



Investment Grade Value Bonds

Headlines

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- A three party game

Fund Facts

Strategy	Value Bonds
Risk	Medium
ISIN	LU0264925727
Share Class Currency	EUR
Fund Inception	2-Nov-2006
Fund Manager	Klaus Blaabjerg
Benchmark	Merrill Lynch Global Broad Market Corporate Index (EUR Hedged)
Morningstar Category	Euro Corporate Bond

- sparinvest.eu

Performance

2010 was a good year for investors in Sparinvest Investment Grade Value Bonds even though last quarter saw a small negative return of 0.42%. The return for 2010 was 17.56%, which was 10.22% higher than that of the benchmark and 13.19% higher than the average for the Morningstar peer group. The high return was generated by a high proportion of financials in the portfolio. Financial credit benefitted from an improvement in the macro economy and from proposed regulatory changes through Basel III. However, the fourth quarter saw volatility come back with a vengeance in the financial space. We comment further on that below.

Sparinvest Investment Grade Value Bonds & Index Return, in %	Q4 2010	YTD
Sparinvest Investment Grade Value Bonds	-0.42	17.56
Merrill Lynch Global Broad Market Corporate Index	-1.50	7.34

Why we pay attention to the euro-zone fiscal crisis

The financials are correlated with sovereign risk, as the European banks are built for a single currency zone, it would have a large impact on the banks if one of the euro-zone members defaulted or left.

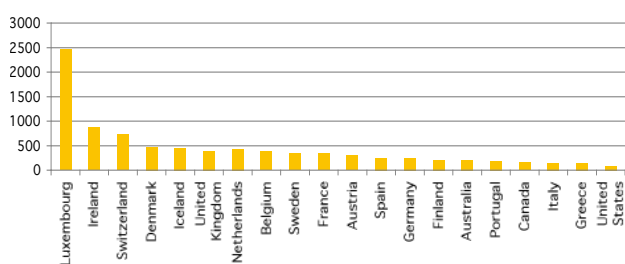
The new reality of a European currency area in which the risk of default varies from country to country means that banks must rethink their approach. Right now, banks do not need to carry buffers against the government bonds of a euro-zone country, be it Germany or Greece. And since any country's assets can be used as collateral when borrowing from the European Central Bank (ECB), and all countries are supposedly irrevocably tied to the same currency, the rule that a bank's assets and liabilities in a country should roughly match is discarded in the euro-zone system.

Banks can gather deposits from German banks and lend them out to consumers and companies on Europe's periphery. In doing this, the European banks have not needed to consider the country risk that is usually involved when taking credit risk.

However, the impact on banks of a collapse would depend on the quality of collateral, the solidity of the counterparties with whom hedges had been taken out, and whether local money had been used to fund loans. The most vulnerable banks would be those with simple cross-border loans funded by money raised at home. Many German banks seem to be in this position, as do some investment banks and some universal banks, such as Barclays; they have retail loans in peripheral Europe that exceed their deposits there. We have not been active in any German banks, but we are active in Royal Bank of Scotland (RBS). RBS had £62 billion (\$100 billion) of assets in its Irish and Northern Irish subsidiary at the end of 2009, equivalent to about 80% of its Tier 1 capital. However, its minimum exposure (its invested equity plus its net loans to its subsidiary) was £17 billion. In the event of devaluation, it could be easy for RBS partly to 'default' on their local debts by converting the local debt to the new currency. Meaning that, RBS could repay its Irish subsidiary's depositors and creditors in devalued Irish punts.

While some European banks are extra vulnerable because of this cross-border risk, the size of the European banking system is quite high compared to the size of the US, see the figure below, which makes the contagion risk even more vulnerable.

Banks assets as a percentage of GDP



Source: IMF

A three party game

In general a game with three parties is never easy. A game with three parties, each with a different agenda is even more difficult. In the euro-zone sovereign debt 'game' we have the three players: IMF, politicians and the financial markets.

The financial markets are nervous about the latest twist in the Euro crisis; the one triggered by inflexible German policies. But Germans themselves have plenty of reasons to be cross about the way the single currency is developing. Their country has been through a painful decade of wage restraint and cuts in government services. Many voters are outraged that their tax-euros might be used to finance early retirement for Greeks, or Ireland's super-low corporate tax. The immediate crisis in Ireland was triggered in October when Angela Merkel suggested, that in future euro crises private bondholders should bear more of the losses and that further European treaty changes were needed. Germany's action has, in turn, created political and financial pressures in 'bailout nations'. Germany should remember that its banking system is very exposed to the periphery countries. At the same time, the EU and IMF are using a lot of effort to agree on the form of the bailout packages.

