SIA
Strategic Investment Advisors Group

Long Term Investment Fund

Newsletter

of June 2020

SIA Funds AG Alpenblickstrasse 25 8853 Lachen Switzerland
tel : +41 55 617 28 70 fax : +41 55 617 28 71 info@s-i-a.ch www.s-i-a.ch

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

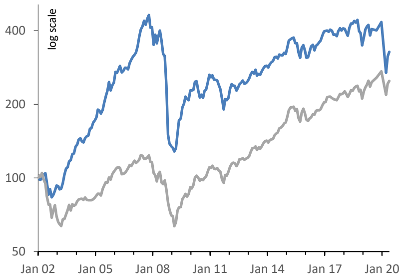


Figure 2: **LTIF Stability A Cap EUR**
vs. HFRX Global Hedge Fund Index EUR

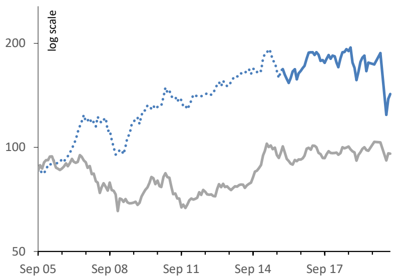


Figure 3: **LTIF Natural Resources EUR**
vs. S&P Global Nat. Res. Net TR Index EUR

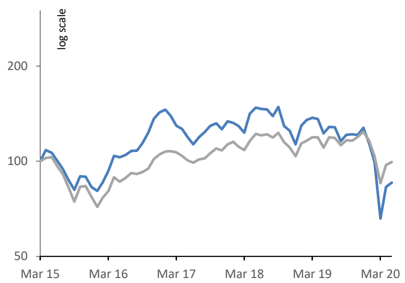
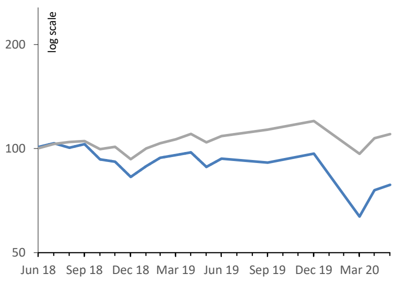


Figure 4: **LTIF SRI EUR**
vs. MSCI Daily T R Net World Index EUR



"We will be buying businesses, year in year out, as long as I live. Given these intentions, declining prices for businesses benefit us, and rising prices hurt us."

Warren Buffett

Overview of our funds

The LTIF Classic is down 19% ytd. at EUR 348 NAV (16th June)

The Classic Fund has recovered a lot from the mid-March lows (levels of EUR 240-250 per share) rising by around 40-45% in 12 weeks to EUR 340-360 levels.

It is incredible how volatile the stock market has been since the beginning of the crisis (we will call it GCC, Global Covid-19 Crisis): a collapse in March and an equally surprising recovery in Q2. What does this say to those who still believe in the efficient market theory? Let me remind you that the NAV of the Classic Fund peaked in February at around EUR 440 per share, so we still have a lot of catching up to do.

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

May 31, 2020	NAV	Δ 3m	Δ 12m	Annualized return (s.i.)	AUM *(in mio)*
LTIF Classic [EUR]	328.34	-11.3%	-14.2%	6.7%	78
LTIF SRI (EUR)	78.60	-530.0%	-11.2%	-11.7%	4
LTIF Natural Resources [EUR]	70.86	-14.0%	-30.1%	-2.2%	16
LTIF Stability A Cap [EUR]	142.76	-22.9%	-14.1%	-3.6%	5

Source: SIA Group

In relative terms, the Classic is somewhat below the broader indices (Standard & Poor's 500 falling by 3% for the year, the European SXXP 600 Index falling by 13%), but quite in line with value indices such as the Russell 1000 falling by 15% and the MSCI World Value Index falling by 17% for the year. In a recession, cyclical stocks, small companies, and value usually tend to underperform in the short term compared to large caps, defensives, and even growth, but this gap closes in the economy's recovery phase.

Until mid-June, the best sectors in the Classic were Technology (+19% YTD) and Consumer (-4% YTD), while the worst were Energy (-50%) and Materials/Mines (-20%, excluding Northern Dynasty, which dou-

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bled on good progress in the permitting process). The rest of the sectors, Industrial, Salmon, Health, Finance, and Discretionary Consumption, have, on average, fallen between 10% and 20%.

Looking at our companies, 10 stocks are up so far this year: VISA, Apple, Reckitt Beckinser, ASML, Viscofan, Devro, Pandora, Air Liquide, Nestle and Northern Dynasty. Stocks that have fallen less than 10% are Metso, Prysmian, Henkel, Leroy Seafood, Antofagasta and Unilever.

