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OUTLOOK FOR 2015

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We start the year with a new broadening of monetary policy brought forth by the European Central Bank. In recent years we have seen how the central banks in Europe, the United Kingdom, the United States, and Japan have lowered their intervention rates–the official interest rates–to unexpected levels and then have continued with the so-called *quantitative easing*, an unconventional monetary policy tool. At a time when interest rates are already very low, central banks have to resort to the expansion of their balance sheets by printing currency. In Europe, the goal is to buy debt issued by member states in order to generate liquidity in the financial system and thus encourage risk taking, credit creation and the depreciation of the euro. In short, the European Central Bank wants to fight the risk of deflation that threatens economic recovery.

The gap between the evolution of risk markets (the stock, credit, and commodities markets) and the real economy continues to widen. Once again the financial markets anticipate that the liquidity injection from the European Central Bank will create anew an increase in the prices of financial assets similar to the one experienced in the United States. Equity and selling euros are the most favoured assets in front of a sovereign debt that has a low credit risk but does not reward investors enough.

Today nobody questions neither the valuations nor the fundamentals of companies. The interventionism of central banks is so massive that assets with attractive valuations and good growth prospects are scarce. Investors cannot find opportunities to generate appealing returns without accepting more risk of incurring losses. In economic terms, demand for financial assets with greater expected return exceeds supply and the price of these assets rises accordingly.

The divergence between market dynamics and the development of the economies and their companies should be balanced one way or another, either by a clear improvement of the economic situation, or by a market correction. In Europe, future economic growth must justify recent increases in the valuation of financial assets. The fundamentals of companies must improve through sales growth, higher margins and increased generation of cash flow. Otherwise, markets will tend to correct, as on previous occasions, the current high valuations either by an unexpected financial shock or by a change in the monetary policy that has dragged them up to their current level.

The European Central Bank has been the last to embark on quantitative easing just as the Federal Reserve has finished its own and starts sending the message that change in the monetary cycle is approaching.

We believe that the current distortion is going to end up in a market correction, driven either by an unexpected shock prompted by the recent fall in oil prices, the currency war, a greater deflation, or any other unforeseen factor, or by the start of an interest rate hike in the United States. Right now the market is focused on the intervention of central banks and does not take into account the accidents that may happen in the future.

During the last quarters we have been readying the portfolios for the correction we anticipate without ceasing to exploit market possibilities. We close 2014 with mean yields ranging from 6.5% in pure fixed income portfolios to 9.13% in equity portfolios. We start 2015 with a low exposure to the stock market, a good selection of fixed income issuers with predominantly short maturities, and an exposure to dollars and pounds to deal with the new cycle.