Scotiabank’s wholesale business in Latin America is widely-diversified with large onshore execution capabilities, supplemented by offshore global operations, and established global industry specializations in Energy, Financial Institutions, Infrastructure, Power & Utilities, and Mining. Our team of over 35,000 employees throughout Latin America oversees established capital market operations and lending relationships as well as equity, fixed income, FX and economics research analysts throughout the region. For more information, please visit gbm.scotiabank.com and follow us on Twitter @ScotiabankGBM.

Scotiabank is Canada’s international bank and a leading financial services provider in the Americas. We are dedicated to helping our 25 million customers become better off through a broad range of advice, products and services, including personal and commercial banking, wealth management and private banking, corporate and investment banking, and capital markets. With a team of more than 96,000 employees and assets of $947 billion (as at July 31, 2018), Scotiabank trades on the Toronto Stock Exchange (TSX: BNS) and New York Stock Exchange (NYSE: BNS). For more information, please visit www.scotiabank.com and follow us on Twitter @ScotiabankViews.
Emerging markets have for many years been arguably the greatest engine of global growth, and now account for about half of global GDP – though still a much more modest proportion of global market capitalisation. While a large part of that has been driven by the emerging markets of Asia, and China in particular, Latin America has also very much played a strong part in the secular trend.

In recent years, as participants in this roundtable attested, the opportunity set in Latin America has been evolving impressively. Not long ago, the economies of LatAm were heavily reliant on the export of basic commodities. There are still very big producers of commodities all across the region, but that is now far from being all they are about. Especially in bigger markets like Brazil and Mexico, the disruptive technologies of the information-based new economy have firmly taken root, and the consumer society of the millennial generation has become arguably as sophisticated as anywhere in the world.

The financial infrastructure, at least in the bigger markets, has also become increasingly sophisticated – making possible an ever broader array of investment strategies.

For this roundtable, we were delighted to bring together such a group of top investment managers of diverse types, from bottom-up stock-pickers and long/short hedge fund managers in equities to more macro and fixed income focused players. They talked with much enthusiasm about the expanding opportunity set, and strategies to invest in it.

While Latin America and its markets may be vibrant, they are however also noted for their bouts of political instability – and intermittent periods of economic stress and crisis, such as we have been seeing in Argentina again in 2018.

LatAm has often been buffeted severely by sharp changes in global trends, especially by changes in the economy of the United States, the economic giant to the north. So, after the era of the financial crisis and unprecedented quantitative easing (QE) flooding dollars into the markets around the world, there are big question-marks again about how the end of that may impact LatAm.

Trade tensions between the US and China, with the latter now vying for economic leadership, may also spark some unpredictable side effects on the LatAm region.

All of these factors gave our panel of participants plenty of things to discuss with us and our partners at Scotiabank, who also brought some of their detailed knowledge and expertise in these markets to the debate. We hope you find this resulting report illuminating.
Panellist biographies

Manuela Cedarmas Tages Capital

Manuela Cedarmas is head of emerging and frontier strategies at Tages, which she joined in January 2013. Manuela is a former head of hedge fund investments at Duemme SGR. She previously worked for Unifortune SGR, with responsibility over the creation and management of Fund of Funds. Manuela worked previously for the Italian Stock Exchange, Citibank and was an intern at the DESA Department of the United Nations Secretariat in NY. She holds a MSc in Econometrics and Mathematical Economics from London School of Economics and she is a CFA Charter holder. Manuela is APFI deputy lead, Italy Chapter, for the Association of Professional Fund Investors (APFI).

Carlos von Hardenberg Mobius Capital Partners

Carlos von Hardenberg is one of three founding partners of Mobius Capital Partners LLP, with 19 years of experience in financial markets. He spent 17 years with Franklin Templeton Investments starting as a research analyst based in Singapore, focusing on South East Asia. He then went on to live and work in Poland before moving to Istanbul, Turkey for 10 years. Carlos has spent extensive time travelling in Asia, Latin America, Africa and Eastern Europe researching companies and identifying investment targets. Throughout his career, the funds that Carlos has managed have received numerous awards, most recently Investment Week’s Emerging Markets Investment Company of the Year 2017, Money Observer’s 2017 Best Emerging Markets Trust and What Investment Trust Awards 2017 Best Emerging Markets Investment Trust.

Bradford Jones Sagil Capital

Bradford Jones is portfolio manager and CIO a founding member of Sagil Capital. Prior to establishing Sagil, Bradford worked at RMB from 2002 to 2008 where he ran the global emerging markets portfolios, with a particular focus on Latin America. From 2000 to 2002, Bradford worked at PricewaterhouseCoopers. Bradford is a Chartered Accountant, holds an IMC and is a Certified Financial Risk Manager.

Benjamin Sarano Emso Asset Management

Benjamin Sarano is portfolio manager for local markets at Emso. He started his career at Rigton Trust in Argentina in 1992. At Rigton Trust, he built valuation tools assisting the trading of the newly structured Brady bonds, specifically Argentine Pars, Discounts, and FRBs. Ben joined Chemical Bank in the Emerging Markets Research group in 1995. After five years at Chemical Bank (which became Chase Manhattan), he became a portfolio manager at CDC ixis, trading emerging market sovereign credit derivatives. Ben joined Emso in 2004 where he currently manages the local market portfolio.
Panellist biographies

Graham Stock  BlueBay

Graham Stock is partner and senior sovereign strategist, emerging markets at BlueBay. He joined in September 2013 to manage the sovereign research team, with particular responsibility for Latin America, and became a partner in July 2018. Before joining BlueBay, Graham was chief strategist at Inspiro Asset Management. Prior to that, he worked for 12 years in emerging markets research at JPMorgan in New York and London, heading up Latin America sovereign strategy, CEEMEA FX strategy and Sub-Saharan Africa research. In the early stages of his career, Graham taught English in Colombia, worked as an economist for the government of Papua New Guinea, was a management consultant in London, and was senior Latin America economist at the Economist Intelligence Unit. He has a First Class BA (Hons) degree in Hispanic Studies from the University of Sheffield, and an MA (Econ) degree in Development Economics from the University of Manchester.

