SIA
Strategic Investment Advisors Group

Long Term Investment Fund

Newsletter

of October 2021

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

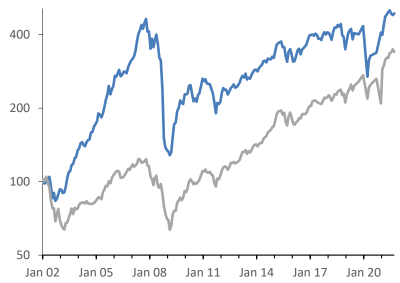
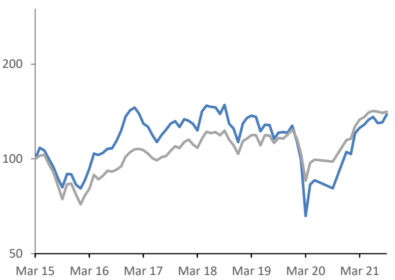


Figure 2: LTIF Natural Resources EUR
vs. S&P Global Nat. Res. Net TR Index EUR



"The truth is that whether we like it or not our energy transition involves long term reliance on fossil fuels. That means that we should stop demonising them — evangelising about ESG, following the trend to divest from shares in oil companies and kiboshing new projects with regulation, high financing costs (many banks are pulling back from the sector) and the like. Instead, we should focus on making their extraction cleaner and more efficient while we wait for the engineering challenges around a renewables-led future to be solved."

Merryn Somerset Webb, Financial Times

Overview of our funds

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

September 30, 2021	NAV	Δ 3m	Δ 12m	Annualized return (s.i.)	AUM *(in mio)*
LTIF Classic [EUR]	488.87	-2.9%	44.9%	8.4%	78
LTIF Natural Resources [EUR]	114.67	1.9%	71.6%	0.8%	51

Source: SIA Group

Covid-19 leaves the front pages. Inflation back in the headlines

Two topics have concentrated investors' attention over the last few months: the development of the Covid-19 pandemic and the likelihood of a period of notably higher inflation. We will show that they are related but deserve separate treatment.

There is increasingly less to say about the Covid pandemic. Without forgetting the tragedy of the millions of lost lives and the need to support all developing countries' vaccination efforts, **we argue that, from an investing point of view, the pandemic is no longer that relevant.** Two points are clear: governments don't want to bring their economies to a halt again and vaccines work. In addition, the first inexpensive, easy to administer treatments, are being approved. All this implies that, barring an unexpected and extremely bad mutation that does not respond to vaccines and treatments, **we can look forward to Covid-19 being rather like a bout of flu in future.** Further,

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given the medical advances that the pandemic prompted, even the Covid-19 virus may be less lethal than a flu in future.

Overcoming the pandemic created, as was expected, a “spring effect” in many sectors of the economy, with demand being stronger than usual (the catch-up effect) and supply lower than usual (disruptions). **This inevitably increases the affected goods or services’ prices. Although this situation will be somewhat transitory, some parts of the economy will see higher prices for much longer.**

In effect, one should not expect that the economy - frozen for half a year – will allow a seamless restart phase. The global economy is an extremely complex system and with trade having been halted for a while, many containers may not be where they “should be” when next required, and transport may be blocked. However, with transport blocked, factories cannot deliver the parts required to make many other articles that, in principle, may not even require containers. This leads to a chain reaction engulfing many other products, ranging from semiconductors, which in turn affect an increasing number of products, to natural gas, which affects all products that require electricity.

The “just in time” management philosophy that has spread to most industries exacerbates this problem. Ever since Japanese auto makers surprised the world in the 1970s by producing much better cars at much lower cost, company managers have been trying to learn from their techniques. One of the most important ones, which truly revolutionized manufacturing and has spread to apply to almost everything, is their “just-in-time” operations: running factories and supply chains with as little inventory as possible to minimize unproductive investment and obsolescence, and to enforce tight management. It’s often noted that some Toyota factories’ suppliers deliver parts several times a day, allowing these factories to carry no inventory at all. This applies right across the supply chain.

Such a system is, of course, “fragile”. If a problem occurs in a part of the chain, it spreads quickly (as happened after certain Japanese earthquakes and after the Fukushima nuclear accident). **But when “just-in-time” is applied to products that are essential, such as natural gas or coal, everything suffers**. If Toyota stops, it’s bad for many people, but if the generation of electricity is interrupted, it’s bad for everybody.

This is exactly what has happened following **years of underinvestment in the energy sector, the scrapping of many “safety” inventories and redundancies, and a product (energy) with an inelastic demand.** Consequently, consumers are going to pay far more than usual to keep things running.

