Letter to Shareholders | Q2 I 13

Sparinvest

Value Bonds

Headlines

- The Helicopter View…
- Sectors Strongly Represented in our Funds
- Corporate Bond Market overview
- Fund News
- Conclusion
- Key Numbers Sparinvest Value Bond Funds

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…

The reason for the introduction of 'tapering off' (the gradual ending of reliance on QE) in the US is that recovery is looking increasingly sustainable. Demand for housing is strong and consumer confidence is spilling into areas such as auto sales which are now getting back to levels last seen pre-crisis.

Europe is improving but not as rapidly as the US and there will certainly be hiccups in the recovery process (as we have already seen with the Italian elections and recent events in Portugal.) Southern Europe has dangerous levels of 'austerity fatigue' which creates a greater risk of political uncertainty and ensures the continuation of a loose monetary policy.

The 'Anglo Saxon' economies are proving the Keynesian theory that 'you can't save your way out of recession'. Governments here must perform a balancing act between clever cost cutting and employment-generating spending. Thus it makes sense for them to cut back on social spending and reinvest in highly visible infrastructure projects.

Japan has gone 'all in' with its policy of monetary easing and money is being forced into fixed income, causing Japanese bonds to trade very expensively.

It is reassuring to note that the monetary policy of the world's developed nations is now in the safe hands of four very sensible and highly experienced central bankers. We believe that any mistakes that they might make will be quickly corrected. In general, we believe that monetary easing is around to stay for the foreseeable future in the UK, Europe and Japan but that the US will begin a gradual weaning process, the speed of which will be dictated by the long-term sustainability of the recovery.

China is giving off mixed signals. There have been some signs of stress in money markets, but nothing that the authorities can't cope with.

The implications of the macro-economic developments noted above are that we will begin to see a stronger US dollar and weaker Yen, and that rates in Europe will not rise as fast as US rates. This is very important for both bond and credit markets and means European credits will remain in 'the sweet spot' for longer. This assumes that stabilization followed by weak but positive growth is a more likely outcome than any slide back into deeper recession.

Sectors Strongly Represented in our Funds

Financials: Of all the corporate bond sectors, financials have seen the strongest performance in the year to date, vindicating our strong exposure to this sector in the developed markets.

Energy: We still like Energy sector bonds and continue to find them very undervalued from an earnings perspective.

Materials: This is a sector that we have been gradually buying into in anticipation of a strong performance in H2 as recovery gathers pace. Although it has been the worst performing sector in the year to date and has been something of a drag on performance, we remain confident for the near future.

In our Emerging Markets fund we also favour Energy and Materials, with the addition of a strong tilt towards Industrials – a sector where we have aligned our buying policy with declared Government plans regarding infrastructure projects.

Corporate Bond Market overview

May and June saw a significant rise in bond yields with retail outflows to the tune of $60 billion in the two weeks from the Bernanke Speech of 19th June to the end of the quarter.

We firmly believe that high yield remains an intelligent investment destination at this time. Whereas high yield spreads are now pretty much in line with their historical average, they are offset by a well-below-average default level. Therefore spreads of 5.5% remain cheap relative to a default rate of only 2%. This offers a solid excess return compared with government bonds and a good margin of safety against any rise in Treasury yields or worsening economic data.

We maintain that concern about a high yield bubble is misplaced for a number of reasons. New issuance as a percentage of the total market is nowhere near problem levels and we are simply not seeing risky CCC credits being issued at this time, so quality remains high. Secondly it is worth noting that companies issuing bonds are doing so primarily for refinancing rather than acquisition purposes. LBO financing can be toxic in the credit market, but this is **not** what we are seeing. Finally, there is no 'maturity wall' in sight. At the start of 2009, nearly every outstanding bond in the market was set to reach maturity by 2015. But now the debt maturing through 2015 has been reduced by $672 billion. There are no short-term maturity worries.

This combination of maturity extension and continuing high levels of quality issuance is what keeps default pressure (and bubble risk) low.