Vivienne Taberer  Investec Asset Management

Vivienne Taberer is an investment specialist and portfolio manager in the Global Emerging Market Debt team at Investec Asset Management, where she is responsible for Latin American bond and currency markets. Prior to joining the firm in 2002, Vivienne worked at Standard Bank in London for seven years, initially specialising in South African fixed income before moving into sales and trading across the whole spectrum of emerging market debt. Prior to this, she worked at Mizuho International in London and First National Bank trading South African bonds. Bond options, FRAs and swaps. Vivienne graduated from the University of the Witwatersrand with a Bachelor of Commerce degree and a Bachelor of Laws degree, and has completed the London School of Business Investment Management Programme.

Eduardo Suarez  Scotiabank

Eduardo Suarez is the chief economist for Latin America at Scotiabank, where he formerly was co-head of Latin America Fixed Income and Currency Strategy. He has been an emerging markets FI/FX strategist in different Canadian banks since 2007, and has been covering different LATAM financial markets for over 15 years. In a previous role, Eduardo was a member of a team was selected as the fourth best EM strategy group by Euromoney. Eduardo worked in Toronto from 2007 to 2015, when he moved to Mexico with Scotiabank. Before switching to the “sell-side”, he worked in Mexico’s Finance Ministry, where he served as an international economist, and also as a department head in the Financial Programming Division. He was also the deputy director in charge of the Investors Relations Office of the Mexican Finance Ministry, which was selected by the IMF as an example of “best practices”. Before that, he was a corporate credit analyst in one of Mexico’s two largest banks. Eduardo studied an MBA in the Rotman School of Management at UofT (with a major in financial engineering), and a BSc in Economics in the University of Warwick in the UK.
At a roundtable of specialists in Latin America, not surprisingly there was plenty of optimism about the future for the region – particularly over the medium to longer term. Over the short to medium term, however, there were also plenty of concerns that some significant challenges and difficulties could lay ahead first.

As Eduardo Suarez, chief economist for Latin America at Scotiabank, put it in his opening remarks: “I think we’re going to have at least a couple of challenging quarters for Latin America. I don’t see how anywhere can ‘decouple’ from what’s happening with global financial conditions.”

Suarez’s concerns about the immediate outlook were partly driven by what was happening in the wider global economy – particularly an end to quantitative easing (QE) and rising interest rates in the United States – and partly also by what was happening within the region: “We have political uncertainty in the two largest markets in Latin America – like what will happen in Mexico with the new government in December and after the [October] election in Brazil.”

Vivienne Taberer, a senior portfolio manager in the emerging markets fixed income team at Investec Asset Management – a big asset manager in EMs – said she started from a relatively sanguine perspective on the global macro environment. “Our global growth picture has been relatively constructive and I think that’s the view we’re still holding at the moment – although it’s being tested by various other factors including what’s happening on trade,” she said.

“For now, we’re sticking with the view that the US is still growing and that it’s relatively late cycle; other parts of the world are probably more mid cycle; and then you’ve got a lot of EM where it’s actually still probably quite early cycle. But the key question for us has been whether that can continue – given the risks for global trade, and the steady raising of interest rates in developed markets.”

Taberer continued: “Overall, we see the environment as relatively challenging for...”

“...I think we’re going to have at least a couple of challenging quarters for Latin America. I don’t see how anywhere can really ‘decouple’ from what’s happening with global financial conditions.

Eduardo Suarez
In previous Fed tightening cycles, emerging markets have performed well – because they benefit from the stronger growth backdrop that brings.

Graham Stock

EM, but one where there should be a lot less vulnerability than in 2012 – and they should be able to manage it better. But obviously, in the world we are in at the moment, we also see quite a lot of idiosyncratic risks.”

Benjamin Sarano, local markets portfolio manager at Emso Asset Management – a macro and fixed income hedge fund group focused on EMs – was particularly concerned about the end of the prolonged era of QE in the United States and other developed markets, and the potential impact of that on emerging markets.

“I think it’s very clear the US and Fed obviously want to keep hiking,” said Sarano. “And with the ECB, we may not know about their ability to act, but I suppose we certainly know the direction of travel.

“I think that level of hiking by central banks actually would be constructive for emerging markets in general – in that economies are sufficiently strong to allow rate hikes,” Sarano argued. “The difficulty is understanding clearly the dollar liquidity – and availability of dollars to invest in our asset class. That is at best unclear and at worst completely unknown.

“I think that as the deficit in the US grows, as the Fed normalises and reduces its balance sheet, then we’re going to have something like a trillion dollars extra required to purchase US Treasuries over the coming years. And that has to take money away from the riskier parts of the market.”

Sarano continued: “It’s going to have an impact. The general macro picture, all other things being equal, at any other time would be quite constructive. I think growth rates are pretty good; commodity prices are pretty supportive; and EM current account positions and debt positions are better than they have been in the past. But the shrinking availability of dollars is something we don’t know the ramifications of.”

