



Monthly perspective | July 16, 2018

## Landslide: hope vs. experience

### SUMMARY

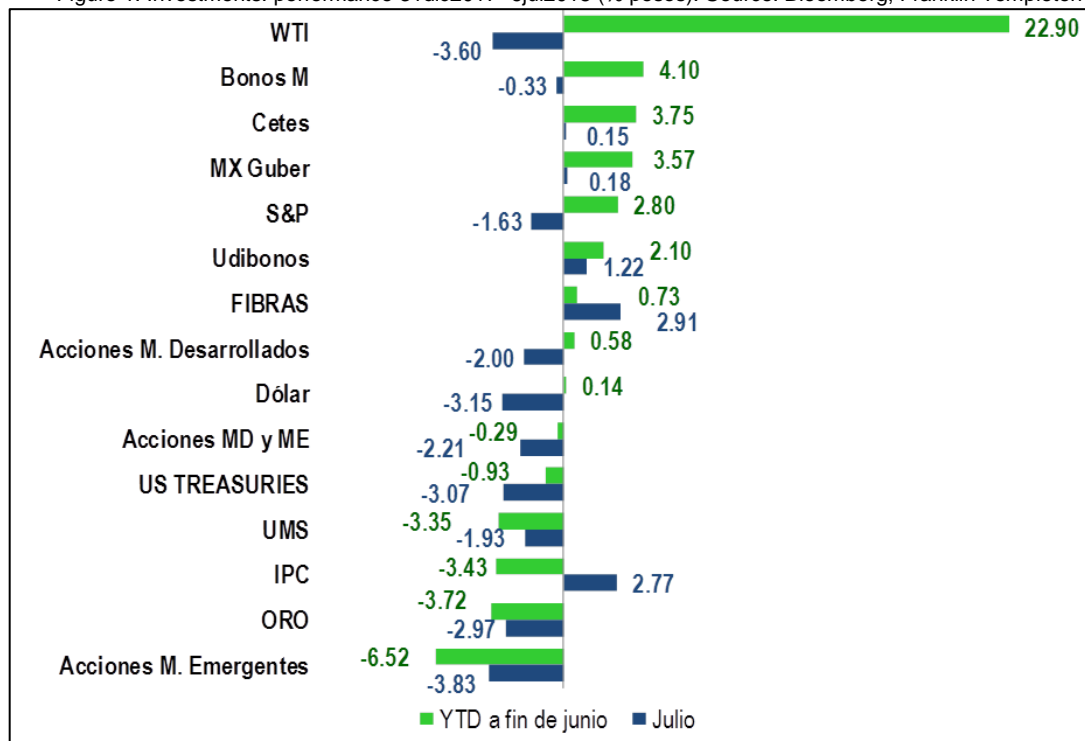
- Globally, investments negative due to US rate increases, trade disputes, and problems in Europe.
- In Mexico, investments positive due to landslide and postelectoral reconciliation.
- Global risks: US trade wars and migration, Europe, geopolitics, monetary policy, cryptocurrencies.
- Local risks: uncertain transition, inconclusive NAFTA renegotiation.
- Investment scenarios 2018, with probabilities: positive (30%), negative (30%), middle (40%).
- Overweight ILS 1-3 year duration, underweight stocks and REITs.

“In a revolution, as in a novel, the most difficult part to write is the end” – Alexis de Tocqueville

### Mexico: a week out of sync

Until June, Mexico had been out of sync, negatively, with the rest of the world, owing to election fears. In the first week of July, owing to the surprising result, and the conciliatory post-election atmosphere, the reverse happened, with Mexican risk investments positive (peso, stocks, REITs), and global investments negative (Figure 1).

Figure 1. Investments: performance 31dic2017- 6jul2018 (% pesos). Source: Bloomberg, Franklin Templeton



**POLITICS****GLOBAL****USA****Trade**

President Trump's protectionist policies continue to generate international tensions – most recently:

- Removal of exemptions from steel and aluminum duties on imports from EU, Canada and Mexico, with reprisals.
- Beginning of investigation on auto imports on grounds of national security, with implied tariff threat.
- Disagreements in G7 meeting in Canada.
- Announcement of US duties on Chinese imports.

**North Korea**

Tensions with North Korea have diminished. President Kim Jong Un has toned down his language and given signals of denuclearization. After a second meeting with Chinese President Xi Jinping, he met, historically, with Trump. The meeting was called a success and more details are awaited on North Korean denuclearization.

