Letter to Shareholders – Value Bonds

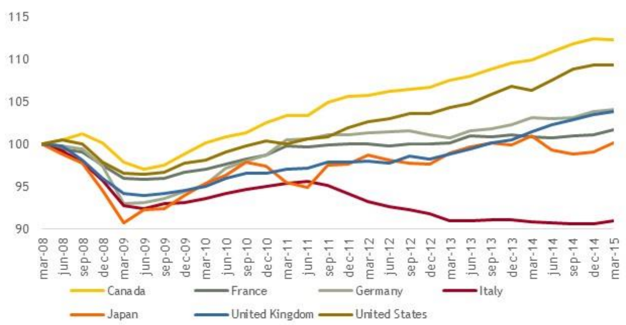
Q2 2015

Dear Investor

In the second quarter of 2015, the global growth picture continued to be mixed, but most developed economies appear to be on positive trajectories.

Markets

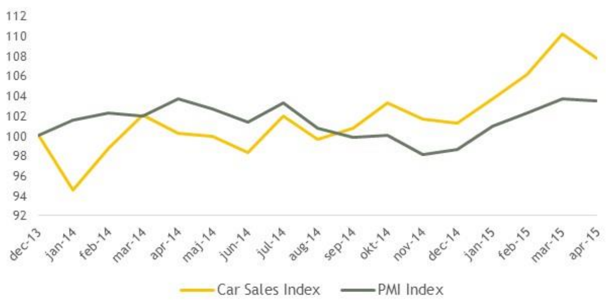
Real GDP Growth since Global Financial Crisis



At the time of writing, European leaders were scrambling to find a solution to the looming Greek default. After months of playing hardball, Greek political leaders finally seemed to realize that a default and subsequent 'Grexit' would be much more damaging to the Greek economy than adopting further fiscal reforms and staying in the Euro. However, it should be noted that the agreement reached is likely to be yet another compromise and not a long-term sustainable or stable solution. Implementation risks will be high and Greek political instability is likely to increase, given that the government will have to renege on several electoral promises in order to placate the country's main creditors (IMF and EU), on which it will remain dependent for the next decade.

Greece only represents a fraction of the vast Eurozone economy, but the debt crisis issue has overshadowed the fact that European key economic data have started to show an improvement in Eurozone growth after years of recession. Car sales and Euro area PMIs are generally improving and other confidence indicators are improving as well. However, the economic turn-around is still in its infancy and confidence indicators are inherently dependent on economic and political stability. That is why a Greek meltdown, driven by a deposit run on Greek banks, a collapse of the country's financial system and subsequent exit from the EURO, would be very damaging and could potentially push the Eurozone back into recession.

European Car Sales Index and Eurozone PMI



German Government Bond Yields

The ECB continued its QE program throughout Q2 2015 and 10-year German yields hit a record low of 0.07% in mid-April.

The release of inflation data mid-April, indicating that the risk of deflation was quickly evaporating, reminded all fixed-income investors that markets can turn on a plate. German 10-year yields skyrocketed to 0.75% in less than 3 weeks, corresponding to a loss of about 10 points on a German 10-year government bond. Further sell-offs pushed yields up to 1% mid-June and thus a 'safe haven' asset class suddenly provided conservative investors with marked-to-market losses of 10-15% on their long duration portfolios.

10 year German Yield

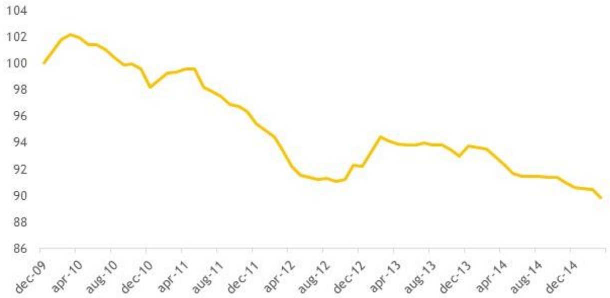
In the United States, economic data were surprisingly weak for the first 4 months of the year. The Federal Reserve's chairperson, Janet Yellen, attributed this to 'seasonal effects' and stated that the Fed would like to see 'decisive evidence that a moderate pace of economic growth will be sustained' before gradually starting to normalize monetary policy. In other words, with GDP growth heading for 2.5% in Q2-Q4, continued improvements in the labour markets and inflation moving back to the Fed's comfort zone of 2%, one to two interest rate hikes are very likely after summer.

