



## Ethical High Yield Value Bonds

### Headlines

- Examples of dislocation and 'value'
- What is in the price?
- Key figures
- Ethix SRI Advisors: Summary of the Exclusion Filters
- Ethix SRI Advisors: Ethical Reporting

### Fund Facts

Strategy	Value Bonds
Risk	Medium (5)
ISIN	LU0473784196
Share Class Currency	EUR
Fund Inception*	01-Feb-2010
Fund Manager	Sune Højholt Jensen
Benchmark	Merrill Lynch Global High Yield (EUR Hedged)
Morningstar Category	Euro High Yield Bond



■ [sparinvest.eu](http://sparinvest.eu)

The 3rd quarter of 2011 will not be remembered for good performance. Value underperformed and so did Europe compared to the US. We know from previous business cycles that Value as an investment style underperforms as the market prices in a recession. This time was no different. And Europe, because of the European debt crisis, underperformed at the same time. This was a double whammy for Sparinvest Ethical High Yield Value Bonds in terms of relative performance.

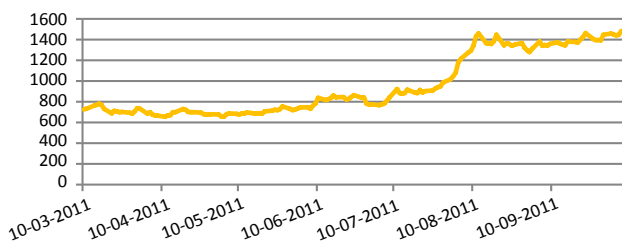
Sparinvest Ethical High Yield Value Bonds & Index Return, in %	Q3 2011	YTD
Sparinvest Ethical High Yield Value Bonds	-15.44	-10.64
Merrill Lynch Global High Yield	-7.10	-2.38

But wait a minute! – The performance of the underlying businesses was actually very strong. Indeed most of our companies have never been in better shape. Take the Energy sector as an example – the price of Brent oil has constantly been above 100\$ a barrel thus the oil sector has generated high income. Drilling companies have been able to charge higher day-rates and oil companies have been able to sell the the oil considerably higher than the cost price. The companies behind our two largest E&P positions have either divested assets or made significant new discoveries thereby increasing the liquidity of the assets. The largest position in Sparinvest Ethical High Yield Value Bonds, Ecobat, has had an excellent first half of the year and retains a solid outlook, yet has seen its bond drop 25% in price to yield more than 20% today. To witness such indiscriminate selling of quality bonds is difficult, but, as Value investors, it is our duty to think long term and stay focused on fundamentals and not fall victim to fear and panic. We believe that Sparinvest Ethical High Yield Value Bonds offers excellent value for the future both in absolute terms and relative to the market.

### Examples of dislocation and 'value'

Edcon is one of the leading retailers in South Africa. The credit premium on the Edcon 9.5% bond maturing in 2018 has risen from 7% over the risk-free rate in May this year to more than 14% today. Edcon's operating performance has not been bad – on the contrary. Revenues and margins have improved compared to last year and the South African economy seems to be performing quite well. That the South African economy is performing OK is reflected in the development of the national stock index TOP40 which is down around 4% in the same period. This does not make sense! – The Edcon 9.5% 2018 bond should not drop from a cash price of 95 to 75 at the same time as the general stock market drops by only 4%. Too much gloom and default risk has been priced into this bond. The gloom cannot be explained by direct links to Europe, since Edcon operates only in South Africa. Indirectly, though, Europe has the answer to the mispricing – Edcon is traded by the European High Yield desks at the big banks in London. And these trading desks have contributed greatly to the panic this summer.

