



## Emerging Markets Corporate Value Bonds

### Headlines

- The impact of the current European debt crisis on Emerging Markets
- Companies are entering the crisis in a better shape!
- Value Bond investing in a volatile world
- EM corporate bonds look attractive at current levels
- Performance
- Valuation of the fund

### Fund Facts

Strategy	Value Bonds
Risk	Mellem (5)
ISIN	LU05195053697
Share Class Currency	EUR
Fund Inception	15-Sep-2010
Fund Manager	Toke Hjortshøj & Sune Højholt Jensen
Benchmark	JP Morgan Corporate Emerging Markets Bond Index Broad Diversified (EUR Hedged) (SPI)
Morningstar Category	Global Emerging Markets Bond

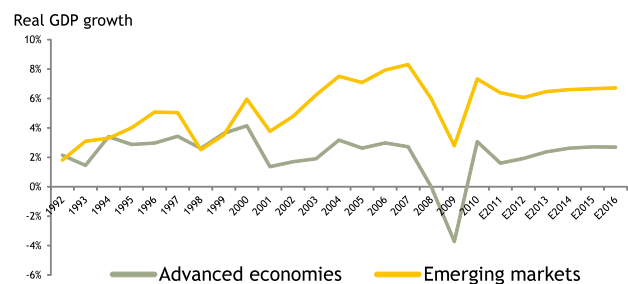
■ [sparinvest.eu](http://sparinvest.eu)

### The impact of the current European debt crisis on Emerging Markets

It all started in Europe – at least that is what many say about for the current financial crisis. But maybe the so-called ‘Eurozone’ crisis is just the symptom of a more widespread problem – the unbalanced government budgets among most developed countries. So it is not just Europe but also the major economies such as USA and Japan that need to address a way to cut government spending and a plan to start lowering government debt. That is not going to be easy with aging populations and exploding health-care costs.

The current economic crisis in the developed countries is undoubtedly having spillover effects on the emerging economies. But still, the economic forecasts continue to indicate solid growth in emerging markets.

Figure 1: Global GDP-growth (% annualized)



Source: The International Monetary Fund (IMF) World Economic Outlook Update, September 2011

Even the new powerful economic engine, China, anticipates economic slowdown next year – but still maintains a forecast growth rate of 6% to 8% in 2012. Such comparatively high growth rates make China and other major emerging market countries look very interesting for investors.

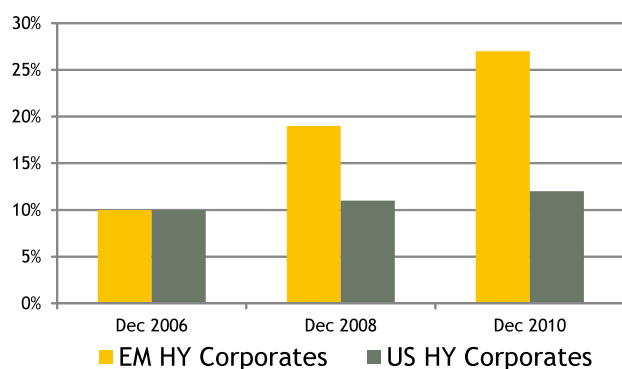
The current uncertainty is not in fact necessarily negative for credit investors. For more than a decade, emerging markets have been driving in the fast lane without even thinking about looking back. The result has been impressive – major growth, huge infrastructure investments and a fast-growing middle class. In China the consequences are increasing wages, decreasing labor force and loss of competitiveness. Indeed, many emerging market countries were faced with the possibility of their economies overheating during the spring.

The current economic slowdown may mitigate the loss of competitiveness and – more importantly from a credit investor's perspective – decrease companies' growth strategies, forcing them to put more focus on increasing profitability and deleveraging their balance sheets. It is important to stress, however, that emerging market companies are, on average, well capitalized and operate with high margins, putting them in a good position to handle lower economic growth in the coming years.

### Companies are entering the crisis in a better shape!

Lehman's default and the financial crisis in 2008/2009 suddenly changed managers' focus from increased risk taking to deleveraging, selling assets and retaining company profitability – all initiatives that lower credit risk. As the financial markets returned 'normality' and lending costs started to decrease, more and more companies slowly began to build up leverage, due to renewed focus on increasing market share and starting new investment programs. However, this new development was stopped in its tracks by the current crisis which will, without doubt, persuade companies to revert to creditor-friendly behaviour. In fact – corporate bonds tend to perform best in low growth periods with management acting more in favour of creditors than shareholders.

