

LatAm Equity Strategy

Downgrading the outperformers; Reducing exposure to Mexico and Chile

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Ahead of our LatAm Midsummer Conference in New York this week, we revisit our country allocation recommendations, as well as the outlook more generally for LatAm equities.

Our main change is to downgrade Mexico and Chile to Market Weight and Underweight, respectively. The valuation argument for these two regional performance leaders has weakened on the back of the 30% and 25% increases YTD in USD terms, respectively. We raise our YE17 MEXBOL target from 54k to 56k, but consider remaining upside to be inadequate to warrant an Overweight.

For Brazil, we maintain our Underweight rating and YE17 target for IBOV of 74k. We still see risk of Brazil underperforming the LatAm region in the short-term due to sluggish growth recovery, unfavorable fiscal trajectory, political uncertainty, downside risk to BRL, and middle-of-the-road valuation.

By reducing exposure to Mexico and Chile, we are able to accommodate exposure to Argentina, where we recently started coverage with an Overweight rating. We are also Overweight Colombia.

LatAm Equities: Country allocation summary

	Previous Rating	New Rating	
 Argentina	Overweight	Overweight	
 Brazil	Underweight	Underweight	
 Chile	Market Weight	Underweight	
 Colombia	Overweight	Overweight	
 Mexico	Overweight	Market Weight	
 Peru	Market Weight	Market Weight	

LatAm equities: regional country allocation summary

Downgrade Mexico to Market Weight. We reduce Mexico to Market Weight, mainly on valuation grounds. The 12% rally in the MEXBOL and 17% recovery in the MXN, year-to-date, have turned the risk/reward less appealing. We still estimate 9% upside to our revised index target of 56k for the MEXBOL (from 54k). Many positive elements of the investment case remain intact. However, in addition to trading at a large premium relative to LatAm, Mexico no longer trades at discounts to its own historical multiples, currently trading at 18.0x forward P/E and 2.6x P/B. We also believe the sharp recovery in the MXN has lifted the currency from extreme levels of undervaluation to a level where risks are more balanced.

In spite of our downgrade, we continue to prefer Mexico over Brazil for the short-term. In favor of Mexico, we point out that: (i) it is the only LatAm market that has been experiencing upward revisions to GDP growth, (ii) its monetary tightening cycle appears to have drawn to an end, (iii) recently published objectives from the USA lead us to believe that NAFTA negotiations will not be disruptive to trade, (iv) credit growth continues at a healthy pace and underpins a favorable domestic demand scenario, and (v) recent gubernatorial elections in the state of Mexico may shift political risk to the backseat, albeit temporarily.

Downgrade Chile to Underweight. We reduce Chile to Underweight on the basis that an election catalyst in 4Q17 has largely been brought forward by the market. We now see Chile trading unfavorably relative to the region and its own historical multiples, trading at 17.6x forward P/E and 1.9x P/B. Different from Mexico, nearly all of the price appreciation in the IPSA came through local market performance, thereby inflating multiples. We do not see the CLP as attractive on FX valuation metrics. Our Underweight stance is also warranted by: (i) weak GDP growth which CS estimates at only 1.4% this year, (ii) little room for additional monetary stimulus, in our view, and (iii) potential downside risk to copper prices, according to CS forecasts.








Still not raising Brazil: maintain Underweight. Although the Brazilian market has lagged LatAm and EM more broadly YTD, we still resist raising our weighting at this time, because: (i) economy recovery looks to be sluggish and gradual, (ii) stability in earnings estimates has been highly dependent on the Materials sector and lacked breadth, (iii) unfavorable fiscal trajectory will likely prevent country risk from falling significantly for the short-term, (iv) social security reform may be heavily diluted before becoming law, (v) risks to the BRL appear more skewed to downside, and (vi) equities are still not clearly inexpensive. We would require a better growth and / or policy outlook in order to turn more positive on Brazil at current valuations.

Argentina and Colombia: reiterate Overweight. By reducing Mexico and Chile, we are able to accommodate exposure to Argentina, where we recently started coverage with a constructive outlook, because: (i) the economy is exiting recession, (ii) inflation is on a decelerating path with monetary loosening on the horizon, (iii) we are positive on Banks, a key index component, and (iv) the lack of upgrade to EM this year should not derail rebounding fundamentals. Please see our [Connections Series report](#) from June 13, 2017, for a comprehensive review of the investment case for Argentina. We also keep a positive view on the Colombian market, as we see a clear valuation case with the market trading at 12.7x forward P/E and 1.2x P/B. COP does not screen as expensive. Inflation has been trending lower, permitting a monetary loosening cycle, which should support better private consumption growth in coming quarters. The government's 4G infrastructure program should also be accretive to growth, especially in 2018.

Basket #1: Highly ranked HOLT stocks in Colombia and Argentina

- We have deployed HOLT's scorecard to identify the highest ranked stocks from our two Overweight markets: Argentina and Colombia. The stocks below meet the following criteria (i) market cap higher than US\$500mn, (ii) daily trading liquidity higher than US\$0.5mn, and (iii) top third overall on HOLT's LatAm scorecard (combination of quality, momentum and valuation) relative to Latin American companies.











Colombian and Argentine Stocks that screen well on HOLT

Name	Ticker	Sector	Market Cap	Overall Percentile	Operational Quality	Momentum	Valuation	Description
Ternium SA	 TX.N	Materials	6,082	98	64	91	99	Ternium S.A. produces finished and semi-finished steel products and iron ore, which are sold directly to steel manufacturers, steel processors or end users.
Banco Macro SA	 BMA.BA	Financials	5,971	80	95	93	1	Banco Macro SA is an Argentina-based financial institution that offers traditional bank products and services to companies, including those operating in regional economies, as well as to individuals.
Transportadora de Gas del Sur SA	 TGS2.BA	Energy	1,180	78	60	90	53	Transportadora de Gas del Sur S.A. is engaged in the transportation of natural gas and production and commercialization of natural gas liquids. The Company operates through four segments: Natural Gas Transportation Services, Liquids Production and Commercialization, Other Services and Telecommunications.
Siderar SAIC	 SID.BA	Materials	2,716	78	23	76	92	Siderar SAIC is an Argentina-based company engaged in the steel industry. The Company's activities are divided into three segments: Coated steel, Uncoated steel and Others.
Banco Davivienda SA	 DVI_p.CN	Financials	1,205	73	37	85	56	Banco Davivienda SA is a Colombia-based banking institution. The Bank's products and services include savings and current accounts, consumer and commercial loans, credit and debit cards, mortgages, fixed-term deposits, portfolio management, foreign trade financing and a variety of insurance policies, as well as other banking operations to individuals and businesses.
Grupo de Inversiones Suramericana SA	 SIS.CN	Financials	8,076	71	65	65	58	Grupo de Inversiones Suramericana SA is a Colombia-based company primarily engaged in the life insurance sector. The Company's activities are divided into three business segments: Fund Management, Insurance and Services.
Grupo Nutresa SA	 NCH.CN	Consumer Staples	4,065	67	31	43	89	Grupo Nutresa SA is a Colombia-based company engaged in the food processing sector.








Basket #2: Top Long/Short Ideas, combining HOLT and CS analyst picks

- Below, we present a list of our top long and short ideas for LatAm by combining highly ranked stocks on HOLT's scorecard with preferred picks from our research team. These stocks meet the following criteria : (i) market cap > US\$1bn, (ii) daily trading liquidity > US\$0.5mn, (iii) rated OUTPERFORM for the long ideas and UNDERPERFORM for short ideas by our analysts, and (iv) best/worst percentiles on HOLT's screening.

Top Long Ideas

Name	Ticker	Rating	Sector	Market Cap	P/E 2017e	Overall Percentile	Operational Quality	Momentum	Valuation
Qualicorp SA	 QUAL3.SA	OUTPERFORM	Health Care	2,982	18.4x	100	70	99	93
Cia de Saneamento Basico do Estado de SP - SABESP	 SBSP3.SA	OUTPERFORM	Utilities	7,391	11.3x	100	89	89	77
Smiles SA	 SMLE3.SA	OUTPERFORM	Consumer Discretionary	2,522	13.8x	98	100	95	61
Kroton Educacional SA	 KROT3.SA	OUTPERFORM	Consumer Discretionary	7,727	11.1x	98	89	75	92
Alupar Investimento SA	 ALUP11.SA	OUTPERFORM	Utilities	1,693	8.8x	96	84	61	88
Coca-Cola Femsa SAB de CV	 KOFL.MX	OUTPERFORM	Consumer Staples	6,003	21.2x	93	68	84	68
Ser Educacional SA	 SEER3.SA	OUTPERFORM	Consumer Discretionary	1,033	12.8x	91	93	51	75
Corporacion Inmobiliaria Vesta SAB de CV	 VESTA.MX	OUTPERFORM	Real Estate	955	14.1x	90	63	90	64
Megacable Holdings SAB de CV	 MEGACPO.MX	OUTPERFORM	Consumer Discretionary	3,589	17.7x	89	66	62	82
BR Properties SA	 BRPR3.SA	OUTPERFORM	Real Estate	1,287	19.6x	82	32	83	80
















Top Short Ideas

Name	Ticker	Rating	Sector	Market Cap	P/E 2017e	Overall Percentile	Operational Quality	Momentum	Valuation
Marcopolo SA	 POMO4.SA	UNDERPERFORM	Industrials	874	22.2x	2	10	18	23
Tenaris SA	 TENR.MI	UNDERPERFORM	Energy	18,760	37.3x	13	20	73	13
SACI Falabella	 FAL.SN	UNDERPERFORM	Consumer Discretionary	22,419	24.4x	19	39	41	22
Natura Cosméticos SA	 NATU3.SA	UNDERPERFORM	Consumer Staples	3,380	21.6x	20	21	22	73
Multiplus SA	 MPLU3.SA	UNDERPERFORM	Consumer Discretionary	1,996	14.8x	31	62	4	60
AES Tiete Energia SA	 TIET11.SA	UNDERPERFORM	Utilities	1,747	9.4x	33	29	15	80
Organizacion Soriana SAB de CV	 SORIANAB.MX	UNDERPERFORM	Consumer Staples	4,468	17.5x	46	22	26	96









Basket #3: LatAm value creators – generating high excess returns

- With the Brazilian economy still struggling to gain momentum and the Mexican market no longer offering the same valuation case as earlier this year, we believe it makes sense to revisit quality names with good prospects for value creation for shareholders. In the two baskets below, we include (i) companies with ROEs in excess of cost of equity (Ke) estimated for 2017 and rated OUTPERFORM by CS, and, (ii) companies rated UNDERPERFORM by CS with ROEs which are not expected to meet Ke in 2017.

High expected ROEs in excess of Ke

Name	Ticker	Rating	Sector	Market Cap	P/E 2017e	EV/EBITDA 2017e	P/B 2017e	ROE 2017e
Smiles SA	 SMLE3.SA	OUTPERFORM	Consumer Discretionary	2,522	13.8x	11.3x	11.9x	86%
Lojas Renner SA	 LREN3.SA	OUTPERFORM	Consumer Discretionary	6,662	26.6x	15.4x	6.1x	23%
Ser Educacional SA	 SEER3.SA	OUTPERFORM	Consumer Discretionary	1,033	12.8x	9.3x	2.8x	22%
Genera SAB de CV	 GENTERA.MX	OUTPERFORM	Financials	2,518	11.3x	5.8x	2.4x	21%
Companhia de Saneamento Basico do Estado de SP – SABESP	 SBSP3.SA	OUTPERFORM	Utilities	7,391	11.3x	6.4x	2.3x	21%
Raia Drogasil SA	 RADL3.SA	OUTPERFORM	Consumer Staples	7,195	38.7x	18.8x	7.1x	18%
Qualicorp SA	 QUAL3.SA	OUTPERFORM	Health Care	2,982	18.4x	10.8x	4.3x	18%
Grupo Aeroportuario del Sureste SAB de CV	 ASURB.MX	OUTPERFORM	Industrials	6,475	27.6x	18.5x	4.9x	18%
Ultrapar Participacoes SA	 UGPA3.SA	OUTPERFORM	Energy	13,017	25.4x	10.8x	4.5x	18%
Bolsa Mexicana de Valores SAB de CV	 BOLSAA.MX	OUTPERFORM	Financials	1,020	17.2x	11.8x	3.0x	17%
Banco Bradesco SA	 BBDC4.SA	OUTPERFORM	Financials	58,035	9.3x	5.9x	1.6x	17%
Equatorial Energia SA	 EQTL3.SA	OUTPERFORM	Utilities	3,580	19.2x	10.5x	3.2x	17%
Banco Santander Brasil SA	 SANB11.SA	OUTPERFORM	Financials	30,867	9.7x	6.0x	1.6x	17%
Grupo Financiero Banorte SAB de CV	 GFNORTEO.MX	OUTPERFORM	Financials	18,361	13.1x	5.3x	2.0x	16%
Promotora y Operadora de Infraestructura SAB de CV	 PINFRA.MX	OUTPERFORM	Industrials	4,741	16.7x	11.7x	2.6x	16%












Low expected ROEs relative to Ke

Name	Ticker	Rating	Sector	Market Cap	P/E 2017e	EV/EBITDA 2017e	P/B 2017e	ROE 2017e
Marcopolo SA	 POMO4.SA	UNDERPERFORM	Industrials	874	22.2x	15.3x	1.5x	7%
Usinas Siderurgicas de Minas Gerais SA Usiminas	 USIM5.SA	NEUTRAL	Materials	3,250	10.4x	9.1x	0.4x	4%
Klabin SA	 KLBN11.SA	NEUTRAL	Materials	5,435	96.3x	10.3x	2.4x	3%
Cyrela Brazil Realty SA Empreendimentos e Participacoes	 CYRE3.SA	NEUTRAL	Consumer Discretionary	1,538	33.5x	15.0x	0.8x	2%
CESP Companhia Energetica de Sao Paulo	 CESP6.SA	NEUTRAL	Utilities	1,548	42.2x	11.8x	0.9x	2%
BRF SA	 BRFS3.SA	UNDERPERFORM	Consumer Staples	9,536	n.a.	12.9x	2.5x	-2%
Eletropaulo Metropolitana Eletricidade de Sao Paulo SA	 ELPL4.SA	UNDERPERFORM	Utilities	755	n.a.	8.6x	1.2x	-7%
Gafisa SA	 GFS3.SA	UNDERPERFORM	Consumer Discretionary	105	n.a.	n.a.	0.2x	-14%















Basket Theme #4: Brazilian Activity to Remain Sluggish

- May's economic activity indicator (IBC-Br) undershot market expectations and consensus GDP estimates for this year continue to be revised lower. These are reminders that the Brazilian economy's recovery is likely to be slow and gradual. In the first basket below, we picked stocks that are likely to have more resilient results, even against a challenging growth backdrop. Alternatively, the second basket has companies that are more dependent on a potential GDP rebound and thus could face more weakness in results from the anemic recovery.

