

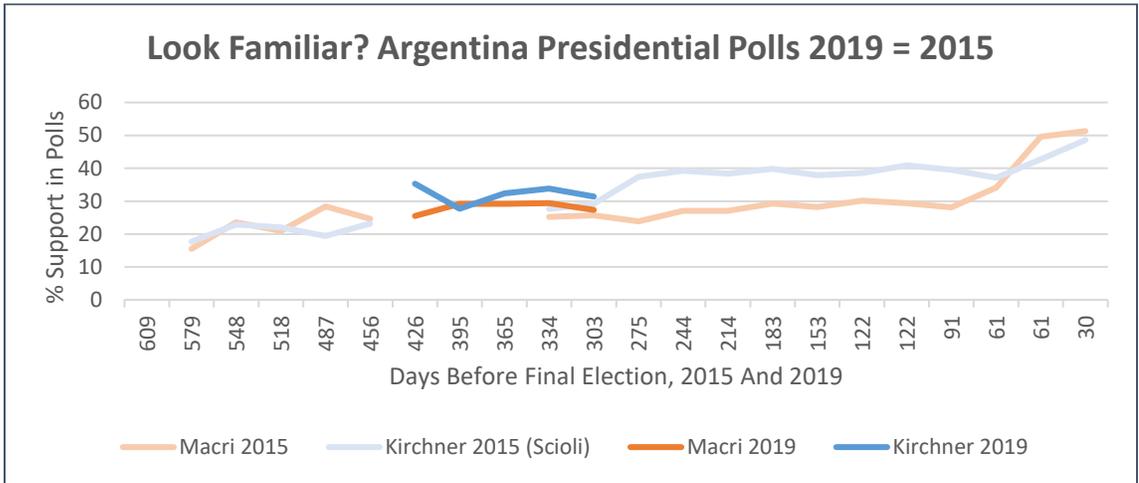
OUTLOOK: Grim Times for Gauchos

“I will come again, and I will be millions.” Evita Peron

Kyklos’s first Argentina position dates to July 2018, following a currency and market meltdown, which was repeated in 2018 and yet again since January 2019. Because the earnings of that company, Central Puerto, benefit from a weaker peso as a regulated electric utility, its shares have been one of the top Argentina performers since purchase, which has somewhat offset the fund’s losses on its position value due to the devalued currency.

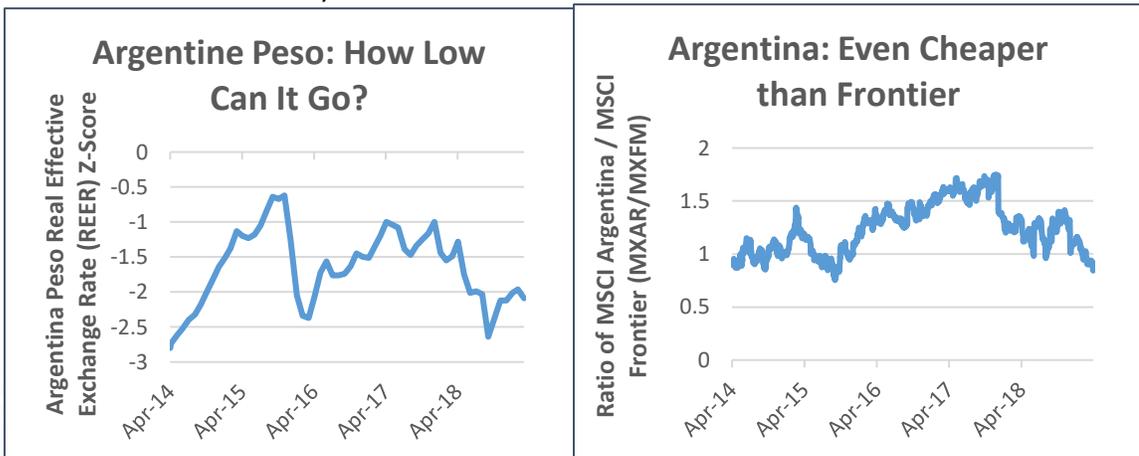
Argentina’s politics, a major reason for its current crisis, could be summed up as follows: Mauricio Macri, the market-friendly candidate, has dire prospects in October’s presidential elections. Polls give an insurmountable lead to his populist opponent, who is largely responsible for the country’s unstable currency, nosebleed-high interest rates, inflation, and lingering recession. In U.S. dollar terms, the country’s stock market has suffered deep double-digit losses over the past six months. Angry workers are in open revolt, as reflected in news headlines such as “Argentina’s National Strike Cuts Off Transport, Cancels Flights” and “Transport Union Strike Paralyzes Argentina.” All hope for a market-friendly outcome is surely lost.

