SIA
Strategic Investment Advisors Group

Long Term Investment Fund

Newsletter

of September 2019

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

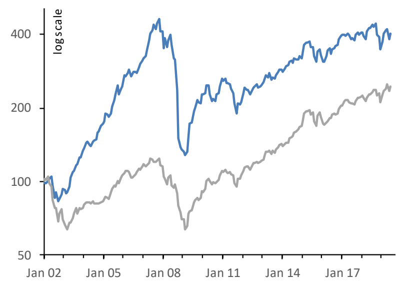


Figure 2: **LTIF Stability A Cap EUR**
vs. HFRX Global Hedge Fund Index EUR

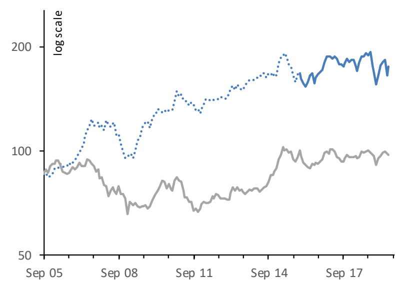


Figure 3: **LTIF Natural Resources EUR**
vs. S&P Global Nat. Res. Net TR Index EUR

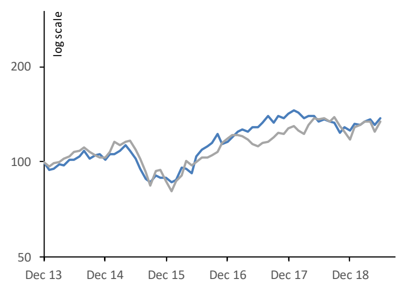
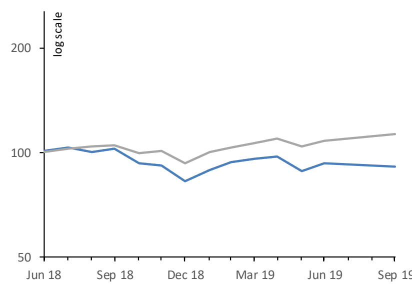


Figure 4: **LTIF SRI EUR**
vs. MSCI Daily T R Net World Index EUR



Recession Risk? Be Greedy When Others are Fearful

Warren Buffett

Overview of our funds

Table 1 and figures 1 through 4 show the recent evolution of our funds' NAV. As can be seen, it's somewhat lower than the main indices. As we'll explain later, this is largely due to natural resources-producing companies' change in prices, as can be seen in the more negative evolution of our Natural Resources fund's NAV.

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

September 30, 2019	NAV	Δ 3m	Δ 12m	Annualized return (s.i.)	AUM *(in mio)*
LTIF Classic [EUR]	401.38	-1.1%	-9.4%	8.2%	119
LTIF SRI (EUR)	91.10	-2.6%	-11.6%	-7.1%	11
LTIF Natural Resources [EUR]	100.42	-5.6%	-18.3%	0.0%	19
LTIF Stability A Cap [EUR]	173.76	-1.2%	-10.6%	4.0%	8

Source: SIA Group

Navigating a Storm

As of September 2019, the LTIF Classic closed with a NAV of EUR 401 per share, +15% 9M19, in the middle of the range of the last 12 months (EUR 450 in September 2018 and EUR 340 in December 2018).

In relative terms, we are more or less in line with the international markets, with the MSCI World index +16%, the S&P500 +19%, the Eurostoxx 600 +16%, and the emerging markets a little weaker with +4%, although China, Brazil, and Russia are in double digits positives.

Overall, most stock markets are in positive territory this year, suggesting that we are having a good 2019, although nothing could be further from reality, since **we are only recovering part of what was lost in 2018**. The investment community is extremely fearful - the word "recession" is everywhere. There is no week that we don't move 2-3% up or down, a massive volatility for a portfolio that we regard as extremely solid.

