



Latin American Corporate Debt

Market context

The US labour market ended the year strongly as nonfarm payrolls in November exceeded expectations. On the monetary side, the US Federal Reserve (Fed) cut rates by 25 basis points (bps) during December, bringing the range down to 4.25%-4.50% and revising its year-end inflation forecast for 2025 upwards to 2.5% from 2.1%. Global markets focused on the geopolitical front and President-elect Donald Trump's economic announcements. Amid some political uncertainty and market volatility, the S&P500 dipped 2.5%, but posted another green year as it grew 23.3%, while the US 10-year Treasury yield jumped 40bps in December, closing 69bps higher in 2024.

Credit markets in Latin America suffered from market volatility, as the JP Morgan CEMBI Broad Diversified Latin America Index decreased by 0.6% in December, closing the year 8.7% higher. EM corporate primary market activity recorded US\$6.0bn worth of new issuances in December, bringing the total issuances in 2024 to almost US\$400bn and representing a remarked uptick of 200% month-over-month (m/m) and 62% year-over-year (y/y). We observed the same trend in Latin America, where primary activity issuances amounted to US\$2.5bn in December and US\$73.6bn in 2024, representing an increase of almost 100% in yearly terms.

In Brazil, the economy grew 4.0% y/y in the third quarter (Q3) of 2024, up from 3.3% in the second quarter, driven by resilient investment. On the other hand, industrial production declined by 0.2% m/m in October. On the monetary side, inflation edged higher in October, with CPI at 0.6% m/m and 4.4% y/y. In response, the Monetary Policy Committee raised the reference rate by 100bps to 12.25%, above market expectations, signalling further hikes in January and March amid rising inflation expectations, currency depreciation and robust economic activity. On the fiscal side, the government posted a primary deficit of 0.24% of GDP, slightly above projections, after the fiscal adjustment plan announced in November. Meanwhile, President Lula's approval rating fell to 47% while the central bank intervened significantly in FX markets to stabilise the Brazilian real. In Mexico, President Claudia Sheinbaum announced a 12% minimum wage increase for 2025, while Congress closed out the year having implemented 14 constitutional reforms. On the monetary side, Banxico reduced the benchmark interest rate by 25bps to 10.00%, reflecting a more cautious easing approach as inflation forecasts for 2024 were revised upwards. The credit rating agency S&P confirmed the country's BBB rating with a stable outlook.

In the Andean region, Chile's November CPI rose by 0.2% m/m while the annual inflation rate dropped to 4.2% from 4.7% in October. The central bank reduced its policy rate by 25bps to 5.00%, emphasising risks related to persistent inflation, particularly in core components such as goods and services. In Peru, the central bank maintained its key rate at 5.0%, citing alignment with neutral levels. On the economic side, economic activity gained again in October, with primary production sectors offsetting weaker secondary performance as copper and gold production declined in annual terms while silver production rose 10% y/y. In Colombia, the current account deficit for Q3 clocked at US\$1.7bn or 1.6% of GDP, consistent with last year's figures. On the monetary side, November's CPI rose by 0.3% m/m and 5.2% in annual terms. As a result, the central bank reduced its policy rate by 25bps to 9.50%, maintaining a cautious easing stance. On the political side, Finance Minister Ricardo Bonilla resigned amid corruption investigations, with Diego

Past performance does not predict future returns; losses may be made.

¹ Where performance is gross of fees, returns will be reduced by management fees and other expenses incurred. Net performance is net of highest institutional segregated portfolio management fee.

Not all securities held have been discussed. For further information on how the overall strategy performed during the period covered, please reference the relative performance noted in the Performance review section.

Guevara stepping in as his replacement.

Lastly, Argentina's economic recovery continued showing mixed results, with industrial production falling 2.0% y/y and construction activity dropping 24.5% y/y in October, while tax revenues grew 4.4% y/y in real terms. On the monetary side, November's inflation decreased to 2.4% m/m, the lowest level since July 2020, prompting the central bank to lower the benchmark interest rate to 32% from 35%. Finally, President Milei's approval rating rose to 47.0%, supported by cooling inflation and some economic recovery.

Performance

The Strategy outperformed the JPM CEMBI Broad Diversified Latin America Index for the month gross of fees, but performed in line with the Index net of fees¹.

Contributing to performance was the Strategy's credit selections in Mexico, Colombia and Chile. This was partially offset by being underweight in Argentina and overweight in Brazil. On a sector basis, the main contributors to relative performance were credit selections in consumer, non-cyclical and financials. This was partially offset by credit selections in the energy and industrial sectors.

In terms of duration, the Strategy benefited primarily from underexposure to the 10+ year range. This was partially offset by credit selections in the 1-3 year range. In relation to credit ratings, the Strategy's selections within and underexposure towards the BBB bucket were the main drivers behind relative performance for the month, followed by good credit selections in the BB and B buckets. This was partially offset by being underweight CCC-rated bonds.

Outlook

The global economy has faced an increasingly challenging landscape, with persistent inflationary pressures, rapid heating of geopolitical conflicts, downward revisions for global growth and volatile electoral processes. However, these headwinds are not evenly distributed among regions, and therefore, some of them will be less affected or may even benefit from the current context. We believe this is the case for most Latin American economies, which have proven to be resilient in a more difficult global environment.

After many decades of dealing with different types of crises, this time around, most central banks in the region have adopted a quick and effective monetary policy to cope with this high inflationary environment. Many countries in the region increased interest rates well before developed markets, which allowed them to tackle inflation earlier in the cycle and gave them space to initiate rate cuts during 2024, supporting GDP growth into 2025. In addition to this, Latam has continued to benefit from high commodity prices, specifically from momentum in metal prices, as well as from robust consumption trends.

Even though the new Trump administration is expected to increase the risk for emerging markets in general, we believe Latin America will be less affected than other regions, considering its strategic commercial relationship with Mexico and potential new relationships with other countries in Central America and the Caribbean. Also, the region's strategic location shields it from the impact of an acute rise in global geopolitical conflicts. Despite Donald Trump's wider-than-expected victory in the recent US presidential election, which could bring volatility to markets, the relative health of balance sheets among corporates presents a wide array of opportunities among companies in strategically important industries.

Overall, Latin America presents a dynamic landscape with diverse opportunities and challenges. On the credit side, we see attractive valuations with wide spreads compared to other regions. Moreover, Latam corporates enjoy healthy balance sheets and strong liquidity, and we expect default rates in 2025 to decrease at the margin, remaining slightly below long-term averages.

Global risks include a potential downturn, as well as uncertainties surrounding the effectiveness of the latest economic measures in China. Regional risks could involve Brazil's lack of fiscal discipline, climate-related challenges in the Andean region, weaker momentum in metal prices and unexpected policies implemented by the new Mexican administration.

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