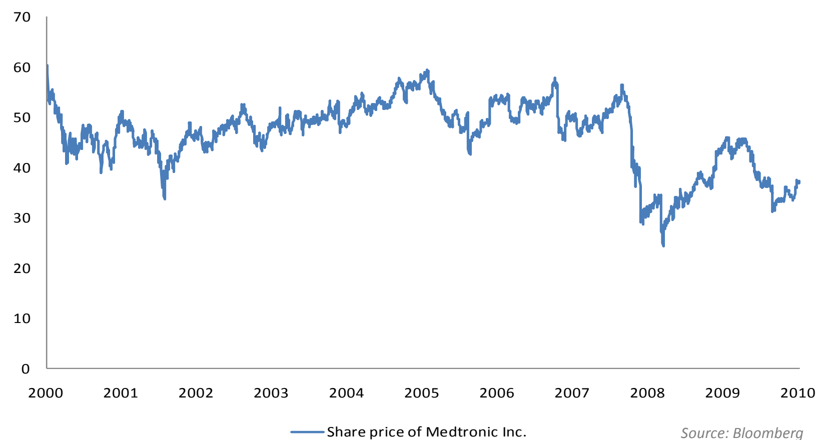
Long Term Investment Fund

“Price is what you pay. Value is what you get” Warren Buffett

Medtronic Inc is a US-based multinational company, world leader in pacemakers and other “med-tech” instruments, with annual sales of more than $15 billion. In the fiscal year 2000, ended in April of that year, its earnings per share were $0.89. Ten years later, its earnings per share is 3½ times more, standing at $3.14. This amounts to an annual growth of more than 13%.

However, the same cannot be said of its share price. As figure 1 shows, it fell from $60.38 in December 2000 to $37.09 at the end of 2010, for a compound decline of -3.73% per year. Medtronic has therefore been an excellent company for these past 10 years… and a bad investment. Why?

Figure 1: **Medtronic share price in USD, 1999-2010**



Well, from all points of view, Medtronic is a better company today than it was in 2000: its sales are up by 315% (USD 5’016 million in 2000 to USD 15’817 million in 2010), it operates in more countries, sells a more diversified product line, maintains its leadership positions… and earns more than three times what it earned in 2000. Sure, growth can probably not continue at this rate, given the company’s current size and market share. Additionally, many governments are trying to contain health care costs, which will put pressure on margins. Yet this is not why the 2000 Medtronic investor has lost so much money. The loss comes from a simple fact: the price paid for the Medtronic shares (with a PE of 45) was not justified by Medtronic’s value. We believe that the opposite can be true today. Despite the “head winds” of health care reform, a company that is a world class leader in producing and marketing something that an ever expanding share of the population both needs and can afford, that has remarkable profit stability, no debt, and can be bought for 10 times this year’s earnings, is probably an excellent investment. The company is the

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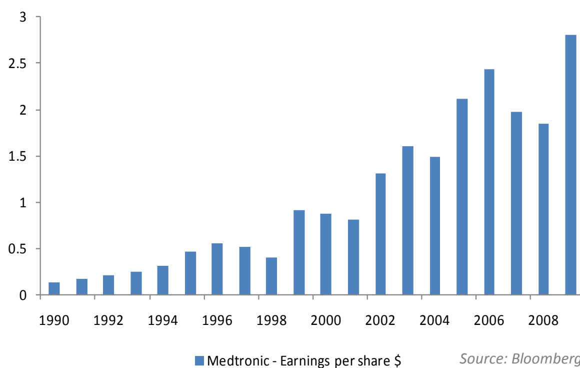
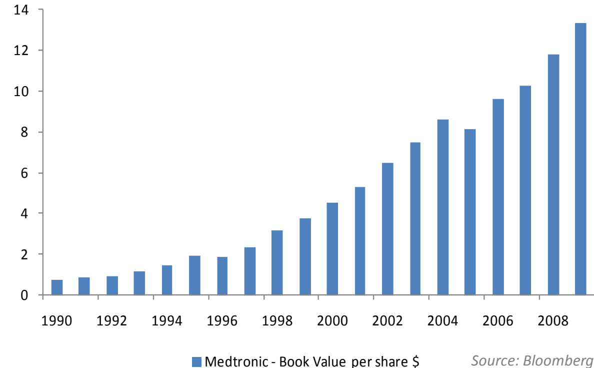
same as it was in 2000, with perhaps less growth now, but a more solid position. But the price is very different. It's almost impossible to make money when paying a PE of 45 for a company the size of Medtronic. It's difficult to lose money when paying a PE of 10.

This distinction between price and value is essential to value investors. We believe that markets do not always price shares correctly, because they let themselves be carried away by periods of "irrational exuberance" or bouts of panic. As we have written several times, the world economy is very stable: although we have suffered the worst world crisis in recorded memory, world GDP went down just by 1.91% in 2009, just to grow 4.50% in 2010. We can therefore affirm that the value of most companies actually changes little from year to year and most certainly, not from day to day: for illustration, our readers can take a look at Medtronic earnings per share and book value per share over the last 20 years in figure 2. Their growth consistency is remarkable. But, as figure 1 shows above, the share price may or may not reflect that stability. In fact, it tends not to. We can say that price is value, which tends to be stable, multiplied by sentiment, which is very volatile.

