







AMLO: popularity vs. reality

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- Portfolio management team with more than 20 years' experience.
- Pioneers in Mexican investments*.

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- Achieve quality results.
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SUMMARY

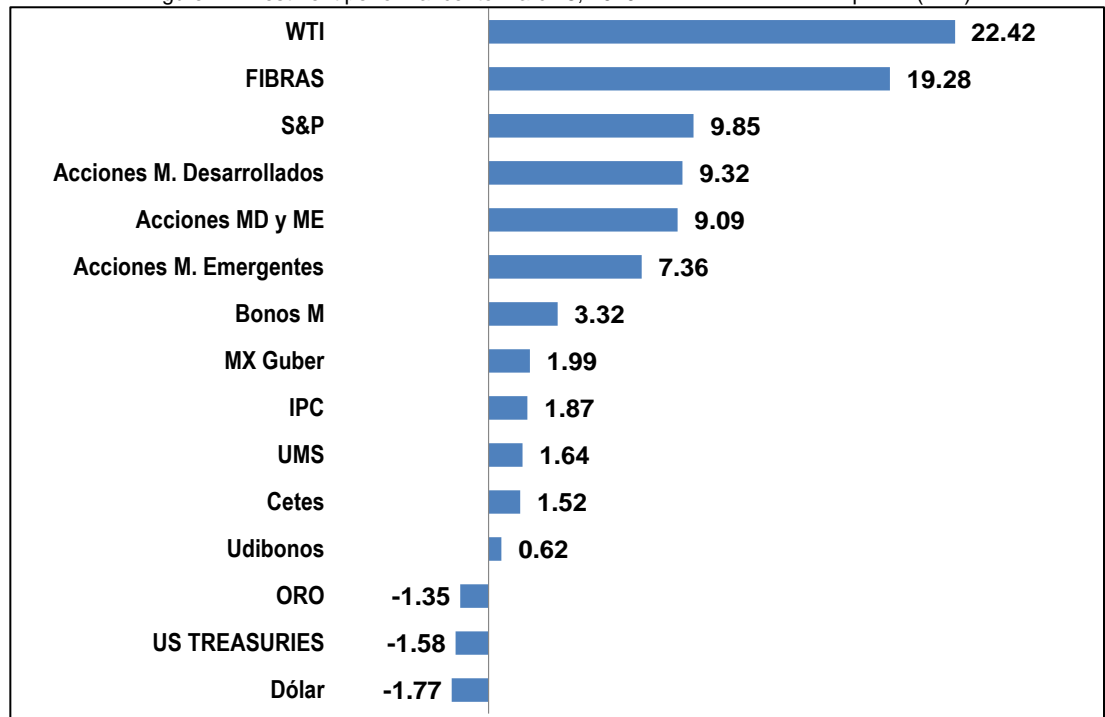
- Global. Global slowdown expected, with possible trade disputes. Frontier wall dispute could cause Fitch downgrade for US.
- Mexico. After first 100 days, AMLO popularity tops 83%, reflecting his clear separation of politics from economics.
- Global risks 2019: sudden slowdown, trade wars, geopolitics, Brexit/Europe, monetary policy, emerging markets.
- Local risks: dysfunctional government, non-ratification USMCA in US, credit downgrade.
- Investment scenarios 2019 with probabilities: positive (20%), negative (40%), middle (40%)
- For peso portfolios, overweight liquidity and ILS 1 to 3 years duration, underweight stocks and REITs.

“It would be nice if we could all agree to this proposition: popularity is not the same as achievement” – Howard Jacobson

Risk assets recover YTD

After its worst December since 1929, the S&P500 had a big recovery, as did foreign stocks and Mexican REITs, although Mexican stocks performed worse. Nominal bonds in Mexico have outperformed ILS as lower inflation is expected for 2019 than 2018.

Figure 1. Investment performance: to March 8, 2019. Source: Franklin Templeton (“FT”)



POLITICS

USA

Partial government shutdown and state of emergency

On February 15, the US Congress approved a law to prevent a second partial shutdown. US\$1.38 bn. for the construction of the frontier wall were included, below the US\$8 bn. Trump requested. Trump therefore declared a state of national emergency to use funds earmarked for other uses (Figure 2).

Figure 2. Source of funds for frontier wall construction. Source: Bloomberg

Rubro original	Monto (US\$ mil mn.)
Aprobados por Congreso	1.4
Construcción Militar	3.5
Lucha contra drogas	2.5
Programa de confiscación de drogas	0.6
Total	8.0

Most Democrats and some Republicans rejected the measure and headed off the state of emergency, undermining the negotiation to the national debt ceiling which expired March 1. No agreement has been reached, forcing the government to fund itself by other means, which will run out at the end of July. If that occurs, the US could enter into a state of default.

Fitch the rating agency stated that without an agreement on the debt ceiling it would have to review whether the US' ability to approve a budget deserved a AAA rating. If no agreement is reached, a Fitch downgrade is probable, as occurred with S&P in 2011, to AA+, its current level. This means that it would be rated AA+ by 2 agencies, leaving out only Moody's.

Trade war

Negotiations between the US and China continued during February. A group of important US businessmen came out in favor of tariffs imposed on Chinese products. China said that 2019 would have lower growth, partly due to a decline in domestic consumption and partly to the trade war. Its growth target was reduced to a range of 6%-6.5%.

