

Global Value Fund Update Q3/08

Performance highlights

Q3 return of -12.12%

Dear Investor

During Q3 2008, global stock markets have suffered considerably, as has Sparinvest Global Value Fund. The third quarter brought a loss of 12.12%, taking our year-to-date return to a negative 29.82%.

The general equity market, when measured by the MSCI World Index, lost 4.94% in the quarter, while MSCI World Value and MSCI World Small Cap declined by 1.83% and 4.56% respectively. Growth stocks declined by 7.88%.

Whatever the state of the markets, we are very dissatisfied with this performance. However, as we will discuss further below, we believe markets are currently paying attention neither to long-term fundamental earnings nor to valuations. Instead, they are being swayed by short-term factors, both real and psychological. Despite the fluctuations in market prices, we are as confident as ever in the intrinsic value of our holdings, and in the long-term performance potential of our funds.

The table below shows the returns from the third quarter and from 2008 year-to-date, and the return from 2007, compared with different stock market indices.

Sparinvest Global Value versus Index			
	Q3 2008	YTD	2007
Sparinvest Global Value (LU0138501191)	-12.12%	-29.82%	-1.04%
MSCI World Index	-4.94%	-21.11%	-1.66%
MSCI World Value Index	-1.83%	-21.79%	-6.74%
MSCI World Growth Index	-7.88%	-20.53%	3.51%
MSCI World Small Cap Index	-4.56%	-19.39%	-9.10%

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

Markets

The past three months have been historic. We will not try to recap all the bad news from the financial sector this quarter. As we write, the amount of negativity is massive and panic is increasing. Just turn on the news and it seems we are facing a financial Armageddon. The financial sector has been playing musical chairs for most of the year, but lately it has become more like a domino game, with the lack of liquidity knocking over one piece after another. At times, it has felt like the financial world of the past few decades is coming to an end. It has seemed like the idea of self-regulating markets is just an illusion, shattered by a crisis caused by unprecedented greed and lack of control. This is hard talk, but nevertheless closer to recent reality than one would like.

So is this the end of the world as we know it? Probably not, but there will be big changes for sure. Banks and financial institutions are disappearing from the map and governments are getting more and more involved, with rescue plans and expanded regulation. People will demand more transparency in the financial sector, and that will be a big part of the solution to stabilize the markets going forward.

We know that these are hard times, and that these days it hurts a lot to look at the year-to-date performance of most investments. In the current market conditions, a lot of people are selling stocks because they are forced to, because they do not believe in the asset class any more, or because they are panicking. In other words, some people are selling without any consideration of either short-term or long-term fundamentals, dumping the shares of fine companies. One indication of the current market's lack of focus on fundamental values is that, over the past twelve months, the 96 companies in our portfolio have earned a combined EUR 35.6 billion of net income. So, our holdings have not seen any permanent loss of capital, but in fact the opposite: an expansion of shareholders' equity. However, panic in the market has pushed the share prices of those same companies down by twenty to thirty percent. From our experience, this is the time to buy shares.

We care about fundamentals – both over the short term and the long term. Our investment horizon does not change, even when a downturn is expected in most economies around the world. To our minds, in good times and bad, screening the markets and sticking with our investment strategy is how we will deliver good returns in the long run.

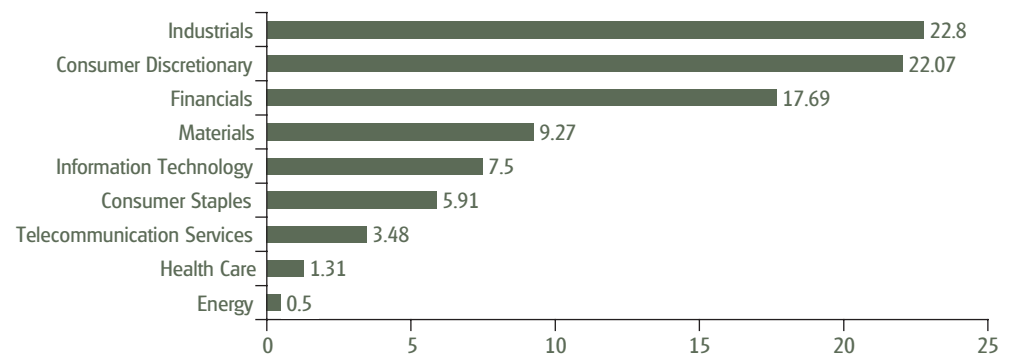
Even factoring in the likelihood of lower earnings for many of our holdings, through-the-cycle earnings levels and asset values show that our portfolio of companies is very cheap. The price correction has been excessive relative to the underlying intrinsic value of our companies. Companies with a proven track record of through-the-cycle earnings and strong balance sheets will persist. For both cyclical and non-cyclical companies, share prices are falling sharper than is justified by changes in the underlying intrinsic value of the companies. This means that our shareholdings offer very good value. The portfolio is trading at more attractive prices than we can recall: at an average 0.74 times price-to-book, and a median 4.5 times EV/EBITDA (a measure of earnings power). The net-debt-to-equity is only 13% - meaning our holdings have considerable financial strength compared to their peers, and indeed, half of our companies have net cash positions.

