



Value Equities

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Our Value Equity Funds

Fund	ISIN code
Ethical Global Value	LU0362355355
European Value	LU0264920413
Global Small Cap Value	LU0264925131
Global Value	LU0138501191

Detailed information is available in the relevant Fund Update.

- sparinvest.eu

Dear Shareholder,

Successful long-term investment is about calm and balanced analysis of one's holdings and the wider investment universe.

We say this because over the last few years, it has sometimes felt as though the world jumps from crisis to crisis. In quick succession we saw first the sub-prime crisis, the Lehman shock, and concerns over Greek and other sovereign debt in Europe. Then, more recently, we have seen social and political unrest in the Middle East and North Africa, with the side effect of rising oil prices. March brought the tragic disaster in Japan. In this letter, we devote some space to this, not only because our global funds have a notable exposure to Japanese equities, but also because we think it demonstrates certain principles that are crucial to a successful investment process: the importance of calm instead of panic, and fundamental analysis instead of speculation.

Faced with a barrage of fearful headlines, it can be easy to focus on the negative. However, as long-term investors, it is vital to remain calmly analytical, and to retain a broad and balanced perspective – because this is what allows the generation of healthy investment returns over the longer term. And, importantly, from this perspective, we believe the outlook is bright. Simply put, there are a lot of negative headlines around the world at the moment, but this should not overshadow the overall picture we see in our holdings, which is clearly positive. We see healthy fundamental developments and attractive valuations, which we believe should drive strong returns over the coming years.

Recovery Continues

Considering the events mentioned above, it is perhaps understandable that after a fairly healthy 2010, equity markets had a relatively lacklustre start to 2011. The

performance of each of our funds is discussed in its individual fund update, but naturally the headwinds faced by the equity market as a whole had an effect on our funds also. However, let us place this within the broader context.

Looking at the markets in which we invest, economic indicators are, as ever, somewhat mixed – but are generally moving in the right direction. To pick a few, in the US we've seen continued improvement in retail sales and employment figures. Industrial production appears to be on the right track in both the US and Europe, where consumer prices are also rising. But, as always, let us stress that we are not top-down investors focussed primarily on macro-economic trends. Rather, we pay close attention to the companies in which we invest: their specific circumstances, earnings, and balance-sheet trends. Naturally each company has individual characteristics, but to paint in broad brushstrokes, we are seeing a continued recovery in revenues as demand gradually picks up, and this is clearly filtering down the income statement to generate stronger earnings at the bottom line. Shipping company A.P. Moeller-Maersk is one example. The underlying developments at a company like Maersk are various and complicated but, at a simple level, the bottom line makes a bold statement. After a sizeable net loss of USD 1.3 billion in 2009, Maersk ended 2010 with record high net income of USD 4.7 billion.

As we noted in the midst of the global financial crisis, recovery was never going to come easily or overnight, but it would come – and certainly at our holdings the overall picture today is of a gradual but continued recovery.

Valuation

Moreover, these companies are still attractively priced. We look at valuations in the individual fund updates, but as usual, we will use Sparinvest Global Value as an example here. The holdings are amalgamated into one theoretical company, to give a rough indication of the valuation. This company has a price-to-book of just 1.04 times, compared to 2.17 times for the MSCI World index. The balance sheet is healthy, with net-debt-to-equity of only 23% (versus 46% for the MSCI World index) and intangibles-to-equity of just 17% (versus 52% for the index).

The portfolio has strong operating leverage, and earnings-based multiples point to the expanding bottom line we discussed above. The price-to-earnings ratio is 16.1 times for the previous fiscal year, but this drops to 12.9 times Bloomberg estimates for 2011 earnings, and 10.8 times for 2012 (compared with 11.9 times for the MSCI World). EV/EBITDA, which is a useful indicator of the price of companies relative to their raw earnings power, is just

4.8 times 2012 Bloomberg estimates, compared with 6.5 times for the MSCI World.

