Figure 1
LTIF – Classic EUR

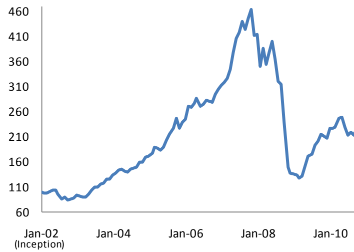


Figure 2
LTIF – Classic II EUR

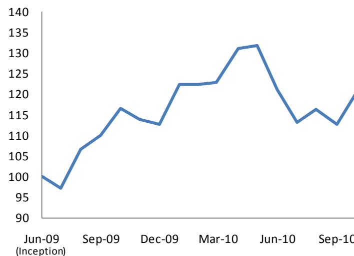


Figure 3
LTIF – Alpha EUR

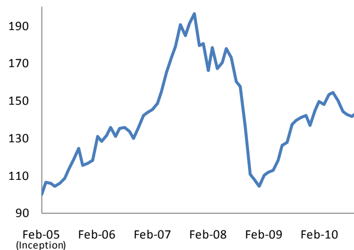
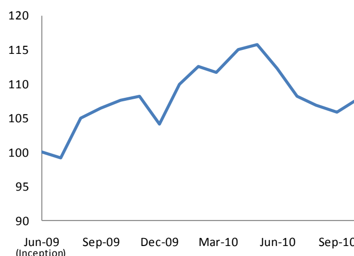


Figure 4
LTIF – Alpha II EUR



Long Term Investment Fund

"The market? It will fluctuate." John Pierpont Morgan, circa 1900

Table 1 and figures 1 through 6 show our funds' Net Asset Valuation evolution through the third quarter of 2010. After the rise in the first quarter and the drop in the second, we're basically where we were at the beginning of the year.

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

September 2010	NAV	Δ YTD	Δ 12m	Ann. Return since Inception	AUM (in mio)
LTIF Classic [EUR]	226.52	-0.53%	5.38%	9.80%	506.11 *
LTIF Classic II [EUR]	120.29	-1.68%	3.26%	14.86%	**combined Classic & Classic II*
LTIF Alpha [EUR]	143.53	-0.97%	1.65%	6.58%	85.73 **
LTIF Alpha II [EUR]	107.62	-2.07%	0.00%	5.66%	***combined Alpha & Alpha II*
LTIF Natural Resources [EUR] (former Global Energy Value Fund)	116.52	-0.82%	9.93%	2.78%	94.56
LTIF Stability Series [CHF] ***	198.70	-5.70%	-6.01%	5.04%	34.97
*** Total Return (incl. Dividend)	3.69	-4.08%			
MSCI World Index TR [EUR] (Bloomberg GDDUWI)	2'888.17	8.38%	15.37%	-0.6% ****	***** Inception date of Classic*

Volatility, duly reflected in our funds, has been the most salient characteristic of this quarter. Figure 7 shows the value of the Eurostoxx, an index closely followed by most of our investors, for the last twelve months. It's important to bear in mind that each of the "peaks and valleys" implies swings in "value" (we should say "price") of more than 15%.

Figure 7: **Eurostoxx 50 Price Index (last 12-months)**

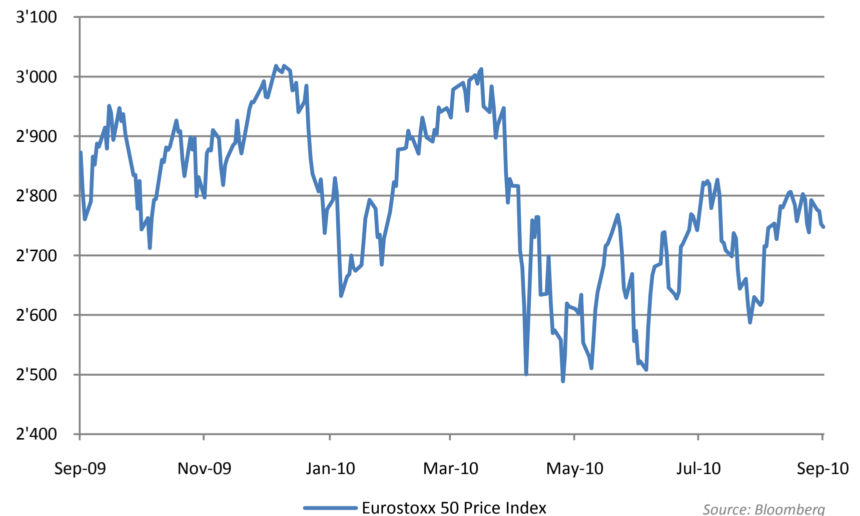


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Figure 5
LTIF – Natural Resources EUR

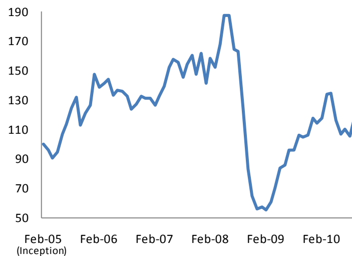
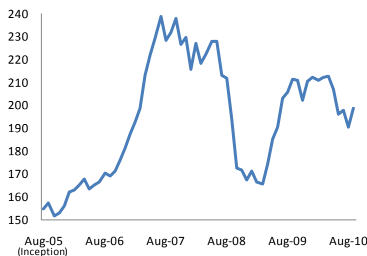


