Long Term Investment Fund

Figure 1
LTIF – Classic EUR

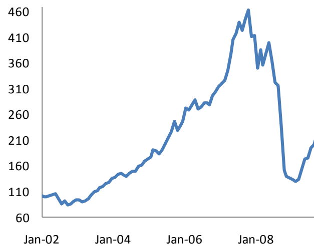


Figure 2
LTIF – Alpha EUR

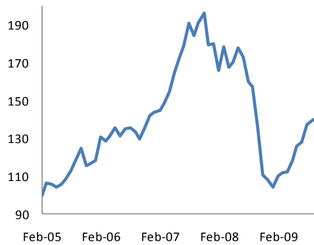


Figure 3
LTIF – Global Energy Value EUR

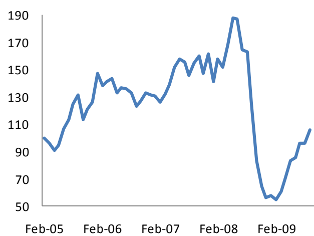


Figure 4
LTIF – Stability CHF

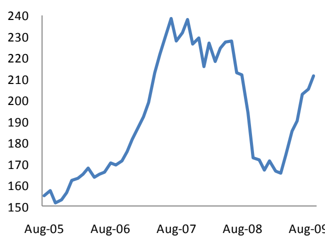
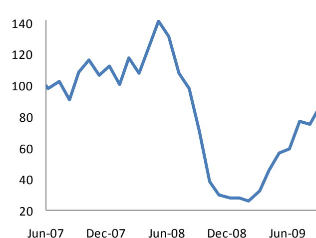


Figure 5
Global Mining Value Fund EUR



Our funds' Net Asset Value has experienced a strong positive evolution during this quarter, as can be seen in table 1 and figures 1 to 5. This is largely just a partial closing of the huge gap between price and value that opened at the end of last year. However, as indicated by figure 6, the gap is still there.

Table 1: Net Asset Value - Net assets under management in EUR

September 2009	NAV	Δ YTD	Δ 12m	Ann. Return	AUM (in mio)
LTIF Classic [EUR]	214.95	59.39%	-9.91%	10.38%	602.73
LTIF Alpha [EUR]	141.20	35.46%	3.82%	7.67%	86.05
LTIF Global Energy Value [EUR]	105.99	89.81%	-14.76%	1.28%	28.65
LTIF Stability Series [CHF]*	211.40	26.44%	8.91%	7.93%	66.50
*Total Return (incl. Dividend)	3.23	28.84%			
Global Mining Value Fund [EUR]	86.83	210.11%	23.02%	-5.87%	48.81
MSCI World Index TR (GDDUWI) [EUR]	2'507.83	19.40%	-5.48%	-2.45%	

Figure 6
NAV vs. Book-value per share

As this figure shows, our shares have typically traded at twice book value, which is a reasonable figure for solidly profitable companies (the corresponding average ratio for the S&P 500 companies is 2.18). It is at that price that, over more than six years, the Fund has returned more than 25% per year. Currently, the ratio stands at 1.15, i.e. our shares are 42%% cheaper than they have been for the past eight years. Although we don't forecast what markets (or even our shares) will do, it seems clear that current valuations still present an outstanding purchasing opportunity, which should provide very good returns going forward.

Does that mean that an investor buying into our funds will see its share price just go up forever? Well, of course not. Markets go up and down, and they always will, which will necessarily affect our funds: some will

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be very affected (on the way up and on the way down), like the Energy and Mining funds, while others will be less affected, like the Alpha and the Stability. What matters is the long-term trend, and this one has been positive for almost eight years, since we started. This trend will continue to be positive, given the earning power of the factories, plants, distributions systems, proprietary technologies, etc., which are the underlying assets of our funds, and the low price at which they can be bought right now.

