investment. We are therefore unperturbed by market vagaries and use price fluctuations as an opportunity to increase our positions.

La Doria is a good example. After the company reported Q2 results in September last year, the stock price took a rapid plunge from 11 to 8 euro, reaching down to almost 7 by mid-November. The report mentioned continued price weakness in final products, due to increased competitive pressure and lower consumption, and the adverse effect on UK sales of post-Brexit sterling depreciation. As a consequence, the company said it expected a 25% fall in 2016 EBIT from 55 to 42 million – whose size happened to coincide with the subsequent price drop. However, while the currency effect was unexpected, the company had been talking about the slowdown since 2015 and had reiterated it in the Q1 report. In fact, we had just discussed the underlying reasons in our latest visit in early

September, before the revised numbers had been announced. After the announcement, we discussed them again over the phone, going through them in detail, line by line.

The conclusion was straightforward: the company was facing a cyclical slowdown, after two years – 2014 and especially 2015 – of exceptional results. It was not a structural change, leading to a permanent reduction in value, but a temporary inflection – nothing that the company had not seen before – leaving it intact on a solid growth path, not as strong as the 2014-15 acceleration, but certainly one that would continue to produce a healthy dose of compounding earnings over the years. Hence the correction was a good buying opportunity. The stock was cheap before and was even cheaper after the drop: with a market capitalisation of 270 million euro, even the 30 million revised net income figure for 2016 put the company at 9 times earnings – a substantial discount to our estimate of intrinsic value. As a result, we added to our position four times. A year later, with the price up to 15 euro, this turned out to be a good decision:



Source: Factset

Our investment approach requires a detailed analysis of a company's business and a careful evaluation of its future prospects. It also requires a close relationship with the company's top management – which in Italy in many cases includes a controlling shareholder – based on mutual trust, respect and fair play. But, above all, it requires a simple but not easy psychological attitude: patience.

Fees

The MIF has three investment classes. Returns reported in our quarterly letters are those of the Institutional class, which started first – 17 May 2016 – and has a lower management fee and a higher minimum investment. The Retail class started a little later – 8 June 2016 – has a higher management fee and a low minimum investment. Finally, the Listed class, which can be bought directly on the Italian Stock Exchange at the NAV of the day, started last – 22 September 2016 – has a management fee which is lower than the Retail class and slightly higher than the Institutional class, but has no minimum investment. All three classes have the same performance fee (this and more information is available on www.atomosicav.com/made-in-italy).

Reflecting such fee differences, the 39.2% year-to-date return of the Institutional class compares with a 38.5% return of the Retail class and a 39.0% return of the Listed class. All returns are net of all fees – including performance fees – and all administrative costs.

Clearly then, fee differences have been minimal compared to the MIF advantage versus the Italian funds universe, which we are happy to report is amply shared by all MIF investors (fund returns on the chart on the page 1 are those of each fund's cheapest class).

Fund costs are important, in the short and – more so – in the long run. MIF's costs are not the lowest – although they are lower than many other funds in the Italian equities universe – and are certainly higher than ETF fees. But the custom of regarding fees as one of, if not *the* most important criterion of fund selection is – we believe – profoundly wrong, based as it is on the erroneous assumption that all funds are ultimately equal and will sooner or later converge towards the same returns.

We don't think so. Our goal is to maintain and extend our return advantage. What ultimately matters to investors is not the costs they pay but the after-cost returns they gain.

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