FIMARGE
your independent wealth managers

December 2015

WHERE IS THE RISK?

GUILLEM BIENERT
Portfolio Management Director
Fimarge SFI, SA

The interventionism of the European Central Bank (ECB) has continued to encourage the acceptance of higher risks to mitigate the ongoing environment of low interest rates. This current financial repression continues to generate an inefficient distribution of money, forcing investors to take higher risks at a time when money does not find how to generate value. The first beneficiary of this situation has been the stock market which, taking advantage of a significant flow of new money, has raised further its valuation ratios. Secondly the euro, which has depreciated against the dollar via further money printing intended to revive the European economy and to import inflation. Finally the interest rates, which have remained exceptionally low along the different sections of the curve.

The truth is that we have managed to identify this financial inflation and take advantage of it. We have invested in good companies, in their bonds or in their share, and, as it should not be otherwise, the rigor of the analysis has paid off. Furthermore, we have done it with some dollar or British pound exposure, taking advantage of the depreciation of the euro, and success has ensued. On November 30 the different portfolio yields vary from about 4.91% for the pure fixed income portfolio to 8.50% for the most enterprising ones, which have remained all year long below half the equity exposure they could reach.

Despite the interventionism of the ECB, it has generally been a transition year in terms of performance of the different asset classes.

In the case of bonds, current yields are still poor and, in some cases, negative. This is because sovereign rates have gone up a bit and the perception of risk of corporate issuers has brought down the price of their bonds. In other words, the market now asks issuers for higher interest rates because it perceives an increased default risk.

The stock market, although it had a surprisingly positive start in the first half of the year, has been losing steam in the second half. The sharp summer correction brought the indices into the red but recently the new interventionism of central banks has boosted positive returns again. The delay occurred in the tightening of US monetary policy and the promise of an even looser monetary policy from the ECB seem to ensure again an economic recovery that could justify current valuations.

Still, the performance of the stock market is no longer as positive as early this year or last year.

Where do we believe the risk stands? As we mentioned earlier this year, in order to normalize the interest rate environment the interventionism of central banks has to generate economic growth to validate current stock market valuations and reach the desired inflation target. This is precisely the risk that worries us: the current weak recovery that European and American economies are experiencing at a time when an exogenous shock can shatter the prevailing high investor optimism. There are many signs to think that way: falling commodity prices, a possible monetary tightening in the United States, inventory reductions because of a fall in demand, a decline in global trade due to the Asian slowdown, etc. If a drop in economic growth is confirmed next year, what we have to worry most about is our exposure to the stock market rather than the current environment of low interest rates.

What is our answer to this situation? We remain little invested in the stock market and we reduce the weight of those issuers that are more exposed to an economic slowdown. In this way we are positioned to increase the weight of US government bonds, which could bring us capital gains in an environment of slower growth, and we maintain a moderate exposure to the dollar.