It is true that the current lack of liquidity has a knock-on effect outside the financial sector – and on our portfolio of companies – by reducing a lot of the M&A activity one would normally see in an economic down-cycle. The financial buyers are long gone, and industrial buyers - who would normally be more active in times like this when acquisition multiples are coming down - are temporarily unable to move due to the same problem, liquidity. But they will make their moves, once the markets start functioning again. From this point of view, the potential for M&A activity involving our portfolio holdings is even greater than before. ■

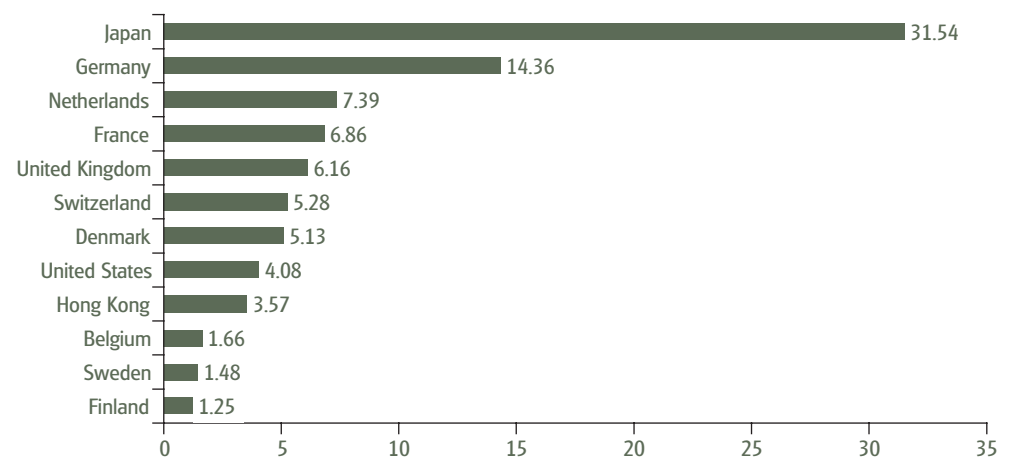
Portfolio update

At the end of the quarter, the cash position was 9.5% of assets under management. The fund had 96 holdings, with the following sector and country breakdowns.

Sector allocation (all Values in %)



Country allocation (all Values in %)



During the quarter, we made three new investments. We bought shares in Italian clothing company, Benetton Group; American oil refiner, Valero Energy, and Finnish paper and pulp company, UPM-Kymmene.

In general rebalancing of the portfolio, we have made additional investments in some stocks. In addition to the exits discussed below, we have also exited two small holdings as part of our ongoing process to remove holdings of insignificant weighting.

At the end of the quarter, our 10 largest positions accounted for 32.1% of total portfolio holdings.

Top 10 holdings		
Holding	Sector	Weight
A.P. Moeller - Maersk A/S B	Industrials	3.79%
Hutchison Whamp/Hk0.25	Industrials	3.57%
J.Sainsbury Plc	Consumer Staples	3.57%
Nippon Tel&Tel	Telecommunication Services	3.48%
Frankfurt Airport Serv.Worldw.	Industrials	3.43%
Msig Holdings	Financials	3.21%
Roy.Philips Electr./Eur 0.2	Industrials	3.18%
Douglas Holding Ag	Consumer Discretionary	2.84%
Gunma Bank Ltd	Financials	2.59%
Deutsche Postbank Ag/Namen-Akt	Financials	2.40%

Looking at the past quarter, we have been hurt by our exposure to cyclical companies in general and, looking at single countries, our German industrial exposure has been costly. Should we sell most of our cyclical companies? Certainly not, when there is already a lot of recession priced in. Why did we not buy commodities and oil-related stocks? Because we found them, and many of the non-cyclical companies, too expensive. We do not think there is anything fundamentally wrong with our investment model and strategy, in which we buy companies that are cheap on long-term earnings power and avoid companies that are only cheap on peak earnings.

