SIA

Strategic Investment Advisors Group

Long Term Investment Fund

Newsletter

of December 2021

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

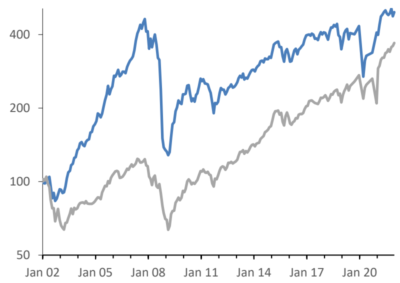

Figure 2: LTIF Natural Resources EUR
vs. S&P Global Nat. Res. Net TR Index EUR

"Oil & Gas supply is moving to net zero, demand is not".

Financial Times

Overview of our funds

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

December 31, 2021	NAV	Δ 3m	Δ 12m	Annualized return (s.i.)	AUM *(in mio)*
LTIF Classic [EUR]	494.26	1.1%	21.2%	8.3%	75
LTIF Natural Resources [EUR]	122.54	6.9%	40.1%	1.2%	62

Source: SIA Group

We are entering the second part of the bull cycle that began in 2009. *Value* is back

By all standards, 2020 and 2021 were two exceptional years, mainly due to the global SARS Covid-19 pandemic. It is fair to say that governments reacted quickly to the virus, achieving rapid economic recovery and some control over the pandemic (which was far from clear at the beginning) by means of lockdowns and strong monetary and fiscal policies. Science of course was the foundation of the recovery.

Against this macroeconomic backdrop, stock markets returned to their upward trend, which started after the Global Financial Crisis (GFC) of 2008/09. **In 2022, we are entering into the last part of this up cycle.** As always in the consolidation phases of bullish cycles, risks are increasing and, in our opinion, in addition to *black swans* (which cannot be anticipated) there are 4 relevant risk factors:

1) SARS Covid-19, Omicron, and possible variants
2) The slowdown of the Chinese economy, mainly the property sector
3) Inflation and interest rates within a *bubbly* bond sector
4) Geopolitical risks with Russia/Ukraine, China/Taiwan, and Iran/Middle East in the lead

In addition to these risks, **the world faces a structural, long-term *green* transition to combat climate change**, which will change the rules in many sectors, obviously starting with energy. We would also highlight a second **global structural trend which slowly tackles inequality, supporting low-income households and what we call the**

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traditional economy (inflation, capex, real assets, commodities… vs. financial assets).

Our base scenario is optimistic/positive, as we believe that these risks will move in the right direction over the course of 2022, and that **value (and commodities) still have a few years of tailwind**, until the next recession (or may be, another black swan) materializes.

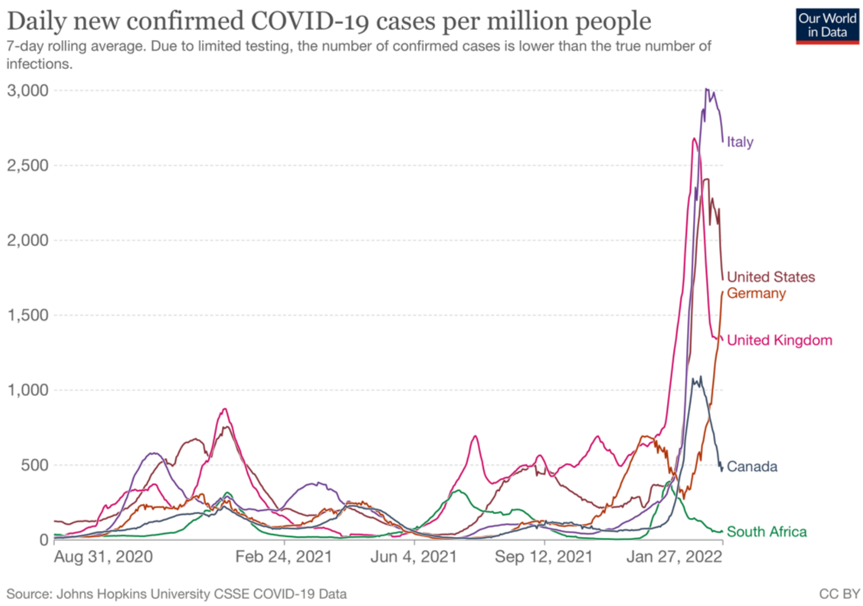
It is true that the risks we mention above might unlock and we are aware that risk is neither predictable nor measurable. **At SIA, we have learned over the years that all this is not really important: whatever happens we keep investing in solid companies with solid management teams and solid balance sheets; we are also concentrated, but well diversified, and our industrial risk is very limited.**

As we have succeeded in doing over the last 20 years, we think we can continue to return close to 10% per year and buy frenetically when there are corrections or recessions. But then, when do we sell our investments? Our thinking follows Warren Buffett's investment philosophy: "Our preferred holding period is forever". Should prices move down, we buy, should they move up, we do compound.

Covid-19 is on its last legs, or so we hope

The main points to note about the Covid pandemic are well known: the new, highly contagious but less virulent **Omicron variant is probably the pandemic's final phase.**

The well-known South African findings reflecting its experience with Omicron are supported by those from the UK and even Switzerland. **A new variant could, of course, develop, but this is less likely now that most people have been vaccinated and/or have recovered.** There is a decreasing population to whom the virus can spread (and, in doing so, mutate). Interestingly, the Spanish flu of 100 years ago lasted about the same length of time: all plagues eventually burn out. The difference this time was that, given the vaccines, the number of serious illnesses and deaths was, fortunately, much lower.



From an economic point of view, most of the disruption is over. Only places like China, which still follows a "zero Covid" policy and whose population has not really been infected (and is therefore inadequately vaccinated), still face uncertainty. Otherwise, the world is almost back to normal. Countries such

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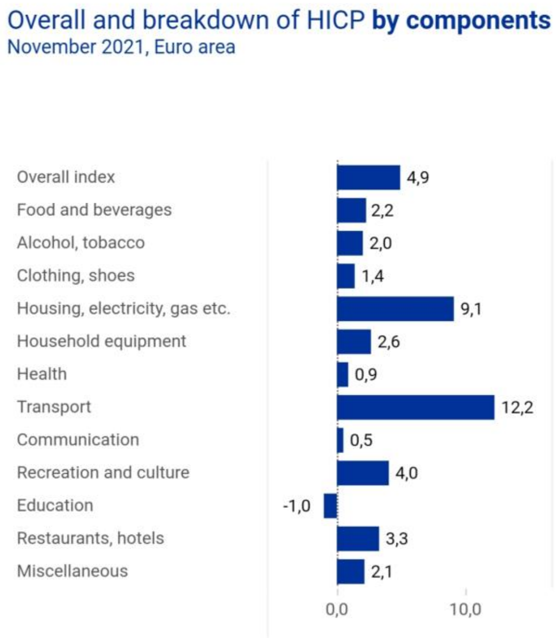
as the UK and Denmark and the Netherlands, hard hit in the last wave, have now lifted all Covid-related restrictions.

