Sparinvest

Global Small Cap Value
Fund Update
Q2/08

Dear Investor

Performance highlights
Q2 return of -3.36%

Global stock markets continued to decline in Q2 2008, and Sparinvest Global Small Cap Value has also suffered. The second quarter brought a loss of 3.36%, taking our year-to-date return to a negative 14.33%. However, we continue to view our holdings with confidence for the long term, and note also that the current markets provide an opportunity to buy stocks cheaply to generate future performance.

The general equity market when measured by the MSCI World Index lost 1.10% in the quarter, while MSCI World Value and MSCI World Small Cap declined 4.77% and 0.36% respectively. Growth stocks performed significantly better during the quarter, with a positive return of 2.50%.

The table below shows the returns from the second quarter and first half of 2008, and the return from 2007, compared with different stock market indices.

Sparinvest Global Small Cap Value versus Index

	Q2 2008	H1 2008	2007
Sparinvest Global Small Cap Value	-3.36%	-14.33%	-14.99%
MSCI World Small Cap Index	-0.36%	-15.54%	-9.10%
MSCI World Index	-1.10%	-17.01%	-1.66%
MSCI World Value Index	-4.77%	-20.33%	-6.74%
MSCI World Growth Index	2.50%	-13.74%	3.51%

MSCI World Small Cap Index, MSCI World Index, MSCI World Value Index, and MSCI World Growth Index are indices that contain a broad selection of companies from all over the World. All returns on investments are in EUR.

Economics

As Q2 began, Fed chairman Ben Bernanke testified to Congress of the risk that the US economy could "contract slightly" in H1 2008. Full-blown recession or not, there is no doubt the economy is now in a weak state. 'Stagflation' is an ugly word for an ugly phenomenon. Policymakers face a dilemma when setting interest rates, caught between inflation risks on the one hand, and unimpressive growth expectations and continuing uncertainty in the financial sector on the other. Making the decision even harder is the fact that inflation is currently being driven by energy and food prices. Rather than generating a virtuous circle of earnings and spending, this type of inflation triggers a tightening of personal and corporate purse strings.

In the US, Q1 GDP was revised upwards to 1.0% annualised, but expectations are that growth slowed to an annualised 0.45% in Q2. Consumer spending got a temporary boost from tax rebates, but wage growth and consumer confidence figures are weak. June became the sixth straight month of job cuts. In Europe, unemployment figures remain fairly encouraging, and May retail sales were reasonably healthy. However, economic confidence is taking a battering here too, with June indicators at their lowest in 3 years. Q1 GDP was estimated at 0.8% (quarterly).

In Japan, GDP expanded by 4,0% annualised in Q1, but expectations are that the economy will slow – or contract slightly – in mid-2008, before a later recovery. Household spending fell in May by 3.2% year-on-year and, although unemployment remains stable, the ratio of jobs to applicants slid in May.

The common theme is inflation. Consumer price indices around the world rose sharply, with food and energy prices the main culprits. Oil continued its ascent during Q2 to surpass USD 145 per barrel in early July, putting heavy pressure on consumers and companies alike. Once oil exceeded USD 140, gold prices were pushed back up by investors seeking an inflation hedge.

The ongoing impact of the credit crunch meant that Q2 began with further monetary easing in the developed markets. The Bank of England cut rates from 5.25% to 5.00% on April 10, while the Fed followed Q1's many cuts with a further 25 basis-point reduction on April 30. However, as Q2 progressed, the concerns of central banks everywhere became increasingly focused on inflation.

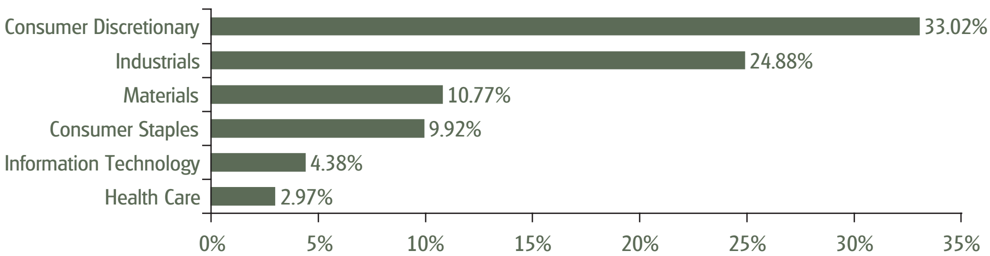
In late June, the Fed stated that downside risks to growth had diminished, and indicated that its focus was now more on the risk of rising inflation - although the language was not hawkish enough to suggest an imminent hike. The ECB, however, implemented a 25 basis-point rate hike on July 3, despite opposition from many (such as French President, Sarkozy) who were worried that a rate hike would threaten growth and exacerbate overvaluation of the Euro.

By comparison with its weak Q1 performance, the US Dollar was fairly stable during Q2. It strengthened slightly against the Euro, only to fall back at the quarter end to the levels of late March at USD 1.57 per Euro. Meanwhile the Japanese Yen reversed its first quarter strength, weakening by around 7% against both the US Dollar and the Euro to end Q2 at JPY 106 per USD and JPY 167 per EUR.

