GRUPO SBS

GC Letter V2, #2, Thursday 18, May 2017

The Bayesian Staker

Back to the Previous Future

In our previous letter, we noted that growth optimism seemed to have remained despite policy implementation delays in the US, but argued that President Trump´s policy agenda was far from secure, warning about the possibility of further disappointment. At the same time, we highlighted that the US economy continued to recover, the orderly US rate sell-off looked losing steam, and asset market volatility remained subdued given the potential shocks ahead, particularly in FX, equity, and credit markets. We acknowledged that such relatively serene market conditions were really remarkable, particularly given the degree of policy uncertainty in the US and of political ambiguity in Europe, ahead of yet critical elections in Netherlands, France, Germany, and Italy. Yes, as discussed, excess global savings endured, and the changing paradigm in the US was encountering too much uncertainty to robustly test that deflationary global setting. But we feared that after many years without inflationary threats, this low rate/low volatility background could rapidly change under different combinations of Trump´s policy promises.

The US administration's difficulties to introduce minimum modifications to the so-called Obamacare health bill simply confirmed President Trump´s challenges to move its policy agenda forward. Indeed, the Obamacare fiasco further exposed the intrinsic contradiction facing the Trump administration discussed previously, where the President´s boldness could be its main drive but at the same time its worst enemy. As noted, Mr. Trump´s eagerness to push forward its initiatives undervalues important tradeoffs, constantly taxing its conservative constituency. Such an internal conflict would be even more evident in the coming discussion on the corporate tax reform. Fiscally weakened by the Obamacare resilience, and without enough political support to increase the fiscal deficit, an aggressive tax reform would be only possible with some revenue measure, such as the border tax. However, the border tax could be quite disruptive given the likely transfer of wealth among winners and losers, and politically unappealing. Therefore, a massive fiscal stimulus is looking now increasingly unlikely.

In the interim, the Dutch general election and the French presidential vote brought some sense of political stability in Euroland. The next focal point is the September 24th general election in Germany, but chancellor Merkel looks likely to extend her leadership for another 4 years, and be able to use some fiscal power to maintain growth momentum. Meanwhile, the EU economy has sustained a solid recovery path and the ECB is currently discussing the best timing to slowly reduce its quantitative easing stance. Similarly, the Chinese economy has shown new signs of marginal growth deceleration, but continuing to transit a delicate deleveraging process with relative success. Probably much more important than any other factor affecting the global financial picture, the US labor supply has recently suggested signs of a fading recovery in participation, squeezing this market further, and convincing the Fed of the need to start tightening monetary conditions, first by pushing Fed Funds rate up, and undoing balance sheet investments later.

Thus, it looks like the global financial outlook is now very much resembling the expected landscape prevailing before President Trump's surprising victory in November last year, albeit with a slightly stronger world economy. This seems characterized by a couple of confronting forces, like excess global savings and depressed growth sustaining low interest rates, and stretching labor market conditions, particularly in the US, demanding monetary tightening sooner rather than later. At the current junction, valuation of most financial assets looks fragile at best, but there does not seem to be a consensus view. Indeed, there are sell side research recommendations for all tastes. There are analysts still hoping to see the positive impact of deregulation and some fiscal impulse, endorsing long equity and credit positions, but short bonds; while there are others afraid of growing disappointment with economic reality over time, and much more worried about an equity correction. And in the middle, we have the Fed, the ECB, and the prospect of raising rates but still challenged by the global savings glut, the subdued investment process, and poor productivity generation.

Agnostic about the Trump´s administration ability to push for a strong reflationary process, we sit on the side of those dreading the US equity market more than anything else. In our view, the US economy is recovering but capped by a slow potential growth pace. Although we do not fully yet disregard the possibility of Trump´s positive policy surprises, we feel the risk/reward metric is particularly worrisome for US equities, as valuations remain high mostly sustained by expectations of strong returns to come, very low volatility, and a relatively weak USD. The latter could be a fragile support if the Fed confirms its path of higher rates to offset inflationary pressures without a meaningful change in the medium term growth & investment outlook. At current levels of valuation, real rates and the USD/EUR, credit markets might also be vulnerable. In this regards, EM bonds might still offer a sensible proposition despite high valuation as well, particularly in a world of gradual monetary tightening in the US, but without major candidates for market disruption besides the equity market. Nevertheless, in such an environment, we do favor the search for some hedges, being equity volatility or US HY spread the most likely to be effective.

Notwithstanding the consideration above, we still feel rather comfortable holding Argentine risk, as discussed in our recent publication, *Argentina: A Fragile, Yet Promising Pre-Electoral Path*[1]. After two months of strong social tension and growing political threat to the government's economic agenda, President Macri´s administration seems to have regained political initiative. This repositioning, however, is hardly the result of the government's achievements, but actually the reflection of a divided political opposition still representing the worst of the past, at least among the more independent sectors. In fact, economic recovery is still slow and heterogeneous, likely to sustain political fragility until mid-term elections. But the government holds some leverage in this rocky road towards the October elections, particularly favored by the expected economic improvement and displeasing opposition alternatives. In our view, this and relative valuation, vis a vis other emerging markets, should sustain interest in Argentina´s assets.