**Europe**

In Italy, new elections are possible which could lead to stronger anti-system parties and a euro referendum. In the UK, the resignation of two proBrexit Ministers, increased the possibility of a soft Brexit, and the risk of a leadership crisis in the Conservative party.

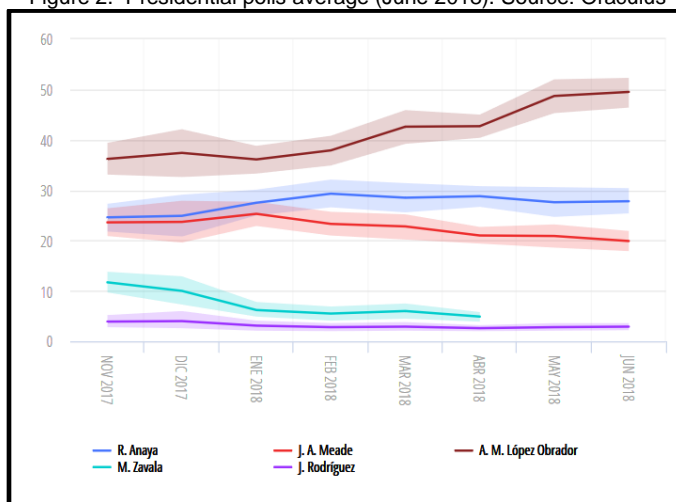
**GLOBAL****NAFTA**

The probability of completing NAFTA renegotiation before the new government takes office on December 1, 2018, receded, owing to the removal of the exemption from steel and aluminum duties, and the threat of tariffs on Mexican exports of cars and vans to the US.

**MEXICO****Elections 2018***Presidency*

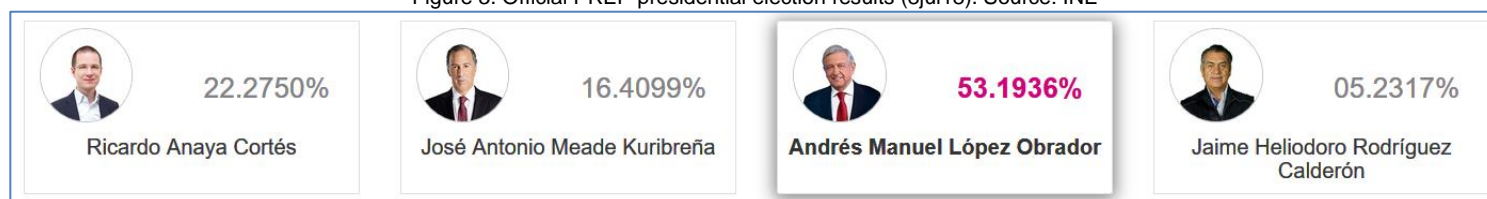
On June 27, election polls closed (Figure 2).

Figure 2. Presidential polls average (June 2018). Source: Oraculus



Elections for President and a record number of federal and local posts were held on Sunday July 1. According to official preliminary results (the PREP of the National Electoral Institute - INE), which are subject to ratification on August 23, Andrés Manuel López Obrador (AMLO) won the presidential elections with a more than 30% lead over the second placed candidate (Figure 3), a result even more overwhelming than that predicted by any poll.

Figure 3. Official PREP presidential election results (8jul18). Source: INE



### Senate and Congress

For Senate and Congressional seats, the coalition of Morena, PT and PES won a majority (303 of 500 Congress and 70 of 128 Senate), followed by PAN, PRD and MC (148 Congress and 38 Senate) and third PRI, PVEM and NA (57 Congress and 20 Senate). With its majority in both houses, the next government will be able to change or pass federal laws, but will need allies to make changes in the constitution. Of the 27 state Congresses where elections were held, Morena is ahead in 12, which implies it will need allies to make constitutional changes.

### State governors

In 9 governors' elections, Morena (Morena-PT-PES) won 5 (Chiapas, CDMX, Veracruz, Morelos y Tabasco), PAN 3 (Puebla, Guanajuato y Yucatán) and Movimiento Ciudadano 1 (Jalisco). This implies that PRI and PAN hold a majority of state governors (Figures 4 y 5).