Some of these are temporary problems, and many should be solved in a matter of weeks or months, but some other are here to stay, like in energy or mining, where capital expenditure has been woefully insufficient. These supply problems are real: when electricity is cut, so is manufacturing, and economic activity in general.

We nevertheless hope that these dislocations will offer us good investment opportunities. One simply doesn’t find good assets at low prices when there is just good news.

By mid-October, the Classic Fund stands at EUR 510 per share +25% ytd.

The LTIF Classic fund has been roughly stable since the end of June, ending the third quarter at EUR 490 per share, +20%. This performance is in line with our expectations of ending the year at around EUR 475 p.s., although the **Classic Fund has continued its upward trend in October, reaching EUR 510 (+25%).**

In absolute terms, we are satisfied with the fund's performance, while, in relative terms, we are slightly ahead of most stock indices: MSCI Global Value +18% to September, MSCI Global Growth +18%,

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SPX US +21%, SXXP Europe +14%, and emerging markets +3%. As always, we have been increasing the weight of our sectors and stocks where we think there is more upside, having raised our exposure to oil/energy, cement, and health/pharma (via Grifols) in the past few months.

We always repeat that the LTIF Classic sectors are not representative of the global listed sectors, because we are very concentrated, but it is useful to review those sectors that have performed well ytd. in the fund: Consumer (+20%), Technology (+32%), Energy (+52%), and Financials (+65%); and those that did not: Mining (+0%) and Health/Healthcare (-2%).

By stocks, the biggest gainers were ASML (+60%), ING (+66%), Devro (+50%), oil companies EOG (+83%), HESS (+64%), and Cenovus (+75%), followed by ISS, Leroy Seafood, Raytheon, and Suncor gaining more than +30%.

Those stocks that led to a loss of sleep and continued review of our investment thesis were Grifols (-15% ytd.), followed by Harbour Energy, Hudbay Minerals, Mocorp, MTU Aeroengines, and Reckitt Beckinser, all with falls of 5-10%.

The Classic Fund. Updated IRR: 13.5%. Intrinsic value (IV): EUR 710 per share

The latest update of our models suggests that **the Classic Fund has an IV of just more than EUR 700 per share**, a level we should reach in 3 years if we achieve our target of making 10% per year net of fees. We calculate the Fund's IV as the weighted average of each security's IV and use a convergent or mid-cycle methodology for cyclical stocks.

Could we aim higher and try to achieve a 20% annual return? Clearly, we could. But we would have to raise the risk to a level not compliant with the basic definition of investing: **capital protection plus decent return** (which we set at 10%) and we do not want any of our trades to lose money.

The Classic Fund has made 9% a year since it was launched in 2002, close to our 10% target, which implies a doubling of the investment every 7 years, a 4-fold increase every 14 years, and an 8-fold increase every 21 years. We are long-term investors (and the SIA team is heavily invested in the Classic Fund) and as far as possible, seek to take advantage of the "**magic of compounding**".

The Classic Fund is both concentrated and diversified. There still is huge upside in oil/energy

The financial industry spends enormous amounts of time and effort chasing performance factors, such as value, growth, quality, defensiveness, high beta, etc., but at SIA Funds we have little to do with this because **we have 50% of the Classic in only 10 stocks and the total in 30+ companies**.

Our basic process is quite simple: we analyze sectors and businesses and invest in them on a long-term basis… in reality, we consider ourselves a small holding company, and, frankly, if it weren't for the obsession with benchmarking and relative return analysis, we wouldn't even look at what the market and its factors are doing.

LTIF Classic Top10 Holdings	
ING Groep NV	7,2%
Grifols SA	5,6%
HeidelbergCement AG	5,4%
Cenovus Energy Inc.	5,4%

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ISS A/S	5,1%
Thales SA	4,9%
Sodexo SA	4,5%
Suncor Energy Inc.	4,2%
Devro Plc	4,2%
Henkel AG & Co	4,1%
TOTAL	**50,6%**

These 10 companies show several characteristics of the Classic that we want to highlight: **business quality** (franchise, returns), **a good management team** (shareholder value), **and a clear strategy** (marginal return, reinvestment, free cash flow to investor), **within a concentrated but well diversified portfolio.**

We are pleased to see that just 10 holdings gather different businesses such as banking, plasma proteins, cement, oil sands, cleaning, aerospace, defense, sausage casings, beauty products, adhesives, and cleaning products. **We have a positive structural or strategic vision of all these businesses and companies, which, due to various short-term issues/fears, are trading at depressed levels. This *relative value* is the Classic Fund's common nexus.**

Finally, we would like to **highlight that the Classic has only one additional driver left, namely energy/oil, with a large weight of 15-20% of the fund,** because we are convinced that the oil sector is structurally undersupplied and that we are heading toward oil prices above $100 per barrel within a couple of years. In addition, oil stocks are still very cheap due to the "green or energy transition" thesis, which is having a perverse effect on capital flows. A simple question… **How can oil (and other fossil fuels') prices not go up if not enough capital is being invested to meet replacement and demand needs?**

Investment case of the quarter: HeidelbergCement AG. IRR: 15%. Intrinsic value: EUR 103

HeidelbergCement is one of our largest positions with a weight of more than 5%. The main idea behind this investment is not a quantitative one, but rather a qualitative one: **the management team change** in 2020 and the **new strategy**.