On the negative side, the stocks down 25%+ are Grieg Seafood, ING, Sodexo, ISS, First Quantum, Hudbay Minerals, Wienerberger, Heidelberg Cement and all the oil companies (Premier Oil, Suncor, Cenovus, and California Resources).

As we mentioned in our last newsletter, **after performing different stress tests on our companies, only California Resources faces a serious financial problem** (< 1% of the fund) should oil prices remain low, but the rest of the companies in which we have invested are going to overcome the crisis and be back to normal fast, at the latest within 12-18 months.

The Covid-19 Pandemic: Where are we?

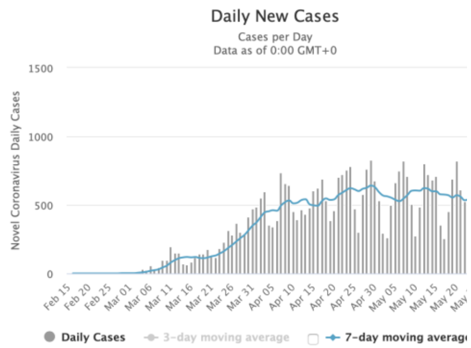
The events of the past three months have shown how severe a pandemic can be for investors. It's not just that stock prices might go down but is also about the pandemic's impact on the real economy (stocks price the underlying reality in the long term).

The amount of damage will, basically, depend on two factors: how long the pandemic lasts, and what governments do to mitigate the negative effects of all the pandemic-enforced measures on society. Let's review where we are regarding these two factors.

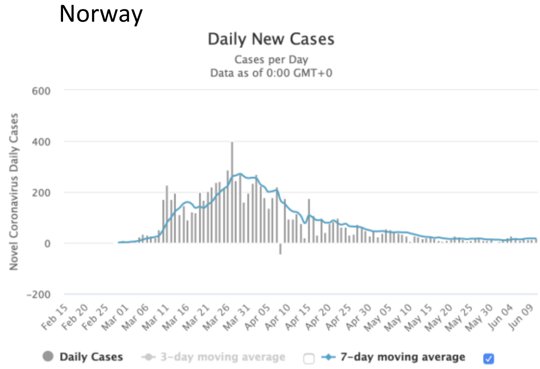
1. **The worst of the pandemic is clearly over**

During these months we have learned a number of things, of which **the most important is** perhaps **that social distancing reduces the probability of infection.** The graphs below show the disease's evolution in four extremely comparable countries. As can be seen, the results of the country that applied light social distancing measures (Sweden) are very different from those of the others.

Sweden



Norway



Deaths per million: *Sweden: 475; Norway: 44; Finland: 58; and Denmark: 102*

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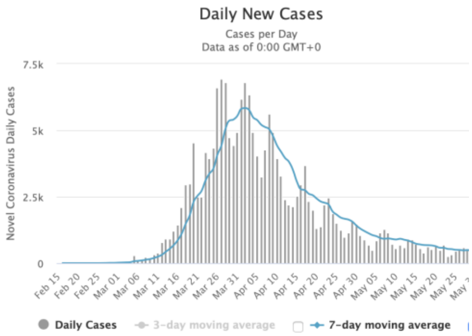
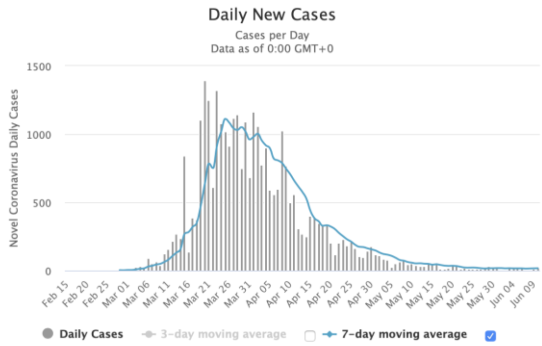
We have also learned that if things are done well, **lifting the social distancing measures after the virus has been strongly reduced does not necessarily lead to a "second wave"**:

Germany

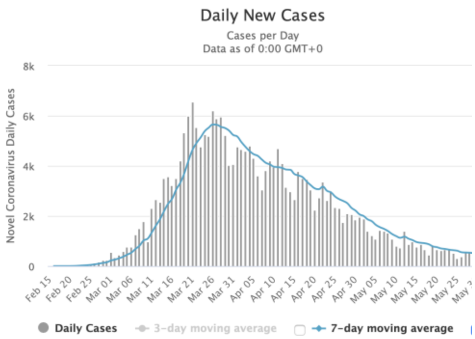


Switzerland

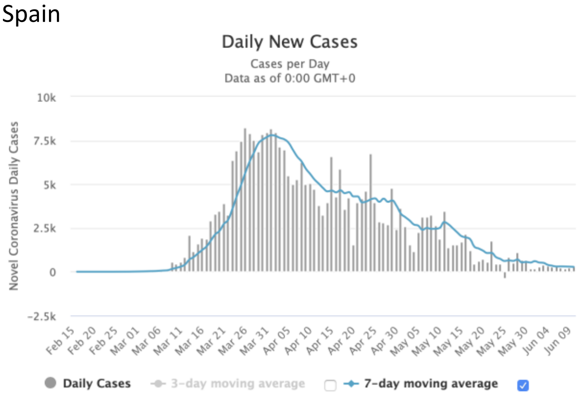


The disease was most active in the following places:

