

Letter From Latin America

Part of the series from our Global Emerging Markets Equities team

**Standard Life
Investments**

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Reforming Latin America

For such a rich and varied region, it is unsurprising that Latin America (LatAm) offers a plethora of interesting companies from across the corporate spectrum. As an active investor, I believe it is vital to meet investee companies in order to fully understand their businesses. To that end, I recently travelled around three LatAm countries – Argentina, Peru and Chile – to get a better sense of conditions on the ground. The trip was certainly illuminating.

It is fair to say that Argentina has had a difficult few years, marred by recession, spiralling inflation and a long-running sovereign debt crisis. But under a new president there are signs that the country has started to turn a corner. Macroeconomic reforms are starting to bear fruit, inflation has halved and consumers are once again willing to borrow. This is creating numerous investment opportunities, notably in the banking and energy sectors. Meanwhile, Peru is also something of a recovery story after a period of political gridlock and falling commodity prices. A recent natural disaster has also taken its toll. Again, though, the situation is gradually improving – and corporate optimism is on the rise.

Finally, Chile feels like the most developed LatAm nation, with a relatively stable regulatory framework and a wealth of quality companies. However, it too has suffered setbacks, notably upheaval in the water and materials sector. Nonetheless, this should not deter investors from looking at this intriguing country. Overall, then, this is an exciting time to be an investor in LatAm. Whether it is companies on the cusp of recovery or those with more established market positions, there are many investment opportunities for diligent, active investors.

**“This is an exciting time to be
an investor in Latin America”**



Market Overview

Turning a corner?

Argentina has certainly had a tumultuous few years. In 2014, the country defaulted on debts of \$1.3 billion – the second time it has reneged on its obligations in 13 years. The economy subsequently plunged into an extended period of stagnation, inflation hit 40% and foreign investment dried up. In 2015, however, right-leaning President Macri was carried to victory on a pro-business reform agenda. His pledges included ambitious public works projects, the lifting of export taxes on the all-important corn and wheat industries and a host of other market-friendly initiatives.

While some of his policies are taking time to implement, the economy has exited recession. Second-quarter GDP came in at 1.1% quarter-on-quarter (the third consecutive quarter of growth). Inflation has fallen to around 22.1% and is estimated to hit 15.6% in 2018.

Importantly, business sentiment is improving. I recently met with the chairman of Banco de Galicia y Buenos Aires, who said that after the dark days of the 2000s, he felt like it was “the ‘90s again” – a period when Argentina prospered and was lauded as the economic star of LatAm. Loan growth, he said, is once again on the rise (mid-30%) and is set to climb further. This is being driven by Argentina’s sizeable middle-class, which retrenched during the recession but is once again starting to borrow. As a result, I think the economy is primed to enjoy a credit-fuelled recovery that could last a decade.

Away from the banking sector, government reforms are also helping the energy sector. Take oil & gas firm YPF. It, like many similar companies, has struggled in a world of low oil prices. However, the government recently cut fuel subsidies, under which citizens only paid one-tenth of the price compared with international markets. This has caused prices to rise – attracting billions in foreign investment into the sector. The competitive environment has been further lifted by reforms to the unions and contractors, which is helping YPF to cut costs, especially for the extraction of unconventional resources such as shale gas.

Investment Insights

Mining returns

Peru has also had a turbulent few years thanks to tumbling commodity prices: the country is the world’s third-biggest producer of copper, with rich deposits of gold, silver and zinc. To make matters worse, intense rains – the worst in two decades – have caused devastating mud-slides, which have tragically claimed lives and caused widespread disruption. Peru has also been gripped by political gridlock, meaning much-needed reforms have languished. Like Argentina, however, Peru has a new pro-business leader at the helm. President Pedro Pablo Kuczynski has vowed to jump-start mining investment and bring basic services to large tracts of the country. True, his majority is slim, but his election victory has been viewed as a popular mandate for action and deals are finally being done. Indeed, the government has pledged to spend US\$33 billion on infrastructure projects.

“Importantly, business sentiment is improving”



“Peru has a new pro-business leader at the helm”



One firm that should benefit from the turnaround is Credicorp, the dominant bank in Peru. I spoke with the bank's management, who were enthusiastic about the long-term opportunity in the sector. This includes getting more people into the banking system – current branches-per-head and credit-to-GDP are considerably below other LatAm markets. Credit costs are also improving. Of course, it's not all positives: Credicorp was recently embroiled in the Odebrecht construction scandal. However, this looks to be a temporary (if disappointing) issue and in our view is fully reflected in the share price.

Chile – but getting warmer

I believe Chile is one of the more developed countries in LatAm. Its regulatory background is fairly stable (recent surprise incursions into the water and materials sectors aside), providing a cultivating backdrop for the corporate sector. True, current economic growth remains subdued after a boom period: like Peru, falling commodity prices have hurt this copper-rich land, while a prolonged miners' strike has also weighed on the economy.

However, increased government spending and recently improving copper prices are helping the country through this period of languid growth, with the economy set to expand by 3% over the next 18 months. Again, during my visit to Chile I met with various management teams, many of which expressed optimism about the country's future.

Here, too, reforms are taking hold, notably in the energy sector. One company that illustrates this is Enel Americas (EA), the LatAm distribution and generation asset of Italian utility Enel. The company is the product of a corporate restructuring, which saw the non-Chilean assets of Enel and its subsidiaries Endesa and Enersis split off and merged into EA. This has created a far cleaner operating structure, significantly improved efficiencies and boosted cashflows. In addition, after years of mismanagement, the company is now more efficiently run, with a better focus on costs and a more concentrated purchasing strategy.

Final thoughts...

LatAm continues to offer many intriguing investment opportunities. From talking with numerous business leaders, I sensed that there is definitely an air of optimism after some difficult years. For one thing, all three countries I visited have business-friendly leaders committed to reform. There will, of course, be challenges along the way, but I think these reforms should ultimately create the environment necessary for companies to thrive.



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