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M.A. International Management & Finance (Double Degree)

The Impact of Country Risk Analysis on Latin American Investment Funds

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Declaration

I hereby declare that I have prepared this master thesis

„The Impact of Country Risk Analysis on Latin American Investment Funds“

independently and without any outside help. I have only used the sources and aids specified in the bibliography.

In addition, I assure that I have not submitted or will not submit this or any related work as an examination paper in other subjects.

Santa Fe, 01.08.2024 Anton Bohling 

Abstract

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Table of Contents

List of Figures

List of Tables

List of Abbreviations

ARS	Argentine Peso(s)
BCRP	Banco Central de Reserva del Perú
CEIC	Census and Statistics Department Economic Information Centre
DAX	Deutscher Aktienindex
ECB	European Central Bank
ECLAC	Economic Commission for Latin America and the Caribbean
EM	Emerging Market
EU	European Union
ETF	Exchange Traded Fund
FDI	Foreign Direct Investment
GBP	Great British Pound
GDP	Gross Domestic Product
HDI	Human Development Index
IMF	International Monetary Fund
ISIN	International Securities Identification Numbering system
LAC	Latin America and Caribbean
MERVAL	Mercado de Valores de Buenos Aires
NASDAQ	National Association of Securities Dealers Automated Quotations
NAV	Net Asset Value
OECD	The Organization for Economic Cooperation and Development
S&P	Standard & Poor s
UCITS	Undertakings for Collective Investments in Transferable Securities
UN	United Nations
UNDP	United Nations Development Programme
U.S.	United States (of America)
USD	United States dollar
WHO	World Health Organization

1. Introduction

Country risk analysis has gained popularity throughout the past years due to several crises impacting the global economy, such as the Financial Crisis 2007/2008. It can appear in various forms such as trade, social, geopolitical, or financial dimensions, with crises often impacting several countries through contagion effects (Bouchet, Fishkin, & Goguel, 2018, p. XXI). An exchange rate devaluation or a political crisis in one country can quickly incite a crisis in a neighbouring country or destabilize an entire region. Rating agencies such as Moody s and Fitch aim to measure the given risks and present their results through country risk ratings (Fitch, 2024) (Moody's, 2024).

Risk levels are especially high in emerging market countries such as many Latin American countries. This is reflected e.g., in a comparison of standard deviations between the stock index MSCI Emerging Markets and the MSCI EM Latin America. While the standard deviation of the MSCI EM from 1988 until 2023 was 7 percentage points higher than the one of the global MSCI World Index, the 10-year standard deviation of the MSCI EM Latin America was additionally roughly 10 percentage points higher than the one of the MSCI Emerging Markets (MSCI, 2024). This is caused by a high average level of political and economic instability in the countries within the region. E.g., Argentina is struggling for years with skyrocketing inflation rates and corruption being deeply engrained in the political landscape (Council on Foreign Relations, 2024). In theory, taking higher risk as an investor should be rewarded with higher returns, but in the case of Latin America, this is not always the case (Morningstar, 2023). The aim of the given thesis is to analyse, which impact country risk analysis may have on the risk profile, the performance, and composition of Latin American investment funds.

In a first part, after explaining the theoretical background behind the term country risk analysis, an in-depth analysis of the two selected countries Argentina and Peru will be conducted. Following the analysis, the results will be presented and both countries will be compared with a focus on their strengths and weaknesses. In a second part, the investment landscape in the region Latin America will be examined followed by an investment fund analysis of the fund “Templeton Latin America Fund A (acc) USD”. Lastly will be analysed, whether country risk analysis, and in particular the ratings given by rating agencies have an impact on the regional portfolio allocation of regional funds, on the performance, and the risk profile of national investment funds and indices. The impact will be measured through descriptive and regression analysis.

2. Country Risk Analysis

2.1 Theoretical Background

As a first part of this thesis, the theoretical background behind the term country risk analysis will be outlined as a basis for the following analyses. To understand country risk, the concept of risk must be outlined in general. While there is no universal definition for risk, it is often used synonymously with the term “uncertainty” (Bouchet, Fishkin, & Goguel, 2018, p. 1). Other sources define risk as the deviation from an expected outcome (The Economic Times, 2024). Companies for example face risks in their day-to-day activities when e.g., hiring new staff, implementing a new strategy, or launching a new product (Bouchet, Fishkin, & Goguel, 2018, p. 1). In a financial context, risk can be defined as the likelihood of a negative outcome which reduces the expected return of an investment (Bouchet, Clark, & Groslambert, 2003, p. 11). According to portfolio theory, investors generally aim to minimize their risk exposure and to maximize their returns (Markowitz, 1991, p. 469 f.). A common strategy to minimize investment risk is portfolio diversification, as explained in Markowitz portfolio theory (Markowitz, 1991, p. 470). For businesses, there are various types of financial risk such as sovereign risk, liquidity risk, insurance risk or default risk (The Economic Times, 2024).

If the business operates internationally, among the types of risk affecting the company is also country risk. In the early stages of research, country risk was defined as the possibility that a sovereign state is unable to produce sufficient foreign exchange currency to repay its national debt (Sargen, 1977, p. 19 f.). It entails the impact of events on a national level such as a sovereign debt default on international companies operating in the given country, as well as on the international financial markets for stocks, bonds, derivatives, or international direct investments (Sun, Feng, & Li, 2021, p. 4329). Additionally, one can differentiate between man-made sources of risk and natural risk affecting countries. Natural risks entail natural phenomena such as seismic activity, bad weather events, which may negatively affect the business environment (Bouchet, Clark, & Groslambert, 2003, p. 16). These phenomena may have a direct impact on businesses by for example damaging facilities, or an indirect impact by e.g., preventing employees from getting to the production site or office. Concerning man-made risk, two types can be distinguished: Socio-political risks and economic risks (Bouchet, Clark, & Groslambert, 2003, p. 17).

Socio-political risks entail possible scenarios in which actions from social groups, political figures or governmental bodies cause significant damage to businesses in the host country. It can further be divided into social risk, government policy risk, and political risk (Bouchet, Clark, & Groslambert, 2003, p. 17). Social risk is specifically related to the actions of organized social groups such as trade unions or non-governmental organizations (NGOs), which peacefully or violently try to influence the local authorities and their policy actions, or foreign firms in the country. A recent example for this are the demonstrations of labor unions in Argentina such as the General Confederation of Labor (CGT), which have been protesting in Buenos Aires in January 2024 against the tough economic measures of the new president Javier Milei (Reuters, 2024).

Government-policy risk entails the risk of policy measures of governmental bodies which have a direct impact on the foreign company. This can be for example trade restrictions, nationalization, foreign exchange controls, subsidies, or trade agreements which only benefit certain companies (Bouchet, Clark, & Groslambert, 2003, p. 19). For example, under the administration of President Donald Trump, in 2018 the U.S. imposed a wide range of import tariffs on USD 283 billion worth of products such as steel and aluminium, lowering the margins for foreign companies exporting the given products (Amiti, Redding, & Weinstein, 2019, p. 187 f.). Loan repudiation refers to the unwillingness of debtors such as the local government to service its local or foreign currency debt. According to economic theory, a country cannot go bankrupt in terms of local currency, as it can simply print more money if necessary. Therefore, non-payment on local debt can be considered a political choice (Bouchet, Clark, & Groslambert, 2003, p. 20).

Lastly, political risk forms the third type of socio-political risks. It includes political instability, government changes, terrorism, war, coups, civil unrest, or democratic developments which may disrupt the foreign business (Bouchet, Clark, & Groslambert, 2003, p. 21). An example would be the right-wing party AfD in Germany, which in recent months is gaining more votes in regional elections (Reuters, 2023). If in power, this could lead to more trade protectionism. A second example is the expropriation of subsidiaries of Bayer, the German chemical and pharmaceutical company. After World War I, Bayer s U.S. subsidiaries were auctioned as reparation payment and it lost its famous “Bayer-Aspirin” trademark locally (Bouchet, Clark, & Groslambert, 2003, p. 22).

The second type of man-made risk forms country-specific economic risk, which can be further divided into macro risk (related to all foreign enterprises) and micro risk (related to enterprises of a specific sector or activity) (Bouchet, Clark, & Groslambert, 2003, p. 22). Contrary to the socio-political risks explained above, economic risk may be the consequence political mismanagement, but must not be the immediate result of a political decision. On a macro level, risks are based on factors in the economic environment the business operates in such as interest rates, foreign exchange rates, inflation, etc. (Bouchet, Clark, & Groslambert, 2003, p. 22). An example for this can be found in the inflation rates of Argentina in recent months, with annual inflation reaching more than 200% in January 2024 (Financial Times, 2024). In a more extreme scenario, Brazil was facing a yearly inflation rate of 4.922% in June 1994 after several ineffective stabilization plans (Banco Central do Brasil, 2024). The inflation rate was finally brought down to 22% in 1995 with the introduction of a new currency, the Brazilian Real (BRL) (Banco Central do Brasil, 2024). Hyperinflation makes planning extremely difficult and forces companies to fulfil additional tasks in their day-to-day activities such as inflation accounting (Liberto, 2022). Furthermore, exchange rate fluctuations may make the business operations more costly. An example for this can be found in the sudden devaluation of the Mexican Peso in 1994/1995 (Bouchet, Clark, & Groslambert, 2003, p. 23).

Microeconomic risks entail events which have an impact on certain industries or at firm level. It encompasses risks related to the input side – raw materials, capital, and labor – as well as the output side, including final product risks and marketing uncertainties (Bouchet, Clark, & Groslambert, 2003, p. 24). Many micro risks are related to the term “glocalization”, which can be defined as a locally modified globalization, in which a company entering new global markets must adopt to local standards (Alsharairi, Atmeh, & Al-Abdullah, 2019, p. 208). A classic example for this is the car industry, in which cars of the same brand with the same general features are sold worldwide but are adapted locally regarding e.g., emission standards, or the steering wheel location (Hayes, 2022). When for example the German car manufacturing company Volkswagen enters the Mexican market, it is faced with risks such as finding the necessary human resources, accessing the necessary technology, adhering to local regulations, or establishing a functioning supply chain network. Lastly, cultural differences may lead to difficulties among the employees (Bouchet, Clark, & Groslambert, 2003, p. 25).

Globalization of world trade has made countries and financial markets more interconnected and -dependent, increasing the potential impact of financial or economic crises (Bouchet, Clark, & Groslambert, 2003, p. 49). This has been demonstrated several times throughout the past century, with crises such as the external debt crises in most developing countries from 1982 to 1985, the exchange rate crisis in Mexico in 1994, or banking system crises in several Asian countries in 1997 and 1998 (Bouchet, Clark, & Groslambert, 2003, p. 49). Before the Asian crisis, the Eastern Asian countries were praised for their rapid growth and significantly improving living standards. This success led to investors underestimating the underlying structural and economic issues and putting pressure on institutions safeguarding the financial sector (IMF, 1998). Ultimately, the pressure built up by large external deficits, an inflated stock market, and a lack of supervision of the financial system (among other factors), lead to the collapse of currencies and equity prices in the developing economies of the region such as Indonesia, Thailand, Malaysia, and the Philippines (IMF, 1998).

In more recent years, the financial crisis in 2007 and 2008 has shown how rapid local incidents through financial contagion and spill-over effects can have impacts on a global scale (Comiskey & Madhogarhia, 2009, p. 271). Back then, banks and commercial mortgage companies made a fortune by selling “subprime” mortgages – those of homebuyers with a poor credit history or low income – on the financial market. In 2005, the market peaked at USD 625 billion in subprime mortgage lending (Comiskey & Madhogarhia, 2009, p. 271). Eventually, rising interest rates led to homebuyers not being able to meet their interest payments and consequently to significant downgrades of the subprime mortgages. The shaken confidence and rapid value loss of these asset-backed securities led to the bankruptcy of major investment banks such as Lehman Brothers, a run on USD 200 billion of funds in the money market from September 15 to 19, 2008, as well as stock market crashes and a subsequent increase of unemployment levels across many industrial countries (Arner, 2009, p. 114 f.). These rapid global developments have demonstrated the various forms in which country risk can appear and why understanding and managing it is key in today s globalized economy (Sun, Feng, & Li, 2021, p. 4329).

2.2 Methodology

Country risk analysis typically entails an evaluation of various factors such as political, social, economic, and financial, which may have an impact on the country s ability to service its debt. Political and social factors may entail events such as protests, strikes, a revolution, or rising corruption levels. Economic events could be a rise of inflation levels or an oil price increase, while financial events may form an interest rate increase or an external debt default (Bouchet, Fishkin, & Goguel, 2018, p. 28). Besides the four mentioned dimensions, some analyses add spill-over effects to the mix, to account for regional or economic turmoil which may affect the country through financial and volatility contagion such as in the case of the financial crisis in 2007 and 2008 (Bouchet, Fishkin, & Goguel, 2018, p. 27). Further examples for spill-over effects could be an appreciation of the US dollar or the bankruptcy of a neighbouring country.

Based on the given factors, a quantitative and qualitative analysis of the country is conducted with the aim of calculating an end result which reflects the country s risk level from a global perspective. This analysis and calculation is conducted by international organizations such as the OECD for its member countries, and by private credit rating agencies (Scott, 2020). The three largest credit rating agencies Standard & Poor s (S&P), Moody s, and Fitch, largely dominate the market (Bouchet, Fishkin, & Goguel, 2018, p. 305). Additionally, the French export credit agency Coface, whose main business entails protecting companies against the risk of non-payment by their clients, provides country risk assessments for currently 162 countries (Bouchet, Clark, & Groslambert, 2003, p. 199) (Coface, 2024).

The OECD applies its analysis in a two-step approach. In the first step, the country is analysed with a qualitative model specifically designed for the given purpose – the Country Risk Assessment Model (CRAM) (OECD, 2024). The CRAM has been revised in 2023 to better reflect the consequences of climate change and to put a stronger emphasis on governance factors (EKN, 2023). The main data sources used for this part of the analysis are usually the World Economic Outlook published by the IMF twice a year in April and October, and key indicators provided by the World Bank (Bouchet, Fishkin, & Goguel, 2018, p. 187). In a second step, the CRAM results are analysed qualitatively by OECD country risk experts to integrate factors not yet covered by the previous analysis. This may lead to an upwards or downwards qualitative calibration (OECD, 2024).

Fitch, initially founded in 1913 by John Knowles Fitch under the name of Fitch Publishing Company to provide independent credit information to investors, follows a similar approach (Finney, 2023). The company describes its published sovereign issuer default ratings (IDRs) as a forward-looking assessment of the capacity and willingness of a country to serve its debt obligations to public debt securities and private-sector creditors on time and to the full amount (Fitch, 2024, p. 1). Similar to the OECD methodology, its analysis entails a synthesis of quantitative variables and qualitative judgements. It is based on the following four analytical pillars: (1) Structural features, (2) macroeconomic performance, policies & prospects, (3) public finances, and (4) external finances (Fitch, 2024, p. 1). Structural features may entail for example GDP per capita, years since last default, or share in world GDP. GDP stands for gross domestic product and measures the monetary value in a given currency of final goods and services, produced within a country in a specific period of time (IMF, 2024). Typically, 18 central variables are observed. The pillars are then weighted with respect to their individual importance to sovereign creditworthiness, with structural features usually being weighted with the highest percentage (Fitch, 2024, p. 1). Currently, the weightings are 53,5% for structural features, 10,1% for macroeconomic performance, policies & prospects, 18,5% for public finances, and 17,9% for external finances. The final result is presented in the form of a rating within the range from AAA (best possible rating) until CCC+ (worst possible rating) (Fitch, 2024, p. 6).

Coface was founded in 1946 by the French government with the purpose of insuring its monetary, political, and exceptional trade risks (Coface, 2024). Nowadays, besides serving more than 100.000 client companies with its core business of trade credit insurance and receivables management, it provides country risk analyses for 162 countries as well as sector-specific risk analyses (Coface, 2024) (Steinhauser & Borovská, 2022, p. 64). The aim of Coface s country risk analysis is to provide an insight into the average credit risk of a country s businesses, based on average payment incident levels in short-term trading transactions (Coface, 2024). The risk is measured as a combination of country-specific risk and business-specific risk (Steinhauser & Borovská, 2022, p. 64). Furthermore, the assessment is based on six pillars: Macroeconomic analysis, banking system review, political developments, climate risk, business environment assessment, and payment experience. The result is presented on an 8-step scale: A1 (highest risk), A2, A3, A4, B, C, D, E (lowest risk) (Coface, 2023, p. 6).

As a major part of this thesis, two countries will be analysed in a similar manner as the approach taken by the mentioned rating agencies. The two countries which will be analysed, rated, and compared, will be Argentina and Peru. For this purpose, after a brief introduction to each country, a total of **18** variables will be analysed from 4 different categories: Structural features, macroeconomic factors, political & governance factors, and socio-economic factors. The same set of variables will be applied to both countries. Structural features will include life expectancy at birth, GDP per capita, share in world GDP, and the Gini coefficient. Macroeconomic factors will entail GDP growth rate, current account balance, inflation, real interest rate, USD exchange rate, unemployment rate, total reserves minus gold, and government debt ratio. While structural features represent fundamental, long-term characteristics of an economy, macroeconomic factors entail short-to-medium term variables, which reflect the current state of economic activity. Negative macroeconomic factors can have drastic consequences for an economy (Bloomenthal, 2023). To the socio-economic factors will count the Human Development Index, and the Economic Freedom Index. Lastly, political and governance factors will entail the Corruption Perception Index, rule of law, the Global Peace Index as well as political stability and absence of violence/terrorism.

Data from the years 2018 – 2022[1] will be used to reflect the dynamics of the given variables. The mix of variables across different categories ensures that the final result will reflect all key risks affecting the given economy and provide an adequate risk ranking. A weighting of the categories such as in the example of Fitch will not take place.

In a next step, the variables will be ranked qualitatively by a scoring model. Each variable will be translated into a number between 0 and 100, with 100 indicating minimum and 0 maximum risk. Afterwards, each variable will be assigned a percentage (total: 100%) according to the impact it has on the overall country risk. Based on the given percentages, a weighted average score will be calculated for each variable by multiplying the average score of a variable across the five years with the assigned percentage. The result will then be calculated by adding up the weighted averages and will also be a number between 0 and 100. The risk scale from AAA until D will finally determine the exact risk ranking for the two countries.

[1] Insufficient data for 2023 to date of this thesis

2.3 CRA Argentina

2.3.1 Country Profile

The Argentina Republic forms the second-largest country in South America with a total land area of 2,78 million square kilometres and a population of roughly 47,2 million people (Britannica, 2024). Besides its mainland territory, Argentina claims several islands in the South Atlantic such as the Falkland Islands / Islas Malvinas, over which it was unsuccessfully waging a war against Great Britain in 1982 (Freedman, 1982, p. 196). Its official language is Spanish, and its currency is the Argentine Peso. As many Latin American countries, its history has been shaped by Spanish colonialization, ongoing for three centuries, until its declaration of independence in 1816 (Britannica, 2024). The country s population is largely made up of immigrants from Spain and Italy, accounting for more than 70% of the immigration flow, as well as France and Germany to a minor share (Sánchez-Alonso, 2013, p. 610 f.). In total, around 7 million Europeans immigrated to Argentina between 1870 and 1930, shaping the culture and workforce until today (Sánchez-Alonso, 2013, p. 601).

Constitutionally, Argentina is a federal union made up of 23 provinces and Buenos Aires as the federal capital district. The executive power is in the hands of the president, who can run for office a maximum of two consecutive four-year terms (Britannica, 2024). The current president, who was sworn in on December 10, 2023, is Javier Milei (Financial Times, 2023). Proclaiming himself to be a libertarian economist, he presented a variety of drastic economic measures to cut government spending, which has led to different reactions within the population (Washington Post, 2023). His role and the impact of his measures will be analysed thoroughly in the upcoming analysis. Before Milei, Argentina s political landscape was largely influenced by so-called Peronism. The term stems from the ex-president Juan Perón, who in 1943 took office as Argentina s minister of labour, implementing a variety of measures in favour of the emerging class of industrial workers (Britannica, 2024). He became president for the first time in 1946 and was re-elected in 1973 after being overthrown and exiled by the military in 1955 (Wellhofer, 1977, p. 335 f.). In more recent years, Kirchnerism became an influential movement as a branch of Peronism, based on populist ideals formed by Néstor Kirchner and Cristina Fernández de Kirchner as a response to the economic crisis in 2001/2002 (Tekiner, 2020, p. 267).

The economy of Argentina is largely based on its rich natural resources in energy and agriculture. The country with its diverse landscapes from the Andes in the west to the hot and humid regions in the north possesses fertile lands, gas, lithium, and high potential for renewable energy (World Bank, 2024). In 2022, its main export products were soybean meal, corn, soybean oil, and wheat (OEC World, 2022). Despite the abundance of resources, the country has been struggling economically for decades. Since World War I, the country has seen an exceptional economic development, declining from one of the top 10 wealthiest countries in the world in 1913 to a middle-income country in constant economic turmoil (Spruk, 2019, p. 1). At the end of the 19th century, its economy was even able to equal the United States in terms of GDP per capita (Bolt & Van Zanden, 2014):

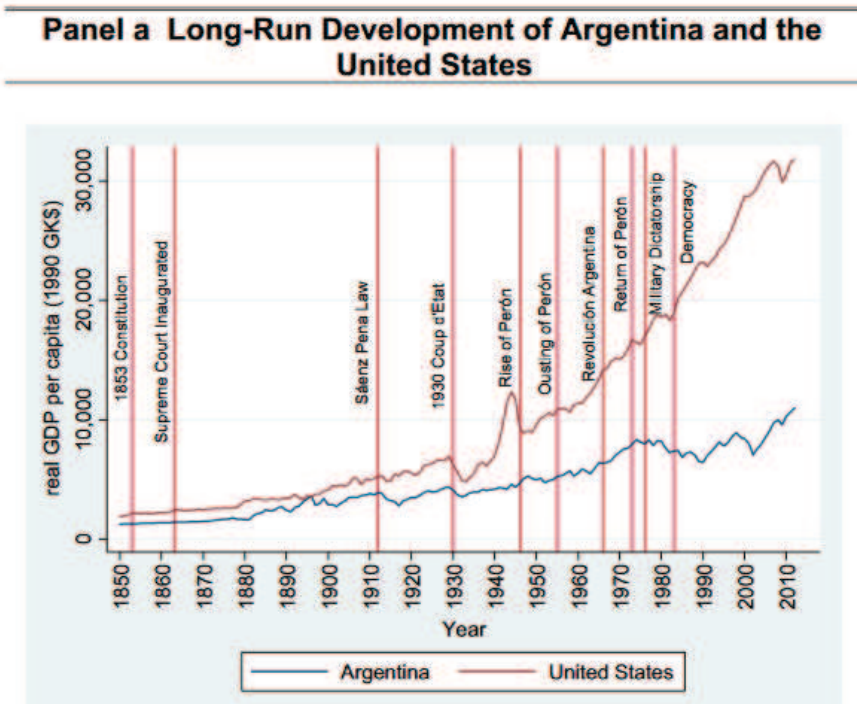

Figure 1 - Argentina s comparative development 1850-2012 (Bolt & Van Zanden, 2014)

Numerous studies have since attempted to explain this rapid downfall, and the root cause of Argentina s underdevelopment is still being debated today. Among a variety of potential reasons researchers named immigration policies, underinvestment in human capital, culture, and the stopping of frontier expansion (Spruk, 2019, p. 2).