There was a general feeling among the participants that EMs in general and LatAm in particular could thus be in for a challenging period – as countries like Argentina and Turkey were already experiencing – even if many are also bullish longer term if the US dollar ultimately weakens in response to a rising US deficit, which could then be more positive for EM.
Vivienne Taberer

Obviously trade is a big concern for everyone, but the thing that really concerns us and keeps us up at night is the size and funding requirements of the US deficit – and the implications for EM.

Bradford Jones

Graham Stock, partner and senior sovereign strategist at BlueBay, another big asset manager in fixed income and credit in EMs, said he would be a little more constructive perhaps than some: “I think the withdrawal of stimulus by developed market central banks can only happen if the global economy is performing better – and I think that is indeed the case,” he argued. “Also, in previous Fed tightening cycles, emerging markets have performed well – because they benefit from the stronger growth backdrop that brings.

“I don’t think it’s different this time around,” Stock went on. “If anything, the stimulus – the QE that’s been in place – was explicitly to offset the structural weaknesses that were exposed in the global financial crisis and is being withdrawn at the pace those weaknesses are healing.”

Stock continued: “I think the backdrop overall is still supportive. But clearly, with the quantity of QE that has taken place, some of it has found its way into places that it maybe shouldn’t have done. So the focus needs to be on the countries that are vulnerable, the countries that have borrowed beyond their means, and the countries that still need to borrow at times when liquidity is going to be volatile at best and maybe in short supply for weeks or months at a time.”

Bradford Jones, portfolio manager at Sagil Capital, a long/short equity focused hedge fund group focusing on Latin America, took a more cautious immediate view mainly due to the global backdrop. “Obviously trade is a big concern for everyone, but the thing that really concerns us and keeps us up at night is the size and funding requirements of the US deficit – and the implications for EM.

“We’re now in a situation where the US deficit is growing, which we’ve never seen happen at this stage in the growth cycle and with these low levels of unemployment in the US,” Jones argued. “We should be seeing the lowest levels of deficit or a surplus at these levels of employment, but we’re going the other way and at an accelerating pace.

“We struggle to comprehend how these US deficits will be funded at such low savings rates in the US – very different from what we see in China and Japan, and some Eurozone...
countries,” Jones continued. “The US deficits need to be funded from somewhere, which will push up yields further, and I think we’re at the stage of discovering the implications on risky countries — like Turkey and Argentina. I think we’re just at the start of that process — and it’s not that those countries will cause contagion onto others, but contagion will come from what is happening in the US.

“We also have concerns from Asia and China,” Jones added. “If you look at infrastructure spending in China, it has turned negative on a trailing three-month year over year basis. The Chinese may try and stimulate their economy to counter the trade tension with the US, but there is a lot of mixed data coming out of China which can have implications for Latin America.”

Finally, Jones also pointed to some of the pressing problems within the region: “We’ve also got a humanitarian crisis in Venezuela taking place where it’s difficult to know what all the implications could be, but that could extend to social unrest and a real unravelling of the whole country at some point.”

The problems within the region were also highlighted by Viv Taberer of Investec: “The trade story is one factor making Latin America a very challenging place to invest in at the moment. Obviously in Argentina there’s a lot happening, and we have the Brazilian elections. Even in Peru, under the radar there’s a congressional and judicial crisis going on there too. And obviously with Venezuela, aside from what’s happening in the country itself, it’s impacting a lot of Latin America countries, plus Central America and the Caribbean too.”

Carlos Hardenberg offered the perspective of Mobius Capital Partners, a new independent emerging and frontier markets investment firm headed by EM investment legend Mark Mobius. The new firm plans to work with companies as an active equity investor, aiming to improve transparency and corporate governance standards and to set out broader environmental, social and governance (ESG) goals — and thus help raise ESG ratings.

Although noted for its bottom-up investment approach, Hardenberg said the new firm would very much keep a very close eye on macro developments too: “There is no clear differentiation anymore between bottom-up in isolation and the bigger macro view,” he stated. “Investors need to understand both. Unless you get the big picture, you can’t be a very good global market investor.”

Historically, EMs in general — and Latin America in particular— have been very much impacted by what was happening to US interest rates and the dollar. But as trade and investment flows with Asia — and with China in particular — have risen, this has led some to question whether the US and the dollar are still quite so critical as they used to be.

But Hardenberg said he didn’t really see the EM world as much less dependent now on the US dollar: “I would say the US dollar is still the ultimate measure when market conditions get tough. Commodities continue to be priced in US dollars; and even if financing is priced in other currencies, ultimately there is a very high correlation to US dollar refinancing rates. Global dependency on what is happening with the US dollar, and with the US/China trade relationship, are still the top factors for risk spreads.

“I agree that the US dollar has structural weaknesses, but this has been the case for a long time,” he continued. “It is nothing new. It has always been a mystery to me how the US got away with this for so long. On reflection, you realise the Chinese don’t have many alternatives. They need to place the liquidity

“There is a lot of mixed data coming out of China which can have implications for Latin America.

Bradford Jones

There is no clear differentiation anymore between bottom-up in isolation and the bigger macro view. Investors need to understand both.

Carlos Hardenberg
somewhere and the US market is the only one that can absorb it.”

The importance of the US/China relationship was echoed by Viv Taberer of Investec: “The US is still critical – though at the margin perhaps a little less critical than before. I think China is also going to be a key driver of what happens in emerging markets. And Europe obviously has had some impact on the market this year, but to a lesser extent.”

Risk driver
She added: “But we certainly think that the US/China story is going to be the key driver of whether risk is going on or off – though, over the longer term, we also think that there are other drivers in the market.”

On the potential impact of quantitative tightening (QT) in the US, Taberer said: “I don’t think we’d disagree that there will be some impact, but we probably think that it’s not something that plays out at this particular point in time – rather it’s a story that’s going to be playing out more into the back half of 2019.”