Portfolio evolution

Although we are long-term investors and buy our companies "for keeps" (i.e. for ever until somebody offers to pay "too much" for what we think they're worth), we do a fair amount of trading and portfolio re-jigging. We buy (and hold) companies because we believe their shares trade at a price below what's justified by what we think will be their future earnings. But, if either the price or our estimation of futures profits changes, then the "Expected Return" (as we call it) changes. Often, share prices go up while our estimation of future earnings remains constant. In that case, the "Expected Return" deteriorates, and we sell the shares. Conversely, we buy more when the price drops further than our profits expectations. This discipline ensures that our portfolio always has at least our target Expected Return of close to 15% per year. In fact, if markets are more or less stable (i.e. not like last year, but like most of the other seven years the Classic fund has been in operation), our investors obtain more than a 15% return, because we keep "buying low and selling high" throughout the year, improving on the original 15% return.

This has clearly happened this year: we had bought shares in the first months of 2009 that we have already sold, because they went up by up to 50% in a few weeks. After those rises, we believed their Expected Return was too low. These shares range from Midas Holdings, a Chinese supplier to the railway industry, to Simcorp, a Danish provider of software systems for investment companies, to Telefónica, a large telecom multinational headquartered in Spain. In all cases, we bought because we thought future profits would provide an excellent return on the price we had to pay. In all cases, the share price went up very fast, up to the point where the future profits were much lower, as a percentage of the market price, than we could obtain with other investments.

As these examples also show, we're well away in our effort to continuously diversify our portfolio. In the last months, we have included companies in many sectors that we didn't have before. Nevertheless, the essence of diversification is not to have many sectors, but to invest in companies that will react differently when economic circumstances change. In this sense, our portfolio is more stable than in the past, with at least 50% invested in companies with relative little correlation with the economic cycle. However, our overall Expected Return still exceeds the sought-after 15%. Investments in this category include some telecom companies, outsourcing giant Accenture, lithium

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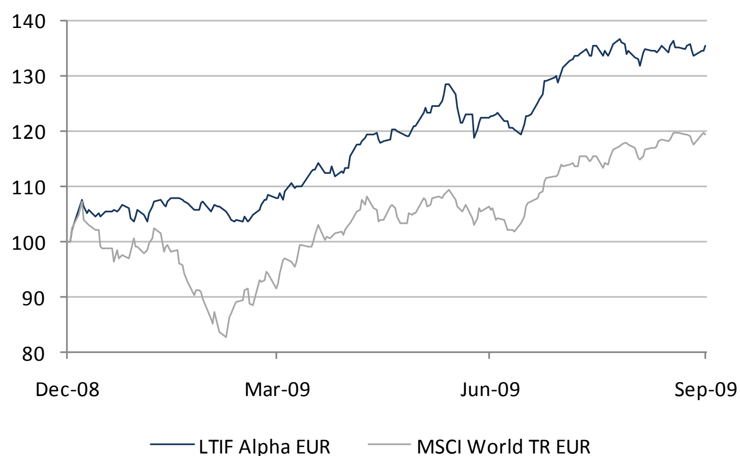
battery manufacturer Saft, insuline producer Novo Nordisk, and salmon farmer Cermaq. Some of these companies have an Expected Return below 15%, but they add stability to the portfolio. What matters to the investor, in the end, is not the return of each individual stock, but of the whole portfolio. We are simply complementing those more stable companies with others, more dependent on growth and offering outstanding returns, particularly in the steel industry. Taking into account the very low levels of interest rates now on offer, we strongly believe that our balanced portfolio is a compelling investment proposition.

Comments on our Funds

The Classic and Alpha funds, which share an identical portfolio, have had the expected relationship: the Alpha fund has had roughly the same performance as the Classic fund, minus the index (35.5%, compared to 59.4% minus 19.7%). This shows that our hedging strategies are working well, and producing an Alpha result that is fairly independent of market fluctuations, as can be seen in the graph below. Of course, to generate an alpha of 35.5% in nine months is completely unsustainable, and it just shows how absurdly low our shares dropped last year. That was an aberration that is being corrected, and we believe our portfolio will continue to generate positive alpha over time. If so, the Alpha fund will provide positive returns regardless of market movements.

