Flash update: BlackRock Latin American

BRLA's wide discount is coupled with cheap underlying markets...

Update
19 November 2024

- **BlackRock Latin American (BRLA) is positioned to benefit from what the managers, Sam Vecht and Cristoph Brinkmann, view as an encouraging macro outlook.**
- **Central banks across the region have begun to cut rates, which is resulting in improved economic activity.**
- **The managers argue both of the largest markets in their region, Brazil and Mexico, look attractive at this point in time, while the region's markets are generally cheap versus their international peers and their own historical valuations.**
- **They note that Brazil's economy is performing well, despite some concerns that public spending might reignite inflation. Fiscal discipline is a key thing to watch for.**
- **The managers have rebuilt positions in Mexico following a post-election sell-off. They argue there are strong economic factors supporting the economy and attractive valuations.**
- **On a medium to long-term view, the managers argue the Latin American region continues to benefit from being able to deal politically and economically with both the USA and China, as tensions remain high between the two largest economies.**
- **BRLA pays a quarterly dividend from capital where necessary. It is fixed as 1.25% of the NAV at the end of each calendar quarter, meaning an annualised 5%. Thanks to the discount the shares are trading at, the prospective yield is higher.**
- **Over the course of 2024, the discount has widened from c. 12% to c. 16% as Latin American markets have retreated following a very strong 2023.**

Trusts In Focus : BlackRock Latin American **Watch on youtube**

Analysts:

Thomas McMahon
+44 (0)203 795 0070

Kepler Partners is not authorised to make recommendations to Retail Clients. This report is based on factual information only.

The material contained on this site is factual and provided for general informational purposes only. It is not an invitation or inducement to buy, sell or subscribe to any product described, nor is it a statement as to the suitability or otherwise of any investments for any person. The material on this site does not constitute a financial promotion within the meaning of the FCA rules or the financial promotions order. Persons wishing to invest in any of the securities discussed in the website should take their own independent advice with regard to the suitability of such investments and the tax consequences of such investment.

Performance

Latin American equity markets posted strong returns in 2023: the MSCI EM Latin America Index was up 25.2% and **BlackRockLatin American (BRLA)** outperformed handsomely, with NAV total returns in GBP of 30.3%, according to Morningstar. This followed a good 2022. However, 2024 has been more disappointing, with the index down 17.9% and BRLA down 26.4%, as the chart below shows. The losses in the region came mostly in the first six months of 2024, since when markets have been more stable. This has pushed the five-year NAV total returns for BRLA to -7.5% compared to benchmark returns of 3.6% (to 12/11/2024).

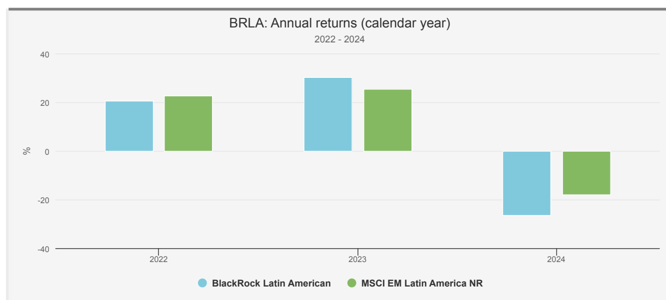
One major factor behind the weak markets seen this year is that expectations for US interest rate cuts were pushed back, as inflation remained higher than expected. BRLA had some rate-sensitive positions that suffered as a consequence. The trust's gearing has been another factor behind the underperformance, with average net gearing of 5% over 2024, according to Morningstar data.