Inflation and interest rates are moving up as the output gap closes

This story is, however, not quite over, since we now have a relatively high degree of inflation, a clear consequence of the disruption that the pandemic caused. The key question in financial circles right now is: will inflation take hold, or will it be "transitory"? Let us try to understand where this inflation comes from for a sensible view of where it may go.

Generally speaking, the price of any good rises for one of two reasons: either its supply decreases or its demand increases (or, perhaps, both). The disruption that the pandemic caused has certainly limited many goods' supply. As we discussed in our previous newsletter, our interconnected world is susceptible to major disruptions arising from relatively limited problems, whether the lack of semiconductors, which can bring the automotive industry to a halt, or the unavailability of containers, making the delivery of finished products impossible, or even just delays some parts, which means entire products can't be manufactured.

These supply problems do not, of course, affect all goods or services to the same extent (see the chart below), but inflation is an average, and these problems increase the average.



Source: European Central Bank

It stands to reason that if some goods are in limited supply, but the demand for them remains constant, their price will rise. It can, however, be argued that demand is even stronger than before the pandemic, at least for some goods and by some buyers. Many people, especially "knowledge workers", maintained their purchasing power throughout the lockdowns, but were forced to "save" part of their

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income, because they no longer paid for a few typical expenses (restaurants, tourism, live entertainment, etc.). Further, government assistance partly subsidized the income of many who had lost it.

In addition, central banks have eased their financial conditions. This loosening of fiscal and monetary policies can only increase the aggregate demand, which was also the purpose, namely, to maintain demand despite the shutdown forcing economic activity to contract. The net result was inflationary pressures in at least a significant part of the economy.

But the discussion about whether inflation is transitory or persistent is actually a discussion about whether the above phenomena will continue to occur: **will supply chains remain tight? Will policy remain as accommodative as it has been? We believe that the answer to both questions will, in the relatively short term, be no.** However, it is fair to say that labor is starting to be tight in some large economies, energy prices are moving up globally and housing prices are suffering from a structural slow supply and elevated prices. Higher inflation should be expected although not at the levels seen in Q421.

This brings us to financial markets' main concern: will high inflation force central banks to increase interest rates to a point that they could stifle the economy? As always, the honest answer is that we do not know, but some ideas could be useful in order to invest correctly in this environment.

First, interest rates are very low, and everyone thinks they will remain very low in terms of historical standards. Reading the financial press, one would think that the rates are constantly changing, and have increased a lot lately. The following table puts matters in perspective:

	May 2012	Jan 2015	Nov 2016	Aug 2019	Jan 2022
US 10 Y Bond	1,80%	1,80%	1,80%	1,80%	1,80%

Source: Bloomberg

It is true that both inflation and interest rates are moving up. It is also true that, all other things being equal, higher real rates require lower multiples for equities. **But there is nothing fundamentally new; it is what tends to happen when business cycles consolidate, and the output gap closes. No big deal.**

China takes the first steps toward a new expansionary monetary policy cycle

We are not going to dwell too much on the Chinese economy, but it is a fact that, after the strong post-Covid-19 growth, during which the GDP grew more than 8%, it dropped to 4% in the last quarter of 2021.

China faces a series of headwinds in 2022, of which we highlight three: First, the **property cycle** that started a downward phase by mid-2021, and which usually lasts 2 years in historical terms. Second, the virus's effect on China due to its **Zero Covid policy**. Third, the **hesitant private domestic demand** due to the property sector's woes - recent estimates mention that this sector is directly and indirectly responsible for 30% of the economy - and the lockdowns.

On the positive side, we highlight China's exports and public investment in infrastructures, some of which are aligned with the energy transition.

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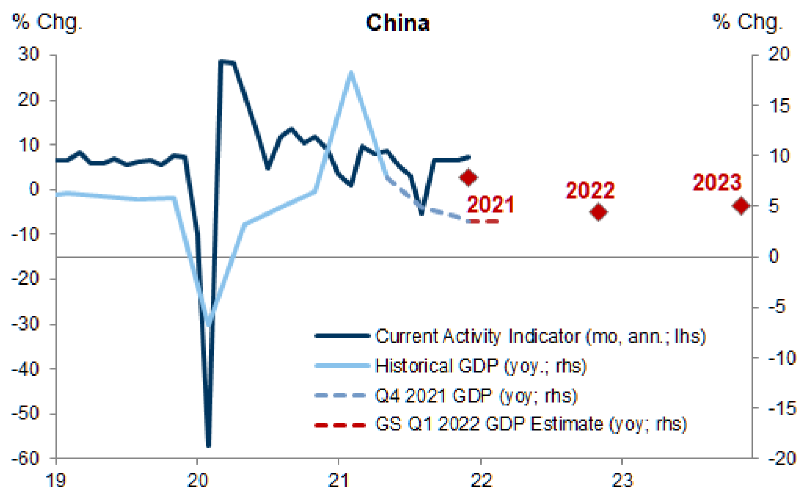
China: GDP 2019-23



Source: Goldman Sachs

We expect the macro trend in 2022 to move to further easing, with more expansionary monetary policy, higher fiscal deficits, sustained credit growth, and an accommodative housing policy, which we think will offset the new lockdowns' impact and the real estate slump.

Our experience suggests that the Chinese government will be able to re-instrument the recovery (the loose monetary policy cycle started in Q421) by focusing on the infrastructure and exports while property and domestic demand slowly regain confidence.

