



Monthly perspective | March 9, 2018

## Two Shocks

### SUMMARY

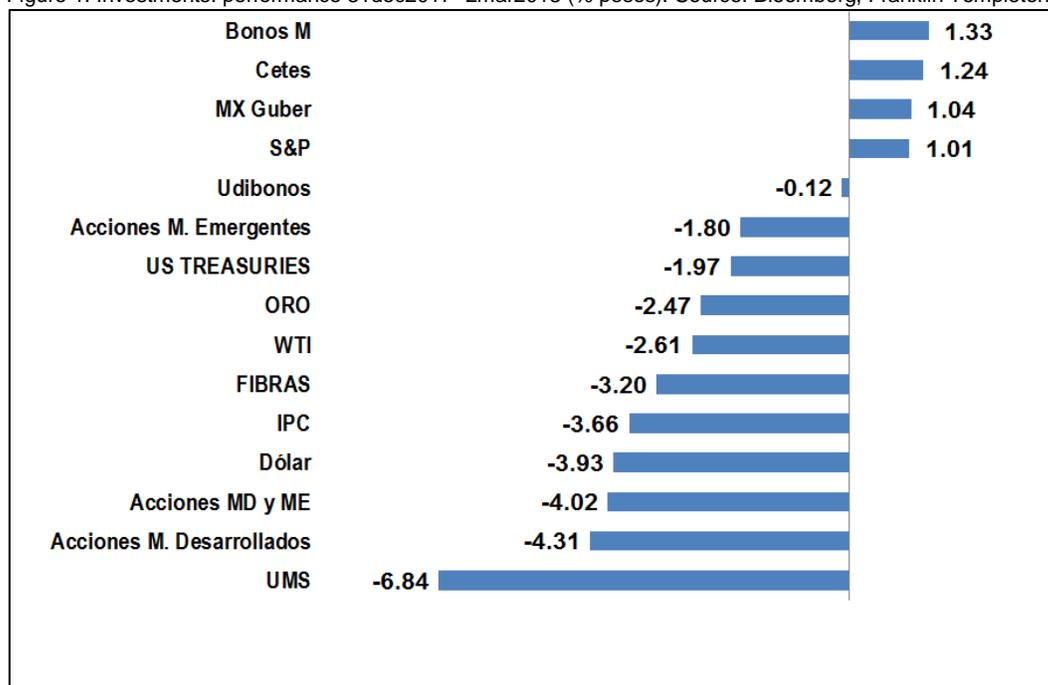
- In February, risk assets fell due to inflationary fears.
- In March, Trump's announcement of tariffs on steel and aluminum, followed by the resignation of Cohn, his economic advisor, revived trade war fears.
- For 2018, foreseeable global risks remain: failed pro-growth measures and trade wars in the US, Europe, geopolitics, and monetary policy.
- In Mexico, abnormal risks: no NAFTA negotiation before elections, adverse election results.
- 2018 investment scenarios probabilities unchanged: positive (20%), negative (40%), middle (40%).
- Overweight ILS 1 to 3 year duration, underweight stocks and REITs

“There is only one kind of shock worse than the totally unexpected: the expected for which one has refused to prepare” – Mary Renault

### Two shocks

Since January two shocks have hit markets. In February, inflationary fears revived, linked to global growth, and reflected in interest rises in the US. In March, the announcement by Trump of tariffs on steel and aluminum (even though it included conditional exemptions for Mexico, Canada and other countries) and the resignation of economic advisor Gary Cohn, unleashed fears of a trade war. The effect were price declines in risk assets, including peso denominated assets.

Figure 1. Investments: performance 31dec2017- 2mar2018 (% pesos). Source: Bloomberg, Franklin Templeton



**POLITICS**

**USA**

**Trade policy**

At the beginning of March, Trump announced duties of 25% and 10% on steel and aluminum imports. Gary Cohn, Chief Economic Advisor, resigned. When the measure was signed on March 8, it was toned down with the inclusion of conditional exemptions for certain countries. For Mexico and Canada, there are exemptions if NAFTA is renegotiated, and for other countries, if there are reciprocal concessions. This measure marks a departure from other progrowth and probusiness measures which he has implemented or announced (e.g. tax reform and infrastructure) and a separation from the traditional economic policy of the Republican Party. In the party, Paul Ryan and another Republican group are looking for ways to find legislation to prevent the President from beginning a trade war.

