SIA
Strategic Investment Advisors Group

Long Term Investment Fund

Newsletter

of December 2014

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Overview of our funds

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

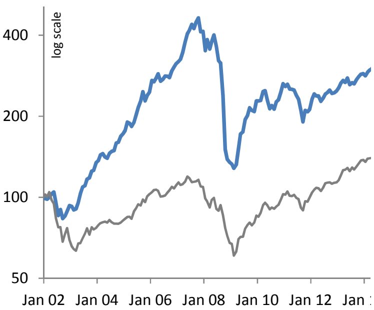


Figure 2: **LTIF Alpha EUR**
vs. HFRX Global Hedge Fund Index EUR

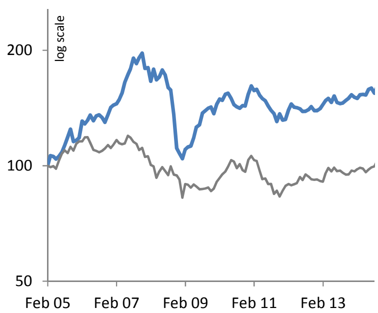
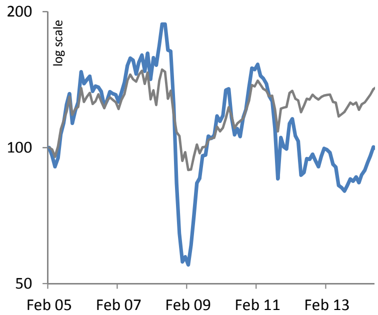


Figure 3: **LTIF Natural Resources EUR**
vs. S&P Global Nat. Res. Net TR Index EUR



Figures 1 through 5 and table 1 show the Net Asset Values of our different funds:

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

December 2014	NAV	Δ 3m	Δ YTD	Annualized Return since Inception	AUM (in mio) **combined Pool*
LTIF Classic [EUR]	321.19	1.3%	11.6%	9.4%	178*
LTIF Alpha [EUR]	158.87	-0.6%	5.4%	4.8%	178*
LTIF Natural Resources [EUR]	82.91	-15.6%	-3.6%	-1.9%	10
LTIF Stability Growth [CHF] *(Total return, dividends included)*	214.60	-1.9%	1.4%	4.5%	22
LTIF Stability Income Plus [CHF] *(Total return, dividends included)*	190.60	-2.0%	1.5%	7.1%	22

Source: SIA Group

The share prices are again broadly up during the previous quarter and the year, as are most of the indices. The change that the prices of the Natural Resources fund have undergone, is rather remarkable: These prices went from being up +20.2% for the year to finishing at just -1.9%. This is, of course, due to the sharp drop in the oil price, which we discuss below.

As we always insist, the evolution of the share prices we own (their "performance") is not really a useful indicator of how our funds are doing. The health and profitability of the companies we own truly matter. Over the long term, these are the only determinant of the share prices, as we'll analyze in great detail below.

2014 was a good year for our companies. The tables 2, 3, and 4, with charts 6, 7, and 8, show the evolution of the earnings per share, of the dividends, and the book value.

Table 2: **LTIF Classic - Profitability for 2012, 2013, 2014e and 2015e**

Year	EPS	Growth	PE	Prof.%	MSCI World PE	MSCI World Prof. %
2012	18.7		13.3	7.5%		
2013	19.3	3.2%	14.9	6.7%		
2014e	24.9	28.7%	12.9	7.7%	17.3	5.8%
2015e	28.5	14.7%	11.3	8.9%	15.8	6.3%

Source: SIA Group / Bloomberg

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Figure 4: **LTIF Stability Growth TR CHF vs. HFRX Global Hedge Fund Index CHF**

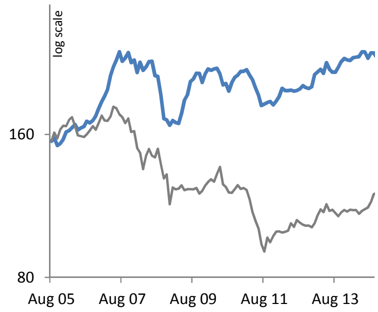


Figure 5: **LTIF Stability Income Plus TR CHF vs. HFRX Global Hedge Fund Index CHF**