Italy



Spain



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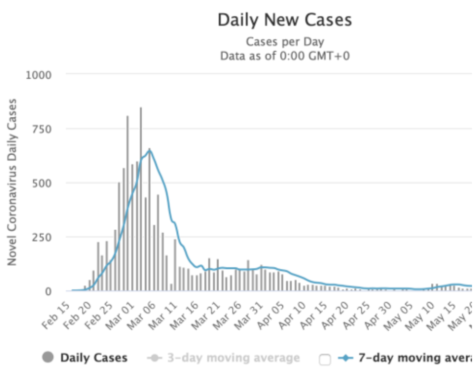
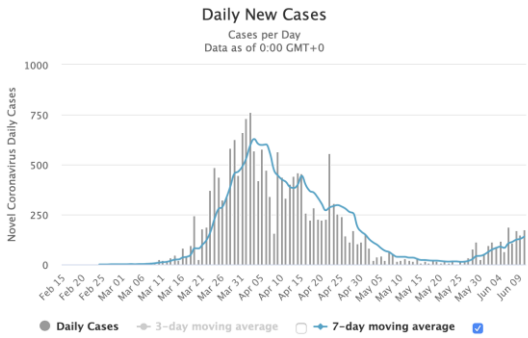
However, if some degree of “rebound” were to happen here, it could be controlled without a huge disruption.

S. Korea



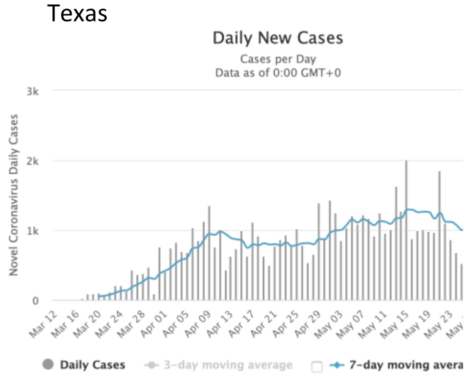
Israel



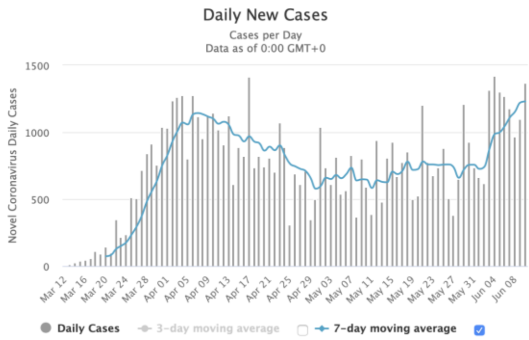
In the above countries, new episodes are quickly detected and acted upon. The absolute numbers are small and manageable.

However, **if proper measures are not applied, the virus takes a much longer time to recede,** and it’s not clear what answer will be found in those states and countries that are basically letting things develop:

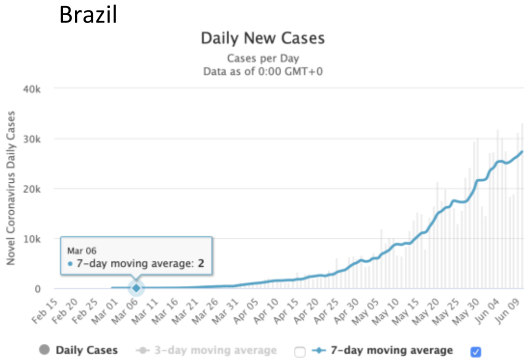
Texas



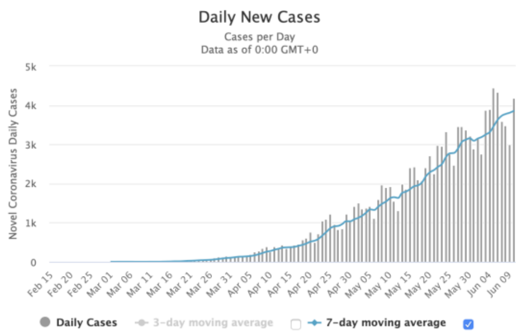
Florida



Brazil



Mexico



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The conclusion is that proper handling of the situation could have solved much of the problem by now, but since many countries are not doing this, a return to full normalcy is fairly problematic, because international travel is a key component of economic activity.

