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## Seeking investment opportunities in times of volatility

In financial markets, episodes of volatility driven by geopolitical noise or other risk events are often viewed as periods in which investors should exercise caution in their portfolios. However, from the perspective of an experienced asset manager, these same episodes can represent particularly attractive windows for alpha generation. Financial markets tend to overreact to news, amplifying the perceived impact well beyond any potential structural deterioration in fundamentals—creating price distortions that can be seized through a disciplined investment process.

Both academic literature and empirical evidence have extensively documented the role of behavioral biases in decision-making. During periods of uncertainty, fear often leads to indiscriminate selling, while in phases of calm or euphoria, overconfidence pushes valuations above reasonable levels. This cyclical behavior generates temporary inefficiencies. Daniel Kahneman, psychologist and Nobel laureate in Economics, described how instincts, beliefs, and biases shape human decisions. As a result, investors do not always act rationally, opening the door to opportunities for those who maintain a systematic and analytical approach—one that dynamically integrates and updates assumptions within their models, continuously adjusting scenarios and implied probabilities.

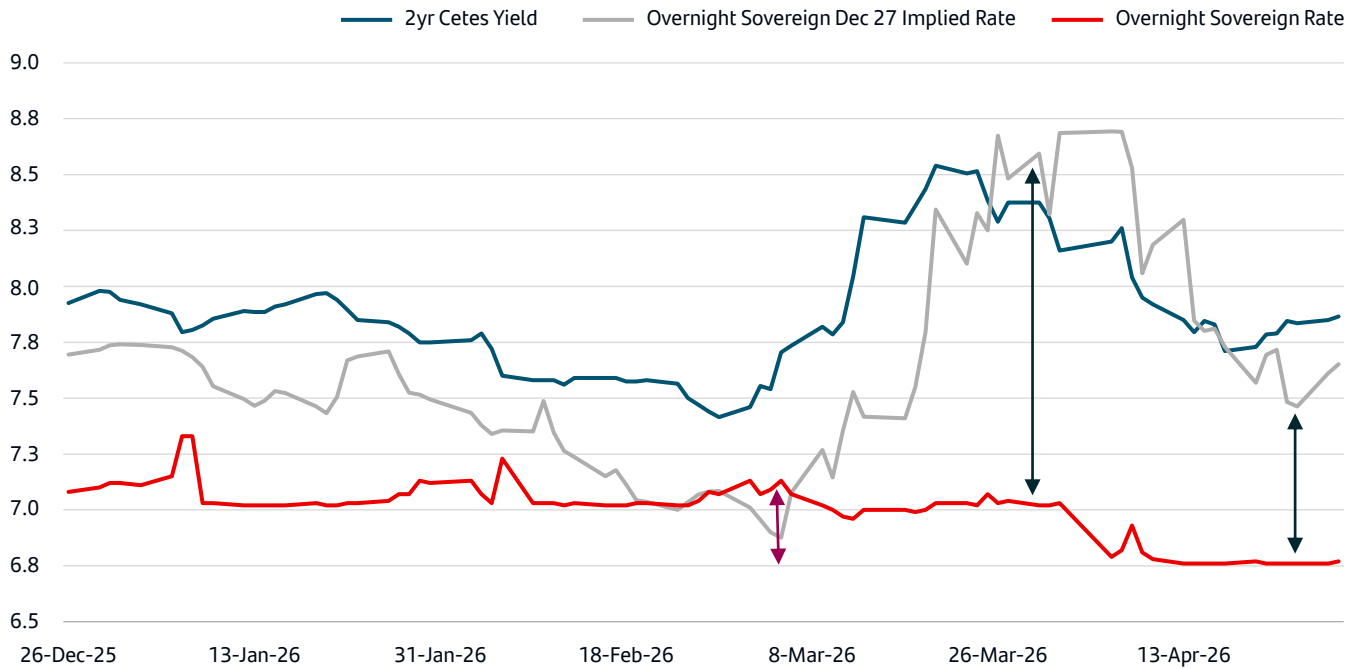
We can observe clear examples of these dynamics during events such as the Brexit referendum in 2016, the COVID-19 pandemic in 2020, presidential elections across multiple countries, and more recently, the escalation of the Middle East conflict between Iran, Israel, and the United States. In the latter case, Brent crude oil prices surged sharply, global equity indices suffered double-digit losses, and interest rates rose by more than 50 basis points across the curve within the first two to three weeks.