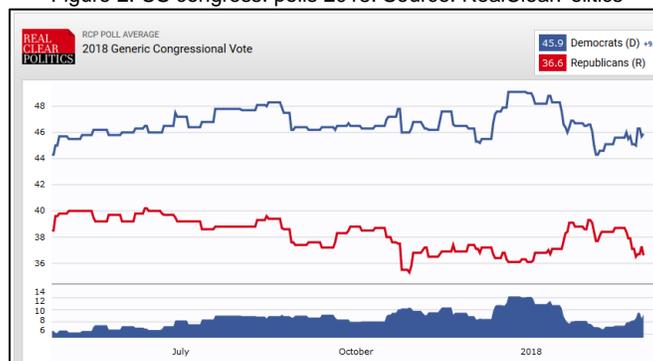
Businessmen and other politicians in the US and abroad have also come out against the measure. The EU has threatened to impose countervailing duties on US products like Harley Davidson bikes, and some jeans brands. China has also threatened countervailing duties on US products.

Idefonso Guajardo, Mexican Economy Minister, commented that duties were not the right way to modernize NAFTA. 80% of US steel exports go to Canada and Mexico. Both countries could apply countervailing duties, meaning that in introducing the measure, the US would be shooting itself in the foot. If it happens, Mexico will reply "immediately".

**Domestic politics**

For the November 6, 2018, mid-term elections in the US polls indicate that the Republicans still trail. Historically, mid-term elections favor the opposition party.

Figure 2. US congress: polls 2018. Source: RealClearPolitics

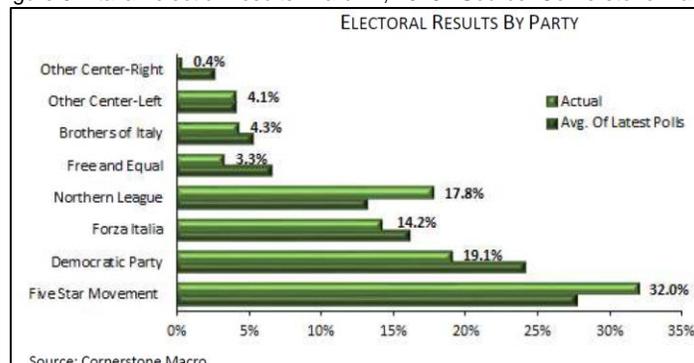


Investigations of Robert Muller, special investigator, of Russian interference in the 2016 elections have led to charges being laid against 13 people tied to the Republican Party and/or Trump. The issue is whether, through some plea agreement, any of them might lead to charges of money laundering against Trump or his people.

**GLOBAL**

**Italian elections**

Figure 3. Italian election results: March 4, 2018. Source: Cornerstone Macro



Elections were held in Italy on March 4. As expected the party of the incumbent Prime Minister (Democratic Party) lost ground to 2 parties: the 5 Stars movement (32% votes) and Northern League (17.8%). Both parties are considered anti-European and together gained around 50% of the total, beating the forecasts of most polls (Figure 3).

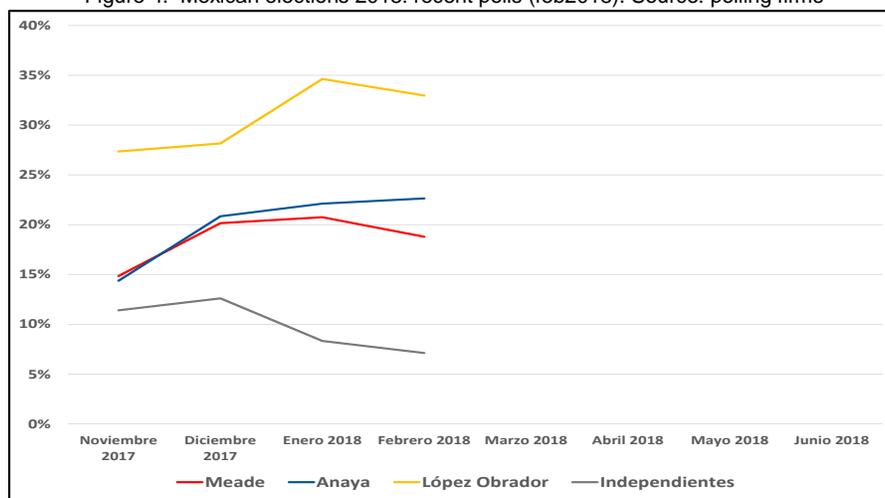
Next stage in the electoral process is for President Sergio Mattarella to decide which party should form the new government. 5 Stars hopes to be chosen as it won a majority of the votes. Even though both parties share many ideas, Matteo Salvini (Northern League leader) has said he would reject a coalition with 5 Stars, which makes a stable government look unlikely. However, 50% of voters opted for a party that proposes major changes to the status quo. This could be dangerous in future years if a referendum is called to leave the EU, as occurred in the UK.

