## Long Term Investment Fund

Figure 1
**LTIF – Classic EUR**

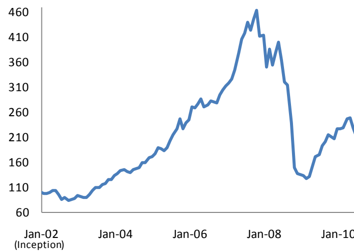



Figure 2
**LTIF – Classic II EUR**

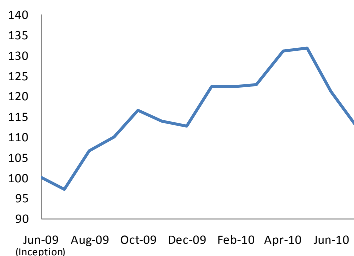



Figure 3
**LTIF – Alpha EUR**

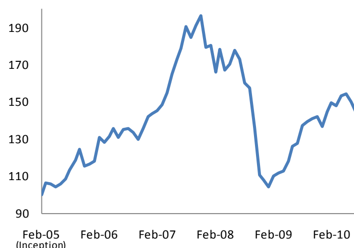
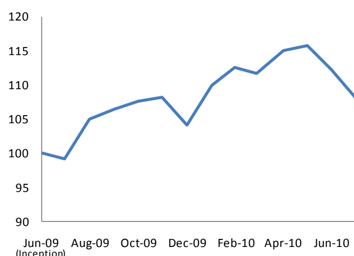



Figure 4
**LTIF – Alpha II EUR**




Our funds' Net Asset Values have had a negative evolution during the second quarter, as shown in Table 1 and figures 1 to 6. This negative evolution can be attributed to two specific issues and, more importantly, to a change in investors' mood, as attested by the fact that most indices have shown a similar decrease.

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

| June 2010 | NAV | Δ YTD | Δ 12m | Ann. Return since Inception | AUM (in mio) |
|---|---|---|---|---|---|
| LTIF Classic [EUR] | 213.09 | -6.42% | 21.77% | 9.31% | 520.48 * |
| LTIF Classic II [EUR] | 113.16 | -7.50% | 16.42% | 12.09% | *combined Classic & Classic II |
| LTIF Alpha [EUR] | 144.36 | -0.40% | 12.83% | 7.01% | 98.59 ** |
| LTIF Alpha II [EUR] | 108.24 | -1.51% | 9.16% | 7.58% | **combined Alpha & Alpha II |
| LTIF Natural Resources [EUR] *(former Global Energy Value Fund)* | 106.76 | -9.12% | 24.85% | 1.23% | 94.15 |
| LTIF Stability Series [CHF] *** | 196.30 | -6.83% | 3.10% | 5.04% | 38.00 |
| *** Total Return (incl. Dividend) | 3.69 | -5.24% | | | |
| MSCI World Index TR [EUR] *(Bloomberg GDDUWI)* | 2'817.89 | 5.75% | 26.98% | -0.90% **** | ****Inception date of Classic |

The specific issues that have affected some of our shares, although indirectly, are the explosion of the BP Macondo oil well in the Gulf of Mexico, and the announcement to introduce a harsh special mining tax in Australia.

The extremely unfortunate explosion at the Deep Horizon platform, which belonged to Transocean, working for BP, not only killed 11 people and played havoc with the ecosystems in the Gulf of Mexico, but has also put a question mark over deep-water drilling and oil exploration in general. We don't own shares in BP or in any other oil producer with important operations in the Gulf of Mexico. We do own about 1.5% of the Classic, Alpha, and Stability funds in Transocean shares, with a further 5% in other drilling companies.

Markets reacted to this accident by not only pushing down the shares of BP to a very low level (understandably, since they are basically responsible for the whole disaster from a legal point of view), but all other oil-producing companies. Similarly, Transocean shares sank deeply (about 50%), dragging all other drillers down with them, even those with no operations whatsoever in the Gulf of Mexico and a business model consisting of using drilling platforms that differ from and are incompatible with those operating in the Gulf.

The market reaction to swiftly sell all shares even remotely connected to the tragedy may be understandable, but it's certainly not rational from an economic point of view. Take Transocean: its legal responsibility is to



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Figure 5
**LTIF – Natural Resources EUR**

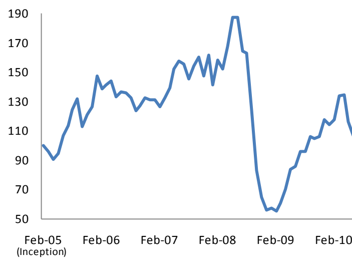
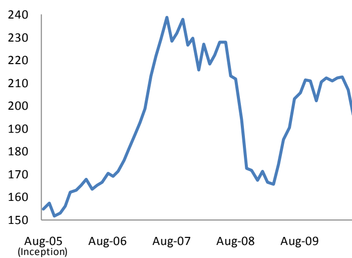



Figure 6
**LTIF – Stability CHF**




hoist and dispose of the wrecked platform safely, for which it is insured. The platform itself was also insured, so its sinking didn't represent any economic loss (they've already collected the insured value of more than $800 million). Its market capitalization before the accident was $30 billion. At the end of June, it was just half that, i.e., the market is assuming the company is worth $15 billion less because of the accident. There is no way those numbers can be justified, even with extremely negative assumptions about the future of deep-water drilling.

This is an important point for valuations: will deep-water drilling be heavily curtailed after this accident? We obviously don't know, but we can offer two important statistics: first, more than 7% of today's world oil consumption comes from deep-water wells; second, a full 80% of all future growth in oil production outside OPEC countries is scheduled to come from deep-water wells, in Brazil, Africa, the Gulf of Mexico, Indonesia, Australia, Vietnam, etc. If deep-water drilling were curtailed, oil would quickly become unbearably expensive. This is not a realistic scenario: the last thing politicians want now is a new recession induced by an oil shock, like those in the 70's.

