



# Sparinvest Emerging Markets Corporate Value Bonds

Diversify your exposure to the world's high-growth economies

**Sparinvest**

## Sparinvest Emerging Markets Corporate Value Bonds – Diversify your exposure to the world’s high-growth economies



### The opportunity in a nutshell:

- Emerging markets have young, working age populations, abundant natural resources, low indebtedness and a rapidly increasing share of world GDP. For all of these reasons, they represent a relevant investment opportunity for foreign investors.
- To date, most people have built their investment exposure to emerging markets through a combination of equities and government bonds. But the universe

of emerging market corporate bonds is growing fast and can be an attractive alternative.

- On average, emerging market corporate bonds currently trade at a higher spread than developed market corporate bonds. This means they offer an important investment premium.
- The companies issuing these bonds often have similar capital structures to companies domiciled in developed markets, as well as better growth prospects. In brief, they are often being penalized solely on grounds of head office location.
- Sparinvest recognizes this scenario as a highly-attractive value-investment opportunity and one in which the proven value bonds investment strategy can offer an emphasis on default avoidance, coupled with long-term outperformance.

This material is only intended as general information about Sparinvest’s new investment product: Emerging Markets Corporate Value Bonds. The material does not constitute individual investment advice and cannot be invoked as a basis for a decision to buy (or not to buy) or sell investment securities in Sparinvest Emerging Markets Corporate Value Bonds.



## The Emerging Markets Opportunity



### Emerging markets have come a long way...

- The blanket term 'emerging markets' is given to all those economies that are not yet considered to be fully developed or mature. And yet many of them are economic powerhouses with better growth trends than their 'fully developed' counterparts. Thus the emerging markets are the geographic regions with the highest growth potential.
- At the 2008 Washington summit, the expanded 'Group of 20' (G20) replaced the G8 as the main economic and political council of wealthy nations. This move

recognized the growth in stature and influence of many newly-industrialized nations. Emerging markets are 'coming of age' – both politically and economically.

### What are the drivers for growth in the emerging markets?

- **Healthy demographics and rising household incomes.** In contrast to developed nations, emerging nations have a higher proportion of younger people – of working age – who make a positive contribution to economic output and create growth in consumption, compared with retired populations.
- **Competitiveness.** As a result of lower labour costs, emerging markets have seen growth in both manufacturing and exports.
- **Rich in natural resources.** The emerging market countries benefit from a disproportionate share of the earth's natural resources such as farmable land and mineral deposits.

- **Low levels of debt.** With production and export levels high and domestic consumption low, many emerging market governments have surpluses available to invest in infrastructure projects. Businesses and consumers also have low debts.

- **Strong fiscal discipline.** Past economic crises have resulted in prudent fiscal regimes being implemented in many emerging market nations. For example, Brazil's government debt now has investment grade rating.

... **and they still have further to go**

- The International Monetary Fund (IMF) forecasts that emerging markets will grow an impressive two to three times faster than their developed counterparts in the years ahead.\*

\* IMF Estimate April 2010



## The Emerging Market Corporate Bonds Opportunity


$$\begin{aligned} & \text{Interesting Risk/Return Profile} \\ & + \\ & \text{Portfolio Diversification Benefits} \\ & + \\ & \text{Emerging Market Premium} \\ & = \\ & \text{More Performance Potential} \end{aligned}$$

### An interesting asset class

- Corporate bonds are a much-appreciated and widely-used asset class. This has been the case for a long time in the US but has been a more recent development in Europe. Globally, the appetite for corporate bonds has mushroomed since the global credit crisis took hold in 2008. Companies that needed loans could not get them from banks and so increasingly accepted the credit market as an alternative source of funding.
- Corporate bonds are attractive for their historically superior risk/return profile and for their low correlation with other

core investments. This gives them important portfolio diversification benefits. Targeting this asset class is a good way for investors to diversify the fixed interest portions of a portfolio. Emerging market corporate bonds are also an excellent way to diversify emerging market exposure away from just equities and sovereign debt (see figure 1).

