ARGENTINA FIXED INCOME MARKET

Weekly Market Strategy Report

August 20, 2019

TOP CHOICES

BUY
Lecap 11 Oct 2019
Lecer Septiembre 2019
Letes 25/10/19
Lecap Agosto 2019
Lecap Septiembre 2019

HOLD
Cons. Serie 8
Prov. Bs. As. 2022
Prov. Bs. As. 2025

SELL
Bonar 2020
Bonar 24 U$S 8,75%
Discount Ley Arg. (DICA)
Discount Pesos

See more details page 13.

HIGHLIGHTS

- **Performance**: In terms of pesos, Argy bonds closed -15.31% on average last week, according to the IAMC Bond index.
- **Global rates**: The UST 10-year yield closed at 1.55% today.

Strategy

Uncertainty over Alberto Fernandez's possible economic actions regarding a possible FX and capital controls and a sovereign debt restructuring led to slumps in prices. In this scenario, Letes with maturities in 2019 having strongly corrected are not at stake.

As for assets in pesos, we favor Lecaps, with very attractive yields for all the curve.

Regarding dollar bonds, our suggestion continues to be to maintain position in dollar denominated Bills maturing in 2019. For more aggressive portfolios, Par bonds are attractive due to its favorable parity that reduces the potential loss in a stress event.

Outlook

The Federal Reserve did not surprise by cutting the rate range by 25 bps. However, Powell's subsequent speech was not welcomed in which he gave no sign of continued cuts. As the decision was based on the fact that the US economy continues to show a mixed scenario, with high job creation and growing consumption, and the greatest risks come from the slowdown in global demand and the persistence of the trade conflict with China.

In this sense, failed negotiations between the US and China resulted in higher tariffs on Chinese imports and a devaluation of the yen that spread to all currencies. Paradoxically, the search for protection raised Treasury prices, with the consequent drop in rates. The 10-year bond yield closed at 1.74%, one of the lowest levels in the last three years.

Therefore, the perception that the trade conflict is far from being resolved, and that the negative effect on the global economy and on the US increased, has raised expectations that the Fed will inevitably lower rates again in the near future. A new cut is expected at the September meeting, and possibly another one at the October meeting.

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Argentina

Restructuring scenarios GPS: From an "Ukrainian" restructuring to an aggressive Argentinian restructuring

After primary elections' result, bonds lost more than 35% in one day, and are currently between 20 and 25% below pre elections' prices. In this context, the relevant discussion nowadays is whether local fixed income should be centered in yield curves, or in parities. As a second step, an investor should consider different potential debt restructuring scenarios, based on Alberto Fernandez's speech in several interviews during the week.

To elaborate the different potential restructuring scenarios, we took Sturzenegger and Zettelmeyer (2005) [1] as reference. The paper is an empirical analysis of different sovereign debt restructuring cases of the late 90's and early 2000's. We will consider five cases: Russia in 1999 and 2000, Ukraine 1998-99, Ecuador 2000, Argentina 2001 and 2005, and Uruguay 2003.

In general terms, investors have typically obtained better returns investing in distressed securities, but this premium is reduced, so there are no clear incentives to invest in defaulted securities compared to more stable markets. On the other hand, this is not applicable to all restructuring cases, so investing in defaulted securities is not attractive for individual investors. When there was no face value reduction but there was a haircut, it is so because of the high exit yield and the term structure of the new securities.

