

## RESEARCH

### SOVEREIGN AND SUBSOVERIGN BONDS

January 28, 2022

## Argent 35 & 38 The Best Way to Play the Deal Trade

- As we reached the final stage of the negotiation with the IMF, we recommend buying the 2035s and 2038s as we expect upsides exceeding 55% from yesterday's close assuming Argentina reaches a full agreement by March.
- We see very limited downside with the 2035s trading at \$28 at levels and, given its high beta, it should lead the recovery and outperform the rest the Sovereign bonds.
- We expect the 2038s to outperform since the market has shown its preference for the higher coupon bonds and we approach to the step-up by which the 2038 will almost double its coupon to 3.88% from the current 2.00%.
- We maintain our preference for NY Law Bonds as we do not see Arg Law bonds especially cheap though they could look more attractive in terms of lower downside to a certain recovery price.

According to the local media, Argentina and the IMF reached an understanding by which parties agreed on limited primary deficit reductions in 2022 and 2023 but faster fiscal consolidation in 2025, as the Fund originally required (Fig. 1)

After the technical agreement, which will need to be approved by the IMF board and Argentina's Congress, we expect Argentina will reach a full program by March. Although there is still a lot of work to be done, we believe this program will provide a clear macroeconomic framework to anchor fiscal and monetary expectations and it will significantly reduce uncertainty in the near term. More importantly, we believe this is a critical step in the right direction towards moderation and the normalization of the economy in the years to come.

### Market Preference for the Higher-Coupon Bonds

As we pointed out in several reports in the past, Sovereign Bonds have had different behaviors since the debt exchange in September 2020, showing a significant preference for the higher coupon bonds. In this period, the Argentina 2041s –the highest coupon bond at 2.5% so far– clearly stands out outperforming the Argentina 2030s –the lowest coupon bond at 0.5%– by 22% (Fig 2).

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Fig 1: Fiscal Consolidation in 2025

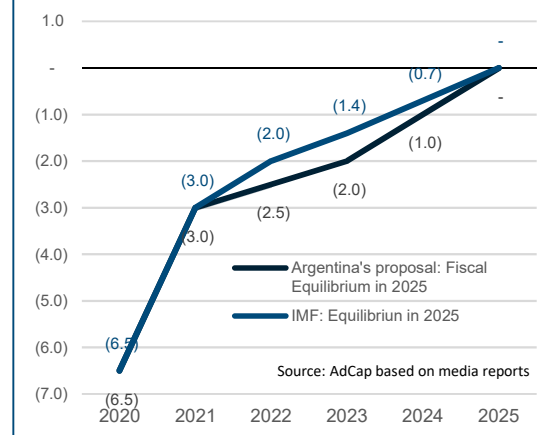
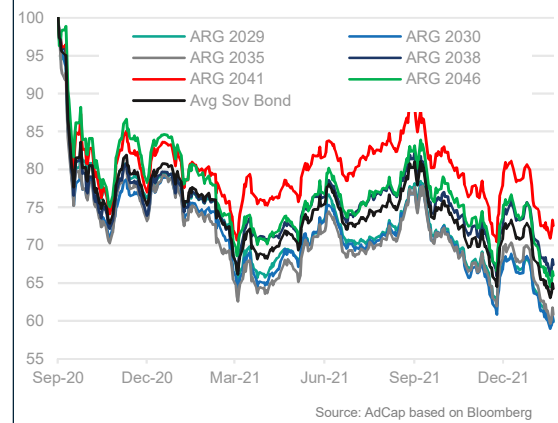


Fig 2: Sovereign Bonds - Total Return Index since the 2020 Exchange



## Historical Behavior and Expected Returns

### Behavior during Corrections and Recoveries

We gain comfort on this approach as we review the historical behavior of each of the Sovereign Bonds in NY Law during corrections and recoveries as compared to the Average returns (Fig 3).

In particular, we see the Argentina 2041 has outperformed the average most of the times and specially since December 2020, when the market started to price to step up to 2.5%. In contrast, the Argentina 2030s has underperformed the market most of the times (Fig 4).

In other words, the 2041s have a +0.04% alpha and captures 109% of the recoveries and only 96% of the corrections. In contrast, the 2030s have a negative alpha, with the similar volatility and only captures only 95% of the recoveries and 103% of the corrections. In the following table (Fig 5), we summarize different performance parameters to help to better describe this behavior.

