Sparinvest

Global Small Cap Value
Fund Update
Q4/08

Dear Investor,

Performance highlights
Q4 return of -18.77%
2008 return of -35.12%

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. The Sparinvest Global Small Cap Value fund also suffered with a fourth quarter loss of 18.77%, taking our full-year return to -35.12%.

The general small cap market, as measured by the MSCI World Small Cap Index, lost 38.87% in 2008, while MSCI World and MSCI World Value declined 37.64% and 37.30% respectively. Growth stocks fell by -38.08%.

This means that the Sparinvest Global Small Cap Value fund achieved better returns than the general index, but also the more specific small cap and value indices. However, we are not satisfied with simply outperforming indices and, however tough the environment may have been, we were extremely disappointed with performance in the Sparinvest Global Small Cap Value fund.

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 Global Small Cap Value versus Index	Q4 2008	YTD	2007
Sparinvest Global Small Cap Value (LU0264925131)	-18.77%	-35.12%	-14.99%
MSCI World Small Cap Index	-24.16%	-38.87%	-9.10%
MSCI World Index	-20.95%	-37.64%	-1.66%
MSCI World Value Index	-19.83%	-37.30%	-6.74%
MSCI World Growth Index	-22.08%	-38.08%	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

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.

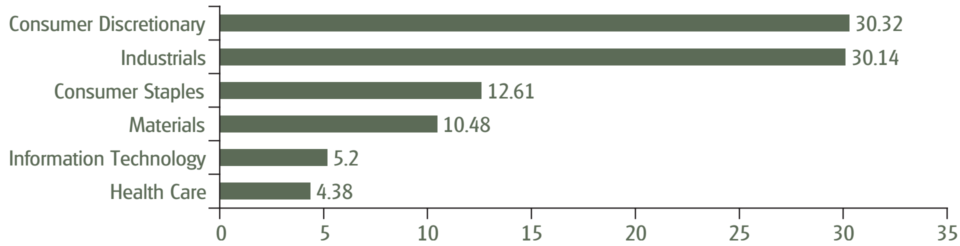
Of course, this kind of market is deeply frustrating. It's hard to see the share prices of strong companies fall, especially when triggered by temporary – or even irrational – factors. However, as value investors, we do not try to play the economic cycle, or to speculate on what short-term market sentiment 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.

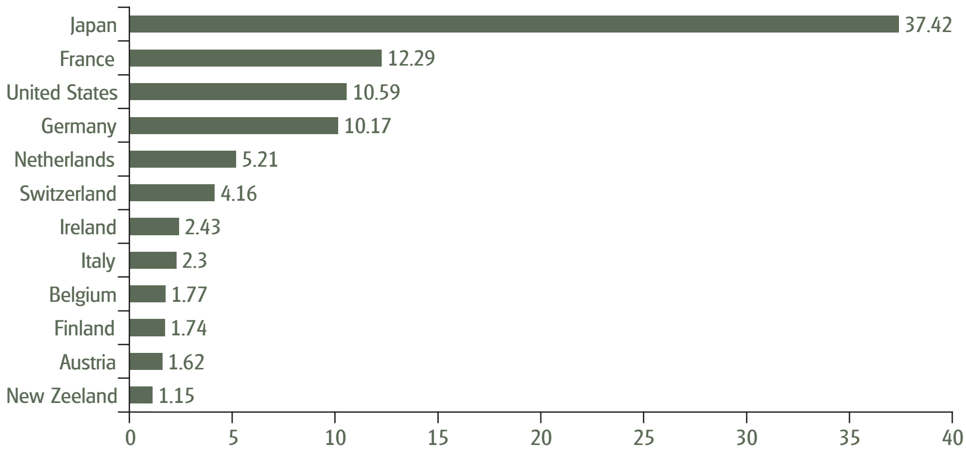
Portfolio update

At the end of the quarter, the cash position was 6.9% of assets under management. The fund had 64 holdings with the following sector and country breakdowns.