**Figure 2: Cash as a % of Total Debt**



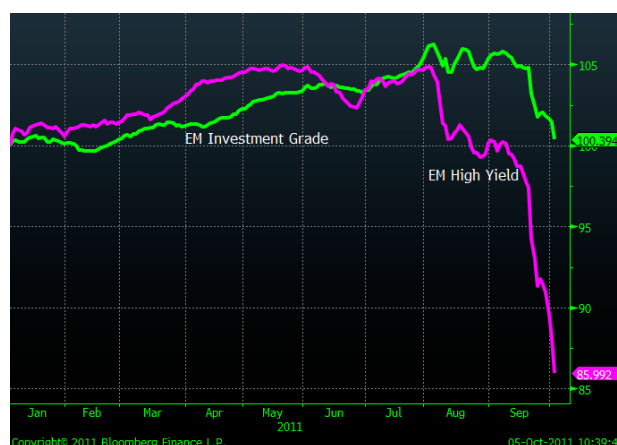
Source: BofA Merrill Lynch, August 25, 2011

Figure 2 shows that EM high yield companies have increased their cash holdings relative to total debt since December 2006. At the same time, the weighted average time to maturity on the outstanding debt has increased, especially since companies used the bull-market in 2010 to issue new bonds and buy-back near maturity bonds. Both factors lower the refinancing risk and increase the likelihood of companies buying back bonds trading well below par.

### Value Bond investing in a volatile world

The third quarter of 2011 has been one of the most volatile ever seen in the asset class – reminding investors of the period after Lehman's default. However, the difference is as already mentioned noticeable. Companies are entering phase two of this ongoing crisis in a better shape than in 2008/2009!

**Figure 3: EM investment grade and high yield index movements in 2011**



Source: Bloomberg and JP Morgan Emerging Markets Investment Grade and High Yield sub-indices of CEMBI broad diversified

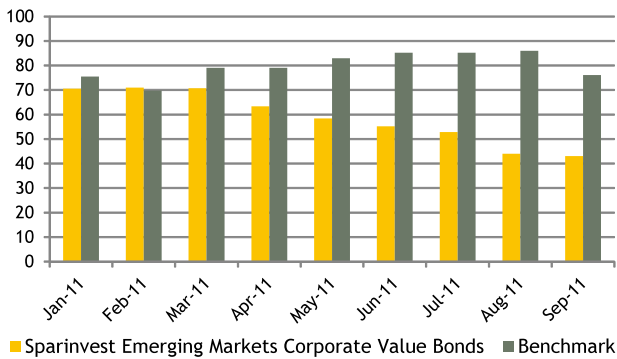
Sparinvest Emerging Markets Corporate Value Bonds has suffered from its overweight exposure to high yield bonds and the underweight to investment grade – a natural consequence of our value investment strategy. (We dislike bank capital in Emerging Markets because of significant loan growth relative to deposits, a booming property market in Brazil and China and general lack of transparency.)

As a result of recent panic corporate bonds are no longer priced in accordance with the fundamentals. In periods where bonds are very sensitive to buy or sell interests, we see large movements that have nothing to do with

the credit risk. The Value Bonds team maintains its focus on company fundamentals and finds increasing upside potential in the fund.

Net-debt-to-equity is one of the most important components of our Value Bonds Investment Process. The focus on low gearing lowers both the default risk and refinancing risk.

**Figure 4: Historical Net-Debt-to-Equity (%)**



Source: Sparinvest, JP Morgan and Bloomberg (excluding financials)

The team has lowered the gearing in the fund in 2011 and ended the quarter with a net-debt-to-equity ratio of 43% relative to the benchmark's 76%. Current high levels of cash on companies' balance sheets also increase the likelihood that they will buy-back bonds at low prices.

**EM corporate bonds look attractive at current levels**

Not only does the solid balance sheet with high cash holdings and low refinancing risk result in an expected default rate of only 2% to 3% in 2012. But close to USD 106 billion is expected to be paid in coupons and amortizations over the next 12 month to investors in emerging markets corporate bonds.

Bonds issued by Nord Gold are one example of bonds that are mispriced. The bonds are not within the JP Morgan benchmark and therefore less followed by analysts and other investors. Nord Gold is a subsidiary of OAO Severstal, one of the world's leading steel and mining companies. The fund owns bonds with a pledge on Nord Gold's most valuable gold mine that currently yields 13.4% on their 9.5% coupon paying bonds maturing in September 30, 2012. According to the loan documentation, the company cannot put any new debt in front of our bonds thereby limiting the credit risk in the bonds substantially.

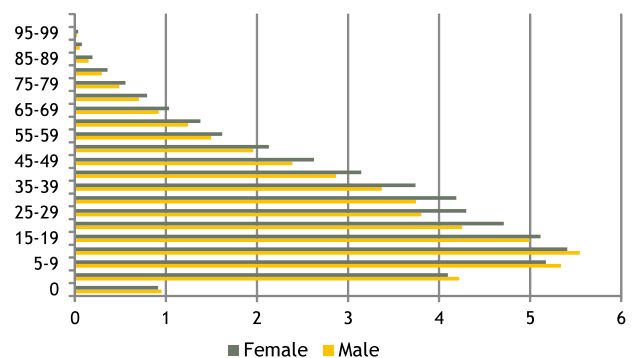
In the beginning of August, Sparinvest Value Bonds visited the homebuilder Urbi as part of a Mexican company conference.