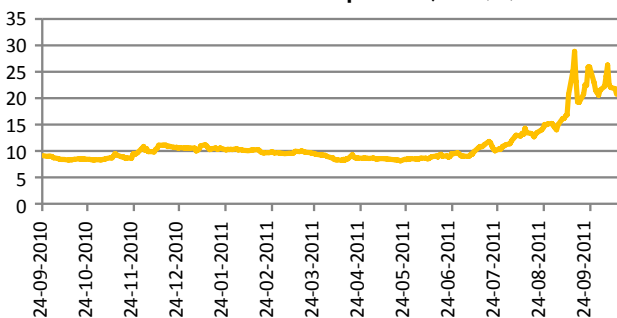
Credit premium on Edcon 9.5% 2018 (bp)



#### Intesa Sanpaolo SpA

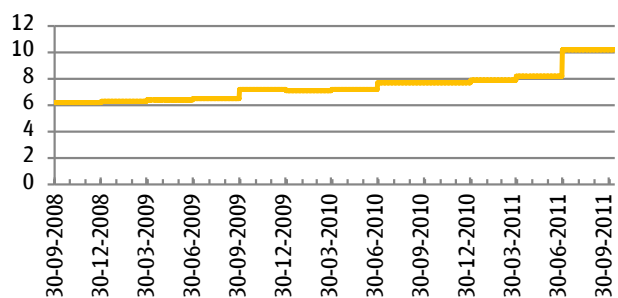
Another example of 'too much gloom in the price' is the 9.5% Intesa Sanpaolo bond. This bond has dropped from a price of 105 in June to 65 today. Intesa Sanpaolo is one of two large banks in Italy. Intesa has not experienced the boom/bust evolution of other large banks, it is been run consistently and conservatively for many years.

Yield on Intesa Sanpaolo 9,5% (%)

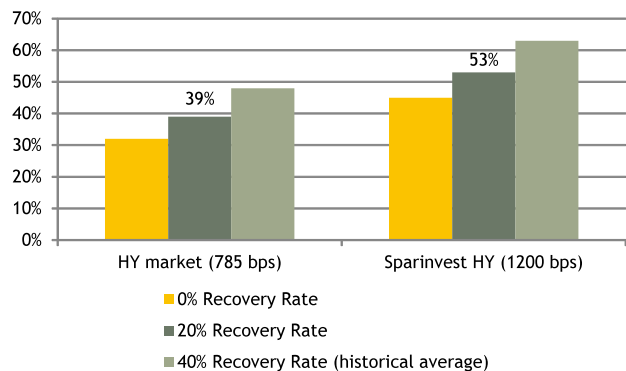


In line with this conservative approach to its business, Intesa performed a rights issue back in the early summer to bring its Core Tier 1 Capital Ratio to 10% – this is the highest it has ever been. Intesa does not have exposure to Greek Government bonds nor Portuguese. But Intesa does have exposure to Italian Government bonds. We see no problem with this. Italy is not Greece. Italy was already running a surplus on its primary balance before implementing new austerity measures. Italy is suffering from a lack of confidence – a situation that could easily be improved by a change of Premiership – something that may not be too distant on the horizon.

Core Tier 1 Capital Ratio for Intesa Sanpaolo SpA



### What is in the price?



One way of looking at whether a portfolio is cheap or not is to look at the number of defaults being implicitly discounted by the average credit premium or spread on the portfolio. Based on the benchmark portfolio where the current credit premium is 785 basis points (= 7.85%), 39% of the benchmark portfolio is expected to default, with an average recovery rate of 20% during the remaining lifetime of the current benchmark portfolio – adopting a buy-and-hold assumption. This is a very bearish expectation and this scenario of the future has no historical precedent. For our fund, expectations are even more bearish; using again a 20% recovery rate

estimate, 53% of our fund is now expected to default. This will not happen since our companies have very low financial gearing. And should we have a default, there is a high likelihood we will get closer to 40% in recovery rate on average because of lower Loan-to-Value among our companies. Using a 40% expected recovery rate for our fund implies an expectation then of 63% of the fund would default within the next 5 years – assuming a buy-and-hold approach. This is a much, much too bearish view on the underlying state of our businesses and the world in general.

### Key figures

The fund has cheapened a lot lately. The yield on the fund today is 14.6% compared to 9.4% for the benchmark. This is the largest difference in yield between the fund and the benchmark we have ever seen. Duration for the fund is 4.4 years, marginally higher than for the benchmark. The average credit rating is BB- for the fund compared to B+ for the broad market. The reason for this is an overweight of financials in our fund.