Figure 7
Evolution Alpha Fund YTD



The above is even more true of the Stability fund, which has proven to be fairly stable over the past tumultuous twelve months: after dropping less than most other funds in last year's chaos, it has almost recovered its peak price, as shown in graph 8 below. It has had a double-digit performance for several years, with little month-to-month volatility, and has already recovered from last year's market collapse. With our current hedging strategy and the mix of our traditional portfolio and some

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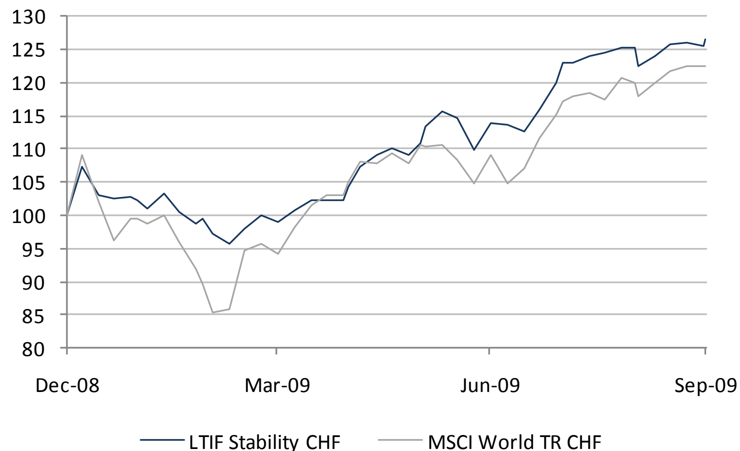
high-yield convertible bonds, the Stability fund offers an excellent risk-reward ratio.

Figure 8
Evolution Stability Fund YTD



Our two specialized funds, the Energy and the Mining fund, deserve special mention. They are up 24% and 46% this quarter and 89.8% and 210.1% over the year. These are indeed astonishing increases, especially for long funds with no leverage. However, as with all our funds, they are just recovering from last year's irrational drop in prices. As we have previously discussed, there were shares in our funds trading below the net amount of cash in the balance sheet. This was just panic selling, or forced liquidation, with no regard whatsoever for the intrinsic value of the company being sold. With the markets becoming more serene, the true value has started to reassert itself. In the case of both funds, that value is still clearly higher than the price at which the shares can be bought. We expect them to continue closing this gap, although they'll be subject to great volatility (which means we can see steep drops from time to time). Honestly, unless the world is really collapsing, any drop in these funds' prices would be a wonderful buying opportunity.

An argument not to buy these funds would be that natural resources already have a meaningful presence in our Classic, Alpha, and Stability funds. That argument would indeed apply to investors with all their assets placed in those funds. However, that's not true of most investors, of course, therefore their overall portfolio's total exposure to natural resources is probably very low. Adding parts of these two funds can re-balance the portfolio, adding a certain degree of high long-term return potential.

Commodity pricing

Why are we so keen on some natural resources, despite their volatility? Simply because that volatility offers excellent investment opportunities.

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Markets tend to treat "commodities" as a whole as an "asset class." However, this approach misses the whole rationale for value investing: buy things when they are cheap, sell when they are expensive. But, the prices of the different commodities depend on their supply and demand, which are mostly uncorrelated.

With the exception of the necessary temporary episodes of stocking or destocking, the price of any commodity – like the price of anything else – depends on its supply and demand. The demand side is very constant - contrary to what many headlines would suggest. The final demand for most commodities – especially those with a large spectrum of applications, such as oil, copper, iron ore, coal, etc. – is closely tied to the world GDP. Commodities are not bought on a whim: everybody buys as little as possible. People buy them because they are needed to produce whatever it is people want to produce. Thus, they are historically very closely correlated with GDP. Put differently, if the world could produce whatever it produces while using less copper, it would already be doing so.

