Sparinvest

European Value
Fund Update
Q4/08

Dear Investor,

Performance highlights
Q4 return of -23.53%
2008 return of -48.00%

2008 brought extremely hostile conditions for equity investors as global stock markets were hit by a global financial crisis of historic proportions and an emerging recession. However, whatever the context, we were extremely disappointed with performance in the Sparinvest European Value fund. The fourth quarter saw a loss of 23.53%, taking our full-year return to -48.00%.

We are, of course, dissatisfied with this return. During the fourth quarter, cyclical European stocks continued to be punished and this was a major factor behind our performance. However, as we will discuss below, we remain convinced of the strengths of our investment strategy and the long-term potential of our portfolio.

The European equity market, when measured by the MSCI Europe Index, lost 43.65% in 2008, while MSCI Europe Value and MSCI Europe Small Cap declined 46.52% and 51.87% respectively. Growth stocks also performed poorly, with a return of -40.76%.

The table below shows the returns from the fourth quarter and from the full years 2007 and 2008, compared with different stock market indices.

Sparinvest European Value versus Index			
	Q4 2008	YTD	2007
Sparinvest European Value (LU0264920413)	-23.53%	-48.00%	-4.13%
MSCI Europe Index	-21.98%	-43.65%	2.69%
MSCI Europe Value Index	-22.86%	-46.52%	-2.38%
MSCI Europe Growth Index	-21.13%	-40.76%	7.82%
MSCI Europe Small Cap Index	-30.01%	-51.87%	-7.51%

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

Markets

2008 was an extraordinary year by any measure. As the quarters progressed, people had to find new ways to describe just how bad the crisis had become. This continued in the fourth quarter, when the turmoil in the financial world was joined by growing evidence of global recession.

We won't attempt to summarise all the negative developments here. We all know this is a significant downturn. Jobs are being lost, plants are being closed – some temporarily, some permanently – and many companies are failing. Government intervention is increasing all the time through regulation and through cash injections.

In any economic downturn, declining earnings mean share prices suffer, especially at cyclical companies. This time round, the financial crisis made it worse. Many factors – like fear, counterparty risk, the lack of liquidity and forced selling – combined, creating a market where share prices often overreacted to news and sometimes moved in ways that had no relation at all to fundamentals.

Just consider Volkswagen. In mid-2008, VW shares rocketed up and down due to panic-driven short covering after Lehman Brothers collapsed. Within a 24 hour period, VW's market cap rose, and fell, by EUR 150 billion: more than the combined market caps of Toyota, Honda, Ford, GM, Renault, Peugeot, Fiat and BMW. It goes to show just how far markets were dislocated from fundamentals this year.

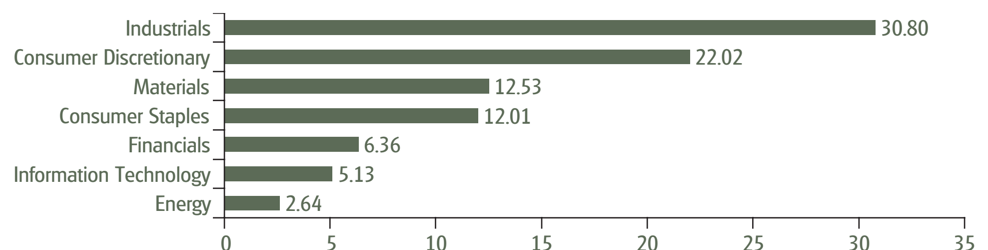
Of course, this kind of market is deeply frustrating. It's hard to see the share prices of strong companies fall, especially when triggered by temporary – or even irrational – factors. However, as value investors, we do not try to play the economic cycle, or to speculate on what short-term market sentiment might do to share prices. We focus on the companies themselves and invest on the basis that we are buying a piece of that company.

Although market focus was often on other factors in 2008, it must ultimately return to fundamentals. We don't like to judge the timing of this but, eventually, fear will recede and strong companies will be rewarded. ■

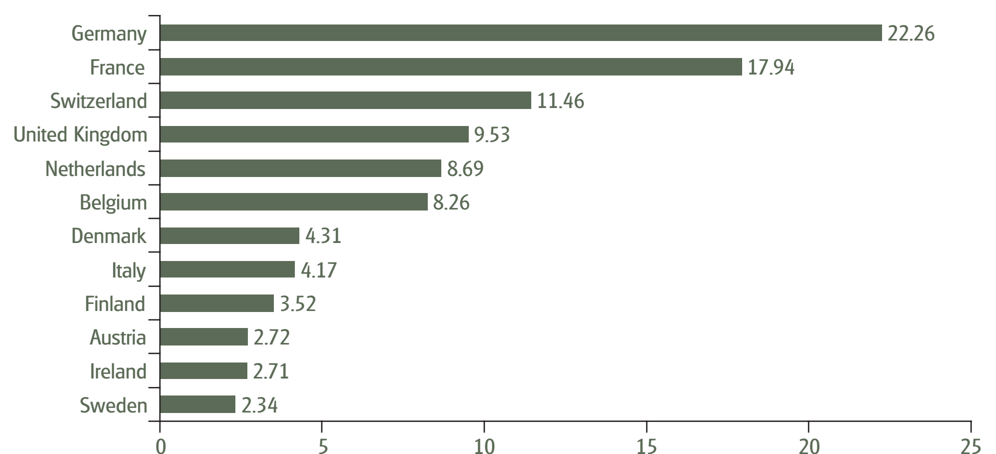
Portfolio update

At the end of the quarter, the cash position was 8.4% of assets under management. The fund had 68 holdings with the following sector and country breakdowns.

