

# **BIENVILLE GLOBAL REVIEW**

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**LATIN AMERICA IN A TRUMP WORLD**

**November 2016**





# LATIN AMERICA IN A TRUMP WORLD

Trump's victory shocked much of the world. Investors are now recalibrating expectations for growth and inflation, and reassessing their positioning across geographies. Trump campaigned on a combination of fiscal stimulus juxtaposed with protectionist, stagflationary policies. As of now, it's unclear which policies Trump will pursue. Yet investors sold emerging markets aggressively, especially Latin America, including select countries that are largely isolated from a potentially changing macro regime in the United States.

- Following Trump's election, financial markets repriced U.S. interest rates, anticipating a more inflationary outlook. The U.S. dollar also appreciated. Both represent potential headwinds for emerging markets. At the margin, investors seeking higher yields globally are now less inclined to look externally.
- On that thesis, investors indiscriminately sold emerging markets. Over three days, 50% of the inflows to EM in 2016 were reversed, consistent with a "sell first, ask later" reaction. Latin America was hit hard. Most countries in the region sold off in unison with Mexico, despite material differences in vulnerability to Trump's protectionist impulses and higher rates in the U.S.
- Trump's framework of the world is 'zero sum.' If a country like China is prospering, it must be at the expense of the U.S. This foundational belief is what drives his desire to formally label China a currency manipulator and to impose tariffs on Chinese imports, another potential headwind for emerging markets.
- Mexico has been in Trump's crosshairs. Immigration aside, the president-elect has threatened to renegotiate NAFTA, a complex and potentially messy affair. More likely are negotiations that manifest in the form of a side letter—less chaotic, yet still providing Trump a "win."
- In Latin America, populism is being defeated, thanks largely to the bust that followed the commodity boom. Ironically, many LATAM countries are implementing center-right policies while much of the developed world is increasingly populist. This peculiar reality has yet to be fully discounted. Institutional investors remain underweight.



