Latin America:
A Range of Opportunities for Active Investing

Acapulco, Mexico

Latin America: A Range of Opportunities for Active Investing

In 2016, Latin America roared back to become the best performing emerging market equity region with a return of 25.7% year-to-date through June 30.[1] A year ago, it was one of the worst performing regions for equity investors. The Latin American region remains highly distinct with some countries experiencing economic growth while others are experiencing cyclical downturns that may soon see a revival as global growth and trade recover. Each of these countries offers a different set of investment opportunities, risks and challenges which is why active management is so important. This region has historically been sensitive to global growth and a potential recovery presents opportunities through highly discerning stock selection in these markets.

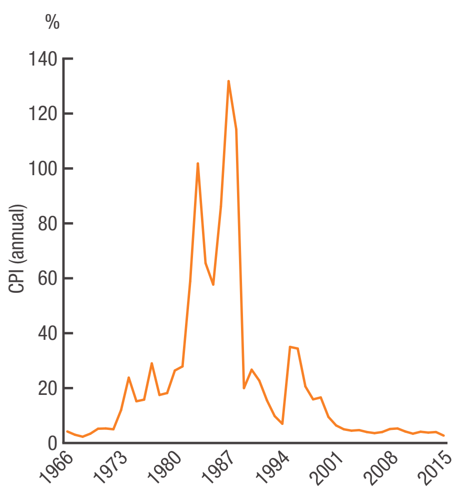
Here we take a close look at the two largest Latin American economies by GDP, Brazil and Mexico, and share our insights about how Mirae Asset invests in these countries.

Mexico: A Confident Consumer

As Latin America's second-largest economy and the US' third-largest trading partner,[2] Mexico offers an array of investment opportunities. The country is currently undergoing favorable economic reforms, improving the labor market, as well as in the telecom and energy sectors. Oil accounts for around 20% of fiscal revenues and thus remains an important part of the country's ability to grow. However, the energy reform, which aims to privatize the oil sector, is particularly attractive to investors who are looking for direct exposure to the structural benefits of Mexico's equity market.

Economic growth is ticking up with real gross domestic product (GDP) growth projected to reach 2.8% for 2016, up from 2.5% the year before.[3] This growth is largely driven by the consumer who has been a resilient, bright spot for the Mexican economy. The domestic market is benefitting from low inflation, low unemployment, low interest rates and positive structural reforms. Inflation, as measured by the consumer price index (CPI), in Mexico reached a low not seen in almost five decades (chart 1). Inflation for 2015 was 2.7%, down from 4.0% the year before, driven by falling prices for electricity, food, and phone services. As inflation stays near record lows, this translates to more spending money for the Mexican consumer.

Chart 1: Inflation in Mexico at Record Lows



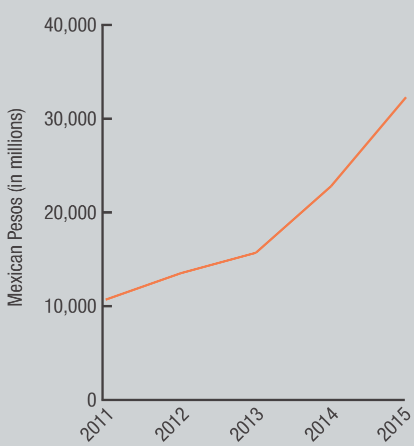
Source: World Bank.

[1] MSCI.
[2] Office of the United States Trade Representative
[3] World Bank, Global Economic Prospects.

Alsea

Alsea is a Mexican multi-brand restaurant operator that is well-positioned to benefit from increased discretionary spending of the Mexican consumer. Alsea's net sales grew at a compounded annual growth rate of 31.9% from 2011 to 2015. Some of the brands that Alsea operates in Latin America include Burger King, Domino's and Starbucks.

