

# Investment Grade Value Bonds Fund Update Q2/08

## Q2 2008

### Dear Investor

Investment grade credit outperformed both equities and government bonds during the second quarter.

Sparinvest Investment Grade Value Bonds performed close to its benchmark during Q2 but is lagging year-to-date.

During Q2, European investment grade continued to underperform US investment grade - primarily as a result of a widening of the government yield differential between the Euro area and the US. So far this has not been good for the relative performance of the fund since the fund is highly underweight the US credit market.

Performance - Investment Grade Value Bonds versus selected markets			
All returns in EUR	Q2 2008	H1 2008	2007
Sparinvest Investment Grade Value Bonds	-0.84%	-7.39%	1.08%
Merrill Lynch Global Investment Grade	-0.57%	-0.79%	1.93%
Merrill Lynch Global High Yield	2.24%	-1.16%	0.34%
Effas 5-7	-3.62%	-0.88%	-2.08%

## 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.

## The Portfolio

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. ■

During the quarter no major changes have been made in the portfolio.

The average yield on the portfolio is 8.8%, compared to 6.1% on the benchmark.

Portfolio figures - Investment Grade Value Bonds		
	Fund	Benchmark
Duration	5.18	5.30
Yield	8.8%	6.1%
Rating	A-	A1
# 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.

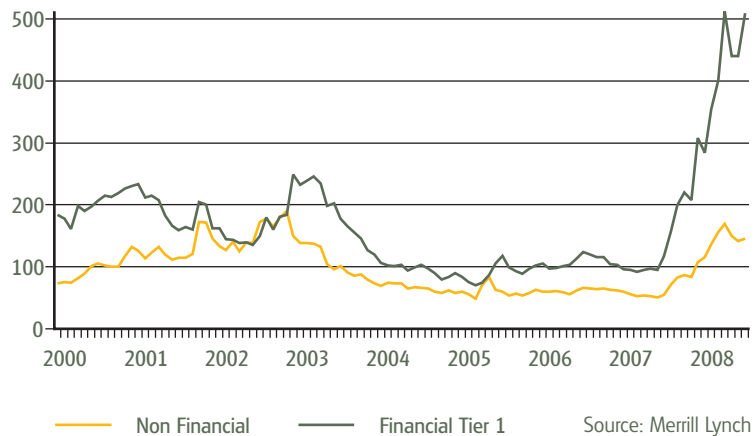
Portfolio figures - Investment Grade Value Bonds		
Industrial Companies	Fund	Benchmark
Market Cap (bn \$)	14007	34267
Net debt/Equity	69.34	119.19
Price/Book value	1.96	3.51
Interest Cover	5.68	13.17
Banks	Fund	Benchmark
Market Cap (bn \$)	22854	41558
Tier 1%	6.51	6.3
Price/Book value	1.10	1.37
Efficiency ratio	42.6	75.0
Insurance	Fund	Benchmark
Market Cap (bn \$)	20597	40070
Net debt/Equity	158.26	182.15
Price/Book value	1.04	1.08
Combined ratio	97.64	123.41

## Investment Grade Value Bonds Fund Update

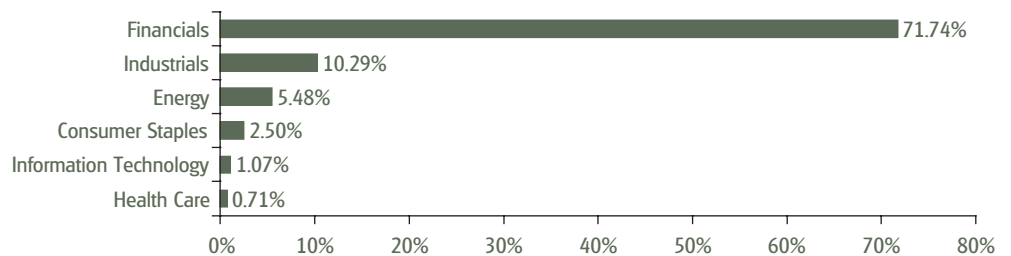
### Large exposure to Banks and Insurance companies

The fund has large exposure towards debt issued by financial companies. The reasons for this are twofold; first we have a desire to minimize the LBO risk coming from the Private Equity firms that frequently target value companies. Second because the credit premiums offered by financial debt compared to non-financial debt are currently at historical extremes (see chart below). In our opinion, this divergence implies that the default risk for financial companies compared to non-financial companies has been over-exaggerated.

