Long-Term Investment Fund

Newsletter January 2005

As explained in the owner's manual, investors in LTIF should look at the results of our companies to gauge how we are doing, more than at the price of their shares (and the liquidation value of the fund, which is simply the sum of the price of the shares we own in a particular date). That's why we essentially talk about "intrinsic performance", more than the performance of the shares.

For a complete description of LTIF's investment philosophy, and its "user manual", that explains in detail our measurement concepts, such as "intrinsic value" and "fund's earnings per share", please refer to our internet site at **www.ltif.com.** You can also find there previous past letters, as well as detailed results for the fund since its inception.
For any inquiries, please write to **info@ltif.com**.

Results on our portfolio

Our companies keep doing well. Results have been strong at most companies. In fact, a large majority of them are now at record profits. For the whole year, growth in profits per share stands out at Barratt Development (25%), McCarthy & Stone (30%), Zehnder (20%), etc.

NAV per share is now € 171.84, up 8.08% for the quarter and 27.95% for the whole of 2004

This growth in profits has allowed the price of the shares to go up, without the companies becoming necessarily more expensive. In this sense, a number of our companies have lower P/Es now than at the beginning of the year. Overall, Net Asset Value (NAV), that is, the liquidation value of the fund (what the shares we own would fetch right now if sold), net of all expenses and fees, stands at € 171.84, which is an increase of 27.95% for the year.

As in previous quarters, money has kept coming to the fund, and net assets stand now slightly above € 37 million, with € 13 more million already committed. This growth in assets has had a number of positive effects. Among others, it allows us to obtain better terms from our main suppliers, i.e. the custodian bank and the Fund administrator. These savings profit directly all investors.

Overall, the year has been fairly regular, both in terms of the intrinsic profitability of our companies and in terms of the prices of the shares (encapsulated in the NAV), as can be seen in the following graph.

LTIF Directory

Administrator:
TMF Fund Administrators BV
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3001 HC Rotterdam
The Netherlands

Investment manager:
J3 Associates Ltd.
Mill Mall, P.O. Box 964
Road Town, Tortola
British Virgin Islands

Registered Office:
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Road Town, Tortola
British Virgin Islands

Custodian:
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29, bd Georges Favon
1204 Geneva
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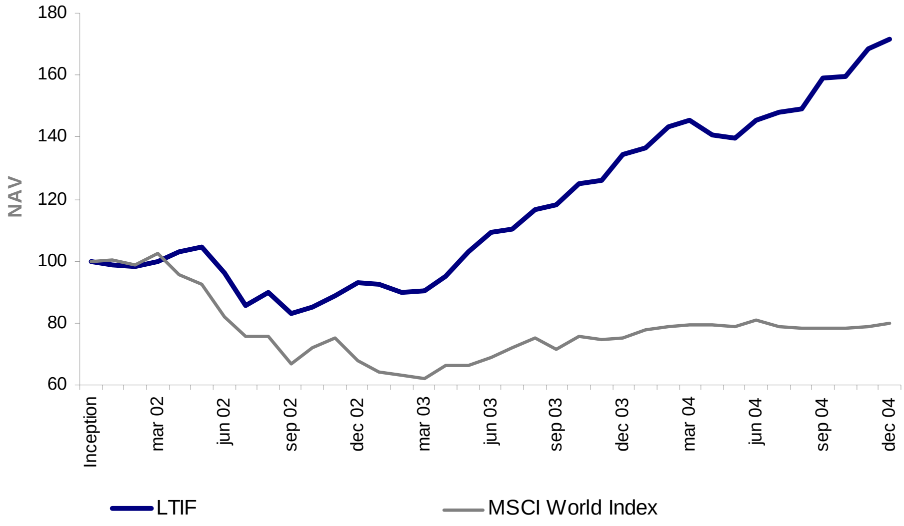
Advisor:
Strategic Investment Advisors, SA
4 Rue de l'Ecole de Chimie
1204 Geneva
Switzerland

Telekurs: 1341036 ***Bloomberg:*** LONGTRM VI

Figure 1
LTIF liquidation value per share, compared to the MSCI World Index



Portfolio news

In this quarter we have bought and sold a number of companies. As in the past, we have kept adding to many of our positions, to fully employ the new funds received.

We bought Gerdau, Usiminas, CST, & CSN in the steel industry; and food processors Perdigao and Sadia.

