SIA
Strategic Investment Advisors Group

Long Term Investment Fund

Newsletter

of June 2021

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Figure 1: **LTIF Classic EUR**
vs. MSCI Daily TR Net World Index EUR

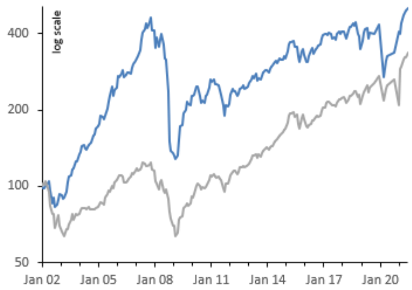
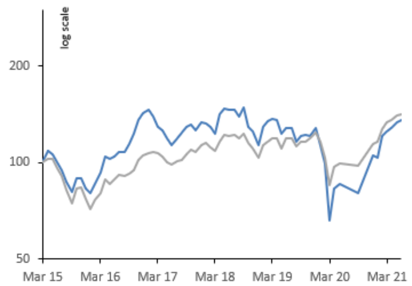


Figure 2: **LTIF Natural Resources EUR**
vs. S&P Global Nat. Res. Net TR Index EUR



"If you expect to be a net saver during the next 5 years, should you hope for a higher or lower stock market during this period?"

Warren Buffett

Overview of our funds

Table 1: **Net Asset Value - Net assets under management of our funds**

June 30, 2021	NAV	Δ 3m	Δ 12m	Annualized return (s.i.)	AUM *(in mio)*
LTIF Classic [EUR]	503.51	6.0%	47.5%	8.7%	85
LTIF Natural Resources [EUR]	112.58	8.3%	50.9%	0.7%	44

Source: SIA Group

Despite the delta variant, the economic outlook remains positive

Markets are understandably worried by the current spread of the Delta variant of the Covid virus. It's more contagious than the previous variants, which is why it spreads so quickly. The fastest spreading variant will, by definition, always be the most contagious one, although this one doesn't seem to be more dangerous.

Vaccines offer strong protection against this variant. Even vaccinated people who do become infected (vaccines never protect 100%), don't develop serious symptoms; let alone life-threatening conditions. The number of vaccinated people who become seriously ill, or even die, is similar to that of typical flu cases.

The data support this conclusion. If we look at the UK, the Western leader regarding Delta infections, and Israel, which had almost eliminated the virus, it becomes clear that although the number of infected people has increased, the number of hospital admissions and the number of deaths have only increased slightly.

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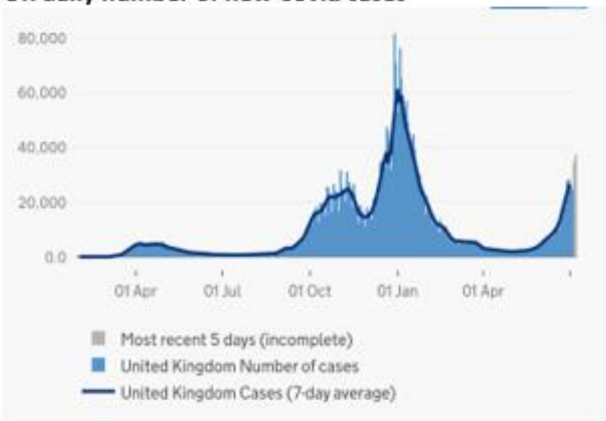
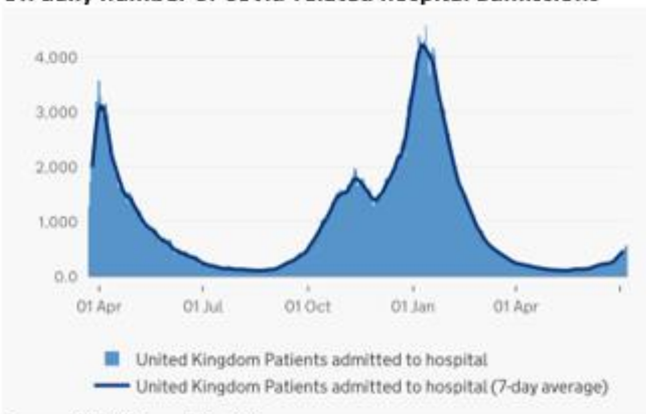
UK daily number of new Covid cases