The worst is clearly over, but there won't be a total solution until a cure or a vaccine is developed.

2. An unprecedented effort in biomedical research: Covid-19

Thanks to the extraordinary efforts by governments, public and private institutions, and pharma companies, **we believe it's reasonable to expect that one or several drugs will not only mitigate the virus's effects, but actually eliminate it in the foreseeable future**. There are several avenues, the most important being the development of specific monoclonal antibodies, which will most likely lead to a fairly effective treatment.

Vaccines are, of course, also being developed. More than 120 serious projects are underway right now, all taking a number of different approaches. Some (perhaps most) will not work, but there is no doubt that in a few months some will. This efficacy will take time to be established, and the vaccine itself will have to be produced in the billions of required doses. But it will happen.

Treatment drugs will probably arrive earlier than vaccines, for the simple reason that their efficacy is easier to test. But we should have solutions within about six months.

But an economy that stops working for a few months and is then "crippled" for, say, another year, is still a terrible environment that can permanently damage many companies. A downward spiral due to a lack of production/lack of demand and an even greater lack of production or demand is all too easy to imagine. **That's why the second variable in terms of this economic episode's duration is so important: the reaction of the world's governments.**

3. An unprecedented government response

It's rather ironic to reflect that the world's experience with the 2008 crisis was, in hindsight, a good thing. As difficult as it may sometimes be to believe, society does learn. The USA's response to the 2008 crisis was barely adequate and that of Europe woefully wrong: hence the very different economic outcomes. Most politicians understand this well now, which is why their response has been much better this time.

When there is a huge shock to demand, the risk is that it will unleash a downward spiral. If many people lose their jobs for whatever reason, they will decrease their consumption. But that consumption is somebody else's demand and that somebody will find him/herself unemployed, thus worsening the situation.

Governments are now basically trying to compensate for the missing demand to ensure that their countries' lack of economic activity does not become a full-blown depression. And the response has been dramatic: although not as large as the drop in "normal" demand, **the government support measures in the US and Europe have been unprecedented**, **compensating more than half of the expected shortfall.** That's why the current recession will most likely not develop into a depression and, subject to the medical advances discussed above, it should not last much longer than a year.

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There are, of course, also other risks. After all, who expected this situation six months ago? The UK is an important economic player, and the chances are increasing that Brexit will be far from a smooth process; the situation in Hong-Kong is tense, and may provoke a worsening of the West's relations with China, etc. Nevertheless, there are always risks, and we must keep investing and producing.

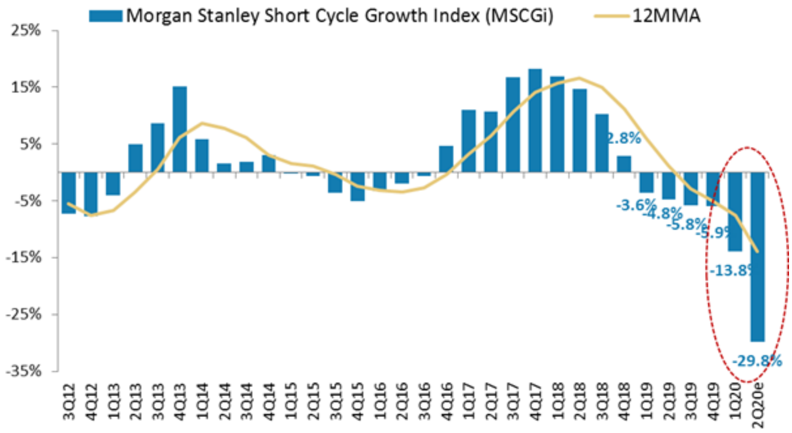
In the end, the situation is that many companies' shares can currently be bought for very attractive prices, although a cloud of worry hangs over the world. But that's precisely why prices may be attractive.

The global economy is back to business

We have not changed our basic scenario, even though the global economy is doing marginally better than expected a couple of months ago. In short, **we expect the global economy to trough in Q220, with double-digit GDP falls in many economies, and the recovery to start in Q320, although the current data suggest that it already started in May/June,** which the stock markets have priced in.

We have been following the industrial cycle as a leading indicator for years. Generally, industrial cycles last 6-8 quarters and we expected the last cycle to trough by the end of 2019, leading to an industrial recovery in 2020 and 2021. The usual industrial cycle pattern matched the progress in the fundamentals: the US-China trade improvement, a soft-Brexit, and a gradual recovery of the Chinese economy, all of which were materializing by the end of 2019.