In summary, while doubts on the US and the global scenario persist, holding a core mid-duration USD EM debt, with an important Argentine bias, seems to remain a good investment proposition. In Argentina, we favor a barbell strategy in the sovereign curve (long LETES, DISCOS, and PARS) combined with mid-duration sub-sovereign and corporate bonds in the USD front, and LEBACS in ARS. Some peso assets with active hedging still seem like a must have, as the macroeconomic forces in Argentina continue to push for further real appreciation of the currency, absent external shocks, even after the Central Bank has acknowledged some concern about a very strong peso. Furthermore, we might add some Argentine and Brazilian equities to that portfolio, but only strategically, as we fear global equity valuation. However, after today news in Brazil, we would be rather cautious on Brazilian assets for the time being, expecting important delays in the reform front. Finally we would include some global equity, credit, and FX volatility protection as a defensive tactic amid high global uncertainty and the view that global rates and asset price volatility have more space to rise than otherwise.

Agnostic about Reflation; Concerned about Labor Dynamics

As discussed, the ability of a new US administration to impose a relative aggressive fiscal and de-regulatory agenda threatened to feature a game changer event, potentially able to move the US economy away from its protracted anemic growth, at least temporarily. President-elect Donald Trump has also promised to curb free trade and free labor mobility, which could eventually represent a handicap for economic growth, nevertheless exacerbating the combined impact on inflation in the short run. However, after an initial spike of optimism, there have been increasing doubts regarding the new administration’s talent to deliver effectively on its promises, both on growth and protectionism. Thus,

[1] “Argentina: SBS Monthly Report”, April 27, 2017.

we seem to be back to the future projected before the November Presidential election, where monetary policy is back on center stage.

The first but failed attempt to undo part of the Obamacare legislation back in March represented an early revelation of the difficulties ahead for President Trump´s economic agenda. Finally, the government was able to get some Obamacare reform hardly passed in the Lower House but discussions at the Senate suggest further gridlock on the official initiative. Even more difficulties are likely to arise for the President's tax proposal.

The White House's opening statement of ideals concerning the tax reform has not yet provided enough content details to anticipate a broad bipartisan agreement. Although personal tax breaks appear to favor the middle class to some extent, they benefit the wealthy as well, opening the door for strong criticism from the Democratic base. Infrastructure and childcare plans might also be popular, but details are missing. Likewise, the omission of a concrete border tax adjustment shows not only the President's lack of endorsement on the House Republican's proposal but limited bipartisan support. Nevertheless, Treasury Secretary Mnunchin has continued to suggest some territorial alternatives that could introduce another blocking stone further down the road. Without a source of significant revenue generation, the aggressive corporate tax reduction envisaged remains at odds with the Senate's reconciliation rules that limit any widening in the fiscal deficit. A higher deficit would also be directly against the preference revealed by the more conservative leg of Congress, such as the Key Freedom Caucus. Therefore, a timely tax cut driven fiscal stimulus is still possible but not more likely than before, and certainly not more probable than the stimulus implied by the remaining optimism in expectations.

For example, a final reduction in corporate tax rate from 35% to 25% (half of the envisaged in the White House statement) together with a modest cut in individual income taxes is estimated to boost US GDP by less than half a point based on simulations with the Fed´s FRB/US model.[2] The latter seems consistent with the CBO current baseline and Bloomberg median forecast anticipating a federal budget deficit widening by one tenth of a percent of GDP this year and three-tenths next year. Thus, it appears today that, on average, expectations do include a decent fiscal impulse, although economic forecasts still reflect a wide range of prospects. Indeed, Figure 1 below reports implied uncertainty from economic forecasts for the US economy from a sample of 62 forecast institutions surveyed by Bloomberg L.P., were 2017-2018 growth projections range from a minimum of 1.2% to a maximum of 4.5%, consumer price inflation from 1.2% to 4.0%, the EUR/USD exchange rate from 0.97 to 1.25, and 10Y treasury rate oscillates within 200bps!

