S I A
Strategic Investment Advisors Group

Long Term Investment Fund

Long-term investors do not make money when the market goes up, nor do they lose it when it goes down. In fact, the amazing truth is that the opposite is true.

For long-term investors, the price level of the market at a given moment is only important if it is at an extreme - either extraordinarily cheap, or extremely expensive. By definition, those occasions are rare.

Prof. Dr. J. Carlos Jarillo

Newsletter

of March 2015

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Overview of our funds

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

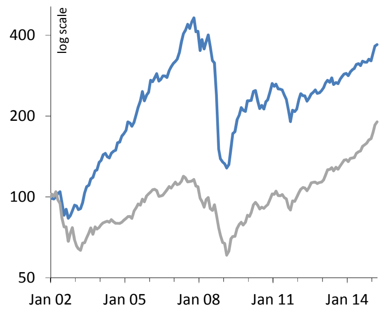

Figure 2: **LTIF Alpha EUR**
vs. HFRX Global Hedge Fund Index EUR

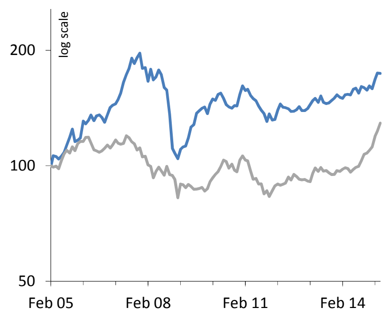

Figure 3: **LTIF Natural Resources EUR**
vs. S&P Global Nat. Res. Net TR Index EUR

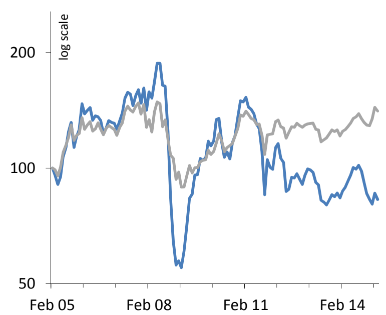

Table 1 and charts 1 through 6 show the evolution of our funds' Net Asset Value during the first quarter. Again, it is a remarkable evolution, indicating that investors are increasingly interested in buying equities.

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

March 2015	NAV	Δ 3m	Δ YTD	Annualized Return since Inception	AUM (in mio) **combined Pool*
LTIF Classic [EUR]	369.18	14.9%	14.9%	10.4%	197*
LTIF Alpha [EUR]	173.98	9.5%	9.5%	5.6%	197*
LTIF Stability A Cap [EUR]	188.19	7.1%	7.1%	*8.8%*	1
LTIF Natural Resources [EUR]	82.83	-0.1%	-0.1%	-1.9%	9
LTIF Stability Growth [CHF] *(Total return, dividends included)*	210.50	-1.9%	-1.9%	4.2%	21
LTIF Stability Income Plus [CHF] *(Total return, dividends included)*	187.00	-1.9%	-1.9%	6.0%	21

Source: SIA Group

It is very important, after a period of strong rises in share prices, to reflect on the first point made above: believe it or not, if you are invested in our Classic fund, you have not "made" 14.9% in the first quarter. In fact, you've made about 2%. How so?

Long-term investors are not in the game of buying and selling stocks for (hopefully) an immediate net gain. They are in the game of owning good companies, and profiting from their business success. If you take the weighted average of the companies we owned during the first quarter of 2015, their profits (real, "more money in the bank" kind of profits), were about €2 per share of the fund per month, which is what our portfolio does almost every month with very small deviations (and gentle long-term growth). So the fortune you own, as measured in real assets (factories, patents, distribution networks, money in the bank), is up by some €6 during this first quarter per share of the Fund. Taking into account that the market value of your shares in the Classic fund was, at the beginning of the year, €321 (you could have sold them at that price, or bought more), the real increase in your net worth is some 2%: You own the same assets you owned at the beginning of the year (factories, inventories, brands…) and have €6 more in the bank.

