

*The Latin American Fund aims to achieve capital growth by investing in a concentrated portfolio of high-quality Latin American growth companies. The Fund seeks high absolute returns over the long term and minimises the level of long-term risk by choosing well-capitalised, high-quality investments at reasonable valuations.*

## INTRODUCTION

The fund returned -9.9% (net of fees) in the third quarter and -2.6% year-to-date. While we had a setback in Argentina during the quarter we believe the region is entering a multi-year economic upcycle. **In particular, Brazil is passing a series of productivity reforms just as it emerges from a bad recession, setting the scene for a prolonged period of strong growth in this top-ten global economy.** We think this is positive for the region as a whole and particularly positive for the private sector in Brazil, where **the government will deliberately shrink the market share of state-owned companies, allowing the private sector to grow much faster than the economy** without taking undue risk. Interest rates at all-time lows in Brazil will stimulate the economy and should drive a reallocation of local assets from fixed income into equities, potentially kicking off Brazil's first domestically-driven bull market. We have both spent time in Brazil in the past couple of months and for the first time in years the mood on the ground is very positive.



**RUPERT BRANDT, CFA**  
Portfolio Manager



**PETER CAWSTON**  
Portfolio Manager

At the end of the quarter we had 64.1% invested in Brazil, 16.5% in Peru, 9.7% in Colombia, 4.8% in Chile, 2.7% in Argentina, and 0.8% in Mexico. Cash was 1.3%. We reduced our exposure to Argentina after the extremely surprising result of the primary election there in early August. **We added to Brazil with the proceeds from the reduction in Argentina ahead of the key pension reform passing (in late October),** and we made smaller additions in Colombia and Peru, where we continue to see an attractive combination of economic growth and strong companies at very reasonable valuations.

Our portfolio remains attractively valued at 13.5x 2020 forecast earnings and 12x 2021 forecast earnings<sup>1</sup>, and the six currencies we invest in trade at an average of nearly one standard deviation below their 20-year inflation-adjusted average against the US dollar. **Value matters because we think we are moving from a period when macro news-flow dominated markets into one where bottom-up fundamentals will be the main driver.**

In the third quarter we spent nearly four weeks visiting five Latin American countries, taking the total for the year to thirteen weeks and six countries. As we write Rupert is spending three weeks in Brazil and we have at least one more trip planned as we approach year-end.

## FUND WEIGHTS

Country Breakdown (30.09.19)		
COUNTRY	% WEIGHT	QTD % CHANGE
Brazil	64.1	+10.3
Peru	16.5	+0.4
Colombia	9.7	--
Chile	4.8	+0.5
Argentina	2.7	-10.9
Mexico	0.8	+0.1
Cash	1.3	-0.6

Source: Factset®. Figures may not add to 100% due to rounding. Geographic breakdown is by country of risk and includes cash and cash equivalents. Data as of 30<sup>th</sup> September 2019.

<sup>1</sup> Source: Factset® and broker estimates. Data as of 30<sup>th</sup> September 2019. The total 2020 and 2021 PE is a weighted harmonic average for all holdings with a positive PE ratio. Please see the end of this letter for methodology, exclusions and important disclosures.

## PERFORMANCE

The fund returned -9.9% (net of fees) in the third quarter of 2019 and -2.6% year-to-date. Currency was the main driver of returns, contributing -7.6% in the third quarter and -8.4% year-to-date. Five out of six currencies were negative contributors over the first nine months of the year and we think this has left the currencies we invest in looking notably cheap just as the economies begin to accelerate. It is worth reminding investors that historically currencies have been positively correlated with economic strength.

During the third quarter our top five performers added 2.3% to our US dollar NAV whereas our bottom five detracted 7.3%<sup>2</sup>. Four of the bottom five were Argentine stocks. The result of the primary election in Argentina in August came as a complete surprise to the market and drove a sharp selloff in both stocks and the currency.

**Key drivers of year-to-date performance were Brazil, which contributed 5.9%; and Argentina, which detracted -6.5%<sup>2</sup>.** The other four countries made a marginally positive contribution in aggregate.

The Brazilian contribution was fairly broad based, driven by an increasingly buoyant mood in that country as economic reforms progress through the legislative process. B3, TOTVS, Marisa, and EcoRodovias were the largest positive contributors in Brazil<sup>2</sup>. **We believe the scene is being set for a powerful economic recovery in Brazil.**

The Argentine year-to-date contribution was driven by the result of the primary election in August. We discuss this in more detail in the Argentina country section below.

## PERFORMANCE CONTRIBUTION

Largest Contributors Q3 2019		
STOCK NAME	COUNTRY	CONTRIBUTION TO RETURN (%)
Lopes Brasil-Consultoria de Imoveis SA	Brazil	0.7
EcoRodovias Infraestrutura e Logistica S.A.	Brazil	0.6
B3 SA -Brasil, Bolsa, Balcao	Brazil	0.4
TOTVS S.A.	Brazil	0.3
Fleury SA	Brazil	0.3

Largest Detractors Q3 2019		
STOCK NAME	COUNTRY	CONTRIBUTION TO RETURN (%)
Bolsas y Mercados Argentinos SA	Argentina	-2.8
GrupoFinancieroGalicia SA Sponsored ADR Class B	Argentina	-2.0
Loma Negra Compania Industrial Argentina SA Sponsored ADR	Argentina	-1.2
ItauUnibancoHolding S.A. Sponsored ADR Pfd	Brazil	-0.7
BBVA Banco Frances SA Sponsored ADR	Argentina	-0.6