Argentina has since 1913 defaulted nine times on its international sovereign debt, with three times just in the past two decades. The last default occurred in May 2020 during the Covid-19 pandemic and had been granted USD 44,5 billion from the IMF in 2018, of which it owes more than USD 40 billion (European Parliament, 2023).

2.3.2 Core Analysis

In the given chapter, the 18 selected variables will be analysed in a suitable order based on the significance of each variable and its connection to other indicators.

The following table shows the life expectancy at birth in Argentina from 2018 until 2022:

2018	2019	2020	2021	2022
77,0	77,28	75,89	75,39	76,1

Table 1 - Life expectancy at birth (in years), Argentina (World Bank, 2024)

According to the OECD, this indicator can be defined as how long, on average, a newborn (male or female) can expect to live, if current death rates do not change. However, it is not possible to know the actual life expectancy of a particular birth cohort in advance (OECD, 2024). The data shows a significant decline in 2020 and 2021, which is caused by Covid-19 pandemic, which led to a global excess mortality of 14,91 million in the given 24 months (WHO, 2024). This excess mortality led to a global life expectancy decline by 1,6 years between 2019 and 2020, with places such as Mexico City and Bolivia facing the largest drops of life expectancy (Institute for Health Metrics and Evaluation, 2024). With a drop of 1,39 years from 2019 to 2020, while forming a large setback for Argentina, this decrease in life expectancy was still below-average. It has then recovered to 76,1 years in 2022 (World Bank, 2024).

Related to this indicator is the Human Development Index, a statistical measure composing life expectancy at birth, education, and GDP per capita (UNDP, 2024):

2018	2019	2020	2021	2022
0,852	0,853	0,841	0,844	0,849

Table 2 - Human Development Index, Argentina (UNDP, 2024)

It is calculated as the geometric mean of normalized indices for each of its three components, with a score of 0 indicating lowest and a score of 1 indicating highest possible human development (UNDP, 2024). With a score of 0,849 in 2022, Argentina was ranked in the “Very High” human development category, securing world rank 47 out of 204 countries and territories (UNDP, 2024). Among its regional peers in Latin America, Argentina took second place behind Chile in each of the years from 2018 to 2022, which reported a higher life expectancy at birth and GDP per capita. The expected years of schooling in Argentina for children of school entering age were 19,0 years in 2022, the longest schooling time in the region (UNDP, 2024).

A second structural feature, which forms a key part in almost any country risk analysis, is GDP per capita. It is calculated by dividing a country s GDP by its total population and serves as a more accurate measure of individual living standards than total GDP (WHO, 2024). For Argentina, the following data has been published:

2018	2019	2020	2021	2022
23.294,14	23.007,79	20.792,52	23.816,97	26.483,66

Table 3 - GDP per capita, current prices in International Dollars, PPP-based, Argentina (IMF, 2024)

Current prices consider the effects of inflation, as prices for each year are measured in the prices for that particular year (World Bank, 2024). Additionally, purchasing-power-parity (PPP) is taken into consideration, which entails a rate at which the currency of one country (e.g. Argentine Pesos) would have to be converted into that of a different country (e.g. USD) to purchase the same amount of goods and services in each country (IMF, 2024). If for example a hamburger is selling for 4 USD in New York and for 4.000 Pesos in Buenos Aires, the PPP exchange rate would be 1 USD to 1.000 ARS (IMF, 2024). With the average in South American economies standing at 16.890 in 2021 and 18.680 international dollars in 2022, Argentina has generated more per capita income in the given years than its regional peers.

To evaluate the year-on-year development of an economy, another suitable indicator forms the real GDP growth rate:

2018	2019	2020	2021	2022
-2,60%	-2,00%	-9,90%	10,70%	5,00%

Table 4 - Real GDP growth, Argentina (IMF, 2024)

The real GDP growth rate is a more accurate measure of the output of an economy than the nominal GDP growth rate, as it is adjusted for inflation or deflation (Banton, 2023). It reflects the actual increase in output of goods and services compared to the previous year. The table shows that Argentina s GDP has fluctuated significantly over the given period, largely due to the sharp economic downturn caused by the Covid-19 crisis and the implemented restrictions to contain it. In 2021, the economy was successfully recovering thanks to an improving health situation and increasing vaccination rates, allowing to lift several mobility restrictions (CEPAL repositorio, 2021). Argentina was then able to maintain its growth in 2022, when economic activities were fully reestablished.

As a third GDP-related variable, to put the economic performance of a country into a global perspective, GDP share of world total servers as a suitable indicator:

2018	2019	2020	2021	2022
0,798%	0,761%	0,707%	0,737%	0,748%

Table 5 - GDP share of world total, PPP-based, Argentina (IMF, 2024)

Within Latin America, Argentina had the third highest GDP share of world total after Brazil with 2,33% in 2022 and Mexico with 1,86% in 2022, throughout the given five years (IMF, 2024). There are five countries which had more than 3% GDP share of world total in 2023: Germany with 3,15%, Japan with 3,7%, India with 7,59%, the United States with 15,56%, and China with 18,73%. Emerging market and developing economies totalling a share of 58,82% in 2023 demonstrates their importance for the global economy now and in the future (IMF, 2024). Argentina s share has been relatively stable throughout the given period, with a decline from 2018 until 2020 and a following increment from 2020 until 2022. This trend is in line with the data concerning real GDP growth. The question remains, whether Argentina will be able to continue on this upward path, or whether economic instability will once again decrease its productivity.

Another key macroeconomic indicator forms the Current Account Balance, indicating whether a country has a current account surplus or a current account deficit (Heakal, 2024):

2018	2019	2020	2021	2022
-5,164%	-0,772%	0,691%	1,363%	-0,68%

Table 6 - Current Account Balance, Argentina (IMF, 2024)

It can be calculated with the following formula:

$$CAB = NX = Y - C - G - I$$

CAB = Current Account Balance
NX = Net Exports
Y = National Income
C = Consumption
G = Government spending
I = Investment

In 2018 and 2019, Argentina was a deficit country, relying on other countries to borrow it money. Argentina was investing more than it was saving and importing more products to meet domestic consumption demand than it was exporting (Heakal, 2024). In 2020 it turned into a surplus country, becoming a net creditor to the rest of the world. In 2022, Argentina ranked number 47 in total exports while being the world s biggest exporter of soybean meal with USD 12 billion worth of exports in 2022 (OEC World, 2022).

The seventh indicator is one Argentina has been infamous for struggling with exceptionally for decades – inflation:

2018	2019	2020	2021	2022
34,28%	53,55%	42,02%	48,41%	72,43%

Table 7 - Inflation rates, end of period consumer prices, Argentina (IMF, 2024)

Inflation can be defined as the rate at which prices increase over a given time period (IMF, 2024). Since 1945, Argentina has ranked among the countries with highest inflation rates with four episodes between 1975 and 1991 which can be characterized as hyperinflationary (Ocampo, 2021, p. 22). While several other Latin American countries were facing periods of high or hyperinflation in the last seven decades such as Brazil, Chile, or Uruguay, Argentina is the only country unable to bring down its very high rates in the long run (Ocampo, 2021, p. 4). That rates have been accelerating again in recent years can be seen in the following graph:

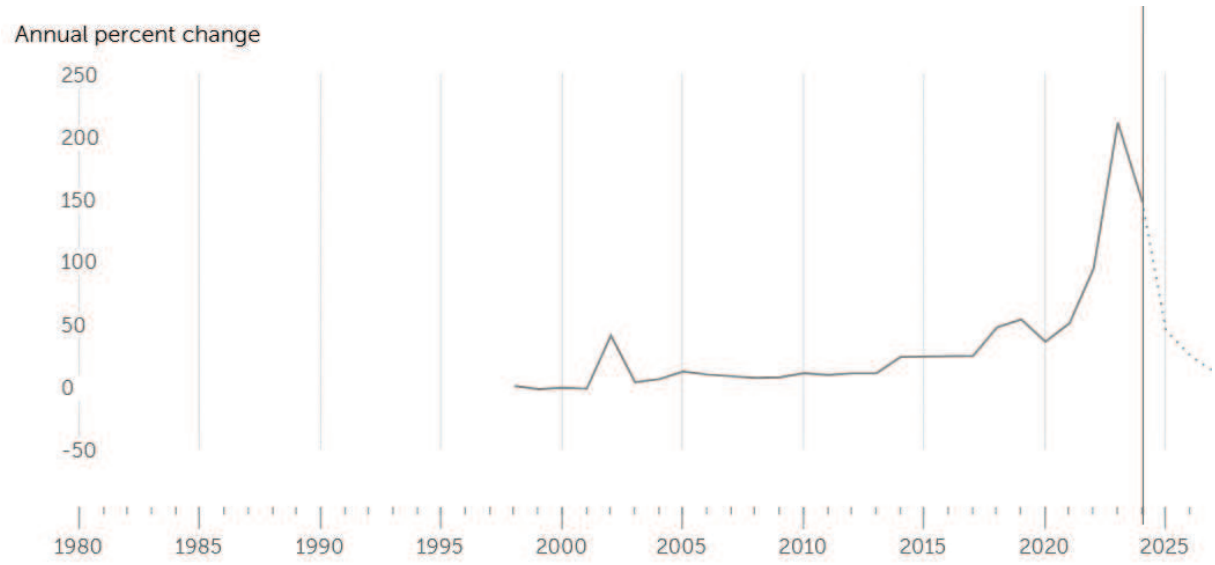

Figure 2 - Inflation rate, end of period consumer prices, Argentina, 1980-2024 (IMF, 2024)

The standard definition of hyperinflation was introduced by Phillip Cagan, according to whom a period of hyperinflation can be identified, if monthly inflation rates exceed 50% for at least one year (Fischer, Sahay, & Végh, 2002, p. 4). Historical evidence additionally suggests that countries with inflation rates exceeding 40% for at least 2 years are at risk of a “high inflation crisis”, and with consistent annual rates exceeding 50% are likely to end up in hyperinflation (Ocampo, 2021, p. 4). Although the rates in the given time horizon do not fall under the definition of hyperinflation, it appears to be a realistic scenario Argentinian policymakers must urgently counteract.

Another key variable which is strongly related to inflation rates is the interest rate. Interest rates are typically used as an instrument by central banks to combat inflation, as demonstrated recently as a response to the rising price levels (especially) in Europe and the U.S. caused by the outbreak of the war between Russia and the Ukraine (ECB, 2022). The following table shows the real interest rate in Argentina from 2018 until 2022:

2018	2019	2020	2021	2022
4,60%	12,10%	-7,60%	-11,90%	-10,10%

Table 8 - Real interest rate, Argentina (World Bank, 2024)

The real interest rate is calculated by subtracting the inflation rate from the nominal interest rate and reflects the actual cost of funds to a borrower and the real yield for an investor or lender (Sun & Phillips, 2004, p. 869 f.). While investors were able to achieve real returns on their investments or borrowed capital in 2018 and 2019, their purchasing power shrank significantly in the following three years when investing in fixed interest rate instruments. The extent to which Argentina s real interest fluctuated in recent years in comparison with economically more stable countries, can be illustrated with the following graph:

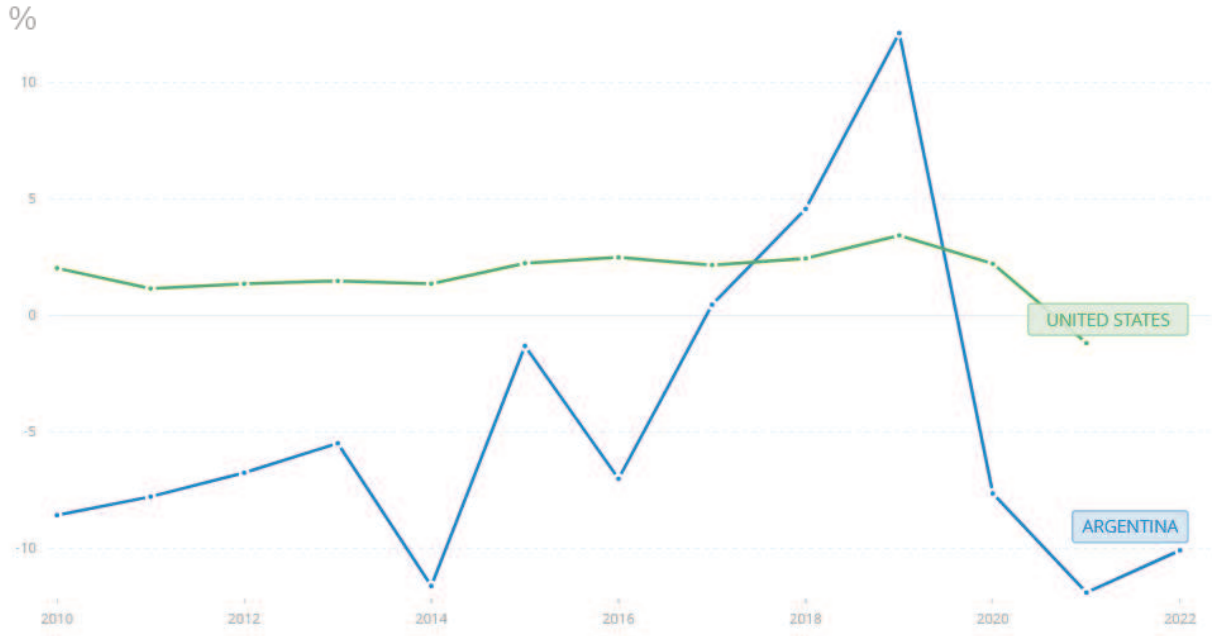

Figure 3 - Real interest rate 2010-2022, Argentina & United States (World Bank, 2024)

The most prominent fixed interest rate instrument in Argentina is currently the “Plazo fijo”, which currently promises between 38% and 57% annual interest (BCRA, 2024).

Besides plazos fijos, a common way for Argentinians to protect their money from inflation, is to purchase dollars on the official or unofficial market (BBC, 2023). The official USD exchange rates from 2018 to 2022 are the following:

2018	2019	2020	2021	2022
37,61	59,84	84,07	102,67	177,14

Table 9 - USD exchange rate in ARG Pesos, end of year (Exchange Rates Org UK, 2024)

Generally, high inflation weakens a currency, which supresses investment and leads to a negative impact on the exchange rate. On the other side, low inflation levels can strengthen the national currency and exchange rate (Ahmad & Ahmed Ali, 1999, p. 237 f.). If the principle of purchasing power parity (PPP) would hold true, the relationship between inflation and exchange rate would be exact. In reality, PPP does not hold true and especially in high-inflation periods price levels and exchange rates can differ greatly (Ahmad & Ahmed Ali, 1999, p. 140). As the data shows, the general tendency of the exchange rate is in line with the inflation levels, although they do not match exactly. In December 2023, President Milei cut the exchange rate by more than 50% to stabilize the Argentinian price levels (El País, 2023).

To gain insights into how easy it is to facilitate trade in a given economy, the Economic Freedom Index is a suitable variable:

2018	2019	2020	2021	2022
52,3	52,2	53,1	52,7	50,1

Table 10 - Economic Freedom Index, Argentina (The Heritage Foundation, 2024)

The Heritage Foundation, which introduced the ranking in 1995 together with The Wall Street Journal, defines economic freedom as the fundamental right of every human to control his or her labour and property (The Heritage Foundation, 2024). The index currently measures the economic freedom of 184 economies based on the following four pillars: Rule of law, government size, regulatory efficiency, and open markets. The four pillars are further divided into three qualitative and quantitative factors each, which are graded on a scale of 0 to 100. The overall score is then derived averaging the given 12 variables with equal weights (The Heritage Foundation, 2024). Ranging from 50,1 to 53,1 in the given five years, the Argentinian economy can be considered “mostly unfree”. Especially property rights and government integrity are consistently receiving low scores, while a comparably low tax burden lift the overall ranking (The Heritage Foundation, 2024).

The final two macroeconomic variables, which provide insights about the financial situation and ability to repay its debt of a country, are its government debt ratio in % of GDP and total reserves minus gold.

2018	2019	2020	2021	2022
85,2%	89,8%	103,9%	80,6%	85,2%

Table 11 - Central government debt (in % of GDP), Argentina (World Bank, 2024)

In general, countries issue debt in the form of e.g., government bonds, and commonly take on debt in times of emergency, instead of burdening the public with increased taxes. For that reason, the Covid-19 pandemic caused a rapid surge in debt levels around the globe, both affecting government debt and private debt (World Bank, 2021). Too high levels of debt can be dangerous for an economy, as they tend to diminish economic activity by crowding out private investment or by forcing an increase in taxes and decreasing public investment for repayments (Yared, 2019, p. 116). Additionally, it becomes more difficult to respond to crises such as financial crises, national disasters, or pandemics, and may in extreme cases result in default (Yared, 2019, p. 116). Argentina s government debt in the given years has been above average, giving reason for concern whether the country could manage such an upcoming crisis financially (IMF, 2024).

Some of its debt could be repaid with the country s total reserves, which include foreign exchange, gold reserves, special drawing rights, or reserves of IMF members held by the IMF (World Bank, 2024). The total reserves minus gold of Argentina are the following:

2018	2019	2020	2021	2022
63,96	42,19	35,65	36,45	41,2

Table 12 - Total reserves minus gold (in current billion USD), Argentina (World Bank, 2024)

The given variable can sometimes be considered a more suitable indicator than total reserves including gold, as gold may not always be usable for the country s immediate financial needs due to its lower liquidity (Arslanalp, Eichengreen, & Simpson-Bell, 2023, p. 1 f.). As the table shows, reserves collapsed in 2019 after the primary elections favouring the centre-left candidate Alberto Fernández and reversing the gains that had previously been achieved (IMF, 2021). Compared to its regional peers, Argentina had higher total reserved minus gold in 2022 than Chile (39,09 bn) and Uruguay (15,12bn), but lower ones than Brazil (317,12 bn) (World Bank, 2024).

Furthermore, the unemployment rate of a country serves as an important indicator to understand the conditions in the labour market of an economy:

2018	2019	2020	2021	2022
9,20%	9,83%	11,55%	8,75%	6,83%

Table 13 - Unemployment rate (% of labour force), Argentina (IMF, 2024)

While high labour market participation rates can stabilize the economy and brings prosperity to the individual, unemployment tends to increase homelessness and crime rates, when no sufficient safety nets are installed (Melick, 2003, p. 35 f.). As the data shows, Argentina was able to bring down its unemployment rates from 9,20% in 2018 to 6,83% in 2022, which an increase by almost 2% in the year 2020 with the major impact of the Covid-19 crisis (IMF, 2024). In 2022 it had one of the lowest unemployment rates in South America, claiming third place after Bolivia with 4,7% and Ecuador with 3,2%. At the same time the example of Bolivia demonstrates that a low unemployment rate does not go hand in hand with a strong economy, as the country counts to the poorest in Latin America with extreme hunger rates and poor infrastructure (World Food Program USA, 2024).

The distribution inequality of income generated within a country by the employed population can furthermore be measured by the Gini index:

2018	2019	2020	2021	2022
41,70%	43,30%	42,70%	42,40%	40,70%

Table 14 - Gini index, Argentina (World Bank, 2024)

Besides salaries, disposable household income which is under the umbrella of the Gini index entails capital and public cash transfers, deducted by income taxes and social security contributions (OECD, 2024). The index result is based on a scale from 0 (0%) to 1 (100%), with 0 indicating total income equality and 1 indicating total income inequality. According to the World Bank, in 2022, the country with the lowest score was the Syrian Arab Republic with 26,6%. The country with the highest income inequality was Colombia with a score of 54,8% (World Bank, 2024). Over the past centuries, income inequality as measured by the Gini index has steadily increased, reaching its peak during the Covid-19 pandemic (Hayes, 2024). Within its region, Argentina counts to the countries of comparably low income inequality, with better scores being achieved in 2022 by Peru (40,30%) and Uruguay (40,60%) (World Bank, 2024). At the same time, Latin America forms one of the most unequal regions in the world.

Regarding political and governance indicators, the Corruption Perceptions Index, which is annually published by the non-governmental organization Transparency International, forms one of the most important variables:

2018	2019	2020	2021	2022
40	45	42	38	38

Table 15 - Corruption Perceptions Index, Argentina (Transparency International, 2023)

It is based on a scale from 0-100, which 100 indicating the lowest level of perceived corruption and 0 indicating the highest level of perceived corruption (Transparency International, 2023). The gathered data is based on expert assessments and opinion surveys, with corruption being defined as an abuse of entrusted power for private gain. Over two thirds of the 180 ranked countries scored below 50 in 2023, with the global average being 43 points (Transparency International, 2023). As many Latin American countries, Argentina has a long history of corruption, with for example former president Cristina Fernández de Kirchner in 2022 being sentenced to six years for a 1-billion-dollar fraud case (The Guardian, 2022). The newly elected president Javier Milei has regularly ranted about the corruption within the previous government and his intentions to fight it (Financial Times, 2023). A successful combatting of corruption may give reason for an upward qualitative calibration of the given indicator.

Another key governance indicator, which is published on a yearly basis by the World Justic Project, is the Rule of Law Index:

2018	2019	2020	2021	2022
0,58	0,58	0,58	0,56	0,55

Table 16 - Rule of Law Index, Argentina (World Justice Project, 2023)

It entails a quantitative assessment on a scale from 0 to 1, which indicates how well countries adhere to the rule of law in practice. 1 stands for strong adherence to the rule of law, and 0 for very poor adherence to the rule of law (World Justice Project, 2023). With a score of 0,55 in 2022, Argentina dropped to rank 59 out of 140 ranked countries and maintained rank 13 within the region. Out of the 8 factors the index is composed of, Argentina achieved the highest scores in fundamental rights (0,68), open government (0,61), and order and security (0,61), and the lowest scores in absence of corruption (0,46) and criminal justice (0,41) (World Justice Project, 2023). The criminal investigation appeared rather ineffective and unable to reduce criminal behaviour. Crime rates are still high, especially in large cities (Buenos Aires Times, 2024).

The third political & governance indicator forms the Global Peace Index, which is highly relevant in times of ongoing global military conflicts such as in the Ukraine and in the Gaza strip (The New York Times, 2023).

2018	2019	2020	2021	2022
1,91	1,98	1,95	1,93	1,90

Table 17 - Global Peace Index, Argentina (Vision of Humanity, 2023)

The analysis is conducted by the Institute of Economics & Peace and the data is yearly published on the website of Vision of Humanity. It is based on 23 qualitative and quantitative indicators to evaluate the peacefulness of each country, with the final scores being presented on a scale from 1 to 5 (Vision of Humanity, 2023). The lower the final score, the more peaceful is the given country. The key three domains covered by the indicators are the level of societal safety and security, the extent of ongoing domestic and international conflict, and the degree of militarisation. In 2022, with a score of 1,90 Argentina was ranked number 64 out of 163 countries, one of the lowest (best) scores in the region and lower than for example that of France with 1,918 (Vision of Humanity, 2023). Despite a high perceived criminality in society and a comparably large, jailed population, there have not been any larger internal or external military conflicts in recent years, and militarisation is rather low (Vision of Humanity, 2023).

