Fixed Income Investing Amidst a Commodities Boom

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ANALYST INSIGHT

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Commodities, particularly ones linked to capital expenditure such as iron and copper tend to perform well in periods of high growth and infrastructure development. Goldman Sachs projects that copper prices will reach an average of US$11,875 per tonne by end 2021, up from as low as US$4775 in June 2020. The current price runs in commodities, if proven to be long term as in the case of a continued upcycle should therefore be an important variable that we factor into our investment decisions. A particular question that is to be asked is in relation to fixed income, particularly sovereign bonds, and that is, who would be the winners from a continued commodity surge and what are the actual channels through which they win?

The most obvious conclusion is that the most likely winners are those commodity exporting nations. Numerous research such as Restrepo-Echavarria et al (2016) and McGregor (2019) will cite that the bond spread of commodity exporting nations tend to be highly negatively correlated to commodity prices. To understand the nuances in this we must understand that for credit analysis, major components that drive both ratings and spreads are the current levels of debt in the country, the level of government revenues and also the projected growth of the local economy. We can then appreciate how surging commodity prices impact these factors for developing countries and by extension the quality of their debt.

Rising commodity prices implies improving terms of trade (the ratio of the price of imports to the price of exports) which facilitates an improvement in what is known as the trade balance. This is the value of exported goods minus the value of imported goods. The Trade balance is a component of the overall Current account balance which encompasses trades in goods, services, transfer payment etc. Rating agencies often use the trend in the current account balance as one of the measures to judge a sovereign's credit quality. A trade/current account deficit must be funded from somewhere. When people in a country are buying more from abroad than they're selling, this leads to a build up of foreign claims on local assets which primarily shows through rising external or public debt.

While in theory an improving term of trade should point to reduced debt, there are several caveats to consider. Firstly, the long-term impact on debt might depend on government. Government expenditure is often sticky upwards, and so spending might increase with revenues in a boom and not decline in a downturn leading to greater long-run debt. Hence the quality of Government resource management is a key factor in determining which sovereigns benefit the most from booms. Secondly, the extent of the impact prices will have on the current account will depend on the ownership structure of the sector. For example, a study done by Medina, Monro & Soto (2007) decomposed the variance of the current account for Chile and New Zealand and noted that commodity price increases had a smaller impact on the current account for Chile, with one reason being the higher degree of foreign ownership which offset trade surpluses with investment income deficits due to copper profits accruing to non-residents.

In the case of non commodity exporting countries, high commodity prices, particular for essentials such as crude, has a deleterious impact on the current account and debt sustainability. It also has the possible effect of raising domestic inflation (which places upward pressure on bond yields and domestic currency depreciation). It is expected that the sovereign credit of these net importer would suffer the most from rising prices. In the context of the Latin America and The Caribbean, such countries include Uruguay, Chile, Peru and most caribbean island nations outside of Trinidad which are dependent net oil importers including, Jamaica, which means that even JAMAN bonds would be negatively impacted. On the flip side, Net exporters such as Colombia, Mexico and Ecuador stand to benefit from rising crude prices and might therefore reflect opportunities to look out for.

Lastly terms of trade improvements might impact the quality of exporting nations' credit by its impact on Government revenue and growth. The windfall through higher revenue from the exporting sector increases the ability of government to pay down debt and/or invest in growth inducing infrastructure further boosting credit capacity. In the context of a floating exchange rate this point is further improved as more exports, all things else constant, will appreciate the domestic currency, reducing the real cost of foreign denominated debt. The potential caveats to this include the prior point of possible poor resource management by government but also the phenomena of Dutch disease which might impact other sectors of the domestic economy. 'Dutch disease refers to the expansion of some sectors of the economy (in this case the commodity export sector due to higher prices and profits pulling in labor) and a decline in other sectors as labor and investment is pulled into the commodity sector. The sectoral impact of commodity prices also presents investment opportunities in the Corporate bond sphere with corporations operating in the commodity spaces enjoying higher margins and profitability. Credit rating agencies incorporate sector outlooks in their credit analysis, and it is common to see credit downgrades/upgrades depending on downward/upward trending commodity prices. We have for example been seeing more US exploration and production companies issue lower yielding debt as oil prices recover from 2020 lows.

