



Monthly Perspective | April 11, 2019

Dissonance: markets vs. economy

SUMMARY

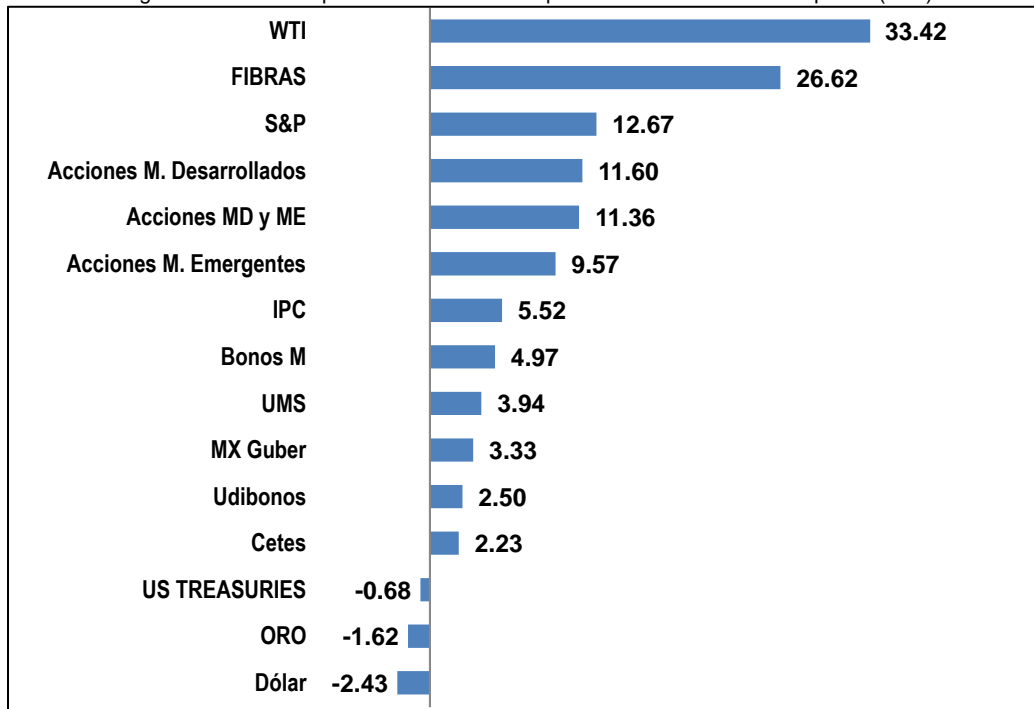
- Global. Risk assets have risen, despite a slowdown expected by the IMF. Market could begin to discount a slowdown before the end of 2019.
- Mexico. Risk assets also strong, despite the reduction in growth estimates for 2019 and 2020 by the Mexican Finance Ministry.
- Global risks 2019: Sharp slowdown, trade wars, geopolitics, Brexit/Europe, monetary policy, emerging markets (EM).
- Local risks: a dysfunctional government, USMCA not ratified in the US, credit downgrade.
- Investment scenarios 2019 with probabilities: positive (20%), negative (40%), middle (40%).
- For peso portfolios, overweight liquidity and Inflation-Linked Securities (ILS) 1 a 3 years duration, underweight shares and REITs (Fibras).

“I believe that economists put decimal points in their forecasts to show they have a sense of humor” - William Gilmore Simms

Recovery vs. uncertainty

In March, the recovery continued in almost all asset classes, mainly in stocks and REITs. The rally was fueled by the Fed, which has indicated that rates will be unchanged for the rest of 2019. Economic data are reviving fears of an end to the current cycle, lowering the probability that the investment rally will continue through to the end of 2019.

Figure 1. Investment performance YTD to 5April19. Source: Franklin Templeton (“FT”)



POLITICS

USA

Trade wars

Negotiations between the US and China showed signs of progress. On April 4 President Trump said he could announce an “epic” agreement next month. At the same time, he threatened Mexico with border closing and imposition of tariffs on auto imports, if Mexico did not increase its efforts to halt the flow of migrants and drugs to the US. Trade flows and border crossing times have been slowed by the reduction in customs personnel. These threats which are political, are likely to continue or increase in the runup to the 2020 presidential elections.