Stock markets are not expensive. Earnings and RoEs are very high

As every year, we have reviewed the main world indices' trading prices and, believe it or not, the stock markets are not expensive. **The US market (Standard & Poor's 500) is trading at a P/E of 22x, although when adjusted for the technology sector (P/E 33x), the P/E is more like 18-19x,** which is in line with the historical average. **Europe (SXXP 600) is trading at P/E 15x**, which is below the historical average of 19x, while the **Nasdaq at P/E 28x** is the only expensive global index.

The problem is not valuation (excluding some sectors we will comment on), **the issue lies with corporate profits which are at historical highs** due to better operating margins, lower financial expenses, and lower taxes, all of which the technology sector reinforces due to its heavy weighting. Corporate RoE's are, on average, well above the historical mean, which is quite normal at this point in the cycle. But beware, it also means that profits are a somewhat "inflated".

Two sectors are appreciably expensive, namely technology and industrials, while two are appreciably cheap, namely energy and financials (banks and insurance). We have made many adjustments to converge earnings and assess indices, geographies, and sectors and our conclusions are as follows (we do not go into details to avoid boring our readers):

1) **Expensive markets:** Nasdaq, Turkey, Industrials, Technology, Growth, Large caps
2) **Cheap markets:** Europe, Brazil, Russia, China, Energy, Financials, Consumer Discretionary, Health, Value, Small caps, Commodities

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3) **Fair markets:** US, Japan, Stable Consumer Stable, Materials

As mentioned above, this analysis is not really the framework for our investments or for the LTIF Classic/NR portfolio's structure but helps us avoid mistakes.

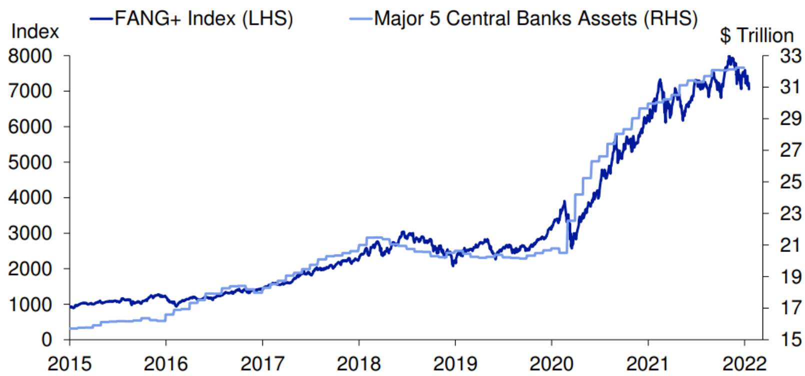
Technology's weight is 30% of the US SPX and its valuation is clearly demanding

We believe that, given the technology sector's current relevance in terms of performance and index weight, it is interesting to spend some time on it. In our opinion, the sector has been maturing over the last few years and faces the final part of the cycle with clear headwinds. **The market has already begun to differentiate between the winners and the losers, with relevant risks beginning to emerge.** We highlight three:

1) **Valuation.** The global technology sector (US driven) is trading at 8.2x book value, close to the peak of the 2000 tech bubble (10x), compared to a historical average of 3.6x.

2) **Interest rates**. Historically, the sector has a strong correlation with interest rates and monetary policies (see chart below), which means the ongoing inflation and interest rate hikes are an unfavorable scenario.

Figure 1: FANG+ Index vs. major 5 Central Banks Balance Sheet Total ($s)



Source : Various Central Banks (Fed, ECB, PBoC, BoJ, BoE), Bloomberg Finance LP, Haver Analytics, Deutsche Bank

3) **Tech trash.** There is currently a strong bifurcation within the technology sector. Some tech companies do not have a strong strategic position and thus are plainly overvalued, whilst some others enjoy a tremendous strategic positioning and thus only valuation can be discussed. Following a period when most tech investments have outperformed, it is time to be much more selective.

This is already visible in today's technology leaders. As an example, our analysis would suggest that Google, Microsoft and Apple are real tech titans, where we can discuss valuation but not strategic position, whilst some other names (e.g. Tesla or Meta/Facebook) lack, in our view a clear competitive advantage. We also consider Amazon a titan, but its valuation is *too difficult* for us to assess. Warren Buffett often recommends having a bin where the *too difficult* can be stored.

Let's take a more concrete example. Zoom Video vs. Exxon

On 19 October 2020, just over a year ago, **Zoom Video Communications, a Chinese company listed on Nasdaq, had a market capitalization of $135 billion. On the same day, Exxon Corporation, the world's**

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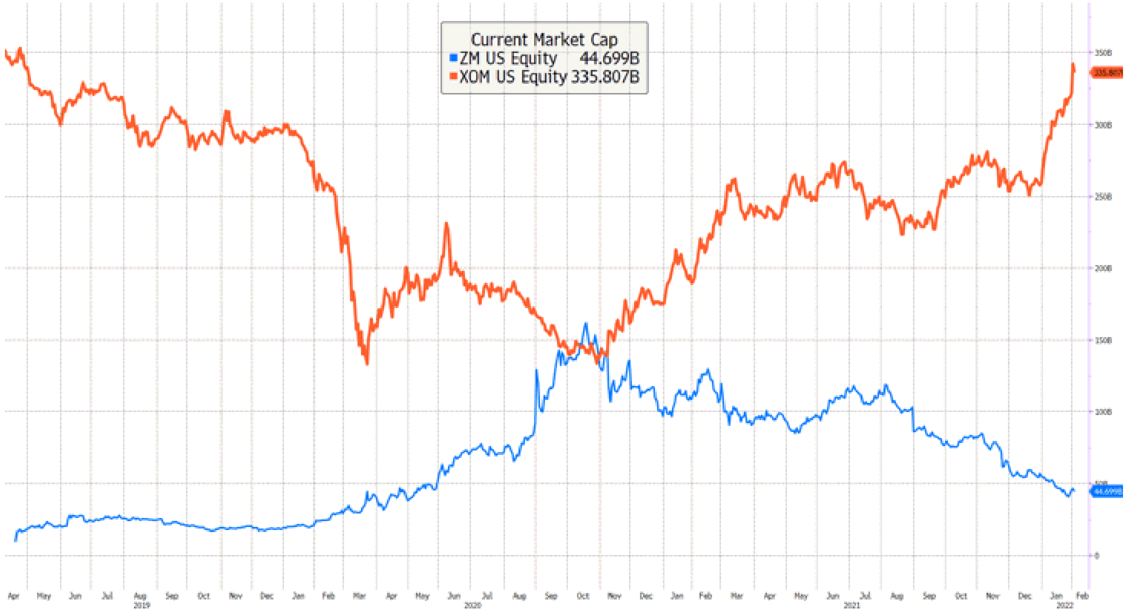
largest private oil producer, had a market capitalization of $115 billion. Zoom sales and net assets: USD 2.1 billion and USD 4.3 billion. Exxon sales and assets: $209 billion and $138 billion.