**MEXICO  
2018 elections**

In the period up to the end of March before the official campaign begins, a common feature for all of the main parties has been the theme of corruption and crime. In the PRI, the theme has been corruption in state government and the accusation that its candidate, Meade, did nothing while he held office to stop it. In the PAN-PRD, the candidate, Anaya, has had to face personal accusations of money laundering. In Morena, López Obrador (AMLO) has attracted criticism owing to the amnesty he has promised to drug dealers and for having chosen people with criminal records as party candidates for the seats guaranteed by proportional representation in Senate and Congress.

In election polls (Figure 4) AMLO remains in the lead, followed by Anaya and Meade, but candidates stress that the official campaign has not yet begun.

Figure 4. Mexican elections 2018: recent polls (feb2018). Source: polling firms



**NAFTA negotiations**

The 7th round of NAFTA negotiations ended in Mexico City on March 5 with some progress. Chapters were finished covering health and safety, regulatory practice, and transparency. There was progress in other chapter including telecoms, ecommerce, financial services and technical trade barriers. This leaves just 6 chapters out of a total 30, left to be revised. Despite progress so far, negotiators are disappointed, because the process has been slower than they expected. The US trade representative said that if negotiations do not end soon, the US might propose a pause in order not to affect Mexico’s election process. However the US also has its November elections and Canada has elections in Ontario in June and Quebec in October, covering more than half the population of Canada. The 8th round is scheduled for the beginning of April, but preparatory meetings will probably be held before in order to speed up negotiations.

**ECONOMICS  
GLOBAL**

Global growth is still estimated to increase in 2018, but a slight slowdown is estimated for 2019 mainly in developed economies (Figure 5).

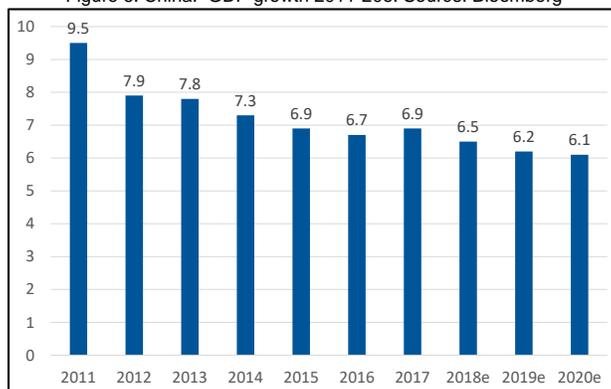
Figure 5. Developed and emerging economies: estimated growth 2017- 2019 (mar2018) Source: Bloomberg

Developed Growth(%)				Emerging Growth(%)			
	2019 E	2018 E	2017 E		2019 E	2018 E	2017 E
<b>World</b>	3.62	3.70	3.60	<b>World</b>	3.62	3.70	3.60
<b>Developed</b>	2.13	2.40	2.36	<b>Emerging</b>	5.01	4.94	4.57
<b>US</b>	2.40	2.72	2.30	<b>China</b>	6.20	6.50	6.90
<b>Euro Area</b>	1.90	2.30	2.50	<b>India</b>	7.40	6.57	6.30
<b>Japan</b>	1.00	1.30	1.60	<b>Rusia</b>	1.80	1.80	1.50
<b>Britain</b>	1.50	1.50	1.70	<b>Brasil</b>	2.70	2.50	1.00
<b>Australia</b>	2.80	2.80	2.30	<b>México</b>	2.35	2.20	2.10
<b>Canada</b>	1.70	2.40	2.95	<b>Corea del sur</b>	2.80	5.30	3.20
<b>Germany</b>	1.80	2.40	1.90	<b>Indonesia</b>	4.00	5.30	6.80
<b>France</b>	1.80	2.10	1.90	<b>Turquia</b>	4.00	4.10	6.80

**China**

Prime Minister Li Keqiang announced at the beginning of March that he expects China to grow 6.5% in 2018, vs. 6.9% in 2017. He estimated inflation to stay around 3%. The budget deficit should fall to 2.6% of GDP (from 3% 2017). Despite the continuous slowdown of the Chinese economy from 2011, its leaders are comfortable with projected growth, saying that it is sufficient to achieve a “moderately prosperous” economy in 2020 (Figure 6).