EUROPE

Brexit

Negotiations in the UK parliament are still stalled in the runup to the due date (March 29) for the application of Article 50, the treaty clause that triggers the Brexit process. After various failed attempts, Prime Minister May submitted her latest deal with the EU, with some changes to placate opponents from Labor and within her own Conservative party, and to meet the due date to avoid a no deal Brexit. She lost the vote, increasing the possibility of an extension of the date, or, less probably a "no deal Brexit". If the date is extended, the probability of a second referendum increases.

MEXICO

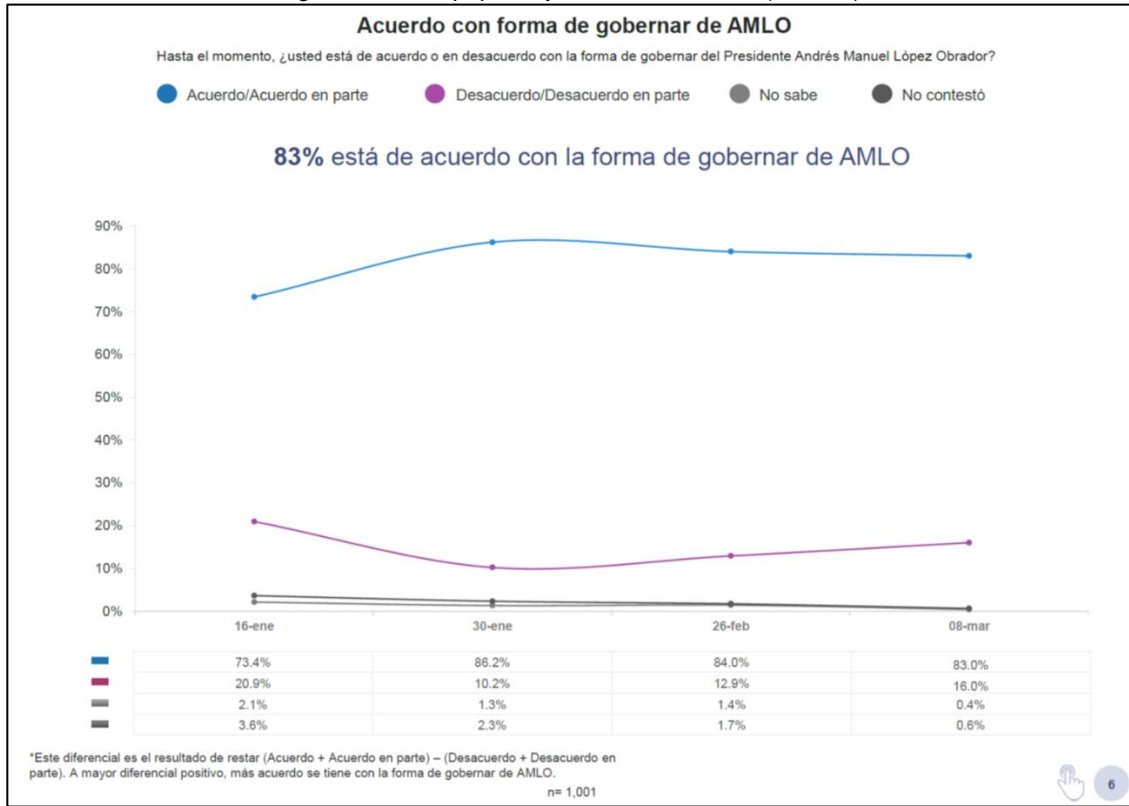
National Guard

In February, the creation of a National Guard was unanimously approved in Congress, and in early March it was approved by 17 local Congresses, enough to enable its execution by the President. AMLO was not entirely satisfied with the law approved by Congress because it decided that the Guard should come under civilian, not military, control, as he had proposed. From March 6, Congress has 60 days to finalize the Law, and 90 days to approve the enabling legislation.

AMLO popularity

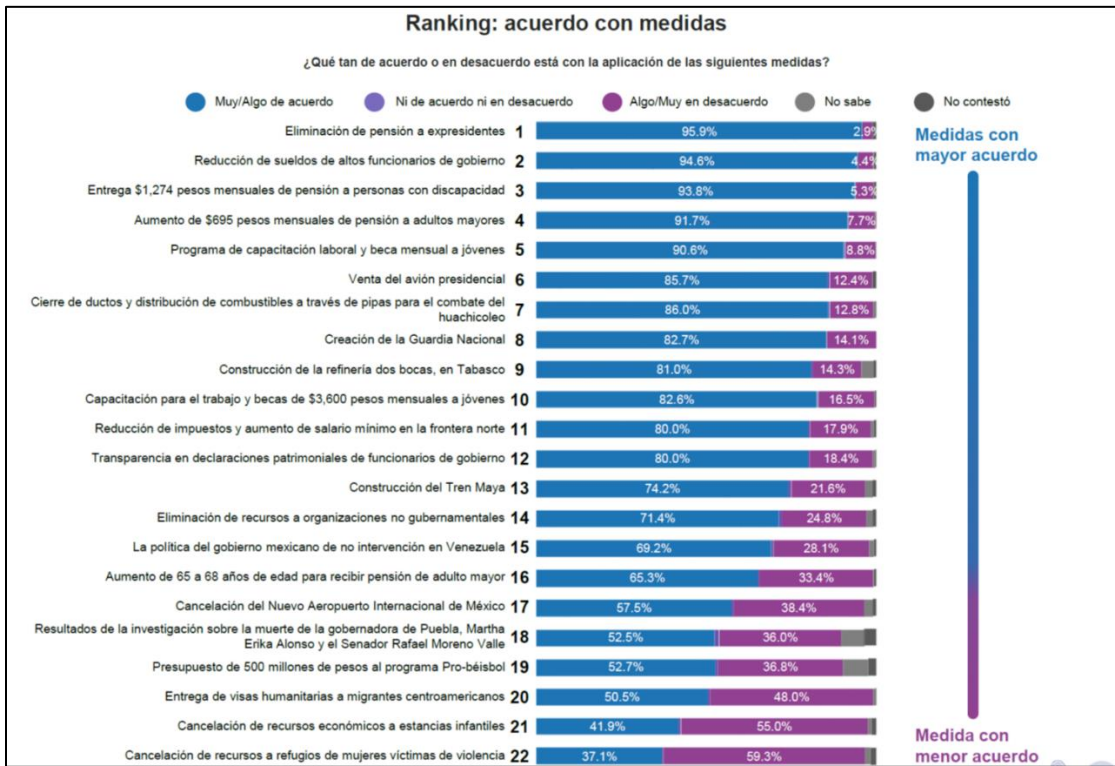
Various polls have measured AMLO's popularity, the most recent being by Gabinete, a polling firm (Figure 3).