Historically, cement has not been a great sector in the stock market, something however unrelated to the business fundamentals. Owing to the transportation costs, the cement sector is a "local sector", with 3-4 companies supplying the local market within an approximately 200 km radius. **Being somewhat cyclical (it follows construction and GDP), it ends up adopting an oligopolistic structure capable of generating double digit returns and strong free cash flow.**

The problem has been that **cement company managers have used this cash accumulation for value-destroying acquisitions,** paying absurd multiples to "be bigger", but without adding synergies or economic sense. It is true that geographic diversification helps mitigate the cycle, but acquisitions at peak multiples and earnings are most of the time value destructive.

In the last two decades, HeidelbergCement has made several acquisitions, and, in our opinion, both Hanson (2007) and Italcementi (2016) were two serious mistakes, dilutive, and lacking strategic sense.

However, the new management team led by Dominik von Achten clearly differs from the old school having set the following strategic targets:

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1) Improving margins and profitability,
2) selling non-strategic assets,
3) consolidating the balance sheet,
4) completing the digital transition,
5) accelerating the company's decarbonization; and
6) returning excess cash flow to the shareholders.

This is exactly what we would do. However, the proof of the pudding lies in the execution of these targets. Several of our investment requirements have therefore been met (good business, good management team, clear strategy, and a healthy balance sheet) and are combined with an undervalued share after a long period of mediocre management.

According to our numbers, HeidelbergCement will generate EBITDA of EUR 4 billion in 2021, which, multiplied by the historical industry average multiple of 8x, equals an EV of EUR 32 billion. Adjusted for debt and minority interests, **we find an equity value of more than EUR 21 bn (EUR 105 per share).** Note that in cyclical upturns, the cement sector usually averages 10x EBITDA with an above average EBITDA margin on sales and HeidelbergCement (at 63 euros per share) currently trades at a PER 22 of 7-8x and EV/EBITDA 22 of 5.5x. Very cheap versus historical averages.

As a reference, HeidelbergCement **recently sold some non-strategic assets in California for $ 2.3 billion (solving the high leverage) at an EV/EBITDA of more than 15x**, level where some of the US companies comparable to HeidelbergCement are trading at. We are possibly missing some information or/and other adjustments but 5.5x versus 15x is a massive valuation gap.

Possibly **the biggest issues affecting the sector, at least in Europe, are energy transition and decarbonization**, which will certainly force HeidelbergCement to raise expenses/investments in the coming years. However, in our opinion, the market's reading is not fully correct, given that 1) from an ESG point of view, it is just as important to invest in polluting sectors to cut their emissions as it is to invest directly in "green assets" and 2) as a sector with a local-oligopolistic structure, the capex and extra costs of the transition will be passed on to the end consumer via prices and we thus not foresee a regime change in the sector. 3) HeidelbergCement is one of the ESG/decarbonization leaders within the building materials business.

Finally, our readers should remember that various **national infrastructure plans** will follow the Covid-19 crisis, requiring a great amount of different commodities, including cement and concrete. The European Recovery Fund, the US Infrastructure Plan, China's Development Plan, etc. all form the basis of a new, global capex cycle. This time the cycle will comprise two overlapping cycles: the normal one (the renovation of basic infrastructures) plus the energy transition capex cycle (renewables, nuclear energy, networks, transport, energy storage, etc.).

Nobody asks questions about Pandora anymore. All is well.

We have learned a lot with Pandora. We made several mistakes, of which the two main ones were underestimating the company's internal damage after years of mismanagement and underestimating Pandora's dependence on its commercial success. The latter is however a factor that is always difficult to anticipate.

We nonetheless believe our strategic analysis was correct: the business has strong barriers to entry, mainly scale and costs/logistics, as well as some **switching costs** (once consumers buy a bracelet, they tend to buy more charms), and — to a lesser extent — the **network effect**, which is possibly more commercial, brand, and fashion related than anything else.