A further perspective was given to the discussion by Manuela Cedarmas of Tages Capital, a specialist investment firm which selects absolute return funds for tailor-made institutional portfolios. Tages has been very active in both bigger emerging markets and in frontier markets, not least in Latin America. And like others taking part in the roundtable, Cedarmas also said it was very necessary to keep an eye on the wider macro picture.

“One of our main concerns is the correlation between regions, given how dependent now Latin America is to China,” Cedarmas noted. “We do also monitor carefully trade issues, as well as secondary effects of events – for instance, the unexpected fragility of Brazil to events like the recent truck drivers’ strike.

“We try as much as we can to decrease such correlation through appropriate diversification. Another key point for us is liquidity – that’s really a big area of focus. We are very concerned about flows, especially those coming from passive investments.

“Through time we have changed the way we look at EM and frontier markets allocations – to take account that China is becoming more important and the inevitable implications China has on the rest of the emerging markets,” Cedarmas added. “In a way we consider China as an asset class apart. We divide emerging markets between the big more liquid ones and the smaller/frontier markets.”

Alongside the end of QE and rising interest rates in the developed world, the other big global macro issue causing food for thought among LatAm specialists is the outlook for global trade – due not least to the somewhat more belligerent posture on trade issues coming from the Trump administration in the US.

In part, regional concerns focus specifically on proposed changes to the North American Free Trade Agreement (NAFTA) – and the potential effects for Mexico. But the possibility of tensions on trade escalating into a full-scale war between the US and China or even between the US and Europe have also become a rising concern for investors in LatAm more broadly.

As Manuela Cedarmas of Tages put it: “I think it’s important to get a sense of the potential effects – and how much these trade tensions could affect specific companies as well as the supply chain.”

Vivienne Taberer of Investec highlighted two specific concerns – on NAFTA in particular and more broadly on US/China trade: “We think the NAFTA agreement in principle is positive for Mexico. It obviously deflects some of the risks away from Mexico. But if the potential for a trade war does get bigger more broadly with China, then there’s going to be some impact given the global supply chains and how integrated they are. There is risk if there is a big escalation in the global trade war.”

NAFTA concessions
“US/China is the big one,” agreed Graham Stock of BlueBay. “On NAFTA, we are close to an agreement, I believe, certainly between Mexico and the US – though it remains to be seen how many concessions the Canadians and the US will be prepared to make to get the tripartite agreement. On the spat between the US and Europe, there are also solutions in sight.

“The US/China one is much more problematic because it’s not really about trade at all,” Stock argued. “It’s about economic and political hegemony – so there isn’t a solution through trade. It’s a tension that’s going to continue to build, certainly while we have the current incumbent in the White House, and probably beyond that because I don’t think US policy is going to change dramatically even after Trump’s one or two terms.”

Stock continued: “It’s unfortunate that trade is the mechanism for that tension to play out – and that has consequences for other emerging markets, without a doubt. It doesn’t dampen my reasonably constructive view for the medium term, but I think it’s one to watch.”

Carlos Hardenberg came to a similar conclusion – that it was a worry but that potential worst-case scenarios ought to be avoidable: “I think that symbiotic relationship [between the US and China], which is somewhat comparable to the Mexican/US industrial relationship, will probably be the ultimate insurance policy we have over the next maybe five or ten years.

“At the end of the day, Trump understands he cannot jeopardise the relationship with the
Chinese — as these two economies are joined as if one,” Hardenberg argued. “The Chinese need to protect their trade-related businesses — which need an open relationship with the US. And equally the guys backing Trump also need the relationship with the Chinese.”

Similarly, Hardenberg felt that Trump’s desire to re-cast NAFTA in a way more beneficial to the US should not ultimately result in a wholesale movement of factories and industries out of Mexico. “It took years, or decades, for the NAFTA ecosystem to develop from education to infrastructure, trade, the connectivity of transport routes, and the whole integration of components,” he pointed out. “Now it’s massive — and the countries are massively connected.”

A similar point was made by Eduardo Suarez of Scotiabank: “If you think about it, you have already trained all the workers — and you probably need very specific types of labour for your factories. If you move out a plant where the government has already grown the infrastructure you need, all that happens is that another company will step in and buy the same piece of land from you and put a plant there — and you will have just kicked yourself out of the supply chain.”

Suarez added that he was starting to think that the Trump approach to trade had more strategy behind it than first meets the eye: “I think Trump’s plan is actually smarter than I first gave him credit for — because he’s been threatening trade wars with almost everybody; and that’s also increased the cost of moving plants somewhere else — because of all the new uncertainty.”

Viv Taberer of Investec was a little more cautious on the trade outlook: “I think Trump is often very quick to call a big deal, but then the detail seems quite scant and needs to be worked out over a much longer period of time. So, for Mexico, certainly the fact that you’ve got a deal in principle is positive, but we think probably there is still some risk around the details — seeing whether Canada remains part of it, and because congressional approvals are needed on both sides of the border.”

**Trump bounce**

Conversely, Brad Jones of Sagil Capital felt that Trump’s hostile approach on trade could actually be helpful for LatAm in some ways: “Irrespective of what happens in the US, China will look to secure commodities from elsewhere and Latin America should be a beneficiary of that trend,” he argued.

“Excluding what’s been happening in Mexico, in the rest of Latin America commodities have really benefited from the trade tensions, such as Brazil beginning to charge a premium for soy. Currencies have depreciated — which has positives as well as negatives. But for the agriculture sector, a combination of higher prices and weaker FX rates has generally been positive.”