Figure 3. AMLO popularity. Source: Gabinete (8Mar19)



The ranking of the reasons for his popularity show clearly the importance given to wealth redistribution over wealth creation (Figure 4). The only items with a rating below 50% are the cutting of funds assigned to daycare centers and female victims of violence.

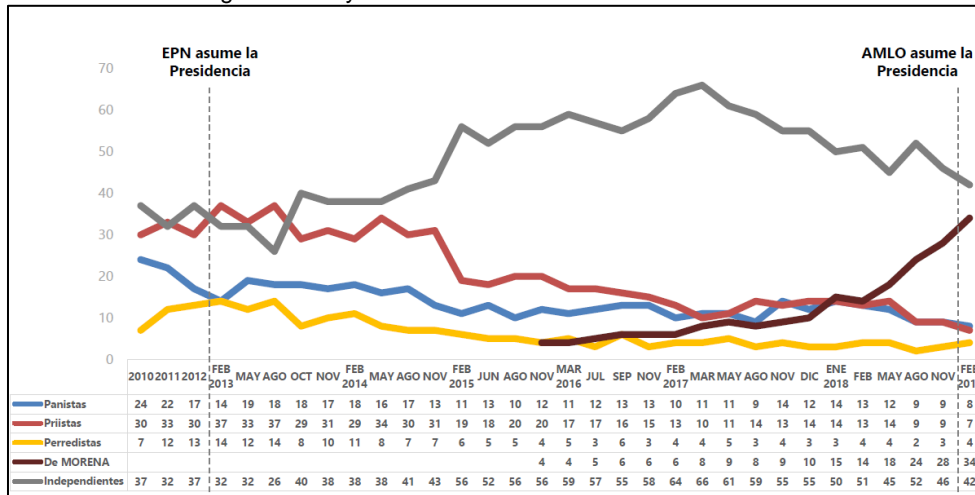
Figure 4. AMLO popularity: ranking of agreement with measures. Source: Gabinete (8Mar19)



Social programs targeted at increasing votes in 2021

Social programs implemented by the AMLO government are aimed primarily at population segments able to vote. Approximately 26% of the electoral register (an estimated 23 mn. voters) will be beneficiaries of a social program for 2021. This is reflected in the increase in party identification with Morena above the other 3 parties (Figure 5), which could be very important for the mid-term elections in 2021.

Figure 5. Party identification. Source: Buendía & Laredo



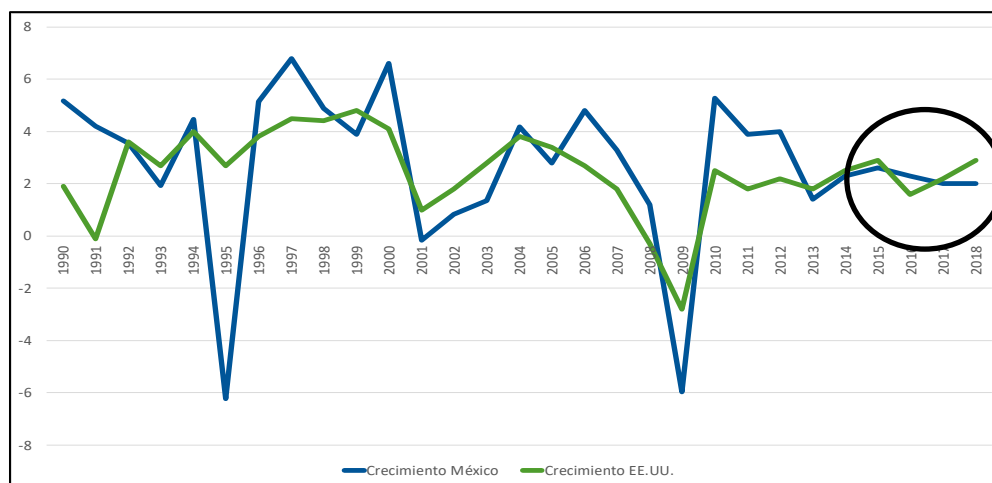
ECONOMICS

GLOBAL

Growth

In 2018, the US economy grew 2.9%, an increase over 2017 (2.2%). One of the main drivers is still consumption. However, decoupling has begun for the Mexican economy. From 1994, the year of NAFTA implementation, the two economies had been closely correlated, but since Trump was elected uncoupling can be observed. (Figure 6).