Lastly, political stability absence of violence/terrorism provides an insight into the overall political stability of the country with a focus on violent crime and domestic security:

2018	2019	2020	2021	2022
47	44	45	48	47

Table 18 - Political Stability and Absence of Violence/Terrorism: Percentile Rank, Argentina (World Bank, 2024)

The data is presented as a percentile rank, indicating that Argentina in 2018 was as politically stable, or more stable, than 47 percent of the ranked countries (World Bank, 2024). This score is above average in South America with for example Brazil ranking at 34 and Bolivia ranking at 36 in 2022. Uruguay sticks out with a percentage rank of 88 in 2022, higher than that of several developed countries such as Germany (67) and France (56) (World Bank, 2024). Even though Argentina has struggled with political and financial crises for decades, it has achieved relative democratic stability. Some critics point out, that its governmental system gives the president too much power, although there is a separation of powers (Council on Foreign Relations, 2024).

2.4 CRA Peru

2.4.1 Country Profile

The Republic of Peru forms the third largest country in South America after Argentina and Brazil with a size of 1,29 million square kilometres and a population of roughly 34 million people (Britannica, 2024). It is bordered by Ecuador in the north, Colombia in the northeast, Brazil in the east, Bolivia in the southeast and Chile in the south. It is characterized by a great diversity of climate zones including the dry coastal plains to the west, the Andean mountains carving their way from Bolivia to Ecuador with peaks of up to 6.768 metres (Mount Huascarán), and the Amazonian region in the east and north of the country (Britannica, 2024). The official languages spoken in Peru are Spanish, Quechua, which is spoken by the Inca s and to date in the Inca capital of southern Peru Cuzco, and Aymara, a language with its origin in the high plains of Bolivia (Max-Planck-Gesellschaft, 2024). Its currency is the Peruvian Sol and its capital is Lima, which accounts for almost a third of the country s population. The country is famous for its heritage of the Incan empire, which lasted from 1438 until 1532 and was the largest empire in America throughout the Pre-Columbian era (Britannica, 2024). Part of it forms the famous UNESCO World Heritage site Machu Picchu, which receives more than one million visitors annually (National Geographic, 2021).

The Republic of Peru was founded in 1821 with the proclamation of independence and the final battle against the Spanish being won in Ayacucho on December 09, 1824 (Palmer, 1994, p. 1). Peru then entered a phase of transition into a self-governed democratic Republic, until it fought the War of the Pacific from 1879 until 1883, which it lost against Chile with Bolivia as an ally (U.S. Department of State, 2024). It then became an aristocratic Republic with high political instability and different civilian and military forces trying to seize power. Some coups succeeded and the most recent period of military rule was from 1968 until 1980, when President Fernando Belaunde Terry was overthrown (U.S. Department of State, 2024). The current president is Dina Boluarte, who was inaugurated on December 07, 2022 (Britannica, 2024). The political landscape is still characterized by high levels of corruption, social instability, and premature changes of government. This is reflected for example in the impeachment of former President Pedro Castillo by Congress in December 2022 and the subsequent protests throughout the country (Farro, et al., 2023, p. 157 f.).

Economically, Peru had seen a period of substantial growth from 2004 until 2013, with poverty rates dropping from 66 to 33 percent (World Bank, 2024). Its economy is largely based on the export of raw materials to developed countries as well as its large fishing industry. Its main exports additionally include copper, gold, petroleum oil, and maize (World Bank, 2021). After the years of high growth, the economy has slowed down in 2014 due to declining mining prices and economic decline of several key trading partners, which resulted in an average growth rate of 3% from 2014 until 2019. The slowdown was further impacted by the Covid-19 crisis, which left Peru with overwhelmed hospitals, the worst per capita death toll worldwide, and a collapsing economy (World Bank, 2024) (The Guardian, 2021). Despite the slowdown, a favourable international trade environment and trade openness had turned Peru from a low-income economy to an upper middle-income economy with a per capita income of USD 7.126 in 2022 (World Bank, 2024). Additionally, tourism provides a significant source of income with roughly USD 3,6 billion in revenues in 2023 (CEIC, 2024). In 2020 and 2021, Peru was able to generate roughly 1 billion in tourism revenues per year, demonstrating the severe impact of the pandemic on the tourism industry (CEIC, 2024). Despite the overall economic growth, some key structural problems the country is currently facing entail a limited creation of formal jobs, limited economic diversification, and rather slow progress in diminishing inequality and poverty (World Bank, 2024). Three out of four workers in Peru are informally employed, making them vulnerable to crises such as a global pandemic.

The geographic dispersion of the Peruvian population also leads to regional differences in income and lifestyle. Poverty rates have historically been higher in the rural areas of Peru, with 42% poverty in the North Andes and 34% poverty in the Central Andes compared to a 26% national average, in 2021 (World Bank, 2023, p. 18). The are very dependent on the agricultural cycle and produce food partly for their own consumption. In case of a bad harvest or a natural disaster, this can lead to periods of hunger in the given areas (Britannica, 2024). Climate change will likely accelerate the given risks for the rural population. In 2023, 7 out of 10 Peruvians were living in poverty or were at risk at falling into poverty (World Bank, 2024). In urban areas, the lifestyle varies largely between different social classes. Workers of a lower social class often work two or three informal jobs at the same time, while people of higher economic status often own several homes and hire servants to perform basic tasks such as cleaning, cooking, or gardening (Britannica, 2024).

2.4.2 Core Analysis

This chapter will entail an in-depth analysis of the selected 18 variables in the same order as in the country analysis of Argentina.

The following table shows the life expectancy at birth of Peruvians from 2018 to 2022:

2018	2019	2020	2021	2022
76,01	76,16	73,67	72,38	73,4

Table 19 - Life expectancy at birth, Peru (World Bank, 2024)

Similar to the data of Argentina, the table shows a significant decline in life expectancy at birth in 2020 and 2021, caused by the Covid-19 pandemic. From the 10th epidemiological of 2020 to week 23 of 2021, 349.756 deaths occurred, resulting in an excess of mortality of 183.237 deaths in the given timeframe (Huarcaya, Monzón, Saldaña, & Driver, 2022, p. 1). Directly connected to Covid-19, the country registered more than 6.500 cumulative deaths per million people as of July 2022, making it one of the most affected countries by the pandemic (World Bank, 2023). As a result of the contracting economy, the national poverty rate increased to 30,1% and the extreme poverty rate to 5,1%, further increasing hunger rates and mortality (World Bank, 2023). In the whole Latin America and Caribbean (LAC) region, life expectancy stood at 75,1 years on average in 2021, an increase of 3,9 years since 2000 (OECD, 2023).

The Human Development Index of Peru has been the following in the selected timeframe:

2018	2019	2020	2021	2022
0,770	0,774	0,758	0,755	0,762

Table 20 - Human Development Index, Peru (UNDP, 2024)

With a score of 0,762 in 2022, Peru was ranked in the “High” human development category, with a world rank of 87 out of 193 countries and territories (UNDP, 2024). With a value of 0,620 in 1990, Peru was able to increase its HDI score by 22,9 percent until 2022. Furthermore, the expected years of schooling in Peru for children of school entering age were 14,8 years in 2022, higher than the world average of 13,0 years. Peru had also scored slightly higher in the given year than Brazil (0,760), with 15,6 expected years of schooling but lower mean years of schooling of 8,3 years (Peru: 10,0 years). Mean years of schooling entail the average completed years of education of the population aged 25 and above, excluding repeated years (UNDP, 2024).

For Peru, the income per capita structure is the following:

2018	2019	2020	2021	2022
13.311,91	13.436,49	12.000,95	14.073,34	15.310,07

Table 21 - GDP per capita, current prices in international dollars, PPP-based, Peru (IMF, 2024)

With 15.310,07 USD GDP per capita generated in 2022, Peru ranked below the South American average of 16.890 USD. At the same time, it ranked above the average of emerging market and developing economies in the given year of roughly 14.250 USD (IMF, 2024). The disparity between emerging market economies and advanced economies in terms of GDP per capita becomes clear, when comparing the two averages. The average GDP per capita of advanced economies in the given year stood at roughly 63.340 USD, which was 4,44 times higher than that of emerging market economies (IMF, 2024). In 2022, Peru was in the same income bracket (15.000-25.000) as Colombia and Brazil, and a higher bracket than e.g., Bolivia, Ecuador, and Venezuela. The southern Latin American countries Argentina, Chile, and Uruguay, all ranked above the 25.000 mark (IMF, 2024).

To analyse the development of Peru s GDP over time, the real, annual GDP growth rate must be observed:

2018	2019	2020	2021	2022
4,00%	2,20%	-10,90%	13,40%	2,70%

Table 22 - Real GDP growth, Peru (World Bank, 2024)

The contraction of the economy by 10,90% in 2020 caused by the Covid-19 crisis was the largest downturn in 30 years and the strongest negative impact on any Latin American economy caused by the virus (World Bank, 2023). During the second quarter of 2020, a total of approximately 6,7 million jobs were lost. The health system was completely overwhelmed with the rapid rise of Covid-19 cases due to previous underfunding, and even strict measures could not prevent that no matter the ability to pay, proper health care could not be accessed during this period (World Bank, 2023). And even though the government implemented the largest relief packages in the region with 8,98% of its 2020 GDP, it was insufficient to protect the poor from falling deeper into poverty (World Bank, 2023). At the same time, Peru achieved a rapid recovery in 2021 of 13,40 GDP growth, when cases declined, and restrictions were lifted. Further structural problems entail high informality, poor living conditions especially in urban areas, and lack of a social system (World Bank, 2024).

To put the economic performance of Peru in a global perspective, GDP share of world total will be analysed as a fifth indicator:

2018	2019	2020	2021	2022
0,330%	0,328%	0,301%	0,321%	0,319%

Table 23 - GDP share of world total, PPP-based, Peru (IMF, 2024)

With 0,319% in 2022, Peru was in the second lowest bracket from 0,1% to 0,5%, as defined by the IMF (IMF, 2024). As a region, South America totalled a share of World GDP of 4,79%. Peru therefore holds a share of 6,67% of the South American total GDP. In comparison to its neighbouring countries, in 2022, it achieved a higher world share than Bolivia (0,07%) and Ecuador (0,15%) but a lower share than Chile (0,35%), Colombia (0,59%), and Brazil (2,33%) (IMF, 2024). Since the Covid-19 pandemic, Peru has been unable to catch up to its previous share, with its current 2024 GDP share of world total standing at 0,31. Before the pandemic, Peru was one of the best performing Latin American countries, with annual growth rates averaging 5,4% over the 15 years from 2004 until 2019 (IMF, 2019). The question remains, whether Peru has fully recovered and can accelerate once again to reach the previous growth levels.

Concerning trade, the following are the current account balances of Peru in the selected timeframe from 2018 until 2022:

2018	2019	2020	2021	2022
-1,167%	-0,551%	1,085%	-2,242%	-4,051%

Table 24 - Current Account Balance, Peru (IMF, 2024)

As the data shows, 2020 was the only year of the given five-year period, in which Peru was able to achieve a current account surplus. As outlined in the country profile, its main exports in 2022 included copper with 13,5 billion USD, gold with 7,4 billion USD, petroleum gas with 3,06 billion USD (OEC World, 2022). Peru s main export partners in the given year were China with 17,6 billion USD in 2022 and the United States with 8,69 billion USD. Among the main imports were refined petroleum with 7,45 billion USD in 2022, crude oil with 2,1 billion USD, and cars with 1,8 billion USD. Just as the export partners, the main countries the given products are imported from were China with 15,1 billion USD and the United States with 13,8 billion USD (OEC World, 2022). In 2022, Peru was additionally the largest importer of Sulphides with 64,8 million USD. In April 2023, Peru was once again able to achieve a current account surplus of roughly 602 million USD (CEIC, 2024).

The price development in Peru over the selected 5-year period can be measured with the yearly inflation rate:

2018	2019	2020	2021	2022
1,317%	2,136%	1,827%	3,979%	7,871%

Table 25 - Inflation rates, Peru (IMF, 2024)

In the given years, its inflation rate has consistently been below the average of emerging market and developing economies, which stood at 9,8% in 2022 and 5,9% in 2021 (IMF, 2024). Back in 1989 & 1990, Peru experienced a severe economic crisis, which was characterized by external debt default, a sharp economic decline, domestic terrorism, and hyperinflation (Werner & Santos, 2015, p. 9). It was the result of the oil shocks in the 1970s, the poor policy response of several countries such as Mexico, which led to further financial contagion, and ultimately resulted in a debt crisis in the 1980s throughout Latin America. For that reason, the given period was later called the region s “lost decade” (Werner & Santos, 2015, p. 9 f.). The described developments and their impact on inflation levels can be illustrated by the following graph:

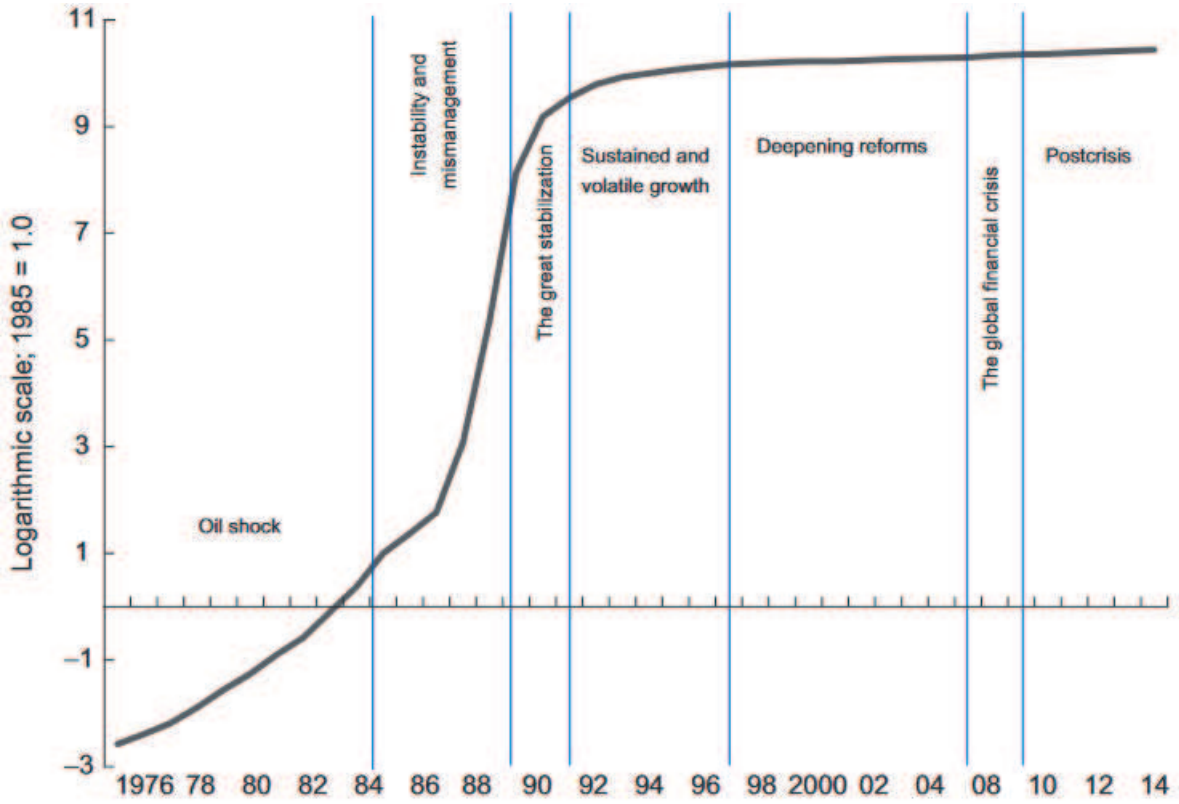

Figure 4 - Consumer price index 1976-2014, Peru (Werner & Santos, 2015, p. 19)

By implementing a stabilization program, Peru was able to bring down hyperinflation rates rapidly and set the basis for its following growth (Werner & Santos, 2015, p. 15).

In 2002, Peru s central bank BCRP additionally implemented an inflation-targeting framework, becoming the first monetary authority to implement such a framework under a dual monetary system (BCRP, 2014, p. 1). Its main objectives were to counter Peru s high level of dollarization and to prevent inflationary pressure from commodity shocks (Werner & Santos, 2015, p. 331). The inflation target was an annual increase of 2 percent of the consumer price index with a tolerance range from 1 to 3 percent, the same target rate as set by the European Central Bank for the European Union (BCRP, 2014, p. 3) (ECB, 2024). The dollarization risks entailed on one hand liquidity risks, as high foreign reserves were required for stabilization, and on the other hand exchange rate risks, which could have strong negative effects on the country s balance sheet (Werner & Santos, 2015, p. 208).

The established framework also allowed Peru to induce quantitative tightening to address spillover effects of the excessive quantitative easing (QE) implemented by developing countries in the region since 2008 (Werner & Santos, 2015, p. 207 f.). Quantitative tightening describes a monetary policy undertaken by a central bank to contract an economy which is accelerating too fast, or to counter rising inflation rates, by raising interest rates (Hayes, 2021). The following table shows the real interest rate in Peru from 2018 to 2022:

2018	2019	2020	2021	2022
12,00%	12,30%	8,70%	2,30%	7,90%

Table 26 - Real interest rate, Peru (World Bank, 2024)

As the data shows, its real interest rate has been positive throughout the five years, meaning that people that invested into fixed interest rate instruments like government bonds, which offered the given rate, gained a real increase of purchasing power during this time. Additionally, bond yields, which are positively correlated with the nominal interest rate set by a country, serve as an indicator for the market s perceived sustainability of a country s fiscal policy (Schuknecht, Von Hagen, & Wolswijk, 2008, p. 8). End of 2021, the Peruvian 10-year sovereign bond yield was at 5,9%, one of the lowest rates in the region (BCRP, 2022). The rates were impacted by global monetary tightening measures caused by the Ukraine war, with Peru increasing its policy rate by 750 basis points in 18 steps to 7,75% from 2021 until January 2023, to combat rising inflation rates (IMF, 2023). For that reason, nominal and real interest rates were residing at a high level in 2022 (World Bank, 2024).

As accounts for all Latin American economies with a rather instable currency or economy, dollars can be an attractive way to save money. From 2018 until 2022, the Peruvian Sol (PEN)/USD exchange rate was the following:

2018	2019	2020	2021	2022
3,38	3,31	3,62	3,99	3,80

Table 27 - USD exchange rate in Peruvian Soles (PEN), end of year (Exchange Rates Org UK, 2024)

As the table demonstrates, the exchange rate was fluctuating a lot less than the Argentinian exchange rate but showed a significant increase from 2019 to 2020 and from 2020 to 2021. As with many of the other variables, the reason for this drop in currency value was caused by the Covid-19 crisis. The severe economic contraction led to a high increase in uncertainty and a fall of the interest rate, devaluating the Peruvian Sol from 3,2 to 3,6 Soles per USD from January to November 2020 (CEPAL repositorio, 2020). Due to interventions of the BCRP on the foreign currency market, the Peruvian Sol was nonetheless more stable than most of the region s other currencies, with e.g., the Brazilian Real dropping from 4,02 Reales per dollar down to 5,19 Reales per dollar from start to end of year (CEPAL repositorio, 2020). Furthermore, the central bank officially declared to pursue exchange rate stability and to contain the risks of financial dollarization, so far quiet successfully (Werner & Santos, 2015, p. 330 f.).

Concerning the Economic Freedom Index, Peru has achieved the following scores:

2018	2019	2020	2021	2022
68,7	67,8	67,9	67,7	66,5

Table 28 - Economic Freedom Index, Peru (The Heritage Foundation, 2024)

Its overall score of 66,5 in 2022 was strengthened by a low tax burden and government spending with scores of 79,5 and 84,2 respectively, and pushed down by comparably low property rights, judicial effectiveness, and government integrity (The Heritage Foundation, 2024). Just in April 2024, the current president Dina Boluarte was accused of corruption, because several Rolex watches were discovered in her possession (El País, 2024). Currently (May 2024), Peru stands at world rank 49 out of 184 ranked countries, with an overall score of 64,8. At the same time, it secures rank 8 out of 32 countries in the Americas region and is considered “moderately free”. The main stated reasons are a gradual reduction in poverty, economic growth reforms, and open-market policies, but still high levels of corruption (The Heritage Foundation, 2024).

To measure the degree of government spending and the indebtedness of the country, the government debt ratio must be considered:

2018	2019	2020	2021	2022
25,73%	26,53%	34,67%	35,66%	33,80%

Table 29 - Central government debt (in % of GDP), Peru (World Bank, 2024)

As a reference, the ECB states that the government debt to GDP ratio of members of the EU should not exceed 60%, except if the rate is approaching the target rate at a satisfactory pace (ECB, 2024). In reality, many countries exceed this rate, with an average 89,9% government debt to GDP ratio in the EU in 2023 (Eurostat, 2024). In South America, the average government debt to GDP ratio stood at 75,1% in 2022, with Peru s ratio being lower than half of the region s average throughout the consecutive five years (IMF, 2024). This performance was once again achieved thanks to the strong policy frameworks Peru has in place and thanks to a non-financial public sector fiscal deficit of just 1,6% of GDP in 2022, which is well within its fiscal rule of 3,75% of GDP per year (IMF, 2023, p. 6). This low fiscal deficit was achieved through increased tax revenues, leading to the government debt being well below the debt limit of 38% of GDP (IMF, 2023, p. 6).

Besides its strong policy framework and low inflation rate, Peru also has accumulated a significant amount of reserves to stabilize its economy. Its total reserves minus gold in the analysed timeframe were the following:

2018	2019	2020	2021	2022
58,9	66,01	72,67	78,5	77,2[2]

Table 30 - Total reserves minus gold (in current billion USD), Peru (World Bank, 2024)

Besides the considerable foreign exchange buffer which is reflected in the given table, Peru has been granted a USD 5,3 billion flexible credit line by the IMF in 2022 (IMF, 2023). Furthermore, the total international reserves equalled 30% of the Peruvian GDP in 2022 (IMF, 2023). In the given year, its reserves/short-term debt ratio dropped slightly to 4,69, indicating that Peru could pay its 2022 short-term debt 4,69 times with its total reserves (IMF, 2024). Furthermore, studies have shown that foreign exchange helps significantly to reduce the exchange rate volatility, which may be a reason for the comparably high stability of the Peruvian Sol (Hviding, Nowak, & Ricci, 2004, p. 15 f.).

[2] Estimated (BCRP, 2022)

Considering the labour market conditions in Peru, the following unemployment rate was published by the IMF:

2018	2019	2020	2021	2022
6,64%	6,57%	13,08%	10,76%	7,74%

Table 31 - Unemployment rate (% of labour force), Peru (IMF, 2024)

The unemployment data once again emphasises the severe impact of the Covid-19 crisis in Peru, increasing the number of unemployed by a staggering 6,51% from 2019 to 2020 (IMF, 2024). At the same time, the stimulating policy response and quick economic recovery led to decreasing unemployment rates in the following years, with rates being back at pre-pandemic levels in 2024 (6,6%) (IMF, 2024). In a regional comparison, Peru borders the two countries with the lowest unemployment rate in South America in 2022: Bolivia with 4,7% and Ecuador with 3,2%. Its remaining neighbours showed higher unemployment rates in the given year with 7,9% in Chile, 9,3% in Brazil, and 11,2% in Colombia (IMF, 2024). In 2023, the LAC region almost reached a decade-low with the regional average standing at 6,3%, compared to an average 10,6% in 2020, when lockdowns left millions without jobs (Reuters, 2023).