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We believe that passive investing, ETFs, and algorithms are partially responsible for the current volatility, and that the large moves are sometimes only based on tweets or specific headlines in the digital media. A decade ago, we knew closely a fund that developed a computer algorithm that could "read" the speeches of the then chairman of the FED, Alan Greenspan, and take either long/short positions. We cannot imagine what such formulae would do currently. But remember, Quant funds work 99% of the time until, one day, they stop working and nobody knows why. It's easy... that 1% (or error) happens.

Since the new cycle started (09), the Classic has met our 10% p.a. target, mildly underperforming in terms of the MSCI World. Don't worry - value and natural resources will be back.

In the longer term, the Classic has not outperformed the MSCI World since the beginning of the new cycle period (Q109, more than 10 years already), during which we have achieved 11% p.a. versus 13% of the Index. However, **we feel a bit better knowing that we have largely outperformed the MSCI World ex FANGs** (Facebook, Amazon ...). In the end, the Classic is built to yield 10% per annum, i.e. double every 7 years, with controlled risk, while most FANGs' valuations already include perfection.

A very relevant factor - **our strong belief in oil and copper the past 2-3 years - is affecting our performance negatively**, but our figures suggest that we should more than recover these "losses". First, we were wrong not to anticipate the shale oil players' lack of discipline; they invested billions of dollars in an unprofitable oil business below USD 60, which has inflated the supply of crude since 2015. Second, since Q418, we have suffered the effects of the global recession fear, which has led all cyclical sectors (commodities first) and value to trade at a deep discount. We believe both factors will reverse, since shale oil is already normalizing and, according to our base case scenario, recession fears should be fading.

We also want to highlight value versus growth's massive underperformance since the 2009 Great Financial Crisis. In our opinion, one of the main drivers of this underperformance is passive investing and ETFs' strengths, which are directing flows towards indices and large/stable/thematic stocks. The bifurcation of valuations is huge, but the truth is that value will, sooner or later, work. Unless you buy the wrong business, buying at a 30% discount to intrinsic value is a winning strategy.

Exhibit 9: MSCI World Value vs. Growth
Price Return (USD)

Goldman Sachs

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Shares prices have been reacting strongly to political events (or, rather, to expectations of events), especially those related to the "trade war" between the USA and China, which might extend to Europe. Economic data, especially in the manufacturing sectors, are coming in relatively weak, probably as a consequence of these trade troubles.

In the previous newsletter, we explained that **tariffs are not a great impediment to economic activity.** They are basically an indirect tax on the affected goods. In macroeconomic terms, the amounts are small, and the large government deficit and low unemployment in the US could easily justify an increase in taxes, although increasing taxes through tariffs is a particularly clumsy way of reducing government deficits.

Tariffs are affecting the manufacturing economy, but through the huge uncertainty that the US trade policy is generating. If the US Government were to increase tariffs permanently, some of the manufacturing that is now done in China would move elsewhere, and that would be it. If tariffs were to be removed, manufacturing would probably stay in China. In both cases, factories would be built, new machines ordered, etc. – just in different places. However, if managers don't know whether there will be tariffs or not, they tend to take a rational "wait and see" attitude. This waiting can be seen in the decreasing orders for capital goods worldwide. This cooling of investment decisions is also reflected in the Brexit saga: Investment in the very important British automotive and aerospace sectors has dropped strongly but has not moved elsewhere. Managers are waiting for clarity.

Will this weakness in manufacturing/capital goods infect the rest of the economy? It could, especially in a country like Germany, where manufacturing of capital goods (machines) and consumer durables (cars) is an important part of the total economy. To some extent, the same applies to Japan. In the developed world in general, however, services are a much larger proportion of the economic activity, and trade wars impact them very little. Unemployment in the largest economies is at historical lows, so consumption is holding well. Clearly, uncertainty is bad for investment decisions, but it's even worse for market sentiment, which is why share prices have dropped more than the underlying profits, and why they will probably recover more strongly once the political uncertainly starts to wane.

Logically, this volatility in share prices has affected the sectors perceived as more cyclical, i.e., more dependent on a stable economic environment for profits, to a greater extent. It has also affected the European indices more than the American ones, since Europe has fewer world-class technology companies, which are seen as protected from the economic cycle, but more banks, which are seen as suffering from low, economy-induced interest rates. Within the cyclical sectors, no shares have suffered more than those of Natural Resources.

