

# Newsletter

of December 2013

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

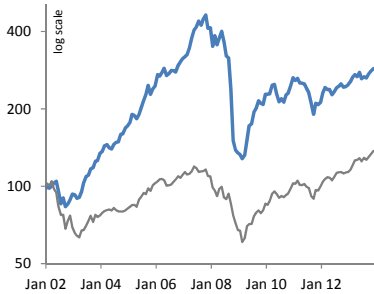


Figure 2: LTIF Alpha EUR vs. HFRX Global Hedge Fund Index EUR

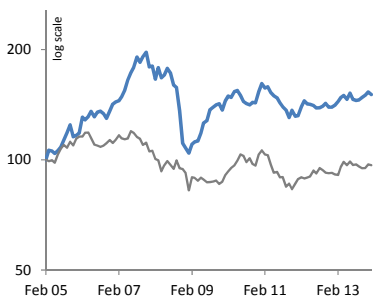


Figure 3: LTIF Natural Resources EUR vs. S&P Global Nat. Res. Net TR Index EUR

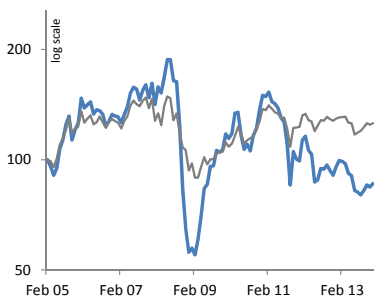
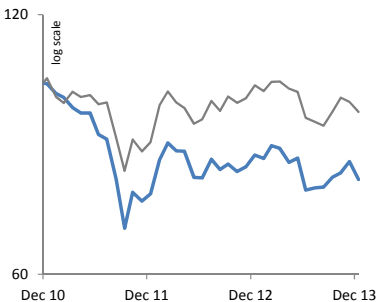


Figure 4: LTIF Emerging Market Value EUR vs. MSCI EM Daily Net TR Index EUR



**Overview of our funds**

Table 1 and Figures 1 through 6 show the evolution of the Net Asset Values of our funds. The generalist funds have done well, as was to be expected in a year that has seen most indices rise worldwide. Only emerging markets and mining stocks have been weak, which is reflected in our specialized funds.

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

December 2013	NAV	Δ 3m	Δ YTD	Annualized Return since Inception	AUM (in mio) *combined Pool
LTIF Classic [EUR]	287.75	5.3%	15.9%	9.2%	207*
LTIF Alpha [EUR]	150.68	1.8%	7.0%	4.7%	207*
LTIF Natural Resources [EUR]	86.05	4.4%	-10.1%	-1.7%	15
LTIF Emerging Market Value [EUR]	77.29	-0.5%	-6.3%	-22.7%	3
LTIF Stability Growth [CHF] <i>(Total return, dividends included)</i>	211.60	2.9%	13.0%	4.9%	22
LTIF Stability Income Plus [CHF] <i>(Total return, dividends included)</i>	196.20	3.1%	13.3%	9.8%	22

Source: SIA Group

Not much has changed in our funds (or the markets, for that matter) since our September Newsletter:

In the Classic fund we maintain our balanced portfolio with stocks of different risk profiles. Many riskier stocks rose sharply this year because markets temporarily concluded that the different macroeconomic risks were not “terminal.” It is normal for a balanced portfolio to have a subdued performance in these circumstances. In 2013, many “low risk,” high quality stocks went up by less than the averages: this is shown in Figure 7.