The changes you see in Table 1 don't refer to your fortune, but to how much some people were willing to pay at the end of March for your fortune compared to how much they had been willing to pay at the end of 2014. As long as you're not selling, this is irrelevant. It just indicates that people are more interested in stocks than they were before. This is not a reason for you to buy or sell stocks.

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Figure 4: **LTIF Stability A Cap EUR**
vs. HFRX Global Hedge Fund Index EUR

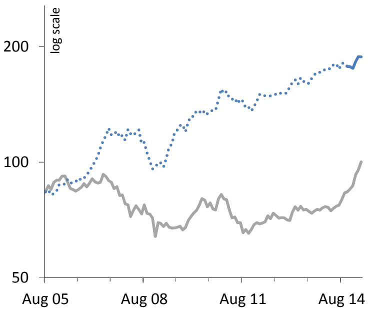


Figure 5: **LTIF Stability Growth TR CHF**
vs. HFRX Global Hedge Fund Index CHF

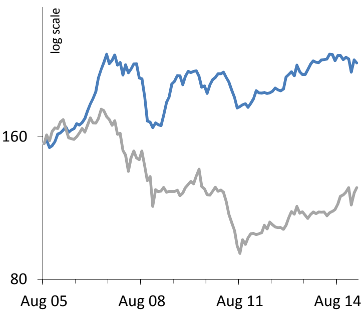
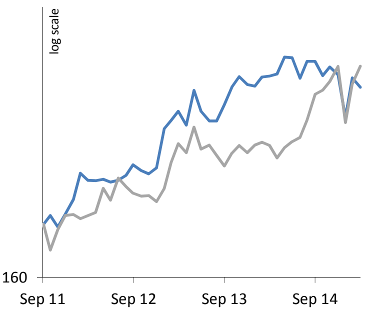


Figure 6: **LTIF Stability Income Plus TR CHF**
vs. HFRX Global Hedge Fund Index CHF



It's also irrelevant, by the way, when the numbers in Table 1 are all red: Just because people are willing to pay less for your assets now compared to three months ago does not change the fact that your real assets (money in the bank) will be up by about €2 per share per month. In the next Newsletter, we will show why these market ups and downs are, in a way, more than irrelevant: They are essential for long-term profitability, and we'll show that it is when the market goes down that long-term investors make much of their money.

Let's concentrate in this Newsletter on the second point expressed above: For a long-term investor, the current price of a share does not really matter all that much, except if it has an extreme valuation. We'll see that with an example.

A Nestlé share is now trading at about 73 Swiss francs. That's the price at which you can sell yours (if you have any), or buy them. What will the profitability of that investment be if you buy these shares now and sell them in one year's time?

Nestlé will most certainly pay you dividends of 2.2 Swiss Francs on April 20: The board has formally declared this. In principle, it will not pay more dividends until in a year's time. Consequently, your profitability for the one-year investment will be:

Gain = Selling Price – 73 + 2.2

Of course, we don't know how much that will be, because we don't know at what price you'll be able to sell. But we do know some things.

We have a clear view of Nestlé's business, its ongoing profitability, and what its profits should be in a year's time. We could, then, re-write the previous "formula" as follows:

Gain = Profits in 2016 * PE at time of sale – 73 + 2.2

"Profits * PE" being, obviously, the same as "Selling Price".

As mentioned, Nestlé has the convenient characteristic of earning very regular profits, so we can have some confidence that our estimate for the next year, 3.5 Swiss Francs per share, won't be too far from reality. So we "only" need to know at what PE Nestlé will be trading in 12 months' time to know the profitability we'll obtain if we buy now and sell in a year's time.

That is, is course, totally impossible. But we can take a look at the range of those PE's in the past to at least give us an indication. Over the last 10 years, the average has been 19, the minimum 14, and the maximum 24.

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Solving the above formula with these assumptions would tell us that our profitability will probably be between – 30% and + 18%. And we say "probably," because nothing prevents the PE from being below 14 or above 24 (or the per share profits not being 3.5 SFr).