Source: Factset®. Figures are gross of fees and taxes. Data as of 30<sup>th</sup> September 2019. The information provided in this material is not intended to be and should not be considered to be a recommendation or suggestion to engage in or refrain from a particular course of action or to make or hold a particular investment or pursue a particular investment strategy, including whether or not to buy, sell, or hold any of the securities mentioned. It should not be assumed that investments in such securities have been or will be profitable. To the extent specific securities are mentioned, they have been selected by the author on an objective basis to illustrate views expressed in the commentary and do not represent all of the securities purchased, sold or recommended for advisory clients. Security returns listed represent the period when the security was held during the quarter. Contribution to

<sup>2</sup> Source: Factset®. Figures are gross of fees and taxes. Data as of 30<sup>th</sup> September 2019. The information provided in this material is not intended to be and should not be considered to be a recommendation or suggestion to engage in or refrain from a particular course of action or to make or hold a particular investment or pursue a particular investment strategy, including whether or not to buy, sell, or hold any of the securities mentioned. It should not be assumed that investments in such securities have been or will be profitable. To the extent specific securities are mentioned, they have been selected by the author on an objective basis to illustrate views expressed in the commentary and do not represent all of the securities purchased, sold or recommended for advisory clients. Security returns listed represent the period when the security was held during the quarter. Contribution to return is calculated by multiplying a security's beginning weight in the portfolio by the security's return on a daily basis, and geometrically linking the return for the reporting period. Numbers may not total due to rounding.

return is calculated by multiplying a security's beginning weight in the portfolio by the security's return on a daily basis, and geometrically linking the return for the reporting period. Top and bottom contributors include cash and cash equivalents.

FX Contribution to Return	Q3 2019
<b>TOTAL</b>	<b>-7.6</b>
Argentinian peso	-1.7
Brazilian real	-4.9
Chilean peso	-0.3
Colombian peso	-0.7
Mexican peso	-0.0
Peruvian sol	-0.1
Cash	-0.0

Source: Factset®. Figures are gross of fees and taxes. Data as of 30<sup>th</sup> September 2019 and includes cash and cash equivalents. The information provided in this material is not intended to be and should not be considered to be a recommendation or suggestion to engage in or refrain from a particular course of action or to make or hold a particular investment or pursue a particular investment strategy, including whether or not to buy, sell, or hold any of the securities mentioned. It should not be assumed that investments in such securities have been or will be profitable.

## STOCK EXAMPLE: LOJAS AMERICANAS

In the last newsletter we introduced our new newsletter format, with shorter country sections to create space for a quarterly themed piece. Last quarter the theme was a discussion of ROE, and how Latin America compares to Asia. This quarter it's a deep dive into a stock that we have recently made a top-five position, Lojas Americanas. It's both a very interesting opportunity and a window into some of the changes taking place across the region.

Lojas Americanas is a retailer. Roughly half of its value is in its brick and mortar operation, which was founded in 1929 and is still growing strongly. The other half is in its online arm, which is one of the leading players in Brazilian ecommerce. But it's probably best to think of them together: retail is increasingly omnichannel, and the winners will be the ones which can integrate online and offline most efficiently to offer the consumer what they want, where they want it, how they want it, when they want it, at the price they want it, and with the lowest costs.

### Offline

Lojas Americanas' offline operation has 1500 stores covering every state in Brazil. The stores sell a broad range of categories aimed at women and convenience – everything from confectionery to toys to consumer electronics, back-to-school, food, nappies, underwear, and more. **The number of stores has tripled over the last ten years, creating one of the few retail platforms in Brazil with the national reach and scale to be an omnichannel leader.** The risk of rolling out stores this fast is that the system gets stretched and store performance drops, but Lojas Americanas have invested heavily in every element of their "support" operation from distribution through merchandising to training, and as a result same store sales have compounded well ahead of inflation over the period.

We expect the company to continue adding stores, although probably at a slower pace relative to the enlarged base. In addition, same store sales should have three strong drivers. The first is the maturation of the store base after a period of strong store openings. The second is the emerging economic recovery in Brazil. And the third is using data to optimise each store's assortment according to local preferences. **We expect to see same store sales grow faster than store costs, driving operating leverage and enabling the company to "invest" in lower prices, deepen its competitive advantages, and stimulate demand.**

In addition to the existing business, Lojas Americanas is piloting a convenience store focussed on food and drink. Brazil doesn't really have this format yet – the demand is met by mom and pops – and there is scope for an efficient scale player to make real headway. Lojas Americanas think they could have 3,000 stores in five years and many more in the long run, and they are looking for ways to accelerate rollout via partnerships and maybe a franchise model. Store-level cash-on-cash returns are 40%<sup>3</sup>, meaning new stores pay for themselves quickly and are accretive to consolidated returns on capital. An important side effect of this new format

<sup>3</sup>Source: Lojas Americanas company meetings.

is that Lojas Americanas' store density should rise very fast, helping to drive omnichannel efficiency and reducing delivery times for online orders.

## Online

**In addition to its brick and mortar business, Lojas Americanas owns 61% of B2W, a leading e-tailer in Brazil**, which is separately listed. It runs three websites, including [lojasamericanas.com.br](http://lojasamericanas.com.br), each with a slightly different target audience.