There have also been some political issues during the year that have affected markets. Concerns about potential fiscal profligacy in Brazil have weighed

This is a non-independent marketing communication commissioned by BlackRock. The report has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on the dealing ahead of the dissemination of investment research.

on its equities, and the central bank has raised rates to get ahead of rising inflation. Meanwhile, the Mexican market has sold off after a landslide win for President Sheinbaum raised fears of a lack of democratic checks and balances in the future. Argentina, on the other hand, has seen strong market gains as a reformist President has implemented some radical policies. Sam and Cristoph have taken measured views on all events, seeing the sell-offs in Brazil and Mexico as providing opportunities and being wary of Argentina, which they think will have to devalue its currency once more.

Fig.1: Returns



Source: Morningstar, 2024 data to 13/11

Past performance is not a reliable indicator of future results.

Strong points for the trust's portfolio during the year include gold and silver miners. Gold has hit record highs in 2024 amidst geopolitical tensions and high inflation. Gold miners have finally felt the benefit, with falling cost inflation improving their economics. Meanwhile, the managers added an off-benchmark position in Singapore-listed engineering solutions provider Seatrium, which is building offshore oil equipment for Brazilian state-owned oil producer, Petrobras, and the stock has performed very well in the last two months.

Positioning & outlook

Sam and Cristoph remain positive on the outlook for Latin American equities more broadly. While the Brazilian central bank recently embarked on a tightening phase to get ahead of persistent inflation, they are still excited about the bottom-up opportunities within the market as earnings have been strong across sectors. They believe that the BRL and interest rates can recover as long as the government increases its efforts regarding fiscal discipline.

There has been some political noise in Mexico, with investors fretting about the potential for a government that has won with a landslide to govern without the normal checks and balances and interfere with judicial independence. Markets responded negatively to the passing of a controversial judicial reform, made possible by the Morena party's near supermajority across both the lower house and senate. The government has shown very strong coordination to move through President AMLO's reform agenda. However, they maintain conviction that President Sheinbaum will move away from some of the more controversial items and focus her attention on economic investment and the country's relationship with the US – the latter being a key sensitivity following the November election. The managers visited the country the week following the election and spoke with key stakeholders, and their view is that President Sheinbaum is likely to be pragmatic and fiscally prudent. As such, they have added to their positions in the country on recent weakness.

In the longer run, Mexico is benefitting from the reshoring of US supply chains away from China. Exports to the US have boomed in recent years, and capital investment in the country has too, as companies relocate elements of their supply chains in Mexico and other countries with better access to US markets. Sam and Cristoph think these trends will continue to support the country's equity market for years to come.

One important factor in the outlook is the US interest rate picture. Lower US interest rates should be supportive for the region, as long as they are not in response to a significant slowdown. The current soft-landing scenario that seems to be unfolding is therefore ideal. High real rates in Brazil and Mexico favour investment in those economies, absent any currency pressures. But lower US interest rates would, all things equal, be supportive for those currencies.

Brazil and Mexico make up 89% of the benchmark index, so are absolutely central to the investment case. However, Sam and Cristoph can add value by investing across the region and have historically taken off-benchmark positions in countries like Ecuador and Panama. In terms of other countries, the managers have moved the trust towards a more neutral position in Colombia. Primarily, they are increasingly negative about the prospects for the oil price, given the structural decline in demand growth from China and increasing global supply over the next 24 months. Oil is a key revenue source for the government, which has already been running fiscal deficits. The negative view on oil has also contributed to the reduction in the position in Brazilian energy producer Petrobras in recent months. Argentina is not in the regional benchmark, although the managers do consider it for investment. They have made good returns in the past on some positions, including Globant, a software and IT services provider, which does business internationally. While Sam and Cristoph remain positively surprised and impressed by the actions that Milei has taken over the past year, especially on the fiscal side, they are concerned about the chosen strategy to intervene in the black-market exchange rate and the expense of foreign reserve accumulation. They still believe that Argentina requires another devaluation of its exchange rate, which the government is trying to avoid.

This is a non-independent marketing communication commissioned by BlackRock. The report has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on the dealing ahead of the dissemination of investment research.