Figure 1: Divergent but persistent growth optimism

	GDP (%)		CPI (%)		EUR/USD		UST 10 Y (%)	Fiscal Deficit (% GDP)	
	2017	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**	**2017**	**2018**
Median Bloomberg	2.20	2.30	2.40	2.30	1.10	1.14	2.80	-3.20	-3.50
Min	*1.20*	*1.50*	*1.50*	*1.20*	*0.97*	*1.00*	*1.60*	*-2.70*	*-2.40*
Max	*2.70*	*4.50*	*3.70*	*4.00*	*1.20*	*1.25*	*3.65*	*-5.00*	*-5.80*
Bank of America	2.10	2.50	2.10	1.80	1.08	1.15	2.85	-3.10	-4.00
Citibank	2.10	2.60	2.40	2.30	1.05	1.05	2.65	-3.00	-3.80
Deutsche Bank	2.30	2.60	1.90	2.20	1.02	0.95	2.90	-3.20	-3.50
JP Morgan	2.00	1.80	2.20	2.20	1.15	1.15	3.00	-3.30	-3.60
Morgan Stanley	2.00	2.00	2.50	2.10	0.97	1.05	2.50	-4.30	-5.80

Source: Bloomberg LP.

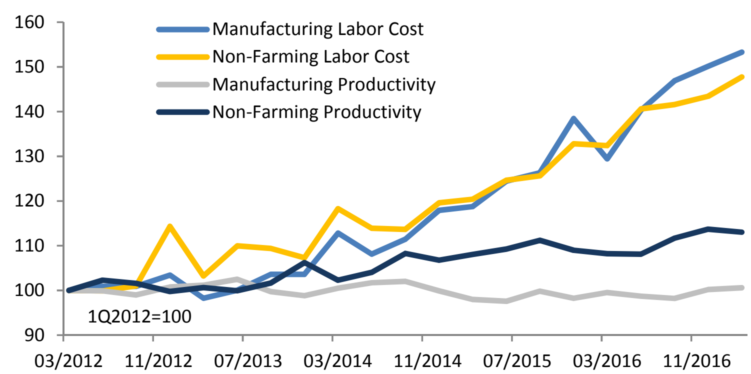
Opportunely, recent developments in Europe have been more stabilizing than political events in the US. The official victory in the Netherlands general election, or the massive rejection for segregation and anti-European initiatives revealed in France's presidential election, have brought some relief to economic recovery in Europe and EUR support. This trend is likely to be reinforced by the September 24th general election in Germany, where chancellor Merkel is expected to extend her leadership for

[2] Available on the Fed web: www.federalreserve.gov/econres/us-models-package.htm

another 4 years, and be able to use some fiscal power to maintain growth momentum.[3] Likewise, it is also valid to argue that despite remaining hazards in the delicate Chinese deleveraging process, the Asian economic path has remained fairly smooth, although risks still remain. Thus, global growth indicators point to sustained positive motion into this quarter, staying well above 3%, and showing some demand rotation away from China. The latter being felt by the commodity spectrum, but mollified by forward oil markets staying at around 50 USD/bbl, under the view that constant control by oil producers would prevent a new fall in prices. In reality, oil inventories have remained high by historical standards, but global growth is being sustained and producers have remained fully committed to maintain coordination.

In the meantime, the US Fed seems increasingly poised to raise rates two more times this year, in June and September, and has recently reinforced its desire to start phasing out the reinvestment of its balance sheet in December. The latter seems consistent with the view that 1Q17 weakness has been transitory and mostly weather related. Indeed, with employment rising an average of 174,000 over the past three months, the US economy seems to be already operating at full employment. Currently, the unemployment rate is 4.4%, declining 0.4% in the last few months. Simultaneously, productivity growth continues to frustrate, declining last quarter and pushing annual growth to only 1% over the past year, further adding to weakening supply side sources to counteract labor demand price push. The latest labor report informing a rise in unit labor cost growth to 2.8% YoY is a clear indicator that wage inflation is pressuring corporate profit margins while productivity fails to pick up, as pictured in Figure 2 below.

Figure 2: Raising unit labor cost amid slugish productivity in the US



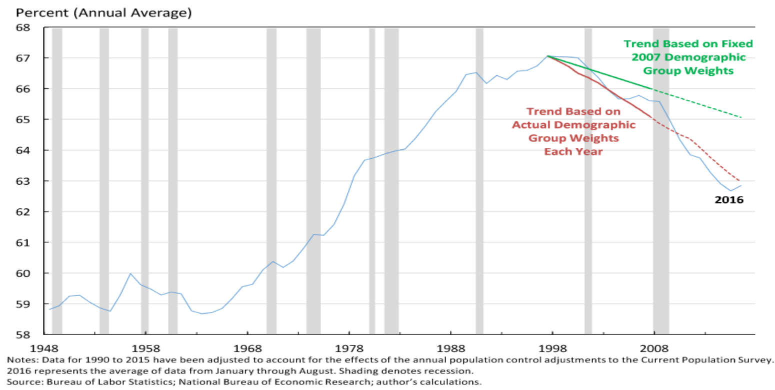
Source: BLS and Bloomberg L.P.