In its first incarnation, B2W sold its own inventory online (first person ecommerce, or 1P). The first things to sell online in Brazil were commoditised items like white goods and consumer electronics, and sellers competed hard on price and payment terms, so the faster the business grew the more cash it consumed. We knew it well in those days but never invested.

Several years ago B2W decided on a change of strategy. First, it decided to build its own distribution infrastructure rather than rely on Brazil's highly inefficient post office, because it saw that ecommerce would never really take off until the customer experience improved and delivery times came down. **B2W's distribution operations are increasingly integrated with the brick and mortar operation to create a true omnichannel system**, so that orders can be collected from stores or delivered to customers' homes in the fastest and most cost-efficient manner possible.

Secondly, B2W decided to move from 1P ecommerce to third party (3P). In 3P, third parties list their products on B2W's marketplace. B2W clips a fee for the listing and for ancillary services such as payment and fulfilment, but does not hold inventory. 3P now accounts for almost 60% of the value of goods sold on B2W's site and is growing far faster than 1P. The only 1P products that B2W sells now are high margin, high turn products that don't demand a lot of working capital. **This shift has transformed B2W's economics.**

**Combined, we think these changes have delivered B2W to a powerful tipping point where faster delivery times can unleash demand and the company can generate free cash flow while it grows.** Ecommerce is underpenetrated within Brazilian retail - sources vary but ecommerce represents about 6-7% of Brazilian retail sales - and we think it will outgrow GDP for many years to come. In addition, the market is highly fragmented but consolidating fast, as smaller players migrate onto two or three big platforms. **As a result of its brand and investments over the last few years, B2W is one of these winners.** It has a market share of 29.7%, which is up 2.7% compared to last year<sup>4</sup>. The value of merchandise sold on its platform is growing at over 20%, or twice the rate of the market<sup>4</sup>. Growth may accelerate in 2020 driven by the launch in 2019 of B2W's cross-border operation, which allows Brazilians to buy direct from producers in other countries, such as China. Cross-border has helped B2W double the number of items for sale on the platform (year over year) to 12 million<sup>5</sup> at the end of 2Q19 and the target is 20 million<sup>6</sup> by year end.

B2W may not generate much in the way of net profits for a while, because it is investing heavily in customer acquisition, but we think it is likely to be a very valuable asset in the future.

## Innovation

Between them, Lojas Americanas and B2W are highly innovative. Every earnings release is peppered with new ideas. If anything our criticism of the company is that it's a little promotional, sometimes announcing capabilities too early, but the range of things they are looking at is impressive. As examples, they have launched or are piloting the following:

- Ame, a wallet that allows peer-to-peer and peer-to-merchant payments online and offline. **Ame will likely become a digital bank over time**, partnering with third parties to offer loans and insurance etc.
- Ame Go, **an automated store like Amazon Go** where customers can walk in, pick up what they want, and walk out, all without queueing.
- Pickup from sellers. Third party sellers on the B2W marketplaces often have stores as well as an online operation. B2W is adapting its distribution so that customers will be able to collect items bought online from any seller's store. This improves the consumer experience and also drives traffic to seller stores, increasing the value to them of partnering with B2W.
- VOE, a **Deliveroo-like delivery app** which enable third party motorbike riders to do B2W's last mile in remote cities where none of these apps exist yet.

<sup>4</sup>Source: B2W Digital 2Q19 report, p.3 Strategic Initiatives, Commercial and Marketing.

<sup>5</sup>Source: B2W Digital 2Q19 report, p.4 Strategic Initiatives, Evolution of Marketplace.

<sup>6</sup>Source: B2W company meetings.

## Management

Since 1982 Lojas Americanas has been controlled by 3G, the Brazilian private equity group that built AB Inbev, Restaurant Brands International, and Kraft Heinz, among others. They are well known for their highly granular incentive systems, and despite the recent issues at Kraft have been very successful over time (we recommend *The 3G Way* by Francisco Homem de Mello for anyone not familiar with the group and wanting to do some further reading). **One of the standout features of Lojas Americanas for us is that every store manager has been internally promoted, which we think makes for a strong incentive and a great culture.** The company has invested heavily in training and has conducted a case study with Harvard on the common characteristics of managers who consistently improve stores.

## Valuation

On a consolidated basis (i.e., including B2W) Lojas Americanas trades on 33x 2020 earnings<sup>7</sup>. This makes it one of our most expensive stocks on P/E, but on EV/EBITDA the stock is on a much more reasonable 10.8x 2020<sup>7</sup>. To put that in perspective its closest peer, which has been well and truly gripped by internet fever in Brazil, trades on 37x 2020 EBITDA<sup>7</sup>.

There are two reasons for the disparity between P/E and EV/EBITDA, and both suggest that EV/EBITDA is the ratio to focus on. First, B2W remains lossmaking today – but it has clearly turned the corner and as losses become profits the consolidated P/E will fall. Secondly, both companies have debt accrued as they expanded their footprint over the last few years. B2W is due to start generating free cash flow in 2019 and we think the brick and mortar business will generate a lot of it over the next few years as the store rollout slows slightly, as same store sales growth drives operating leverage, and as they reduce working capital investments they had to make during the recession. On a consolidated basis, therefore, we expect Lojas Americanas to de-lever fast, driving net income growth ahead of operating earnings.