Conclusion? Investing in Nestlé shares with a one-year horizon is a fairly stupid thing to do: Regardless of what 2016 PE you consider "reasonable," the empirical volatility of markets means that it can be anywhere, seriously endangering your investment. A small change in the PE more than makes up for all the dividends that the company could pay. It's sobering to realize that Nestlé may have an annual dividend yield of 3%, but shares go up and down by more than that in many weeks. For a one-year investor, market gyrations are far, far more important than the company fundamentals. Your profitability will basically depend on the mood of the market at the time of sale, not on the company's performance. Not something very solid on which to build your financial future.

Moreover, it's a structural characteristic of investing in good shares that the potential loss in one year tends to be bigger than the potential gain: An episode like 2008 can happen (it did happen, reducing Nestlé's PE by almost 40%); on the other hand, it's basically impossible to imagine an episode where that PE suddenly goes up by 40%, except if it's rebounding from the previous drop.

In spite of all this, we keep telling our investors that stocks are a very low-risk form of investment. Let's see how the passage of time decreases the volatility of returns.

Nestlé, as we have already said, is a regular profit grower. Over the last 10 years, it has grown at a compound rate of more than 8%. To estimate how much money we'll make if we keep the share for 10 years, we have to estimate the profits that the company will make in 2025, to which the then-current PE will be applied; and we have to add all the dividends we'll have received. To be conservative, let's assume a growth rate of just 6%, both in profits and dividends (dividends have grown more than 10% per year in the last 10 years, which is certainly too high for the future).

Table 2: **These would be the profits and the dividends, if they grew at 6% annually over the next 10 years**

Year	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Profits	3.5	3.71	3.93	4.17	4.42	4.68	4.96	5.26	5.58	5.91
Dividends	2.3	2.44	2.58	2.74	2.9	3.08	3.26	3.46	3.67	3.89
Cummulative dividend	2.3	4.74	7.32	10.06	12.97	16.04	19.31	22.76	26.43	30.32

Source: SIA Group / Bloomberg

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Now, what will our profitability be if we buy Nestlé now and sell it in 10 years' time? As we said, it will depend on the PE that the market gives it then. If it is the average PE (19 times), the share will be worth 112.3 SFR (assuming 2025 profits of 5.91, as shown on Table 2), we will have received 30.32 in dividends, and the compound annualized profitability will have been 7%. But what if the market is only paying a PE of, say 15? The annualized profitability would then be 5%. Of course, the market could pay 24 times, and then our profitability would be slightly above 9%. These profitabilities are, of course, annualized, and are calculated conservatively: The "exact" numbers would be somewhat higher.

Interestingly, the PE at which we sell becomes less important as time goes by, for the growth in profits and dividends is exponential over time, and eclipses the changes in the PE's importance, as shown below.

But, for the most part, one is not forced to sell stocks on a given day. We can simply allow them to compound, enjoying the dividends. If, one day, the price at which they sell (the PE) sounds extremely high, we can certainly sell some; conversely, we could try to buy more if the price drops to an extreme low. To repeat, the final return we'll get from investing in a given stock is made up of three components: the initial profit/dividend, the growth in that profit/dividend, and the difference in valuation (PE) between the time we buy and the time we sell. As time goes by, profits and dividends grow exponentially (if the stock is well chosen, of course), so the difference in PE becomes less important, as shown in Table 3.

Table 3: **What happens to Nestlé's share if we buy at a PE of 20 (today) and sell at a PE of 15 (crash situation), over time**

Selling after years	1	2	3	4	5	6	7	8	9	10
Annualized %	-24.9%	-9.0%	-3.2%	-0.1%	1.7%	2.8%	3.6%	4.2%	4.7%	5.0%

Source: SIA Group

If we were to wait 20 years, and then be forced to sell due to a big crash, our annualized profitability would have been 6.2%.