However, instead of the recovery we were expecting, we had the Covid-19 outbreak and the global recession, which led to two quarters of industrial horror, extending the downward cycle to 10 quarters.



The positive side of the recent industrial performance is that we can anticipate two low-visibility events with great certainty: 1) the quarterly **low will be Q220** and 2) the annual low will be 2020, both of which usually match the stock market low, for obvious reasons. This means that the stock market low is behind us and that 2021 should be better than 2020, excluding new black swans.

It is true that, as we mentioned, there are still risks: a second wave of Covid-19 in the second half of the year, a lack of agreement in the Brexit negotiation, the China-Hong Kong problem, and the US-China tensions, all which could have serious consequences. Furthermore, the pace of the recovery is still very uncertain, which is normal at the beginning of every crisis.

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We do not share the view that Covid-19 will change the world

We differ from the consensus view in respect of two GCC aspects: first, we think that the recovery will be faster than expected, and, second, we believe Covid-19 will not change the world's main structural trends.

Regarding the speed of the recovery, 4 factors, beside what we are seeing in China, lead us to be optimistic:

1) **Government support measures,** which on average terms will reach between 5 and 15% of GDP, are colossal and, as we said, they will replace the loss of private demand.

2) Most countries have implemented plans to **support corporates, large or SMEs**, and employment, and we think that an important part of the current loss of jobs can be recovered in H220

3) Thanks to governments and central banks, **the flow of credit is being maintained,** and continues to work much better than in the Global Financial Crisis 2008/09.

4) As we also stated, there are a number of very advanced projects for medicines and vaccines against Covid-19, some of which are already far advanced. We also do not believe in a new resurgence of Covid-19 in H2 (as opposed to sporadic outbreaks), given the measures that most affected countries have put in place and what we, as a society, have learned.

The GCC is an extraordinary, never before seen crisis, during which governments decided to close their economies for two months and then reactivate them with a liquidity shock and a strong dose of monetary and fiscal policy.

We also believe that human beings' capacity to adapt to existing conditions should not be underestimated**. Consequently, we are convinced that, with the exception of two or three sectors, we will have turned the page within 12-18 months.** It is quite normal to extrapolate the current economic conditions into the medium and long term, but the reality is that the global economy is already recovering and that the seeds for acceleration have been planted.

Furthermore, we deeply disagree with those who think that Covid-19 is going to dramatically change the world. **We still think that globalization, tourism, education, business travel, catering, etc. are going to return to normal, with some marginal changes.** Furthermore, there is a high probability that we will have a vaccine by the end of the year. The other side of the coin is that some countries are accumulating large deficits and public debts, a problem which they will need to tackle after the recovery.

If we look to at Global Financial Crisis 2008/09 as a reference and start with the low in March-09 (when banks were expected to collapse, and corporates were closing down at breakneck speed), it took the stock market 7 quarters to recover to the pre-crisis levels. The GCC 2020 is certainly a deeper crisis, but also a much shorter one, so it looks as if we will recover much sooner.

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At the current prices, the Classic Fund is cheap, yielding a 16/17% expected return, with an updated I.V. of EUR 680

Over the many years of valuing numerous companies, we have learned that an expected IRR of 20% is roughly equivalent to doubling their value in 3-4 years. The Classic currently yields a 17% return, not far from the 20% level. Should the recovery materialize in the way we think it will, the NAV should be around EUR 500 within two years - at the end of 2021 - and move toward EUR 680 in the medium term.

In the Q1 newsletter, we withdrew our 2020 NAV target due to the GCC leading to lower visibility and set a EUR 500 target for Dec. 21, a target we are sticking to (*we did this before the Chinese government withdrew its 2020 GDP growth target!*). If, as we think, the global economy is back to normal by 2022, the market will anticipate this as early as next year, and the Classic will return to a more normalized return of 11-13%.

At SIA, we believe that it is important to set valuation targets for the companies we buy and the funds we manage. First, because we must calculate returns and intrinsic values in order to buy the stocks at the right levels (and also stress testing downside scenarios); second, because it is important to know when the fund is cheap or not, in order to enhance its positioning; and, finally, because it forces us to work harder, to be disciplined, to know the companies, and to know the portfolio, all of which should lead to our investments performing better.

In fact, this is one of the few things where we disagree with the Omaha oracle who never publishes targets or valuations and used to say that the future is unknown. We respect this view but establishing a base-case scenario whose assumptions are backed by common sense and experience, gives us clear performance objectives for each company and for the funds, which is extremely useful for us, and, we hope, for our investors.