Photo: Sparinvest Value Bonds, Portfolio Manager Toke Hjortshøj

Urbi is one of the leading homebuilders in Mexico specializing in the low-income market. The Mexican homebuilder sector is interesting because of the lack of supply of affordable homes to the rapidly increasing middle class. The Mexican government has recognized the structural challenge in fulfilling the need for more than a million homes every year over the coming decade.

**Figure 5: Mexican population demographics by age (population in mm)**



Source: United Nations and Mexican Statistics

The combination of the young Mexican population (see figure 5) and the competitive wage level explains why many US industrial companies have been moving production to Mexico. To solve the resulting housing problem, the government is working closely with the largest homebuilders by granting mortgage loans to the middle classes to finance their new homes. The fund owns the BB- rated 9.5% 2020 bonds priced at 95 and yielding 10.4%.

## Performance

The fund suffered from the increased risk aversion among investors and ended the third quarter of 2011 with a return of -10.49% relative to a return of -4.94% for the benchmark.

Sparinvest Emerging Markets Corporate Value Bonds & Index Return, in %	Q3 2011	YTD
Sparinvest Emerging Markets Corporate Value Bonds	-10.49	-6.00
Credit Suisse Emerging Markets Corporate Bond Index	-4.94	-1.38

The fund suffered from the overweight in high-yield bonds and underweight in financials. Figure 3 show that the underweight to investment-grade bonds explains a major part of the underperformance. The fund ended the quarter with a 6% exposure to China/Hong Kong, relative to a benchmark weight of 11%. During the last two weeks of September we saw a massive sell-off in Asian high-yield bonds regardless of the companies' fundamentals. Today bonds look very attractive in a number of industrials yielding more than 20%. China Automation Group is one example of the high potential in some of the Asian high-yield industrials. The company provides safety and critical control systems for the petrochemical, oil & gas, and railway industries in China. The company has a net-debt-to-equity of 6.33% and solid positive operating cash flow. Sparinvest Emerging Markets Corporate Value Bonds is invested in bonds issued by China Automation with 7.75% in coupons maturing in 2016. At September 30th, the bonds traded at 55 with the yield-to-worst of more than 24%. At these levels, we find bonds very attractive when issued by companies with solid balance sheets, very low debt burden, low refinancing risk and positive cash flow. We are comfortable with our investments in China and see high upside potentials in our holdings.

## Valuation of the fund

The fund is attractively priced with an effective yield of 11.56% compared to a 6.73% benchmark yield. The average credit rating is B+ relative to BBB for the benchmark and the average net-debt-to-equity is 43% relative to 76% for the benchmark. The fund ended the quarter with a spread level of 1018 basis points, pricing in a default rate substantially higher than the expected rate of 2% to 3%. On top of that, the bottom-up Value Bonds investment strategy lowers the default risk by focusing on the company fundamentals and strong bond documentation. Finally, with an average bond price of 86 we find the fund well positioned to make attractive long-term returns for our investors.

**Toke Hjortshøj** Portfolio Manager  
**Sune Højholt Jensen** Senior Portfolio Manager  
 11 October 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 Emerging Markets Corporate Value Bonds available share classes	ISIN
EUR I	LU0611996918
EUR R	LU0519053697
EUR RD	LU0611997213



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.

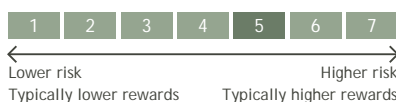
The mentioned sub-fund is part of Sparinvest SICAV, a Luxembourg-based, open-ended investment company. For further information we refer to the full and/or simplified prospectus and the current annual / semi-annual report of Sparinvest SICAV which can be obtained free of charge at the offices of Sparinvest 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 corporate bonds issued by companies located or with the bulk of their earnings in emerging markets. Emerging markets are defined as countries that are not classified as developed countries, according to MSCI - market classification. The investment universe includes investment grade bonds, high yield bonds and non-rated corporate bonds. The fund can be invested in bonds, issued in both local currency and hard currency.