Alsea's Net Sales

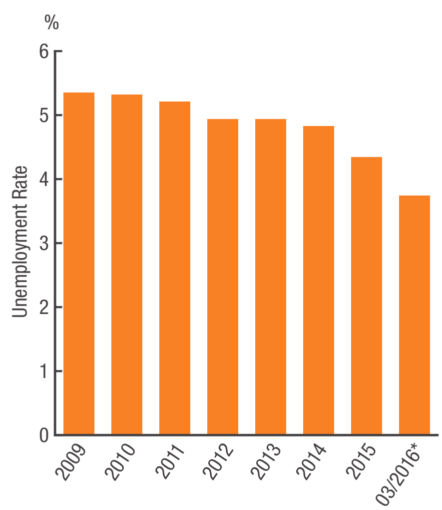


Source: Alsea's Annual Report 2015.
This figure does not reflect a measure of performance for any mutual fund.

Unemployment in Mexico has also been declining steadily (chart 2). Last year, Mexico had one of the world's lowest unemployment rates at 4.3%, compared to Germany at 4.6%, the US at 5.3% and the European Union at 9.4%.[4] Mexico's downward trend of unemployment has continued into 2016, falling to 3.7% in March, the lowest in almost eight years.[5] Another positive employment factor is from remittances or the transfer of money by a foreign worker to a relative in his or her home country. Remittances, the second-largest source of foreign exchange for Mexico after exports and an important source of revenue for Mexican households, are also rising. In 2015, flows from remittances were higher than oil exports, which reached $24.8 billion (chart 3). Most of these remittances come from the US and are another channel that ties the US economic cycle to that of Mexico and its consumers. We see the employment growth as sustainable given how competitive Mexico has become in a global context and now offers global companies an inexpensive back door entry to the world's largest market, the US.

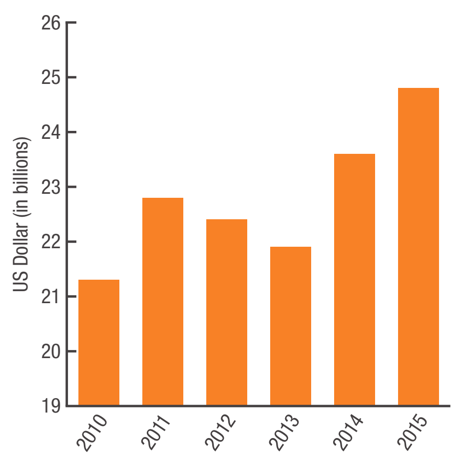
The low unemployment rate, coupled with low inflation, supports discretionary consumer spending. In February of 2016, Mexico's year-over-year retail sales reached a record high of 9.6%, up from 5.2% in January.[6] Consumer credit is also experienc-

Chart 2: Mexico's Unemployment Rate Continues to Decline



Source: OECD, *Bloomberg.

Chart 3: Remittances into Mexico are Rising



Source: Banco de Mexico.

[4] OECD.
[5] Bloomberg.
[6] Trading Economics, Instituto Nacional De Estadística y Geografía.

ing healthy growth as consumer confidence increases. Currently, credit penetration in Mexico is low by both global and regional standards, at around 17% of GDP versus 68% in Brazil and 125% in South Korea.[7] This ability to increase leverage in the future differentiates Mexico from many other emerging markets and means that consumption growth is still in its early stages.

Mexico is the 11th most populous country in the world and with over 122 million people has a potential consumer base as large as those of Spain, France and Portugal combined.[8] Mexico is also a relatively young country, with approximately 45% of its population under 25 years old and an average age of 27.3. Within the next 10 to 20 years, Mexico is expected to reach its lowest total dependency ratio in a century.[9] Mexico's urbanized area has increased significantly since 1940, with the urbanization rate rising from 35% to over 77% in 2015.[10] This large, young and urban group of consumers, with increasing disposable incomes, can have a considerable impact on high-quality companies that cater to the Mexican consumer.