In conclusion rising commodity prices can greatly impact the quality of debt issued by commodity producing nations and corporations and as such if the current trend in commodity prices (particularly copper and capex commodities) continues, these entities will likely benefit. However, an investor would be better able to extract maximum benefits from monitoring countries that have a history of proper management frameworks in place for export earnings and also countries where the benefits from price increases more directly accrue to government and to the actual owners of external debt locally.

References
Juan Pablo Medina & Anella Munro & Claudio Soto, 2007. "What Drives the Current Account in Commodity Exporting Countries? The Cases of Chile and New Zealand," Working Papers Central Bank of Chile 446, Central Bank of Chile.
CNBC, Goldman says copper is the new oil, raises price forecast to $11,000 per metric ton, retrieved from: https://www.cnbc.com/2021/04/14/goldman-says-copper-is-the-new-oil-raises-price-forecast.html
McGregor, T. (2019). Pricing Sovereign Debt in Oil-Rich Economies.
Restrepo-Echavarria, P., Mendoza, E., & Hamann, F. (2016). Commodity Prices and Sovereign Default: A New Perspective on The Harberger-Laursen-Metzler Effect. In 2016 Meeting Papers (No. 806). Society for Economic Dynamics.

Further Suggested Reading
Alberola, E., & Benigno, G. (2017). Revisiting the commodity curse: a financial perspective. Journal of International Economics, 108, S87-S106.
IMF : Many factors go into assessing how much debt an economy can safely carry, link: https://www.imf.org/external/pubs/ft/fandd/2020/09/what-is-debt-sustainability-basics.htm

LOCAL EQUITIES MARKET

For the week ended Friday, our local stock market decreased week-over-week. The JSE Combined Index decreased by 1.38%, the Main Market Index decreased by 1.42%, the JSE All Jamaican Composite Index fell by 0.39%, the JSE Junior Market Index declined by 0.86%, and the JSE USD Equities Index declined by 1.31%.

During the week, MPC Caribbean Clean Energy was the largest gainer, rising by 27.33% to close at J$148.49. The biggest loser was Express Catering Ltd. which fell by 14.02% to close at J$5.52.

Year to Date, The Junior Market Index (+26.28% YTD) continues to outpace its Main Market counterpart (+8.97% YTD).

As of Friday June 20t5hth, 2021, Overall Market activity resulted from trading in 109 stocks of which 46 advanced, 54 declined and 9 traded firm. Market volume amounted to 81,653,332 units valued at over $706,609,143.77. Wigton Windfarm Limited ordinary shares was the volume leader with 22,117,612 units (27.09%) followed by Transjamaican Highway Limited with 5,997,853 units (7.35%) and Future Energy Source Company Limited ordinary shares with 4,289,032 units (5.25%)

Revisiting relevant news during the week:

REMITTANCE and retail cambio revenues have helped to reverse the losses recorded by Lasco Financial Services in 2020.

https://www.jamaicaobserver.com/sunday-finance/remittance-retail-cambio-main-drivers-of-growth-for-lasco-financial_224642?profile=1056

TransJamaican Highway Limited (TJH) is proposing to develop new interchange lanes to curb the growing problem which it expects to get worse especially with the growth of construction.
https://www.jamaicaobserver.com/business-report-daily-biz/transjamaican-highway-plans-to-introduce-interchange-lanes-to-address-traffic-issue_224590?profile=1056

Members of the micro, small and medium-sized enterprises (MSME) are set to benefit from increased access to finance following the recent launch of a programme by Government which will see the sector benefiting from loans at a concessionary interest rate of 4.75 per cent per annum.
https://www.jamaicaobserver.com/business-report/msmes-to-benefit-from-new-4-75-per-cent-interest-rate-loan-facility_224563?profile=1056

Jeffrey Moss-Solomon, general manager at Jamaica Grains and Cereals, a Seprod Group subsidiary, and project manager for construction projects underway, says the group's new warehouse is expected to be commissioned in first quarter of 2022 while new office space under development is slated for the third quarter of 2022.
https://www.jamaicaobserver.com/business-report/seprod-s-building-projects-get-covid-19-tweak_224547?profile=1056