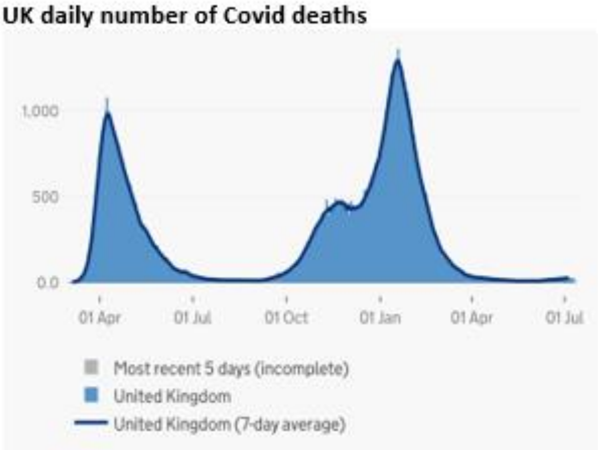
Source: UK Ministry of Health

UK daily number of Covid-related hospital admissions



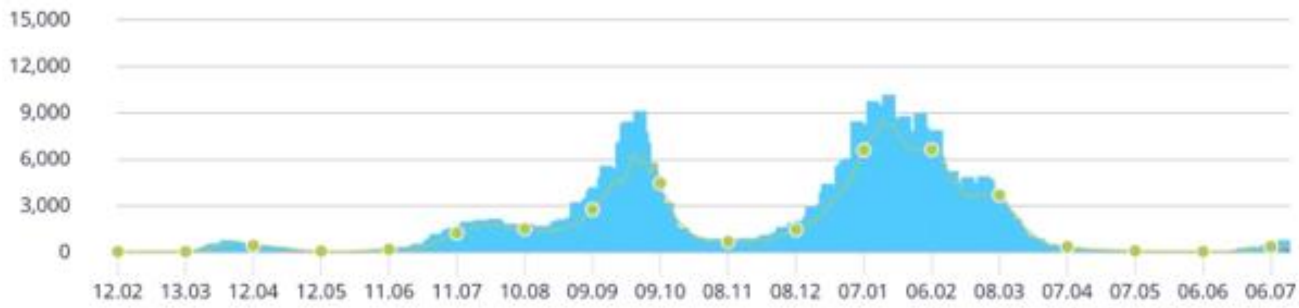
Source: UK Ministry of Health

UK daily number of Covid deaths



Source: UK Ministry of Health

Israel daily new Covid cases



Source: Israel Ministry of Health

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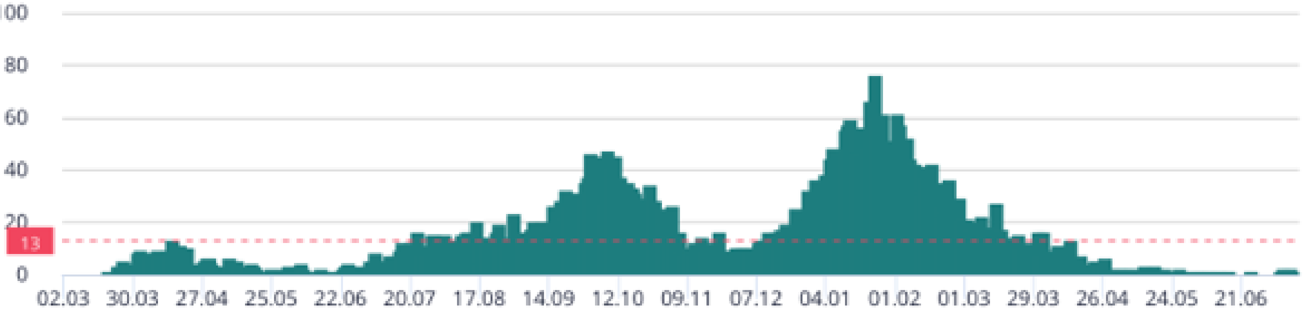
Israel daily Covid-related serious cases

Source: UK Ministry of Health

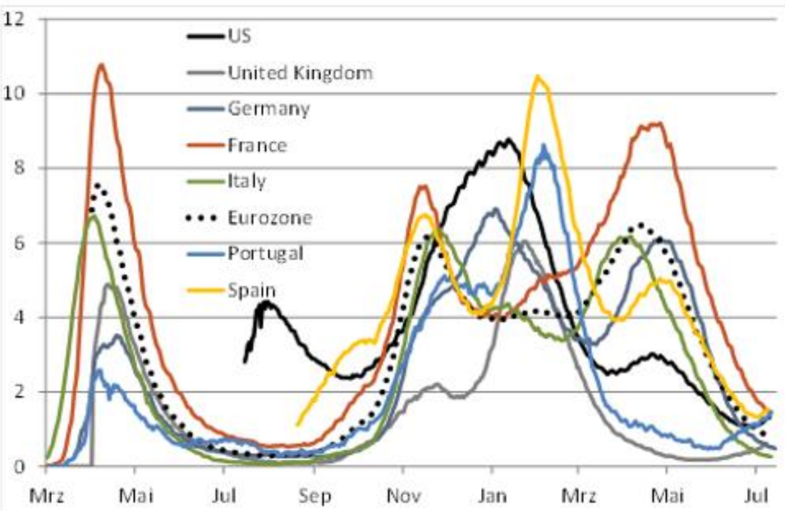
Israel daily Covid-related deaths



Source: UK Ministry of Health

These lower morbidity and mortality figures are due to the vaccines. And, of course, most people who are currently getting infected are young, since older people have mostly already been vaccinated. This disease has indeed always affected young people relatively mildly. Older, vaccinated people, who are infected by the new variant, generally experience very mild symptoms.

