FIMARGE
your independent wealth managers

January 2016

PATIENCE, PRUDENCE, AND DIVERSIFICATION

GUILLEM BIENERT
Portfolio Management Director
Fimarge SFI, SA

December has been very harsh on financial investors. European shares have fallen -5.3%, American shares -1.7%, and British shares -1.85%. The dollar has depreciated -2.8% against the euro and global bonds have fallen -1.45%. In this context, the European Central Banc has increased its prescribed amount of lax monetary policy and the Federal Reserve (Fed) has started the first interest rate hike since 2004.

We are in a new phase in the financial cycle. In the previous stage, the interventionism of central banks has been able to stabilize the evolution of their respective economies and generate the sought-after financial inflation. Now, in this new phase, we fear we will see a destabilization of the financial system stemming from a lack of economic growth, high valuations, and the new course of US monetary policy, divergent from European, Chinese, and Japanese ones. December can probably be a sign of things to come. Let's recall that interest rate hikes have always been followed by corrections in the GDP growth rate. Needless to say, the current growth rate is unusually low and, therefore, the risk of error is very high.

We think there is a chance the Fed may find along the year that the economic recovery is not strong enough, urging it to revise its current approach to go on hiking interest rates. Recent history shows the Fed is too optimistic in its growth forecasts. If this were the case, current stock markets valuation ratios would not be justified. It is true that forecasts or expectations about the economy are subjective, but valuations—the prices of assets—are objective to us.

Now more than ever, patience, prudence, and diversification shall prove their worth. During 2015 we have applied this approach and we have generated more liquidity in our portfolios in order to eschew what seems to us like an increasingly illiquid financial market. The various risk profiles in our portfolios have about 40% in liquidity, defined as money in current account plus bonds of moderate risk maturing in less than a year. What we have chiefly done during the first week of December has been to lower equity exposure still more. We now only keep a third of the acceptable equity risk and an 8-10% dollar exposure, after we also reduced it at the beginning of December, at around 1.0625.

We continue to maintain an exposure close to 10% to US Treasuries for lower risk profiles. The reason is that, on the one hand, they offer the liquidity we now value so much and, on the other hand, we know that in times of financial destabilization they will make us earn money while insuring the capital if we keep them to maturity.

In short, we maintain a structure of prudent portfolios that we have been building asset by asset, taking advantage of market inefficiency, buying them with a discount, and we wait for better market opportunities to incorporate new assets.