INVESTLOGIC
Your Investment Connection

The Search For New Emerging Markets

Latin America's New Tigers forge ahead

Investor interest growing as Colombia and Peru economies boom

Not too long ago, most investors looking to put money into Latin America had a relatively simple choice: Brazil or Mexico, or maybe Chile. But not anymore.

A new group of countries in the region is emerging as a viable alternative. Characterized by youthful populations, growing middle classes, relatively low debt and dynamic economic expansion, these countries are poised to grab a bigger share of the region's growth and attract more money from international investors.

Brazil's economy is overheated. Argentina's economy is teetering as it battles inflation. Venezuela's president is fighting cancer. And the rebel group FARC in Colombia says it has stopped kidnapping people.

Should investors stay clear of these countries for any of these reasons? Or, on the contrary, are they reasons why now may be a good time to invest?

Before you ask those questions, you need to ask yourself: Why are you investing in Latin America in the first place when there are plenty of companies in your own country? That's a fair question. But if you consider that over the past 10 years Latin America has gained an average 18.68% annually, to just 2.85% for the Standard & Poor's 500 Index, the question then becomes: Why wouldn't you invest in Latin America?

But where in Latin America? Should a company's home country have much bearing on whether you invest? To be sure, the political, economic, regulatory and other risks within a country should factor into your decision on whether a company has potential as an

investment. But in general, your investments should be done on a stock-by-stock basis, not on a country-by-country basis. Most mutual fund managers, whether they're investing internationally or regionally, are stock pickers at heart, although they do pay varying levels of attention to the macro environment.

Target market is key

In Latin America, the target market a company serves is more important than the country where it is headquartered and where the stock is listed. Latin America has become more intertwined.

Regional tariffs and trade barriers have come down sharply over the past decade. Buying wood grown in Brazil and harvested by a Chilean company for use in Mexico is now commonplace. Arauco, a subsidiary of Empresas COPEC SA, does just that. Looking to buy a refrigerator in Argentina and made by a Brazilian company? Consider Whirlpool S.A .. Can't find peanuts while in Uruguay? Look at Almacenes Exito SA — a Colombian supermarket chain that has expanded to Uruguay and other countries in South America.

And it isn't just goods, the concept also pertains to services. Travel services, technology, telecommunications and airlines are examples of industries where companies based in Latin America do a thriving business in countries outside their base.

So, back to our original question: What countries should you invest in? Once you've resolved that picking stocks should be based on the stocks themselves, and not the countries they are in, you can then consider the regulatory, currency, political and economic risks within countries.

Country Risk

One source for finding country risk is Euler Hermes, a subsidiary of global insurance firm Allianz Because they're an insurer, they take into account things like whether the country has enough money to pay its debt, and whether it does so on time; the business environment, exchange rate risk and convertibility.

Country	Low Risk	Medium Risk	Sensitive Risk	High Risk
Argentina				X
Brazil	X			
Chile	X			
Colombia	X			
Costa Rica		X		
Ecuador				X
Mexico	X			
Panama	X			

Peru	X			
Venezuela				X

This is just one firm's analysis of risk, and doesn't take into account whether or not the country is a good environment for an equity market. But it does give a broad idea whether the country has a good environment for business.

As we said before, investing in equities is about stock picking, not countries. When investing, one of the criteria should be how an investment relates to your overall portfolio. For example, what is its correlation to the home country index. If you're in the United States, that index would be the S&P 500. But it's better to look at how a stock correlates to the S&P 500, rather than how a country correlates to the S&P 500.

So does that mean you should ignore some countries completely? Absolutely not. Stock picking in Latin America still is about the ability to "look under rocks" that someone else may have overlooked. It pays to invest in countries which have high growth potential, but maybe not as much stability. Colombia, for example, is a country that has made strong strides in erasing its image as a haven for drugs and rebels, transforming into a country where businesses are more welcome. The same goes for Uruguay and Panama, though to find equities in either of those countries you may have to go to stock exchanges in Canada or the United States.

If you have strong nerves and are comfortable with taking on more risk, you can also venture to Venezuela or Ecuador. You can probably find stocks there with low correlations to the U.S.. But remember, you get what you pay for!

Strong performance in the region makes investing there attractive

Standing out in this group of Latin America's "New Tigers," Colombia and Peru are growing at a fast clip and are expected to continue doing so. Their currencies are solid and stable, they have a grip on inflation, their credit ratings are stronger or steadier than most, and their governments have shown themselves willing to step up to the plate when things begin to come apart

Both countries have booming economies. Last year, Colombia grew 5.9% and Peru grew 6.9%. In 2012, Colombia's real gross domestic product is forecast to grow 4.7% and Peru's by 5.5%, according to the International Monetary Fund.