**US/China is the big one. It’s not really about trade, but about hegemony – a tension that will continue to build.**

Graham Stock
EM as an asset class? Diversification, correlation and contagion…

One issue that has long sparked debate and continues to do so is the question of whether emerging markets – such as those of Latin America – should be regarded as a single asset class or not. After all, they include a huge variety of different economies across very different parts of the world – spanning Eastern Europe and Asia and Africa as well as LatAm; and from what have become vast markets like China to some of the tiniest and least developed. Moreover, there are prolonged periods where there is enormous dispersion in their market performance.

On the other hand, there have been repeated episodes – usually sparked by a market crisis, when the correlation between different types of EMs suddenly shoots up in what is often referred to as a ‘contagion’ effect, with problems that may begin in one emerging market spreading like wild fire across many.

Graham Stock of BlueBay argued that there were some important nuances to this debate: “I think EM is an asset class, though the concept of an asset class is a bit artificial to start with.”

Clear differences

Stock explained: “We divide investment opportunities up into asset classes to make it easier for the end investor to understand what they’re buying, what they are taking exposure to. And there is clearly a difference between the emerging markets and developed markets. The border between them is a bit blurred – and probably more so now than it was 20 years ago. But it makes sense to have that division and it helps us to understand what the potential risk of investment might be.”

Stock pointed out that it is difficult for index providers to come up with clear rules for when countries graduate from one category to another – or need to be relegated from one to another: “I think you can’t get away from that,” he said. “We can criticise the index rules as we often do, but you need rules of some kind.”

Ben Sarano of Emso saw the issue slightly differently: “I think the problem with EM is that it’s not one asset class. It’s many asset classes,” he argued. “Bonds are bonds, but it’s madness for Thailand and the Czech Republic to be in the same local market index as Argentina and Turkey. It’s definitely a square peg rammed into a round hole. But that’s also quite fortuitous for guys like us because it means that you definitely need a guide to navigate these markets.

“There are definitely contagion issues,” Sarano added – because when there is a problem in one market investors inevitably search for liquidity elsewhere. “I think South Africa has already been highly contaminated by what has been going on in Turkey. But SA is a hedging vehicle for Turkey, a hedging vehicle for the asset class, and it’s easy to trade. So there are problems.

“Mexico – certainly the Mex peso – suffered over numerous years as it was the only EM currency trading around the clock.”

Viv Taberer said Investec also viewed EMs as an asset class: “It’s something our clients see that way – so a lot of our clients are sensitive to specific EM shocks. But it is something that is going to evolve,” she argued.

“Some of the markets are moving into a more developed market space, and at the other extreme there are frontier markets, such as in Africa. So you can have many emerging markets not reacting with a high correlation to each other – until you reach a tipping point, and when you reach that tipping point then the correlation suddenly does go up, and the whole universe gets very much treated like a single risk asset class.”

Taberer hence agreed with Sarano’s point that problems in one market, such as in Turkey recently, do unfortunately often lead to contagion elsewhere: “It certainly puts pressure on markets and the impact is likely to be on those countries that are seen as most vulnerable,” she argued. “The whole Turkey story and global backdrop has made the Argentina picture much more vulnerable than it would otherwise have been.”

To trade a range of EMs successfully, flexibility is thus very important, according to Carlos Hardenberg of Mobius Capital Partners. “We are currently in an environment where participants can benefit from the ability to invest across the larger and the smaller markets, often known as ‘frontier markets’. I think Africa is totally underestimated and under-appreciated. Over the next 10-15 years the kind of returns you can make in Africa are likely to be incomparable to anything else.”

Passivity problems

But Hardenberg argued that the EM investment sector as a whole now has a big problem with the enormous volume of passive money that has been entering into it through exchange-traded funds (ETFs): “There’s a huge fundamental crisis in our business per se which has come in from ETFs. They are now the largest owners of assets in all emerging markets. This is very much a sentiment-driven flow – as opposed to the more diversified flow we used to see in the past from hedge funds, local funds and foreign funds, in which we were the main owners of the assets. Now 10-15% of companies can be controlled by just the head of one pool.

“China taking up around 51-53% of the index also creates a number of absurdities in the market,” Hardenberg continued. “Didn’t we all learn about the benefits of globally diversifying? Now suddenly you’re selling an ETF which everybody else owns and half of it is in one country.”

However, this can also create an opportunity, he added: “We are setting up our funds and being backed mainly by institutional and family offices – and they are asking us specifically to have zero exposure to index names.”
While the immediate global macro outlook may be giving some pause for thought among investment managers in Latin America, there was certainly no shortage of enthusiasm or ideas for investing in the region among the roundtable participants.

Some of the ideas aired seek to exploit secular, longer-term trends in the region, others to take advantage of short-term opportunities—and sometimes a timely blend of the two.

As Carlos Hardenberg of Mobius Capital Partners put it: “We’re an independent, bottom-up, contrarian investor — so we always like situations where the market is overreacting and where currencies are giving us a cheap entry point to opportunities.”

Hardenberg had immediate examples of opportunities he would point to: “If you look at some of the smaller caps in Brazil or Mexico they’ve been punished almost too much, for lack of a better word. The valuations are now often 30-40% below their own historical averages in US dollar terms. It is quite an interesting opportunity if you wish to act as a contrarian.”

The wider opportunity set across LatAm was also now much richer and wider than in previous years, he argued: “The big difference between the 1990s and today is that in Latin America — Argentina maybe less so, but especially in Brazil and Mexico — you have a total change in the landscape.

“It has moved dramatically from exporting mainly commodities like soy beans, coal, iron ore and so on — to much more idea-based, engineering-focused business models. Many companies have become globally competitive by also setting up manufacturing capabilities in other regions like Asia and Russia. Today, there are also many Brazilian businesses which produce in Europe.