The Classic look through

The Classic has a backbone of compounders, or quality, or growth at a reasonable price (GARP), comprising about 40% of the fund and which are highly diversified companies, such as VISA, ASML, Unilever, Viscofan, Apple, Medtronic, Grifols, etc. These are all business models about which we need to worry very little, since they are excellent franchises with extremely solid strategic positions (moats). When selecting such companies, the added value that we try to provide lies in the businesses' strategic analysis and in our effort to buy them when they experience a rough patch, therefore becoming somewhat cheaper.

60% of the Fund is invested in more traditional value stocks, namely in sectors and companies that we believe are very cheap relative to their intrinsic values (we are patiently increasing this part of the Fund during the downturn). As a result of our bottom-up analysis, we have found ourselves concentrated on five sectors where we believe there is a lot of value: **oil/energy (9%), aerospace (7%), salmon (7%), building materials (7%), copper/mining (10%), business services (8%),** and accounting for another 40-45%. The remaining 15% is invested in different sectors/businesses, such as ING (bank), Pandora (affordable jewelry), and Prysmian (electric/telco cables).

In aerospace, a sector that we believe will have a bright future once the effects of Covid-19 have been digested**, we have bought back MTU Aeroengines**, an old friend that fell a lot during the crisis but will recover without problems in a couple of years' time. In this sector, we already own Thales and Raytheon (formerly United Technologies), two strong businesses that will have a tough year in 2020.

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Within the consumer discretionary broad sector, which is obviously cyclical, **we have two large positions Sodexo (catering) and ISS (cleaning),** two companies that fell quite a lot during the crisis, but in which we do not see liquidity or solvency problems. We also think that both will be back to normal in 2021, from both a business and a stock market perspective. ISS has an option that the market has not priced in so far: it should benefit from the hygiene measures that almost all companies and public administrations will have to implement.

The LTIF Natural Resources is up 50% from the lows but remains incredibly cheap

The Natural Resources Fund has recovered 50% from the March lows with a NAV of 75 euros per share, or -29% ytd. The Fund has an intrinsic value of more than EUR 183 per share and, at current prices, an IRR of 22%.

We have taken advantage of the strong market correction since March to sell part of our food investments (especially salmon) and to buy more energy and mines, which are trading at strike prices. **In mid-June, the fund has 40% of its investment in energy/oil and another 40% in mines, with only 20% in agri-food and infrastructures**. Generally, we try to balance it out a bit more with 1/3 in each sector (energy, mining, and agrifood&infra), but given the current valuations, we have been raising the weight of energy and mines.

1. Oil. Covid-19 is only a pause in the upward cycle

In terms of oil, we are quite comfortable, because **the market has gone into an undersupply situation faster than expected** following the OPEC+ cuts, shale collapse, and the well shut-ins caused by low oil prices. Following the decision of the OPEC++ to cut production further, inventories have peaked, and oil prices moved to marginal cash cost levels (around USD 40 Brent).

Against a backdrop of undersupply, but high inventories, oil prices generally move up slowly (from the marginal cash cost, but below the incentive price) until the inventories normalize. According to our figures, inventories should normalize in Q221, but some experts are already suggesting Q420 on the basis of the better demand performance. Once inventories are back to normal, the oil incentive prices are usually reached (around USD 70 Brent), since an increase in production is required to meet demand. **Our model suggests we should end 2020 at around USD 50 per barrel Brent (again, thanks to OPEC+ cuts), and move towards incentive levels in 2021.**

Summarizing the sector situation in a few sentences, we think that 1) shale does not work below USD 60 Brent, meaning that shale production could fall by c.3m b/d, unless oil prices move up sharply. 2) OPEC+, which has far lower costs, is slowly going to replace those 3m plus 1-2m b/d globally requiring higher prices. 3) OPEC+ will try to manage prices and inventories in a USD 60-USD 75 range.

Aside from increasing the existing exposure to oil, we also started investing in some new names. **Pioneer and EOG, two of the leading US E&Ps, have joined the portfolio.** These 2 companies are highly rated, have excellent management teams, a proven track record, and a sound exposure to shale oil in the Permian.