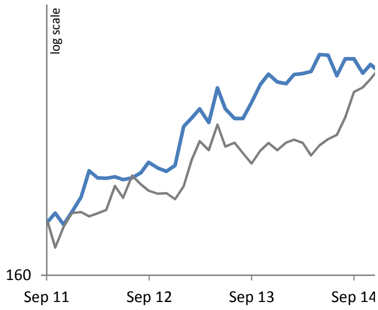
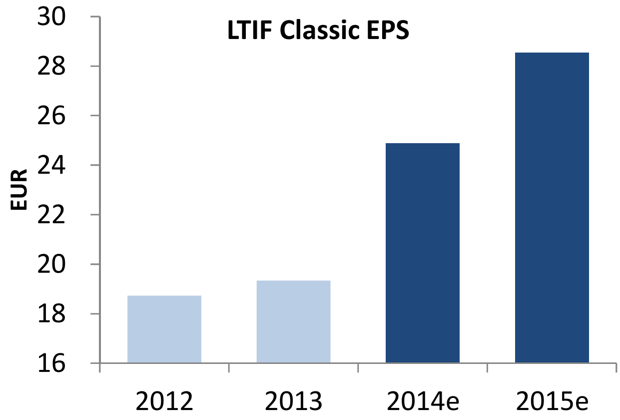


Figure 6: **Earnings per share for 2012, 2013, 2014e and 2015e**



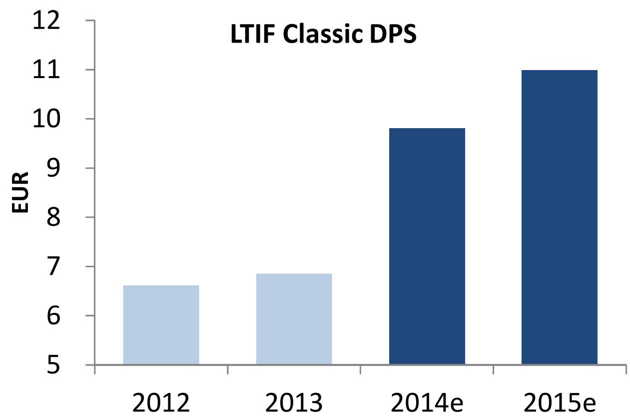
Source: SIA Group / Bloomberg

Table 3: **LTIF Classic - Dividends per share and yield for 2012, 2013, 2014e and 2015e**

Year	DPS	Yield	MSCI World DY
2012	6.6	2.7%	
2013	6.9	2.4%	
2014e	9.8	3.1%	2.5%
2015e	11.0	3.4%	2.6%

Source: SIA Group / Bloomberg

Figure 7: **Dividends per share for 2012, 2013, 2014e and 2015e**



Source: SIA Group / Bloomberg

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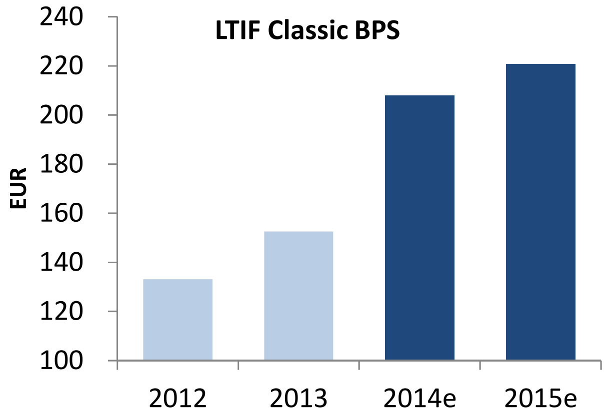
Table 4: **LTIF Classic - Book value per share and P/B for 2012, 2013, 2014e and 2015e**

Year	BPS	Growth	P/B	MSCI World P/B
2012	133.1		1.9	
2013	152.5	14.6%	1.9	
2014e	207.9	36.3%	1.5	2.1
2015e	220.7	6.1%	1.5	2.0

Source: SIA Group / Bloomberg

Figure 8: **Book Value per share for 2012, 2013, 2014e and 2015e**



Source: SIA Group / Bloomberg

It is highly satisfactory to increase profits by more than 20% in a year in which the European economy (the world's largest) was basically stagnant. As we'll discuss below, we have positive expectations for 2015.