Figure 2: **Medtronic earnings & book value per share over the last 20 years**





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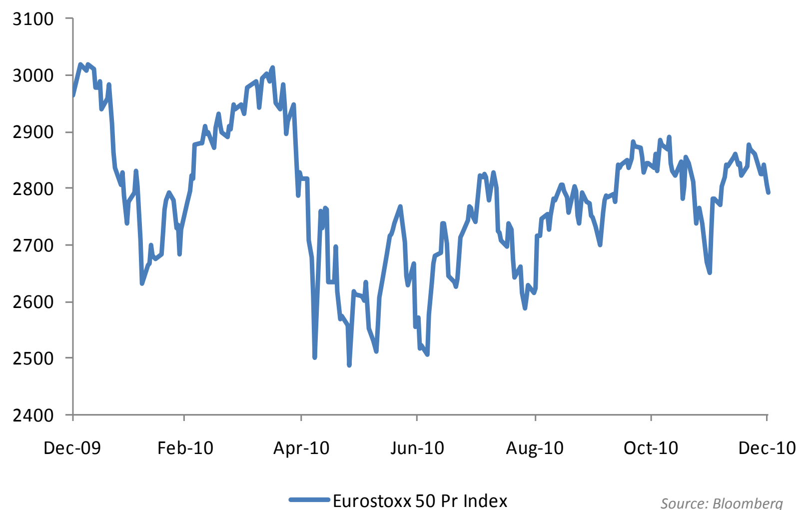
2010 in the markets

As we mentioned in our previous newsletter, 2010 was even more volatile than usual, as can be seen in figure 3:

Figure 3: **Eurostoxx 50 Price Index (last 12-months)**



There were many discussions about the Euro's problems and the possibilities of a "double dip" in the US economy. In conjunction with these "macro" fears, the SEC lawsuit against Goldman Sachs; the Macondo accident, which halved the share price of one the UK's key dividend payers; new governments' threats to increase mining taxes everywhere; all had a devastating impact on market sentiment. From this point of view, the markets fully anticipated the "double dip", which was logically reflected in our funds' prices. Figure 4 shows the level of the "Vix Index", that roughly shows how much market participants are ready to pay to protect their positions against violent swings. The spike in May 2010 was the strongest for 10 years, after the 2008 crisis.

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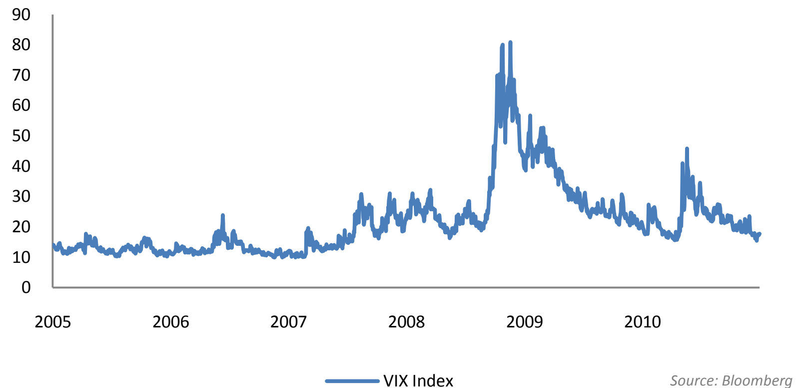
Figure 4: **VIX index between 2005 and 2010**



Source: Bloomberg

But value has been fairly stable. The world economy has continued growing, and corporate profitability is at record levels. Specifically, the companies we own have done very well in general, as we will discuss later.

What to expect from *prices* in 2011

The answer to this question is fairly simple - more volatility. There are at least two issues that are going to be in the headlines in 2011, and are going to impact share prices worldwide. They are the Euro crisis and the tightening of policy in emerging markets, exemplified by China's interest rate increase at the end of December 2010.

The Euro crisis is obviously far from over. We don't know what's going to happen, but one thing is clear: the debt position of several Euro members is not sustainable, and what is not sustainable, has to change. How this change will occur, we don't know, but investors should expect many panicky headlines when more countries are bailed out, or when the ones that have already been "bailed out" default, or both. Even if nothing happens, which is highly unlikely, markets will be subject to periodic scares as enormous debt rollovers come due throughout 2011. A mid-size European bank not paying back its debts in full can (will?) trigger one or more of these scares. Ireland's story is one of how a country can go bankrupt by trying to save its banks. Expect European voters to prefer letting bank investors down rather than having to absorb the losses themselves.

Most emerging markets face a starkly different problem: not too much debt, but too much growth. If inflation is to be controlled - and it will eventually be, one way or another - interest rates will have to go up. This is not bad. When a country raises interest rates because it's growing too fast, its companies tend to do very well. But since most of the world's economic growth comes from emerging markets (particularly China), anything that may imply a slowdown in their growth tends to spook markets.

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2011 will not be different, and this volatility may affect natural resources companies more than others. By now, everybody knows that the key reason for many commodities' historically high prices is demand from emerging markets. Investors will probably assume that, if those markets are going to grow less, commodities prices will go down. Expect exceptional volatility in this area.

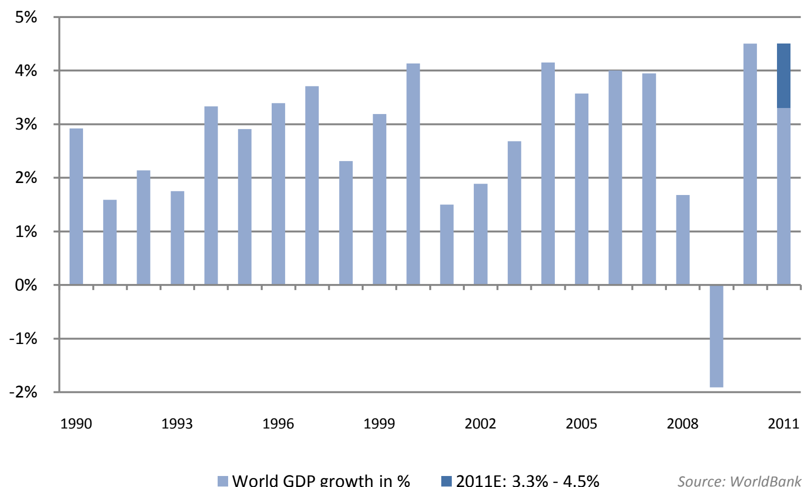
To these two issues we could add a third that may or may not occur: The possibility that the bond market will refuse to continue funding the US deficit. This is highly unlikely, but any hint of this would clearly rattle the markets.