# LATIN AMERICA IN A TRUMP WORLD

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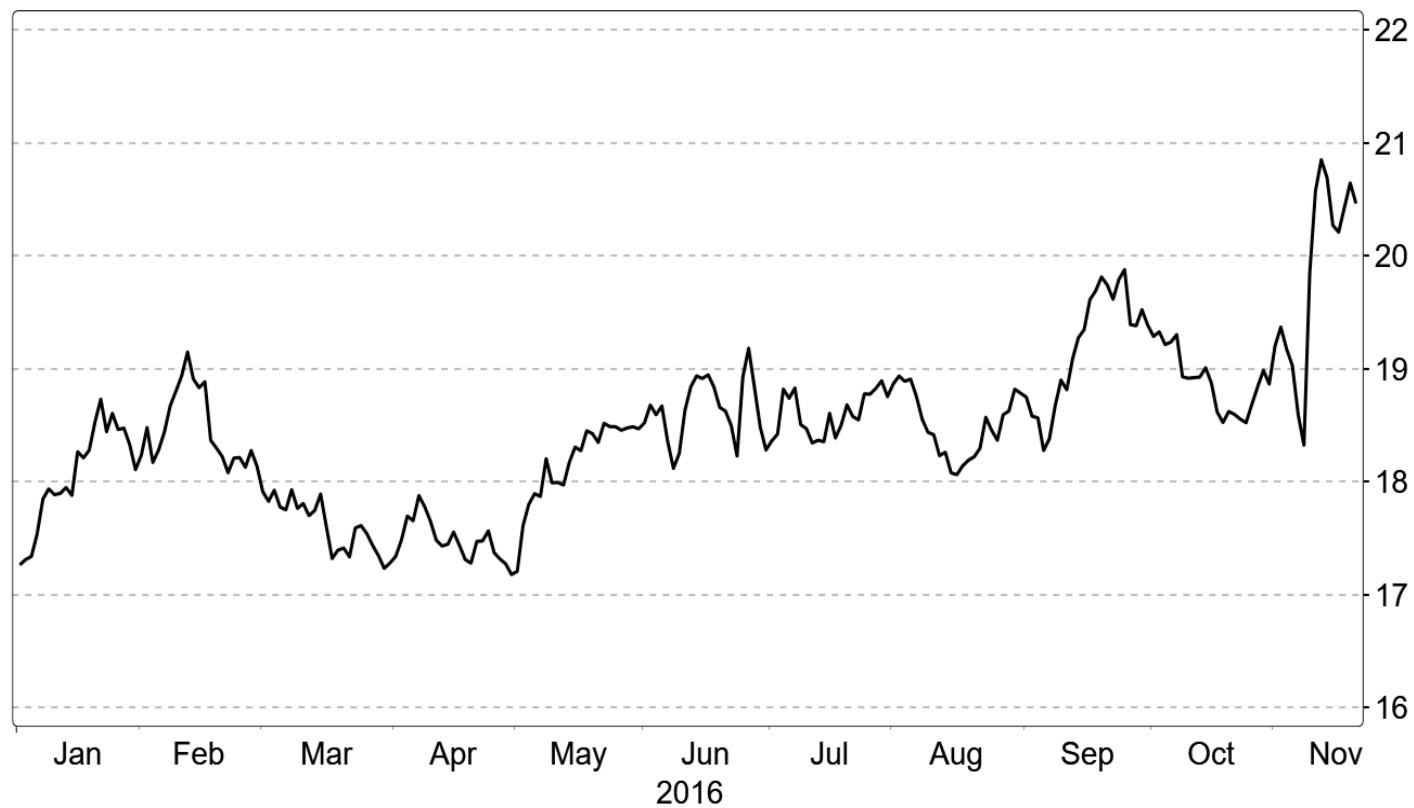
- Higher interest rates in the U.S. may be a headwind for emerging markets in general, but they do not necessarily prevent a domestic recovery for countries where trade with the U.S. is inconsequential, and real interest rates are comparatively high, such as Brazil and Argentina.
- For example, since the “taper tantrum” in 2013, the U.S. dollar has risen 25%. Yet domestically-focused Argentine equities—those benefiting from regime change—were some of the world’s top performers, appreciating more than 300% on average.
- Similarly, the political and economic cycle in Brazil seems to have turned. Policy is moderating and the economy is stabilizing. Growth should return in 2017. Inflation is falling, and the central bank recently commenced an expected prolonged easing cycle.
- Despite the strong performance of the Brazilian equity market in 2016, the country remains a distressed and recovery story. Investors may be overlooking this. Real interest rates are still far too high, reform under Temer is progressing nicely, and as conditions stabilize, the top and bottom lines of domestically-focused companies are set to improve.
- As policies are revealed by the Trump administration, investor flows could contribute to asset price volatility across EM. In select Latin American countries, these flows could continue to create opportunities to buy cheap assets that should benefit from an improvement in domestic conditions.



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Following Trump's election, the Mexican peso continued to depreciate.

## Mexican Peso



Source: Macrobond



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The Brazilian real sold off in sympathy. The exodus from all emerging market assets caused the BRL to retrace some of the appreciation from the cheap levels witnessed earlier in the year.