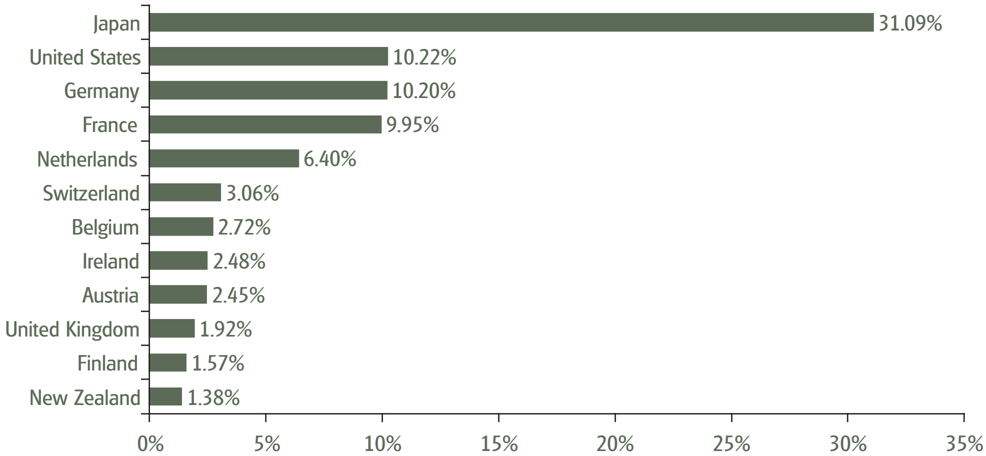
Portfolio update

At the end of the quarter, the cash position was 14.1% of assets under management. The fund had 59 holdings, with the following sector and country breakdowns.

Sector allocation



Country allocation



During the quarter, we invested in four new companies. We acquired shares in Fleury Michon, a French maker of pre-packaged foods and in Toppan Forms, a Japanese printer of business forms. In the USA, we invested in Frisch's Restaurants, an operator of family restaurants and in Columbia Sportswear, a manufacturer of sports and outdoor clothing.

We made additional investments in two existing portfolio stocks.

At the end of the quarter, our 10 largest positions accounted for 24.2% of total portfolio holdings.

Top 10 holdings

Holding	Sector	Weight
Freds Inc A	Consumer Discretionary	2.96%
Tessenderlo Chemie	Materials	2.72%
Grammer Ag	Consumer Discretionary	2.64%
Tachi-S	Consumer Discretionary	2.57%
Miba Ag -Priv.-B-	Consumer Discretionary	2.45%
Ste L D C Sa	Consumer Staples	2.24%
Rsdb Nv	Industrials	2.24%
Scholastic Corp.	Consumer Discretionary	2.22%
Koenig + Bauer Ag	Industrials	2.14%
Jungheinrich Ag /Vorz.O.St	Industrials	2.00%

PZ Cussons
Sold with profit

PZ Cussons' origins lie in soap manufacturing, but the group is now one of the world's leading producers of toiletries, while other business areas include household cleaning products and pharmaceuticals. It operates in Europe, Africa and Asia, and controls household brands such as Imperial Leather, Carex, and Original Source.

We first invested in PZ Cussons in December 2006, paying GBP 1.66 per share. The balance sheet enjoyed a healthy net cash position, and earnings were stable if not expanding rapidly. The stock was trading close to book value, and was also cheap on earnings-based valuation measures. It had historically offered a dividend yield of 4-8%.

Since the 1990s, PZ Cussons has steadily expanded its operations. The management has used cash to acquire strong brands such as Original Source (in 2002) and Charles Worthington (2004). Sales are now over 25% above the 2003 level. Most impressive of all has been the company's success in improving profitability.

The market has steadily rewarded PZ Cussons with increasing valuations. We sold our holding at an average price of GBP 1.94, giving us a total return on the initial investment of 20.3% annualised. ■

Outlook

The first half of 2008 has been very tough for small caps. Inflation, driven by oil and food prices, combined with the added punch of the credit crisis, has resulted in one of the worst first half-year periods for equity markets.

All regions and sectors have been negatively impacted by the current market conditions and, in relative terms, small caps have actually been one of the best-performing segments. Given our approach and focus on absolute value, we are not satisfied to see negative performance, but in times where the market is driven by psychology and sentiment more than fundamentals, it is impossible to hide. There is no doubt that the current global economic outlook is far from clear. It is very much influenced by the price of oil and on how the credit crisis pans out. So, for market participants attempting to predict the future months, the task is even more of a guessing game than usual. Historically, periods of poor economic visibility have combined with short memories and short-term investment horizons to mean that even quality companies are priced down.

A simple example is production capacity - something which swings in people's minds from being an asset to being a liability at such times. Short-term memories recall that margins fell for the past three quarters, bringing concerns that margins will continue to fall and this fear is underpinned by the lack of overall economic visibility. Therefore investors sell. And yet, on a long term view, if the business model is sustainable, the value of existing production capacity will not drop below the cost of setting up new capacity. That is precisely why long-term investors can find opportunities in markets like these. Of course, there are some sectors where earnings will never get back on track, but most mature sectors – such as supermarkets – will. This is just a little dip on the long-term road.

The current market situation is not all bad: it is also a window of opportunity to secure the future returns of the fund. The strong process we have used at Sparinvest for the past decade ensures that the companies added to the portfolio are strong and sustainable. And in the first half of this year we have made as many new investments we did in the whole of last year. In the short term these purchases may not help performance, but we are confident they will in the long term. Our portfolio is trading at a Price-to-Book Ratio of 0.8 and a median EV/EBITDA ratio of 4.2 and the portfolio is net-debt free. These valuations are very similar to those we saw at the end of the last century.

We are here to produce positive returns and so can in no way be satisfied with a period of negative returns. However, we remain convinced of the strength of our portfolio. The decline in the markets does not reflect a decline in the fundamental quality of our investments. We continue to see considerable upside in them and we are confident in the future potential of our holdings. ■

Yours sincerely,

Sparinvest Asset Management

Kasper Billy Jacobsen
Lead Portfolio Manager
8th July 2008