The Earthquake in Japan

On 11 March, Northern Japan was struck by a major earthquake and subsequent tsunami. These caused widespread destruction, and the human cost is truly devastating. Our thoughts and condolences are with the Japanese people during this terrible time. We feel a deep respect for the calm and stoical manner in which the Japanese have responded to the disaster, and we share with them a conviction that the country and its people will recover.

There has, of course, been considerable concern over the damaged Fukushima nuclear power plant. Clearly, the situation is serious, and work to resolve it continues. We are certainly not nuclear experts. However, we have noted that – especially in the initial days – much of the media coverage has been highly speculative, with a tendency to increase panic, instead of being based on a sober assessment of facts.

This panic was also seen in the stock markets. In the days immediately following the earthquake, the Japanese equity market fell sharply: the Nikkei 225 stock index dropped almost 18% within three days. Sparinvest's global funds have around a 25% exposure to Japanese equities, and inevitably, the majority of our investments there saw sharp share price declines in those few days. However, based on available facts, these declines seemed out of proportion to the disaster's impact on the long-term health of those companies. Indeed, by 31 March, the Nikkei 225 had regained close to two-thirds of its initial decline, and many of our investments had seen sharp rebounds. We do not place much importance on short-term comparisons with market indices, but Sparinvest's Japanese holdings ended the quarter with marginally stronger performance than the wider Japanese market.

In any crisis, the biggest challenge for an investor is not to panic. One must distinguish between short-term market reactions and long-term fundamental impact. At Sparinvest, we do not make investment decisions on the basis of short-term speculation, nor do we let market movements tell us what to think. We remain analytical and focussed on the reality of the situation at the companies in which we invest. We question whether the share price movements are justified. We consider carefully whether any of the long-term assumptions behind the investment cases have changed, and whether the shares continue to offer a significant discount to the real worth of the company. If we believe the investment case has been compromised, we do not hesitate to act.

So, during recent weeks, we have been closely monitoring and reviewing our investments in Japan. For many companies, there is clearly some short-term impact. However, we have confirmed our initial impression that the long-term investment cases remain very much intact. Indeed, we think that our Japanese investments are particularly attractively valued, offering considerable potential. Below, we'll consider some general issues regarding the impact of the earthquake, but then look at how we have responded with regard to our holdings.

Some General Considerations

In terms of the wider economy, there will inevitably be a short-term negative impact, and economists' expectations for GDP growth in 2011 are being reduced somewhat. However, rebuilding will follow, and certainly this has led some to raise their estimates of Japan's GDP growth in 2012 and beyond. We won't engage in economic forecasting here, but let us briefly consider some general factors which might influence the scale of the impact, and the speed with which Japan is able to recover from this disaster.

When the earthquake struck, Japan had not been going through a period of corporate excess, with massive capital spending and inflated cost bases. On the contrary: Japanese companies have experienced a tough few years, with demand pushed down by the global financial crisis and with a strong yen hurting the exporters. The corporate sector has been holding back on investment, restructuring, and reducing its cost base to adapt to this tough environment. This certainly makes it better placed to deal with the current situation. Japan's corporate balance sheets are robust – as indeed are household finances – and Japan's private sector remains one of the world's biggest creditors.

Direct and Indirect Impacts

In terms of the direct impact on industry, it's important to consider Japan's geography. The most severe impact of the earthquake and tsunami was in the Tohoku region – the north east of Japan's main island. Roughly speaking, this region generates around 4% of Japan's GDP. It is not Japan's industrial heartland: that lies further south and west, with significant concentrations near major cities such as Tokyo, Nagoya, and Osaka. In addition, many Japanese companies have major overseas operations, generating a large proportion of their earnings.