Sector allocation (all values in %)



Country allocation (all values in %)



Global Small Cap Value Fund Update

During the quarter we made five new investments. In Italy, we bought positions in railway company, FNM and tour operator, I Grandi Viaggi. We also acquired shares in German handtool maker, Einhell Germany; Danish brewer, Harboes Bryggeri; and Haulotte Group, a French maker of hydraulic cranes.

As part of general rebalancing of the portfolio, we made additional investments in some existing holdings.

At the end of the quarter, our 10 largest positions accounted for 23.43% of total portfolio holdings.

Top 10 holdings			
Holding	Country	Sector	Weight
NSC Groupe	France	Industrials	2.97%
Fukuda Denshi Co Ltd	Japan	Health Care	2.45%
Yonex Co Ltd	Japan	Consumer Discretionary	2.38%
Denkyosha Co Ltd	Japan	Industrials	2.36%
Maezawa Kasei Industries Co	Japan	Industrials	2.28%
Tsutsumi Jewelery Co Ltd	Japan	Consumer Discretionary	2.26%
Charle Co Ltd	Japan	Consumer Discretionary	2.24%
Guyenne & Gascogne SA	France	Consumer Staples	2.19%
Sonton Food Industry	Japan	Consumer Staples	2.15%
Werner Entreprises INC	United States	Industrials	2.15%

Japanese holdings

During 2008, our Japanese holdings performed relatively well, especially thanks to a rising yen. Our weighting there increased to almost 40% and we took advantage of this strength to reduce some of our positions. We remain very positive on our Japanese holdings, but we do consider almost 40% exposure a high level and anticipate reducing it to levels closer to 30%. Note that while we made two new Japanese investments in the fourth quarter, these were substituting others: the current market is depressing the prices of many quality companies, and we consider this an excellent opportunity to diversify.

Our large position in Japan is not the result of an active top-down strategy. Ours is a bottom-up investment process that looks for attractive value stocks, wherever they might be. Why do we feel comfortable with the high Japanese weighting that this has resulted in?

If we generalise a little, Japanese companies tend to be conservatively managed, especially when it comes to their balance sheets. After some tough decades, the leaders of corporate Japan have learnt some important lessons. This means low debt levels – indeed, some of our holdings have net cash positions greater than their market capitalisation – and conservative investments. In the recent turmoil, Japanese exposure to toxic assets has been notably low.

Strong balance sheets are more important now than ever. As many companies around the world struggle to meet their obligations, it is often Japanese companies that are able to demonstrate that "cash is king", as they take advantage of difficult markets to make acquisitions.

What's more, these strong balance sheets can be bought cheaply. In absolute terms, one can buy the TOPIX or Nikkei indices for below book value, but get an earnings yield over 8%. In relative terms, Japan looks very cheap on price-to-book or price-to-sales ratios. On price-to-earnings, Japan has, historically, looked a little pricier than other developed markets, but that gap has shrunk recently.

Moreover, a major reason for the relatively high price-to-earnings is the low debt we talked about above. Arguably, if Japanese companies took on a bit more debt, they could boost earnings per share. The ideal debt level is open for debate: at one extreme are companies so conservative that they sit on piles of cash and generate almost no earnings, while at the other extreme are companies that borrow up to their eyeballs, generate significant earnings per share, but easily go bankrupt when times get tough. We like what we see in Japan. Management remains conservative and debt averse, but is becoming more aware of the need to deliver solid returns on equity.

Domestic shareholders are increasingly active in encouraging management along this path. Many major pension funds in Japan will now vote against re-election of the management where a company's return on equity falls below 8% for too long. Japanese managements are becoming increasingly proactive when it comes to shareholder needs – indeed, we have seen a marked increase in the number of Japanese company leaders wishing to visit us in Denmark to explain their strategies. Returns to shareholders, in the form of dividends and share buybacks, are growing strongly.

Certainly, the current economic environment in Japan is not particularly rosy – but nor is it elsewhere. Japan has low levels of personal and corporate debt, relatively low unemployment, world-beating technology in many areas and experience of hard times. It may well emerge from this crisis relatively quickly and strongly. Yet we are not overly concerned whether it does or not. We remain, as always, bottom-up investors and we are very confident in our investments in Japan. ■

Charle (Ten Arrows)
Management buyout failed

In our last update, we noted the announcement of a Management buyout in Japanese clothing company Ten Arrows – which has since reverted to its original name, Charle. The buyout group offered JPY 800 per share, and Charle's Board of Directors initially responded positively, having employed external valuers to evaluate the company.