Figure 4. State election results (8jul18). Source: INE

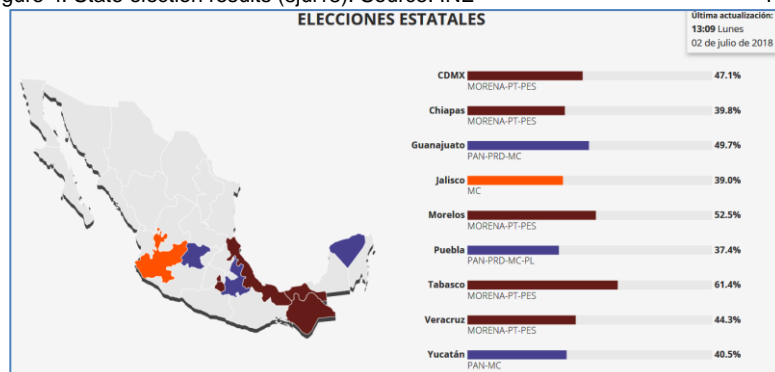


Figure 5. State governors by party (jun2018). Source: INE.

Partido	# de estados		
	Actual	Esperado	PRELIMINAR
PRI	14	12	12
PAN	11	11	11
PRD	5	2	2
MORENA	0	5	5
INDEPENDIENTE	1	2	2
PVEM	1	0	0
Total	32	32	32

### Reaction to elections

On election night, Ricardo Anaya and Jose Antonio Meade conceded to AMLO before 2100, unusually early. That same night in two speeches, in the Hilton hotel and the Zocalo, Mexico City's main square, AMLO adopted a conciliatory, moderate and respectful tone, reading, unusually, from a prepared speech. He pronounced respect for the autonomy of the central bank (Banco de Mexico) promised fiscal discipline without increasing taxes in real terms, and expressed his respect for the role played by President Peña Nieto in the electoral process. He emphasized especially his concern for the poor and the need to eradicate corruption.

On July 2, Carlos Urzúa, named by AMLO as probable Treasury Secretary in his administration, held a conference call with investors. He repeated central bank autonomy and spoke of the necessity of increasing investment from current levels of 22% of GDP to 28%, between 5% from government and 23% from the private sector (compared to current levels of 3 and 19% respectively). He emphasized the role of foreign investment.

There was a meeting between Peña Nieto and AMLO to smooth the process of transition until the inauguration of the next president on December 1. In the same tone there was a meeting with businessmen and a video was published on social media, where private sector thought leaders publicly announced that the electoral process strengthened Mexican democracy, and supported the next government.

## Electoral considerations

There is a historical logic in Morena's victory. After 70 continuous years of PRI power until 2000, the PAN had the opportunity to govern for 12 years until 2012, and the PRI regained power through Enrique Peña Nieto from 2012 to 2018. Morena, a party founded as recently as 2014 by AMLO, who has been campaigning since 2000, channeled popular indignation against corruption, violence, poverty and inequality. This weighed more than tangible progress over the last 30 years, measured by social, economic and educational indicators. Morena won, by a landslide, Presidency, Senate and Congress, 5 governorships and an unexpected number of state congresses.

There is general approval of the electoral process, with the view that it represents a maturing of the electoral system. There has also been surprise at the immediate support of the elected president and party expressed by sectors which were opposed to them during the electoral process, particularly the private sector and the punditocracy.

On the one hand, the landslide is positive because it provides an historic opportunity to Morena, a new party, to change Mexico in its "Fourth Transformation", after Independence (1810), Reform (1857), and Revolution (1910). If everything turns out well, it will be good for the government and country, and this is the message which has been expressed by different sectors about the elections. Owing to the overwhelming election results, the conciliatory tone of the opposition, and the origin of many of the members of Morena (including AMLO), many have compared the new party to the PRI in its heyday, when it had absolute power.

On the other hand, some have not lost sight of the main arguments against the electoral ambitions of AMLO and Morena. Taking account of AMLO's previous experience as mayor of Mexico City 2000-2005 and his campaign promises, there is concern about various issues, including mainly:

- *Leadership*: the democratic, measured tone shown by AMLO during his campaign and after his election is different from the authoritarian and unpredictable style shown in previous years.
- *Morena*: the new party, in order to win the elections, has had to forge alliances with many people who are either unknown or have questionable backgrounds.
- *Macroeconomics*: campaign themes like redistribution to eliminate poverty and inequality, food self-sufficiency, price controls, and increased public Investment seem like a return to the state controlled protectionist economies of the immediate post-war period.
- *Microeconomics*: campaign proposals seem to imply the elimination, or delay of modernizing structural reforms and projects of the Peña Nieto administration.
- *"Fourth transformation"*: the meaning of this phrases was not specified in the campaign, but it can be assumed that it refers to the eradication of corruption and violence through the establishment of a Rule of Law. But there is no indication of how this might be achieved.

