

“You should invest in equities during recessionary phases”

Bestinver’s investment director says it is best to keep out of the market when there are no cheap stocks.

Last year Bestinver Bolsa and Bestifond were the only Spanish equity funds to make money, 8.25% and 9.17% respectively, in a year when the stock market index fell by more than 23%. And it wasn’t just a lucky year. Bestinver, which belongs to the Acciona group, has performed spectacularly on the Spanish market. The value of its Bestifond fund has risen by 467% since its launch in 1993, compared with the 188% rise in the value of the Madrid Stock Exchange General Index in the same period. Francisco García Paramés, investment director of Bestinver Gestión, explains the keys to this success and his vision of the market.

Question: What are the keys to your success?

Answer: We looked at what had been successful in other countries. US managers such as Peter Lynch or Warren Buffet had been doing things well for 25 years and we try to apply their management theories. All it involves is finding stocks that could be worth more than their share price. We calculate the value of the company and if it offers a discount to the market price we start buying. When the share reaches the target price we had set, we sell.

Q: But the market goes through stages of euphoria such as the boom at the start of the 90s. What do you do when prices are sky high?

A: When there is nothing available at a discount it is better not to invest. In 1998, for example, our fund reached 35% in liquidity. Everything was priced in and it wasn’t worth investing. At times of euphoria the same thing always happens: something comes along and ruins it. When the market reaches high P/Es, negative situations are created.

Q: When is the market cheap?

A: The historical average in the US markets shows that shares trade at 15 times their profits (P/E of 15x). Any market above 15x is expensive and, conversely, any below this figure is interesting. Our current portfolio stands at a P/E of between 9 and 10x. We buy shares when they reach these multiples. They have to be well-managed companies, good businesses and have a reliable management team.

Q: With this vision, what is the most difficult time to invest?

A: Our fund finds it difficult to make money at the peak of the stock market cycle. The stock market performance in 1999, for example, was out of the ordinary. At times of euphoria it is impossible to convince someone that they are taking a great risk and buying at high prices. You have to be in the market at times of recession.

Q: As I understand it, the key to success lies in good analysis of the company.

A: Establishing the value of a company is 95% of our work – though it goes without saying that management must be dynamic. The decision to buy a stock is taken as if we were going to buy the business. How much would someone pay to enter this business? It’s all a question of value and price.

Q: What analysis do you use?

A: We use fundamental analysis. We value companies according to discounted cash flow. The amount I put in and my return from the business in which I have invested. We do not use technical analysis. I switch on my computer at six in the evening.

Q: How important is macroeconomic analysis when making a decision?

A: It is much more difficult to talk about the macroeconomy than how a company is going to perform. In our analysis we look at the general context in which a company is operating, but it is more important for us to accurately value the company.

Q: How do you cope when something you have sold continues to rise or when there is no interest in a cheap stock?

A: The important thing is to remain patient. With some companies we wait seven or eight years until the market reflects their true value. Demand for these shares comes eventually. At some point the economic agents act when there is a large divergence between price and value. You need patience and steady nerves to know how to wait and to sell when the target price has been reached, even if the share price is continuing to rise. We think we are the only ones that do this in Spain.

Q: In your portfolio there are small and medium-sized stocks. What do they contribute?

A: We look for opportunities in stocks regardless of whether they are large or small. Small companies are no more problematic than larger ones. There are even advantages. Who is in a position to make a takeover bid for Telefónica? These operations are frequent with small and medium-sized companies though. There is a tendency to buy the big stocks when the market is booming because it is easier. Also, many funds are indexed and a vicious circle develops.

Q: With the exception of your funds, no others have made money. What's going on?

A: The major banks have difficulty performing this type of management as they move a lot of money and it's difficult to explain to the client. If you follow the market's trend you are not risking your job, as you have the market performance to fall back on. If you lose money with Telefónica along with everyone else, it doesn't matter. If you lose money with, for example, Mapfre, the fund manager's head is likely to give you the boot. This means that you accept the risk as a manager and, to an extent, put your job on the line every day.

Q: What risk do your funds take to achieve this return?

A: Based on objective data we are the most profitable fund and are among the funds with the least risk. The cheaper you buy, the less risk you face.

Q: Do you look for stocks with a high dividend yield?

A: Our current portfolio has a dividend yield of around 4%. But this yield is a consequence of the type of stocks in which we invest and not of our specifically seeking out such a return.

Q: How do you see the stock market in 2003?

A: We think the stock market is close to its valuation, as are the European and US exchanges. Prices have adjusted and are more reasonable. We do not expect the stock market to rise much, nor do we forecast significant falls. We are seeking companies with low gearing and which are not dependent on the economic cycle. We forecast 6% profit growth for listed companies, with some additional profit from strategic transactions on the market. We are therefore targeting a yield of between 8% and 12% from the fund this year taking little risk.

Small but powerful

Francisco García makes no secret of his investment preferences in what will be a difficult year. Never deviating from his philosophy of buying cheap companies which therefore have scope for upside, he is putting his faith in small and medium-sized companies in preference to the major stocks whose high multiples he regards as unattractive.

The size of the company isn't a fixed rule; he simply believes that most of the stocks that comprise the Ibox 35 are still not in the price ranges his management demands. In other years, however, this select group of stocks has fuelled the growth of the funds managed by Bestinver.

He doesn't like Telefónica or the banks and construction and real estate companies do not feature heavily in his portfolio. He is therefore banking on a very conservative portfolio with a very small cyclical component. Corporación Mapfre, Aldeasa, Auxiliar de Ferrocarriles (CAF), Aguas de Barcelona and Miquel y Costas. A selection based on sound management, a good price and a high dividend yield. Within the electricity sector he sees scope for upside in Endesa and Iberdrola, whilst Unión Fenosa is already trading above Bestinver's analysts' estimated target price.