Russian interference: the investigation

Robert Mueller presented the conclusions of his investigation of Russian interference in the 2016 elections to the US Attorney General. The report, not yet published, concludes that there is no evidence of interference, but does not exonerate Trump from obstruction of justice. This is favorable for his chances of reelection in 2020.

EUROPE

Brexit

Two and ¾ years since the Brexit vote, its resolution is stuck in the UK parliament. After another round of lost votes, Theresa May procured a second extension until October 31. During this period, anything is possible, including a negotiated solution before the deadline, May's resignation, or a second referendum.

MEXICO

President

In the last few weeks, the centralizing tendency of AMLO has been increasingly confirmed:

- *Comisión Reguladora de Energía (CRE-Energy Regulatory Commission)*. Four people were appointed to 4 vacancies (out of a total of 7), legally imposed by the President following two rejections by the Senate.
- *Pemex*. The resignation of the 4 independent directors was accepted, on the basis that they had "neoliberal" ideas that are different from those of the current administration.
- *Supreme Court*. A proposal was made to increase the number of judges to assure a majority appointed by AMLO. Interior Minister Olga Sánchez Cordero opposed it. It has to be approved by the legislature, but it is not obvious how it can be stopped.

AMLO requested that the King of Spain and the Pope apologize for what Spain and the Catholic church did during the conquest of Mexico, with a private letter. It was understood as a subtle manipulation to divert attention from the more important matters mentioned in the previous paragraph.

Morena

On March 27, the Senate approved with an overwhelming majority a constitutional reform to remove the exemption from prosecution for the President and legislators while in office. If approved by the Chamber of Deputies, they could be prosecuted for electoral crimes, corruption, organized crime, murder, rape, murder, and people trafficking.

Before the current congressional session ends on April 29, Morena will present the following measures:

- *Education Reform*. With the changes proposed by AMLO, the government is fighting the teachers' union (CNTE) to keep some parts of the Reform and not return control of hiring, to prevent corruption.
- *Presidential reconfirmation*. The opposition has postponed debate on the basis that a reconfirmation could be used as a mechanism for reelection. Similar mechanisms were used in Bolivia and Venezuela.
- *Labor reform*. This is considered beneficial to workers as it provides more freedom of association, transparency and dispute resolution in judicial tribunals. The US Congress regards it as indispensable for the approval of the USMCA.

Within Morena, the governing party, many differences are becoming clear: between politicians and technocrats; among politicians, between moderates and extremists; and among technocrats between Carlos Urzúa and Arturo Herrera, and Alfonso Romo, the President's adviser. This affects public pronouncements, lowers confidence in the private sector and slows investment decisions.

ECONOMY

GLOBAL

Growth

At the beginning of April, the IMF lowered its global growth estimate from 3.5 to 3.3%, its lowest level in the last 10 years (Figure 2). It estimates that 70% of economies will slow down in 2019. The probability of a recession is low but negative outcomes from trade wars and Brexit could impact the global economy.

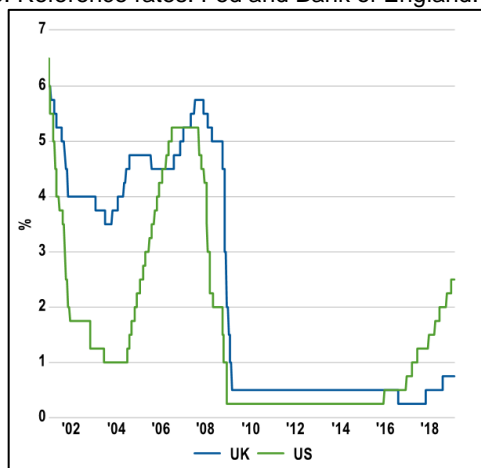
Figure 2. World Economic Outlook. Source: FMI

