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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

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Value Bonds

Dear investor,

The Helicopter View...

Our macro-economic view is one of guarded optimism. We do not envisage steep recoveries occurring anywhere in the world, but we do see scope for the US and China to make gradual 'middle-of-the-road' recoveries, leading to slow improvement globally.

The potential drivers for growth are different in each case. In China, an easing of monetary policy means that credit restrictions are being lifted and we expect positive effects from this to filter through to the real economy. In the US, the housing sector recovery is probably already stronger than we see it reported in the Press and should lift consumer spending. In the current low interest-rate environment, it is entirely possible for the US private sector to compensate for the inevitable fiscal retrenchment. The key for policy makers is to get the timing right. We do not, therefore, envisage a recovery strong enough to require a US interest-rate hike.

In Europe, we believe that Mario Draghi's now famous speech of 26 July 2012 drew a line in the sand for the sovereign debt crisis. His exact words: *"Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."* were exactly the backstop that the market needed and essential for unlocking the extreme monetary tightening in the periphery countries. From a monetary perspective, Europe should now improve. Political risks and uncertainties remain, but we find it hard to believe that the Italians will opt for a further dose of Berlusconi and any regime change in Germany is likely to be more growth-positive than no regime change.

Even though super-high growth looks unlikely, we may still see very high asset inflation as a result of loose monetary policy. Low returns from Government bonds will drive investors into risk assets in the search for yield. Just stable rather than stellar growth in China will be very positive for commodities, and energy in particular.

Sectors Strongly Represented in our Funds

Financials: Stricter regulation of capital adequacy has provided the impetus for the whole sector to deleverage very quickly. Hard-core debt reduction in European financials has been a great credit story. Bond issuance by financials made a negative contribution to supply, proving that debt has been reduced and banks are now close to where they want to be. The next chapter of the credit repair story could well be earnings improvements. We await Q1 and Q2 figures with interest. If earnings also rise, then we have not yet seen the end of the rally. Euro financial spreads could compress even further.

Energy: The stability of the oil price over the past quarter (Brent Crude at 110) has been extremely positive but is not yet factored into bond or equity prices. Energy sector bonds are still very undervalued from an earnings perspective. The real negative for this sector would be a hard landing for China (which we do not expect.)

Materials: China growth is the driver here. Back in August, when inventory draw-downs for China caused the market to panic about a potential hard landing, iron ore bonds became extremely undervalued. We viewed this as a buying opportunity and our High Yield Value Bonds now has a significant exposure to the price of iron ore. In Q4, this sector saw some really bullish price action, but we don't need a high iron ore price for good performance from the bonds.

Corporate Bond Market overview

In general, spreads have continued to tighten – this effect has been most evident in Financials and in European companies to a greater extent than in US companies. This has been very positive for the performance of our High Yield and Investment Grade funds which were positioned precisely for a narrowing of spreads in European financials. We believe this position offers further performance potential.

Bond supply remains low and is not keeping pace with demand. This could be interpreted bullishly. If companies are not taking advantage of the current highly attractive rates for borrowing, it could indicate that they have made great progress in deleveraging/repair. The next step in the economic cycle is recovery.

We expect the global high yield default level to stay low for the next 2 years or so – at around 2-3%. Therefore spreads of 500 basis points are still too high. The fact that

we do not see highly-indebted (CCC) companies issuing bonds, means the rally has further to go. In terms of premiums, we find that – everything outside the US is cheap compared to the US. For alpha, we still look to secondary markets and overlooked names.

Fund News

In **High Yield Value Bonds**, we have reduced exposure to banks (e.g. French BPCE) as targets have been reached. (The bonds remain solid but they are no longer priced at the discount that we continuously look for.) We have increased exposure to insurers and, in particular, we invested in the UK insurer, Friends Provident, which has seen excellent performance in Q1.

The big inflow into our **Investment Grade Value Bonds** has been used to buy into rock-solid names (such as GE and Ericsson); big, 'boring' companies where bonds were still too cheap. We have also been taking steps to reduce interest-rate exposure through a focus on short maturities and floating-rate notes.

We increased our Mexican exposure in **Emerging Markets Corporate Value Bonds**, to benefit from the recovery in the US economy and the strong links between the US and the Mexican economies. We also maintained some weight in Chinese companies, with focus on sectors highlighted in the next Five-Year-Plan just outlined by the new Chinese leadership. After a trip to Beijing in November 2012, we bought bonds issued by Sound Global, a company that provides water and waste-water treatment solutions in China – one of the highly prioritized sectors for the coming decade.

2012 has undoubtedly been a very good year for corporate bond investors and the fact that all the main funds in the Sparinvest Value Bonds 'stable' have picked up performance awards this year is an indication of the strength of the value strategy for credits. But we are active managers and the job never stops. We continue to sell bonds when too expensive and buy undervalued bonds. This is how we maintain portfolios that are still cheap, even after delivering performance of 20 – 30% last year. We believe our holdings still have great potential for generating strong returns in 2013, as the table on the next page shows.

Yours faithfully,

Klaus Blaabjerg
Chief Portfolio Manager
16 January 2013

Key Numbers Sparinvest Value Bond Funds

Key numbers for Sparinvest Value Bond funds	High Yield Value Bonds	Emerging Markets Value Bonds	Investment Grade Value Bonds	Corporate Value Bonds
Yield to Maturity	11.39%	7.69%	5.78%	5.39%
Expected returns 2013	10-14%	7-9%	5-7%	3-4%
Duration	3.17	3.18	3.7	4.78
Average NDE	78%	75%	98%	75%
Avg. Interest Coverage	2.52x	7.85x	6.16x	12.23x
Average Price-to Book	0.75x	1.42x	1.38x	0.93x
Default activity ytd	0%	0%	0%	0%

Sparinvest Value Bonds-Team



From left to right:

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

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