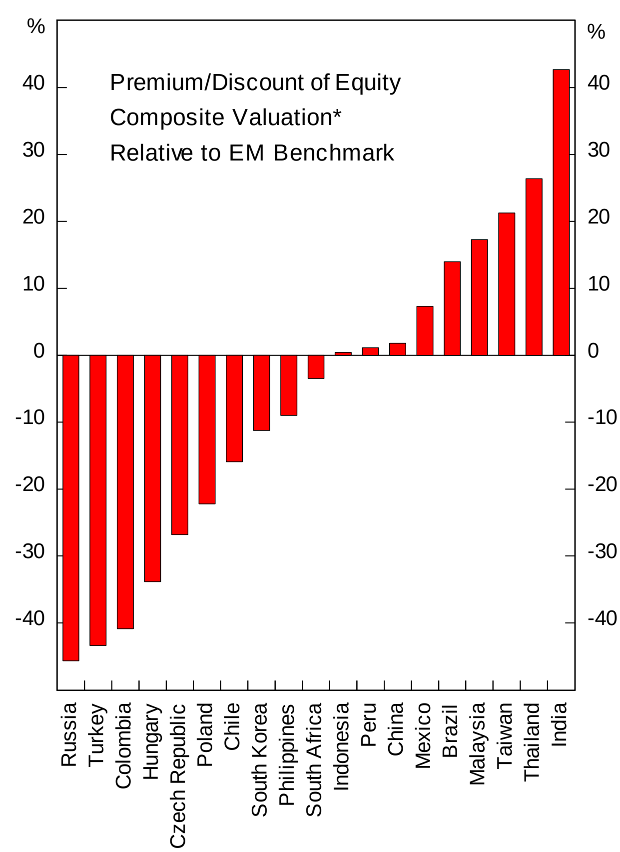
Brazil: Negative Outlook

- Valuation is dearer than the average EM countries, although the rout has knocked out excessive valuation for Brazilian stocks. Book value multiple has indeed declined from 2.3x to 1.8x currently, but weak profitability due to depressed commodity prices has translated into an expensive forward earnings multiple at 14x, which is the upper band of its historical level. This has often signaled an impending correction. The good news is that the BRL is among the cheapest in EM universe and may resume its upward trajectory as global risk appetite improves.

- After an aggressive fiscal and monetary actions, the country is now out of bullets to combat further economic weaknesses. The central bank has cut rates by 425 bps since the second half of 2019 and by 225 bps this year. As a result, real policy rate is hovering around zero despite inflation being below 2%, a historical low, and is at risk of earlier than expected tightening cycle should global improvement and economic reopening result in higher than expected inflationary pressure. Meanwhile, the government has announced some 11% of GDP of fiscal stimulus related to COVID-19 response, which will bring the public debt above 90% of GDP. This will limit further stimulus by the government, which prior to the crisis has been focusing on public sector reform.

- The country's healthcare situation is mortifying, which will impede the lockdown to be lifted and various policy (in)action by the government has made the healthcare crisis into a political crisis. President Bolsonaro's popularity has tumbled significantly amid his handling of the crisis, and political risk is increasing over the on-going investigation on his family and resignation of the popular justice minister following his sacking of the police chief. The country's asset prices will remain more volatile than other EM countries due to the self-feeding effects of the country's healthcare, economic, political conditions.

Chart 1



*Average of P/E, forward P/E and P/B value

Mexico: Positive Outlook

Although both Mexico and Brazil still experience upward trajectory in its COVID-19 infection cases, there few reasons for investors to be more positive on the former:

- First, from a valuation standpoint, Mexican equity is much cheaper than its Brazilian counterpart. P/B value of Mexican equity is now at two-decade low of 1.5x, compared to 1.8x for Brazilian equity, and forward earnings multiple is at a historical average of 12.8x relative to 14x for Brazilian equity. Moreover, although both country's currency is among deeply undervalued, according to our fair-value model, the MXN is well supported by the relatively higher nominal and real policy rate.

- Second, both Mexican government and central bank have much more room to ease further. The government has doled out only 2.1% of GDP fiscal stimulus as part of COVID-19 relieve response and its much lower public debt level and borrowing cost translates to better ability for the government to borrow if necessary to stimulate the economy. The central bank has cut its policy rate by 325 bps since the second half last year and 225 bps YTD, but low inflationary pressure and still relatively high real policy rate allow the central bank to ease further in the coming months.

