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## Frontier Markets

# ARGENTINA STUMBLES BUT REMAINS A VIABLE INVESTMENT

### KEY POINTS

- We believe Argentina's recent actions to stabilize its currency will help the country restore investors' confidence and continue with its longer-term reform agenda.
- While seeking loan support from the IMF will cost President Macri some political capital, we believe it was the right thing to do and will not cripple his chances for reelection in 2019.
- Short-term volatility and uncertainty can be a friend to patient, long-term investors. We have been cautiously leaning into market weakness and selectively adding to some of our high-conviction positions.

We believe Argentina's recent actions to stabilize its currency, including central bank interest rate increases and obtaining International Monetary Fund (IMF) assistance, will help the country recover from recent policy missteps, restore investors' confidence, and continue with its longer-term reform agenda. Since the election of President Mauricio Macri in late 2015, Argentina has made great strides in recovering from years of economic mismanagement. Macri and his team have implemented various policies and reforms that have boosted the economy and reopened the country to the global marketplace. These efforts have also made the government better situated to deal with macro and financial issues, which boosts our confidence in Argentina's structural changes and its ability to attract foreign investment capital.

Unfortunately, Argentine financial markets have struggled in 2018 due to a combination of deteriorating investor

sentiment and relatively minor policy mistakes in late 2017 and early 2018. Specifically, the central bank lifted its 2018 inflation target and prematurely reduced interest rates. The peso, in particular, has fared poorly due to increased inflation expectations.

In an initial attempt to restore its credibility and arrest the peso's decline, the Argentine central bank used some of its foreign exchange reserves to defend the currency. This proved to be difficult, especially given the headwinds of a strengthening U.S. dollar and rising U.S. interest rates. Then, in a more orthodox policy move, the central bank raised interest rates three times in one week, lifting its key interest rate to 40%, an extraordinarily high level, to re-anchor inflation expectations.

Simultaneously, the government announced a tightening of fiscal policies and initiated discussions with the IMF to seek and secure loan support. The IMF has endorsed the

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government's economic reform efforts and recently agreed to provide a USD \$50 billion credit line to Argentina in exchange for the acceleration of some reforms. While reaching out to the IMF will cost Macri some political capital, given bad memories stemming from the country's prior dealings with the IMF, we believe it was the right thing to do. The speculative momentum driving the peso lower needed to be stopped, and IMF involvement helps to anchor investors in Argentina. We also believe turning

to the IMF will not cripple Macri's chances for reelection in 2019. This move was needed to stabilize the current situation and immediately restore the government's credibility with investors. The IMF fiscal plan seems to factor in that there are important elections toward the end of next year and should allow Macri to regain popular support in time for the elections.

While the government's recent actions have helped stabilize Argentina's financial markets somewhat, and

while MSCI's recent decision to return Argentina to the emerging markets universe next year boosts investor confidence, uncertainty is likely to linger, in our view, and Argentine assets could be periodically volatile. Indeed, the country still has some significant hurdles ahead of it. Pension reform, for example, is necessary to bring the fiscal situation under control. Elevated inflation also needs to be tamed—though it may take longer than previously expected.

Short-term volatility and uncertainty may be unsettling at times, but we believe it can be a friend to patient, long-term investors. In response, our frontier equity and emerging markets bond portfolio managers have been cautiously leaning into market weakness and selectively adding to some of their high-conviction positions. We are confident that the underlying macroeconomic backdrop in Argentina is still much healthier than it was a few years ago and that the country's medium-term outlook remains favorable.

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