- Emerging market corporate bonds offer a significant investment premium. On average, they are trading at a higher spread than similarly-rated companies in the developed markets, despite the fact they have similar capital structures, higher growth potential and lower leverage. This represents opportunities for early investors.
- Emerging market corporates is a young asset class, offering interesting returns. The only asset class with – historically – a better risk/reward profile is emerging market sovereigns. However, lack of substantial increase in sovereign debt issuance since 2001, coupled with the high level of inflow into this asset class and the number of rating upgrades,

**Correlation Properties of Emerging Market Corporate Bonds Against Other Asset Classes 1999-2009\***

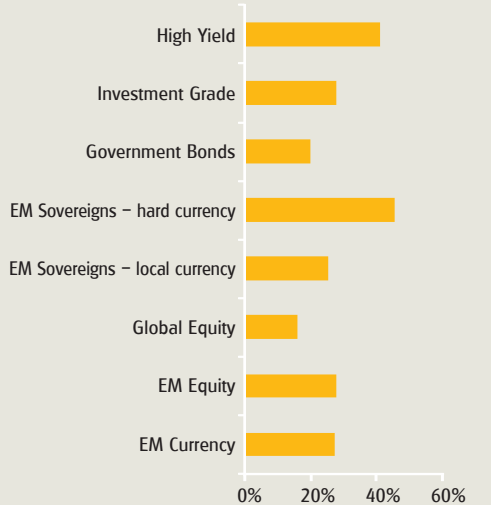


figure 1

**Yield on Emerging Markets Corporate Bonds**

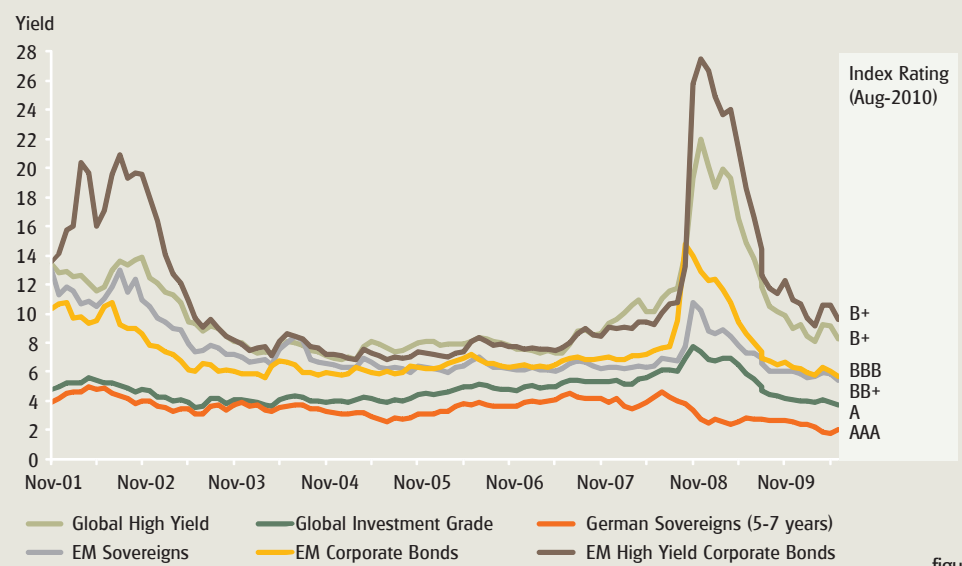


figure 2

means that the return from sovereigns is unlikely to be sustained at these levels moving forward. By contrast, the fast-growing emerging market corporate debt universe, which has increased by more than 200% since 2001, offers greater investment choice, a continuation of average ratings at current levels and thus an interesting risk/return profile.

- The demand for investment in emerging market corporate bonds from US pension funds is expected to increase in coming years. This should lead to good price development for the bonds as well as a good yield (see figure 2).

\* Please refer to the backpage of this brochure for exhaustive references and/or additional source data. Please note that past performance is no guarantee for future returns.

## The Emerging Market Corporate Bonds Opportunity (Continued)

■ One of the factors explaining the emerging market investment premium is the need to compensate for political and governance risk. But, increasingly, things are moving in the right direction – both in terms of the improvement of regulatory standards (including investor protection measures in countries seeking inward investment) and in terms of the greater availability of reliable data concerning worldwide governance trends. Using the Worldwide Governance Indicators makes it possible

to examine the quality of governance in one country/region relative to the rest of the world and drill down to investigate governance in six dimensions:

1. Voice and Accountability
2. Political Stability and Absence of Violence/Terrorism
3. Government Effectiveness
4. Regulatory Quality
5. Rule of Law
6. Control of Corruption

### Worldwide Country Risk – A Composite Picture from World Governance Indicators

indicates the position in 2009 with dark green representing countries with the lowest risk and dark red the highest risk. Yellow is medium risk.