There are, of course, indirect effects. The situation at the Fukushima nuclear plant means certain parts of Japan – basically Tokyo and further north-east – will experience scheduled power cuts for some time. This does imply that some factories will not be able to run with optimal efficiency. However, this is limited to certain regions, does not mean factories there must close altogether, and will

ultimately be resolved. Incidentally, we do not invest in Tokyo Electric Power, the utility company that owns the Fukushima plant.

A major consideration is disruption to the supply chain. Even companies which suffered no direct damage in the disaster may face shortages of certain components. This has been seen already, with various companies announcing reduced production volumes, or production halts, due to supply chain problems. Such problems certainly have an impact on earnings, and we should not be surprised if companies issue cautious earnings guidance. The Japanese fiscal year runs from April to March, and it is quite feasible that some companies will post weak earnings in the first half of the new fiscal year. However, it's vital not to become too focussed on the short term, but to consider instead the medium and long-term impact.

We think there are two crucial points here. The first is that supply chain problems are a global, not just a Japanese, phenomenon. We have previously commented that Japanese companies continue to have high global market share in components for a wide range of products, from cars to flat-screen televisions. So if Japanese component producers are temporarily unable to supply their products, there is a risk of disrupted production at companies around the world.

The second, and more reassuring point, is that a crisis on the supply side is very different from a crisis on the demand side. When demand drops sharply, as with the Lehman shock, one knows that demand will eventually recover – but it can be hard to predict and can take a long time. Until demand recovers, companies face lower sales volumes and lower prices for their products. In contrast, when there are supply disruptions, demand does not disappear, and product prices should not suffer as severely. People still want to buy cars, and once components are available, the cars will be built and sold. When considering the indirect impact of the earthquake on corporate earnings in Japan and elsewhere in the world, we think this distinction is crucial.

Japanese Exporters

For exporters, currency is important. After the earthquake, the Japanese yen initially strengthened sharply, reaching a record high against the US dollar. Among other factors, there was speculation that Japanese companies would buy the yen in large volumes, as they brought money home from overseas to pay for recovery. However, the Bank of Japan, in unison with all other G7 central banks, made it clear that they would counter such speculation, and intervene in currency markets to encourage stability and prevent excessive yen strength. By early April, the yen had weakened fairly significantly. Our last letter to shareholders discussed the impact of currency on our

funds, so we won't spend too much time here. However, we stress again that many Japanese exporters, including various Sparinvest holdings, have spent recent years adjusting their cost bases so that they can make healthy earnings even with a strong yen. Should the yen weaken, the potential boost to their earnings is significant.

Our Holdings in Japan

As ever, our main focus has been on what is actually happening at our individual investments. For each of our Japanese holdings, we sought to confirm employee safety, damage to facilities, and potential earnings impact. To the best of our knowledge, across all our holdings, no employees lost their lives in the disaster, and serious injuries have been very limited.

Several of our holdings do have facilities located in the Tohoku region, and some were damaged in the disaster. However, none of the companies are purely 'local' to the region. Most have national or global networks of production and sales sites, meaning that while certain sites may be temporarily closed, this must be considered in the context of a far wider network. Moreover, one should not underestimate the ability of Japanese companies to repair facilities and restart production with considerable speed: this is something we are seeing at all of our affected holdings.

An Example: Toyo Seikan

These issues are best illustrated by a concrete example of one of our holdings that suffered direct damage from the earthquake and tsunami. Toyo Seikan is a holding in certain of our global funds. It makes plastic, metal and glass packaging, such as drinks cans and bottles. In the days immediately after the earthquake, the company announced that it had suffered damage and halted production at 8 factories within the group.

However, these 8 factories must be placed in context. Toyo Seikan's group structure includes the parent company, and 64 subsidiary companies. The group serves a wide range of customers in various locations, so it has a diverse manufacturing base. The parent company alone has 16 plants across Japan. Many of the 64 subsidiaries have multiple operating locations. The group also has operations in China, Vietnam, Malaysia and Thailand.