Another way of looking at this is to value B2W at market and calculate the implied valuation of the “stub”. On this basis, the brick and mortar business is trading on 15x 2020 P/E<sup>8</sup>. We think that’s attractive given its growth, free cash flows, operating leverage (something we really like given the recovery unfolding in Brazil), and nascent convenience store business, which could really explode into life if things go well.

**We have made Lojas Americanas a 5.4% position and think it will do very well over the next one to three years but the opportunity is bigger than that.** We think Lojas Americanas is destined to be one of Brazil’s dominant retailers for a very long time and if that thesis plays out we hope to own it for at least five years and hopefully ten.

## CHILE

Chile represents 4.8% of our NAV. The economy is growing, but not as fast as it could be. That might change as the recent influx of Venezuelans gets better integrated and as the government passes some reforms, for example to simplify corporate taxes. That said, the unrest of recent days will dent short-term GDP and perhaps medium-term confidence. This unrest is unusual – the headlines about high inequality are correct, but salaries have been growing ahead of inflation and inequality has been falling, and the metro price increase that supposedly triggered the riots was tiny – but the damage has been significant. The government has reacted with a series of announcements on social spending and we suspect Chile will go back to being the best run and most stable country in the region. The stock market and the currency are well down from the post-election highs of late 2017, but we have struggled to find new buy ideas that compete with our holdings elsewhere in Latin America. We believe our three Chilean holdings are high quality compounders with the potential to grow for a very long time.

## PERU

Peru represents 16.5% of our NAV. Peru’s economy is recovering, although headline GDP often moves in fits and starts in Peru and 1H19 was slower than most people expected. We visited in September and most of the companies we spoke to felt the economy was reaccelerating. Growth is expected to be 2.5% in 2019 and 3% in 2020, and inflation is very well contained at 2%. **As we have said many times, Peru’s strongly pro-market economic structure, strong central bank, low sovereign debts, large international reserves, and high-quality companies make it a very attractive place for us to invest for the long term.** That said, political noise looks likely to result in congressional elections in early 2020. We think that could be a good thing, as politics

<sup>7</sup>Source: Bloomberg. Data as of 23<sup>rd</sup> October 2019.

<sup>8</sup>Source: Brown Advisory calculation.

has kept a lid on confidence for the last eighteen months or so.

In September we spent a full day with Credicorp, Peru's largest bank and a top ten position in the fund, and came away very happy with our investment. **The day added weight to a thesis we have been developing for a couple of years now that technology is an opportunity for big banks in the region, not a threat.** Five years ago, Credicorp would have dismissed fintech as not relevant for Peru. Three years ago they saw it as a threat, and started reacting. About a year ago, they started discussing it as an opportunity. **What has become obvious over those five years is that incumbents have the greatest advantage of all: clients.** If they sit back and ignore the threat this won't help them, but if they move fast to give those clients a better user experience and to automate processes they have a huge opportunity to grow the client base and cut costs. Fintechs have opportunities in certain niches, and there are also opportunities for the big banks to work with fintechs to the advantage of both, but the idea that fintechs will bite away big chunks of a bank's lending business by having a better app is fading away. Instead, the technology is increasingly commoditised (Credicorp got the minimum viable product version of its new app, Yape, to market in 16 weeks) and **fast-moving incumbents can use it to address entire segments of the population who have never been banked before while reducing the costs of many processes by up to 90%.** The overriding question is therefore whether the incumbents are culturally capable of moving fast. Credicorp was frankly ruthless about this, and has restructured itself and its management team to make digital transformation the overriding company goal. We think its clients and shareholders will be very happy with the result.

## BRAZIL

Brazil represents 64.1% of our NAV. **This is a high allocation for us and an active choice.** We expect the Brazilian stock market to produce robust performance in the coming years.

Several factors seem to be aligning in Brazil including an improving cyclical outlook, a powerful and disinflationary economic reform programme, and interest rates low enough to start Brazil's first ever domestically-driven equity bull market.

The economy is continuing to emerge from its five-year downturn and growth looks poised to accelerate in 2020 and again in 2021. The external sector remains in great shape on the back of an attractively valued currency. Inflation has fallen to a probable 3% in 2019. Disinflationary reforms combined with plenty of spare industrial and labour capacity should anchor inflation in the 3-4% zone for several years. **Interest rates have fallen from 14.3% to 5.5% and look set to fall to 5%, or even 4.5%, soon. These rates represent all-time lows for Brazil – indeed Brazil is entering its first ever multi-year period with single-digit interest rates.**

**It's very hard to overstate what a change this represents** compared to the last thirty years, during which Brazil generally had high rates as it fought to bring inflation under control. That battle appears to have been won, and we think the impact will be a long period of low borrowing costs and strong growth. Private sector banks are generally in great shape and are ready to lend. Mortgage penetration is low at approximately 8% of GDP<sup>9</sup> and rates keep dropping, so we think mortgages will be a huge growth product in this cycle. That should drive both middle class spending and job creation in the construction sector, turbocharging Brazil's recovery from its painful recession. Lopes, which is the leading real estate agent in Sao Paulo, saw project launches rise by 69% y/y in 2q<sup>10</sup> and mortgage sales rise 56%<sup>11</sup>. These mortgages had an average loan-to-value of 57% and an average interest rate of 8.7%, suggesting very healthy conditions for lenders<sup>11</sup>. We have 2.3% of the fund in Lopes.