There is a cautious consensus about the historic opportunity for AMLO and Morena. During these early days, many give him the benefit of the doubt, a combination of hope and encouragement he will do the right things. Meanwhile it is undeniable that given his past career and campaign promises, there is uncertainty about his real position on many matters. To the extent that uncertainty diminishes, market volatility can be reduced.

## ECONOMICS

### GLOBAL

Global growth is expected to increase in 2018, and to stagnate in 2019, with a slowdown in developed markets offset by higher growth in emerging markets (Figure 6).

Figure 6. Developed and emerging markets: estimated growth 2017- 2019 (jul2018) Source: Bloomberg

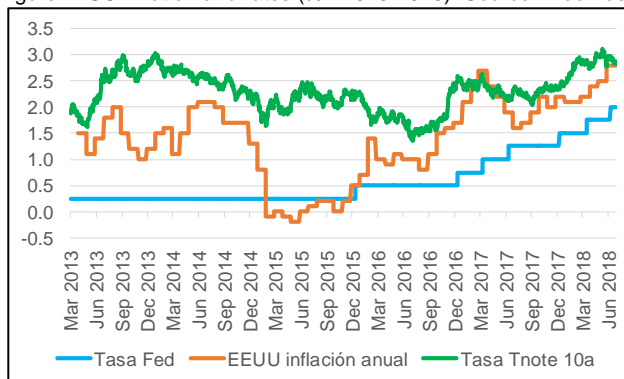
Developed markets				Emerging markets			
Growth(%)	Growth(%)			Growth(%)	Growth(%)		
	2019 E	2018 E	2017 E		2019 E	2018 E	2017 E
World	3.70	3.70	3.60	World	3.70	3.70	3.60
Developed	2.18	2.44	2.36	Emerging	5.10	5.01	4.57
US	2.50	2.80	2.30	China	6.30	6.50	6.90
Euro Area	1.96	2.30	2.50	India	7.40	6.66	6.30
Japan	1.00	1.30	1.60	Rusia	1.80	1.80	1.50
Britain	1.50	1.50	1.70	Brasil	2.77	2.59	1.00
Australia	2.80	2.70	2.30	México	2.40	2.20	2.10
Canada	1.90	2.10	2.95	Corea del sur	2.80	2.90	3.20
Germany	1.90	2.40	2.50	Indonesia	4.05	5.30	5.10
France	1.80	2.10	1.90	Turquia	4.05	4.25	6.80

### USA

#### Fed rates

The Fed decided to raise its reference rate by 0.25% to the 1.75-2% range. With the expectation of slightly higher growth due to the tax stimulus in 2018, the Fed forecasts 4 hikes 2018 instead of 3. However, it has not changed its forecast of a 3.4% rate for end-2020 (Figure 7).

Figure 7. US inflation and rates (% - 2013-2018). Source: Bloomberg

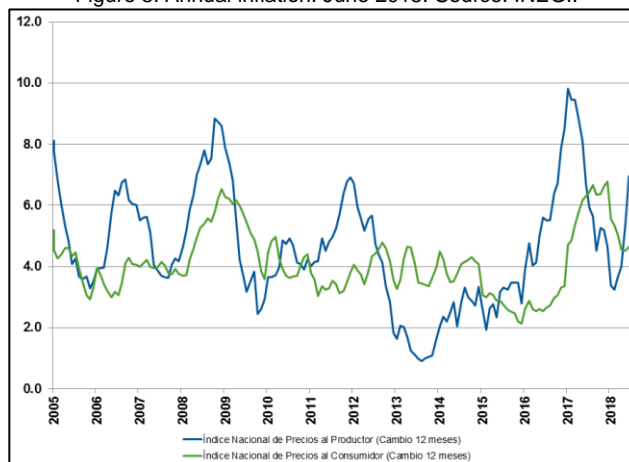


### MEXICO

#### Inflation

In June annual consumer inflation grew slightly from 4.51% to 4.65%. However producer inflation rose strongly to 6.95% from 5.41%, its biggest rise since 2005, due to the exchange rate and gasoline prices (Figure 8).

Figure 8. Annual inflation. June 2018. Source: INEGI.