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The stock is certainly a counterexample of the “efficient market”, with lows in 2011 close to DKK 30 per share, highs of DKK 1000 five years later in 2016 (x33), back down to DKK 200 in 2020 (-80%) and up to DKK 815 in October 2021 (x4) whilst the group has always been one of the leading luxury brands in the world, one of the few selling more than 100 million pieces per year.

Pandora has been a headache for us for around 3 years. **We jumped in at levels of 600 DKK per share in 2017 and patiently averaged down during 2018 and 2019**. However, since the arrival of the new management team (2019) and the restructuring of the company (2019/2020), Pandora has become a source of good news and positive contribution to the Classic Fund. The stock is now trading above 850 DKK per share, yielding a very good net return to us.

Having experienced the whole process **we are now strongly aligned with Pandora’s new management team.** Consequently, we are still invested in the company, but with a slightly smaller position after realizing some profits, and surprised that no one is asking us about Pandora anymore.

This means that all is well.

The LTIF Natural Resources fund is well positioned for a long upcycle

The LTIF Natural Resources fund is having a very good year with a +32% gain as of September (EUR 115 per share) and +45% by mid-October (EUR 127 p.s.) outperforming most indices both geographically and from a sector view. Furthermore, we are convinced that this just the beginning, as we believe that we are **entering a commodity super cycle,** which is usually of long duration due to the difficulty of developing new supply.

In fact, as we stated, we believe that we are facing the overlapping of two cycles, the normal commodity/capex cycle (following 10 years of underinvestment) and the capex needs stemming from the energy transition.

The energy part of the NR Fund has been the best performer in 2021, +47% to September, followed by mining (+30%) and agri-food/salmon (+20%), taking advantage of the rise in energy prices. The fund kept a **heavy weighting in oil and gas (c.50% of assets)** compared to 30% in mining, which has been “fueled” by uranium, where we keep a large position (10-12%).

The "disappointing" part of the fund has been infrastructure (+1% to Sep.) with HeidelbergCement, Buzzi Unicem, and Mocorp performing surprisingly poorly. We are patiently buying more shares in the two cement companies, while we are coming close to our purchase levels in Mocorp (engineering and mining equipment). The disappointing parts of the funds always lead to short-term concerns, deep disappointment, and hours of extra-work, but usually become (if our strategic analysis is proven correct) excellent long-term investment opportunities.

The LTIF Natural Resources trades at an IRR of 14%. Mid-cycle IV of EUR 162

The NR Fund’s updated IRR is currently 14%, with an intrinsic value of EUR 162 per share at convergence or mid-cycle valuation. However, as previous commodity cycles have shown, the market does not tend to stop at mid-cycle valuations, but goes from one extreme to another, like a pendulum.

At the March 2020 lows when the stock market was anticipating a global economic recession, the fund briefly touched a NAV of EUR 50 p.s. or 70% below our IV. Should we apply this 70% to the positive end, we could go to EUR 275 per share (2.3x the current NAV). We acknowledge that these calculations are not based on any fundamental analysis, but it is also true that this is exactly what we have experienced

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in each of the past cycles: the market applies high (peak) stock market multiples to high (peak) earnings at the peak of the cycle, resulting in valuations well above mid-cycle values.

Furthermore, **we fear that this commodity cycle will be longer than usual because the normal cycle has been joined by the energy transition**, which is having a "perverse" influence on capital allocation. In other words, two cycles are overlapping, namely the normal commodity boom/bust cycle and the one triggered by the energy transition… and not in an efficient manner.

Capital (expenditure) is fleeing from fossil fuels, mining, cement, and CO_2-emitting industries, moving *en masse* toward renewable energies and non-polluting industries despite we still have decades of dependence on fossil fuels and "traditional industries". We call this the "**green paradox**": capital is moving too fast toward green energy when it should continue to invest in fossil fuels and traditional/polluting industries to meet short- and medium-term demand and to reduce their emissions.

The first signs of the green paradox: energy prices are soaring

With colder temperatures on the horizon in the northern hemisphere, the problem of tight supply chains is shifting to the energy sector. At the end of October, **energy shortages are spreading in many geographic areas and becoming a problem for the world economy** by impacting supply, industrial production, and GDP almost globally.

Thermal and metallurgical coal, natural gas, and oil prices are rising sharply, also impacting the price of electricity, and the reason is not demand, Evergrande's financial problems, or other stories moving around, but simply supply/investment shortages combined with several short-term factors.

A looming energy crisis

After last winter's energy tensions (Japan, Texas, and other Asian countries that even experienced blackouts), the symptoms of an **energy crisis are reappearing at a global scale** with large impacts in several economies.

In our opinion, **these events show that the world's energy generation capacity is extremely tight and are a foretaste of what is likely to happen in 2023 and beyond** when the prices of fossil fuels, electricity, and energy will generally be at much higher levels.