Falling energy prices in recent weeks have helped maintained inflation at 2.2% YoY (1.2% annualized in the three months through April!). Surprising, core inflation fell as well, now below 2% YoY, although partly affected by a large decline in global food prices driven by the Chinese market. However, this recent price behavior should be understood as reflecting high volatility more than a trend, where recovery in global growth and tightening US labor market conditions should be in command in the medium term, particularly as last year's rise in labor force participation rates looks like slowing or pausing. The latter should not be much of a surprise, as demographic trends continue to push participation rates lower. Furthermore, recent studies on the labor market have suggested that most recent increases in labor force participation had been more the result of a slower rate of departure from the labor force of the long-term unemployed than the cyclical reflow of discouraged workers back to the labor force.[4] Thus, we might well be witnessing a near ending of the rise in labor participation and the going back to the standard labor market stretching sooner rather than later.

[3] More likely than ever after the solid victory obtained this past weekend in North Rhine- Westphalia.

[4] See for example the analysis presented by Alan Krueger in the last Fall's Boston Fed conference, in October 2016, entitled "Where Have All the Workers Gone"

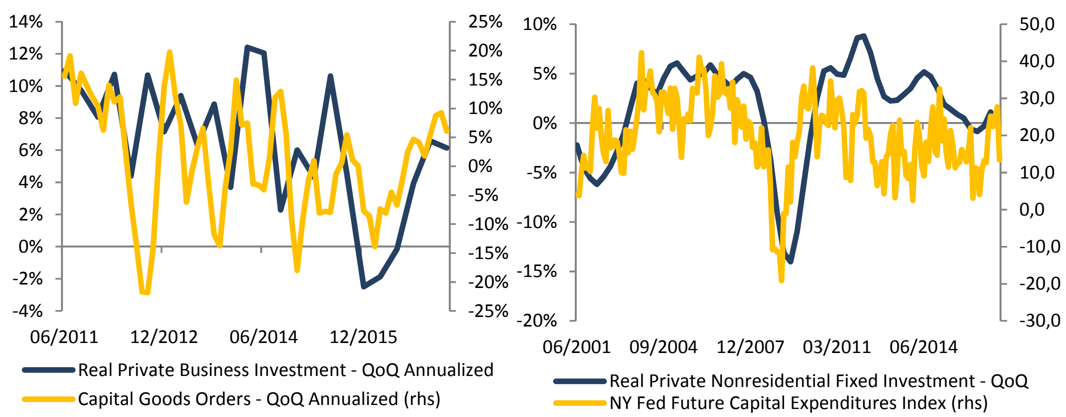
Figure 3: Actual US labor force participation rate and projections



Source: Alan Krueger's Where Have All the Workers Gone, Oct, 2016

Absent an exogenous stimulus, such a changing dynamic in the labor market, together with a still subdued business spending on capital goods and productivity generation, brings back worries of short term inflationary pressures without a constructive modification of the long term perspective. Therefore, while the excitement regarding a solid lift in investment demand is fading, inflation pick up is becoming increasingly the short term risk to the US economic outlook. In other words, the fundamental sources sustaining the global savings glut appear to have remained, as well as the prospect for protracted low real interest rates, but nominal shocks seem to be regaining predominance in the short term.

Figure 4: US capital spending has yet to confirm an upward lift



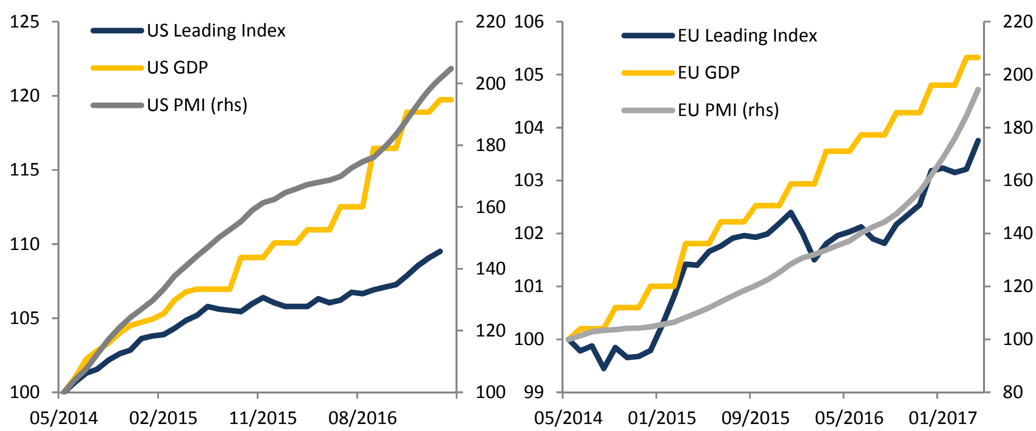
Source: BEA, FRB, and Bloomberg L.P.