In terms of the financial sector, we have made our mistakes in not realising earlier the sheer magnitude of the meltdown. We think this has to do with the fact that when you analyse a financial company, certain systems and processes in the financial market tend to be taken for granted. Those systems, such as inter-bank lending, have stopped working in the past three months in a way that few anticipated. We have, of course, thoroughly reviewed our exposure to the sector, as will be seen with Dexia, below.

Our exposure to Japan remains high, not least due to the relative strength of our holdings there recently. With low valuations (Japan's TOPIX index is now trading at book value) and robust financial health, we remain convinced of the long-term value of our Japanese holdings. Indeed, the current environment is drawing attention to the strength of Japan's balance sheets, with Japanese companies showing that as the crisis throws up attractive M&A opportunities overseas, they will swiftly take advantage. We continue to see signs of changing attitudes in Japanese management and corporate governance, with dividend payout at record levels and an ever-increasing focus on capital efficiency. Note the recently-announced management buyout in Ten Arrows, which we discuss below. ■

Ten Arrows Management Buyout Announced

Ten Arrows - previously named Charle Co - has been in the fund since inception. The company sells women's underwear via door-to-door sales and home parties. Ten Arrows boasted an extremely strong balance sheet, with a net cash position equivalent to almost half of shareholders' equity. The stock was trading at well under book value.

Recently, however, the company has seen sales suffer - due to tougher competition and a consumer shift away from door-to-door sales. In late September 2008, management decided that drastic restructuring was needed, and that taking the company private would

give the most stable platform for this. Therefore, they launched a Management Buyout (MBO), offering shareholders JPY 800 per share. This is a premium of almost 60% to the share price at time of announcement, but does not necessarily reflect the full potential of the company. The unspoken implication is that management – like us – thought the shares were significantly undervalued.

We think Ten Arrows demonstrates the strength of our investment process. We invest in companies which we consider to have a sustainable long-term business model, but also a solid balance sheet. That balance sheet strength means that if – as happened with Ten Arrows - the business model comes into question, the strength of the balance sheet offers considerable protection for shareholders. ■

DEXIA
Sold with loss.

Dexia was created by the 1996 merger of Crédit Communal de Belgique and Crédit Local de France. The company is based in Belgium, and has two main areas of operation: retail banking (with 5.5 million customers in Belgium, Luxembourg, Slovakia and Turkey) and public sector finance.

We first bought shares in December 2006, for around EUR 20.80. The stock was trading at reasonable levels on both earnings- and asset-based valuations, and offered a generous dividend yield. Core-capital and solvency ratios were healthy, and management had a conservative, risk-averse track record. The company was steadily expanding earnings, and generating over 20% returns on equity.

For Dexia and its US subsidiary FSA, which engages in bond insurance, the operating environment is now completely different from when we first invested. Risk has increased, and balance sheet visibility has been clouded, which seriously damages the investment case and effectively removes any certainty in calculating a margin of safety. We therefore decided to exit our position in Dexia in September 2008, and realised an average price of EUR 9. This amounts to a total loss on the investment of approximately 55%. While we are by no means satisfied with this return, we consider it important to apply our investment criteria with discipline, not only in entering stocks, but also in exiting. ■

FPIC
Reached target

FPIC (First Professionals Insurance Company) provides medical professional liability insurance for doctors, dentists and other healthcare providers. Based in Florida, FPIC writes policies in fourteen US states.

We first bought shares in FPIC in June 2002, paying around USD 15.30 per share. The late 1990s and early 2000s had been tough for medical insurance companies. Excessive competition had driven premiums down to levels where it was hard for insurers to make a profit, and this had resulted in lower reserves relative to the scale of risk insured.