Regional carrier Caribbean Airlines Limited (CAL) in its first quarter performance this year reported US$25.7 million or TT$172.7 million in losses — a 75 per cent downturn in revenues when compared to the corresponding period of last year.
https://www.jamaicaobserver.com/business-observer/caribbean-airlines-downsizes-due-to-covid-19-losses-450-jobs-to-be-retrenched-as-company-seeks-to-restructure_224291?profile=1056

Index	25/6/2021	18/6/2021	31/12/2020	Week/Week	Year-to-Date
JSE Main Market	431,109.83	437,322.11	395,614.93	-1.42%	8.97%
JSE Junior Market	3,338.17	3,367.03	2,643.38	-0.86%	26.28%
JSE Combined Market	432,634.29	438,670.37	392,435.92	-1.38%	10.24%
JSE USD Equities Market	195.46	198.06	186.30	-1.31%	4.92%
JSE All Jamaican Composite Index	473,387.69	459,273.23	433,521.09	3.07%	9.20%

INTERNATIONAL DEVELOPMENTS

Stocks rebounded from the previous week's declines, bringing the S&P 500 Index and the technology-heavy Nasdaq Composite index to new highs and helping both record their best weekly gains since early April. Stocks moved steadily higher through much of the week, if on generally lackluster summer volumes, according to T. Rowe Price traders. Energy shares fared best within the S&P 500 as oil prices reached their highest levels since October 2018 on falling global inventories. Utilities and real estate stocks lagged.

Moderating inflation fears may have factored in helping reverse the previous week's drop. Some signs emerged that supply chain pressures that had caused a spike in commodity prices were easing. Lumber prices continued a sharp decline from record highs, and metal prices came under pressure as China released stockpiles to cool the market.

Durable goods orders rose less than expected in May, with many analysts pointing to supply chain issues, while weekly jobless claims came in higher than expected, at 411,000. New home sales fell 5.9% in May, and previous months' sales were revised lower, with many builders citing materials shortages and costs. IHS Markit's gauge of June manufacturing activity beat expectations and climbed to a record 62.6 (with readings above 50 indicating expansion). Conversely, the firm's services gauge came in much lower than anticipated (64.8)—if off another all-time high of 70.4 in May. Finally, personal spending was flat in May, defying expectations for a 0.4% gain. Supply shortages, particularly in autos, again appeared to be at work.
https://www.troweprice.com/personal-investing/resources/insights/global-markets-weekly-update.html#US

Top Things to Watch in Markets in the Week Ahead

1. **Jobs report:** The June nonfarm payrolls report is expected to show that the economy added 675,000 new jobs, pushing the unemployment rate down to 5.7% from 5.8%.

2. **Economic data:** Ahead of Friday's jobs report, markets will get updates on pending home sales, ADP private sector payrolls, jobless claims and ISM manufacturing activity.

3. **Half time:** Investors may be sorry to see the first half of the year end after a strong six months in markets. Global stocks are on track to post their second strongest H1 gains since the turn of the century, but the second half looks harder to predict.

4. **OPEC+ meeting:** The Organization of the Petroleum Exporting Countries and allies, known as OPEC+ will hold a series of meeting in the coming week to review the situation in the global oil market ahead of an official meeting on Thursday. Thursday's meeting is expected to result in another boost in output as the demand outlook continues to recover. Oil prices climbed to their highest since October 2018 on Friday, putting both benchmarks up for a fifth week in a row.

5. **EURO zone inflation:** The euro zone is to release flash June inflation figures on Wednesday as the debate around rising price pressures continues. Euro zone inflation rose above the ECB's 2% target in May, but ECB chief economist Philip Lane has dismissed inflation pressures as temporary, pointing to weak wage growth.

https://www.investing.com/news/economy/top-5-things-to-watch-in-markets-in-the-week-ahead-2543304

