

# Global Small Cap Value Fund Update Q3/08

## Performance highlights

Q3 return of -6.77%

## Dear Investor

During Q3 2008, global stock markets have suffered considerably, and this is also true of Sparinvest Global Small Cap Value Fund. The third quarter brought a loss of 6.77%, taking our year-to-date return to a negative 20.13%.

The general small cap equity market, as measured by the MSCI World Small Cap Index lost 4.56% in the quarter, while MSCI World Index and MSCI World Value Index declined 4.94% and 1.83% 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 Small Cap Value versus Index			
	Q3 2008	YTD	2007
Sparinvest Global Small Cap Value (LU0264925131)	-6.77%	-20.13%	-14.99%
MSCI World Small Cap Index	-4.56%	-19.39%	-9.10%
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, 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. ■

## 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. 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.

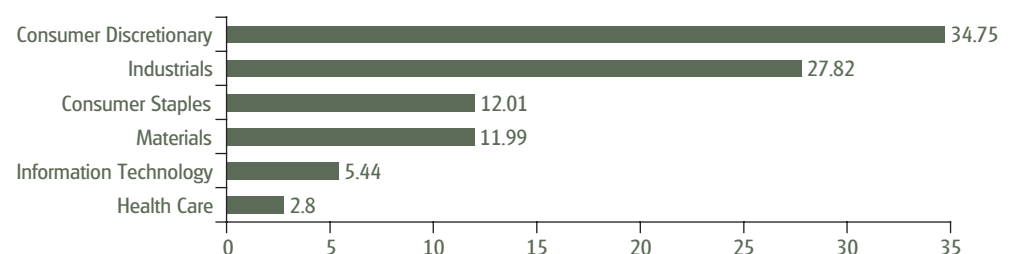
Even factoring in the likelihood of lower earnings for many of our holdings, through-the-cycle earnings levels and asset values show that our portfolio of companies is very cheap. The price correction has been excessive relative to the underlying intrinsic value of our companies. Companies with a proven 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.

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. ■

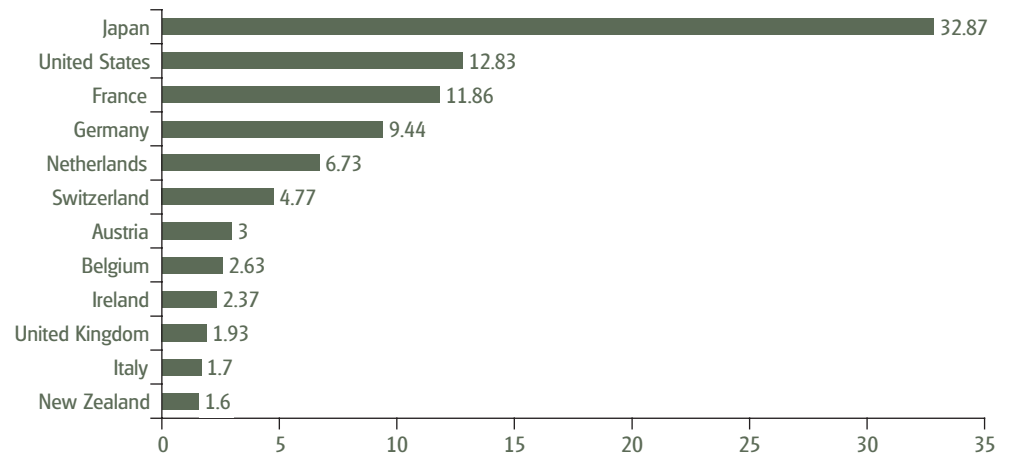
### Portfolio update

At the end of the quarter, the cash position was 5.2% of assets under management. The fund had 59 holdings, with the following sector and country breakdowns.

#### Sector allocation (all Values in %)



### Country allocation (all Values in %)



During the quarter, we made one new investment, in German consulting company, IDS Scheer. We made additional investments in six existing portfolio stocks.

At the end of the quarter, our 10 largest positions accounted for 27.0% of total portfolio holdings.