What will (and should) probably happen is a tightening of regulations, to make deep-water drilling safer, more fail-safe systems, more pre-arrangement of accident-mitigating solutions, and more redundancy overall. This will increase the cost of drilling, which is just a small part of the overall cost of producing oil, and it will be money well spent.

In fact, all this has already happened. During this crisis, few people have mentioned that on July 6, 1988, the Piper Alpha platform, operating in the North Sea off the British coast, exploded. 167 men were killed and only 59 survived. At the time of the disaster the platform accounted for approximately ten percent of North Sea oil and gas production, and it was the worst offshore oil disaster ever in terms of lives lost and industry impact. Occidental Petroleum, an American company with a bad safety record at that time, operated the platform - they've improved enormously, and we own their shares now. Political response was not to vilify some nasty foreign company and try to expropriate its assets, but to re-write safety regulations thoroughly. Since then (a period of more than 20 years), no major accident has happened in the North Sea, in spite of being one of the harshest environments in the world for oil exploration and production. Platforms, supply vessels, even helicopters operating in that area are subject to much higher labor and safety standards than in the rest of the world, and it seems to have paid off. An extension of those standards to most other deep-water drilling areas could and should be an outcome of this tragedy. But this will not negatively affect the economics of the business: drilling costs will go up, but so will oil prices eventually.

The net result, from an investor's point of view, is that only major drilling companies will probably be allowed to continue drilling, and more rigs will be needed, to meet all the likely back-up regulations. After a few months of confusion, the industry must go back to business, as the world



SIA Funds AG Parkweg 1 8866 Ziegelbrücke Switzerland
tel : +41 55 617 28 70 fax : +41 55 617 28 71 info@s-i-a.ch www.s-i-a.ch

needs that deep-water oil. It will have to do so under better regulations, and at higher costs. But its profitability should be the same or even better as a result of the barriers to entry that new regulations will erect. It's remarkable that our drilling companies (half of them operating in the North Sea, half operating worldwide) have sustainable dividend yields well above 10% at current prices.

Obviously, the preceding paragraphs also apply to oil-producing companies, only more so. If deep-water drilling is going to be more expensive and perhaps somewhat constrained, our oil sands companies can only do well. The tragic accident in the Gulf of Mexico will serve to remind people of how hard it actually is to find oil nowadays, and that visions of "plentiful oil" at current prices are unrealistic. To refresh our readers' memory: the largest oil discovery of the last 30 years, the "pre-salt" fields off Brazil's coast, are twice as deep as the oil being sought in the doomed BP Macondo well.

To summarize: the big drop in energy-related share prices seen during this quarter is not justified by any fundamental reasons - with the possible logical exception of those of BP. Therefore, prices will recover to their previous levels, and surpass them, as they were low before the drop.

The second negative development for many of our shares was the Australian government's planned introduction of what is called the "super profit" tax on mining companies. In its first draft, the law was clearly punitive and would have rendered many mining projects unattractive. The law was eventually modified, and the final version is much more reasonable, allowing companies to earn a return on capital invested proportional to the risks they run.

The impact of the news led - again understandably - to a drop in the shares of all mining companies, both in Australia and elsewhere. But again, if one studies the economic fundamentals of the situation, one can see that this should not have happened.

As we have argued many times in these newsletters (see, e.g., Newsletter of March 2008, page 11-16, and Newsletter of September 2009, page 4-8, for a discussion on the future price of copper), commodity prices are determined over the long run by the need to cover the full costs - including a minimum return on capital invested for the miners. If this does not happen, miners won't invest, scarcity will develop, and prices will go up. But taxes are simply a component of costs, in that investors look at their returns on an after-tax basis. So, if taxes increase, so will prices, and margins will not be affected. This is in fact what happens to oil. It is already very highly taxed: in many countries, different taxes take more than 80% of crude oil's selling price, and this does not include the very high taxes that many consumer countries impose on gasoline. Commodity producing companies simply look at projects' profitability on an after-tax basis, and decide to go ahead or not depending on that profitability. Higher taxes



SIA Funds AG Parkweg 1 8866 Ziegelbrücke Switzerland
tel : +41 55 617 28 70 fax : +41 55 617 28 71 info@s-i-a.ch www.s-i-a.ch

simply mean that the commodity price needs to be higher for the project to be carried out.

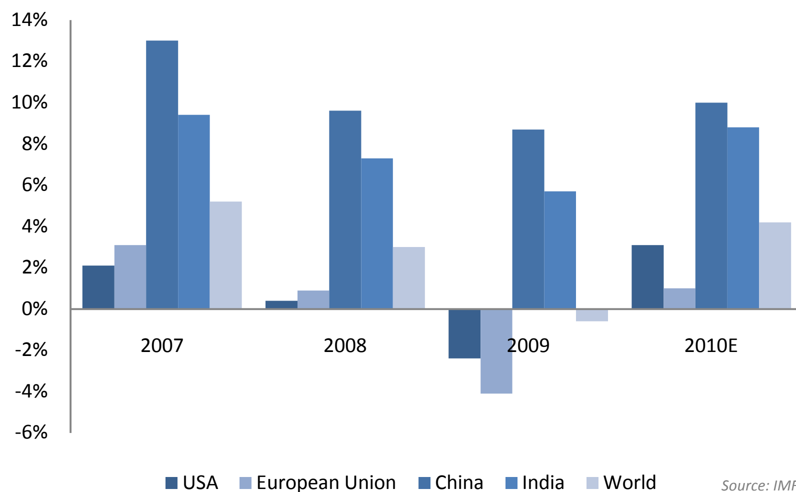
Unexpected taxes, however, affect those projects that are already in place, and they may become less profitable after the tax. As mentioned, prices will adjust to absorb the tax, but that will take time, and the companies that were already invested will make less money than they expected. Fortunately, we don't have any company in such a situation in our portfolio. So the truth is that, from a fundamental point of view, the final changes in Australian laws don't really affect the profitability of our funds. As in the case of energy-producing companies, the drop in the shares has been mostly unjustified and, as such, it will reverse itself.