It is an investing fact that one can be wrong no matter how well reasoned one's position is. This is one of the reasons why diversification is important. We have a clear view of why some Natural Resources shares are a very attractive investment opportunity, and we have been of this opinion for some time, even though the market has not really corroborated our view. Good investors must combine strong convictions (otherwise, why not just buy the index?) with a willingness to constantly reassess their views in light of new information.

Markets are driven by macro factors, fear is king

The three main macro risk factors have not changed, although both they and we are getting rather old: the UK voted for Brexit in June 2016, more than 3 years now, while the Chinese economy's slowdown and the trade war have already been on the bill for more than a year.

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In addition to these three factors, which we monitor closely, new risks have recently appeared: tensions in the Middle East (Iran/Saudi Arabia), the impeachment of President Trump, and demonstrations in Hong Kong, which, although they seem a minor issue, can lead to intense geopolitical problems.

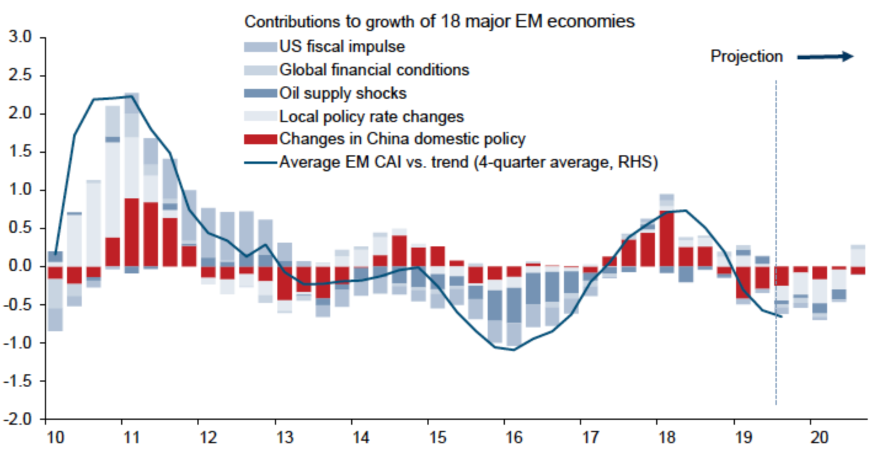
There is always a long list of risks and fear factors, but remember, in the long term, the stock market generates an average return of 6-7% p.a., well above almost any asset, and very possibly for exactly that reason - it is volatile and generates fear. Frankly, it is extremely difficult to handle these *yo-yo* mark to markets. We do not understand how the financial world can be desperate for zero or negative rates (bonds), but be scared of the most profitable asset (equities). Nor do we understand how a bond can work without yielding an interest. Will we have to eat something? Pensions are another relevant problem that must be tackled. How can they be financed without a higher share of savings going into stocks? Stocks are companies, most of which are good, solid, and profitable. They are real assets. Is this so difficult to understand?

Some light at the end of the tunnel

1. **The Chinese economy appears to be stabilizing, although the trade war, swine fever, and demonstrations in Hong Kong clearly do not help.** We were at the Goldman Sachs/Berenberg conference in Munich a few weeks ago and after meeting 30 companies, we left with rather more grip on the Chinese economy. In sum: a function using electricity consumption, transport, cement consumption, and other observable variables would suggest that 1) the Chinese industrial growth is currently 2%, slightly below the official figure of 4%, and 2) it appears to be bottoming, with some indicators showing positive deltas.

   We continue to think that the monetary, fiscal, and public investment measures in infrastructures that the Chinese government has implemented for more than a year will stabilize the economy. Two sectors (autos and semiconductor electronics) are starting to show better numbers. It is true that a trade agreement with the US would help a lot in 2020, because the Chinese cycle has a strong influence on Southeast Asia and on emerging markets. The following chart illustrates our views for 2020.