However, it later emerged that the company president had, among other things, attempted to influence the valuation methods used by the independent valuers. Although his actions do not appear to have had a material impact on the offer price, nonetheless, his behaviour was entirely inappropriate. The Board of Directors responded strictly, removing the president from his position. They had no choice but to withdraw their support for the offer. When the subscription period closed, although many shareholders had chosen to accept the offer, the number fell below the level needed for the takeover to go ahead.

It remains to be seen whether the buyout group will launch a new bid. While we are naturally disappointed with the president's actions, we were reassured to see the swift and decisive action by the Board of Directors. Charle remains a company with a strong balance sheet and considerable intrinsic value. ■

Outlook

What have we learned in 2008? It has been a harsh reminder that there is always risk in equity investing. In this past year, the market reaction has been worsened by the fact that several of the risks that emerged had been unexpected. 2008 brought sub-prime, counterparty risk and the liquidity crisis; fraud on a massive scale (Madoff, for example); the collapse of various household names and plenty more. Certainly, much of this had been experienced before but to have so many negative developments in such quick succession was rare. Besides, just as history tends to repeat itself, so the market tends to have a short term memory.

The driver in all these events was greed. And, although we don't necessarily agree with Gordon Gekko's famous statement that: *"Greed is good"*, we do think greed is part of human nature. So, what happened in 2008 will probably occur again in the future. Of course this will, hopefully, be many years from now, when the pain of 2008 has started to fade.

So the lesson to take from the past year is that risk is present and we should never forget it.

That is exactly what value investing is about. It focuses on having a strong process which analyses the past even more than the future and which is applied in the same way in all market conditions. At present, short-term psychological factors have driven the market down and, of course, this does not help short-term performance. Yet, if we apply our process in the same way that we have always done, this market is an excellent opportunity to make investments that will secure the future return of the fund. We made fifteen new investments in 2008. There's no way of knowing for sure, but we imagine that in five years from now, some of our best-performing stocks will be those we acquired in 2008 and 2009.

Benjamin Graham characterized the stock market as a manic-depressive person. His "Mr. Market" tended to be extremely optimistic at some points and extremely pessimistic at others – but he was rarely able to see the whole picture. This past year, there were so many negative developments that "Mr. Market" became almost paranoid, seeing risk everywhere. This paranoia dwarfed the reality that companies will adapt and survive, as they have done before. Certainly, companies face lower earnings in the short term, but a well run company can handle that. They are even better able to cope with hard times if they have a strong balance sheet and this is something our process concentrates on. To take one example, we actively weed out companies which have 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 – not an investment of ours – which filed for bankruptcy in early November, struggling under a combination of debt and leasing obligations.

We do not know when the market will truly return its focus to fundamentals and reassess earnings and assets on a going-concern basis. Around the world, all possible tools are being used to get the global economy back on track and, eventually, these measures will produce results. The question is how long it will take and how bumpy the ride is going to be. The one thing we can be certain of is that the economy will recover and, as it does, it is hard not to see strong companies coming into the spotlight again.

The Sparinvest Global Small Cap Value fund is cash positive and trades on a price-to-book of 0.60. Net fixed assets are equivalent to 85% of the current market price and, with intangibles equivalent to only 9.9% of equity, the risk of major write-downs seems limited. So, the asset base is solid. It is also important to note that these companies are still making money now and are expected to continue doing so in 2009. We believe we have a very strong portfolio from a fundamental point of view.

In our process, risk always comes top of the agenda. In the current markets, we see the benefit of this focus mostly in the companies we have avoided: those with high debt, intangibles, leasing and pension liabilities. This approach did not materialize in performance in 2008, when the market's attention was far from fundamentals. Nonetheless, we remain certain that our process can and will secure a good long-term return for clients. Never forget: the risk is out there. ■

Yours sincerely,

Sparinvest Asset Management

Kasper Billy Jacobsen
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.