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

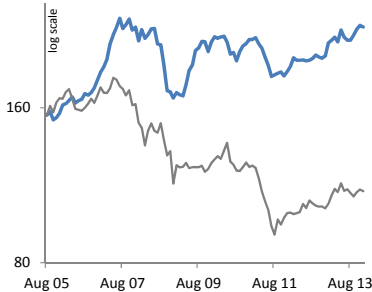


Figure 6: LTIF Stability Income Plus TR CHF vs. HFRX Global Hedge Fund Index CHF

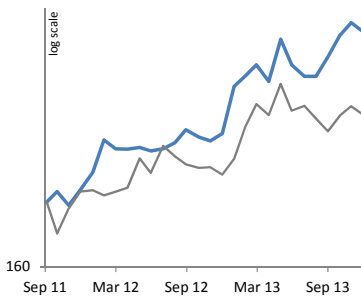
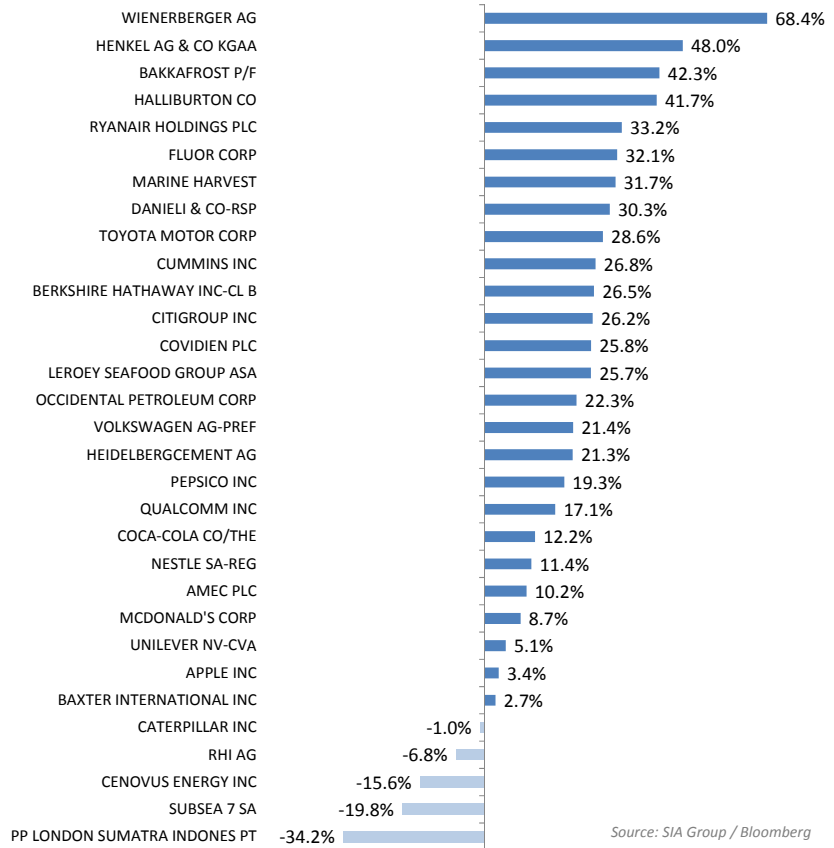


Figure 7: performance of our Category 1 & Category 3 stocks in Euro throughout the year, dividends included



As we have insisted over the last few years, it is the risk-adjusted performance that matters. The risk in our portfolio – defined as the chances that our companies will lose permanent value – is very low.

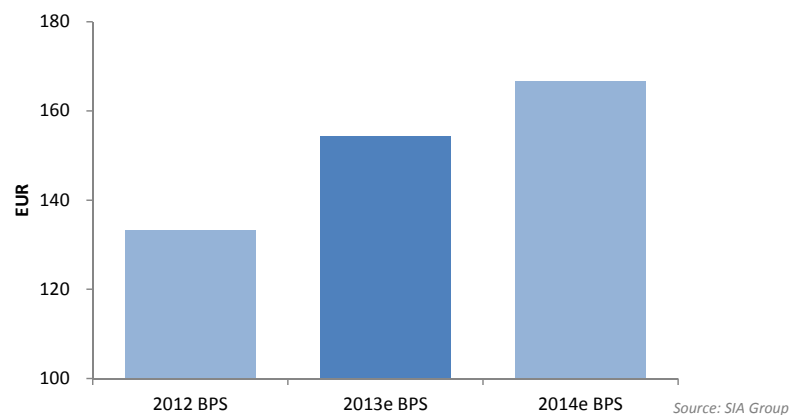
Long-term investors don't measure performance by what the share prices do, but by what the companies do: are they making money, paying dividends, strengthening their competitive positions? These are the really important issues over the long term. In this sense, the "fundamental performance" of our fund is far more important information than its "market performance." By "fundamental performance," we mean exactly what company owners all over the world mean: how the companies (not the shares) are doing.

If we consider that a share in our fund is but a share in a "holding company" that owns positions in some forty corporations, we can derive the earnings, dividends, multiples, etc. of our fund as though it were a company itself.

The first figure to consider is the “book value”: this is the accounting value of all the assets owned by our companies, minus their debts. This figure is always only a rough approximation of a company’s true value, because it tends to underrepresent this value: for instance, many brands that a company has developed are given no value as they stem from years of expenditure on advertising, and they do not therefore show up on the balance sheet. Many plots of land have a higher value on the open market than in the books. A company’s sheer strategic strength, its management systems, etc. are not recognized in the accounts. But book value is a good starting point: it’s a conservative view of what one is buying when buying a company. And it is particularly useful when used not as a “point in time,” but as part of an evolving continuum.

Our companies had a book value of EUR 133.15 per share of the Classic fund at the beginning of 2013. At the end of the year, this book value was EUR 154.43, an increase of 16%. This is the real increase in our Classic fund’s value, not the one shown in Table 1. Over time, of course, the two coincide, but the increase in the book value is the “fundamental performance” of the fund (of our companies), whereas the market performance simply shows what people, driven by current data and sentiment about the future, are now ready to pay for that fundamental value.

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



The owner of one share of the Classic fund, with a market value of EUR 248.37 at the beginning of the year, has gone on to earn EUR 20.03 in 2013 through the participating companies, which is a profitability of 8.1%. This compares with profits per share of EUR 18.7 in 2012, which means profitability has grown 7% year-on-year. The consensus of analysts is that 2014 will see profits per share of EUR 23.4, or 16.7% growth. Analysts tend to be overly optimistic at the beginning of a year, normally lowering their expectations as reality sets in. But 10% would already be a very acceptable rate of growth.

