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LATIN AMERICA MACRO UPDATE

FOCUS ON FIXED INCOME

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MARKET OVERVIEW

The start of 2019 reinforced the dovishness of the Federal Reserve's (FED) message, ruling out rate hikes for 2019, with a significant impact on the market that is still very much positioned with less duration than their corresponding benchmarks. The 10 year US treasury yield printed a 2.41% level at the end of the quarter, highlighting value both at the Investment Grade and the High Yield subsectors of the credit universe and the search for yield returned.

One of the main themes affecting performance in the quarter was concerns over the fate of Brazil's pension reform. An ambitious project targeting BRL 1.2 billion in savings in 10 years was sent to congress on 20 February. Conversations began quite positively, but they went into a standstill when ex-President Michel Temer and ex-Minister Moreira Franco were arrested over an alleged Lava Jato involvement. The Brazilian Real was weak and volatile but managed to settle after reform conversations restarted.

Controversy around Pemex was the other theme that generated significant volatility in market prices. The rating agencies are reviewing the stand alone rating (without government support) and the foreign currency rating (with implied government support) due to concerns surrounding higher capex and a deviation from exports to local refining. The government reacted by earmarking the Oil Stabilization Fund as an eventual source of a capital injection if debt markets are reluctant to refinance Pemex's maturities. The adjustment on expectations and spending supported the rally in Pemex bonds, advancing 6% in the quarter (10 years benchmark).

LATIN AMERICA COMMODITIES

Commodities were strong, led by oil showing a significant comeback (WTI +29.31%, Brent +23.84%). The rally was sustained by resilient demand from India, China and Europe and, on the supply side, an agile adjustment on volumes by Saudi Arabia, the loss of Venezuelan exports

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and the expectations of less oil coming from Iran as some waivers on their sanctions expire.

Metals were less supported by fundamentals but China's acceleration on credit growth and the Fed's embrace of dovishness should help prices until the trade war between China and the US is settled. Gold and silver showed no direction while copper shined (+8.68%) and iron ore soared (+16.27%) on concerns about Vale's (world's largest iron ore producer, based in Brazil) ability to supply the market with more news about dams being suspended from operations on security concerns.

LATIN AMERICAN CURRENCIES

Latin American currencies had mixed returns. The Argentine Peso was again the main underperformer, sliding -13.05% against the USD in the quarter, on the back of disappointing inflation and low approval ratings for President Mauricio Macri who will likely seek re-election in October. Brazilian Real was very volatile during the quarter, appreciating 6% in January but selling-off all the way to 4 BRL/USD on Pension reform discussions (9.2% devaluation from the peak), to end up the quarter with just a -1% depreciation. Chile, Colombia, Mexico and Peru currencies were stable with minor advances. It is a bit puzzling that this new stance from the FED had a huge effect on interest rates but not on the US dollar, which remains well bid versus emerging markets (EM) and majors.

Primary markets are recovering but do not seem to be in a rush to tap the new inflows that the asset class is getting from investors. YTD, there has been more than USD 20 billion in inflows to EM (a bit less than 40% towards Latin America), while total issuance in the region (net for coupons, amortizations, calls and tenders) is almost flat.

Petrobras was the first that used the new demand for duration with USD 2.25 billion in a new 30 years issue priced at 6.9%. The ultra long end was also the target bucket for a new Hybrid (junior subordinated) from AES Gener (Chilean utility) with a 2079 maturity, callable after five years. Other new issues to highlight came from Brazilian pulp and paper producer Klabin, that returned to the market with a 2 tranche issue (USD 500MM each) on 10 years and 30 years, getting much more traction from investors interest on the latter.

MARKET OUTLOOK

The latest FED actions provided support to the markets, mainly to emerging market economies. Despite evidence of macroeconomic weakness in developed economies, central banks' strategies have limited the potential impact on their respective markets and economies. In our view, these actions should result in a weaker USD but recession fears are supporting it at current levels.

Trade discussions between the US and China continue to play a key role in Global Market conditions, with expectations of when these may conclude varying on an almost daily basis. A positive outcome would undoubtedly benefit Latin American countries but, even with potential headwinds, Chinese data has remained stringent. Business expectations and consumer confidence have improved in recent months, albeit on an expected positive outcome that now seems challenging, and were supportive of manufacturing indicators that came stronger than anticipated. Chinese authorities are planning tax cuts and other credit facilities to stabilise the economy, therefore we would expect Chinese economic indicators and markets to continue to be encouraging.

The Eurozone is also providing supportive conditions to global markets and economy as they are expected to maintain rates at zero percent for the foreseeable future and have reactivated Long Term Refinancing Operations (LTROs). That being said, macroeconomic weakness in the Eurozone will likely remain, with particular focus on Germany's manufacturing downtrend.

Focus for investors in Latin America will continue to be on the countries that provided most of the headlines in 2018. The success of Brazil's pension reform negotiations will determine how well credits will perform this year with early indications of optimism. In Mexico, all eyes will be on Pemex's credit strengthening strategies and the new administration's conviction to see out its election pledges. In Argentina, presidential election poll trends will add volatility to sovereign and credit markets, particularly if

President Mauricio Macri's approval ratings continue to disappoint on the down side and former president, Cristina Kirchner, is able to capture voters beyond what is considered her ceiling of support.

We believe that global macro factors will be the main drivers for emerging market credit for the remainder of the year, with standalone fundamentals and technical remaining relatively stable. After a strong performance YTD of the asset class, we believe there is further room for tightening but expect the rally to be more gradual. Primary markets are expected to remain active and the pipeline should continue to be strong.