World GDP is one of the most stable economic magnitudes on earth. In 2007, it was probably the best ever: +5%. This year, it's probably the worst ever (with the exception of war years): -1%. Next year, it should be between +3% and +4%. Thus, regarding the demand for commodities: this year, in a very bad recession, oil consumption is down by less than 2% worldwide (more or less like GDP). Other commodities are harder to measure directly: the unprecedented de-stocking of the past quarters, together with the partial Chinese re-stocking, makes apparent consumption seem very volatile. However, we know that the actual amount of copper being consumed cannot differ very much from last year's, because the world GDP does not differ greatly from last year's.

If demand is more or less stable – secular growth of between 2% and 5% per year, depending on the commodity –, then price variations must be explained by supply issues. Supplying many commodities is a fairly complicated mattter with very long leading times for new capacity (typically, 10 years), frequent setbacks and delays, accidents, and very large operations. At the same time, most commodities, since they are non-renewable, just disappear over time: oil fields last a few decades, copper mines about 15 years, many natural gas wells last only for three years. This means that if people did not reinvest all the time, there would very quickly be an acute shortage of the commodity in question, which would make its price explode, and launch a new cycle of investment… which can take many years to deliver. These are all these reasons that make commodity prices volatile and make them stay very high or very low for relatively long periods of time compared to other industries in which it is easy to satisfy growing demand (or to adjust to dropping demand).

But, if one knows the supply situation, and understands price formation, forecasting prices for the medium term is not particularly difficult. Let's analyze price formation.

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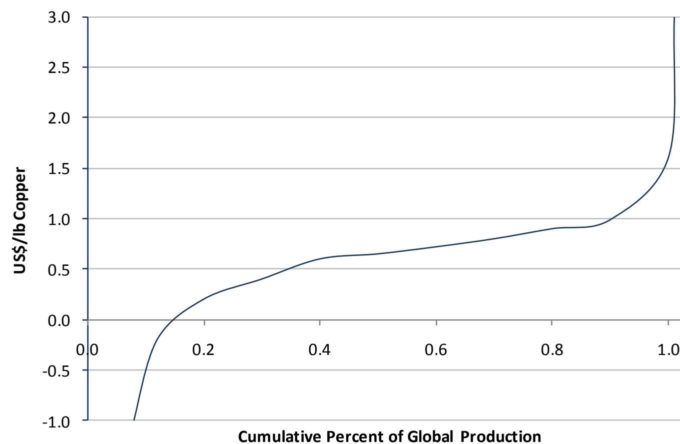
The three pricing regimes

A given commodity can be, at a given time, in one of three supply/demand regimes, which determine its price. These regimes are excess capacity; incentive pricing; and auctioning. Let's discuss them in turn.

1. There is excess capacity in a commodity when producers – who, remember, must make investment decisions 10 years before production actually starts – can collectively supply more than the world needs. Demand for commodities is fairly inelastic, as people will buy pretty much the same amount of zinc whether it sells for 50 cents/lb or 150 cents/lb; consequently, the extra supply weighs on the market, pushing prices down. How far down? That is easy to answer. Look at figure 9. This is a list of all copper producers, indicating their "cash cost" per pound. "Cash cost" is the money that they must pay out of pocket to produce a pound of copper – basically for salaries and energy. No company is going to produce below that cost for more than a few weeks but, if times are tough, companies will be willing to get close to that point. A company selling, say, 10% above its cash cost loses money, but at least gets some positive cash flow.

Figure 9
Copper producers' "cash cost" per pound



Thus to know where the price will be, you estimate the total demand, and look in the graph what the cash cost of the marginal (most expensive) producer is to get to that volume. If total demand were 90% of available capacity, the price would be around $1.2/lb. If it were lower, all companies to the right of that point (i.e. with higher cash costs) would close their mines, and demand and supply would be in balance again.