That summary, however, was actually the situation in April 2015, before the elections that brought Macri to power. (The first quoted headline is from today, and the second from almost exactly four years ago.) In October 2015, Macri defied expectations by winning the presidential election, floating the currency, and unleashing a stock market rally that nearly doubled the MSCI Argentina Index within two years. While one could argue that the political shoe this time is on the other foot, with Macri as incumbent and Kirchner in opposition, in reality it remains Macri who presents voters with a change agent, versus Cristina Kirchner’s return to longstanding and ruinous interventionist policies. Kirchner’s new biography was just released, and the sight of her smiling face beaming from bookstore windows will inspire both compliments and thrown rocks alike. Parallels with 2015 are downright spooky, with current polls nearly identical with 2015 at a similar stage in the campaign (below).



Sources: Elypsis, Management & Fit, Wikipedia.

As for fundamentals, Kyklos’s internal country macro risk model rates Argentina the second-most attractive among 38 Frontier economies, helped by one of the world’s most undervalued currencies, attractive stock valuations (below), and recent debt rating upgrades. In addition, MSCI has done its best to provide a bonus catalyst for its stock market, by helpfully “promoting” Argentina to its Emerging Markets Index, effective in June. Looking at recent performance, it appears that the many passive investment funds that slavishly follow MSCI’s changes have, understandably, avoided taking positions-- but will do so eventually. The IMF has stood behind the current government’s efforts to defend the currency, with the organization’s largest-ever credit line. Exports have surged to put Argentina’s trade balance into positive territory and current account in recovery.



Source: Bloomberg, BIS.

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An active manager should usually act when faced with huge price moves in markets. Kyklos added a position in Bolsas y Mercados Argentinos (BYMA) to the portfolio in April. BYMA owns Argentina's main stock exchange and securities custody businesses, which are natural monopolies, offering significant barriers to competition, high profitability, and low need for capital. As the major custodian for nearly all investors in Argentina, BYMA is a major beneficiary of the weak currency, with some of its fees based on the value of dollar- and euro-denominated assets translated into depreciated pesos. In U.S. dollar terms, the share price has fallen below its 2017 listing price. Current valuations, at a trailing PE ratio of about 11, are already far below comparable companies. Company earnings would benefit mightily from any post-crisis recovery of stock exchange volumes and IPO activity.

Timing in Argentina's financial markets, unlike in a tango or a bottle of Malbec, is unpredictable, but the fund sees an opportunity.

Charlie Gushee
April 30, 2019

Interesting April Reading

A coup prediction model: <https://www.economist.com/international/2019/04/20/how-to-predict-when-a-despot-will-fall>

Latest on Belt and Road: <https://www.reuters.com/article/us-china-silkroad/chinas-xi-says-belt-and-road-must-be-green-sustainable-idUSKCN1S104I>

Foreign Affairs sees fresh hope for Africa's People Power:
https://www.foreignaffairs.com/articles/africa/2019-04-25/people-power-rising-africa?sp_mid=59128269&sp_rid=Y2d1c2hlZUBreWtsb3NjYXBpdGFsLmNvbQS2&spMailingID=59128269&spUserID=MzcOTM0NzU4Mzc1S0&spJobID=1623722196&spReportId=MTYyMzcyMjE5NgS2

Hope for Macri? One poll doth not a bear market make:
<https://www.bloomberg.com/news/articles/2019-04-25/as-argentine-bonds-slump-macri-adviser-says-market-has-it-wrong?srnd=markets-vp>

S African energy options point to alts: <https://www.economist.com/middle-east-and-africa/2019/04/20/how-to-solve-south-africas-energy-crisis>

Uganda tries dodging the Resource Curse: <https://www.economist.com/middle-east-and-africa/2019/04/04/uganda-tries-to-dodge-the-presource-curse>

Remittances= developing country bootstraps, bigger than FDI or ODA:
https://www.knomad.org/sites/default/files/2019-04/Migrationanddevelopmentbrief31.pdf?utm_source=newsletter&utm_medium=email&utm_campaign=newsletter_axiosworld&stream=world

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