This background had pushed down share prices in the sector, and we were able to invest in FPIC below book value. The company's profits had indeed suffered, but we were impressed with management's disciplined attitude. FPIC argued that the aggressively-low pricing of its competitors was irrational, because it would erode their long-term financial strength and increase risk for both policyholders and shareholders. FPIC committed itself to actuarially-sound pricing, and in both 2000 and 2001 the company bolstered reserves significantly.

Management also took an aggressive stance on reducing loss ratios, developing stricter underwriting guidelines and risk management programmes for policyholders.

National Presto Reached Target

FPIC's attitude was rewarded. Many large players dropped out of the market, and gradually prices recovered. Since then, FPIC has steadily increased its policyholder base and premiums written, and the shares have steadily increased in value. We chose to sell our shares in September 2008, at 1.5x book value. We realised an average price around USD 50.00, over three times what we initially paid for the shares, and giving an annual return of 20.9%. ■

National Presto started business in Nebraska in 1905, making canning equipment. It now produces household appliances - such as pressure cookers, deep fryers, corn poppers, and pizza ovens - and also various defence-related products.

We first acquired shares in March 2002, paying around USD 28.00. The earnings track record was solid, but household appliance margins were suffering temporarily due to manufacturing inefficiencies and increased advertising costs. The shares had dropped below book value, despite a net-cash position approximately equal to the market capitalisation.

Since then, management have turned the company around. In household appliances, sales to the main customer - Wal-Mart - have steadily decreased, but new sales channels and improved efficiency have returned the segment to good health. Meanwhile, starting with an acquisition in 2000, National Presto has used its ample cash to build a second core business, producing munitions and other products for the US Department of Defense. In 2007, this segment overtook household appliances in both revenues and profits.

We chose to exit our position in National Presto during the summer of 2008, because the shares had reached our intrinsic value target. The average selling price was approximately USD 77.00, which makes for an annual return of 22% on our initial investment, including dividends. ■

Outlook

In the past three to six months one could start feeling a bit like Bill Murray in the film "Groundhog Day" - reliving the same day over and over again - with the relentless flow of bad news, falling markets, rising pessimism and doomsday headlines on the front pages of the newspapers.

This is not the end of the world. Times are more challenging than they have been in the past decades, so patience is vital. It's important to realise that the efforts being made by politicians and regulators to save the financial system will not have full traction from day one. The financial sector is key, and it will take some time for it to get back on its feet, but markets will normalize eventually - and that tends to happen when the herd least expects it. It is worth noting that historically, a large proportion of total returns on equity investments have been made during brief upswings - and it is important to be invested during those upswings.

As we noted previously, a downturn will temporarily lead to a reduced use of production capacity, with a knock-on effect on earnings. Viewed over the longer term, however, the production capacity remains a strong and enduring asset, assuring future earnings. At present, consumer spending is being hurt by a combination of private deleveraging and rising prices, and this inevitably hurts earnings in companies. The pertinent question is not whether cyclical companies will cut short-term earnings forecasts, but by how much. Yet the valuations of many companies suggest that a severe impact is already being priced in, and we find comfort in this. Our companies - and especially the cyclicals - are now priced with major discounts to their historical average multiples, which suggests a significant decoupling from their fundamentals.

There are some brighter notes. We have previously argued that commodities and oil were forming the latest bubble in the market. Since July, that bubble has largely deflated, and this may give global industry and consumers something of a break from relentless cost increases. As we write, various central banks have announced coordinated rate cuts, and there is the possibility of more to come. So the outlook is not entirely dark.

The world has experienced economic and market downturns before, perhaps not as severe as this one, but it will land on its feet again. In such times, we think it's especially important to remain disciplined and stick with our strategy. We continue to focus on the operational value of our companies and not short-term fluctuations in the market price. Once you decide to invest in equities, you also expose yourself to market risk. On the other hand, risk on individual stocks can be minimized through careful research, and this has led to our portfolio of companies with impressive long-term earnings power and strong balance sheets. Even though we have seen very volatile markets in the past quarter, with much uncertainty and panic, and although we see few signs of an improving environment in the short term, we have a genuinely positive conviction on the future potential of our investments, due to the quality of the companies in the portfolio. ■

Yours sincerely,

Sparinvest Asset Management

Jens Moestrup Rasmussen
Chief Portfolio Manager
10th October 2008

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