Country	Restructuring Case	Date	Face value (*)	Participation Rate	Cash payment	Face Value Reduction	Haircut (**)	
							Average	Standard Deviation
Rusia	GKO/OFZs - residents	1/3/1999	4,81	95	Sí	Yes	45	1,1
	GKO/OFZs - nonresidents	1/3/1999	3,5	89	Sí	Yes	61,1	0,8
	MinFin3	1/2/2000	1,31	75	No	No	63,2	-
	PRIN/IAN	23/8/2000	29,08	99	Sí	Yes	52,6	2,6
Ucrania	OVDP - residents	26/8/1998	4,47	84	No	No	6,9	1,5
	OVDP - nonresidents	22/9/1998	0,42	82	Sí	No	56,3	1,9
	Chase Loan	20/10/1998	0,11	100	Sí	No	30,7	-
	ING Loan	20/8/1999	0,16	100	Sí	Yes	38	-
	Intl. Bonds	7/4/2000	2,6	97	Sí	Yes	27,8	5,5
Ecuador	Intl. Bonds	23/8/2000	6,51	98	Sí	Yes	27,4	10,4
Argentina	Residents (fase I)	6/11/2001	64,37	65	No	No	41,7	10,5
	Pesificación	3/2/2002	57,55	65	No	Yes	45,6	10,4
	Canje 2005	1/4/2005	79,7	76	Sí	Yes	72,9	7,3
Uruguay	External	29/5/2003	3,77	90	No	No	12,9	4,5
	Domestic	29/5/2003	1,62	99	Sí	No	23,3	6,9
						Weighted Average	**52,17**	

(*) In USD Billions, iincluding domestic

(**) Haircut = 1 - NPV (new, r new) / NPV (old, r new)

Source: Sturzenegger, Zettelmeyer (2005)

Comparing the above-mentioned cases, the first conclusion is that in cases where there was the greatest haircuts were those with the greatest face value involved (Argentina, and Russia in 2000). This may be due to greater "bargaining power" of the debtor. On the other hand, there is no consensus regarding haircut percentage in a restructuring process, with significant differences in the structure of the instruments involved, their face value, and the new securities offered in the exchange. On the other hand, in the case of Argentina and Uruguay, residents were treated similarly to non-residents, while in the case of Russia and Ukraine, they were treated better than foreign investors. Finally, longer term bonds tend to suffer smaller losses in NPV terms, although they do not follow an obvious pattern. It is worth mentioning that the haircut is influenced by the exit yield, as it is used in the NPV calculation of old and new instruments.

[1] Sturzenegger, F. y Zettelmeyer, J. (2005), *Haircuts: Estimating Investor Losses in Sovereign Debt Restructurings, 1998-2005*.

For the current Argentine case, we consider three scenarios:

Scenario	Estimated Haircut
Optimistic "Uruguayan"	18,1
Neutral "Ukrainian"	31,9
Pessimistic "Argentinian"	53,4

In order to estimate a potential profit at current bonds' prices, it is useful to compare current parities with the recovery rate of each scenario. It is worth mentioning that estimated profit is calculated without taking into account possible yields of exit from the same, or structures of securities offered. The estimated profitability compares the possible recovery vs. each bond's current parity.

Bond	Parity as of 8/16	Profitability vs. Scenario Estimated Recovery		
		Optimistic	Neutral	Pessimistic
Bonar 20	66,65	23%	2%	-30%
Bonar 24	52,82	30%	8%	-26%
Par NY	44,81	83%	52%	4%
Par Argentina	33,22	147%	105%	40%
Century 2117	53,74	52%	27%	-13%

Regarding the Par bond, as it was issued under Argentine law, which offers less protection from the legal point of view in case of litigation for not accepting a very aggressive restructuring compensates the attractive return.

As a conclusion, there is very little upside potential in the event of restructuring, which does not compensate for the time lapse between the default and the exchange events (in the case of Argentina's last restructuring, there were 4 years between the 2001 default and the first exchange in 2005). Then, considering the current context, it is more feasible to think of a "Ukrainian" scenario as an optimistic scenario, with a 30% haircut, than the Uruguayan case with 20% haircut, while the pessimistic scenario could be the case of Argentina 2005 with a 75% discount, which eliminates any incentive to buy distressed bonds in order to participate in the eventual exchange. We continue to suggest reducing local fixed income positions, migrating towards more conservative options.