- Lastly, regardless of the outcome of November's presidential election, intensifying pressure between the U.S. and China will likely see more companies with manufacturing base in China to shift their production to other low-cost countries, such as Vietnam, India and Mexico. In this case, Mexico benefits particularly from its proximity to the U.S. market and exemption of many taxes due to the USMCA trade agreement.

Chart 2

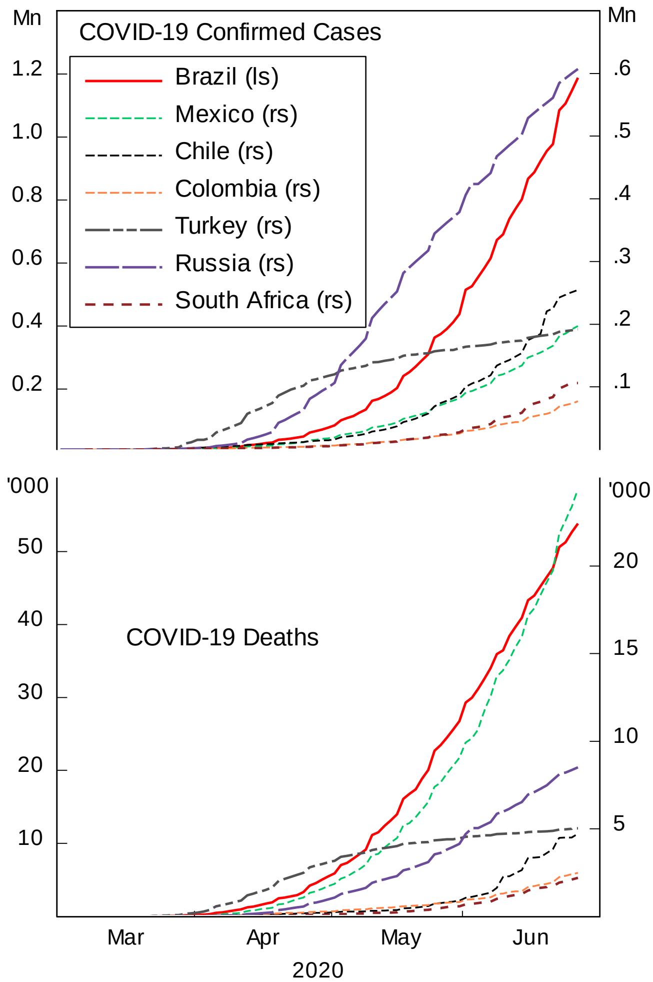


Chart 3

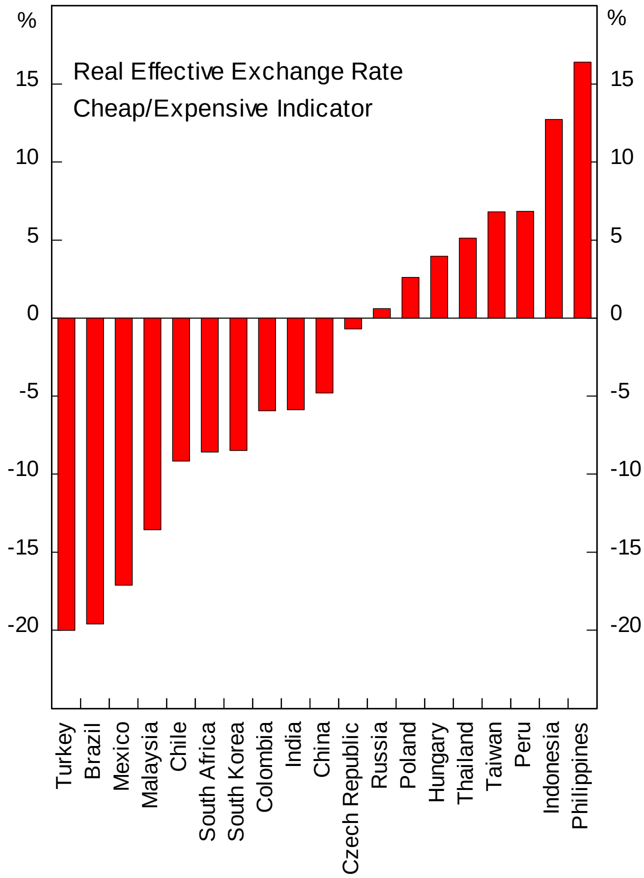
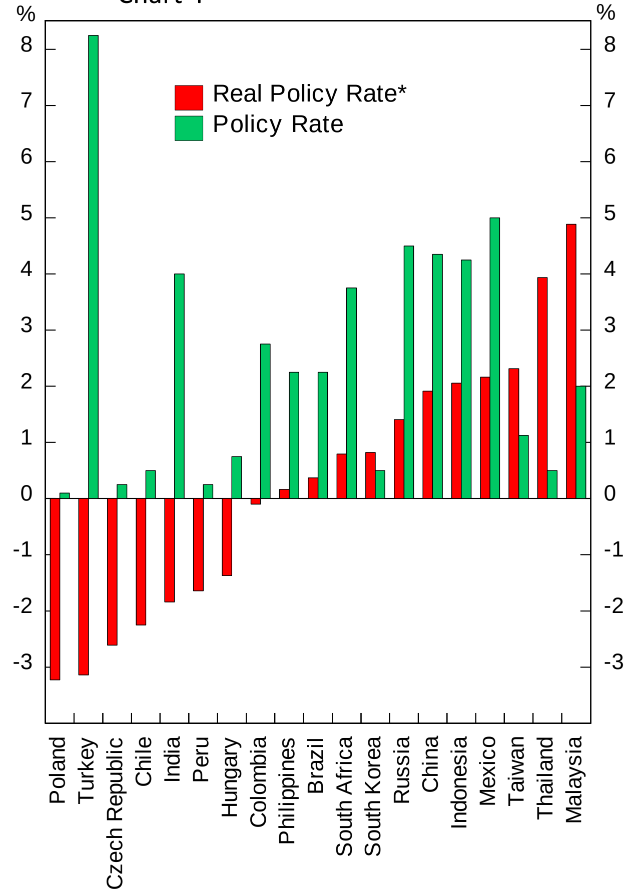


Chart 4



*Policy rate minus CPI inflation

Turkey: Positive Outlook

- Turkish equity, despite already rallying 30% from its low, is still one of the cheapest bourses across EM. It is trading below book value and forward and trailing earnings multiple are only 6.1x and 8.1x, respectively. Moreover, the risk of insolvency is low. Since the peak in 2018, Turkish firms have been deleveraging and seen its debt decline from 80% to 65% of GDP, which strengthened their balance sheet prior to entering the crisis. Bank's non-performing loans rate have also declined to 4.66% in the middle of June, with the non-performing loans amount itself declining from TRY 153 Bn to TRY 150 Bn.

- One more catalyst that may drive Turkish asset prices higher is that monetary policy has turned more defensive, highlighted by the central bank's decision last week to not cut the policy rate further. Investors have been previously concerned that too loose monetary policy will result in the lira weakening and prevent inflation to come down further. The shift in policy expectation is likely to boost the much-undervalued lira and result in a more positive investor sentiment toward Turkish assets. Further decline in inflation resulting from a stable or strengthening lira would, in turn, drive capital inflow back to the country after the exodus in the past few years.

- Turkey is one of the rare, more developing EM countries that succeeded in curbing the COVID-19 infection, allowing large part of the economy to reopen. The country also benefits from declining infection across Europe, where manufacturing productions have slowly resumed and are well integrated to Turkish manufacturing exports.