Less dependent on macroeconomic activity stocks

Name	Ticker	Rating	Sector	Market Cap	P/E 2017e	EV/EBITDA 2017e	P/B 2017e
Smiles SA	 SMLE3.SA	OUTPERFORM	Consumer Discretionary	2,522	13.9x	11.5x	12.1x
Raia Drogasil SA	 RADL3.SA	OUTPERFORM	Consumer Staples	7,195	39.2x	19.0x	7.2x
Ambev SA	 ABEV3.SA	NEUTRAL	Consumer Staples	95,864	22.5x	12.8x	6.4x
Banco Bradesco SA	 BBDC4.SA	OUTPERFORM	Financials	58,035	9.4x	5.9x	1.6x
Banco Santander Brasil SA	 SANB11.SA	OUTPERFORM	Financials	30,867	9.6x	5.9x	1.6x
Qualicorp SA	 QUAL3.SA	OUTPERFORM	Health Care	2,982	18.4x	12.0x	4.3x
Fleury SA	 FLRY3.SA	NEUTRAL	Health Care	2,965	28.4x	15.6x	5.8x
Iguatemi Empresa de Shopping Centers SA	 IGTA3.SA	OUTPERFORM	Real Estate	2,060	35.8x	15.9x	2.3x
Telefonica Brasil SA	 VIVT4.SA	OUTPERFORM	Telecommunication Services	23,595	15.8x	5.6x	1.2x
Equatorial Energia SA	 EQTL3.SA	OUTPERFORM	Utilities	3,580	19.1x	10.5x	3.2x
Cia de Saneamento Basico do Estado de Sao Paulo - SABESP	 SBSP3.SA	OUTPERFORM	Utilities	7,391	11.1x	6.3x	2.3x

More dependent on macroeconomic activity stocks

Name	Ticker	Rating	Sector	Market Cap	P/E 2017e	EV/EBITDA 2017e	P/B 2017e
Even Construtora e Incorporadora SA	 EVEN3.SA	NEUTRAL	Consumer Discretionary	324	n.a.	23.6x	0.5x
Cia Hering	 HGTX3.SA	NEUTRAL	Consumer Discretionary	1,059	14.1x	13.7x	8.1x
Via Varejo SA	 VVAR11.SA	NEUTRAL	Consumer Discretionary	2,116	48.0x	4.5x	1.5x
Odontoprev SA	 ODPV3.SA	NEUTRAL	Health Care	2,166	30.4x	20.7x	9.7x
Randon SA Implementos e Participacoes	 RAPT4.SA	NEUTRAL	Industrials	525	14.6x	8.7x	1.4x
Totvs SA	 TOTS3.SA	NEUTRAL	Information Technology	1,593	23.6x	14.8x	3.6x
Companhia Siderurgica Nacional	 CSNA3.SA	UNDERPERFORM	Materials	3,292	n.a.	n.a.	n.a.
Usinas Siderurgicas de Minas Gerais SA Usiminas	 USIM5.SA	NEUTRAL	Materials	3,250	10.5x	9.1x	0.4x
Aliansce Shopping Centers SA	 ALSC3.SA	NEUTRAL	Real Estate	1,054	23.9x	13.4x	1.3x
Sonae Sierra Brasil SA	 SSBR3.SA	NEUTRAL	Real Estate	481	16.6x	8.1x	0.6x
Companhia Paranaense de Energia	 CPL6.SA	NEUTRAL	Utilities	2,031	7.3x	4.0x	0.5x
Eletropaulo Metropolitana Eletricidade de Sao Paulo SA	 ELPL4.SA	UNDERPERFORM	Utilities	755	-17.5x	8.7x	1.2x
EDP Energias do Brasil SA	 ENBR3.SA	NEUTRAL	Utilities	2,812	12.5x	5.3x	1.1x
Light SA	 LIGT3.SA	NEUTRAL	Utilities	1,462	12.1x	6.2x	2.1x

Basket #5: More constructive on LatAm currencies

- Our global FX team recently become more constructive on LatAm currencies. They now forecast most currencies be stable or only post only slight depreciation against the USD until year-end. Our basket below includes companies that we believe are positioned to benefit from this tailwind, either by direct positive impact on USD-denominated costs and debt, or indirect impact, such as the friendlier environment for consumption with contained inflation, increasing purchasing power.

Stronger local currencies winners

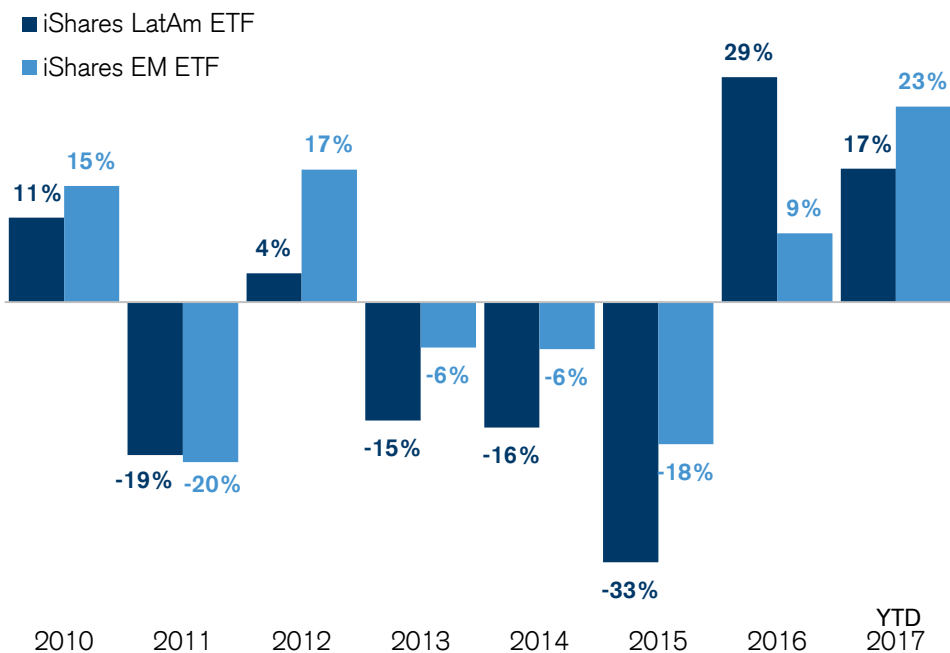
Name	Ticker	Rating	Sector	Market Cap	P/E 2017e	EV/EBITDA 2017e	P/B 2017e	YTD % Chg
Grupo Sanborns SAB de CV	 GSNBRB1.MX	OUTPERFORM	Consumer Discretionary	2,820	12.4x	6.2x	1.6x	1%
El Puerto de Liverpool SAB de CV	 LIVEPOLC1.MX	NEUTRAL	Consumer Discretionary	11,437	20.7x	11.4x	2.4x	7%
Lojas Renner SA	 LREN3.SA	OUTPERFORM	Consumer Discretionary	6,662	26.6x	15.4x	6.1x	41%
Megacable Holdings SAB de CV	 MEGACPO.MX	OUTPERFORM	Consumer Discretionary	3,589	17.7x	9.4x	2.8x	7%
Grupo Televisa SAB	 TV.N	NEUTRAL	Consumer Discretionary	15,507	46.4x	10.1x	3.2x	28%
Hypermarcas SA	 HYPE3.SA	OUTPERFORM	Health Care	5,475	17.5x	15.9x	1.9x	12%
Alfa SAB de CV	 ALFAA.MX	OUTPERFORM	Industrials	7,255	10.5x	4.9x	1.6x	-2%
Elementia SAB de CV	 ELEMENT.MX	OUTPERFORM	Industrials	1,573	21.4x	10.3x	1.3x	16%
Gol Linhas Aereas Inteligentes SA	 GOLL4.SA	NEUTRAL	Industrials	555	-8.7x	13.1x	-0.7x	86%
Latam Airlines Group SA	 LTM.N	NEUTRAL	Industrials	7,280	38.5x	11.0x	1.7x	45%
Cemex SAB de CV	 CX.N	OUTPERFORM	Materials	14,101	27.0x	9.5x	1.5x	24%
Telefonica Brasil SA	 VIVT4.SA	OUTPERFORM	Telecommunication Services	23,595	16.0x	5.6x	1.2x	11%
Cia de Saneamento Basico do Estado de SP - SABESP	 SBSP3.SA	OUTPERFORM	Utilities	7,391	11.3x	6.4x	2.3x	23%

Performance: LatAm has lagged the emerging markets rally

- Mexico rebound led the region.** So far, in 2017, LatAm equities have benefitted from an overall supportive environment for global equities. The region's benchmark ETF (iShares) has had a healthy increase of 17% YTD in USD terms. In spite of this strong performance, LatAm regional equities still lagged the overall EM asset class, which increased 23%, powered by South Korea, China and India. With this performance gap, LatAm resumes its customary place as a laggard in the asset class. Besides 2016, LatAm equities have trailed EM's performance in each year since 2009. 2017 appears to be on track to do the same.
- Heterogeneous country performance.** LatAm's overall underperformance masks heterogeneous performance at the country level. The region has been led by the sharp recovery of the Mexican index, which has climbed 30% in USD terms from post US election lows, and, a strong rebound in Chile. On the other hand, performance in Colombia (lower oil price) and Peru (weaker GDP growth) has held back the region. Currency swings have traditionally played a major role in determining equity returns in LatAm. This was clearly the case for Mexico in 1H17, as MXN appreciation explained more than half of the of absolute gain for foreign investors. However, currency has had a muted effect in other major LatAm countries in 1H17, as the COP was close to flat and the BRL, CLP and PEN only appreciated slightly.