Looking at how the generated income is distributed among the population, the Gini index for the chosen timeframe was the following:

2018	2019	2020	2021	2022
42,40%	41,50%	43,70%	40,10%	40,30%

Table 32 - Gini index, Peru (World Bank, 2024)

With a score of 49,1% in 2000, Peru s Gini index has been on a significant downward trend since, which was interrupted by a 2,20% jump in 2020 (World Bank, 2024). In general, LAC is the region with the most unequal income distribution, with 10% of the highest earners making on average 12 times more than the poorest 10% (IDB, 2024). Additionally, in countries such as Chile, Uruguay, and Columbia, roughly one percent of the population has control over 37%-40% of the country s total wealth, while the poorer half only controls roughly one tenth of the total wealth (IDB, 2024). According to literature, Peru s improvements in terms of inequality is partly due to economic growth fuelled by higher demand of China, redistributive policies to combat poverty, and an emerging middle class (Carbonnier, Campodónico, & Vázquez, 2017, p. 143). Countries such as Brazil and Colombia are facing significantly larger inequality, with a Gini index of 52% and 54,8% in 2022 respectively (World Bank, 2024).

Regarding political and governance indicators, Peru has been rated the following Corruption Perceptions Index scores:

2018	2019	2020	2021	2022
35	36	38	36	36

Table 33 - Corruption Perceptions Index, Peru (Transparency International, 2023)

Alike many Latin American countries, Peru has been struggling with corruption for decades. With a score of 36 in 2022, it was ranked 101 out of 180 countries, with rank one indicating the lowest perceived corruption (Transparency International, 2023). Its ranking further decreased in 2023, placing it at rank 121 with a score of 33 points. Additionally, according to Transparency International, 65% of people thought corruption increased in 2023, and 30% of public service users paid a bribe in the given year (Transparency International, 2023). Nearly every Peruvian president over the past three decades has been accused of corruption, with many being sentenced to prison. A prison complex in the capital, Lima, currently houses the following two former presidents: Alejandro Toledo, charged for money laundering in 2000, and Pedro Castillo, who tried to dissolve congress in December 2022 (NPR, 2023). Ex-president Alberto Fujimori was released from the given prison in December 2023 (Al Jazeera, 2023). As mentioned previously, the current president also faces an investigation, with her brother being arrested in May 2024 (Reuters, 2024).

Concerning the Rule of Law Index, Peru has achieved the following scores:

2018	2019	2020	2021	2022
0,52	0,51	0,50	0,49	0,49

Table 34 - Rule of Law Index, Peru (World Justice Project, 2023)

With a score of 0,49 in 2022, Peru was ranked 90 among 140 countries, with rank 1 indicating the strongest Rule of Law. Its score was furthermore below the regional average of 0,52 in 2022, leading to rank 20 out of 32 analysed countries in the LAC region (World Justice Project, 2023). Out of the 8 variables the index is composed of, Peru achieved the lowest scores in absence of corruption (0,33) and criminal justice (0,32), and the highest scores in fundamental rights (0,61) and order and security (0,61) (World Justice Project, 2023). According to Human Rights Watch, the rule of law has been undermined in March 2024 by Congress, when it arbitrarily removed two of the seven board members of the National Board of Justice (Human Rights Watch, 2024).

The third political & governance indicator which is applied to Peru is the Global Peace Index:

2018	2019	2020	2021	2022
1,93	1,94	1,99	2,02	2,12

Table 35 - Global Peace Index, Peru (Vision of Humanity, 2023)

The numbers are similar to those of Argentina, but with a significant increase in the year 2022. With a score of 2,12, the country placed rank 102 out of 163 ranked countries, slightly below the global average of 2,122 in the given year (Vision of Humanity, 2023). The three factors weighting most negatively in the given year were the perceived criminality in society, the jailed population, and the amount of UN peacekeeping funding. Positive factors were a low number of displaced people, a comparably difficult access to weapons, and a relatively low degree of organized internal conflict (Vision of Humanity, 2023). The significant worsening of the ranking was caused by the attempted shutdown of the Congress by former president Pedro Castillo in December 2022 and the following protests throughout the country (Farro, et al., 2023, p. 157). The protests escalated to a point at which the famous tourist attraction Machu Picchu was closed down for several weeks, leading to a loss of many thousand dollars in revenues (The New York Times, 2024).

Lastly, the scores of the indicator political stability absence of violence/terrorism in the analysed timeframe were the following:

2018	2019	2020	2021	2022
37	42	34	33	28

Table 36 - Political stability and Absence of Violence/Terrorism: Percentile Rank, Peru (World Bank, 2024)

The numbers indicate that e.g., in 2022, Peru has been as politically stable or more stable as only 28% of all ranked countries. This is below average in the LAC region and a lower score than its neighbours such as Brazil ranking at 34, Bolivia at 36, and Ecuador at 39 in 2022 (World Bank, 2024). The result is based on the various reasons stated before, which led to Peru suffering the highest rates of dissatisfaction with democracy and government institutions in Latin America. The current Rolexgate scandal involving current president Dina Boluarte, which emerged in April 2024, is already sparking new protests and may lead to a further increase of political instability and a decrease of the given variable in the near future (El País, 2024). An adequate qualitative calibration may be necessary.

2.5 Variable Ranking & Result Calculation

As a next step, the variables will be ranked qualitatively by a scoring model, translating each into a number between 0 and 100, with 100 indicating the least possible country risk and 0 indicating the highest possible risk. Some variables, whose ranking naturally uses the given scaling, will be translated into the identical value, rounded to a full number (e.g., Corruption Perceptions Index). Additionally, each variable is assigned a percentage weight out of a total 100%, based on its importance for the overall country risk. Based on the average score per variable throughout the five years and the assigned variable weight, a weighted average is calculated. By calculating the sum of the weighted averages, the final risk result is achieved, which will ultimately be translated into the country risk ranking from AAA to D. The following tables show the ranking as done according to the described methodology.

Index	2018	2019	2020	2021	2022	Average	Variable weight	Weighted average
Life expectancy at birth	77	77	76	75	76	76,33	0,05	3,82
Human Development Index	85	85	84	84	85	84,78	0,06	5,09
GDP per capita	68	68	61	69	76	68,40	0,07	4,79
Real GDP growth	40	42	10	98	70	51,92	0,06	3,12
GDP share in world total	50	48	42	45	46	46,20	0,04	1,85
Current account balance	35	48	52	54	48	47,26	0,06	2,84
Inflation rate	30	22	26	28	16	24,40	0,06	1,46
Real interest rate	64	86	27	14	20	42,26	0,06	2,54
USD exchange rate	50	42	36	30	24	36,40	0,05	1,82
Economic Freedom Index	52	52	53	53	50	52,08	0,05	2,60
Central government debt	15	10	0	19	15	11,84	0,06	0,71
Total reserves minus gold	36	30	26	27	29	29,60	0,04	1,18
Unemployment rate	46	43	36	47	56	45,60	0,06	2,74
Gini index	58	57	57	58	59	57,84	0,06	3,47
Corruption Perceptions Index	40	45	42	38	38	40,60	0,07	2,84
Rule of Law Index	58	58	58	56	55	57,00	0,05	2,85
Global Peace Index	77	76	76	77	78	76,65	0,05	3,83
Political stability and absence of v/t	47	44	45	48	47	46,20	0,05	2,31
Sum	**928**	**933**	**808**	**920**	**887**	**895**	**1,00**	**49,85**

Table 37 - Country risk calculation, Argentina

Index	2018	2019	2020	2021	2022	Average	Variable weight	Weighted average
Life expectancy at birth	76	76	74	72	73	74	0,05	3,72
Human Development Index	77	77	76	76	76	76	0,06	4,58
GDP per capita	45	45	41	48	52	46	0,07	3,23
Real GDP growth	66	59	11	100	61	59	0,06	3,56
GDP share in world total	50	50	45	48	48	48	0,04	1,93
Current account balance	46	48	53	43	38	46	0,06	2,75
Inflation rate	85	95	92	65	44	76	0,06	4,57
Real interest rate	86	87	76	57	74	76	0,06	4,56
USD exchange rate	50	56	59	62	68	59	0,05	2,95
Economic Freedom Index	69	68	68	68	67	68	0,05	3,39
Central government debt	74	73	65	64	66	68	0,06	4,10
Total reserves minus gold	65	68	70	72	72	69	0,04	2,78
Unemployment rate	57	58	30	39	51	47	0,06	2,82
Gini index	58	58	56	60	60	58	0,06	3,50
Corruption Perceptions Index	35	36	38	36	36	36	0,07	2,53
Rule of Law Index	52	51	50	49	49	50	0,05	2,51
Global Peace Index	63	62	60	59	55	60	0,05	3,00
Political stability and absence of v/t	37	42	34	33	28	35	0,05	1,74
Sum	**1.091**	**1.109**	**998**	**1.051**	**1.017**	**1.054**	**1,00**	**58,22**

Table 38 - Country risk calculation, Peru

Additionally, the thresholds set for the individual variable ranking are shown in Appendix 1. In the “Extreme risk” bracket Argentina ranks with its central government debt ratio in the five consecutive years, with alarmingly high rates of close to or above 100%. The current government has implemented several austerity measures such as cutting down ministries in an attempt to bring down the giant debt accumulated over the past years (Financial Times, 2023). Besides the government debt ratio, it ranked in the given bracket with its real GDP growth rate in 2020 with -9,90%, from which it recovered in the following years, with its inflation rate of 72,43% in 2022, and with its real interest rate of -11,90% in 2021 (IMF, 2024). “Very high risk” can be observed for several variables such as the elevated inflation rates from 2018 to 2021, its negative real interest rates in 2020 and 2022, its CAB in 2018, and its low total reserves minus gold throughout the given five years (World Bank, 2024). “Very low risk” is displayed in its Human Development Index across all five years, due to high levels of education and one of the highest life expectancies at birth in the region, in the real interest rate of 12,10% in 2019, and in the real GDP growth rate of 10,70% in 2021 (UNDP, 2024)

Peru only falls into the “Extreme risk” category with one indicator, which is its real GDP growth rate in 2020, of -10,90%. Similar to Argentina, it saw a quick economic recovery in terms of GDP in the following two years (IMF, 2024). “Very high risk” is reflected in its unemployment rate spike in 2020 of 13,078%, and its low political stability and absence of violence/terrorism scores from 2020 to 2022 (World Bank, 2024). Even though corruption is a severe problem in Peru throughout the given years, its scores are from 35-38 just above “Very high risk”, in the “High risk” category. “Very low risk” is displayed in its real GDP growth rate of 13,40% in 2021, its inflation rates close to the target rate of 2% from 2018 to 2020, and its real interest rates in 2018 and 2019 (IMF, 2024).

As stated previously, the individual variable weights intend to reflect the significance of each variable for the overall country risk. The highest weight was given to the indicators GDP per capita (7%), as the individual wealth generally has a high explanatory power about the general state of an economy, as well as the Corruption Perception Index (7%), as corruption forms a major issue for many Latin American countries with severe economic implications. A significant weight of 6% each was furthermore distributed to a total of 8 variables such as the Human Development Index, real GDP growth, and the inflation rate. A lower weight of 4% was given to GDP share in world total and total reserves minus gold.

The year-over-year results are furthermore depicted in Appendices 2 & 3, with the exact results being shown in the following two tables:

2018	2019	2020	2021	2022
51,41	52,27	45,08	51,95	50,08

Table 39 - Year-over-year results, Argentina

2018	2019	2020	2021	2022
60,50	61,26	54,23	56,89	54,83

Table 40 - Year-over-year results, Peru

The tables show the severe impact of the Covid-19 crisis on the Argentinian and Peruvian economy, decreasing the ranking results by 7,19 and 7,03 respectively, from 2019 until 2020. But while Argentina s numbers recovered quickly in the following two years, the Peruvian economy was struggling with longer lasting effects. Especially the trade deficit leading to a current account balance of -4,051% and an accelerating inflation rate of 7,87% in 2022 led to the given numbers (IMF, 2024). Additionally, the protests in early 2022 significantly impacted Peru s Global Peace Index and the political stability absence of violence/terrorism indicator (World Bank, 2024). At the same time, Argentina s economy remains highly volatile and displayed extremely high inflation rates in 2022, a government debt ratio of a staggering 85,20%, and extreme levels of corruption, among other factors (IMF, 2024). Throughout the entire timeframe, Peru was scoring significantly higher than Argentina, maintaining a score difference between 4 and 10 points. While the difference amounted to 9,09 in 2018, it declined to 4,75 points in 2022.

The final risk rating of the two countries is determined by the following scale:

Rating	Risk	Range
AAA	Very low	92 - 100
AA	Low	84 - 91,99
A	Satisfactory	76 - 83,99
BBB	Reasonable	68 - 75,99
BB	Rather high	60 - 67,99
B	High	52 - 59,99
C	Very high	44 - 51,99
D	Extreme	< 44

Table 41 - Final rating scale

The scale begins with the lowest risk (AAA) and moves downward by 8 points per rating score. Finally, any total score below 44 points is considered extreme risk (D) With a final score of 49,85, Argentina is rated **C** / very high risk. Peru with a final score of 58,22 is rated **B** / high risk, fairly close to the BB bracket. This result differs slightly from the current ratings of some of the rating agencies described in the methodology such as Coface and Fitch. According to Coface s country risk map, which is updated and published quarterly, Argentina displays extreme risk (E), while Peru displays “quiet high” risk (B) (Coface, 2024). Additionally, Coface rated the business climate in Argentina with B, and the business climate in Peru with A4. As core strengths of Argentina, Coface states a large economy and domestic market, a major agricultural industry, rich natural resources such as oil and gas, and a high level of education. Core weaknesses form, among others, weak fiscal accounts and a high dependence on IMF financing, skyrocketing inflation, and high political and social tensions (Coface, 2024). Peru also benefits from abundant mineral resources such as gold and copper, displays low levels of public debt, and high levels of foreign exchange reserves. At the same time, it is highly dependent on Chinese demand, shows grand regional disparities, and weak infrastructure, healthcare, and education systems (Coface, 2024).

Within the region, besides Argentina Coface gave the rating E (extreme risk) to Bolivia and Venezuela, with Bolivia having a GDP per capita of only 3.705,3 USD, and Venezuela being plagued by extreme rates of inflation, poverty, and corruption (Coface, 2024). Stronger ratings of A4 were achieved by Uruguay and Chile, with Uruguay benefiting from significant direct investments with good trade relations with the EU and the United States, and Chile benefiting from strong institutions and numerous free trade agreements (Coface, 2024).

Fitch in June 2024 has affirmed Argentina s Long-Term Foreign Currency Issuer Default Rating (IDR) at CC (Fitch, 2024). As key reasons the rating agency stated a probable bond restructuring or default event and a lack of ability to sustainably build up foreign exchange. Peru s Fitch rating was affirmed at BBB in April 2024, with key drivers being political fragility impacting governance, low public debt compared to regional peers, and a fiscal account which is likely to improve, among others (Fitch, 2024). Its real GDP contracted by 0,6% in 2023 due to decreased private investment and consumption, as well as high political uncertainties and social unrest (Fitch, 2024).

Lastly, the current situation in the given two countries may give reason for a qualitative calibration, improving or worsening the calculated rating. Especially political turmoil or changes in government can have a severe impact on country risk and must therefore be considered in the given analysis.

In Argentina, the election of President Milei has led to drastic changes with an economic plan focusing on aggressive fiscal adjustment and a lower dependency on the central bank (Fitch, 2024). Some of the implemented measures have already shown effects. For example, the FX control efforts, which by devaluing the Argentine Peso on the international currency market successfully lowered the gap between the parallel and official exchange rates. Additionally, inflation rates have lowered in the medium term after a jump immediately after the devaluation. The policy changes have also enabled an increase of the net international reserves from USD -12,5 billion to roughly zero in the timeframe of mid-December 2023 to May 2024 (Fitch, 2024). At the same time, it remains unclear how sustainable the reserve build-up is, and further challenges lay ahead. In the upcoming years 2025-2027, annual bond payments are expected to rise to USD 9 billion – USD 10 billion, and economic activity declined sharply due to the austerity measures, with an estimated contraction of 3,6% in 2024 (Fitch, 2024). Based on the given developments, Argentina s rating remains at **C** / very high risk.

In Peru, there has been political instability throughout several years, with new protests emerging recently due to the Rolexgate scandal involving President Dina Boluarte. Since 2018, there have been six different presidents and more than 150 cabinet reshuffles, sparking protests on a regular basis (Fitch, 2024). Despite a lack of political representation in Congress, Dine Boluarte for now remains president, while the unpopular congress passed reforms which allow legislative re-elections and a restoration of the senate. Apart from the political developments, the economic situation remains stable with an expected rebound of economic activity in 2024, low inflation rates, and comparably strong fiscal accounts (Fitch, 2024). Peru s rating therefore also remains at the calculated result of **B** / high risk. A downward calibration would be considered necessary in the case of emerging social unrest undermining government effectiveness, or a sharp decline in prices natural resources which are key to the Peruvian economy such as copper or gold.

2.6 Country Comparison

In the given segment, the prerequisites of the given countries, its analysis results from 2018-2022, as well as the current situation in each country will be compared.

As mentioned previously, both countries have abundant natural resources, which could bring long-term prosperity. Argentina has a giant landmass of 2,78 million square kilometres with in 2021 43,1% agricultural land suitable for growing soya, wheat, and corn, especially in the provinces of Buenos Aires, Córdoba, Santa Fe, and Entre Rios (World Bank, 2024). Additionally, the country is a major exporter of oil and gas, with 2.883 billion cubic metres of natural gas having been exported in 2022 (CEIC, 2024). Unfortunately, several unfavourable trade deals and economic policies paired with high levels of corruption led to Argentina historically being unable to fully capitalize on its high resource potential. An example for this is the Roca-Runciman treaty of 1933, which aimed to secure Argentinian beef exports to the British market, but heavily favoured British interests and ultimately limited the sovereignty of Argentina s economy (Britannica, 2024).

Peru s natural resources entail abundant mineral resources such as copper, gold, iron, zinc, and lead, and agricultural products such as berries, grapes, coffee, and avocado (Coface, 2024). Additionally, the Peruvian fishing industry with revenues of approximately 4,6 billion USD in 2022 accounts for a substantial part of Peru s GDP, which amounted to 242,63 billion current USD in 2022 (WWF, 2023) (World Bank, 2024). In June 2023, the industry suffered severe losses due to the weather phenomena “El Niño”, when the ministry of production cancelled the first anchovy fishing season in the given year. As climate change exacerbates the effects of El Niño, which typically entail a weakening of trade winds blowing from the eastern Pacific and consequently a warming of ocean water around Christmas, Peru was forced to spend approximately 1 billion USD in 2023 to counter the given effects (Wodne Sprawy, 2023). Besides the abundance of natural resources, Peru benefits from partaking in several international trade blocs. Peru is a member of the Pacific Alliance, a trade bloc established in 2011 with Chile, Colombia, and Mexico, and of the Andean Community, a customs union founded in 1969 to facilitate trade between the member countries Bolivia, Colombia, Ecuador, and Peru (Comunidad Andina, 2024). Lastly, Peru forms part of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, signed 2018 as a successor to the Trans-Pacific Partnership (Coface, 2024).

For a comparison of the data gathered and the variable ranking results of the given two countries, the following table provides an overview:

	Argentina		Peru	
Variable	**Data Average**	**Ranking Average**	**Data Average**	**Ranking Average**
Life expectancy at birth	76,33	76,33	74,32	74,32
Human Development Index	0,848	84,78	0,764	76,40
GDP per capita	23.479,01	68,40	13.626,55	46,20
Real GDP growth	0,24%	51,92	2,28%	59,30
GDP share in world total	0,75%	46,20	0,32%	48,20
Current account balance	-0,91%	47,26	-1,39%	45,84
Inflation rate	50,14%	24,40	3,43%	76,20
Real interest rate	-2,58%	42,26	8,64%	75,92
USD exchange rate	92,27 ARS	36,40	3,62 PEN	59,00
Economic Freedom Index	52,08	52,08	67,72	67,72
Central government debt	88,94%	11,84	31,28%	68,40
Total reserves minus gold	43,89	29,60	70,66	69,40
Unemployment rate	9,23%	45,60	8,96%	47,00
Gini index	42,16%	57,84	41,60%	58,40
Corruption Perceptions Index	40,60	40,60	36,20	36,20
Rule of Law Index	0,57	57,00	0,50	50,20
Global Peace Index	1,934	76,65	2,00	60,00
Political stability and absence of v/t	46,2	46,20	34,80	34,80

Table 42 - Country comparison variables

It shows the average data points and respective score averages of the timeframe from 2018 to 2022. Concerning life expectancy, Argentinians on average lived roughly two years longer than Peruvians, with the Argentinian life expectancy having increased by 5,1 years from 1990 until 2017 (UNDP, 2024). At the same time, a significant increase in excess mortality in 2020 and 2021 due to the Covid-19 pandemic is lowering Peru s average score (Huarcaya, Monzón, Saldaña, & Driver, 2022, p. 1). In addition to a higher life expectancy, the longest years of schooling in the region of 19,0 years led to Argentina s Human Development Index being significantly higher than the Peru s HDI (UNDP, 2024).

Thirdly, the PPP-based GDP per capita in Argentina is almost twice as high as the one in Peru, which may indicate a higher level of individual wealth (IMF, 2024). At the same time, Argentina showed a poverty rate of 37,3% in 2021, when Peru s average poverty stood at 26% (World Bank, 2024). This contradiction in GDP per capita and poverty rates may be explainable by income inequality, inflation eroding the purchasing power of people, social safety nets in the given countries, or different measurements. With the average Gini index only differing by 0,56%, income equality has been roughly equal in Argentina and Peru, therefore not being able to fully explain the contradiction (World Bank, 2024).

Inflation rates in Argentina are lowering the purchasing power of Argentinians on a daily basis, with yearly inflation hitting 290% in May 2024 (DW, 2024). According to economic theory, inflation leads to several types of costs for an economy. One type is e.g., the misallocation of resources and so-called “menu costs”, which implies that too infrequent price changes on a company level my lead to an ineffective resource allocation, and the costs of updating prices, such as reprinting price lists or updating digital prices (Agarwal & Kimball, 2022, p. 1 f.). Additionally, “shoe-leather costs” are incurred by people holding less money and going more often to the bank, and “unpredictability” entails the costs of increased uncertainty due to inflation. The given costs increase with rising inflation, constantly troubling Argentina s economy (Agarwal & Kimball, 2022, p. 2).