Index	25/6/2021	18/6/2021	31/12/2020	Week/Week	Year-to-Date
Dow Jones	34,433.84	33,290.08	30,606.48	3.44%	12.51%
S&P 500	4,280.70	4,166.45	3,756.07	2.74%	13.97%
NASDAQ 100	14,345.18	14,049.58	12,888.28	2.10%	11.30%
FTSE 100	7,136.07	7,017.47	6,460.52	1.69%	10.46%
Euro Stoxx 50	4,120.66	4,083.37	3,552.64	0.91%	15.99%

Local Economic Conditions

Local Foreign Exchange Market

- Our local currency depreciated marginally by 0.49% against the U.S. Dollar week on week to settle at $151.28 as at close of trade Friday, relative to $150.55 per US$1.00 at the end of the prior week. Year to date, the Jamaican dollar has depreciated by approximately 6.05%.

Interest Rates and Inflation

- Since the onset of the pandemic in March 2020, market volatility has declined significantly. Notwithstanding, the BOJ maintains its position; supportive of the wider economy and continues to hold the policy rate at 0.50%.

- At this rate, based on its assessment, the BOJ notes that inflation will generally continue to remain within the target of 4.0% to 6.0% over the next two years.

- As at May 2021, point-to-point was recorded at 5.0%.

Currency Pair	25/6/2021	18/6/2021	31/12/2020	Week/ Week	Year-to-Date
JMD: USD	151.28	150.55	142.65	-0.49%	-6.05%
JMD:CAD	123.48	123.42	111.41	-0.05%	-10.84%
JMD:GBP	210.05	210.32	193.66	0.13%	-8.46%

Unit Trust Performance

- Year to Date, The Money Market Fund has increased by 1.92%, the FX Bond Portfolio has increased by 0.84%, the F.X. Growth Portfolio increased by 2.80%, the Real Estate Portfolio has decreased by 2.03% and the Capital Growth Fund has grown by 10.64%.

- Barita's Collective Investment Schemes ("CIS") offer the opportunity for investors to remain invested in the market at this delicate stage of the market cycle; moreover, there is a diversification benefit and opportunity to have a professional portfolio manager make the best-in-class professional judgements on your behalf.

- The F.X. Growth Fund, which is benchmarked against the S&P 500, has increased by 13.97% year to date.

- As at June 25th, 2021, the Capital Growth Fund has delivered a YTD return of 10.64%.

- The FX Bond Portfolio remains an attractive fixed-income portfolio, particularly when viewed within the context of global interest rates which have declined significantly as central banks maintain low policy rates to drive the economic recovery.

"It's not how much money you make, but how much money you keep, how hard it works for you, and how many generations you keep it for."

– Robert Kiyosaki

Unit Trust

Unit Trust Fund	29/4/2021	17/6/2021	Week/Week Return	Year-to-Date Return	1 Year Return	Yield
Capital Growth	93.90	93.00	0.97%	10.64%	21.15%	-
Money Market	15.0592	15.0472	0.08%	1.92%	3.62%	2.26%
Income Portfolio	100.00	100.00	-	-	-	2.26%
FX Bond Portfolio (US$)	1.3676	1.3682	-0.04%	0.84%	5.73%	1.95%
Real Estate Portfolio	5,716.61	5,812.79	-1.65%	-2.03%	-12.30%	-
FX Growth Portfolio	1.0265	1.0244	0.20%	2.80%	16.20%	-

If you're a millionaire by the time you're 30 but blow it all by age 40, you've gained nothing. Grow and protect your investment portfolio by carefully diversifying it, and you may find yourself funding many generations to come.