## RISKS AND SCENARIOS FOR 2018

Taking account of foreseeable risks, we present three investment scenarios for the second half of 2018, where the objective is Mexican economic growth. In the positive scenarios, all risks turn out positive for Mexican growth, in the negative scenarios, negative, and in the middle scenario, there is a mix, (type, intensity and duration).

### RISKS

#### Global

- USA failure of progrowth initiatives, trade wars
- North America: NAFTA renegotiation.
- Geopolitics: Europe, Middle East, Russia, China, North Korea
- Global slowdown, monetary policy
- Bitcoin

#### Mexico

- Transition 2018
- Security
- Corruption
- Oil price
- Debt increase: debt rating

### SCENARIOS

#### Positive (30%)

- USA: tax reduction, deregulation, infrastructure Investment, no trade wars.
- NAFTA renegotiation: "win-win".
- Europe, China, Russia, Korea, Middle East: risks do not materialize.
- Synchronized global growth and successful monetary policy.
- Bitcoin: crash does not affect economy.
- Mexico: positive transition.

#### Negative (30%)

- USA: pro-growth measures fail, trade wars.
- NAFTA renegotiation fails.
- UK and EU collapse, risks in China, Russia, Korea and Middle East materialize.
- Global slowdown owing to politics, economics, or monetary policy.
- Bitcoin: crash affects economy.
- Mexico: negative transition.

#### Middle (40%)

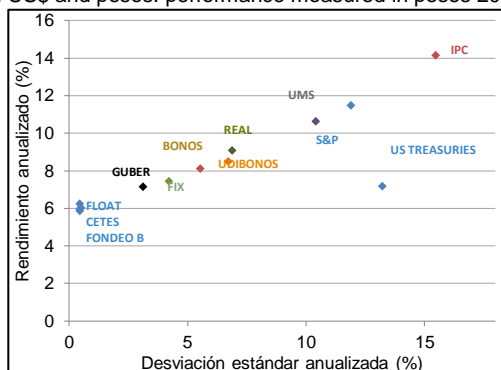
- USA: pro-growth measures work partially, some tariffs
- NAFTA renegotiation with mixed results.
- Europe, China, Russia, Korea, Middle East; some risks materialize.
- Global growth continues, but less synchronized than 2017: monetary policy with varied success.
- Bitcoin: crash affects economy partially.
- México: uncertain transition.

## MARKETS

### Investments in US\$ and pesos: comparative performance

Despite peso depreciation, long term (2000-2018) investments denominated in pesos have outperformed US\$ investments denominated in US\$, converted to pesos (Figure 9).

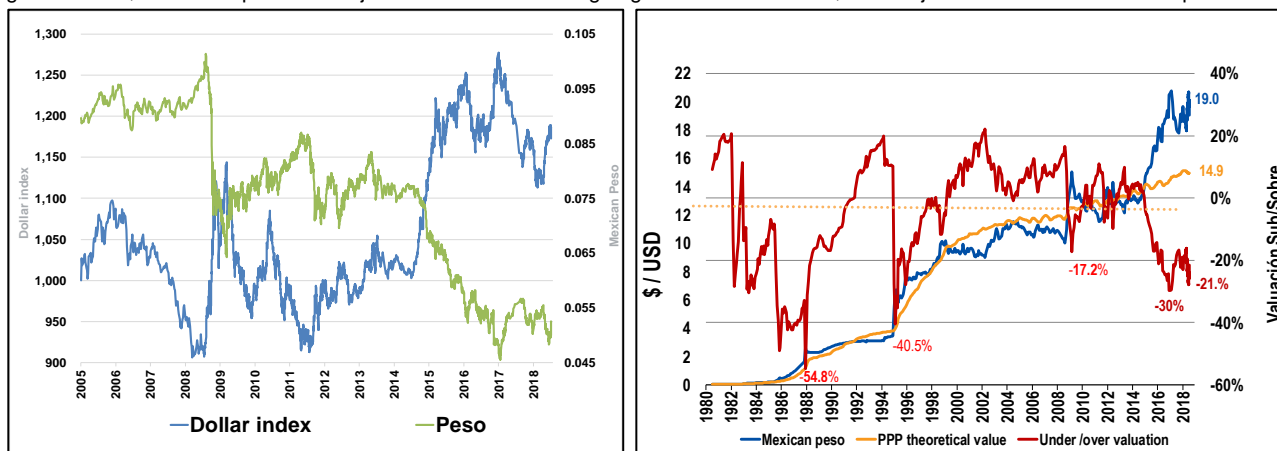
Figure 9. Investments denominated in US\$ and pesos: performance measured in pesos 2000-jul2018. Source: Franklin Templeton



## US\$ and peso

The US\$ has strengthened against other currencies owing to the possibility of more aggressive rate hikes by the Fed. This is beginning to provoke outflows from emerging markets. The peso weakened to February 2017 levels owing to NAFTA and elections fears (Figures 10 and 11), then appreciated strongly after the elections. This implies that the election result was discounted.