Much of this earning power was translated into dividends (reinvested in the Classic fund according to its policy):

Figure 9: Earnings per share 2012, 2013e and 2014e

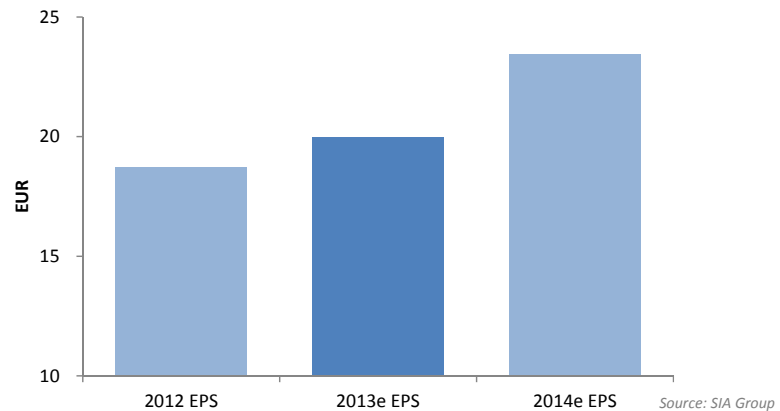
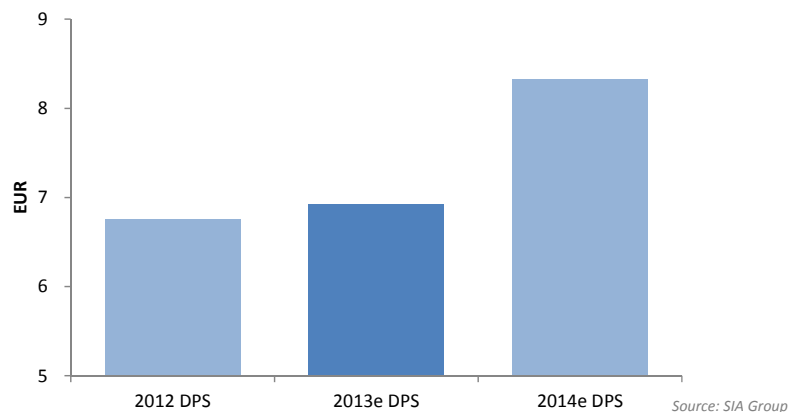


Figure 10: Dividends per share for 2012, 2013e and 2014e



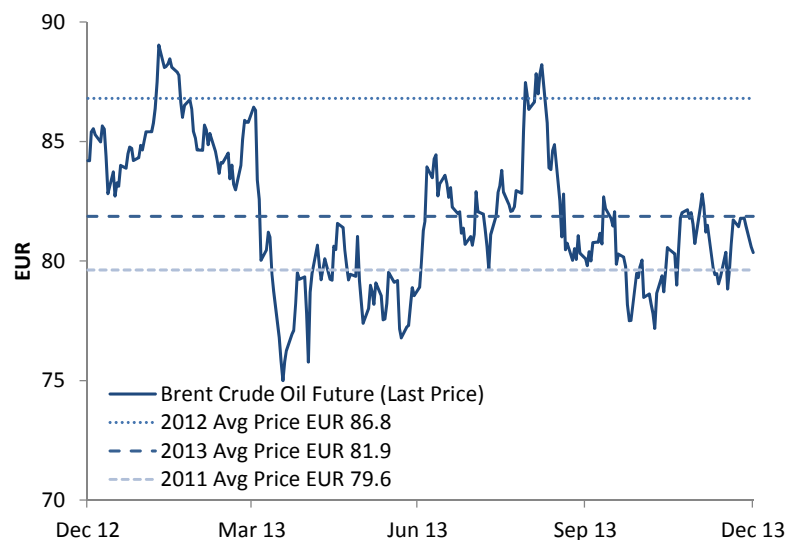
This “fundamental performance” is what really matters, not the ups and downs of the stock exchange. There are two important reasons for focusing on this: on the one hand, it’s the best indication of how companies are doing and, on the other hand, it’s a far more stable measure than stock prices. The stock price combines the fundamental performance with the prevailing sentiment, and sentiment has a way of changing quickly and becoming extreme from time to time. We have no idea of how sentiment is going to evolve, except that the extremes will, eventually, reverse. We can therefore best focus on the fundamentals, avoid being swayed by sentiment, and take advantage of it by selling high and, specifically, by buying low when everybody is depressed.

Our hedged funds, the Alpha and the Stability, had a lower performance than the Classic, as you would expect in a year in which the markets were up. Taking these funds’ protection against sharp market drops into ac-

count, they still offer a decent return for conservative investors. This year, the Income version of the Stability fund paid a cash dividend of CHF 8.5 – a strong increase of 6% over last year’s. Measured in dollars, as most hedged funds are, our hedged funds show a very reasonable return (11.8% in USD and 17.2% in USD respectively for the Alpha and the Stability).

The Natural Resources fund has again disappointed. The main underlying commodities have done well: oil is EUR 80.35 (more than USD 100), copper is EUR 2.46 (more than USD 3.3) and salmon filets are above EUR 6, more than 30% higher than last year (see Figures 11 to 13). Many oil-related companies and salmon producers in particular did very well this year.