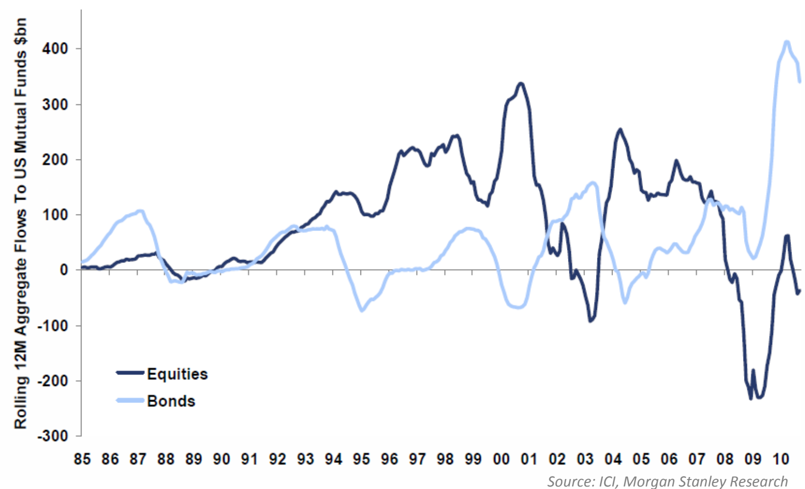
Figure 6
LTIF – Stability CHF



Confronted with this continued volatility, many investors are simply giving up on equities. If, regardless of what's happening to the real companies behind the shares, you define "losing money" in your stock investments as their price going down you shouldn't be in this game. Nobody in his right mind should put his savings in a business scheme that can, for no apparent reason and with no warning, lose 20% of the capital in three weeks, then recover it, only to lose it again. This is what happens to people with a bit of surplus cash in casinos when they're out to have a pleasant evening, but it's not supposed to happen with their life savings.

This "disgust" with equity investing, emerging from the wild volatility we are experiencing, is reflected on startling statistics, like those shown in figure 8: Investors are now putting more money in bonds than they did in equities at the peak of the huge 1998-2000 equity bubble. Refusal to invest in equities does, of course, depress their price.

Figure 8: **Flows to US bond funds exceed those to equities at the peak of the TMT bubble**



Source: ICI, Morgan Stanley Research

We believe that there is a good chance that this volatility will continue. The reasons for this go beyond the structural fluctuations alluded to by JP Morgan in our opening quotation (which was his standard response, in all circumstances). There are two factors that right now increase volatility. We believe they will fade one day, but are probably going to remain with us for a while.

The first is the unprecedented level of what we can call "macroeconomic fear and confusion." The second is the extreme correlation of trades.

Let's start with the second reason. On a typical day, some stocks will go up, some will go down, and the index will simply be an average of what all the stocks did. It is conceivable that half the stocks could go one way, the other half the other, and the index will not move. In this case, the so-called correlation between stocks and indices would be low. In the oppo-

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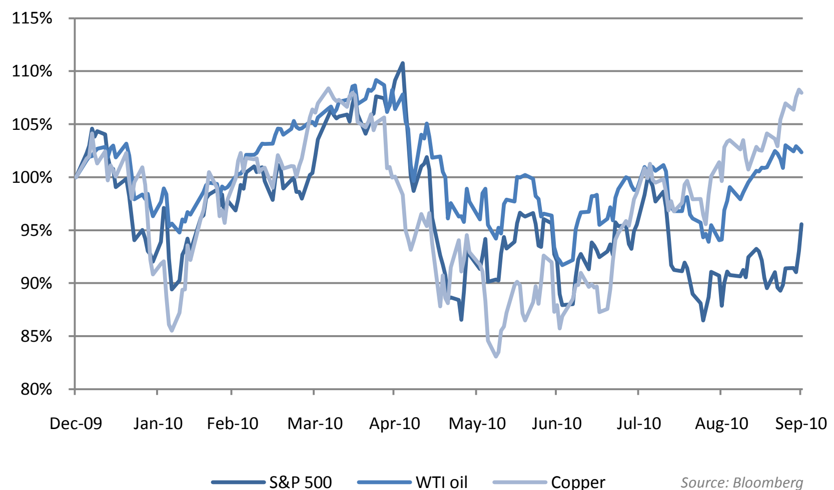
site case, all the stocks would go up or down by the same amount and, logically, so would the index, which is just the average. In this second case, correlation would be 1. In the first case, correlation would be close to zero. These numbers measure how "synchronized" the moves are. If all stocks go up or down at the same time (high correlation or synchronization), volatility in the index goes up, because there are no opposite moves to cancel each other.

Historically, correlation has been around 0.4: on a given day, only 40% of the movement in a typical stock is due to "the market," the other 60% is independent, with each stock "doing its own thing." In the last few months, correlation has been 0.8. In essence, this means that with the exception of big news on specific stocks, they all go up and down with the market, regardless of what is going on in the companies themselves (while some are, logically, doing much better than others).

What's more, this synchronization has not only increased in stocks, but also in almost all other investable assets. Many people invested in commodities in the last decade on the basis of empirical evidence that, for years, commodity prices had been negatively correlated with stock prices, so they were a good "diversifying asset class." Well, figure 9 shows the price of the S&P 500 index and the next-month contract prices for copper and WTI oil. Not much diversification there.

