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Argentina – Strategy
July 11, 2023

Rallying bonds, worsening fundamentals: Is it all about the election trade?

- **IN THIS PIECE.** Since mid-April, Argy assets have seen a massive rally across the board, including sovereign bonds bouncing back as much as 30%, before hitting a road bump late last week. We look deeply at the latest Argy rally to identify how much of the rally has been idiosyncratically driven and how much the result of global catalysts. While global factors have been clearly supportive, the role of idiosyncratic drivers is mixed in a context where fundamentals deteriorated significantly, but the election outlook improved materially.

- **OUR KEY TAKEAWAYS.** We decompose the total return of the ARGENT and the Bonar curves into four components, (i) the carry, (ii) the compression resulting from shifts in the UST curve, (iii) the compression resulting from a tightening of the CCC-peer spread, and (iv) the compression of the purely idiosyncratic Argy risk premium. We find that global drivers explain 65% of the average 3000bp in total return accumulated since mid-April, with the carry explaining 5% and the compression of the Argy risk premium explaining about 30%. With the rally mostly related to global EM drivers, we feel that the pure-Argy risk premium remains stuck at the trade-off between deteriorating fundamentals and an improving electoral outlook.

  On the fundamentals side, the Government's need for a Samaritan bailing the BCRA out is growing daily. BCRA gross reserves have dropped below USD27bn, of which we estimate that at least USD23bn is not usable (including bank reserves, the inconvertible tranche of the PBOC swap, and gold), leaving just over USD4bn in firepower at the CenBank. We estimate that private sector demand drains about USD2bn from BCRA reserves, which means that the Government has barely enough reserves to make it through July, factoring in USD1bn in coupon payments to private creditors due this week and SDR1.98bn in IMF payments before the end of the month. We identify three paths going forward. The first alternative is Mr. Massa accepting the Staff's terms to secure a net new money deal with the IMF, particularly executing a REER correction. We believe that we could see a substantial upside to valuations, as creditors would price a regime change with a higher chance of successfully implementing the next Administration's reforms agenda in a context where the current Administration gets saddled with the political cost of the devaluation. The second path involves the IMF blinking and giving Mr. Massa his net new money deal with no conditionalities. We believe this is fully priced in. The final scenario, where neither side blinks, seems likeliest. The Gov't secures a deal that keeps Argentina current with the IMF but has no new money for the FX market. In this final scenario, we would expect valuations to suffer, as the deal would underwhelm the market, and the BCRA would need to resort to selling bonds in the market to contain the BCS.

  By contrast, the political outlook is improving. Mr. Milei's Libertarians are seeing their voter support plummet 5pp over the past few weeks on the back of a failed pivot to social issues and a campaign financing scandal. In this context, the election resembles a traditional two-way race between JxC and Peronists, diluting the risk of Mr. Milei. On the other end of the spectrum, the arm-wrestling match that put Mr. Massa atop the Peronist ticket left Kirchenrism unrepresented in the Peronist ballot for the first time since 2001. With Kircherism sidelined, Creditors will now see a race between Mrs. Bullrich and Messers. Larreta and Massa, all of which seem like acceptable outcomes.

- **STRATEGY IMPLICATIONS.** In our view, the likelihood of the Government running out of reserves and the IMF deal not including enough net new money to prevent the BCRA from needing to dump dollarized bonds into the market to intervene in the BCS before the primaries remains substantial. In this context, we remain at MW for now. If the Government secured a better-than-expected IMF deal or Mr. Massa blinked and agreed to the IMF terms, taking off the table the risk that the BoP problems might spill over to valuations, we would move OW in the coming weeks. Stay tuned; with IMF negotiations entering the final stretch, we're very close to the election trade being the sole driver of valuations.