Europe daily Covid-related hospitalization rates



Covid-19 patients, hospital occupancy per 100,000 people. We use the population-weighted average of available country data on the Eurozone. Source: ECDC, UK government, COVID-19 Tracking Project, Berenberg

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With even more people being vaccinated and non-vaccinated people being infected and developing antibodies, this latest wave should crest soon. New “refresher” shots, like those used yearly against the flu, are currently being developed and applied. It’s therefore very unlikely that this disease will still be in the news in a year’s time although it is important to highlight the need to dramatically increase vaccination rates in some developing markets (Latam, Africa and parts of Asia). Developed countries must realize that Covid-19 is a global, not local, issue and must be tackled from that perspective.

Despite all of the above, economies keep improving. Although the latest Covid developments are a hard blow for tourism in Europe, affecting the countries and industries dependent on it negatively, most other sectors are improving fast. Industrial production statistics reflect this, as do the price increases. The almost 15-year period of successfully taming inflation has now come to an end.

All of this predicts a fairly benign scenario for many companies in the next few quarters. With the pandemic’s powerful waves receding and the elation of the recovery fading over time, stock picking will again become very important. Some companies will do better than others, and some shares will be cheaper than others. These are the determinants of long-term investment success.

As of mid-July 2021, the LTIF Classic is around EUR 500 (+20% ytd.)

In recent months, following the strong stock market performance and the high valuations of some sectors and stocks, we have been trimming our sails a little, building a little more cash, reducing the 3-4 categories somewhat, decreasing our exposure to mining, and marginally strengthening the portfolio’s quality component.

Warren Buffett explains that if you are going to invest your savings over the next few months or years, it is much better if the stock market goes down, so that you can buy cheaper. We are waiting for that small correction (or big one, you never know) before jumping into action. If, on the other hand, the stock market keeps going up, “*no problemo*”, we will go up with it.

The Classic Fund is up 20% so far this year and stands at around EUR 500 per share. The main American (S&P500) and European (STOXX Europe 600) indices are up 13-15% so far this year, so we continue to catch up, including emerging markets, which are, with an average performance of +5%, not doing too well so far in 2021.

By sector, energy (+50%), consumer discretionary stocks (+30%), and financials (+30%) have been the stars of the Classic so far this year, highlighting that all of our sectors are in positive territory. It should be remembered that these sectoral commentaries do not have a broad reading, given that we only have 3-4 companies per sector; consequently, it is the selection of the stock and not the sector that really counts.

The following stocks, all of which are above +20%, are leading the 2021 performance to date: Raytheon, Mocorp, Devro, the salmon companies (Leroy Seafood and Mowi), CompassGroup, ISS, Pandora, ASML, and the oil companies (Cenovus, Hess, EOG, and Suncor).

On the “disappointing” side, only two of our companies are in the red this year, namely MTU Aeroengines and Grifols, two high-quality companies of little concern to us. In respect of Grifols, we have been steadily averaging down, and should we get the chance, we will increase our position in MTU at lower levels. MTU’s long-term outlook is so outstanding that it is one of the few stocks where a fall in its share price will be welcome (to buy much more of course).

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Classic's current IRR is 13%. Updated Intrinsic Value: EUR 680 per share

Our updated discounted cash flow models put Classic's intrinsic value (IV) at EUR 680 per share, with a medium-term upside potential of 35-40% and an IRR on investment of 13%. These are average numbers for the Classic, suggesting that equity markets are now trading overall at "fair" levels.

It is curious, but if we start at the Classic's launch date (early 2002) and calculate a 10% annual appreciation over 20 years (our target appreciation after fees), we get a NAV of EUR 673 per share, close to our Intrinsic Value. It is true that we are slightly behind, but we will do our best to get closer to that target in 2022.

This is the magic of compound interest: making 10% per year means doubling the investment roughly every 7 years, so that it is multiplied by 8x (2x2x2) within in 21 years. By the way, it is quite clear to us that one of the solutions for many countries' pensions issue is greater exposure to the stock market, with long-term returns far superior to most assets (fixed income, real estate, gold, etc.) and inflation protection. In countries like the US/Switzerland the exposure to equities is already higher than average (interest rates in Switzerland were very lower/negative much earlier) and we think other governments could follow.

We recently analyzed a renowned German reinsurer's investment portfolio and found that only 2% of it is invested in equities. There is a deep mismatch between most pension assets and liabilities (both public and private). One of the solutions could be to increase the weight of the equities in portfolios to achieve the historical 6-7% annual return. Volatility is not risk and risk cannot really be modelled.

The Classic fund is both concentrated and diversified. We very clearly see oil's upward path

Currently, the Classic fund has only one concentration factor, the oil sector, where we hold around 17% of the fund. It is true that, like oil prices, this sector has risen sharply so far this year (>50%), but it is also true that E&P companies are still extremely cheap, pricing oil at $50 per barrel when Brent is above $70.