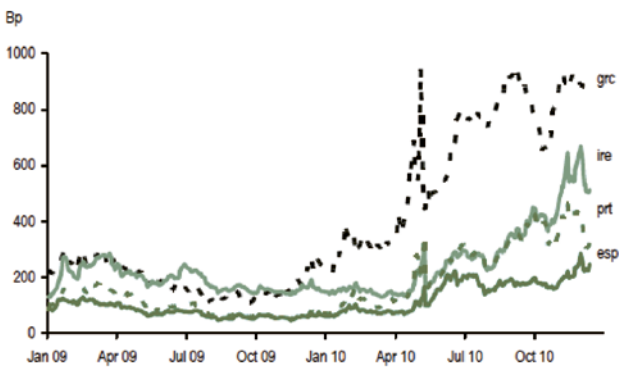
As we see from the table below, there are some huge financial needs across the world. Actually not just in the European periphery, but worldwide, an enormous refinancing of existing debt will take place over the next year. With the fragility of banks across the periphery region and the region's lack of credibility in international markets, a sustained source of official financing will be needed.

	2010			2011		
	Maturing Debt	Budget Deficit	Total Financing Need	Maturing Debt	Budget Deficit	Total Financing Need
Japan	43.4	9.6	53.0	48.9	8.9	57.8
United States	15.4	11.1	26.5	18.1	9.7	27.8
Italy	20.3	5.1	25.4	18.2	4.3	22.5
Ireland ²	6.5	31.9	38.4	6.1	11.8	17.9
Belgium	17.8	4.8	22.6	18.4	5.1	23.4
France	14.3	8.0	22.3	16.0	6.0	22.0
Spain	10.8	9.3	20.1	11.0	6.9	17.9
Portugal	11.6	7.3	18.9	15.5	5.2	20.7
Greece	10.3	7.9	18.2	16.5	7.3	23.8
Canada	13.1	4.9	18.0	13.3	2.9	16.2
United Kingdom	5.3	10.2	15.5	7.5	8.1	15.6
Germany	8.5	4.5	13.0	9.1	3.7	12.8
Finland	9.1	3.4	12.5	9.3	1.8	11.1
Sweden	4.1	2.2	6.3	4.5	1.4	5.9
Australia	1.5	4.6	6.1	2.0	2.5	4.5
Weighted Average	17.0	9.1	26.1	19.3	7.6	26.9

Source: IMF Fiscal Monitor Nov., 2010

Although the recent EU summit delivered an agreement on a change to the Lisbon Treaty to create a permanent crisis resolution mechanism, Europe’s leaders have not yet done enough to clarify the future of such an ‘EU liquidity hospital’. The failure to provide this clarification is a recipe for further market pressure to build in early 2011. There is a reasonable path to debt sustainability in Europe, but this path requires the periphery to deliver considerable fiscal consolidation, and will not prove successful unless sovereigns can enjoy a long period of liquidity support at subsidized borrowing costs from the financial markets.

Sovereign 10-year debt spread to German bonds



Source JP Morgan, Global Data Watch, December 2010

The periphery countries’ large deficits and debt rollovers are highly sensitive to borrowing rates, currently the

borrowing costs are too high to meet their obligations. The figure shows that the countries are borrowing at spreads that are considerably higher than Germany. The EU is providing liquidity support at around 350bp above where Germany can borrow. If this spread were cut by 100bp, the debt dynamics across the periphery would improve dramatically and solvency concerns would fade as fiscal conditions improved over the coming decade.

For more details, please visit Sparinvest.eu

Klaus Blaabjerg
Lead Portfolio Manager
12 January 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 Investment Grade Value Bonds available share classes	ISIN
EUR I	LU0264926378
EUR R	LU0264925727
EUR UKI	LU0264926535



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 fund invests in global listed corporate bonds issued by listed and private corporations. The company analysis is based on value principles, securing a high credit quality and subsequently better preservation of capital. Bond selection is also based on theoretically founded principles with emphasis put on default risk, not the potential return. The Sub-Fund invests in investment grade fixed income transferable securities that are rated from AA to BBB-. The currency exposure is partly hedge into EUR.

