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Emerging Markets

For investors, Argentina represents both one of the most attractive markets, but also one of the most challenging. The nation is blessed with a resource rich geography, including the second largest reserve of shale gas, fourth largest reserve of shale oil worldwide, and worlds third largest lithium reserve. The economy has however been epically mismanaged. This has included defaulting on its sovereign debt three times since 2021, inflation currently running at over 100%, and offshore bonds trading at 30 cents on the dollar.

Change however is afoot – for better or worse. Self-described “anarcho- capitalist” Javier Milei became President elect on Sunday after defeating his left-wing rival, Sergio Massa. A former political pundit, Milei has an extremely colourful personality. Referring to China, Argentina’s closest trading partner, as “murderous”, and the Pope as a “communist turd”, he has pulled no punches when sharing his opinions. Through the campaign however, he has walked back on some of the more brash rhetoric in an effort not to isolate support beyond his base, an encouraging sign that there is a practical aspect to his persona. The confident 56% of the vote that he won, a strong mandate for his agenda, has however likely dampened the extent of further substantive compromise from here.

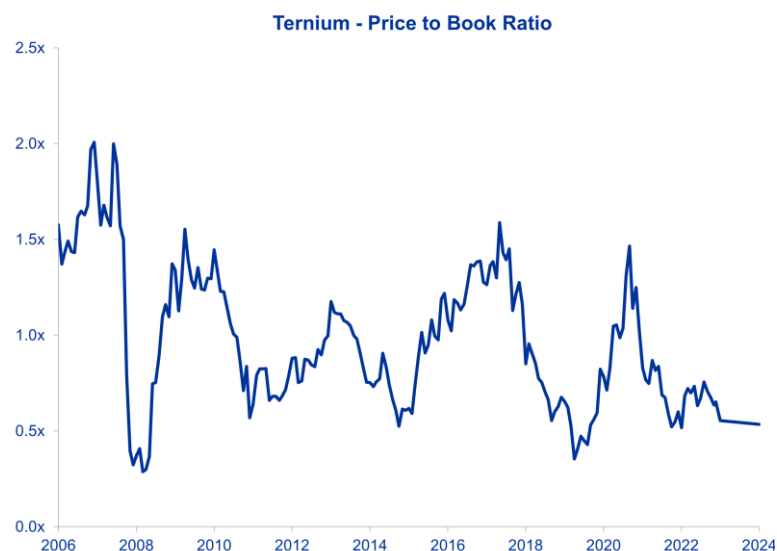
In terms of his economics, Milei is a libertarian, with key pillars of his reform program including dollarisation of the currency, slashing government spending, and shutting of the central bank. Economic shock therapy. These are largely relatively textbook policy remedies for a state in desperation, however while investors might be comfortable with the destination, the challenge is going to be the journey. Within Argentina, an estimated 4 in 10 already live in poverty, and the situation will undoubtedly grow more difficult before it improves, creating the very real risk of social unrest. In addition, there remains a considerable gap between the official and unofficial FX rates. The official rate was devalued 18% in August, but at 350 Argentina Peso to the dollar it is considerably overvalued given the unofficial rate lies above 800. This will be a circle that it is hard to square without creating interim inflationary pressure.



Source: Bloomberg. Date: as at 20th November 2023.

For the index aware equity investors, Argentina sits in classification purgatory having dropped to “Standalone Status” in 2021 - a consequence of the capital controls imposed. Given Milei’s libertarian instincts, these capital controls will likely be loosened, if not eliminated. This could mean that Argentina gets welcomed back into the EM fold. Indeed, in terms of the per capita development level, the country remains comfortably in-scope for the asset class, even if its capital market volatility is notably more consistent with frontier market exposure.

The Oldfield Partner Emerging Market funds are index agnostic, and as such index classification has not been a consideration. The considerable outlook uncertainty however has, and therefore no Argentinian listed company is held. The fund does however have a holding in Ternium, a steel company listed and largely operating in Mexico, domiciled in the Netherlands, but nonetheless considered ‘Argentinian’ due to its Argentinian HQ and parent. The holding combines high-quality steel production assets in Mexico, a growth market for domestic steel, with a depressed valuation, both relative to its own history and to peers. The firm does have some exposure to Argentina, albeit this is less than one-fifth of sales, and importantly, all its Argentinian sales are invoiced in dollars, thus managing down the currency risk.



Source: Bloomberg. Date: as at 20th November 2023.

In the near-term, we have yet to see a compelling enough reason to hold a company focused on domestic Argentina. The challenge is not a lack of upside if the economy normalises, but rather the high level of execution risk to get there. There are plenty of instances where an economy has gone through a reform programs, often under the supervision of the IMF, however typically change is gradual. To understand the Milei agenda, one really has to look back into 1990’s Russia under Yeltsin to get a feel for what radical economic shock looks like. In practice, the most probable outcome is a mix of the two, a middle-path balancing social considerations with structural change, however the path to success is narrow. Therefore, in our view investing in Ternium - a company with a deep knowledge of the Argentinian market, a management we respect, and with the balance sheet to invest should opportunities in its sector arise - remains the correct positioning at this point.

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The value of all investments and the income from them can go down as well as up; this may be due, in part, to exchange rate fluctuations. Past performance is not necessarily a guide to future performance

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