We have also bought a position in Surgutneftegaz, the third largest oil producer in Russia after the state-owned Rosneft and Lukoil (US, Saudi Arabia, and Russia are the 3 major oil producing countries, each of which has around 10% of the total supply). The company is the best-run Russian oil company, has nearly double the recovery rate that its peers have, its reserve replacement ratio was 120% during

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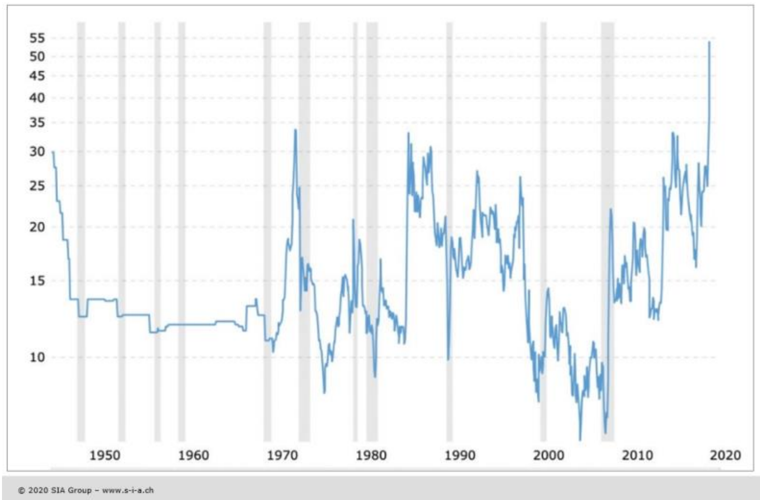
the past few years (all organic), its idle well rate is the lowest in of the industry, and it has a nearly 100% utilization rate of its associated petroleum gas production.

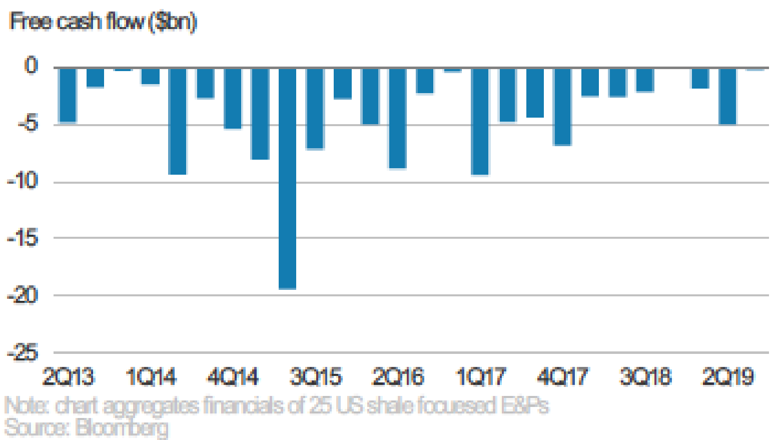
Surgutneftegas trades at 3 times cashflow and has a huge net cash position. We cannot state the EV/EBITDA multiple, **as the company's cash position is over USD 50 b, double the market cap.**



Gold/Oil ratio, opportunity of a century?

2. We expect a structural change in shale oil
Shale oil is facing a structural change from uncontrolled growth with unlimited funding **to first a reset at a lower level (we estimate 5-6 m b/d) and thereafter consolidation, growth within cash-flow, return on (and to) capital, and discipline.**

Shale oil works, but only in a more controlled manner, in order to reverse what the chart below shows, spiced with the >USD 200 bn debt.



Remember that the rig count was already falling long before the GCC, meaning that a large number of wells did not work below USD 60 Brent. The financial markets have burnt their fingers and will closely

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monitor those frackers that do not demonstrate financial discipline. The situation and outcome might even be comparable to the oil sands in Athabasca, where the extraction also differs fundamentally from extracting from an underground liquid reservoir.

Tar sands are large-scale open pit or underground in-situ operations. In-situ is used for deposits that are too deep or too thin for conventional underground mining (a major part of world's Uranium, mostly in Kazakhstan, uses in-situ leaching) and the economics are very different from that of conventional oil production.

Fifteen years ago, oil sands were a big hype. **Nobody cared about the proper calculations of returns and, with oil prices high, the players focused on organic reserve growth or replacement and energy companies all over the world invested in such projects.** Fort McMurray became a hotspot; it had some of the highest real estate prices and the highest Starbucks hourly earnings in North America, which led to a typical gold rush situation (note that the average annual temperature is 0.5 degrees Celsius and as soon as the ice thaws, mosquitoes arrive). This boom came to an abrupt end when the oil price collapsed in 2008, most projects stalled, were divested, etc.

Since major European oil companies tend to act in a very procyclical manner, they invest billions at USD 100 oil, while at USD 30 they make themselves fit for ever declining oil prices. Suncor produced its first oil from sands in the 1970s and most oil sands projects, with opex/bbl at around $35, are good businesses for experienced operators. Despite the end of the boom, large operations like Syncrude and Albian Sands continued to produce or grow and became more efficient. Leading companies like Suncor and CNQ took the opportunity and bought interests in companies like Royal Dutch, which sold at the bottom after investing billions at the peak. Today, most oil sand production is in the hands of CNQ and Suncor whilst minority interests are still owned by Chevron, Exxon's subsidiary Imperial, and the Chinese state-owned companies CNOOC and Sinopec.