Let's take a quick look at the symptoms:

- **Shortage of thermal coal in China, leading to high prices rapidly spreading to the rest of the world** due to the closure of coal mines (emissions) and the flooding of some producing Chinese provinces. In India, stocks are down to only 4 days (!) and in China stocks are barely 2 weeks, well below normal levels. Both, the biggest consuming countries globally, are urging companies to reactivate production and even to import coal.

- **Global (almost) shortage of natural gas** due to low hydraulicity in several LatAm countries, low wind power generation in Europe, political interference in Russia and the North of Africa, depletion of European wells, structural lack of investments etc. LNG cargoes are not reaching Europe due to strong demand from Asian countries. **Prices have boomed.**

- **Europe is facing a difficult winter, since gas inventories are around 70% of capacity compared to the usual 90%.** The lack of LNG and the structural depletion of European wells (exacerbated by an outage at Europe's largest field, Troll, which reduced Norwegian exports by a third) have

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led to Europe facing a Texas-like winter of 2020 scenario. It is easy to blame Gazprom and Russia, but according to our numbers, Gazprom has not reduced exports, fulfilling its contracts instead. Russia warned many times that this would happen, and even *Vladimir Putin went as far as to publicly ask a year ago how the Germans would warm themselves in winter if they shut down their nuclear and coal (lignite) capacity?*

- The **UK is paying high prices for the restart of coal-fired power plants (DRAX)** and countries like **Japan are bringing back oil-fired power plants.**

- **With coal and gas shortages, and high prices for both, China rationed electricity in some intensive industries during the summer, even extending this rationing to households**. Power cuts and price hikes have led to closures of older smelters and metal refineries, which further restricts aluminum, steel, and other products' availability.

- **The crisis is having global repercussions slowing down production or introducing rationing in many countries.** Nyrstar is shutting down its zinc processing plant in the Netherlands; fertilizer companies, such as CF Industries and Agrium, are shutting down production (most fertilizers are made from natural gas), some metal refineries have cut their production, etc. Interestingly, there is also a shortage of CO_2 for use when animals are slaughtered. In summary, many shutdowns are occurring in many countries throughout the globe.

- **High coal and gas prices have led to increased demand for oil, pushing up oil prices**.

- Finally, **electricity prices are also moving up** as fossil fuels are usually the marginal producer, which sets the price.

Why are energy prices soaring?

Energy prices are soaring due to a combination of factors which have created a shortage of fossil fuels, leading to higher electricity prices. Why are they soaring?

i. **Drought** in Brazil, other Latam countries, and in some regions of China caused lower than average hydroelectric production.
ii. **Lack of wind** in southern Europe and the UK (wind power).
iii. **Falling gas production** in Europe due to ageing wells, and a lack of investment (and political decisions).
iv. **Cutbacks in China's coal** mining production to reduce emissions and due to mines flooding after heavy rains (affecting more than 400 mines in just Shanxi province) in a context of a strong energy demand.
v **Falling production of associated gas** in many oil-producing countries after the 2020 oil price slump.
vi. **Slower LNG capacity expansion** after the expansionary 2016-2020 cycle. New projects will only start in 2024/25.
vii. **Rising CO_2 prices in Europe**, together with rising gas prices, have led to higher electricity prices.
viii. Rising maritime **transport costs** and global **supply chain issues**.
ix. Problems caused by **Covid-19 in commodities production**/refining facilities.
x. Strong **growth in demand for energy in China** in 2020 and, especially, in 2021 (+15%) due to industrial recovery, followed by the recovery in the USA.
xi. Energy demand **recovery Europe and Asia** in late 2020 and accelerating in 2021.

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Many other factors have also led to the current situation, but the real issue is **the current shortage of fossil fuels (coal, gas, liquids, and crude)** leading to higher prices. We can only hope that the winter will be mild, and things will calm down, but Murphy's Law tends to kick in at times like these.

As we stated, marginal power generation, which is often gas, coal, and even oil, sets the price of electricity in many countries, with the result that electricity prices are skyrocketing in Europe, China, parts of Asia, and, to a lesser extent, the USA. This is extremely relevant due to the impact of electricity on many (if not all) economic sectors, including households.

We derive three quick conclusions from the current situation:

1) Reserve margins in energy and some commodities are at their limit, starting with China,
2) Covid-19 has continued to have negative impacts on the supply side; and
3) capital expenditure is needed as the world faces two capex cycles: the traditional one to renew/modernize infrastructures and traditional industries and a new one related to the energy transition.

