AdCap

ARGENTINA STRATEGY
RESEARCH

Sovereign & Sub-Sovereign Bonds in USD
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Argentina: Counting Pennies, 2021 Edition

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- **After the 14% correction experienced by the average Sovereign Bonds since the Primary Elections, we believe the market has reached the bottom of its trading range.**
- **These levels were visited by the end of March 2021 when the 2035s went below $30 (Fig. 1) as the market realized the negotiations with the IMF were going to be delayed beyond the mid-term elections.**
- **Given that the Net Liquid Reserves are close to zero (Fig 2), but especially considering the strength of the outflows, we believe the government will be forced to change the tone towards the IMF and start showing progress in the negotiations to restore confidence.**
- **We recommend buying the 2038s as we expect them to outperform the rest of the Sovereign Bonds. We see an upside of 13% in a conservative scenario and 46% in a constructive scenario until March 2022.**

- In this report, we reassess our targets for March 2022 under two scenarios: Our base case is that Argentina will trade between a conservative scenario (maintaining the current status quo) and a constructive scenario (a soft agreement with the IMF).
- Under these scenarios, we expect the market will favor the higher coupon bonds, but especially the 2038s as it will start accruing the highest coupon among Sovereign Bonds, almost doubling the current 2.0% coupon.

Conservative Scenario

- In this scenario, we assume that the status quo will remain the same with many uncertainties unsolved on both political and economic fronts but, somehow, the government manages to delay the painful measures. As a result, we maintain the current shape of the Sovereign Curve (Fig 3).
- For a more conservative approach regarding coupons, we recalculate target yields as a function of combining the differences between coupons and modified duration to the average bond. As a result, we obtain a less disruptive curve than the one we described in this report, particularly regarding the target yields of the 2038 and 2035.

Fig 1: Argentina - Global Bonds

Source: AdCap based on Bloomberg

Fig 2: Central Bank Reserves

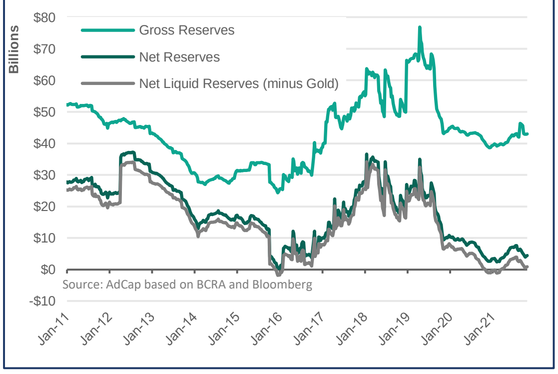
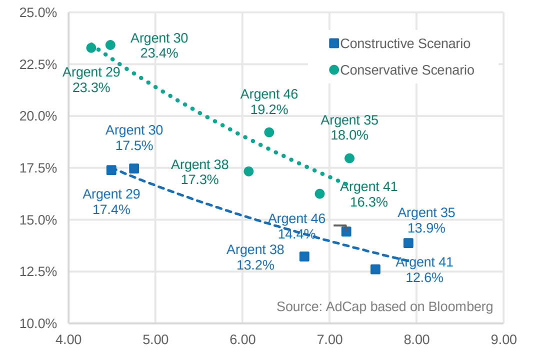


Fig 3: Sov Bonds - March22 Target Yields



- Nevertheless, we maintain our belief that the market will increase its preference for the 2038 as we expect it to take the place of the 2041 by next year. In July 2022, it will start accruing the highest coupon (3.875%) among Sovereign Bonds, almost doubling the current 2.0% coupon. It is worth reminding that the 2038s are more liquid and shorter than the 2041s.
- As we pointed out in this report, we believe the market has been favoring the 2041 over the rest of the global bonds due to its higher coupon and, therefore, higher current yield. Despite being one of the longest bonds, the 2041s have been behaving better, showing a positive alpha (outperforming in the rallies and falling less in the corrections).
- In Figure 6, we summarize the historical behavior of each of the Sovereign Bonds compared to their average and measure the upside and downside capture ratios to describe the nature of the 2041's outperformance: Historically, the 2041s have captured 115% of the rallies and only 96% of the corrections.
- In contrast, the 2035s have also outperformed during the rallies (114%) but were also the worst performers during corrections, the expected behavior of a higher duration and therefore higher beta bond. However, this bond could become preferred for the market in binary scenarios: In a stress scenario (e.g., default with the IMF), they have lower downside to a recovery value at $30. In an optimistic scenario (e.g. regime change), they should also outperform due to its higher beta.

