



Insigneo Weekly Dispatch

Equity Investing in the Latin American Region: Diversification is Key

Participating in Latin America's growth potential through the equity markets is not as straightforward as in other areas of the world. Investors should carefully evaluate the different options available, to ensure proper diversification.

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Equity Investing in the Latin American Region: Diversification is Key

Latin America is an incredible region, full of life, promise, and diversity. Its many countries are rich with culture and amazing cuisine. From Parrilladas to Pupusas, from Arepas to Mariquitas, its cuisine is as distinct as its people. Its diverse economies, bolstered by nascent industries, embody the promise of a better tomorrow. Themes such as Fintech and Near-Shoring could be game changing. However, it is not particularly easy to gain access to the region's prosperity through traditional investment vehicles.

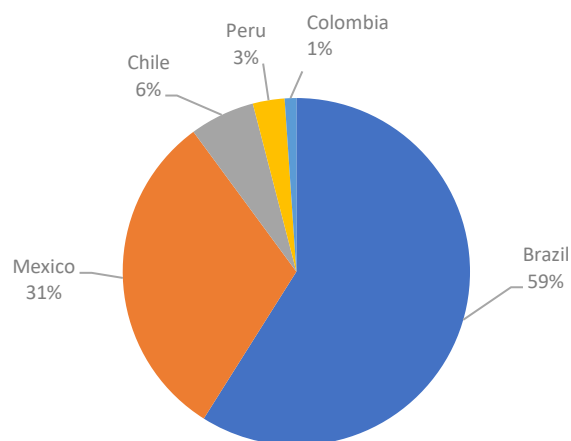
Bonds and other fixed income products offer access to the cash flows of some companies in the region. These markets are reasonably deep, offering a variety of issuers and vehicles through which to access them. However, the region's equity markets are not as deep, offering a limited number of options from a relatively narrow number of industries and an even smaller subset of countries. As a result, many of the vehicles offering access to the region's equity markets tend to be heavily concentrated in a small number of industries and a handful of countries.

The MSCI Emerging Markets Latin America Index (MXLA) is the most widely used index for the region. As of May 31st, 2023, the index was composed of just 5 countries in Latin America: Brazil, Mexico, Chile, Peru, and Colombia. As we can see on the

following chart, out of these countries, Brazil and Mexico comprised 90% of the index. This particular index is not readily investable, but many other regional ETF's and mutual funds that are investable tend to have similar country allocations. In fact, out of sample set of 4 ETFs and 3 mutual funds that focus on the region, the average concentration in Brazil and Mexico combined was 87%. Sector allocations also tend to exhibit high concentrations. As of May 31st, 2023, approximately 73% of the MXLA index was concentrated in the following 4 sectors: Financials (25%), Materials (20%), Consumer Staples (17%), and Energy (11%). Again, looking at the same sample set of ETFs and mutual funds mentioned above, the average combined concentration of these 4 sectors was close to 70%. Put another way, on average, only 1 out of every 10 dollars invested in many Latin America equity products is allocated to countries other than Brazil and Mexico. Additionally, based on the 11 sectors that traditionally comprise an index, on average, 7 out of every 10 dollars invested in many Latin America equity products are concentrated in roughly only one third of the available sectors. Granted these findings are comprised by a relatively small sample set of data. As such, we are by no means implying that that every Latin America equity product is allocated in this manner. We are just trying to put in perspective the relatively high country and sector concentrations found in many equity products focused on this region.

These concentrations can be generally attributable to the industries that have traditionally dominated the region, as well as the countries with the most developed equity markets. As we know, commodities have historically represented large

MXLA COUNTRY ALLOCATION



MXLA is the symbol for the MSCI Emerging Markets Latin America Index

Source: MSCI, Insigneo

As of 5/31/23

and important industries in the region. This is evident by the outsized weights of the Materials and Energy sectors in the MXLA index, combining to represent over 30% of its constituency. In fact, taking a deeper look into the individual equities in the index, Vale and Petrobras combine to create a 17% allocation. Almost 20% of the index's weight falls on 2 companies.

Commodities are and will continue to be an important part of the region's economies. But what about the region's emerging middle class? What about sectors such as Consumer Discretionary that would traditionally benefit from increased spending power of the local population? What about Fintech and other nascent, but very promising technology-driven industries all over the region? As of the end of last month, the Consumer Discretionary and

Information Technology sectors combined to represent 2.5% of the MXLA index, less than 1/10th of the combined weight of Materials and Energy. In fact, Info Tech represented less than 1% of the index, and various other regional ETFs don't even have an allocation to this sector.

Promising technology companies with the potential to revolutionize the region such as Mercado Libre (MELI), Globant (GLOB), StoneCo (STNE), and Pagueseguro Digital (PAGS), among others, are not a part of many equity products focused on Latin America. Additionally, other investment trends prevalent in the region such as Volaris' (VLRS) revolutionary business model for travel in the Northern part of Latin America, Embraer's (ERJ) foothold in the region's Defense industry, or YPF's potential to meaningfully impact the region through the successful development of the Vaca Muerta hydrocarbon formation, are not present in many of the more traditional products investing in Latin America.

Participating in Latin America's growth potential through the equity markets is not as straightforward as in other areas of the world. Investors should carefully evaluate the different options available, to ensure that country, sector, and political risks are properly mitigated through diversification and other

risk management parameters. Additionally, it is important to ensure that the region's promising growth potential is also being reflected in a product's various holdings. Commodities will continue to be an important part of the local economies. However, we cannot afford to overlook Latin America's many other promising industries and opportunities.

It is important to keep in mind that the ETFs and individual equities referenced here can exhibit high degrees of volatility and are not suitable for every investor. These investments are best considered on a case-by-case basis, based on a particular investor's willingness and ability to tolerate risk. If you need more information or would like to discuss these potential ideas in more detail, please do not hesitate to contact the Insigneo Research Team.



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