

In search of yield. Why we went far and wide to LatAm.

By Brookvine Pty Ltd

**As we look forward to welcoming Moneda Asset Management to Australia early in August, we delve into the question: Why should Australian investors be looking at Latin American high yield?**

**Brookvine CEO Steven Hall answers the hot topic of ‘why’ below, giving insight into this highly attractive, yet off-the-beaten-path opportunity.**

**Q. Why do you think USD-denominated LatAm high yield is an opportunity that Australian investors should consider?**

A. Outsized returns and diversification benefits. The ‘LatAm’ label may sound exotic to some, but the label belies the breadth and quality of LatAm corporate debt stock. The LatAm index yields more than other high yield markets, while corporate leverage is lower and default metrics are in line with global markets. There is substantial scope for value-added active management. Moreover, in order to achieve the types of returns available from this strategy, investors would more normally need to lock up their money in closed-end (illiquid) funds or take some substantial risk in another form. From a portfolio standpoint, the inclusion of this strategy has historically improved risk adjusted returns.

**Q. What is Moneda’s particular designation of ‘LatAm high yield’?**

A. Primarily public debt issued by companies in Latin America in USD, and typically by the leading players in each industry grouping. To a far lesser degree, opportunistic investment in distressed debt, which are securities over companies that are experiencing financial or operational distress, default or are under bankruptcy. Albeit this typically represents less than 10% of AUM, Moneda has successfully been involved in over 50 of these restructurings in the region, each typically delivering 20%+ p.a.

**Q. Why now?**

A. The hunt for yield is making parts of the US corporate bond market look a lot like 2007, and we note some allocators are pulling back from traditional credit allocations given yield compression. Others, particularly private wealth and SMSF investors, are making substantial commitments to private lending platforms and we wanted to offer an alternative. LatAm is currently an overlooked opportunity.

**Q. What led you to LatAm?**

A. We sought an opportunity with high yields in global markets, delivering returns of 10%+. We also wanted a good diversifier, with a discernible premium for risk. Thus, we focused on overlooked, under-invested and more specialised asset classes. Of course, we also looked to validation by ‘knowledgeable’ investors elsewhere in the world and wanted a manager with a solid track record executing the strategy.

**Q. Where does the fund invest?**

A. Principally in the LatAm 5, being Brazil, Mexico, Argentina, Colombia and Peru. Of interest perhaps, even though the LatAm 5 represent half of China’s population, the aggregate middle class income is higher than in China.

### Q. What most attracted you to Moneda?

A. Moneda offers the only dedicated strategy investing in LatAm high yield and distressed credit. Amongst our key observations:

- Moneda has consistently originated mis-priced opportunities, extracted a premium return and mitigated risk,
- It has a lengthy (19 year) track record, led by the same PM (Fernando Tisné) since inception,
- Moneda has an almost unparalleled insight into corporate debt markets in the region,
- There is now US\$3 billion invested in the strategy and tellingly, it has won support from savvy sovereign wealth, pension and endowment investors in the region,
- Moneda has delivered returns of 12.4% p.a. since inception<sup>1</sup>, better than EM debt and equities, and the current yield to maturity of its underlying holdings is almost 9% p.a.,
- There have been just 3 years of negative returns, all followed by strong gains, it has beaten benchmark in all but 4 years and its history of low defaults is impressive.

### Q. What is the currency risk?

A. Only USD directly. The fund is denominated in USD, and all the underlying credit assets are denominated in USD. However, whilst there is no 'direct currency risk' a large devaluation of a currency may impact local currency revenues and a company's default risk may increase; this is carefully monitored by Moneda.

### Q. And what about historical volatility and drawdowns?

A. Volatility since inception has been roughly in line with the strategy's returns. Since its inception, the strategy's volatility has been 11.3% versus 9.2% for the Bloomberg Barclays Corporate High Yield Index, 8.3% for the CS (Global) High Yield Index, 15.3% for MSCI ACWI Index and 21.5% for the MSCI Emerging Markets Index. Over the past 5 years volatility has been just 6.9%. The fund's worst calendar year return was -31.3% in 2008, and this was followed by a return of +78.6% in 2009. The second worst return in a calendar year was -5.5% in 2015, which was followed by a return of +23.2% in 2016.

### Q. Isn't Latin America a risky region to invest in?

A. There is added regional and country-specific risk, and investors should be prepared for 'headline' shocks and surprises. But you can gain comfort from Moneda's experience, the underlying assets it favours<sup>2</sup>, the strategy that it deploys and its capacity to exploit these 'shocks and surprises'. You are also relying on Moneda to seek out the best opportunities and manage risk.

The US and LatAm are often at different stages of their respective business cycles, and indeed, individual LatAm markets are often out of sync with one another. This augurs well for diversification. I also like that LatAm is a significantly overlooked and underinvested region.

