



Insigneo Weekly Dispatch

Latam: a shining star on the horizon?

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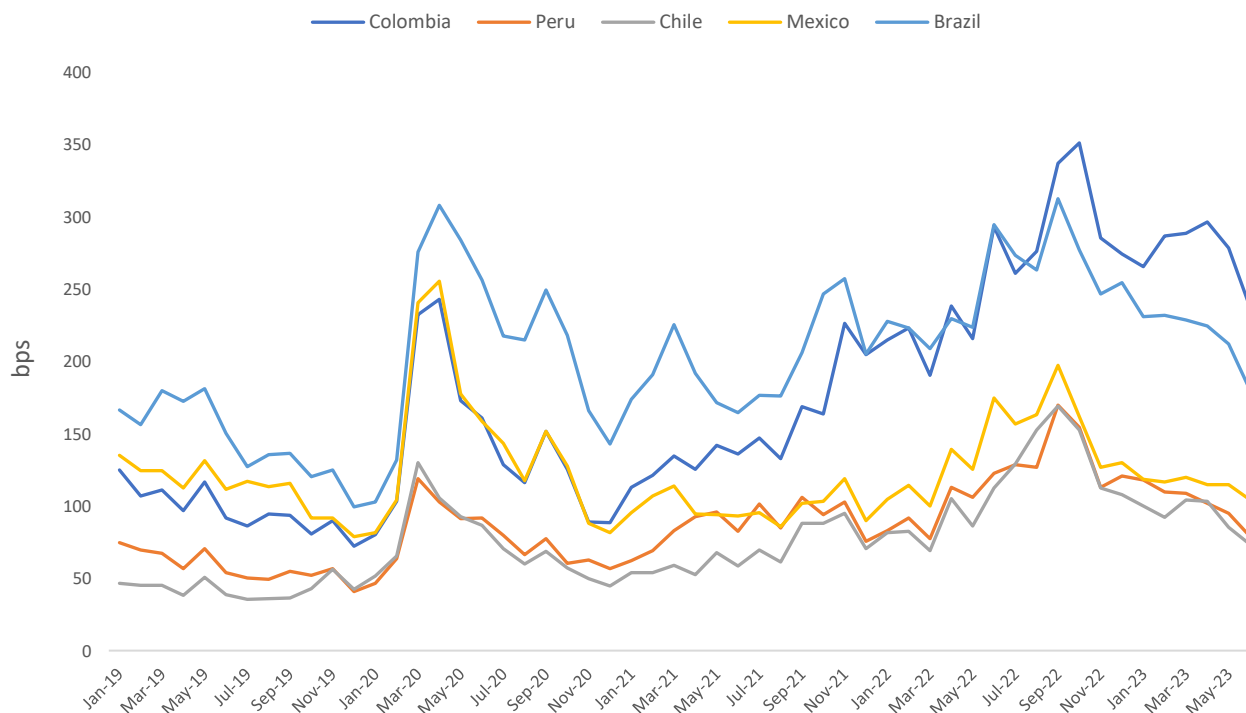
Insigneo

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For a while, several market participants have been considering Latam as an attractive investment opportunity for 2023, even if its political backdrop would have suggested otherwise and would have made it look like a riskier bet. With one half of the year already gone, we wanted to revisit our initial idea at the beginning of the year: that investing in the Latin American markets could prove beneficial, even if it seems contradictory.

Firstly, we need to consider the macroeconomic landscape: the main Latam economies were ahead of the curve in terms of implementing tighter monetary policy, with most of the central banks of the region starting their hiking cycles by mid-2021, far ahead of their developed counterparts like the Fed or the ECB. Those aggressive hikes that, like everywhere else in the world, were destined to tame inflation also drove the local fixed income markets to levels not seen before while incorporating an attractive discount into the region. Thus, now that the dust has settled, investors have realized that Latin American markets remain an attractive investment alternative against a current backdrop of more controlled inflation and the possibility of central banks easing sooner rather than later. In their latest monetary policy meetings, the forward guidance of Latam central banks has pointed toward rate stability, with an easing bias if inflation continues to subside.

Additionally, it is relevant to highlight that the risk perception in the region has receded, which is visible in the behavior of the 5-year CDS of the major economies. Since reaching their highs in the last quarter of 2022, the downward trend has been remarkable and constant across the region, as can be seen in the following graph:



Source: Bloomberg. Data as of June 28, 2023

This behavior could be seen as the markets interpreting that the political left swing the region took last year has not been as radical as initially thought, with most reforms not garnering enough support from their respective congresses and, for the better part, the *status quo* has remained present in most of the region. Even if that situation will be put to the test later this year with elections in Argentina and Colombia, as well as the constitutional process in Chile, it seems like the markets have put additional hopes in the region maintaining a friendlier environment for investors rather than giving in entirely to the social demands touted during the political campaigns.

The overperformance of the region has proven true in

several market realms: on the equity front, the MSCI EM Latin America Index has returned approximately 13% appreciation YTD, outperforming global equities by almost 2%. Meanwhile, the overperformance of the region has also been underpinned by the US Dollar’s prevailing weakness year-to-date. The DXY, the trade-weighted Dollar Index, has been almost flat, while all major Latam currencies – except for the ARS – have appreciated more than 4% at the time of this writing. This strength has also been visible in the fixed income markets, with a generalized yield tightening occurring in most local-currency denominated curves, propelled by the perception that the region’s central banks are past the peak in their tightening cycles. Even if the shorter end of the local-currency curves has had an

important tightening that would imply that market participants are expecting an easing to start in upcoming months, the longer end's appreciation has been even starker, suggesting weaker growth expectations which, in turn, also bring a deceleration of inflation.

Despite these opportunities, we have also stressed on [previous occasions](#) that investing in the region comes with challenges. Equity markets tend to be less liquid, while the fixed income market may lack depth in some of the countries. Still, it is worth recognizing value where we see it and, against a backdrop of scarce and volatile negotiations in the developed world, Latam may be a star shining bright on the horizon.



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