But we could be lucky enough to live through a crash like that of 2008 again, and then be able to buy the shares at a PE of 15. Now assume that we sell them at a PE of 19 (the historical average), after a number of years. The following would be the annualized returns:

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Table 4: **What happens to Nestlé's share if we buy at a very low PE of 15 (2008) and sell at a normal PE, over time**

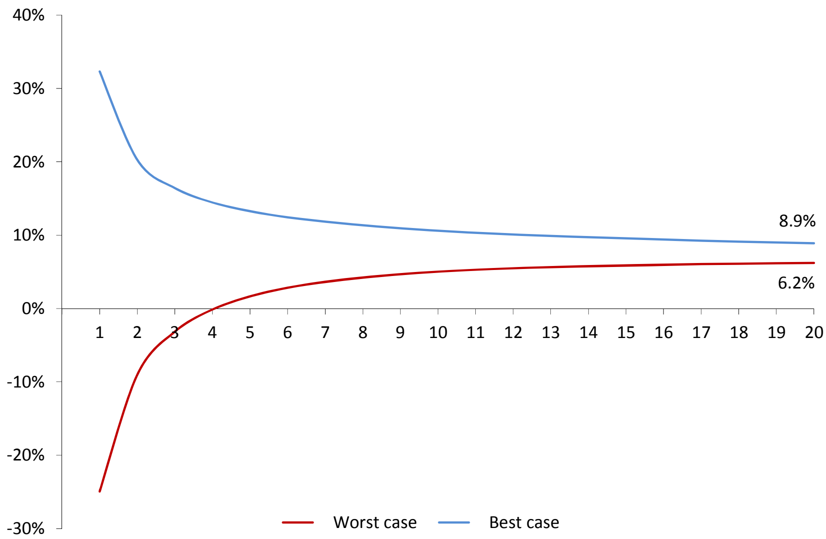
Selling after years	1	2	3	4	5	6	7	8	9	10
Annualized %	32.3%	20.3%	16.4%	14.5%	13.3%	12.4%	11.8%	11.3%	10.9%	10.6%

Source: SIA Group

After 20 years, the annualized return would be 8.9%. In other words, after 20 years, the fact that we sell at the worst possible time, or that we had bought at the best possible time, has a small impact.

Figure 7 shows this graphically. The upper line shows the profitability, as the years go by, of buying at the bottom and selling at the top: the best possible outcome. The lower line shows the opposite case. Of course, it's much better to buy low and sell high. But, over the long term, what really matters is the growth in earnings and dividends. Over one year, almost anything can happen, as we saw before. After 20 years, returns will be determined almost exclusively by the quality of the underlying profits.

Figure 7: **Annualized returns of buying and selling at the best and worst possible times for a company with Nestlé's expected profitability, after a number of years**



Source: SIA Group

But let's highlight something important to answer the question in everybody's minds today: "Is the market now too expensive?" According to our estimations, buying a Nestlé share today and selling it in ten years' time, in the depth of a crisis as bad as that of 2008, would give us an annualized return of 5%. Nestlé's 10-year bonds are now yielding less than 1%.

All the preceding analysis is only pertinent if the underlying stock does obtain the expected profits. If one cannot have a reasonable idea of

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where the profits will be in 10 years' time, the truth is that one is then not investing: One is speculating. Imagine somebody buying a building for rent and being told that, as far as anybody knows, it's impossible to get a reasonable idea of what the rents might be in 10 years' time. Making money then becomes a question of luck.

In the absence of a reasonable view of long-term profits, only the hope of selling for a higher price than the shares were bought at is important. But that, as we mentioned, is a fairly random exercise over the short term.

And this goes to the core of our understanding of risk: Risk is not the possibility that the market may drop (that's a certainty, sooner or later). Risk is the size of the error we can expect in our long-term profit forecasts. For us, Nestlé is not very risky, because we have very solid reasons to believe that its real numbers won't be too far from our assumptions. However, we cannot say the same of, for instance, Facebook.

At the end of this Newsletter, we'll come back to how riskiness affects profitability and how the profitability of our portfolio compares at this moment to other investment options. In the coming Newsletter we'll show - in detail - how big market drops are good for long-term investors.