## The "growth scare"

In addition to these two specific issues, there was a broad change in the mood in the markets, which became very concerned about the possibility of a "double-dip recession" in the world. Let's briefly discuss this issue.

First of all, many market actors continue to fixate on Western markets as though they were "the market". This is understandable if one is an amateur (after all, one values what one sees), but is rather superficial for professional investors. Indeed, to have a double-dip recession you need a single-dip one first, and most of the most vibrant emerging markets did not have a recession in 2008 (see figure 7, GDP growth in the US, EU, China, India, World in 2007, 2008, 2009, and 2010E).

Figure 7: **GDP growth in percent for US, EU, China, India and World, 2007-2010E**




Second, the amount of short-termism is pretty ridiculous: the problem seems to be that China may be cooling down. But that means going from GDP growth of more than 10% to more than 8% for a few quarters. This



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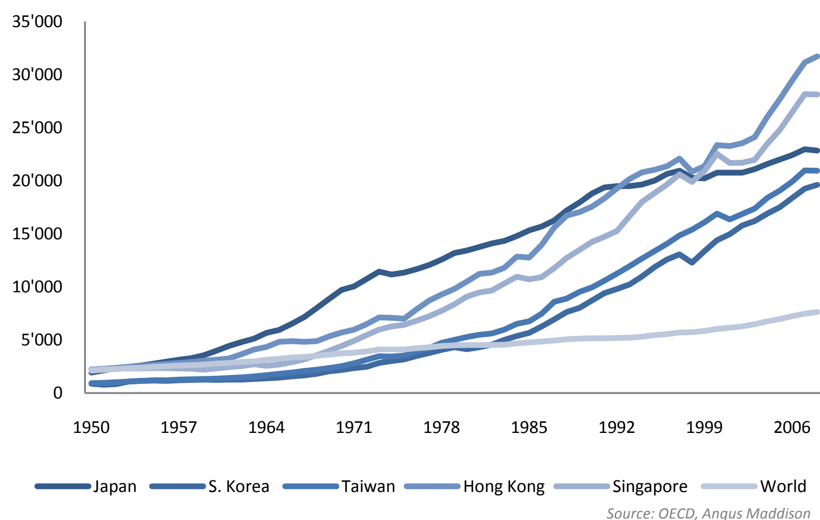
will not make the slightest difference to the value of most shares. When one looks at the world economy with a minimum perspective of, say, the next five to ten years, a very different scenario emerges. It is one in which billions of people are lifting themselves out of poverty, and hundreds of millions are joining the middle class, with its associated expenditure on housing, transportation, leisure, etc. In the following pages we're going to provide our investors with some hard statistics that show that the world is experiencing an unprecedented change: its "economic centre of gravity" is moving firmly eastwards. It is pathetic that "market commentators", and the naïve investors who follow their recommendations, are fixated on what happens in the next few quarters. This is something completely impossible to predict, even by the world's best macroeconomic experts, and moreover has no real impact on shares' valuations. At the same time, those "commentators", and investors, ignore the medium-term evolution of the global economy, which is transparent for all to see, and determines what a company is really worth.

## The development of Asia

The first point to understand is that, by and large, "this time is not different". What we are now seeing as a world-impacting phenomenon is something that, in fact, started 50 years ago with the industrialization of Japan, followed a couple of decades later by that of the "Asian Tigers": Hong-Kong, Singapore, Korea, and Taiwan. Figure 8 shows their GDP evolution, compared to that of the world. It's worth underlining that at the start of the period, Korea's per capita GDP was just 50% of the world average.

**Figure 8: GDP evolution of "Asian Tigers" versus the world, 1950-2008**




*Source: OECD, Angus Maddison*

This huge jump in economic activity lifted some 200 million people out of poverty, and planted them firmly among the richest nations in the world.



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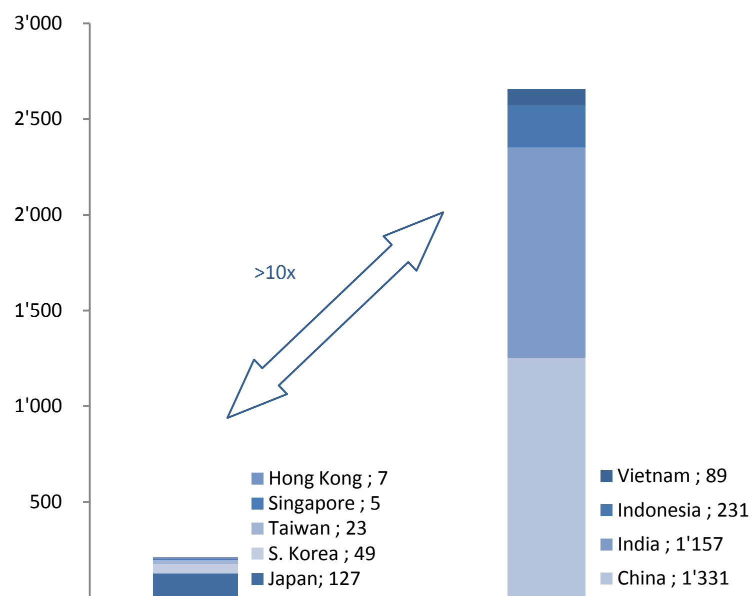
Of course, 200 million are a great many people: Germany plus France plus Italy - the three largest euro-economies. Nevertheless, their impact on the world economy was not that large. After all, they are slightly less than 5% of the world population, some 15% of the developed world.