Chart 5

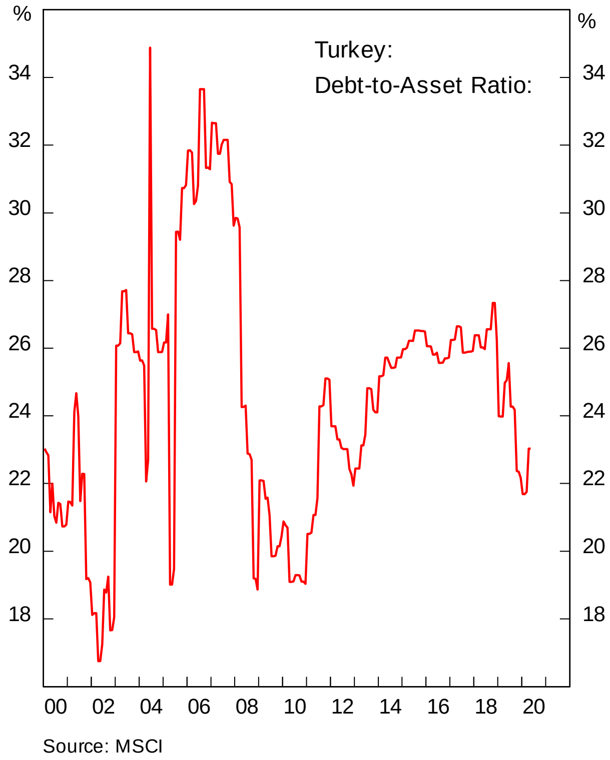
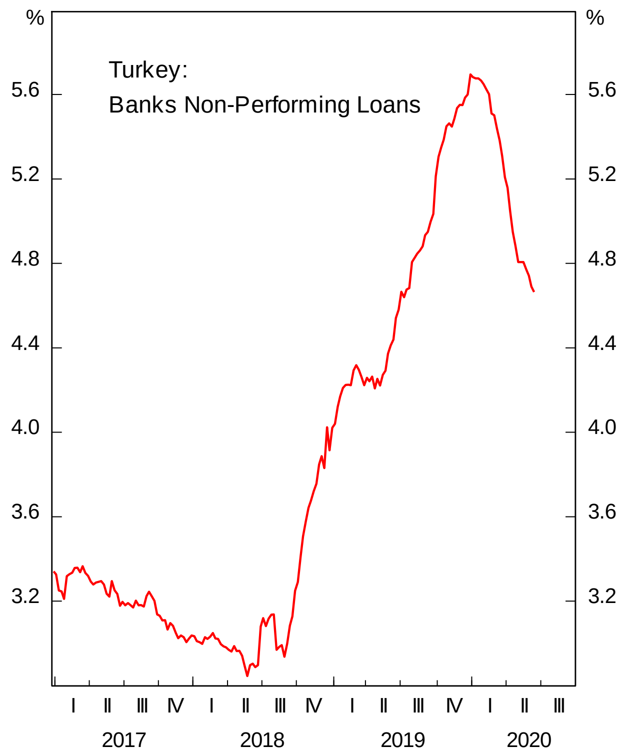


Chart 6



South Africa: Negative Outlook

- The country's release of planned fiscal budget last week put the question of debt sustainability back into investor's mind. The government budget projection for 2020/2021 expect fiscal balance to record 15% of GDP deficit and public debt to rise to 80% of GDP. The country is currently in talk with IMF over $4 billion loans arrangement. Not only the public finance is in a poor shape, the country's GDP is also expected to drop 5.8% this year, among the hardest hit in EM universe. All this combination will likely translate to a much higher country risk premium required by investors and a headwind for the ZAR to appreciate from current level.

- The pandemic has shed light on many failings of South African economy. After years of economic stagnation resulting from low savings rate, chronic twin deficit, high unemployment rate and institutional weaknesses, it remains difficult to see how the country could grow. South African government and household are ill-equipped to face the pandemic and prolonged lockdown, in which some 20% of household depends on government grants to survive.

- The country equity valuation is not cheap and deteriorating macro picture will likely see continued capital outflow from the country. Currently we think the risk/reward trade off for South African assets as unattractive.