Both countries also have strong credit ratings. Each is ranked in the bottom rung of investment grade by Fitch, Moody's and Standard & Poor's, better than many in the region. Only Chile ranks above them in Latin America, and their ratings put them on par with Brazil and Mexico, and some European countries like Italy and Ireland.

Peru and Colombia are also among only six countries in Latin America to win a coveted "low risk" rating from Euler Hermes, a subsidiary of global insurance firm Allianz.

While Brazil, Chile and Mexico still have stronger credit ratings, more diverse trade, and stronger capital markets, they no longer demonstrate many of the characteristics of "emerging markets" that once made them the darlings of international investors surveying the region.

Although interest in Colombia and Peru is running high among investors, there are risks. The commodities boom has lifted both economies over the past decade and both are vulnerable to a potential decline in energy and metals prices, which has already begun. But positive underpinnings in both countries could help them withstand a long-term decline in commodities if it does in fact occur.

Peru's path to growth

After suffering through hyperinflation and economic hardship, Peru started opening up its economy and implementing reforms in the early 1990s. State-owned companies were privatized and investment barriers were removed. That laid the groundwork for the current economic boom.

Its rich deposits of gold, silver, copper, zinc and other metals have attracted billions of dollars of investment from foreign mining companies. The mining sector is a key source of tax revenues for the government.

Between 1999 and 2005, exports fueled Peru's economy, with mining playing a large role. But since 2006, the economy has been driven by private investment in sectors such as services, construction, manufacturing and mining.

The most important economic feature in Peru is the recreation of the middle class. As more Peruvians join the middle class, demand is growing for everything from new apartments and shopping malls to better health-care and education services.

The gleaming new office buildings in the San Isidro business district of Lima are a testament to this new prosperity. However, the barbed-wire fences and heavy security in the well-off neighborhoods, as well as the pueblos jovenes, or shantytowns, of the capital tell a different side of Peru's story. The economic boom has no doubt led to a dramatic reduction in poverty, but even with those gains, around 30% of the population is still poor, with poverty in rural areas particularly high. Any external shock could bring many people back below the poverty line.

In some parts of the country, such as in the northern Cajamarca region, the local population has opposed big mining projects proposed by foreign companies. Such social conflicts, while isolated, have presented a major challenge for the administration of President Ollanta Humala.

However, Peruvians in some poor, rural regions have not seen any benefits from the country's economic growth, he said. It's very difficult to convince a part of the population that mining respects the environment and can generate employment.

In addition to social conflicts tied to mining, Peru is also plagued by weak institutions, corruption, inadequate infrastructure and a large informal economy. Dollarization, or the widespread use of foreign currency, mainly U.S. dollars, is another challenge for the government and monetary policy.

Peru gold, copper mining opposition intensifies

Ever since Peru opened up its economy in the early 1990s, its resources have drawn foreign mining firms. The country has rich deposits of copper, silver and gold, as well as lead, zinc, tin and iron ore.

Minas Conga is estimated to hold 6.1 million ounces of gold and 1.7 billion pounds of copper. Like the Yanacocha gold mine, the project is a joint venture between Newmont, which has a majority stake, and Compania de Minas Buenaventura, a Peruvian precious-metals company. International Finance Corp. also has a small stake.

An analyst at the Peru Institute, Miguel Santillana, said there was bad blood from the beginning between the local community and the Yanacocha mine operators, as people in Cajamarca tend to associate mining with abuse of resources.

North of this sprawling capital city and high in the Andes Mountains lies Cajamarca, a region well-known in Peru for two main reasons: the conquest of the Inca Empire by Spain's Francisco Pizarro and the area's extraordinary wealth of natural resources.

Here, Colorado-based Newmont Mining Corp. has been operating Latin America's largest gold mine, Yanacocha, since 1993. The mine is nearing the end of its life and Newmont wants to develop the nearby $4.8 billion Minas Conga copper and gold project, which will be the biggest foreign investment in Peru's history. But the project has run into intense local opposition and five people were killed during recent protests, causing the government to impose a state of emergency.

Opponents, led by Cajamarca's president, contend that the project will harm scarce water resources in the area. Their position has clashed with that of Peruvian President Ollanta Humala, who officially announced his support for Minas Conga in late June. This conflict has become a high-stakes test of how Peru treats foreign investment. The country has more than $50 billion in mining investments in the pipeline and taxes from mining are a key source of government revenue.

Resolving the conflict is a major challenge for the one-year-old administration of Humala, whose approval ratings are declining even as the economy is projected to grow 5.5% this year and 6% in 2013.

