MOUNT MURRAY INVESTMENT

Weekly Blog
October 20th, 2023

We were in New York last week for a Latin American conference organized by Brazil's premiere investment bank, BTG.

The opportunity for us at these conferences is that we meet a larger number of companies efficiently. We don't spend an hour between meetings stuck in traffic because of inadequate infrastructure, as we might in Mexico City or Sao Paulo. We also get a chance to meet other investors to swap notes, and to talk "off the record" to the analysts.

The disadvantage is that we don't get to spend time in taxis talking to the drivers who are often a great source of local news. We don't get to see the people walking in the streets, or shopping in malls, or on site, all of which tell us a real story.

So, what did we learn? Our Mexican friends were feeling good. A couple suggested that Mexico was finally reaping the promise of the North American Free Trade Agreement, even if 30 years late. Either one of the two candidates expected to replace AMLO as President next year is likely to be more pragmatic. They can easily reverse the poor legislation that he has passed, most notably the restrictions he has placed on foreign participation in electricity generation. This is important because the lack of infrastructure, particularly power and water, are cited as the major threats to the friend-shoring story. You can't operate a modern factory without electricity.

Disappointingly, Mexico hasn't generated much in the way of "animal spirits" when it comes to new companies. Primarily, we are talking to the same dependable companies we have been following for several years. Most of the investment we are hearing about is coming from subsidiaries of foreign multinationals. Korean companies have invested so much into northern Mexico that Monterrey now boasts two Korean schools. For Mexico's sake, we will take that, but we would love for Mexico to capture more of the gains.

The Brazilians definitely have a more dynamic corporate sector. We met several companies, from healthcare to utilities, whom we have been following on paper but had yet to meet face to face. They may have been privatizations, spin-offs from larger companies, or relatively recent initial public offerings. What they have in common is that they are using the capital markets to fund capital expenditure, restructure subsidiaries, or to consolidate a sector through a classic rolling up of the smaller players. There was a real focus on investment and growth rather than rent seeking. They went into details about the differing ROEs they obtain on greenfield rather than brownfield expansions. They even compared their own direct delivery models to those of Chinese food firms.

The Brazilians were keen to point out that Congress has been showing its teeth, keeping some of the President's more populist plans in check. A stronger Congress may be able to make some progress on the necessary reforms, such as pensions, that keep getting stalled. They even managed a half-hearted fiscal reform. But no one predicted a sustained uplift in economic growth. The current better-than-expected GDP numbers were the result of one-off factors, most notably higher agricultural output, that are unlikely to extend to the broader economy. Brazil will definitely be a stock pickers' market for quite some time.

We met 14 companies over 2 ½ working days. We have a better understanding of the quality of management for each and every one of them. Those whom we expect to execute their business plans well, those whom we may need a little more convincing on. So, who is going to make it into the portfolio? Well that's for another time.

Best regards,

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