S I A
Strategic Investment Advisors Group

Long Term Investment Fund

Newsletter

of June 2018

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Overview of our funds

Table 1 and figures 1 through 3 show the evolution of our funds' NAV during recent months.

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

June 29, 2018	NAV	Δ YTD	Δ 1m	Δ 3m	Δ 12m	Annualized Return *(s.i.)*	AUM *(in mio)* * *Pool*
LTIF Classic [EUR]	427.30	4.5%	-0.1%	12.0%	11.2%	9.2%	152
LTIF SRI (EUR)	101.01	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	13
LTIF Stability A Cap [EUR]	121.20	9.5%	-0.9%	18.9%	29.5%	1.5%	10
LTIF Natural Resources [EUR]	188.55	2.4%	0.0%	10.4%	6.0%	5.1%*	18

Source: SIA Group

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

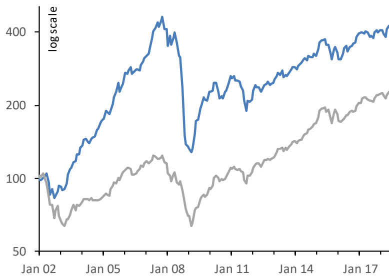


Figure 2: **LTIF Stability A Cap EUR**
vs. HFRX Global Hedge Fund Index EUR

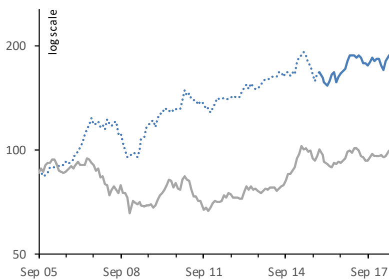
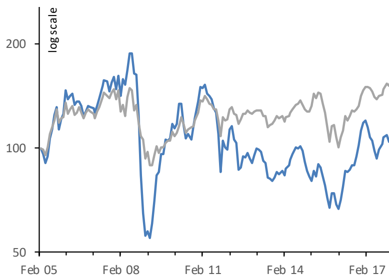


Figure 3: **LTIF Natural Resources EUR**
vs. S&P Global Nat. Res. Net TR Index EUR



They show an increase in price that is somewhat higher than that of most indices. More meaningfully, the Classic Fund's price is up 63% over the last five years. As we discuss below, these results are, logically, the average of the evolution of the shares we own. This evolution has been very heterogeneous, with some shares having more than doubled this year, while others are selling at a 35% discount on their price at the beginning of the year.

When we focus on the "signal" (profits) instead of on the "noise" (share price), it is very evident that our companies' economic performance, helped, of course, by the overall economy, has been very good on the whole. World companies' earnings per share growth is more than 20% over last year's. This is the first time that this has happened since 2010 when the world was recovering from the huge drop in profits that the 2008/2009 crisis caused.

However, this does not apply equally to all companies. Within our portfolio, we have (as usual) had a few disappointments and some pleasant surprises in the context of an overall rising economic performance.

Sodexo is a Paris-based multinational company specialized in running other companies' canteens. This is an excellent business that is very stable (a changing economic cycle does not change the demand for food), is subject to economies of scale, particularly with regard to purchasing, and has a great deal of know-how of managing large workforces all over the world. It is fairly critical for the client, too: Serving mediocre food every day is a good way of demotivating your work force. It is also a growing business, because more and more companies are no longer providing this service themselves, but subcontracting it. Together with the London-based Compass Group, Sodexo is one of the world's leading caterers.

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Companies with these characteristics tend to trade at relatively high multiples; they are defensive business (not cyclical), with medium, stable growth.

Figure 4: **PE Chart Sodexo and Compass, last 5 years**

As you can see in the chart above, Sodexo has gone from an excessive multiple of around 30 to a miserly (for this business) 16, which we believe is way too cheap. Sodexo generates a better than 5.5% free cash flow yield and should be able to systematically grow at close to 5%. This would give us a 10% long term return on a business with an extremely low risk.