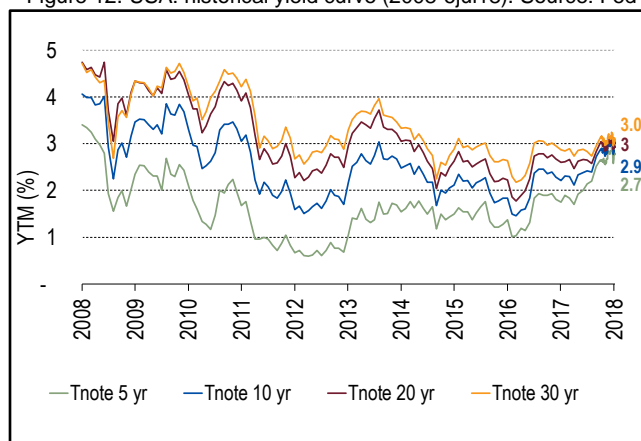
Figure 10. US\$ index and peso 2005-6jul18. Source: Bloomberg Figure 11. Peso vs. US\$: 1980-6jul18. Source: Franklin Templeton



## Deuda

US rates rose during the month over all terms. In general US bonds are pressured by higher issue amounts and Fed hikes, but this is offset by the escalation of trade disputes (Figure 12).

Figure 12. USA: historical yield curve (2008-6jul18). Source: Fed



The market is still expecting rates to rise in most developed markets, and to level in emerging markets (Figure 13).

Figure 13. Developed and emerging markets: estimated 10 yr. nominal rates end-2018 (6jul18). Source: Bloomberg, Franklin Templeton

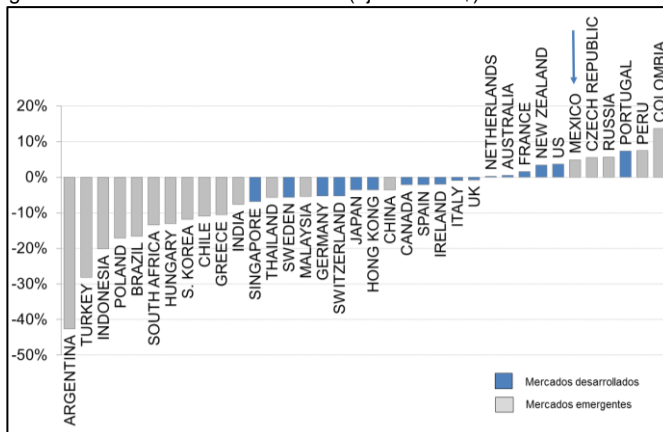
Developed				Emerging			
local 10y yields (%)				local 10y yields (%)			
	4Q18e	Actual	Aumento		4Q18e	Actual	Aumento
US	3.17	2.95	22	China	3.66	3.66	(0)
Euro Area	0.80	0.49	31	India	7.84	7.96	(12)
Japan	0.09	0.04	5	Rusia	7.46	7.37	9
Britain	1.68	1.41	27	Brasil	10.33	11.64	(131)
Australia	2.97	2.80	17	México	7.72	7.89	(17)
Canada	2.61	2.31	30	Corea del sur	2.79	2.73	6
Germany	0.80	0.49	31	Indonesia	7.35	7.30	5
France	1.11	0.91	20	Turquia	14.93	15.32	(39)



## Stocks

During 2018 developed markets have been affected owing to the recent rise in trade disputes, and emerging markets by rate rises and US\$ dollar strength. The Mexican market was in line with the rest of the world in local currency terms until end-June, but affected by peso weakness. It rose strongly following the elections owing to the market rise in pesos, and was then boosted in US\$ terms by peso appreciation (Figures 14 and 15 – see also page 1).