Chart 7

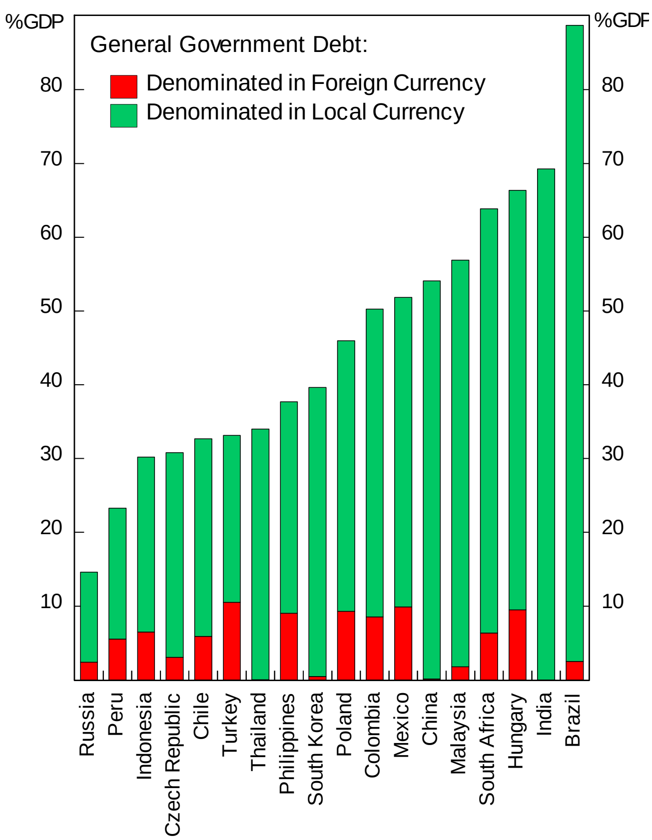


Chart 8

(real GDP, annual percent change)	2019	2020	2021
World Output	2.9	-3.0	5.8
Advanced Economies	1.7	-6.1	4.5
United States	2.3	-5.9	4.7
Euro Area	1.2	-7.5	4.7
Germany	0.6	-7.0	5.2
France	1.3	-7.2	4.5
Italy	0.3	-9.1	4.8
Spain	2.0	-8.0	4.3
Japan	0.7	-5.2	3.0
United Kingdom	1.4	-6.5	4.0
Canada	1.6	-6.2	4.2
Other Advanced Economies	1.7	-4.6	4.5
Emerging Markets and Developing Economies	3.7	-1.0	6.6
Emerging and Developing Asia	5.5	1.0	8.5
China	6.1	1.2	9.2
India	4.2	1.9	7.4
ASEAN-5	4.8	-0.6	7.8
Emerging and Developing Europe	2.1	-5.2	4.2
Russia	1.3	-5.5	3.5
Latin America and the Caribbean	0.1	-5.2	3.4
Brazil	1.1	-5.3	2.9
Mexico	-0.1	-6.6	3.0
Middle East and Central Asia	1.2	-2.8	4.0
Saudi Arabia	0.3	-2.3	2.9
Sub-Saharan Africa	3.1	-1.6	4.1
Nigeria	2.2	-3.4	2.4
South Africa	0.2	-5.8	4.0
Low-Income Developing Countries	5.1	0.4	5.6

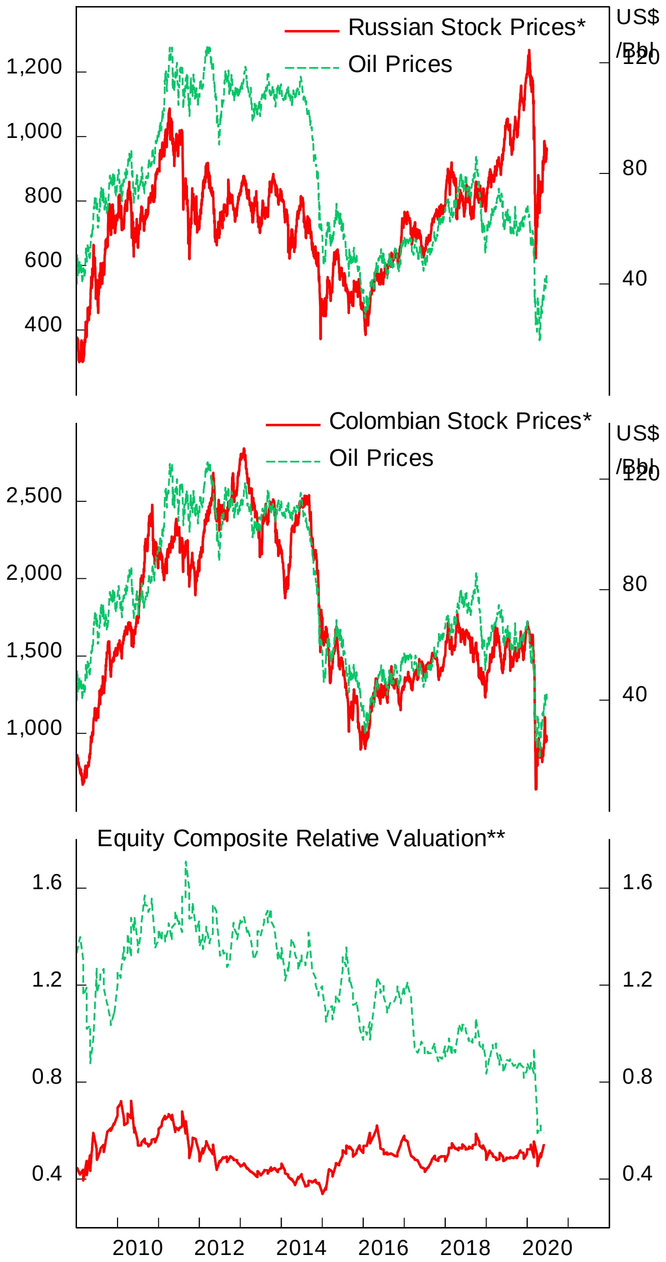
Source: IMF, *World Economic Outlook*, April 2020