	2018	Projections		Difference from January 2019 WEO Update ¹	
		2019	2020	2019	2020
World Output	3.6	3.3	3.6	-0.2	0.0
Advanced Economies	2.2	1.8	1.7	-0.2	0.0
United States	2.9	2.3	1.9	-0.2	0.1
Euro Area	1.8	1.3	1.5	-0.3	-0.2
Germany	1.5	0.8	1.4	-0.5	-0.2
France	1.5	1.3	1.4	-0.2	-0.2
Italy	0.9	0.1	0.9	-0.5	0.0
Spain	2.5	2.1	1.9	-0.1	0.0
Japan	0.8	1.0	0.5	-0.1	0.0
United Kingdom	1.4	1.2	1.4	-0.3	-0.2
Canada	1.8	1.5	1.9	-0.4	0.0
Other Advanced Economies ²	2.6	2.2	2.5	-0.3	0.0
Emerging Market and Developing Economies	4.5	4.4	4.8	-0.1	-0.1
Commonwealth of Independent States	2.8	2.2	2.3	0.0	0.0
Russia	2.3	1.6	1.7	0.0	0.0
Excluding Russia	3.9	3.5	3.7	-0.2	0.0
Emerging and Developing Asia	6.4	6.3	6.3	0.0	-0.1
China	6.6	6.3	6.1	0.1	-0.1
India ³	7.1	7.3	7.5	-0.2	-0.2
ASEAN-5 ⁴	5.2	5.1	5.2	0.0	0.0
Emerging and Developing Europe	3.6	0.8	2.8	0.1	0.4
Latin America and the Caribbean	1.0	1.4	2.4	-0.6	-0.1
Brazil	1.1	2.1	2.5	-0.4	0.3
Mexico	2.0	1.6	1.9	-0.5	-0.3

Fed

On March 20 the US Fed decided, as expected, to maintain its reference rate between 2.25 and 2.5% (Figure 3). The difference from its previous meeting is that the Fed expects to keep rates unchanged for the rest of 2019 and has lowered its estimates of inflation and growth. The decision was positive for stocks and debt.

Figure 3. Reference rates: Fed and Bank of England. Source: FT



MEXICO

Macroeconomic policy 2020: preliminary guidelines

According to law, on April 1 the Mexican Finance Ministry (SHCP) presented to Congress its Preliminary Guidelines for Macroeconomic Policy in 2020 (Pre-Criterios de Política Macroeconómica 2020) as a basis for debate on the 2020 budget (Figure 4). Growth estimates were lowered from 2.0 to 1.6% in 2019 and from 2.6 to 1.9% in 2020. Inflation estimates are in line with Banco de Mexico at 3.4% in 2019 and 3% in 2020. Rates are expected to fall once more in 2019 and twice more in 2020. Income is expected to fall by 0.5% of GDP, to be balanced by an equivalent cut in spending. The guidelines reaffirm the commitment, at least on paper, to fiscal discipline. AMLO said that these estimates were pessimistic and that he was expecting 2019 growth above 2%.

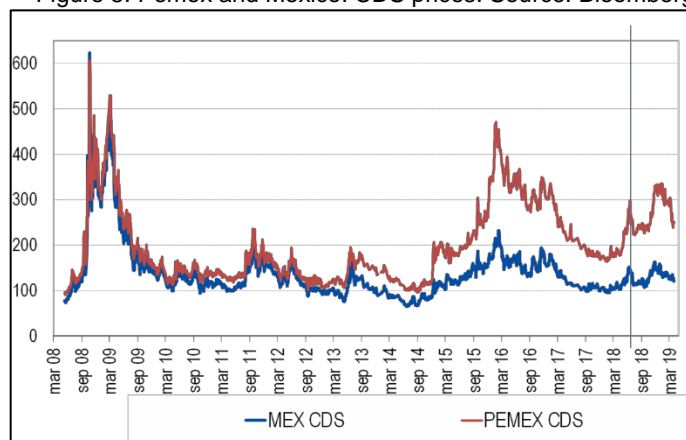
Figure 4. Macroeconomic policy 2020; preliminary guidelines. Source: SHCP

Producto Interno Bruto		
Crecimiento % real (Rango)	1.1 - 2.1	1.4 - 2.4
Nominal (miles de millones de pesos, puntual)*	24,873.8	26,178.0
Deflactor del PIB (variación anual, % promedio)	3.9	3.2
Inflación (%)		
Dic. / dic.	3.4	3.0
Tipo de cambio nominal (pesos por dólar)		
Fin de periodo	19.9	20.1
Promedio	19.5	20.0
Tasa de interés (Cetes 28 días, %)		
Nominal fin de periodo	8.0	7.6

Pemex

The government announced another Pemex rescue using the Special Stabilization Fund, affecting public finance. Even though the rescue is insufficient, it was positive for the prices of Pemex debt, with spreads falling (Figure 5). Pemex' future depends on whether rescue funds will be used to increase the production platform or on unproductive projects.