However, the last two quarters have been disappointing, which explains the drop in the multiple — but not in profits, which keep increasing, although at a slower pace than expected. As we mentioned in our previous newsletter, this could be a typical “fallen angel”: A company that does extremely well for a long time, consequently achieves a very high multiple, but eventually hits a rough spot. Once again we underline that, in this business and within the context of high profits (ROE > 20%), a “rough spot” means organic growth of 0-1% instead of 3%. Nevertheless, the disappointment makes the share price drop fast. We started investing when this “derating” started and were confronted with a longer than expected turnaround, which means the shares we bought are down in price. We nonetheless bought more shares, and with the stock price’s current recovery, we are more or less at break even.

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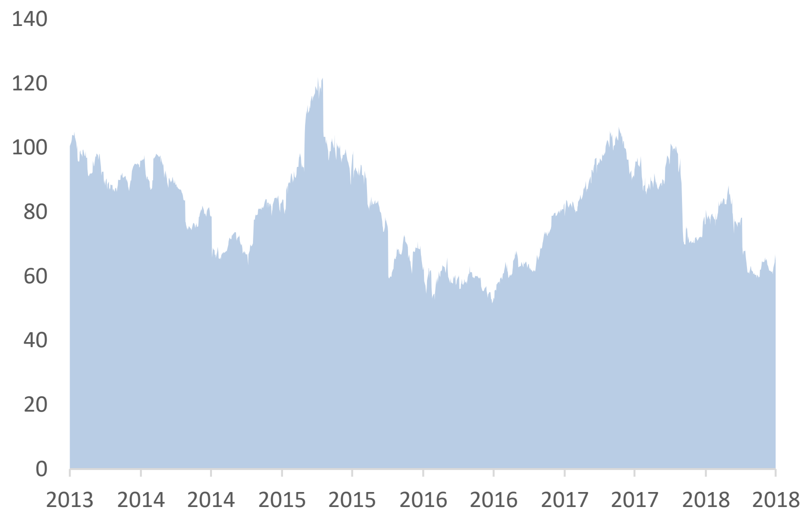
Nothing in the business's structure has changed, and the company has already started fixing the management problems that led to the underperformance. We expect good results going forward.

Figure 5: **Share Price Drägerwerk, last 5 years**



Drägerwerk is another company whose results have disappointed. The company is implementing a multi-year upgrading of its medical products. This R&D effort dented its profitability, but we invested with the idea that the effort would eventually pay off and that the share price did not reflect the future increased profitability. Unfortunately, the effort is constantly being prolonged and the results being pushed further into the future. If we assume that the profitability will normalize, the shares are indeed very cheap and the company represents a great investment opportunity with a great upside in a not very risky business. That's why we are still invested. On the other hand, based on the company's constant need for reinvestment in R&D, we have concluded that the company could be too small for what it is trying to do. Ultimately, in its field, Drägerwerk is competing with companies (Siemens, Philips, GE) that are almost ten times larger.

In the past, the shares' volatility (see figure 5) allowed us to profitably enter and exit a couple of times. We regard the current profits as the bottom of the company's cycle, so there's not much risk, but if the profitability never turns around, the upside will also be limited. We plan to continue monitoring Drägerwerk's progress in order to make a final decision in the next couple of quarters.

The quarter's final disappointment came from Deutsche Post. This company is really a mixed bag of different business: DHL is doing extremely well, the logistics is mediocre, and the business than gave the company and its 400,000 employees its name is a dying one. Although the good parts are

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doing well, the company, as expected, announced the deep restructuring of the traditional mail business, which hit its short-term margins. The shares have dropped 30% year-to-date, which is, we believe, way too much. We have bought a few more shares at these lower prices and remain convinced that the explosive growth of e-commerce-driven parcel delivery will reward our investors in the end.

On the other hand, some companies have surprised us with better than expected results. Apple is perhaps the best example. For a number of reasons, the market became convinced that the Apple X top-of-the-line phone model was not selling well, although it has turned out to be Apple's best-selling model to date. The average price at which Apple sells its phones increases every year, which is directly contrary to the market consensus that a "hardware manufacturer" is condemned to see price deflation and margin erosion. This has not happened for more than 10 years, which should make people realize that Apple is no "hardware manufacturer" like Nokia or Sony. We believe Apple is both a fantastically well protected business and a very inexpensive investment. If we back up its cash, which it is actually returning to its investors, it has a PE of about 13 compared with a US market PE of 16. We don't think Apple is worth less than the average of all other large US companies, including the great successes… and those that will decline over the next few years. Merely giving Apple an average multiple would increase the share price by 20%. With an amazing free cash flow yield of 7%, and growing very fast, it would still not be too expensive.