This is not the place for a full discussion of their respective valuations, but most readers of this newsletter will accept that these valuations obviously did not make any sense (*those who disagree can contact us directly*). The chart below shows the market "correction". In the end, **the market becomes a weighing machine and not a voting machine, as Benjamin Graham so aptly put it in the 1930s.**



This process of adjustment is relatively advanced in the most inflated stocks; that is, companies that did not make a profit and traded at huge valuations in the hope that they would "disrupt" the market that they intended to enter, or in the hope that investors would simply sell them at a higher price.

The person who "invests" in NFTs, paying good money for nothing because "it's going up", is not influenced by 0.5% higher interest rates. In 1999, when we had the previous massive tech bubble, interest rates were 3 times higher than today (above 5%). This is rather the puncturing of a bubble, a process perhaps precipitated by a slight increase in interest rates, but **simply depending on gravity**. By the way, the process is by no means over, and there is still a lot of junk in the market, which the indices will have to absorb.

By contrast, there are many good companies trading at reasonable prices outside the technology sector. These corrections are good for us (in 2002, our first year of trading the Classic Fund, the market was at the end of a long post-bubble correction and our stocks performed more than 20% better per year than the index over the next 5 years). **We do not see an "adjustment induced fall", but we do anticipate the beginning of the digestion of a bubble in part of the market, especially in technology.**

At 31/12/2021, the Classic stood at EUR 494 p.a. +21% in the year. 2022 started well

The LTIF Classic fund remained flattish in the second half of 2021, ending the year at EUR 494 per share, +21% in 2021. This performance is in line with our forecast of ending the year at around EUR 475 p.s. and has allowed us to more than recover from the slight fall that the Covid-19 pandemic caused in

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2020. **We started 2022 well, with a mid-January NAV of EUR 527p.a (+7% in 2022 ytd.)** in a year that, as stated, should remain a value year.

In absolute terms, we are satisfied with the fund's performance, while we are, in relative terms, very much in line with most stock indices: **MSCI Global Value + 19% (in US$) in 2021, MSCI Global Growth +20% ($), SPX US +27% ($), SXXP Europe 22% (EUR), in a negative year for emerging markets, down 5% on average**. As always, we have been increasing the weight of sectors and stocks that we think have more upside. In respect of 2021, we highlight the increase in our exposure to oil/energy, cement, and health/pharma, with Grifols.

The sectors that have performed well in the Classic in 2021 were: Consumer Discretionary (+20%), Technology (+70%), Energy (+70%), and Financials (+40%). On the negative side, due to Grifols' sharp fall, there are only two sectors: Materials/Cement (-2%) and Health (-27%). It should be noted that due to the Classic's strong concentration, its performance may not be comparable to that of the broad sectors.

In terms of stocks, the biggest gainers were Raytheon (aerospace, defense), Devro (sausage casings), Leroy Seafood (salmon), Compass Group (catering), ISS (cleaning), Pandora (low-cost jewelry), ASML (semiconductors), First Quantum (copper), as well as all the oil companies (except Harbour Energy).

On the downside, we highlight Grifols, MTU Aeroengines, and Henkel, which saw double digit declines in 2021. Nevertheless, we regard all three as excellent investments, and we continue to slowly buy them when we can.

Classic's current IRR at 14%. Intrinsic Value: EUR 780 p.s.

Our models' latest update suggests that the Classic has an intrinsic value approaching EUR 800 per share, a level we should reach within 2-3 years, i.e. around 2024-2025, if our objective of making 10% per year net of fees materializes. As a reminder, we calculate the fund's intrinsic value as the weighted average of each stock's intrinsic value, while we use a convergent or mid-cycle methodology for more cyclical stocks.

We have been trying to understand the Classic's fluctuations for many years and our analysis suggests that the current 14% IRR is in the mid-range of Classic's NAV, which has been between 12% and 17% since 2002. **The Classic is therefore neither expensive nor cheap relative to its historical performance, which is in line with stock markets in general**. What can we expect? If we deduct fees from the expected IRR and some investment mistakes, which we will surely make, we should achieve 10% per year.

There are some investors who tell us that 10% is not very much, to which we reply that **10% doubles every 7 years and multiplies by 4 every 14 years, with limited risk (not to be confused with volatility).** The path is clear: EUR 575 in 2022 and EUR 1,000 per share in 2028. Draw a straight line and we all know what the plan is. Anyway, allow us quasi-philosophical license: The important point is not to obsess about the goal, but to enjoy the journey, enjoy the business, the macro, the micro etc. in our quest to be a better professional and person every day, day after day.

Something does, however**, bother us deeply - the obsessive comparison of our short-term performance with the indices.** A couple of ideas in this regard please:

1) In our opinion, **the short term is not significant in equities** and to evaluate the outperformance or underperformance of a fund, at least a decade is required.

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2) If we make 9-10% per year as we have done since 2002, we will naturally beat the broad equity index, which historically achieves 6-7% per year, in line with the nominal world GDP by the way. **Thus, beating the indices is a passive consequence of our strategy and not an active short-term pursuit.**

The LTIF Classic is, as always, both concentrated and diversified. Capital preservation and decent returns are our mantra

As frequently stated, the LTIF Classic simultaneously seeks concentration and diversification and we generally have half of our investments in 10 companies, with no more than 15% in any single theme or driver.

As of today, the companies in our top 10 are Suncor and Cenovus (oil), ING (financials), Grifols (pharma), Heidelberg Cement, ISS (cleaning), Sodexo and Compass Group (catering), Thales (aerospace, defense, cybersecurity), and Henkel (adhesives, cleaning, beauty). We believe that all these businesses are very solid, the management teams are excellent, the balance sheets are healthy, and they all give us an IRR on investment well above 10%.