**We think this improving outlook matters for the region and is also globally relevant – there aren't many global top ten economies that appear to be accelerating sustainably, and we think Brazil will increasingly draw the attention of global investors.** Brazil's economic up cycles typically last for 8-9 years - its economy has only been in recession for 12% of the time since 1950 – and the disinflationary reforms being enacted should underpin a long period of growth.

The importance of the reforms is rooted in Brazil's economic history. Ever since the hyperinflationary crisis of the late 1980s and early 1990s Brazil has been fighting to rectify several structural economic problems. It has fixed inflation, it has fixed its external payments issue, and it has fixed the currency mismatch caused by the fact that it used to borrow primarily in US dollars. **The last**

<sup>9</sup> Source: Morgan Stanley Research Paper. Data as of 11/09/2018.

<sup>10</sup> Source: LPS Brasil, 2Q19 Earnings Release, p.1.

<sup>11</sup> Source: LPS Brasil, 2Q19 Earnings Release, p. 7.



**structural problems are Brazil's hitherto chronic fiscal deficit, and productivity.**

Approximately half of Brazil's budget goes on social security and in particular on its extraordinarily generous and unfair pension system, so without a pension reform Brazil can't balance its budget. **The big news is that the pension reform has passed, resulting in a fiscal saving of US\$200bn over the next 10 years,** which is a better outcome than the market expected at the start of this year. The cherry on the cake is that another potential pension reform, targeting states and municipalities, is expected and could result in further savings.

After dealing with pensions the government plans to pass a fiscal reform, probably by mid-2020, which will simplify Brazil's labyrinthine tax system and enable companies to cut costs. They also plan sector reforms, for example in sanitation and electricity, which are expected to have a significant impact on investment, and an administrative reform, which along with a planned simplification of environmental licensing laws should further simplify the business environment. Finally, they plan to make the central bank fully independent and to reduce tariffs (either by direct cuts or signing free trade agreements). **All of these reforms are disinflationary and good for productivity.**

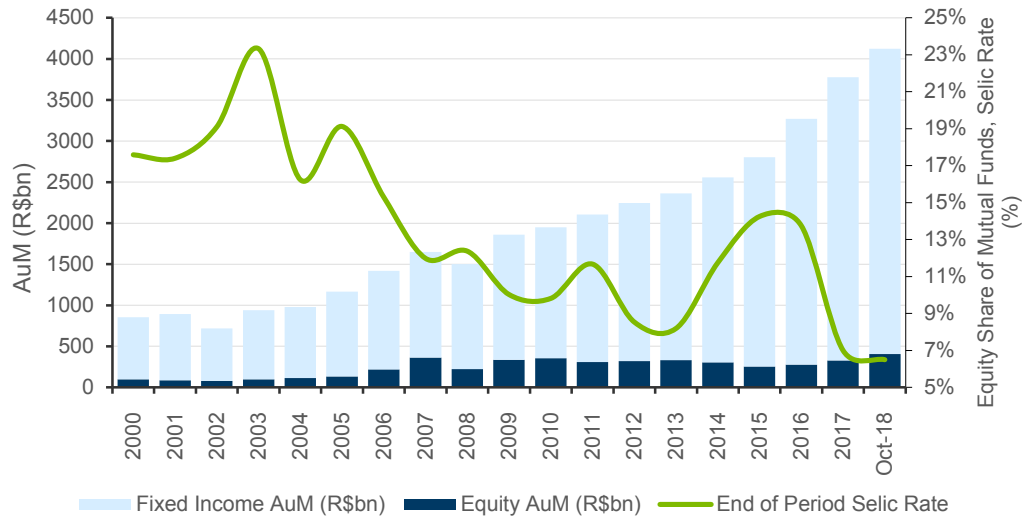
This programme builds on reforms already done by the brief Temer administration. One of these aimed to encourage private investment in Brazil's pre-salt oil and gas fields. It's taken a couple of years for that reform to start to pay off, but block auctions are starting. The November auction alone is expected to yield a US\$20-25bn windfall to the government and US\$250bn in investment commitments over the next 30 years. **Brazil has the potential to become a top five hydrocarbon producer as well as a global leader in solar and wind. The feeling on the ground is that, taken together, the energy and potential electricity reforms have the potential to unleash a cheap energy revolution in Brazil** akin to what the US experienced as a result of the shale revolution.

Another Temer reform encouraged PPP investments in infrastructure, and the current government has built on this to ensure that **there is a fat pipeline of attractive projects coming up for bid in the rail, airport, road, and port sectors.** These bids and renewals are attracting global interest and will drive investment and, ultimately, reduce the infamous "Brazil cost".

**To cap it all, the government plans a substantial privatisation programme.** This involves asset sales, the proceeds of which will be used to pay down debt, which combined with the pension reform savings **should help Brazil return to investment grade.** It also involves a deliberate reduction of the market share of state-owned companies. The Brazilian state has over 50% market share in a wide range of industries including banking, electricity, oil and gas, sanitation, etc. **As state companies donate share over the next few years, the private sector in those industries will be able to grow at rates well ahead of GDP.** For example, we think private sector banks will be able to grow at twice the industry growth rate without taking undue risk. This is a rare opportunity.