Disappointment Fears, Equity Valuation, and Low Volatility Backdrop

Despite 1Q17 demand weakness, the dominant expectation remains a recovering US economy. Consensus estimates point to growth exceeding 2.0% this year while the Fed's GDP trackers already suggest a faster pace of growth. Likewise, survey data has been rather strong, but exacerbated by measures of consumer and business sentiment, which are forward looking or simply expectations. Such a benign view about the next few months, nonetheless, coincides with diminishing expectations about Trump´s coming fiscal impulse as discussed above. Thus, if any, there seems to be more room for disappointment than positive surprises.

In such an uncertain policy and economic environment, risk assets have performed relatively well. Equities have been up again in more than a month while bond yields have been rising smoothly, somehow reflecting a positive growth and inflation trend. This notwithstanding, there seems to remain an increasing vulnerability in asset pricing, particularly for those depending critically on economic growth. First, as discussed, current expectations are still based on some degree of optimism regarding President Trump´s pro-growth policy agenda. Figure 5 below somehow pictures the disparity between expectations and leading indicators in US vs EU. Second, business fixed investment has remained sluggish although orders of capital goods have been growing recently. Thus, cheerfulness is yet based on Fed´s surveys on plans to increase capex in the near future, and recent improvement in the energy sector responding to partial recovery in oil prices over the past year. Regulatory easing is also expected to keep lifting business sentiment. However, capital spending has been just a promise for a long while, yet unable to produce the significant increase in productivity needed to envision a faster pace of sustainable growth. Third, growth in capital services has rebounded but remains low, compared to the pre-crisis levels, adding doubts on a rapid pick up in labor productivity growth. Fourth, the low productivity, low labor participation, rising labor cost path is increasingly demanding tighter monetary conditions in the immediate future, independently of the final performance of investment and productivity growth.

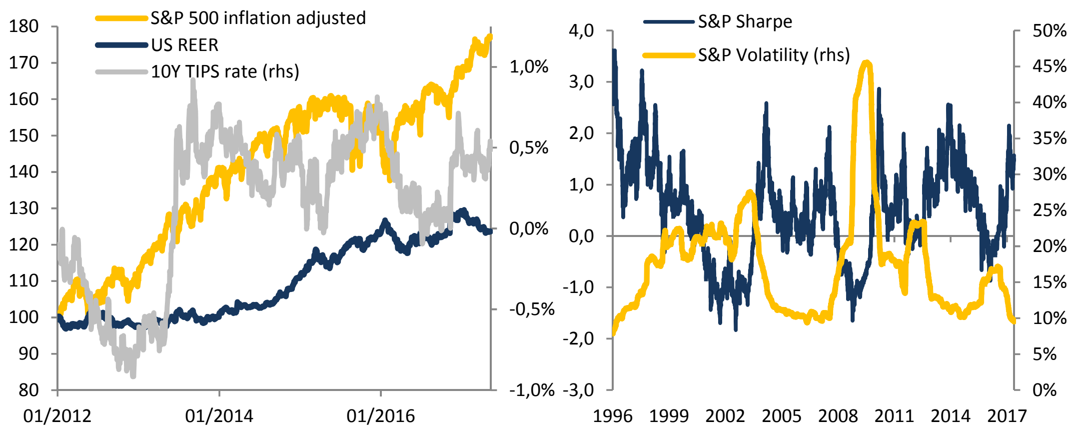
Figure 5: US/EU economic activity in data and expectations



Source: Bloomberg L.P.

Therefore, tighter monetary conditions responding to inflationary pressures without clear signs of a faster sustainable pace of growth in the US does not exactly bode well for risk assets. Similarly, inflation worries should be a major risk factor for bonds, but might be contained by excess savings globally and depressed economic perspectives in the medium term. In addition, USD strength due to higher rate differentials in favor of the US will further cap corporate earnings if a faster pace of growth is not the underlying source of greater demand and inflation. Interestingly, higher US rates have been accompanied by a weaker USD in recent weeks, mostly for political reasons (France elections vs. Trump´s campaign dealing with Russia, among other factors), soothing the net effect on equity valuation. Figure 6 below shows the S&P index adjusted by inflation, compared with the USD real effective exchange rate, and real rates implied in 10Y TIPS, illustrating that recent strong performance in the equity spectrum has been contemporaneous with higher real rates but a depreciating USD. This notwithstanding, both real rates and the USD REER are likely to rise further, possibly challenging equity valuation, unless accompanied by a solid economic rebound.

Figure 6: US equity, its drivers and volatility



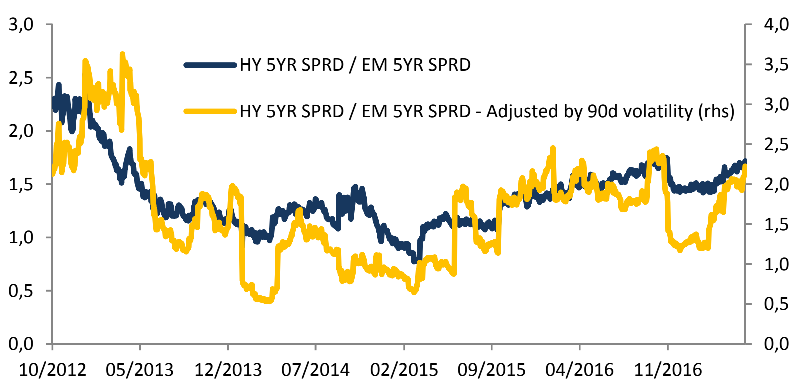
Source: Bloomberg L.P.