Figure 5. Pemex and Mexico: CDS prices. Source: Bloomberg



Bank of Mexico

On March 28, as expected, the Bank of Mexico decided to maintain its reference rate at its current level of 8.25%. It confirmed that the slowdown in the last quarter of 2018 has continued into this year and that inflation is falling owing to the fall in food and energy prices.

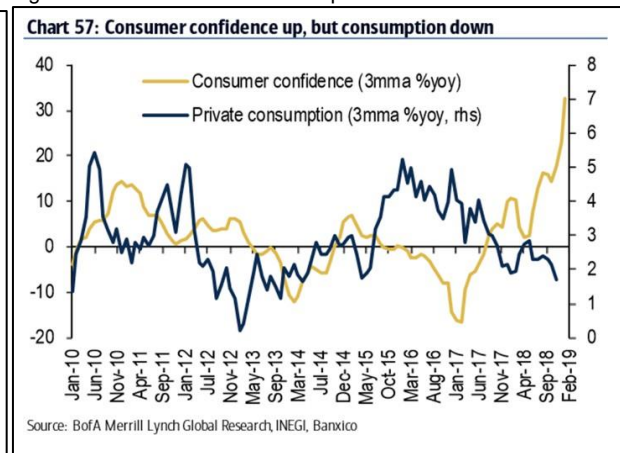
Growth

Growth estimates continue to fall for 2019, following world trends and due also to Mexican political uncertainty. Interestingly, although consumer confidence is very high, consumption is falling (Figures 6 and 7).

Figure 6. Mexico: growth estimates in 2019. Source: Bloomberg



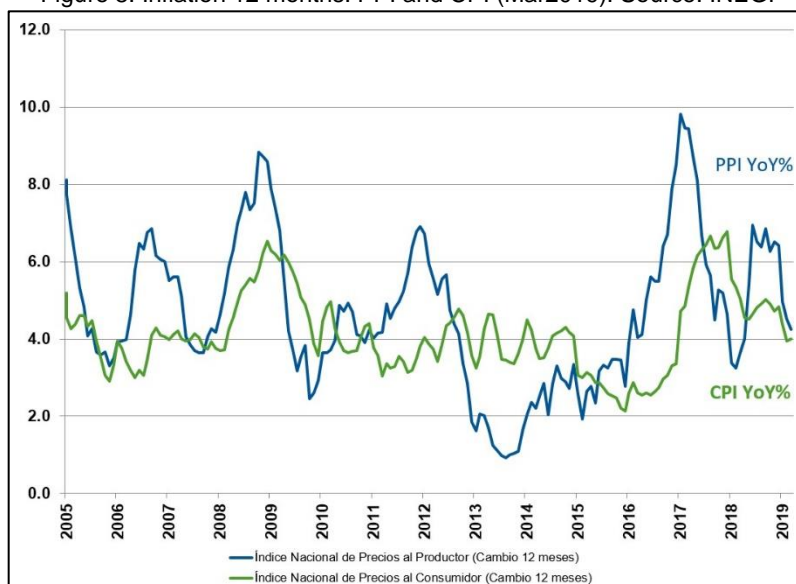
Figure 7. Confidence and consumption. Source: BofAML



Inflation

Consumer inflation in March as 0.12%, raising end February annual inflation of 3.95% to 4.06% end-March (Figure 8). The main cause was the rise in onion and tomato, which account for half the monthly increase.

Figure 8. Inflation 12 months: PPI and CPI (Mar2019). Source: INEGI



RISKS AND SCENARIOS FOR 2019

The objective is Mexican economic growth. In the positive scenario, all risks turn out favorable for growth, in the negative, unfavorable, and in the middle, mixed. Estimates for each scenario are given in Figure 9.

RISKS

Global

- US: monetary policy, recession, the dispute between the executive and legislative branch
- Global: trade wars
- Geopolitics: Europe, Middle East, Russia, China, North Korea, Venezuela

Mexican

can New

- government
- Security
- Corruption
- Oil

SCENARIOS

Positive (20%)

- US: expansion continues, trade disputes but no major consequences
- Monetary policy does not derail cycle.
- Rapid ratification USMCA.
- Geopolitical risks do not materialize.
- Global growth.
- EM: no crisis or contagion.
- Mexico: new government functions, spending drives infrastructure/consumption, measures anticorruption and anti-violence work.