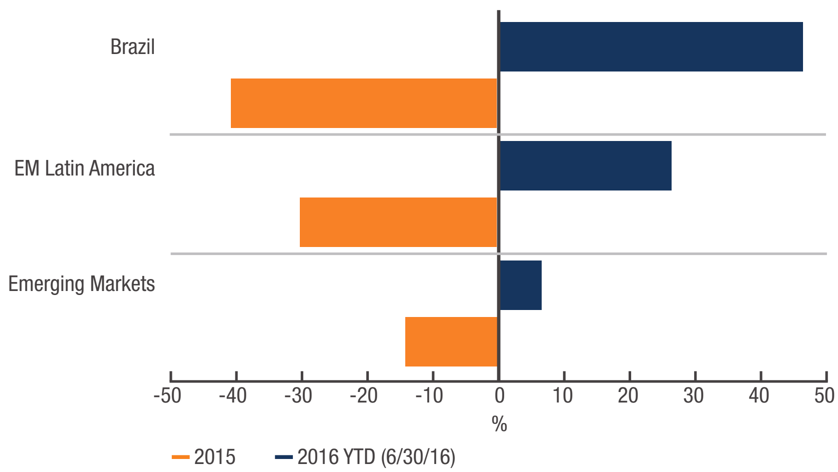
We see the employment growth as sustainable given how competitive Mexico has become in a global context.

Brazil: A Reversal of Fortune?

Brazil, Latin America's largest economy, has been one of the best performing equity markets in 2016, not only in Latin America, but across the developed and emerging market regions. In the first half of the year, Brazil's equity market returned an impressive 46.5%.[11] This is made even more remarkable given that Brazil's equity market was one of the worst performers of 2015, declining more than 41% (chart 4).

Yet, despite the notable rebound of Brazil's equity market, led by a recovery in global market expectations and a potential bottoming out of commodity prices along with optimism over potential market-friendly policy reforms, the country remains very

Chart 4: Brazil has been a Standout Performer in 2016



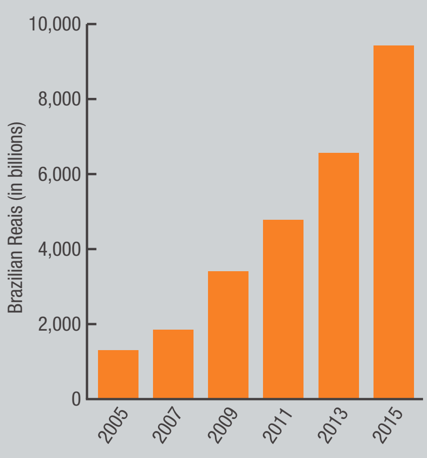
Past Performance Does Not Guarantee Future Results.

[7] JP Morgan Latin America Equity Research, May 2016.
[8] Forbes.
[9] CELADE, The Latin American and Caribbean Demographic Centre.
[10] INEGI.
[11] MSCI.

RaiaDrogasil

RaiaDrogasil is Brazil's largest drugstore chain. The company has demonstrated that a strong business model can provide growth even in a weak macro-economic environment. Since 2005, RaiaDrogasil's gross revenues have grown more than seven times.

RaiaDrogasil's Gross Revenues

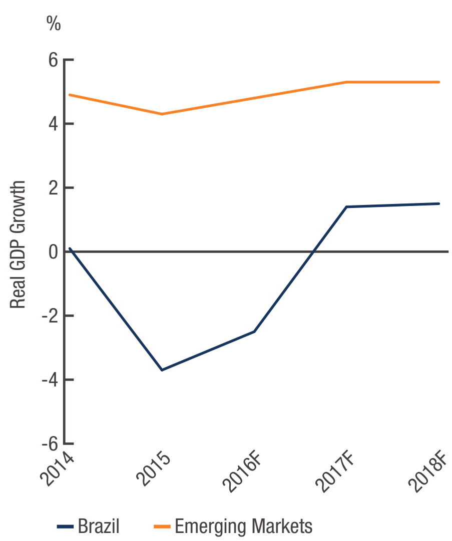


Source: RaiaDrogasil.

fragile. Brazil is currently facing a host of issues including political unrest involving the country's impeached President, an economic recession plagued by high unemployment and high inflation, growing government debt and sovereign rating downgrades to junk status by major rating companies. Brazil's economy is expected to continue to contract this year before returning to growth in 2017 (chart 5). What's needed now, in our opinion, is for structural reforms to lead to a period of sustainable growth by improving business and consumer confidence which has been at an all time low but is starting to turn (chart 6). The political changes currently occurring in Brazil could be the catalyst for that. We expect reforms to help increase investments and private spending, and lower inflation which should lead to lower interest rates and spur growth. The impact of reforms cannot be underestimated in the emerging markets and their effect on the equity markets can be meaningful.