Fund News

Despite the record retail outflows seen in the market during June, we are gratified to note that we have seen no significant outflow from our funds. We would therefore like to thank you for your vote of confidence.

It is worth commenting on the credit quality of our **High Yield Value Bonds**. Over 60% of the portfolio is currently invested in bonds rated at B and below. Across the entire market, B-rated bonds currently offer an average premium of 3.47% and strike the best balance between limited rate sensitivity, macro risks, income potential and default risks. However, our value bonds strategy captures a number of higher-yielding B-rated bonds issued by smaller companies who find it hard to achieve BB ratings from Rating Agencies simply on grounds of their size. We also like BB bonds (portfolio exposure is 24.3%) but these are much more interest-rate sensitive. For us, B is the rating sweet spot.

High Yield Value Bonds currently offers a running yield (i.e. average coupon divided by average price) of 10%/0.97 and we still expect solid positive returns for the rest of the year, made up of small price increases plus the regular coupon payment/reinvestment.

Our **Emerging Market Corporate Value Bonds**, which can invest across the entire ratings spectrum, also has a high concentration of B-rated bonds – currently 55.6%. It has a running yield of 6.77%/0.98. The current focus for this fund is on preparing for what perhaps might be a little slower growth in Emerging Markets.

Conclusion

Although we are not expecting a rate-hike any time soon, it is worth noting that Bond funds typically recover from the declines suffered during such an event by bringing in more yield as they buy new paper at the better rates. (It's a sort of in-built rebalancing exercise.) What this means is that the time taken to recoup any losses in this asset class is typically short.

In fact, there have only been four 'down years' for high yield returns since 1980 and it is worth noting what happened in the year immediately following each of these.

1990 returns:	-6.4%	1991 returns:	43.8%
1994 returns:	-1.6%	1995 returns:	19.6%
2000 returns	-5.8%	2001 returns:	5.5%
2008 returns	-26.8%	2009 returns:	58.9%

The JP Morgan Global High Yield Index shows average returns over the past 15 years of over 7% with low volatility compared with equities.

All in all, we would argue that if your investment objective at this time is to achieve higher yield than sovereigns with lower volatility than equities, high yield is the place to be and that the bubble blowers have got it wrong.

Yours faithfully,

Klaus Blaabjerg
Chief Portfolio Manager
5th July 2013

Shareholder Information

As a general rule, fixed income funds do not invest in equities. This is also normally true for **Sparinvest - High Yield Value Bonds** and **Sparinvest - Ethical High Yield Value Bonds**. However with a view to ensuring full transparency, we must report to you that – as a result of a financial restructuring process by one of our holdings (whereby bonds were converted into shares) – these two sub-funds have temporarily been passively invested in the shares of the energy company, PA Resources instead of its bonds. Almost immediately after this corporate action occurred on 7th February 2013, the price of the shares fell and therefore, in the best interest of our investors, we decided to keep them – a decision based on our analysis that they would recover in value. Indeed, this has proved to be the case. PA Resources is now in a much healthier position, which is reflected in a higher share price. As from 5th July the company has been put up for sale. Sparinvest - High Yield Value Bonds and Sparinvest – Ethical High Yield Value Bonds are therefore in the process of selling their entire shareholding and returning to being pure fixed income funds.

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	12.01%	8.37%	6.06%	5.16%
Duration	3.24	3.75	4.00	5.02
Average NDE	94%	85%	87%	47%
Avg. Interest Coverage	2.55x	7.2x	5.65x	15.51x
Average Price-to Book	0.85x	1.6x	3.13x	1.55x
Default activity ytd	0%	0%	0%	0%

Sparinvest Value Bonds-Team

From left to right:

Toke Katborg Hjortshøj
Senior Portfolio Manager
Sune Højholt Jensen
Senior Portfolio Manager
Klaus Blaabjerg
Lead Portfolio Manager
Peter Dabros
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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