LTIF Classic Top10 Holdings	
Cenovus Energy Inc.	7,0%
ING Groep NV	5,9%
Grifols SA	5,7%
Heidelberg Cement AG	5,3%
Suncor	4,9%
ISS A/S	4,7%
Sodexo SA	4,7%
Thales	4,6%
Compass Group plc	4,4%
Henkel AG & Co	4,1%
TOTAL	**51,4%**

The Classic continues to have overexposure to only one sector, namely energy/oil&gas, where we have just over 15-20% of the fund. We will discuss the sector in detail in the Natural Resources section as our scenario is finally coming to fruition. We do not want to boast, because the reality is that we are several years late: the shale oil nonsense 2014-20 hide the structural oil shortage we are starting to experience.

It is *value* time, and it will last for a few years

After 10 years of underperformance, we believe that the value factor will revert to the historical mean. It has always done so, and we see no reason why it should not do so again. There are many traditional companies trading at very attractive multiples compared to the *growth* and/or technology sector, which, as we stated, is facing a tougher period due to 1) inflation and interest rates, 2) competitive and regulatory tightening, and 3) demanding valuations.

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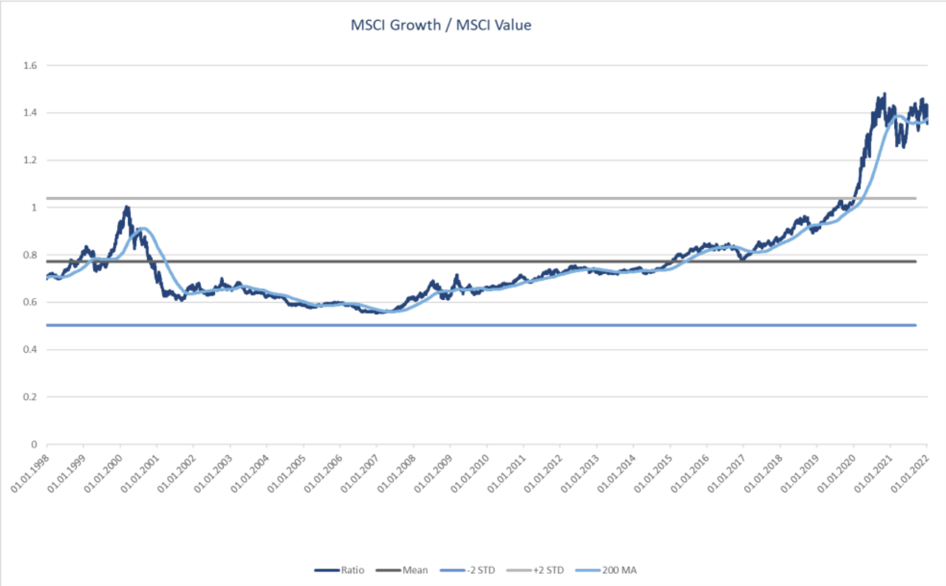

Investment case of the quarter: Grifols Prefs. @ IRR 24%. Intrinsic value of EUR 25

Who could have guessed that Grifols would be the worst stock in the fund in 2021 (-33%)? This is a business with all the characteristics of a quality compounder within an oligopolistic structure and with huge barriers to entry.

As we usually do when a stock that we own starts to fall, we did several in-depth reviews of the business over the course of 2021 to understand why the share was falling and if we were wrong. We found 4 main reasons for the underperformance:

1) **Too much debt,** including *orchestral maneuvers in the night* (factoring, preferred dividends in subsidiaries, etc.).
2) **EPS downgrades**, namely 20% of the 2021 earnings' expectations (could explain an important part of the fall).
3) **Strategic shift** announced at the CMD.
4) **Attitude towards minority shareholders.**

We can understand and even accept the first 3 issues. **The debt comes from a decade-long process of acquisitions** that led Grifols to become one of the world's leading plasma protein companies. The **lower estimates are mainly due to the Covid-19 crisis,** which prevented the collection centers from operating at a normal pace, to which the costs of expanding Grifols' capacity must be added. Finally, **the strategic shift toward the development of products other than plasma proteins also makes sense** (in fact, it somewhat follows CSL's strategy), although Grifols needs to demonstrate the execution of this change over the next few years.

However, the management team (the Grifols family and the main shareholders) worries us most, since we believe it somewhat disregards the minority shareholders. The company's transparency is satisfactory, but it could improve; the acquisition process should not only be structured in terms of strategy, size, market, and technology, but also in terms of returns on capital. The balance sheet should also maintain reasonable debt levels.

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In our due diligence (as outsiders, of course) we found no serious problems in the business or new products directly threatening Grifols blood proteins, while the purchase figure for Biotest surprised us, since, if it is true, this purchase will increase the group's profits strongly. However, we do think that the management team must improve its financial discipline and communication.

How can Grifols' preferred shares trade at a 2023 P/E of 8x when the shares of CSL, a competitor, trade at 33x? As far as the companies' returns on invested capital are concerned, CSL generates 19% and Grifols 6%. Goodwill is very much to blame.

We continue to average down, because the business is fantastic, and we trust that the management team will listen to the minority shareholders who, in good faith, try to "advise" them. If SIA were a private equity fund, we would buy a significant part of the company and support/help the management team, align the minority and majority shareholders, and double the share price in the process.

According to our figures, Grifols Pref. has an IRR on investment of 24% and our intrinsic value is EUR 25 per share compared to the current price of EUR 11 p.s.

Questions moved from Pandora to Harbour Energy

The feedback we receive from the funds' investors, who tend to focus on companies or stocks that underperform, is extremely interesting and welcome. Focus has lately moved to **Harbour Energy, which disappointed badly in 2021 (keeping the path set by Premier Oil in previous years).**

Harbour Energy remains a key holding in our Classic and NR funds. Following the recent Capital Markets Day our conclusions are:

- **Its management and strategy are sound.** We like the new management (from Chrysaor). It has a good M&A track record, cash-flow management, balance sheet, and cost control.

- **Harbour is not going to be an exploration company.** Its main strategy lies in maintaining its production at around 200,000 b/d and growing by acquiring the majors and other players' divestments. Since oil is becoming a "toxic" asset in the energy transition, HBR plans to buy medium-sized assets to offset the declines and fuel growth.