US equity optimists argue that historically low volatility indicators should also anticipate steady returns. We have a hard time agreeing with that proposition, particularly in a policy environment as uncertain as the one described previously. In addition, we noted that consensus forecasts and market expectations have continued to have a positive Trump premium, although fading gradually overtime. The latter also presents a biased risk/reward condition, where frustration seems to be less expected than otherwise. Therefore, for the reasons above, we would be quite cautious regarding equity investment, at least not until having more concrete evidence that some meaningful fiscal stimulus is likely, and/or fixed investment demand is finally picking up on a sustained basis.

A similar consideration guides our fixed income selection, where US HY corporate credit shares some of the risk factors facing US equities. The latter exacerbated by historically low volatility indicators in most asset classes, but particularly low in US high yield. Again, in a steadily improving environment, declining volatility in asset prices should be a welcoming and reassuring confidence factor. The latter, however, could well backfire if such improvement proves to be just temporary.

Appetite for US High Yield Corporates and Emerging Markets seems even stronger than pre-US election days, with the US High Yield 10Y spreads tightening by more than 100bps, almost twice the compression witnessed in EM 10Y spreads in the same time span. In the meantime, 10Y treasury rates are about 60bps higher than before the election but almost 30bps lower than their peak in March this year, and certainly still well below their post-taper tantrum pick of 300bps. Thus, both HY and EM are vulnerable to rising interest rates driven by inflation qualms, but HY might be more so given direct links with US growth disappointment, recent performance, historically low volatility, and weaker credit quality than EM.

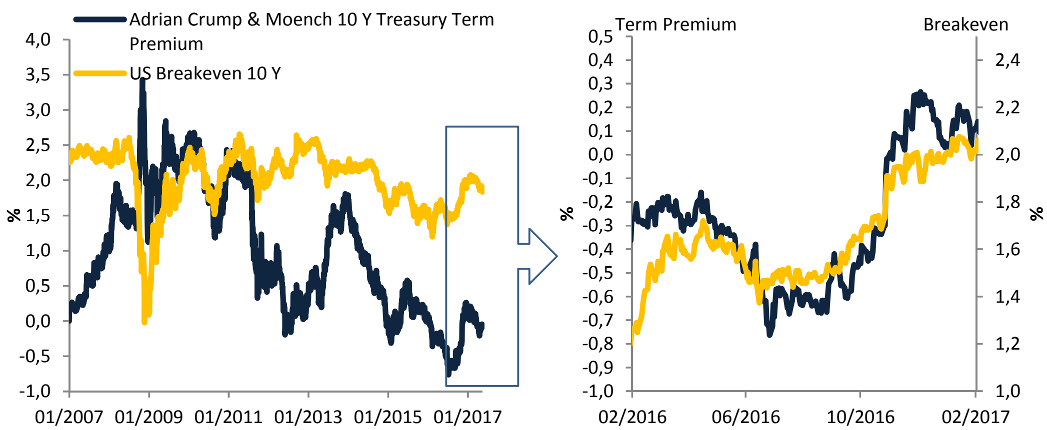
Figure 7: HY/EM Relative valuation and vulnerability



Source: Bloomberg L.P.

Interestingly, the partial recovery in 10Y rates since April 18, roughly by a bit less than 20 bps, has been accompanied by a relatively stable breakeven inflation, at around 1.85%, although showing some recent volatility. Thus, increasing nominal rates in recent weeks has been reflected by a similar increase in real rates, and some added risk premium, as pictured in Figure 8 below. Based on the discussion above, both rate factors have room to move higher, but stable breakeven inflation recently might be an additional source of concern. Nevertheless, as discussed, risk premium might be still very sensitive to prevailing policy uncertainty and its relatively low level from historical standards.

Figure 8: Risk premium slightly up; inflation expectations not much



Source: Bloomberg L.P.