#### Extreme credit premiums in financial debt

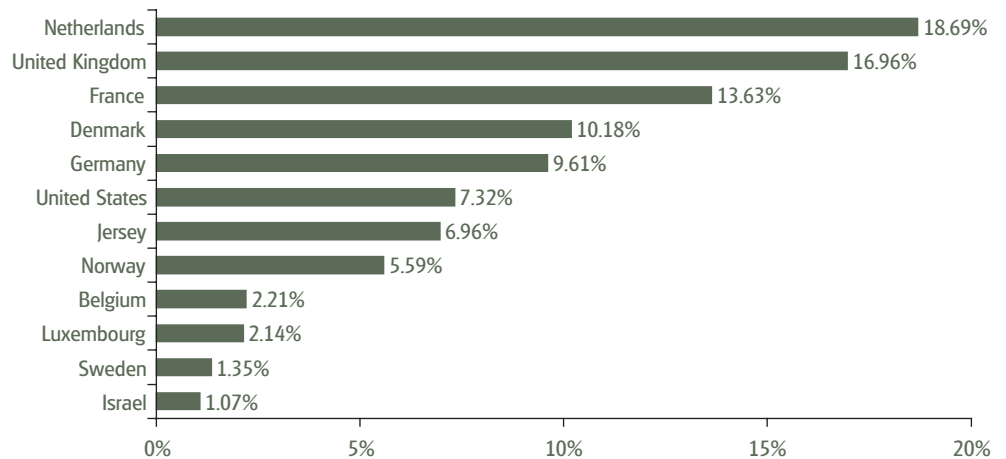


#### Sector allocation



A large part of the financial exposure in the fund is linked to Germany. German banks have been hit very hard by the financial turmoil which obviously has not been good for the fund. Looking forward though, we expect a reversal of this trend as a consequence of the consolidation in the German banking industry that will take place later this year and into 2009. Away from Germany, the fund is overweight Scandinavia through holdings of Danske Bank, Nykredit and SEB. The fund has a big underweight of the US.

### Country allocation



### Major holdings - Investment Grade Value Bonds

Holding	Country	Sector	Weight
Seb Tv 07-... Perp	France	Financials	5.42%
Roy.Bk Scot.7.0916%(Tv)07-Perp	United Kingdom	Financials	4.93%
Ht1 Fdg 6.352%(Tv) 06-...Perp	Germany	Industrials	4.35%
Linde Fin.7.375%(Tv)06-14.766	Netherlands	Energy	3.97%
Eureko Bv 6% 06-..Perp.	Netherlands	Financials	3.89%
Solvay Fin.6.375% 06-2.6.2104	Netherlands	Financials	3.76%
Komm.Ldspens.5.25%(Tv)06-.Perp	Norway	Financials	3.08%
Prosecure Fd 4.668% 06-30.6.16	Jersey	Financials	2.99%
Elm Bv 5.252%(Tv) 06-Perp.	Netherlands	Financials	2.95%
Commzkb Cap.5.012%(Tv)06-Perp	United States	Financials	2.90%

### 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 and in the pricing of European financials. 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 of non-financial corporates.

We expect outperformance from our European financial exposure once the financial crisis eases. ■

Yours sincerely,

Sparinvest Asset Management

Klaus Blaabjerg  
Senior Portfolio Manager  
8<sup>th</sup> 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.