Comments on our portfolios

Following our philosophy, we have not traded much during this quarter. We have a well-balanced portfolio, which we believe will provide us with good returns in the long term, and see no point in moving it much. In fact, every time we buy a new stock, we have the hope of a good performance — and the reality of a new risk.

We have therefore mostly increased some positions, basically in Drägerwerk and Zurich Insurance.

Drägerwerk is a multinational company based in Lübeck in Germany. It is active in two main fields of activity: medical monitoring and gas delivery. The company, whose current chairman is Mr. Stephan Drager, has cele-

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brated its 125th anniversary as a family company. The company is organized into two divisions, Medical (64% of sales, 63% of EBIT, 9.9% margin) and Safety (the rest, 10.3% margin).

In Medical, Drägerwerk is the global leader in the pulmonary ventilation market (33% share in 2011, followed by Getinge at 29% and Covidien at 24%), is the #2 player in the anesthesia market (40% share in 2011, just behind GE's 41%, #1 in Europe), and the #4 player in the patient monitoring market (9% share in 2011, Philips is first, commanding 46%, then GE 21%, and Mindray 11%). In these markets, a reputation for quality and reliability is a high barrier to entry, thus making rapid shifts in the market position less likely. Each of these businesses has meaningfully different profitability profiles, with spare parts having a high margin and patient monitoring barely breaking even. This last business, which the family acquired from Siemens some 10 years ago, has proven very difficult to integrate. The business faces unexpectedly severe low-cost competition, which has been a drag on the company's overall profitability. Much of the company's huge R&D expenditure is now focused on monitoring. Analysts and critics have demanded that the company sells this business, but Drägerwerk is convinced it can turn it around.

In Safety, Drägerwerk is the leader in the gas detection systems market (27% share in 2011, the next largest player is Honeywell with 18%) and the #4 player in the respiratory protection market (16% share in 2011, behind 3M with 21%, MSA 19%, and Honeywell 17%). These markets are also characterized by a need for quality and accuracy, resulting in fairly stable market shares. These are excellent businesses. The products' total cost for the buyer is very low, but they are absolutely critical for their clients: It's a typical case of buyers not being price-sensitive, but quality- and reputation-sensitive. In some areas, the company has an unbelievable 80% world market share.

Overall, the company's profitability is high, but this has been tarnished by the monitor business. The share price went down, and we profited from the opportunity. We believe that even if the monitor business does not improve, the stock should still give us an extremely safe 10% return in the long term. If the company manages to turn it around, the return should increase. Overall, we find the risk/reward proposition very attractive. The company's managers are strongly focused on the key strategic variables, and understand the challenges well.

Zurich Insurance is a company we have owned for a long time, but we have increased our position lately. It is well established in all kinds of insurance, but mostly in "property and casualty" in most developed markets. This part of the business is much less volatile than life assurance. The dividend yield is very high, 6% in Swiss Francs and well covered. The company is very well managed and, being aware of the mature nature of the industry, it simply returns the profits to the shareholders. It's reasonable to expect a 2-3% growth in the long term — which will be less than

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the nominal economic growth —, so a long-term return of 8-9% in Swiss Francs from a very low risk company seems attractive.

We have taken small positions in two copper-producing companies that we know well, Lunding Mining and First Quantum. Copper prices are finally dropping to below $3/lb. They should weaken a bit more, but not much more, and then the traditional supply/demand tensions will reappear. Both these companies have embarked on large expansions and, in the past, proved very good at execution. They have 2016 PEs below 7. We have bought a small position, because we don't know when the market will turn around. Our plan is to increase our position when the demand for copper tightens, which should happen within two or three quarters. But by then it will probably be too late to buy the shares inexpensively.

The sharp drop in oil prices, which we discuss below, has made two of our recent investments lose quite a bit of market value: Petrobras and Nokian Tires.

Petrobras's share price has been hit thrice: the oil price drop, political turbulence, and depreciation of the Brazilian Real, which was mostly due to the previous two. The past few weeks have shown a pattern of corruption within the company that, although widely known, was not officially recognized. A short-term consequence is that the company has postponed the publication of its third quarter results, until it can quantify the correct write-offs. Obviously, the market has not taken this patiently, especially as the corruption charges and postponement coincided with the drop in oil prices and a general flight from emerging markets.