We bought a number of Brazilian companies in two basic industries: steel and food. The steel companies are Gerdau, Usiminas, CST, and CSN. They are extremely undervalued (EV/Ebitda below 3 times, in some cases) and have both a booming internal market and a strong export position, having some of the lowest costs in the world. They represent in total 8% of our portfolio.

The food industry is represented by Sadia and Perdigao, the two largest producers of poultry and pork, both fresh and elaborated. Again, these companies enjoy a strong internal market and an enviable position as exporters: Brazil has the world's lowest costs for soy beans, corn, and other animal feeds. Exports to former soviet republics and China are growing rapidly, and we believe their competitive advantages to be well protected. Valuations are very low (2005 PEs below 7).

We sold Boskalis, Bachoco, Cementir, & Imperial Sugar.

We sold Boskalis, Cementir, Bachoco, and Imperial Sugar. In all cases, the reason was a share price so high that we couldn't justify it with future profits. We thought our money could be deployed more profitably elsewhere. The sales were profitable, reaping in all cases more than a 40% capital gain.

Administrative news

The Fund has been charging 1% to all new investors. This charge was introduced to cover trading costs, and reverted to all fund owners. Since the fund is now much larger, the charge is unnecessary and has been eliminated.

The possibility to list the fund in Ireland or even in Switzerland is now under study. The idea is to facilitate investment for residents of

Switzerland and the European Union. In any case, it will only be done if the extra costs are small enough to be compensated with the savings derived from higher volumes.

Taking some stock: our first three years

The so-called "fund industry", like any other, uses a number of basic statistics to measure the quality of its products. One of them is the "three-year performance" of a given fund, understood as the annualized change in net asset value (NAV) per share in the fund during those three years. The three first years of life in our fund represent thus a milestone that invites some reflection on what we have done… and what lies ahead.

A couple of mistakes cost our investors money in 2002. We hope we have learned from them

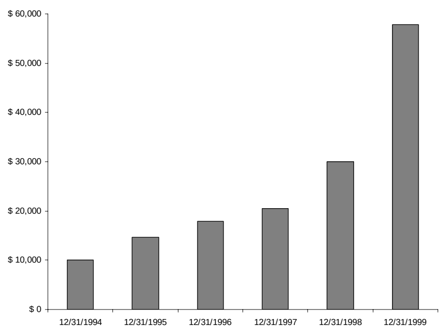
First, the bad news: we made two mistakes, both in the first year, that cost our investors money. We bought a company that was a fraud (Actrade, US) and one that was much less valuable than we thought (Teleplan, NL). We could certainly find some excuses, but the truth is that both mistakes could and should have been avoided. Unfortunately, we'll make other mistakes in the future. But not those two: when a company provides no information on its clients and the numbers look too good to be true… they probably are. In the case of Teleplan, complex mergers accounting hid the reality of low profitability. Fortunately, we haven't had any other "mistake" in the sense of buying a company that turns out to be worth less than what we paid (we have a couple of companies whose share price is now below our purchase price, but we don't consider that a mistake, since we believe those companies are worth much more).

Performance looks very good but… what is performance?

Then, the good news: our performance. But what is performance? According to the industry, as we said, performance is the annualized appreciation of NAV per share. Following that definition, our three-year performance has been pretty good: 19.26% per year, in euros, with an annualized volatility of 10.63%, which puts LTIF at the very top of any ranking of equity funds. But is that something to be really proud of?

Take the fund presented in figure 2. It looks like an excellent investment, with an outstanding performance. The bad news is, of course, that the graph ends in January 2000, and we know now what happened afterwards. Those investors who cannot predict market movements (many of them, we think, including us) lost more than 50% of their investment, over the next two and a half years.

Figure 2
NAV per share, Fidelity Select Software & Computer Fund, year end 1994-1999



And, it is important to underline, those losses are permanent: most of the companies making up that fund don't even exist any more.

Consider now the investment in figure 3, represented by the dark bars (the lighter ones are the index's performance). It doesn't look very appetizing, underperforming the index over four years by more than 40% in total. But that investment, priced at $38 per share at the end of 1975 trades today for more than $ 87 *thousand,* for an appreciation of more than 2.000 times. The investment, of course, is Berkshire Hathaway. What is the point?