Figure 6. China: GDP growth 2011-20e. Source: Bloomberg



**MEXICO  
Growth**

On February 23, INEGI (the government statistics agency) confirmed growth for 2017 at 2%, slightly below its preliminary estimate (2.1%), and less than 2.9% of 2016. Official estimates for 2018 and 2019 take no account of possible strong effects of NAFTA cancellation or the presidential elections (Figure 7), and could be a potential cause for negative surprises in future years.

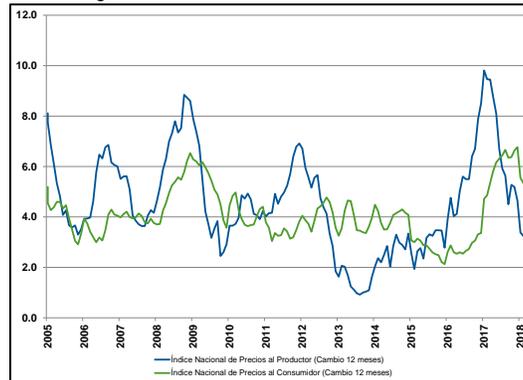
Figure 7. Macroeconomic Framework 2018-2023. Source: SHCP

Marco Macroeconómico 2018-2023						
(Cifras estimadas)						
	2018	2019	2020	2021	2022	2023
<b>PIB</b>						
Crecimiento % real	20-30	2.5-3.5	3.0-4.0	3.5-4.5	3.5-4.5	3.5-4.5
Nominal (miles de millones de pesos, puntual)*	22,832	24,411	26,149	27,930	29,833	31,865
Deflactor del PIB (variación anual, %)	4.8	3.8	3.5	3.2	3.2	3.2
<b>Inflación</b>						
Dic/dic	3.0	3.0	3.0	3.0	3.0	3.0
<b>Tasa de Interés</b>						
Nominal promedio	7.0	6.4	5.8	5.6	5.5	5.5
Real acumulada	4.1	3.5	2.9	2.7	2.6	2.6
<b>Cuenta Corriente</b>						
% del PIB*/	-1.8	-2.0	-2.1	-2.2	-2.3	-2.3

**Inflation**

Inflation continues to fall. In February consumer inflation fell from 5.55% to 5.34%, and producer inflation from 3.38% to 3.24%.

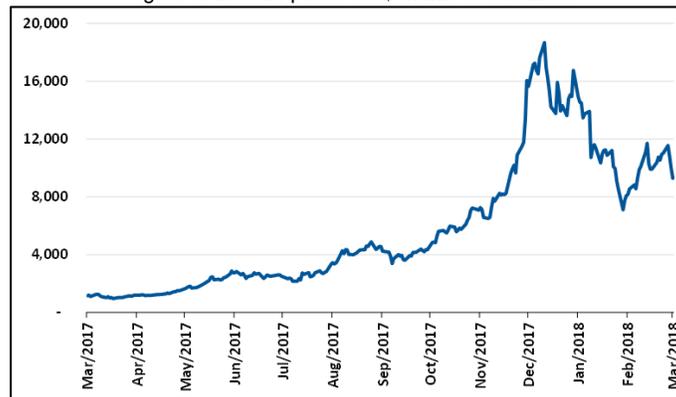
Figure 8. Annual inflation: Source: INEGI



**BITCOIN**

Bitcoin prices have continued volatile, and appear to have hit a new upper limit of US\$10,000 (Figure 9). Cryptocurrencies have a new champion in Stephen Bannon, Trump’s former chief strategist, currently banished from the White House. In a recent speech in Zurich, he stated that cryptocurrencies free the people from the tyranny of the central banks, who have the freedom to debase currencies. It remains to be seen whether the arrival of Bannon is positive or negative for the future of cryptocurrencies.

Figure 9. Bitcoin: prices US\$ mar2017-mar2018



**SCENARIOS 2018**

**Foreseeable Risks**

*Global*

- US: failure of progrowth policies (taxes, deregulation, infrastructure), trade wars
- NAFTA renegotiation
- Europe: Brexit, Catalonia and elections (Italy)
- Geopolitics: China, Korea, Middle East, Russia
- Global slowdown, monetary policy
- Bitcoin

*Mexican*

- Elections 2018
- Security
- Corruption
- Oil price
- Debt increase/credit rating

**Scenarios**

Taking into account foreseeable risks presented in the previous section, we present 3 scenarios for 2018, where the objective is Mexican economic growth. In the positive scenario, all risks turn out positive for Mexican growth, in the negative, all turn out negative, and in the middle, they vary different (in nature, intensity and/or duration).