The social conflict tied to Minas Conga is probably the highest-profile one in Peru now, but it's certainly not the only one. For instance, in the south of the country, Xstrata has recently seen violent protests against its Tintaya copper mine, which the Anglo-Swiss firm wants to expand.

Colombia: A reprieve from war and violence

Colombia emerged much more recently from its civil war than Peru did. In fact, the war with the FARC rebels is still simmering today, and the drug trade is likewise still active. But by strengthening its military and reducing bombings and kidnappings, and by going after the leaders of the drug trade, Colombia appears to have convinced foreign investors that the changes are here to stay.

And, the growth in Colombia's economy has a lot to do with the reduction in violence.

Like Peru, Colombia's economy has been lifted by the commodities boom. But unlike Peru, Colombia doesn't rely on metals as much, and instead has a large contribution from energy and agriculture.

If the government manages to lift oil production from the current level of about 1.1 million barrels per day to about 1.5 million barrels per day within five years, and if oil and energy prove to be one of several commodities that buck a downward price trend, Colombia could see substantial growth from the energy sector.

Also, while agricultural commodities have underperformed other industries over the past decade, some analysts do see a recovery in food commodities. Finance Minister Juan Carlos Echeverry is one of those. "Colombia is the only Latin American country that didn't

have an economic miracle. Colombia has cocoa, palm oil, rubber and cattle — any one of those could be that miracle."

Colombia has also built a middle class that has propelled industries such as retail, manufacturing, telecommunications, housing, transportation and tourism. It also has a youthful population — a key factor in driving growth. Forty percent of the total population is below 20 years old, and 80% is below 50 years old.

Colombia's government has also pledged to spend $100 billion over the next 10 years on rebuilding infrastructure. The government of President Juan Manuel Santos has also promised to build 100,000 homes and give them away free to the poor, and pledged to make 140,000 mortgages available to low-income families.

Colombia's building sector poised for growth

If all goes well, Colombia's antiquated system of pot-holed roads and highways will be supplemented by a modern network of superhighways and roads built over the next few years.

Colombians and foreigners have long complained about the poor roads and deteriorating infrastructure in Colombia. Apparently the government has finally heard that message.

Prosperity highway

The first major project to be built is the so-called Prosperity Highway. Infrastructure companies have already lined up to form bidding consortiums on the estimated $8 billion project.

"Highway" is a misnomer. The Prosperity Highway is actually a network of highways designed to link Colombia's interior state of Antioquia with ports on the Pacific Coast on the West and the Caribbean in the North, as well as major cities in Colombia and beyond.

It will carry trucks full of raw materials — nickel and gold, coffee and palm oil — to ports that connect Colombia with its traditional partners in Europe and the United States and

emerging partners like China and Brazil. And it will take Colombians and tourists to places that were previously hard to reach.

At least four major Colombian public companies are expected to submit bids. They are Grupo Odinsa , Construcciones El Condor, ConstructoraConconcreto and InterconexionElectrica, known as ISA. But they will also compete with several closely held companies in Colombia and with several foreign companies from Brazil, Italy, Spain, Canada and others.

It's hard to say which companies will end up with contracts. ISA has the upper hand, having designed the plan at an estimated cost of more than $20 million. But ISA is an electric company at heart, and only a year ago formed a road construction unit to bid on projects.

Bidding process

Forming the right consortiums will be key to winning bids. The public and the press are keeping a close eye on the bidding process. Colombia is well-known for corruption, and recent changes to make the court system more effective and less prone to bribes will be a test for the administration of President Juan Manuel Santos — and of the Colombian congress.

The Prosperity Highway is just one of many infrastructure projects that the government has said it wants to build over the next 10 years. Finance Minister Echeverry has said the Colombian government wants to spend $100 billion over the next 10 years. For many of those projects, the government will need congress's approval — and given the time it has taken to win approval for the Prosperity Highway, approval for many of those projects could take two years or more, with construction adding even more time.

Nonetheless, at this point, most Colombians agree on the need for spending money on infrastructure. The growth of the Colombian economy has helped create a window, which could close at any time.

An estimated 28 projects are scheduled to be auctioned within months, all aimed at maintaining Colombia's existing roads, bridges and dams. Many of those will be bid on by Colombian companies. For example, El Condor is being considered on a major project in Medellín to build the proposed Ituango hydroelectric plant. A decision on that should be made soon.

The projects will benefit infrastructure companies and others as well. The projects will need financing, and BanColombia could be one source that infrastructure companies reach out to. For suppliers, cement companies will be among the major beneficiaries. Cementos Argos) is likely one of those.