Figure 9: S&P 500 Price Index, WTI oil and copper continuous future (YtD, indexed)



If all investments go up and down at the same time, portfolios become much more volatile (no "compensation effect" of some investments going up while others go down, and vice versa), and investors feel sicker and sicker. In the end, only cash and government bonds seem a safe haven: cash does not move, and bonds have been mainly going up, precisely because of the huge transfer of money into them as shown in figure 8 above.

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Why is this synchronization happening? The reason is our other point: “macroeconomic fear and confusion.” It’s not normal to find articles predicting inflation and articles predicting deflation in almost every edition of an economic journal. In fact, the strong price of gold would logically suggest that the market is fearful of inflation and does not want to keep “paper money.” But current bond yields only make sense if one expects deflation, when “paper money” becomes an excellent investment. On a given day, both gold and bonds can move in the same direction, which, over time, must be shown to be impossible.

For most market participants, the 2008 crisis has been the first experience of a real crash. Sure, markets had dropped a lot in the past (the S&P 500 dropped 20.4% on October 19th, 1987; and 49% between 2000 and 2003). But those drops did not threaten the whole economic and financial system, and were absorbed relatively quickly, thus not having much of an impact on the real economy. Banks kept doing their business, and there were no clear emergencies. Even a horrible decade for stocks such as the 70s happened 40 years ago, and it was a decade, not a sickening two weeks in which everything seemed to collapse, as in October 2008.

Furthermore, the consequences of the crisis are going to stay with us for a long time: huge government debts, high levels of unemployment, necessarily constrained consumption by over-indebted families, etc., etc. The lack of clear precedents for such an enormous crisis, plus the intrinsic difficulty of modeling a modern economy, all lead to the spectacle of eminent economists and superficial commentators alike taking very different sides of the arguments, thus causing extreme confusion for the investing public. Investors come away with a clear, probably warranted conviction: nobody really knows what is going to happen next.

This is both a cause and a consequence of the “correlation trades” we mentioned before: people don’t have a very clear picture. When good news arrives, they rush to buy - almost anything. When news is bad, let’s sell everything, because everything went down in 2008. The net result is, as discussed, disgust with practically all “asset classes,” with the possible exception of bonds, which seem to be “safe.” Their yield is very low, of course, (i.e. their price is very high), precisely because they’ve become the investment of choice. It’s the famous “risk on/risk off” theme of the past few months.

As we have mentioned, this situation may last for a while. This is the first time in almost 50 years that developed countries find their fiscal soundness under question. Will certain governments collapse under the debt they’ve accumulated? Some will come close, and will probably have to restructure their debt. This will create even more confusion although, again, this will not have a huge impact on the real economy: simply, it is a transfer of wealth from those who own bonds to those who issued them. The productive capacity of the world will remain mostly intact. But, in their efforts to avoid default, governments will reduce their expenditure,

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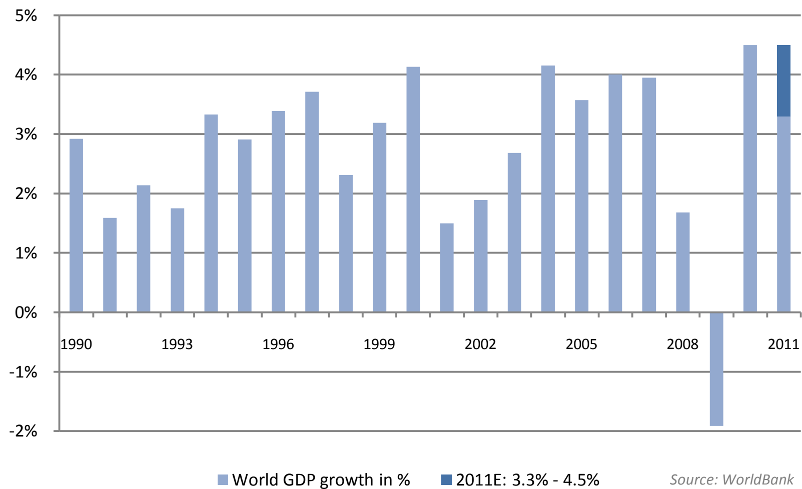
lower interest rates (once more transferring wealth from creditors to debtors), and generate overall nervousness and a morose economic environment.

But, parallel to all this, something very strange is happening: the world economy is booming. 2010 is going to be the fastest year of economic growth in the last 20 years.

Figure 10: **World economic growth in the last 20 years in %**



This is, of course, corroborated by all kinds of statistics: commodity consumption is at an all-time high (see figures 11 & 12 for copper and steel); Germany has now more jobs than ever in history, having passed the mark set before the 2008 crisis (see figure 13). An interesting anecdote: the increase in China's imports for the year is bigger, in absolute terms, than the whole Greek GDP. In fact, China has just offered to fund the Greek Government deficit, to help "to tide (it) over the once-in-a-century financial crisis," according to Prime Minister Wen.

