

Francisco García Paramés: “The recession won’t ease until house prices come down”

Francisco García Paramés, “the Spanish Warren Buffett”, as he is sometimes styled, is Spain’s best-known, highest-performing fund manager; he has won high praise, but is no stranger to envy and criticism. Neither is he one to mince his words as an outspoken detractor of how Spain is handling the crisis; unlike the English-speaking countries, he says, we’re not facing the real difficulties head-on. Over the past 15 years Paramés has built up an unbeatable track record, ahead of all US equity funds over the same period. In 2008, however, he scored his worst year ever, with some Bestinvest funds taking losses of over 40%. But he’s kept faith with the value investment philosophy, moving into robust stocks when their market price looks cheap. And, in the present climate of pervasive gloom, he is upbeat about equities.

What stage of the crisis are we at?

Everything that’s happening now started with the US real estate market and over-borrowing. In the United States and in the UK, the property market is correcting at breakneck speed, because the Anglosaxon people tend to deal with their problems straight away. Prices have already come down by 50% in California and Florida, and Lennar, the United States’ largest real estate firm, is selling properties at an 85% discount. They’re closer to the end than to the beginning.

What about Spain?

We haven’t taken on board such steep price cuts because our culture is more like Japan’s: we would rather not take the bull by the horns. And the recession won’t ease till house prices come down. Even **Pedro Solbes**, the Spanish finance minister, has admitted that the crisis won’t end until prices drop by 30%. The trouble with such a sharp correction is that the banking system feels the pain. The banks have already taken the hit in other countries; the correction hasn’t happened here yet, but it needs to take place. What we don’t know is how it might affect the banks’ financial health.

Will Spain nationalise any of its banks? Should it leave the euro?

I’m not sure if there’s enough money to fund nationalisations. I think what is likely to happen is that France and Germany will end up bailing us out. Leaving the euro is a possibility, but I think it’s less practicable: we are too large of a country to leave the single currency, but still small enough to be bailed out.

What do you think of the steps the Government has taken to tackle the crisis?

They're irrelevant, because they're trying to prop up prices artificially at non-market levels. Solving a problem of over-borrowing with yet more borrowing is absurd. The key is for asset prices to come down to a reasonable level. Until that happens, public spending is useless, and later on you need to pay for it: it's a stopgap solution that will turn round and bite us later on. The good news is the increase in savings - long-term growth must be based on savings. The clearest example is China, where the rate of saving is close to 40% and people are highly debt-averse. Internal demand is making up for falling exports, with productivity rising 5 and 6%.

So what effects are all the stimulus packages going to have?

Governments are over-indebted, so the only way to make up the deficit is via inflation - printing more banknotes. The usual approach is to climb out of a crisis via inflation; that's why the most dangerous asset to hold right now is government bonds. However, I think it's inevitable that Spain will enter a deflationary phase, because there's no other way of getting past the crisis than by a downward adjustment of the factors of production, land and wages.

What is your view of the market?

I'm fairly upbeat about it. After 2008, the stock market's worst year since 1931, one would expect a good year, though not a historic best. We swim against the current at Bestinvest: we're bearish when everyone else is euphoric, and now that it's all doom and gloom, we're more positive. I think the downbeat views have been overplayed, and we need to come back to a midpoint.

Are share prices really all that attractive, given that corporate earnings are in freefall?

I'm not going to talk about Bank of America or Citi, because it's impossible to assess them with any certainty. But equities have taken a 40% correction precisely so as to fall in line with tumbling profits. The trouble is the banks; I'm optimistic about the rest. The stock markets' bearish cycle started in 1998, not 2008. Back then, the average price/earnings ratio was 20. Now, after 50% declines, we're on a price/earnings ratio of 8. So I don't see that the markets need to correct much farther. We're not in the situation of Japan in the 1990s, where the market had to come down from a price/earnings ratio of 70. We've never held as much cash on our portfolios as we did in 1998, nor have we ever made as many purchases as we're making now.

Well, the market needs to climb a long way for you to recoup your losses for 2008.

You're right. Last year, value investors did badly after six years of outperforming the market. Even Buffett lost 40%, and the stocks in his holding company are at the levels of ten years ago. But we did even worse in 1999, when we lost 10% and the market rose 11%. Exactly the opposite happened in 2000 to 2002 - we made a lot of money while everyone else was floundering. Now, even after lowering valuations for almost all the companies in our portfolio, the target value of the fund has risen 10%. The recession, except in one or two cases, has left our portfolio valuations intact, and that's what counts. The market always ends up recognising the value of a good company, so a good company on a price/earnings ratio of 3, for instance, is ripe for a

powerful rebound, crisis or no crisis. You just need to give it time, it's like a barely perceptible drizzle of rain.

But some people are very upset with Bestinver...

We simply ask our clients to be patient. Last year we had 20% redemptions, and a third of that was because people just needed the money, not because they had lost confidence. Personally, I think anyone deciding to sell then made a mistake. For example, a customer deciding to redeem €10,000 at Bestinver is in fact redeeming €35,000, because that's what his or her holding is really worth. That's the fact of the matter, and that's why we've seen only a few redemptions. Anyone who refuses to take that on board is better off investing elsewhere. A lot of people don't look at the value of something; they can only see the price. And some people are not really ready to invest in the stock market.

Right. But it's hard to understand why, after publicly predicting the downturn, you got burned so badly by it.

The reason for that was a massive liquidity problem, not an issue of fundamentals. People can't tell the difference between one and the other, and sell everything. So defensive assets fall just as much as non-defensive ones. When that happens, something isn't working right. People have sold at any price because they needed the money. But that also means we can now buy at bargain prices. The steeper the fall in valuations, the better.

Do you regret any of your investment decisions?

Yes, we were wrong about McClatchy, a US newspaper group. We underestimated the speed at which the media were going to shift from print to the web.

What are your top picks right now?

We are very keen on the Italian CIR group, controlled by Cofide, the Benedetti family holding company, and BMW, which is our main portfolio position because, as the world's fastest-growing car company, it is ridiculously cheap. In Spain, we like Alba: its participations are worth three times its market price.