“Some companies are benefiting from depreciating local currencies — as they are making increasing hard currency revenues and have quite a bit of their cost base in local currency,” Hardenberg added.

But that was not the only reason they were of such interest for him: “The opportunity set in
the domestic economy has also changed from the story of plain vanilla banking products and breweries of the 1990s – to a varied structure where you suddenly have companies which cater to the increasing demand for healthcare and education services, and businesses which disrupt in terms of software solutions.

“There are more idea-based, sophisticated, innovative, entrepreneurial-driven businesses which have developed locally,” Hardenberg also argued. “They offer unique access to a consumer segment which is also growing very fast. Everybody focuses on China and the Chinese consumer, but when you talk to the millennials in Latin America, they are really quite similar and they shop in similar ways. They use social media in similar ways, they consume the same kind of data as Asians. I would watch this space carefully.”

The theme of an emerging information-based new economy within the LatAm region was also highlighted by Brad Jones of Sagil Capital: “The biggest city in the world for Uber is São Paulo,” he pointed out. “Brazil is the second biggest country in the world for Uber after the US. And we’ve reached levels of cell phone penetration and Smartphone penetration where these things become very important.

“Adoption is incredibly high, and it happens very quickly, like what we see with Uber in São Paulo. We’ve had other disruptive things circumventing the infrastructure problems of the government, companies like Rappi emerging – and problems that have been there are now being solved because of the technological innovations.” Jones also predicted the region was also set for an e-commerce boom – a notion echoed by Eduardo Suarez of Scotiabank.

“The financial industry globally, and in LATAM is being disrupted by technology,” said Suarez. “There are some really innovative people that are doing some really interesting stuff – including what are basically new credit factories for some of the large banks in Mexico, as well as innovations on many processes.”

On Brazil in particular, however, enthusiasm for exciting opportunities in the secular trends was also tempered by some concerns about the outlook. “I’m concerned about Brazil – with issues on pensions, inflation rates and the fiscal policy side,” said Suarez.

“It’s hard to see a scenario where we get a reformist government with a reform mandate, so we will likely see a fiscal deficit remaining in the range of 6-8 percentage points of GDP, and the pension problem – probably the largest pension deficit anywhere tracked by the OECD – remaining unresolved. I think that the interest rate investment side looks like it will be painful for investors.”

Those concerns were shared to some extent among the more macro and fixed income-focused managers taking part. As Graham Stock of BlueBay put it: “There is a lot of risk around the outcome of the election and therefore a lot of uncertainty about the policy agenda that results.”
Unemployment in Mexico has been declining for 10 years, remittances are high and the economy is not leveraged at all.

Brad Jones

Vivienne Taberer of Investec took a similar view: “On Brazil, we are very cautious – as we think there is so much election uncertainty.”

Ben Sarano of Emso added: “The Brazilian real is probably cheap. But at the same time, it’s extremely cheap to be short. And it’s not obvious where the inflows are coming from.”

Sarano added: “I don’t think Brazil needs higher rates at all, other than perhaps to protect the currency. But we’re in a very difficult market environment for emerging markets in general — and, if there is a demand for dollars, as these currencies weaken materially that is difficult to deal with.”

Attractive valuations

Brad Jones of Sagil, however, was enthusiastic about at least one sector in Brazil — consumer cyclicals — following recent price activity: “The market is incredibly pessimistic on Brazil post the truckers strike in May and with the upcoming elections,” he argued. “There’s a lot of uncertainty around — but there are also some of the most attractive valuations we’ve ever seen in Brazil.”

Carlos Hardenberg also felt there were broader reasons to remain positive on Brazil: “I would be slightly less concerned overall because I think the big difference from ten years ago is that there are now very robust institutions in the banking sector in Brazil — and especially among the privately-owned banks. You also have a pretty much repaired current account, so that also gives more room to manoeuvre.

“You now have a very diversified, highly sophisticated private sector — unlike the Brazil of the past, which was all about commodities,” Hardenberg argued. “That’s in contrast to Turkey, which is still mostly exporting washing machines and assembling cars.”

There was also a long discussion among roundtable participants on Mexico — the second biggest economy in the LatAm region — led by Eduardo Suarez of Scotiabank, who felt that views were still changing rapidly about how things will develop under the newly elected President Andres Manuel Lopez Obrador, universally referred to as ‘AMLO’.

“We’ve been arranging meetings for clients with AMLO’s team and I imagine clients may be re-evaluating Mexico risk,” said Suarez. “I like the short end although I would, because of Fed risk, probably pair it against Colombia — as I think Colombia is behind the curve on the Fed [interest rate raising schedule] while Mex is probably ahead of it — so I’d probably look to receive three-year Mex versus pay three-year Colombia.”

Suarez was sanguine about the short-term outlook: “This year the budget will be supervised by the outgoing team anyway, so my guess is this year’s budget will be somewhat of an inertial one. That’s why I like the short end [of the yield curve].”

He was also not overly concerned about some more specific issues which have been causing concern among some investors: “There’ll be noise about the office space in Mexico City if AMLO starts moving ahead with some of his plans to move 32 agencies out of the city — but there’s no way he can move five agencies per year during a single presidential term.”

And on developments with senior appointments at state oil company Pemex: “The reaction on Pemex [senior appointments] was strong, but we may see that the people they put underneath are professional oil industry players — so it’s less bad than it looks.”

On the proposed major airport development: “There is strong interest in it, particularly from the infrastructure players – [though] the structure will of course matter.”