This will be the situation until demands improves (we know it happens very gradually) or supply disappears. Since mines become exhausted, and there is always some increase in demand, we reach a point where the production capacity below

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the current price is not enough: the price goes up, and some of the previously closed mines go back into production. This phenomenon continues until all excess capacity is absorbed, i.e. until there are no idle mines and new ones must be built. This leads us to the second regime

2. We call it an "incentive" regime because, since there are not enough mines to satisfy demand, new ones must be built, which nobody will do if the current (and, especially, the expected) price of the commodity is not high enough to provide a decent return on the investment. Nobody builds a mine to just recover the cash costs and not make any money. The incentive price thus covers all costs – both "cash" and "sunk" – and a return on the capital employed, adjusted by the risk – which is high in many of these projects. This is the "normal," "long-term" price of any commodity: when it falls below this price, people stop building capacity and, due to depletion and demand growth, a shortage develops. If the price goes above this price, there is by definition an incentive to bring capacity to the market, which ends up pushing the price down. Therefore, this is the "equilibrium" price, on which any long-term assessment must be made: the price that covers all production costs and provides an "acceptable" risk-adjusted return on the investment.

3. There is a third regime when demand outstrips supply, and supply cannot respond, or has a long lag. Since commodities are necessary, people will start bidding the price up until somebody gives up trying to buy. With caviar, or old masters (art), it's obvious that their price has nothing to do with costs, but with a demand that cannot be fully satisfied unless it is severely restricted by a high price. In this regime, the price is determined by demand destruction – the point at which some people start giving up on buying the commodity altogether – and substitution – if oil becomes expensive enough, it'll be cheaper to use electric cars.

   In principle, the "auction" regime is temporary, as is the "excess capacity" regime. Since prices are very high compared to the costs, all producers earn very good returns, which attracts supply. But, as we saw, these "temporary" regimes may last a long time, because reducing and increasing capacity are both difficult in this area.

Therefore, determining commodity prices just requires an understanding of an industry's supply dynamics: what are its costs, at what price is capacity added, at what price is capacity shut down? Since most of the market does not analyze commodity-producing companies this way, the possibilities for profit are very large. The mispricing of shares occurs relatively frequently, as we saw in the last few quarters. At SIA, we know many of these sub-sectors intimately, keep databases of all meaningful mines and oil projects in the world, and constantly track changes in prices and costs since they are far from static.

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And this takes us to the last point: how to invest in these companies. Here, we follow the standard approach that we use in all sectors: once the future profits have been estimated, we buy those shares whose price makes it a worthwhile investment, i.e. where the value is higher than the price. This takes us very far from buying "commodities" in general. First, many commodities are in very unattractive regimes (there is excess capacity in zinc, nickel, steel…), and some companies producing those scarce commodities (copper, metallurgical coal…) may be too expensive. Only when the combination of price and expected profit is good, do we invest. This is a company-by-company decision: we can find overvalued and undervalued companies in almost any commodity. We believe that this in-depth analytical approach will provide an above average return for our specialized funds over the next years and contribute to our generalist funds' performance.

What to expect from our funds

As usual, we don't have a precise view of where the markets are going. Clearly, they were much too cheap in March. That's been largely corrected. We don't think they are too expensive, either. They will therefore probably fluctuate around these prices. Our Alpha and Stability funds, carefully hedged, will experience much less volatility, and should have a positive evolution in almost every quarter.

Fortunately, we have been able to produce meaningful "alpha" (i.e. outperformance) for the last eight years. The huge drop last fall is now being corrected: our annualized outperformance this year is much stronger than our past average (45% vs. 20%). If the market does not collapse (which is fairly unlikely now), we'll probably "catch up" a bit more. Our funds are still too inexpensive compared to their historical valuation, and then we'll go to a more normal regime. What will that be? As long as we can find companies with an expected intrinsic return of 15%, and don't make many mistakes, this should be the long-term return of our funds. So far, we are finding such companies. We are not too concerned by forecasts of V, U, W, or whatever kind of recession. We must simply continue finding good companies (i.e. profitable) at low prices to profit – and do so in a diversified way. In the next Newsletter, we'll have a detailed discussion of our largest position in the portfolio: the insurance industry.