Other companies doing especially well are: Easyjet, growing at 8% per year and filling its planes more than 95% on average; Visa, profiting fully from the world's increased economic activity and switch to digital payment systems; MTU, finally able to deliver the new airplane engines so many years in the making, etc. The salmon farmers deserve a special mention in this row of companies: During the last quarter of 2017, the amount of salmon available was much higher than in the previous months, causing fish prices to fall. The market quickly marked the producers' shares as though fish prices would be low forever. They weren't, of course, because when salmon prices go down, people just eat a lot more salmon. The overstock was cleared, and prices went up again. Salmon farmers' profits have recovered and the share prices with them (more than 25% year to date on average).

These are some comments on companies' economic reality. Share price movements always generate quite a bit of noise. In this sense, some shares stand out: Pandora, Sodexo, ING, and copper-related stocks, which are on the way down; salmon producers, Apple, Visa, and oil producers, which are on the way up. We have already discussed Apple, Sodexo and the salmon producers. We'll discuss copper and oil producers in the next section on the Natural Resources Fund. Let's briefly mention Pandora and ING.

During the last year, Pandora's share was one of the worst performing in Europe. This is especially baffling, because there doesn't seem to be anything terribly wrong with the business — its sales and its profitability are both above those of the previous year.

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Obviously, the market expects all kinds of disasters going forward. The company is in the process of changing its distribution model from a traditional one, through wholesalers and independent retailers, to a modern, integrated one with the company directly controlling its shops. This change makes analyzing the numbers, which are not really comparable from one quarter to the next, difficult and lends credibility to the fears that the company is hiding very bad news from investors. For the time being, the reality is that the profits are holding up and that the multiple has gone down: from a PE of 25 — typical for a growing luxury company — to 7.8 — typical for a company with no growth and a dubious future. In the meantime, the company continues to gush cash-flow, is re-purchasing shares, and paying 5% dividends with all that extra cash. We don't know whether a "profit warning" is imminent, with the management acknowledging that the company growth will be lower than expected in the next few years. However, at the current prices, only the business's complete collapse would justify a further drop in the share price. We don't see that happening; in fact, we don't see any indication that this could occur, but we may be wrong and this wouldn't be the first time. We'll have to wait and see. If our opinion is correct, expect a doubling of the share price in the coming year.

ING is, of course, a very different story, but its shares have dropped more than 20% over the last few months — more or less together with those of the entire European banking sector. The entire sector dropping may make some sense, but there is absolutely nothing wrong with ING. In fact, the bank is doing very well, with a ROE above 10% and well-covered cash dividends above 5%. However, the regulators want to make sure that banks hold plenty of capital and are not allowing the few banks with excess capital, such as ING, to distribute this to their shareholders. The market is disappointed and has marked the shares down. We believe ING is a long-term, low-risk compounder that should give us more than 10% per annum.

Mining companies' shares have dropped sharply in the last month, driven by two fears: the Chinese economy will cool down and trade disputes may lower the world's growth rate. These things may or may not happen. The Chinese economy will indeed cool down one day; investors have apparently been (expensively) protecting themselves against this eventuality for the last 15 years. But we don't invest on the strength of a macro analysis: We do know that the world needs more than 20 million tons of copper a year to literally keep the lights on, and that not enough copper mines are being developed. In a few months, the reality of dwindling stocks will replace the current "expectations-driven" drop in metals prices. Our companies will do extremely well.

Which is what has happened to our oil investments: California Resource's shares are up 180% in the quarter (i.e., they've almost multiplied by 3), Premier Oils are up 85%, and Cenovus's are up 30%. We'll discuss these two sectors (mining and oil) in more detail in the next section.

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The Natural Resources Fund

We had a public presentation in Zurich, during which we had the chance to meet more than 50 investors interested in our Natural Resources fund. The essence of the discussion returned to what we have been arguing in these newsletters: Oil and mining sectors are subject to very long and very pronounced cycles. These cycles happen because both underinvestment and overinvestment take a very long time (between 5 and 15 years) to correct themselves. This is how long it takes between the discovery and the production of most mines and oil fields. Coupled with high rigidity in the demand — we do need these commodities— prices increase significantly and decrease significantly, remaining high or low for several years.