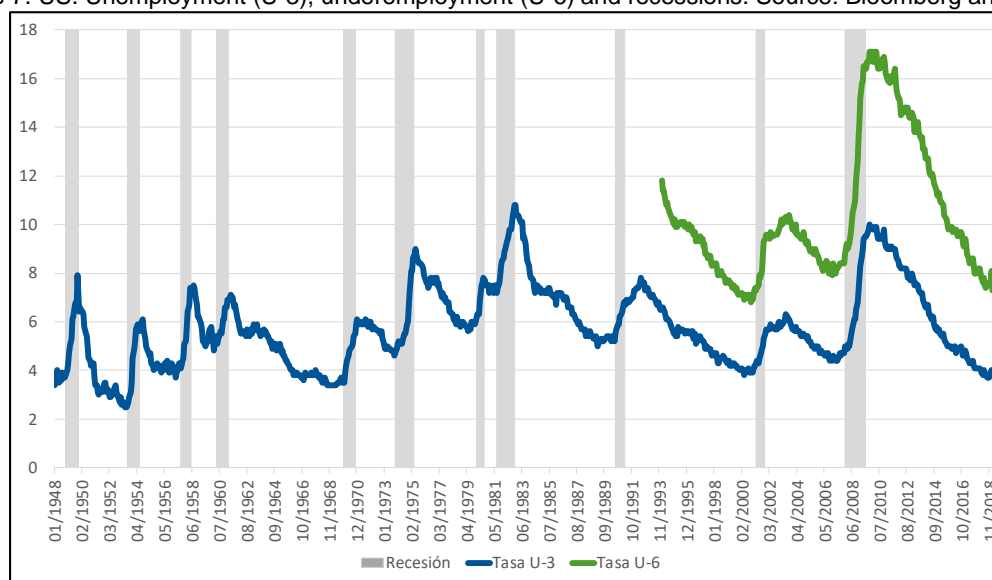
Figure 6. Mexico and US: annual GDP growth. Source: Bloomberg



Employment

In the US, 20,000 jobs were created in February, below the consensus estimate (180,000). However the unemployment rate (U-3) fell from 4% to 3.8%. The underemployment rate (U-6) also fell from 8.1% in January to 7.3% in February (Figure 7). Although the job creation number might appear to imply a slowdown in February, the unemployment rate remains close to its record low (3.7% in November).

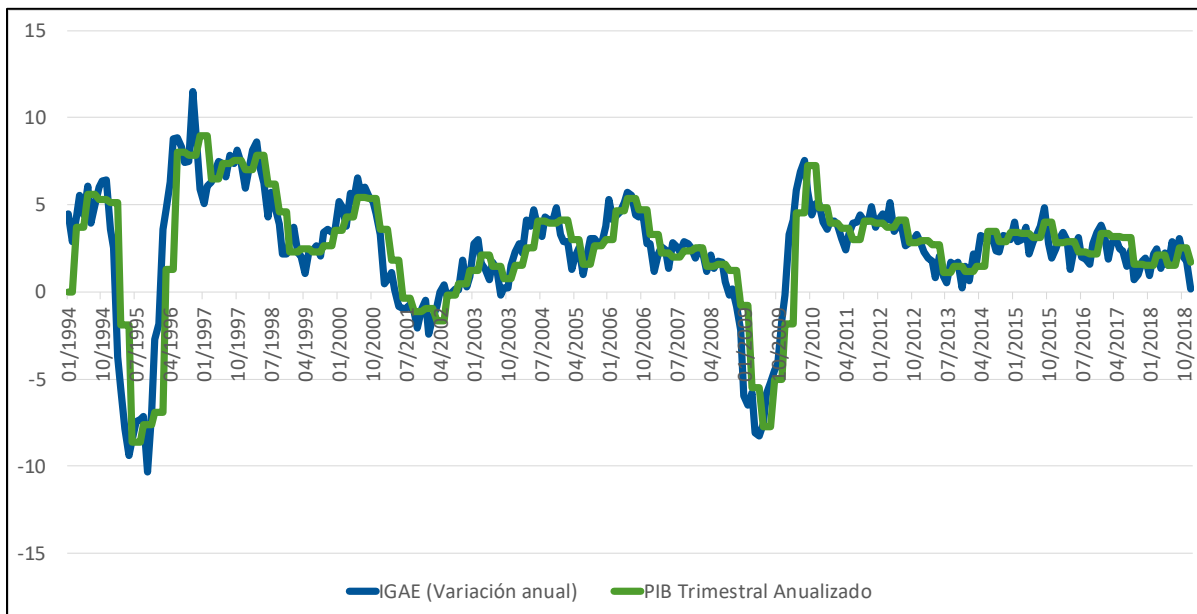
Figure 7. US. Unemployment (U-3), underemployment (U-6) and recessions. Source: Bloomberg and NBER