Risk indicator - 31-Dec-2010



Basic Information

ISIN	LU0264925727
Bloomberg	SINGVBR.LX
Share Class	EUR R
Fund Inception	02-Nov-2006
Share Class Currency	EUR
Income Type	Accumulating
Company name	Sparinvest S.A.
Domicile	Luxembourg
Share Class Inception	02-Nov-2006
Fund size (MN) - 31-Dec-2010	12.93 EUR
Manager	Sparinvest S.A.
Fund Manager	Klaus Blaabjerg
Fund Manager Start Date	02-Nov-2006
Benchmark ¹	Merrill Lynch Global Broad Market Corporate Index (EUR Hedged)
Morningstar Category ²	EUR Corporate Bond
Latest NAV - 31-Dec-2010	105.67 EUR
Subscription fee (up to)	2.00 %
Redemption fee (up to)	0.00 %
Management Fee	0.80 %
Total expense ratio - 31-Dec-2009	1.04 %

Returns - Month End, Dec-2010

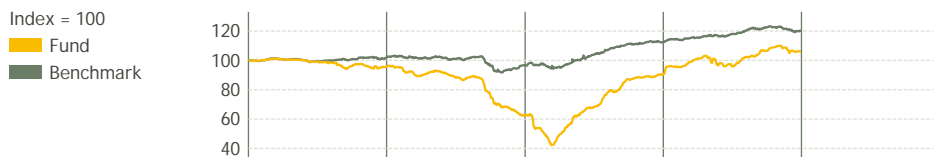
Returns	Fund	Benchmark ¹	Difference
YTD	17.56%	7.34%	10.21%
1 Month	0.98%	-0.53%	1.51%
3 Months	-0.42%	-1.50%	1.08%
1 Year	17.56%	7.34%	10.21%
3 y ann.	3.51%	5.83%	-2.32%
5 y ann.	-	4.17%	-

Risk 3 years - Month End, Dec-2010

Risk	Fund	Benchmark ¹	Morningstar ²
Volatility	23.43%	6.56%	6.72%
Sharpe R.	0.17	-	0.36
Info Ratio	0.01	-	-

Morningstar Rating™ **★**

Performance - 31-Dec-2010

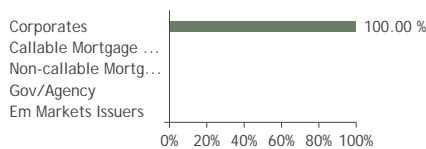


Returns	2007	2008	2009	2010	-
Fund	-4.06%	-34.79%	44.66%	17.56%	-
Benchmark	1.95%	-4.99%	16.22%	7.34%	-
Morningstar Category™	-1.39%	-7.68%	16.59%	4.37%	-

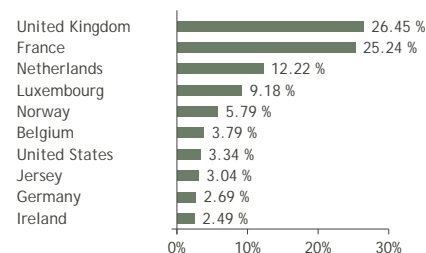
Asset Allocation

Holdings	Equities	Bonds	Other	Cash
39	0.0%	100.0%	0.0%	0.0%

Bond Type



Top 10 Countries



Portfolio (Top 10) - 31-Dec-2010

Name	Bond Type	Type	Country	Weight
Stalif 5.314% 04-Perp.	Corporates	Bonds	United Kingd...	6.84%
Bnpp 7.195% 07-Perp	Corporates	Bonds	France	5.63%
Aviva 5.9021%(Tv) 04-Perp.	Corporates	Bonds	United Kingd...	5.45%
Glencore Fin 7.5% 10-06.10.49	Corporates	Bonds	Luxembourg	5.32%
Eureko Bv 6% 06-...Perp.	Corporates	Bonds	Netherlands	4.69%
Axa 5.777% 06-Perp	Corporates	Bonds	France	4.16%
Elm Bv 5.252%(Frn) 06-Perp.	Corporates	Bonds	Netherlands	4.15%
Storebrd Liv.9.404%(Tv)08-Perp	Corporates	Bonds	Norway	4.14%
Fuerst Cap Frn 09-Perp	Corporates	Bonds	Luxembourg	3.85%
Ccbb 9.25% 09-Perp	Corporates	Bonds	France	3.85%

Bond Credit Quality

AAA	AA	A	BBB	BB	B and below	Not Rated	Effective Duration
0.0%	0.0%	4.0%	77.6%	8.7%	9.8%	0.0%	5.1

Notes:

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

Benchmark Comment

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