### Q. Why back a regional manager rather than a global one? What about Asia?

A. I think manager skill in security selection is a more sustainable source of return in inefficient markets than skill in making global allocation calls. In respect of LatAm, local, specialised expertise also has a significant advantage. Understanding corporate governance and having strategic insight into each borrower, for example, is paramount. You must know the senior management of companies across the region and their willingness to repay in good times and bad. Finally, it is as much about finding capacity with the best manager as it is about favouring LatAm versus Asia. You will likely be well served with the best managers in either one or both regions, albeit LatAm probably enhances the diversification benefits for an Australian investor.

1. Data between Feb-2000 and Oct-2007 corresponds to MDLAT, the Chilean domiciled vehicle of the strategy. Data between Nov-2007 and Aug-2010 corresponds to MLCD Share Class (A). Data from Sept-2010 onwards corresponds to MLCD Share Class (C). MLCD is the Cayman domiciled vehicle of the strategy. Data as of March 31st, 2019.

2. Moneda's top holdings are typically large (some multi-national) companies such as Petrobras, Itau and Cemex. As well, the average rating of the Moneda portfolio is B. For comparable rated US high-yield credit, you would receive significantly lower yield, yet default metrics are similar.

### **Q. Where does it fit in a portfolio?**

A. An extension to a credit portfolio, sitting alongside more vanilla credit strategies to bolster returns, as a part of a defensive alternatives strategy, or as a complement to existing EM debt and equity investments. Plainly, it competes on its merits in several different guises.

### **Q. Is it a good fit for Brookvine?**

A. Absolutely. It has the key requirements our clients expect from Brookvine offerings:

- A strategy that produces portfolios very different to popular benchmarks
- Superb investment judgement, applied to a less efficient market
- Stellar track record, over multiple investment cycles
- (Typically) 1st generation team
- Employee-owned, client-centric firms
- Supported by ‘tier 1’ sophisticated investors, with a high rate of client retention
- Institutional grade operating infrastructure, with a high level of transparency
- Often less well-known, from across the globe

### **Q. Is this an Australian domiciled fund?**

A. The strategy is currently investible via a Cayman vehicle. If there is sufficient demand in Australia, we will consider launching an Australian domiciled fund (which would also likely be denominated in USD).

## RESEARCH NOTE

### About Moneda Asset Management

Headquartered in Santiago, Chile, Moneda Asset Management (Moneda) is an independent asset manager specialising in Latin America, investing across the capital structure in both equity and credit securities. Moneda has been operating in the region since 1994 and has over US\$9.5 billion in assets under management. Moneda has a long term client base of pension, sovereign wealth funds and family offices across the globe and is the largest dedicated manager of LatAm high yield debt. Moneda also has offices in New York City and Buenos Aires. Moneda was the first investment manager in Chile to become a signatory of the UN-supported Principles of Responsible Investment.

### About the Moneda Latin American Corporate Debt Fund

Moneda's Latin American Corporate Debt strategy invests in high yield corporate credit denominated in USD. Moneda searches for mispriced opportunities throughout the region with a long term, bottom-up, country and benchmark agnostic approach. The strategy invests in public and private debt of companies located in, or with significant operations in Latin America and the Caribbean. A small allocation is invested in distressed opportunities managed by Moneda's specialised restructuring team.

For more information about the Moneda Latin American Corporate Debt Fund please contact:

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### Disclaimer

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An investment in the Funds will be suitable only for certain sophisticated investors who have no need for immediate liquidity in their investment. Such an investment will provide limited liquidity because interests in the Funds will not be freely transferable and may be withdrawn only at certain intervals. There will be no public or secondary market for interests in the Funds, and it is not expected that a public or secondary market will develop. The interests in the Funds will not be registered under the Securities Act of 1933 as amended nor under any states blue sky law in reliance upon exemptions available under such laws. Among other requirements, such exemptions require that the transfer of interests in the Funds must be restricted. An investment in the Funds has not been recommended by any US federal or state securities commission or any other governmental or regulatory authority. Furthermore, the foregoing authorities have not passed upon the accuracy, or determined the adequacy, of this document. Any representation to the contrary is unlawful. Certain information contained in this document constitutes forward looking statements which can be identified by use of forward looking terminology such as may, will, target, should, expect, attempt, anticipate, project, estimate, intend, seek, continue, or believe or the negatives thereof or other variations thereon or comparable terminology. Due to the various risks and uncertainties, actual events or results in the actual performance of the Funds may differ materially from those reflected or contemplated in such forward looking statements. Notwithstanding anything to the contrary contained herein, any prospective investor (and each employee, representative, or other agent of such prospective investor), may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the Funds, and (any of its transactions, and all materials of any kind (including opinions or other tax analyses) that are provided to the prospective investor relating to such tax treatment and tax structure. Past performance is not indicative of future results.