## Brazilian Real



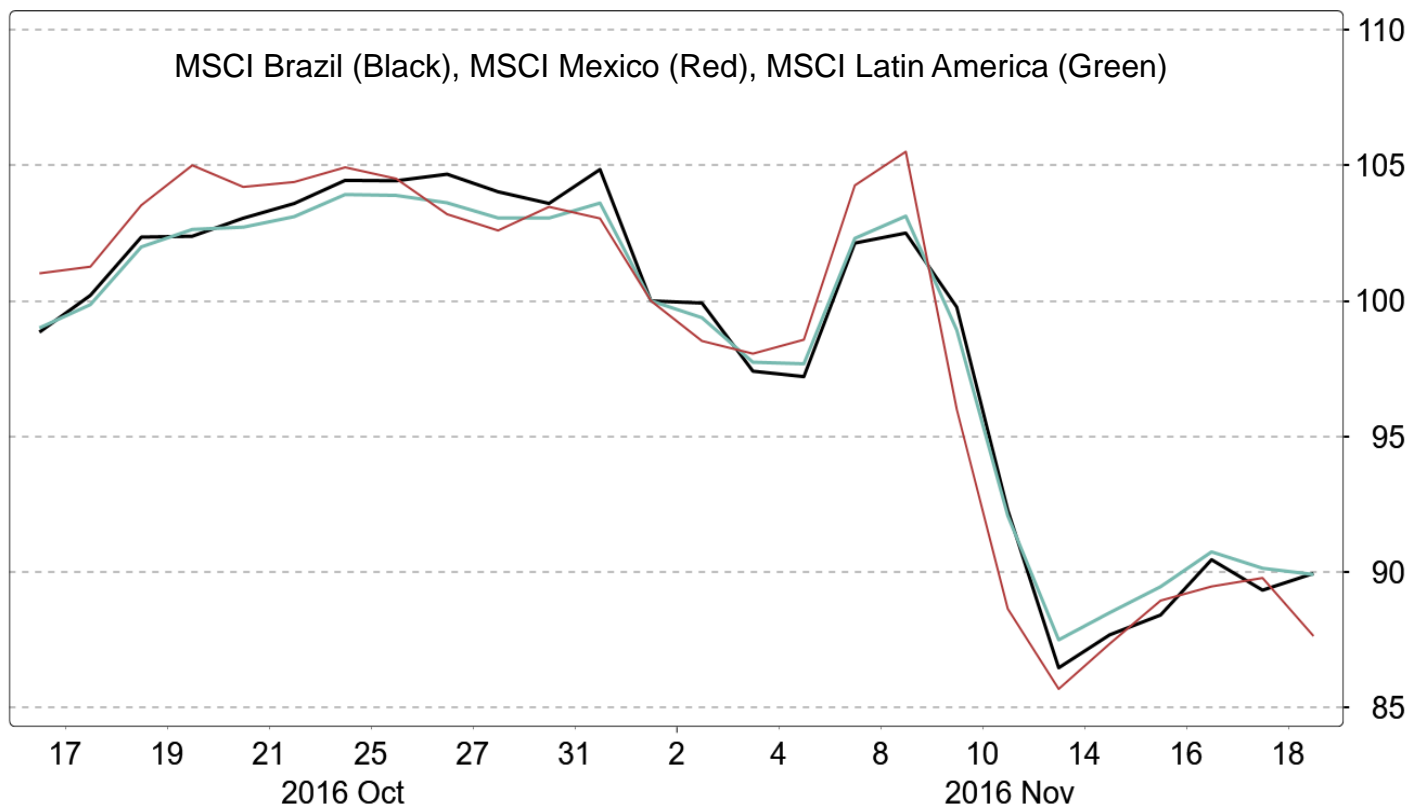
Source: Macrobond



# LATIN AMERICA IN A TRUMP WORLD

Investors sold Latin American equities aggressively. Countries considerably less vulnerable to Trump's protectionist proposals and higher interest rates in the U.S. traded in unison with Mexico.

## Latin American Equities (Indexed to 100)



Source: Macrobond



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Brazilian equities dropped 17% in the three days following Trump's victory. Although still a top-performer in 2016, the Brazilian market remains well below the levels preceding the country's crisis.