## Risk and Reward Profile



## Basic Information

ISIN	LU0519053697
Bloomberg	SPEMCVR LX
Share Class	EUR R
Fund Inception	15-Sep-2010
Share Class Currency	EUR
Income Type	Accumulating
Company name	Sparinvest S.A.
Domicile	Luxembourg
Share Class Inception	15-Sep-2010
Fund size (MN) - 30-Sep-2011	100.70 EUR
Manager	Sparinvest Fondsmaeglerselskab A/S
Fund Manager	Toke Hjortshøj, Sune Højholt Jensen
Managed Since	15-Sep-2010
Benchmark <sup>1</sup>	JP Morgan Corporate Emerging Markets Bond Index Broad Diversified (EUR Hedged)(SPI)
Morningstar Category <sup>2</sup>	Global Emerging Markets Bond
Latest NAV - 30-Sep-2011	96.12 EUR
Subscription fee (up to)	2.00 %
Redemption fee (up to)	0.00 %
Management Fee	1.25 %
Total expense ratio - 31-Dec-2010	1.61 %

## Returns - Month End, Sep-2011

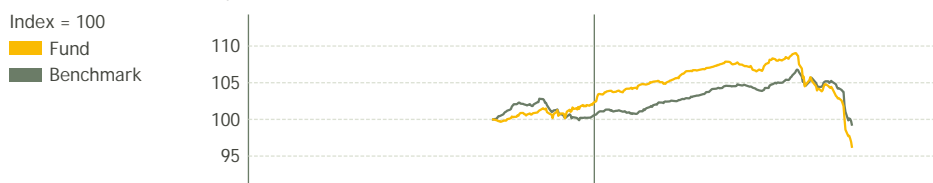
Returns	Fund	Benchmark <sup>1</sup>	Difference
YTD	-6.00%	-1.38%	-4.62%
1 Month	-7.97%	-5.58%	-2.38%
3 Months	-10.49%	-4.94%	-5.55%
1 Year	-3.72%	-1.91%	-1.81%
3 y ann.	-	8.84%	-
5 y ann.	-	5.10%	-
10 y ann.	-	-	-

## Risk 3 years - Month End, Sep-2011

Risk	Fund	Benchmark <sup>1</sup>	Morningstar <sup>2</sup>
Volatility	-	14.76%	13.81%
Sharpe R.	-	-	0.77
Info Ratio	-	-	-

Morningstar Rating™ —

## Performance - 30-Sep-2011

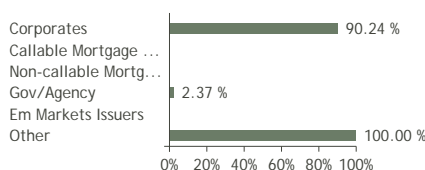


Returns	2010	09-2011
Fund	-	-6.00%
Benchmark	11.19%	-1.38%
Morningstar Category™	19.11%	-1.43%

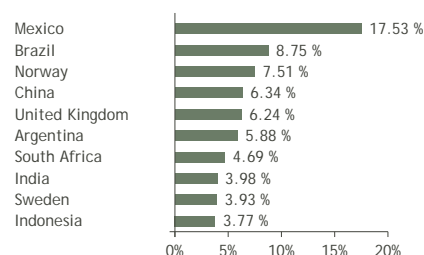
## Asset Allocation

Holdings	Equities	Bonds	Other	Cash
68	0.0%	100.0%	0.0%	0.0%

## Bond Type



## Top 10 Countries



## Portfolio (Top 10) - 30-Sep-2011

Name	Bond Type	Type	Country	Weight
Ferrexpo Fin 7.875% 11-7.4.16	Corporates	Bonds	United Kingd...	4.19%
Pso Finance 12% 10-06.10.15	Corporates	Bonds	Cayman Islands	3.44%
Mol Hu O&G 5.875% 10-20.4.17	Corporates	Bonds	Hungary	3.20%
Iplic Gmtn 5.875% 11-14.03.21	Corporates	Bonds	United Arab ...	3.07%
Vedanta Resou 8.75% 08-15.1.14	Corporates	Bonds	India	2.84%
Ddi Holding As 9.3% 06-19.1.12	Corporates	Bonds	Norway	2.79%
Dno Intl Frn 11-11.04.16	Corporates	Bonds	Norway	2.58%
Yuksel 9.5% 10-10.11.15 Regs	Corporates	Bonds	Turkey	2.56%
Br Escrow 8% 11-18.8.18 Pool	Corporates	Bonds	Chile	2.49%
China Auto 7.75% 11-20.04.16	Corporates	Bonds	China	2.48%

## Bond Credit Quality

AAA	AA	A	BBB	BB	B and below	Not Rated	Effective Duration
0.0%	3.0%	0.0%	8.5%	25.8%	46.2%	16.6%	4.3

## Notes:

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

## Benchmark Comment

Until 02/05-2011: Credit Suisse Emerging Markets Corporate Bond Index, hereafter the present.

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 selected currency, without consideration of subscription or redemption fees. For further information we refer to the prospectus and the current annual / semi-annual report of Sparinvest SICAV which can be obtained free of charge at the offices of Sparinvest S.A. or of appointed distributors. Investments are only made on the basis of these documents. Sources: Sparinvest S.A., Morningstar, Standard & Poors, Bloomberg, as of the dates indicated.