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January 2023

Investment Committee: There is value in the rest of the world

We have not changed our view of the market from the last meeting. We remain cautious and without substantial dissent within the committee. We believe that the market anticipates too early a successful anti-inflationary move by the Fed and therefore foresees a rapid end to the current rate hike cycle. Portfolio adjustments from our last report are marginal. The reopening of the Chinese economy and the weakness of the dollar motivated us to slightly reduce our cash position, and to increase our allocation to emerging debt and commodities, mainly energy.

At its last meeting of the year, the Fed decided to raise the benchmark rate by 50 basis points (bps) and showed a more aggressive attitude and greater determination to lower inflation, despite recent reports showing a slowdown in prices. The Fed expects rates to end the year at 5.1%, some 50-75 bps above current levels, and does not envisage any rate cut. Its economic projections were also more pessimistic, estimating a meager growth of the economy at 0.5% (versus the 1.2% expected in the previous quarter) and an unemployment level of 4.6%, slightly higher than previous estimates, but well above the current 3.5%.

However, the market has a much more optimistic view, estimating that rates will rise by 50bp at most in the first quarter and fall by at least the same magnitude throughout the second half of the year. That outlook is heavily influenced by the last three US inflation readings, which showed significant declines, and by the perception that there could be a mild recession by mid-2023.

Our view is closer to that of the Fed, given that core inflation - especially services inflation, which seems quite entrenched - could take longer than expected to come down, especially due to the unusually strong labor market, which has the lowest unemployment in 52 years. On the other hand, the weak dollar is likely to put upward pressure on imported prices and the resurgence of the Chinese economy could give commodity prices, especially oil, a further boost. So, interest rates may not come down as fast as the market expects, deteriorating corporate earnings and consequently weakening the stock market.

We continue to maintain a defensive posture

		--	-	Neutral	+	++	Comment
Cash	TBills USA 6m						**We remain overweight in cash, although we reduced the position to increase weightings in emerging markets and commodities.**
Bonds							**We remain cautious on fixed income. More positive on emerging debt due to slower rising interest rates and a weaker dollar.**
	Treasury Bonds						Long-term TIPs have positive real rates of 1.5%.
	IG Corporative						Debt up to 5 years provides attractive yields and protection against recession
	High Yield						Vulnerable to recession. We would increase when spread exceeds 700
	Emerging Markets						We would take more aggressive positions with the spread over 500
Stocks							**There is more value in stock markets outside the United States.**
	USA						Small caps and the energy sector continue to be attractive.
	Europe						Despite recent rise, Europe is cheap by valuations and currency
	Japan						Cheap valuations and currency, beneficiary of China's recovery 2023-24
	Emerging Markets						We favor Emerging Asia
Commodities	Ind/Agr/Energ						**The reopening of the Chinese economy, the suspension of sales of strategic reserves in the US, and the weak dollar all play in favor of oil.**
Precious Metals	Gold						**Despite positive real interest rates, it benefits from the weak dollar and provides protection against systemic crises.**
Others	Estructured Products						**It remains an environment that favors structured products. We would look for products with a minimum downside hedge of 20%.**

Source: Investment Committee - Latin Securities

We continue to hold a strong cash position, albeit slightly smaller than in the previous quarter, as part of it was directed to increase fixed income and commodities positions. With U.S. rates already above 4%, cash is back to attractive yields after many years, and we believe they will continue to rise. We prefer 6-month US Treasury bills, which could occupy between 5% and 15% depending on the portfolios. Cash reduces portfolio volatility and gives us the option to buy riskier assets once they reach a more attractive valuation. The macroeconomic scenario is ideal for conservative portfolios, which can lock in attractive rates more than 5% over 2-3 years, which, given a contained inflation scenario, can result in real rates of 2% or more.

We continue with a neutral, wait-and-see stance on the fixed income market. It makes little sense to take duration risk with a yield curve as inverted as the current one except for the inflation-adjusted bond curve (TIPs), which offer attractive real interest rates in the vicinity of 1.5%. Nominal bond yields are at more attractive levels than a few months ago, although it is not yet clear that inflation can easily drop to the Fed's 2% target. A few rate hikes and several months of inflation fighting are still to come. Therefore, we maintain an underweight position in long nominal bonds and an overweight position in 10-year inflation-adjusted bonds (TIPs).

We maintain an overweight position in investment-grade corporate debt, preferring bonds with medium durations, up to 5 years, which offer good protection against a recession. In high yield, we continue to expect to take positions at wider spreads than current ones, probably when a recession is already underway, so we maintain an underweight position. We believe that spreads against treasuries close to 700 basis points, some 250 points above current levels, represent a good entry point as it was in previous crises.

In emerging market corporate and sovereign debt we increase the weighting from neutral to slightly overweight. Emerging markets in general have had fewer problems with inflation, as they have been much more fiscally prudent. Therefore, central banks have had much less hawkish stances than those in Europe and North America and are much further along in the process of raising rates. We continue to consider taking more aggressive positions if the spread against Treasuries were to exceed 500 points (vs. 380 currently).

We prefer to maintain an underweight position in equities, with a negative view on the US and a more positive view on the rest of the world. We remain concerned about the possibility of a sharp drop in earnings estimates, which have started to fall incipiently in recent months, but have remained resilient of late. However, history shows that with a slowing economy corporate earnings should begin to fall. We believe that the current earnings season will be important, as it will include the outlook from senior management, which could be the catalyst for a more accelerated drop in estimates. In the U.S. market we would start to rise slightly when the P/E based on 12-month earnings estimates reaches levels of 17x, which assuming a 10% drop in earnings estimates could mean levels equivalent to 3,400-3,500 of the S&P500.

In Europe, despite the strong recovery in recent months, we maintain a neutral stance. The region is already in recession, and inflation has not only started to come down slowly, but seems to be much less entrenched in the economy than in the US. Therefore, it is likely that services inflation will not develop the same inertia as in the Americas. Valuations remain much lower than in the US, providing greater potential yield and resilience should markets weaken again. We continue to be positive on Japan and emerging markets, particularly in Asia, both trading at attractive valuations and with prospects of benefiting from the recent reopening of the Chinese economy after long confinements and a weaker dollar. Asian countries, on the other hand, have much lower hard currency debt ratios and exchange rates unpegged to the dollar, which helps to maintain macroeconomic stability. In Europe, Japan and emerging markets, we prefer unhedged positions.

In commodities we moved from a slightly underweight position to a neutral position, with a bias towards energy commodities and neutral in basic materials and industrials. We also have a neutral position in precious metals, which, while losing some attractiveness in the face of positive real rates, compensate with some level of inflation protection, as well as providing an important hedge against disruptive macroeconomic events, such as during the 2008 crisis.
Finally, in terms of structured products, although the drop in volatility has reduced potential returns, we remain positive on those vehicles that offer capital protection above 20%, which we believe is sufficient to mitigate the risk of market downturns.

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