Figure 11: **Global refined copper consumption**

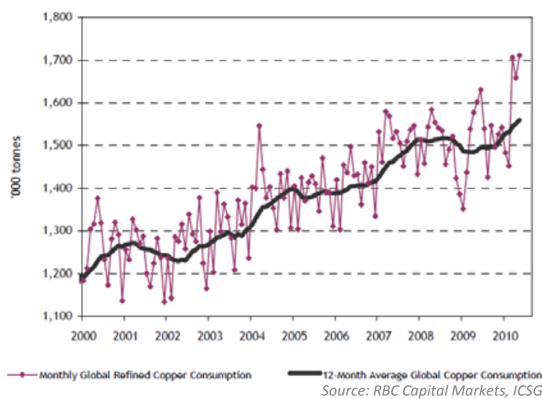


Figure 12: **World consumption of crude steel**

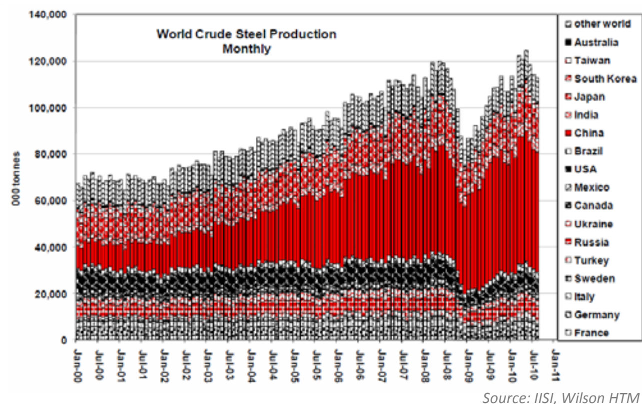


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Figure 13: **Unemployment rate of Germany in % (since 1991)**

Why this disconnect between many investors' extreme fears and what is actually going on? In our opinion, it has to do with much economic journalism originating from the US, and the US economy is not doing all that well (in fact, on most measures, somewhat worse than Europe's). In March 2008, two-and-a-half years ago, we wrote:

> *The macro picture is, in fact, relatively simple: the US has been consuming for years much more than it produced, hence its trade deficit. This was matched by much of the rest of the world's trade surplus, i.e., the Chinese (and the Swiss!) were producing much more than they consumed. Now, as demanded by policy makers everywhere for years, this permanent imbalance is correcting itself.*
>
> *The problem is that this does not look like correcting an imbalance to the US citizens: it looks like hell, because they have to consume less, pay their enormous debts, and let those Chinese and Swiss (and Japanese, and French…) producers enjoy more of what they produce. Worse, to make up for years of over-consumption, the US has to send those foreigners something more valuable than subprime based CDOs and shares in Blackstone or Carlyle Capital, taking that "something" out of their current consumption. They feel horrible, and it shows. They will talk about recession for years to come… (Newsletter of March 2008, Page 4)*

That's exactly what's happening. The US economy is indeed growing, but not much, and it will probably continue like this for a while, with (small) ups and (scary) downs. Deep "balance-sheet" recessions take time to heal, because it takes time to repay debt: it cannot be done all at once, because not everybody can save at the same time. Somebody must buy for others to sell; somebody must run a deficit for others to run a surplus.

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The (very favorable) difference with previous recessions, which Western investors find difficult to "feel," is that three billion people are now part of the world economy, and they don't have any of the problems of the over-indebted, graying advanced economies. When the oil shocks of the 70s hit the advanced economies, China was suffering under Mao's nihilistic economic policies and India was all but closed to economic development. Current "dragons" such as Vietnam were literally at war, while Brazil was under the yoke of a military Junta, terrible politically and thoroughly illiterate economically. The economies comprising those three billion people are all growing now at more than 8% per year. And although economies such as India and Vietnam are still coming off a very low base, China has already become the world's second largest, and Brazil is about to overtake position 9 (ahead of Spain). For the first time in 300 years these countries matter a lot, something Western nations are having a difficult time internalizing.

But the facts are there: U.S. Energy Information Administration EIA projects world oil consumption growth of 1.6 million barrels per day for this year, despite a decrease in Europe and quasi-stagnation in the US, because car sales in China went up 56% in 2009 to 11.7 million, and will reach 20 million in the next five years (they'll be more than 15 million in 2010). Most industrial commodities' prices (including those like coal and iron ore, for which there are no futures markets that speculators could "inflate") are fetching prices close to those of 2008, pre-crisis. The reason is simple: demand is again where it was, and supply has not grown. That's a strong reason to invest in our Natural Resources Fund, by the way. We believe it should have an impressive return in the next few quarters.

So, what's an investor to make of all this? We believe there are 4 options (plus a combination of them):

1. Opt for safety, and accept no returns
2. Play with fire in search for "safe high yield"
3. Go for solid, inexpensive businesses
4. Try investments that try to strike a balance between profitability and volatility

As we've mentioned, many investors are embracing the first option right now. To take even the safest government bonds at very low rates when, in fact, inflation is already higher than those rates, is to accept a world of no returns, except in the case of massive, sustained deflation. A very wealthy investor could rationally opt for ensuring he suffers no losses, and simply "eat off" his capital. It is not a bad strategy, but it requires a lot of capital to be sustainable. Anybody who needs some rents cannot do this for more than a little while.