It's no wonder that Cementos Argos decided to split off its infrastructure company into Inversiones Argos couple of months ago. With the potential of winning bids in the future, Inversiones Argos stands better-positioned to bid on its own than as part of a conglomerate, while Cementos Argos gains as a supplier.

Foreign direct investment in Colombia has been growing at a brisk pace, up 25% in the first four months of 2012 over the same period a year ago. Oil and energy still make up a

large portion of that, but infrastructure projects could lift that even higher over the next six months.

As the war with the guerrillas is winding down, and with fewer kidnappings, and an economy expected to maintain strong growth, Colombia stands to benefit from higher foreign direct investment.

Investments : Consumer goods, infrastructure, mining surface as solid bets

Think young and think basic needs when you consider building exposure to Colombia and Peru.

Many consumers who make up the countries' youthful population and increasingly affluent middle class are out there to buy their first car, their first house, starting to engage in credit-card transactions and out to buy their first washing machine.

It's that increase in consumption that puts sectors such as consumer staples and financial institutions, and companies including Peru's largest banking firm Banco de Credito and consumer-goods maker Alicorp SAA on solid footing.

In addition to a youthful population, Peru boasts a wealth of natural resources: it's the world's second biggest producer of copper and silver; it is also an important gold producer. Meanwhile, Colombia is undergoing an oil boom, a favorable development for majority state-owned oil producer Ecopetrol SA.

Economic activity in both countries stands out in the region, with 2011 growth of 5.9% and 6.9% in Colombia and Peru, respectively, outstripping rates in most of the region and in developed economies world-wide. Even as the global economy slows, the International Monetary Fund expects Peru to grow 5.5% this year and 6% in 2013. Colombia is projected to grow by 4.7% this year and 4.4% in 2013.

Colombia, meanwhile, has touted a near doubling in foreign direct investment over a year. And after double-digit losses in 2011, equity benchmarks in Colombia and Peru saw jumps of at least 20% in local currency terms this year before paring year-to-date gains.

Investor interest in these markets reflects a remarkable improvement for both countries, where decades of political instability in Peru and civil war and battles over the cocaine trade in Colombia kept both off many investors' radar.

Now, the two of them are extremely attractive markets that have gone through political and economic turnarounds.They offer a very good macroeconomic story and hot territories where infrastructure, commodities and investments are potentially huge.

But risks remain, underscored by protests against expansion in resource equity index fell 11%, the blue-chip Colcap index lost 1% and Lima's LSE General Index dropped 14% as investors dumped those emerging markets seen as riskiest in light of slowdowns in China and Europe.

ETFs, mining stocks

For those captivated by the countries' growth prospects, there is a slate of U.S.-listed securities from which to choose, though analysts say they'd like to see the list grow. One of the newest offerings is Peru's Cementos Pacasmayo SAA, whose shares debuted on the New York Stock Exchange in February.

Investment managers say exchange-traded funds, along with American Depositary Shares, including BanColombia SA , are the easiest vehicles for retail investors. The iShares MSCI All Peru Capped Index Fund from BlackRock Fund Advisors and the Global X FTSE Colombia 20 ETF are among the ETFs that provide exposure to the countries.

While companies supplying goods to consumers are hot, one of Latin America's traditional strengths — its vast resources in energy, metals and minerals — still presents plenty of opportunity. Its offerings include the Global Resources Fund and the Gold and Precious Metals Fund , which held a stake in Peruvian mining heavyweight Buenaventura SA.

Keeping in mind the need for vast infrastructure improvements in Peru, we can point to Ferreycorp SA , a distributor of Caterpillar Inc.-branded industrial equipment. Ferreycorp only trades on the local exchange.suggesting that retail investors work with a broker to gain access to locally traded equities.

Another way to think about investing in Colombia or Peru is to think of Canada, including Toronto-based Pacific Rubiales Energy Corp. Rubiales runs Colombia's biggest oil field and has expanded to Peru.Rewards and risks

An indicator of interest in a country's prospects, foreign direct investment in Colombia surged more than 90% in 2011 from the year-ago period to a record $13.2 billion.

Peruvian stocks stumbled last year, in significant part because many investors were very worried about President Ollanta Humala. Markets were nervous that Humala would nationalize natural-resources assets, much like Hugo Chavez has done as president of Venezuela. But instead Humala adopted market-friendly policies.

It seems he learned a lesson from former Brazilian President Lula instead of Chavez...and that's a good point for Peru. It has a lot of resources and the Peruvian people work hard.

Along with global slowdown concerns, analysts say risks to the Peruvian and Colombian economies include lower prices for natural resources and pullbacks in demand for commodities, particularly from China, which both Peru and Brazil call their largest trading partner.