**MEXICO
Growth**

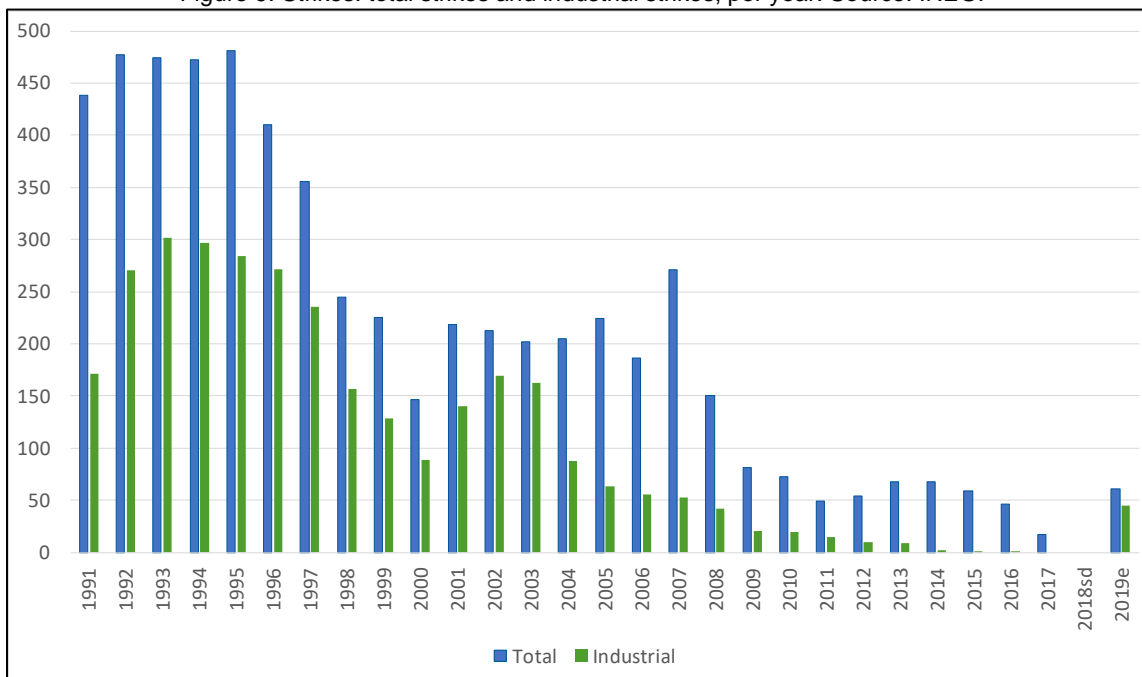
According to data published at the end of February, the Mexican economy grew 2% in 2018, the same as 2017. However, the advance indicator of INEGI (IGAE – the government statistics department) shows an important slowdown at the end of 2018 and the beginning of 2019, due to the change of government, gasoline shortage in January, blockages in Michoacán state and strikes on the Northern frontier. All this probably implies a weak 1Q 19 (Figure 8). For the full year 2019, at end February, Bank of Mexico lowered its economic growth forecast from a range of 1.7-2.7% (published October 2018) to 1.1-2.1%.

Figure 8. Annual variation advance indicator IGAE vs. GDP (quarterly annualized). Source: INEGI



Since the beginning of the AMLO administration, there have been 45 strikes, significantly higher than the number of strikes during the six years of the previous (Peña Nieto) administration (Figure 9).

Figure 9. Strikes: total strikes and industrial strikes, per year. Source: INEGI



S&P: deterioration of outlook for credit rating

On March 4, S&P lowered Mexico’s credit outlook from neutral to negative, keeping the rating at BBB+ global. This implies a minimum 33% probability of a ratings downgrade in the next 12 months. The main reason was the change of government policy to diminish the private sector’s role in the energy sector, which could increase Mexico’s contingent liabilities and reduce economic growth. Current ratings and outlook for the main three agencies are listed below (Figure 10). Also, in early March, an initiative was introduced to Congress by a member of Morena to remove

the license of ratings agencies considered negative to the Mexican economy. This was rejected by the leader of the Morena delegation, Ricardo Monreal, and by AMLO in one of his early morning press conferences.

Figure 10. Mexico ratings; main ratings agencies. Source: rating agencies

	Calificación global	Perspectiva	Último cambio
Fitch	BBB+	Negativa	31-Oct-18
S&P	BBB+	Negativa	1-Mar-19
Moody's	A3 (A- en escala homologada)	Estable	11-Apr-18

The government has said it will announce new support measures for Pemex. In March, news came from the Financial Times of an announcement in London by Treasury Undersecretary Arturo Herrera, that construction on the new Tabasco refinery would be postponed to 2020, in order to strengthen Pemex finances, but this was immediately denied by AMLO in another press conference.

Inflation

February consumer inflation was -0.03% less than January, cutting annual inflation from 4.37% at end-January to 3.94% at end-February. The main cause were fruit and vegetable prices that fell by up to 30% during the month, offsetting the prices rises of low octane gasoline.

Even overall inflation is expected to fall in 2019, we expect an upturn in the next few months due to: 1) the increase in low octane gasoline in February and March with a weighting of 5.36% en the INPC price index; and 2) the change in the INPC calculation methodology in August 2018, and the fact that the normal “deflation months” will not be as strong as before, implying that 12 month inflation increase March-April. Electricity weighting fell from 2.81% to 1.49%.

RISKS AND SCENARIOS FOR 2019

The objective is Mexican economic growth. In the positive scenario, all risks turn out favorable for growth, in the negative, unfavorable, and in the middle, mixed. Estimates for each scenario are given in Figure 11.

RISKS	
<p><i>Global</i></p> <ul style="list-style-type: none"> • US: monetary policy, recession • Global: trade wars • Geopolitics: Europe, Middle East, Russia, China, North Korea, Venezuela • EM: crisis and contagion <p><i>Mexican</i></p> <ul style="list-style-type: none"> • New government • Security • Corruption • Oil • Debt rating 	<p>SCENARIOS</p> <p><i>Positive (20%)</i></p> <ul style="list-style-type: none"> • US: expansion continues, no trade disputes. • Monetary policy does not derail cycle. • Rapid ratification USMCA. • Geopolitical risks do not materialize. • Global growth. • EM: no crisis or contagion. • Mexico: new government functions, spending drives infrastructure/consumption, measures anticorruption and antiviolence work. <p><i>Negative (40%)</i></p> <ul style="list-style-type: none"> • US: expansion stops, trade wars affect global commerce. • Monetary policy derails cycle. • USMCA not ratified, elimination threatened. • Geopolitical risks materialize.