- **The balance sheet is much improved and will be managed "conservatively".** The management team has clarified that leverage should not be added to this volatile sector, and continues to manage hedges, cash flow, and balance sheet conservatively. We like this approach because this sector has enough volatility/leverage. Don't forget the $4bn in tax losses carried forward.

- **The operational risks are controlled, since the oil production comes from a variety of different fields and does not just rely on one.** The company has two main areas, the North Sea and Southeast Asia. Its production and reserves comprise 50/50 oil/gas, which we also like, because gas is not as fungible as it seems, and demand will increase greatly in the coming decades (mainly due to Asian demand and coal substitution).

- **Harbour is a *quasi-low-cost* E&P with OPEX is in the region of $15 per bbl.** There are better companies (some have an OPEX below $10), but $15 is a good level. The management is very cost/return focused.

- **According to our figures, the company can generate a 20% ROIC on $80 oil,** which is an incentive level for us (mid-cycle). EBITDA 2022E es expected to be around $3bn at $70-80 oil and

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3.5$ mmcf gas. This compares to a market cap of $4.6bn and 22E net debt of around $1.5bn. EV/EBITDA is around 2.1x compared to its historical average of 5-6x.

- We believe oil prices will reach $100+ from H222 or 2023, when OPEC+ spare capacity will fade substantially.

- **With oil at $80, HBR produces free cash flow of about $1.2bn, which means they could buy the entire company in about 4 years (25% free cash flow yield).**

- Finally, it should be remembered that after the PMO-Chrysaor merger, **the debt-to-equity conversion and the Chrysaor share lock-up forced many shareholders to sell.** This will end in 2022, after which the stock should resume trading at more normal levels. We believe 650p is the level at which it should trade at $80 oil and $3.5 mmcf gas, but at a much higher level if oil goes above $100.

In conclusion, good management, tier 2 assets (not growing and fighting declines), good costs/returns, M&As at a good time and under a disciplined team, a very cheap company, all wrapped up in high risk.

We are not invested in HBR on exploration, but there is potential in Indonesia and Mexico (the Zama field and some acreage around it). **Finally, please note that we assign a category 4 risk to Harbour (maximum risk),** which is due to its size and operational risks (very small for the E&P sector).

On net, this is a stock that should double when oil and gas prices are at $80 and 3x at higher prices, albeit with a well above average risk.

The LTIF Natural Resources had a good 2021 (+41%). We have a very long cycle ahead of us

We are very proud to have achieved the distinction of the **best Natural Resources fund of 2021 on the Sharing Alpha platform,** which aims to be an independent investment hub. A bit of love is welcome after the stress of two years of global pandemic. We want to share this with all investors as we start a new year.

The LTIF NR ended 2021 with +41% (EUR 123 per share), well ahead of most indices, both geographically and from a sector perspective. It has been a good year and, as we commented previously, we are very convinced that this is just the beginning: a commodity super cycle is forming, a cycle that is normally long in duration due to the difficulty of developing new supply. **The LTIF NR also started strong in 2022, up 9% to end January at EUR 132 p.s.**

We are convinced that we are **entering a super cycle** due to the overlapping of the 2 cycles: the commodity/capex boom/bust cycle (after 10 years of under-investment) and the cycle driven by the energy transition. This is generating very strong demand for some commodities (copper, lithium, cobalt, aluminum, nickel, gas, etc.), whilst, simultaneously, slowing the supply of some other (mainly fossil fuels).

The energy and mining part of the LTIF NR has been the best performer in 2021 (with a rise of more than 50% in both sectors), while the infrastructure (cement, above all) and agri-food sectors appreciated by around 10%. We have taken proper advantage of energy prices' rise, with a very strong weighting in oil and gas (around 50% of the fund), and in mining (35% of the fund), with uranium greatly helping its performance in 2021.

We remain very optimistic regarding the infrastructure sector, with which the US, Europe, China, and many other countries are moving ahead with new infrastructure plans; furthermore, the investments needed for the energy transition supports these plans. We have seen reports mentioning that US$ 6 trillion in annual global investment are required for the energy transition (1/3 of the American GDP every year!), an exorbitant figure that we understand is almost impossible to meet, given that coordinating such a large volume of resources will be complicated, whether for commodities, workers, logistics etc. Investments in infrastructures will benefit companies such as Heidelberg Cement and Buzzi Unicem (both of which have a strong exposure to the US), which are extremely cheap, and whose shares we continue to buy - slowly but surely.

As we expected, salmon prices have returned to all-time highs. It is not that complicated to analyze, given that the supply from Norway (+4-5% per year) and Chile (+0% in 2021), which account for 75% of the world supply, cannot meet the demand. The result - rising prices. The salmon farms we have in the LTIF Natural Resources are cheap and will soon start posting far more buoyant results. It should be noted that most food prices are rising, that high gas prices (and shortages) have reduced fertilizer production, and, therefore, the food supply. High food prices will reveal how competitive "salmon" is as a product at EUR 7 per kg at origin. The consolidation process is also continuing.

The LTIF Natural Resources trades at an IRR of 13-14% and a mid-cycle IV of EUR 175

The LTIF Natural Resources has an IRR on investment of 13-14% and an intrinsic value of EUR 175 per share, although we are awaiting an update on some of the stocks that will be releasing results in the coming weeks. With commodity prices at such high levels, companies are generating a humongous free cash flow, which is causing valuations to move faster than usual (we have many companies generating free cash flow at 20-25% of their market cap; at this rate, *enterprise value's* is consumed within 3-4 years). Our updates quickly become obsolete as we struggle to keep up with free cash flows.

We want to remind you that the calculation of the fund's IRR and intrinsic value is done with mid-cycle valuation models. As we experienced in previous commodity cycles, the market does not tend to stop at mid-cycle valuations, but, like a pendulum, moves from extreme to extreme. We understand that, in our commodity super-cycle scenario, we should be able reach a NAV of EUR 275-300 in the medium term, and the purpose of our fund is to be fully exposed to this trend.

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The super-cycle has only just begun

After the LTIF NR's strong 2021 performance and with some commodity prices at quite high levels, some investors want to know if we are approaching the end of the cycle. **Our answer is clear: this cycle has only just begun and will be longer than usual** due to the overlap between the normal commodity cycle and the energy transition's impact.

The energy transition is distorting the usual capital flows, which are, *en masse*, flowing out of fossil fuels, cement, and other CO_2-emitting industries, flowing to renewable energy and green industries. The trend is structurally correct - the problem lies in timing and execution. Sounds familiar.