Average real GDP growth has been higher in Peru in the given timeframe, as the country was seeing moderate growth rates before the outbreak of the pandemic and was able to recover quickly. Argentina s real GDP growth on the other hand had been negative before the pandemic, with positive growth rates achieved in 2021 and 2022, before contracting once again by 2% in 2023 (World Bank, 2024). This development was in line with the GDP share in world total of both countries, with Argentina having the higher share throughout the time period, as it is the larger economy (IMF, 2024).

Two more indicators which differ greatly between the two countries are the USD exchange rate and the real interest rate. Due to extreme inflation rates, Argentina has one of the most unstable currencies in the region, while the Peruvian Sol is one of the region s most stable currencies due to effective policy making by the central bank (CEPAL repositorio, 2020). Interest rates have been fluctuating remarkably in both countries in the given timeframe, but while the Peruvian real interest rate has always been positive, Argentina s interest rate has plummeted in 2020 to -7,60%, and has since not recovered (World Bank, 2024).

Corruption and political instability are issues that both countries have been struggling for decades, with Peru experiencing one corruption scandal after another and corruption seemingly being engrained into the Argentinian political landscape (El País, 2024). This is reflected in the consistent low scores in the Corruption Perceptions Index, and in the political stability absence of violence/terrorism index. Global Peace Index scores were slightly higher in both countries, while declining from 2020 onwards due to the Covid-19 crisis and nationwide protests in Peru (Vision of Humanity, 2023).

Today s Argentinian president Javier Milei promised in December 2023 to combat corruption and proposed numerous reforms to tackle corruption and inefficiencies in the public sector (El Pais, 2023). Originally, his so-called omnibus law entailed more than 600 articles, proposing the privatization of several state-owned companies such as YPF and Aerolineas Argentinas, the reframing of social protest as a crime, and the deregulation of the economy removing several trade laws, among others (CELS, 2024). After several negotiations in which numerous articles were rejected by lawmakers, the bill in his new form consisting of 230 articles was approved by the lower house in April 2024 (Reuters, 2024). Even though at least 50.000 construction workers were laid off as a result of a decree stopping public construction works, the unemployment rate in 2024 is slightly lower than the average in the selected timeframe, standing at 8% (Reuters, 2024) (IMF, 2024). Its GDP per capita in current prices (PPP-based) decreased slightly to 26.390,00 international dollars in 2024, leading its share in world GDP to shrink to 0,67% (IMF, 2024). According to Fitch, President Milei will be able to successfully reduce government spending, which could lead the fiscal deficit to decline from 4,5% in 2023 to 2,9% of GDP in 2024 (Fitch, 2024). For now, the government debt ratio in % of GDP remains high with 86,2% in 2024, and the current account balance stands at 0,9% of GDP (IMF, 2024).

As mentioned previously, Peru is already facing its next corruption scandal, with current president Dina Boluarte being found in possession of several expensive Rolex watches, and her brother and lawyer being arrested over influence-peddling accusations (Reuters, 2024). Besides the given incidents, Peru s economy is currently recovering from several consecutive climate-related shocks and social turmoil in 2023 (IMF, 2024). Thanks to the central bank s intervention and successfully implemented monetary tightening measures, the annual inflation rate (average consumer prices) has receded and is standing at 2,3% in May 2024 (IMF, 2024). The unemployment rate has also decreased significantly and is currently standing at 6,6%, with still a high share of informal labour (IMF, 2024). GDP per capita in current prices (PPP-based) has reached a new all-time high in 2024 with roughly 16.630,00 international dollars, with GDP share of world total remaining in a similar position at 0,31% (IMF, 2024). The real GDP growth rate remains positive at 2,5% and the government debt ratio remains considerably low with 33% of GDP (IMF, 2024). As the data shows, several Peruvian macroeconomic indicators have stabilized again after the Covid-19 crisis, but many issues remain such as corruption, poverty, and high informality (World Bank, 2024).

2.7 Conclusion & Outlook

To conclude the given analysis, a SWT analysis will be conducted, displaying six key strengths, weaknesses, and threats for the selected two countries. While many other factors may form strengths, weaknesses, or threats, the following tables include some of the major points outlined in the conducted country risk analysis:

Strengths	Weaknesses	Threats
Rich in natural resources (oil, gas, gold, copper, lithium)	Financial dependence on IMF	Geopolitics → Ukraine war impacting agricultural prices
Major agricultural player (soya, wheat, corn)	Low foreign currency reserves	Climate → potential droughts
High levels of education and life expectancy	Political and social tensions, corruption	Strong exchange rate fluctuations
Large domestic market	Skyrocketing inflation	Escalating social tensions
Great renewable energy potential	High poverty and informality rates	Accelerating debt → Sovereign default
Popular tourist destination due to diverse landscapes	Dependence on commodity prices	Increasing poverty and crime rates

Table 43 - SWT Analysis Argentina, own illustration

Argentina should focus on its strengths to maximize its economic potential. At the same time, corruption and a history of unfavourable trade deals as well as economic instability for decades have complicated this strategy (Britannica, 2024).

Strengths	Weaknesses	Threats
Abundant mineral resources (Gold, copper)	High dependency on Chinese demand	Newly erupting political unrest
Strong agriculture (coffee, avocados) and fishing industry	High informality leading to lower tax revenues	Shortfall in tax revenues amid economic slowdown
Member of several international trade blocs	High regional income disparities	Potential rise of inflation levels
Low levels of inflation	High levels of corruption	Sustained negative current account balance
Low level of public debt compared to peers	High poverty rates, especially in rural areas	Fluctuations in commodity prices
Independent central bank & high foreign exchange reserves	Weak education system, healthcare, and infrastructure	Impact of climate change / El Niño on fishing and agricultural sector

Table 44 - SWT Analysis Peru, own illustration

Peru s strengths are similar to those of Argentina. The country is rich in natural resources but due to high levels of corruption, high informality, and a weak infrastructure is unable to fully capitalize on its potential (Coface, 2024).

To conclude the first part of this thesis, an outlook will be provided on how the analysed data may develop in the future. In general, economic forecasting entails the process of using statistical models to predict the future condition of an economy in terms of variables such as GDP, inflation, or interest rates (Liberto, 2020).

According to the World Bank, the Argentinian economy is expected to contract by 2,8% in the ongoing year of 2024, but expected to grow by 5% in 2025 (World Bank, 2024). Analysts expect the stabilization plan implemented by the new government to work, intended to eliminate fiscal and external imbalances and to realign relative prices. Additionally, more favourable weather conditions boosting the agricultural sector are expected, compared to 2023 (World Bank, 2024). A fiscal consolidation plan, which was implemented as part of a 30-months Extended Fund Facility (EFF) with the IMF, is furthermore expected to result in a total accumulated 10 billion USD in net international reserves by the end of 2024 (World Bank, 2024). The rating agency Fitch believes that President Milei will be able to successfully tighten fiscal policy, narrowing the estimated fiscal deficit in 2024 down from 6,2% to 2,9% of GDP. Additionally, it has revised its (average) inflation forecast up from 260% year-on-year to 300% in 2024 due to the removal of price caps and subsidy schemes (Fitch, 2024).

Concerning Peru, its nominal GDP is expected to grow by 2,7% in 2024 and by 2,4% in 2025. In the medium-term future, an average nominal GDP growth rate of 2,4% is expected, supported by exports which will be generated through new mining projects (World Bank, 2024). The public deficit is expected to reach 2,4% in 2024 and decline to around 2% in 2025, with a stable debt-to-GDP ratio of around 34%. Inflation rates are expected to remain in the 1-3% target range if no exceptional shocks occur, supported by a moderate growth in domestic demand (World Bank, 2024).

Besides the mentioned expected figures, Fitch has qualified its rating outlook for Peru as negative. This qualification is based on the current political instability, which is expected to remain in the medium-term future, as well as weakened private investment and economic growth prospects (Fitch, 2024). Similar to the World Bank, Fitch expects the Peruvian economy to rebound by 2,6% in 2024 after a 0,6% contraction in 2023 due to falling private investment, consumption, and social unrest, and to maintain a growth rate between 2%-2,5%. The growth rates will supposedly be achieved amid lower inflation rates, the recovery of several key industries, and stronger private consumption (Fitch, 2024).

3. Latin American Investment Funds

As a second part of this thesis, the investment fund landscape in Latin America will be analysed, to then investigate a relationship between country risk analysis and the given funds.

3.1 Theoretical Background

In general, several different types of investment funds can be distinguished such as mutual funds, exchange traded funds, index funds, hedge funds, private equity funds, or UCITS (Morningstar, 2024). All fund types in some form pool the investments of several individual or institutional investors and invest it into a variety of securities with the aim of paying back the initial investment plus a healthy return (Stulz, 2007, p. 175 f.). In the case of active investment funds such as hedge funds, a professional fund manager is entrusted with the money and attempts to beat the returns of a benchmark index, such as the S&P 500. This can be done through e.g., selecting specific stocks which the manager believes will achieve above-average returns, by attempting to time the market, or by assigning different sector or geographical weights than the benchmark (Crane & Crotty, 2018, p. 33). The manager also has the right to short positions or to use derivatives extensively. Additionally, hedge funds are more costly as investors must pay fees such as management or performance fees, and are unregulated with a limited number of investors (Stulz, 2007, p. 176 f.).

Mutual funds on the other hand are strictly regulated investment products offered to the public and typically much larger in size and lower in cost than hedge funds. They are regulated by the Securities and Exchange Commission through two major directives: The Securities Act of 1933 and the Investment Company Act of 1940 (Stulz, 2007, p. 175) There are different kinds of mutual funds which entail different securities. For example, there are funds which only invest into fixed income instruments such as bonds, which can reduce overall portfolio risk and form an attractive investment in times of high interest rates (Morningstar, 2022). Furthermore, there are multi-asset funds which invest into a variety of different securities. The mutual fund choice of an investor mainly depends on his risk profile and investment objective, with share classes differing in their target investor group (Morningstar, 2022). By investing into a mutual fund, an investor does not become shareholder of each security the fund is made up of, but a shareholder of the mutual fund. Often the given funds require a minimum investment (Vanguard, 2024).

At the same time, passive investment funds such as index mutual funds or exchange traded funds try to *match* the performance of a specific benchmark. Exchange traded funds have gained large popularity in recent years and are investment companies, which either invest into all or a representative sample of securities of the index it is trying to match (Morningstar, 2024). The first ETF introduced was the Standard & Poor s Depository Receipt, a unit investment trust which holds a portfolio matching the S&P 500 index (Bodie, Kane, & Marcus, 2010, p. 104). Many similar products followed based on the Dow Jones Industrial Average and on the NASDAQ 100 Index. Compared with index mutual funds, they promise the same low costs, diversification, and tax benefits, while providing a lower minimum investment and real-time pricing. Investors are able to purchase as little as 1 share of an ETF (Vanguard, 2024). In February 2024, the ETF market reached a record high of USD 11,7 trillion AUM (assets under management), due to more investors investing into equities and bonds instead of hoarding their cash (Yahoo Finance, 2024).

A private equity fund is similar to a mutual fund, as it pools the money of all investors and the fund manager uses the pooled money to make investments on behalf of the fund. Unlike mutual or hedge funds, the investment horizon is long-term of typically 10 years or more, and value is generated by taking over a controlling interest in an operating business and improving its management (Investor.gov, 2024)

Funds can furthermore be registered as UCITS, which stands for *Undertakings for Collective Investments in Transferable Securities*. The UCITS framework was established by the European Commission to provide unified regulation and investor protection for investors in the European Union (Chen, 2023). If any assets held by the investor or any other institution involved in the investment chain get lost, the depositary is obligated to replace them adequately as soon as possible (European Commission, 2016). Due to the strict rules, UCITS fund managers may have to pay higher fees to establish the fund and charge lower fees for the fund management. Also, the regulations may lower the potential returns for investors (Chen, 2023).

Besides Europe, UCITS form a popular investment in South America and Asia, for investors who seek an investment into a diversified unit trust in their country. A prominent example of a Latin American UCITS ETF is the iShares MSCI EM Latin America UCITS ETF, which seeks to track the performance of an index composed of selected emerging markets companies from Latin America (BlackRock, 2024).

3.2 Investment Landscape

Taking a closer look at the overall fund and investment landscape in Latin America, a broad variety of investment funds can be observed, which investors can choose from. One of the largest ETF providers is iShares, which is managed by Black Rock, one of the world s leading investment companies (iShares, 2024). Its most prominent Latin America ETFs are the Latin America 40 ETF, which seeks to track the performance of an index composed of 40 of the largest Latin American listed companies, and the previously mentioned MSCI EM Latin America UCITS ETF (iShares, 2024). The investment firm MSCI, which provides global indices such the MSCI World or the MSCI Emerging markets to invest in, published the index which the previous fund is based on – the MSCI Emerging Markets Latin America Index. It is denominated once in Euros and once in USD (MSCI, 2024). The 5-year annual performance of the USD index stands at 3,07% with a dividend yield as of May 2024 of 5,88%. In comparison to the indices MSCI ACWI and MSCI Emerging Markets, its performance since 2009 had been the following:

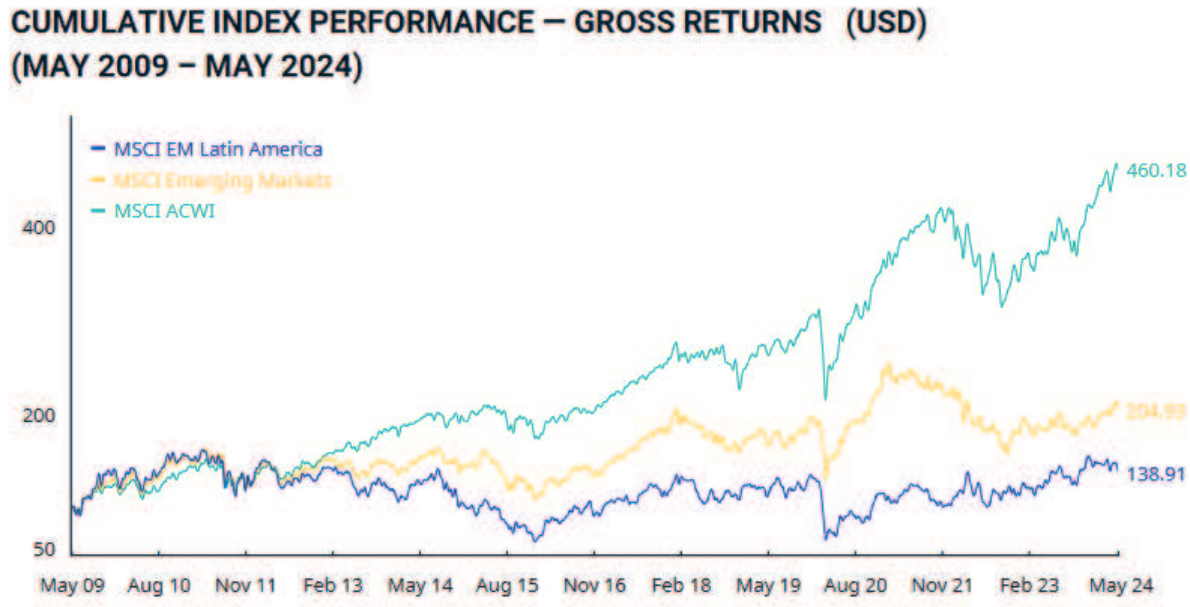

Figure 5 - MSCI Emerging Markets Latin America USD Cumulative Index Performance (MSCI, 2024)

The MSCI ACWI Index entails approximately 85% of the global investable equity opportunity set with 2.837 constituents and represents large and mid-cap companies from 24 emerging market and 23 developed market economies. The MSCI Emerging Markets Index represents 1.373 large and mid-cap constituents across 24 emerging market economies and is a popular investment to increase the emerging market share in a portfolio (MSCI, 2024).

As the graph shows, the MSCI EM Latin America has generated significantly lower returns than the other two funds, with a total return of 138,91% over the given timeframe compared to 460,18% of the MSCI ACWI. Concerning country weights, the index entails 57,41% Brazilian equities, followed by 30,91% Mexican equities, making it highly dependent on the equity performances of the given two countries (MSCI, 2024). The total market capitalization of the index is currently USD 587,76 billion.

The second Latin America Index MSCI offers is the MSCI Emerging Markets Latin America 10/40, which has imbedded a 10/40 rule. This rule in accordance with the UCITS III directive limits the weight of a single company to 10% and the summed-up weight of companies between 5 and 10% to 40%, to ensure a sufficient diversification. The fund shows a slightly better performance from May 2009 – May 2024 of 148,97% than the MSCI EM LA (USD), while also holding 91 constituents (MSCI, 2024).

Besides investing into a broad index such as the mentioned examples, one can also invest directly into a country within the region. This can be done by for example investing into the MSCI Brazil index (USD), the MSCI Mexico Index (USD), or the MSCI Peru Index (USD), each covering approximately 85% of the national equity universe (MSCI, 2024). A country with an exceptional index performance in the recent year is Argentina, realizing a 65,71% return with the growth rate still accelerating. Thanks to the recent growth rate, its 10-year annual return stands at 12,04%, compared to 2,66% annual return of the MSCI Emerging Markets and 8,40% (MSCI, 2024). At the same time, its annual returns are highly fluctuating.

Concerning foreign direct investments into the region, the United States represented the largest segment of foreign investors with 38% of total investments in the LAC region, followed by the EU with 17%, in 2023 (ECLAC, 2023). According to the Economic Commission for Latin America and the Caribbean (ECLAC), foreign direct investments rose by 55% in 2022 with a total of USD 224,58 billion USD being received in the given year. This is an exceptional growth given that global FDI inflows decreased by 12% compared to 2021, totalling roughly USD 1,29 trillion (ECLAC, 2023).

The country receiving the largest portion of the investments is Brazil, with 41% of total investment received in 2022, followed by Mexico (17%), Chile (9%), Colombia (8%), Argentina (7%), and Peru (5%). Sector-wise, the largest share of FDI with 54% went into the services sector, followed by electricity, natural gas and water, and information and communications (ECLAC, 2023).

3.3 Fund Analysis – Templeton Latin America Fund A (acc) USD

To investigate, whether Latin America as a region could be an attractive investment, the mutual fund Templeton Latin America Fund A (acc) USD will be analysed in detail.

3.3.1 Key information & Fund composition

3.3.1.1 Fund overview

The given equity fund was issued by the global investment organization Franklin Templeton on February 28th, 1991, with the objective of long-term capital appreciation through investments into equities with their principal business activities in Latin America (Franklin Templeton, 2024). The fund is a share class of the sub-fund Templeton Latin America Fund, which qualifies as a UCITS. The share class currency of the fund is the US dollar as the title states, and it is managed by Gustavo Stenzel since April 01st, 2016. The fund is domiciled in Luxembourg with the ISIN LU0128526570, and a minimum amount of USD 1.000 is required make an investment (Morningstar, 2024).

Furthermore, the notation “acc” in the fund title must be explained. There are two different fund classes with the annotations “acc” and “dist”, standing for accumulation and distribution. While accumulating funds automatically reinvest the dividends generated by its underlying holdings, a distributing fund pays out the dividends to its investors. Therefore, accumulating funds are a suitable investment for investors planning to build capital over the long term, while distributing funds are suitable for investors who would like to receive regular payments, e.g., to enhance their current living standard (DeGiro, 2024).

The letter “A” stands for the share class of the given sub-fund. In this case, the share class A indicates that a portion of the initial investment is paid to the brokerage firm instead of being invested into the fund. The maximum sales charge is stated to be 5,75% (Franklin Templeton, 2024). Class A shares often offer breakpoint discounts, meaning that the front-end load (sales charge) is lower, the higher the investment. A breakpoint discount is not applied for the given fund, the sales charge is always 5,75%. Additionally, class A shares tend to have lower operating expenses compared to other share classes such as B or C. The ongoing charges are stated to make up 2,26% of the investment per year (Franklin Templeton, 2024). The cost structure will be outlined in more detail in *3.3.1.2*.

The net asset value (NAV) as of June 05, 2024, stands at USD 62,02, and the total fund size at USD 645,29 million assets under management (Morningstar, 2024). The net asset value of an investment fund is the net value of its assets minus its liabilities, divided by the number of shares outstanding. It is calculated at the end of each trading day to demonstrate at which price the fund shares are traded, based on the closing market prices (Chen, 2024). As mutual funds commonly pay out their income such as interest earned or dividends to their shareholders and distribute realized capital gains, which decreases the NAV, it is not the best performance measurement. Instead, the total annual return or the compounded annual growth rate (CAGR) offer a more complete picture of the profitability of the investment (Chen, 2024).

Concerning the fund strategy, the fund aims to generate value for the investor over the medium to long term with a recommended minimum holding period of 3 to 5 years. To achieve this, it invests mainly into equities of companies located in or doing significant business in Latin America. To a minor extent, the fund invests into debt securities of companies located in or doing significant business in Latin America, and into equity and debt securities issued by governments of any country (Franklin Templeton, 2024). The investment team with Gustavo Stenzel as lead fund manager uses in-depth financial analysis to identify stocks it believes are undervalued and have potential to increase the fund value over the long term. The benchmark indicated by Franklin Templeton Investment Funds is the MSCI EM Latin America NR USD, and its Morningstar benchmark the Morningstar EM Americas TME NR USD (Morningstar, 2024).

3.3.1.2 Cost structure

Firstly, there are so-called “one-off” charges, which must be paid only once when entering or exiting the fund. As mentioned previously, the entry cost forms a sales charge of a maximum of 5,75%, which is applied to the amount of the initial investment. There is no exit or redemption fee to be paid (Franklin Templeton, 2024).

Secondly, there are ongoing costs which are incurred each year. The ongoing costs are further split up into management fees and other administrative operating costs, and transaction costs. The management fees and other administrative operating costs currently amount to 2,26%, while transaction costs amount to 0,01% of the investment. While management fees compensate the effort made by fund managers to actively generate returns, transaction costs reflect the costs incurred when the underlying investments for the product are bought and sold. The total ongoing costs therefore amount to 2,27% (Franklin Templeton, 2024).

Finally, some funds incur performance fees, which are payments made to the fund manager for generating positive returns. Among hedge funds, a “2 and 20” annual fee structure is common practice, which entails a 2% management fee of the fund s NAV and a 20% performance fee on the generated profits (Chen, 2022). The given Templeton fund does not apply any performance fees.

The recommended holding period is stated to be 5 years, with different return scenarios based on the fund performance in the given timeframe. Example scenarios with an investment of 10.000€ are the following:

		If you exit after 1 year	If you exit after 5 years
Scenarios			
Minimum	There is no minimum guaranteed return. You could lose some or all of your investment.		
Stress	What you might get back after costs	470 USD	360 USD
	Average return each year	-95.30%	-48.56%
Unfavourable	What you might get back after costs	5,400 USD	6,890 USD
	Average return each year	-46.00%	-7.18%
Moderate	What you might get back after costs	9,370 USD	9,650 USD
	Average return each year	-6.30%	-0.71%
Favourable	What you might get back after costs	13,690 USD	14,010 USD
	Average return each year	36.90%	6.98%

Table 45 - 5-year return scenarios (Franklin Templeton, 2024)

According to the table, besides the stress scenario, a five-year holding period leads to a better result after deducting costs than a one-year holding period (Franklin Templeton, 2024).