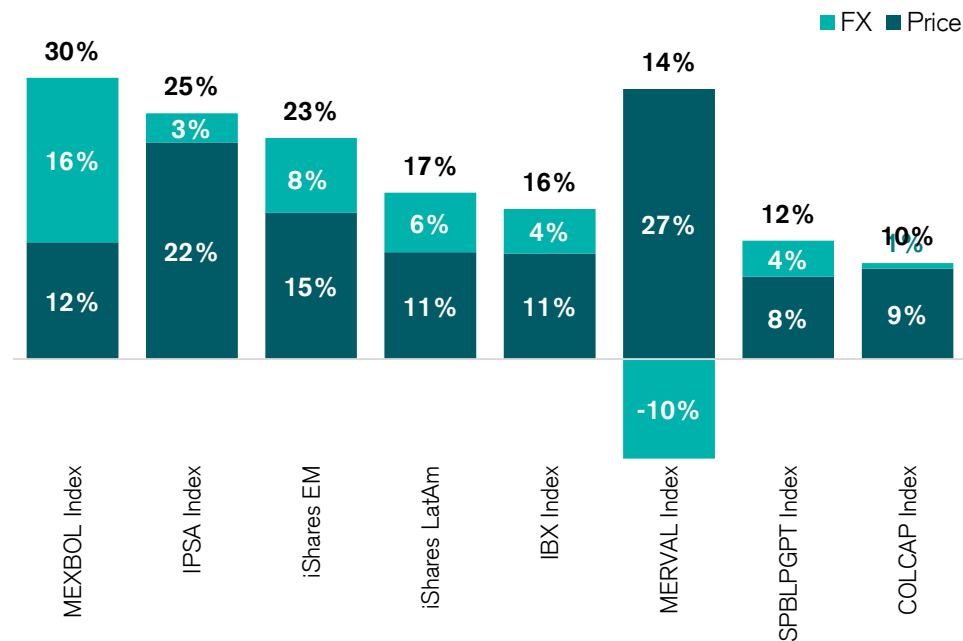
LatAm vs. EM ETF performance

in %, USD terms



YTD Performance breakdown

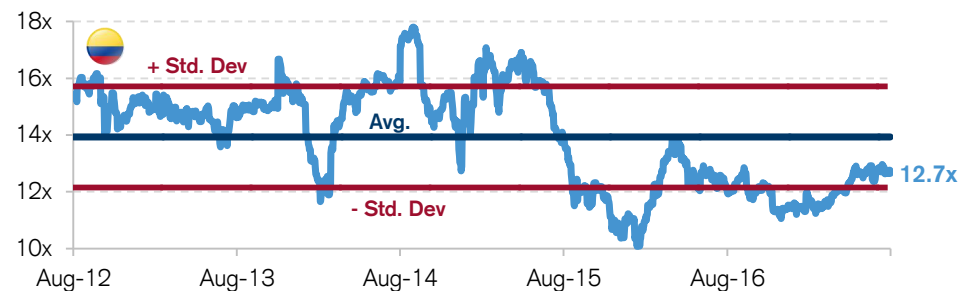
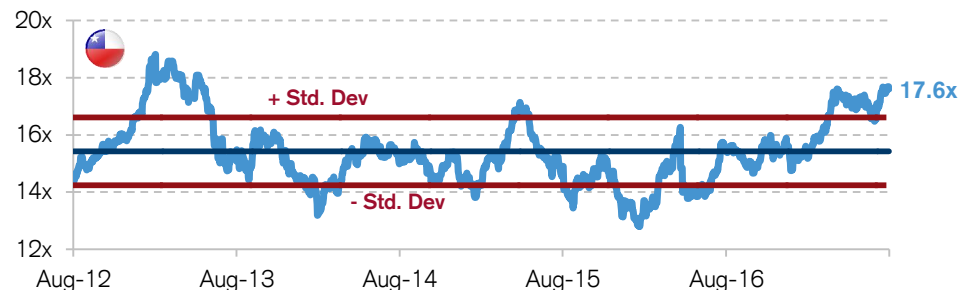
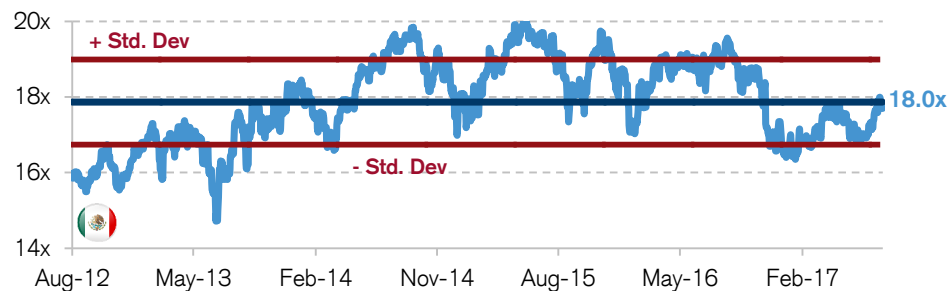
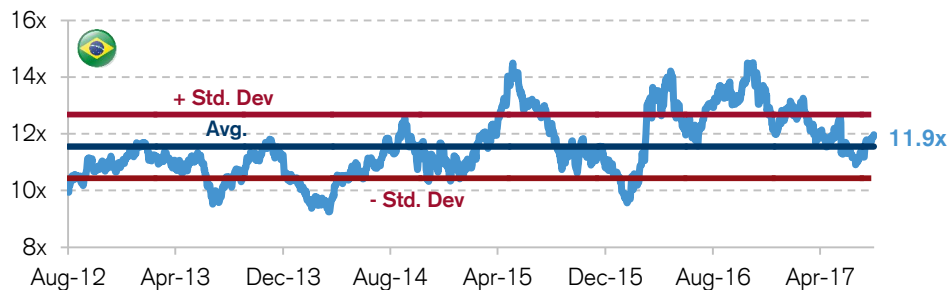
in %



Valuation: Chile screens as least attractive, while Colombia as most attractive

- Chile: Multiples have become rich.** In wake of disparate country performance YTD, we now view valuation as least attractive in the region in Chile, where we are downgrading to Underweight, and most attractive in Colombia, where we maintain our Overweight. Nearly all of the rally in Chilean equities this year came from local price appreciation (rather than FX), leading multiples to expand. We estimate the Chilean market is trading at 17.6x 12-month forward consensus earnings, which is a sizeable premium to Chile's own historical average multiple of 15.4x. It places Chile among the most expensive markets in EM. Investors appear to have priced already the benefits of higher copper prices this year and potential for a favorable election outcome in 4Q17. On the other hand, Colombia is most compelling on valuation, trading at 12.7x forward earnings, under the cloud of lower oil prices. The Colombian market has historically warranted a higher multiple of 14x.
- Brazil and Mexico: valuations are middle of the road.** For Brazil and Mexico, we view valuations as "middle of the road" -- not especially expensive nor inexpensive. In the wake of the sharp May correction due to Lava Jato newsflow, the Brazilian market now trades at 11.9x forward P/E. This is consistent with IBOV's historical valuation levels, but it affords no cushion for heightened political uncertainty, potential FX depreciation, concerning fiscal trends, etc. In Mexico, the strong rally YTD has weakened the appeal of the MEXBOL on valuation terms and warrants a downgrade to Market Weight, in our view. At current forward P/E of 18.0x, Mexico is no longer at a discount to its own historical valuation. Even though the Mexico market "always" trades expensive (i.e., at a premium to the LatAm region), it now appears to have priced-in a better growth outlook and diminished external policy risks from the USA. A case for additional multiple expansion seems difficult to justify in our view.

LatAm 1 year forward P/E ratio (in x)

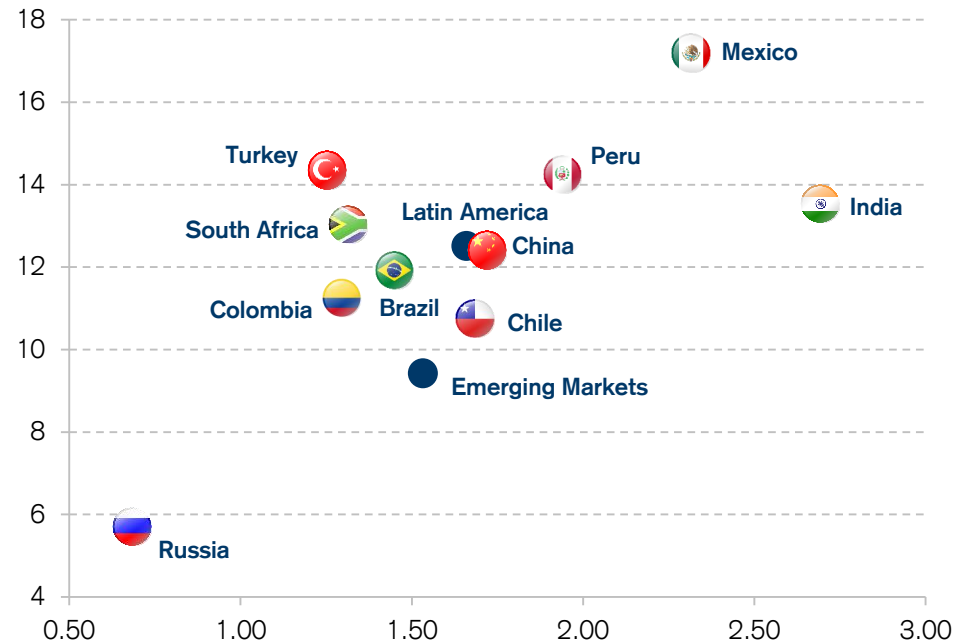


Valuation: P/B ratios point to similar conclusions as P/E

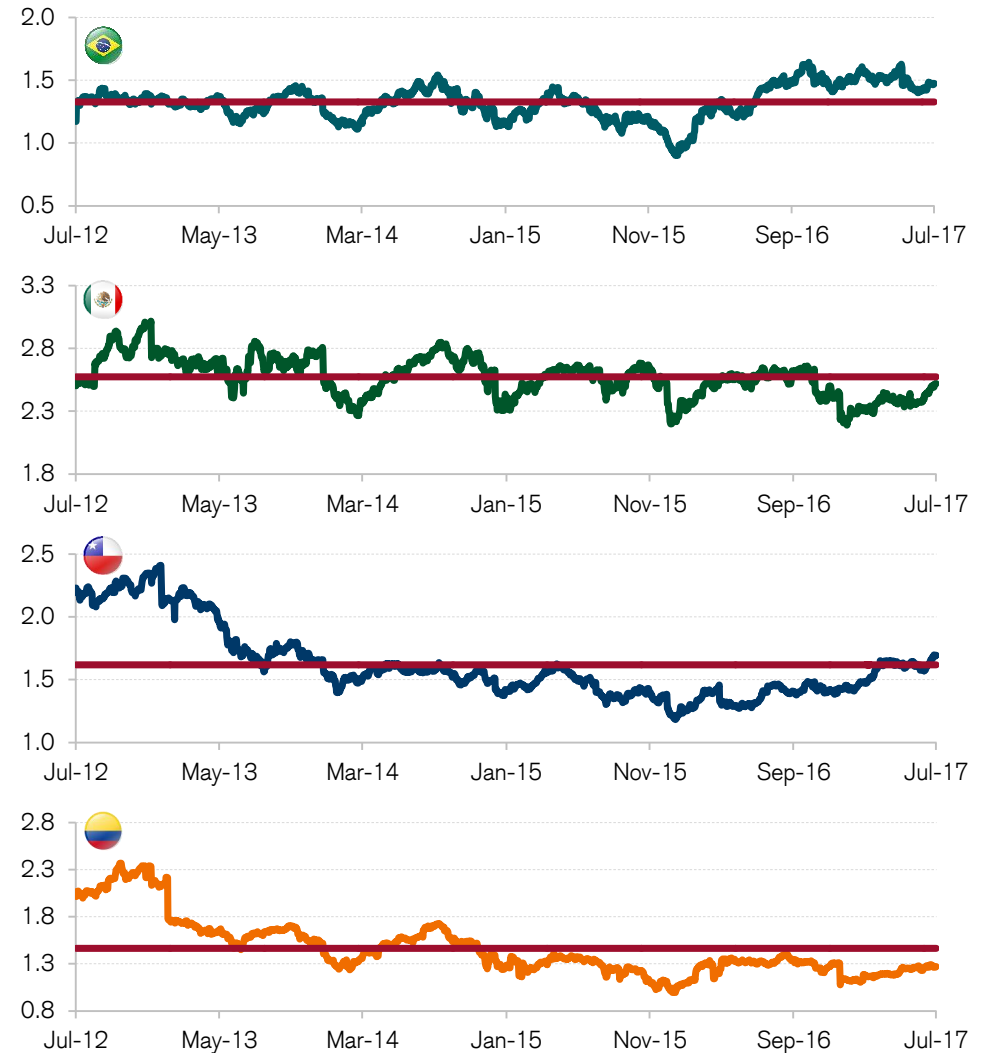
- Price/Book ratios:** Brazil and Chile at premiums to historical. The conclusions drawn from P/B ratios are consistent with the conclusions from P/E ratios, in our view. Brazil trades at a slight premium to its historical average on P/B. A wider premium looks difficult to justify based on current capital costs and levels of return on equity. After the YTD rally, Chilean equities have moved to a premium to historical average on P/B, compared to the discount where they started the year, no longer looking attractive. Mexico's discount to historical P/B has closed with its rally YTD, although the market still does not look pricey based on the high levels of ROE generated. Finally, Colombia is the least expensive LatAm market on P/B and the only market at a discount to its historical average.

LatAm P/B ratio vs. 2017e ROE

P/B in x, ROE in %



LatAm historical P/B (in x)

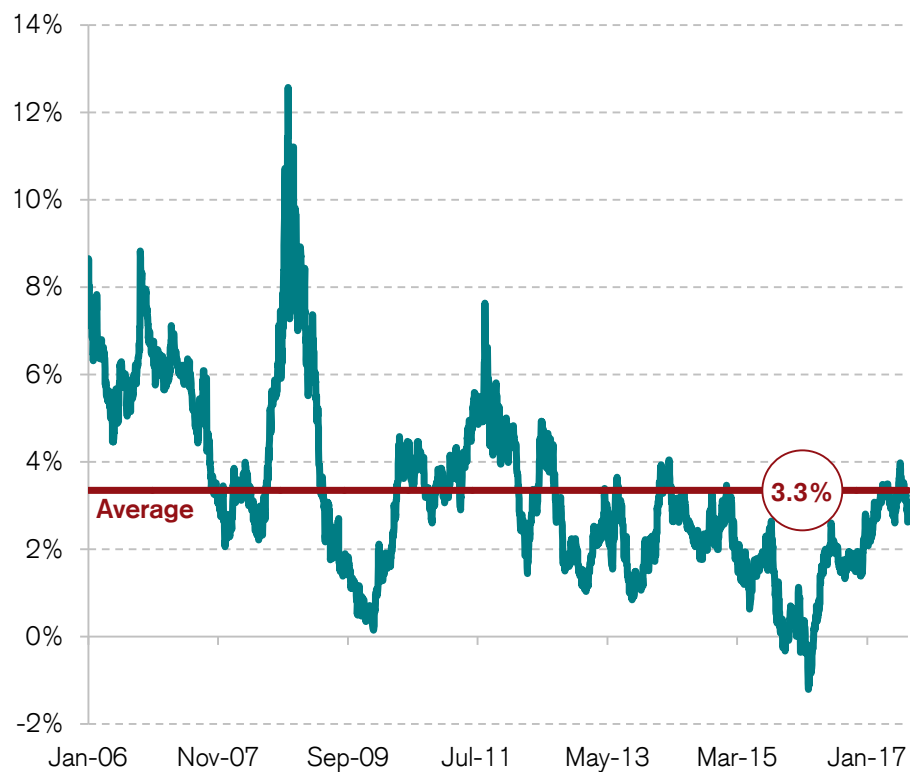


Valuation: On implied equity risk premium, Mexico already looking stretched

- ERP not sending a buy signal for Brazil and Mexico.** In addition to P/E and P/B ratios, another important valuation metric to monitor is the implied equity risk premium, i.e., equities relative attractiveness vis-à-vis fixed income. For Brazil, equity risk premiums have recovered from February 2016 lows, when they went into negative territory due to the spike in bond yields. While attractiveness of equities has improved as local bond yields have tightened, in Brazil equities still do not actually look compelling relative to historical averages. In Mexico, equities are screening as unattractive versus local bonds, as ERP looks thin compared to historical levels. The MXN and equities have recovered, but local yields have still not tightened to pre-election (USA) levels, enhancing the attractiveness of fixed income vis-à-vis the MEXBOL.