We call it the "green paradox": capital is moving too fast toward green energy when it should continue to invest in fossil fuels and traditional/polluting industries to satisfy demand in the short to medium term, while forcing a reduction in their emissions. **Supply is moving to zero carbon, but demand is not,** as the *Financial Times* recently published. Straight to the point.

In fact, we are slowing down some commodities' supply (mainly fossil fuels) in the face of growing demand (the result: high prices), whilst accelerating demand for others (mainly industrial metals) in the face of limited supply (again, high prices). We are clearly **entering an era in which emitting CO_2 is going to be very expensive, and this will have a major impact on energy and commodity prices.**

We believe that after a decade of underinvestment in oil and with demand rising, there will be a shortfall that will push prices above $100 in 2022 or 2023, once the excess of OPEC+ inventories normalizes. Here we again face the "green paradox". **How do we invest in oil when we can't invest in oil? How to propose a multi-billion-dollar investment in a 15-year oil project when most people think it is polluting/toxic, and we are close to peak demand?** Some judges even think it is against the law.

Oil is already near $90. Prices need to incentivize supply

How the story changes within just a short time! A few months after Biden opposed the Keystone pipeline and proposed reducing federal licenses for US oil production, his administration, due to high oil prices, launched an aggressive campaign to pressure OPEC to increase oil production.

This is again evidence of the green paradox: Biden is both sending a domestic message of the need to accelerate the energy transition, and simultaneously calling for other countries to produce more fossil fuels. Makes no sense. Moreover, the US has negotiated the sale of strategic reserves together with several countries, including China and Russia, to lower prices, but this is only a very short-term solution, and in our view, it is time for reserve building not for reserve depleting. What will they do when prices will reach triple digits?

The main problem is the sharp fall in investment since 2013, which translates, for example, into new field discoveries falling to the lowest level in 75 years in 2021. The industry discovered about 4.7 billion barrels in 2021 compared to 12 billion barrels in 2020. Given the collapse of investment, exploration, etc., we can't expect any miracles, and the world faces a structural deficit for many years to come.

In addition, there are various geostrategic problems, such as Mexico's announcement of the end of crude oil exports within two years. Mexico is the third largest exporter in the Americas after the United States and Canada, and is a major supplier to the United States, China, India, South Korea, and Europe.

We cannot emphasize enough that declining rates and growing domestic consumption in countries as populous as Mexico mean that exports are declining. China, for example, was a net exporter of crude oil

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just 20 years ago, but now imports about 10m b/d, 10% of the world's production. Pemex's giant offshore field, *Cantarell*, was the second most productive in the world with more than 2m b/d in 2019, not so long ago, but its production is now down to 160,000 bpd.

The oil market is still in deficit in January 2022

Based on falling global inventories, we have calculated that the oil market ended 2021 with a shortfall of around 1m-1.5m b/d. Saudi Aramco calculates that gas shortages are adding 0.5mb/d to crude demand, the winter deficit is therefore likely to be somewhat larger.

Further, OPEC+ is not able to increase its production by 400,000 b/d per month as planned, due to a variety of problems ranging from attacks on facilities (Libya), investment/decline problems (Russia), and structural problems (Angola, Nigeria). The OPEC+ production increases have only been in the order of 250,000 b/d during the last two months.

Once the OPEC+ inventory overhang is corrected this summer, the crude oil should start price in a **risk premium** ($10(?) or $20(?) per barrel), because every time there is a geostrategic issue, oil prices will skyrocket. Interesting times.

In the longer term, two very relevant news items summarize how complicated increasing the oil supply in the coming years will be:

- **Aramco has declared that its maximum production capacity might not exceed the 12-13 million bpd that it estimates achieving in 2027**. Its current capacity stands at 11m bpd, which means we cannot count on the world's largest exporter to increase the supply substantially.

- **Russia's energy minister has recently commented that most of its reserves will be difficult to recover, requiring huge investments.** We recommend looking at the Vostok project (or projects already completed, such as Yamal LNG, Power of Siberia, etc.) to understand the scale and risks of these projects.

Oil is expensive. Really?

Those people claiming that oil prices are expensive should look to the following chart. The graph shows that, in real terms, the price of oil is not far from that of 1990. In fact, our analysis suggests that we have been leaving in an era of cheap energy that is coming to an end. The world needs to complete an extremely complex energy transition which will require higher energy and commodity prices. It is not only a matter of tackling the supply side of the equation (massively cut CO_2 emissions) but also the demand side (reduce or optimize energy consumption per capita which is way too loose).

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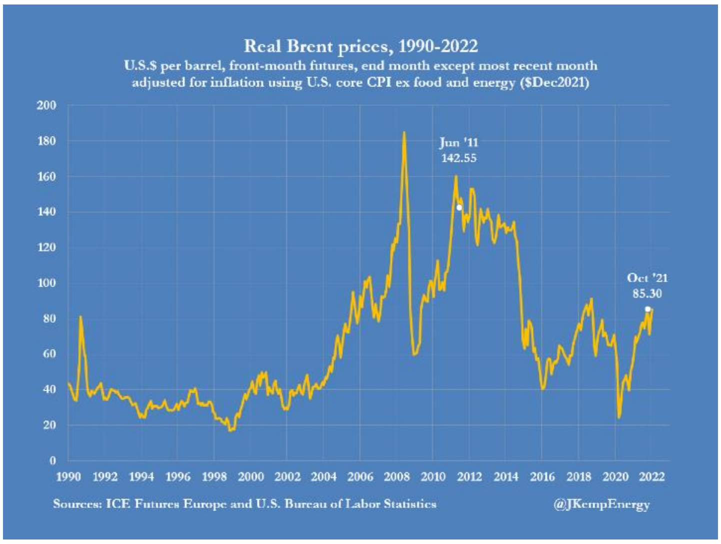

The oil sector finally starts to generate free cash flow

It is hard to find much bad news at the corporate level, because **profits are at a record level**, the sector is producing huge free cash flows (and paying dividends) and stocks are starting to outperform. More importantly, the sector sticks to its recently adopted financial discipline, which is a real regime change.