China News

Chinese data continued to disappoint in Q2 and the Chinese central bank cut the RRR rate twice. It should be noted that reduced monetary policy rates do not compensate for the dramatic drop-off in lending that has been experienced in China in recent years.

China's mining, construction and real estate sectors continue to contract and further fiscal reforms are needed in order to mitigate this. The severe property downturn in China has had a profound impact on emerging markets and commodity prices over the past two years, and there are risks that a continued downshift in the Chinese economy will lead to a longer-term decline in the world's second largest economy for foreign industrial imports (capital goods) such as machinery.

China Real Estate Climate

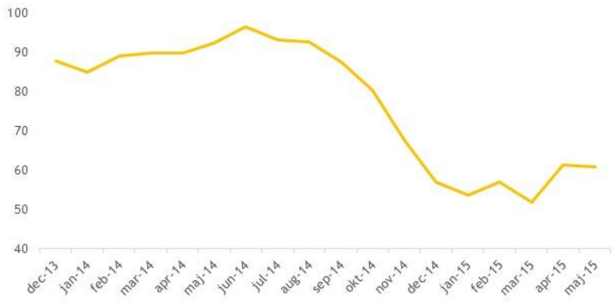


High Yield Strategies

The HYVB fund delivered an attractive return for Q2 2015 of 2.88% vs benchmark of 0.44%. But a return of -1.44% against benchmark 3.04% for the first half of 2015 is disappointing, and the fund continues to underperform due to backlog effects of last year's allocation to the energy sector. Oil prices have rebounded somewhat from last autumn's dramatic sell-off, but the sector is still adversely affected from a credit perspective, with bank lending to the energy sector having been largely shut down early in 2015. Over the past few years, many smaller- and mid-sized energy companies that have issued expensive HY bonds in order to finance their balance sheets, have relied on their ability to refinance these 'expensive' bonds with cheaper bank debt in a USD 100+/bbl price environment. With oil prices now in a USD 55-65/bbl price environment, bank financing is no longer available and several issuers now face refinancing risk in the HY bond market at maturity, with significant higher cost-of-capital likely.

Many of the world's oil majors have also cut the capital expenditure dramatically – up to about USD 35 billion in Q1 – further contributing to a downbeat outlook for many of the fund's investments in smaller- and mid-sized HY issuers. As such, a number of restructurings have taken place in the fund the past 9 months leading to market-to-market losses, contributing to the fund's underperformance.

Oil



Investors should note, however, that despite the short-term losses, the restructurings have resulted in issuers with smaller debt burdens, and the fund's portfolio managers have sought to create significant optionality for an attractive performance upside by partially converting debt to equity in some cases.

The fund's allocation to the financial and industrial sectors have created attractive returns in the fund for the first half of 2015 and with a duration shorter than benchmark and a yield-to-worst of +8% compared to the 6% of benchmark, the fund is positioned for attractive returns for H2 2015.

Maturity Products

The performances of Sparinvest's maturity strategies diverge somewhat. This is due in part to the various timings of their launches as well as to their sectoral allocations. None of the funds has been - or will be - affected by the significant volatility particularly in long-term interest rates, as the strategies are all short duration in nature.

The 2017 strategy continues to underperform somewhat, due to the large allocation to the energy sector and the fund's performance is solely attributable to the refinancing risk currently priced in in the fund's investments in smaller- and medium-sized energy companies.

The portfolio managers have sought to ameliorate this situation by actively engaging in dialogue with some of the issuers in order to minimize the impact of this refinancing risk. In some cases, restructurings are in progress and partial debt-to-equity conversions are expected. This may continue to cause some short-term volatility in the fund's performance throughout Q3 2015 but it is expected that significant upside to performance can be captured.

The HYVB 2018 strategy continues to outperform and the strategy is largely performing as expected with steady returns and low volatility. This strategy's energy exposure was capped at 20% at launch and the return volatility from this sector has been minimal. The strategy is on track to continue to deliver the expected returns of +4% p.a. after costs.