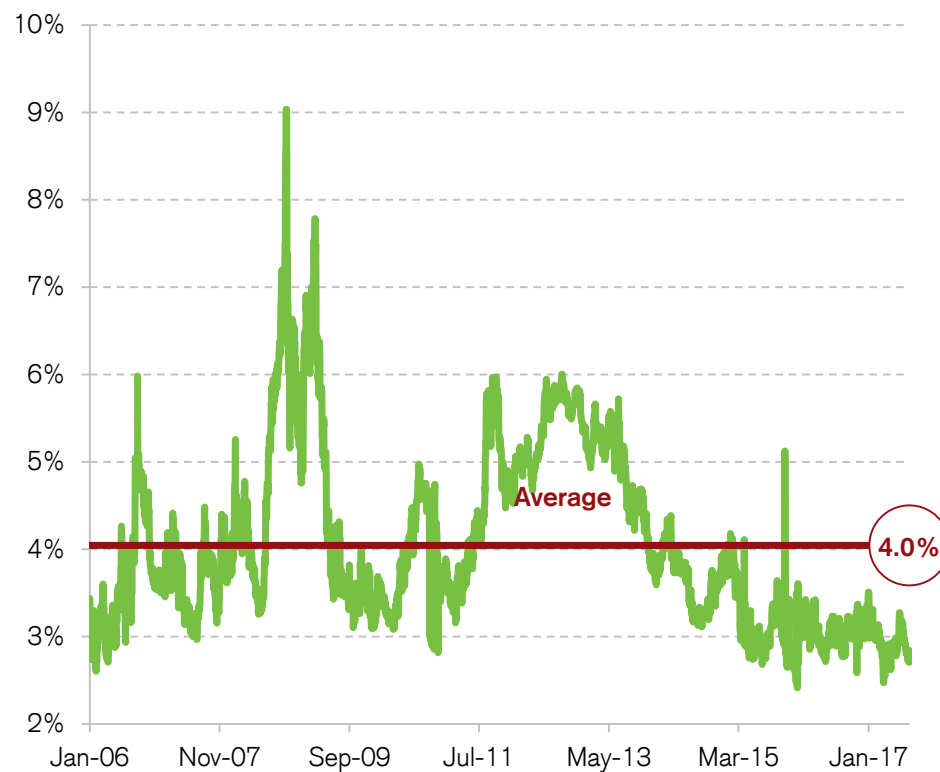
Brazil Market Implied ERP

Earnings yield – Real Risk Free, %



Mexico Market Implied ERP

Earnings yield – Real Risk Free, %

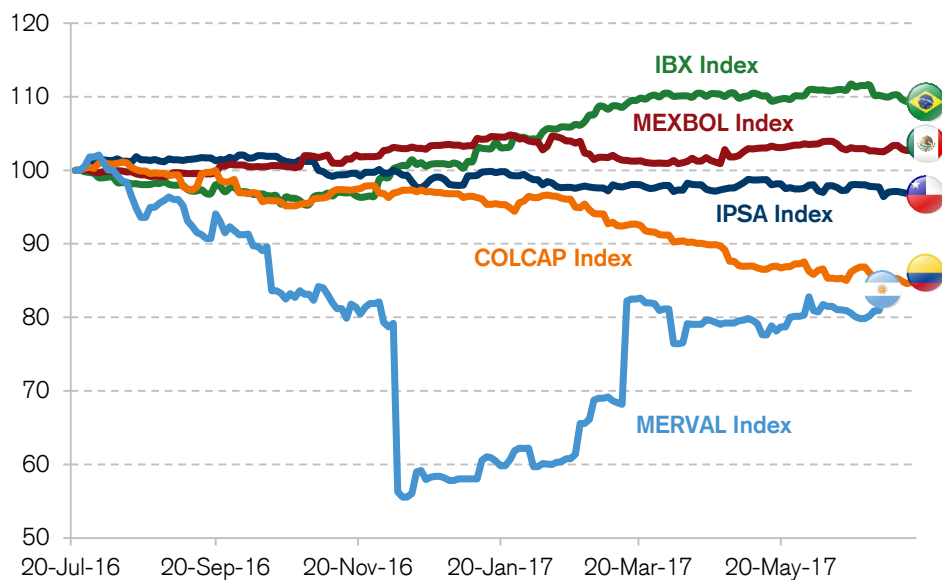


Earnings: uncharacteristic stability in estimates in recent months

- Estimates for 2017 are bucking the trend.** One of the drivers of healthy equity performance in LatAm this year has been a more favorable dynamic in corporate earnings. Over the past four months, consensus EPS estimates for the main LatAm markets have basically held stable, excluding Colombia. This stability contrasts with the “normal” dynamic of analysts expressing excessive optimism at the beginning of the year and then revising estimates down persistently throughout the year. The last year that consensus earnings were revised up in Brazil from beginning to end of the year was 2010 (recovery from the financial crisis). Estimates have “never” been revised up in Mexico from beginning to end of year (i.e., not in the duration of our database). However, we are more than halfway through 2017 and consensus estimates for Argentina, Brazil and Mexico are actually higher than where they started the year and only slightly lower in Chile. At a minimum, it seems that downward revisions should be smaller this year than the typical downward revision cycle for the region.
- Looking ahead to 2018 earnings growth.** As investor attention shifts to 2018, earnings growth expectations are concentrated at 12-14% for the main markets in local currency terms, a level that we see as realistic based on the current outlook. The only market with considerably higher expectations is Colombia, where consensus is looking for 27% growth, pinned on hopes for a recovery from weak earnings in 2017. In spite of resilience in other markets, Colombian EPS for 2017 has continued to be revised lower, dragged by lower oil prices and a weaker consumption environment. Our macro team recently reduced their GDP growth forecast for Colombia from 2.4% to 2.1%, owing to VAT increase and weak consumer confidence. Acceleration to higher growth levels looks like a pre-condition to meeting the market’s EPS estimates for next year.

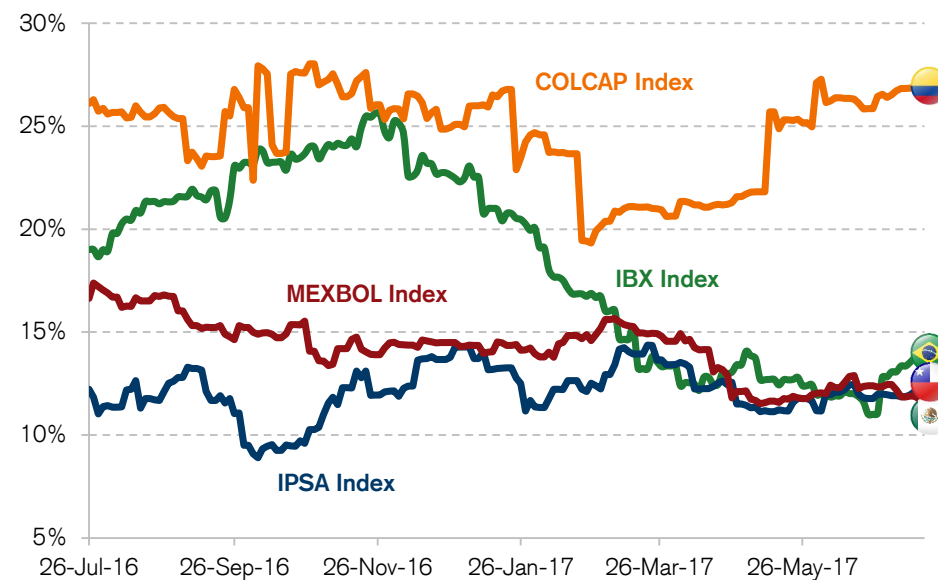
LatAm 2017 expected EPS

Based as 100, last 12 months



LatAm expected EPS growth 2018

in %

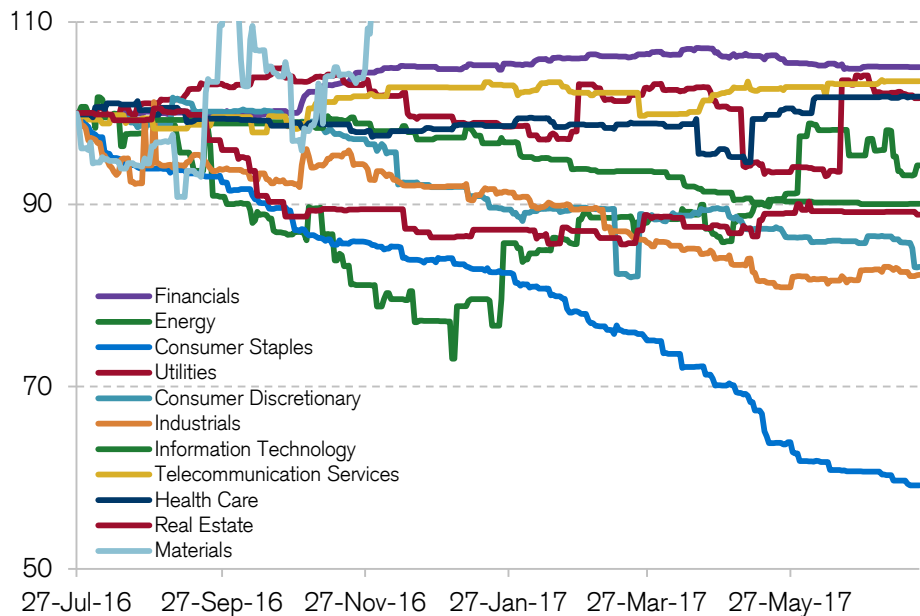


Earnings: stability less impressive when viewed at sector level

- Materials sector has anchored EPS.** We believe the stability in regional earnings estimates this year is less encouraging when we drilldown to the sector level. In general, stability in earnings has not been supported by high breadth as the number of companies with upgrades has not exceeded downgrades. In Brazil, overall stability in earnings has been anchored by sharp upward revisions in the Materials sector. These upgrades in Materials were due to: (i) strong rally in pulp prices YTD, (ii) declines in iron ore prices which have not been as severe as feared, and (iii) BRL stability which has been better than the consensus expectation of depreciation, reducing financial expenses for USD borrowers. Materials is the only sector to undergo a meaningful upgrade cycle. Estimates for Financials, the most important sector in the index, have held steady. On the other hand, the Consumer Staples sector (including Food) has been undergoing a sizeable and persistent downward revisions cycle.
- Mexico: some similarities to Brazil.** Like in Brazil, Materials is also the sector that has led the upgrades in Mexico. In Mexico, we attribute these upgrades in Materials to (i) strength in copper prices, (ii) lower financing costs and better FCF at Cemex, and (iii) the pronounced rebound in MXN, which reduced financial expenses for USD borrowers. As in Brazil, estimates for Financials have held steady in Mexico. Finally, like in Brazil, the Consumer sectors have not participated in the upward revision cycle. One highlight in Mexico has been the Telecom sector, which had been a major headwind in recent years, but has no longer dragged on earnings revisions this year, driven by better results at AMX.