It is also clear to us that oil demand will return to normal by 2022 (>100 million barrels per day), and that inventories and the OPEC+ spare capacity will be absorbed during the course of next year. What does this mean? That we are going to witness an explosive cocktail combining the 5 following main factors:

1) Depletion or **production declines of 3-4% p.a. (3-4m b/d, or 1 Saudi Arabia every 3 years).**
2) **Massive upstream underinvestment since 2014** (see graph on p. 6).
3) **Oil companies increasingly investing in "clean" businesses to lower emissions**, leading to lower spending on oil exploration and production.
4) **Lower capex due to the financial discipline** that the oil sector adopted on their investors' demand after a decade of very poor returns.
5) **Maturity of the American shale oil.**

We understand that this cocktail will end with oil prices at least at an incentive regime ($70-80) and very possibly much higher, due to the difficulties of obtaining new supplies and the inelasticity of the demand. We think that **oil prices are going to increase a lot, in order to incentivize new investments in the coming years**. Moreover, we also think that oil prices could remain high even if demand were to fall (which we will not see until at least 2030). *Please see the LTIF Natural Resources part for some more comments.*

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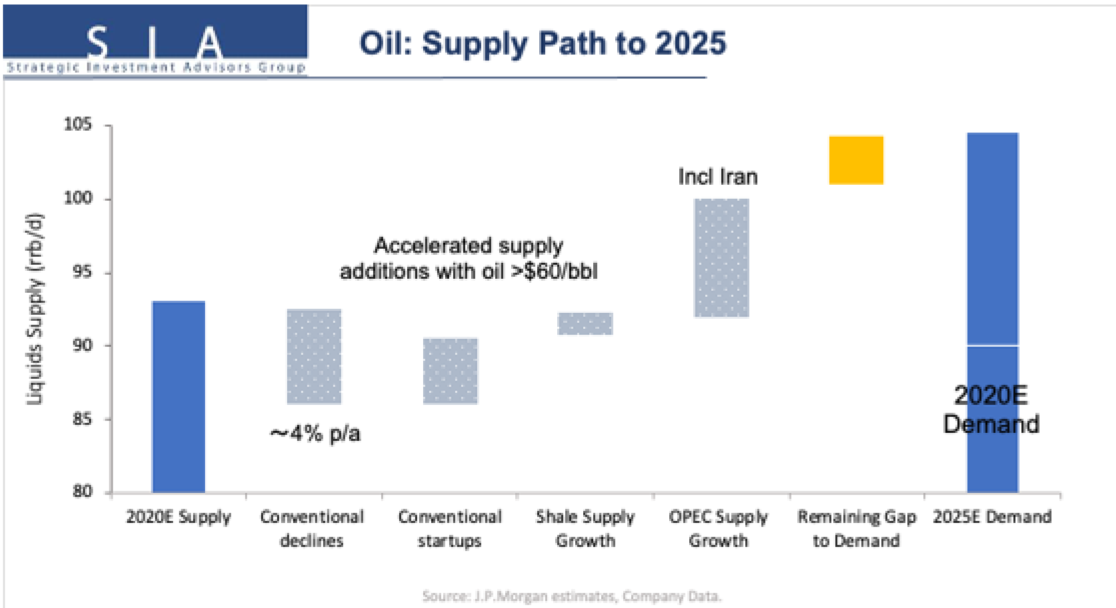

The rest of the fund (see table of top 10 positions) is extremely diversified, although, if we aggregate the sectors, we end up with 10% of the assets in each aerospace, salmon and catering/cleaning services, which are the "most representative sub-sectors”.

One of the ways of understanding the Classic’s degree of diversification is to look at **the top 10 positions that normally make up half of the fund**. We have large positions in banks (ING), cleaning services (ISS), catering (Sodexo), blood plasma (Grifols), cement (Heidelberg Cement), aerospace (Thales), oil (Cenovus and Suncor), consumer (Henkel), and sausage casings (Devro) companies.

This is no coincidence: **on the one hand, we want to be diversified** so that our investments do not depend on just a few factors (risk management), but **we also want to be concentrated** so that we have a chance of beating the indices and passive management in general.

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Top 10 Holdings	% of NAV
ISS A/S	6.4
ING Groep NV	5.8
HeidelbergCement AG	5.8
Cenovus Energy Inc	4.8
Grifols SA	4.7
Thales SA	4.7
Devro PLC	4.6
Sodexo SA (CFD)	4.2
Suncor Energy Inc	4.1
Henkel AG & Co KGaA (CFD)	4.1
Total	49.2

Regarding these 10 companies critically, **we do believe that ALL of them have both outstanding QUALITY and VALUE**, which reflect our strategic decision to never invest in bad businesses, even if they are, apparently, being sold for a song and dance.

Investment case of the quarter: Grieg Seafood. IRR 17%. IV 150 NOK

We have an important position in a salmon farming company, Grieg Seafood, where, for once, we made an exception in terms of the balance sheet. Grieg Seafood has too much debt (net debt of NOK 4.5 billion, about EUR 450 million) due to a bad 2020 (Covid-19 crisis), heavy investments in both fixed and working capital, and recent acquisitions (including salmon farms in Canada).