Negative

(40%) US: expansion stops, trade wars affect global

- commerce. Monetary policy derails cycle.
- USMCA not ratified, elimination threatened. Geopolitical risks materialize.
- Global recession.
- Mexico: new government dysfunctional, spending out of control, anti-corruption and violence measures backfire.

Middle

(40%) US: slow expansion continues, rhetorical trade disputes.

- Adequate monetary policy, but uncertain.
- USMCA approved late, with changes. Geopolitical: risks materialize partially. Global slowdown, unsynchronized.
- EM: crisis and some contagion from vulnerable countries.

Figure 9. Estimates for scenarios 2019. Source: FT

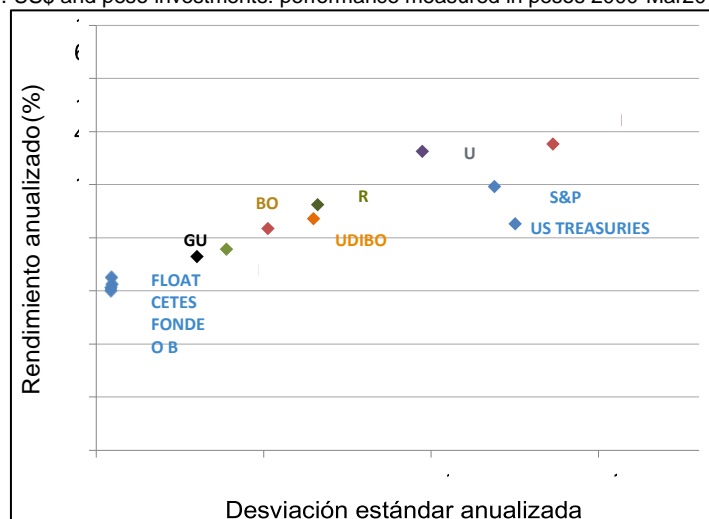
	Escenarios para 2019			2018
	Alto	Bajo	Base	Observados
Probabilidad	20%	40%	40%	
EU				
Crecimiento PIB	> 2.40%	< 2.40%	2.40%	2.90%
Inflación	> 1.90%	< 1.90%	1.90%	2.50%
Déficit fiscal	< 4.50%	> 4.50%	4.50%	4.20%
Déficit cuenta corriente	< 2.60%	> 2.60%	2.60%	2.50%
Tasa T-Bills	> 2.75%	< 2.75%	2.75%	2.50%
TNote 10 US	> 2.98%	< 2.98%	2.98%	2.69%
Petróleo (WTI)	> \$59.8	< \$59.8	59.80	45.41
México				
Crecimiento PIB	> 1.64%	< 1.64%	1.64%	2.00%
Inflación	> 3.67%	< 3.67%	3.67%	4.87%
Déficit fiscal	< 2.50%	> 2.50%	2.50%	2.10%
Déficit cuenta corriente	< 1.60%	> 1.60%	1.60%	1.60%
Cetes28 (fin de año)	> 8.05%	< 8.05%	8.05%	8.42%
Peso/US\$ (fin de año)	< \$20.19	> \$20.19	20.19	19.65

MARKETS

Investments in US\$ and in pesos: comparative performance

After peso depreciation since Trump, long term (2000-2019) the gap between US\$ and peso investments, both converted to pesos, has narrowed. However, peso investments have outperformed US\$ investments (Figure 10).

Figure 10. US\$ and peso investments: performance measured in pesos 2000-Mar2019. Source: FT



US\$ and peso

More than four months since AMLO took office, the peso has strengthened owing to US\$ weakness, rate differentials (Figure 11) and foreigners' appetite for Mexican risk. Sentiment measured by Banxico deteriorated in January and February but improved slightly in March (Figure 12).