In the specific case of Mexico, losses observed in the fixed income space during March of 2026 reflected a sudden and aggressive shift in monetary policy expectations for Banxico. A clear example was the two-year CETE yield (zero-coupon Mexican government debt), which rose 68 basis points to 8.51% over a two-week period—effectively pricing in a central bank tightening cycle of 100 to 200 basis points in the near term (see graph 1). This scenario was hard to justify given the central bank's own press release pointing toward additional rate cuts, as well as a subdued GDP growth. For portfolio managers whose models already incorporated moderate economic growth in Mexico, relatively anchored inflation expectations (mainly due to public subsidies on gasoline that are normally implemented when oil prices rise), and a strong currency, such a restrictive policy path was not supported under any reasonable scenario. This created an investment opportunity with a high probability of success driven by short-term market distortions. In the following three weeks, the yield declined to 7.71%, generating an annualized return of approximately 30% and validating the investment thesis.



### Graph 1: 2-year Cetes Yield and Implied Risk Free Rate Dec27 based on TIEF Swaps

Source: SAM using Bloomberg data.



In risk assets, investment opportunities inherently involve higher uncertainty but are often compensated with greater expected returns when managers adhere to disciplined processes, continuously update their models, and avoid being influenced by market sentiment, biases, or prevailing narratives that are present on critical moments.

In 2024, the Mexican equity market declined by 14%, reaching a valuation of 10x forward earnings—a level observed only twice in the past twenty years. Not even during the peak of the global market Covid dislocation in 2020 did valuations fall to such levels. For a traditional investor influenced by herd behavior or market psychology, it was easy to justify avoiding exposure in Mexican Equities due to negative analyst sentiment, global trade risks, political concerns, and other pessimistic views on the country.