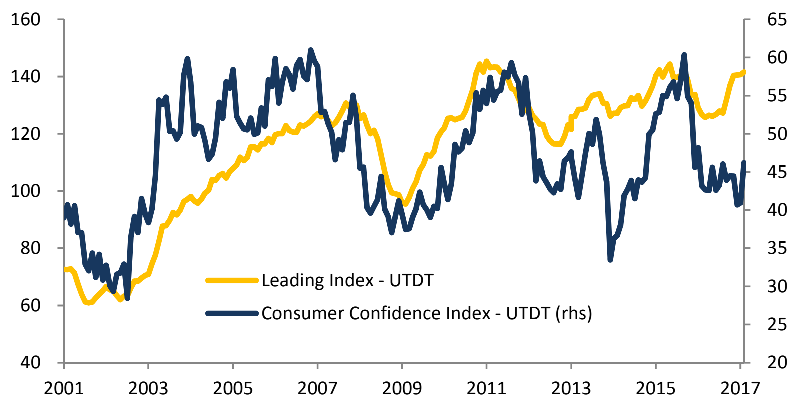
In summary, Donald Trump's victory in the US presidential elections had the potential force for a dramatic change in US policies with far reaching implications for global markets. Initially the question was whether Trump´s pro-growth agenda was not going to be overshadowed by his other policy initiatives. More recently, President Trump´s reflation hopes have been losing steam. Nevertheless, markets are still granting the new administration some benefit of the doubt. In this uncertain backdrop, we continue to suggest a prudent investment approach. Worth noting, we have not discussed Trump´s trade policy initiatives, simply because they do not seem a priority nowadays, but remaining possibly quite disruptive anyway. In the meantime, risk assets could do well, but demanding active management and the use of hedges to stay protected against extreme scenarios.

Argentina: Still on a Promising Path

As noted in our recent piece on Argentina, events over the last few weeks have renewed reasons to remain cautiously optimistic about Argentine assets, without underestimating the external risks and the pending domestic challenges. In particular, after two months of strong tension and growing political threat to the government's economic agenda, President Macri's administration seems to have regained political initiative. This repositioning, however, is hardly the result of the government's achievements but mostly the reflection of a divided political opposition, still representing the worst of the past, at least among the more independent voters. In fact, economic recovery is still dawdling and political fragility is likely to persist until mid-term elections. But the government continues to have some leverage in the difficult path towards the October elections, particularly favored by the expected economic improvement and the uninspiring opposition.

Determination in the salary negotiation with teachers of the Province of Buenos Aires and a firm stance maintained by the authorities in the face of the hardest political and union sectors, have shown a government committed to a change that most of the argentine society calls for. Trade unions' discredit and fear of going backwards have strengthened the government's strategy. This became especially true after a massive, independent and spontaneous demonstration of the reforming sectors, which took place in big cities on April 1st, with the "support democracy" slogan. These demonstrations not only eclipsed the faded image created by several consecutive protests, strikes and road blockings that occurred over the previous weeks, but also strengthened the government's action and helped improve social mood.

Figure 9: Confidence and leading indicators are recovering

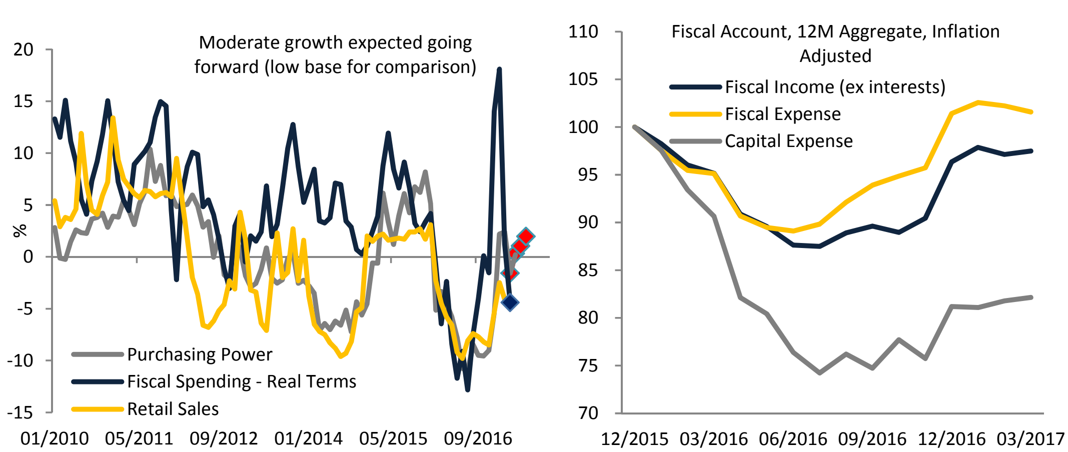


Source: UTDT and SBS Research

This reversal in President Macri's government image after the deterioration of the last months was not free of cost, as it entailed certain fiscal tolls. Neither was it powerful enough to substantially modify the economic/political fragility resulting from the official strategy of gradual adjustment and slow and mixed recovery. Expenditure in social subsidies is still on the rise (33% Y/Y), although amounts continue to be manageable. But the government has also chosen to make the economic reform agenda more flexible by delaying the programmed increases in gas and water rates, postponing the increase in transportation fares to an indefinite future date, and relaxing its trade liberalization policy (by imposing non-tariff barriers to certain sectors.)