- Global recession.
- EM: crisis and contagion.
- Mexico: new government dysfunctional, spending out of control, anticorruption and violence measures backfire.

Middle (40%)

- US: slow expansion continues, rhetorical trade disputes.
- Adequate monetary policy, but uncertain.
- USMCA approved late, with changes.
- Geopolitical: risks materialize partially.
- Global slowdown, unsynchronized.
- EM: crisis and some contagion from vulnerable countries.
- Mexico: government partially functional, continued mixed signals.

Figure 11. Estimates for 2019 scenarios. Source: FT

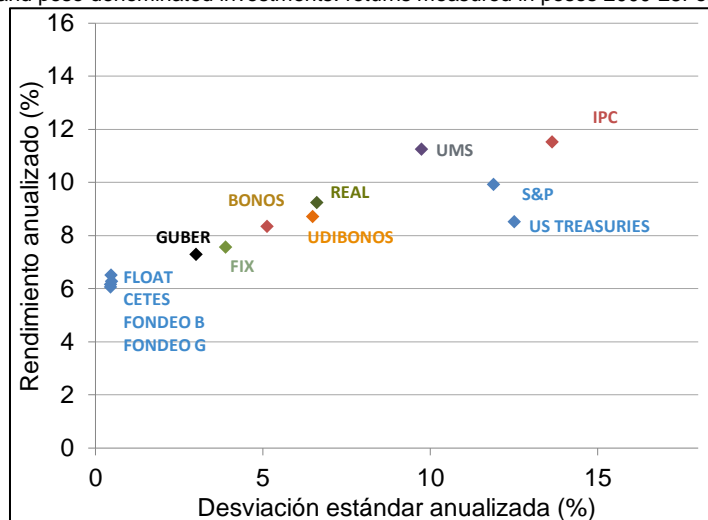
	Scenarios for 2019			2018
	High	Low	Base	Observed
Probability	20%	40%	40%	
US				
Economy	> 2.40%	< 2.40%	2.40%	2.90%
Inflation	> 1.90%	< 1.90%	1.90%	2.50%
Budget deficit	< 4.50%	> 4.50%	4.50%	4.20%
Current account deficit	< 2.60%	> 2.60%	2.60%	2.50%
Fed Funds rate	> 2.75%	< 2.75%	2.75%	2.50%
TNote 10 US	> 2.98%	< 2.98%	2.98%	2.69%
Oil (WTI)	> \$59.8	< \$59.8	59.80	45.41
Mexico				
Economy	> 1.64%	< 1.64%	1.64%	2.00%
Inflation	> 3.67%	< 3.67%	3.67%	4.87%
Budget deficit	< 2.50%	> 2.50%	2.50%	2.10%
Current account deficit	< 1.60%	> 1.60%	1.60%	1.60%
Cetes28 (year end)	> 8.05%	< 8.05%	8.05%	8.42%
Peso/US\$ (year end)	< \$20.19	> \$20.19	20.19	19.65

MARKETS

Investments in US\$ and pesos: comparative performance

Following peso depreciation since Trump, long term (2000-2019) the gap in returns on investment in peso denominated investments and US\$ denominated investments, converted to pesos, has diminished. However, peso denominated have still outperformed US\$ denominated investments, risk adjusted (Figure 12).

Figure 12. US\$ and peso denominated investments: returns measured in pesos 2000-28Feb2019. Source: FT

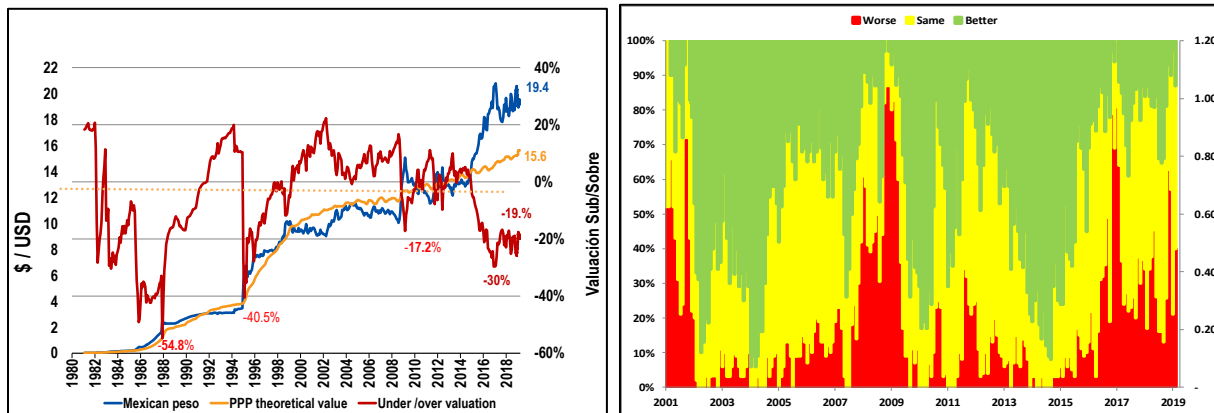


US\$ and peso

Practically 100 days into the AMLO administration, the peso has appreciated owing to general US\$ weakness, the interest rate differential, and foreign investor appetite for Mexican risk (Figure 13). Sentiment measured by Bank of Mexico improved slightly in December but deteriorated in January and February (Figure 14).