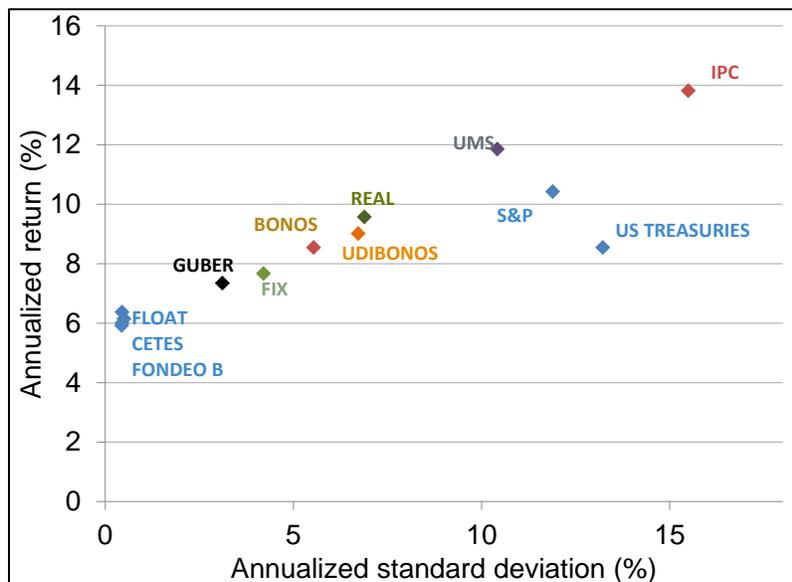
SCENARIOS	
<i>Positive (20%)</i>	
<ul style="list-style-type: none"> <li>• US: tax reduction, deregulation and infrastructure Investment, absence of trade wars.</li> <li>• NAFTA renegotiation “win-win”.</li> <li>• Europe, China, Russia, Korea and Middle East: risks do not materialize.</li> <li>• Global synchronous growth, successful monetary policy.</li> <li>• Bitcoin crash does not affect economy.</li> <li>• Mexico: corruption and security risks contained, positive elections.</li> </ul>	
<i>Negative (40%)</i>	
<ul style="list-style-type: none"> <li>• US: progrowth policies fail, trade wars break out.</li> <li>• NAFTA renegotiation fails.</li> <li>• Europe (UK and EU) disintegrates, risks in China, Russia, Korea and Russia materialize.</li> <li>• Global slowdown due to politics, economic dynamics, or monetary policy.</li> <li>• Bitcoin crash affects economy.</li> <li>• Mexico: corruption and insecurity increase, negative elections.</li> </ul>	
<i>Middle (40%)</i>	
<ul style="list-style-type: none"> <li>• US progrowth measures partially successful, mixed trade measures.</li> <li>• TLC renegotiation partially positive.</li> <li>• Europe, China, Russia, Korea and Middle East: risk materialize partially.</li> <li>• Global growth continues, less synchronized than 2017 and monetary policy partially successful.</li> <li>• Bitcoin crash partially affects economy.</li> <li>• Mexico: corruption and security partially contained, uncertain elections.</li> </ul>	

**MARKETS**

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

Despite peso depreciation, long term (2000-2018) peso denominated investments have outperformed US investments denominated in US\$, converted to pesos (Figure 10).

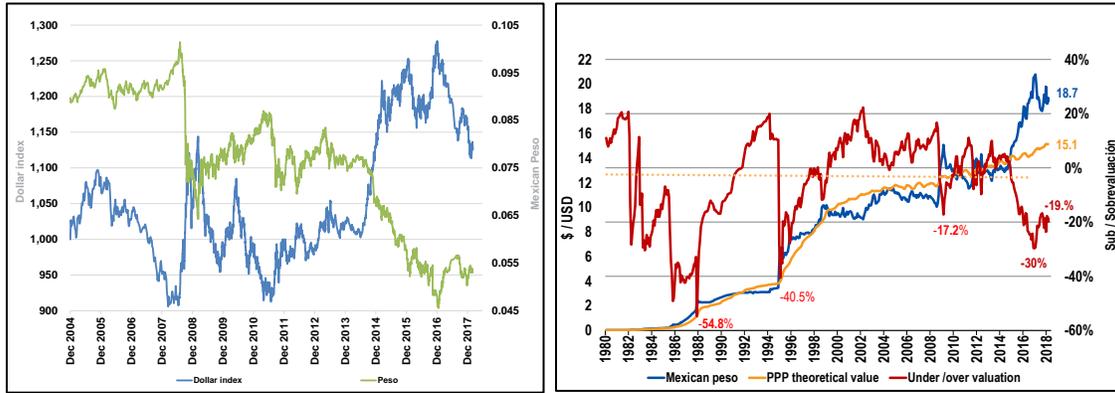
Figure 10. Investments in US\$ and pesos: performance measured in pesos 2000-mar2018. Source: Franklin Templeton