Moreover, in early April, Toyo Seikan confirmed that at 7 of the 8 affected plants some production had either restarted already or was scheduled to restart by mid-April. Meanwhile, alternative production sites have been used to maintain the flow of products to customers. This is certainly not to say that the company is entirely unaffected. Naturally, short term earnings will suffer somewhat the production disruption. Meanwhile, repairing or renewing damaged facilities requires investment. However, consider the company's financial strength: Toyo Seikan enjoys a net cash position of JPY 93 billion (EUR 0.8bn),

equivalent to a third of its market capitalisation.

We continue to monitor the situation at Toyo Seikan closely. However, we anticipate that the effects of the disaster will prove to be relatively short term, and taken within the context of the company's wide production base and financial strength, we do not anticipate a significant change to its long-term earning power or intrinsic value. As a side note, from March 11th to March 15th, Toyo Seikan's share price dropped 28.5%. From March 16th to March 31st, the share price rose 36%.

The Insurance Sector

Our Japanese investments include exposure to the non-life insurance sector, through companies MS&AD, Tokio Marine, and NKSJ. One might intuitively assume that insurance companies would suffer greatly as a result of a major earthquake, but in practice, the individual claims burden faced by insurance companies is relatively limited. We won't go into too much detail here, but we'll briefly consider how Japan's earthquake insurance works.

Earthquake related damage, is not covered by standard insurance policies. A typical car insurance policy, for example, would not cover it. In corporate insurance, it is very much case-by-case, and depending on the individual contract, earthquake damage may be covered – but the Japanese insurers have taken out reinsurance to cover the bulk of the risk, considerably reducing their own direct burden.

Household insurance, again, does not include earthquake cover as standard. There is a special earthquake insurance scheme, set up by the government and insurance companies together, which makes it possible to buy earthquake cover as a special addition to the household policy. This additional cover has been bought in under half of all household insurance policies, meaning under 25% of households have earthquake cover. Moreover, the scheme is designed to limit significantly the risk for the individual insurance companies. The basic structure is that there is a cap placed on the total claims payable after an earthquake; within that cap, the vast majority of claims are paid by the government; and of the remainder, half is covered by reinsurance, and half is covered by the insurers themselves. (For those readers interested in a more detailed explanation, MS&AD Holdings have an FAQ, available at http://www.ms-ad-hd.com/en/ir/news/2010/0325_3/file.pdf).

Moreover, these insurance companies are extremely well-capitalised, with sizeable catastrophe reserves, and this financial health is even more robust after a recent round of industry consolidation. Considering the relatively low direct burden of risk carried by the companies, their financial strength, and their already low valuations, we consider that the non-life insurers offer considerable potential.

It is still only a few weeks since the earthquake struck, and above all, our thoughts lie with the people of Japan in what continue to be difficult and painful times. As investors, we are carefully and continually assessing our holdings and monitoring new developments to ensure that our portfolio offers a deep discount to intrinsic values and thereby, considerable potential for investment returns.

United Nations Principles for Responsible Investment

In December 2009, Sparinvest signed the United Nations Principles for Responsible Investment (UN PRI), which aim to encourage the financial industry towards more socially responsible investment. Key focuses are a greater integration of environmental, social, and corporate governance issues (often called 'ESG issues') into the investment process, and encouraging more active ownership by institutional investors.

There is sometimes a perception that such principles might be good for encouraging positive change in the world, but not particularly useful in achieving good investment performance. However, this is not how we see it. UN PRI calls for greater consideration of environmental, social and governance issues, but stresses that our primary duty is always to act in the best interests of our investors. So, we see UN PRI as a way to enhance our analysis of intrinsic value at our investments, and potentially to help generate investment value over the longer-term.

UN PRI and the Analytical Process

In our investment analysis, the overriding principle is to consider downside risk before upside potential. This means that for both new and existing investments the value equity team runs through companies with a fine-toothed comb, checking for any potential risk factors. Those factors inevitably include some environmental, social and governance (ESG) issues. An obvious example might be a company with a legacy of asbestos litigation. Without wishing to sound cold hearted, we look at such issues purely from an investment perspective: we are analysing the value of companies, and any risks to that value.

