Aberdeen Latin American Income Fund Limited

Aberdeen

Transcript

Piers Currie: Welcome, my name is Piers Currie; I'm Group Head of Marketing at Aberdeen Asset Management. What you're going to see and hear today is a summary short presentation regarding a proposed closed-end fund offering, the Aberdeen Latin American Income Fund Limited. I'm joined by Devan Kaloo, Head of Emerging Markets Equities at Aberdeen, and Brett Diment, Head of Emerging Market Debt.

Please note that once issued the prospectus should be read in its entirety by potential investors before making any application for shares. An investment in the shares of the Fund is suitable for investors capable of understanding the risks and evaluating them and the merits of such an investment and those who have sufficient resources to bear any loss which may result from it.

Moving on, I will now hand over to Devan to take you through the background to this new vehicle.

Devan Kaloo: Hello. What I would like to do today is to talk a little bit about the investment proposition in terms of the new Fund that we're looking to launch, the Aberdeen Latin American Income Fund, and then hand over a bit later on to my colleague, Brett, who will be talking about the macro changes that have occurred within Latin America and then I will go on and talk a bit more about some of the corporate changes and indeed the Fund itself.

In terms of the investment proposition, what we're looking for is for investments within Latin American equity and Latin American debt. In summary what we would say is that we believe that there have been significant changes in Latin America. On the one hand you've had major macro changes whereby fiscal discipline has been implemented, orthodox policy is pursued and that's allowed interest rates and inflation to come down. With that, a significant value has been seen in external debt, but no such rally has been seen to date in the local currency sovereign debt and that's the opportunity that we see. The one other feature of this is that as those interest rates have come down, it's allowed greater prospects for the domestic economy in Latin America to do a lot better as domestic consumption and domestic investment take hold.

On the micro side or the other side of the story, what you have is corporates which have significantly improved as well over the last 10 to 15 years. We're seeing that in terms of the profitability of the companies; they're significantly better than they were before; and of course perhaps most importantly the governance of these companies has improved significantly.

The second point I would make in terms of the proposition is that with this Fund you get exposure to two very experienced and well regarded teams, the Emerging Market Equity Team and the Emerging Market Debt Team have been covering the region for quite some time now and have worked very closely together on a number of products. We believe this is a tried and tested team that can provide the turns going forward.

The last point I'd make just in terms of the proposition is that the structure of this Fund is very attractive. We're looking for a yield north of 4% and we believe that the mix between equity and debt will certainly allow flexibility to do a progressive dividend going forward. Indeed, I think the most important element here is that because the Latin American debt that we're investing in is providing the yield, it gives us great ability on the equity side to be unconstrained and that's important, because we think going forward there are significant growth opportunities in Latin America and you want to be able to catalyse on that as much as possible.

The structure of the Fund is very simple and will be almost a carbon copy or a sister Fund to a very successful Aberdeen Asian Income Fund, simple, conservative, well run and we think a very good opportunity.

With that I hand over to Brett to talk about some of the macro changes that occurred in Latin America.

Brett Diment: The popular perception of Latin America has been that it's an area that suffered from high inflation, weak politics, and weak governance. It's very dependent on commodities and the US interest rate cycle and has had a poor company choice with the equities that were dominated by state companies or entrenched families. That's not the case; the region really has developed and this is what offers the opportunity for investors. We've seen some recognition of this by the markets. You can see it's been a relatively strong performing region in the equity space and also in the debt space we've seen some performance of Latin America and also a relatively attractive risk return profile, but we think we have significant further gains to come from this region.

What's changed? We have stable democracies in most of the region. We've had a switch between centre left and centre right in countries such as Brazil and Mexico; orthodox economic policies; inflation, as you'll see, has been tamed; and the risk profile has fallen. We now have countries like Brazil, Mexico, their hard currency, their US Dollar, bonds trade at far lower spreads than many developed countries and not just Greece and Spain, but also not far off where the UK trades, for example. Domestic consumption is gathering pace, the economy is strengthening and corporate standards greatly improved.

As evidence of this, here we look at debt to GDP numbers and you can see over the past ten years debt to GDP has been declining for most of the major economies in the region as policymakers before followed orthodox policies.

Inflation has also been very well contained. You can see, looking at Brazil, Mexico, Columbia and Peru here, the past six years inflation has remained in single digits throughout that period. Central Banks have moved to inflation targeting, monetary policy regimes and politically that's popular. Inflation typically hurts the poorer sectors of society and in democracies keeping inflation under control has got very strong support across the political spectrum in these countries.

Because the fiscal situation has been strong, Latin American countries learned some hard lessons in the 1990s. They learned that loose fiscal policy can have very negative economic consequences and as a consequence of that they really moved to balance their budgets. You can see that really paid fruit during the financial crisis we've seen over the past three years. If we look to 2008/2009, fiscal deficit in Latin America deteriorates from just 0.8 to 3.1% of GDP. Actually, the best performing region in the world's not only far better than the developed markets, US, UK, but also better than Asia and EMEA region.

As yet, this has not been discounted by the markets. The debt focus of this Fund will be on the local currency bond markets. These illustrate the yields available on ten-year Government bonds. Brazil, for example, a country, as you've seen, with low and contained inflation, and a strong fiscal stance, has got ten-year bond yields of 12.45. Inflation in Brazil is just over 5%, so we have very high real yields available for a strongly rated credit and that's how we're able to pay the yields on this Fund. The bulk of the heavy lifting will come from the fixed income side and we think over time these bond yields will fall, also leading to some capital gains for investors.