Top 10 holdings			
Holding	Country	Sector	Weight
Ten Arrows Co Ltd *Opa*	Japan	Consumer Discretionary	3.23%
Miba Ag -Priv.-B-	Austria	Consumer Discretionary	3.00%
Scholastic Corp.	United States	Consumer Discretionary	2.98%
Ste L D C Sa	France	Consumer Staples	2.80%
Loeb Hld /B.Part.	Switzerland	Consumer Discretionary	2.68%
Tessenderlo Chemie	Belgium	Materials	2.63%
Werner Enterprises Inc	United States	Industrials	2.50%
Arctic Cat Inc	United States	Consumer Discretionary	2.47%
Nsc Groupe	France	Industrials	2.46%
Rsdb Nv	Netherlands	Industrials	2.23%

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.

### Ten Arrows Management Buyout Announced

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 - 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. ■

### Chofu Seisakusho Sold with Loss

Chofu Seisakusho was founded in post-war Japan as a maker of kerosene-fired heaters to dry rice. Nowadays, the main products are various types of water heater, as well as air conditioners, co-generation systems, and bathroom and kitchen units.

The stock has been in the portfolio since inception. When we first invested in Chofu Seisakusho, the stock was trading at a significant discount to book value, despite a cash rich balance sheet.

In recent years, the balance sheet has remained solid and sales have increased, but profit margins have suffered. Raw material costs have risen, and high oil prices have hurt demand for oil-fired water heaters, which are the company's most profitable product. We spoke at length with management about these issues. The company was attempting to raise product prices and boost profitable overseas sales, but we felt that management's restructuring efforts lacked the necessary sense of urgency. We therefore decided to sell our holding in Chofu Seisakusho during the summer of 2008, realising a total loss on the initial investment of 11.2%, or 6.6% annualised. ■

**Outlook**

History is being written in the markets, and indeed much could change in the few days between the writing and the reading of this letter. One certainty is that during crises or economic slowdowns, behavioural factors influence the pricing of businesses. The current situation is no exception, and indeed the behavioural influence is even bigger than we have seen historically. Extreme uncertainty over the economy is being multiplied by a financial sector in crisis, leading investors to focus on the short-term, and not on long-term earnings potential.

We remain in a phase of waiting for market focus to normalize and look at fundamentals again. But the recent rescue plans for the banking sector are a step in the right direction. As we write, it is difficult to judge whether the plans announced so far will be sufficient, but there is no doubt that the recovery will take time, and will not be completed in the near future. It is important to be patient. Historically, the market has turned its attention back to quality stocks as economic recessions start to ease.

The vast majority of stocks in our portfolio are still making profits: in the past 12 months, they generated EUR 693 million: a return on equity of approximately 3.2%. Stable earnings, and a solid outlook, mean that the intrinsic value of our holdings has changed very little. Yet compare this with the share prices, which have dropped around 35% over the same period. This gives a good indication of how much the current market is driven by short-term considerations and behavioural factors, and not the long-term value of companies.

Naturally, sharp share price falls are justified in some cases, but looking at the portfolio overall, it is diversified in terms of the number of holdings, operating regions, and sectors. It has no direct exposure to financials, and no debt (net-debt-to-equity of -0.37%), and it is priced at a historical low price-to-book ratio of 0.64. We believe our investors can sleep soundly at night.

Our strong process and strategy lead us to sectors and regions that are out of favour, but have a limited risk of permanent loss of capital. What we are seeing now is similar to other crises in the past, and as some investors were selling, we were buying. We are confident that our approach can and will reward long-term clients with good returns. ■

Yours sincerely,

Sparinvest Asset Management

Kasper Billy Jacobsen  
Chief Portfolio Manager  
10<sup>th</sup> October 2008

The mentioned sub-fund is part of Sparinvest SICAV, a Luxembourg-based, open-ended investment company. For further information we refer to the full and/or simplified prospectus and the current annual / semi-annual report of Sparinvest SICAV which can be obtained free of charge at the offices of Sparinvest or of appointed distributors together with the initial statutes of the funds and any subsequent changes to such statutes. Investments are only made on the basis of these documents. Past performance is no guarantee for future returns. Investors may not get back the full amount invested. Investments may be subject to foreign exchange risks. The investor bears a higher risk for investments into emerging markets. The indicated performance is calculated Net Asset Value to Net Asset Value in the fund's base currency, without consideration of subscription fees. For investors in Switzerland the funds' representative and paying agent is RBC Dexia Services Bank S.A., Zurich Branch, Badenerstrasse 567, P.O. Box 101, CH-8066 Zurich. Published by Sparinvest, 28, Boulevard Royal, L-2449 Luxembourg.