What *is* a bit different this time, and has a huge impact on the world economy, is that the countries that seem to have taken the same path as the Asian tigers did 50 years ago are much larger. Figure 9 captures this huge size difference graphically.

Figure 9: **Population of previous "Asian Tigers" versus new ones in millions, 2008**




*Source: OECD*

The way countries grow is that, first, people move to the cities, where they probably spend the first generation as very poor laborers accumulating the basic wealth - either for themselves or, more often, as profits for their employers - that pays for the infrastructure (both physical and educational) that allows the second generation to enter the middle class. This is the way Europe and North America developed over the 19th and 20th centuries. And this is what Asia is doing now. There are, however, two differences. The first is simply the amount of people involved. The second is the speed. Figure 10 shows the number of years that a number of countries required to go from $3.000 to $6.000 per capita income, which means getting out of poverty and joining the middle class; followed by reaching $18.000 per capita, which is considered the threshold of wealth.



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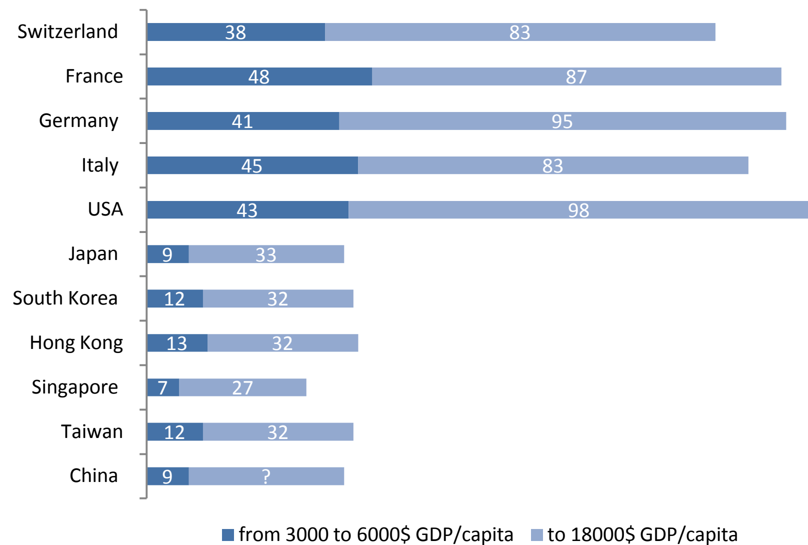
Figure 10: **Number of years required to grow from $3'000 to $6'000 per capita income, then to $18'000 per capita**

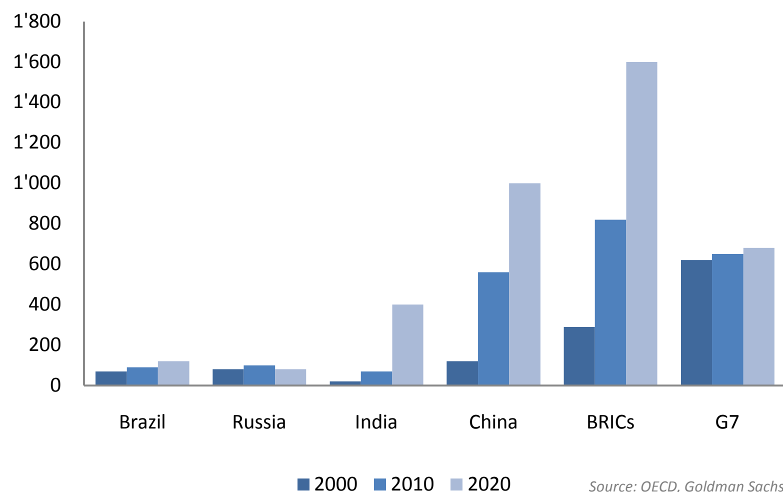



*Source: OECD, Angus Maddison*

One can speculate forever on why that which took the Europeans 100 years to achieve, the Asian countries achieved so much faster. The simplest explanation is probably that it's easier to copy the Industrial Revolution once it's happened somewhere than to painfully invent it. "Followers" enjoy the luxury of a more advanced market to which they can export and from which they can obtain finance and technology.

Figure 11 shows the explosive growth of middle class citizens in certain emerging countries, and how their total number is about to become *double* that in the most developed countries.

Figure 11: **Millions of people in the BRICs to enter middle class income bracket by 2020**




