FUND MANAGER DIARIES

LATIN AMERICA FUND

A two-week trip to Latin America, travelling through Argentina, Chile and Peru, gives our fund management team food for thought as change is underway in the region...

ARGENTINA:
MACRI, THE "MESSI" OF THE ARGENTINE ECONOMY?

Touring the Bohemian area of Palermo Soho in Buenos Aires, with its eclectic collection of trendy shops and restaurants, it doesn't feel as though the country is in a recession. It's been over one year since Mauricio Macri was elected president of Argentina and we came to meet with industrial and consumer companies to gauge the position of Argentina's economic recovery.

Since Macri took power he has reached an agreement with sovereign bond holdouts, removed capital controls and amended the regulated tariffs. This has allowed institutions to regain trust and begin to act responsibly, by being transparent about fiscal challenges and the real economy.

This move away from the farcical "Kirchner" economic model is increasing business confidence and willingness to invest in growth. For example, the country's largest mall operator is looking to finally receive municipal approval for a 10 million square meter residential project, for which they've been waiting more than 10 years.

THE VIEW OVER BUENOS AIRES

KEY TAKEAWAYS

1. Revival of business confidence in Argentina
2. Argentina's cyclical adjustment is being driven by Macri's credible policies and infrastructure investment
3. Great stock opportunities in Chile as valuations suffer the Bachelet discount
4. Chilean elections in 2017 should see a political change to a more pro-business administration driving growth
5. World class operations at two of our Peruvian holdings show huge future growth potential

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The economic adjustment is well underway and was further confirmed by meeting with our holding Pampa Energia, whose electricity distributor Edenor, saw its electricity tariffs increase allowing them to capture a proper return on assets and invest to expand. The average household's electricity bill in northern Buenos Aires rose from US$3/month to US$16/month, but is still among the lowest in Latin America. We hold 4.5% of the fund in Pampa Energia, and its value has climbed 350% since we initiated our investment.

The consumer sector in Argentina is not doing well, in large part due to the high level of unemployment (8.5%), and a still high, though declining, level of inflation.

Both these factors are symptoms of an economy going through its cyclical adjustment. The main factor to follow, which will over time improve both employment and consumption, is a resumption of infrastructure investment. This is crystal clear to Macri and will be the pathway to prosperity.

VISITING THE EMBOTELLADORA ANDINA PLANT

CHILE: TIME FOR BACHELET TO BE SUBSTITUTED?

After 4 years of poor political management, corporate Chile is eagerly looking forward to a new political cycle. Based on our discussion with company managers, clients and bankers, the last local elections outcome and Bachelet 's approval rating of less than 15%, we can safely say that change is on the horizon. Their hope is that the elections this year will extend the structural political swing from populist left to a more pro-business right, following in the footsteps of Argentina, Peru and Brazil.

Over the last few years, the companies we've met have scaled down investment in Chile, using their highly cash-generative domestic base to re-invest in more investor-friendly and growing markets in the region: namely Peru, Colombia, Mexico. For example our holding Falabella has increased its share of business in Peru, Colombia, Argentina and Mexico combined, from 26% in 2009, to 45% in the latest 2015 results.

Chile is not a typical emerging market; it enjoys first-world type of infrastructure, has sophisticated consumers and world-class industry. Our tour of Las Condes, the Costanera Center and Valparaiso provided ample evidence if this was needed.

Our holdings in Chile are supported by very strong fundamentals and capable managers leading world-class operations as illustrated by our visit to the Embotelladora Andina plant a few miles away from Santiago (3rd largest bottler of Coca-Cola in Latin America, with concessions in Chile, Argentina, Paraguay and Brazil). With a strong track-record of capital allocation over several cycles, delivering good returns to shareholders like us. All this comes at an undemanding valuation as they suffer from the "Bachelet discount", despite most of their growth coming from neighbouring countries.