- Robery Kiyosaki

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Equities

Stock Ticket	Stock Information (As at June 25th, 2021)	Analyst Outlook
WISYNCO Wisynco Group Ltd	P/E: 21.50 P/B: 3.89x Price: J$15.48 Div Yield: 1.23%	**OVERWEIGHT** The local fiscal support to both households and businesses was instrumental in maintaining individuals' consumption capacity, particularly those furloughed and made redundant, which supported the demand for consumer staples distributed by manufacturers and distributors Wisynco. We expect that with continued fiscal support through either direct household support or government spend on projects to stimulate employment, Wisynco's business will thrive in this environment.
LASM Lasco Manufacturing	P/E: 16.32x P/B: 2.86x Price: J$5.45 Div Yield: 1.11%	**OVERWEIGHT** The local fiscal support to both households and businesses was instrumental in maintaining individuals' consumption capacity, particularly those furloughed and made redundant, which supported the demand for consumer staples distributed by manufacturers and distributors LASM. We expect that with continued fiscal support through either direct household support or government spend on projects to stimulate employment, LASM's business will thrive in this environment. Given that more restrictive curtailment measures do not seem likely, LASM is likely to perform better than in the April - June quarter. The national curfew measures were particularly restrictive and, therefore, negatively impacted LASM's revenue growth.
LASD Lasco Distributors	P/E: 15.51x P/B: 2.11x Price: J$4.02 Div Yield: 1.27%	**OVERWEIGHT** The local fiscal support to both households and businesses was instrumental in maintaining individuals' consumption capacity, particularly those who were furloughed and made redundant, which supported the demand for consumer staples distributed by manufacturers and distributors as LASD. We expect that with continued fiscal support through either direct household support or government spend on projects to stimulate employment, LASD's business will thrive in this environment.

Ratings Definitions

OVERWEIGHT/BUY
Exposure to this asset should be between 5% and 10% of your total portfolio

MARKETWEIGHT/HOLD
Exposure to the asset should be equal to 5% of your total portfolio

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Reduce exposure in your portfolio to less than 5% for this particular asset

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Stock Ticker	Stock Information (As at June 25th 2021)	Analyst Outlook
SEP Seprod Limited	P/E: 18.44x P/B: 3.14x Price: J$72.28 Div Yield: 0.83%	**OVERWEIGHT** Seprod has undergone significant structural changes within the last 5-years aimed at improving the underlying performance of the company. Within this period, particular emphasis has been placed on optimizing the distribution, warehousing and logistics capabilities of the company. This gradual, multi-year, improvement was accomplished through reinvestment within the organization coupled with strategic acquisitions aimed at increasing the distribution reach and quality of the company. Another major change was the closure of the Group's loss-making sugar division; a move that enhanced shareholder value. These changes have positioned Seprod to deliver robust growth through an expansive product mix and access to consumer markets both locally and regionally.
PROVENJMD Proven Investments Limited	P/E: 17.79x P/B: 1.14x Price: $35.61 Div Yield: 2.21%	**OVERWEIGHT** Given the current economic environment, characterized by low interest rates and increased uncertainty, PIL has shifted from the carry trade business to more private equity and real estate ventures, thereby allowing for diversification benefits to be realized - particularly as it relates to the "spreading" of risk. Given the business model of PIL wherein capital is used to acquire strategic assets, this APO is expected and should make the stock accessible to a wider pool of investors. At present, only a small subset of listed companies pursue private equity investments which makes PIL an attractive security for investors who want the liquidity the stock market provides as well as exposure to non-listed companies that can provide value.

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PROVENUS Proven Investments Limited	P/E: 18.06x P/B: 1.15x Price: US$0.25 Div Yield: 3.11%	**OVERWEIGHT** Given the current economic environment, characterized by low interest rates and increased uncertainty, PIL has shifted from the carry trade business to more private equity and real estate ventures, thereby allowing for diversification benefits to be realized - particularly as it relates to the "spreading" of risk. Given the business model of PIL wherein capital is used to acquire strategic assets, this APO is expected and should make the stock accessible to a wider pool of investors. At present, only a small subset of listed companies pursue private equity investments which makes PIL an attractive security for investors who want the liquidity the stock market provides as well as exposure to non-listed companies that can provide value.
SCIJMD Sygnus Credit Investments	P/E: 13.25x P/B: 0.64x Price: J$15.00 Div Yield: 2.39%	**OVERWEIGHT** Sygnus provides funding to Mid-Size firms within the lending market, which is considered to have a higher risk and generally overlooked by providers of traditional financing forms. This provides a largely untapped/under-tapped niche market within the Caribbean lending space for Sygnus, a few direct competitors. The flexibility in the financing terms offered by the Company is a clear advantage to borrowers, and it allows SCI to manage its credit risk to generate double-digit risk-adjusted returns on investments, which, consequently, bolsters shareholder value.
SCIUSD Sygnus Credit Investments	P/E: 19.74x P/B: 0.95x Price: US$0.15 Div Yield: 1.66%	**OVERWEIGHT** Sygnus provides funding to Mid-Size firms within the lending market, which is considered to have a higher risk and generally overlooked by providers of traditional financing forms. This provides a largely untapped/under-tapped niche market within the Caribbean lending space for Sygnus, a few direct competitors. The flexibility in the financing terms offered by the Company is a clear advantage to borrowers, and it allows SCI to manage its credit risk to generate double-digit risk-adjusted returns on investments, which, consequently, bolsters shareholder value.