The company's market capitalization is therefore down by more than $60 bn., while all the problems can hardly be worse than a few billion. We believe the shares should rebound.

Nokian, whose main market is Russia, has also suffered. A third of its profits used to come from Russia. It is clear that Nokian's profits will suffer if the value of the Ruble halves, and the number of tires sold decreases due to a recession.

But, again, much of that problem (probably too much) is already in the price, and the market may be ignoring that Nokian also exports a lot of tires out of Russia, meaning its costs are also sharply down. If and when the Russian economy turns around, which will happen when the oil price turns around (see below), Nokian will be a fantastic investment.

In any case, both investments (which, fortunately, are fairly small) probably have a common underlying defect: A large part of their value is dependent on political decisions. This – true of all investments to some extent – is especially meaningful for these two investments. We cannot put our economic future in the hands of political systems that are very corrupt, or even moderately corrupt. In both cases, the intrinsic value of the companies is much, much higher than the market price; we are therefore

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protected and have an upside. But we will be even more careful in the future to not put ourselves in uncontrollable situations.

However, many other investments have done well: Our salmon producers have had a banner year with profit increases of 50% and important share appreciations. Something similar can be said, especially from the share price appreciation point of view, of our healthcare investments (Covidien shares are up 66% for the year, for instance), consumer goods producers (Pepsi's up 27%, plus dividends), and Tata Motors, which has almost doubled. All these numbers were affected by the currency movements during the past year, with the dollar +13.7% against the Euro (and the Norwegian Kroner down by -7.4% also against the Euro). Company profits and share prices eventually adjust to all this, but in the short term there is an important impact.

Overall, we maintain our balance between stable companies and those more exposed to the economic cycle. The latter is less pleasant (see these companies' drops in July, October, and December), but can be more profitable over time, if bought cheaply (and can be deadly if bought when they are expensive).

Table 5: **Expected returns of the LTIF Classic**

Category	Equity	Expected Return	Marginal Volatility
1	21.4%	9.4%	8.1%
2	26.5%	10.6%	10.7%
3	49.6%	13.2%	14.7%
4	2.6%	32.1%	17.6%
Overall	**100.0%**	**12.2%**	**12.3%**

Source: SIA Group / Bloomberg

Views on market

There are few times when the consensus on what the near future holds is almost unanimous: The US economy is going to do much better than that of Europe. But just because something is a consensus view does not make it wrong. Being consensus, it is reflected in the price. Thus, US stocks are clearly more expensive than European ones. This means that if the US does a bit worse than expected, or Europe a bit better, the relative performance of these markets will be very strongly in favor of Europe, as 2014 was very strongly in favor of the US. Certainly, Europe has its problems (see Greece, for instance), but we believe that our portfolio of European companies, most of them exporters, will do very well over time, and are cheap to buy and hold.

Our choice of more European than American stocks for our portfolio has led to our funds having gone up less than the world indices. The MSCI World Index now contains 58.4% US stocks, against only 25.0% European ones. But the American indices went up 20% more than the European

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ones this year; consequently, any portfolio with an “overweight” of European stocks must have gone up less than the world average. However, over the long term, we feel that, at these prices, there is more value to be had in Europe.

In any case, the world economy is healing: For the first time since the great crisis (6 years ago!), salaries in the US and UK are clearly increasing more than inflation. People are finally starting to, very slowly, recover their purchasing power, which is the motor of the economy. Europe is still far from this (in fact, salaries in the periphery are still going down in absolute terms), but China, Japan and most of the emerging markets are growing, and will receive a big boost from the drop in oil price, even if it is relatively short-lived.

What should we expect from here, after years of stock price increases? We have always insisted on taking a long-term view, so let’s see what we should expect from current markets in, say, 10 to 20 years’ time.

First of all, let’s make a clear distinction between the expected return of the total market and the return of a stock-picker’s portfolio. The latter is unlimited: Somebody who buys stocks that go up 20% in a few months — there are plenty of them, all the time —, sells them, and repeats this, can mathematically have a 50% return per year with no problem. But this is hard to do, and even harder to specify beforehand. So let’s first examine the expected return of the entire market and return to individualized portfolios later.