Figure 13. Peso vs. US\$: 1980-11Mar2019. Source: FT

Figure 14. Business sentiment Dec2001-Mar2019. Source: Banxico



Debt

Rates are expected to rise in DM and all EM, except Brazil and China (Figure 15).

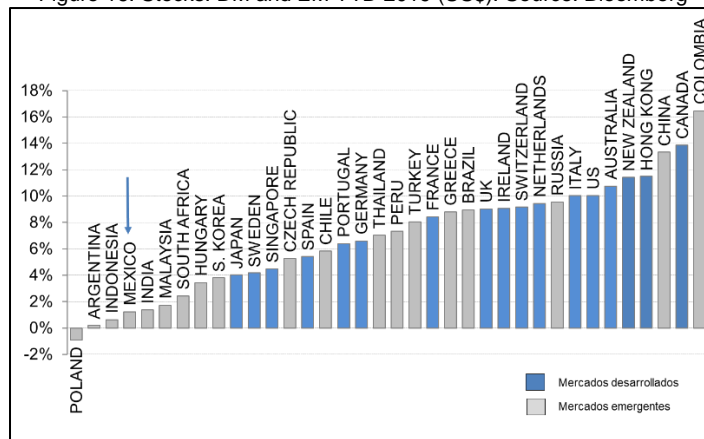
Figure 15. DM and EM: estimated 10 year rates for end-2019 (8Mar19). Source: Bloomberg, FT

Developed				Emerging			
local 10y yields (%)				local 10y yields (%)			
	4Q19e	Actual	(bps)		4Q19e	Actual	(bps)
US	3.03	2.75	27.69	China	3.11	3.20	-9.4
Euro Area	0.71	0.18	52.7	India	7.48	7.38	10.3
Japan	0.08	(0.02)	9.5	Rusia	8.33	8.12	20.6
Britain	1.70	1.30	40.4	Brasil	8.97	9.05	-7.5
Australia	2.42	2.15	26.8	México	8.74	8.16	58.3
Canada	2.44	1.94	50.2	Corea del sur	2.46	1.99	47.5
Germany	0.71	0.18	52.7	Indonesia	7.92	7.85	6.7
France	1.11	0.58	53.2	Turquia	15.70	15.28	42

Stocks

During 2019 YTD, stock performance measured in US\$, in sharp contrast to 2018, has been globally positive owing to pro-market statements by the Fed, and expected resolution of trade disputes (Figure 16).

Figure 16. Stocks: DM and EM YTD 2019 (US\$). Source: Bloomberg



REITs (Fibras)

Since inception, Fibras have outperformed stocks (Figures 17). In 2019 strong performance is due to higher dependence on global trade than most IRT stocks (Figure 18).

Figure 17. Fibras vs. IRT Mar2011-8Mar19.