Grieg Seafood also fails to meet another of our basic premises – avoid restructuring businesses – because it is in the process of reducing its costs, and improving its efficiency and productivity, in order to bring the company to a level that is closer to that of the leading farmers. Historically, Grieg Seafood's quality has been below the industry average, but the Grieg family (main shareholder) and the management team are determined to take the company to the next level.

We have long-term knowledge of the sector, having been invested in salmon farming for more than a decade, and our position in this company is based on the two following main factors:

1. **According to our estimates, the supply of salmon will not, in the coming years, meet the demand.** We therefore expect high salmon prices (> 6-7 euros per kilo at the source).

2. Grieg Seafood has just **announced the sale of its assets in Scotland** (Shetland Islands) for NOK 2 bn, which solves the problem of financial leverage. We also understand that **the restructuring process is on the right track**, mainly following a post-smolt strategy (rearing fish until they reach 500 grams on onshore fish farms and then moving them to the sea farm to reduce their biological risk and mortality, the business's main problem).

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In this context, the share trades with a PER of around 10-12x compared to the sector average of 18-20x and a free cash flow yield of over 10%, to mention just a couple of ratios, are very attractive levels for investment.

But aside from the numbers, the salmon sector and Grieg Seafood enjoy a great strategic positioning, with huge barriers to entry and a return on capital employed above 20% when prices are not cyclically depressed. It is a phenomenal business, with the risk of new competition 5-10 years down the road really low.

We have a total of 8-10% of the Classic fund in salmon, with positions in Leroy Seafood and Mowi, which, according to our figures, have IRRs of 10-12% with a very low risk. Grieg Seafood is a somewhat riskier investment at an IRR on investment of 17% and, according to our model, an intrinsic value of NOK 150 per share compared to the current price of NOK 90.

The Natural Resources fund (LTIF Natural Resources) just started a long-term upward cycle

The Natural Resources fund has also rallied strongly so far this year, with a 20% appreciation in 2021 and a NAV of EUR 105 per share. As we discussed in recent newsletters, this fund could have an exceptional 5–10-year outlook, because we are convinced that a new commodity cycle (or super-cycle) will start after the Covid-19 crisis, keeping in mind that such commodity cycles are long cycles which last up to a decade.

After experiencing the bear cycle that started in 2013 (8 years to 2020), the LTIF Natural Resources is once again generating interest. The natural resources topic is raised at most of our meetings with and presentations for investors, due to climate change’s importance, the consequent electrification of economies, and the huge impact this transition will have on various natural resources.

At SIA Funds, we endeavor to understand the deep changes that are coming and, so far, we have identified 4 long term impacts that we try to capture in the fund:

1) **The current copper mines (producing and with FID) are not sufficient to meet the growing demand** which the electrification of the global economy is driving.

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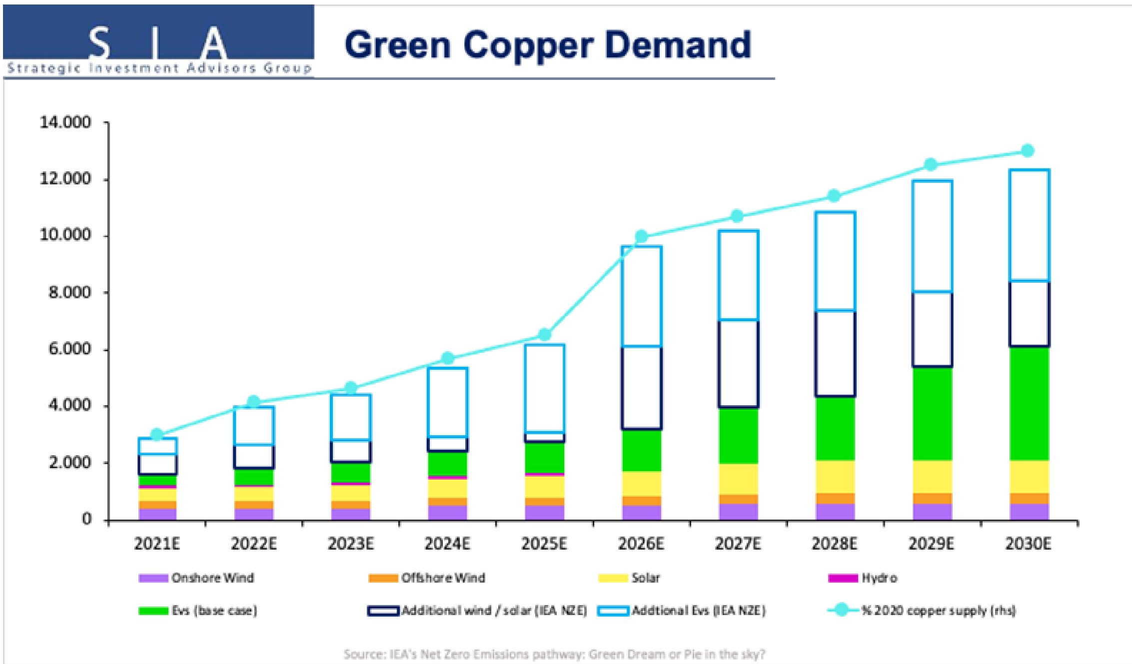

2) **The demand for nickel will grow massively due to its use in electric batteries, and supply will struggle to keep up with demand.**

3) It is increasingly clear that **nuclear energy is one of the few ways to support decarbonization,** because it does not produce CO_2 or other greenhouse gases.