*Source: OECD, Goldman Sachs*



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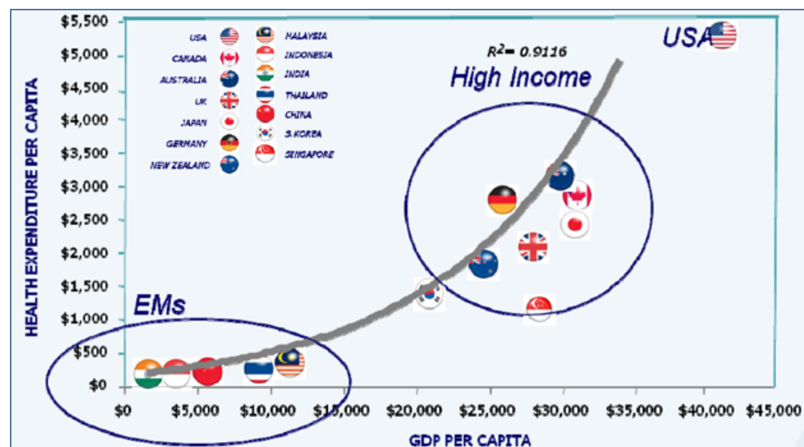
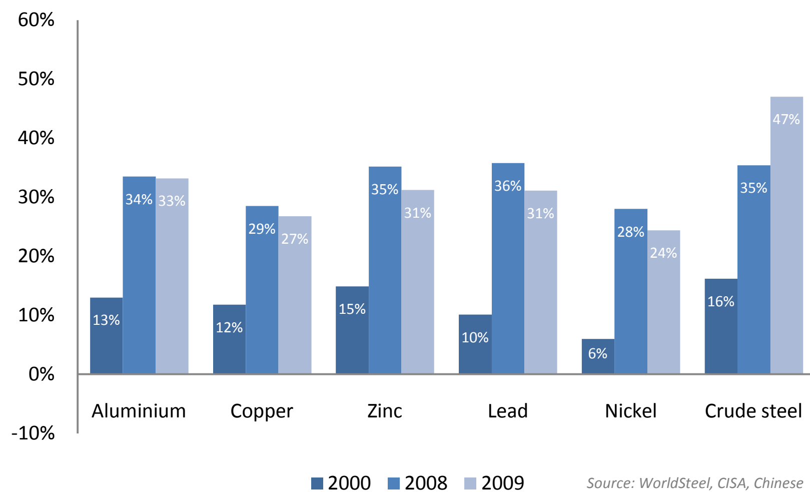
The impact of this huge transformation - it’s estimated that more than 100.000 people are moving from cities to the countryside *each day* - on many industries cannot be exaggerated. From the automobile industry, where China is going from having a market half the size of the American one to having one twice the size of the American one in less than 10 years; to health care (figure 12) and to raw materials consumption (figure 13).

**Figure 12: Health care expenditure per capita, emerging markets versus mature markets**




*Source: WHO, GSK*

**Figure 13: China’s share of world demand of materials consumption, 2000-2009**




*Source: WorldSteel, CISA, Chinese Customs, Macquarie Research*

And what’s even more important: this process has just started accelerating. As figure 14 shows, the physical infrastructure in emerging markets is still very poorly developed (that’s why they are still developing, after all). This lack of infrastructure, together with many of those countries’ very high savings rates, ensures continued investment. It is estimated that the per capita fixed infrastructure in China is just 5% of what it is in the USA.



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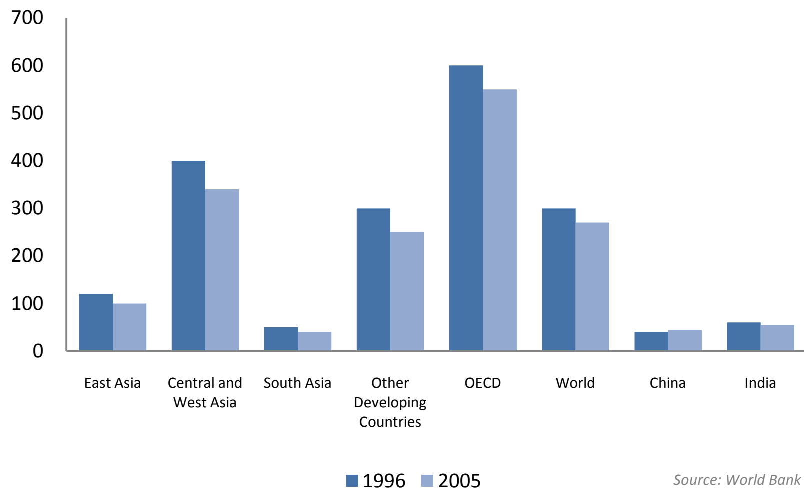
Figure 14: **Railway density per 1m polulation in developing countries in km, 1996-2005**




*Source: World Bank*

The conclusion from all of this is fairly simple: world economic growth is not about to collapse. It will be slow in developed markets, mostly for demographic reasons, and it will be brisk in emerging markets, for both demographic and "catch-up" reasons. The overall result will be a growth rate close to the historical average of 3% to 5% for the foreseeable future, with an eventual flattening when the main developing economies (China, India, Brazil) start reaching development levels close to those of, for instance, Korea or Spain. This will very likely take another 30 years.

At SIA we don't do macroeconomic forecasting to guide our investments. We don't know what the world economy will do in the next few quarters and, in all honesty, we don't believe anybody else does either. This does not, of course, deter analysts and commentators from constantly predicting all kinds of outcomes; some of which will necessarily be right… this time.

But there is a macroeconomic scenario behind our valuations, of course. There has to be one: almost any company will sell more if the economy around it has been doing well for a prolonged period of time than if its home country is experiencing a long depression. Our macroeconomic forecast is simple: the world will continue to grow, more or less and on average, between 3% and 5% for the next 10 years. To give a reference point: growth is going to be 4.6% this year; the average during the past 10 years has been 3.5%. In other words, we believe the world will continue to turn, although not necessarily at exactly the same speed every day. As long as this is so, our forecasts will hold, and our investors will do very well.

But markets don't take this approach. To justify their very existence, analysts, commentators and managers try to "outguess" what the economy will do next month or, more exactly, what the other investors think the



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economy will do in the next month. In the immortal words of lord Keynes, “most of these persons (professional investors) are, in fact, largely concerned, not with making superior long-term forecasts of the probable yield of an investment over its whole life, but with foreseeing changes in the conventional basis of valuation a short time ahead of the general public. They are concerned, not with what an investment is really worth to a man who buys it for "keeps", but with what the market will value it at, under the influence of mass psychology, three months or a year hence." This was in 1936. Few people today care for what the market will think “a year hence”: it’s more like “next month”.