While this makes for very difficult company management, it offers investors who understand the cycle very good opportunities. We believe we are there.

Right now, we have seen oil finish its down leg. This started in 2014, touched a very low point in 2016, and really started to climb in 2017. This cycle has been a bit shorter than in the past, thanks to shale oil, which, unlike all other technologies, can react relatively fast on the way up, as well as on the way down. But once increased demand and the increasing depletion of all other assets swallow the shale addition to the world, we will be back to where we were in 2004: A world in which nobody has invested enough to accommodate future demand growth. Expect the oil price to keep climbing and, with it, our shares' price. The stock market has only recently started accepting that oil will not return to $50 and be stuck there forever.

Nickel and, especially, copper will be the next commodities to turn up. These markets are, in terms of economic importance, far smaller than that of oil, and trader "sentiment" modifies the short-term prices more. However, the economic reality is exactly the same: Permanent, gradual growth in demand, the fast depletion of producing assets, and a lack of investment during the last six or seven years. Some mining shares will soon reflect what we have seen in oil shares.

That's why be believe that our Natural Resources fund currently presents a "once every 15 years" opportunity to reap very high returns with very little risk for at least a few years. Sure, there could be a huge economic disruption, which would probably not be bigger than that of 2008 that had no lasting impact on the price of oil or copper, as figure 6 shows. An economic crisis does not increase supply — it actually decreases it at the margin by forcing some marginal players to close — and only decreases demand for a few months. Once the crisis has passed, prices return to where they were before. In 2011, copper prices started going down constantly and those of oil in 2014 when the supply of both overwhelmed the demand. We are now at the opposite point in the cycle.

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Figure 6: **Price of copper and oil, from 2000 to today, re-based**

There are, of course, ups and downs in these processes: Venezuela may or may not implode, Iran will be hit with further sanctions… or not, and Escondida copper mine workers may or may not go on strike (Escondida, in Chile, is the world's largest copper mine). These issues, like the current "panic" over metal prices, do impact prices, but are transient, because none of them is big enough to modify the logic of the overinvestment/underinvestment cycle. They just move what is going to happen forward or delay it by a few weeks/months.

We would be very surprised if many of the shares we own in this fund do not at least double in price over the next three or four years.

(You can find the presentations that were held at the Zurich event in the "Presentations/Newsletter" section here)

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The Long-Term Investment Fund "Socially Responsible Investing"

At SIA, we take pride in investing for the long term, even calling our funds this. But no investment can be successful over the long term if it's not based on a sustainable strategy. Consequently, it's not really surprising that the investments we have made over the years in our Classic fund receive very high marks when tested against the different ranking systems for Socially Responsible Investment (SRI) or Environmental, Social, and Governance (ESG) criteria.

Nevertheless, some investors demand a portfolio that meets these criteria explicitly, without a single investment deviating from the standards. In fact, 6 years ago, a large private investor asked us to manage an account for him that would replicate our Classic portfolio, but would be subject to a strict SRI/ESG test filter. We have been doing this ever since, and the account's performance has been very similar — in fact, slightly better — than that of the Classic fund — and much better than that of most "SRI/ESG funds."

We have now turned that account into a new compartment of the LTIF Sicav, in which anybody can invest. This follows our traditional investment criteria 100%, but subjects our investment choice to a formal filter. The presentation on our web site (Long Term Investment Fund SRI) provides all the details of how the filter operates.

We have created a share class in dollars and two in euros, one of which will distribute annual dividends — we aim for an initial yield of 4%, which should grow every year. Investors interested in this approach are more than wel-come to contact us and discuss this.

(You can read the SRI presentation here)

Looking forward

As we write this, the world is concerned about trade wars, Brexit, etc. As usual, we tend to think that investors pay too much attention to political developments and not enough to economic developments. Currently, the economic developments are truly interesting: concerted growth throughout the world, indications of a certain reflation (finally!), the massive urbaniza-tion of the next one billion people, demographic changes, with the graying of the population changing demand patterns and savings needs, etc. We are convinced that our investments, through the volatility that gives them their daily liquidity, will give us the annual long-term 10% return we expect.

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