The second option is what led investors to investments like sub-prime CDOs, apparently non-volatile hedge funds which turned out to be frauds, or, lately, to non-investment grade bonds at a price that does not include a reasonable chance of default. These investments are stable… until they

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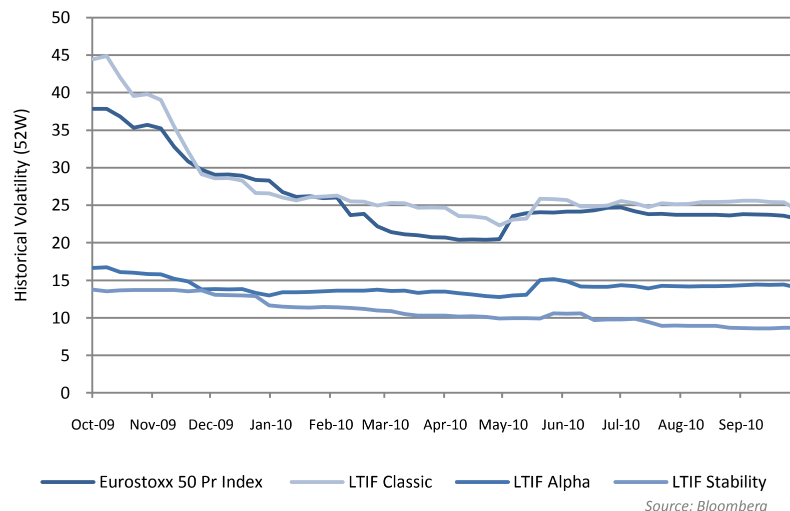
aren't. Compared with stocks, they don't go up and down every day. They promise a fixed return. But, as Mark Twain said, sometimes the return ***of*** capital is more important that the return ***on*** capital.

The third option is the one we have been advocating since the beginning: buy shares of good companies at low prices. Sure, you'll see huge drops in their prices from time to time, but as long as the underlying business is okay, all those drops will be erased. At the start of this newsletter we mentioned that our funds are basically where they were at the beginning of the year. But our companies aren't: most of them have made a lot of money in these nine months, and they are much more valuable than in January. Investors may be fearful and not ready to buy them for more money, but that does not mean there is not more money in the bank. Eventually, it'll show.

Finally, investors can use instruments to gain some of the long-term value of stocks while trying to lower their volatility. Among many offerings in the markets, we have the Alpha and Stability funds. Figure 14 shows those funds' volatility over the last year, compared to that of the Euro-stoxx Index (we also include the Classic for reference).

Figure 14: Historical weekly volatility of LTIF Classic, Alpha and Stability compared to that of the Eurostoxx 50 Price Index (last 12-months)



Source: Bloomberg

Of course, as mentioned before, investors could (and probably should) go for a combination of these approaches. But as we pointed out in our March newsletter, it is precisely when the market is most depressed that the best returns can be obtained for the long term. Inflation or deflation, double dip or not, there are many companies that are going to do very well over the next 10 or 20 years, and many can be bought now at a very good price. As an example, look at Toyota's share price during the worst of the Japanese "lost decade," in figure 15. It shows that companies can do very well even in stagnant markets, provided they have the right strat-

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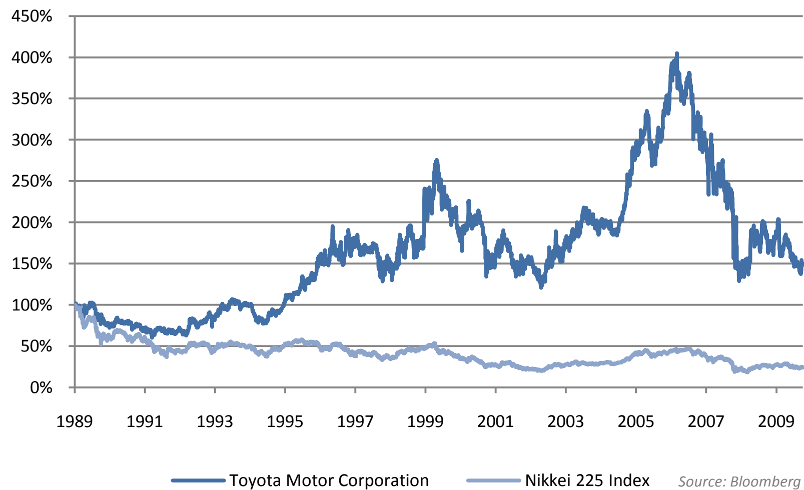
egy. It also shows how good stock-picking pays, also regardless of market conditions.

Figure 15: Share price of Toyota Motor Corporation compared to that of the Nikkei 225 Index (since 1989, indexed)



We are now carefully adding to our portfolio "blue chip" companies, such as IBM or Medtronic, which were always too expensive for our taste, but that can be bought at a price now that we believe ensures double-digit returns over the long term. These opportunities are rare.

Besides these "blue chips," we continue adding Asian companies to our portfolio. In total, our emerging markets exposure is 10.89%. We are finding companies operating in environments with very high growth, no debt, excellent demographics, and all at reasonable prices. Our Singapore office is providing us with a constant stream of ideas, and the best are being added to our portfolios. Investing where there are no problems is a way of avoiding problems.

Emerging markets (like all markets) are, of course, volatile, and one day they'll go down (in fact, the Shanghai market is seriously down this year). That's why we maintain a diversified portfolio, also geographically. But we have decided to let our investors exploit our growing expertise in emerging markets more directly by launching the Emerging Markets Value Fund.

At SIA we don't want to proliferate our funds. In fact, last quarter we reduced the number of funds on offer by merging the Energy Value fund and the Global Mining Fund. However, we are ready to offer our investors a specific opportunity when (as with those two funds) we find a theme that we believe is underrepresented in many portfolios, has long-term appeal, and where we think we can add expertise. The broad category "emerging markets" meets those criteria.