Viv Taberer said Investec was currently taking a cautious stance in Mexico: “What is key is whether there is a continuation with a market-friendly environment,” she argued. “I think so far AMLO has been benign on that. But how far rates can come down is going to depend on what happens to inflation — which is proving to be a little bit stickier than we originally anticipated. On the Mex peso, our views are more mixed — so we are neutral for now.”

Brad Jones of Sagil was more bullish on consumption in Mexico: “Post the Trump election in the US, we saw business spending really disappear given the trade concern with NAFTA; then that extended to be concerned with the elections we had at the beginning of July; then we saw consumer confidence dropping for the exact same reasons.

“But if we take a look at other figures, we see unemployment has been declining consistently for ten years; remittances are extremely high given the strength in the US economy; the Mexican economy is not leveraged at all; and everything the new President has said post-election has at least
been positive for the markets.”

Jones continued: “So we’re very optimistic on the consumption trend; we think business confidence has already improved; consumer confidence reached the highest levels in ten years in July following the election; and we can really see a rebound in spending following these events.”

Graham Stock of BlueBay also cited Mexico as his ‘top pick’ currently in LatAm – though with caveats: “We still need to see the evidence that AMLO is going to be the moderate, at least on fiscal policy, that he seems to be billing himself as. I think the 2019 budget will be fairly cautious, but as we move further out through his term and he struggles to deliver on some of the things that got him elected, we could see more populist solutions. So it’s hard to take a long term view there.”

Given some major problems recently – with a collapse in the value of the peso and the need for IMF assistance, and its history of repeated crises – Argentina was also a major talking point. As Viv Taberer of Investec said: “There is a lot of uncertainty now about whether the FX can stabilise and at what kind of levels.”

Graham Stock of BlueBay added: “It’s a problematic situation without a doubt – though I think default fears are overdone at this stage simply because the near-term amortization schedule in hard currency is very light.”

But Stock didn’t think it was the market that was driving the weakness of the Argentine peso: “I think it’s Argentine households who are a year away from an election that could be a disaster for them – and history shows that the safest thing to do is to buy dollars. There are market participants who certainly would prefer not to be holding as much dollar debt or local currency exposure, but I don’t think they’re the triggers for this [current problem]. It’s the Argentine private sector and households in particular.”

Brad Jones of Sagil felt this gave rise to a specific opportunity to go short of the banks in Argentina: “Banks in Argentina face a really difficult time at the moment,” he argued. “Reserve requirements have been upped repeatedly in recent months. We think the speed of lending is going to collapse, asset quality is going to deteriorate. So valuations are completely unsustainable.”

Carlos Hardenberg said he wasn’t so sure what the market was pricing in yet: “At this point, I get a strong sense the market is much more sensitive towards politics. The reason why Argentina has been attacked can only be explained through a political lens; it cannot be explained through any kind of fundamental macroeconomic relationship.

“The Argentines announced an insurance policy and it was not enough – like the Bank of England in 1992 when Soros attacked the pound,” he continued. “This is a similar situation, as the central bank came out with a package and no one even listened because there is a confidence crisis.”

But Hardenberg felt this did also reflect a deeper problem with the fiscal system in Argentina: “The discussion we need to have is whether the central government has the ability to negotiate with the local provinces or not, what is actually the power of these local provinces. My understanding is that more than half of the entire reform package is related to local municipalities, not the central government. If they don’t get this under control in Argentina, there’s no stop to it.”

Exploiting opportunities

Beyond the bigger economies of LatAm, participants discussed a wide variety of other opportunities across the region – including frontier markets and whether in most places they continue to be mostly a long-only rather than long/short opportunity (see box on page 18) or indeed whether private equity was the best way to invest in them.

As Eduardo Suarez of Scotiabank put it: “Markets like Chile, which has a very low correlation to US rates, are probably the sort of place where you want to hide at the moment. Or maybe Peru, where you have a very steady carry at the long end, combined with a low volatility currency.”

He continued: “But I’m also starting to feel that there is a bigger dispersion now among how clients are thinking about Latin America. I think there’s going to be a fantastic opportunity in private equity as global liquidity gets tightened and a lot of capital gets sucked out of a lot of countries in Latin America. When that happens, I think people in the private equity space will do well.”

Carlos Hardenberg said there was generally not so much interest yet in listed equities in the frontier markets: “Investors really need to
A long/short or long-only opportunity?

Another long-running topic for debate in emerging markets has been whether they are essentially just a long-only opportunity – because the variety of hedging instruments and market liquidity, especially at times of stress, makes it too difficult for a genuinely long/short approach to work over the full cycle.

Manuela Cedarmas of Tages argued that there very much is an opportunity to invest long/short and even in some of the smaller, frontier markets – if the managers are disciplined enough to operate within the inevitable liquidity constraints.

“We believe there are a limited number of managers who are able to invest successfully long and short in frontier markets,” she said. “We believe that managers of small size have a clear advantage in these markets. Furthermore, we value very much disciplined managers, especially in the long/short space, who stick to their AUM limit even after very good performance and increased investor demand.

“For Latin and Central America we invest in frontier markets mainly through fixed income strategies – with the exception of Argentina, where we have been very active also on the equity side,” Cedarmas added. “In the last 5 years, we’ve also been active in Africa ex South Africa, across strategies, in countries like Nigeria, Kenya, Egypt, Ghana, Zambia, Senegal, Ivory Coast and Zimbabwe.

“We believe that the main risk in these frontier markets is liquidity: it is therefore key to know who the other investors are and favour managers of decent size,” she stressed. “We are very positive on the investment opportunities that frontier markets present although investing in the space requires a very high level of investment and operational due diligence.”

