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Our Value Equity Funds

Fund	ISIN code
Emerging Markets Value	LU0760183672
Ethical Emerging Mkts Value	LU0760183912
Ethical Global Value	LU0362355355
European Small Cap Value	LU0256591552
European Value	LU0264920413
Global Small Cap Value	LU0264925131
Global Value	LU0138501191

Detailed information is available on sparinvest.eu

- sparinvest.eu

Value Equities

Dear investor,

2012 - Review

After more than four years of hunting for value in the wake of the global credit crisis, the portfolio of our Global Value Fund is – unsurprisingly – overweight in the most neglected and unpopular areas of the market, where we see the most compelling bargains.

Given that 2012 was another year of roller-coaster volatility and macro-induced risk-on/risk-off swings, we acknowledge that it has been an uncomfortable 12 months, with the fund well ahead of index early in the year, but closing behind. But there were two good spells – one at the beginning and one at the end of the year – when we saw sharp outperformance from the value strategy and our fund, and which are encouraging for the future.

Global Value Performance

In the first two months of the year, we benefited from a renewed (but short-lived) focus on fundamentals, with the fund soon over 6% ahead of MSCI World.

But from March through to mid-November, macro fears resurfaced about Europe, while sentiment on Japan was hit by extreme strengthening of the yen. Lower risk appetites meant equity buyers herded in the opposite direction to us, into perceived ‘safe havens’. Investors crowded into the US, and more defensive, blue-chip stocks – many of which were in a valuation territory exceeding our price range (and comfort zone). This rapid shift meant that the fund lost ground, and was by summer around 8% behind the index.

Then again in the final quarter, as the US tottered towards its 'fiscal cliff', investors began to realise that alternative regional investment options did exist and perhaps the punishment of Europe and Japan had been overdone. Indeed, due to the strong performance of Q4, the fund caught up much of the ground lost during the summer to end the year with a double-digit return of 10.78%, but still behind the MSCI World Index's 14.05%.

Our value process involves the careful selection of quality long-term investments from the cheapest parts of global markets - as measured by classic metrics such as low price-to-book, low price-to-earnings and dividend yield. This can create considerable divergence from the index in terms of regional exposure.

	GVF	MSCI World
Japan	27.32%	8.64%
US	14.80%	53.37%
W. Europe	49.32%	26.94%

Average regional exposure through 2012.

In the long-run, value equity outperformance is driven by correction of mispricing in the market – as investors shift into undervalued stocks. In recent years, macro swings have often taken attention away from stock valuations – and ultimately this also hurt performance in 2012. But it was encouraging to see at least some emerging signs that market focus will, ultimately, shift back to valuation. In the beginning of 2012, we saw it at the individual stock level, and at the end of the year, at the broad geographical level.

Reasons for Optimism 1 – Europe

We hold a broad selection of undervalued European companies with strong balance sheets, valuable assets and prospects for resuming strong earnings patterns as we come out of recession. Our holdings continue to be cheap but a number of factors combine to keep us positive about our European exposure moving forward.

Progress in the on-going effort to solve the global financial crisis may not be smooth, but where undervaluation has been overdone in specific regions, sectors or companies, we see reversion to mean as inevitable.

Since Mario Draghi's summer statement that the ECB would do 'whatever it takes to preserve the euro', there has been a sea-change in European sentiment. With calmer conditions now prevailing, investors are starting to realise the extent to which Europe was heavily oversold,

with macro fears pushing share prices far below the level justified by corporate fundamentals. We believe there remains good potential for further revaluation of European stocks.

Reasons for Optimism 2 – Japan

Japanese elections at the end of 2012 returned the traditionally business-friendly Liberal Democratic Party, headed by Shinzo Abe. Abe has been quick to signal a much more expansive fiscal policy with two clear targets: to end deflation (positive for domestic banks) and to weaken the yen (positive for Japan's exporters). Abe has also announced a \$117 billion spending package, the biggest stimulus for Japan since the financial crisis began.