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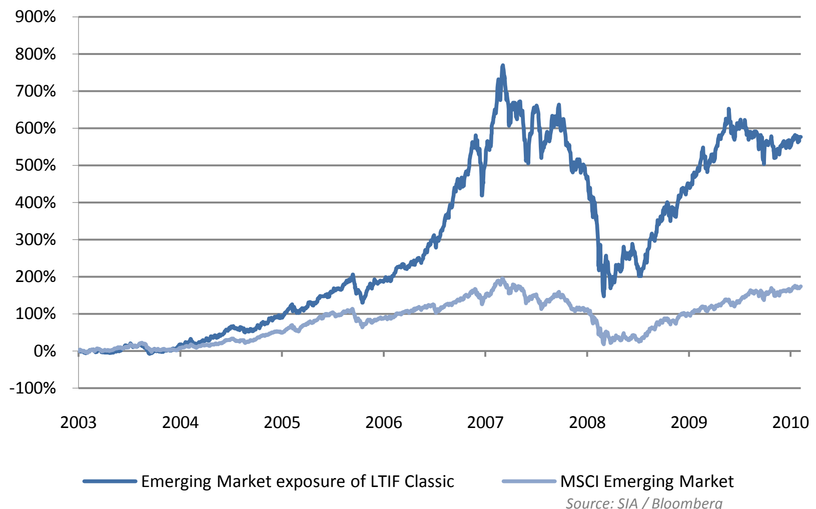
In our June newsletter (available here) we discussed why we think Asia is a very important element in today's investment universe (the entire presentation we made in spring can be obtained here). One can add Latin America to those Asian countries, as Brazil is fast becoming a very important global player, plus many other areas, such as Turkey. Rates of growth are very high, and quoted companies' return on equity is structurally higher (by more than 2% on average) than that of companies in developed markets. This is only logical: growth is higher, opportunities abound, and there is less competition of the kind found in mature or even stagnant markets.

We believe our fund is relatively original in that we are going to continue to concentrate on value investing. In fact, companies we already own in the other funds will make up the core of the fund. Many emerging markets funds tend to follow a "growth" or "momentum" approach. While we expect better growth than in Europe or the US, and we recognize a positive momentum now, we will only buy companies that pass our strict quality/value tests. Figure 16 shows that our basic value approach does work in Emerging Markets:

Figure 16: **Performance of Emerging Market exposure of LTIF Classic compared to that of the MSCI Emerging Market Index (since 2003, indexed)**



Source: SIA / Bloomberg

This figure shows the performance of a theoretical "sub-fund" made up of the emerging markets positions we have had in the past in the Classic fund, bought and sold at the time and the prices at which we actually bought and sold them. As the graph shows, performance has been positive and clearly better than the corresponding index.

Technically, the fund will be a "compartment" of the LTIF Luxembourg Sicav that already contains the Classic, Alpha, and Natural Resources funds. We'll send all the details within a few weeks so that those interested investors can participate.

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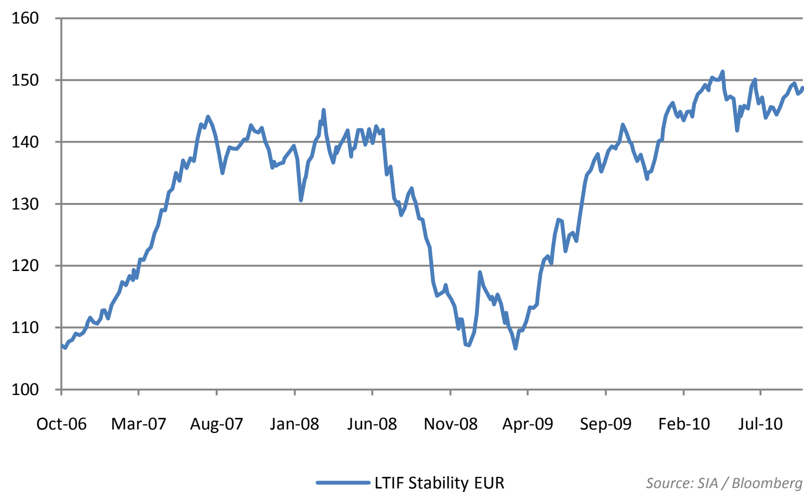
The Stability Luxembourg fund

As mentioned above, a fund that combines value, long-term investments and some hedging can be an interesting proposition in highly volatile times. Our Stability fund is such an investment.

The Stability fund is made up, roughly, of 80% of shares, mirroring the Classic/Alpha portfolio, and then some cash or, opportunistically, some high yield bonds issued by companies we know well through our equity analyses. It's a Swiss fund, only quoted in Swiss francs, although very few of its investments are in that currency.