**US\$ and peso**

The US\$ has recovered against other currencies (Figure 11). However, the peso has stabilized around 18.50-18.80 (Figure 12) owing to NAFTA uncertainty.

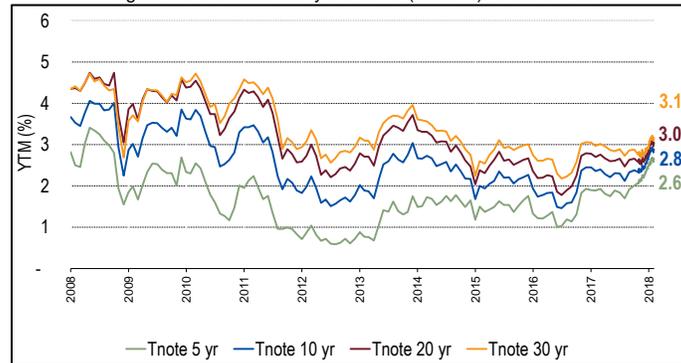
Figure 11. US\$ index and peso 2004-mar2018. Source: Bloomberg Figure 12. Peso vs. US\$: 1979-mar2018. Source: Franklin Templeton



**Debt**

US rates have risen in 2018, with a flattened curve. Term premium has fallen from 1.08% to 0.51% in the last 12 months (Figure 13). The Fed has insinuated that inflation is increasing and that this could imply faster rhythm of monetary normalization.

Figure 13. US: historical yield curve (6mar18). Source: Fed



Rates are expected to rise in practically all developed markets with mixed performance in emerging markets (Figure 14).

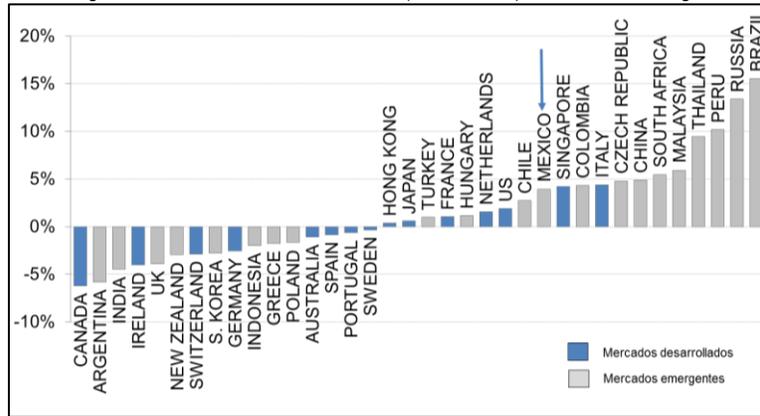
Figure 14. Developed and emerging markets: estimated 10 year nominal rates at end 2018 (6mar2018). Source: Bloomberg, Franklin Templeton

Developed				Emerging			
	local 10y yields (%)				local 10y yields (%)		
	4Q18e	Actual	Aumento (bps)		4Q18e	Actual	Aumento (bps)
US	3.04	2.87	17	China	3.99	3.85	15
Euro Area	0.95	0.66	29	India	7.41	7.73	(32)
Japan	0.13	0.05	9	Rusia	7.07	6.88	19
Britain	1.80	1.50	30	Brasil	8.97	9.61	(64)
Australia	3.06	2.77	29	México	7.45	7.63	(18)
Canada	2.67	2.24	44	Corea del sur	2.76	2.74	2
Germany	0.95	0.66	29	Indonesia	6.69	6.63	6
France	1.37	0.92	45	Turquia	11.91	11.92	(1)

**Shares**

2018 began positively owing to optimism from synchronized growth and US tax reform. February and March have been affected by the dual shocks of inflationary and trade war fears. The Mexican market followed the rest of the world but is positive in US\$, owing to peso strength so far (Figure 15).

Figure 15. Mercados accionarios: 2018 (06mar - US\$). Source: Bloomberg



Both in Mexico (Figure 16), and the US (Figure 17), markets show higher volatility than 2017, but normal in a historical context.