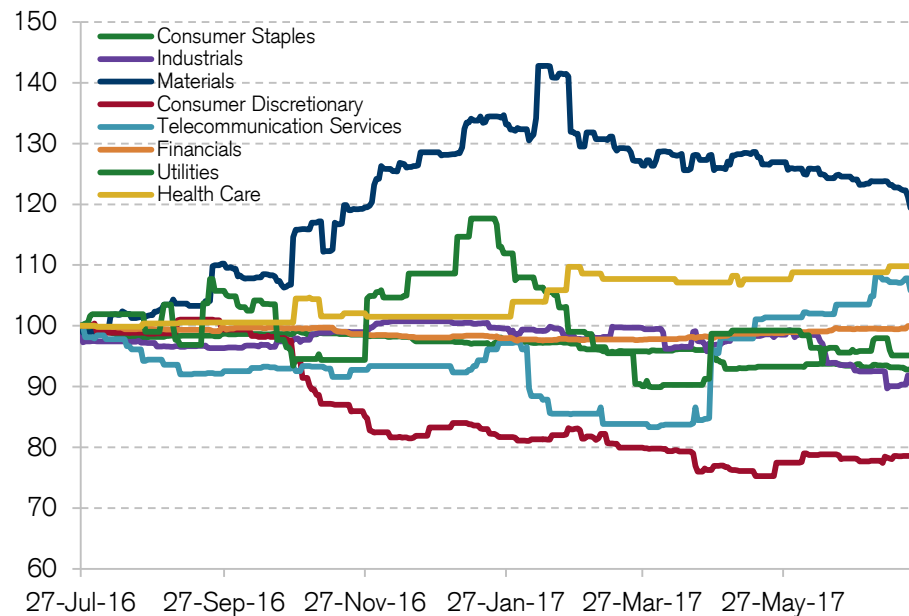
Brazil Sectorial EPS Revisions*

based as 100, last 12 months



Mexico Sectorial EPS Revisions

based as 100, last 12 months

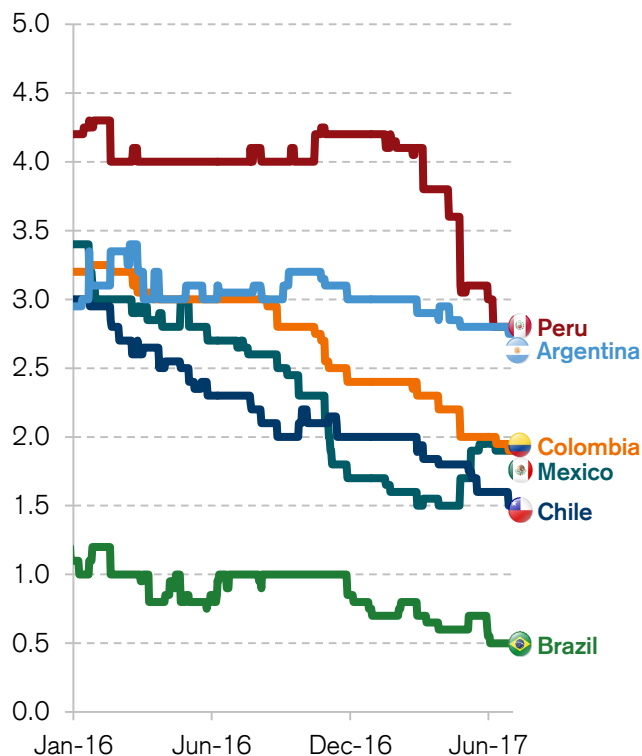


Economic growth: Better earnings not attributable to GDP growth

- Only Mexico seeing upward GDP revisions.** Curiously, the more stable environment for corporate earnings has not been driven by stability in GDP estimates, which have grinded lower this year. Even the higher growth markets (Peru and Argentina) are now expected to grow less than 3% in real terms in 2017. Revisions have been especially abrupt in Peru, aggravated by a slowdown in infrastructure spending. Eagerly awaited signs of recovery in Brazil have been elusive. Brazil should once again trail the region in growth, as our team expects GDP to be close to flat in 2017. Political uncertainty and unfavorable fiscal trajectory are factors preventing a stronger rebound in GDP growth. The only LatAm market with increasing GDP estimates is Mexico, where consensus estimates reached a low point of 1.5%, but growth now looks likely to exceed 2.0%. Credit growth, strong remittances and rebounding confidence are fueling growth. Excluding Mexico, we believe better top line outlook is still not contributing to the better earnings environment.

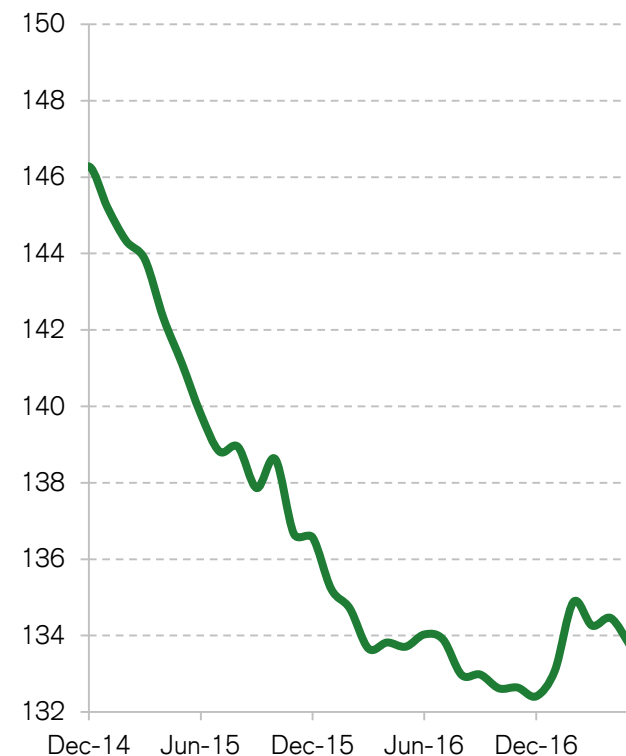
LatAm GDP Revisions

2017 Consensus estimates, %



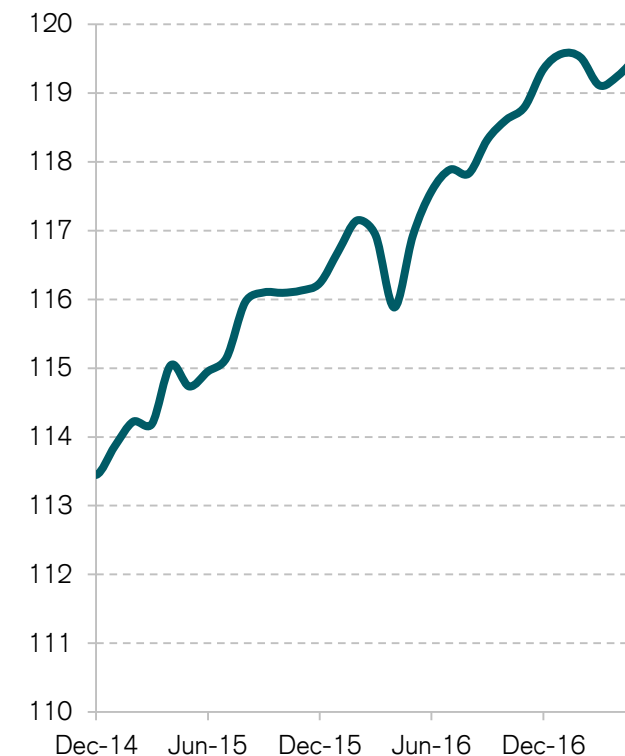
Brazil Economic Activity Index

IBC-Br Central Bank Index



Mexico Economic Activity Index

IGAE Central Bank Index

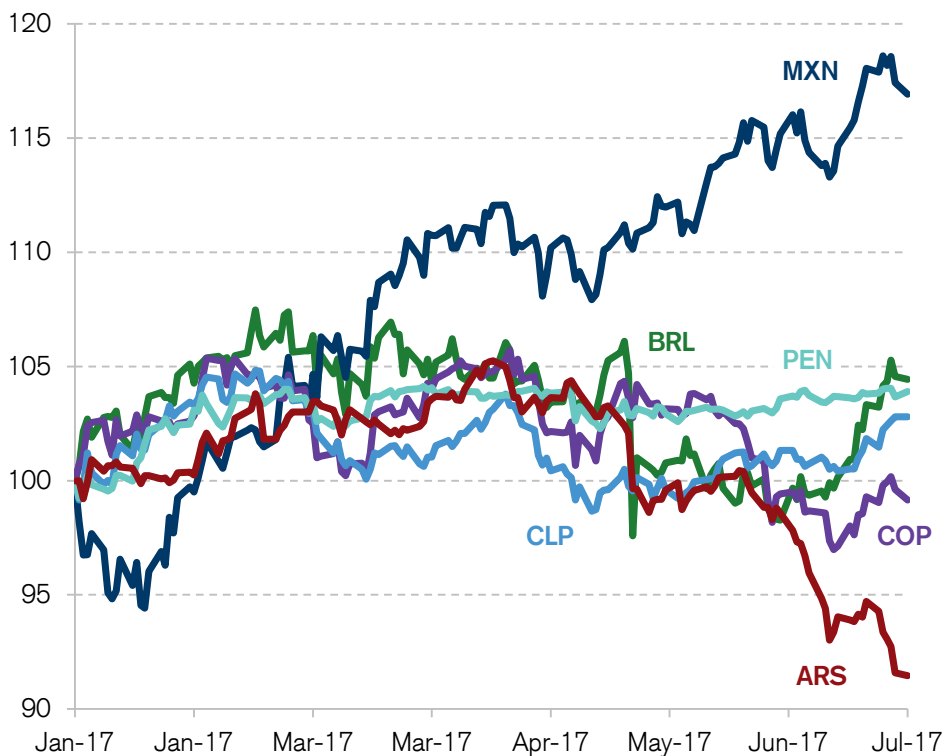


FX: more constructive on LatAm currencies

■ **Stronger local FX contributing to EPS resilience.** Even though GDP growth has not surprised positively, stronger than expected local FX has contributed to better corporate earnings this year. More appreciated local FX tends to have a positive impact on earnings over the short-term due to lower financial expenses at companies with USD borrowings. For the most part, FX depreciation that analysts had expected has failed to materialize, while the MXN actually has appreciated significantly. The only currency to suffer nominal depreciation YTD has been the ARS, which is less surprising considering that Argentina is a higher inflation country. Our global FX strategy team recently turned more constructive on LatAm currencies. On their revised forecasts, the main LatAm currencies are expected to finish this year close to current levels (i.e., less than 5% depreciation), which is consistent with broader USD weakness. Currencies have held their value in spite of less favorable carry trades, with Brazil, Colombia, Peru and Chile, all reducing policy rates this year. A continuation of strength in local currencies would bode well for the resilience of earnings in 2H17.

LatAm Currencies Performance YTD

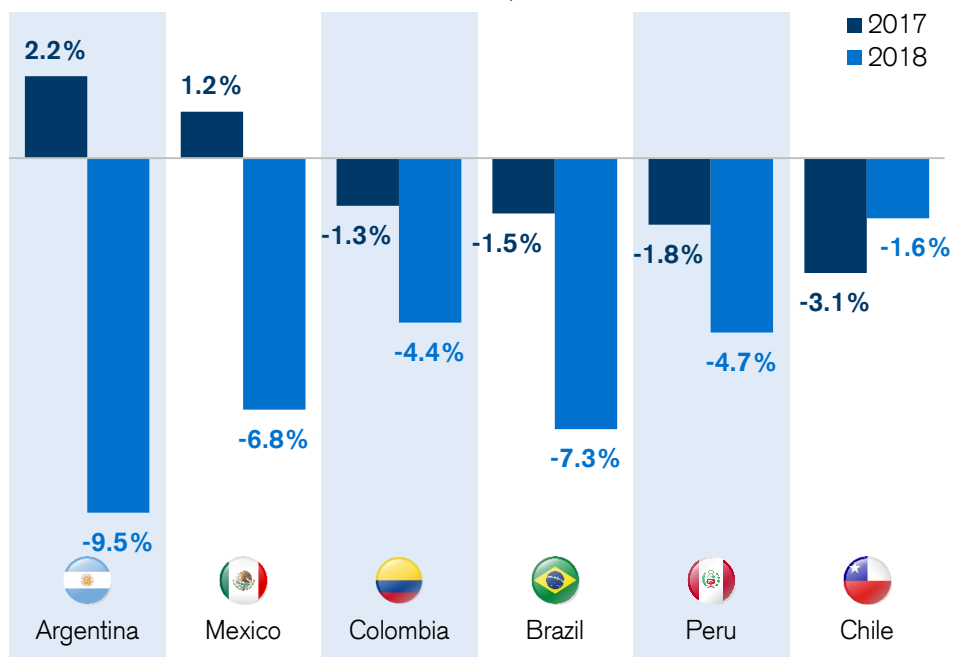
Based as 100, 31-Dec-2016



CS Expected change to current levels

%, year-end

Local ccy per USD	Argentina	Mexico	Colombia	Peru	Brazil	Chile
Current	17.80	17.77	2,996	3.23	3.13	653
2017e	17.25	17.50	3,050	3.30	3.20	670

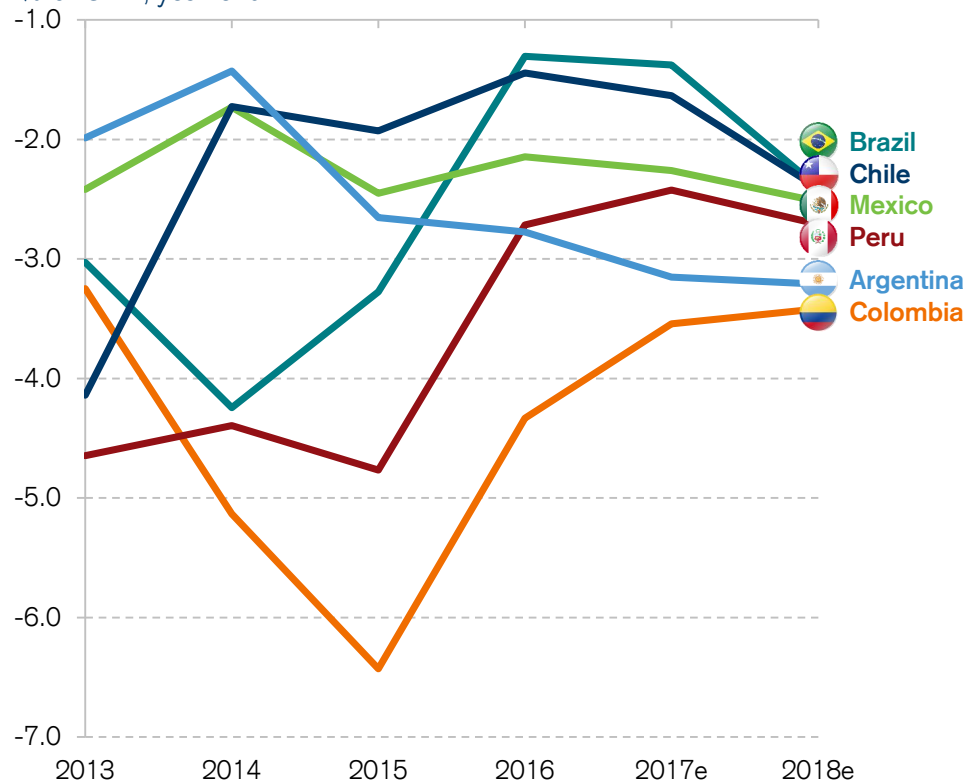


Currency valuation: after rally, MXN still screens as inexpensive

■ **More risks for BRL and CLP.** CS forecasts that LatAm currencies will finish this year close to current levels relative to the USD. However, from a currency valuation standpoint, we believe medium-term risks are relatively lower for the MXN and COP and higher for the BRL and CLP. In spite of its appreciation YTD, the MXN still tilts towards inexpensive on REER and PPP metrics. High local policy rates should continue to provide support for the short-term. Valuation on the COP also skews towards inexpensive, although recent weakness in the oil price and a wider current account deficit (3.5% of GDP estimated) than regional peers may prevent the currency from appreciating, in our view. We see more risk in the BRL, which screens as more expensive after recovering ground lost from the May Lava Jato-induced correction. The BRL looks especially rich on PPP measures, although we highlight considerable improvement in external accounts in recent years. The aggressive monetary loosening cycle by the Brazilian Central Bank could undermine support, however. Finally, the CLP also screens as one of the more expensive currencies within EM and lowest regional policy rates may discourage portfolio flows.