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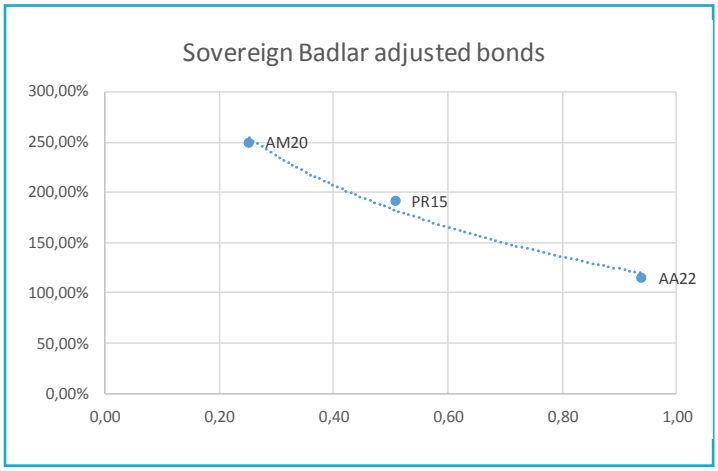
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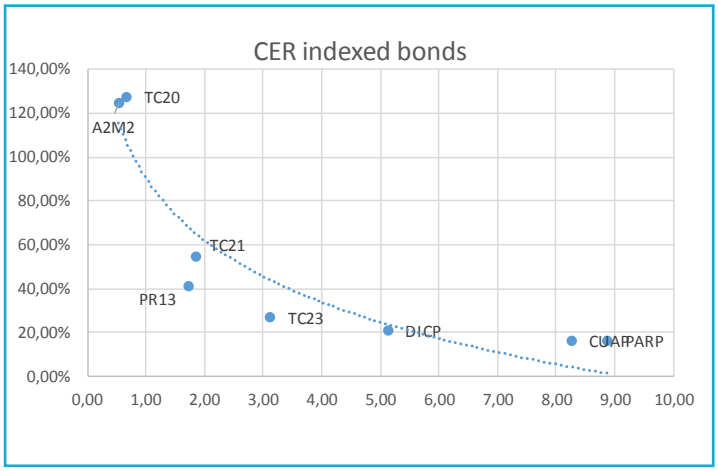
Bond's Indexes Weekly Evolution

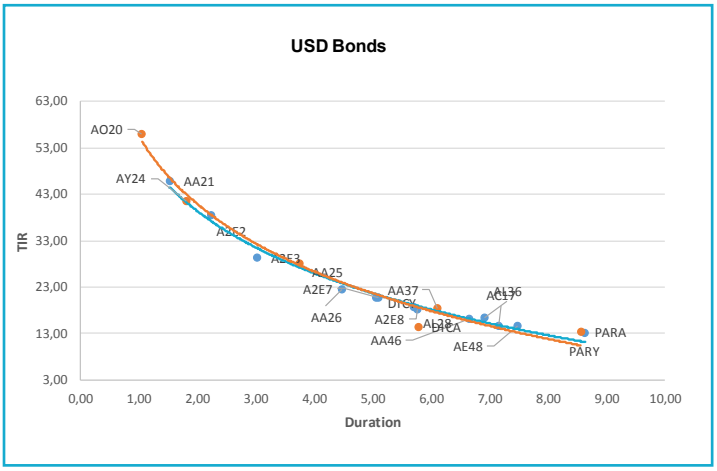
	Last 16-ago.-19	Weekly % 9-ago.-19	Month% 31-jul.-19	YTD % 28-dic.-18
Argentine Bonds General Index	16395,88	**-15,31%**	**-14,30%**	**5,84%**
Short duration USD Bonds	7845,05	**-10,44%**	**-8,19%**	**10,31%**
Long duration USD Bonds	17730,55	**-14,35%**	**-13,53%**	**13,95%**
Short duration ARS TIPS	9204,59	**-21,41%**	**-21,37%**	**-8,53%**
Long duration ARS TIPS	12807,60	**-37,89%**	**-39,55%**	**-29,56%**

Source: IAMC (Instituto Argentino de Mercado de Capitales)

Yield Curves







Source: CMA (Capital Markets Argentina). Bloomberg and Bolsar

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