It's the structural issues that are worrying

Our view is that the current *mini-crisis* is only a wake-up call and that it will normalize in the coming months, but there are several structural issues that could turn this mini-crisis into a much more serious one.

i. We have had **low capital expenditures in oil and gas** for nearly a decade now.
ii. Mining companies are **not investing in coal mines**, which are being sold/shut.
iii. **Coal-fired power generation is being reduced** in Europe and mainly in the US but is also being "controlled" in China and many other countries.
iv. **Nuclear power generation and investment in new capacity has been in the doldrums** since Fukushima (2011).
v. There is a global effort to reduce emissions and, therefore, to develop **renewable or non-polluting energies (mainly wind and solar) but these are intermittent.**
vi. **Capital is shifting too fast from fossil fuels and nuclear to renewables**, including hydrogen (which will have no material effect for at least 10 years), although there is no energy storage technology to offset their intermittency.
vii. It takes a **long time and huge amounts of investment to transform a country's electricity generation mix**, especially in emerging countries where resources are limited.

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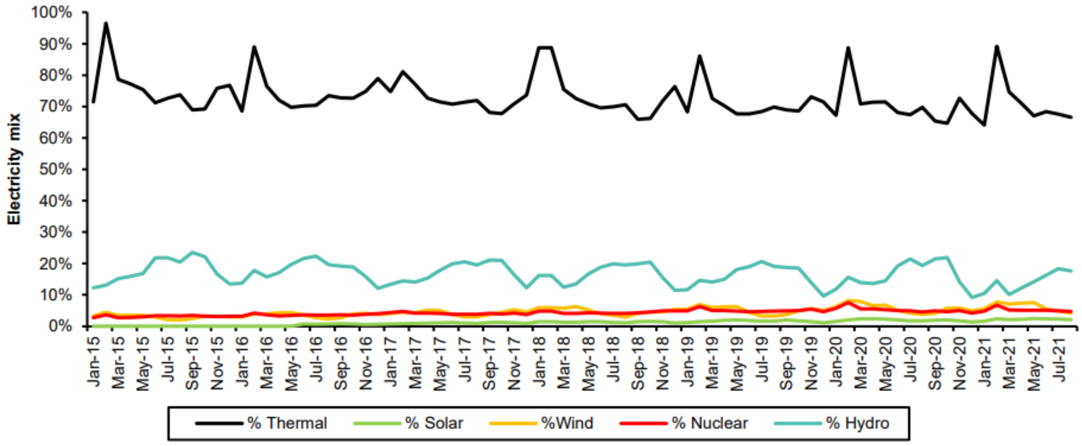
China's generation mix. Energy transition takes time



Source: Bernstein

viii. **Wind and solar energy need back-up** until a new energy storage technology (batteries?) is developed. We also need to get the numbers right, including emissions from the whole value chain (copper in turbines or concrete in foundations).

ix. **Electric cars are not going to have a significant impact on oil demand in this decade**, until the installed base starts to change.

In short, **the world is investing in a much more sustainable system (good) but abandoning the current system too fast (bad)**. The current system needs to endure for at least another few decades as the transition is extremely complex and difficult to execute.

As we have discussed, we call this the **green paradox**, or the effect of a too rapid capital shift toward "green labels". The problem lies in the **timing (too fast),** in the **scale of the shift (huge and underestimated),** and in the **stereotypes/inefficiencies (what is “green”?),** not in the fundamentals.

The exit and/or conversion from fossil fuels must be well planned and the role that emerging countries are expected to play should consider that many of them have not even completed their industrial revolution.

Given the lack of investment in fossil fuels (ongoing for approximately a decade) and the current reluctance to reactivate such investments, we believe that oil, gas, and coal prices will trade at very high prices, well above incentive levels, which will enable greater investments, while simultaneously having a disincentive effect on demand due to the price elasticity.

These high prices are not at odds with the energy transition; on the contrary, they should accelerate it. Maybe energy has been simply too cheap (flying, driving, heating for a few pennies) and this has to change to make its use way more efficient and cleaner.

Capital is leaving fossil fuels

The impending energy transition from fossil fuels throughout the globe means that **capital is rapidly leaving the sector**. The oil companies’ investment cuts are enormous. For instance, Exxon will invest 16 billion dollars in 2021 compared to 31 billion in 2019 and Chevron has reduced capex to 13 billion in 2021 from 40 billion in 2014. Global upstream capex was massively cut in 2020, down more than 30%, and is now running at around 50% of the 2006-2011 average levels. This is unsustainable.

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The oil majors are structurally changing their businesses, raising the weight of renewable energies, maintaining capital returns and shareholder remuneration, and lowering the weight of their traditional business: oil and gas, especially the former. This is a real and deep regime change with huge implications.