Sector allocation (all values in %)



Country allocation (all values in %)



During the quarter, we invested in three new companies. We bought shares in Royal Dutch Shell and OMV of Austria, both of which are integrated oil and gas companies. We also invested in Haulotte Group, a French maker of hydraulic cranes.

In general rebalancing of the portfolio, we have made additional investments in some existing stocks. In the weak equity markets of the fourth quarter, we did not sell any of our positions.

At the end of the quarter, our 10 largest positions accounted for 26.39% of total portfolio holdings.

Top 10 holdings

Holding	Country	Sector	Weight
J. Sainsbury PLC	United Kingdom	Consumer Staples	3.14%
Hochtief A.G.	Germany	Industrials	3.01%
A.P. Moeller - Maersk A/S B	Denmark	Industrials	2.99%
Ste L D C SA	France	Consumer Staples	2.68%
Roy.Philips Electr./Eur 0.2	Netherlands	Industrials	2.65%
Frankfurt Airport Serv. Worldw.	Germany	Industrials	2.61%
Buzzi Unicem	Italy	Materials	2.50%
Ericsson Tel. B	Sweden	Information Technology	2.31%
Bqe.Cantonale Vaudoise/Nom.	Switzerland	Financials	2.30%
Salzgitter AG	Germany	Materials	2.20%

Outlook

Stock markets tend to front run the development in the underlying economy and that is certainly true this time around. There is no doubt that, in the coming quarters, the world is facing a serious economic downturn that will lead to falling growth rates and earnings in companies around the world. There are no short cuts, no quick fixes, for the global economy. However, much of this is already factored into share prices. Equity markets have suffered large declines and our holdings have shared the pain. Many of the value companies that we hold were already cheap, but have become cheaper, and extreme negativity is leading many investors to completely avoid certain sectors and even stocks in general.

So, how did we respond to these volatile markets? In the words of Benjamin Graham: *"Basically, price fluctuations have only one significant meaning for the true investor. They provide him with an opportunity to buy wisely when prices fall sharply and sell wisely when they advance a great deal. At other times he will do better if he forgets about the stock market and pays attention to his dividend returns and to the operating results of his companies".*

So in 2008 we did what we always do. We focused on our disciplined investment process, both in terms of our existing investments and potential new positions. We scoured the markets to find stocks at attractive discounts to their intrinsic values and invested in them. In other words, we exploited short-term sentiment and fear to buy good stocks at bargain prices and, in 2008, we added ten new positions.

We rigorously monitored our existing holdings to make sure that intrinsic values were intact. In two cases – Dexia and Agfa – we had serious question marks and exited the positions. But in our other positions, the investment cases remain extremely strong. Although the market makes it hard to believe right now, their fundamentals have not completely changed and their long-term potential remains intact. Share prices may have dropped, but this does not turn a good company into a bad one.

Why do we remain confident in our holdings? This comes down to our initial investment process and its focus on the balance sheet and long-term earnings power. In recent years, there was a lot of fuss about the cost of equity and, as a result, many companies took on more debt. They are now feeling the burden, as companies everywhere undergo a kind of "stress test" of their financial health. To continue the cinematic theme of our last letter, it reminds us of the submarine in the classic film 'Das Boot', as its hull creaks and groans from the strain of water pressure at extreme depths. Our process aims to identify the companies that can survive the financial strain of down cycles, come out the other side, and generate solid earnings over the long term.

For example, we actively weed out companies with excessive leasing or pension liabilities. These liabilities are not debt, as such, but can place a similar strain on the balance sheet when times get tough and concrete examples of this are emerging nowadays. Take US retailer Circuit City – a stock we did not invest in – which filed for bankruptcy in early November, struggling under a combination of debt and leasing obligations.

None of this is to deny that many companies – including our holdings – are facing weak earnings at present. Yet cyclical downturns are an inevitable part of investing. This is why our process focuses so much on assessing earnings across the business cycle. Unless one believes that this truly is the end of the world, the cycle will turn upwards eventually. We must remember that, historically, some of the best years for equity investors have come after extremely troubled times with very low valuations - just like those we are experiencing right now.

Even bearing in mind lower short-term earnings expectations, equities in general – and our holdings in particular – are cheap. One indicator of low valuations is the sheer number of companies passing our basic valuation screenings each month. We have seen the numbers swell throughout 2008. Finally, let us consider the valuation of our fund itself: a price-to-book of 0.79, with net-debt-to-equity of just 14.9% (excluding financials). Given the share price declines of the past year, these low valuations may seem like small consolation but the reality is that the portfolio is trading at a larger discount to intrinsic value than ever before, and that bodes very well for future returns.

We are in no way satisfied with the fund performance of the past year. But we have often said that value investors can look like the foolish student in the class and that success requires stamina and confidence in the inherent value of one's holdings. You must stick to your guns in good times and bad because while value investing may not always deliver immediate returns, it does deliver solid returns over the long term. A global recovery won't happen overnight. Government measures will eventually have an effect - but it's also vital that banks start lending again. Yet, even now, when economic sentiment is as weak as it gets, we are convinced that the strength and low pricing of our portfolio will carry us through tough times and allow us to generate competitive returns in the long run. ■

Yours sincerely,

Sparinvest Asset Management

Jens Moestrup Rasmussen
Chief Portfolio Manager
13th January 2009

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 statues 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.