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Why investors can't ignore what's happening in South America

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Savvy global investors are watchful of developments in Brazil, Argentina, Peru and Chile.

For the global investor, the economic outlook in South America appears to matter more now than at any time since World War II.

Australian companies and investors, either directly or via investment exposure through ASX companies such as BHP, Alcoa or Newcrest, already actively engage with the southern continental Americas.

But given the heightened international sensitivity to geopolitical risk during this stage of the global economic cycle and the flux that both fiscal and monetary US circumstances have caused, savvy global investors are ever more watchful of Argentina, Peru, Brazil and Chile in particular.

With much public attention in the US this week to the fiasco in Puerto Rico — which is now facing a deepening debt crisis by the hour — South America's importance to the financial markets should not be underestimated or ignored given the tinderbox of global risk factors.

It has primarily only been “courageous” Australian investment communities who

have either directly or via listed markets, pursued South American plays and for those who believe all ships rise together and that the US will lift all across the continent, popular but controversial investment plays have been found via the NYSE-Arca quoted Global X MSCI Argentina ETF (ARGT: US) or iShares' Brazil Capped ETF (EWZ: US), to name but two.

Taking a step back and recognising that global markets came into this year hoping for a shift away from the volatility that characterised the “Rates Riot” and China retracements of 2015, it is now timely to appreciate where the global economic status quo sits in relation to South American emerging markets — sometimes also called “Latam” for Latin America — the trends, valuations and most importantly of all, risks and contagion factors.

Recognising this goes a long way to explain why Brasil Bovespa (IBOV: IND) and Argentina Merval (MERVAL: IND) have both been the best EM equity performers universally since 11 February 2016. Informed global investors respect the following:

- Economically, moderate global growth in 2016, falling slightly to 3 per cent, is the slowest pace since the Great Recession. Recent data has been mixed, signalling steady but sluggish momentum.
- Worryingly, US growth has fallen to 1.4 per cent in 2016, after slumping again in Q1.
- In the eurozone, growth remains steady near 1.5 per cent. Nevertheless, momentum should slow slightly after rising to near- cyclical high in the first quarter, and “Brexit” remains a serious risk factor affecting all.
- Brazil contrasts with other emerging markets such as South Africa, Asia or Latin America in that they are only now beginning to tighten monetary policy. This divergence runs havoc for Latin American credit and bond markets.
- The spectre of a China hard landing, as well as being a concern for sharper contraction of domestic Sino demand, dragging down global growth and potentially bringing about by debt-related stresses, directly affects South America as commercially these two economies are locked into ever-deeper financial trysts and co-investments. Despite this global backdrop, within Latin America, Argentina finally appears to be the one on the right track to sustainable economic growth.

This is because in less than six months in office, President Mauricio Macri has

removed restrictive regulation on foreign exchange and lending, led a negotiation with default holdouts that culminated with the largest bond offering ever from an emerging market and laid out a plan to lower inflation from the current 30 per cent level.

This should help unlock the potential of a resource-rich economy that once was one of the five largest in the world. The country is the fifth-largest economy in the Americas, with the second-highest GDP per capita in Latin America and enjoys substantial natural resources: considerable oil and natural gas reserves, including a large, not yet fully explored shale gas and oilfields, as well as a host of mineral deposits, including gold and copper and plentiful water.

Given that the Argentine economy experienced a period of strong growth in the 1990s based on policies that pegged the currency to the Greenback, much of the current economic state of the country can be traced back to the sovereign debt default of 2001.

With the recent debt resolution, Argentina is set to re-enter the fray and present savvy global investors fresh opportunities to seek fixed income exposure to the Americas that is independent of NAFTA, which unite Canada, US and Mexico into a single bloc.

Nothing about either the global economy or South America presents as clear cut or straight forward at the moment and, most importantly, Australian global investors cannot ignore developments on the southern half of the world's most influential financial continent. Watch this space.

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