

# Investment Grade Value Bonds Fund Update Q1/08

Q1 2008

## Dear investor,

The global credit crunch and huge asset write downs in the financial sector have put a lot of pressure on the performance of corporate bonds. The negative trend experienced in 2007 continued well into first quarter of 2008.

The quarter was especially tough for investors in the Sparinvest Investment Grade Value Bond fund with a loss of 6.60% - which was clearly not satisfactory. The general investment grade market, as measured by the Merrill Lynch Global Investment Grade Index, lost 0.22%.

The table below presents the first quarter return and the 2007 return of the fund compared with benchmark and selected markets:

Performance - Investment Grade Value Bonds versus Selected markets		
	Q1 2008	2007
Sparinvest Investment Grade Value Bonds	-6.60%	-4.06%
Merrill Lynch Global Investment Grade	-0.22%	1.93%
Merrill Lynch Global High Yield	-3.32%	0.34%
JP Morgan Emerging Markets	0.78%	4.74%
JP Morgan Europe Govt. Bonds	1.18%	0.93%

The reasons for the underperformance of the fund compared to benchmark are two-fold. First, the fund has been overweight European subordinated debt where spread widening has been massive. Second, the fund has been underweight US interest rates – US interest rates fell about 1% in the quarter whereas European interest rates only fell by 0.35%. ■

## Economics

The first quarter of 2008 has been dominated by the continuing themes of sub-prime related losses and the associated credit crunch, and concerns of a recession in the United States. Central banks – in particular the US Federal Reserve, the ECB, and those of England, Canada and Switzerland – continue their coordinated efforts to ease liquidity pressures, and the Fed has moved aggressively on interest rates. It had cut rates by a total of 100 basis points in Q4 2007 but, after an unscheduled meeting on January 22nd, the Fed announced a sharp 75 basis point cut, and made a further 50 point cut at its regular meeting eight days later.

Many feared that the liquidity crisis would eventually fell a major US investment bank. March 17th brought the bittersweet news that Bear Stearns had emerged as a victim, but that JPMorgan Chase had acquired the investment bank in a hastily arranged deal involving considerable capital input from the Fed. The following day, another 75 basis point rate cut and relatively encouraging earnings from Lehman Brothers and Goldman Sachs combined to give some solace to markets. Later in March, US Treasury Secretary, Henry Paulson outlined proposals to reorganise government regulation of financial institutions, including a broader role for the Fed.

In Japan, Bank of Japan Governor Fukui ended his tenure, but the appointment of a replacement has been delayed by a stalemate between the ruling Liberal Democrats and

the opposition Democratic Party of Japan. A compromise candidate finally appears to have emerged in the form of Masaaki Shirakawa, formerly deputy governor.

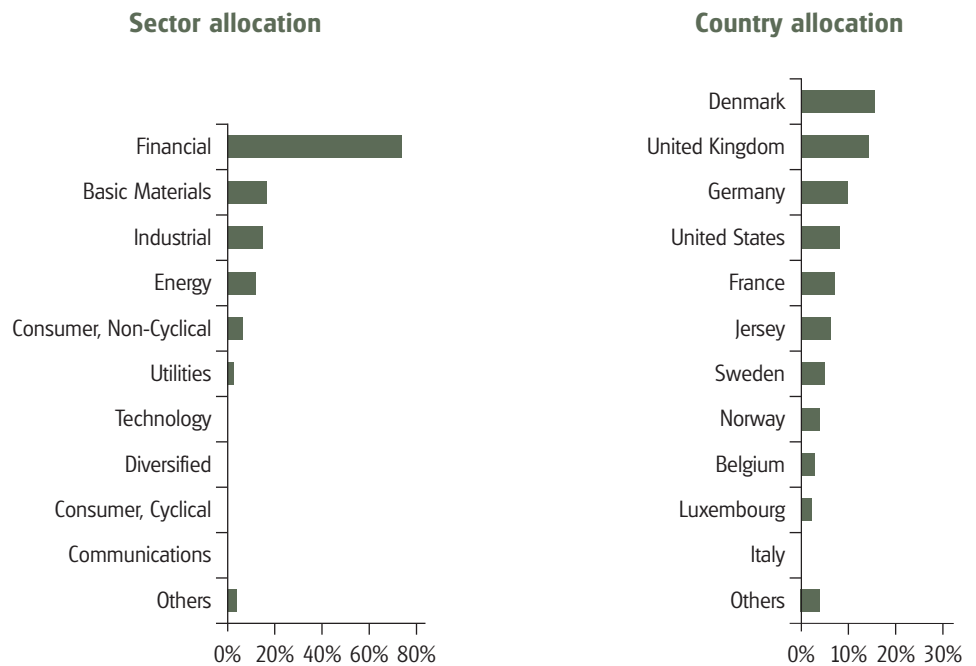
The US dollar has fallen steeply during the quarter, approaching EUR 1.60 and JPY 95 in mid-March, although the final two weeks of the quarter have seen some easing of this downward pressure. Perhaps unsurprisingly amid such dollar weakness, rising oil prices have remained another source of pressure on the markets. After New Year highs, prices dropped back to below the USD 90 mark, but rallied again from mid-February, breaking over USD 110 in mid-March. Gold prices have been similarly strong.