Its performance since inception has been fairly interesting, especially if one regards it from the point of view of a Euro-based investor (as most of our clients are):

Figure 17: **LTIF Stability in Euro (since inception)**



The fund is essentially at the highest mark ever, having paid 1.85% in dividends. Figure 18 shows the NAV evolution of the Classic, Alpha, and Stability funds this year:

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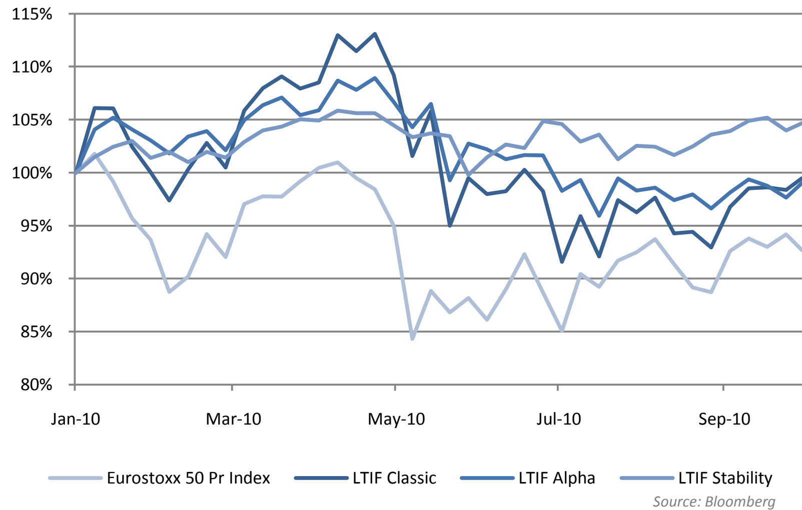
Figure 18: **YtD performance of LTIF Classic, Alpha, Stability and Eurostoxx 50 Index in Euro**



Source: Bloomberg

Since many of our investors have a strong preference for euro-denominated instruments based in a EU country, we're also launching a Luxembourg UCITS-III Sicav, in the form of a Specialized Investment Fund (SIF) the LTIF-Stability (Luxembourg) fund. It will simply be a "feeder" to the Swiss fund, so its performance will be the same. Again, we'll send the specific details in a few weeks, once the fund is available.

SIA news

We continue strengthening our team. In August, Yiyi Jiang joined our Geneva office as an Equity Analyst. Born in China, Dr. Yiyi Jiang holds a Ph.D. in Finance from IE Business School (Spain), an MA in Economics from Yale University (USA) and a BA in Finance from Renmin University of China.

In her doctoral dissertation, she designed a complex multi-factor trading model which combines various macro, fundamental and technical indicators to explore the market inefficiencies using the principles of Genetic Algorithm programming in MATLAB. Furthermore, she developed her expertise in security valuation and portfolio construction during her professional experience at BBVA Research Center and China Galaxy Securities.

We expect Yiyi to reinforce our China research capabilities and move to our Singapore office after a couple of years in Geneva.

We are also pleased to share with our investors that Burcu Gabrache from our Geneva office and Jordi Costa from Singapore have gained the Chartered Financial Analysts (CFA) certification from the CFA Institute after all the regulatory exams.

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Figures of the USD classes

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

September 2010	NAV	Δ YTD	Δ 12m	Ann. Return since Inception	AUM (in mio)
LTIF Classic [USD]	309.24	-5.35%	-1.58%	15.23%	690.95 *
LTIF Classic II [USD]	164.22	-6.44%	-3.55%	11.77%	** combined Classic & Classic II*
LTIF Alpha [USD]	195.95	-5.77%	-5.06%	7.46%	117.03 **
LTIF Alpha II [USD]	146.92	-6.82%	-6.60%	2.82%	*** combined Alpha & Alpha II*
LTIF Natural Resources [USD] (former Global Energy Value Fund)	159.07	-5.63%	2.68%	3.29%	129.10
MSCI World Index TR [USD] (Bloomberg GDDUWI)	3'933.68	3.01%	7.31%	4.30% ***	**** Inception date of Classic*

Figure 19
LTIF – Classic USD

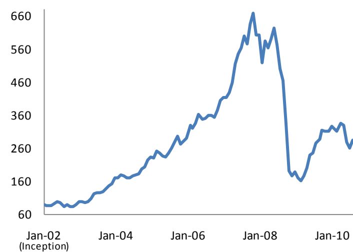


Figure 20
LTIF – Classic II USD

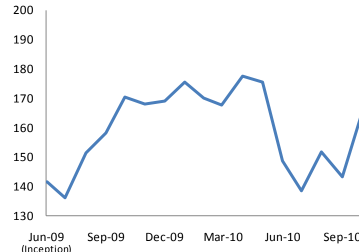


Figure 21
LTIF – Alpha USD

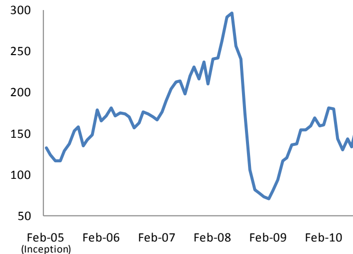


Figure 22
LTIF – Alpha II USD

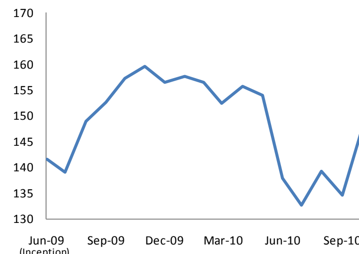
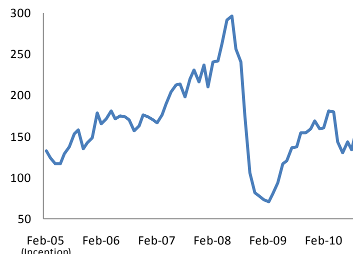