Figure 18. Fibras vs. IRT. Jan18-8Mar19 (base 100). Source: Bloomberg

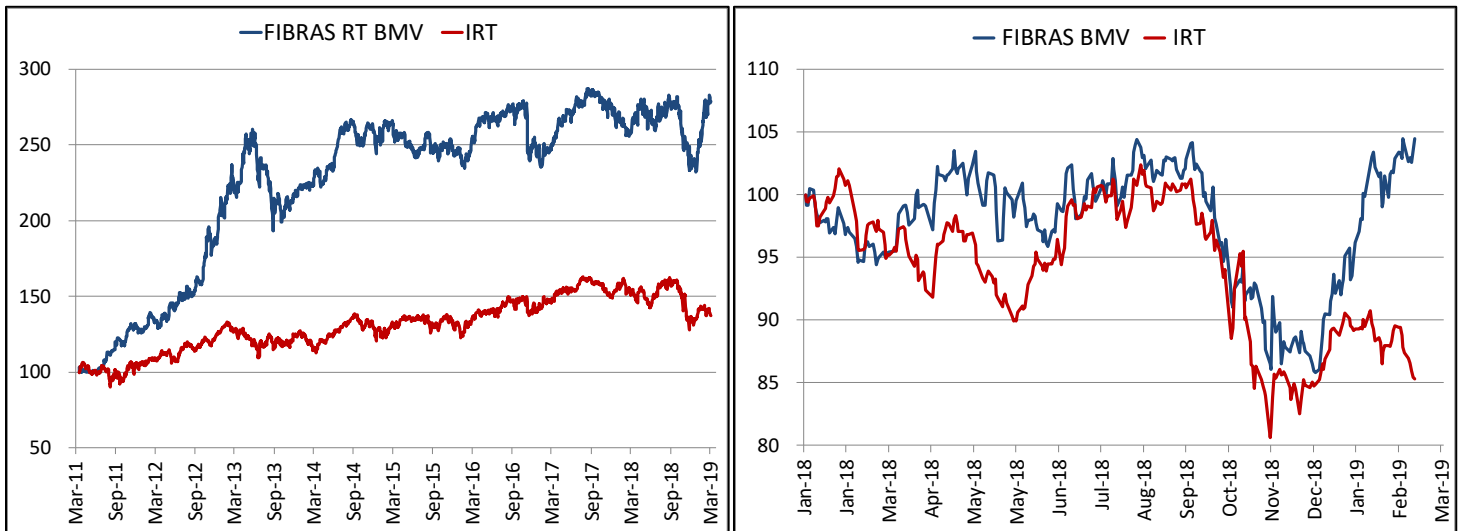


Figure 19. Fibras: valuation and dividends (8Mar2019). Source: Bloomberg

	Mcap (M)	Calendarized					
	(MXN)	2015	2016	2017	2018	2019	2020
FUNO11 MM	95,062	4.8%	6.3%	6.5%	7.9%	8.1%	8.7%
DANHOS13 MM	35,179	5.0%	6.3%	8.3%	8.5%	9.2%	9.2%
FIBRAPL MM	21,626		6.8%	6.4%	6.6%	7.4%	7.5%
TERRA13 MM	19,696	6.5%	7.5%	7.8%	10.4%	10.5%	10.9%
FIBRAMQ MM	14,898	7.6%	7.1%	6.9%	7.8%	8.8%	9.4%
FIHO12	8,064	7.6%	7.8%	8.3%	11.6%	12.5%	12.5%
FMTY14 MM	7,539			8.6%	8.8%	9.2%	10.0%
FINN13 MM	5,204	5.7%	6.4%	8.6%	8.0%	10.0%	10.1%
FSHOP13 MM	4,102	5.4%	8.2%	9.4%	110.5%	14.1%	12.8%

Conclusion

The global outlook has improved for risk assets, with a milder slowdown and less aggressive monetary policy. Perception of local risk has increased with redistributive social spending policies and deterioration in investment becoming clearer, reflecting the government’s emphasis on “politics” over “economics”. We advise caution for peso denominated portfolios, overweight liquidity and ILS 1 to 3 year duration, underweight stocks and fibras.

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Editor: Timothy Heyman
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Investment indicators to February 28, 2019

In February in Mexico, the IPC stock index fell 2.65%. Nominal rates fell except for 28 day Cetes. 10 year real rates fell and 30 year rates rose. The US\$ rose by 1.17% against the peso. In the US: DJ, S&P500 and Nasdaq rose. All nominal rates rose. WTI oil rose 5.86%. In the Bank of Mexico business climate survey, optimism rose to 22% (17% previous), no change fell to 31% (37%), and pessimism was unchanged at 47%.

Mexico					
Stock market and oil					
	28-Feb-19	31-Jan-19	Month	YTD	2018
IPC	42,823.80	43,987.94	-2.65%	2.84%	-15.63%
Local currency (USD/MXN)	19.26	19.04	1.17%	-1.99%	-0.06%
Mexican oil mkr (USD/bl)	58.62	55.03	6.52%	31.17%	-20.47%
Nominal rates					
	28-Feb-19	31-Jan-19	Month	YTD	2018
CETES 28	8.46%	8.44%	2 bps	4 bps	110 bps
CETES 360	8.06%	8.30%	-24 bps	-43 bps	103 bps
M5	7.99%	8.18%	-19 bps	-53 bps	93 bps
M10	8.23%	8.45%	-22 bps	-43 bps	101 bps
M30	8.74%	8.75%	-1 bps	-15 bps	111 bps
Real rates					
	28-Feb-19	31-Jan-19	Month	YTD	2018
UDIBONO 10	4.05%	4.14%	-9 bps	-6 bps	61 bps
UDIBONO 30	4.33%	4.32%	1 bps	21 bps	42 bps
Commodities					
	28-Feb-19	31-Jan-19	Month	YTD	2018
Gold	1,314.40	1,320.21	-0.44%	2.63%	-1.70%
WTI (USD/bl)	57.22	54.05	5.86%	28.04%	-20.47%
UMS					
	28-Feb-19	31-Jan-19	Month	YTD	2018
UMS 10 years	4.67%	4.73%	-6 bps	-25 bps	129 bps
UMS 20 years	5.42%	5.58%	-16 bps	-36 bps	125 bps
UMS 30 years	5.59%	5.37%	21 bps	-25 bps	120 bps
Stock markets (US\$)					
	28-Feb-19	31-Jan-19	Month	YTD	2018
MSCI Developed	8,635.20	8,379.03	3.06%	11.11%	-8.20%
MSCI Emerging	2,357.78	2,352.28	0.23%	9.03%	-14.25%
MSCI Mexico	8,377.62	8,741.11	-4.16%	5.21%	-15.29%
MSCI Brazil	7,118.50	7,449.55	-4.44%	12.54%	-0.15%

US					
Stock market					
	28-Feb-19	31-Jan-19	Month	YTD	2018
DJ	25,916.00	24,999.67	3.67%	11.10%	18.04%
S&P	2,784.49	2,704.10	2.97%	11.08%	11.97%
Nasdaq	7,532.53	7,281.74	3.44%	13.52%	23.26%
Nominal rates					
	28-Feb-19	31-Jan-19	Month	YTD	2018
Tbill 90	2.45%	2.41%	4 bps	0 bps	194 bps
Tnote 5	2.52%	2.43%	9 bps	1 bps	58 bps
Tnote 10	2.73%	2.63%	10 bps	4 bps	24 bps
Tbond 30	3.09%	3.03%	6 bps	11 bps	-8 bps
Real rates					
	28-Feb-19	31-Jan-19	Month	YTD	2018
Tip 5	0.68%	0.73%	-5 bps	-32 bps	91 bps
Tip 10	0.78%	0.78%	0 bps	-20 bps	48 bps
Tip 30	1.11%	1.08%	3 bps	-10 bps	22 bps

Bank of Mexico survey		
Indicator	2019	2019 anterior
PIB	1.64%	1.80%
Inflation	3.67%	3.85%
Cetes 28	8.05%	8.18%
Local currency	20.19	20.16
Business conditions		
	28-Feb-19	31-Jan-19
Optimism	22%	17%
No change	31%	37%
Pessimism	47%	47%

Source: Bloomberg, Banco de Mexico

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