The election later this year may well be a catalyst for a re-rating of Chilean Equities after 4 years in the doldrums (-9% as measured by the MSCI Chile over the last 4 years in USD). But this will just be the cherry on the cake as the fundamental earning power of the multi-latinas will keep delivering over the long term.

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PERU:
CEMENTOS PACASMAYO AND FERREYCORP - TWO WORLD-CLASS TEAMS

Piura is located about 400km north of Lima with a population of 500,000 people. We came to Piura to visit Cementos Pacasmayo's brand-new cement plant and Ferreycorp's workshop.

RETAIL SITES IN PIURA

Our day began early, and we woke up at the crack of dawn to avoid the sweltering heat, with our journey taking us through the city's main retail artery. It was mostly populated by local retail operations characterised as simple stores, though the regional behemoth and a holding in our fund Grupo Falabella, was well represented with Tottus, its supermarket operation, and Falabella, its department store.

Driving out of the city involved dodging the swarm of three-wheeler taxi cabs, which we learned was the most popular taxi type and an easy alternative for self-employment. Upon exiting the city we were surrounded by the desert environment of Piura, a perfect location for a cement plant due to the expansive and uninhabited location.

The plant took 3 years to build costing US$ 370million. Using the most advanced German technology the plant was built with the goal of limiting its environmental impact.

It sources its raw material from a nearby quarry, avoiding having to import clincker (a critical binding agent for cement).

The 1 million square meter operation was truly impressive. Health and safety procedures were evident from the moment we entered the facility as each one of us had to pass a breathalyser test to ensure we would not put anyone at risk. Cementos Pacasmayo has been on our watchlist since the launch of the fund, as a high quality company benefiting from a local dominance and high barriers to entry.

By the time we ended our visit the temperature had risen to 30C, so a good time to make our way in an air-conditioned minivan to Ferreycorp's regional offices. We were welcomed by the group treasurer, who travelled especially to Piura to host our visit, and the local sales and operations team.

The sales team presented the firm's positioning in Piura, which is endowed with a high level of industrial diversity in the form of agricultural, mining, fishing and infrastructure activity. The past few years have been lean years for the sector, with many players exiting and/or lacking commitment to the local market. Ferreycorp's long term commitment and strategy led to them increasing their regional market share to 70%. The presentation was followed by a visit to their parts supply room, not only was this a superbly organised meeting, it also showed their adherence to 'just in time' practices with carrying parts that they know will be in demand according to their programmed maintenance schedule of the regional fleet of machines. One of their key comparative advantages is having highly skilled personnel that undergo significant amount of training throughout their Ferreycorp careers. Being a 5-star rated Caterpillar dealer is one of the major reasons why companies select Ferreycorp and reinforces their market leading position. We currently have 2.9% of the fund in Ferreycorp and we estimate it is currently selling at a 35% discount to intrinsic value.


ROBERTO & FLORIAN MEETING THE TEAMS AT FERREYCORP (LEFT) & CEMENTOS PACASMAYO (RIGHT)

We left Piura with a better understanding of Pacasmayo's long term vision and Ferreycorp's regional opportunity. Continuation of the city's development will come through the development of its natural resources, both in the soft commodity and bulk materials area. Its low cost profile and high productivity potential will continue to attract entrepreneurial investment, which we believe will lead to a strong and sustainable level of growth.

For more information on the Alquity Latin America Fund, please contact:

MIDDLE EAST & ASIA
Suresh Mistry
+44 207 5577 867
suresh.mistry@alquity.com

EUROPE & LATIN AMERICA
Benoit Ribaud
+44 207 5577 862
benoit.ribaud@alquity.com

UK
Steven Williams
+44 207 5577 865
steven.williams@alquity.com

www.alquity.com
@Alquity
/company/alquity-investment-management-limited
/Alquity

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Swiss Representative: FIRST INDEPENDENT FUND SERVICES LTD., Klausstrasse 33, 8008 Zurich.

Swiss Paying Agent: Neue Helvetische Bank AG, Seefeldstrasse 215, CH-8008 Zurich.

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