Closing our tactical Mexican equity call with a small profit

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- **On October 16 last year we recommended a tactical call on Mexican equities with a view that the market (and the peso in particular) which suffered from Mr Trump's pre-election campaigning would rally on the back of a Mrs Clinton victory**
- **However, with Mr. Trump winning the presidency the negativity exacerbated causing Mexican equities to underperform significantly**
- **The inauguration of Mr Trump was a turning point for Mexican assets; from that point the market was no longer driven purely by fear and speculation over the new US administration's stance towards Mexico**
- **Instead investors were able to scrutinise real actions which turned out to not be as bad as was priced in**
- **Mexican equities have been among the best performers globally over the past two months, rallying c21% from their January lows**
- **We now sell into this strength, closing the call with a slight profit of 2.6% on a total return basis (although relative to global equities the call has of course underperformed)**

For Mexican equities actions spoke louder than words

Our Mexican equity recommendation was purely a call on the outcome of the US presidential elections. Given that Mexican equities and currency underperformed significantly in the run-up to the November 8 elections, the call aimed to benefit from a relief rally which we expected to ensue following a Mrs Clinton victory. This failed to materialise and the rest is history.

Populist and protectionist fears in the immediate aftermath of Mr Trump's victory were being expressed via Emerging Market assets and in particular via Mexican equities, bonds and the currency. In the two weeks following the US elections Mexican equities were down c16% in dollar terms vs. -5% for EM in aggregate. The temptation to close a losing trade is always high. Nevertheless we stuck with it in the belief that the market always reacts most aggressively in the lead-up to an event before adjusting later on. We had the benefit of being able to draw on similar examples in recent history, such as the Saudi and Brazilian equity market sell-offs, both of which reversed sharply following more clarity on the respective outlooks (in Saudi the fiscal outlook improved on the back of a successful bond issue and in Brazil it was the political backdrop). We therefore chose to wait at least until Mr Trump's inauguration on January 20 to see if the new President's actions would match his rhetoric vis a vis Mexico. The performance of the market over the past 2 months since Mr Trump's inauguration tells us that too much negativity had been priced into Mexican assets.

Overall it boils down to political risk, and 2016 was a year of political risk. More specifically, however, it was a year where political risk was regularly overstated in terms of its impact on financial markets, see market reactions to Brexit and Mr Trump. Political risk as it pertains to the outlook for Mexican equities turned out to be no different. Since Mr Trump's inauguration on 20 January Mexican equities have rallied c19% in dollar total return terms, outperforming EM equities by c10% and global equities by c14%. Overall on our trade we make a slight profit of 2.6%, however, Mexican equities have underperformed overall global equities (+c10%) since we recommended the trade.

The recent strong rally in Mexican equities provides a good opportunity to sell the market we believe. Especially as we expect recent US dollar weakness to be temporary. As and when the dollar rally resumes, emerging markets more broadly will come under renewed pressure. Given the catch-up which has taken place in Mexican equities, we do not expect that the market will be able to buck this trend.

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Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. *Bloomberg*
2. *Wall Street Journal*
3. *RTTNews*
4. *Reuters*
5. *Gulfbase*
6. *Zawya*

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