Fig 5: Sovereign Bonds Performance Parameters

Bond	Alpha	Beta	Volatility	Upside Capture	Downside Capture	Capture Ratio
Argent 29	-0.03%	0.87	17.2%	79%	98%	0.80
Argent 30	-0.02%	1.00	19.4%	95%	103%	0.93
Argent 35	0.00%	1.08	21.0%	112%	106%	1.06
Argent 38	0.01%	1.00	19.4%	101%	98%	1.03
Argent 41	0.04%	1.02	19.8%	109%	96%	1.14
Argent 46	0.02%	1.06	20.7%	110%	101%	1.09
<b>Avg Sov</b>	<b>0.00%</b>	<b>1.00</b>	<b>19.0%</b>	<b>100%</b>	<b>100%</b>	<b>1.00</b>

Source: AdCap based on Bloomberg

### Expected Returns for Sovereign Bonds in a Constructive Scenario

Since we believe most of this market preference is explained by the higher coupons, we expect the 2038s to replace the 2041s as the preferred Sovereign Bond as we approach to the step up of the 2038s, which will almost double its current coupon from the current 2.00% to 3.875% in July 2022.

In a constructive Scenario, in which Argentina reaches a full deal by March, we expect returns for the Sovereign Bonds ranging from 45% to 57% assuming the yield curve takes Ecuador's shape in Jan 21 (before Lasso's victory which also removed political uncertainty).

We expect the 2035s and 2038s to outperform given its high beta and higher coupon, respectively (Fig 6).

Fig. 3 - Sovereign Bonds Behaviour during Ups & Downs

Ups & Downs	Argent 29	Argent 30	Argent 35	Argent 38	Argent 41	Argent 46	Avg
Sep20 - Oct20	-25.3%	-29.1%	-29.7%	-27.8%	-25.9%	-24.9%	-27.1%
Oct20 - Nov20	8.0%	11.0%	14.5%	11.9%	14.7%	15.4%	12.4%
Nov20 - Dec20	-5.6%	-6.6%	-9.0%	-8.5%	-9.5%	-9.7%	-8.1%
Dec20 - Dec20	4.3%	7.4%	8.3%	7.8%	8.6%	8.0%	7.3%
Dec20 - Mar21	-18.3%	-19.1%	-21.0%	-16.5%	-15.6%	-18.5%	-18.1%
Mar21 - Jun21	18.0%	18.0%	18.9%	18.1%	18.7%	16.3%	18.0%
Jun21 - Jun21	-8.8%	-7.5%	-8.0%	-6.9%	-6.3%	-8.1%	-7.6%
Jun21 - Sep21	11.5%	11.5%	13.6%	10.8%	10.4%	13.1%	11.8%
Sep21 - Nov21	-20.3%	-21.7%	-20.3%	-18.7%	-18.8%	-20.1%	-20.0%
Nov21 - Dec21	9.7%	12.3%	13.1%	14.3%	14.5%	14.3%	13.0%
Dec21 - Jan22	-13.0%	-13.7%	-14.7%	-12.1%	-11.9%	-15.0%	-13.3%
Jan22 - Jan22	1.2%	1.6%	2.0%	2.2%	2.3%	2.4%	1.9%

Source: AdCap based on Bloomberg

Fig. 4 - Out / Underperformance vs Avg Sov Bond

Ups & Downs	Argent 29	Argent 30	Argent 35	Argent 38	Argent 41	Argent 46
Sep20 - Oct20	1.9%	-2.3%	-2.4%	-0.1%	1.3%	2.2%
Oct20 - Nov20	-4.3%	-1.3%	2.1%	-0.4%	2.4%	3.0%
Nov20 - Dec20	2.5%	1.5%	-1.3%	-0.3%	-1.2%	-1.1%
Dec20 - Dec20	-3.1%	0.1%	1.0%	0.5%	1.3%	0.7%
Dec20 - Mar21	-0.1%	-1.1%	-2.1%	1.6%	2.6%	-0.3%
Mar21 - Jun21	0.0%	0.0%	0.9%	0.1%	0.7%	-1.1%
Jun21 - Jun21	-1.1%	0.1%	-0.4%	0.7%	1.3%	-0.4%
Jun21 - Sep21	-0.2%	-0.3%	1.9%	-0.3%	-1.1%	1.3%
Sep21 - Nov21	-0.3%	-1.1%	-0.4%	1.3%	1.2%	-0.1%
Nov21 - Dec21	-3.1%	-0.1%	0.1%	1.3%	1.6%	1.3%
Dec21 - Jan22	0.3%	-0.3%	-1.1%	1.2%	1.5%	-1.1%
Jan22 - Jan22	-0.1%	-0.4%	0.1%	0.2%	0.4%	0.4%

Source: AdCap based on Bloomberg

### Constructive Scenario

Fig 6: Holding Period - Total Return

Bond	Jan 27 Close	Mar-22	Jun-22	Sep-22
Argent 29	\$ 32.4	48%	51%	56%
Argent 30	\$ 30.9	45%	49%	54%
Argent 35	\$ 28.2	57%	59%	63%
Argent 38	\$ 34.3	55%	61%	65%
Argent 41	\$ 32.2	47%	50%	54%
Argent 46	\$ 28.6	48%	50%	54%

Source: AdCap based on Bloomberg

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