Having said that, valuations remain incredibly low, as the market continues to believe that the sector is toxic in ESG terms and that we are close to peak demand. For instance, Goldman Sachs expects Petrobras to pay a 30% dividend to shareholders in 2022 with the stock trading at 2.5x EV/EBITDA (which is typical in our portfolio).

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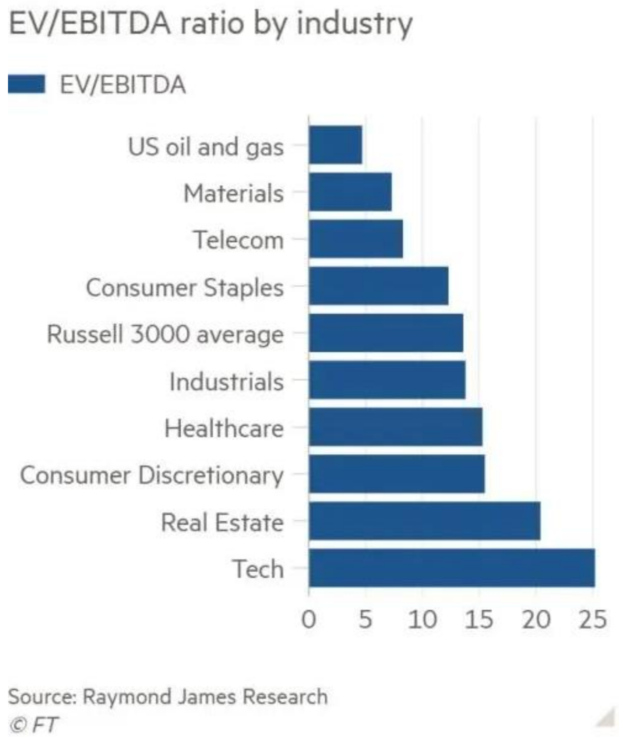

We have a great opportunity to acquire these assets at bargain prices, which is why we have almost half of LTIF Natural Resources in energy, mainly oil and gas. It is very surprising (and in our experience this inefficiency eventually corrects itself) that with Brent at $90, the sector is still trading as if oil were at $60.

In addition, the LTIF NR is mostly invested in high quality small and medium-sized companies, which means we have a much greater exposure to the sector, given that most of the majors are taking cash flows from oil and gas projects (with IRRs close to 20%) and investing them in renewables (with IRRs below 5%). This is the reason why, **in the NR space, it is not advisable to invest in indexes or ETFs which are largely exposed to the majors and large caps. where marginal free cash flow is flying to "*low return-high regulatory risk-green assets*".**

Nuclear energy continues to gain support to help with transition

Nuclear power continues to gain momentum, **with the UK putting nuclear power at the heart of its zero emissions strategy, and the EU seeking to label nuclear and gas as green energy** (there is no other option). This is only the beginning, and we understand that most countries will be forced to change their energy strategies and bring back nuclear energy to the baseload.

It is true that many countries and public opinion resist this move. The green party in the German government and their "big and powerful" allies Luxembourg and Austria lead the resistance, which will ultimately come to nothing, because rising consumer bills and their impact on elections will overtake them.

German energy utilities are starting to struggle and the giant Uniper has just announced liquidity problems due to the soaring gas import prices and its difficulties with passing price increases on to its consumers, which means it is being squeezed. Never invest in companies that cannot pass cost increases

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(Eskom in South Africa is an excellent example). Despite the chaos, Germany took 3 of its 6 remaining nuclear power plants off the grid by the end of 2021 and plans to close the rest by the end of 2022!

There is currently a lot of talk about small modular nuclear power plants. Rosatom already connected the first floating nuclear power plant in 2019, and Russia made a strategic decision to rely mainly on this type of reactor to develop its Arctic regions. Although the press hasn't reported much about it, the development of the Arctic route as competition for the old Suez Canal is a huge project that will have a substantial impact on the world in the coming years. The development of the Russian Arctic region (which comprises most of the Arctic) will be an important issue in the coming years. It may not be suitable for a summer holiday, but it is the main reservoir of untapped natural wealth.

We have 10% of the LTIF NR in uranium that, we understand, will require higher prices to incentivize new supply. The sector did very well in 2021 and we expect the same in the coming years.

We have 35% of the LTIF NR in mining (including uranium)

We remain very positive about the mining sector in the medium and long term and are only a little cautious about the slowdown in the Chinese economy, which usually accounts for more than 50% of global demand for many commodities, such as copper. We are mainly invested in copper and nickel, two of the commodities whose demand is going to explode due to the energy transition to renewables (cables, batteries, turbines, electric cars, etc.; all need copper and nickel).

The sector is not as cheap as the energy sector, trading around mid-cycle levels, but still has tremendous potential. For example, our estimate that Glencore would make more than $20bn EBITDA in 2022 at the then current spot prices compares to a market capitalization of $50bn. The company has a serious problem: what should it do with so much money? It has finally stated that net debt below $10bn is not optimal and that the money will go to shareholders. This is happening throughout the industry, which continues to show a financial discipline as never seen before.

An industry consolidation process is also beginning (or continuing), with most majors looking for new projects aligned with the expected demand for "green metals". We highlight BHP's interest in/discussion with Ivanhoe in the Congo, which demonstrates the problem that the majors face - not enough good projects with scale. With regard to copper, most new projects do not exceed a grade of 0.5% compared to the current 1% of mines in production. There are problems with the scale, grades, costs, taxes, and the environment without even mentioning the political/legal nightmares such as those that Pebble (Northern Dynasty) are experiencing in Bristol Bay. As we said, it is extremely challenging to bring new supply to the equation.

The expected consolidation of the Western Australian nickel industry is materializing with Independence's acquisition of Western Areas. After many problems and poor project execution, Panoramic finally shipped its first ore in late December (Western Areas cites its 20% stake in Panoramic as the main future nickel lever). A consolidated nickel company could attract interest from the two big companies in the region (Glencore/BHP), or someone else, given the lack of nickel mines (a very small market). We have all three companies in the portfolio. Given current valuations and earnings´ flows, what is going to happen seems obvious: a continued M&A wave.

To conclude this newsletter, we have added a couple of charts that show where we are in the cycle and the potential that lies ahead. **The super cycle has just begun. Enjoy the ride.**
Ratio MSCI World /MSCI Mining

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Source: Bloomberg

Ratio MSCI World /MSCI Energy

Source: Bloomberg

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