Portfolio figures – High Yield Value Bonds		
	Fund	Benchmark
Duration	4.41	4.22
Yield	14.6%	9.4%
Rating	BB-	B+
#Issues	69	2655

Our Market cap, on average, is higher than that of the broad market which is again related to our exposure to large European financials. Regarding financial gearing, net-debt-to-equity for our fund is 72.63%, on average compared to almost 300% for the broad market. Finally, we would like to stress that our fund consists of some very cheap companies – many of which are obvious takeover targets. The fund is constructed in such a way that this would be a beneficial rather than detrimental development.

Portfolio figures – High Yield Value Bonds		
	Fund	Benchmark
Market cap. (bln \$)	8.711	3.943
NDE	72.63	292.57
P/B	0.69	3.88
Interest Cover	3.73	4.05

### Ethix SRI Advisors: Summary of the Exclusion Filters

#### Norm-based Screening (UN principles)

- Zero tolerance

#### Sector-based Screening

*For Porn, Alcohol, Tobacco and Gambling*

- Zero tolerance for production
- 5% tolerance for distribution

*Weapons*

- Zero tolerance for combat equipment
- 5% tolerance for other military equipment and associated services

## Ethix SRI Advisors: Ethical Reporting

### New holdings:

During 2011 no potential new investments were excluded as a result of the ethical screening criteria

### Ocean Rig

Issue	Country	Norm-Based Screening			Sector-Based Screening				
		Red	Amber	Green	Weapons	Alcohol	Gambling	Pornography	Tobacco
Ocean Rig 9,5% 11-24.4.16	CY	—	—	—	—	—	—	—	—

Ocean Rig offers offshore drilling services to the oil and natural gas exploration industry. The company operates ultra-deepwater offshore drilling rigs, and specializes in drilling in harsh environments, which gives Ocean Rig a competitive advantage. The rigs have a proven track record of high efficiency deepwater and ultra-deepwater operations in severely harsh water conditions, conditions where other drilling service companies do not have suitable rigs and equipment.

As the table shows Ethix SRI Advisors do not find any involvement in controversial activities for Ocean Rig.

### Existing holdings:

There were no developments of note during the quarter.

### Sune Højholt Jensen

Senior Portfolio Manager

11 October 2011

This Fund Update should be read together with the latest 'Letter to Shareholders', in which our Value Bonds team offer their perspective on value investment and market developments.

Sparinvest Ethical High Yield Value Bonds available share classes	ISIN
EUR I	LU0473785169
EUR R	LU0473784196



Sparinvest is a signatory of UN PRI and member of Eurosif and Dansif.

UN PRI is an international investor initiative sponsored by the UN and based on six principles for responsible investments. The aim is to help investors actively to incorporate environmental, social and governance issues into their investments.

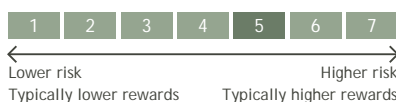
The mentioned sub-fund is part of Sparinvest SICAV, a Luxembourg-based, open-ended investment company. For further information we refer to the full and/or simplified prospectus and the current annual / semi-annual report of Sparinvest SICAV which can be obtained free of charge at the offices of Sparinvest 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.

## Description

### Investment Concept: Value Bonds

The Sub-Fund aims at providing a positive return over the long term by investing in high yield corporate fixed income transferable securities that are admitted to official listing on a stock exchange or that are traded on a Regulated Market within the OECD countries, EU Member States, Singapore or Hong Kong. The Sub-Fund mainly invests in non investment grade fixed income transferable securities that are NOT AT risk of payment default or subject to bankruptcy proceedings or otherwise in payment default at the time of purchase.

## Risk and Reward Profile



## Basic Information

ISIN	LU0473784196
Bloomberg	SPSHIBR LX
Share Class	EUR R
Fund Inception	01-Feb-2010
Share Class Currency	EUR
Income Type	Accumulating
Company name	Sparinvest S.A.
Domicile	Luxembourg
Share Class Inception	01-Feb-2010
Fund size (MN) - 30-Sep-2011	26.07 EUR
Manager	Sparinvest Fondsmaeglerselskab A/S
Fund Manager	Sune Højholt Jensen
Managed Since	01-Feb-2010
Benchmark <sup>1</sup>	Merrill Lynch Global High Yield (EUR Hedged)
Morningstar Category <sup>2</sup>	EUR High Yield Bond
Latest NAV - 30-Sep-2011	104.61 EUR
Subscription fee (up to)	2.00 %
Redemption fee (up to)	0.00 %
Management Fee	1.25 %
Total expense ratio - 31-Dec-2010	1.58 %

