



**NAPLES
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Peru Research Trip 2013

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Individual investors have increasingly evaluated the risks and gained comfort with the notion of investing in the emerging markets. After all, it is difficult to resist participating in and benefiting from the attractive demographic and overall economic trends occurring outside the U.S. In light of the changing political, tax and economic environment inside the U.S., where we as a firm go to find investment opportunities for our clients is also changing in direct response to the relative risks and rewards. We are forced to ask ourselves, is it riskier to invest in countries experiencing high unemployment, slow growth and government debt equivalent to or greater than GDP or to devote a portion of what we invest to countries enjoying consistently strong economic growth, low inflation, relative political stability and the emergence of a ravenous consumer class fueling the local demand for goods and services?

Opportunities in today's emerging markets aren't necessarily discovered in the same places where they have traditionally been found. Countries like Brazil, Russia, India and China have historically been the emerging markets receiving the most attention and foreign investment. It is difficult in 2013, however, to think of very developed economies like those found in Sao Paulo and Beijing as emerging. Quality investments can still be identified and made in these countries, but it's a path that is now well worn. We continue to believe the best investment opportunities are often found in places where the least amount of people are looking.

Increasingly, we are seeing compelling investment opportunities in the frontier emerging markets, which include much of Latin America and Southeast Asia and parts of the Middle East, Africa and Eastern Europe. A year ago, we conducted an investment research trip to Colombia and wrote about the very positive changes implemented there. Most recently, we visited Peru, another rising Latin American country many believe to be the next economic hotspot.

We started the journey by flying Copa Airlines, a highly profitable Panamanian carrier principally serving South and Central America, through Panama, and into Lima, which boasts Latin America's best airport. Lima is the energetic capital of Peru, crammed with one third of the country's Andean/Spanish population and seemingly filled otherwise with 80's pop music and vintage Volkswagen Beetles. For many years, Peru was known principally for the wonder of the tourist destination of Machu Picchu and for political and economic dysfunction. What we found was a surprisingly modern country nestled between the Pacific Ocean and the Andes Mountains, rich in natural resources and hard-working yet modest people somewhat wary of their newfound prosperity. Although deservedly vilified for many reasons, former President

Alberto Fujimori instituted major social and economic reforms in the mid-1990's, which enabled Peru to begin to emulate its financially savvy neighbors in Brazil and Chile while attempting to ride the wave of increasing economic success sweeping over South America.

Although there remains a natural fear of the return to the socialist leanings which historically plagued the country, Peru is currently enjoying a virtuous circle of economic growth. Foreign investment has poured in over the past decade while the country's steadily booming commodity exports have provided consistently strong tax revenues and helped stabilize the currency. The government of current President Ollanta Humala, aided by the Central Reserve Bank of Peru, has at least so far, deftly handled its new found success: reducing poverty to its lowest recorded level, keeping inflation in check, securing an investment grade credit rating and keeping government debt-to-GDP to less than 25%. The result has been the rapid expansion of the demand for consumer products and an economic growth rate that has averaged better than 7% per year for the past eight years. According to the International Monetary Fund, Peru is now in the best position among all Latin American countries to withstand a global economic meltdown.

Despite the potential attractiveness of investing in Peruvian companies, it is still quite challenging to invest in the country. Massive amounts of foreign direct investment over the past few years has resulted in valuations among publicly traded companies appearing to be somewhat stretched. There is an exchange traded fund, the iShares MSCI All Peru Capped Index Fund (EPU), which roughly tracks the Lima Stock Exchange and is one way to invest in the growth of the country. However, this ETF is 50% comprised of metals and mining companies, which is not so much investing in Peru as it is making a commodities sector bet. Peruvian mining companies have long appeared lucrative, but the appeal has related more to the demand for commodities than to the potential for sustained and consumer driven local economic growth. Instead, we are closely following two rapidly growing Peruvian banks that drive the majority of their revenues not from their investment banking subsidiaries or proprietary trading desks, but from their provision of the most basic of banking services to an under-banked populace. We also like the prospects of a leading cement manufacturer. This cement company is protected by significant barriers to entry, enjoys dominant market share and its earnings are tied directly to both major infrastructure projects and local consumer demand associated with the shortage of housing (estimated at 2 million individuals and families with the means to acquire or self-build).

Our enthusiasm and optimism of the investment opportunities in Peru must be somewhat tempered or at least balanced versus the risks that remain. While the trends are certainly encouraging, Peru has never before had or sustained such a prolonged period of political and economic consistency. We will be watching closely to see if the socialist-type missteps often facing governments at this stage of development can be avoided and if the country's economy can truly emerge as an economic wonder that matches its famed tourist attractions.