Figure 11. Peso vs. US\$: 1980-April2019. Source: FT

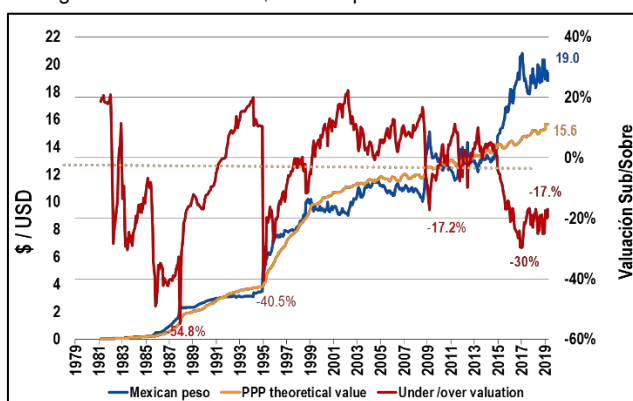
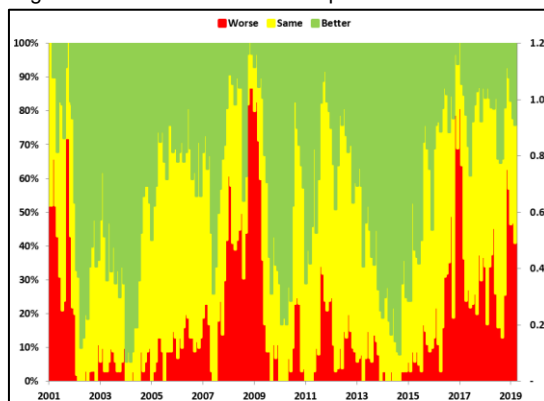


Figure 12. Sentiment: Dec2001-April2019. Source: Banxico



Debt

Rates are expected to rise in DM and all EM, except Brazil, China, Mexico and Turkey (Figure 13).

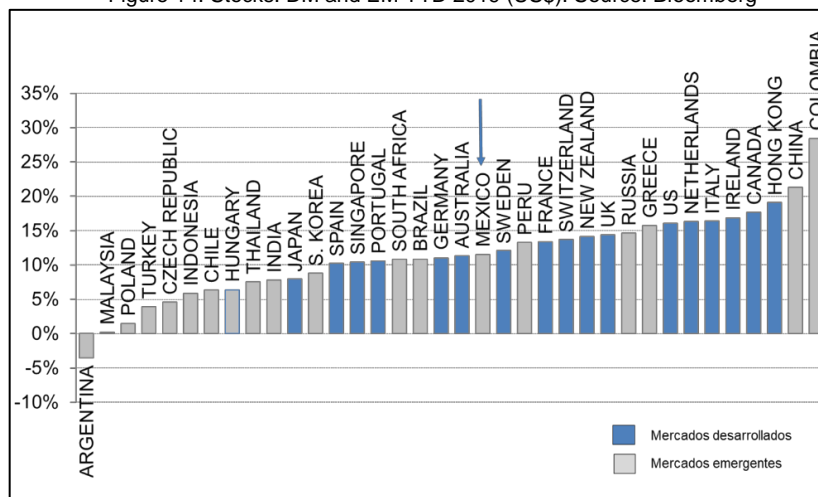
Figure 13. DM and EM: nominal rates 10y estimated YE 2019 (April 19). Source: Bloomberg, FT

Developed				Emerging			
local 10y yields (%)				local 10y yields (%)			
	4Q19e	Actual	(bps)		4Q19e	Actual	(bps)
US	2.96	2.48	47.51	China	3.06	3.15	-8.8
Euro Area	0.45	(0.02)	47.2	India	7.40	7.35	4.9
Japan	0.06	(0.08)	14	Rusia	8.17	8.07	9.8
Britain	1.68	1.04	64.2	Brasil	8.52	8.97	-44.5
Australia	2.09	1.80	28.8	México	8.00	8.01	-1
Canada	2.32	1.67	64.6	Corea del sur	2.32	1.87	45.5
Germany	0.45	(0.02)	47.2	Indonesia	7.87	7.61	25.7
France	0.84	0.38	46	Turquia	15.92	17.49	-157

Stocks

In 2019 YTD, stock performance measured in US\$ has been positive owing to promarket comments by the Fed and the expected resolution of trade wars. Most markets are positive in US\$ after a widespread negative performance in 2018 (Figure 14).

Figure 14. Stocks: DM and EM YTD 2019 (US\$). Source: Bloomberg



REITs (Fibras)

Since inception, Fibras have outperformed stocks since 2011 (Figure 15). In 2019, they have performed strongly owing to an improved outlook in global trade and lower interest rates (Figure 16).