SIA news

Following the request of some of our investors, the Luxembourg Sicav that covers the Classic and Alpha funds has authorized the transfer of shares between those two funds, even in the old (Classic I and Alpha I) share classes. This means that, although these old shares classes are closed to new investment, holders of the old class in one compartment can change their shares into the old share class of the other compartment. So, Classic I shares can be converted into Alpha I shares, and vice versa. Please, contact our office in Ziegelbrücke (info@s-i-a.ch) if you are interested.

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Another piece of news is that we are reinforcing our Singapore office with the addition of Cristian Busquets. Cristian joined SIA a couple of years ago in the Barcelona office as a junior Analyst. After a very successful period in Barcelona, he's moving to Asia for what we expect will be a strong impulsion to our work there.

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Figures of the USD classes

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

September 2009	NAV	Δ YTD	Δ 12m	Ann. Return	AUM (in mio)
LTIF Classic [USD]	314.19	67.60%	-6.25%	17.60%	881.01
LTIF Alpha [USD]	206.39	42.44%	8.04%	10.35%	125.78
LTIF Global Energy Value [USD]	154.93	99.59%	-11.30%	3.43%	41.88
Global Mining Value Fund [USD]	126.92	226.09%	28.02%	-2.30%	71.34
MSCI World Index TR (GDDUWI) [USD]	3'665.76	25.55%	-1.64%	3.92%	

Figure 11
LTIF – Classic USD

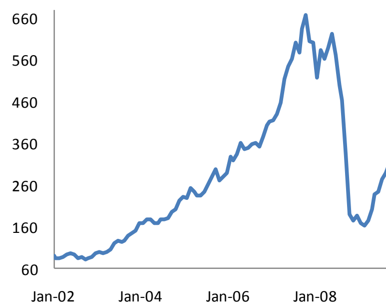


Figure 12
LTIF – Alpha USD

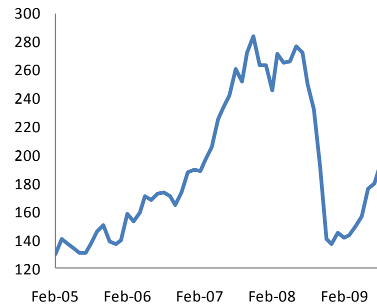


Figure 13
LTIF – Global Energy Value USD

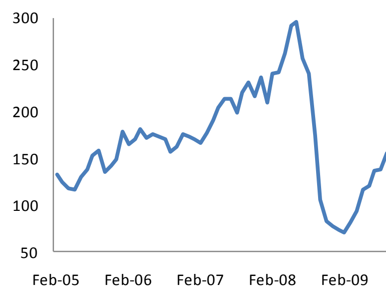
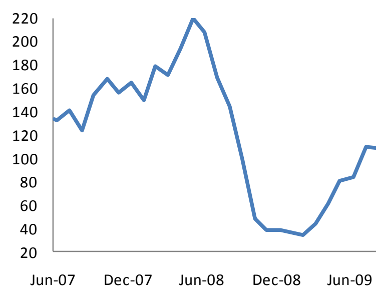


Figure 14
Global Mining Value Fund USD



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Figures of the CHF classes

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

September 2009	NAV	Δ YTD	Δ 12m	Ann. Return	AUM (in mio)
LTIF Classic [CHF]	326.02	63.40%	-13.24%	10.72%	914.18
LTIF Alpha [CHF]	214.16	38.87%	-0.02%	7.19%	130.52
LTIF Global Energy Value [CHF]	160.76	94.59%	-17.91%	0.87%	43.45
Global Mining Value Fund [CHF]	131.70	217.91%	18.48%	-9.50%	74.03
MSCI World Index TR (GDDUWI) [CHF]	3'803.73	22.40%	-8.97%	-2.13%	