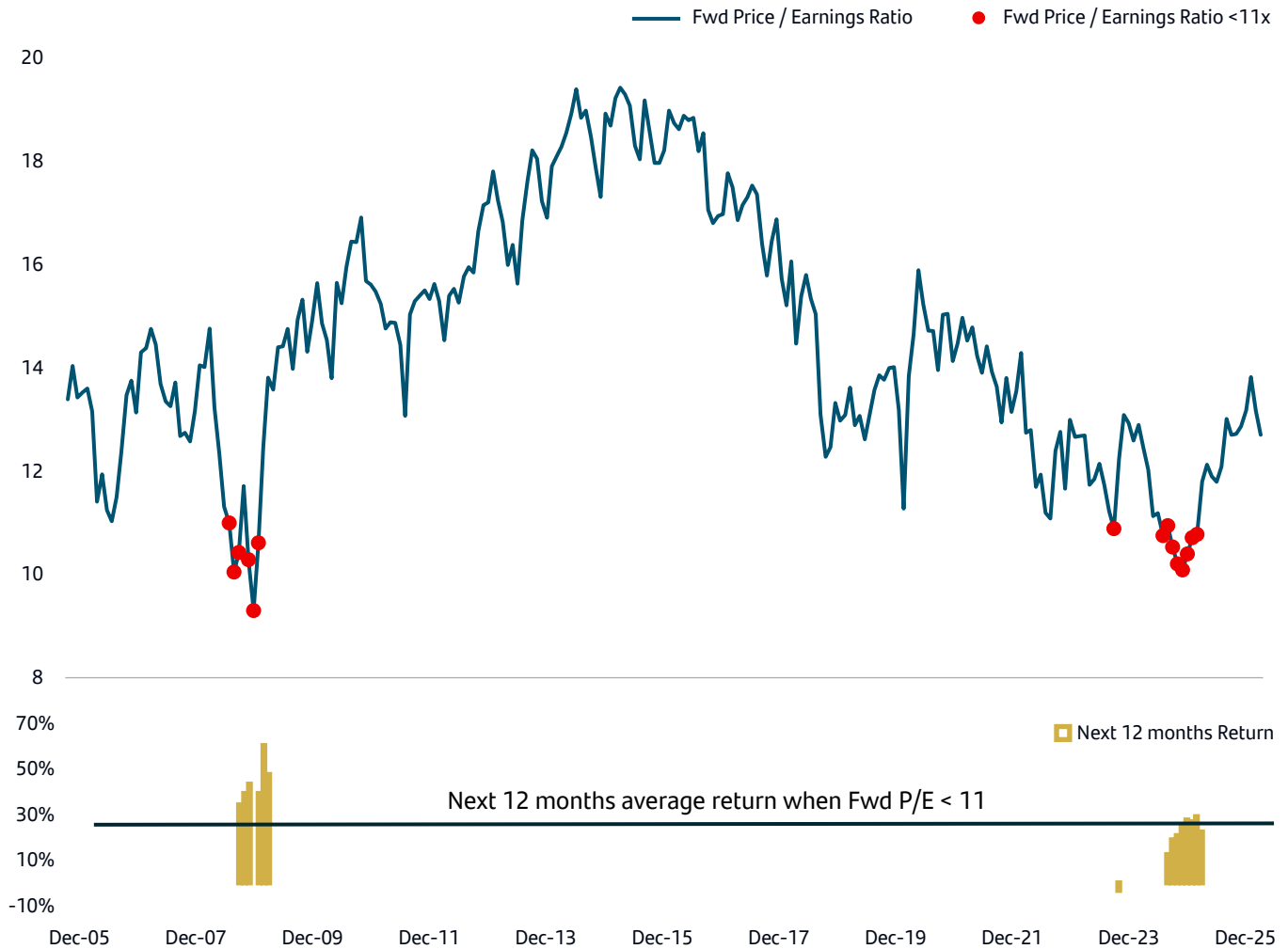
By contrast, an opportunity-driven investor would not ignore these risks but would also recognize the combination of depressed valuations, solid corporate earnings, high returns on equity, expected inflows from Afores (mandatory pension system) driven by the expected growth in assets under management, and historically low foreign ownership following five consecutive years of outflows.

Additionally, historical data show that over the past twenty years, when the market traded below 11x earnings, investors experienced gains during the following twelve months in all but one case (-3.3% loss) – see graph 2. The average return in such cases was approximately 30%, and excluding that negative observation, the worst outcome was a decent +12% gain. While the probability of success was not absolute, the odds were clearly skewed in favor of the investor. Over the subsequent twelve months, the market rebounded by 30%, correcting the pricing distortion.



## Graph 2: Mexican Equities Valuation and 12-month return when P/E ratio < 11x

Source: SAM using Bloomberg data



These past experiences illustrate how professional investors, through fundamental analysis and continuous scenario evaluation, seek to identify situations during market dislocations where the expected probability of success exceeds 50%. It is important to emphasize that this does not eliminate the possibility of error and subsequent losses. Even well-founded investment theses can be challenged by incorrect assumptions or unforeseen events. However, the key lies in diversification and in consistency of the investment process. Much like in baseball, where a strong batter does not need to succeed at every at-bat opportunity, a portfolio manager can achieve solid results by maintaining a favorable “batting average” over time. This is accomplished, among other things, by increasing position sizing when the analysis suggests a high probability of success and being prudent or more conservative when visibility is limited.

In conclusion, volatility should not be viewed solely as a threat, but as a potential source of opportunity when its origin or nature can be properly identified. When volatility is driven more by emotional factors than by structural changes or regime shifts, it tends to create temporary deviations between market price and “fair value.” For the patient and disciplined investor, these moments provide an opportunity to build positions with attractive risk-return profiles. The key lies in maintaining a robust investment process, recognizing market biases, and acting with conviction when probabilities are in one’s favor.

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