## MSCI Brazil

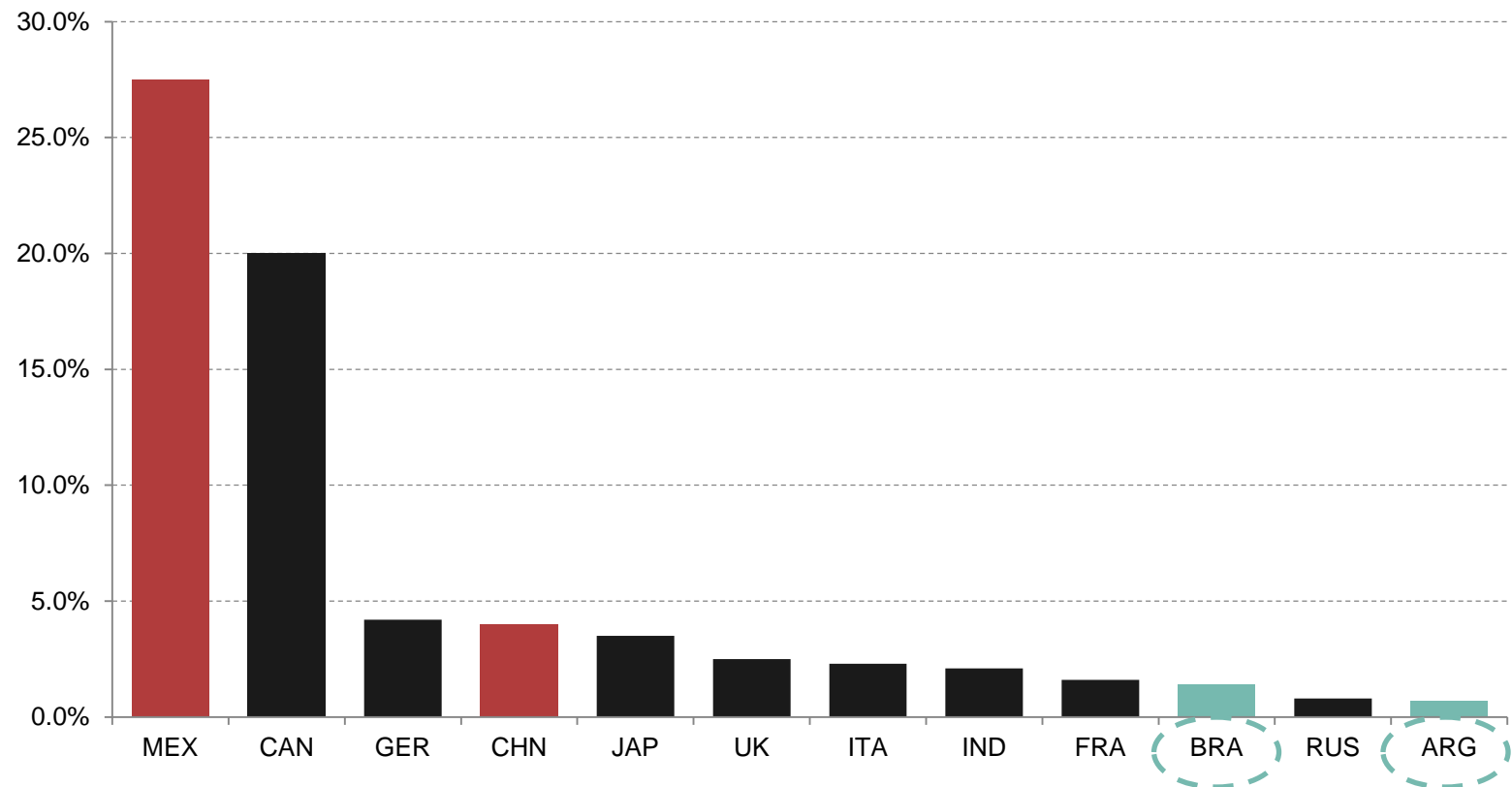




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In terms of trade, Mexico and China are the most exposed emerging markets to protectionist policies. By contrast, the exports of Brazil, Russia, and Argentina to the U.S. are inconsequential.

Trade Exposure (Exports to U.S. as % of GDP)







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With higher interest rates in the U.S., yield-seeking investors may reduce EM exposure. Low-yielding countries are perhaps most vulnerable. Conversely, Brazil offers unusually high nominal and real rates.