Within this context, UN PRI is an opportunity to enhance both the structure and depth of our analysis of ESG risk factors. A key factor is that, as part of the entire UN PRI movement, the sheer volume and quality of independent research into ESG issues has improved considerably. Our core fundamental research is always carried out in house, but to augment our ESG analysis, we have entered into an agreement with an internationally acknowledged research provider, offering up-to-date, in-depth research on these issues.

UN PRI and Active Ownership: Voting and Dialogue

UN PRI also includes a commitment to be active owners. Again, this is not new to Sparinvest. We have never hesitated to contact our investments in order to gain greater insight into fundamentals or to express our opinion on key issues. We have also exercised voting rights on behalf of our investors, on issues which we believe affect the long-term corporate value. Under UN PRI, this continues, but with a more systematic approach.

This means that as we continue our overall communication with holdings, we are implementing a focussed dialogue programme on ESG issues. In discussing any issue, our primary consideration is always long-term corporate value. On ESG issues, the aim is to encourage our holdings towards higher standards, because we believe that in the long-run, this enhances value, and can therefore contribute to higher long-term investment returns. We are not interested in dialogue for its own sake: rather, it should be dialogue with impact. We believe it must be a genuinely two-way, constructive dialogue, founded on mutual respect, because this garners the best results over the long-term. Moreover, we will not enter into a dialogue with every single holding on every single potential issue. Instead, we will focus on selected companies where we believe that results are possible.

Closely linked to this dialogue with impact, is voting. We are committed to actively exercising voting rights in holdings on behalf of our investors, again with the aim of securing the best long-term investment returns. In order to gain independent advice on voting decisions, we have an agreement with an external proxy advisory service – but the ultimate voting decisions are taken by the value equities team.

We believe that the implementation of UN PRI offers an excellent opportunity to formalise and enhance existing aspects of our investment process. It gives us greater insight into potential investment risk, as we bolster our analysis of environmental, social and governance risk factors. As we enter into closer dialogue with our holdings on such issues, and as we actively exercise our voting rights, we are convinced that we are placed well to exercise a positive influence on our holdings over the longer term, contributing to shareholder value, and thereby generating stronger long-term returns for our funds.

Conclusions

The tragic events in Japan, and unrest in the Middle East and North Africa, are certainly serious. However, as investors our response is the same as in any crisis. We always try to avoid unjustified optimism or pessimism, but instead keep focussed on facts and fundamental

conditions. In Japan, we own a diverse portfolio of companies with robust long-term business models and marked financial strength. We continue to monitor each company closely, but are confident that they will recover swiftly from the impact of the earthquake, and we believe their intrinsic value remains clearly undervalued. Indeed, valuations for the wider Japanese equity market look notably low. It's interesting to note that in the week following the earthquake, the Tokyo Stock Exchange saw a huge inflow of capital from overseas investors: in fact, close to JPY 1 trillion, the second highest weekly inflow on record.

Political unrest in the Middle East has pushed oil prices up sharply. For certain companies, this will mean some inflation of the cost base, but let's not forget that these companies are no strangers to the concept of oil above USD 100 and, in addition to the general cost-cutting of the past few years, many have been working to boost energy efficiency. Meanwhile, let's remember our portfolios have a reasonable exposure to the energy sector.

2010 was a strong year for equity markets in general,

and our funds in particular. 2011 has got off to a more difficult start, but we believe the overall outlook for equity investors remains positive. For our fund, potential drivers which we have discussed in earlier letters remain very much in play, and give considerable grounds for confidence. M&A activity continues to increase. Earnings are heading in the right direction. The companies trade at a significant discount to their intrinsic value. Our funds offer a wide margin of safety, and strong potential for healthy long-term investment performance.

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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.