Since our valuations are made by taking a long-term view of moderate growth, it’s not surprising that our shares plummet when the market decides that there’s going to be no growth. This view can, of course, only apply to the next few quarters, unless something thoroughly unique is about to happen: the permanent end of growth that started 200 years ago. However, if no economic growth is included in forecasts, then our shares are overvalued, and their drop is logical. In reality, what’s happening is exactly the game depicted by Keynes: if investors believe that other investors believe that growth will stop, it’s better to sell any shares whose value implies some growth right away.

Subsequently, when those fears of a lack of growth, or those speculative games on “what’s the right thing to own in the next quarter” turn around and people see that there is indeed some growth, and companies do make money, the negative speculative game turns around as well, and shares shoot up. An excellent example of this phenomenon is our Global Mining Value Fund, which we discuss in detail below.

To summarize: the long-term value of our investments is completely unaffected by short-term growth issues. As long as the world keeps growing at a reasonable pace, our investments will do very well. And everything that is happening in Asia (and large parts of Latin America) leads us to believe that this “normal” growth is by far the likeliest scenario for the foreseeable future. Since we don’t adjust our investments to follow the “mood of the week”, our investors will see high volatility, but we’re convinced they’ll also see very good returns over the long term.

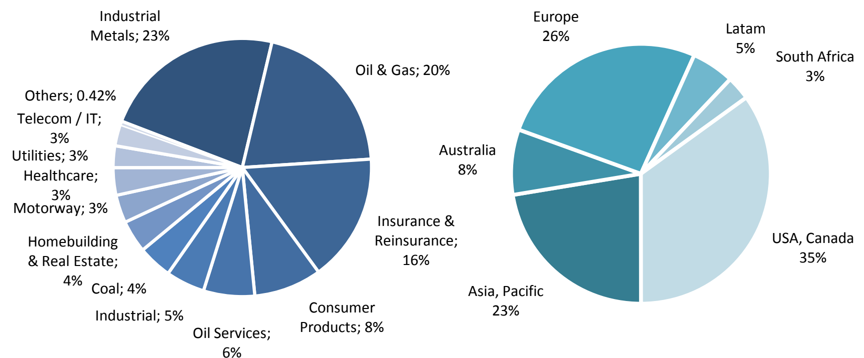


SIA Funds AG Parkweg 1 8866 Ziegelbrücke Switzerland
tel : +41 55 617 28 70 fax : +41 55 617 28 71 info@s-i-a.ch www.s-i-a.ch

## News on our funds

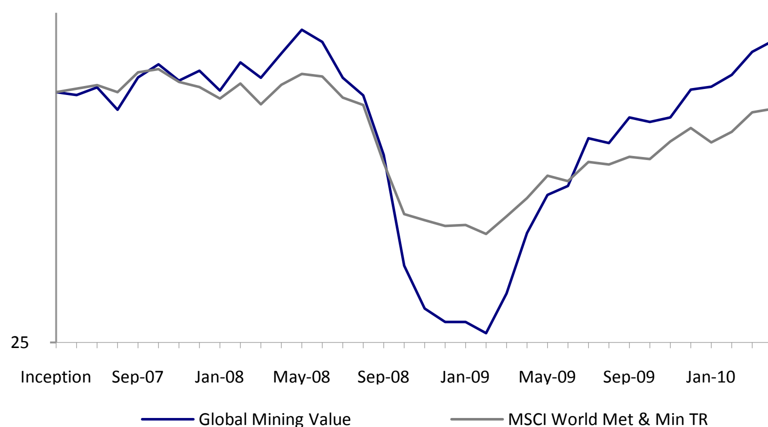
Figure 15 shows the industry and geographic breakdown of our Classic fund as of June 30th, 2010.

Figure 15: **Industry and geographic breakdown of LTIF Classic**




On April 26th, the Global Value Mining Fund was liquidated and merged into the Global Energy Value Fund to form the Natural Resources fund. A very interesting fact is that the Global Value Mining Fund had an official Net Asset Value per share in euro of 132.62 on that day. That is nearly as high as its high water mark, achieved on June 30th, 2008, which was euro 138.59. In other words, just before disappearing as an independent fund, it had recovered almost all the losses incurred after the crisis. From its inception in June 2007 to the end, its annualized return was about 11%, which is not too bad if one takes into account that one of those three years was 2008. Figure 16 shows the evolution of the Global Mining Value Fund from inception until April 26th, 2010.

Figure 16: **Value Opportunities Fund - Global Mining Value, 2007-2010**



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This is one more example of how value pays in the long term - or not so long, in this case. The volatility of the fund has indeed been enormous: from top to bottom its NAV fell by 82%. But if the fundamental value is there, that volatility is not a problem for long-term investors. On the contrary, it's an opportunity. It allowed investors to buy excellent companies at an unbelievably cheap price and see their investment appreciate several times in less than a year. Steady investments may look more attractive, but don't offer these opportunities.

## SIA news

We had presentations on "The Impact of Asia's Development on Investing" in Zurich and Geneva in early June. Interested investors can find the presentation here (Workshop Asia).

We also had a "Natural Resources Workshop" in Geneva and Madrid at the end of the month. The presentation is available here (Workshop Natural Resources).

Two new analysts have joined us during the month of May: Antoine Bachmann, at the Geneva office, and Sung Hoon Jung, at the Singapore office.

Antoine is Swiss and has 15 years of experience in equity analysis and fund management, mostly acquired at Capital International Research Inc.; he previously worked as a systems engineer and project manager at IBM. He holds a degree in Physics Engineering from the Federal Polytechnic School of Lausanne and a Master of Business Administration from Insead, in Fontainebleau.