Brad Jones also set out the case for long/short in EMs – as demonstrated by the long track record of Sagil investing successfully with that method: “The argument for using long/short strategies in emerging markets is that the markets are extremely inefficient,” he argued, “and you have a lot less competition for the same trades when you compare to developed markets.

“In Latin America, and emerging markets in general, politics can also have a very big impact – sometimes a complete 180-degree change in direction like we saw in Argentina with Macri coming into power after Kirchner,” Jones added. “I’m not sure you can succeed by just employing a one-way strategy when politics can have such very big implications.

“You have to also bear in mind the high level of government involvement in the stock markets – such as YPF in Argentina, and Petrobras in Brazil, which are big portions of the indices.”

A genuinely long/short approach is perhaps easiest to execute successfully in FX and fixed income markets, where there is likely to be more volume and liquidity – though that can still be very variable. As Ben Sarano of Emso put it: “EM has the capacity to be a good long/short environment. You do have periods of time where correlations go to zero and for a long time. The distribution between the best performers and the worst performers is often enormous. So we certainly do approach it from a long/short perspective – though the short side can be challenging as we’ve seen recently in Turkey.”

Graham Stock of BlueBay also highlighted that there are still limits to the range of strategies deployable – even on the fixed income side: “It’s harder in the hard currency bond space because you only really have a two-way market in a handful of the more liquid sovereign names where you’ve got a CDS [credit default swap].

“But in local markets, it’s very straightforward,” Stock added. “You can buy or sell dollars against the currency and in the biggest markets you can go long or short on the interest rates as well. There are opportunities also if you take a longer timeframe to pick winners and losers as well, and that’s how active managers like us would try and show that [passive] ETFs are the wrong way to approach this asset class.”

A further talking point was the location of managers – and whether it was better to be trading LatAm from a global centre like London or New York or to be based on the ground within the region.

Manuela Cedarmas indicated that Tages uses managers of both types: “We do like managers that have a proven knowledge of Latin American markets as well as its culture and political environment,” she said. “We have been investing both with managers located in global centres like London and New York as well as within the region – in Brazil mainly, but also in Argentina when we played Argentina as a country-specific bet.”

Cedarmas said it was important to have at least some managers that sit outside the country of focus because they can think more globally - as they are not unduly affected by the sentiments of the local community. “At the same time, it’s also very important to have local knowledge and a good network,” she added.

At the present time, in what Cedarmas referred to as “an environment of politically induced volatility”, it was particularly important to be flexible and able to reallocate quickly across regions: “We continue to favour active managers with the ability to short, especially in this environment, and to look across the capital structure of companies and take advantage of the opportunities which arise from current market dislocations, both on the long and short side.

“The other aspect which is very important for us is liquidity, and for that reason we do favour managers that are not too big in size and have the ability to be nimble taking advantage of opportunities which are less liquid,” she added.
dig very deep – they just do not provide the diversity of opportunities yet, as they are still very young capital markets.

“The businesses in most of these places are more of a private equity opportunity,” he argued. “If you have a sizeable private equity fund, you can write big tickets. But in the public markets, in countries like Peru, Colombia or Panama, there is not much available. It is very different to a place like India where you have thousands of listed stocks. Or China, where the national stock exchange has more than 10,000 listed companies.”

On the fixed income side, however, there was perhaps more to be found in the smaller markets. “Ecuador is one I like currently,” said Graham Stock of BlueBay. “It’s high yield and an improving story. We’ve had some good news in recent weeks with the funding. They’ve made progress in securing funding at a time when the bond market is still probably closed to them – so that buys a little bit of time to continue with the fiscal adjustment the new President is pursuing.”

Small can be beautiful

He added: “There are other smaller countries too where there are opportunities – such as in Central America. Dominican Republic we quite like; Paraguay is an improving story, still. Bolivia has been tricky but is now looking a bit better, and that’s a fairly non-correlated story – not a great government to be honest, but while commodity prices are high, they do okay.”

Jones of Sagil also cited another, different way to play EMs like Latin America: “We think the market is missing an opportunity to be short of stocks in developed markets with EM exposure, especially in the US where the domestic markets have remained relatively strong,” he said. “We see a number of opportunities in developed markets listed names but where people maybe aren’t following it quite as closely as the Latin America-focused crowd.”

One final topic which provoked debate was Venezuela and whether, given its current serious crisis and after many years of being regarded as almost uninvestable, that could start to change — and, if so, how and when.

According to Ben Sarano of Emso, it was not that there was no interest in the idea. “I think that there are a lot of distressed EM guys that are excited about Vene and the restructuring trade. But they’ve been excited since 2015,” he quipped.

Sarano cast doubt on how quickly things could start to improve: “I think operationally it’s extremely challenging. There are airline debts; there are a whole lot of other contingent liabilities that we don’t know about. Perhaps it’s not impossible – with the right political will and the right institution or governmental connections, everything is doable. But in the current landscape, it’s a big challenge.”

Graham Stock of BlueBay, who had done a research visit not long ago, put it more starkly: “The problem is that there’s no one in the government to talk to,” he said. “They either won’t talk to you because they’re not interested in what foreign investors have to say – or they don’t know what they’re talking about anyway. It’s more a question of meeting with analysts and the private sector to see if there’s any sign of political change – and I came away thinking there wasn’t.

“You could double or treble your money, yes,” Stock concluded. “Or you could be sitting on a bond that’s worth fifteen cents on the dollar.”

For Carlos Hardenberg, the opportunity in Venezuela could thus be summed in a rhetorical question: “Why take a risk there if you can make a decent return in other places where you can move your capital in and out?” Clearly, there are plenty of other places in LatAm where you very much can.
Latin America: markets and opportunities