

Latin America - Brazil & Argentina

January 2018



Fundamental research is at the core of our investment process. Our analysts are continually meeting with company management and attending roadshows in order to develop and maintain relationships with the companies in which we invest. They also make regular research trips to visit the companies which they cover.

Emerging market corporate debt is a US\$1.4 trillion dollar asset class, with debt issued by companies in over 60 emerging market (EM) countries globally. The sub-asset class is well diversified by sector and region and offers investors the chance to benefit from higher yields than similar-rated credits in developed markets, in an asset class with an average investment grade rating.

We talk to Marcos Räisänen following his research trip to Latin America.

How large is the Latin American segment of the corporate market? Are there any dominant sectors/regions?

In terms of issuers, Latin American corporates make up close to 30% of the global investment universe of emerging market corporate debt (within an issuer universe of around 850 companies). Issuers in Brazil and Mexico are the most numerous followed closely by Chile, Argentina and Peru.

Many of these countries have sizable oil and commodities deposits. As a result, oil & gas and metals & mining corporates tend to form a solid portion of these markets. Financials, consumer and pulp and paper sectors also form a notable presence.

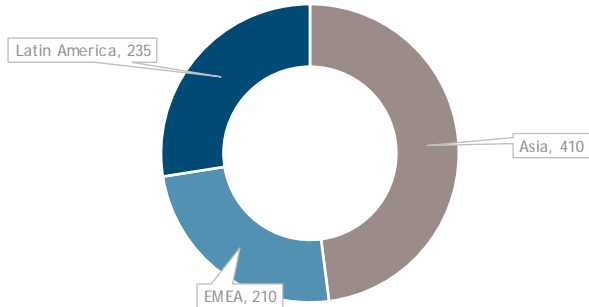
Brazil has been experiencing a number of political and economic headwinds for some time. Did your visit alter any preconceptions you had about the country?

I left Brazil more bullish than when I arrived. Fundamentally things seem to be better than expected with an increase in real wages and disinflation and other signs of economic improvement, in addition to better corporate earnings.

In terms of opportunities, we are finding candidates in the 'rising star' segment of the market, which are being driven by a pick up in earnings and domestic growth.

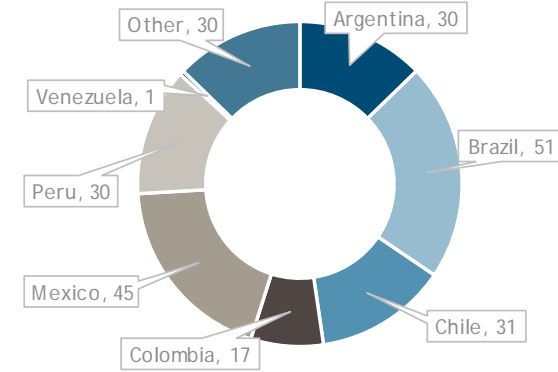
I think the expression that sums up my trip would be that I am now cautiously optimistic.

Fig. 1 EM Corporate Issuer Universe by Region



Source: ICE BofA Merrill Lynch, as at 29 December 2017

Fig. 2 Latin American Corporate Issuers by Country



Source: ICE BofA Merrill Lynch, as at 29 December 2017

Does this year's general election have an impact on your outlook for Brazilian corporates?

Yes. While I said I am cautiously optimistic I would caveat this statement because it very much depends upon the outcome of the presidential elections which could be a source of volatility.

While the country is starting to recover economically, further economic and fiscal reforms are still needed. If ex-president Lula or his Worker's Party is re-elected, then any progress the country has made towards reforms may be lost.

However, Lula is on trial for corruption (on the back of his alleged links with the Operation Car Wash scandal). Judgement by the appeals court will take place on 24 January. If convicted, it will significantly lessen the chances of him running for president. I believe this outcome will have a positive impact because election noise is likely to have a less pronounced effect on markets, so we may therefore see less volatility.

Which sectors do you believe offer investment potential in Brazil?

In my view, companies in areas such as transportation and logistics are already benefiting from the improving economic backdrop. For example, at one of the companies I visited, their light vehicle rental business was up 40% in 2017, a statistic which I found incredible and illustrated that things may be getting better faster than expected. I also see value in companies in the capital goods sectors; for example, car exports to other parts of Latin America are at their highest-ever levels.

I think exporters should also do well in any scenario, as they can benefit from a weaker currency as well as from a strong domestic market.

What was your main takeaway from your visit to Argentina? Is the country becoming a more attractive place to invest under President Macri?

I think the keyword that best describes my trip to Argentina was "gradual", in that I think everything should improve gradually. The locals I spoke to seemed to agree that this was the right approach taken by Macri in order to maintain some sort of political stability, while taking the actions necessary to fix the economy.

In a scenario of gradual improvement, Argentine paper appears to offer higher carry (and potentially lower volatility than for example Brazil) than in other markets. While improvements will take time, in my view they should continue to head in the right direction.

Are there any risks that you are particularly concerned about that could have a negative effect on Argentine corporates?

Overall, I do not see any specific risks affecting Argentine corporates in 2018. The current government's support strengthened following the legislative elections which will help them pass on reforms needed to put the country back on track. The only issue I would highlight is one where, in a worst-case scenario, the country is unable to fund itself - which would probably trigger a sell-off in corporates. However, in my view this is highly unlikely.

Which sectors do you believe are benefiting from the current environment?

The energy/electricity sector looks to be benefiting from the new government's policies aimed at stimulating investment, in light of the energy deficit in the country.

How have your findings shaped the way you look at opportunities in these two markets in the year ahead?

In 2018, I believe Argentinean corporates could appear attractive due to their ability to offer carry. Brazil however should be approached on a more opportunistic basis, especially as the elections and reform noise in Brazil may provide better entry points for Brazilian corporate paper.



Marcos Räisänen, Credit Analyst

Marcos joined Muzinich in 2012 and has over a decade of investment experience. His area of expertise is Latin America where his Brazilian-Argentinian heritage and understanding of the culture and language of the region makes him well placed to develop strong and in-depth relationships with the companies in his investment coverage.

Prior to joining Muzinich, Marcos was with Hermes Fund Managers, where he worked as a credit analyst within the Global Credit Team for three years. Previously, Marcos worked at Fortis Investments as a credit analyst within the Global Credit and Hybrids business. He earned a B.S. in Business Administration from the Helsinki School of Economics and an M.Sc. in Economics from the Swedish School of Economics.

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