The Only Way Out: To Restore Confidence

- Given that the Net Liquid Reserves are close to zero (Fig 2), but especially considering the strength of the outflows, we believe the government will be forced to change the tone towards the IMF and start showing progress in the negotiations.
- We expect the Frente de Todos to take reasonable measures to remain in power beyond 2023, if not by conviction, due to the need to restore confidence.
- Not long ago, CFK already took rational measures when she appointed Alberto Fernandez as her presidential candidate in 2019 with a similar goal: to win the elections.
- A similar experience took place in 2013 when, after losing the mid-terms, she replaced the Economy Minister and the chairman of the Central Bank.
- After the mixed signals given towards the IMF in the context of this year's political campaign, we believe the administration will end up reaching an agreement with the Fund by March 2022 when the strong maturities begin, and there are no resources to face them. (Fig 7)

Conservative Scenario

Fig 4: Sovereign Bonds - Target Prices

Bond	Current Price	Dec-21	Mar-22	Jun-22
Argent 29	$ 36.2	$ 36.5	$ 37.5	$ 38.4
Argent 30	$ 34.1	$ 33.9	$ 34.8	$ 35.8
Argent 35	$ 31.0	$ 32.0	$ 32.7	$ 33.0
Argent 38	$ 36.6	$ 39.0	$ 40.8	$ 42.0
Argent 41	$ 34.4	$ 34.9	$ 36.0	$ 36.4
Argent 46	$ 31.5	$ 30.4	$ 31.1	$ 31.6

Source: AdCap based on Bloomberg

Conservative Scenario

Fig 5: Holding Period - Total Return

Bond	Dec-21	Mar-22	Jun-22
Argent 29	1.2%	4.6%	7.8%
Argent 30	-0.4%	2.7%	5.8%
Argent 35	3.7%	6.8%	8.8%
Argent 38	7.1%	13.1%	17.8%
Argent 41	2.5%	7.3%	10.1%
Argent 46	-3.0%	0.1%	2.4%

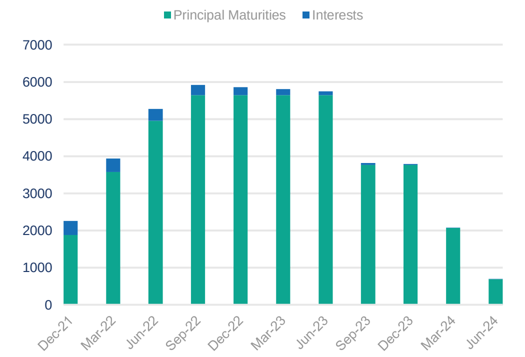
Source: AdCap based on Bloomberg

Fig 6: Historical Behaviour vs Avg Sov Bond

Bond	Alpha	Beta	Upside Capture	Downside Capture	Capture Ratio
Argent 29	-0.03%	0.90	78%	98%	0.79
Argent 30	-0.01%	1.00	97%	103%	0.95
Argent 35	0.00%	1.13	114%	107%	1.07
Argent 38	0.01%	0.98	102%	98%	1.05
Argent 41	0.02%	1.02	115%	96%	1.20
Argent 46	0.01%	1.08	108%	97%	1.11

Source: AdCap based on Bloomberg

Fig 7: SBA - Maturities with IMF



Source: AdCap based on IMF

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Politics offer little room for maneuvering

- Even though we do not expect a strong program with strict commitments on the fiscal and monetary fronts, we believe that the lack of an agreement would evolve into such an economic turmoil that would leave the Kirchnerite out of the presidential race for 2023.
- It is worth mentioning that some fractions of the Peronism have started to make their own plans. On the one hand, the "**Schiarettism":** There are numerous news pieces on the attempt to install the presidential candidacy of the current Governor of Cordoba, Juan Schiaretti, after November's mid-term elections. It is worth mentioning that he cannot be reelected as governor as this is already his second term. Moreover, he been showing himself as a third option pointing his criticisms at the current leaders of both coalitions: CFK and Rodriguez Larreta.
- On the other hand, the so-called "**Republican Peronism**" is becoming a growing force inside Juntos x el Cambio, lead by Miguel Pichetto, Macri's former candidate for the vice-presidency in 2019.