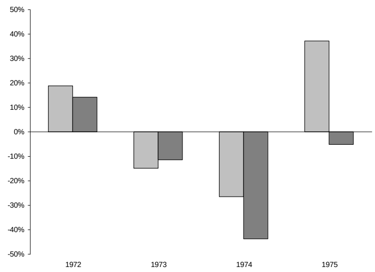


Figure 3:
Annual share price performance, compared to the S&P 500 Index, 1972-1975

The "performance" that really matters over the long term is the performance of the business, not of the share price

The point is that, in the short to medium term, the performance of the company and the performance of its shares can become disconnected. If an investor cannot predict what a share price will do, he or she should ignore share price movements, for they may not mean much, and concentrate on how the company (or companies in the fund) is doing. Of course, the "ideal investor" would buy shares in the Fidelity fund in 1994, sell them in February 2000, and then buy things like Berkshire Hathaway in 1976 (not a year earlier) and then sell them in February of 2004, when it reached its peak. But we don't know that investor, and have no idea how this can be done. We will therefore keep buying investments like Berkshire Hathaway in 1972 if we believe they are worth more than their current share price and will continue avoiding inflated securities at any time. Experience shows that, over the long term, our money will grow. Thus, the really important definition of performance is that of the business we are buying, not that of the past prices of its shares.

Now for the really good news: the performance of our companies has been excellent over these three years. The best way to look at it is to imagine the fund as a fairly diversified firm that owns participations in some businesses (our companies). We can thus calculate the earnings per share in the fund. The calculation is not exact, for there are a number of complex adjustments (currencies, periodifications, etc.) to make, but it gives a good idea of the evolution of the real profitability of the fund.

Our businesses have performed very well: our shares earn now 70% more than three years ago (this is due to increases in profits, and our selling higher PE shares

In 2002, the profits earned by the companies we owned represented € 10.2 per share in the fund. Since those shares started life with a price of € 100. each initial investor "earned" more than 10% in his investment (at the end of the year, the market price of the fund's shares was down by 7%). In 2004, that same share in the fund has "earned" €17. And this is the real performance of our businesses: we are making more and more money with them. The fact that the *and buying low PE ones over these years)*

market has recognized it, pushing up the value of our shares, is secondary. Over the long term, no market can ignore a company earning more and more money every year (and if it did, we'd get rich with the dividends, which amount to more than 3% of our investment, with a strong rate of growth).

If the companies we invest in maintain their profitability, we can be confident of the long term strong appreciation of our shares, regardless of any short-term "underperformance" in the value of the stock. One day, all markets will go down, as they did in 2002, and our shares will go down too. As long as the companies continue performing, we should take advantage of that situation to buy more (the stock market is the only market when buyers like prices going up, which shows how wrong most of them are and explains why they don't make much money over the long term).

The road ahead

Three years is a short period of time for investment, particularly in an instrument called "Long-Term Investment Fund". We must then look forward.

In our prospectus, written when the Fund started, we stated our aim as obtaining a 15% return per annum. This is clearly not easy, for it's well above long-term market returns. How have we achieved it and, particularly, how are we going to achieve it in the future?

To maintain our performance we have to keep finding undervalued companies, wherever they are, without increasing our risk profile

The formula is simple: buy profitable companies, with a solid future, at a low price. If an investor does that systematically, long-term out-performance is assured. This is what we have done. The challenge is to keep doing it.

As we said in a previous newsletter, the higher markets go, the harder it is to find suitable investments. Right now, investing in "blue chip" firms (well established, large companies) ensures that investors will not reap a long-term 15% return: the starting price is so high, that markets cannot, over a number of years, support that rate of growth. What to do, then?

The answer is not to "take more risk". That adds no value, and we don't believe investing is about taking risks. In fact, it's about minimizing risks while obtaining a good return. What we have to do is what we have done during these three years, only more so: look for investments that are profitable and overlooked, thus inexpensive.

Since markets are subject to "fashions", valuable companies tend to cluster by country, our industry, or some characteristic that the market is overlooking

In 2002, that meant mostly small companies. Many investors avoided those, because they were perceived as "riskier". But that (whether true on average or not) is a gross, useless generalization: there are dozens of thousands of small companies in the stock markets, and the only thing they have in common is that they're small (and that only temporarily: many grow and become large, and others disappear). We found good investments in that area, some of which we still keep (McCarthy and Stone, for instance, up more than 100% since we bought it) or have already sold at a good profit (Petroleum Development Corporation, sold for more than three times the purchase price).