3.3.1.3 Fund composition

Concerning the asset class allocation, the fund has a net exposure of 96,93% to equity and holds 3,07% as cash reserves. In comparison, the category index Latin America Equity as of May 2024 invested 88,52% into equity, holds 1,81% in cash and invested 9,46% into other, unspecified asset classes. Furthermore, the fund is actually economically exposed to a net 89,04% of equity, 6,85% of fixed income, and 4,10% of cash. Thirdly, the total net market value is made up of 93,11% equity, 4,10% cash, and 2,79% derivatives (Morningstar, 2024).

Sector-wise, the fund invests into a broad variety of cyclical, sensitive, and defensive sectors. Investments flow into financial services with the largest share of 23,54%, followed by consumer defensive products with 18,33%, basic materials with 18,02%, industrials with 17,10%, and energy with 10,61%. To a minor share it invests into utilities, technology, consumer cyclical products and healthcare (Morningstar, 2024). *Figure 11* additionally shows a comparison of the invested amounts of the Templeton Fund with the fund category Latin America Equity:

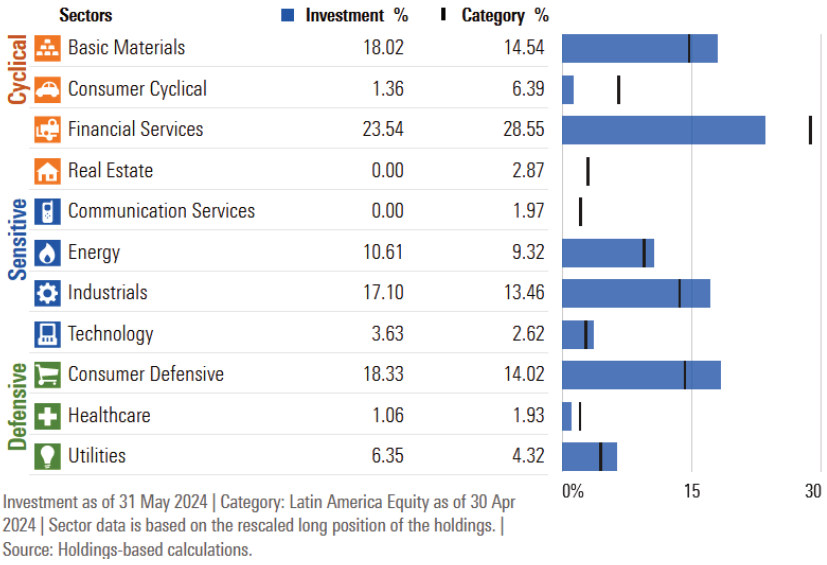

Figure 6 - Comparison of sector investments with category (Morningstar, 2024)

As the figure shows, the fund category invests a larger proportion into financial services (28,55%), but a minor proportion into consumer defensive products (14,02%) and basic materials (14,54%), among others. Compared with the Morningstar benchmark fund EM Americas TME NR USD, the benchmark invests larger shares into financial services (25,74%) and into basic materials (18,60%), while investing minor shares into e.g., consumer defensive (14,74%) and industrials (12,04%) (Morningstar, 2024).

Geographically, as the fund is focusing on Latin America, the weights are 98,86% Latin America and a small share of 1,14% in the Eurozone.

The top five holdings are Petroleo Brasileiro SA Petrobas with 10,04%, Vale SA with 7,20%, Grupo Mexico SAB de CV with 6,73%, Itausa S.A. with 5,77%, and Grupo Financiero Banorte SAB de CV with 5,29% (Morningstar, 2024). With the top two equities being Brazilian, this country contains the largest weight (58,88%), followed by Mexico (30,89%). As it is a UCITS fund, the 10/40 rule must be respected. Currently, the weight of Brasileiro Sa Petrobr exceeds the allowed 10% of a single security, which will be adjusted in the next portfolio rebalancing. The equities with a weight between 5% and 10% reach a sum of 35,03%, which is within the allowed 40% (Morningstar, 2024).

In a next step, the stock style graph is examined, depicting the security allocation of the fund and its peers:

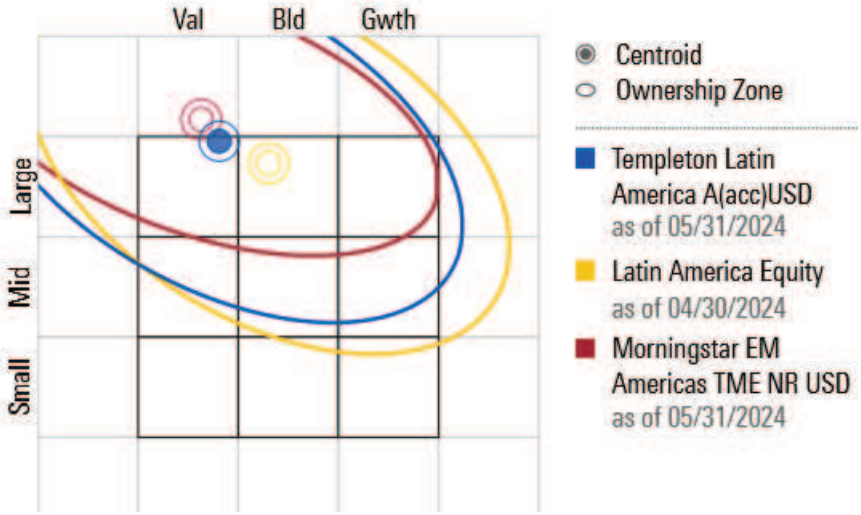

Figure 7 - Stock style (Morningstar, 2024)

Compared to its peers, the Morningstar EM Americas TME NR USD focuses the most on value and large-cap stocks, while the Latin America Equity category is leaning more towards blend stocks and stocks with a slightly smaller market capitalization. In general, value stocks can be defined as stocks trading at price levels perceived to be lower than their fundamental value, and promising a low price in relation to dividends, earnings, or sales. They are commonly characterized by high dividend yields and a low P/E ratio (Smith, 2023). The Templeton fund is in between the two peers, also mainly consisting of value stocks and large caps. The fund may therefore be an attractive investment for value investors (Morningstar, 2024).

3.3.2 *Technical Analysis*

In the given segment, the historical performance of the fund Templeton Latin America A (acc) USD will be described and analysed. In financial terms, the technical analysis or also called chart analysis implies the identification of trade patterns based on price movements and volumes, which is often used by investors to examine whether they should invest into a certain stock, bond, or fund (Hayes, 2024).

The following graph shows the fund development of a 100 GBP investment from January 2014 until June 2024 (dark blue) compared to its category Latin America Equity (light blue) and its Morningstar benchmark Morningstar EM Americas TME NR USD (red) (Morningstar, 2024):

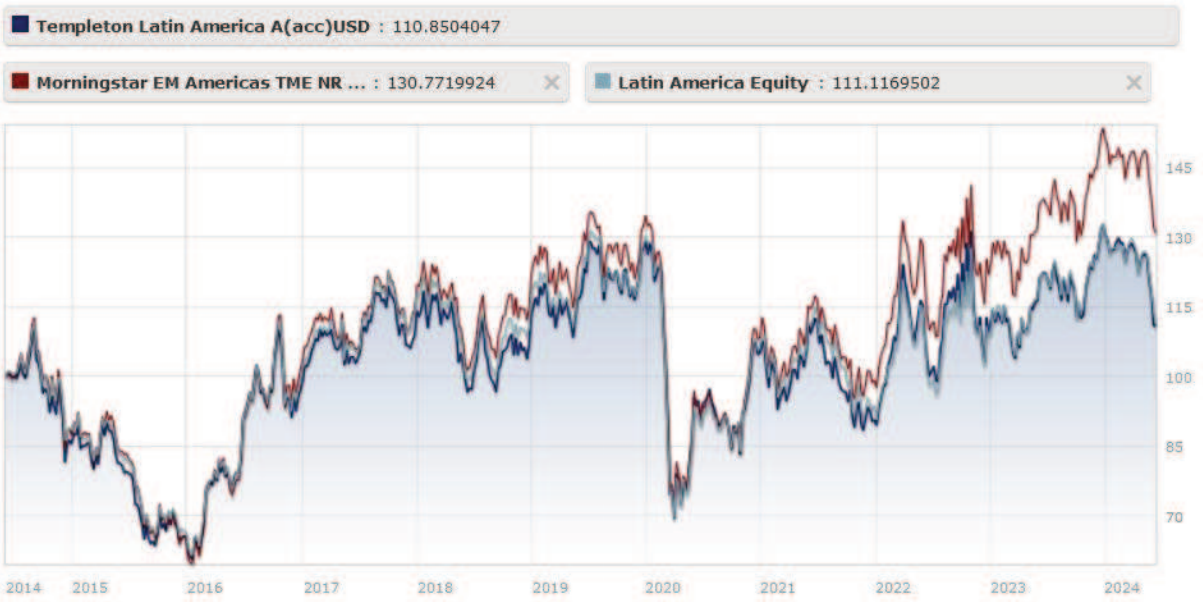

Figure 8 - Historical fund performance (Morningstar, 2024)

While Frankline Templeton indicates the MSCI EM Latin America Index-NR (USD) as a benchmark, the Morningstar benchmark is used in the given analysis, as it was selected by an independent third-party rating company (Franklin Templeton, 2024). The given index was introduced on June 20, 2008, and incepted on March 31, 2020. It measures the performance of large- and mid-cap stocks in emerging markets in the Americas by covering the top 85% of investable equities in the region measured by their float-adjusted market capitalization (Morningstar, 2024). It is based in USD and its return type is net total return (NR), which accounts for withholding taxes on dividends paid by companies in the index. Its reconstitution, which entails a review and adjustment of the components, is being done semi-annually, and its rebalancing on a quarterly basis (Morningstar, 2024).

Overall, the performance of the three has been similar until 2022, when the Morningstar benchmark started to perform significantly better. They all suffered a drastic NAV decrease in early 2020 due to the outbreak of the Covid-19 pandemic, declining from roughly 120 GBP down to roughly 72 GBP. The benchmark was able to reach their pre-pandemic levels again in March 2022, while the Templeton fund and the fund category needed until October 2022 to fully recover again (Morningstar, 2024). The weaker performance from 2021 until end of 2022 of the fund category can likely be explained by different portfolio components. Other Latin American Equity funds such as the GSF Lux Sicav “Latin America Equity” have e.g., a strong weight of 7,7% in the electricity utility company Enel Chile, which had been on a downward trend from April 2021 until July 2022. The other stocks in the top five are similar to those of the Templeton fund with 9,2% invested into Petroleo Brasileiro SA, 5,9% into the Brazilian metals and mining company Vale SA, 5,5% into Banco ABC Brasil SA, and 5,4% into Grupo Financiero Banorte SAB de CV (NinetyOne, 2024). The Morningstar benchmark is overall slightly more diversified and invested a 7,77% share into Vale SA, 6,12% into Petroleo Brasileiro SA Preferred stocks, 5,11% into Petroleo Brasileiro SA Petrobas, and 5,10% into Itau Unibanco Holding SA. The strong weight of a total 11,23% in Petroleo Brasileiro significantly enhanced the recent performance, with the common stock gaining +33,96% in value over the past five years. Additionally, the Petroleo Brasileiro Preferred stock achieved a 1-year return of +48,55% over just the past year (Morningstar, 2024). Likely, the fund category on average also invests less into the given stock, giving another reason for its decreasing performance from 2021 onwards.

Concerning the total performance in the given time horizon of 10 years, the benchmark reached the highest end result, followed by the category in second place and the Templeton fund in third place, the latter two closely paired together. All three achieved overall positive returns, although the net returns deducting fund fees may be negative (Morningstar, 2024). In numbers, the 10 years annualised return of the Templeton fund stands at 0,80%, which is 0,49% below the fund category performance and 1,76% below the benchmark performance. Regarding the past 5 years, the Templeton fund recorded a performance of -1,59%, which is 0,41% below the category and 2,28% below the benchmark. Due to a large market dip in May 2024 affecting several components, the one-year trailing return of the Templeton fund as of June 2024 stands at -8,78%, which is a staggering 4,62% lower than its benchmark (Morningstar, 2024).

3.3.3 Fundamental Analysis

In a next step, a fundamental analysis of the Templeton fund will be conducted. Fundamental fund analysis may be defined as the practice of determining a security s intrinsic value by examining related economic and financial indicators (Segal, 2023). If the fair market value determined by the given analysis is higher than the current market price, the stock is considered undervalued. While this thesis will not provide a recommendation to buy or to sell the given fund, it can be used as an information basis. The following table shows some of the key fundamental metrics of the Templeton Latin America A (acc) USD in comparison to the fund category and the benchmark index (Morningstar, 2024):

Measures

Value & Growth Measures	Investment	Cat. Average	Index
Price/Earnings	8.77	9.22	7.93
Price/Book	1.42	1.48	1.28
Price/Sales	1.31	1.20	1.01
Price/Cash Flow	4.59	4.34	4.18
Dividend Yield %	6.91	7.06	7.34
Long-Term Earnings %	12.59	9.32	13.79
Historical Earnings %	3.89	4.16	3.55
Sales Growth %	7.12	7.05	-4.54
Cash-Flow Growth %	-0.34	0.59	-10.99
Book-Value Growth %	7.37	7.98	6.66

Investment as of 31 May 2024 | Category: Latin America Equity as of 30 Apr 2024 | Index: Morningstar EM Americas TME NR USD as of 31 May 2024 | Data is based on the long position of the equity holdings.

Table 46 - Financial ratios (Morningstar, 2024)

The calculation of the given ratios is based on Morningstar.

P/E ratio

The Price/Earnings ratio measures how much an investor is willing to pay for one dollar/GBP of the fund s earnings (profit). This means, that a higher P/E ratio indicates that the market participants expect the company to increase its earnings in the future. The P/E ratio of a fund as shown in *Figure 14* entails the average P/E ratios of the stocks within the portfolio (Morningstar, 2024). The respective shares of the different stocks within the fund are therefore reflected in this ratio. Consequently, the value of 8,77 means that for a GBP of the fund s earnings, an investor is willing to pay 8,77 GBPs.

The given value (8,77) is lower than the category average P/E ratio (9,22) but higher than the benchmark index PE/ratio (7,93). The values can be explained by the difference in stock composition of the fund and its category/benchmark. Usually, growth stocks indicate a high price and low earnings, leading to a high P/E ratio. As the category contains the most blend stocks in comparison, which contain a mix of value and growth stocks, while the Templeton fund and its benchmark contain mainly growth stocks, it should have the highest P/E ratio. With a value of 9,22, this is the case. With the highest share of value stocks, the benchmark has consequently the lowest P/E ratio of the three (7,93) (Morningstar, 2024). This is also reflected in the P/E ratio of Petroleo Brasileiro of 3,86, which holds a significant weight in the benchmark fund.

Price/Sales and Price/Cash Flow ratio

Differing values can also be observed regarding the Price/Sales ratio, which measures how much an investor is willing to pay for one dollar of sales. It can be calculated by taking the total market capitalization of a company and dividing it by the company s total sales over the past 12 trailing months (Morningstar, 2023). Concerning an investment fund, the P/S ratio is the weighted average of the P/S ratios of its components. The lower the ratio compared to other companies/funds in the same industry, the more attractive an investment. The P/CF ratio serves a similar purpose, dividing the market capitalization by the 12-months cash flow instead of sales.

The differing values between the fund and its benchmark can once again be explained by the focus on value stocks of the benchmark. As sales and cash flows of growth stocks are typically lower than those of value stocks, its P/S ratio is higher. E.g., Petroleo Brasileiro as a value stock displays a comparably low P/S ratio of 0,95.

Dividend yield (in %)

The given ratio can be calculated by dividing the annual dividend per share paid out by a company to its shareholders by its current stock price. A high dividend yield compared to the peer group indicates that the company rewards its shareholders disproportionately and is a common feature of value stocks (Morningstar, 2021). A stable or growing dividend yield may additionally indicate that the company is in a financially stable position. Regarding an investment fund, Morningstar once again uses the weighted average of the dividend yield of its fund components.

As the table shows, the benchmark with the largest share of value stocks indeed displays the highest average dividend yield. In a global perspective, all three dividend yields can be considered high, with yields ranging from 2 to 6% typically being considered a good yield (Forbes, 2024). At the same time, a “good” yield cannot be generalized, as several factors must be considered, such as that the yield may be elevated due to declining stock prices (Fernando, 2024).

Growth rates

Taking a look at growth rates, there are three different growth rates published by Morningstar: Sales growth %, cash-flow growth %, and book-value growth %.

The sales growth % measures how a company s stock sales per share has developed over the past five years. It gives an investor the ability to track how rapid a company can increase its sales. Morningstar uses a share-weighted rate for the fund ratio (Morningstar, 2024). As the table shows, the fund s shares and category shares have been growing at a rate of 7,12 and 7,05 respectively, while the sales of the benchmark funds shares have been declining by 4,54% over the past 5 years. A possible reason for the much lower sales growth of the benchmark may be the higher diversification with many investments into smaller stocks (Morningstar, 2024).

Concerning cash-flow growth %, the fund has slightly underperformed the category average by 0,93%. This indicator tells the investor how fast a company can generate cash inflows from its operations. While growth stocks usually display high cash-flow growth % ratios, value stocks tend to have a low or sometimes negative ratio. The values are therefore once again in line with the strong focus on value stocks of the benchmark, which apparently in the given timeframe were unable to increase their cash flow per share (Morningstar, 2024).

Lastly, a company can increase its book value by increasing its assets or decreasing its liabilities, or through share buybacks. A high book value growth % therefore also indicates a strong growth orientation of the company. While the differences are significantly smaller for this ratio, the category average once again displays the highest value, followed by the Templeton fund. It is difficult to precisely state the reasons behind the respective growth rates based on the different way mentioned above.

In conclusion, the results of the fundamental analysis are in line with the stock-style diagram depicted in *3.3.1.3*.

3.3.4 Risk Analysis

The following part of the given fund analysis forms a detailed risk analysis. As stated in *2.1*, in a financial context, risk can be defined as the likelihood of a negative outcome which reduces the expected return of an investment (Bouchet, Clark, & Groslambert, 2003, p. 11). To measure the risk of an investment into a fund, there are several indicators to be considered. Among the most frequently used are the standard deviation, the sharpe ratio, the beta, and the alpha (Banton, 2024).

Standard deviation

The standard deviation is a statistical variable, which measures the dispersion of a dataset in relation to its mean. It can be calculated by taking the square root of the variance, which is the sum of the deviations to the mean divided by the number of individual values (Hargrave, 2024). The fund displayed a standard deviation of 26,85% over the past 5 years and of 22,70% over the past 3 years. Its mean return over the past 3 years stands currently at 6,35% (Morningstar, 2024). In general terms, the given standard deviations can be considered high, but for a higher explanatory power they must be compared to the fund category. The category on average displayed a 5-year standard deviation of 27,26% and a 3-year standard deviation of 22,34% (Financial Times, 2024). In the 5-year timeframe, an investment into the Templeton fund was therefore less risky compared to the category, and in the 5-year timeframe riskier. Compared to the benchmark, the Morningstar EM Americas TME had a 5-year standard deviation of 30,00% and a 3-year standard deviation of 24,86 and was therefore a significantly riskier investment in both timeframes (Morningstar, 2024).

Sharpe Ratio

The sharpe ratio is a mathematical expression, which measures the return of an investment with its risk. It implies the insight that returns above an industry benchmark over a period of time often signify more volatility, rather than investing skill. The ratio can be calculated with the following formula (Fernando, 2024):

$$Sharpe\ Ratio = \frac{R_p - R_f}{\sigma_p}$$

$$R_p = portfolio\ return$$
$$R_f = risk - free\ rate$$
$$\sigma_p = standard\ deviation\ of\ portfolio's\ excess\ return$$

The 5-year sharpe ratio of the Templeton Latin America Fund A (acc) USD is 0,08 and the 3-year sharpe ratio 0,15. In the respective timeframes the category Latin America Equity displayed a sharpe ratio of 0,08 and 0,14 (Financial Times, 2024). Lastly, the benchmark has a 5-year sharpe ratio of 0,16 and a 3-year sharpe ratio of 0,15. In general, the higher the sharpe ratio the better, as this indicates higher portfolio returns or lower volatility compared to a lower sharpe ratio. As highlighted in the previous section, the benchmark has a significantly higher standard deviation than the Templeton fund and the category. The higher sharpe ratio must therefore be achieved by higher returns, which as the technical analysis showed, were indeed achieved by the benchmark over the given time horizons (Morningstar, 2024). Consequently, a rational investor should prefer an investment into the Morningstar EM Americas TME index over the Templeton fund, as its portfolio is safer given any level of volatility.

The risk return ratio compared to the category can furthermore be depicted by the following graph:

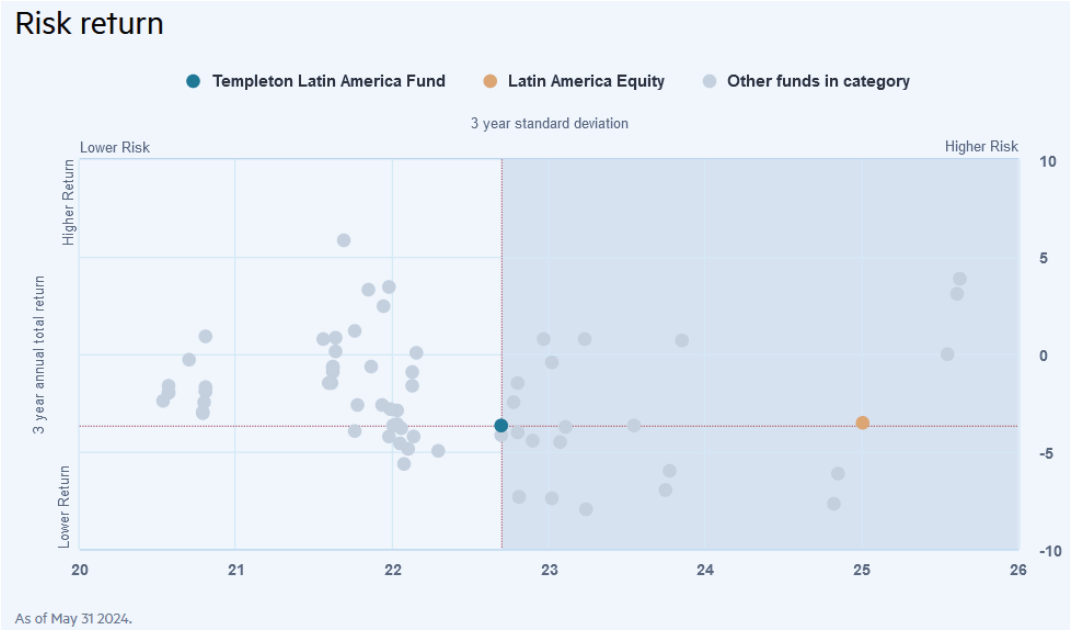

Figure 9 - Risk-return ratio (Financial Times, 2024)

According to the scatterplot, the Templeton fund is attached to a moderate level of risk, with more funds in the category displaying lower risk levels than higher risk levels. With a slightly higher 3-year total return of -3,52% but a 3-year standard deviation of 25,01%, the Latin America Equity fund can be considered a significantly riskier investment. Based on the sharpe ratio, an investor should therefore prefer the Templeton fund over the Latin America Equity (Financial Times, 2024).