Figure 16. Mexico. acciones (IRT pesos). 01ene17-06mar18. Source: Bloomberg

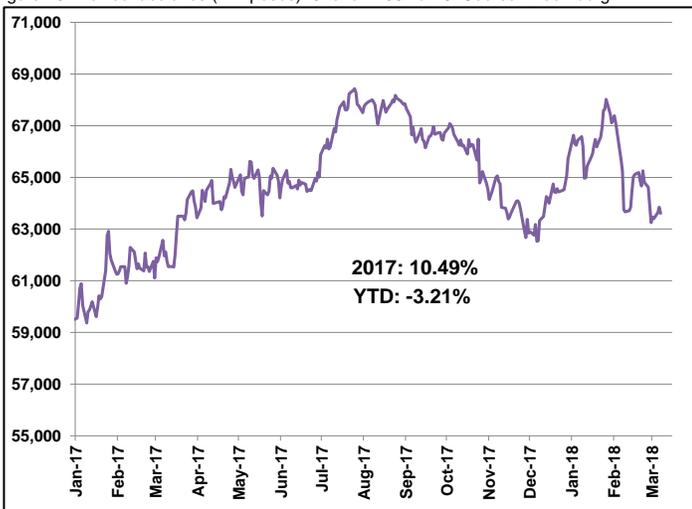


Figure 17. EEUU : acciones (S&P500 dólares). 01ene17-06mar18. Source: Bloomberg



### Fibras

Owing to novelty, high dividends, and inflation protection, Fibras have performed better than stocks since 2011 (Figure 18). Since Trump's election in 2016, Fibras have been affected by NAFTA and Mexican election uncertainty, and most recently by global inflation and trade war uncertainty (Figure 19).

Figure 18. Fibras vs. acciones mexicanas (IRT) mar2011-06mar2018 (base 100 MXN\$). Source: Bloomberg

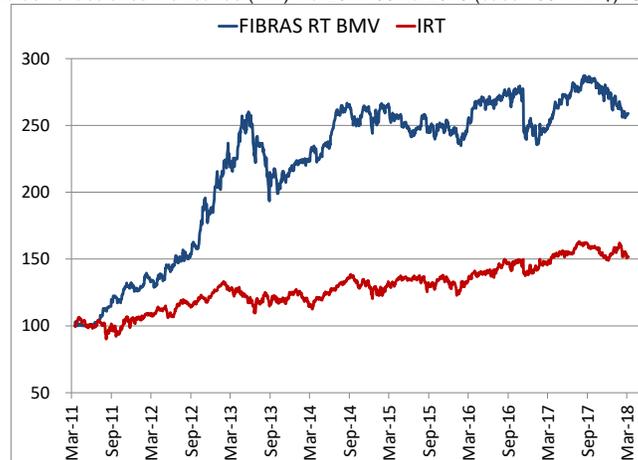


Figure 19. Fibras: valuación y dividendos (06mar2018). Source: Franklin Templeton

	Mcap (M) (MXN)	Calendarized						
		2013	2014	2015	2016	2017	2018	2019
FUNO11 MM	106,081	6.8%	7.4%	7.4%	7.7%	7.8%	8.8%	9.9%
DANHOS13 MM	42,185	6.0%	6.6%	7.1%	5.9%	7.6%	8.2%	8.2%
TERRA13 MM	22,291	6.8%	6.9%	7.4%	8.7%	8.7%	8.9%	9.2%
FIBRAPL MM	22,194	2.6%	4.7%	5.9%	6.4%	6.3%	6.4%	6.6%
FIBRAMQ MM	16,430	8.2%	7.5%	8.8%	7.4%	7.8%	8.1%	8.0%
FIHO12	8,742	8.3%	8.2%	9.0%	8.4%	10.4%	12.6%	11.4%
FHIPO	8,052		11.7%	11.8%	12.0%	12.5%	13.1%	12.8%
FMTY14 MM	7,909					8.5%	8.7%	
FSHOP13 MM	5,299	9.0%	10.0%	10.8%	9.8%	9.6%	9.3%	9.1%
FINN13 MM	5,276	6.6%	6.1%	7.4%	8.3%	8.8%	9.5%	

Another hotel Fibra (FSTAY) is expected as is a Fibra specialized in universities and a Fibra E related to hydraulic projects in Southern Mexico. All these issues are expected before July elections.