These objective concerns will probably create more volatility than normal since the wounds of 2008 are still open in many investors' minds. As we saw in the spring of 2010, any hint of a "market crisis" provokes a quick sell-off. We would not be surprised to see some of these this year.

What to expect from *value* in 2011

Several years ago, the world embarked in the biggest economic expansion in history, triggered by almost three billion people gradually joining the modern, industrial economy. Not even the worst financial crisis ever, which threatened the very foundation of the US and Europe's financial systems, has been able to derail it, as figure 4 shows.

Figure 4: **World economic growth in the last 20 years in %**



This is not going to change. Some parts of the world, which used to be the whole world from an economic point of view, will grow slowly, burdened by high debt and unfavorable demographics. But emerging markets, much bigger in population terms, and becoming very large in economic

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terms, will continue growing very fast. People who talk of a “China bubble” have probably not examined the data carefully.

Consider housing, which many people, perhaps traumatized by their US experience, deem to be in the middle of a bubble. It’s true that apartment prices in “first tier” cities, such as Beijing, Shanghai, and Shenzhen have gone up more than is reasonable. But China is very large. Rural China has a population of over 700 million, and they want to join the economic party enjoyed by their eastern countrymen. The government, logically interested in accommodating those wishes, is doing all it can to move economic activity westwards. Just in the area of housing, it has planned to almost double the number of affordable apartments to be built in 2011 – 10 million, compared to 2010’s target of 5.8 million. 10 million won’t of course be built: the real figure for 2010 was 3.7 million, somewhat more than 30% off the target. But a similar accomplishment in 2011 would mean close to 7 million new apartments. This is necessary to accommodate the more than 1 million people who move to the cities every month plus housing for some of those people already in the cities but poorly housed. This is going to continue for many years. The exact growth rate will fluctuate, but the phenomenon is not going to stop. The “China bubble” will not burst, because there is no China bubble.

Figure 5 graphically illustrates the current size of the middle class in each continent and in twenty years’ time. Two points stand out: Asia’s future total dominance, from an economic point of view; and the enormous increase of the middle class in absolute terms. Being middle class, defined as having an annual income between $10.000 and $100.000 is not a purely theoretical concept. It implies owning a car, a washing machine, a TV set, enjoying piped water and sanitation, heating in the winter and cooling in the summer. The amount of raw materials needed to produce all those goods is simply staggering, as is the amount of energy needed to run them.

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Figure 5: **Global middle class in 2009 and prediction for 2030**

Source: Standard Chartered Bank

We strongly recommend that our readers watch a 5-minute video on economic growth over the last 200 years (as our readers know, we are long-term investors!). The video is very instructive and can be found by just clicking on the link: *200 countries, 200 years (www.youtube.com).*

In any case, it's important to keep in mind that the volatility in prices that we expect should have little impact on our value. The fact that a medium-sized European country cannot roll over its debts will most likely roil the markets, and send all share prices down. Nevertheless, the value of Nestlé, Shenzhen Motorways, or Medtronic, for that matter, won't change that much, if at all.

Impact on investment: How to position the portfolio

This heterogeneous rate of growth is the first determinant of how to position the investment portfolio. But a second parameter is essential – price. We've seen how Medtronic was a fantastic company to own in 2000, but the price at which it could be bought was way too high. It will not help an investor to buy Chinese shares if their prices already discount all expected growth.

We thus continue to favor our value approach: Buy shares whose price is lower than their future profits warrant. This can apply to shares in fast-growing companies, or shares in low-growth companies – if the price is low enough.

Over the months, we have sold shares that were, in our opinion, fully priced. Logically, we have replaced them, thus constantly re-building the portfolio. When positioning it we have worked on creating a balance be-

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tween steady and fast growers, always demanding a deep discount. Consequently, about 50% of our portfolio now comprises companies whose profits have historically been very stable, and that shouldn't vary too much with the unavoidable economic ups and downs. Medtronic would be an example of this, as would Unilever. These are companies with PEs around or below 10, outstanding cash flows, and very stable business models. They pay high dividends – in some cases more than 6% per year. They trade at the lowest prices (compared to profits) in a generation, except during the crisis days in early 2009. We believe they form an excellent foundation for any investment portfolio, and continue to search the world for such opportunities. This is necessary, because many of these shares tend to go up relatively quickly, and we proceed to sell them, replacing them with new ones with similar characteristics but a lower price. In this area we own Chinese motorways, healthcare companies such as Medtronic or Baxter International, and some blue chips such as IBM. What we said about Medtronic at the beginning of this Newsletter applies to many of these blue chips: Their share prices have halved during the last 10 years, while their profits are strongly up. This shows how overvalued they were in 2000, and why they can be an excellent opportunity now.

The other half of our portfolio is made up of companies with excellent growth prospects and prices that do not reflect them. Most of them are natural resources producers that we have owned for a long time. As explained in previous newsletters, we have concentrated our investments in companies producing oil, copper and, to a lesser extent, coal, because we believe those are the commodities where supply has more difficulty satisfying demand. The prices of these commodities have gone up this year (copper, for instance, is up almost 30% in 2010, more than gold), and we expect them to remain strong.

On the whole, our "expected return" is about 15% for this mixed portfolio of companies with a slightly lower expected return, but very steady profits and those more volatility but better expected returns.