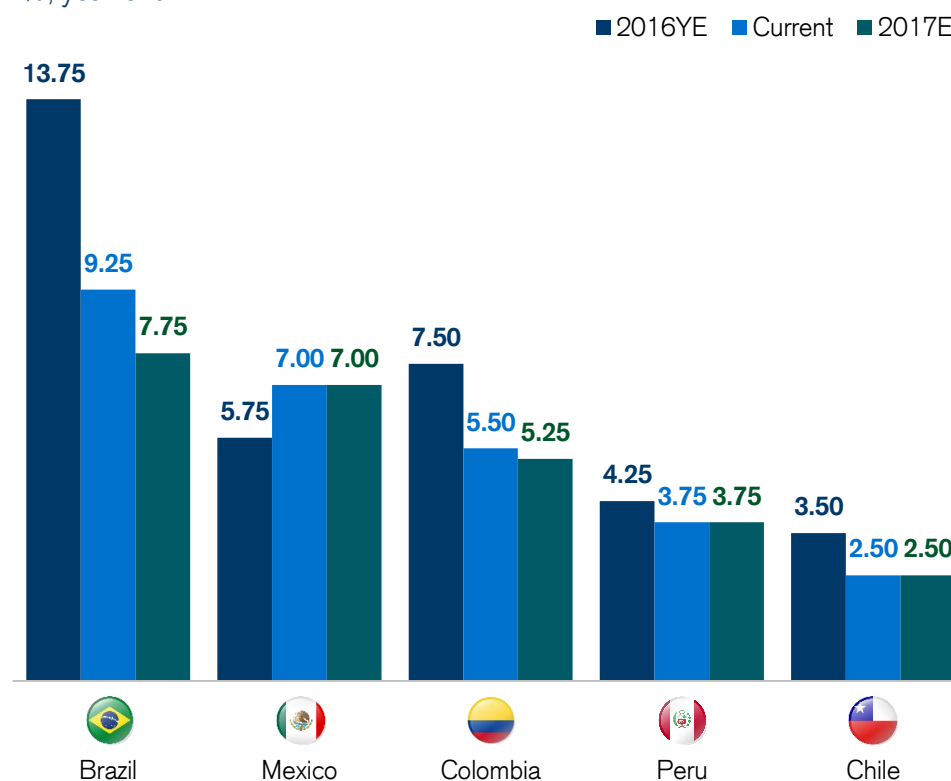
LatAm Current and Expected Current Account Balance

% of GDP, year-end



LatAm Current and Expected Policy Rates


















% , year-end



FX: EM Currency Valuation Scorecard (global equity strategy team)

- On our global equity strategy team's currency valuation scorecard, the CLP and BRL screen among the most expensive currencies. While we do not expect an abrupt correction for the short-term, we point out that medium-term risks could be exacerbated by a less favorable outlook for their respective key commodity prices for each market (i.e., copper for Chile and iron ore for Brazil, respectively). In both cases, the forecasts from the CS commodities team point to downside risks on a medium-term basis, mainly because of a less favorable supply dynamics and potential for a slowdown in Chinese demand. On the other hand, the medium-term outlook is more neutral for the COP on account of a more benign outlook for oil prices.

Global Strategy Team FX Scorecard

	Deviation of REER from long term trend	Real Bond Yield	Big mac deviation from PPP (%)	Big mac, std from 10y avg	IMF PPP deviation (%)	IMF PPP, std from 10y avg	Average Z-score	Rank
 Malaysia	-8.6%	-0.1%	-39.1	-1.5	-66.5	-2.1	-0.9	1
 Russia	-14.0%	3.3%	-30.3	-1.0	-60.5	-1.2	-0.9	2
 Turkey	-19.0%	-0.5%	-8.5	-2.1	-60.4	-2.4	-0.8	3
 Mexico	-14.3%	1.3%	-15.6	-1.5	-50.0	-2.7	-0.8	4
 Indonesia	-4.8%	2.9%	-20.7	-1.3	-68.6	-0.7	-0.7	5
 Poland	-11.1%	1.3%	-20.3	-1.1	-52.5	-1.8	-0.6	6
 Colombia	-14.2%	1.8%	3.8	-1.4	-57.6	-1.3	-0.5	7
 Hungary	-12.1%	0.8%	-6.4	-1.5	-50.0	-1.6	-0.5	8
 South Africa	11.0%	3.0%	-27.6	-1.4	-53.0	-1.2	-0.4	9
 Taiwan	16.5%	0.5%	-41.1	-1.7	-50.8	-1.6	-0.3	10
 India	7.4%	4.0%	-6.5	1.5	-72.2	-1.2	-0.2	11
 Philippines	15.7%	1.9%	-11.6	-0.8	-64.1	-0.7	-0.1	12
 Czech Republic	-9.2%	-1.3%	-10.6	-1.0	-40.0	-1.7	-0.1	13
 Chile	-4.4%	1.6%	11.0	-1.0	-40.3	-0.9	0.0	14
 China	0.8%	4.3%	-9.6	0.7	-48.2	0.0	0.0	15
 Brazil	-14.7%	6.3%	56.9	-0.2	-32.6	-0.6	0.1	16
 South Korea	10.1%	0.2%	-5.6	-1.1	-24.1	-1.0	0.4	17

Commodities: CS outlook for key LatAm commodities

Key LatAm Commodities Outlook Summary



Iron ore

Short-term: Neutral / Medium-term: Negative. After a sharp correction from the year high's, major restocking looks likely to support prices close to \$70/t in 3Q17, though favorable seasonality is expected to unwind in 4Q17. Though visibility is low, Chinese demand seems likely to roll down gradually through 2018, pressuring prices.



Copper

Slightly Negative. Miner strikes and other supply disruptions paved the way for a more supportive environment for prices YTD, but supply / demand conditions are expected to loosen for the rest of the year. For the medium-term, expected supply growth poses a risk to prices, though supply growth should be tame compared to the high rate in 2016.



Oil

Short-term: Neutral / Medium-term: Slightly positive. While OPEC's compliance with the production cap has been laudable so far, Nigerian and Libyan production surprised to the upside. On top of that, sluggish demand growth seen so far and high inventories should prevent significant near-term price upside. Longer term prices should have upside, although it may be constrained as capex and cost efficiency improves through time.

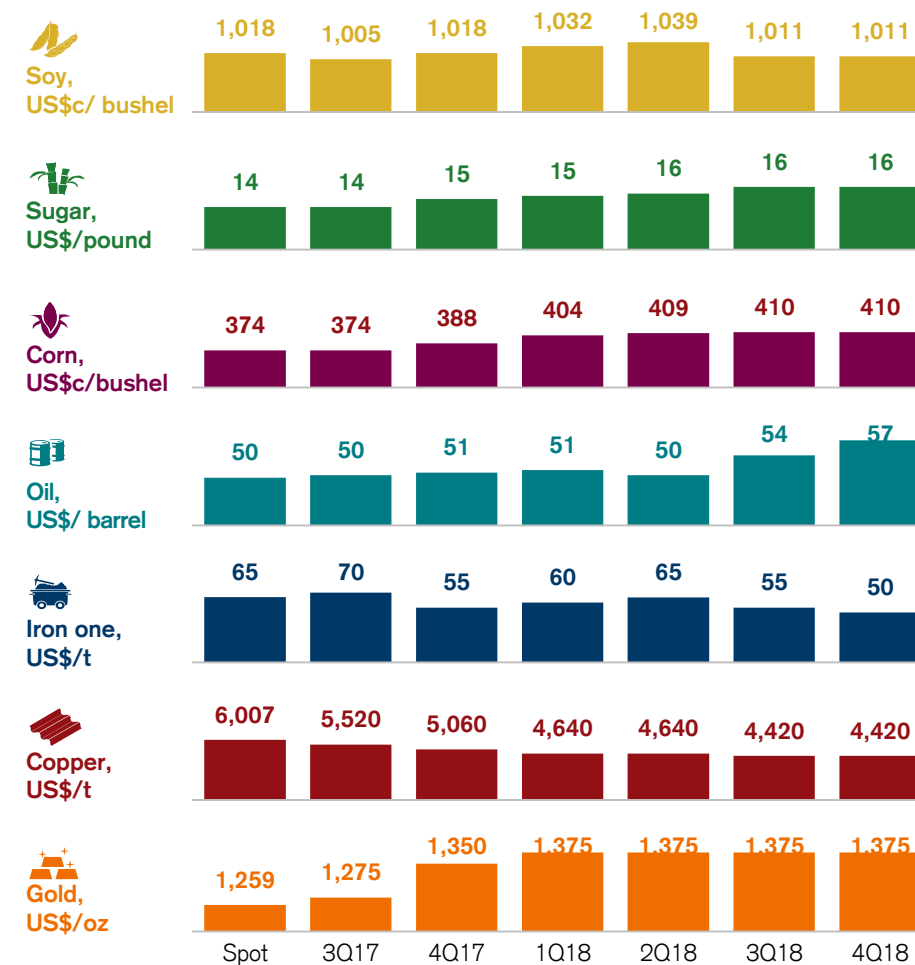


Gold

Positive. Our team has a bullish view on gold on the back of US real rates that are expected to surprise on the downside. That, along with waning USD strength and supportive Chinese investment demand, should sustain a positive momentum for gold prices, as well as potential for a disruptive geopolitical event.

Key LatAm Commodities Forecasts, Quarterly

Oil, Iron Ore, Copper and Gold - CS estimates
Soy, Corn and Sugar - Forward Price Curve

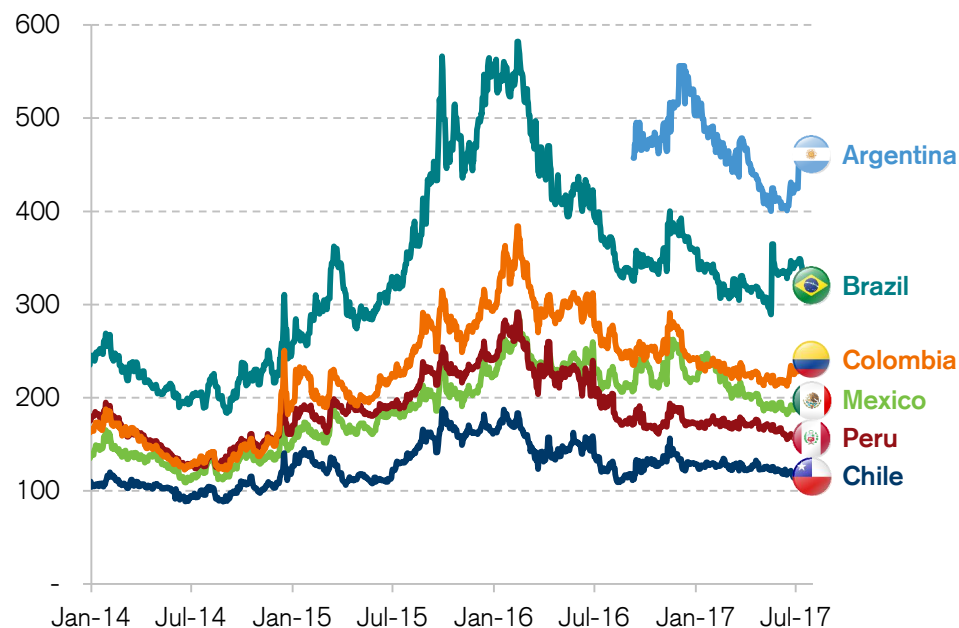


Discount rates: external environment has favored lower sovereign spreads

- US Treasury yields and LatAm sovereign spreads have narrowed.** The behavior of fixed income markets has generally been supportive of LatAm equities so far this year. In spite of our concerns heading into 2017 that Fed tightening and higher US rates would create a headwind for LatAm assets, US 10-year Treasury yields have actually tightened slightly this year from about 2.5% to 2.3%. With markets having already absorbed two 25bps rate increases this year, our US economics team forecasts the Fed will initiate its balance sheet reduction in September, to be followed by another rate hike from 1.25% to 1.50% in December. Our US rate strategists' year-end target is 2.8% for the US 10-year Treasury yield.
- External factors appear to be main driver.** Supplementing the underlying strength in US bonds, sovereign spreads for most LatAm countries have also tightened slightly this year from 10 to 50bps, depending on the market. This has even been the case for Argentina and Brazil, in spite of some backtracking in yields over the past couple of months. The general move towards lower sovereign spreads across the region suggests the preeminence of external factors (e.g., weakening of USD versus the EUR) over idiosyncratic factors at the country level (e.g., elections outlook, reform agenda, political risk, etc.). In any case, the changes in country risk have not been material enough for us to revise the guidance that we provide to investors and our analysts regarding appropriate level of capital costs to assume when valuing LatAm stocks (available upon request).