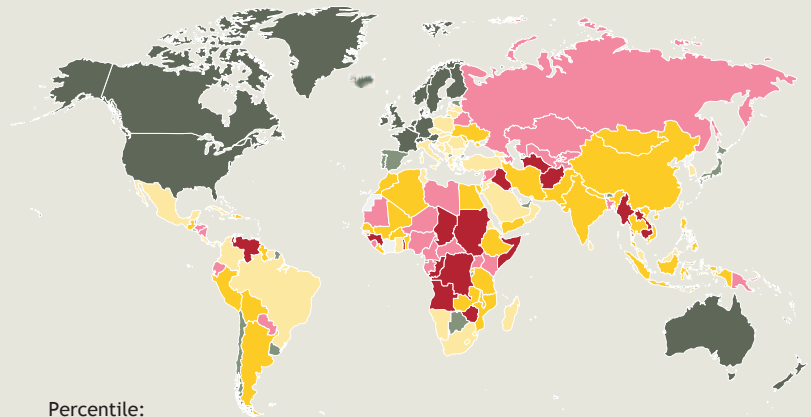


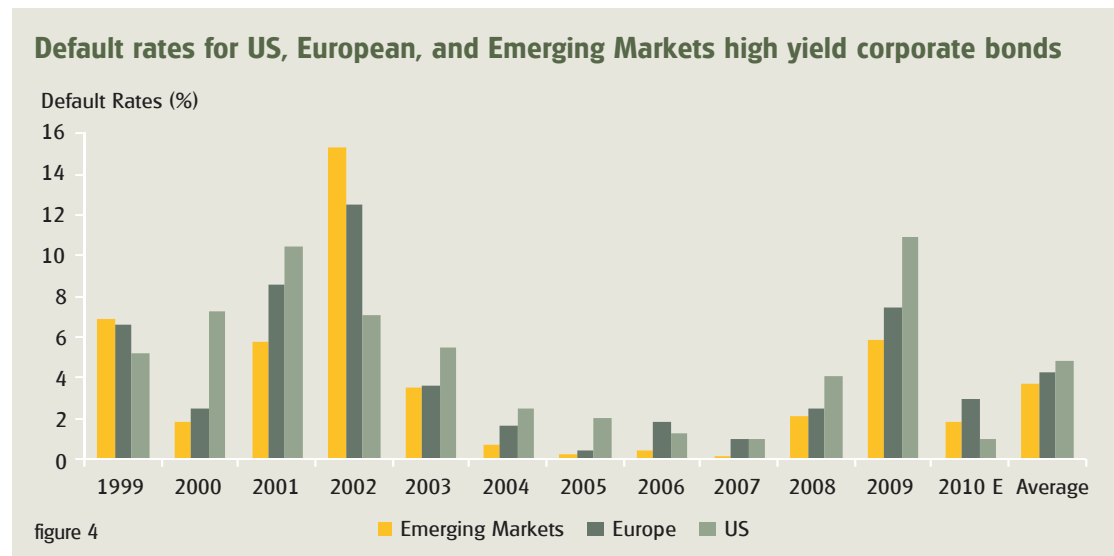
figure 3

## Emerging Markets – A Good Record of Debt Repayment

Figure 4 shows default rates for high yield corporate bonds. Many would expect emerging market corporate bonds have a higher rate of defaults. However, the figure shows that default rates for emerging market corporate bonds have been surprisingly low in recent years and, on average, their record of debt repayment over the past decade has been better than for Europe and the US.

Some of the reasons for this are:

- Foreign investors are increasingly investing into emerging markets. Greater liquidity lowers the refinancing risk.
- The average company issuing corporate bonds is larger in size than we have seen recently in the US and Europe. Larger companies are often more mature and less growth oriented – a fact that decreases their default risk.
- Many companies are owned or part-owned by governments.
- Lower government debt and healthier fiscal balances give governments room to stimulate the economy.