Comments on our portfolios

This year's first quarter has seen more trading than usual, basically because some stocks have really gone up and we have found better value for money elsewhere. Thus, when Nokian stock, which we had bought a few months back, went up 37%, we sold it. It's still an excellent company, and worth perhaps a third more than its current price if all the Russian problems were somehow to disappear. But the risks are now too high compared to the potential rewards. We also sold RHI, up 42% in the quarter. It's still not too expensive, but again we felt that the future returns did not look too enticing, risk adjusted.

We also sold two banks, for very different reasons: Halkbank, of Turkey, was up at some point by 20%, and we therefore sold. Turkish banks are not expensive, prima facie, but, importantly, inflation inflates the nominal returns and one cannot ignore the increasing political risk in the region, and in the country itself.

The other bank we sold is HSBC, for very different reasons. HSBC is a very large bank (one of the world's largest), operating in many different countries, with a colonial origin (its initials mean Hong-Kong and Shanghai Bank Corporation). We bought it about three years ago, because it was cheap (like most banks). We thought it did not have some of the dubious assets found in many banks, and the management articulated a clear path to improve returns. Its dividends have been around 5%, something very few banks can boast of.

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But the bank has disappointed again and again with "one-offs": Restructurings in some countries, huge fines in other countries, and an overall impression of a lack of central control over the "colonies." Several of the bank's subsidiaries have been in the headlines for breaking the law — from drug money laundering to tax evasion. We are still convinced that the bank's assets are worth much more than the current share price, but we prefer to be out, and may come back when we see evidence of strategic clarity. Over the years, the share price has not moved, but we have at least earned the 5% annual dividend.

On the purchasing side, we have included Cummins, the biggest US truck engine manufacturer, which we owned in the past but sold at a high price; Sodexo, a French multinational company specializing in the outsourcing of enterprise restaurants; and two banks: Sumitomo of Japan and ING of the Netherlands. Both are similar stories in that they have restructured, are inexpensive, and pursue simple and, we believe, profitable strategies. We have also gradually increased our exposure to copper mining companies, Lundin and First Quantum, which also mine nickel and, interestingly, zinc, one of the rare commodities which is scarce now, and which is likely to increase in scarcity in the next few years. We have also increased our position in California Resources, a US-based oil producer, which we perceive as being very low risk, and having high profit potential.

Expectations

As we mentioned at the end of our previous Newsletter, it's important for investors to have sensible expectations. Nothing "goes up" by 15% per quarter for a long time. The previous discussion on returns' sensibility to current prices is illustrative: As long as a given share is not extremely cheap or expensive, its return over the long-term will be the same, and will depend on its profits, not on what "the market does". You can see in the examples above how the profitability of owning a Nestlé share" normalizes" over time under different assumptions and gets close to 8-9% after 20 years, which is what we believe is it's "Expected Return", regardless of what the market (PE) does, provided the underlying profits develop as expected.

Our Expected Return for the Classic fund's total portfolio is now 11.5% per year. Compare this to other investment opportunities, especially bonds. Stocks are like very long-term bonds, and those are not very attractive right now: Switzerland just launched a 10-year bond at -.5% per year. Ireland is selling a 30-year bond for less than 2%. Mexico has issued a 100-year bond at 4%. In contrast, we expect about 8-9% for Nestlé (and similar companies), 11.5% for the overall portfolio (Nestlé is more expensive than the portfolio average, because its risk level is lower, in our opinion). Even if we are off by a few points, it's hard to deny the attractiveness of our investments. They will certainly go up and down, but will contribute about €2 per share per month to our investors… and grow every

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year. This is the really important performance, not whatever prices the market is willing to pay for that stream of cash at any given time.

This shows that our value added at Strategic Investment Advisors is not to “guess” what the market is going to do, but to correctly estimate future profits for the very long term, which requires a deep understanding of the business from which those profits must come. In the next Newsletter, we’ll show why market drops are an essential component of good long-term results.