Beta

As another key risk indicator, the beta measures the level of systematic risk the fund is exposed to in comparison to the market. As a reference, typically the S&P 500 is used, which has a beta of 1,0. While unsystematic risk can be eliminated through diversification, there is always a portion of systematic risk / market risk, that the investment is exposed to. Portfolios with a beta higher than 1,0 are considered more volatile than the market, and portfolios with a beta lower than 1,0 less volatile (Kenton, 2024). It can be calculated by dividing the product of the covariance of an individual stock s return and the market s return by the variance of the market s return:

$$\beta = \frac{Covariance(R_S, R_M)}{Variance(R_M)}$$

The 5-year beta of the fund stands at 0,99 and its 3-year beta at 1,00. In comparison, the category average 5-year-beta is also 0,99, and its 3-year beta 0,96. In this case, the market is reflected by the benchmark index Morningstar EM Americas TME ER USD. On a 3-year-basis, the fund with 1,00 therefore was attached to the same volatility as the (regional) market (Morningstar, 2024). While other funds in the category of the Templeton fund were on average attached to the same level of systematic risk in a 5-year period, in the past 3 years the Templeton fund was more volatile. Adding an investment into the Templeton to a market portfolio would not increase the risk, as its beta for the two periods is equal or lower than 1 (Kenton, 2024).

Alpha

Alpha is often used together with beta and indicates whether an investor or fund manager managed to beat the performance of the market or a specified benchmark over a certain period. The excess or deficient return compared to the benchmark is the investment s alpha (Chen, 2024).

In the case of the Templeton fund, its performance is compared to the Morningstar EM Americas TME NR USD. The 3-year alpha of the fund as stated by Morningstar is -3,74. The fund has therefore underperformed its benchmark by 3,74% during these years (Morningstar, 2024). Based on this figure, an investor looking to maximize its return should invest his money into the benchmark index instead of the analysed fund.

3.3.5 Rating & Conclusion

In its key information document about the fund, Franklin Templeton depicts a rating of the risk of its product. On a scale from 1 to 7, the estimated risk is the following (Franklin Templeton, 2024):

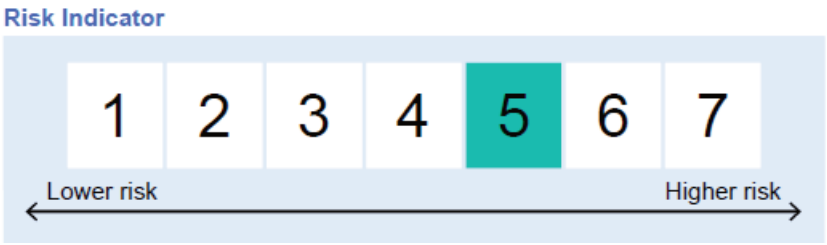

Figure 10 - Templeton risk rating (Franklin Templeton, 2024)

The indicator assumes that an investor holds its investment for five years and entails the risk of losing money in the market or the entire investment because Franklin Templeton is unable to pay out the invested sum. In the third highest rating class out of 7, this risk can be estimated as rather high (Franklin Templeton, 2024).

One of the most popular risk ratings of investment funds is furthermore the rating on a five-star-scale by Morningstar. It entails an assessment of the past downside risk of a fund in comparison to, based on variations and its monthly returns. The return is measured for up to 3 time periods (3, 5 and 10) with the rating reflecting a weighted average of the separate measures. The Morningstar risk rating for the Templeton Latin America Fund A (acc) USD in May 2024 was the following:

Morningstar Rating™(Relative to Category)			31/05/2024
	Morningstar Return	Morningstar Risk	Morningstar Rating™
3-Year	Average	Average	★★★
5-Year	Average	Average	★★★
10-Year	Average	Average	★★★
Overall	Average	Average	★★★

Table 47 - Morningstar risk rating (Morningstar, 2024)

Each timeframe received a rating of 3 stars with the risk being evaluated as average, which led to an overall risk rating of 3 stars with the same risk estimate. The rating therefore confirms the results of the previous analysis. An investment into the Templeton is attributed to a certain amount of risk, while not significantly higher than the category average (Morningstar, 2024).

The conclusion can be split up into three parts focusing on the three different types of analysis conducted: Technical analysis, fundamental analysis, and risk analysis.

Concerning the historical performance of the Templeton fund in comparison to the category and its benchmark, the fund has underperformed its benchmark in a 1-year, 3-year, and 10-year timeframe. While all of them suffered great losses in spite of the Covid-19 pandemic, the benchmark was able to recover significantly faster and achieve all-time-highs nearly 20% higher than the Templeton fund. Regarding the category, the fund has performed below its average with a 0,47% annualised underperformance in the past 10 years. The differences in returns are mainly due to differences in fund composition, with the benchmark investing largely into value stocks such as Petroleo Brasileiro, which have shown strong performances over the past 3 years (Morningstar, 2024).

Regarding the fundamental analysis, the price ratios are in line with the stock style graph with the fund s P/E ratio and P/S ratio being lower than the category s but higher than the benchmark s ratios. Value stocks generally score lower in the given ratios, on which the benchmark focuses most of the three. While the dividend yield of all three can generally be considered high, the Templeton fund stocks on average paid the least dividends with a yield of 6,91%. Considering growth rates, the benchmark with the highest share in value stocks once again achieves the lowest results, with a negative sales growth rate of -4,54%, and a negative cash flow growth rate of -10,99%. The growth difference is significant and may lead to a decreased performance of the benchmark in the future by negatively impacting the companies financials (Morningstar, 2024).

Lastly, the risk analysis determined a lower standard deviation of the Templeton fund compared to its fund, but also a lower sharpe ratio. In comparison to its category, the fund is attached to moderate levels of risk while having generated moderate returns in recent years. Based on the beta results, the fund was exposed to the same level of systemic risk as its benchmark. Finally, the alpha emphasized the underperformance of the fund, especially in the past 3 years, compared to the Morningstar EM Americas TME NR USD index (Morningstar, 2024).

Consequently, for an investor seeking to maximize its performance in the LAC region without increasing the risk drastically, an investment into the benchmark index instead of the Templeton fund is advisable.

4. Impact Analysis

After analysing the investment landscape in the region and conducting an in-depth analysis of a selected Latin American investment fund, the question remains, what impact country risk analysis may have on investment funds in the region. To investigate the given issue, the potential kinds of impact to be considered must be outlined.

Firstly, a negative country risk rating due to economic or political instability may have a negative impact on the performance of national bonds or stock indices. On the other hand, sound economic policies and stable growth prospects may enhance a country s rating and lead to a better fund/index performance. Secondly, high risk countries such as Argentina likely are included to a lower percentage in regional investment funds such as the Templeton fund or its Morningstar benchmark, as they may drive up the standard deviation and the overall fund risk without an adequate return compensation. Fund managers regularly use country risk analyses as an information basis to make decisions about the fund composition of actively managed funds, driving the given impact.

Thirdly, country risk analysis often involves sovereign credit ratings, which impact the valuation of debt instruments such as government bonds, which may form part of the investment portfolio. For example, Greece is since its debt crisis peaking in 2010 still seeing high levels of public debt and partly for that reason being rated moderately by several rating agencies such as Allianz with BB2 (moderate risk) (Picardo, 2024) (Allianz, 2024). Additionally, its 10-year government bond yield stands at 3,582% as of June 2024, compared to Germany with a AA1 rating and a 2,409% 10-year government bond yield (World Government Bonds, 2024). According to several studies, having a strong sovereign risk rating can significantly reduce financing costs for a country and consequently lower its sovereign spreads (Bustillo, Perrotti, & Velloso, 2018, p. 25). This relationship will be further investigated in the given segment.

Lastly, an impact is created indirectly through several variables which are analysed as part of a country risk assessment such as inflation or interest rates. While high interest rates can increase the cost of financing for companies, high inflation rates such as in Argentina can erode generated returns.

The following analysis will focus on the first three points mentioned and will evaluate the impact based on existing academic studies and data.

4.1 Performance Impact

In the given segment, the impact of country risk analysis on the performance of investment funds and national stock indices of Latin American countries will be investigated. A focus will be put on the two countries which were analysed in depth in the first chapters of this thesis: Argentina and Peru.

To measure the performance of a country s stocks, an index composed with some of the major companies of the country can provide a meaningful insight. Concerning developed countries, in Germany the most prominent index for the given purpose it the DAX, which consists of the 40 major blue-chip companies trading on the Frankfurt Stock Exchange (Bloomberg, 2024). Components currently listed on the index are e.g., BASF, Adidas, Rheinmetall, and SAP, with index prices being stated by Xetra, a German electronic stock exchange operated by the Deutsche Börse. The USA do not have a single official stock index, but three core indices regarded as primary benchmarks: The Dow Jones Industrial Average, the S&P 500, and the NASDAQ Composite.

4.1.1 Argentina

In Argentina, the equivalent to the German DAX would be the S&P MERVAL (Mercado de Valores de Buenos Aires), which as of June 2024 is composed of 21 companies such as YPF, BYMA, and Telecom Argentina, and listed on the Buenos Aires Stock Exchange. The exact number of constituents varies over time due to periodic rebalancing and changes in the market (Yahoo Finance, 2024). In the past year, the index has gained returns of 273,60%, rising from roughly 400.000 ARS to roughly 1,5 million ARS (May 2024). While this appears to be a staggering return for investors, for the real return one must deduct the inflation rate over the given timeframe, as the returns were made in the highly volatile ARS. With year-on-year inflation standing at 276,40% in May 2024, the real return is actually negative, with an approximately -2,80% (BBVA Research, 2024).

Another index measuring the performance of the large and mid-cap segments of the Argentine stock market is the MSCI Argentina Index (USD). The index as of June 2024 is covering approximately 85% of the Argentinian equity universe with 18 constituents (MSCI, 2024). In contrary to the S&P MERVAL, the MSCI index is denoted in USD, allowing a visualization of returns closer to the real returns:

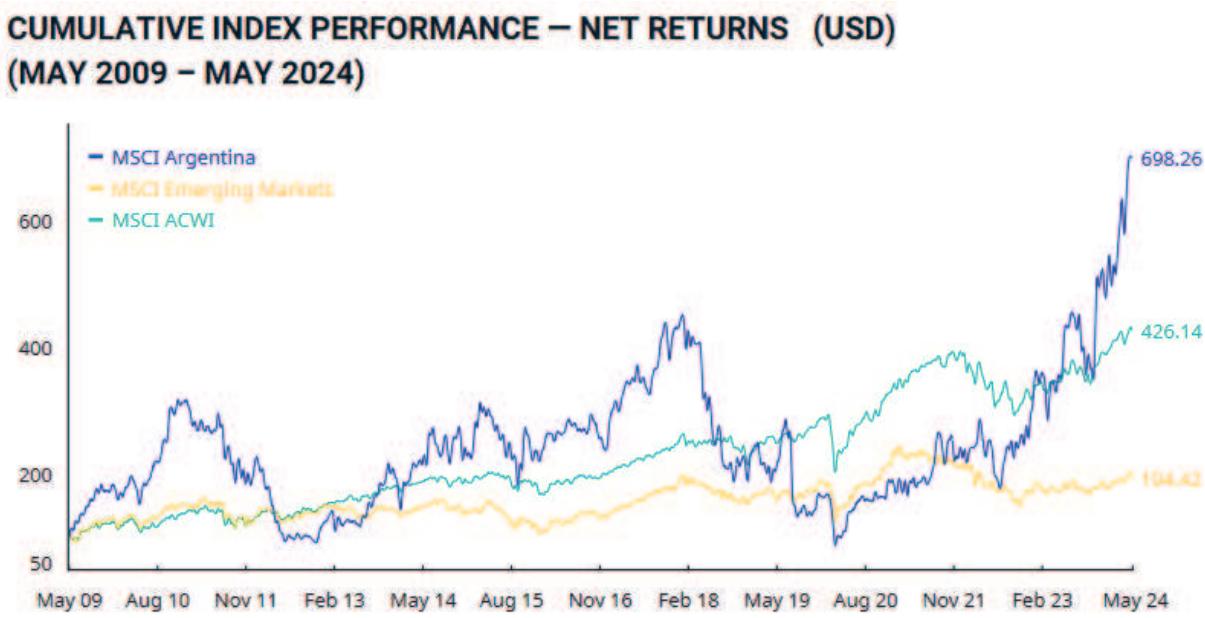

Figure 11 - MSCI Argentina Cumulative Index Performance (MSCI, 2024)

The depicted graph shows the historical performance of the MSCI Argentina index from May 2009 until May 2024, compared to the MSCI ACWI and the MSCI Emerging Markets. Over the given period, the index was able to achieve net total returns of 698,26%, compared to 426,14% of the MSCI ACWI. Especially from January 2024 onwards, the index achieved high returns, following the election of President Javier Milei in December 2023 (Financial Times, 2023).

Compared to S&P Merval, the index is denoted in USD. The purchasing power increase therefore does not depend on the inflation rate of the Argentinian Peso, but of the US dollar. The US dollar had an average inflation rate of roughly 2,57% per year from 2009 to date, leading to a cumulated price increase of 46,39% accounting for the compounding effect each year (Srinivasan, 2024). Deducting the calculated amount from the cumulated net returns of the MSCI Argentina index, one is left with an (approximated) result of 651,97%, compared to a 379,75 cumulated net performance of the MSCI ACWI. In the past year 2023, the MSCI Argentina achieved net returns of 65,71% and the MSCI ACWI net returns of 22,20% (MSCI, 2024).

The current list of the top 10 constituents is headed by YPF with an 19,87% index weight, Grupo Financiero Galicia B ADR with 17,70%, and Banco Macro B ADR with 12,69%. The index therefore has a strong focus on financials and energy, with 35,7% and 25,81% respectively. The following sectors are utilities with 14,09% and consumer discretionary with 8,91% (MSCI, 2024).

Based on the given index, Argentina has performed significantly better than the World Index MSCI ACWI. In a next step will be analysed, whether Argentina s risk ratings in the given timeframe are in line with this performance.

The following table shows Argentina s Fitch long-term foreign-currency issuer default ratings (end of year, except 2024) from 2009 until 2024:

Year	Rating (LTFCIDR)	Year	Rating (LTFCIDR)
2009	RD	2017	B
2010	B	2018	B
2011	B	2019	RD
2012	B	2020	CCC
2013	CC	2021	CCC
2014	RD	2022	CCC
2015	RD	2023	CC
2016	B	2024	CC

Table 48 - Argentina Fitch long-term foreign currency IDRs 2009-2024 (Fitch, 2024)

The long-term foreign-currency issuer default rating reflects the country s ability to meet its foreign currency obligations and ranges from AAA (1.) indicating the highest credit quality to D (11.) indicating default on sovereign debt (Fitch, 2024). Argentina s ratings have been varying throughout the years, while always being in the very low bracket between B (5. / Highly speculative) and RD (10. / Restricted default). The given ratings indicate a very high level of credit risk with potential difficulties in meeting financial obligations or severe consequences such as sovereign default. The country is accompanied at the lower end of the scale including CCC (7.), CC (8.), C (9.), and RD (10.) by countries such as Ethiopia, Ghana, Lebanon, Sri Lanka, and Ukraine (Fitch, 2024). Countries, which are (also) suffering from chronic poverty, economic instability, or even war.

The superior overall performance compared to the MSCI ACWI is therefore not in line with the country risk ratings Argentina has received over the past years, which are far below the global average. Additionally, the recent performance increase in spite of the elections in December 2023 are not reflected in the country risk rating, which was affirmed at CC in June 2024. At the same time, the worst country risk ratings (2009, 2014, 2015, and 2019) were given in years in which the index was also denoting at its lowest levels.

For a more precise analysis, a linear regression analysis may determine the impact of the given country risk ratings of the performance of the MSCI Argentina. For that purpose, an independent variable x and a dependent variable y must be determined (Maulud & Abdulazeez, 2020, p. 140). In this case, the yearly country risk ratings are used as independent variable x impacting the yearly index performance as dependent variable y . Additionally, the rating scale from AAA to D is converted based on the table shown in Appendix 4. The following figure shows the linear regression model consisting of a scatter plot of the data and a regression line:

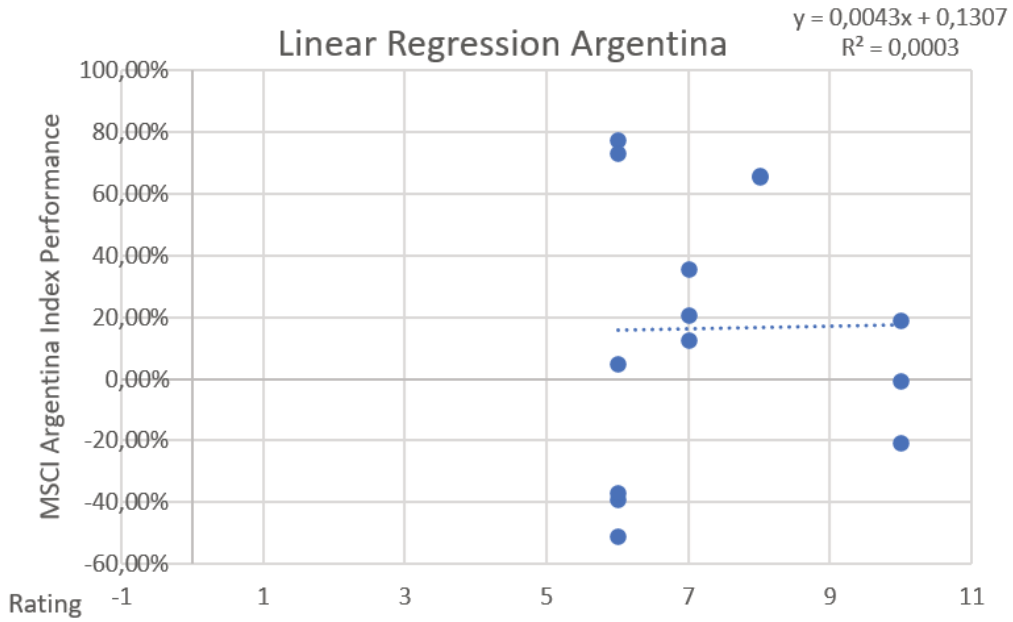

Figure 12 - Linear regression analysis Argentina, own calculation/illustration based on (Fitch, 2024), (MSCI, 2024)

R^2

The R-squared in a linear regression model is a statistical measure indicating the proportion of variance in the dependent variable which can be explained by the independent variable. It ranges from 0 to 1 with 1 indicating a perfect explanation by the regression model of the data, and 0 indicating a very low explanatory power of the model (Fernando, 2024). With a higher number of regressors, the coefficient of determination R increases or at most remains the same, as the sum of the squared residuals cannot become smaller after adding a regressor using the least squares method, on which the regression model is based. A higher explanatory power of the goodness-of-fit of the model is therefore provided by the adjusted R-squared, correcting the original value (Schulze & Porath, 2012, p. 501 f.). In the given model, the R-squared value is 0,00003 and the adjusted R-squared value -0,08306, indicating a very low explanatory power of the data by the regression model.

Formula

For any linear regression model, the formula of the regression line is (Rottmann, 2010, p. 1):

$$\bar{\gamma}_i = \beta_0 + \beta_1 x_i + \varepsilon_i$$

$\bar{\gamma}_i$ stands for the dependent variable, in this case the index performance, which can be calculated by the following equation. β_0 forms the y-intercept, i.e. the value that results for $\bar{\gamma}_i$ if all other coefficients equal 0 (Schulze & Porath, 2012, S. 492 f.). β_1 is the slope parameter, which indicates by how many units $\bar{\gamma}_i$ changes if x_i increases by one unit, keeping all other influencing variables constant (Rottmann, 2010, p. 1). x_i stands for the independent variable, in this case the country risk rating, which may have an impact on the dependent variable $\bar{\gamma}_i$. Lastly, the residual ε_i is a random variable that contains other influencing factors on Y that are not explained by the function (Schulze & Porath, 2012, S. 476).

In the given regression model, the y-intercept is 0,1307 (13,07%). This means that if all other variables equal 0, on average the annual index performance would be 13,07%. A rating score / x_i of 0 is impossible, as it would indicate a rating better than AAA. The slope parameter is 0,0043, indicating a 0,43% increase in index performance with each increase by one unit in country risk rating. As a higher rating score by number stands for a worse rating (see Appendix 4), the regression model suggests a decline in performance with an increase of country risk rating. With the given parameter the slope is very flat compared to the range of almost 130% of the yearly performance values (MSCI, 2024). Furthermore, due to the high variance of the yearly performance of the MSCI Argentina, many data points are far away from the regression line, and no clear trend is visible.

Conclusion

Based on the given results, there cannot be identified a clear correlation between Argentina s country risk rating and the performance of the MSCI Argentina index. Additionally, due to a low R-squared value and adjusted R-squared value, predictions of the model would not be very accurate. While further variables may increase the explanatory power of the model, this paper focuses solely on the relationship between the country risk ratings and the index performance.

4.1.2 Peru

In Peru, the national stock index is the S&P/BVL Peru General Index (Índice General de la Bolsa de Valores de Lima), which tracks the performance of the largest and most actively traded stocks on the Lima Stock Exchange. It is a modified market capitalization-weighted index launched on May 4, 2015, and denominated in PEN (BVL, 2024). It is made up of 33 components with a 45,5% weight on materials, a 31,5% weight on financials, and a 12,1% weight on consumer staples, and currently a 24,2% weight of the largest component. The index has an overall performance of 3,36% over the past 5 years, of 11,00% over the past 3 years, and of 11,18% year-to-date. Among the top 10 holdings of the index are currently the Southern Copper Corporation, Credicorp Ltd., Alicorp S.A.A., and Buenaventura Mining Company Inc. (BVL, 2024). Due to the significance of the Peruvian mining sector on the international commodity market, the index forms an interesting investment for global investors wanting to increase their exposure to the Peruvian market. Lastly, it serves as a key benchmark for the Peruvian stock market.