TPCG ARGENTINA
STRATEGY VIEW

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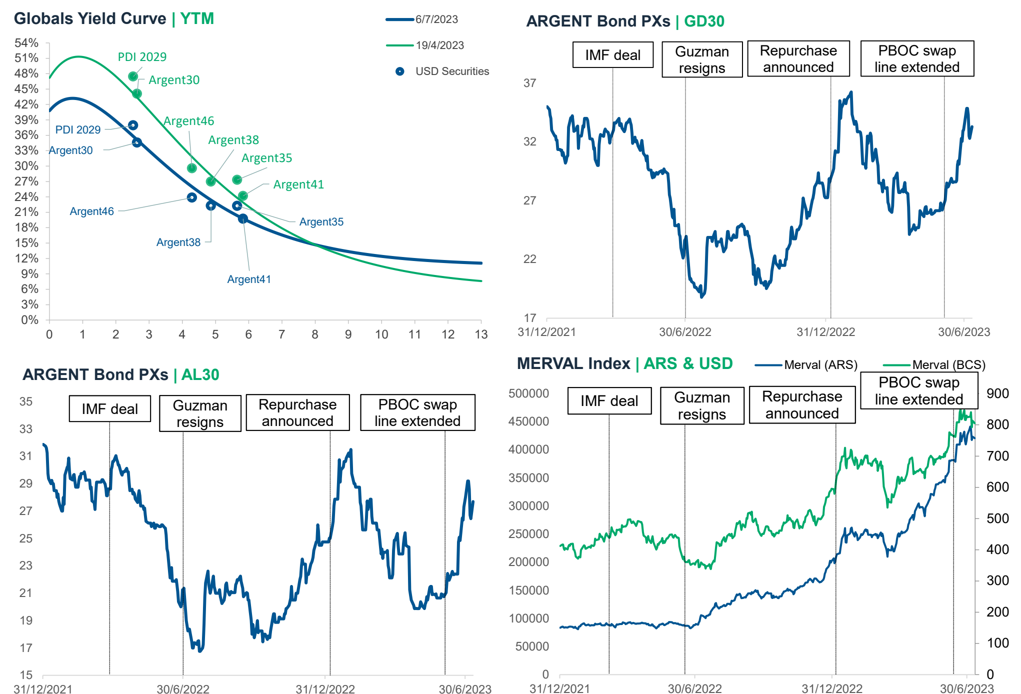
Rallying bonds, worsening fundamentals: Is it all about the election trade?

Bonds continue to rally, beating our expectations.

Argy assets continued to rally through June and early July. The rebound in valuations occurred across the board, with the ARGENT curve bouncing back to January levels, AL paper improving substantially, and equities continuing to test new highs.

Argy assets continued to rally through June and early July. The rebound in valuations occurred across the board, with the ARGENT curve bouncing back to January levels, AL paper improving substantially, and equities continuing to test new highs. By late 2022, it seemed Mr. Massa could do no wrong. The differentiated FX for soy exporters rebuilt the BCRA's NIR position, the Government managed to hit all of the EFF program's end-2022 targets, and assets had been rallying since September. In January, Mr. Massa turbocharged the rally by announcing a bond repurchase that pushed bond prices to two-year highs. But then Mr. Massa's miracle run out of steam. A combination of deviations from the fiscal and external targets driven by the drought and a weakening of fiscal discipline in 1Q23 turned creditors more bearish, triggering a -30% rout that extended between late January and mid-April. The deterioration in valuations made sense considering the rapid worsening in fundamentals. The BCRA was burning through its NIR position unsustainably fast, dollar inflows dwindled, the private sector's ARS debt rollover ratio slogged well below the baseline, increasing money printing to cover fiscal dominance considerably, and the primary deficit was widening rather than compressing. But then again, in mid-April, valuations surprised, turning around and triggering a 35% rally that extended until last week. Everything improved. The ARGENT curve compressed considerably, sovereign bond valuations improved between 25% and 35%, and equities improved 50% in ARS and almost 30% in USD. Putting the finger on the idiosyncratic drivers of the latest rally is more challenging than the late 2022 rally. A more encouraging election outlook and the certainty of the payment of the July coupons certainly helped. Still, the data suggest that global drivers accounted for the lion's share of the rally.

Figure 1: Argy assets have rallied around 30% since mid-April.