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Figures of the USD classes

Table 5: **Net Asset Value - Net assets under management in USD**

March 2015	NAV	Δ 3m	Δ YTD	Annualized Return since Inception	AUM (in mio) **combined Pool*
LTIF Classic [USD]	396.50	2.0%	2.0%	11.9%	212*
LTIF Alpha [USD]	186.85	-2.8%	-2.8%	3.6%	212*
LTIF Natural Resources [USD]	88.96	-11.3%	-11.3%	-3.9%	10

Figure 8: **LTIF Classic USD**
vs. MSCI Daily TR Net World Index USD

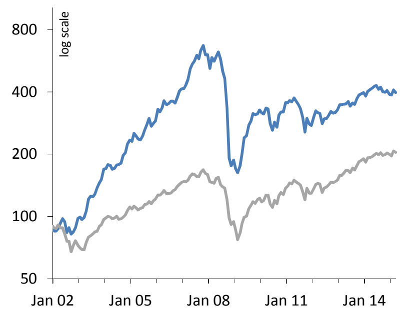


Figure 9: **LTIF Alpha USD**
vs. HFRX Global Hedge Fund Index USD

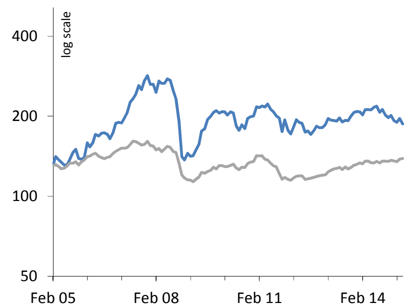
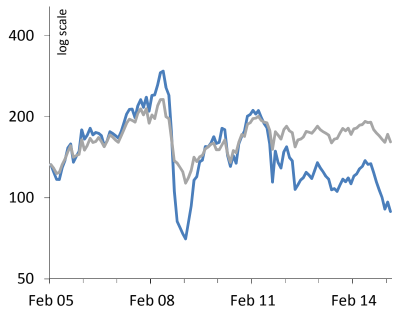


Figure 10: **LTIF Natural Resources USD**
vs. S&P Global Nat. Res. Net TR Index USD



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Figures of the CHF classes

Table 6: **Net Asset Value - Net assets under management in CHF**

March 2015	NAV	Δ 3m	Δ YTD	Annualized Return since Inception	AUM (in mio) **combined Pool*
LTIF Classic [CHF]	385.12	-0.3%	-0.3%	7.5%	206*
LTIF Alpha [CHF]	181.49	-5.0%	-5.0%	1.6%	206*
LTIF Natural Resources [CHF]	86.41	-13.3%	-13.3%	-5.6%	10
LTIF Stability Growth [CHF] *(Total return, dividends included)*	210.50	-1.9%	-1.9%	4.2%	21
LTIF Stability Income Plus [CHF] *(Total return, dividends included)*	187.00	-1.9%	-1.9%	6.0%	21

Figure 11: **LTIF Classic CHF**
vs. MSCI Daily TR Net World Index CHF

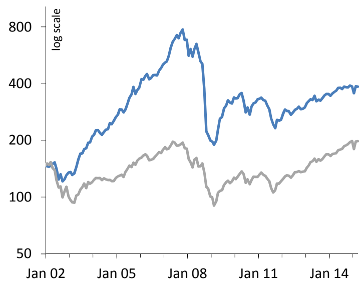


Figure 12: **LTIF Alpha CHF**
vs. HFRX Global Hedge Fund Index CHF

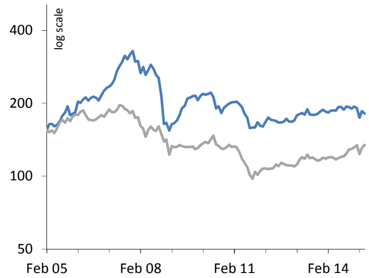


Figure 13: **LTIF Natural Resources CHF**
vs. S&P Global Nat. Res. Net TR Index CHF

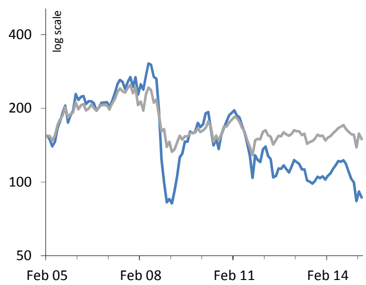


Figure 14: **LTIF Stability Income Plus TR CHF**
vs. HFRX Global Hedge Fund Index CHF