Sparinvest has launched a number of other 2018 maturity strategies this year where various mixes of Investment Grade and High Yield are used. These strategies are also performing in line with expectations and are expected to continue to deliver attractive absolute returns with low volatility.

Emerging Market Corporates (EMCORP)

This strategy experienced a satisfactory performance of 4.05% vs benchmark (3.48%) for the first half of 2015, despite some allocation to the energy sector. A low allocation to LATAM countries and financials along with overweights in the materials and industrial sectors contributed significantly to the fund's performance, as did the allocations particularly to bonds rated BB and B. The strategy's allocation to Russian corporate issuers in particular has generated attractive returns year to date, as the Russian bonds repriced to more 'normal' levels after the draconian sanctions imposed on Russia last year by the international community.

The strategy is poised to deliver attractive returns for the rest of 2015, as duration is lower than that of benchmark and expected yield-to-worst is at an attractive +8%.

Metrics	Fund	Benchmark
Duration	3.0	4.8
Yield	8.5	4.8
Rating	B+	BBB

Investment Grade strategy

The Investment Grade bond market has grown exponentially over the past few years. New issuance has been dominated by the need for financial institutions to strategically improve their balance sheets in order to adapt to the changes in the financial regulatory environment. Moreover, large corporate issuers have used the historically low interest rates to lock in long-term funding rates typically for 10+ years at attractive levels. This has led to a significant increase in duration (interest rate risk) on all major IG benchmarks where duration is now approaching 7.

When the world's major central banks initiated their various QE programs – all of which largely revolved around buying massive amounts of government bonds – many investors were forced to search for better yields and returns by migrating into the corporate credit asset classes. The effect was to drive massive portfolio shifts down the credit spectrum and into longer-duration securities such as Investment Grade. These investors received a major wake-up call as long-term yields started their rise in mid-April and investors realized that Investment Grade in particular harboured a lot of interest rate risk, as the slim credit premiums did not mitigate for the long duration.

The performance of Sparinvest's IG strategy was for Q2 2015 in line with benchmark (-2.68% vs -2.66%), and despite the volatility in long-term interest rates the strategy delivered 0.68% vs benchmark -0.55% for the first half of 2015.

Return	Fund	Benchmark
Year-to-Date	0.68%	-0.55%
1 Year	3.21%	1.64%
3 Years	11.97%	4.08%

Allocations to the financial sector continue to be a major part of the strategy, given that the financial sector accounts for roughly 40% of the total benchmark. However, Sparinvest continues to explore strategic and opportunistic allocations to various parts of the capital structure in major global financial institutions such as international banks. For example, allocations to legacy bonds have been especially effective in Q1 and Q2 2015.

As yields are expected to rise in the US and remain effectively capped in Europe due to the ECB's QE program, the strategy will continue to be overweight longer-dated EUR-denominated debt and underweighted accordingly in USD-denominated debt. Moreover, the significant underweight – especially to the telecom industry will be maintained due to tight credit spreads, as well as some technological and capital expenditure risk in the medium to long term. Apart from this, the strategy will largely remain invested as it is at present, with significant exposure to the BBB and A segments, in order to capitalize on attractive spreads in a benevolent business cycle.

Metrics	Fund	Benchmark
Duration	5.3	6.2
Yield	4	2.8
Rating	BBB	A-

Concluding Remarks

The fall-out from more than five years of tighter regulation of the financial markets and financial institutions continues to build. The prevailing theme in global fixed-income markets continues to be liquidity (or lack thereof) and, with liquidity drying up, debt markets are becoming more volatile.

Years of easy monetary policy, where the world's largest central banks have been buying government bonds, have also added to the liquidity conundrum by reducing supply of government bonds. The major sell-off in April in long government bonds was a clear reminder that exaggerated volatility and potential dislocations are likely over the next year, as the Federal Reserve moves to tighten monetary policy by lifting the Fed. fund rate for the first time in almost 10 years.

Sparinvest's Value Bond strategies will continue to maximize returns by identifying and investing in smaller bond issues. But the portfolios will be more balanced from a liquidity perspective in order to minimize risks from crowded trades as well as reduce tracking error.

This edition concluded on 3 July 2015.

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

Signatory of:

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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.