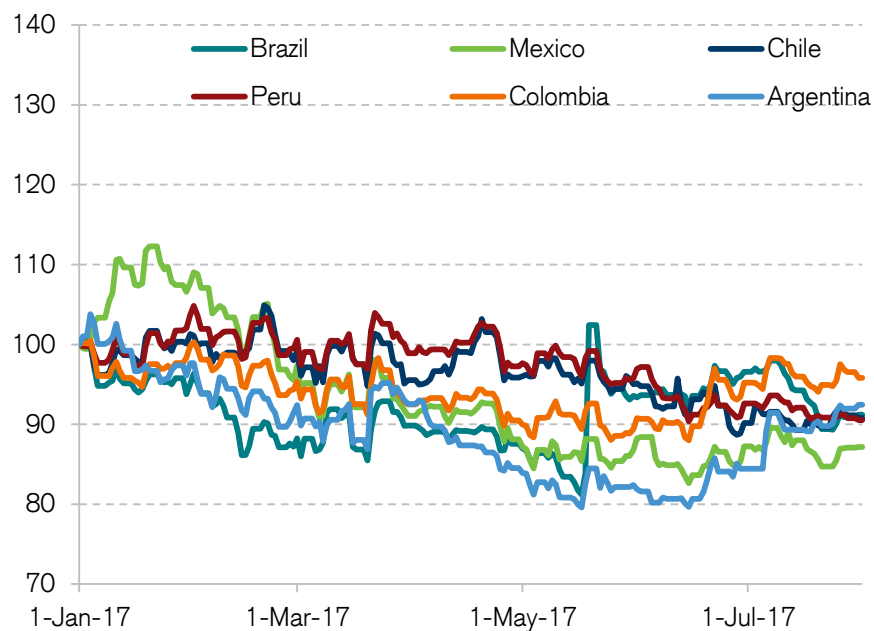
LatAm 10y CDS Spreads

in bps



LatAm 10y CDS Spreads

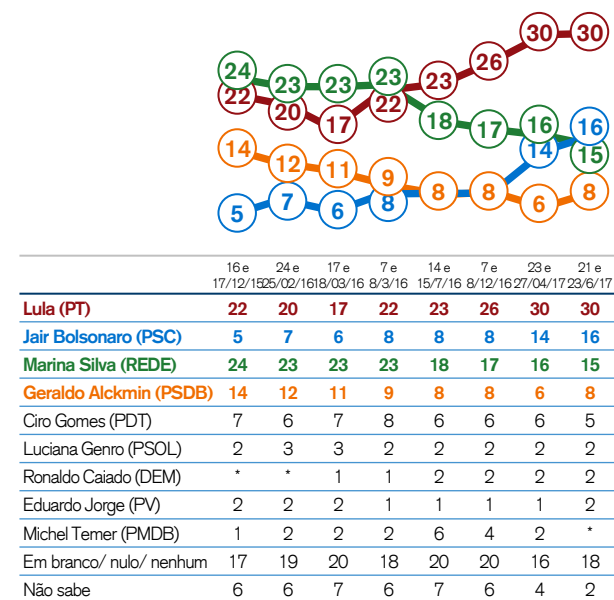
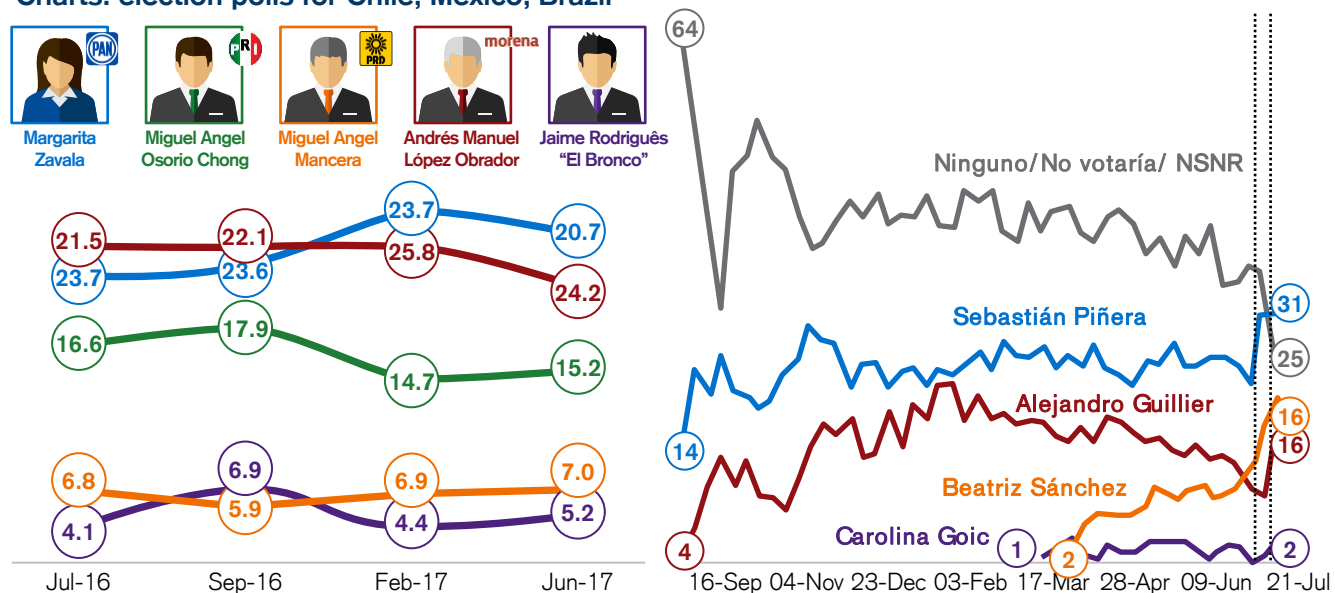
based as 100, as of 1-Jan-17



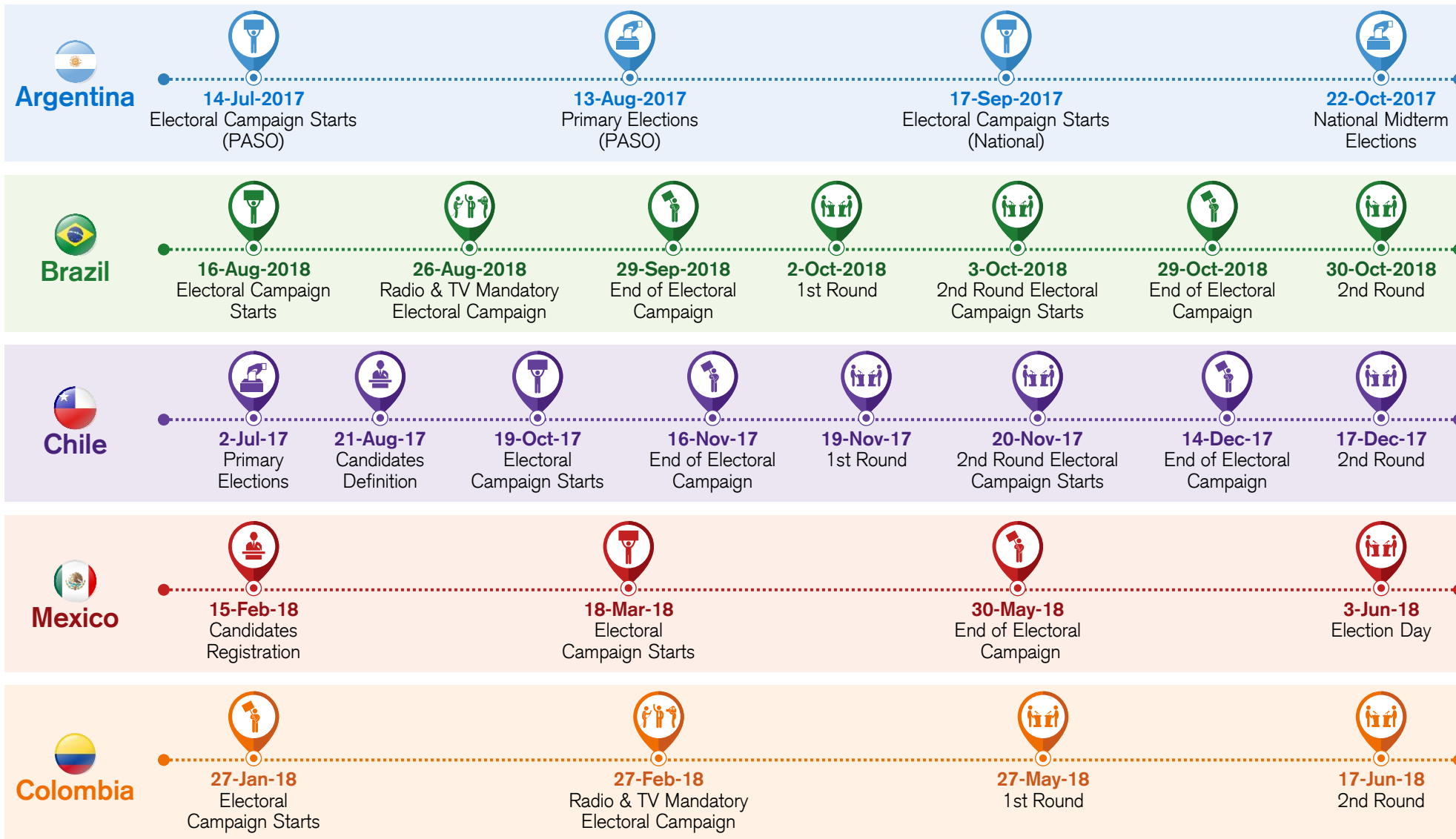
Discount rates: elections and fiscal dynamics are main local drivers

- Argentine to kickoff intense election cycle.** While the global liquidity scenario may have the greatest influence on capital costs in coming months, the election outlook and fiscal dynamics are factors at the country levels that investors should follow closely, in our view. The region will enter a period of intense political newsflow in the coming months, heading towards mid-term elections in Argentina in October and presidential elections in Chile in November. In both cases, we see risks skewed to the upside for markets. Argentina's ruling coalition could solidify its powerbase and Chile appears to favor a more market-friendly candidate, although a second round election should be necessary in December to reach a final outcome. These positive outcomes may already be priced into equity markets in Chile, but we still see room for country risk to fall and Argentine equities to rise in the event President Macri gains a stronger mandate for his reform agenda.
- Getting an early start on 2018.** As only happens every twelve years, in 2018, Brazil, Mexico and Colombia will elect presidents in the same year. Already by the end of this year, expectations for 2018 are likely to increase volatility in these markets. Colombia holds first round elections in May 2018. Visibility is still low as no potential candidate has attracted more than 17% of the vote in recent polls. In between the first and second rounds of the Colombian elections (if necessary), Mexico will choose its president in June 2018. We have already sensed some unease from investors about a potential policy shift towards the left due to the early lead in polls from Morena's candidate, Andres Manuel Lopez Obrador. From our point of view, speculation about the outcome seems premature until the main rival parties (PRI and PAN) have selected their nominees and the dynamic of the campaign can be better defined. Finally, Brazil's presidential election will only happen in October 2018, but investors are likely to seek an early read on potential outcomes considering (i) elections should be a gauge of potential continuity for the reform agenda, and, (ii) the high uncertainty regarding eligibility of several leading candidates owing to alleged involvement in corruption schemes.

Charts: election polls for Chile, Mexico, Brazil



LatAm Elections Timeline

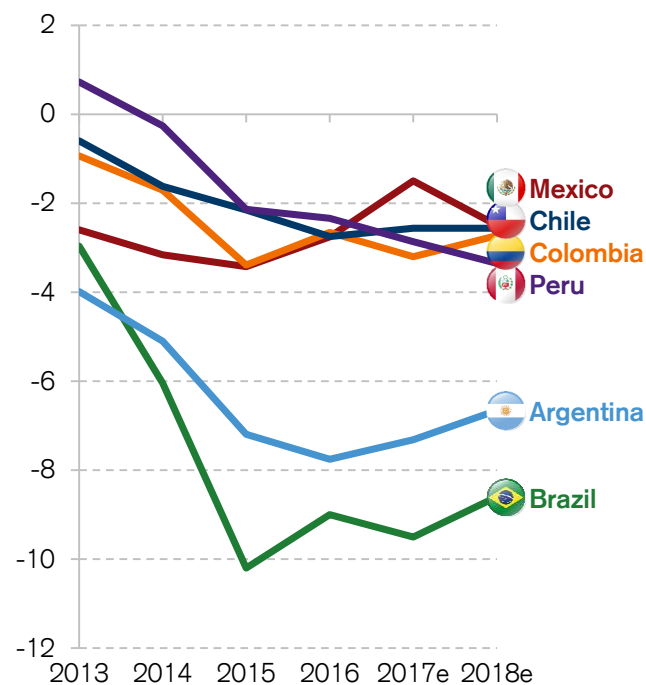


Fiscal: deficit may impede a cost of capital rally in Brazil

■ **Brazil social security savings already heavily diluted.** In addition to elections, the other factor with most potential to sway country risk is the trend in fiscal deficits, in our view. Even though Peru is likely to experience a widening deficit in coming quarters (flood reconstruction efforts) and our macro team is concerned about slippage of fiscal targets in Colombia, we believe this issue is most relevant for Brazil. Not only is Brazil estimated to have another large nominal deficit of 9.5% of GDP in 2017 (CS estimate), but the level and trajectory of gross government debt also catches our attention, estimated to reach 78% of GDP by the end of this year. We are concerned that much of the remedy to this problem may be left to the next government that takes office in 2019, when government debt/GDP is likely to be well above 80%. While the current government continues to support a necessary and important reform of the social security system, our macro team estimates that the savings versus the government's original reform proposal have already been diluted by 45% through the congressional committee process. The final bill that passes congress (if any) may be further watered down. We believe delays and dilution of fiscal reform could put a floor on country risk that could prevent another "cost of capital rally" for equities in Brazil.

