

High Yield Value Bonds

Fund Update

Q2/08

Q2 2008

Dear Investor

April 2008 turned out to be one of the best months ever for high-yield investors, thereby making up for a very poor Q1. The Merrill Lynch Global High Yield index returned +4.46% in April alone, thus reversing the negative performance in Q1. However, the positive sentiment did not last for long, and by the end of the second quarter 2008, the index had returned -1.16% YTD.

During April, the Sparinvest High Yield Value Bonds portfolio had a tough time keeping pace with the benchmark. This was due primarily to the small cap nature of the portfolio and not to any change in the credit metrics of the holdings which remain robust. As the rally faded in May our fund caught up with and substantially outperformed its peers. By the end of the second quarter the return was -3.4% versus an average -4.6% in the Morningstar Category. The fund has kept its position in the Morningstar universe among the top 34%.

During Q2, the European high-yield sector continued to underperform its US counterpart as the government yield differential widened and European investors sold quite heavily. In the US, high yield has been a fixed part of investors' portfolios for many years, whereas in Europe the high-yield asset class is still something of a novelty and therefore subject to greater speculation. Despite being underweight of US high yield, the fund was able to keep track with the benchmark.

Performance - High Yield Value Bonds versus Selected markets

All returns are in EUR	Q2 2008	H1 2008	2007
Sparinvest High Yield Value Bonds	2.16%	-3.39%	-1.09%
Merrill Lynch Global High Yield	2.23%	-1.16%	0.34%
Pan European High Yield Index	1.22%	-4.84%	-2.01%
Merrill Lynch Global Investment Grade	-0.57%	-0.79%	1.93%
MSCI World	-1.10%	-17.01%	-1.66%
EFFAS 5-7	-3.62%	-0.88%	-2.08%
Morningstar percentile		34%	30%

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).

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. ■

The Portfolio

The Fund experienced a large capital inflow during the second quarter and trading activity has primarily been focused on rebalancing the portfolio. Our investment in Hornbach AG hit the target price of 90 in April and the bonds were sold with an absolute gain of 12% in just three months. We reduced our holdings in the Greek dairy producer, FAGE; the Austrian sport-producer, Head; and German film-producer, Treofan on less favourable outlooks.

During the quarter, we have built five new positions: Vedanta Resources (which operates and owns metal mines in India and Australia); two oil & gas producers, Kazmunaigaz National Co. and Tristan Oil; British bank, Lloyds TSB and Mexican cement producer, CEMEX. All the companies have very strong balance sheets with solid assets and low debt, thus contributing to an overall strengthening of the credit metrics of the fund. In March 2008, Vedanta had no net debt and was running an interest cover (earnings/interest expense) of 17x. The Vedanta bond is BB1/BB rated but still yields 9.5% - or approximately 575 bps - more than a corresponding Government bond.

The inclusion of better-rated issuers and the reduction of CCC issuers have positively affected the average rating of the fund which now stands at BB-, a strengthening achieved with virtually no reduction to the average yield on the portfolio which is currently 11.45%, compared to 11.02% on the benchmark.

High Yield Value Bonds Fund Update

Portfolio figures - High Yield Value Bonds		
	Fund	Benchmark
Duration	4.05	4.38
Yield	11.45%	11.02%
Rating	BB-	B+
# Issues	94	1990

The credit metrics of the fund continue to be strong and fully in accordance with our value criteria - i.e. the fund is focused on small companies with strong balance sheets.

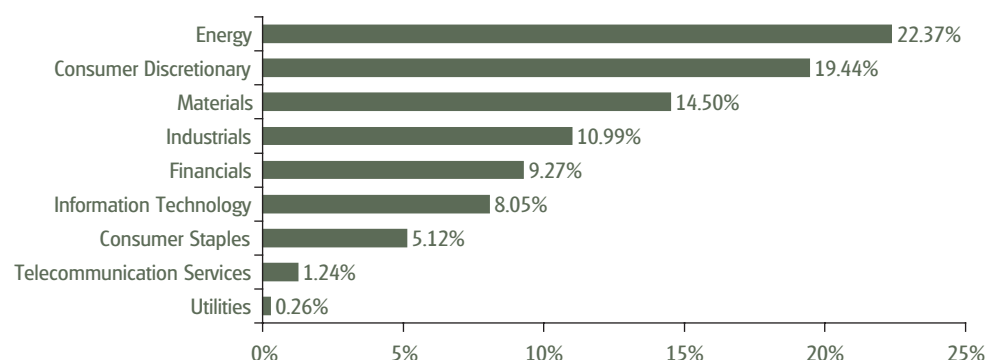
Portfolio figures - High Yield Value Bonds		
Financials	Fund	Benchmark
Market Cap (bn \$)	1993	5125
Net-Debt-to-Equity	81,10	538,10
Price-to-Book-Value	1,74	4,53
Interest Cover	4,11	4,18