Russia and Colombia: Neutral to Positive Outlook

- Valuation is cheap and both countries' equity market is driven by fluctuation in oil prices, which has seen its cyclical low in March. Oil price is likely to drift further upward as shale oil production in the U.S., source of the oil supply glut in the past decade, have declined significantly and OPEC+ seems to be having its member under control.

- Both countries' number of deaths from COVID-19 infection has seen a flattening of late, which will allow economic activity to resume in both countries.

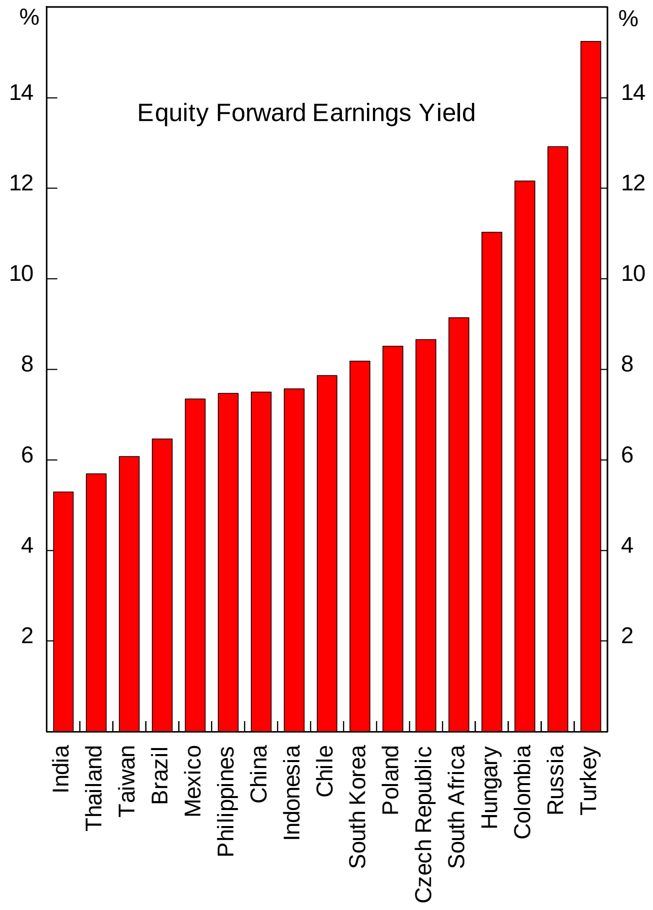
Chart 9



*In U.S. dollar terms; source: MSCI

**Average of relative P/E, forward P/E and P/B value

Chart 10



Copyright © 2020, Putamen Capital. All rights reserved.
The information, recommendations, analysis and research materials presented in this document are provided for information purposes only and should not be considered or used as an offer or solicitation to sell or buy financial securities or other financial instruments or products, nor to constitute any advice or recommendation with respect to such securities, financial instruments or products. The text, images and other materials contained or displayed on any Putamen Capital products, services, reports, emails or website are proprietary to Putamen Capital and should not be circulated without the expressed authorization of Putamen Capital. Any use of graphs, text or other material from this report by the recipient must acknowledge Putamen Capital as the source and requires advance authorization. Putamen Capital relies on a variety of data providers for economic and financial market information. The data used, or referred to, in this report are judged to be reliable, but Putamen Capital cannot be held responsible for the accuracy of data used herein.