I'm now going to hand across to Devan, who's going to focus on the prospects and opportunities in the equity market.

Devan Kaloo: In terms of the economy and indeed the backdrop, it's an extremely positive one for equities and I think it's worthwhile here focusing on some of the returns and the profitability of the companies that you can find in Latin America. If you look at this chart, you'll see the return in equity and the gearing ratio or the net debt to equity ratios highlighted. The return on equity for Latin American equities overall has bumped between 15 and 20% over the last few years. That might not seem particularly impressive, but it is certainly at a premium to developed markets. It's even more impressive when you think that that's been achieved despite a major backdrop of deleveraging in the region. While they've been taking debt off their balance sheet, they have been able to sustain a return on equity, so essentially they have been improving their margins, been improving their profits, been improving their cash flow and that's extremely encouraging.

I think there are two key reasons why that's the case. The first is that many of the state-owned enterprises out in the region have discovered profits are as important as their social responsibility, but perhaps more importantly there's a much wider and growing pool of privately owned companies listing in the markets who are very concerned about the bottom line. Perhaps most importantly for us as stock pickers, these companies are also very aware of their requirements to all shareholders, so the governance standards in Latin America today are on par with certainly all the emerging markets and in some cases many of the developed markets. The big difference between today and 10 years ago is that the companies are significantly better than we've seen.

If we look at the next slide, what we're just trying to show is that while the valuations are slightly higher than you would find in developed markets, if you look on a price-to-book basis, we think this is more than justified by the fact that they're much more profitable. When you take into account that it's not just more profitable, that they're also growing their earnings faster, we think these higher valuations perhaps are certainly sustainable over the long-term and potentially could get higher or wider versus the developed markets.

In terms of dividends, we've seen continued growth, strong growth in dividends out of Latin American countries. They've certainly been growing at a faster rate than many other regions in emerging markets and certainly within the developed countries, but I think perhaps the most important thing to emphasise here is that in an uncertain world going forward, it's not necessarily a given that companies will maintain their payout ratios or indeed maintain their dividends. In developed countries you could see fallen profits leading to falling dividends and that certainly puts at risk equity income; and in emerging markets you might find that companies prefer to conserve cash or indeed invest cash, so it's important to highlight again that for this Fund we're not reliant on providing the income from the equities. As we've highlighted already, the heavy lifting will be done by the bonds.

Why Aberdeen? I think Aberdeen's investment style is fairly well known, but I would emphasise a couple of things. The first is that we are fundamental investors and that's true whether you're talking about the equities or the debt. In terms of the equities, we get out and look at the companies and we do hundreds of company visits in Latin America every year; and on the debt side we go out and visit the policymakers, the people who invest money, the people who have influence on the bond market to see what is happening on the ground and that's extremely important. It's about understanding first hand the risks that you're taking when you invest within the region. To be able to do that though, that's a labour intensive process and hence one of the reasons why we have one of the largest teams covering the region and certainly we're well resourced in that regard managing lots of assets under management within the region to be able to sustain that.

That has generated decent performance, so whether you're looking again at the equity or debt portion, we have significantly outperformed our peer group over all of the time categories, which then take us to the investment policy or the objectives of the Fund. The Fund's objective is to generate a yield of over 4% and certainly the target yield will be 4.25%. The restrictions on this Fund will be fairly limited, so the minimum and maximum restriction will be we will have a minimum in equities or bonds of 25% and maximum in equities or bonds of 75%. The Fund will be allowed to gear up to 20%, but it's highly unusual that we would get beyond 15%. We prefer to run our trusts in a conservative manner. Indeed when we look at borrowing, we will look to take out bank debt n US Dollars or Sterling, because our view is that over the long-term the emerging market currencies will appreciate relative to these developed market currencies and therefore potentially that's an additional source of value.

On the next slide just to give you some idea or colour of the investment universe, I think the first thing to say is that when you look at the bonds, we have significant liquidity within the bond universe. There is over $340 billion in Latin American sovereign local currency debt; that's big and liquid. With regard to the equities, what we have is a market which is large and growing and in particular we would point out the non-benchmark companies where there are over 600 of them currently listed in Latin America. These are the companies where we think there are some significant opportunities going forward.

In terms of allocation, you'll see that the big overweights for us would be Brazil and Mexico; that's where we think the best prospects are. Certainly, the other point to make is that we will be heavily skewed towards domestic consumption, because we think that's the long-term story, so overweight financials, overweight consumer staples, and overweight consumer discretionaries.

We have a number of slides talking about the corporate structure. As I said earlier on, this Fund will be very much a carbon copy or a sister fund of our very successful Asian Income Fund and there will be no surprise, if you're familiar with that, relative to this Fund.

If we can move on to the summary then, if I can just say a few comments. I think one of the great opportunities here is that Latin America still is relatively undiscovered and we think there are significant changes that have occurred at the macro and micro level that make this a very interesting investment opportunity over the long-term for anybody. Certainly we think that we'll be able to generate significant yield for those sorts of investors who are looking for that. Indeed in these uncertain times, the idea of diversifying your equity income or your income streams would be very attractive.

I suppose the last thing to say is that really we believe at Aberdeen that we have the team, the capability, the resources and the knowledge to be able to manage these Funds very well and for all of our investors. Thank you.

Piers Currie: We hope as time goes on we'll be able to post more information on the Aberdeen Latin American Income Fund website, which if you Google search should be easy to locate. Thanks Devan, thanks Brett. I look forward to talking to you again.

For further information:

www.latamincome.co.uk

Important information