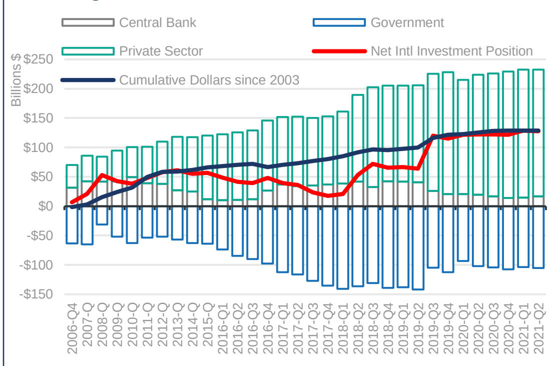
The economy forces to restore the confidence to reverse the outflows:

- Argentina's main economic problem are not the stocks, but the flows. Despite the Government's debt stock, it is worth reminding that Argentina is a Net Creditor for the rest of the world as the Private Sector has stashed more than $230 billion of dollar bills. As a result of a long history of little incentives to invest in the country, the private sector has purchased $129 billion in the official market since 2003 that have left the financial system. (Fig 8)
- To emphasize the problem with flows, it is worth mentioning that the Central Bank missed to cash in more than $3,000 million in only two months due to the deterioration of the financing of trade. (Fig 15). During those months, the Central Bank could not purchase any dollars to accumulate reserves, despite the record trade surpluses. (Fig 9)

Constructive Scenario

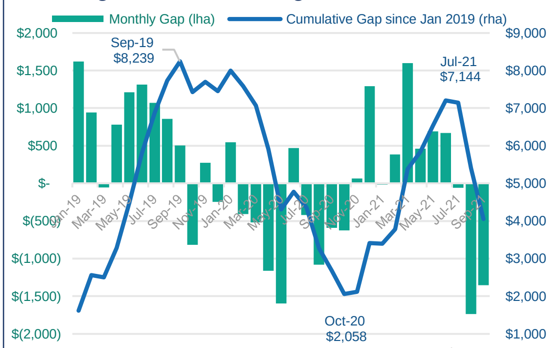
- In this scenario, we assume that the government reaches an agreement with the IMF supported by the main political coalitions in the Congress.
- Although we do not expect tough commitments in terms of deficit reduction or monetary financing, we believe that even a soft but credible agreement will provide the right framework to begin moving in the right direction under the Fund's audit.
- Under this scenario, we assume the Sovereign Curve takes the shape of Ecuador's curve (Fig 3) before Lasso's victory meaning that the economic framework improves, but the politics remain the same.

Fig 8: Net International Investment Position



Source: INDEC, BCRA

Fig 9: Trade Financing: INDEC vs BCRA



Source: INDEC and BCRA

Constructive Scenario

Fig 10: Sov Arg Global - Target Prices

Bond	Current Price	Dec-21	Mar-22	Jun-22
Argent 29	$ 36.2	$ 46.7	$ 47.7	$ 48.6
Argent 30	$ 34.1	$ 43.9	$ 44.9	$ 45.9
Argent 35	$ 31.0	$ 43.4	$ 44.1	$ 44.5
Argent 38	$ 36.6	$ 51.2	$ 53.0	$ 54.3
Argent 41	$ 34.4	$ 45.9	$ 46.9	$ 47.4
Argent 46	$ 31.5	$ 41.5	$ 42.2	$ 42.6

Source: AdCap based on Bloomberg

Constructive Scenario

Fig 11: Holding Period - Total Return

Bond	Dec-21	Mar-22	Jun-22
Argent 29	29%	32%	36%
Argent 30	29%	32%	35%
Argent 35	40%	43%	46%
Argent 38	40%	46%	51%
Argent 41	34%	38%	41%
Argent 46	32%	35%	37%

Source: AdCap based on Bloomberg

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