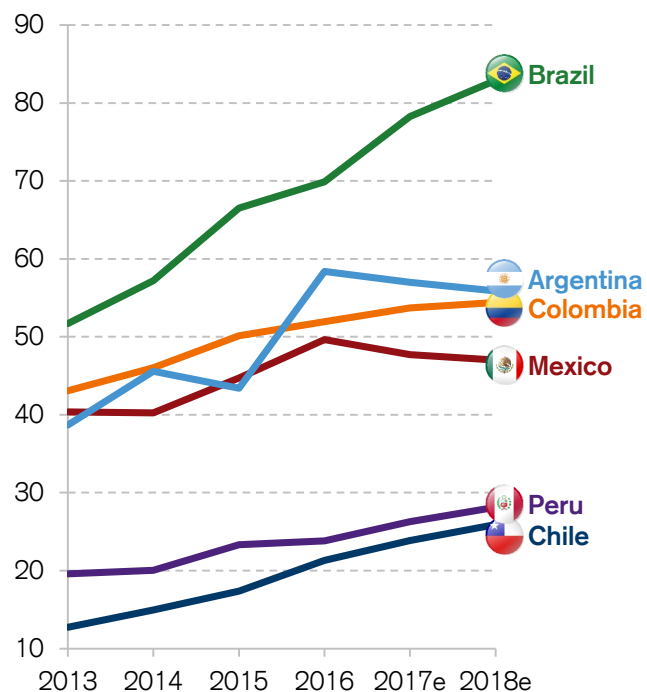
LatAm Nominal Govt Fiscal Balance

% of GDP, year-end

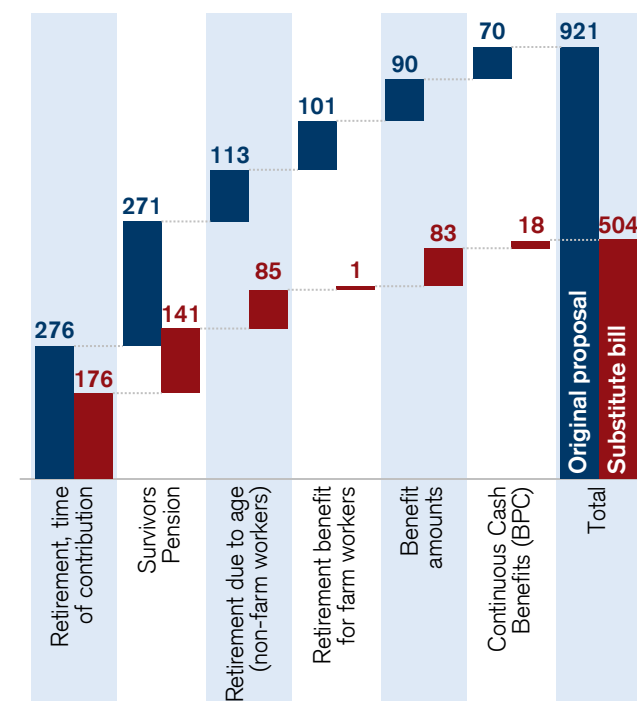


LatAm Gross Govt Debt

% of GDP, year-end



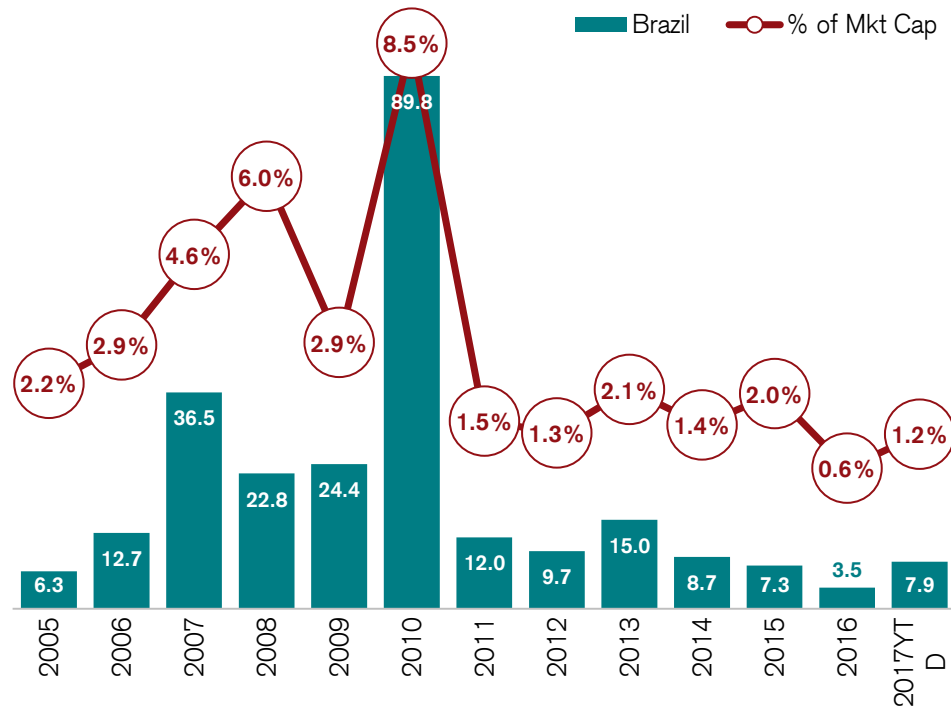
Brazil – Social Security Reform before and after committee BRLbn



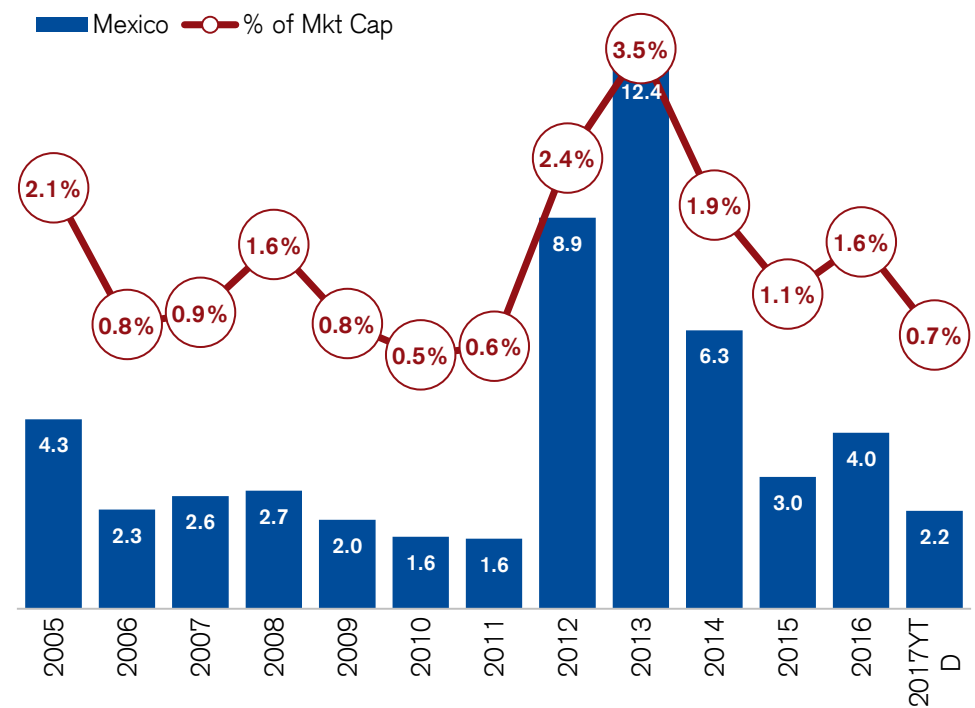
Offerings: More vibrant capital markets activity YTD

■ **Brazil: best year for equity issuance since 2013.** Even though leverage at the sovereign level appears more as a risk factor for markets, at the corporate level we believe a de-leverage process is underway that should enhance integrity of balance sheets. This is most notable in Brazil and Colombia after leverage peaked in 2015. While capital discipline has played an important role, we believe that enhanced access to equity capital markets has also been a positive. In Brazil, we have seen a pick-up in companies that have turned to equity financing as an alternative to debt. In this sense, capital markets activities have been strong so far in 2017, as evidenced by the 7 IPOs YTD. Based on funds raised so far, 2017 should be the best year for equity offerings since 2013, although we caution that appetite has softened since a fresh round of political scandals broke in May 2017. In Mexico, if annualized, equity raisings this year should approximate the values from 2016. From a market perspective, we believe the more active issuance calendar has not reached the point of creating excess supply or becoming a strong technical overhang for the market.

Brazil IPOs and Follow-on Offerings
USDbn and % of Mkt cap



Mexico IPOs and Follow-on Offerings
USDbn and % of Mkt cap



Companies Mentioned

(Price as of 31-Jul-2017)

AES Tiete (TIET11.SA, R\$14.0)	Grupo Sanborns (GSNBRB1.MX, MXN21.8)
ALFA (ALFAA.MX, MXN25.27)	Hypermarcas S.A. (HYPE3.SA, R\$27.3)
Aliansce (ALSC3.SA, R\$16.39)	Iguatemi (IGTA3.SA, R\$36.77)
Alupar (ALUP11.SA, R\$18.21)	Klabin (KLBN11.SA, R\$16.1)
BR Properties (BRPR3.SA, R\$9.9)	Kroton (KROT3.SA, R\$14.98)
Banco Davivienda (DVI_p.CN, peso33600.0)	LATAM Airlines (LTM.N, \$11.86)
Banco Macro (BMA.BA, \$157.55)	Light Servicos de Eletricidade (LIGT3.SA, R\$22.6)
Banco Macro S.A (BMA.N, \$88.07)	Liverpool (LIVEPOLC1.MX, MXN159.8)
Bolsa Mexicana de Valores (BOLSAA.MX, MXN30.47)	Lojas Renner S.A. (LREN3.SA, R\$29.53)
Bradesco (BBDC4.SA, R\$29.75)	Marcopolo (POMO4.SA, R\$3.24)
Brasil Foods (BRFS3.SA, R\$37.0)	Megacable Holdings, S.A.B. De C.V. (MEGACPO.MX, MXN74.01)
CCR (CCRO3.SA, R\$17.06)	Multiplus (MPLU3.SA, R\$38.79)
CIA Hering S.A. (HGTX3.SA, R\$20.7)	Natura Cosméticos S.A. (NATU3.SA, R\$24.71)
Cemex (CX.N, \$9.61)	PINFRA (PINFRA.MX, MXN200.82)
Cesp (CESP6.SA, R\$15.67)	PINFRA (PINFRAL.MX, MXN155.0)
Coca-Cola Femsa (KOF.L.MX, MXN153.7)	Qualicorp (QUAL3.SA, R\$32.8)
Coca-Cola Femsa (KOF.N, \$86.44)	RD (RADL3.SA, R\$68.2)
Companhia Brasileira de Distribuicao (PCAR4.SA, R\$72.41)	Rumo Logística (RAIL3.SA, R\$10.42)
Companhia Siderurgica Nacional (CSNA3.SA, R\$7.48)	Sabesp (SBSP3.SA, R\$34.09)
Copel (CPLE6.SA, R\$25.87)	Santander Brasil (SANB11.SA, R\$25.61)
Cyrela (CYRE3.SA, R\$12.13)	Ser Educacional (SEER3.SA, R\$26.01)
Elementia SAB de CV (ELEMENT.MX, MXN25.51)	Siderar (SID.BA, \$10.6)
Eletropaulo Metropolitana (ELPL4.SA, R\$14.18)	Smiles (SMLE3.SA, R\$64.18)
Energias do Brasil (ENBR3.SA, R\$14.51)	Sonae Sierra (SSBR3.SA, R\$19.83)
Engie Brasil (EGIE3.SA, R\$34.93)	Soriana (SORIANAB.MX, MXN43.98)
Equatorial Energia (EQTL3.SA, R\$56.8)	SulAmerica (SULA11.SA, R\$17.8)
Even (EVEN3.SA, R\$4.54)	Suramericana (SIS.CN, peso41980.0)
Falabella (FAL.SN, CLP\$5979.6)	Telefonica Brasil (VIVT4.SA, R\$47.05)
Fideicomiso Hipotecario (FHIPO14.MX, MXN23.3)	Televisa (TV.N, \$26.74)
Gafisa (GFSA3.SA, R\$11.81)	Tenaris (TENR.MI, €13.39)
Genomma Lab Internacional (LABB.MX, MXN23.91)	Ternium (TX.N, \$30.34)
Gentera (GENTERA.MX, MXN27.31)	Totvs (TOTS3.SA, R\$30.31)
Gol Linhas Aéreas (GOLL4.SA, R\$8.6)	Tran Gas Del Sur (TGS2.BA, \$53.45)
Gru Nutresa (NCH.CN, peso26600.0)	Ultrapar Participacoes SA (UGPA3.SA, R\$73.75)
Grupo Aeroportuario del Sureste (ASURB.MX, MXN382.41)	Usiminas (USIM5.SA, R\$5.14)
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