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CCC Caribbean Cement Company	P/E: 24.84x P/B: 6.08x Price: J$93.38 Div Yield: 0.00%	**OVERWEIGHT** Throughout the COVID-19 pandemic, all industries have been affected by what has been a significant downturn in aggregate demand as the pandemic has created a need for persons to reduce travelling and physical interaction. Despite this setback which predominantly materialized in Q2 of 2020, the construction industry has rebounded significantly (7.0% in Q3 2020 and 6.2% in Q4 2020), ahead of many other industries and well ahead of the overall economy. This strong growth over the last two reported quarters has been a significant tailwind for Caribbean Cement and the company has consequently seen a significant increase in the demand for its product, well in excess of previous years. On the heels of what has been a great year for the company, management expects demand to increase further, fuelled by upcoming government projects that will require substantial cement deposits. The recent government budget lends to this expectation as one of the main components of the government's SERVE Programme is infrastructure development. With that said, the company is positioning itself to meet this demand while maintaining its more efficient cost structure which was displayed in 2020, chief among these was the reduction of debt, which in turn reduced the company's cost of debt.
LAB The Limners and Bards Limited	P/E: N/A P/B: 5.62x Price: J$3.02 Div Yield: 2.45%	**OVERWEIGHT** The Lab provides a unique opportunity for investors to get exposure to the first and only advertising and film production company listed on the Jamaica Stock Exchange (JSE). The Lab's business model is built on providing innovative solutions to clients through its main services including its brand/communication strategy, campaign concepts & execution, media buying, and film production. Throughout the pandemic, the company has repositioned its business to meet the demand of clients who needed digital solutions. Consequently, while many industries and companies faltered in 2020, The Lab reported strong top and bottom-line growth of 44.30% and 34.13%, respectively. This growth has continued into 2021, reflecting significant double-digit growth in two of the company's three operating segments. Against the backdrop of a strong, stable business model coupled with robust financial performance, we have issued an OVERWEIGHT recommendation for The Limners and Bards Limited.

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CPFV Eppley Caribbean Property Fund SCC	P/AFFO: 27.09x Price: J$42.92 AFFO Yield: 3.69%	**OVERWEIGHT** Since Eppley became the investment manager of the fund, there has been a material improvement both in portfolio's country exposure and type of real estate structures. This has led to a steady increase in the total square feet of the portfolio and increase Net Asset Value (NAV) with diversification. The Fund's pivot towards introducing Jamaican assets, especially in the industrial space will have a positive material impact on the company's long-term performance. This as the Manufacturing and Distribution (M&D) and construction industry have shown material resilience to the impact of COVID-19. As such, the continued focus on improving value to shareholders through divesting away from Barbados and retail properties will act as a positive tailwind for the long-term performance of CPFV.
Mailpac Mailpac Group Limited	P/E: 21.00x P/B: 18.00x Price: J$3.78 Div Yield: 3.97%	**OVERWEIGHT** Having raised just under $500 million in its November 2019 junior market initial public offering (IPO), by March of 2020 the global economy was grappling with the COVID-19 crisis. This posed both a challenge and an opportunity for the Mailpac Group given the sudden and immediate need for e-commerce capabilities in light of social distancing and other non-medical interventions to reduce the spread of the virus. That the company was able to generate $1.7 billion in revenue during 2020 is demonstrative of the management's agility and competence of the company's leadership. They were able to pivot in building both scale and capacity, which are likely to sustain Mailpac's performance prospectively, given the likely scenario that e-commerce is likely to become more enconsced among Jamaica consumers, across various social classes.

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