Large exposure to oil & gas has stabilised performance of the fund

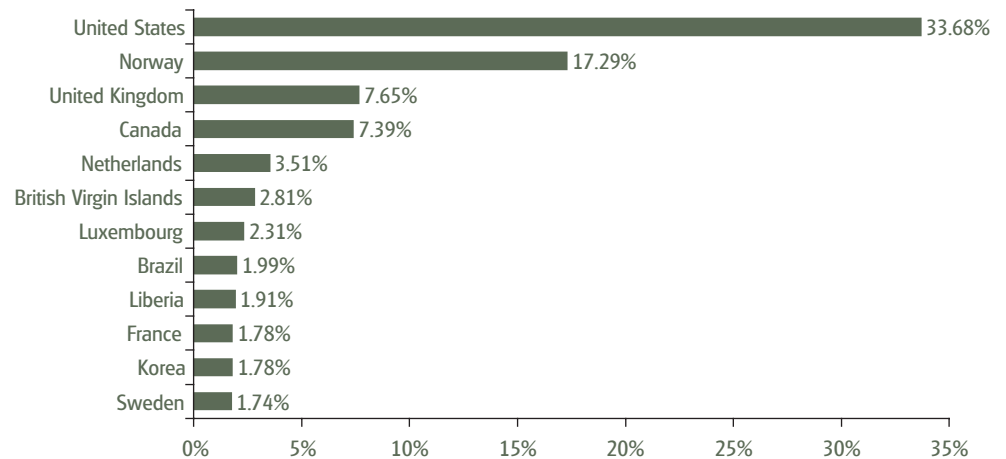
A large exposure to the oil and gas sector has stabilised performance of the fund and is likely to make a positive contribution to performance going forward. Current oil prices are not reflected in the credit ratings of oil & gas companies - a fact which the rating agency, Standard & Poor's, has also come to realise. On May 16, Standard & Poor's published a report on the oil & gas sector lifting their expectations for the sector. The introduction of the report says: "In the coming weeks, we will review ratings in the sector to assess the effect of the increase. In the past, such increases have encouraged a trend of upgrades".

Therefore current bonds are underrated by the rating agencies. What's more important to investors is the fact that the prices on these bonds do not reflect the investment risk involved. Hence the bonds issued by the oil & gas companies in our fund offer good value both on an absolute - as well as a relative - basis.

Sector allocation



Country allocation



Norske Skog

Positive news has started to come from Norske Skog. Norske Skog has announced a sale of their Korean assets for a total of EUR 4.2 billion – close to book value but decisively higher than market expectations. This transaction will allow Norske Skog to reduce debt materially (by 25% if bonds and loans were to be redeemed at par or by up to 40% when using market-based values instead). At the beginning of July, Norske Skog also announced the selling of the Steti Mill in the Czech Republic. The Steti Mill was also sold at book value.

Major holdings - High Yield Value Bonds

Holding	Country	Sector	Weight.
Norw.Energy Co 11% 07-13.7.10	Norway	Energy	4.11%
Ineos Group 7.875% 06-16 Reg.	United Kingdom	Materials	3.95%
Norske Skogind 7% 07-26.6.17	Norway	Materials	3.51%
Landry S Rest.9.5% 07-15.12.14	United States	Consumer Discretionary	2.81%
Nxp Bv/Nxp Fd 8.625% 07-15-Wi-	Netherlands	Information Technology	2.69%
Bombardier 7.25% 06-15.11.16	Canada	Industrials	2.65%
Perry Ellis 8.875% 03-13 S.B	United States	Consumer Discretionary	2.47%
Sinvest 9.5% 05-22.12.09	Norway	Energy	1.92%
Royal Caribb.5.625% 07-14 Regs	Liberia	Consumer Discretionary	1.91%
O Charleys 9% 04-01.11.13	United States	Consumer Discretionary	1.90%

Outlook

Market sentiment continues to be poor and a stabilisation of the banking sector is an absolute must before we can expect a recovery in financial markets. Credit tightening by the banks is expected to hurt both consumers and - to some degree - corporations. Going forward, this is likely to lead to an increase (from historical lows) in the number of defaults. However, this scenario has already been priced in. Hence we believe that long-term investors should exploit the current market weakness to pick up cheap bonds issued by sound and strong corporations who will survive a downturn in the cycle.

We expect an outperformance from our oil-related exposure. The companies involved are generating free cash flows of unprecedented amounts, and we expect the bonds to continue to deliver high returns on a going-concern basis and due to expectation of redemption at very attractive levels. The duration on the oil-related bonds is rather short. This, combined with a favourable oil forward-curve (meaning that companies have the ability to lock in high oil prices using the futures market), should remove any fears of defaults. ■

Yours sincerely,

Sparinvest Asset Management

Klaus Blaabjerg
Senior Portfolio Manager
8th July 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.