Japan is offering some encouraging signs, with preliminary estimates for Q4 2007 real GDP showing 3.7% annualised growth, and February core CPI was up 1.0% - the steepest growth in 15 years. In the US, existing home sales rose in February for the first time in 7 months, but consumer confidence for March emerged at a 5-year low. On April 2nd, Fed chairman Ben Bernanke testified to Congress, warning of the risk that the US economy could "contract slightly" in H1 2008.

In the Euro-Zone, the final estimate for Q4 2007 GDP was released on April 9th, confirming that growth slowed to 2.3% from 2.7% in the previous quarter. As we head into the second quarter, there are some signs of stabilisation, but financial markets look likely to remain under stress for some time. ■

### The Portfolio

The fund is currently fully invested in 42 issues with the following country and sector breakdowns:



The fund has a large overweight of financials compared to the benchmark. As previously stated, this has proved very costly as spreads on financial bonds have widened the most. However, the average yield on the fund is now 8.0% compared to 5.6% for the benchmark which, historically, looks very cheap.

Investment Grade Value Bonds  
Fund Update

Portfolio figures - Investment Grade Value Bonds		
	Fund	Benchmark
Duration	5.37	5.39
Yield	8.0%	5.6%
Spread	400	237
Rating	BBB1	A1
# Issues	42	7882

Trading activity has been moderate during the first quarter. The fund has reduced its holding in the Danish Utility, DONG and invested the proceeds in the Norwegian insurance company, Storebrand Livsforsikring.

Major holdings - Investment Grade Value Bonds			
Holding	Country	Sector	Pct.
SEB 7.0922%	Sweden	Financial	4.92%
RBS 7.0916%	United Kingdom	Financial	4.70%
Eureko 6%	Netherlands	Financial	4.25%
Ht1 Fdg 6.352%	Germany	Financial	4.09%
Siemens 5.25%	Germany	Industrial	3.80%
Storebrd Liv. 9.404%	Norway	Financial	3.76%
Linde 7.375%	Germany	Basic Materials	3.64%
Solvay 6.375%	Netherlands	Basic Materials	3.62%
Henkel 5.375%	Germany	Consumer, Non-Cyclical	3.59%
Danske Bk A/S 4.878%	Denmark	Financial	3.58%

## Storebrand Livsforsikring

Storebrand Livsforsikring AS is a leading player in the Nordic markets for pension, life and health insurance. The company has a high domestic market share which is expected to increase even further as the company is expected to gain from new legislation being implemented in Norway.

Due to the acquisition of the Swedish SPP insurer, Storebrand Livsforsikring AS issued a subordinated upper tier 2 bond in February to bolster its core capital ratio. The bonds (rated BBB+/Baa1) were issued at par with a coupon of 9.4%, which at the time of pricing, looked approximately 150 basis points too cheap, compared to the secondary market.

The bonds have no stated maturity (perpetual) but the issuer has the option to call the bonds in June 2013, which is highly likely as the funding level is abnormal. If the company does not call the bond in 2013, the coupon will step up by another 0.75%.

The bonds have traded very well since the issuance and currently trade at price of 103.5 which is equivalent to a spread tightening of 100bps and the bond is now trading at the secondary market level. ■

### Outlook

Market conditions have been tough for the last couple of quarters and returns disappointing. However, central banks have injected billions and billions into the financial system, solving the banks' short term funding needs and collateral issues. The hardest hit banks have been able to raise new equity, thereby restoring the cushion for creditors. Furthermore, it seems that the sub-prime write downs are coming to an end.

For the long-term investor, financial credit spreads are looking attractive. ■

Yours sincerely,

Sparinvest Asset Management

Klaus Blaabjerg  
April 8<sup>th</sup>, 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.