Born in Seoul, Sung Hoon holds a Bachelor degree in Materials Science and Engineering with minor in Business Administration from Yonsei University (Korea) and a Master degree in Materials Science and Engineering from Stanford University (USA). Before he joined SIA, he worked for DBS Vickers Securities based in Singapore as a research analyst covering Korean consumer and small-mid cap sectors with focus on gaming companies.

With Sung Hoon's arrival, our Singapore office has now four full-time analysts.



SIA Funds AG Parkweg 1 8866 Ziegelbrücke Switzerland
tel : +41 55 617 28 70 fax : +41 55 617 28 71 info@s-i-a.ch www.s-i-a.ch

## Figures of the USD classes

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

| June 2010 | NAV | Δ YTD | Δ 12m | Ann. Return since Inception | AUM (in mio) |
|---|---|---|---|---|---|
| LTIF Classic [USD] | 261.01 | -20.11% | 6.34% | 13.43% | 637.53 * |
| LTIF Classic II [USD] | 138.61 | -21.03% | 1.66% | -1.93% | *combined Classic & Classic II |
| LTIF Alpha [USD] | 176.83 | -14.97% | -1.46% | 5.79% | 120.76 ** |
| LTIF Alpha II [USD] | 132.58 | -15.92% | -4.68% | -5.88% | **combined Alpha & Alpha II |
| LTIF Natural Resources [USD] *(former Global Energy Value Fund)* | 130.77 | -22.42% | 9.03% | -0.28% | 115.32 |
| MSCI World Index TR [USD] *(Bloomberg GDDUWI)* | 3'453.89 | -9.56% | 10.77% | 2.85% *** | ***Inception date of Classic |

Figure 17
**LTIF – Classic USD**

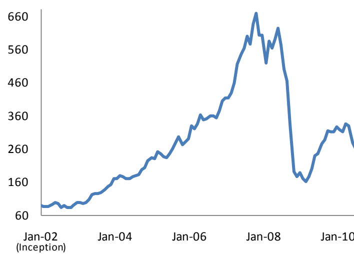



Figure 18
**LTIF – Classic II USD**

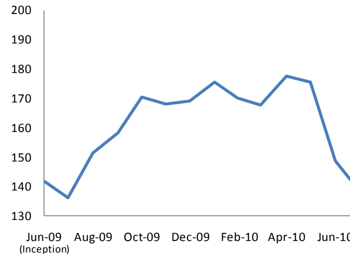



Figure 19
**LTIF – Alpha USD**

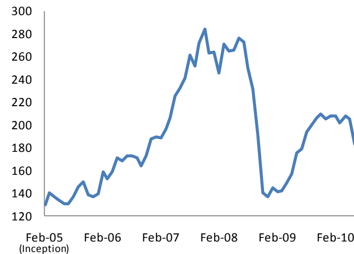



Figure 20
**LTIF – Alpha II USD**

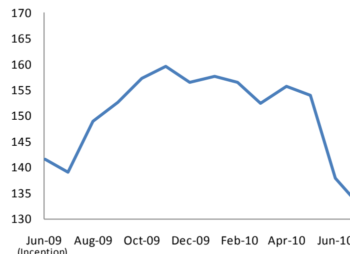
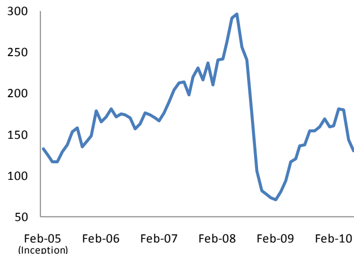



Figure 21
**LTIF – Natural Resources USD**






SIA Funds AG Parkweg 1 8866 Ziegelbrücke Switzerland
tel : +41 55 617 28 70 fax : +41 55 617 28 71 info@s-i-a.ch www.s-i-a.ch

## Figures of the CHF classes

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

| June 2010 | NAV | Δ YTD | Δ 12m | Ann. Return since Inception | AUM (in mio) |
|---|---|---|---|---|---|
| **LTIF Classic [CHF]** | 281.46 | -16.67% | 5.44% | 7.85% | 687.48 * |
| **LTIF Classic II [CHF]** | 149.47 | -17.63% | 0.81% | -1.38% | **combined Classic & Classic II* |
| **LTIF Alpha [CHF]** | 190.68 | -11.30% | -2.30% | 3.91% | 130.22 ** |
| **LTIF Alpha II [CHF]** | 142.97 | -12.29% | -5.48% | -5.35% | ***combined Alpha & Alpha II* |
| **LTIF Natural Resources [CHF]** *(former Global Energy Value Fund)* | 141.02 | -19.07% | 8.11% | -1.70% | 124.35 |
| **LTIF Stability Series [CHF]** *** | 196.30 | -6.83% | 3.10% | 5.04% | 38.00 |
| *** Total Return (incl. Dividend) | 3.69 | -5.24% | | | |
| **MSCI World Index TR [CHF]** *(Bloomberg GDDUWI)* | 3'722.26 | -5.80% | 10.03% | -2.20% **** | *****Inception date of Classic* |