**Each of these changes is good for private sector confidence, fixed capital formation, productivity, and inflation. Combined, they could transform Brazil, and they are being passed just as the economy is recovering from very subdued levels with interest rates at all-time lows.**

**The stock market will be a big beneficiary of all these trends in Brazil.** The local mutual fund industry has about US\$1tn of assets under management, which is huge for an emerging market, and about 90% of these assets are invested in local fixed income. That's been a very sensible allocation for most of living memory in Brazil, because real interest rates had to be kept high throughout the inflation-fighting years. Today, however, with inflation tamed, fixed interest returns have dropped sharply. This, as well as rising confidence and the advent of investment apps, is beginning to drive local money into equities. We believe that the development of a strong local bid in Chile drove equity valuations up and volatility down, and the same could happen in Brazil. Bear in mind that Brazil's market cap/GDP ratio is under 50% and the market trades just US\$4b per day.



Source: BTG Pactual. Data as of November 30, 2018 and is the most recent data available.

**A growing local bid might be particularly good for the kinds of stocks we own.** Local investors are well aware of the problems that plague many of Brazil's state owned and commodity stocks, and we think that as the economy recovers they may shy away from these index heavyweights and focus on high quality domestic growth stocks.

Finally, Brazil's correlation to global equities may fall over the long term as the local bid replaces foreign flows as the main driver of the market.

## MEXICO

Mexico represents under 1% of our NAV and there is no change to how we view the country. **We continue to be concerned by the interventionist agenda of the new president, known as AMLO, which we feel is undermining private sector confidence.** To quote Scotia bank: "The Mexican economy is on the brink of recession in 2019 while the outlook for 2020 remains bleak...investment is plummeting, job creation is slowing rapidly, construction activity is falling, and private consumption runs at the weakest pace in a decade."<sup>12</sup> We also bear in mind that Mexico is by far the most exposed of our economies to a US slowdown and to Trump risk, either of which could be a trigger for things in Mexico to get worse.

Despite this, stocks remain fully valued. Most of the multiple compression we have seen has been in lower quality companies that could be really exposed if the economy goes south. High quality consumer growth companies continue to trade at approximately 20-25x forward earnings. And while the peso is statistically cheap there is no catalyst for a revaluation – in fact, we fear it is prone to a derating as the Central Bank embarks on a new easing cycle.

We continue to watch carefully for opportunities in Mexico but currently feel the risk/reward in other countries is far better.

## ARGENTINA

Argentina represents 2.7% of our NAV, a significant reduction to earlier in the year. Until August we felt that Argentina represented an extraordinary opportunity. Stocks were cheap, the currency was cheap, and after decades in the economic wilderness the country seemed to be moving towards the "Chilean model" of free markets, fiscal discipline, and controlled inflation that has

<sup>12</sup> Source: Scotia LatAm Views Oct 11: Latin America Economics Quarterly Outlook.



created so much wealth elsewhere.

In the run up to the August primary elections, which were a dress rehearsal for the real thing in October, the economy had passed a positive inflection point and all the polls suggested that the incumbent pro-market government would perform credibly. This would have allowed Argentina to spend the next four years reaping the benefits of all the tough reforms they have done over the last four years - something that could have changed the political landscape for a generation. In fact, the left-wing opposition routed the government and went on to win the presidential election on October 27th. The primary result in August was a huge shock and caused a selloff in the peso, which will drive a reacceleration of inflation and either postpone or cancel the economic recovery.

**In our experience it is better to correct mistakes quickly rather than to rewrite an investment thesis that has expired.** Argentina's future under an interventionist government simply won't be what it could have been under a pro-market one. We therefore reduced our Argentine weight from 13.5% to 2.5% the day the news came out. This was not fun but so far it has been the right thing to do and, more importantly, it has allowed us to focus fully on opportunities elsewhere.

We have maintained one holding, in BYMA, which we think represents a tremendous long-term investment opportunity. BYMA is the monopoly custodian for all onshore financial assets in Argentina which includes local currency government debt, corporate bonds, equities, OTC instruments and exchange traded derivatives. This business is structurally growing and represents 80% of cash flows. The rest comes from BYMA's monopoly onshore equity trading and post-trade monopoly, which is expanding into derivatives and fixed income. As revenue grows the company is cutting costs, having only demutualised recently, so **net income is growing strongly despite Argentina's recession and we think it will multiply many times over the long term. BYMA has net cash<sup>13</sup>, half of which is in US dollars, and is trading at approximately 3-4x forward earnings.**

It is important to say that the situation in Argentina (and Mexico for that matter) is domestic. **We don't see any risk of contagion across the region.** If there is any contagion it will come from Brazil, which is moving in a strongly pro-market direction, and it will be positive.

## CONCLUSION

Argentina took a clear step back in 3Q19 and we have reduced our exposure there. Our fund is now concentrated in Brazil, Peru and Colombia. Brazil is particularly exciting and is a large position for us.

**Brazil's pension reform has passed**, resulting in fiscal savings of \$200bn over the next 10 years. **A raft of other reforms – some already done, and some planned – promise to increase investment and decrease inflation.**

**On top of this Brazil has huge pent-up demand after exiting an enormous recession and has all-time-low interest rates.** The pieces of a recovery have been falling into place over the last two years in Brazil and we think we are on the cusp of a major acceleration. This will be good for Brazil, but since Brazil is a huge economy – it's in the global top ten and the same size as India – it will also be very good for the region.

**Our portfolio of high-quality domestic companies is capable of rapid earnings growth in the kind of environment we think we are entering.** On consensus forecasts the portfolio trades on a weighted average 13.5x 2020 earnings and 12x 2021<sup>15</sup>. The implied growth rate of earnings is 19% in 2020 and 16% in 2021<sup>16</sup>.