US shale might be in a comparable situation. The boom is over. Investments and subsequent production have started to decline. After years of ignoring proper economic calculations, reality is setting in, many players will disappear, and the market will consolidate. EOG and Pioneer are the most efficient companies, the only ones that ever-made money. Within a few years, they might be in a similar situation as CNQ/Suncor with regard to tar sands.

Recessions and crisis provide opportunities to invest cheaply

As long as we do not make unforced errors (bad business and debt, mainly), stock market falls should become investment opportunities for us and our investors, since we can buy the same assets at much lower prices. And that is what we are doing, **strengthening our positions in companies that we already have (e.g., Wienerberger and Heidelberg Cement) or buying new ones from our watch list (e.g., MTU Aeroengines and EOG).**

Buffett repeatedly comments that he would like to live through many crises and recessions, which is something that a long-only fund with daily liquidity finds difficult to cope with. But he is right, the objective of the Classic as a vehicle and of us/our clients as the final investors is to invest our savings and reinvest our profits, and thus the best thing for the Classic and its investors is for the stock market to fall, allowing us to buy cheaper and gain a higher return in the medium to long term.

We have come close to enjoying recessions having experienced two of the worst in history in 2008/09 (GFC) and 2020 (GCC), but it is tough, incredibly tough. Let's try to follow Buffet again and enjoy the current crisis, be constructive when the stock market drops, when the economy deteriorates, and when things go wrong, because stocks become very cheap, which is the basis of value investing.

SIA Funds AG Alpenblickstrasse 25 8853 Lachen Switzerland
tel : +41 55 617 28 70 fax : +41 55 617 28 71 info@s-i-a.ch www.s-i-a.ch

The key to succeed is having a quality fund before any crisis materializes, something that we will be pursuing slowly but surely in the short, medium, and long term.

It is time for value investing

As we can see in the graph, the value strategy has underperformed strongly in the last 3 years, mainly for the two following reasons: 1) the performance of the FAANGS (and huge market caps.), and 2) the Covid-19 crisis which, in the short term, negatively affects cyclical stocks and value in general.

Starting from the cyclicals' current depressed valuation (very normal in an economic downturn, led by commodities, industrials, autos, banks, and insurers) and the sky-high ratings of most FAANGS and health stocks, we think that the value strategy will recover what it has lost in recent years. We do not doubt that most of the FAANGs are excellent companies, but it will be difficult for them to maintain the recent high-growth pace in the long term.

The Classic Fund has beaten the indices since 2002 but has underperformed slightly since 2009. We believe that in the next few years we will see some "mean reversion," allowing value to regain ground and the Classic Fund to outperform. We will see.

SIA Funds AG Alpenblickstrasse 25 8853 Lachen Switzerland
tel : +41 55 617 28 70 fax : +41 55 617 28 71 info@s-i-a.ch www.s-i-a.ch

Moving to ESG

Many months ago, we decided to accelerate the transition to a more sustainable investment model by following stricter Environment Social Governance (ESG) criteria.

From now on we will undertake an ESG due diligence of each company and apply a rating. Our intention is to create 3 ESG categories (just as we created 4 risk categories in the past) and to apply an A - high ESG compliance, B - medium ESG compliance, and C - low rating, to each company; this will allow us to gradually identify which companies lead the pack, which are failing to make the required transition and invest accordingly.

This is not really new to us, as the Classic has already been awarded an AA ESG rating by MSCI, but we want to make progress by structuring our process better. We are convinced that high ESG standards are going to be increasingly relevant for the investment world and are therefore moving steadily in that direction.

Marcos Hernández Aguado
Urs Marti
SIA Team
June 23th, 2020

SIA Funds AG Alpenblickstrasse 25 8853 Lachen Switzerland
tel : +41 55 617 28 70 fax : +41 55 617 28 71 info@s-i-a.ch www.s-i-a.ch

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Bloomberg: LTISTAC

Central Administration Agent:
FundPartner Solutions (Europe) SA
15 avenue J.F. Kennedy
L-1855 Luxembourg
Grand-Duchy of Luxembourg

Investment Manager:
SIA Funds AG
Alpenblickstrasse 25
CH-8853 Lachen
Switzerland

Custodian:
Pictet & Cie (Europe) SA
15A avenue J.F. Kennedy
L-1855 Luxembourg
Grand-Duchy of Luxembourg

Registered Office:
15 avenue J.F. Kennedy
L-1855 Luxembourg
Grand-Duchy of Luxembourg

SIA Funds AG Alpenblickstrasse 25 8853 Lachen Switzerland
tel : +41 55 617 28 70 fax : +41 55 617 28 71 info@s-i-a.ch www.s-i-a.ch