One of these implications is value destruction as companies such as **Royal Dutch** (which we do not have in the fund) continue to liquidate their assets. They **recently sold their Permian shale oil business** to Conoco Phillips (which we do have) for $9.5 billion, with a valuation of 4x EV/EBITDA at $60 oil when the spot WTI price is above $80.

The craze has also reached the mining industry

Within the energy transition framework **many corporates are destroying value in the pursuit of a "green label"** (or to reduce/compensate for emissions), without properly analysing their profitability or the real demand needs.

Cerrejón in Colombia is one of the best coal mines in the world, legally constituted as a 33% JV between Anglo, BHP, and Glencore. BHP and Anglo's coal divestment strategy led both to sell their shares to Glencore. According to our calculations, the sale price was extremely low, below 2x EBITDA at incentive prices (not spot). We understand that selling coal assets at knock-down prices is not a strategy that generates long-term value, which is why we are not invested in either BHP or Anglo but are invested in Glencore.

There are also surprising moves, such as **China starting to sell metals from its strategic inventories, or the US wanting to release its oil reserves**. These are decisions that have historically not had much effect on prices. In fact, if we were advisors to both governments, we would recommend that they expand their reserves to face what is coming within 2-3 years. In the end, "strategic inventories", whether copper, nickel, oil or whatever commodity, only represent a few weeks of consumption. In our view, these moves are useless and short-sighted.

We continue to avoid companies that destroy shareholder value (majors selling oil assets and moving into renewable energy; miners selling coal assets; mergers and acquisitions to enlarge the "green label", etc.) and prefer to maintain exposure to companies such as Glencore (the world's largest coal exporter), Gazprom (the world's largest gas exporter), Surgutneftegas, ConocoPhillips, Harbour Energy, and many others.

Some moves go unnoticed but have great importance

Certain news items might seem marginal, but are of relevant strategic importance, such as **BHP Billiton approaching R. Friedland regarding the areas adjacent to the Kamoa-Kakula copper mine in the Democratic Republic of Congo** (*source: Financial Times*), a world-class asset (6% grade!) that has just started commercial production.

Kamoa-Kakula will become the second largest copper mine in the world, after Escondida, within a few years. **According to Friedland, the adjacent areas not only contain new copper deposits, but comprise a new copper province**. The LTIF Natural Resources fund has had a significant position in Ivanhoe (owner of Kamoa and the land) for quite some time.

This news is also important for two strategic reasons: 1) It confirms copper's importance for the big mining companies, showing that there will be a shortage of copper in the medium term. 2) There has been a

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strategic change in respect of a company like BHP moving closer to the DRC, a country that it had previously avoided entering due to the risk criteria.

Most of the natural resources are in developing geographic areas, which kindles a strong clash between energy transition and ESG standards. If we were to apply the ESG criteria fully, nobody would be allowed to invest in copper in the Congo – once again leading to another angle of the **green paradox** for which there is no solution in the short to medium term.

Two news items on uranium and nuclear power generation are also very interesting. A few days ago, Boris Johnson commented that the UK needs more nuclear capacity to advance its energy transition (we are making progress with what is a truism on a global scale), while the Polish copper and silver mining giant KGHM ordered four small modular reactors for its power production (KGHM is Poland's second largest energy consumer after the railways). Further, a team of 10 European countries led by France is lobbying the European Commission to take a fresh look at nuclear generation as a driver of decarbonization.

This news reinforces our view that nuclear power is not only key, but necessary for decarbonisation. This is also why we maintain a 10-12% fund in uranium, even after the uranium and companies' strong performance in recent weeks.

The LTIF Natural Resources fund has a strong exposure to energy

The NR Fund is benefiting from the weight of energy/oil/gas (the biggest exposure by far) as large earnings upgrades are driving stock prices up. However, and despite these moves, the sector remains very cheap, trading well below historical averages (around 4x EV/EBITDA, well below the 6x EV/EBITDA historical mean).

Companies like **Surgutneftegas (preferred) paid an 18% dividend yield** a few months ago, even before the sharp rebound in oil and gas prices, and **Gazprom announced that the dividend yield will reach 25% of the market capitalisation in the next 2 years** (half of the company's value back to shareholders in 2 years, mostly through the excess of free cash flow).

It is very surprising (in our experience, this inefficiency eventually corrects itself) that with Brent at $85, the sector is still trading as if oil were at $55-60 levels.