<sup>13</sup> Source: BYMA company meetings.

<sup>14</sup> Source: Factset®. Data as of 30<sup>th</sup> September 2019.

<sup>15</sup> Source: Factset® and broker estimates. Data as of 30<sup>th</sup> September 2019. The total 2020 and 2021 PE is a weighted harmonic average for all holdings with a positive PE ratio. Please see the end of this letter for methodology, exclusions and important disclosures.

<sup>16</sup> Source: Factset® and broker estimates. Data as of 30<sup>th</sup> September 2019. Implied EPS Growth Rate for 2020 and 2021, year over year.

### *The Latin American Team*

*Portfolio Managers: Rupert Brandt, CFA & Peter Cawston*

Annual Performance	Latin American Fund
Inception to Year end 2006	17.90%
2007	19.08%
2008	-55.34%
2009	142.11%
2010	34.43%
2011	-23.44%
2012	35.02%
2013	-7.55%
2014	-7.83%
2015	-35.54%
2016	24.60%
2017	25.68%
2018	-10.95%
YTD	-2.63%
Cumulative performance since inception	46.43%

Source: BBH. The performance shown above includes the performance of the Findlay Park Latin American Fund between 10 October 2006 and 28 March 2018 which merged into the Brown Advisory Latin American Fund on 30 April 2018. Past performance is calculated using the U.S. Dollar class of share and net of fees. The Brown Advisory Latin American Fund was launched under Brown Advisory's Irish UCITS umbrella on 30 April 2018. Data as at 30<sup>th</sup> September 2019.

Sector Breakdown		
SECTOR	FUND WEIGHT %	QTD % CHANGE
Consumer Staples	21.2	+1.3
Consumer Discretionary	18.5	+2.2
Banks	18.4	-1.8
Financial Exchanges	8.5	-3.3
Shopping Malls	5.5	+0.1
Private Education	5.2	+0.1
Other Financials	4.4	+0.7
Health Care	4.0	+0.9
Transportation	4.0	+1.0
Real Estate Brokers	2.9	+1.0
Utilities	2.5	+0.3
Technology-Services & Software	2.4	+0.7
Building Materials & Cement	1.3	-2.3
Industrials	--	--
Cash	1.3	-0.6

Source: Factset®. Data as at 30<sup>th</sup> September 2019 and includes cash and cash equivalents. Sectors are based on a custom classification as classified by the Brown Advisory Latin American Fund portfolio managers. Numbers may not total 100% due to rounding.

Top 10 Positions Q3 2019		
SECURITY	COUNTRY	FUND WEIGHT (%)
Itau Unibanco Holding S.A. Sponsored ADR Pfd	Brazil	7.9
Grupo Nutresa S.A.	Colombia	6.5
InRetail Peru Corp.	Peru	6.2
Banco Bradesco S.A. Sponsored ADR Pfd	Brazil	6.1
Lojas Americanas*	Brazil	5.4
B3 SA -Brasil, Bolsa, Balcão	Brazil	4.7
Alicorp SAA	Peru	4.5
Credicorp Ltd.	Peru	4.5
Ambev SA Sponsored ADR	Brazil	4.1
EcoRodovias Infraestrutura e Logística S.A.	Brazil	4.0

Source: Factset®. Data as at 30<sup>th</sup> September 2019. \*Lojas Americanas represents a 2.9% holding in Lojas Americanas S.A. and a 2.5% holding in Lojas Americanas SA Pfd. Top 10 holdings include cash and cash equivalents. The information provided in this material is not intended to be and should not be considered to be a recommendation or suggestion to engage in or refrain from a particular course of action or to make or hold a particular investment or pursue a particular investment strategy, including whether or not to buy, sell, or hold any of the securities mentioned. It should not be assumed that investments in such securities have been or will be profitable.

Largest Purchases YTD 2019	
STOCK NAME	COUNTRY
Banco Bradesco S.A. Sponsored ADR Pfd	Brazil
Fleury SA	Brazil
Itau Unibanco Holding S.A. Sponsored ADR Pfd	Brazil
Bolsas y Mercados Argentinos SA	Argentina
EcoRodovias Infraestrutura e Logística S.A.	Brazil

Largest Sales YTD 2019	
STOCK NAME	COUNTRY
Grupo Financiero Banorte SAB de CV Class O	Mexico
B3 SA -Brasil, Bolsa, Balcão	Brazil
Wilson Sons Ltd	Brazil
Grupo Financiero Galicia SA Sp ADR Class B	Argentina
Loma Negra Compania Industrial Argentina SA Sp ADR	Argentina

Source: Factset®. Data as at 30<sup>th</sup> September 2019. The information provided in this material is not intended to be and should not be considered to be a recommendation or suggestion to engage in or refrain from a particular course of action or to make or hold a particular investment or pursue a particular investment strategy, including whether or not to buy, sell, or hold any of the securities mentioned. It should not be assumed that investments in such securities have been or will be profitable.

## Methodology, Terms & Definitions

Our portfolio stats are downloaded from Bloomberg and Factset. In the few cases where Bloomberg and Factset do not have data we source forecasts from individual brokers and historic data from company financials.