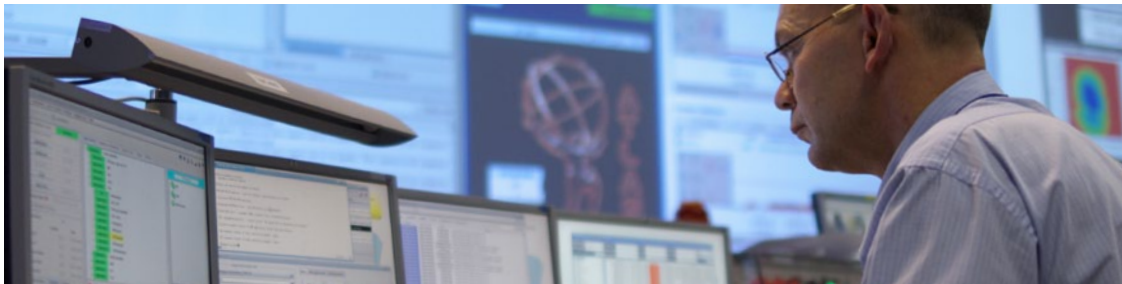
## The Value Strategy Opportunity



- Research by the American academics, Elton and Gruber, shows that value/size factors also work in the credit markets (see figure 5). This is because value companies and smaller companies are routinely underrated and underpriced. The same is probably true of emerging

market companies which are sometimes considered riskier on geographical grounds alone.

- To identify the companies with the best 'value bond' characteristics requires first a rigorous screening process and then a deep investigation at company level and close scrutiny of the bond paperwork. The ideal value bond has a strong balance sheet, low indebtedness, good asset coverage and a history of debt repayment and yet, for various reasons, it is likely to be underrated by the market.
- Companies from emerging markets are now global players, meaning that if they seek to attract foreign investors, it is in their interests to be reliable and to use



## Research by Elton and Gruber Explains the Risks Behind the Credit Premium

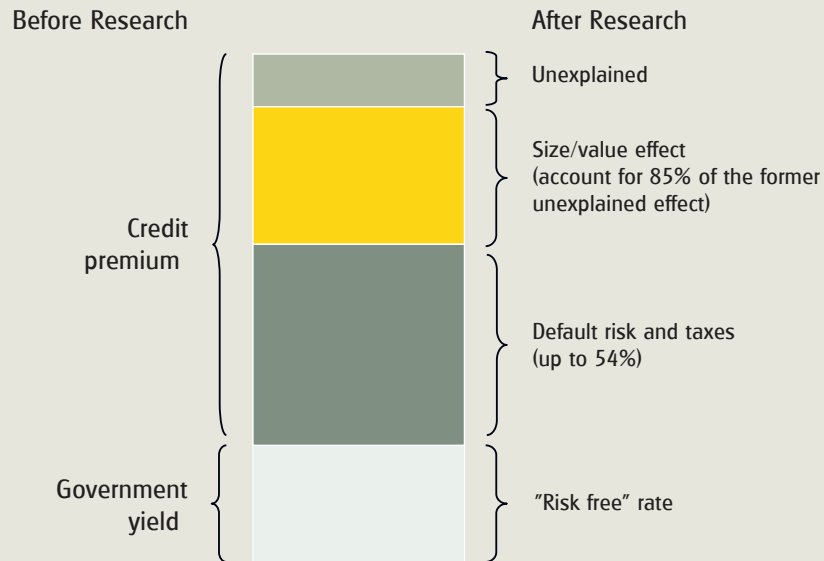


figure 5

Source: Elton, Gruber et al (2001)

high quality and transparent accounting standards. This is important for the value bonds strategy where a natural step in the investment process is to go through the accounting reports in great detail – hence it favours companies that provide high quality and transparent reports and accounts.

- Research shows that value investments require longer timeframes to reach their full outperformance potential. This is because the investment opportunity is based on finding the companies whose true potential has not yet been recognised by the rest of the market. It takes time for the market to correct its view.

## Why Sparinvest?



- Sparinvest has successfully applied its value bonds strategy to mature global credit markets with its top-performing High Yield Value Bonds fund and Investment Grade Value Bonds fund.
- The value process is designed to select companies with strong balance sheets,

low debts and a good record of debt-repayment. The track record of Sparinvest Value Bonds strategy in terms of default avoidance has historically been significantly superior to the market average (see figure 6) which partly explains its superior performance record.

- Sparinvest's Value Bonds team currently manages a total of approximately EUR 700mn in value bond funds (as of September 2010).

