REFLECTIONS FROM MEXICO AND ARGENTINA

Luke Bridgeman, March 2025

In March I headed to Mexico and to Argentina – both for the first time – for five days of meetings with local corporates after having spent a few days in the U.S. with colleagues[1].

Mexico was an opportunity to check in with some longstanding names in the Hosking Partners portfolio such as Cemex, once a distressed casualty of the financial crisis, now an investment-grade peer of other aggregates companies who share a focus on North America but trade on a big premium to Cemex. Escalating tariff talk and uncertainty over the USMCA free-trade agreement provided a further reason to visit this country with a 130 million population on the doorstep of the U.S.'s fastest growing region.

We had initiated positions in a couple of Argentine companies in 2024 soon after the election as president of reforming outsider Javier Milei. A visit was in order to check in on them as well as to meet other companies for the first time, while testing the thesis that this time really may be different in Argentina - a dangerous proposition.

MEXICAN DISCOUNTS ON AMERICA'S DOORSTEP

My first stop in Mexico was Monterrey. Just a three-hour drive south of Texas, the journey into the city from the airport passed endless industrial plants and factories catering to the northern neighbour. While the uncertainty created by the Trump administration was a concern for all companies I met, tariffs themselves were less of an issue, with companies having already taken steps since Trump's first administration to be able adapt to changes in the terms of trade. A common theme in both Monterrey and Mexico City was "local for local" – meaning U.S. sales are mostly manufactured in the U.S. – and the focus now was on diversifying international revenues.

A controlling family shareholder was a recurring trait in the companies and banks I met with, something we are familiar with in other emerging markets. Founding families often hold on to majority stakes in their companies for years after listing them, and investing alongside the right family can be an efficient way for financial investors like us to mitigate the principal-agent problem and to avoid some of the pitfalls of investing in countries with less developed governance and legal systems. However, the risk of minority abuse is always present, so the track record of capital allocation is a key test of whether there can be alignment between family and outsiders. I met companies such as tortilla producer Gruma, which had an admirable focus on improving returns and returning cash to shareholders via dividends and buybacks, but also companies (who shall remain nameless) who had failed to resist the temptation to invest in non-core areas where they lacked experience and poor returns destroyed shareholder value – tuna fishing being one such example! One company failed to turn up for my meeting, which was a helpful insight into how they regard outside shareholders.

A standout feature of every company was a Mexican valuation discount relative to peers in other countries. The question in each case is whether the discount is justified in order to reflect the various risks of operating in this so-called emerging market, or on the contrary whether it might be undeserved, as the growth opportunity arising from a younger population and a less competitive marketplace surely justifies a valuation premium. In Mexico City, Coca-Cola FEMSA, the largest Coke bottler in Latin America was a good example of the latter. As capital cycle investors, we well

[1] My trip took place before President Trump's "Liberation Day", but both countries look well placed to withstand the subsequent market disruption that has arisen from the U.S. tariff announcements.

appreciate the value of the barriers to entry arising from a Coke franchise, and a recent reset of the terms of Coca-Cola FEMSA's relationship with the Coca-Cola Company have opened up significant opportunities to deploy capital at attractive returns in projects to increase production and remove distribution bottlenecks.

Mexico is a country with a huge opportunity on the doorstep of the U.S. but dominated by family companies where the question of alignment is key. Demographics are highly attractive, but underinvestment presents a significant bottleneck to growth, with just 1% GDP growth expected in 2025. If Mexico City is somehow able to reset its trading relationship with Washington there could be a domestic consumption boom. In the meantime there are still a few attractive opportunities with a Mexican discount for those willing to invest.

Argentina: High Stakes, Higher Hope

Argentina is dominated by the question of whether President Milei's reforms will succeed or if will they give way to another crisis, repeating the usual cycle – the reforms of President Mauricio Macri (2015-19) are the precedent to be avoided. The good news is Milei's personal support is strong, above 50%, the working class having been won over by the slaying (or at least hobbling) of inflation (200% in 2023, 100% in 2024, c. 20% forecast for 2025) as they are the ones hurt most by inflation's erosion of their spending power. Milei has managed this by achieving a fiscal balance overnight, magically cutting subsidies and handouts by getting rid of the take to the Peronist machine which distributed them, while ensuring a minimum level to those who need the support. Capital controls remain in place, however, so the peso is massively overvalued, hurting exporters and, if they are removed precipitously, creating the risk of capital flight, a currency collapse and then the return of inflation. The imminent US$20 bn deal with the IMF will help address this, but until central bank reserves are built up it will be a tricky exercise. As an indication of the scale of the challenge, Milei contested the election on promise to dollarise the economy and shut down the central bank as a means to ensure the end of currency printing! He did, however, abandon this policy once elected.

Development of the Vaca Muerta shale basin is a bright spot – Argentina could soon become a net oil exporter, which will provide needed support to Central Bank reserves. That said, major changes to capital controls may need to wait until after the mid-term elections in October, when Milei hopes to have a stronger base in Congress, where currently his political party has minimal representation.

I had 15 meetings in Argentina, 12 of which were with corporates. Equity valuations had surged in the year since Milei's election but have pulled back since January, reflecting uncertainty over the IMF deal and timing of capital control changes. I had positive meetings with our two existing holdings - leading cement producer Loma Negra and farmland developer Cresud which is also the controlling shareholder in real estate company IRSA.

Companies I met for the first time spanned telecoms, banking, energy, airport operators and stock exchanges. The energy companies are all excited about shale oil in Vaca Muerta (as opposed to shale gas, which has been developed earlier), and each have very significant capex projects to exploit this. All will be beneficiaries of a weaker peso, but it may be worth waiting for a better entry point as their capex projects approach completion.

The banks were the first to see their share prices benefit from Macri, but there is huge growth potential, not least from acquiring the operations of departing foreign banks (HSBC and Itau have already left, Santander may be next) and the opening up of corporate and mortgage lending (until last year, their assets were largely government paper).

Overall, despite Milei already having achieved a huge amount in terms of balancing the fiscal books and taming inflation, and the strong optimism shown by almost everyone I met, the jury must still be out on the question whether he will succeed with his reforms.

The Argentine cultural predisposition to keeping assets abroad maybe coming to an end but will be difficult to change quickly. Until capital controls are loosened, uncertainty over the path forward and the deflationary impact of the strong peso may hold back equities, even if an IMF deal is announced. I'll be keeping a watch on Argentine developments over the northern hemisphere summer and ahead of the mid-term elections.

Insight you can only get on-the-ground

It's important for the Hosking Partners investment team, that we make the effort to visit businesses on the ground – not just manage portfolios remotely from the comfort of our offices in London. The five days I spent across Mexico and Argentina have given me plenty to chew on, and they've already started to help shape some of my thinking around the portfolio.

Thank you to everyone who opened their doors to me and took the time to share their thoughts and perspectives.