The whole market has very real limits over the long term, although it can do almost anything in the short term — from the ridiculous peaks of 2000 (a PE of 30 for the S&P 500, for instance) to the absurd lows of 2009 (selling for a third of the peak price). But over the long term, stock prices follow earnings, and the earnings of the total market are closely related to the economy. Figure 9 shows the cash dividends paid by the S&P 500 companies over the last 54 years. We have previously published this chart, but find it very instructive.

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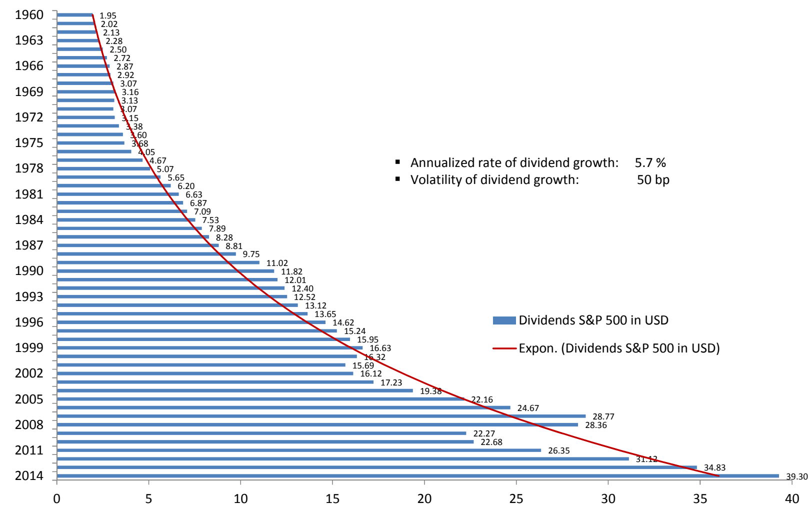
Figure 9: **S&P dividends over the last 54 years**



Source: Bloomberg

As we can see, the rate of the dividends' growth, which must be very close to the rate of the earnings' growth over time, is slightly above 5%. This is the rate of the economy's nominal growth. Thus, the long-term return of the market is whatever dividend it is paying now (in 2015 it will be a bit less than 2% in the US), plus the long-term rate of the economy's growth. Unless the world economy structure changes radically, the market cannot give more than this over time — nor should it give less. If, instead of looking at the US market, we look at the world average, the expected dividend for next year is 3%.

The economy's historical 5% growth is nominal, as it includes about 2% inflation. However, inflation is now almost universally well below this. Two things may then happen — inflation either stays low forever, or goes back to the norm. If it stays low forever, the economy's nominal growth will be lower, and the stock returns will be lower, but only in nominal terms: In real terms, they'll be the same. If the world economy grows less than 3% forever — this year it was about 3.4%, and a bit more is expected in 2015 —, real returns will be lower than in the past. Nobody knows what will happen and this is the difference with bonds: If you buy a 10-year German Government bond, you know exactly that your return will be 0.6%, nominally, per year. No less and no more.

One can add the expected return from stock picking to this basic market return. This is, of course, impossible to predict: The "opportunity set" presented to the same fund manager will be drastically different at each given time. Sometimes, there are many bargains, sometimes there aren't.

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But three approaches offer systematically better returns than the overall market: value, momentum, and stable stocks.

Value investing has been well proven over time. This consists of buying things when the expectations are not too high, so that the prices are reasonably low. The risk lies in buying things that are cheap, because they deserve to be cheap. But, if one is careful, there is plenty of evidence of good long-term results.

Momentum is almost the opposite. The idea is not to buy expensive things, but those whose prices are increasing. Many empirical tests have proven that this approach works. We don't plan to follow it: The risk obviously lies in being too late when buying and to over-pay. We are fundamental investors, who don't buy shares to re-sell them at a higher price, but to enjoy their profits and dividends. The surge of money going into US stocks at the end of the year is simply chasing this year's performance, and increasing it. We'll see how it ends.

Finally, there is the "low-risk anomaly": Shares that are less volatile than the average — they are typically consumer goods producers, such as Nestlé — and do better, as a group, than the whole market. This strongly contradicts basic market theory, but it does work.

We try to apply our particular kind of value investing, which we call "strategic investing": The idea is not to, systematically, buy everything that is apparently cheap, but to look for stocks whose earnings visibility seems to offer a very attractive return. This requires a clear opinion of the company's future, which implies understanding its industry's competitive dynamics and the key risks that the company runs. We believe that by pursuing this strategy, we can add value over the market averages.