Sparinvest Emerging Markets Corporate Value Bonds will be managed on a day-to-day basis by Sune Højholt Jensen and Toke Hjortshøj with regular input from the whole Value Bonds team.

### The Sparinvest Value Bonds team



**Klaus Blaabjerg**  
(M.Sc. Economics,  
University of Copenhagen)

Chief Portfolio Manager,  
Value Bonds team leader



**Sune Højholt Jensen**  
(M.Sc. Economics and Business Accounting,  
Copenhagen Business School)

Senior Portfolio Manager for  
Sparinvest Emerging Markets  
Corporate Value Bonds

## Low Default Record from Value Bonds Strategy

Default Rates (%)

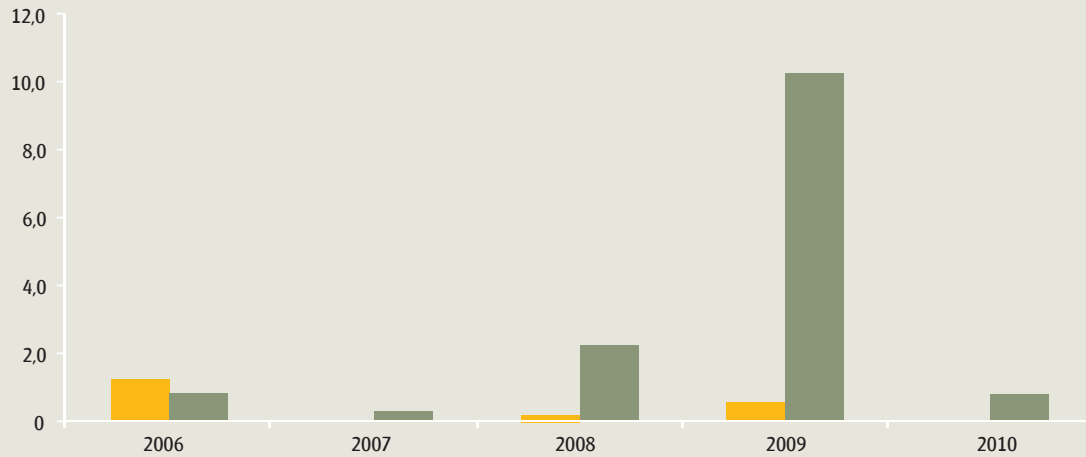


figure 6

■ Sparinvest High Yield Value Bonds ■ The Global High Yield Market



### Toke Hjortshøj

(Ph.D. Finance, University of Aarhus)

Portfolio Manager for Sparinvest Emerging Markets Corporate Value Bonds, together with screening and analysis of new cases



### Anne Margrethe Tingleff

(M.Sc. University of Copenhagen)

Analyst, screening and analysis of new cases, together with optimisation of the teams data tool

## Why Sparinvest Emerging Markets Corporate Value Bonds?



Emerging markets are generally considered to be more risky than other markets, but the right investment approach can reduce the risks.

### **Sparinvest Emerging Markets Corporate Value Bonds will:**

- Aim for higher risk-adjusted returns rather than maximum yield through investment in emerging market corporate bonds with ratings from investment grade to high yield in companies with low-gearing.

- Use the proven Sparinvest Value Bonds investment process to seek out undervalued or underrated bonds with good price development potential.
- Use the proven Sparinvest Value Bonds investment process to reduce default risk.
- Use the World Bank Country Governance Indicators to analyze the risk of corruption and direct theft in specific countries and to understand where country risks are increasing or decreasing.

### **Who can invest in Emerging Markets Corporate Value Bonds?**

- The fund is aimed at investors who want exposure to emerging markets and who are willing to invest in securities with a medium risk based on 3 years benchmark volatility.

## Summary

### Emerging markets

- Provide investors exposure to geographic regions with highest economic growth.
- Have healthy fiscal balances and low indebtedness which will enable them to sustain economic growth.
- Are an increasingly attractive destination for foreign investment.

### Emerging markets corporate bonds

- Have an impressive track record with an attractive risk-adjusted performance.
- Offer excellent correlation properties that fit well into a strategic asset allocation philosophy.
- Offer the chance to diversify both fixed income and emerging market exposures.

### Sparinvest Emerging Markets Corporate Value Bonds

- Is founded on the highly successful investment process used for Sparinvest High Yield Value Bonds (Morningstar 4 stars).
- Uses the World Bank Country Governance Indicators to minimize risk of corruption and political risk.