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Figure 6
LTIF – Classic EUR

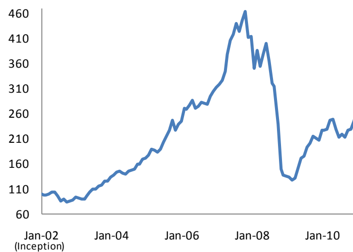


Figure 7
LTIF – Classic II EUR

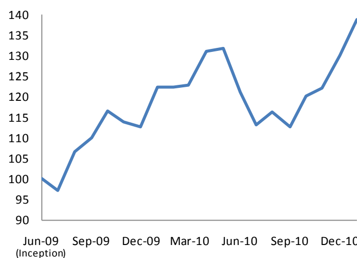


Figure 8
LTIF – Alpha EUR

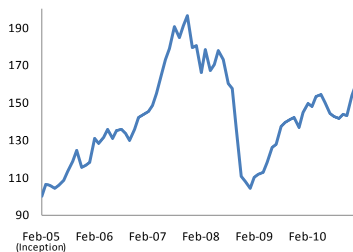
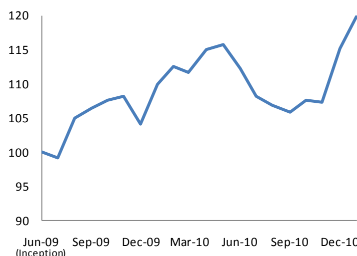


Figure 9
LTIF – Alpha II EUR



Comments on our funds

Figures 6 to 12 and table 1 show the evolution of our funds' Net Asset Value. This is the first year since we started nine years ago that the funds' "performance" has been relatively close to the 15% we aim for. In general it's been much higher, or much lower (e.g. 2008). The Classic fund has gone up 11.40% per year since inception. The Alpha fund has returned 8.44%, with much lower volatility.

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

December 2010	NAV	Δ YTD	Δ 12m	Ann. Return since Inception	AUM (in mio)
LTIF Classic [EUR]	264.21	16.02%	16.02%	11.40%	527.28 *
LTIF Classic II [EUR]	138.98	13.60%	13.60%	23.11%	** combined Classic & Classic II*
LTIF Alpha [EUR]	161.49	11.42%	11.42%	8.44%	83.96 **
LTIF Alpha II [EUR]	119.92	9.12%	9.12%	12.16%	*** combined Alpha & Alpha II*
LTIF Natural Resources [EUR] *(former Global Energy Value Fund)*	149.85	27.55%	27.55%	7.18%	125.85
LTIF Emerging Market Value [EUR]	99.74	-0.26%	-	-	5.30
LTIF Stability Series [CHF] ***	209.70	-0.47%	-0.47%	5.86%	33.98
*** Total Return (incl. Dividend)	3.69	1.23%			
MSCI World Index TR [EUR] *(Bloomberg GDDUWI)*	3'209.67	20.45%	20.45%	0.58% ****	***** Inception date of Classic*

The Natural Resources fund is, as could be expected, both a higher return fund, but also has higher volatility, with an annualized 7.18% performance since inception in 2007, just before the 2008 crisis. The fund has returned 27.60% in 2010, and we still see much value left. As we've discussed many times, some essential raw materials are scarce, and producing them is becoming ever more costly. Copper, particularly, seem to be constrained and we would not be surprised to see even higher prices in the coming months, given the situation of supply and demand. Oil is probably a few quarters away from a similar price rise, having gone up by 12% in 2010. Our investment in these companies producing those commodities is not based on an expectation of ever-rising commodity prices (it won't happen), but on the fantastic profits they make at these prices… and even at lower ones. Commodity prices have a component of "fundamental" reality, and some speculative "add-on" that in the case of copper and oil can be of about 10%, given how difficult (expensive) it is to store these commodities.

Therefore, when financial players get excited about a given commodity, they can push up the prices above what the fundamentals would warrant, just to flee the market (or even short it) when they believe things have gone too far. This exposes commodity prices to short-term volatility that, from a purely fundamental point of view, should not swing that much, given how constant production and consumption are (see figure 13 for

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Figure 10
LTIF – Natural Resources EUR

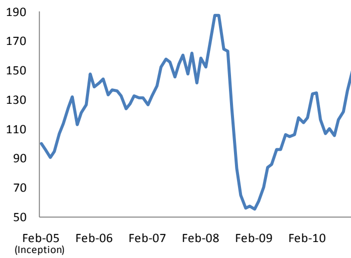


Figure 11
LTIF – Emerging Market Value

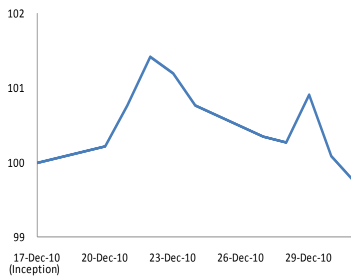
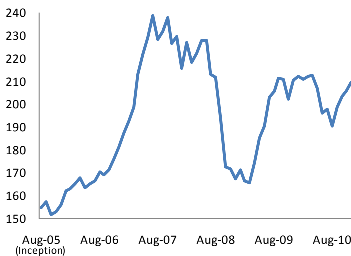


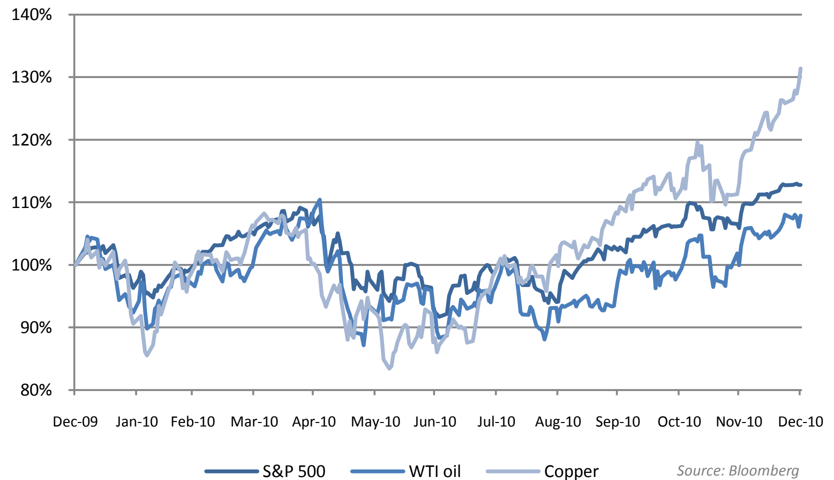
Figure 12
LTIF – Stability CHF



the 2010 evolution of copper and oil prices). But prices cannot venture very far from reality because, unlike shares, financial buyers or sellers must roll their positions over as the "spot" moment arrives. Thus the swings in share prices that all commodity companies experience every three or four months are an excellent opportunity to invest. We would be surprised if we didn't see one of those episodes in 2011 - probably when a piece of "bad news" comes from China. We would also be very surprised if the Natural Resources fund did not obtain a solid double-digit return in 2011.