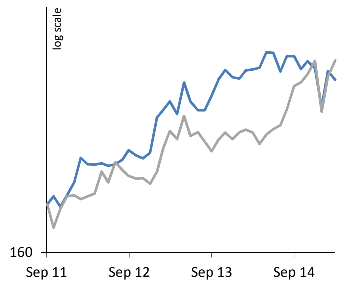
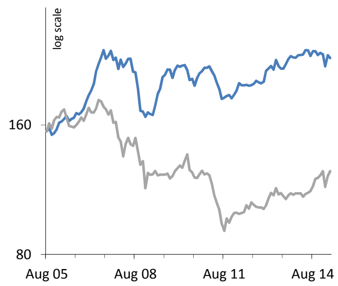


Figure 15: **LTIF Stability Growth TR CHF**
vs. HFRX Global Hedge Fund Index CHF



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Figures of the GBP classes

Table 7: **Net Asset Value - Net assets under management in GBP**

March 2015	NAV	Δ 3m	Δ YTD	Annualized Return since Inception	AUM (in mio) **combined Pool*
LTIF Classic [GBP]	267.09	7.2%	7.2%	11.6%	143*
LTIF Natural Resources [GBP]	59.93	-6.9%	-6.9%	-1.4%	7

Figure 16: **LTIF Classic GBP**
vs. MSCI Daily TR Net World Index GBP

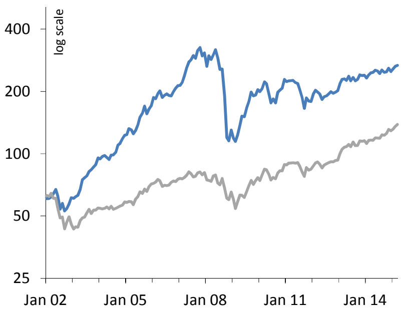
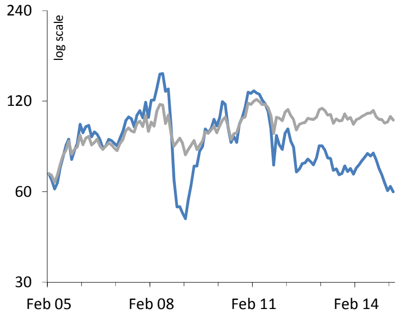


Figure 17: **LTIF Natural Resources GBP**
vs. S&P Global Nat. Res. Net TR Index GBP



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Bloomberg: LTIFCLA LX

LTIF – Classic USD
ISIN: LU0301247077
Telekurs: 3'101'820
Bloomberg: LTIFCLU LX

LTIF – Classic CHF
ISIN: LU0301246772
Telekurs: 3'101'817
Bloomberg: LTIFCLC LX

LTIF – Classic GBP
ISIN: LU0750886714
Telekurs: 18'032'305
Bloomberg: LTIFCLS LX

LTIF – Alpha EUR
ISIN: LU0244072178
Telekurs: 2'432'573
Bloomberg: LTIFALP LX

LTIF – Alpha USD
ISIN: LU0301247150
Telekurs: 3'101'828
Bloomberg: LTIFALU LX

LTIF – Alpha CHF
ISIN: LU0301246855
Telekurs: 3'101'824
Bloomberg: LTIFALC LX

LTIF – Natural Resources EUR
ISIN: LU0244072335
Telekurs: 2'432'575
Bloomberg: LTIFGEV LX

LTIF – Natural Resources USD
ISIN: LU0301247234
Telekurs: 3'101'839
Bloomberg: LTIFGEU LX

LTIF – Natural Resources CHF
ISIN: LU0301246939
Telekurs: 3'101'836
Bloomberg: LTIFGEC LX

LTIF – Natural Resources GBP
ISIN: LU0457696077
Telekurs: 10'638'983
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ISIN: CH0026389202
Telekurs: 2’638’920
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LTIF – Stability Income Plus
ISIN: CH0135996012
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