4) We think that **oil prices are going to increase a lot, in order to incentivize new investments in the coming years**. Moreover, we also think that oil prices could remain high even if demand were to fall (which we will not see until at least 2030). This point is possibly the main difference between the LTIF Natural Resources fund and consensus, the latter being somewhat hooked by the peak oil demand narrative.

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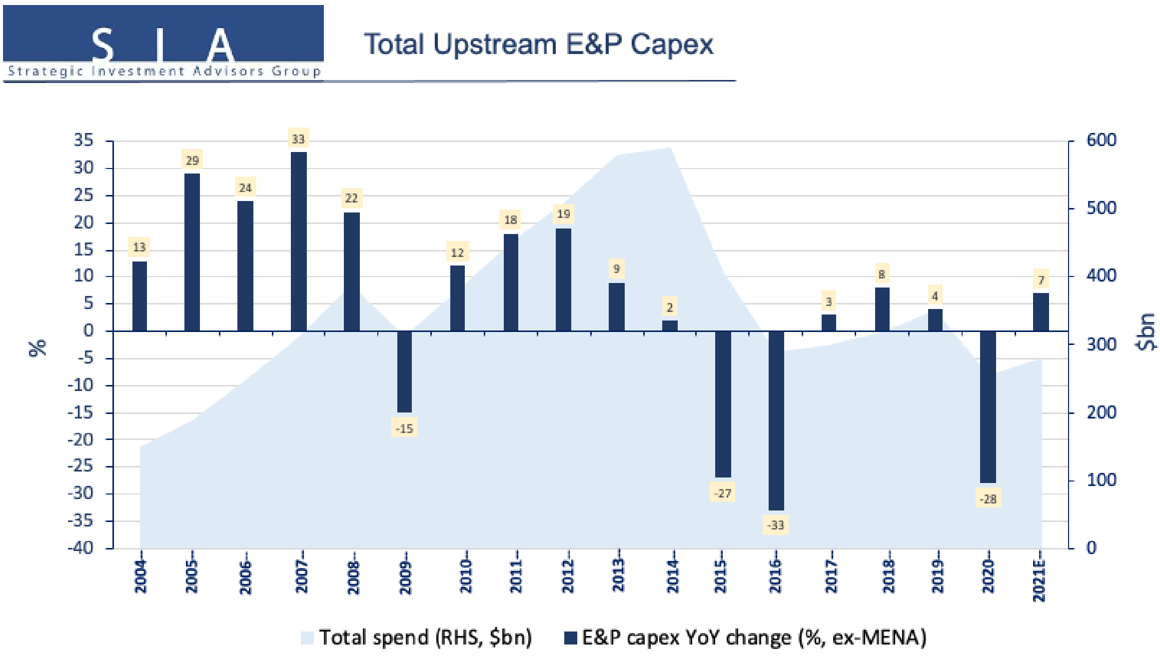

Source: J.P. Morgan estimates, Company data.

These 4 themes currently account for 3/4 of the Natural Resources fund with the largest weighting in oil (> 40% and up c. 50% in 2021), followed by copper with 20%, and 10-15% in nickel and uranium mines.

The LTIF Natural Resources shows an IRR of 14% and an IV of EUR 160, but that is mid-cycle

The world of natural resources is a very complex one when the macro, sector (supply and demand), commodity price (the valuation's main input), and micro (reserves, costs, law, etc.) factors come into play and cloud the cashflows' visibility and, therefore, the valuations.

Over the years, we have developed a valuation model based on convergence (or mid-cycle), i.e., we value companies at incentive commodity prices (the equilibrium point between supply and demand that encourages new investment), while converging the margins and the returns on capital based on these prices and on the companies' historical average.

This method is the only one that allows us to calculate a structural IV for companies but is by no means a perfect method.

The big problem is on the supply side which has a very long cycle – building a new mine can take a decade, the same as an offshore oil well – and this leads to imbalances between supply and demand that last for many years. In most economic sectors, supply reacts relatively quickly to high prices, but this does not apply to commodities, which need more time to start production.

In addition, demand for most natural resources is very inelastic, which means that prices, when production is scarce, increase to levels well above the incentive price and can remain there for several years.