Figure 11: the 2013 evolution of the Brent Crude Oil Future price as well as their 2013 average price against the 2012 and 2011 average prices (all in EUR)



Source: Bloomberg

Figure 12: the 2013 evolution of the Copper Future price as well as their 2013 average price against the 2012 and 2011 average prices (all in EUR)

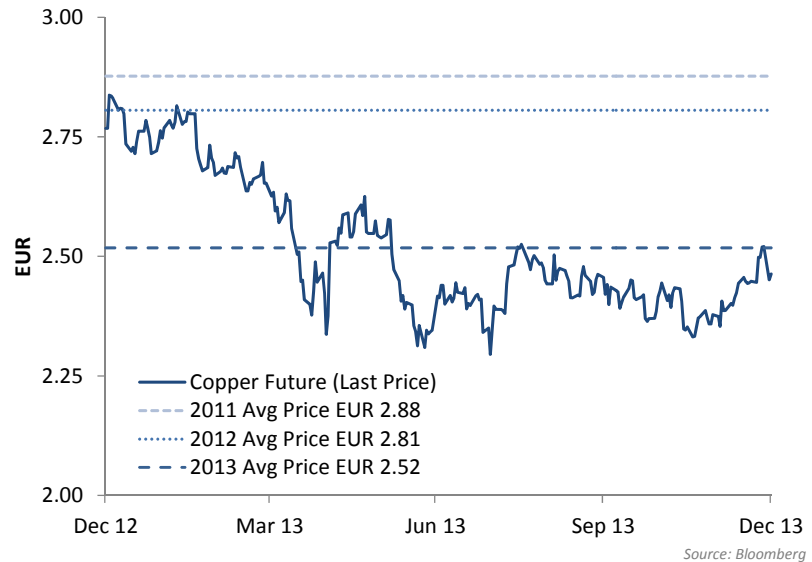
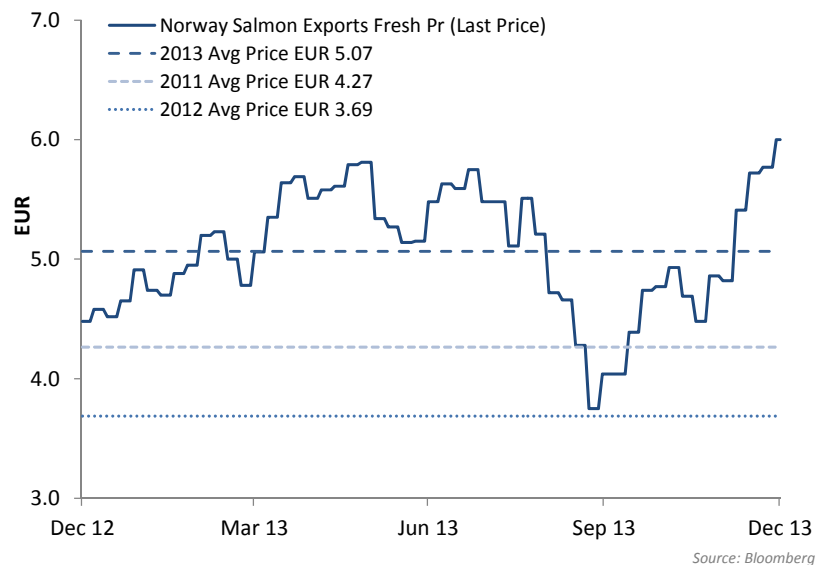


Figure 13: the 2013 evolution of the Norway Salmon Exports Fresh Price as well as their 2013 average price against the 2012 and 2011 average prices (all in EUR)



But palm oil producers and, generally speaking, miners' shares have done very badly. We believe this is transitory, and keep our fund open, as we are convinced it has deep value. The following is an example:

Ivernia is an Australian company listed on the Toronto stock exchange, which owns one of the few dedicated lead mines in the world. Early in 2011, the mine had to stop production due to leaks detected during the transport of lead ore, which is toxic. It took the company two years to completely overhaul its procedures. It re-

ceived all the authorizations required to restart production in mid 2013.

At the current lead prices (which should hold, or perhaps go slightly up in 2014), we expect Ivernia to earn 5 cents per share in 2014 and 7 cents per share in 2015. Right now, the stock is trading at 13 cents per share, which gives a PE of 2.5 for this year and less than 2 for 2015.

But other companies too represent deep long-term value. Most “hard” commodities (i.e. not agricultural ones) operate in relatively long cycles: it takes between five and ten years for a new mine or oil field to start producing; depletion (i.e. the natural decrease in production due to mines and oil wells being exhausted) is at around 3 to 5% per year; many costs are fixed; demand is very inelastic (people try to buy the same amount of copper whether the price is 3 or 4 US\$/lb). Together, this means that if there is not enough copper, the price goes up, and it takes a relatively long time for new supply to balance the situation; if there is too much copper, because high commodity prices have led to many mines being opened, it takes time to re-balance: miners then stop marginal projects, close the least-performing mines, and spend money on lowering costs rather than on increasing supply. Depletion and demand growth eventually restore the equilibrium. But there is a great deal of inertia, and the results are only seen after a few years.