An area where there is not much value is trying to time the market: Will it correct? Should we wait? Is this the right time? Trading costs are very high, while being in cash and waiting for the right moment have high opportunity costs: As we saw, 8% per year on average. If the timing is good, the rewards are high, which is why so many people try this. But doing it consistently and earning more than the opportunity and trading costs over a lifetime are very, very difficult. We therefore certainly don't try.

But, simultaneously, one has to be realistic: As we mentioned in previous Newsletters, current stock prices do not justify expectations of very high returns. Interest rates are very low, inflation is very low, and multiples are reasonable. In 2008 we learned that aiming for very high returns in all environments can ultimately be expensive. We believe that the current market situation, plus our stock-picking strategy, should deliver returns close to 10% per year. Considering the investment alternatives, we believe this is a very attractive return.

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On the oil price

During this quarter, the biggest market event has been the drop in oil prices. This drop directly affects a small part of our holdings in the Classic, Alpha, and Stability funds (a bit less than 10%), and a much more important percentage (about a third) of our investments in the Natural Resources fund. However, it must be said upfront, this drop affects almost all other holdings and mostly positively: The total oil consumption amounts to about 5% of the world GDP. A sustained drop of 20% would thus imply a very large gift for importing countries, which are all the large economies like the US, China, Europe, and Japan, but also India, Turkey, and Indonesia, while negatively affecting exporters like Russia, Nigeria, Venezuela, and the Gulf countries.

How lasting will this drop be? While we cannot forecast the exact dates, we can provide some numbers that should clarify the issues.

In 2014, the world consumed a bit more than 90 million barrels of oil per day (bopd). Every year, about 5% of production simply disappears, because the wells literally run dry. That's about 4.5 million bopd which must be replaced if production is to remain constant (technically, this is called "depletion"). In addition, 90 million cars are built every year, while some 15 million are retired: The world is increasing its fleet by some 70 million cars per year out of a total stock of about 1 billion (less than 50,000 of these new cars are electric, by the way). Further, the number of flying planes is increasing, as is the number of ships. All in all, the world has increased its demand for oil by about 1 to 1.5 million bopd per year. This means that next year, about 6 million additional bopd must be produced from new wells. And this is the case every year.

The world spent about $700 bn. last year searching for oil. The total new reserves amount to a consumption of less than 5 months. This is not a very sustainable trajectory.

Over the short and medium term, demand for oil is fairly inelastic: It remains constant even if the prices change. The reason for this is that most oil utilization is not optional: There is no substitute, and the tasks for which it is used must be carried out. One could, of course, postpone a ski trip and spend the holidays watching TV or playing videogames if oil prices were to shoot up. But the truck that delivers food to the city must keep doing this, a plane needs to continue flying, and a ship needs to continue carrying vital cargo.

Nobody will invest in delivering the new 6 million bopd required every year if such an investment does not look profitable. How high the price of oil must be for a new well to be profitable varies, obviously, according to the type of well: Some are much more expensive to develop than others. But at the current prices practically no new well can be profitably developed in the world. In fact, 18 months ago, when the oil price was well above $100 per barrel, many large oil companies started cutting their in-

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vestment in new capacity, because they didn't find enough attractive opportunities.

However, an oil price below the price at which companies invest in new oil facilities does not imply an immediate drop in production: Most oil projects are very long-term affairs, with a long delivery time. Further, even if oil became very, very cheap, these projects would still be completed and start production. Nevertheless, within a few years there would not be enough oil if investment were to be cut, as it is being cut now.

When there is too much oil, the price drops, investment slows down, and the relentless reality of depletion and new demand absorbs the excess capacity within a few years. This is what happened in the 1980s and 1990s.

And this is what would be happening now, but for an interesting fact: The characteristics of the technology that has produced the excess capacity by extracting "shale or tight oil" in the US are very different from those of the old technologies.

