



# Argentina at a Crossroads

Key opportunities in less cyclical stocks as uncertainty prevails.

June 2019

The fortunes of Argentinian stocks are being driven by domestic factors, where electoral uncertainty and economic growth at a trough are setting the backdrop for share price performance. The country faces a presidential election in October and a second round in November—with a small chance of left-leaning populists Alberto Fernandez and Cristina Kirchner (as his deputy) gaining power. While unlikely, this scenario could pave the way for the reintroduction of capital controls, would pose a risk to the performance of all financial assets, and could lead to another sovereign default.

A key challenge for incumbent President Mauricio Macri's reelection hopes is that, faced with a potential return to power of Cristina Kirchner, on-the-ground developments could lead to a vicious cycle of currency weakness, higher inflation, and weaker economic performance that, in turn, would reduce Macri's chances ahead of the election.

Domestic economic equilibrium is currently very fragile: A recovery in real wages is anticipated and the currency appears to be stabilizing, but electoral trends or an external shock could undermine these positive developments.

We are finding pockets of opportunity on an individual stock level, though, including companies with real assets



## NOTES FROM THE ROAD

Traveling the Frontier Markets

### Oliver Bell

Portfolio Manager, Frontier Markets Equity Strategy

and those that have more diversified, and therefore less cyclical, earnings streams. On our recent trip to Argentina, we had conducive meetings with the management teams of many of these companies. Furthermore, we advocate avoiding utility companies, which are sensitive to domestic developments, while banks could offer attractive risk/reward characteristics in the case of an improvement in the macroeconomic backdrop.

#### Taking Stock of Economic Conditions

While there are some bright spots in the economic landscape, the negatives currently outweigh the positives. A USD \$57 billion support package that Argentina has agreed to with the International Monetary Fund, dictating the implementation of strict monetary rule and fiscal targets, has brought about a degree of currency stability, while financing needs for 2019 have pretty

We are finding pockets of opportunity on an individual stock level...

# 2%

Argentina's current account deficit is projected to fall to 2%, from 5% last year.

much been covered. Argentina's current account deficit is projected to fall to 2%, from 5% last year.

However, the economy is in a recession, with gross domestic product contracting by 2.6% in 2018 and expected to contract by a further 1% this year. Inflation ended the year at around 47%, and recent month-on-month inflation prints have been heavily scrutinized. Interest rates remain high at 50%.

## Politics—Taking the Reform Route or Succumbing to Populism?

October's presidential election will signal whether Argentina is likely to continue on a path of reforms and macroeconomic normalization or pursue a more populist agenda. Incumbent President Mauricio Macri is seeking reelection, but his support has taken a hit amid high inflation and a severe economic downturn. Former President Cristina Kirchner surprised some investors in announcing her intention to run as vice president under the leadership of Alberto Fernandez.

Macri's lead in the polls has narrowed, but we still believe that a victory for the Fernandez and Kirchner ticket is unlikely. We anticipate the markets will rally in the case of an "anybody but Cristina" election outcome. Inflationary trends should moderate given the recessionary conditions and the free-floating currency. Wage adjustments and export growth should go some way to supporting consumption and a broader economic recovery. We believe that markets have overreacted to the negative trends, driving many asset prices to excessively cheap levels: This could make for an attractive entry point.

Much hinges on the evolution of the economy in the coming months, particularly trends in inflation, real wages, and the exchange rate. One concern is

that an external shock triggers a run on the peso. Any downturn in economic conditions is likely to increase Kirchner's chances. Meanwhile, even modest improvements would allay market concerns and increase Macri's chances of reelection.

## Searching for Investment Opportunities Against a Volatile Backdrop

Despite the economic and political uncertainty, pockets of opportunity exist for investors capable of conducting rigorous on-the-ground research. On our recent trip, we met with the management teams of several promising investments that we believe can weather the potential turbulence ahead.

 Leading cement producer in Argentina. While volumes fell 15% in January, a recovery is expected in the second half of the year. The company has been able to implement price increases to the tune of 75%, in excess of inflation. The coming online of a new cement plant, L'Amali, should help boost profit margins, while the company has a strong balance sheet.

 Supplier of steel pipes and related services. The firm has limited direct exposure to Argentina, only around 10% of operations, and is on track to enter the Russian market, which should provide a modest boost to earnings margins. It is generating free cash flow in excess of USD \$1 billion per year, which should leave it well placed to increase dividend payments.

 Bank. The environment facing banks is weak loan demand and rising delinquencies. However, margins have been resilient in a high interest rate environment, while liquidity is ample. The investment case for Argentinian banks in the case of a Macri electoral win is attractive, given loan-to-GDP ratios of 15%.



Online marketplace operator and digital provider of financial services.