## Interest Rates & Expected Inflation

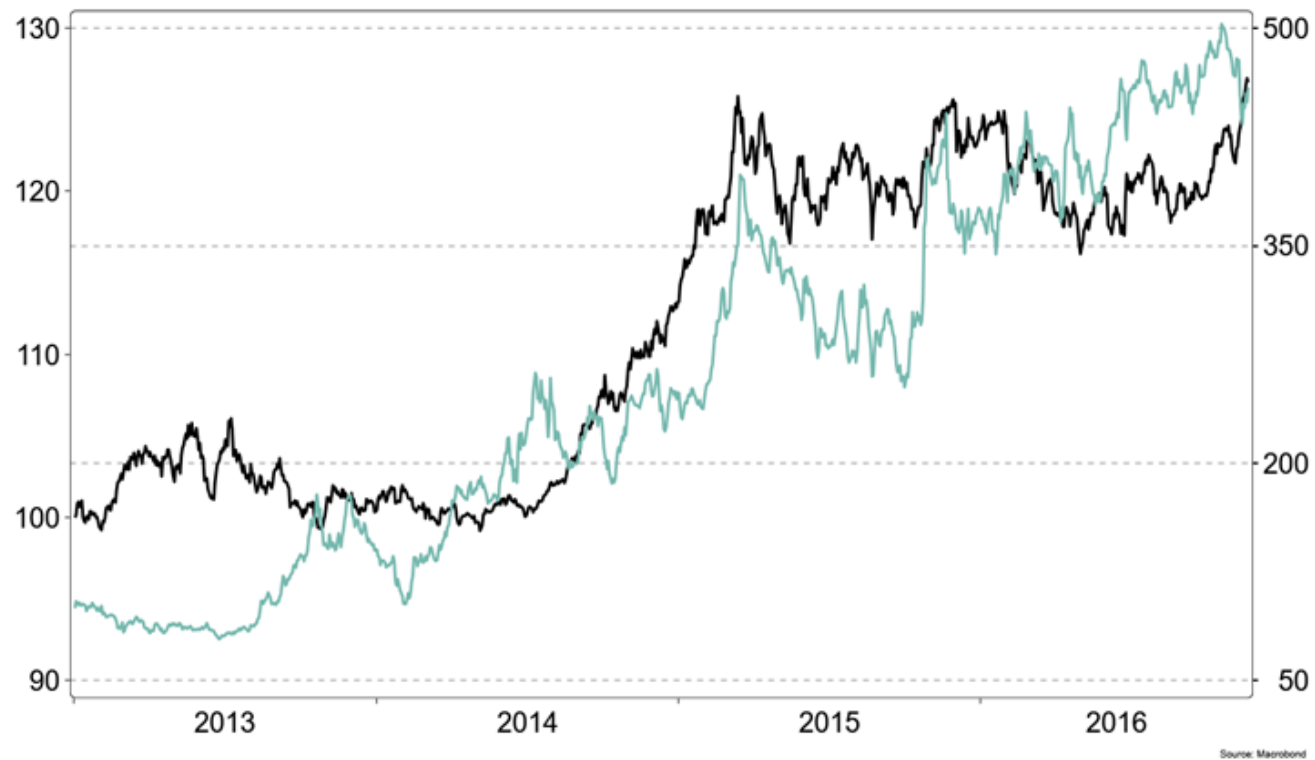
	Overnight Policy Rate	5 Year Nominal Bond Yield	Expected Inflation (2017)	Real Interest Rate
United States	0.25%	1.8%	2.0%	-0.2%
Brazil	14.0%	12.0%	5.0%	7.0%
Nigeria	13.0%	15.8%	16.1%	-0.3%
Turkey	7.5%	10.8%	7.7%	3.1%
Korea	1.25%	1.9%	2.0%	-0.1%
Taiwan	0.25%	0.9%	1.4%	-0.5%



# LATIN AMERICA IN A TRUMP WORLD

A stronger USD doesn't preclude a domestic recovery for emerging markets undergoing policy change. The dollar has risen 25% since 2013. Yet domestically-focused Argentine equities rallied 300%.

**Composite of Domestically-Focused Argentine Equities (Green, RHS) and Dollar Index (Black, LHS)**





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