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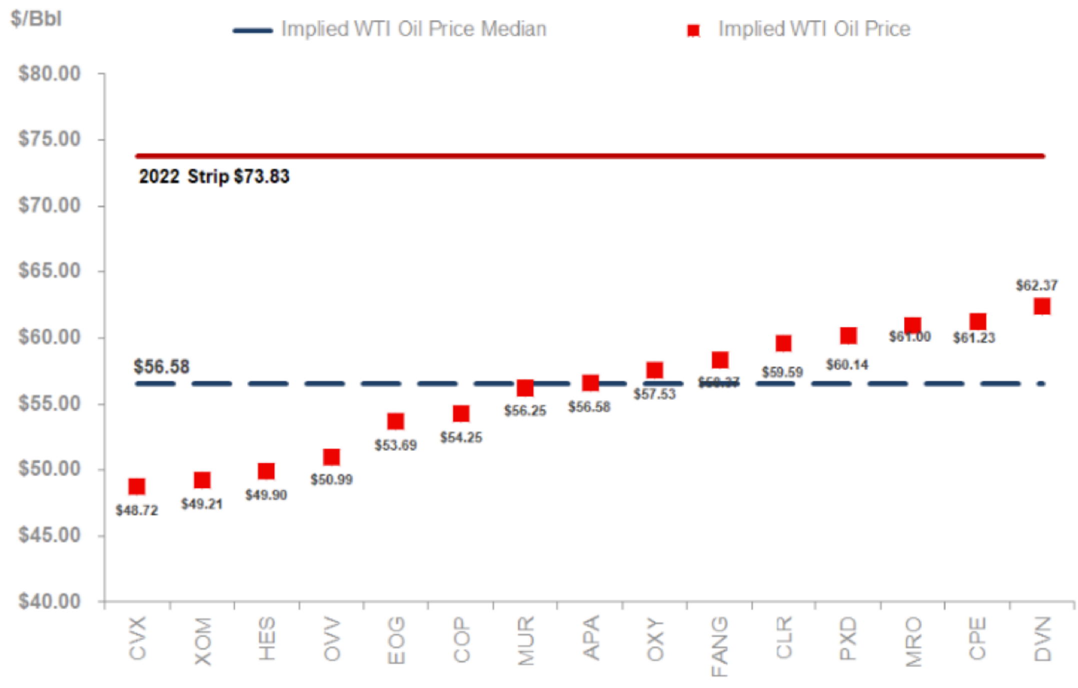
Exhibit 26: The E&P sector now reflects a median WTI price of ~$57/bbl, or ~23% below 2022 futures prices.



Source: Bloomberg, Morgan Stanley Research; Note: As of 10/5/21

We believe that after a decade of underinvestment in oil and with demand rising, there will be a deficit that will push the prices above $100 in 2022/23 when the excess of OPEC+ inventories normalize. Again, the **"green paradox"** comes into play. **How do you invest in oil when you can't invest in oil?**

JPM gives us the answer to the question of when OPEC+ inventories will normalize: in summer 2022. Fill up your tanks before then and, if you buy a Tesla, please check the generation mix you use to charge it.

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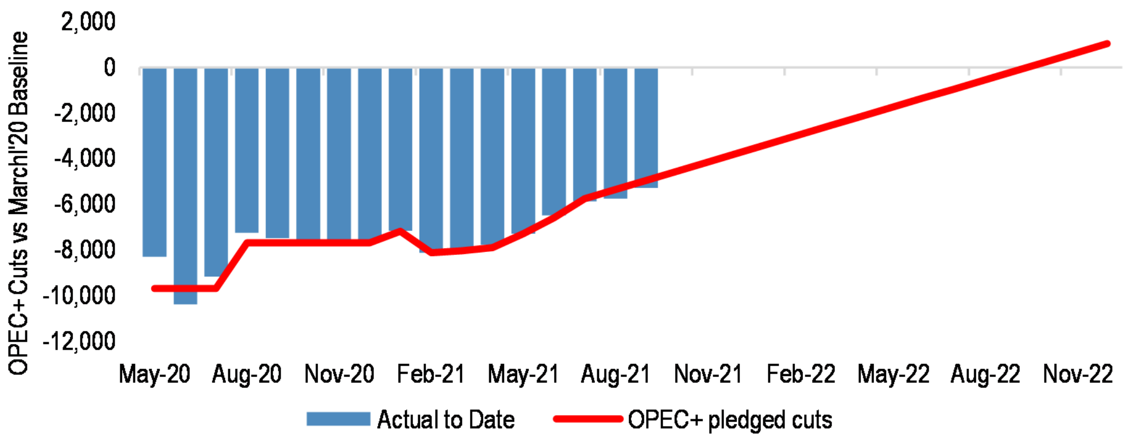
OPEC+ spare capacity. Pledged cuts. Excess OPEC+ inventories will disappear by mid-2022.



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October 2021

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