## Fund Facts: Sparinvest Emerging Markets Corporate Value Bonds

Investment Concept	Value Bonds
Income Type	Accumulating
Risk	Risk of the benchmark is medium – based on 3 years volatility
Notes	The sub-fund is a part of Sparinvest SICAV, a Luxembourg-based, open-ended investment company
ISIN	LU0519053697
Fund Inception	15 <sup>th</sup> September 2010
Share Class	EUR R
Share Class Currency	EUR
Company name	Sparinvest Luxembourg
Domicile	Luxembourg
Subscription from	15 <sup>th</sup> September 2010
Subscription price	EUR 100
Manager	Sparinvest Fondsmæglerselskab A/S
Fund Managers	Lead Manager Sune Jensen and Co Manager Toke Hjortshøj
Fund Manager Start Date	15 <sup>th</sup> September 2010
Public distribution in	Luxembourg, Denmark, Iceland, Sweden, Germany, Greenland, Holland, Faroe Islands, Finland, France, Norway, Switzerland, United Kingdom, Austria, Italy, Spain
Benchmark	JP Morgan Corporate Emerging Markets Bond Index Broad Diversified (EUR Hedged)(SPI)
Morningstar Category™	Global Emerging Markets Bond
Investment universe	Emerging Markets according to MSCI classification
Subscription fee (up to)	2.00%
Redemption fee (up to)	0.00%
Management Fee	1.25%



Figure 1: Source: Correlation comparison between EM Corporate Bonds and other global asset classes over the period January 1999 to December 2009. BofA Merrill Lynch Global Investment Grade, BofA Merrill Lynch Global High Yield, BofA Merrill Lynch Emerging Markets Corporates, BofA Merrill Lynch Pan European Government Bonds, J.P. Morgan Emerging Local Market Index Plus, MSCI/Bloomberg World Index & Emerging Market Index. All indices are USD denominated. Correlations on Emerging Market Sovereigns – local currency is based on the period January 2002 to December 2009.

Figure 2: Source: Yield (Yield-to-Worst) comparison between EM Corporate Bonds and other fixed income asset classes over the period November 2001 to May 2010. Indices used are: BofA Merrill Lynch Global High Yield, BofA Merrill Lynch Global Investment Grade, BofA Merrill Lynch German Sovereigns (5-7 years), BofA Merrill Lynch Emerging Markets Sovereigns, J.P. Morgan Emerging Markets High Yield Corporate Bonds, and Credit Suisse Emerging Markets Corporate Bonds.

Figure 3: Source: D. Kaufmann, A. Kraay, and M. Mastruzzi 2009: Governance Matters VIII: Governance Indicators for 1996-2008.  
Note: The governance indicators presented here aggregate the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organisations, and international organisations. The aggregate indicators do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group.

Figure 4: Source: Historical default rates are Standard & Poors'. The US expected default rate is based on Sparinvest Value Bonds Default Model. The European and Emerging Markets default rates are based on J.P. Morgan forecasts.

Figure 5: Source: Elton and Gruber.

Figure 6: Source: Sparinvest and J.P. Morgan.

## Risk

Investing in emerging markets is obviously not without risk and even if you choose to invest through the Emerging Market Corporate Value Bonds, which has a prudent risk diversification, the risk is still higher than in the mature markets. This can be explained by the economic, social and political systems which are more uncertain than in developed economies. As is the case with ordinary bonds, corporate bonds can also fluctuate in price. Exchange rate differences may result from interest rate movements in the bond market and from market expectations about corporate insolvency risk. In "bad" times, this risk increases and may cause large fluctuations in corporate bonds in both emerging markets and mature markets.

The fund Emerging Markets Corporate Value Bonds can therefore fluctuate more in price than general government bonds and the risk of the fund is expected to be medium, based on 3 years benchmark volatility. The fund will use hedging to cover the majority of the currency risk against the Euro.

## Disclaimer

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/representatives 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 Investor Services Bank S.A., Zurich Branch, Badenerstrasse 567, P.O. Box 101, CH-8066 Zurich. Published by Sparinvest, 28, Boulevard Royal, L-2449 Luxembourg.

Sparinvest makes reservations for typos, calculation mistakes and other possible mistakes in the material.