Letter to Shareholders Q3 I 13

Sparinvest

Value Bonds

Headlines

Our Value Bonds Funds

Fund	ISIN code
Corporate Value Bonds	LU0620744002
Emerging Markets Corporate Value Bonds	LU0519053697
Ethical High Yield Value Bonds	LU0473784196
High Yield Value Bonds	LU0232765429
Institutional Corporate Value Bonds	LU0760185370
Investment Grade Value Bonds	LU0264925727

Detailed information is available on sparinvest.eu

- sparinvest.eu

Dear investor,

The Helicopter View…

Despite the political shenanigans, the US is still on track for recovery. Two factors look particularly promising – there is now good momentum in home prices and a pleasingly large contribution from net trade. As a result of fracking, the US has become a net exporter of energy – in particular coal. In fact US coal exports are starting to put pressure on European coal exports. So the US recovery, barring the politics is heading really fast in the right direction. We expect the backdrop to be one of low but more sustainable growth with no wild boom/bust cycle developing. Energy self-sufficiency is a huge competitive advantage in today's global marketplace.

In the Eurozone we are pleased by four developments:

- The make-up of Germany's new government which is likely to lead to a softer stance on austerity.
- The public shooting of himself in the foot and subsequent departure of Italy's loose cannon, Silvio Berlusconi.
- Strong signs that Spain and Ireland are moving in the right direction and with falling labour costs and higher productivity.
- New rounds of LTRO which indicate the resolve of the ECB to avoid a double dip recession by supporting Spanish banks and, by implication, Spanish property prices.

Italy and France still have work to do to reduce unit labour costs but aside from that, the Eurozone is now in a much healthier place.

The Emerging Markets are still reliant on Developed Markets' growth as they are unable to grow alone. Thus if monetary policy remains supportive, underpinning a slow Developed

Markets recovery, we do not foresee any hard landing for the Emerging Markets. However, for sustainable future growth, there is a need for them to deleverage and rely less on credit while growing.

China's balance of payments is down but this is no surprise given the government's aim of turning it into a consumer nation. Thus as US exports rise, and China begins to import more, the Chinese balance of payments will fall. It's a zero sum gain.

Sectors Strongly Represented in our Funds

Financials: This has been our favourite sector in the year to date and now underlying improvements suggest that there is room for even more spread-tightening. So we have maintained our exposure to financials in Europe and especially the UK.

Energy: The world scarcity of oil partly explains our liking for Energy sector bonds. Apart from in Iraq, exploration companies are finding that they have to go deeper and deeper to extract oil. For this they need lots of costly offshore equipment – meaning there will be no drop in oil prices any time soon. For this reason, we have increased our exposure to this sector which remains our favourite from a valuation and risk perspective.

Materials: As commodity prices have fallen, this sector has continued to be a drag on performance but we remain confident that this is a good position to maintain as recovery gains traction.

Our Emerging Markets Fund also has high exposure to Energy and Materials for similar reasons. In addition, there is a strong tilt towards Industrials and Consumer Discretionary – the latter should benefit from the transition towards consumer-driven economies. This is especially true for the more 'mature' emerging market countries such as China and Brazil.

Corporate Bond Market overview

Europe looks like it is following the US out of recession which is also good for maintaining low default rates. Spreads have tightened a lot but we still find bargains in some sectors – specifically in Energy which we like for the reasons discussed above. Whilst Europe's banks are still shying away from lending money to exploration companies, the task falls to the bond market – which is good news for us! Our Energy exposure has a strong Northern European flavour as we like both the strong regulations governing North Sea exploration and the fact that companies issuing bonds here tend to offer valuable assets as security. Our latest purchase in this sector comes with a first lien mortgage on an exploration vessel.

The summer sell-off in Emerging Markets means that many good companies are now attractively valued. The spread in EM High Yield relative to US B rated bonds is now around 100 basis points. But at present, we find comparatively better value (relative to quality) in Investment Grade credits. We currently have a 30%/70% split IG/HY in our Emerging markets fund.

Fund News

High Yield Value Bonds maintains a high average coupon of 10% and we still expect solid positive returns for the rest of the year.

Our **Emerging Market Corporate Value Bonds** fund celebrated its third anniversary in September and was immediately launched into the limelight as it topped fund performance league tables throughout Europe.

In recent months we have encountered a lot of interest from investors in the idea of fixed maturity, short duration strategies, designed to lock in potentially high coupon payments for a fixed period while interest rates are set to be low. Indeed we have already attracted EUR 415m into such strategies this year with significant further investment expected before the year end.

Conclusion

It might seem strange, but this slow and nervous recovery is exactly the environment we like best in the credit markets. It stops companies from taking unnecessary risks with their money, and that means they have more set aside to repay their bondholders. Plus, while the recovery remains weak we see no prospect of monetary tightening and thus no end in sight to the current low interest rate environment.

Although there are no longer any ‘easy pickings’ in the corporate bonds market, our process still uncovers many interesting bonds offering a ‘value premium’ where the reward for investment is high compared with the risk that is taken. Against a backdrop of low interest rates and default rates and cautious company management we are confident that we can extract the value premium from our investments.

Yours faithfully,

Klaus Blaabjerg
Chief Portfolio Manager
4th Oct 2013

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Key Numbers Sparinvest Value Bond Funds

Key numbers for Sparinvest Value Bond funds	High Yield Value Bonds	Emerging Markets Value Bonds	Corporate Value Bonds	Investment Grade Value Bonds
Yield to Maturity	11.43%	8.15%	5.82%	4.9%
Duration	3.66	3.46	3.87	4.61
Average NDE	85%	85%	101%	51%
Avg. Interest Coverage	3.86x	8.11x	5.85x	17.55x
Average Price-to Book	0.78x	1.28x	2.84x	1.41x
Default activity ytd	0%	0.5%	0%	0%

Sparinvest Value Bonds-Team

From left to right:

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Senior Portfolio Manager
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Senior Portfolio Manager
Klaus Blaabjerg
Lead Portfolio Manager
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Portfolio Manager

Sparinvest is a signatory of UN PRI and member of Eurosif and Dansif.

UN PRI is an international investor initiative sponsored by the UN and based on six principles for responsible investments. The aim is to help investors actively to incorporate environmental, social and governance issues into their investments.

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