Strategy commentary

Ninety One Latin American Equity

Month ending 31 January 2024

The following commentary gives the views of the investment manager at the time of publication.

Key points

- Latin American equities posted a negative return (-4.8%), underperforming global equities (+0.5%)
- The Strategy outperformed the MSCI EM Latin American Index over the period
- In terms of sectors, the main relative contributors were materials, consumer staples and financials, while the main relative detractors were consumer discretionary, utilities and energy
- We prefer companies with attractive risk-reward profiles, higher liquidity, and that are more sensitive to interest rates due to the ongoing easing cycle

Market background

The S&P500 continued its positive momentum into the latest earnings season, with 72% of companies reporting earnings per share above estimates thus far. In fixed-income markets, the US 10-year Treasury yield closed relatively flat at 3.9%, despite high intra-month volatility. During their January meeting, the US Federal Reserve (Fed) kept its benchmark rate unchanged, while implying that cuts could start by mid-year or possibly thereafter.

In Brazil, the central bank delivered a fourth consecutive 50bps cut, as expected, with the key rate reaching 11.25%, while guidance also remained unchanged. It is forecasting a year-end inflation print of 3.50% and a Selic rate of 9%. Meanwhile, the government continues its discussion with Congress regarding sections of its proposed administrative and tax reforms, as the government tries to capitalise on President Lula's approval remaining above 50%. In Mexico, President Obrador is aiming to present some constitutional reforms during the last months of his administration, despite not having enough votes in Congress for their approval. The reforms cover an array of topics such as the pension system, wages, and the electoral and justice systems, among others. On the economic side, GDP growth during the foruth quarter (Q4) of 2023 surprised to the downside after increasing by only 0.33% SAAR quarter-over-quarter (q/q), compared to an expected rate of 0.8%. Nevertheless, for 2023 Mexico grew at a very strong pace of 3.2%, directly benefiting from the nearshoring trend.

In the Andean region, the Central Bank in Chile cut rates again at a higher pace, decreasing rates by 100bps to 7.25% in the new board's first meeting, with the expectation that the convergence of inflation to the 3.0% target will materialise earlier than expected. In Peru, Boluarte started her second year in office with a record-low approval rating and the possibility that Finance Minister Alex Contreras could resign, rumours which he has since denied. The administration expects the economy to grow 3.0% this year, which appears to be optimistic relative to market expectations. In Colombia, the easing cycle continued, with the central bank delivering a 25bp cut and bringing the policy rate down to 12.75%. The decision took place after December's inflation print came in below expectations at 0.45%, and a more moderate annual reading of 9.28% relative to the 10.15% reported for November. Meanwhile, discussions surrounding the 2024 fiscal outlook continue, as the Constitutional Court ruled the measure restricting the deduction of non-renewable natural resources royalties unconstitutional.

Lastly, in Argentina, tensions escalated after the government's defeat in Congress regarding the omnibus bill. Despite its general approval, lawmakers in the Lower Chamber of Congress voted against many individual items, reducing the number of articles from 386 to around 100. As a result, the government decided to send the bill back to the Committee for another vote. On the economic side, the government continued with its crawling peg at the low monthly pace of 2.0%, despite a monthly December inflation rate of 25.50%, in its attempt to stabilise the economy and diminish inflation expectations.

Performance review

The Strategy outperformed the MSCI EM Latin American Index during the month, gross and net of fees[1], primarily due to selections in Mexico and Brazil.

In terms of sectors, the main relative contributors were materials, consumer staples and financials, while the main relative detractors were consumer discretionary, utilities and energy. Regarding individual names, our underweights in Bradesco, B3 and WEG were among the largest contributors to relative performance. The main detractors for the month included overweights in Vasta, Vitru and Infracommerce.

Portfolio activity

In terms of countries, we increased our weight to Brazil while reducing our exposure to Mexico and Colombia. Regarding individual names, in Brazil, we bought Sabesp and Rumo on account of our improved outlook for 2024. In Mexico, we reduced our position by trimming exposure to names such as Kimber and GAP. In Colombia, we continued reducing our position in Geopark on the back of our negative outlook for the name.

Outlook and strategy

Investors are placing part of their bets for equities to rally in 2024, based on the ongoing easing cycle in the region. What is worth noting is the advanced progress central banks in the region have made relative to their developed market peers. While the former has already begun its loosening policy during the third quarter of 2023, the latter (most notably the Fed) has seen it wise to postpone its initiation until some point during the first half of 2024. This represents a material amount of runway for our region, as it benefits not only from the advantageous moment in its own cycle, but also from beneficial global circumstances.

In 2023, Chile led the way in terms of rate cuts, reducing its benchmark rate by 300bps during the second half of 2023. Brazil was next with 200bps, followed by Peru with 125bps and Colombia with 25bps. Particularly, Mexico has chosen a more conservative route for its monetary policy and consistently maintained its benchmark rate throughout the year. When observed on an aggregate level, the region slashed rates by 650bps during 2023. Looking ahead, for the upcoming year, Colombia is expected to lead with a reduction of 450bps followed closely by Chile with 425bps, Peru with 225bps and Brazil with 200bps. Mexico is also expected to initiate its easing cycle the year with a 150bps reduction projected by the end of December, implying a total of 1450bps worth of rate decreases projected for the year.

In summary, the momentum towards a more favourable monetary policy throughout the region continues. Positive updates from regional central banks are expected, as long as the overall trend in inflation we are seeing remains on course. Despite the rally in equities we saw last year, we believe there are still plenty of potential returns on the table.

[1] Where performance is gross of fees, returns will reduced by management fees and other expenses incurred. Net performance is net of highest institutional segregated portfolio management fee.

Not all securities held have been discussed. For further information on how the overall strategy performed during the period covered, please reference the relative performance noted in the Performance review section.

Specific risks

Geographic / Sector: Investments may be primarily concentrated in specific countries, geographical regions and/or industry sectors. This may mean that the resulting value may decrease whilst portfolios more broadly invested might grow. Currency exchange: Changes in the relative values of different currencies may adversely affect the value of investments and any related income. Developing market: These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems. Equity investment: The value of equities (e.g. shares) and equity-related investments may vary according to company profits and future prospects as well as more general market factors. In the event of a company default (e.g. bankruptcy), the owners of their equity rank last in terms of any financial payment from that company.

Important information

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