Caution Required Amid Panic Over Argentina

Election shock prompts investor exodus.

August 2019

Ben Robins
Portfolio Specialist, Fixed Income Division

Leigh Innes
Portfolio Specialist, Equity Division

KEY INSIGHTS

- President Mauricio Macri's surprise defeat in last weekend's primary election prompted fears that key reforms may be reversed, causing a sell-off in the peso and Argentine stocks and bonds.
- Populist opposition candidate Alberto Fernández is now expected to win October's general election, but considerable uncertainty remains over what policies his government will pursue.
- We have trimmed our exposure to some Argentine assets in our equity and debt funds and are ready to act further should the situation change.

The rout of Argentine assets that followed last weekend's surprise election result has caused considerable concern among emerging market investors. A number of T. Rowe Price funds have been exposed to the sell-off, and although we have reduced our exposure in some areas, we continue to hold some Argentine assets while we monitor the situation in order to properly gauge the country's medium- to long-term economic and political prospects.

Argentine primary elections are held to whittle down the number of candidates participating in the general election and are typically regarded as a reliable guide to the outcome of the latter. Although the market-friendly President Mauricio Macri is safely through to October's general election, his heavy defeat to populist Peronist opposition candidate Alberto Fernández and vice presidential candidate Cristina Fernández de Kirchner (32% versus 47%) in last weekend's vote was a shock. Polls had suggested a much closer race.

While it remains unclear exactly how presidential candidate Fernández and vice presidential candidate Kirchner would govern if they were to win the general election, Kirchner's record when she was president from 2007 to 2015 alarms investors: Her tenure was characterized by corruption, rampant inflation, and damaging government intervention in the economy. Since gaining power, Macri's technocratic government has pursued a number of key economic reforms; the prospect of those reforms being reversed prompted this week's sell-off.

> The market's worst fears are that a Fernández-Kirchner victory would see a return to a Peronist government characterized by populist policies, currency and capital controls, and debt defaults.
>
> — **Leigh Innes**
> *Portfolio Specialist, Equity Division*

T. Rowe Price's Exposure to Argentina

In fixed income, our largest exposure to Argentina is in our Emerging Markets Bond Fund, which had an overweight position in the country relative to its benchmark when yields spiked on August 12. The vast majority of our Argentina exposure in this fund is in hard currency government bonds with maturities inside of 2030. Given our overweight position here, the sell-off had a negative impact on the fund relative to the benchmark.

We had minimal exposure (less than 1% on August 12) to Argentina in both our Emerging Markets Local Currency Bond Fund and our Emerging Markets Corporate Bond Fund. We expect this week's sell-off to have a neutral impact on the former fund's relative performance and a positive impact on the latter fund's relative performance given its underweight position to Argentina compared with its benchmark. We will continue to weigh the strong yields available from Argentine debt against the risks associated with them.

In terms of equity strategies, within frontier markets, we had cut our absolute positions in Argentina to keep risk under control after the country left the MSCI Frontier Markets Index at the end of May. The primary election result has significantly altered our outlook for prospects for Argentine stocks, particularly domestically focused companies dependent on the performance of the local economy. We are reviewing remaining portfolio holdings accordingly.

For emerging market equity strategies more generally, companies with business exposure outside Argentina have held up relatively well amid the broader market downturn, with a relatively muted price reaction. Their longer-term prospects will continue to be underpinned by the performance of their operations outside Argentina. We will continue to monitor the fundamentals of these companies in the evolving environment.

All Eyes on October

While it is possible that Macri regains ground before October's general election, perhaps benefiting from a higher turnout and investor nervousness at the negative market reaction to the primary election result, the size of his task looks insurmountable. It is therefore prudent to assume a strong likelihood that a new government led by Fernández and Kirchner will take over the running of Argentina later this year.

The market's worst fears are that a Fernández-Kirchner victory would see a return to a Peronist government characterized by populist policies, currency and capital controls, and debt defaults. Therefore, the key question is whether Fernández will take more concrete steps to outline an economic program consistent with a new International Monetary Fund program and reestablishing market access. He comes from a more moderate strain of Peronism than Kirchner and has made some market-friendly overtures as the campaign has progressed. However, he has not defined a coherent economic policy program and uncertainty reigns. Until Fernández can establish some degree of trust with markets, capital outflows from local and foreign investors will intensify and the macroeconomic situation is likely to deteriorate. In the meantime, the specter of default risk is likely to weigh heavily on Argentine assets until the election is held.

We are cautiously positive on emerging markets more broadly. In the past, markets have typically focused on country-specific economic and political attributes, and we expect this to continue. However, the situation in Argentina may put renewed focus on countries that appear vulnerable in terms of funding.

> We are cautiously positive on emerging markets more broadly.
>
> — **Ben Robins**
> *Portfolio Specialist, Fixed Income Division*

Globally, the situation in Argentina will be monitored closely by markets already nervous about tense U.S.-China trade relations, Brexit, the inverted yield curve, and the rise of populism. A Fernández-Kirchner general election victory could be interpreted as yet another example of populist politicians seizing power from pro-market parties and, as such, would be greeted with widespread apprehension.

INVEST WITH CONFIDENCE®

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

To learn more, please visit troweprice.com.

T.RowePrice®

Important Information

Call 1-800-225-5132 to request a prospectus or summary prospectus; each includes investment objectives, risks, fees, expenses, and other information you should read and consider carefully before investing.

This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action.

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 associates.

All investments are subject to market risk, including the possible loss of principal. International investments can be riskier than U.S. investments due to the adverse effects of currency exchange rates, differences in market structure and liquidity, as well as specific country, regional, and economic developments. These risks are generally greater for investments in emerging markets.This information is not intended to reflect a current or past recommendation, investment advice of any kind, or a solicitation of an offer to buy or sell any securities or investment services. The opinions and commentary provided do not take into account the investment objectives or financial situation of any particular investor or class of investor. Investors will need to consider their own circumstances before making an investment decision.

Information contained herein is based upon sources we consider to be reliable; we do not, however, guarantee its accuracy.

Past performance is not a reliable indicator of future performance. All investments are subject to market risk, including the possible loss of principal. All charts and tables are shown for illustrative purposes only.

T. Rowe Price Investment Services, Inc.

ID0002543 (08/2019)
201908-929221