Chinese policy shifts have been a big driver of EM growth cycles
Contribution to growth of 18 major EM economies, percentage points



Source: Haver Analytics, Bloomberg, Goldman Sachs Global Investment Research.

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2. **The US-China negotiations look marginally better.** We don't have any grip on this topic and we're not very fond of the tweets and headlines published every day. Common sense (according to Voltaire, the least common sense) points to an agreement, even if only a framework agreement, or modular, in phases... but the US Administration is nothing but uncertainty and the differences are too substantial to anticipate the outcome. The most important is perhaps that companies and their supply chains are already adapting to these frictions, some investment will be redirected to other countries in SE Asia, such as Vietnam or Cambodia, but some will return to the U.S. Corporates will not wait and are already adapting, meaning that the incremental or delta damage will be marginally lower, unless, of course, a full trade war starts.

3. **There is a lower probability of a hard Brexit** thanks to the UK Parliament and a new bill setting the course for a negotiated deal. However, the whole process remains as uncertain as it has been during the past three years. Is it so difficult to create a special economic area for Ireland in which UK-EU regulations coexist long enough to solve the technical details? In reality, most issues were already negotiated and agreed on under Theresa May. Ultimately, the UK cannot leave the European continent physically, so nothing can really change in the medium to long term.

GS/Berenberg Conference in Munich: Slowdown yes, recession no.

In September we went to the Goldman Sachs/Berenberg conference in Munich in order to check companies and sectors’ current situation, meeting with about 30 companies. Our main conclusions, bearing in mind that this is a small sample, are as follows:

- Sectors with weak prospects are: automobiles, the manufacturing industry, semiconductors, insurance, robotics, banks, and chemicals. Some sectors, however, face structural challenges which could lead to a regime change (e.g., automobiles and banks).

- Sectors with strong prospects: aerospace, defense, medtech, payments, industrial gases, construction, fragrances/flavors, and electronics

- We have put some of these companies on our watch list, but have not as yet bought or sold anything based on this conference. Again, growth/resilient companies are fairly valued (some show rich valuations), while it may be too early to buy some cyclicals, despite their low ratings.

- There is some risk of EPS downgrades in Q3 and Q4 2019 (although most have already been done) within the current synchronized global slowdown, although the environment is not at all recessionary. Most of the sectors (except trucks, which looks awful) see an improving 2020.

We are also starting to see signs of stabilization in some sectors/indicators, such as autos, the production of ICEs in China, electronics-semiconductors, growth of M1-M2 in the US, China, and even in Europe, the Surprise Index (which includes the delta of a series of macroeconomic indicators) has rebounded, and, more importantly, the U.S., Europe, and most countries have already implemented lower interest rates, as well as other monetary and fiscal policies, to compensate for the slowdown. Many years ago, we learned a phrase widely used in Wall Street "*do not fight the FED*".

It is true that whenever we talk about stabilization we feel alone, nobody believes that the world economy can recover.

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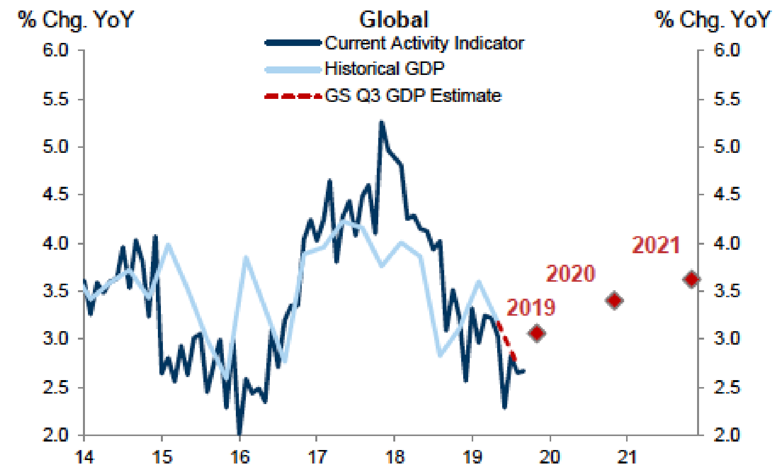
The economic surprise index for the advanced world

GDP-weighted average of Bloomberg economic surprise indices US (57%), Eurozone (36%) and UK (7%). September 2019 based on 12 September data. Source: Bloomberg, Berenberg

Would the Dow Jones Index be at the current levels if there were a high probability of recession? We do not think so; it would be 20/25% below the current levels. It is currently trading at a PER of 16/17x at historical average levels. This Index does not seem to anticipate any recession for the time being. We sense that the recession fear is more Europe centric.