A second index capturing the performance of the large and mid-cap stock landscape in Peru is the MSCI Peru, covering approximately 85% of the Peruvian equity universe with just 3 constituents (MSCI, 2024). As the MSCI Argentina, this index is denominated in USD with the following returns from May 2009 until May 2024:

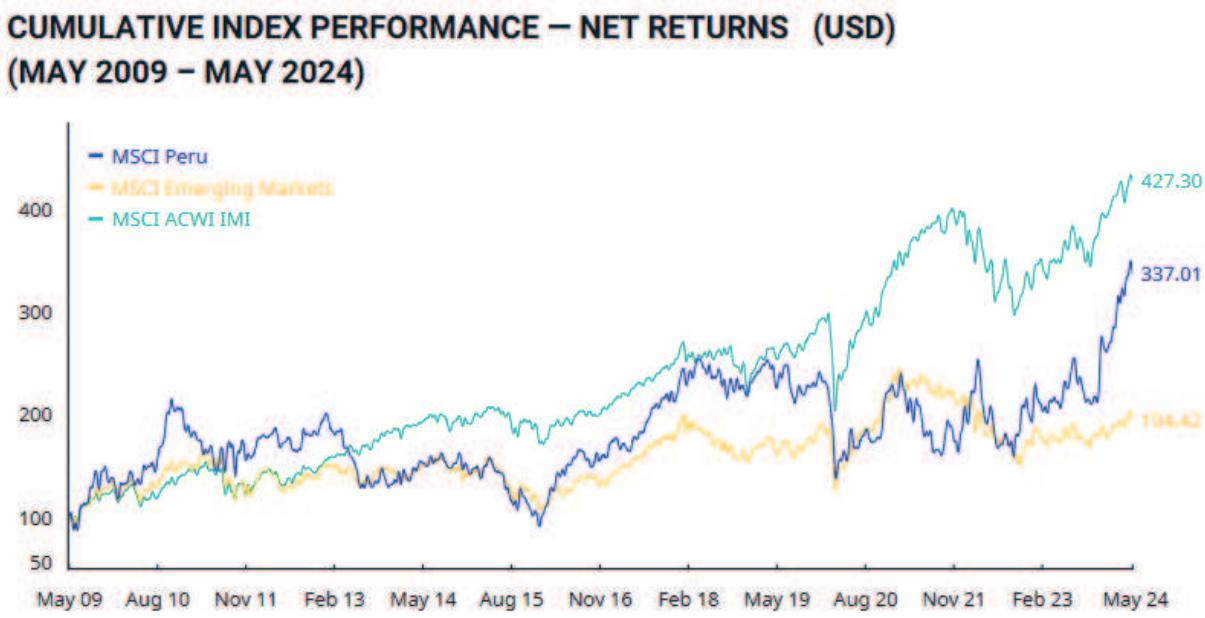

Figure 13 - MSCI Peru Cumulative Index Performance (MSCI, 2024)

The three constituents of the index are Credicorp with a 44,70% weight, Southern Copper Corporation with a 40,77% weight, and Buenaventura Minas ADR with a 14,53%. Credicorp Holding is a financial advisory company which emerged through a merger of Credicorp Capital Peru, Credicorp Capital Colombia, and Creditcorp Capital Chile. The Southern Copper Corporation is a copper mining company founded in 1952, while Buenaventura Minas ADR is a precious metals company focused on the mining of gold, silver, and other metals. The index is composed of only three stocks as according to MSCI s methodology, only stocks fulfilling the necessary criteria regarding market capitalization, liquidity, and foreign accessibility, are selected (MSCI, 2024). Relative to the MSCI ACWI IMI, the index holdings are rather inexpensive and smaller in size, benefit from momentum, have sound balance sheets, and are attached to lower risk levels. Their total float-adjusted market capitalization is USD 25 billion.

As the depicted graph shows, the overall index performance over the given time period of 337,01% has been in between the performance of the MSCI ACWI IMI with 427,30% and the performance of the MSCI Emerging Markets with 194,42%. For several years after the 2007/2008 financial crisis, the MSCI Peru was outperforming both the MSCI ACWI and the MSCI Emerging Markets, before declining significantly from February 2013 until September 2015. In the following years, all three indices were able to generate considerate gains before collapsing in 2020 due to the Covid-19 crisis with Peru being one of the hardest-hit countries due to a poor healthcare system (The Guardian, 2021). For that reason, Peru s annual performance 2020 finalized at -4,71%, while the MSCI ACWI IMI and the MSCI Emerging Markets were able to recover in the same year with a final performance of 16,25% and 18,31% respectively. While global growth further accelerated in 2021, Peru s three major stocks were suffering from the consequences for a longer time period, with an index performance of -19,87% in the given year. In the past year and current year until May, the stocks accelerated with a index performance of 36,63% in 2023, compared to 21,58% of the MSCI ACWI IMI (MSCI, 2024).

For that reason, on a 10-year basis, the index outperformed the MSCI ACWI IMI with 8,29% per year compared to 8,20% per year. At the same time, the MSCI Peru displayed a significantly higher risk level with a 10-year standard deviation of 26,26% compared to 17,15% of the MSCI Emerging Markets and 15,05% of the MSCI ACWI IMI. The 10-year index sharpe ratio stands at 0,38 compared to just 0,15 of the MSCI Emerging Markets and 0,50 of the MSCI ACWI IMI (MSCI, 2024).

The following table shows Peru s Fitch long-term foreign-currency issuer default ratings (end of year, except 2024) from 2009 until 2024:

Year	Rating (LTFCIDR)	Year	Rating (LTFCIDR)
2009	BBB-	2017	BBB+
2010	BBB-	2018	BBB+
2011	BBB	2019	BBB+
2012	BBB	2020	BBB+
2013	BBB+	2021	BBB
2014	BBB+	2022	BBB
2015	BBB+	2023	BBB
2016	BBB+	2024	BBB

Table 49 - Peru Fitch long-term foreign currency IDRs 2009-2024 (Fitch, 2024)

What becomes clear at first sight, is that Peru s foreign-currency issuer default ratings over the past 15 years have been significantly less volatile than those of Argentina, with a rating range from BBB- to BBB+. On the 4th place of the rating scale, BBB stands for good credit quality, reflecting the generally solid economic indicators of Peru (Fitch, 2024).

Interestingly, despite the severe economic impact of the Covid-19 crisis, the rating remained at BBB+ in 2020, although with a negative outlook. The negative outlook was explained by a weakened government balance sheet, a weakening of political institutions since 2016, and social and governance indicators below BBB -medians. At the same time, Peru displayed strong external finances and an international liquidity ratio of more than 200% of current external liabilities (Fitch, 2024).

Compared to the index chart, the ratings have been consistently strong, while the performance of the three selected Peruvian stocks in the MSCI index had been fluctuating significantly. Furthermore, the years with the strongest ratings from 2013 until 2020 (BBB+) displayed varying stock performances ranging from -31,66% in 2015 to 55,61% in 2016. The years with the lowest ratings 2009 and 2010 did not show negative index performances with 53,32% in 2010 being the second-best annual performance in those years (MSCI, 2024).

Additionally, the following regression chart illustrates a potential correlation between the rating as an independent variable x and the index performance as a dependent variable y :

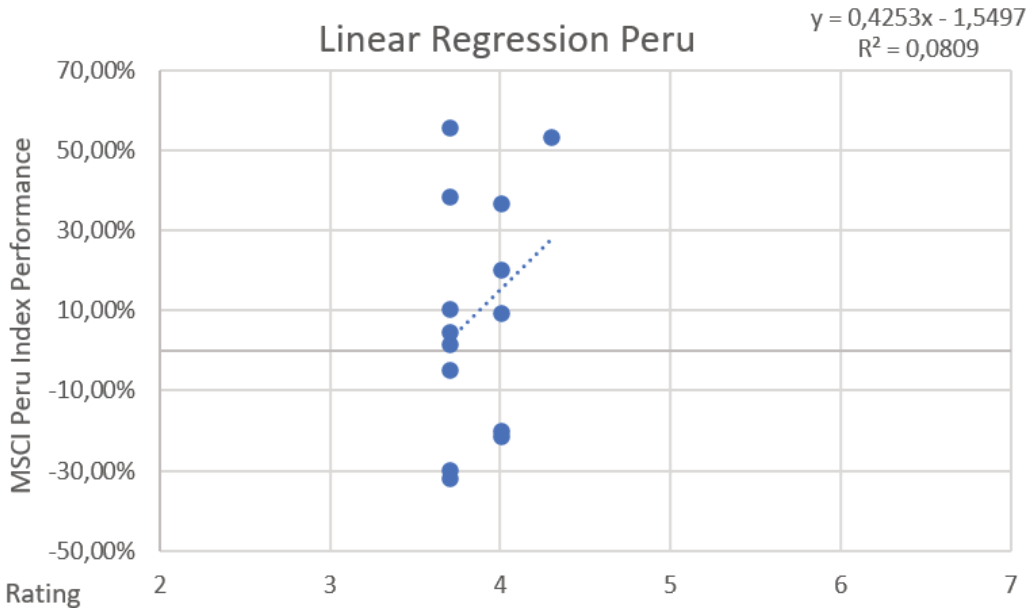

Figure 14 - Linear regression analysis Peru, own calculation/illustration based on (Fitch, 2024), (MSCI, 2024)

In the case of Peru, the R-squared value is 0,0809 and the adjusted R-squared value 0,0043. While slightly higher than the R-squared values of Argentina, the explanatory power of the model of the model can still be evaluated as low.

The y-intercept is -1,5497, indicating a performance of -154,97% if all other variables are 0. Additionally, the slope parameter of 0,4253 indicates an increase by 42,53% in annual index performance with each increase in country risk rating. Such as in the case of Argentina, based on the given graph, a worse country risk rating leads to a better index performance. While the dispersion of the data points is also very high due to the high standard deviation of the annual performances, the slope is much steeper. All dots are within the rating range of 3,7-4,3, as Peru only received BBB+, BBB, and BBB- ratings in the given timeframe (Fitch, 2024). Furthermore, the two worst performances in 2013 and 2015 were achieved while Peru was rated BBB+.

In conclusion, there is no clear correlation visible between the annual performances of the MSCI Peru Index and Peru s historical country risk ratings by Fitch. While the stock market was highly volatile with a performance range of more than 85% over the given time period, the country risk ratings were very stable in the given 14 years. Additionally, predictions of the regression model would not be very accurate due to its low R-squared values.

In the following segment will be investigated, whether the country risk ratings have an impact on the assigned weight in regional investment funds.

4.2 Portfolio Allocation

As a second part of the impact analysis will be assessed, whether lower-rated countries are also less represented in Latin American investment funds. For this purpose, firstly will be determined, which countries make up the highest fund shares. As stated in 3.2, MSCI provides a regional index which can be invested into through different iShares ETFs – the MSCI Emerging Markets Latin America Index. The exact country weights of the given index are the following:

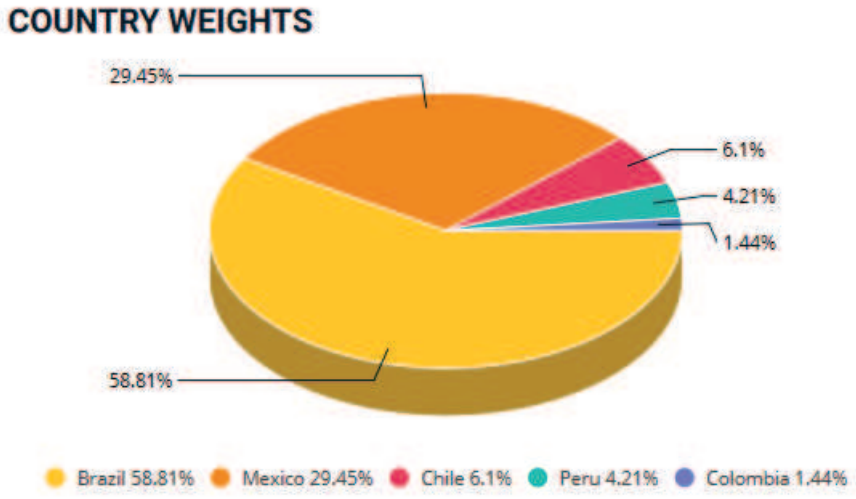

Figure 15 - MSCI Emerging Markets Latin America Index country weights (MSCI, 2024)

The focus of the index is on Brazil with a wide margin, followed by Mexico with a significant share of 29,45%. The Templeton Latin America Fund A (acc) USD in comparison displays similar country weightings with 56,82% invested into Brazil, 28,23% into Mexico, 4,98% into Peru, and 4,01% into Chile (Franklin Templeton, 2024). Most regional investment funds follow a similar order assigning Brazil the largest equity share and Mexico the second largest equity share.

As the country weights of the MSCI EM Latin America Index reflect the current decisions of MSCI, the current country risk ratings are the most adequate metric for a comparison. As of June 2024, Brazil s Long-Term Foreign Currency Issuer Default Rating (IDR) was affirmed at BB. The rating was supported by Brazil s diverse and large economy, strong external finances, and a comparably high income per capita (Fitch, 2024). In December 2023 Fitch affirmed Mexico s rating at BBB- with a stable outlook, supported by stable and robust external finances, and easing inflationary pressures. At the same time, Mexico is experiencing rising fiscal pressures and has weak governance indicators (Fitch, 2023).

Interestingly, Argentina with some of the worst ratings of the region, is not included in the index at all, as well as in most other regional indices (Fitch, 2023). Although this may be caused by the given ratings, the impact is not as clear. As part of its methodology, MSCI classifies global markets according to its market classification framework into 4 different categories: Standalone markets, frontier markets, emerging markets, and developed markets (MSCI, 2023, p. 2). The three criteria on which the category for each country depends are economic development, size and liquidity, and market accessibility. Based on the given criteria, Argentina is currently classified as a standalone market rather than an emerging market, due to several factors. Despite having a significant equity market, the market capitalization and liquidity of Argentinian listed companies do not meet MSCI s criteria for an inclusion in the emerging market category. While the total market capitalization of the Brazilian stock market currently stands at around 4,4 trillion Reais (~USD 870 billion), the Argentinian stock market only has a market capitalization of roughly USD 39 billion (Simply Wall St, 2024).

Additionally, as outlined in the country risk analysis, Argentina has a long history of economic and political instability, impacting the efficiency of the market s operational framework and institutional framework. This has direct impact on points C.3 and C.5 of the market accessibility criteria (MSCI, 2023). Due to many imposed restrictions stemming from the country s deteriorating financial situation such as currency controls and capital flow restrictions, the Argentinian financial market is furthermore less accessible to foreign investors. An example forms the limited access to foreign currency for businesses and consumers which was introduced in 2019, affecting the Argentinian population as well as foreign investors who want to repatriate their profits (U.S. Department of State, 2023). Regarding capital controls, Argentina has placed limits on the amount of money which can be transferred out of the country, affecting the transfer of dividends, interest payments, and capital repatriation.

Besides Argentina, a country which is excluded from most regional investment funds is Venezuela, with extremely high inflation, poverty, and inequality levels (Coface, 2024). The country is not being rated by Fitch anymore since 2019 due to sanctions imposed by the United States on the Venezuelan government. Its Coface risk rating currently stands at E (Extreme risk) (Coface, 2024). According to the MSCI market classification, Venezuela is classified as a standalone market since 2006, displaying very low levels of market accessibility and liquidity (MSCI, 2024).

Concerning Peru, the country enjoys a small yet significant share in the index. With a Fitch rating of BBB in 2024, Peru has currently a stronger rating than Brazil. Based on the previously stated MSCI market classification criteria, the country does classify as an Emerging market. Compared to Argentina, the country has more companies fulfilling the size and liquidity criteria, as well as a higher market accessibility (MSCI, 2023).

At the same time, the Peruvian stock market, although significant, is smaller and less liquid than the stock markets of Brazil and Mexico. As of May 2024, the total market capitalization of the Lima Stock Exchange amounts to 817,5 billion Peruvian Soles, equalling roughly USD 217,5 billion (BVL, 2024). This is significantly higher than the Argentinian stock market capitalization of just roughly USD 39 billion, but significantly lower than the Brazilian market capitalization of roughly USD 870 billion and the Mexican market capitalization of USD 1,02 trillion (Bolsa Mexicana, 2024).

Despite the smaller stock market, the country counts to one of the economically most stable within the region. While the economy is relying on a few key sectors such as commodity and mining, making it vulnerable to commodity price shocks, many of its economic indicators as outlined in 2.4 are stable (World Bank, 2024). This explains why it is included with a significant percentage of 4,21% despite a higher standard deviation of the MSCI Peru compared to the MSCI EM Latin America.

Similar to Peru, Chile enjoys a reasonable share in the index. With a Coface rating of A4, the country has one of the strongest ratings, supported by a comparably stable economy and strong institutions (Coface, 2024). Its stock market Santiago stock exchange has a similar size as the Peruvian stock market, with a current market capitalization of roughly USD 170 billion (CEIC, 2024). Based on the MSCI market classification, Chile as well as Peru fall into the emerging market category, displaying medium levels of liquidity, market capitalization, and market accessibility (MSCI, 2024). Regarding risk, the MSCI Chile index displays a 10-year annualized standard deviation of 25,67%, which is slightly lower than the one of the MSCI EM Latin America index with 27,50%. Despite a small and open economy vulnerable to external shocks, and a high exposure to climate risks, the Chile index does not display higher risk levels than the MSCI EM Latin America (Coface, 2024) (MSCI, 2024). Once again there appears to be a correlation between country risk and the index weight, with Chile being included to a significant percentage despite its relatively small stock market.

4.3 Bond Valuation

Thirdly, country risk analysis may have an impact on the bond valuation of government bonds issued by the respective country.

As part of their analysis, rating agencies such as Moody s and Fitch also directly rate government bonds, indicating their quality and stability. While country risk ratings provide a broad assessment of the risk of doing business in a given country, sovereign bond ratings directly measure a country s ability to service its debt obligations. More precisely, the agency rates the probability of default on one of more bond payments, which may lead to an investor losing some or all of the principal amount invested (Merrill Edge, 2024). In the case of Fitch, the long-erm foreign currency issuer default rating (IDR) and the sovereign rating are intertwined, as the foreign currency IDR forms a key component of the sovereign rating. The sovereign rating additionally considers the local currency IDR as well as broad economic or political factors impacting the country s creditworthiness (Fitch, 2024).

Among the countries with the highest rated bonds are e.g., the Unites States and Germany, which are currently rated AAA by Moody s and Fitch. Concerning the Latin American region, Fitch expects mixed sovereign ratings in 2024 with performances varying to a large extent between countries (Fitch, 2024). While Bolivia has been downgraded to CCC, Jamaica and Costa Rica have received an upgrade to a BB rating. Highly speculative-grade sovereigns (CCC or worse) with a high estimated risk of default are besides Bolivia the countries Argentina and Ecuador. Peru is rated investment grade with BBB. As shown in 4.1.2, this equals its current long-term foreign currency IDR (Fitch, 2024).

Argentina s sovereign bond rating currently stands at CC, which is also in line with its current long-term foreign currency IDR as displayed in 4.1.1. Argentinian government bonds currently have a yield of

5. Conclusion

In conclusion, country risk analysis does not appear to have a impact on the performance of national investment funds and indices in Argentina and Peru. As a result of the analysis conducted as part of this thesis, Argentina was rated C / very high risk due to skyrocketing inflation, high levels of corruption, and weak fiscal accounts, among other factors. Peru achieved a better rating of B / high risk, with high foreign exchange reserves but also high levels of corruption and a strong dependency on Chinese demand. Based on a descriptive analysis of the rating and performance data as well as a linear regression analysis, no significant correlation could be identified. In the case of Argentina, the country achieved some of worst country risk ratings throughout the given time period, while outperforming the MSCI ACWI in several years as well as displaying a higher overall performance. While Peru was displaying stable country risk ratings ranging from BBB- to BBB+, its annual performances were varying strongly.

On the other hand, country risk analysis appears to have an impact on the allocation of Latin American investment portfolios. High risk countries with the worst ratings in the region due to economic or political instability such as Argentina and Venezuela are mostly not included in the regional indices. Brazil and Mexico enjoy the largest portfolio weights with comparably stable economies and large and liquid stock markets. Market capitalization, liquidity, as well as overall economic stability appear to form the key underlying reasons for the allocation decisions of portfolio managers or of index creators such as MSCI (MSCI, 2023). Countries with a comparably smaller stock market yet stable economies such as Chile or Peru are assigned small portfolio weights typically between 3 and 8% (Franklin Templeton, 2024). The core reason for portfolio managers to not include high risk countries such as Venezuela or Argentina is that the given countries display a higher standard deviation which is not reliably compensated with higher returns.

Lastly,

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Appendix

Appendix 1:

Threshold	Interpretation
80-100 points	Very low risk
65-79 points	Low risk
50-64 points	Medium risk
35-49 points	High risk
20-34 points	Very high risk
0-19 points	Extreme risk

Table 50 - Individual variable risk scaling

Appendix 2:

Figure 16 - Year-over-year progression, Argentina

Appendix 3:

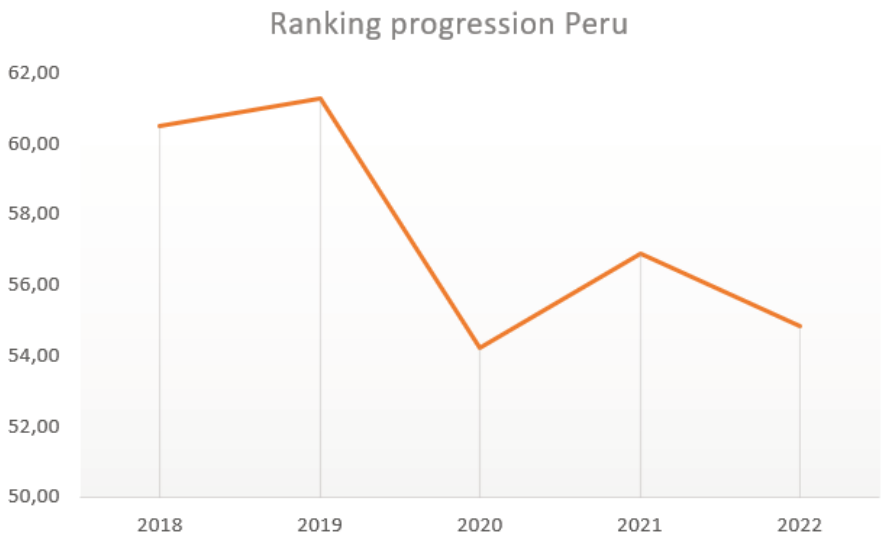

Figure 17 - Year-over-year progression, Peru

Appendix 4:

Rating	Conversion
AAA – Highest credit quality	1
AA – Very high credit quality	2
A – High credit quality	3
BBB – Good credit quality	4
BB – Speculative	5
B – Highly speculative	6
CCC – Substantial credit risk	7
CC – Very high credit risk	8
C – Exceptionally high credit risk	9
RD – Restricted default	10
D – Default	11

Table 51 - Rating conversion based on Fitch (Fitch, 2024)

Appendix 5

Criteria	Frontier	Emerging	Developed
A Economic Development			
A.1 Sustainability of economic development	No requirement	No requirement	Country GNI per capita 25% above the World Bank high income threshold* for 3 consecutive years
B Size and Liquidity Requirements			
B.1 Number of companies meeting the following Standard Index criteria	2	3	5
Company size (full market cap)**	USD 1,033 mm	USD 2,066 mm	USD 4,133 mm
Security size (float market cap)**	USD 73 mm	USD 1,033 mm	USD 2,066 mm
Security liquidity	2.5% ATVR	15% ATVR	20% ATVR
C Market Accessibility Criteria			
C.1 Openness to foreign ownership	At least some	Significant	Very high
C.2 Ease of capital inflows / outflows	At least partial	Significant	Very high
C.3 Efficiency of operational framework	Modest	Good and tested	Very high
C.4 Availability of investment instruments	High	High	Unrestricted
C.5 Stability of the institutional framework	Modest	Modest	Very high

* High income threshold: 2021 GNI per capita of USD 13,205 (World Bank, Atlas method)
** Minimum in use for the May 2023 Index Review, updated on a quarterly basis

Figure 18 - MSCI Market classification framework (MSCI, 2023)