Sparinvest

Letter to Shareholders Q1 | 12

Value Bonds

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Our Value Bond Funds

Fund	ISIN code
Corporate Value Bonds	LU0620744002
Emerging Markets Corporate Value Bonds	LU0519053697
Ethical High Yield Value Bonds	LU0473784196
High Yield Value Bonds	LU0232765429
Institutional Corporate Value Bonds	LU0760185370
Investment Grade Value Bonds	LU0264925727

Detailed information is available in the relevant Fund Update.

- sparinvest.eu

Dear Investor

Performance in Q1

Both in absolute terms and relative to their benchmarks our Value Bond funds enjoyed a very satisfactory start to the year.

By the end of last year, the European banking system was virtually frozen, with an obvious negative impact on the European markets in particular. But in December, the European Central Bank embarked on two rounds of its so called 'Long Term Refinancing Operations'. These operations had the desired effect (at least in the short term) of restoring confidence in Europe, unfreezing the system to a large degree and driving up bond prices on European corporate bonds and high yield bonds in particular.

Economics

We are cautiously optimistic about the outlook for the global economy. We believe that the global economy will keep growing, benefiting from pent-up demand associated with a gradual recovery of spending on durables and structures after the 'Great Recession' and stimulative monetary policy.

Emerging economies will continue to lead the global expansion with growth rates triple those in the advanced economies on average. Emerging markets should benefit from an easing of monetary policy during 2012 – following tightening of monetary policy during 2011. We don't expect a hard landing in China. In fact we believe that the Chinese economy hit a bottom around first quarter of this year. In terms of growth, we expect to see relative strength from Japan among the advanced economies as the country rebuilds following last year's earthquake.

Recent oil price increases have to a large extent been driven more by demand than supply factors – although the risks going forward are probably more supply related (Iran). We are, however, encouraged by some signs of the ramping up of Saudi production aimed at rebuilding global inventories. Even though we are highly over-weighted the Energy sector in both emerging and developed market high yield, we don't wish for a 'super spike' in the oil price, because such a spike could become very demand destructive with the potential of bringing about a new global recession.

Another sign of strengthening growth in Asia is the rising price of iron ore. This price strength is something that works in favour of our funds since we are overweight producers of iron ore. During Q1 2012 we took profit on bonds from the Italian bank Banca Intesa in our High Yield fund (from 4.5% of the fund down to 0.3%). We invested the proceeds in a producer of iron ore from Sweden.

We do see potential risks to the gradual recovery in the global economy. On the economic side, recession could persist in southern European countries as a result of too much austerity. The structural reforms undertaken in these economies will probably work in the medium term – but NOT short term! So these economies NEED a supportive central bank in this very difficult period of transition. The US economy also faces risks going forward, related to fiscal consolidation – although these risks probably won't 'get real' until the end of 2012. Under current law, US federal taxes are scheduled to rise and spending is to be cut by a combined total of 3.5% of GDP – in other words, the US has NOT started reducing budget deficits yet.

The risks facing the global economy are VERY visible in 'risk- free rates' – both the US 10-year rates and German 10-year rates are arguably too low given fundamentals-based models. In this regard we can't exclude a major sell-off in AAA/AA rated bonds once/if risk aversion subsides more meaningfully.

Default Trends and Outlook

The default rate for the global high yield market remains well below the 25-year average of 4.2%. The default rate was unchanged at 1.9% for March 2012. We don't expect the default rate to increase during the rest of 2012 and 2013. The reason for this is the continuing focus on debt reduction among companies and heavy refinancing activity during the past three years. If our view on default risk is correct, there is still considerable upside in the global high yield market, because the option-adjusted spread on global high yield is just under 7% – I.e. investors in the global high yield market are over-compensated for the risk of loss from defaults.

Another important reading in this respect is the number of rating upgrades compared to downgrades. For the fourth month in a row now, we have seen more upgrades. This, together with a still expanding global economy, bodes well for global corporate credit going forward.

Yours faithfully,

Klaus Blaabjerg
Lead Portfolio Manager
16 April 2012

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