Sparinvest

Letter to Shareholders | Q4 I 09

Value Bonds

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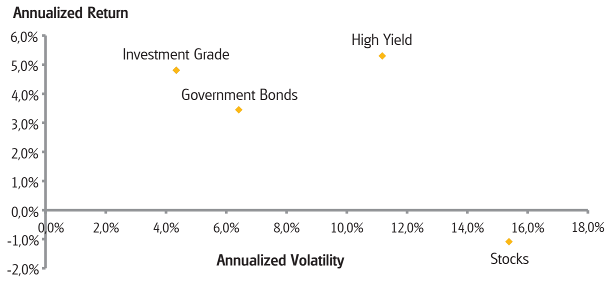
- sparinvest.eu

Economic weather forecast

The various economic outlooks published in December were encouraging. Central banks are expected to maintain historically low interest rates and all forecasts indicate higher global growth. It seems that we are on our way out of one of the longest and worst economic crises since the 1930's. The economic drivers are once again in play and companies now have the chance to grab the new opportunities that arise once consumer confidence returns. In 2008 and 2009 companies have optimized their production facilities, which may lead to greater profitability in 2010.

The credit market has shown its relative strength on its way through the crisis

The figure shows the risk and return profile for different asset classes between 1999 and 2009. During this historical period investment grade bonds returned 5% p.a. with very low volatility. High yield bonds returned more but also with greater volatility. With respect to stocks you could argue that this asset class 'lost the decade'.



Source: BofA Merrill Lynch, Indices are EUR hedged.

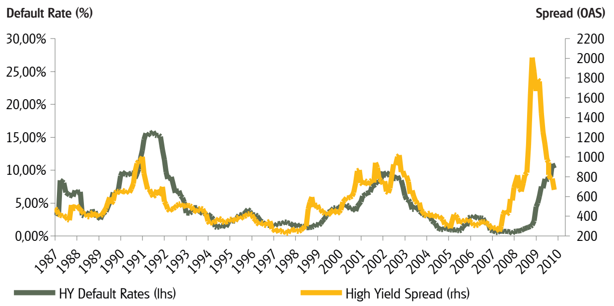
The meltdown on the global financial markets resulted in huge negative returns on almost all asset classes – including corporate bonds. The huge drop in bond prices called into question the robustness of an asset class which historically has been known to deliver attractive returns with a reasonable risk profile. Such doubt, however, was not justified and the credit market delivered historically high returns in 2009. At the turn of the year all current investors in Sparinvest High Yield Value Bonds have a positive return, regardless the date of investing into our fund – something we are very pleased about.

Positive outlook for the credit market

During the summer, confidence and liquidity returned to the credit market. Continuing optimism on the financial markets, together with a number of positive economic outlooks, points to encouraging prospects for the credit market in 2010.

Decreasing default risk

In 2009 we saw a significant drop in the credit risk and this trend is expected to continue in 2010. Companies are still focusing on cost cutting and reducing debt by selling assets or issuing stocks. Therefore companies today look a lot stronger than they did at the beginning of 2009. Listening to corporate managers, we conclude that they are still committed to optimizing operations to increase future profitability – initiatives that benefit creditors and enhance the prospects for achieving attractive returns on corporate bonds.



The large rating agencies expect a decreasing default rate in 2010 – down to 4% - 6%. The credit spread may very well follow and decrease even further.

Expected high coupon payments

A number of companies issued corporate bonds in 2008 in a period where investors demanded high coupons for bearing the economic risk. In 2010 those investors will be able to achieve high returns by clipping coupons.

Interest rates are expected to remain low

Despite the fact that the global economy is moving in the right direction, it is expected to do so at a very slow pace. Hence, central banks are likely to keep the interest rates at low levels and investors may need to take more risk to achieve greater returns by investing in either stocks or corporate bonds.

A number of factors points to further narrowing of the credit spread in 2010. At the moment corporate managers are behaving as we creditors like them to – reducing debt, issuing stocks, and optimizing production to increase corporate profitability.

Expected return for 2010

We are confident about what 2010 may bring. Despite the macro-economic uncertainty that still persists, we see increasing optimism – not only among global companies but also among investors. Sparinvest High Yield Value Bonds will not rest on its laurels. To minimize the risk of permanent loss of capital, we continue to focus on companies with low leverage. We also screen for bonds that are overlooked by the general market and therefore provide a higher yield.

At the turn of the year, Sparinvest High Yield Value Bonds had a coupon of more than 8% with an average bond price of 87 and an effective yield of 13%.

The team behind Sparinvest High Yield Value Bonds would like to express gratitude for the support we have received in 2009 and we look forward to 2010 with great confidence.

Klaus Blaabjerg
Lead Portfolio Manager
8 January 2010

Sparinvest Value Bonds-Team

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