Figure 15. Fibras vs. IRT Mar2011-5April19.

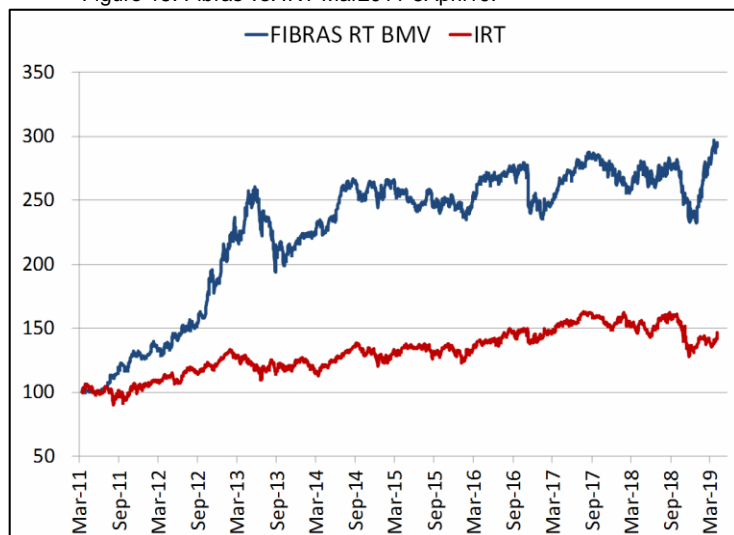


Figure 16. Fibras vs. IRT. Jan18-5April9 (base 100). Source: Bloomberg

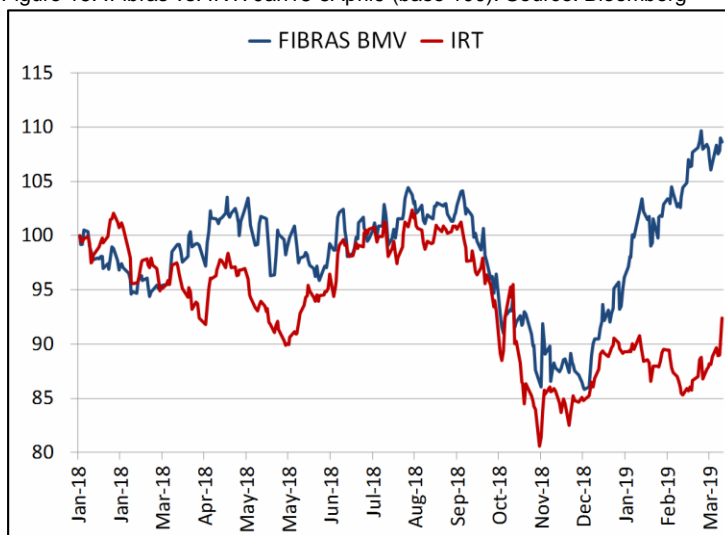


Figure 17. Fibras: valuation and dividends (April2019). Source: Bloomberg

	Mcap (M)		Calendarized					
	(MXN)	2015	2016	2017	2018	2019	2020	
FUNO11 MM	95,062	4.8%	6.3%	6.5%	7.9%	8.1%	8.7%	
DANHOS13 MM	35,179	5.0%	6.3%	8.3%	8.5%	9.2%	9.2%	
FIBRAPL MM	21,626		6.8%	6.4%	6.6%	7.4%	7.5%	
TERRA13 MM	19,696	6.5%	7.5%	7.8%	10.4%	10.5%	10.9%	
FIBRAMQ MM	14,898	7.6%	7.1%	6.9%	7.8%	8.8%	9.4%	
FIHO12	8,064	7.6%	7.8%	8.3%	11.6%	12.5%	12.5%	
FMTY14 MM	7,539			8.6%	8.8%	9.2%	10.0%	
FINN13 MM	5,204	5.7%	6.4%	8.6%	8.0%	10.0%	10.1%	
FSHOP13 MM	4,102	5.4%	8.2%	9.4%	110.5%	14.1%	12.8%	

Conclusion

Globally, risks assets have recovered owing to a weaker slowdown and more dovish monetary policy. In Mexico, risk perception has increased owing to more clear government policies, including centralization of power and redistributive social spending, reflecting the government's emphasis on politics over economics. We advise caution for peso portfolios, overweight liquidity and ILS 1 to 3 years duration, and underweight stocks and fibras.