Global GDP vs. CAI



Source: Haver Analytics, Goldman Sachs Global Investment Research.

Although we are approaching the end of the year, we maintain the NAV2019 target at EUR 450 per share, +29% yoy.

The theoretical NAV of the Classic (the weighted sum of the intrinsic value of all the shares in the portfolio) has not changed. It remains EUR 660 per share, with a potential of c65% in the mid-term and an IRR on investment of just over 15%. Looking at the end of 2019, and excluding a global recession or a black swan event (e.g., a war), we expect a NAV of EUR 450, 30% higher than the NAV at the end of 2018. It seems a lot, but, as we stated, a large part of this performance is only to make up for what was lost in 2018.

What if there is a global recession in 2020?

Well, not much will change for a long-term investor. It is true that the net asset value of all long-only funds will fall sharply, first slowly and then all of a sudden (Hemingway's description of bankruptcies). However, a portfolio like the Classic, built on good businesses, with no debt, and well diversified in terms of factors, should not suffer any structural damage. The same applies to private equity investments, but with a painful mark to market, which is inversely proportional to panic. Our companies might then sell a little less, some might have lower margins, but given the robustness of our investments, we would return to normal in 12-18 months. It is important not to sell when Mr. Market panics, because valuations largely overshoot.

It is true that we have oil companies (9-10% of the fund) and copper companies (9-10%) strongly correlated to macro. However, the remaining **80% of the Classic is strongly diversified in terms of businesses, sectors, and geographies**. In addition, we also use the risk categories to minimize risk, with 1/3 of the fund in diversified compounders at a reasonable price, and 1/3 in diversified value - quality businesses and value are a winning combination. We should do reasonably well in a hypothetical recession, and recover relatively fast afterwards. By the way, we still have 10% in salmon farmers, a very unique and profitable business trading at very interesting multiples.

It should be noted that we do not foresee any relevant bubbles that would make the recession particularly deep like the 2008/09 one. The average of the market fall should therefore not be that different from the one experienced Q418, perhaps just 10-15% more. We have decided to stop thinking in terms of "recession yes, recession no" and merely in terms of a mild recession being the same as a deep slowdown. For peace of mind, the Classic is invested in 30 good businesses with a long-term approach - which a recession will not change. In addition, our estimates suggest an undersupply of oil and copper in 2019 and 2020 - two sectors that already discount a significant portion of a possible recession.

Portfolio Review to September 2019

As we have commented, the LTIF Classic portfolio has recovered part of what was lost in Q418, but the sectors that started leading the rise have turned around. All Classic sectors went up at a double-digit rate in 9M19, but we lost momentum in Energy (+3% 9M19, up 50% in Q119), Mines (-16%, +30% in Q119), and Discretionary Consumption (+2%).

Overall, the Classic did well until September. The outperformers were United Technologies, Metso, Nestlé, Bakkafrost, Coca-Cola, Medtronic, Apple, ASML, Cenovus, Wienerberger, and Visa. The underperformers included Thales, Henkel, Reckitt Benckiser, Leroy Seafood, Pandora, ISS, California Resources, and the copper mines.

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It is still surprising that of our three high conviction and weight investments (oil, copper, and salmon), only salmon has worked in 2019 (despite a bad Q3). However, this is normal in an environment that fears recession. This is also bad luck, because both copper and oil have experienced two years of falling inventories, which suggests there is some undersupply, and this usually translates into a rise in the commodity prices to encourage new projects.