Figure 22
**LTIF – Classic CHF**

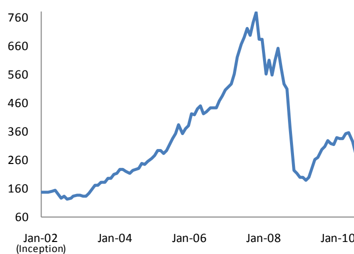



Figure 23
**LTIF – Classic II CHF**

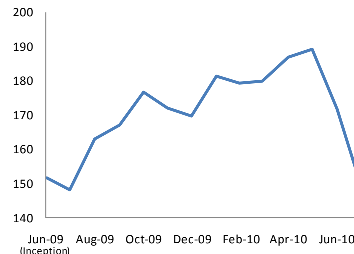



Figure 24
**LTIF – Alpha CHF**

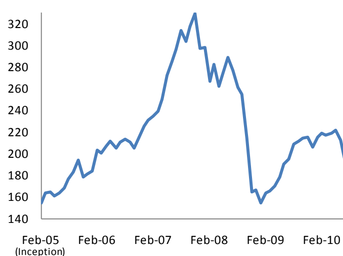



Figure 25
**LTIF – Alpha II CHF**

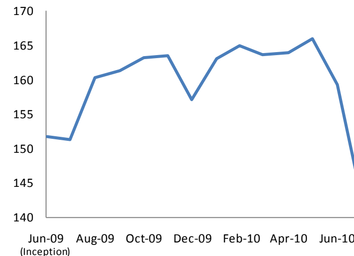



Figure 26
**LTIF – Natural Resources CHF**

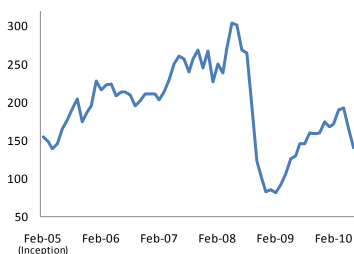
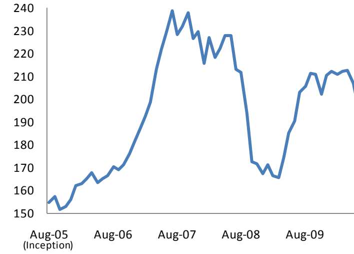



Figure 27
**LTIF – Stability CHF**






SIA Funds AG Parkweg 1 8866 Ziegelbrücke Switzerland
tel : +41 55 617 28 70 fax : +41 55 617 28 71 info@s-i-a.ch www.s-i-a.ch

## Figures of the GBP classes

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

| June 2010 | NAV | Δ YTD | Δ 12m | Ann. Return since Inception | AUM (in mio) |
|---|---|---|---|---|---|
| **LTIF Classic II [GBP]** | 92.65 | -14.77% | 11.91% | 6.91% | 426.13 *(combined Classic & Classic II)* |
| **LTIF Alpha II [GBP]** | 88.62 | -9.24% | 4.93% | 2.61% | 80.71 *(combined Alpha & Alpha II)* |
| **LTIF Natural Resources [GBP]** *(former Global Energy Value Fund)* | 87.41 | -16.26% | 19.80% | 4.56% | 77.08 |
| **MSCI World Index TR [GBP]** *(Bloomberg GDDUWI)* | 2'308.29 | -2.39% | 21.89% | 15.49% ** | *** Inception date of Classic II* |

** Performance up to 05.11.2009 is converted on a simulation basis from EUR in GBP. NAV's from 01.06.2009 to 04.11.2009 are not official.*

Figure 28
**LTIF – Classic II GBP**

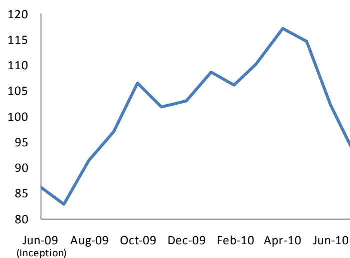



Figure 29
**LTIF – Alpha II GBP**

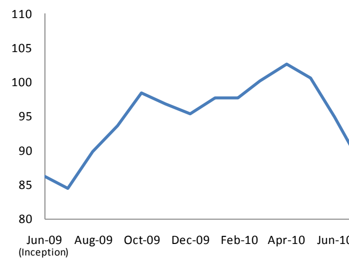
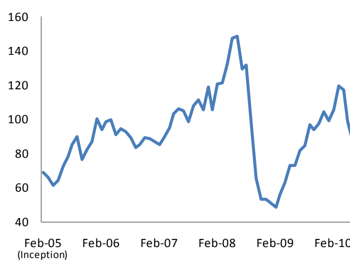



Figure 30
**LTIF – Natural Resources GBP**






SIA Funds AG Parkweg 1 8866 Ziegelbrücke Switzerland
tel : +41 55 617 28 70 fax : +41 55 617 28 71 info@s-i-a.ch www.s-i-a.ch

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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

***Administrator:***

Pictet & Cie (Europe) S.A.
1, Boulevard Royal
L-2449 Luxembourg
Luxembourg

***Investment Manager:***

SIA Funds AG
Parkweg 1
CH-8866 Ziegelbrücke
Switzerland

***Custodian:***

Pictet & Cie (Europe) S.A.
1, Boulevard Royal
L-2449 Luxembourg
Luxembourg

***Registered Office:***

1, Boulevard Royal
L-2449 Luxembourg
Luxembourg

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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.

***LTIF – Stability***
*ISIN:* CH0026389202
*Telekurs:* 2'638'920
*Bloomberg:* LTIFSTA SW

***Administrator:***

Pictet Funds S.A.
Route des Acacias 60
CH-1211 Geneva 73
Switzerland

***Investment Manager:***

SIA Funds AG
Parkweg 1
CH-8866 Ziegelbrücke
Switzerland

***Custodian:***

Pictet & Cie
Route des Acacias 60
CH-1211 Geneva 73
Switzerland



SIA Funds AG Parkweg 1 8866 Ziegelbrücke Switzerland
tel : +41 55 617 28 70 fax : +41 55 617 28 71 info@s-i-a.ch www.s-i-a.ch