Figure 14. Stock markets: YTD 2018 (6jul18 - US\$). Source: Bloomberg

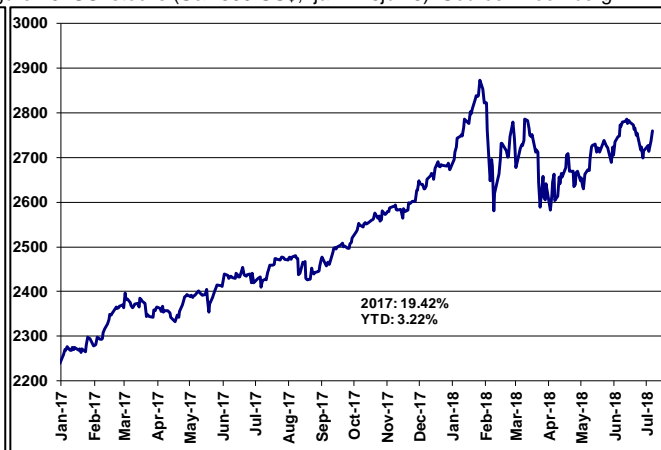


Both in Mexico (Figure 15), and the US (Figure 16), volatility has increased in recent years due to political uncertainty.

Figure 15. Mexico: stocks (IRT pesos, 1jan17-6jul18).



Figure 16. US: stocks (S&P500 US\$, 1jan17-6jul18). Source: Bloomberg



## REITs (Fibras)

Owing to novelty, high dividends and inflation protection, Fibras have performed better than stocks since 2011. Since the Trump election in November 2016, Fibras have been hit by NAFTA fears and domestic politics, and in recent months fears about inflation, interest rates, and trade wars. They rose after the July 1 elections (Figures 17 and 18).

Figure 17. Mexico: fibras vs. stocks (IRT) mar2011-6jul18 (base 100 MXN\$). Source: Bloomberg

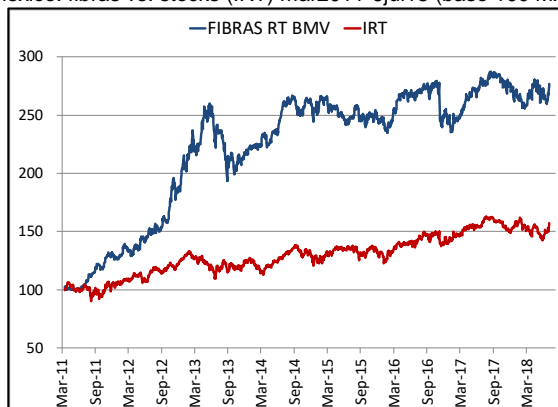




Figure 18. Fibras: valuation and dividends (6jul2018). Source: Franklin Templeton

	Mcap (M) (MXN)	Calendarized						
		2013	2014	2015	2016	2017	2018	2019
FUNO11 MM	109,691	6.6%	7.2%	7.2%	7.4%	7.6%	8.5%	9.1%
DANHOS13 MM	42,200	6.0%	6.6%	7.1%	5.9%	7.9%	8.4%	7.5%
FIBRAPL MM	22,296		4.7%	5.9%	6.4%	6.6%	7.0%	7.3%
TERRA13 MM	21,120	7.2%	7.3%	7.8%	9.2%	9.5%	9.6%	9.5%
FIBRAMQ MM	16,381	8.2%	7.5%	8.8%	7.5%	7.6%	7.9%	8.2%
FIHO12	9,023	8.0%	8.0%	8.7%	9.8%	11.0%	12.3%	13.6%
FMTY14 MM	7,712			7.9%		8.7%	8.9%	
FHIPO	7,606		12.3%	12.5%	12.7%	13.3%	13.9%	13.5%
FINN13 MM	5,373	6.5%	6.0%	7.3%	8.2%	8.2%	8.3%	9.3%
FSHOP13 MM	4,849	9.7%	10.9%	11.8%	10.7%	9.9%	9.6%	9.0%

A new FIBRA E was issued: INFRAEX raised \$6.1bn. pesos at a price of \$18.5 at the lower end of the range. Its principal assets are prisons, roads, and, soon, hospitals. Another traditional Fibra was issued: EDUCA 18 raised \$9.4bn. at a price of \$20 also at the low end of the range. It specializes mainly in the development and rental of educational properties. The issue of FSTAY, a hotel Fibra, was postponed, because Hoteles City Express will fund its expansion with a syndicated credit of \$1.2bn.

### Conclusion

The global economy has become more complex owing to rising interest rates and trade uncertainty. Meanwhile, Mexico faces a new kind of uncertainty with the election of AMLO and Morena. Volatility is likely for both global and Mexican investments. For peso denominated investments: overweight ILS 1-3 years duration, underweight stocks and Fibras.