Several of the differences between the unadjusted and adjusted portfolio statistics stem from the fact that over the last two years we have allocated about 5% of our portfolio to high quality cyclical small cap stocks in Brazil. Because they are cyclical these stocks are making losses or very small profits as they exit Brazil's major 2015-6 recession. We do not believe this performance is representative of their earnings power as the cycle normalises so we strip them out of some of the statistics so that the characteristics of the core portfolio holdings can be seen more clearly.

### PE Methodology:

The total 2020 and 2021 PE is a weighted harmonic average for all holdings with a positive PE ratio. PE ratios are sourced from Bloomberg or Broker Estimates selected by the portfolio managers.

### ROE Methodology:

Unadjusted ROE: 9%.

Adjusted ROE: 23%.

We show Return on Equity excluding acquisition-related intangibles as a measure of the barriers to entry our businesses possess and of their ability to internally fund organic growth. We believe the substantial majority of future growth will be organic. Most of the goodwill at these companies relates to one-off acquisitions that are unlikely to be repeated in the future. We make a number of other more minor adjustments which we can explain on request.

### EPS Growth Rate Methodology:

Implied EPS Growth Rate for 2020 and 2021, year over year.

All financial statistics and ratios are calculated using information from Factset as of the report date unless otherwise noted. FactSet® is a registered trademark of FactSet Research Systems, Inc.

An investor cannot invest directly into an index.

**Market Capitalization** refers to the aggregate value of a company's publicly traded stock. Statistics are calculated as follows: Weighted Average: the average of each holding's market cap, weighted by its relative position size in the portfolio (in such a weighting scheme, larger positions have a greater influence on the calculation); Weighted Median: the value at which half the portfolio's market capitalization weight falls above and half falls below; Maximum and Minimum: the market caps of the largest and smallest companies, respectively, in the portfolio.

**Net Debt to EBITDA Ratio** is a measurement of leverage, calculated as a company's interest-bearing liabilities minus cash or cash equivalents, divided by its EBITDA. The net debt to EBITDA ratio is a debt ratio that shows how many years it would take for a company to pay back its debt if net debt and EBITDA are held constant. If a company has more cash than debt, the ratio can be negative.

**FX Return** is the actual rate of return of a currency over a given period of time.

**Local Currency and Local Currency Return** refer to the currency in which a security is denominated and its rate of return over a given period of time; e.g. a Colombian equity is denominated locally in Colombian Pesos.

**Contribution to Return** is a security's impact on the actual rate of return for a pool of investments over a given time period. All of the above ratios for a portfolio are expressed as a weighted average of the relevant ratios of each portfolio holding, EXCEPT for P/E ratios, which are expressed as a weighted harmonic average.

## Disclosures

### *Past performance is not a guarantee of future performance and you may not get back the amount invested.*

The views expressed are those of the author and Brown Advisory as of the date referenced and are subject to change at any time based on market or other conditions. These views are not intended to be and should not be relied upon as investment advice and are not intended to be a forecast of future events or a guarantee of future results. The information provided in this material is not intended to be and should not be considered to be a recommendation or suggestion to engage in or refrain from a particular course of action or to make or hold a particular investment or pursue a particular investment strategy, including whether or not to buy, sell, or hold any of the securities mentioned. It should not be assumed that investments in such securities have been or will be profitable. To the extent specific securities are mentioned, they have been selected by the author on an objective basis to illustrate views expressed in the commentary and do not represent all of the securities purchased, sold or recommended for advisory clients. The information contained herein has been prepared from sources believed reliable but is not guaranteed by us as to its timeliness or accuracy, and is not a complete summary or statement of all available data. This piece is intended solely for our clients and prospective clients, is for informational purposes only, and is not individually tailored for or directed to any particular client or prospective client.

Performance data relates to the Findlay Park Latin American Fund between 10 October 2006 and 28 March 2018 which merged into the Brown Advisory Latin American Fund on 30 April 2018. The performance is net of management fees and operating expenses. This communication is intended only for investment professionals and those with professional experience of investing in collective investment schemes. Those without such professional experience should not rely on it. Changes in exchange rates may have an adverse effect on the value price or income of the product. The difference at any one time between the sale and repurchase price of units in the UCITS means that the investment should be viewed as medium to long term. This factsheet is issued by Brown Advisory Ltd, authorised and regulated by the Financial Conduct Authority. This is not an invitation to subscribe and is by way of information only. Cancellation rights do not apply and UK regulatory complaints and compensation arrangements may not apply. This is not intended as investment advice. Investment decisions should not be made on the basis of this factsheet. You should read the Fund's prospectus in full to understand the features and risks associated with this Fund. The Fund's prospectus and Key Investor Information Document are available by calling 020 3301 8130 or visiting the Brown Advisory website. The Brown Advisory Latin American Fund is a sub-fund of Brown Advisory Funds plc, an umbrella fund with segregated liability between sub-funds. The Fund is authorised in Ireland as a UCITS pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2011 as may be amended, supplemented or consolidated from time to time) and a recognised collective investment scheme for the purposes of section 264 of the Financial Services and Markets Act 2000. The Fund is managed by Brown Advisory LLC. Brown Advisory is the marketing name for Brown Advisory LLC, Brown Investment Advisory & Trust Company, Brown Advisory Securities LLC, Brown Advisory Ltd., Brown Advisory Trust Company of Delaware LLC and Brown Advisory Investment Solutions Group, LLC. [www.brownadvisory.com](http://www.brownadvisory.com).