We leave the technical details for a forthcoming Newsletter, but the following is relevant: Whereas a typical oil field takes perhaps 10 years to build and then produces oil for 50 years, a shale oil well is built in months and lasts, with meaningful production, less than three years. This has a very important implication: If the oil price drops and investment is curtailed, the drop in production is much, much faster than in the past. In spite of everything being said (i.e., that the US can forever produce oil in unlimited amounts at $60 per barrel), we struggle to see how shale oil production is going to grow much in 2015 when the current oil price has led many US producers to already cut their investment. And the US is basically the only area in the world where "experts" expect some growth in the coming years.

Thus, we should see a bottoming of the oil price at not much below the current price, and a relatively rapid increase towards prices at which companies invest. This means, in the short term, $80-90 and, in the long term, much higher.

How this will play out exactly, we cannot say. It may take a few months, or a few quarters. But it will happen. There is only one big unforeseeable variable that could impact the market substantially: Iran could see its sanctions lifted, and Iraq could continue to increase its production — it is the only country besides the US that has increased its production meaningfully over the last few years. These events would delay the recovery in oil price by perhaps six months, because Iran could, at best, increase its production by 2 million bopd, and Iraq somewhat less. The opposite price movement could come from geopolitical issues: A well-placed bomb in the Straits of Hormuz, or in the Basra loading terminals in Iraq, would see the availability of oil severely constrained.

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Whatever the case, the world is going to continue using oil for a long time (all those new cars) and companies, such as Schlumberger, will be needed to find it and lift it. We believe our investments are very solid and even at the current prices the shares offer a very attractive return. We don't want to increase our positions too early, but we certainly count on a gradual increase, as the prices show clear signs of bottoming. This is a volatile sector, but one that offers good opportunities from time to time. We believe this is such a time.

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Figures of the USD classes

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

December 2014	NAV	Δ 3m	Δ YTD	Annualized Return since Inception	AUM (in mio) *combined Pool
LTIF Classic [USD]	388.66	-3.0%	-2.0%	12.0%	215*
LTIF Alpha [USD]	192.24	-4.8%	-7.4%	4.0%	215*
LTIF Natural Resources [USD]	100.33	-19.1%	-15.4%	-2.8%	12

Figure 10: **LTIF Classic USD**
vs. MSCI Daily TR Net World Index USD

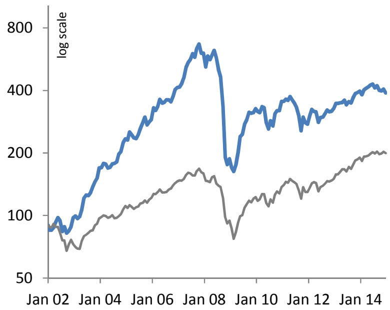


Figure 11: **LTIF Alpha USD**
vs. HFRX Global Hedge Fund Index USD

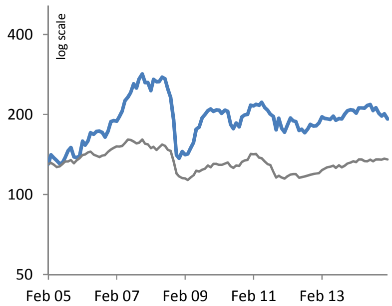
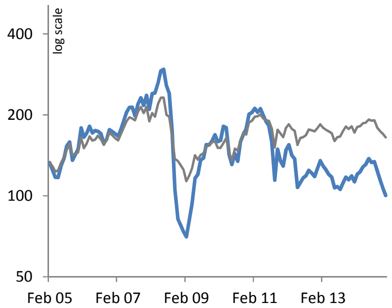


Figure 12: **LTIF Natural Resources USD**
vs. S&P Global Nat. Res. Net TR Index USD



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Figures of the CHF classes

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

December 2014	NAV	Δ 3m	Δ YTD	Annualized Return since Inception	AUM (in mio) **combined Pool*
LTIF Classic [CHF]	386.18	0.9%	9.5%	7.7%	214*
LTIF Alpha [CHF]	191.02	-1.0%	3.4%	2.1%	214*
LTIF Natural Resources [CHF]	99.69	-15.9%	-5.5%	-4.4%	12
LTIF Stability Growth [CHF] *(Total return, dividends included)*	214.60	-1.9%	1.4%	4.5%	22
LTIF Stability Income Plus [CHF] *(Total return, dividends included)*	190.60	-2.0%	1.5%	7.1%	22