Right now, much of the natural resource “space” is in a cost-cutting mode and the most expensive new projects are being delayed. This makes some sense for the companies, but we are going to see a new round of relative scarcity, particularly in zinc, copper, and oil, over the next two or three years. Now is probably not the best time to invest, but in a few quarters, when the current cycle is more advanced, it will be. Unfortunately, we cannot time the whims of the market; we therefore remain invested in companies in which we believe the combination of low costs and profitable growth projects will make for a very attractive long-term investment, even if some commodity prices are weak for a while. The current cost-cutting mood also affects suppliers to the industry. Consequently, many of these suppliers’ share prices are down, and we are tracking some very attractive opportunities.

It is hard to believe today, but 12 months ago there was an almost universal agreement that 2013 would be a great year for Emerging Markets, especially in the first six months, and that Developed Markets would only do better in the latter part of the year. It certainly did not work that way. It’s clear that many emerging markets are suffering growing pains; but it’s also clear that many of them have little debt, high growth, and favorable demographics. Their stock prices are even more subject to sentiment swings than those of developed markets, because their capital pools are very small and are easily swamped by developed market investors’ in and out moves. However, the stories we have been relating over the last 10 years about the incorporation of more than a billion people into the glo-



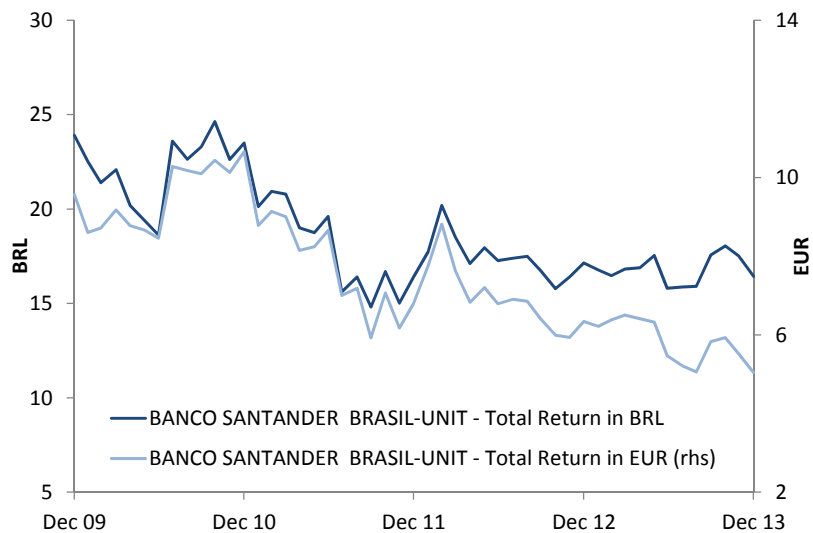
bal middle class are absolutely true. They are a background reality on which most of the world's economic growth depends and is going to depend for the following 20 years. Right now, equities in most of these markets are cheaper than they have been for a long time, both in absolute and relative terms. All analysts are negative now. It may be a good opportunity.

**Portfolio news**

Although we invest for the long term and do not change our portfolio all that much, there are always reasons for selling and buying. The two main reasons to sell are, first, that a company turns out to have a less bright future than expected; and, second, that the share price has gone beyond what we consider a reasonable level, and we believe that the money can be more profitably invested elsewhere. This year saw a few such occasions.

Among the investments that we sold because we re-assessed our views of the company was Santander Brasil. This bank, a subsidiary of Banco Santander of Spain, was first listed on the Sao Paulo stock exchange in 2009. Figure 14 shows its share price, including the dividends paid, since then, both in reais and euro. Not brilliant.

Figure 14: Santander Brasil, both in BRL and EUR



Source: Bloomberg

We found the share attractive in 2010. Its return on equity was much lower than that of its competitors, as it had been formed by the merger of two banks and a great deal had to be done to increase its efficiency. We reasoned that if the new management could improve its operations, the valuation would be much higher, and the multinational group that owns the Brazilian subsidiary is well respected for its operations ma-

nagement. But two things happened: first, turning the operations around took longer than expected (as usual), and then Brazil's economy started deteriorating. We tend to insist that macroeconomic considerations are not that important for most companies, as their profitability depends much more on their strategic position and operational skills than on a few points of GDP growth. However, banking is an exception: it's really dependent on the overall economy. After coming to the conclusion that we had no particular insight into the turnaround of the Brazilian economy, we sold the shares at a loss of some 20%. The bank is still an attractive investment, and Brazil is a huge developing market; we may therefore revisit this investment, taking advantage of our detailed understanding of the bank. But we do not think that the time has come.