Progressively, we moved our portfolio to "basic resources" and now to

A value portfolio will always be somewhat concentrated, but we'll make sure we are well diversified

some "emerging markets" (we have several Brazilian and Korean companies). But we are not chasing "themes" or changing approach. It stays the same: look for solid companies at low prices. What happens is that, as markets move, "value" appears in different places. We don't (and won't) change our strategy; we simply follow it to where it takes us.

This strategy has an interesting effect: many investors will never like our portfolio, because we buy overlooked things. But that is a necessary corollary of our investment style: what people like is, almost by definition, expensive.

We repeat, we don't think we are taking more risks. Before we commit funds to a company, we try to understand its business and its position. The fact that the company is relatively small, or operates in a far away country, doesn't make it a risky investment. It may look risky to investors who don't take the trouble to understand the business, and prefer to stick to well-known names. But, how safe an investment are the shares of a "blue chip" pharmaceutical company, the bulk of whose profits come from a couple of drugs whose patents (or safety) is under challenge, and that are selling at more than 20 times expected (if-all-goes-well) profits? Many investors have found out this year. We'll talk in more detail about risk in a forthcoming newsletter, for we believe it is a key concept, poorly understood.

We adopted from the beginning a policy of investing in some twenty companies in the fund. The reason is that it's very difficult to really follow many more than that, and it introduces a healthy discipline: if we find a company we like, we ask ourselves: do we like it more than some of the companies we have? If yes, we substitute it, and improve the quality of the portfolio. Otherwise, we don't buy it, for it would dilute that quality. We are, however, making now two exceptions to this rule (in fact we have right now 26 companies).

We are now taking "group" positions in very similar companies in the same industry, to lower operational risk.

But we maintain our overall policy of holding around 20 "positions"

First, in some cases we buy several companies in the same industry, which share most characteristics, such as Canadian oil producers or Brazilian steel manufacturers. We believe the fundamental analysis applies similarly to at least some of those companies, and purchasing several of them lowers operational risks. We thus buy small positions that, together, add to a full position.

The second exception is when we find a company that we really like, and seems very inexpensive, but where there are some lingering question marks (if those are important, we don't buy). In those cases, we may buy half a position, with the idea of completing it once those doubts have been cleared up. If after a few months that has not been the case, we sell. Since, by definition, we only buy very cheaply, it's highly likely it will be a profitable trade (this has always been the case so far).

But in spite the general overvaluation of stocks, we remain convinced that we will find enough investments to, over the long term, achieve our goals, without taking undue risks, even if this implies companies and industries that are out of fashion… and out of the way. This is how we believe we earn our fees (many fund managers seem not to be working to earn their fees, but to protect them: who got ever fired for buying over-priced blue chips or whatever stocks were in fashion?).

We would like to take advantage now of this “forward look” to mention of couple of developments related to the Long-Term Investment Fund.

The Alpha series

The first of those is the launch of the “Alpha Series” of the fund. As readers know, it will be an investment consisting of shares in the LTIF and a “short sale” of the overall market index so as to make the fund “immune” to the markets’ up and downs. This will generate better results than LTIF when the indices go down and worse results when they go up. Overall, those periods should cancel each other, which means that, long term, the results will be similar for both funds, but will be steadier for the Alpha Series.

Some investors who understand well our philosophy have argued that the Alpha Series is superfluous, if the long-term results will be similar and we don’t care for short-term fluctuations. We fully agree. But the truth is that many investors do prefer lower short-term volatility, if it can be achieved without loss of long-term performance.

All the details about the Alpha Series can be seen at our web site, www.ltif.com

The Global Energy Value Fund

The second development is the launch of the Global Energy Value Fund. In our previous newsletter we explained why energy (and especially oil) will probably be an excellent investment over the next several years. LTIF has about 20% invested in energy, and we believe it should not go beyond that limit, on obvious diversification grounds. But we believe each investor should have an important part of their portfolio (at least 10-15%) invested in energy. Our research in the industry has led us to develop this fund which is, we believe, a very efficient way to achieve that level of investment. As usual, its characteristics are very measured risks, limited as much as possible, very low entry points, and high potential upside. Once the fund is operational (in a few weeks), we’ll post the information on www.ltif.com, pending the development of its own website.

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