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April 11, 2019

Investment indicators to March 29, 2019

In March, in Mexico, the IPC rose 1.07%. Nominal and real rates fell over all terms. The US\$ strengthened 0.61% against the peso. In the US: DJ, S&P500, and NASDAQ rose. Nominal and real rates fell over all terms. WTI oil rose 6.13%. Business climate according to Banxico: optimism rose to 24% (22% previous), no change rose to 35% (31%), pessimism fell to 41% (47%).

Main financial indicators

Mexico					
Stock market and oil					
	29-Mar-19	28-Feb-19	Month	YTD	2018
IPC	43,281.28	42,823.80	1.07%	3.94%	-15.63%
Local currency (USD/MXN)	19.38	19.26	0.61%	-1.39%	-0.06%
Mexican oil mix (USD/bl)	61.28	58.62	4.54%	37.12%	-20.47%
Nominal rates					
	29-Mar-19	28-Feb-19	Month	YTD	2018
CETES 28	8.41%	8.46%	-5 bps	-1 bps	110 bps
CETES 360	7.86%	8.06%	-20 bps	-63 bps	103 bps
M5	7.83%	7.99%	-16 bps	-69 bps	93 bps
M10	8.08%	8.23%	-15 bps	-58 bps	101 bps
M30	8.46%	8.74%	-28 bps	-43 bps	111 bps
Real rates					
	29-Mar-19	28-Feb-19	Month	YTD	2018
UDIBONO 10	3.89%	4.05%	-16 bps	-22 bps	61 bps
UDIBONO 30	4.13%	4.33%	-20 bps	1 bps	42 bps
Commodities					
	29-Mar-19	28-Feb-19	Month	YTD	2018
Gold	1,291.71	1,314.40	-1.73%	0.86%	-1.70%
WTI (USD/bl)	60.73	57.22	6.13%	35.89%	-20.47%
UMS					
	29-Mar-19	28-Feb-19	Month	YTD	2018
UMS 10 years	4.49%	4.67%	-18 bps	-43 bps	129 bps
UMS 20 years	5.12%	5.42%	-30 bps	-66 bps	125 bps
UMS 30 years	5.09%	5.59%	-50 bps	-75 bps	120 bps
Stock markets (US\$)					
	29-Mar-19	28-Feb-19	Month	YTD	2018
MSCI Developed	8,754.49	8,635.20	1.38%	12.65%	-8.20%
MSCI Emerging	2,378.03	2,357.78	0.86%	9.97%	-14.25%
MSCI Mexico	8,404.65	8,377.62	0.32%	5.55%	-15.29%
MSCI Brazil	6,845.55	7,118.50	-3.83%	8.22%	-0.15%

US					
Stock market					
	29-Mar-19	28-Feb-19	Month	YTD	2018
DJ	25,928.68	25,916.00	0.05%	11.15%	18.04%
S&P	2,834.40	2,784.49	1.79%	13.07%	11.97%
Nasdaq	7,729.32	7,532.53	2.61%	16.49%	23.26%
Nominal rates					
	29-Mar-19	28-Feb-19	Month	YTD	2018
Tbill 90	2.40%	2.45%	-5 bps	-5 bps	194 bps
Tnote 5	2.23%	2.52%	-29 bps	-28 bps	58 bps
Tnote 10	2.41%	2.73%	-32 bps	-28 bps	24 bps
Tbond 30	2.81%	3.09%	-28 bps	-17 bps	-8 bps
Real rates					
	29-Mar-19	28-Feb-19	Month	YTD	2018
Tip 5	0.45%	0.68%	-23 bps	-55 bps	91 bps
Tip 10	0.53%	0.78%	-25 bps	-45 bps	48 bps
Tip 30	0.89%	1.11%	-22 bps	-32 bps	22 bps

Bank of Mexico survey		
Indicator	2019	2019 anterior
PIB	1.56%	1.64%
Inflation	3.65%	3.67%
Cetes 28	7.97%	8.05%
Local currency	19.97	20.19
Business conditions		
	29-Mar-19	28-Feb-19
Optimism	24%	22%
No change	35%	31%
Pessimism	41%	47%

Source: Bloomberg, Banco de Mexico

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