Finally, the Stability fund has had a flat year in Swiss francs, doing slightly better than the Swiss stock index. The Swiss Franc has been an extremely hard currency in 2010, up 20% against the Euro. The Stability fund has therefore been an excellent performer for Euro-based investors: 20.20% in 2010, including 1.76% paid in dividends, with a lower volatility than any of our other funds… or any index, for that matter. As we announced in our previous Newsletter, we're preparing a Luxembourg-based instrument that will allow non-Swiss investors participate in this fund, which shows a combination of returns and low volatility that make it very attractive.

Figure 13: **S&P 500 Price Index, WTI oil and copper continuous future (2010, indexed)**



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A special mention is needed of our new fund, the Emerging Market Value Fund. We started it in mid-December, with €5 million. It will follow our deep value approach, not following mindless "momentum investing", which is all too typical of emerging markets investing in general. We will only buy what we believe are inexpensive companies with good growth prospects. For all the reasons discussed above, which can be seen in detail in our presentation (by just clicking on the link: *LTIF Emerging Market Value Fund*), we believe this fund should provide excellent returns in the future, and provide a good diversification to those investors with a strong European-based investment bias. We start with a fairly diversified portfolio, shown in figures 14a/b/c/d/e/f. These are some of the companies we own:

Figure 14a: **AMVIG Holdings Ltd**

Source: Bloomberg

- AMVIG Holdings Ltd, through its subsidiaries, prints cigarette packages and manufactures laminated papers for cigarette packages in China.
- Forward PE: 10.5
- DY 12-mths: 4.1%

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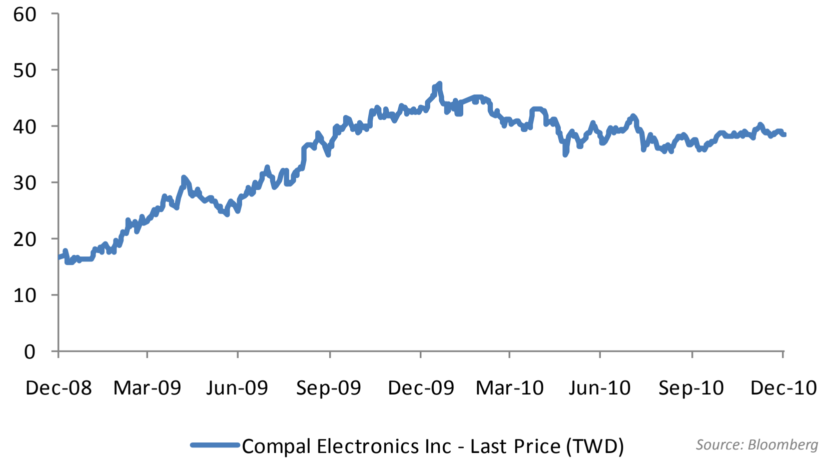
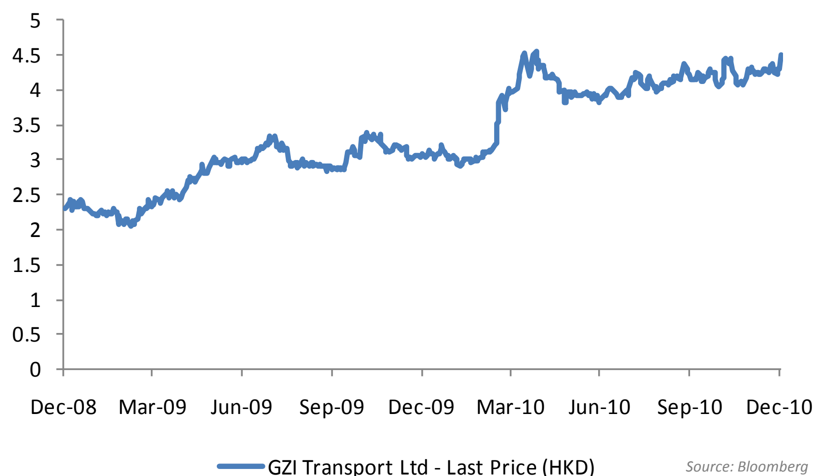
Figure 14b: **Compal Electronics Inc.**



- Compal Electronics Inc. manufactures and markets notebook computers and color monitors. The Company also produces liquid crystal displays and other computer related products. Compal Electronics exports its products to the United States, Europe, and Asia.
- Forward PE: 7.3
- DY 12-mths: 6.0%

Figure 14c: **GZI Transport Ltd**



- GZI Transport Limited, through its subsidiaries, invests in, develops, operates, and manages toll highways, expressways, and bridges in China.
- Forward PE: 10.9
- DY 12-mths: 4.9%