How can valuations therefore be approximated? Commodity prices tend to rise well above the incentive price for several years – or conversely, also fall below the marginal cash cost for quite some time –

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when there is a shortage of supply. The stock market is no stranger to these swings, and values companies well above the mid-cycle during up-cycles, but also well below during down-cycles. Generally speaking, when a mining company's earnings are much higher than its normalized or convergent earnings, the market should put a low P/E on it, but this does not happen in reality.

We understand that the Natural Resources fund will continue experiencing great volatility around IV, which should be very positive in a long term up-cycle, if our argument is correct.

Applying the drawdown of the fund during the Covid-19 crisis (March 2020 when the market “priced in” a global recession) in the reverse direction, the LTIF Natural Resources should multiply by 2-2.5x over the next few years once the copper, nickel, uranium, and oil shortages, among others, become evident.

The oil narrative is SOOOO negative, it reminds us of tobacco. Please take a look at tobacco stocks’ performance during the past 2 decades (10% p.a. since 2001)

Generally, there is a structural negative oil and fossil fuels narrative including peak oil demand, carbon and other gas emissions, political pressure, regulation, etc. **leading to a severe “risk premium” being applied to the sector.** This is why valuations, which are massively depressed, only “price in” a $50 oil price in the long term, while, in sharp contrast, Rosneft (the world’s second largest producer after Aramco) recent warned of a severe future oil shortage given the decade of underspending.

Some oil majors, particularly the European ones, got rid of their oil assets and Shell, for instance, sold its onshore upstream assets in Egypt at an estimated valuation of 1-2 times EV/EBITDA (at current $75 Brent). These flows will possibly be reinvested in renewable projects with low single-digit IRRs and an understated regulation risk: A great transfer of value from Shell shareholders to third parties.

The largest producer in the North Sea, **Harbour Energy, which trades on an estimated valuation of 2 times EV/EBITDA at $75 Brent**, which obviously excludes the value of non-operating assets (Zama, Sea Lion, etc.) and tax losses carried forward, is another example. The company produces more oil in the North Sea than BP, Exxon, Shell, Chevron, etc. but nobody cares; the stock trades as a “dog stock”, and we are patiently buying more.

For these and other reasons, the fund continues to avoid most oil majors and prefers to invest in companies with direct exposure to oil such as Suncor, CNQ, Surgut, Gazprom, Petrobras, Hess, Conoco, Harbour, Cenovus, Lundin Energy, etc., which, in our view, will benefit strongly from higher oil prices. By the way, most of these companies have top-class ESG standards and lead the decarbonization effort in the sector.

One last word on Hess: Offshore Guyana is showing a larger and larger potential, and some industry experts are beginning to talk about a new oil province, comparable to Venezuela, developing. This might be very far into the future, but the companies involved are Exxon, CNOOC, and Hess. The latter, in which we are invested, is the company with the largest leverage, given the Guyana fields’ potential size compared to the company’s size.

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Copper: The transition to electricity implies accelerated demand in a moment where there is a lack of new projects

Glencore's ex-CEO Ivan Glasenberg recently mentioned that copper production needs to double until 2050 to meet future demand. Unfortunately, it is hard to see where new production could come from, given a decade of underspending.

Adding to the current lack of projects, when commodity prices rise, governments are keen to make extra revenue and increase taxes, which Chile and Peru (with 50% of the world's copper supply) are just doing. This does not support new spending, but raises the bar for projects, and we expect other countries to follow. If they do, they will be ignoring the adage short-term easy money, long-term reduced spending.

The Economist recently even mentioned the possibility of mining volcanos where there are relevant copper reserves, although the scale, mining conditions, geology, etc. make this very difficult. Nor do we see ocean mining, which could actually be done on a substantial scale, as an alternative, for environmental concerns.

We are slightly increasing our investments in cement

Draghi announced a EUR 220 bn revival package for Italy covering many areas, such as infrastructure, high-speed rail, and energy. Such infrastructure investments, which are happening in many countries (the European Recovery Funds, US Infrastructure Bill, China etc.) will maintain demand for many commodities, cement among others.

We think the sector is out of favor due to its large carbon emissions. Cement producers show similarities with integrated steel companies that own iron ore/coal mines: First, limestone and clay need to be mined and grinded; to produce clinker, these subsequently need to be heated to 1450 degree Celsius, which is very energy and CO_2 intense. Producing a ton of clinker requires the energy equivalent of 135 kg of coal, or 86 kg of crude oil; further, similarly to other bulk commodities, the transport costs are significant.

However, cement companies are somewhat shielded from competition since they are a type of local oligopoly. Companies like Heidelberg trade below 6 times EV/EBITDA and will benefit from the rising demand and local oligopoly structure, which should allow them to pass the cost increases (the decarbonization costs) on. Heidelberg is one of the ESG and decarbonization leaders, and we think that they will be able to place most of the extra generated costs onto their clients.

