

ECONOMY

Of populist policies,
debt restructuring and investment



Istanbul, Turkey.
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Think Strategically: Peer-to-Peer Conversations

Swain Upholds FOMB Authority to Approve, Certify Fiscal Plans, Ends Roadblock With Gov't; Fortaleza Capital Partners Talks Wealth Management

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Week in the Markets: Turkey crisis, liquidity concerns

The three main market indicators closed with mixed results with the Dow Jones Industrial Average standing at 25,313.14, or a loss of 149.44 for the week. The S&P 500 closed at 2,833.28, or a loss of 6.97 for the week, and the Nasdaq closed at 7,839.12, a gain of 27.11 for the week. The mixed results are a consequence of several factors having an impact on the markets. On one front, we have the Turkish lira meltdown that hit new record

lows. The lira is down more than 34 percent since January, and now stands at 6.40 lira to \$1.00.

Causes of Turkish crisis?

- Negative investor sentiment by Turkish companies that increased their leverage levels handsomely to profit from a construction boom in the country. They may have to struggle to repay dollar or euro-denominated loans.
- Worsening relations between Turkey and the U.S. with sanctions by the Turkish Justice and Interior ministers with the doubling of tariffs on Turkish aluminum and steel.
- A mostly populist government that prefers spending measures and tax breaks.
- Implementation of structural economic reforms have all but halted.
- Government's role in key sectors and use of economic institutions and regulators that target political opponents.
- Since July 2016, and again in March 2017, the three credit-rating agencies downgraded Turkey's sovereign credit ratings to BB-/B and Baa2.
- Another indicator of Turkey's travails is that even though there is soaring inflation and a decreasing currency, Turkey's Central Bank has kept interest rates low.

• This action is considered a result of political pressure from the government.

Turkey is just the most recent example of how overspending, populist policies and a deteriorated domestic agenda have an impact on the movement of their currency against the dollar to create a much larger crisis.

The 11-month rout of the British Pound Sterling to a new low of \$1.27 to \$1.00, combined with the latest round of sanctions by the U.S. on Russia are interpreted as declaring economic war. This is mixed with investors' increased sense that a market correction is on the horizon, with significant loss of liquidity and increased volatility being the current market drivers.

The Trump administration's doubling down with tariffs, which many thought might not have an impact on the U.S. economy at all, creates the basis for just how "isolationist" the "America First" policy can affect U.S. consumers. As evidenced by a recent study by the Peterson Institute for International Economics, which discovered that President Donald Trump's proposal in May to impose 25 percent tariffs on imported automobiles and parts may significantly raise prices and even eliminate buyers with limited incomes from the auto market. We

expect car prices to increase by a low of \$1,400 to a high of \$6,972.

P.R. Credit Update: Judge Taylor Swain rules on Cofina

After a somewhat busy week for Puerto Rico debt and the Financial Oversight & Management Board (FOMB), we note that Judge Laura Taylor Swain's ruling upholds the authority of the FOMB to approve and certify the Fiscal Plans and budgets for the commonwealth and its instrumentalities, ending the roadblock.

FOMB cites areas for progress:

- Fiscal Plan Reform Implementation;
- FY 2019 Budget Implementation;
- Public-Sector Financial Transparency; and
- Debt-Restructuring Plans of Adjustment with Creditors.

Cofina agreement reached

The FOMB announced a consensual debt-restructuring agreement in principle with all Sales Tax Financing Corp. (Cofina) bondholders. The restructuring provides a 32 percent reduction in Cofina debt and provides Puerto Rico nearly \$17.5 billion in debt-service reductions.

The agreement avoids litigation and allows local bondholders in Puerto Rico to receive a significant recovery, while providing the government flexibility to manage debt refinancing.

This is the first of many restructurings that must occur to properly take care of our bondholders, which cannot wait any longer.

Final Word—Peer-to-Peer conversations: Key approach to manage wealth

We have incorporated an occasional peer-to-peer conversations with CEOs of other companies to discuss their views on a variety of issues. This week, we formulate five essential questions to José J. Rodríguez Suárez, president of Fortaleza Capital Partners, a financial-services firm serving corporate clients and entrepreneurial families by providing independent financial advice.

What is your philosophy for investment management?

In its purest form, investment management involves the allocation of finite resources over time to create value and manage risks.

Our philosophy is grounded in three principles:

- Strategic asset allocation;
- Broad diversification; and
- Low costs and fees.

What are the best metrics to evaluate investment performance?

Most businessowners and entrepreneurs hold a mix of assets composed of a significant interest in a private company and a liquid portfolio. For private companies, it is essential to measure the return generated by its operating assets and then to analyze how the firm's financing decisions affect the return on shareholders' equity. For a liquid portfolio, the total return, which comprises a cash-flow yield and capital appreciation, helps investors track performance over time.

What tips can you give our readers about building the right portfolio?

Portfolio construction entails striking the right balance between expected return and risk to meet investment objectives. The advent of index funds provides investors access to low cost, and diversified and liquid investment products; there are zero-cost index funds now available.

How can individuals rebalance a portfolio consisting of both private company interests and tradeable securities?

Many securities trade in an efficient market. These can be quickly converted into cash and reallocated based on the investor's strategic asset allocation. Meanwhile, other securities, including those of private company interests, trade in an illiquid market, which makes the critical process of price discovery a challenge. Advisers help in determining valuations and taking assets to market.

What are your views on Puerto Rico's economic future and global capital markets?

We are cautiously optimistic about Puerto Rico's economic future. The level of funds expected to enter the local economy should have a positive and multiplier effect, as long as they are allocated and managed efficiently.

Global capital markets are experiencing central bank tightening and trade tensions. Both processes require a nimble approach to manage assets based on the three principles for investment management.

Francisco Rodríguez-Castro, president & CEO of Birling Capital, has more than 25 years of experience working with government, and multinational and public companies.