Figure 13: **LTIF Classic CHF**
vs. MSCI Daily TR Net World Index CHF

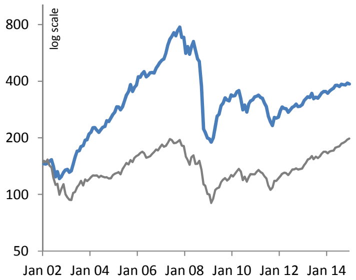


Figure 14: **LTIF Alpha CHF**
vs. HFRX Global Hedge Fund Index CHF

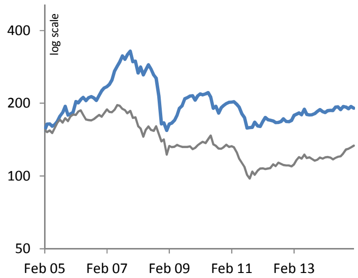


Figure 15: **LTIF Natural Resources CHF**
vs. S&P Global Nat. Res. Net TR Index CHF

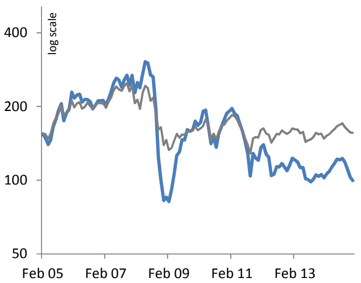


Figure 16: **LTIF Stability Income Plus TR CHF**
vs. HFRX Global Hedge Fund Index CHF

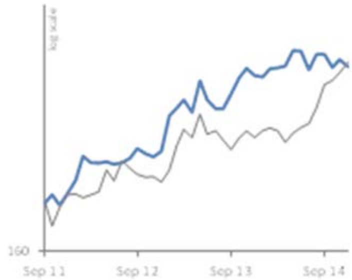
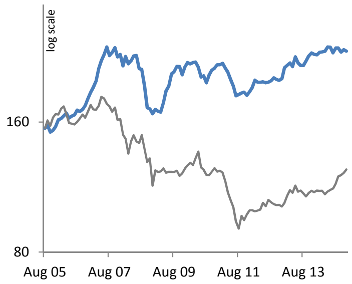


Figure 17: **LTIF Stability Growth TR CHF**
vs. HFRX Global Hedge Fund Index CHF



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Figures of the GBP classes

Table 8: **Net Asset Value - Net assets under management in GBP**

December 2014	NAV	Δ 3m	Δ YTD	Annualized Return since Inception	AUM (in mio) **combined Pool*
LTIF Classic [GBP]	249.26	0.9%	4.1%	11.3%	138*
LTIF Alpha [GBP]	120.08	-3.6%	-4.2%	5.6%	138*
LTIF Natural Resources [GBP]	64.34	-15.9%	-10.1%	-0.7%	8

Figure 18: **LTIF Classic GBP**
vs. MSCI Daily TR Net World Index GBP

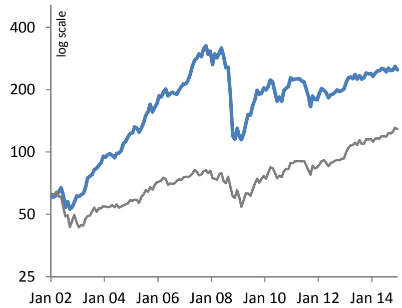


Figure 19: **LTIF Alpha GBP**
vs. HFRX Global Hedge Fund Index GBP

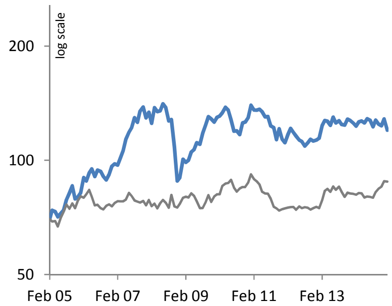
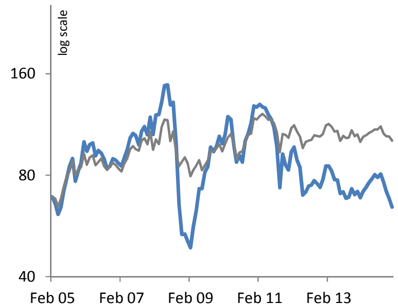


Figure 20: **LTIF Natural Resources GBP**
vs. S&P Global Nat. Res. Net TR Index GBP



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