Figure 23
LTIF – Natural Resources USD



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Figures of the CHF classes

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

September 2010	NAV	Δ YTD	Δ 12m	Ann. Return since Inception	AUM (in mio)
LTIF Classic [CHF]	302.12	-10.55%	-7.33%	8.49%	675.02 *
LTIF Classic II [CHF]	160.43	-11.58%	-9.20%	4.27%	** combined Classic & Classic II*
LTIF Alpha [CHF]	191.43	-10.95%	-10.61%	3.81%	114.34 **
LTIF Alpha II [CHF]	143.54	-11.94%	-12.06%	-4.08%	*** combined Alpha & Alpha II*
LTIF Natural Resources [CHF] (former Global Energy Value Fund)	155.41	-10.81%	-3.33%	0.10%	126.12
LTIF Stability Series [CHF] ***	198.70	-5.70%	-6.01%	5.04%	34.97
*** Total Return (incl. Dividend)	3.69	-4.08%			
MSCI World Index TR [CHF] (Bloomberg GDDUWI)	3'858.15	-2.36%	1.54%	-1.74% ***	**** Inception date of Classic*

Figure 24
LTIF – Classic CHF

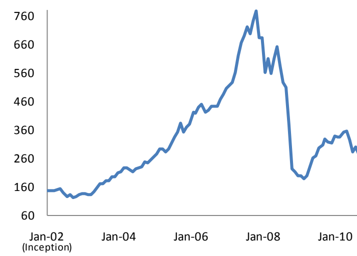


Figure 25
LTIF – Classic II CHF

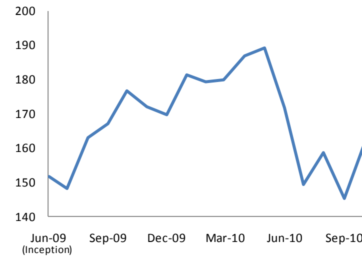


Figure 26
LTIF – Alpha CHF

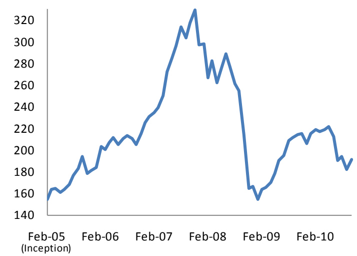


Figure 27
LTIF – Alpha II CHF

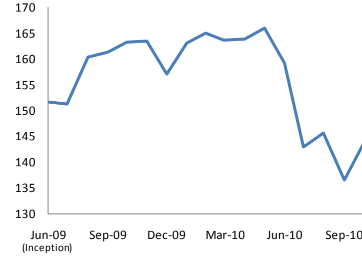


Figure 28
LTIF – Natural Resources CHF

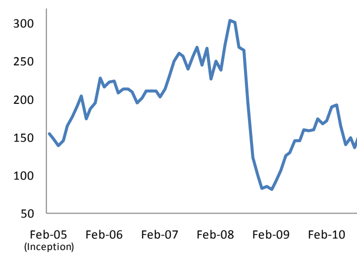
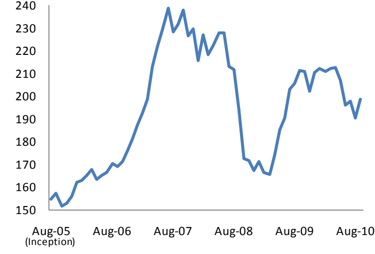


Figure 29
LTIF – Stability CHF



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Figures of the GBP classes

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

September 2010	NAV	Δ YTD	Δ 12m	Ann. Return since Inception	AUM (in mio)
LTIF Classic II [GBP]	104.21	-4.13%	-2.12%	15.32%	438.47 *(combined Classic & Classic II)*
LTIF Alpha II [GBP]	93.24	-4.51%	-5.20%	6.09%	74.27 *(combined Alpha & Alpha II)*
LTIF Natural Resources [GBP] (former Global Energy Value Fund)	100.95	-3.29%	4.17%	7.08%	81.92
MSCI World Index TR [GBP] (Bloomberg GDDUWI)	2'501.07	5.76%	9.28%	19.15% *	** 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 30
LTIF – Classic II GBP

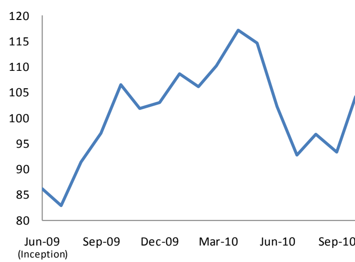


Figure 31
LTIF – Alpha II GBP

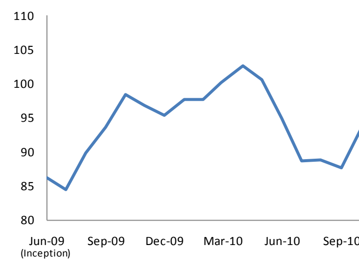
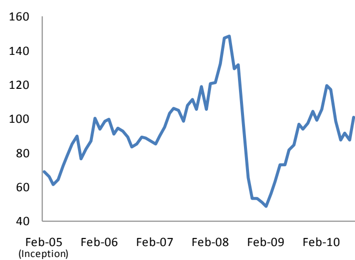


Figure 32
LTIF – Natural Resources GBP



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ISIN: LU0423699429
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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
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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
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