### Conclusion

Two possible external shocks, inflation and a trade war, must be taken into account, as well as the two Mexican risks, NAFTA renegotiations and elections. As there is more clarity in these areas (without including the unexpected) markets could stabilize and volatility fall. Meanwhile, there may be windows of opportunity in financial markets. We overweight ILS with 1 to 3 years duration, and underweight stocks and Fibras.

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**March 9, 2018**

**Main financial indicators: monthly at February 28, 2018**

In February 2018, in Mexico, the IPC fell 5.98%. Nominal and real rates rose in all terms. The US\$ strengthened 1.22% against the peso. In the US, DJ, S&P500 and Nasdaq fell. Nominal and real rates rose in all terms. In Bank of Mexico's business climate survey, optimism fell to 13% (16% previous), no change rose to 70% (50%), and pessimism fell to 17% (34%).

Mexico					
<b>Stock market and oil</b>					
	28-Feb-18	31-Jan-18	Month	YTD	2017
IPC	47,437.93	50,456.17	-5.98%	-3.88%	8.13%
Local currency (USD/MXN)	18.83	18.61	1.22%	-4.22%	-4.64%
Mexican oil mix (USD/bl)	55.59	58.39	-4.80%	-1.07%	21.36%
<b>Nominal rates</b>					
	28-Feb-18	31-Jan-18	Month	YTD	2017
CETES 28	7.59%	7.39%	20 bps	27 bps	148 bps
CETES 360	7.67%	7.52%	15 bps	21 bps	103 bps
M5	7.52%	7.48%	4 bps	-7 bps	38 bps
M10	7.64%	7.61%	3 bps	-1 bps	15 bps
M30	7.89%	7.81%	8 bps	11 bps	-4 bps
<b>Real rates</b>					
	28-Feb-18	31-Jan-18	Month	YTD	2017
UDIBONO 10	3.67%	3.55%	12 bps	17 bps	45 bps
UDIBONO 30	3.88%	3.76%	12 bps	18 bps	-9 bps
<b>Commodities</b>					
	28-Feb-18	31-Jan-18	Month	YTD	2017
Gold	1,318.31	1,345.14	-1.99%	1.19%	12.48%
WTI (USD/bl)	55.59	58.08	-4.29%	-1.07%	4.60%
<b>UMS</b>					
	28-Feb-18	31-Jan-18	Month	YTD	2017
UMS 10 years	4.21%	3.91%	30 bps	58 bps	-64 bps
UMS 20 years	4.92%	4.67%	26 bps	39 bps	-74 bps
UMS 30 years	4.96%	4.70%	26 bps	32 bps	-62 bps
<b>Stock markets (US\$)</b>					
	28-Feb-18	31-Jan-18	Month	YTD	2017
MSCI Developed	8,549.70	8,915.28	-4.10%	0.98%	23.07%
MSCI Emerging	2,606.49	2,732.11	-4.60%	3.36%	37.75%
MSCI Mexico	9,416.07	10,138.69	-7.13%	0.17%	16.27%
MSCI Brazil	7,257.43	7,402.26	-1.96%	14.56%	24.48%

US					
<b>Stock market</b>					
	28-Feb-18	31-Jan-18	Month	YTD	2017
DJ	25,029.20	26,149.39	-4.28%	1.25%	25.08%
S&P	2,713.83	2,823.81	-3.89%	1.50%	19.42%
Nasdaq	7,273.01	7,411.48	-1.87%	5.35%	28.24%
<b>Nominal rates</b>					
	28-Feb-18	31-Jan-18	Month	YTD	2017
Tbill 90	1.65%	1.39%	26 bps	38 bps	76 bps
Tnote 5	2.65%	2.20%	45 bps	51 bps	21 bps
Tnote 10	2.87%	2.40%	47 bps	45 bps	-3 bps
Tbond 30	3.13%	2.74%	39 bps	30 bps	-23 bps
<b>Real rates</b>					
	28-Feb-18	31-Jan-18	Month	YTD	2017
Tip 5	0.61%	0.54%	7 bps	35 bps	17 bps
Tip 10	0.75%	0.61%	14 bps	28 bps	-3 bps
Tip 30	0.99%	0.80%	19 bps	27 bps	-27 bps

Bank of Mexico survey		
<b>Indicator</b>	2018	2018 anterior
PIB	2.28%	2.19%
Inflation	4.09%	4.06%
Cetes 28	7.42%	7.33%
Local currency	18.86	19.04
<b>Business conditions</b>		
	28-Feb-18	31-Jan-18
Optimism	13%	16%
No change	70%	50%
Pessimism	17%	34%

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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