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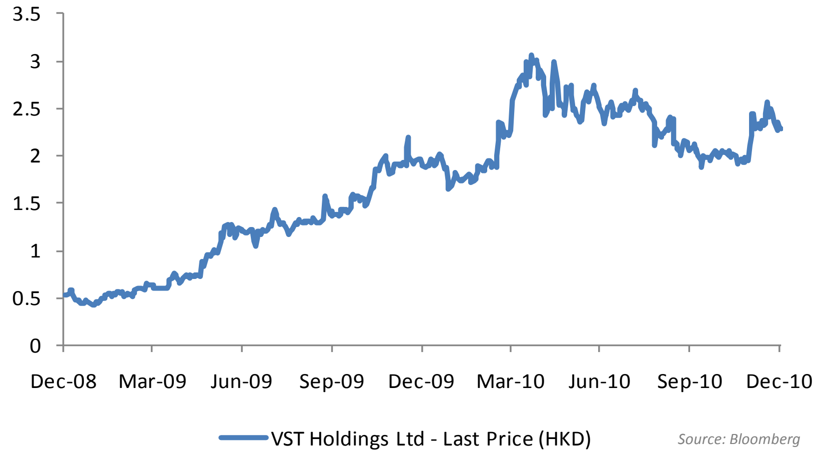
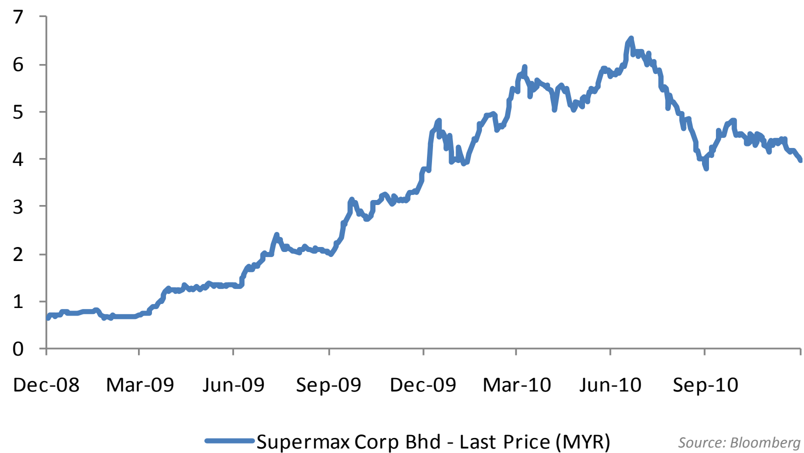
Figure 14d: **VST Holding Limited**



Source: Bloomberg

- VST Holdings Limited distributes a wide range of IT products, including data storage device, CPUs, media products, PC motherboards, and server motherboards. The Company also provides value-added services to its suppliers as well as support and after-sale service to its customers.
- Forward PE: 6.9
- DY 12-mths: 1.7%

Figure 14e: **Supermax Corporation Berhad**



Source: Bloomberg

- Supermax Corporation Berhad is an investment holding company whose subsidiaries manufacture, sell, and export various type of latex gloves around the world.
- Forward PE: 7.6
- DY 12-mths: 2.3%

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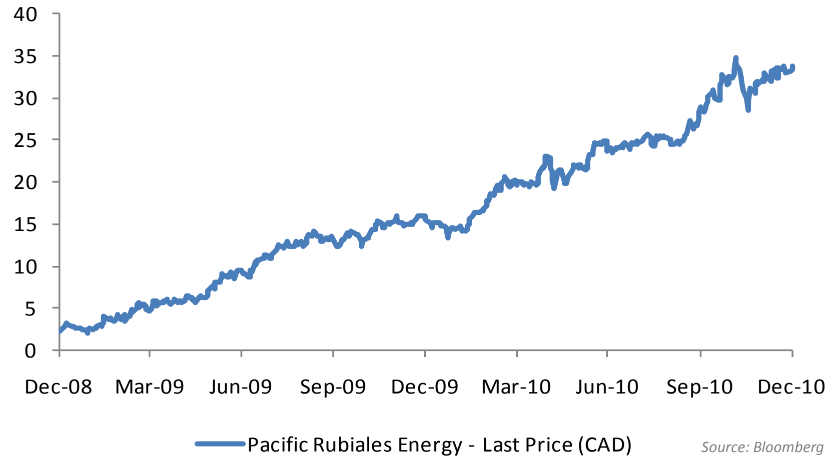
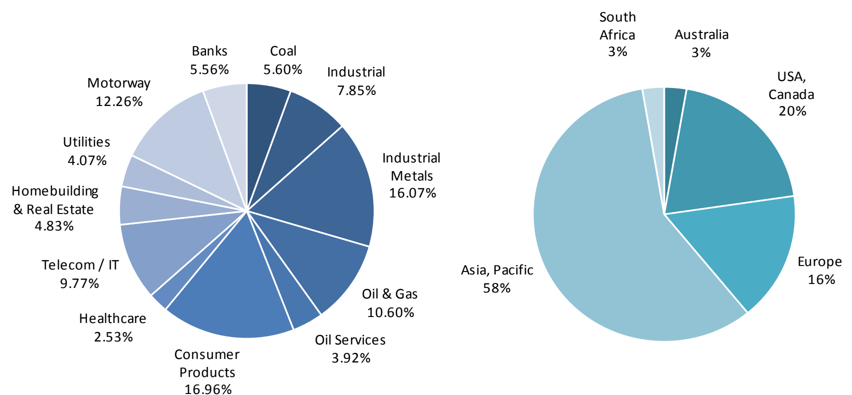
Figure 14f: **Pacific Rubiales Energy Corp**



- Pacific Rubiales Energy Corporation focuses on the exploration, development and production of heavy crude oil, light and medium oil, and gas in Colombia. The Company also has exploration blocks in Peru.
- Forward PE: 41.3
- DY 12-mths: 0.3%

Figure 15: **Breakdowns by industry and country in the LTIF Emerging Market Value, as of December 31st, 2010**



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SIA news

In addition to the launch of the Emerging Market Value Fund, the most important piece of news is that Burcu Gabrache (Geneva), Jordi Costa (Singapore), Xavier Brun, and Alberto Carrasco (Barcelona) have been promoted to Senior Analysts. Marcos Hernandez (Geneva), Joan Borràs (Barcelona), and Ed Yau (Singapore), have been promoted to Managing Directors, and become partners of the SIA Group.