This clear demonstration of new political will is perhaps the most significant development that we have seen in Japan in over eight years and could represent a real 'game change'. The path remains difficult, and it's early days for the new regime but the fact that markets have responded so positively to the prospect of 'Abenomics' shows the extent to which Japan had dropped off the radar screens for all but the world's most committed value investors.

Many Japanese companies have been prevented by the strong yen from being competitive internationally. A weaker yen should help bring them back from obscurity and highlight their many strengths. Similarly, pumping money into domestic infrastructure projects will create new jobs and opportunities which could add around 1% to the nation's GDP. Abenomics may well involve an increase in Japan's debt burden, but it may also be the key to economic revival.

Reasons for Optimism 3 – Fundamentals & M&A

During 2013 we hope to see a broader focus on fundamentals in the stock market, leading to more discerning stock-picking behaviour and thus a focus on classic value metrics.

Any increase in M&A activity tends to amplify this, in a virtuous circle effect whereby increased levels of actual takeovers draw more attention to corporate valuations in general. There is still a great deal of corporate and private equity money sitting on the side-lines, earmarked for M&A. During 2012, whilst there were reasonable numbers of M&A deals in the US and Japan, activity in Europe fell off, to around the low levels seen in 2009. Thus the region's stock markets did not benefit from the 'dose of

reality' that takeover transactions can bring to corporate valuations.

Nevertheless, we still saw three companies leaving Global Value Fund as a result of takeover bids. They were Benetton, Guyenne et Gascogne and Douglas. This gives us confidence that our portfolio is well-positioned to benefit from future increases in takeover activity.

Dedicated Followers of Value

Although we can buy heavily into specific areas while shares are cheap and promising, we are not permanently committed to any region or sector. Our only commitment is the hunt for value in individual companies and here we have ideas in all markets. Indeed, during the recent fall in the US market on the back of political concerns, some companies saw their share prices fall by 40-50%. This is the kind of scenario that can place more US companies back on our value radar screen.

But at the end of the day we should remember this. Buying shares means buying participation in the future earnings of a company. In a global marketplace, it matters less and less where that company is based and more and more how astutely it adapts to change and deploys its assets. The objective of running a company is to create profit and that profit is what translates into jobs and economic growth. Mature businesses with consistent track records of profit delivery over complete economic cycles should never be written off during short-term downturns. Yes, their assets can become temporarily undervalued but as long as their business models remain intact, their products or services relevant and their production capacity flexible, we know that there is scope for them to deliver future profits.

At Sparinvest, we have never wavered from our simple view that successful investment is all about buying quality companies at the right price – regardless of what others are doing and where. Every time the market has to deal with a new unknown quantity, be it new technology in the 1990's or the on-going credit crisis that began in 2008, it can become temporarily price inefficient, creating pain, but also buying opportunities for bargain hunters like us.

Conclusion

For the greater part of 2012 it felt as though we were trekking across a desert with virtually no signs of life. But, much like camels, value investors are a hardy and stubborn breed, often seeming to have minds and

agendas all of their own. The brief reminder during January and February that markets do return to fundamentals was enough to sustain us until mid-November when we reached another oasis – one where markets seemed to remember that global market menus offered more choice for risk appetites than the repetitive diet of the US or blue chip defensives.

Our expectation for 2013 is that investors' risk appetites will gradually return and become more discerning, lifting global stock markets generally. We can also hope that increased stock picking, supported by M&A activity, will prompt a renewed focus on fundamentals, benefiting our classic value style.

Yours faithfully,

Jens Moestrup Rasmussen
Chief Portfolio Manager
18 January 2012



Sparinvest Value Team

Upper row, from left to right:

David Orr
Senior Portfolio Manager
Lisbeth Søgaard Nielsen
Portfolio Manager
Jeroen Bresser
Portfolio Manager
Per Kronborg Jensen
Senior Portfolio Manager
Morten Rønnow Tandrup
Equity Analyst

Bottom row, from left to right:

Karsten Løngaard
Senior Portfolio Manager
Jens Moestrup Rasmussen
Team Leader / Chief Portfolio Manager
Trine Uggerhøj
Portfolio Manager
Kasper Billy Jacobsen
Chief Portfolio Manager

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