The company is a leading provider to both consumers and businesses. It is underpinned by a large profit pool, its base of existing merchants offsetting the cost of investments to acquire new

customers. The company is focused on expanding into new categories and improving logistics. While the company has exposure to Argentina, more than half of its earnings come from Brazil and the Latin American region more broadly.

### WHAT WE'RE WATCHING NEXT

We continue to have exposure to several companies in Argentina that feature attractive risk/reward propositions. We will closely monitor economic and political developments, and how these come to impact domestically focused companies and those with less cyclical earnings streams. Our preference remains for the latter, and we will continue to closely monitor their performance amid the unfolding backdrop.

#### **Key Risks**—The following risks are materially relevant to the strategy highlighted in this material:

Transactions in securities denominated in foreign currencies are subject to fluctuations in exchange rates which may affect the value of an investment. Returns can be more volatile than other, more developed, markets due to changes in market, political and economic conditions. Investments are less liquid than those which trade on more established markets.

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.



#### Important Information

This material is being furnished for general informational purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, and prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction.

**Australia**—Issued in Australia by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. For Wholesale Clients only.

**Brunei**—This material can only be delivered to certain specific institutional investors for informational purpose upon request only. The strategy and/or any products associated with the strategy has not been authorised for distribution in Brunei. No distribution of this material to any member of the public in Brunei is permitted.

**Canada**—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

**China**—This material is provided to specific qualified domestic institutional investor or sovereign wealth fund on a one-on-one basis. No invitation to offer, or offer for, or sale of, the shares will be made in the People's Republic of China ("PRC") (which, for such purpose, does not include the Hong Kong or Macau Special Administrative Regions or Taiwan) or by any means that would be deemed public under the laws of the PRC. The information relating to the strategy contained in this material has not been submitted to or approved by the China Securities Regulatory Commission or any other relevant governmental authority in the PRC. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the PRC that are expressly authorized under the laws and regulations of the PRC to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the PRC. Potential investors who are resident in the PRC are responsible for obtaining the required approvals from all relevant government authorities in the PRC, including, but not limited to, the State Administration of Foreign Exchange, before purchasing the shares. This document further does not constitute any securities or investment advice to citizens of the PRC, or nationals with permanent residence in the PRC, or to any corporation, partnership, or other entity incorporated or established in the PRC.

**DIFC**—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd. by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

**EEA ex-UK**—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

**Hong Kong**—Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 21/F, Jardine House, 1 Connaught Place, Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

**Indonesia**—This material is intended to be used only by the designated recipient to whom T. Rowe Price delivered; it is for institutional use only. Under no circumstances should the material, in whole or in part, be copied, redistributed or shared, in any medium, without prior written consent from T. Rowe Price. No distribution of this material to members of the public in any jurisdiction is permitted.

**Korea**—This material is intended only to Qualified Professional Investors upon specific and unsolicited request and may not be reproduced in whole or in part nor can they be transmitted to any other person in the Republic of Korea.

**Malaysia**—This material can only be delivered to specific institutional investor upon specific and unsolicited request. The strategy and/or any products associated with the strategy has not been authorised for distribution in Malaysia. This material is solely for institutional use and for informational purposes only. This material does not provide investment advice or an offering to make, or an inducement or attempted inducement of any person to enter into or to offer to enter into, an agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities. Nothing in this material shall be considered a making available of, solicitation to buy, an offering for subscription or purchase or an invitation to subscribe for or purchase any securities, or any other product or service, to any person in any jurisdiction where such offer, solicitation, purchase or sale would be unlawful under the laws of Malaysia.

**New Zealand**—Issued in New Zealand by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering document or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

**Philippines**—THE STRATEGY AND/ OR ANY SECURITIES ASSOCIATED WITH THE STRATEGY BEING OFFERED OR SOLD HEREIN HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES REGULATION CODE. ANY FUTURE OFFER OR SALE OF THE STRATEGY AND/ OR ANY SECURITIES IS SUBJECT TO REGISTRATION REQUIREMENTS UNDER THE CODE, UNLESS SUCH OFFER OR SALE QUALIFIES AS AN EXEMPT TRANSACTION.

**Singapore**—Issued in Singapore by T. Rowe Price Singapore Private Ltd., No. 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

**Switzerland**—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

**Taiwan**—This does not provide investment advice or recommendations. Nothing in this material shall be considered a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person in the Republic of China.

**Thailand**—This material has not been and will not be filed with or approved by the Securities Exchange Commission of Thailand or any other regulatory authority in Thailand. The material is provided solely to "institutional investors" as defined under relevant Thai laws and regulations. No distribution of this material to any member of the public in Thailand is permitted. Nothing in this material shall be considered a provision of service, or a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person where such provision, offer, solicitation, purchase or sale would be unlawful under relevant Thai laws and regulations.

**UK**—This material is issued and approved by T. Rowe Price International Ltd, 60 Queen Victoria Street, London, EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

**USA**—Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

© 2019 T. Rowe Price. All rights reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.