

Latin America Markets

OTG Latin America Fund “On The Ground”

ARE THE ANDEAN COUNTRIES READY FOR A RECOVERY?



Set among the Andean mountain range, and stretching from the Caribbean to the Patagonia, is an area with beautiful views. This area is what has become known as the “Andean Three”.

These three dynamic and often overlooked, economic powerhouses – Peru, Colombia and Chile – already have a combined GDP equaling almost 75% of Mexico’s GDP. Together, these economies were forecasted to grow faster than Mexico and Brazil due to rising foreign direct investment.

These countries have already forged an alliance binding their financial and commercial markets together. They have free-trade and investment agreements and their stock exchanges have merged to form the Integrated Latin America Markets.

If we sum up all these positive factors, can we expect these three countries to emerge rather quickly from the crisis that we are living through? Are the three countries prepared to recover confidence internally and externally?

We will explore some of the conditions and the measures that these Governments put in place to palliate the deceleration from 2024.

There should be some value found amid the pandemic’s impact on the Region.

In the case of Peru and Colombia, we expect that both economies will experience V-shaped recoveries, with signs of improvement emerging in 4Q2024.

In this crisis we could find two routes of resilience:

- Exposure to essential sectors relatively less affected by cyclical related stocks (Alicorp, SMU and Inretail).
- Flexible cost structures which will allow firms to offset top line headwinds.

We look for companies with sound fundamentals that will prove their resilience in the crisis, even in a stressed short term scenario. We look for firms that may have been overly punished in the short term and/or those firms who will only temporarily suffer the impact of the health crisis.

Another key aspect for recovery will be the responsiveness to monetary and fiscal policies that these economies are implementing. Central banks have acted swiftly by cutting their monetary policy rates and announcing measures to inject liquidity into the economy to protect the payment chain.

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With all of this in mind, we have to be very selective in our investment decisions and more than ever patience is key.

Sectors which we are focusing on:

CONSUMER

Retail: Grocery and products of basic necessity sales remain resilient amid broad retail contraction.

Based on our global experiences in search of evidence to help us forecast the trajectory of pharmacy sales and supermarket sales, we found some trends which can help us to determine similar behavior in Andean countries.

- Grocery and products of basic necessity sales have emerged as the global winners within the retail space in the current context, whereas non-essential retailers have seen huge drops.
- There is a change in consumption patterns, with high growth rates on sales of grocery and basic necessities, followed by stabilization of growth rates above historical trend levels.
- Online sales are double the pre-pandemic levels and are accelerating through the lockdown and pushing up e-commerce penetration.

INRETAIL in Peru could be a beneficiary of these new trends where the big contributor of its EBITDA comes from groceries and pharmacies.

Food and Beverage:

- Higher demand for personal and home care products since focus on hygiene has increased.
- Consumers inclination to convenience stores and digital channels to avoid concentration of people.
- Preference for easy to prepare and durable products which are useful in quarantine periods.

Within this consumer trend/behavior are two companies that are very well positioned, Alicorp (Peru) and SMU (Chile). Both companies have more than 60% exposure to these type of products. Both companies produce essential goods which leave them in better shape than other companies in other sectors.

FINANCIALS

It has been a really tough time for financial institutions on almost every aspect of their business. We do not believe that this crisis will lead to a destructive financial fallout. The banks that we follow have a good capital base and it is unlikely that they will suffer from liquidity issues, especially if we add the role of the central banks as lenders of last resource who will inject the necessary liquidity into the system.

In this scenario, banks like Credicorp (Peru), Bancolombia (Colombia) and BCI (Chile) are the ones to follow since we expect a better recovery for these banks.

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Looking ahead, we anticipate that lower inflation and more relaxed monetary policy will continue to bolster consumer spending. In Colombia, however, this will be somewhat counterbalanced by the anticipated decline in oil prices this year, which is expected to impact the country's exports. Conversely, elevated copper prices will offer an additional boost to the economies of Peru and Chile. Overall, we foresee a growth acceleration in the Andean economies in 2025, with Chile's economy projected to be the standout performer in the region.

We are in a cautious mode; however, we are looking for opportunities in different sectors and countries that we cover with our presence On the Ground.

This opinion article was written in January 2025 by: Mauricio Alvarez of OTG Latin America Fund.

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