Sarah Lombardi, one of our analysts based in Geneva, is moving to our Singapore office for some time. In addition to building a solid research team made up of people with Asian language skills, we want to send people from other offices to Singapore to both help extend the "SIA way" of investing and allow them to have a first-hand experience of the amazing development in that part of the world.

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Figures of the USD classes

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

December 2010	NAV	Δ YTD	Δ 12m	Ann. Return since Inception	AUM (in mio)
LTIF Classic [USD]	354.45	8.49%	8.49%	16.53%	707.38 *
LTIF Classic II [USD]	186.45	6.22%	6.22%	19.00%	*combined Classic & Classic II
LTIF Alpha [USD]	216.65	4.18%	4.18%	8.97%	112.63 **
LTIF Alpha II [USD]	160.88	2.03%	2.03%	8.41%	**combined Alpha & Alpha II
LTIF Natural Resources [USD] *(former Global Energy Value Fund)*	201.03	19.27%	19.27%	7.38%	168.84
LTIF Emerging Market Value [USD]	133.81	1.76%	-	-	7.11
MSCI World Index TR [USD] *(Bloomberg GDDUWI)*	4'290.05	12.34%	12.34%	5.18% ***	***Inception date of Classic

Figure 16
LTIF – Classic USD

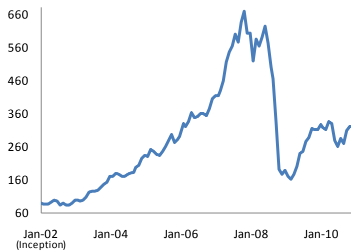


Figure 17
LTIF – Classic II USD

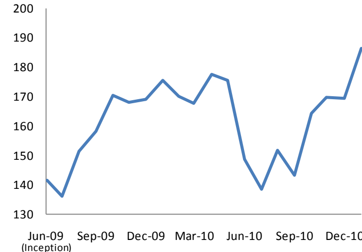


Figure 18
LTIF – Alpha USD

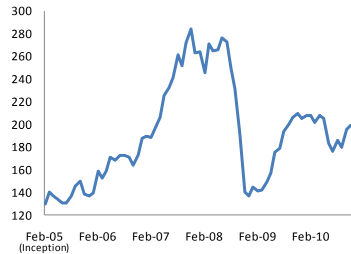


Figure 19
LTIF – Alpha II USD

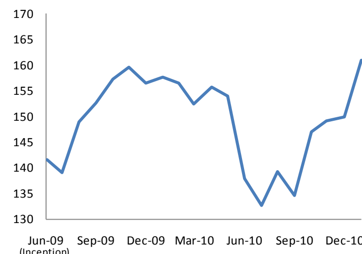


Figure 20
LTIF – Natural Resources USD

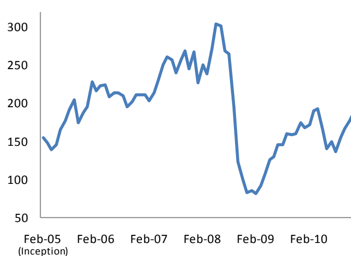
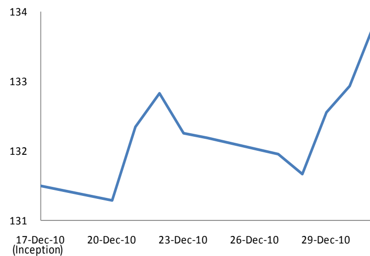


Figure 21
LTIF – Emerging Market Value USD



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Figures of the CHF classes

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

December 2010	NAV	Δ YTD	Δ 12m	Ann. Return since Inception	AUM (in mio)
LTIF Classic [CHF]	330.38	-2.18%	-2.18%	9.33%	659.35 *
LTIF Classic II [CHF]	173.79	-4.22%	-4.22%	8.95%	**combined Classic & Classic II*
LTIF Alpha [CHF]	201.94	-6.06%	-6.06%	4.59%	104.98 **
LTIF Alpha II [CHF]	149.96	-8.00%	-8.00%	-0.74%	***combined Alpha & Alpha II*
LTIF Natural Resources [CHF] *(former Global Energy Value Fund)*	187.38	7.54%	7.54%	3.36%	157.37
LTIF Emerging Market Value [CHF]	124.72	-2.35%	-	-	6.62
LTIF Stability Series [CHF] ***	209.70	-0.47%	-0.47%	5.86%	33.98
*** Total Return (incl. Dividend)	3.69	1.23%			
MSCI World Index TR [CHF] *(Bloomberg GDDUWI)*	4'006.47	1.39%	1.39%	-1.28% ****	*****Inception date of Classic*