In addition, as mentioned, we are witnessing a strong bifurcation of valuations (value vs. growth, cyclical vs. non-cyclical, small vs. large). Growth companies (technological or not) are well valued at ratios that assume continuity in growth and profitability, while cyclicals are at rock-bottom prices. Half of a recession is already priced in the most cyclical sectors.

In terms of sectors, automobiles, airlines, energy, mining, and some industrials are so cheap that they reflect the perfect economic storm. In addition, banks have returned to lows due to the monetary policies' impact. In total, it could *grosso modo* be 1/3 of the market or more. We will write about banks in our future newsletters, because they seem extremely challenged.

Diversified Compounders (1/3 of the portfolio) are having a good 2019. Unilever (+14%), Visa (+36%), Nestlé (+39%), Henkel (-1%), UTX (+28%), Sodexo (+9%), Grifols (+14%), Medtronic (+21%), Reckitt Benckiser (+4%), Coca-Cola (+18%), ISS (-13%), and Air Liquide (+17%) are our growth at reasonable price type investments and, on average terms, they are doing just fine - as expected.

Diversified Value, excluding oil, mines, and salmon (1/3). This part of the portfolio, which is extremely diverse, is also doing fine in 2019: Metso (+38%), Prysmian (+14%), Devro (+9%), Pandora (+2%), Apple (+50%), ING (-4%), Thales (-4%), Heidelberg Cement (+14%), and Wienerberger (+21%).

Oil, Copper, and Salmon (1/3). Commodities are already trading at very depressed levels due to recession fears, as the futures markets (financial participants), which are massively short, show. We think that: 1) demand is not going to fall that much, because we are nowhere near a global recession, and 2) it is more important to look at the supply side that has been struggling to satisfy demand for two years. Let us make a first forecast: Shale oil production will underperform expectations massively in the next few quarters unless Brent moves to 70$+.

Let's take a look at our view of the oil and copper markets

As in all cases, a natural resources company's profits influence its share price, while the price of the commodity being produced influences its profits very strongly. By definition, commodities have standard prices, and the costs don't change much with the **commodity price, which means that price movements have a disproportionate impact on profits**. Consequently, investing in natural resources companies with at least a medium-term view requires a positive view of the price of the resource being produced - as for any share, the short term is, of course, purely speculative.

We know what determines a commodity's price: supply and demand. The supply of most industrial commodities, certainly of oil and copper, can be assessed in advance, since the lead times for new capacity are very long. The maximum supply in the next few years can therefore be estimated by just looking at the new projects being developed. There are, of course, surprises, for example, shale oil's amazing productivity, the ability to develop copper oxides, and the introduction of ferronickel, but they are rare, occurring more or less once in a generation when the commodity's price is almost very high, which strongly motivates innovation.

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From the supply point of view, both the copper and oil markets are severely constrained. True, shale oil has been more prolific than expected, thus lengthening the period of low prices, but the level of investment in traditional oil and copper production has been so low over the last five years that we know that the supply growth will probably not meet the expected demand growth. This development is not frequently discussed: After all, there are only a few new mines (or large oil fields), and anybody can count them. Investors may, however, differ with regard to the demand.

It's almost axiomatic for many investors that when the economy seems to be turning down, demand for commodities will suffer greatly. However, the evidence does not underpin this sentiment: **Oil and copper - and most other industrial commodities - are so widely used in so many different sectors, that they tend to grow with world GDP.** Nevertheless, we have seen a new discourse on oil - the world needs to reduce global warming, oil demand has peaked, so investing in oil is not a good idea.

However, there is no evidence whatsoever that this is the case. We know that oil is used mostly for transportation, and there are very few real alternatives. **Electric cars are still less than 1% of total sales, even when heavily subsidized.** The moment these subsidies decrease, sales will collapse, as it recently did in Norway and China. Gasoline-consuming cars sales are still increasing worldwide and will continue doing so for the foreseeable future.

