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HOW TO SURVIVE A BEAR MARKET

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In the last months we have explained why we think financial markets are in a transitional process that generates a higher volatility and will offer good investment opportunities. In these moments of uncertainty a tested method and analytical rigour make a difference.

The strong correction experienced in January upholds our conservative positioning while we look forward to implementing of a portfolio with a higher yield potential. We now think it is still too early to reduce our liquidity. As we feared, reality has dawned on financial markets: there is an important divergence between the negative evolution of corporate results, and the global economic slowdown it entails, and the high ratios prevailing in the markets. Corporate results are lagging and the fall of commodity prices, currency depreciation, and the Chinese downturn do not bode well for a quick recovery.

There is a clear risk that forecasts of corporate results will be revised downwards. If this is the case, the valuation of financial assets will suffer a correction. We fear a worse correction still if the liquidity the markets have become addicted to comes to an end. The Federal Reserve has given up the monetary illusion and, because of regulation, investment banks will no longer be able to rescue those investors deciding to mass sell in the worst moment.

When markets hint that the cycle may be reversing it is time to adapt the strategy of the portfolios. In my opinion these are the strategies that must be followed to face a bear market.

On the one hand, market exposure should be lowered. Few assets help to protect capital, although some do. Specifically, a high level of available cash must be retained, in order to be able to invest at the right time, and a low exposure to equity must be applied; a priority must also be given to credit risk rather than to equity risk.

On the other hand, increasing the portfolio's credit quality by way of incorporating US Treasuries is appropriate. In times of high risk aversion, the Treasuries are considered a haven which appreciates with the influx of new buyers. Today the ten-year offers a 1.85% return, much higher than the German Bund's 0.3%.

Reducing those positions that may have a lower appreciation potential, a lower liquidity, and, without doubt, a lower quality is also necessary. In the environment we expect, quality can only be found in companies with little debt, recurrent sales, and entry barriers. They will be able to better weather the storm. And let's not forget, in order to be protected, to insist on really attractive valuations: credit analysis and security selection are critical.

We are convinced that in the next months this un-optimistic scenario concerning the evolution of the global economy will be upheld and that we will see recurring downward revisions of quarterly corporate results. When the current divergence between the fundamentals of financial assets and their valuations disappears we will start to consider the inclusion of new assets.