Figure 22
LTIF – Classic CHF

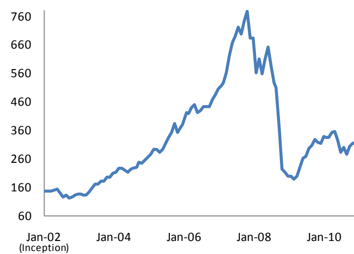


Figure 23
LTIF – Classic II CHF

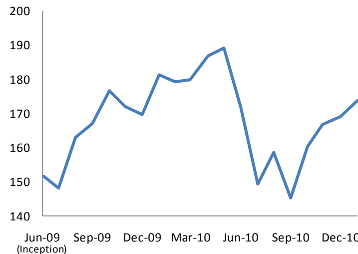


Figure 24
LTIF – Alpha CHF

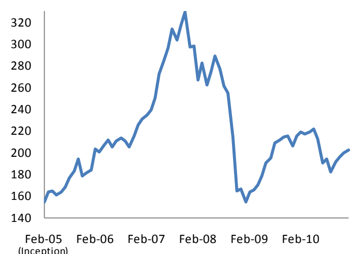


Figure 25
LTIF – Alpha II CHF

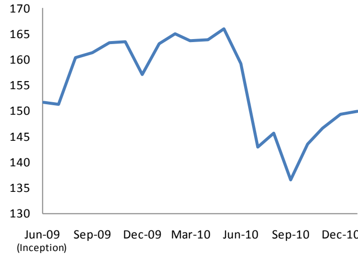


Figure 26
LTIF – Natural Resources CHF

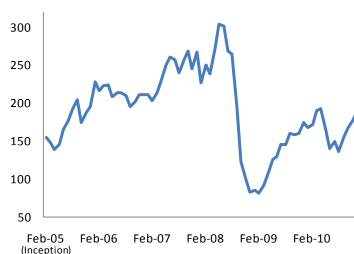


Figure 27
LTIF – Emerging Market Value CHF

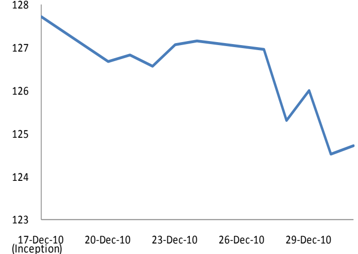
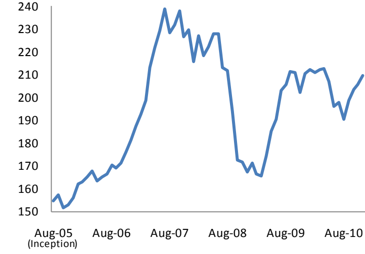


Figure 28
LTIF – Stability CHF



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Figures of the GBP classes

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

December 2010	NAV	Δ YTD	Δ 12m	Ann. Return since Inception	AUM (in mio)
LTIF Classic II [GBP]	119.09	9.56%	9.56%	22.67%	451.81
LTIF Alpha II [GBP]	102.76	5.24%	5.24%	11.76%	71.94
LTIF Natural Resources [GBP] *(former Global Energy Value Fund)*	128.40	23.01%	23.01%	11.26%	107.84
LTIF Emerging Market Value [GBP]	85.46	0.53%	-	-	4.54
MSCI World Index TR [GBP] *(Bloomberg GDDUWI)*	2'751.62	16.35%	16.35%	22.90% *	** Inception date of Classic II*

** Performance up to 05.11.2009 is converted on a simulation basis from EUR into GBP. NAVs from 01.06.2009 to 04.11.2009 are not official.*

Figure 29
LTIF – Classic II GBP

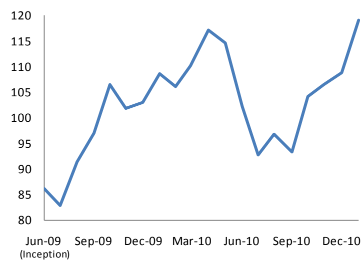


Figure 30
LTIF – Alpha II GBP

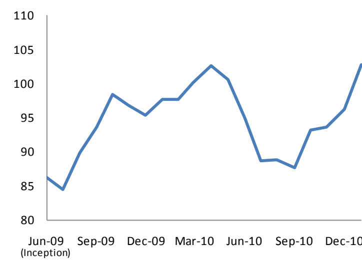


Figure 31
LTIF – Natural Resources GBP

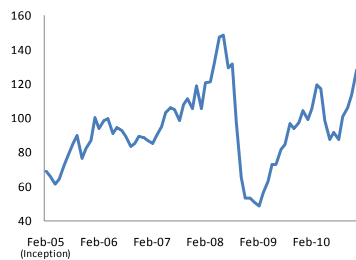
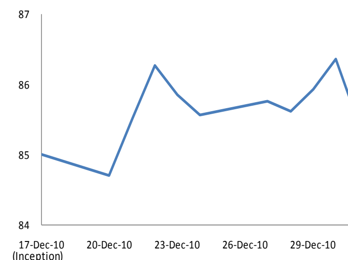


Figure 32
LTIF – Emerging Market Value GBP



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LTIF – Classic II EUR
ISIN: LU0423699429
Telekurs: 10'096'865
Bloomberg: LTIFC2E LX

LTIF – Classic II USD
ISIN: LU0423699692
Telekurs: 10'096'889
Bloomberg: LTIFC2U LX

LTIF – Classic II CHF
ISIN: LU0423699775
Telekurs: 10'096'893
Bloomberg: LTIFC2C LX

LTIF – Classic II GBP
ISIN: LU0457694296
Telekurs: 10'638'930
Bloomberg: LTIFC2G LX

LTIF – Alpha II EUR
ISIN: LU0423699858
Telekurs: 10'096'895
Bloomberg: LTIFA2E LX

LTIF – Alpha II USD
ISIN: LU0423699932
Telekurs: 10'096'898
Bloomberg: LTIFA2U LX

LTIF – Alpha II CHF
ISIN: LU0423700029
Telekurs: 10'097'000
Bloomberg: LTIFA2C LX

LTIF – Alpha II GBP
ISIN: LU0457693215
Telekurs: 10'638'835
Bloomberg: LTIFA2G 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
Bloomberg: LTIFGEG LX

LTIF – Emerging Market Value EUR
ISIN: LU0553294868
Telekurs: 11'901'448
Bloomberg: LTIFEME LX

LTIF – Emerging Market Value USD
ISIN: LU0553295592
Telekurs: 11'901'450
Bloomberg: LTIFEMU LX

LTIF – Emerging Market Value CHF
ISIN: LU0553294785
Telekurs: 11'901'447
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ISIN: LU0553296053
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Long Term Investment Fund Stability (SIA Funds) was approved by the Swiss Banking Commission on July 13, 2006. The fund started trading denominated in Swiss Francs as of October 1st, 2006. This newsletter is only addressed to qualified private investors who have expressed a desire to receive it, and by no means constitutes an offer to sell financial products that may not be suitable for its readers.

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