Political fragility should be expected to remain the dominant backdrop until the elections, but with a positive bias in favor of the government. This crumbly but yet improving political path would be supported by at least few factors. First, an economic policy that has started to reap political benefits in terms of activity recovery, although not yet convincing enough to guarantee strong support for the government. Second, the absence of any alternative leadership that can capitalize the government's lack of results and the current demand for change. Third, the continued radicalization of some opposition sectors seeking to gain exposure, which to some extent favors the official electoral strategy. And fourth, the growing tension between the political goal of succeeding in the elections and the needed implementation of a structural reform agenda to support the current economic strategy.

Figure 10: Purchasing power and fiscal impulse to be the recovery drivers



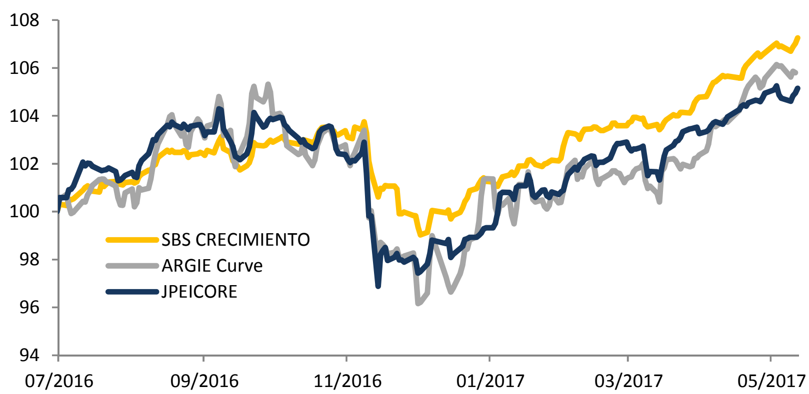
Source: MECON, FYE, and SBS Research

Challenges do remain, with 2H2017 anticipating increasing political confrontation ahead of the mid-term election, and 2018 embodying the real test to start adjusting fiscal imbalances. In the meantime, inflation in March and April surprised on the upside but the government remained firm in its anti-inflationary effort, even hiking interest rates from already elevated levels recently. This will inevitably bring escalating labor market confrontation ahead of the October elections but the government seems convinced this is a battle worth fighting. Delays in tariff increases will nevertheless help inflation deceleration between now and the elections. A recovering economy should somehow tame potential conflicts, while a declining inflation later in the year should help gain further credibility. The latter, however, is unlikely to prevent further real peso appreciation as the by-product of tight monetary policy and relaxed fiscal spending.

Portfolio: Prudent EM with Argentina´s Bias Continuing

The backdrop discussed above does not present an immediate or significant risk to global recovery. It, nevertheless, highlights pending uncertainty regarding economic policy and identifies potential market disruptions ahead. Thus, the investment environment still justifies the prudence, simplicity, and nimbleness called for in our previous edition. This is exactly what we have been doing in the last couple of months with our *SBS Crecimiento FCI*, first described in our Letter V1,#1, on June 2016. After trimming duration in our core Latin American sovereign and corporate debt portfolio early on in the year, we decided to take on more risk in the wake of the first Obamacare failed voting, cutting protection against additional increases in global rates, and reducing our equity position. In addition, we increased our stake in ARS LEBACS once again, while actively managing ROFEX coverage. All these changes resulted in a 6% return YTD (net of fees), a superior performance of our portfolio vis a vis a weighted Argy curve and the EMBI.

Figure 11: SBS Crecimiento vs Argie curve and EMBI



Source: SBS and Bloomberg L.P.

Looking forward, while doubts on the US and the global scenario persist, holding core mid-duration USD EM debt, with an important Argentine bias, seems to remain a good investment proposition. In Argentina, we particularly like long LETES, DISCOS, and PARS in the USD curve, as mid-duration bonds look relatively expensive. We also like to add some yield by holding selected subnational and provincial debt, particularly City of BA 27s, Province of BA 21s, 23s, and 24s, and Cordoba 21s. Among corporates, we prefer YPF 25s, PAMPA 27s, and ALBANESI 23s. On Argentine ARS we still favor short LEBACS, and some CPI linkers while inflation remains high, or for another month or so. This peso position is accompanied by active hedging given the ARS level and the Central Bank recent hint that the authorities might be increasingly uncomfortable with a stronger peso. On Latam, we maintain a bias in favor the usual high credit suspect in the region, with a new bet on Chile´s SMU. Furthermore, we might add some Argentine and Brazilian equities to that portfolio, but only strategically, as we fear global equity valuation. Nevertheless, after this morning news on Brazil, we would be rather cautious Brazilian assets, expecting a delayed progress in the reform process. Finally we would include some global equity, credit, and FX volatility protection as a defensive tactic amid high global uncertainty and the view that global rates and asset price volatility have more space to rise than otherwise.

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