Kepler View

BRLA is the only investment trust offering exposure to a region with a number of exciting secular growth drivers behind it, which offer diversification to the dominant trends in the US stock market and indeed the UK stock market too. We think the reshoring trend is likely to continue, and should see the Mexican economy in particular benefit. Meanwhile, Brazil is also well-placed to continue to trade with both China and the USA and the respective allies of each. Meanwhile, the deep natural resources of the region include industrial metals, traditional hydrocarbons and precious metals. This brings positive exposure to the energy transition as well as to the counter-cyclical gold price. We think this could make it an interesting counterpoint to a holding in a US-led, tech-heavy global equity portfolio.

An additional selling point of the trust is the attractive yield, equivalent to an annualised 5% of NAV. With the trust sitting on a double-digit discount as the region remains out of favour, this equates to c. 5.9% on the share price. We like this policy of paying from capital, as it means the managers can focus on selecting stocks without worrying about their dividend outlook. Meanwhile, shareholders can elect to take the dividend as income or reinvest it in the shares.

Latin America is a volatile region, with politics historically being one reason for this. This year has seen politics have its impact, but Sam and Cristoph take the view that the outlook for their economies has not fundamentally deteriorated and governments in Brazil and Mexico should remain relatively prudent. Given the cheap valuations of equities in the region and the strong growth drivers discussed above, this could therefore be an opportunity to take exposure to the region when it is out of favour, the cheapness of the portfolio being magnified by the 16% discount of BRLA's shares to NAV. The board has committed to a 25% tender offer next year, conditional on a performance target not being met, and at the time of writing the portfolio is behind the target. We think this increases the attraction of buying on a wide discount, as there is a plausible path to a redemption closer to par, even if sentiment remains weak.

Read our latest research on BRLA

Click here to add BRLA to your watchlist

This is a non-independent marketing communication commissioned by BlackRock. The report has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on the dealing ahead of the dissemination of investment research.

Disclaimer

This report has been issued by Kepler Partners LLP. **The analyst who has prepared this report is aware that Kepler Partners LLP has a relationship with the company covered in this report and/or a conflict of interest which may impair the objectivity of the research.**

Past performance is not a reliable indicator of future results. The value of investments can fall as well as rise and you may get back less than you invested when you decide to sell your investments. It is strongly recommended that if you are a private investor independent financial advice should be taken before making any investment or financial decision.

Kepler Partners is not authorised to make recommendations to retail clients. This report has been issued by Kepler Partners LLP, is based on factual information only, is solely for information purposes only and any views contained in it must not be construed as investment or tax advice or a recommendation to buy, sell or take any action in relation to any investment.

The information provided on this website is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Kepler Partners LLP to any registration requirement within such jurisdiction or country. In particular, this website is exclusively for non-US Persons. Persons who access this information are required to inform themselves and to comply with any such restrictions.

The information contained in this website is not intended to constitute, and should not be construed as, investment advice. No representation or warranty, express or implied, is given by any person as to the accuracy or completeness of the information and no responsibility or liability is accepted for the accuracy or sufficiency of any of the information, for any errors, omissions or misstatements, negligent or otherwise. Any views and opinions, whilst given in good faith, are subject to change without notice.

This is not an official confirmation of terms and is not a recommendation, offer or solicitation to buy or sell or take any action in relation to any investment mentioned herein. Any prices or quotations contained herein are indicative only.

Kepler Partners LLP (including its partners, employees and representatives) or a connected person may have positions in or options on the securities detailed in this report, and may buy, sell or offer to purchase or sell such securities from time to time, but will at all times be subject to restrictions imposed by the firm's internal rules. A copy of the firm's Conflict of Interest policy is available on request.

PLEASE SEE ALSO OUR TERMS AND CONDITIONS

Kepler Partners LLP is authorised and regulated by the Financial Conduct Authority (FRN 480590), registered in England and Wales at 70 Conduit Street, London W1S 2GF with registered number OC334771.