Figure 15
LTIF – Classic CHF

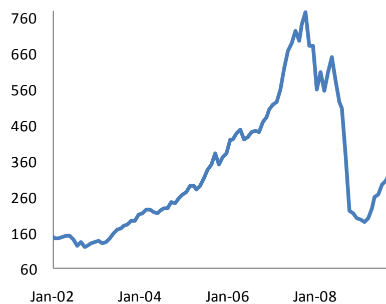


Figure 16
LTIF – Alpha CHF

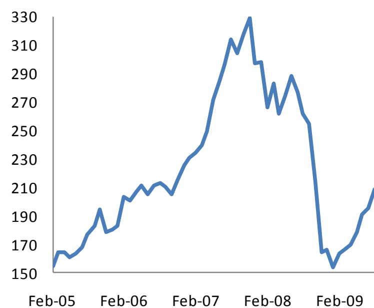


Figure 17
LTIF – Global Energy Value CHF

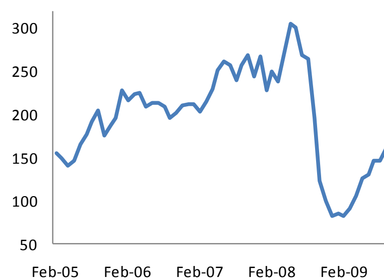
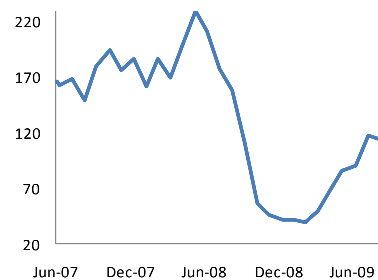


Figure 18
Global Mining Value Fund CHF



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Performance up to 31.05.06 is that of the BVI-based LTIF, of which the LTIF Luxembourg is an identical successor. Previous performance is audited by Ernst & Young. Reports are available from SIA Funds AG. Past performance is no guarantee of future trends.

Long Term Investment Fund is an open-ended investment company of the umbrella type organised as a "société anonyme" under the laws of the Grand Duchy of Luxembourg and qualifies as a Société d'Investissement à Capital Variable ("SICAV") under Part I of the Luxembourg law of 20th December, 2002. It has three active compartments, called "Classic", "Alpha", and "Energy", which fully resemble both the Long-Term Investment Fund in BVI (classes "Classic" and "Alpha") and the Global Energy Value Fund with regard to their investment objectives and operational structure. 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 – 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 – 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 – Global Energy Value EUR
ISIN: LU0244072335
Telekurs: 2'432'575
Bloomberg: LTIFGEV LX

LTIF – Global Energy Value USD
ISIN: LU0301247234
Telekurs: 3'101'839
Bloomberg: LTIFGEU LX

LTIF – Global Energy Value CHF
ISIN: LU0301246939
Telekurs: 3'101'836
Bloomberg: LTIFGEC LX

Global Mining Value Fund is a Luxembourg multiple compartment Investment Company organised as a "societe anonyme" incorporated on June 6, 2007 and subject to the Luxembourg law of February 13, 2007 relating to Specialized Investment Funds (SIF).

GMVF-Global Mining Value EUR
ISIN: LU0305469388
Telekurs: 3'183'766
Bloomberg: GMVFEUR LX

GMVF-Global Mining Value USD
ISIN: LU0305469545
Telekurs: 3'183'768
Bloomberg: GMVFUSD LX

GMVF-Global Mining Value CHF
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Performance up to 30.09.06 is that of the LTIF BVI Fund, restated in CHF, of which the LTIF Stability is an identical successor. Previous performance is audited by Ernst & Young. Reports are available from SIA Group. Past performance is no guarantee of future trends.

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

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