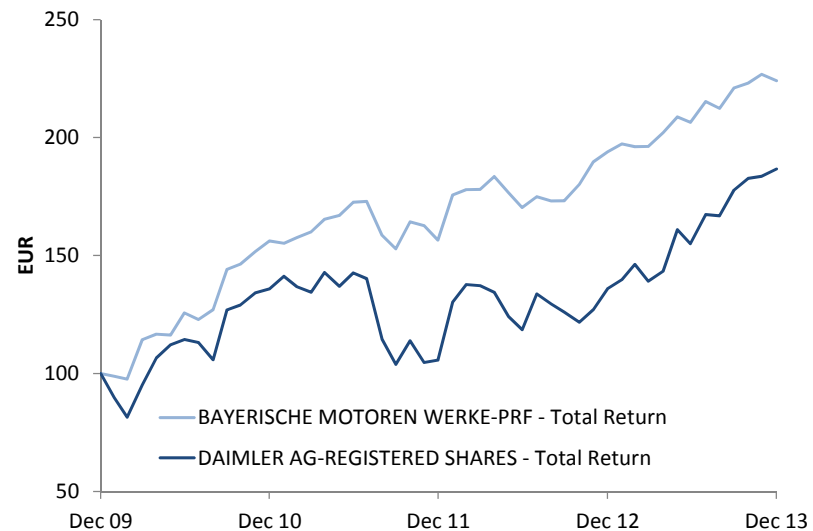
The ASML and Daimler stories are more encouraging. We bought ASML at a price of around EUR 30 per share in late 2011. It is a manufacturer of the large machines used to produce computer chips. This is a very concentrated business, with just three or four competitors worldwide. Each new machine generation is more complex than the previous one, and more capital intensive; so much so, that only ASML is developing the apparent winning technology for the near future. This means they will have a de facto monopoly of one of the world's key industries. The technology may, of course, be subject to delays, cost overruns, or may even not work as expected. But when we bought the shares, it was pretty clear that the chances of the technology working well were very good. We believed it was an attractive investment, even if we had to wait a couple of years for the profits to materialize. Unexpectedly, the market seemed to agree immediately, and the share started going up pretty strongly. When it reached EUR 70 we decided to sell: the price included the technology's success and the great profits from the monopoly. And there were still risks. Undoubtedly, ASML may continue to discover new technologies during the next 5 to 10 years. But this is very much in the realm of possibilities and beyond the value we envisaged. The risk/reward ratio was no longer attractive to us, so we sold.

Daimler manufactures some of the best cars in the world, but is a strong candidate for the title of worst-managed company in post-war Europe. For many decades, it systematically destroyed most of the wealth generated by making and selling its wonderful cars by investing in unrelated ventures (airplanes, satellites, dishwashers, consultancies...), ending with the absolutely disastrous takeover of Chrysler. As one would expect, even the fantastic Mercedes operation was ultimately weakened by so many years of management distractions. The share price reflected this chronic underperformance, and reached a low of 0.9 times book value in 2011. This meant that you could buy Daimler by just paying for its (depreciated) physical assets (factories, inventories...), thus acquiring one of the world's best brands for free.

A few years ago, Daimler finally got rid of Chrysler, and started the long process of refocusing on its Mercedes operations. It has taken time, but Mercedes now boasts one of the best lineups of new models in the world.

As a medium-sized manufacturer, it has to overhaul its production processes to obtain competitive costs; and it has had to adapt its large truck operation to the recession. But most of that has been done, which is reflected in the share price:

Figure 15: share prices of Daimler, BMW, last three years (rebased in EUR)



Source: Bloomberg

We bought the shares at around EUR 40, and sold at EUR 60. At this price, there is probably value left. But the “easy money” has been made, and Daimler now trades at a PE of 12, 1.4 times book value. From now on, Daimler management cannot make any mistakes if they are to justify their share price. The managers at BMW, Audi, etc. are not sitting idle (and their shares are cheaper). We have taken our profits from Daimler and invested some of that money in Toyota and Renault. The latter owns 43% of Nissan and trades at a very modest 7 times 2014 PE (0.6 times book value).

Insurance is one subsector in which we have been heavily and fairly successfully invested over the last 7 or 8 years, especially reinsurance, and even more especially, property re-insurance. This is an interesting sector in that its profits are volatile, but completely unrelated to the economy or the stock markets: re-insurers lose money when big catastrophes hit, and make money when nothing happens. The two outcomes eventually self-correct: after a year of bad catastrophes, insurance demand and prices go up; after a few calm years, the demand and rates go down. This is therefore a cyclical, volatile industry. As such, its shares have typically traded at modest prices. But because its volatility is unrelated to the stock market, it is very attractive. That’s why we liked it.

The problem – as with all good things in finance – is that more and more people have started liking it. Re-insurers themselves have been creative about attracting capital to the industry, offering institutions and wealthy

individual “cat bonds,” i.e. bonds that pay a very nice coupon (much higher than the low interest rates we have seen since the crisis), but which underperform if there are big “cats” (catastrophes). Investors have gradually accepted the idea that, over time, returns are interesting if their lack of correlation to the economic cycle is taken into account. However, returns have started coming down for this very reason. We sold our holdings little by little.

We have, however, increased our investment in banks. We started with the safest investment we could find: Wells Fargo in the US. With the stabilization of the housing market, and the progressive righting of the American economy, the bank is returning to its old profitability. Its shares were very cheap when we bought them and although they are sharply up (and therefore offer less value than before), we believe they are still attractive if we take the business’s very low risk into account. We have added positions in Lloyds of the UK, HSBC (active mostly in emerging markets), Citi and BNP.