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 July 16, 2018

**Main financial indicators: monthly at June 29, 2018**

During June, in Mexico, the IPC rose 6.72%. Nominal rates rose in the short term and fell in the medium and long term. Real rates fell over all terms. The US\$ fell 1.43% against the peso. In the US, S&P500 and Nasdaq rose, while DJ fell. Nominal rates rose in short and medium terms, and fell for the 30 year term. Real rates rose for the 5 year term and fell for the 10 and 30 year terms. In the Bank of Mexico business climate survey, optimism fell to 16% (19% previous), no change rose to 58% (35%), and pessimism fell to 26% (45%).

Mexico					
Stock market and oil					
	29-Jun-18	31-May-18	Month	YTD	2017
IPC	47,663.20	44,662.55	6.72%	-3.43%	8.13%
Local currency (USD/MXN)	19.69	19.98	-1.43%	0.14%	-4.64%
Mexican oil mix (USD/bl)	68.72	63.48	8.25%	22.30%	21.36%
Nominal rates					
	29-Jun-18	31-May-18	Month	YTD	2017
CETES 28	7.81%	7.63%	18 bps	49 bps	148 bps
CETES 360	7.91%	7.81%	10 bps	45 bps	103 bps
M5	7.67%	7.79%	-12 bps	8 bps	38 bps
M10	7.60%	7.80%	-20 bps	-5 bps	15 bps
M30	7.71%	7.91%	-20 bps	-7 bps	-4 bps
Real rates					
	29-Jun-18	31-May-18	Month	YTD	2017
UDIBONO 10	3.72%	3.74%	-2 bps	22 bps	45 bps
UDIBONO 30	3.77%	3.88%	-11 bps	7 bps	-9 bps
Commodities					
	29-Jun-18	31-May-18	Month	YTD	2017
Gold	1,252.60	1,298.51	-3.54%	-3.85%	12.48%
WTI (USD/bl)	68.72	63.48	8.25%	22.30%	4.60%
UMS					
	29-Jun-18	31-May-18	Month	YTD	2017
UMS 10 years	4.46%	4.52%	-6 bps	83 bps	-64 bps
UMS 20 years	5.20%	5.28%	-8 bps	67 bps	-74 bps
UMS 30 years	5.08%	5.20%	-12 bps	44 bps	-62 bps
Stock markets (US\$)					
	29-Jun-18	31-May-18	Month	YTD	2017
MSCI Developed	8,530.35	8,531.33	-0.01%	0.76%	23.07%
MSCI Emerging	2,357.69	2,458.18	-4.09%	-6.51%	37.75%
MSCI Mexico	9,157.15	8,378.85	9.29%	-2.58%	16.27%
MSCI Brazil	5,246.21	5,721.71	-8.31%	-17.19%	24.48%

US					
Stock market					
	29-Jun-18	31-May-18	Month	YTD	2017
DJ	24,271.41	24,415.84	-0.59%	-1.81%	25.08%
S&P	2,718.37	2,705.27	0.48%	1.67%	19.42%
Nasdaq	7,510.30	7,442.12	0.92%	8.79%	28.24%
Nominal rates					
	29-Jun-18	31-May-18	Month	YTD	2017
Tbill 90	1.93%	1.93%	0 bps	66 bps	76 bps
Tnote 5	2.73%	2.68%	5 bps	59 bps	21 bps
Tnote 10	2.85%	2.83%	2 bps	43 bps	-3 bps
Tbond 30	2.98%	3.00%	-2 bps	15 bps	-23 bps
Real rates					
	29-Jun-18	31-May-18	Month	YTD	2017
Tip 5	0.67%	0.65%	2 bps	41 bps	17 bps
Tip 10	0.74%	0.76%	-2 bps	27 bps	-3 bps
Tip 30	0.87%	0.91%	-4 bps	15 bps	-27 bps

Bank of Mexico survey		
Indicator	2018	2018 anterior
PIB	2.29%	2.26%
Inflation	4.06%	3.92%
Cetes 28	7.79%	7.50%
Local currency	19.62	19.02
Business conditions		
	29-Jun-18	31-May-18
Optimism	16%	19%
No change	58%	35%
Pessimism	26%	45%

Source: Bloomberg, Banco de Mexico

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\*Timothy Heyman, President of FTSAM, founded Heyman y Asociados in 1985. In 2013, Franklin Templeton established FTSAM and merged it with Heyman y Asociados.

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