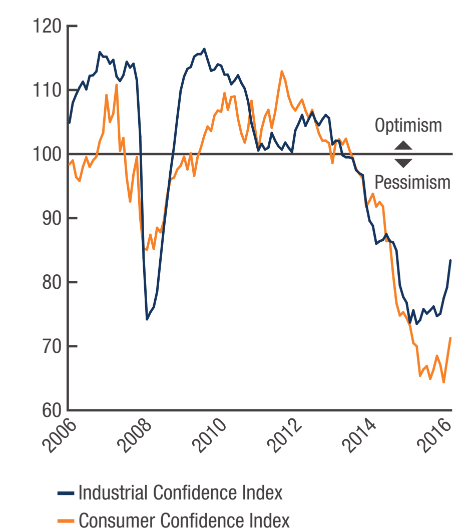
Despite Brazil's near-term economic difficulties, its equity market still offers exciting investment ideas and access to high-quality companies. Many companies can still thrive even in a difficult economy and we, as investors in the emerging markets, see this as an opportunity to increase our existing positions or as an entry point to invest in structurally sound companies with strong management teams and solid business models. As the country undergoes potentially transformative reforms and should confidence and growth return to the economy, underpinned by a more business friendly environment, these companies are expected to benefit.

Chart 5: Brazil's GDP Growth is Lower than the Rest of the Emerging Markets



Source: World Bank, Global Economic Prospects, Jan 2016.

Chart 6: Brazil's Business and Consumer Confidence are Heading in the Right Direction



Source: Getulio Vargas Foundation (FGV), Credit Suisse.

F=forecast. Forecasted numbers are projections and not guarantees.

Past Performance Does Not Guarantee Future Results.

Other Emerging Latin America Economies

In Latin America, with all the attention focused on Brazil and Mexico, it's easy for investors to forget that some of the most interesting investment opportunities can be found in the smaller markets of Peru, Colombia and Chile. In Peru, the equity market may have poor liquidity but market-friendly reforms have made the country more attractive to investors and its economy is viewed as having the fastest growth potential in Latin America. Meanwhile, Colombia is still dealing with the fiscal constraints from current oil prices but its economy, driven by infrastructure spending, is expected to expand by 3.0% in 2016, slightly better than the world GDP growth of 2.9%.[12] Chile continues to struggle with low consumer and business confidence but benefits from economic and political stability. Despite these headwinds, active equity investors can still seek to uncover potential opportunities.

Active Investing in Latin America

Latin America is home to a diverse group of countries with each economy moving in a different direction and affected by different macroeconomic issues. Mexico's consumer economy is showing resilience amid global volatility while Brazil is facing near-term economic challenges.

As an active, bottom-up investment manager, Mirae Asset can analyze each country and each individual company based on its own set of circumstances. This allows us to discover high-quality companies that have the potential to outperform in the long-term, even in a tumultuous economy, and also seek to avoid risky companies with weak fundamentals. The equity markets in Latin America may be more susceptible to cyclical swings so the need for an active manager who understands these markets becomes even more essential.

[12] World Bank, Global Economic Prospects 2016.

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Consumer Price Index (CPI) — measures changes in the price level of a market basket of consumer goods and services purchased by households.

Gross Domestic Product (GDP) — is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

Past performance is no guarantee of future results.

Investment Risk — There can be no guarantee that any investment strategy (risk management or otherwise) will be successful. All investing involves risk, including the potential of loss of principal. **Emerging Markets Risk —** The risks of foreign investments are typically greater in less developed countries, which are sometimes referred to as emerging markets. For example, legal, political and economic structures in these countries may be changing rapidly, which can cause instability and greater risk of loss. These countries are also more likely to experience higher levels of inflation, deflation or currency devaluation, which could hurt their economies and securities markets. For these and other reasons, investments in emerging markets are often considered speculative. Similarly, investors are also subject to foreign securities risks including, but not limited to, the fact that foreign investments may be subject to different and in some circumstances less stringent regulatory and disclosure standards than US investments.

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