Nevertheless, the most interesting part is that an electric car uses ten (10) times more copper than a normal car. Renewable electricity production, whether wind or solar, uses between three and 15 times more copper than non-sustainable production. It is therefore impossible for the demand for oil and copper to both go down at the same time. One can be wrong regarding one or the other scenario, but not regarding both.

Current oil and copper prices do cover the cash cost of their production for most producers, which is why they keep at it, but do not cover the cost of investing in new capacity. In the case of shale oil (almost the only source of growth right now), production has been supported by a huge bubble of private equity and debt looking for "the next new thing". This huge waste of money - debts in the industry exceed $200 billion, and no company is currently generating positive cash-flow - is coming to an end. **The large, conventional projects started when oil prices were still high (before 2015), are now almost all completed**. There is nothing to follow them. The same applies to copper.

However, commodity prices have been falling lately: oil went down by 14% in Q3, and copper by 5% from a very low level. Short term trade-war anxiety determines these prices. The scarcity in commodities will make itself felt soon. At the same time, many producer shares have dropped even more than those of commodities, because the market assumes that these companies have no future. Some of the companies we own are as cheap now as they have ever been, particularly when taking into account that we invest in companies with a growing production.

Our conviction that these investments will work out very well for us in the next quarters is as strong as ever.

Our energy/oil holdings, Premier Oil, Cenovus, and Suncor, are in positive territory this year, but California Resources has fallen 50%. Nonsense. Copper has done worse, with our three positions all in the red until September: First Quantum -8%, KAZ Minerals and Hudbay Minerals have fallen more than 20%.

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Salmon is still an important Classic investment (9-10%)
And working as expected, but Leroy Seafood, our main position, has fallen quite a bit due to a profit warning in Q1. This fall was not due to anything structural and we averaged down. Another forecast: The supply of salmon from Chile in 2020 (1/3 of the world supply) will disappoint, with salmon prices back to highs (60-70 NOK kg).

Portfolio Changes

We have continued to buy the worst performing portfolio securities (some oil, copper, and Leroy) that meet our risk control criteria. 50% or more of the portfolio is in low risk categories (Cat1 and Cat2) and never more than 10% in Cat4 (which is a high risk category, such as small commodity companies or restructurings). We have also been partially selling some of the positions reaching our target prices, for example, Nestlé and Apple.

As an exercise in self-criticism, the Classic currently has a small weak point (although already included in the net asset value), because the 10% invested in Category 4 stocks (the riskiest) is concentrated in oil and copper, which are too strongly correlated to macro. We have thought a lot about this due to the sector's volatility/risk. To be honest, this sector should be better diversified, but we have a fairly educated opinion of both the commodities and of the companies in which we have invested, and believe that our estimated IRRs of over 20% will materialize in the short/medium term. We do not have any special interest in these sectors and will therefore leave when the valuations normalize.

By the way, we have returned to Viscofan. It has fallen from EUR 60 to EUR 40. Thank you volatility and fear. Thank you! It is true that the Asian Swine Fever in China could affect both the production of sausages and their prices, but we think this is a short-term issue which could be positive for Viscofan in the long term (the replacement of natural casings with artificial ones). If the share keeps falling, we will buy more, as we have already defined the levels for doing so. Nevertheless, we are in no rush to do so. Regarding sausages, some day we will explain how "reformulation" works, but beware - once you learn, you stop buying cheap sausages.

We've also entered ASML, but it's gone up so fast that we couldn't buy more. It's a very solid company, a leader in semiconductor equipment technology (almost a monopoly), and a good addition to the portfolio. What a pleasure it is to have companies in which you want the share to go down. Why? To buy more, of course!

SIA News: new shareholder structure

It was Prof. Jarillo's long term wish to make the key members of SIA partners in the company, in order to ensure the long term success of the group whilst keeping its core assets: the team and its "strategic value" investment philosophy.

Since this summer, SIA is now equally owned by five partners: J. Carlos Jarillo, Alex Rauchenstein, Marcos Hernandez, Urs Marti plus an external shareholder.

With this change SIA sets a solid foundation for the years to come.

SIA TEAM
October 2019

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