The fund has started adding a position in Buzzi Unicem. Given this company's family ownership and very good global market position, it is a well-run, debt-free, and undermarketed company. Besides its position in Europe, it also has a strong market position in the US and worldwide. It should also benefit from the capex recovery in the oil and mining industry. The company has, among other places, a strong presence in Texas, Minas Gerais in Brazil, and the Ural in Russia. Suchoi Log's catalogue includes, for example, special cements used in the oil extraction industry.

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Why is the fund not invested in onshore salmon farming?

We started looking at onshore salmon farming many years ago and undertook many due diligences, models/numbers/DCFs, because we liked the salmon farming industry's growth in demand and its supply scarcity. We distinctly remember providing all kinds of capex, working capital, prices, costs, etc. figures.

We also spoke with certain companies to cross check our work, but **one meeting derailed the whole process**, **leading us to focus on the risks**. This was when the ex-CEO of Marine Harvest (now Mowi) told us that onshore salmon farming was a high-risk venture, far more so than generally appreciated, because biology is not maths, and their trials had failed many times. We subsequently decided to look at the onshore farming development from the outside and, so far, so good.

As in many other areas, the natural resources industry, and salmon farming, have experienced their fair share of the private equity boom, which meant that in recent years, many onshore fish farming projects could obtain finance. We are therefore no longer surprised that market participants are not very keen on buying the reasonably valued, cashflow generating, lowest cost industry leaders in Norway, but prefer early stage, riskier onshore start-ups. Well, this is only half true… just see the recent bid launched over Norway Royal Salmon, at ridiculously low prices.

Atlantic Sapphire, the largest onshore aquaculture company, is the most important start-up. As we have mentioned, the existing cost leaders always told us that, given the huge capex/costs and biological issues associated with onshore fish farming, it is a difficult and risky endeavor. Land, water, licenses, facilities, working capital, filters, cooling systems, and artificial currents are expensive compared to salmon's natural habitat (the sea), and the numbers might only add up when salmon prices are at their peak. However, the issue is not really number crunching, but the risk. There is an underappreciated risk of onshore farming being much slower and far less profitable than expected, which are not good for IRRs, especially when also taking relevant mortality episodes into account.

We keep following these ventures from the distance, mainly to evaluate their potential production over the long term. To date, they do not seem to be a threat for the sector, and, frankly, nobody mentions the climate's and the ESG's impact on onshore farming. Is the industry really a bio one? We believe that offshore farming, with its ever-rising standards, is truly the bio part of the salmon industry.

Good news about one of our holdings: Panoramic Resources

In July, Panoramic started underground mining at Savannah ahead of schedule. The nickel/copper/cobalt concentrate will be shipped to Port Wyndham in the Kimberley region of West Australia. The old off-take agreement (Jinchuan) expired, but a new one was signed with Trafigura.

Given the tightness in concentrate, such an off-take agreement is substantially better for mining companies, which receive a larger part of the revenue than the smelters do. These agreements are not always transparent, but also hardly ever followed closely. The effect is therefore often comparable to a commodity price increase of 20-30%, in addition to the quoted LME prices for nickel, copper, zinc, cobalt, etc.

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The LTIF Natural Resources approaches 50 million AuM

Back in 2016, we at SIA Funds were uncertain about the future of the LTIF Natural Resources, given the long bearish cycle with no end in sight, and the consequent flight of investors who only took assets below €5 million under management. That year, a well-known commodity fund manager came to SIA Funds and pushed us to hold the fund, convinced that a new commodities upward cycle, like the one between 2002 and 2013, was on the horizon.

That manager, Urs Marti – now a partner at SIA and a member of the investment committee – not only provided the energy needed to keep the LTIF Natural Resources, but also greatly helped us reach close to EUR 50 million in assets under management.

If our scenario holds true, this is only the beginning, and this fund will more than double its assets through valuation alone, while opening the door for Urs to navigate the commodity bull cycle once again.

Will it be a 2022-2032 cycle? We think so, and that will be good for our investors (and us), the only caveat being that we will be considerably older.

Marcos Hernández
J. Carlos Jarillo
Urs Marti
SIA Team
July 2021

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	LTIF – Classic EUR	LTIF – Classic USD	LTIF – Classic CHF	LTIF – Classic GBP
ISIN:	LU0244071956	LU0301247077	LU0301246772	LU0750886714
Telekurs:	2'432'569	3'101'820	3'101'817	18'032'305
Bloomberg:	LTIFCLA LX	LTIFCLU LX	LTIFCLC LX	LTIFCLS LX

	LTIF – Classic EUR-D
ISIN:	LU1449969846
Telekurs:	33'180'015
Bloomberg:	LTIFCLD LX

	LTIF – Natural Resources EUR	LTIF – Natural Resources USD	LTIF – Natural Resources CHF	LTIF – Natural Resources GBP
ISIN:	LU0244072335	LU0301247234	LU0301246939	LU0457696077
Telekurs:	2'432'575	3'101'839	3'101'836	10'638'983
Bloomberg:	LTIFGEV LX	LTIFGEU LX	LTIFGEC LX	LTIFGEG LX

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