Since we sold stocks that we felt were fully priced, we added new companies, such as Recordati, a small, family-owned, and very well diversified Italian pharmaceutical company; HeidelbergCement, which is exposed to the European recovery, as well as emerging markets’ construction; and Michelin, the French tire maker. Most of its profits come from the very large special tires made for huge mining trucks. The market (for the reasons we discussed above) is afraid that the mining business will go down, so the shares are not expensive. But we think tires are an on-going mining expenditure (they must be changed every year), which means that although fewer new mines are being developed this does not change the current demand for tires.

#### **What to expect in 2014**

The world economy should grow faster than in 2013. In fact, it will probably grow faster than at any time since 2007. Some of the debt mountains are being reduced and, for the first time in 6 years, there is enough oil production to allow economic growth without energy prices overheating. The euro crisis, with an extremely slow healing process, will continue in the background, perhaps interrupted by some episodes of nervousness. All this should lead to solid profit growth for many companies.

How markets will evolve in 2014 is, of course, a different question. We have now had two and a half years without a serious correction in most markets. The strong surge in stock prices has reflected the conviction that the worst of the crisis is over. From now on, profits must justify these prices. The markets are not expensive, but they are not too cheap either: we believe the expected return is now a mid to high single digit. This is not too bad, considering the alternatives, but it’s very far from the stock price increases of the last two years. Investors must be realistic, and they should not expect higher long-term returns than the economy can provide. But markets do not normally move in straight lines: the expected

high single digit annual returns will be delivered through some years of high increases, and some years of decreases. We have no idea which of the two 2014 will be.

But we do know that our portfolio of companies will continue to do well, paying their dividends, and, on the whole, working towards the delivery of the more than 10% annualized long-term return we expect.

**Figures of the USD classes**

Table 2: Net Asset Value - Net assets under management in USD

December 2013	NAV	Δ 3m	Δ YTD	Annualized Return since Inception	AUM (in mio) <i>*combined Pool</i>
LTIF Classic [USD]	396.51	7.2%	21.1%	13.2%	285*
LTIF Alpha [USD]	207.63	3.6%	11.8%	5.4%	285*
LTIF Natural Resources [USD]	118.57	6.3%	-6.0%	-1.3%	21
LTIF Emerging Market Value [USD]	106.50	1.3%	-2.1%	-19.0%	4

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

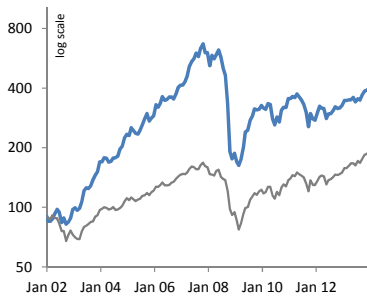


Figure 17: LTIF Alpha USD vs. HFRX Global Hedge Fund Index USD

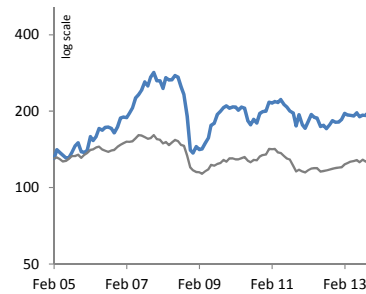


Figure 18: LTIF Natural Resources USD vs. S&P Global Nat. Res. Net TR Index USD

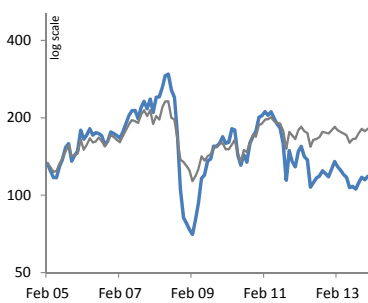
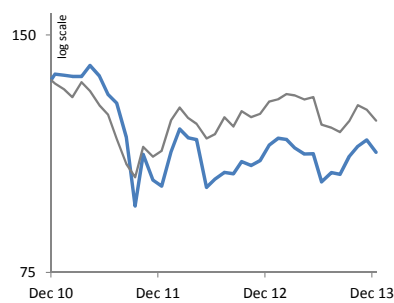


Figure 19: LTIF Emerging Market Value USD vs. MSCI EM Daily Net TR Index USD



**Figures of the CHF classes**

Table 3: Net Asset Value - Net assets under management in CHF

December 2013	NAV	Δ 3m	Δ YTD	Annualized Return since Inception	AUM (in mio) <i>*combined Pool</i>
LTIF Classic [CHF]	352.63	5.4%	17.6%	7.5%	253*
LTIF Alpha [CHF]	184.66	1.9%	8.6%	2.0%	253*
LTIF Natural Resources [CHF]	105.45	4.6%	-8.7%	-4.2%	19
LTIF Emerging Market Value [CHF]	94.72	-0.4%	-4.8%	-25.8%	3
LTIF Stability Growth [CHF] <i>(Total return, dividends included)</i>	211.60	2.9%	13.0%	4.9%	22
LTIF Stability Income Plus [CHF] <i>(Total return, dividends included)</i>	196.20	3.1%	13.3%	9.8%	22