## Returns - Month End, Sep-2011

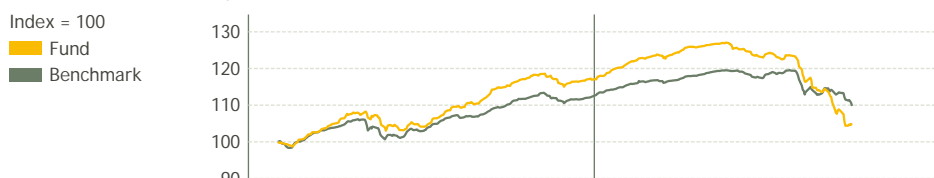
Returns	Fund	Benchmark <sup>1</sup>	Difference
YTD	-10.64%	-2.38%	-8.26%
1 Month	-8.33%	-3.87%	-4.46%
3 Months	-15.44%	-7.10%	-8.34%
1 Year	-9.10%	-0.15%	-8.95%
3 y ann.	-	12.81%	-
5 y ann.	-	5.94%	-
10 y ann.	-	8.25%	-

## Risk 3 years - Month End, Sep-2011

Risk	Fund	Benchmark <sup>1</sup>	Morningstar <sup>2</sup>
Volatility	-	17.10%	16.23%
Sharpe R.	-	-	0.50
Info Ratio	-	-	-

Morningstar Rating™ —

## Performance - 30-Sep-2011

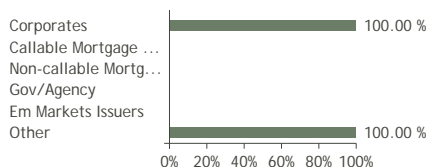


Returns	2010	09-2011
Fund	-	-10.64%
Benchmark	14.51%	-2.38%
Morningstar Category™	13.22%	-5.41%

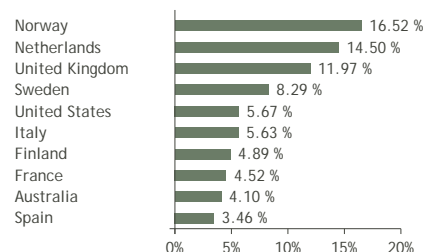
## Asset Allocation

Holdings	Equities	Bonds	Other	Cash
71	0.0%	100.0%	0.0%	0.0%

## Bond Type



## Top 10 Countries



## Portfolio (Top 10) - 30-Sep-2011

Name	Bond Type	Type	Country	Weight
Boats Inv. 11% 07-31.3.17 /Pik	Corporates	Bonds	Netherlands	5.34%
Noreco 12.9% 09-20.11.14	Corporates	Bonds	Norway	4.92%
Pa Res 12.25% 11-05.04.16	Corporates	Bonds	Sweden	4.85%
Santos Fin 8.25%(Frn) 10-22.9.70	Corporates	Bonds	Australia	4.10%
Ocean Rig Ud 9.5% 11-27.4.16	Corporates	Bonds	United States	3.48%
Bbva Intl Frn 09-Perp	Corporates	Bonds	Spain	3.46%
Fuerst Cap Frn 09-Perp	Corporates	Bonds	Germany	3.28%
Srlev Nv 9% 11-15.4.41	Corporates	Bonds	Netherlands	3.16%
Intesa San 9.5%(Frn) 10-Perp	Corporates	Bonds	Italy	3.14%
Edcon Holdings 9.5% 1.3.2018	Corporates	Bonds	South Africa	3.06%

## Bond Credit Quality

AAA	AA	A	BBB	BB	B and below	Not Rated	Effective Duration
0.0%	0.0%	0.0%	20.3%	20.2%	24.0%	35.4%	5.5

## Notes:

The mentioned sub-fund is a part of Sparinvest SICAV, a Luxembourg-based, open-ended investment company.

## Benchmark Comment

-