Figure 20: LTIF Classic CHF vs. MSCI Daily TR Net World Index CHF

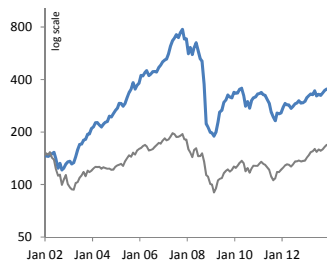


Figure 21: LTIF Alpha CHF vs. HFRX Global Hedge Fund Index CHF

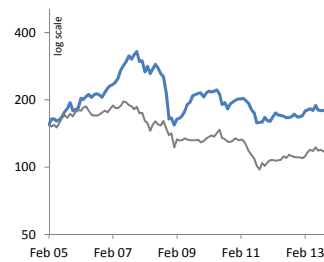


Figure 23: LTIF Natural Resources CHF vs. S&P Global Nat. Res. Net TR Index CHF

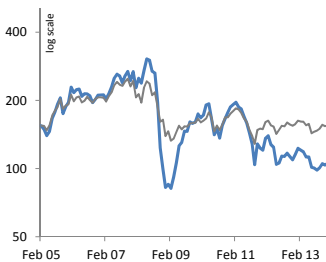


Figure 24: LTIF Emerging Market Value CHF vs. MSCI EM Daily Net TR Index CHF

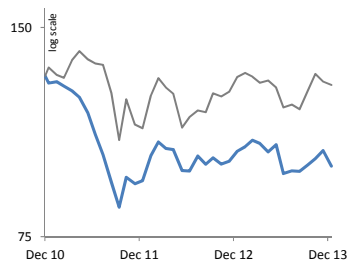


Figure 25: LTIF Stability Growth TR CHF vs. HFRX Global Hedge Fund Index CHF

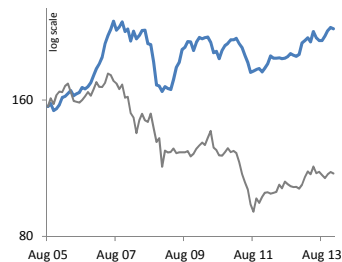
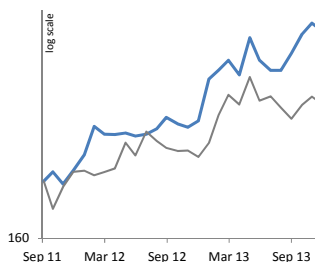


Figure 26: LTIF Stability Income Plus TR CHF vs. HFRX Global Hedge Fund Index CHF



**Figures of the GBP classes**

Table 4: Net Asset Value - Net assets under management in GBP

December 2013	NAV	Δ 3m	Δ YTD	Annualized Return since Inception	AUM (in mio) <i>*combined Pool</i>
LTIF Classic [GBP]	239.40	4.8%	18.8%	11.9%	172*
LTIF Alpha [GBP]	125.36	1.3%	9.7%	6.8%	172*
LTIF Natural Resources [GBP]	71.59	3.9%	-7.7%	0.4%	13
LTIF Emerging Market Value [GBP]	64.30	-1.0%	-3.9%	-24.4%	2

Figure 27: LTIF Classic GBP vs. MSCI Daily TR Net World Index GBP

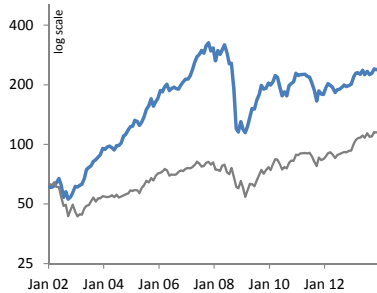


Figure 28: LTIF Alpha GBP vs. HFRX Global Hedge Fund Index GBP

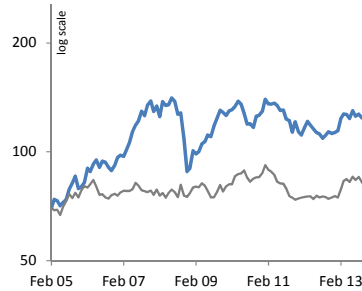


Figure 29: LTIF Natural Resources GBP vs. S&P Global Nat. Res. Net TR Index GBP

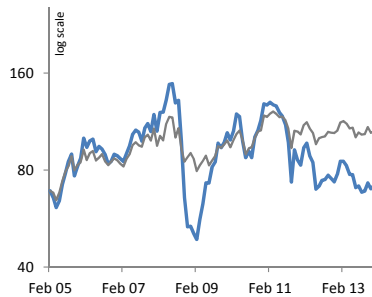
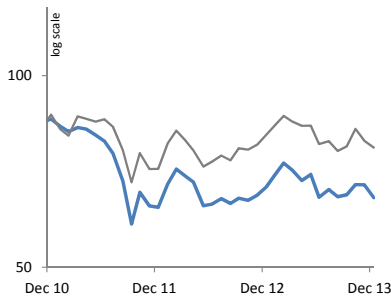


Figure 30: LTIF Emerging Market Value GBP vs. MSCI EM Daily Net TR Index GBP





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ISIN: LU0244071956  
Telekurs: 2'432'569  
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**

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### **LTIF – Emerging Market Value GBP**

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*ISIN:* CH0026389202  
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