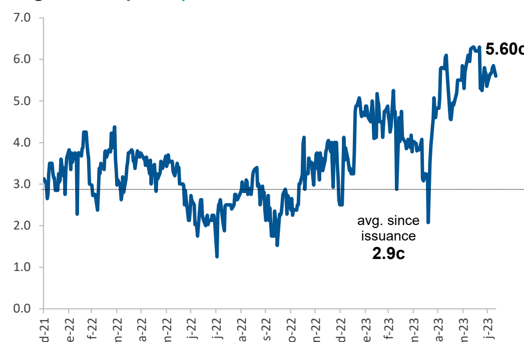
Source: TPCG Research based on TPCG Trading Desk

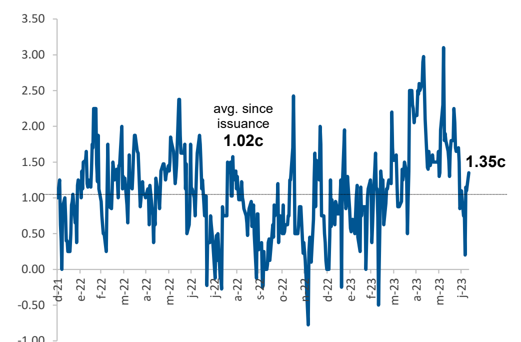
New indenture bonds overperformed relative to the 2005 Indenture securities, while Bonars underperformed the ARGENT curve as the legislation spread widened.

New indenture bonds overperformed relative to the 2005 Indenture securities, while Bonars underperformed the ARGENT curve as the legislation spread widened. When we look at the sovereign bonds, we find that the new indenture bonds accumulated a total return of around 3643bp since the rally began in mid-April (the 46s lagged a little but performed over 3200bp). Since the carry in these bonds adds little (308bps in the best case -the 41s- and 46bps in the worse -the 30s-), most gains concentrate on spread compression / higher clean prices. In this context, the new indenture bonds, which lagged in 1Q23 relative to the 38s and the 41s, overperformed as the ARGENT30s climbed back into the low-30s and the ARGENT35s breached the 30c line. Despite the more attractive carry, the 38s and the 41s, which entered the rally richer, offered a total return slightly under 3100bp, lagging behind the 30s and the 35s by about 500bp. The Bonar curve also underperformed marginally, averaging a total return of about 3300bps, with only the Bonar35 matching the performance of the Globals. In this context, the legislation spread in the 30s (measured as ARGENT30-Bonar30 PXs) widened from about 2c in mid-April when the rally started to about 5.6c currently, well above the 2.9c average over the lifetime of the bonds. Clearly, most of the Bonar curve remains weighed down by the supply risk of the BCRA dumping its holdings into the market to intervene in the BCS. The only legislation spread that didn't widen was the 35s because of the robust performance of the Bonar35s.

Figure 2: The ARGENT35 and the PDI29 outperformed the rest of the curve, with the ARGENT30 close behind. Bonars underperformed slightly.

	10-jul.-23			Since the start of the rally			YTD		
	MD	YTM	PX (Conv.)	Carry (bps)	Δ Clean PX (bps)	Total Return (bps)	Carry (bps)	Δ Clean PX (bps)	Total Return (bps)
US Law Securities - ARGENT curve									
PDI 2029	2.5	37.9	32.60	94	3,679	3,773	197	2,187	2,384
Argent30	2.6	34.6	33.30	46	3,779	3,826	97	2,220	2,317
Argent38	4.8	22.3	35.45	302	2,667	2,968	620	992	1,612
Argent46	4.3	23.9	30.20	144	3,071	3,215	301	1,615	1,916
Argent41	5.8	19.7	31.95	308	2,918	3,226	634	1,113	1,747
Argent35	5.6	22.3	30.10	150	3,609	3,759	304	1,689	1,993
Argy Law Securities - Bonar curve									
PDI 2029 AL	2.4	43.1	28.75	100	2,897	2,997	215	1,722	1,937
Argent30 AL	2.4	41.9	27.70	53	3,098	3,151	108	1,300	1,407
Argent38 AL	4.6	24.6	31.75	341	2,863	3,205	623	-97	527
Argent41 AL	5.5	21.8	28.50	349	3,086	3,435	658	290	948
Argent35 AL	5.5	23.1	28.75	160	3,882	4,042	310	1,400	1,710





Source: TPCG Research based on TPCG Trading Desk

Unlike the late 2022 rally, idiosyncratic drivers explain about one-third of the current rally. The figures suggest that improving global appetite for risk has buoyed Argy's assets.

Unlike the late 2022 rally, idiosyncratic drivers explain about one-third of the current rally. The figures suggest that improving global appetite for risk has buoyed Argy's assets. The depth of the recent Argy rally surprised us because it took place as fundamentals took a material turn for the worse. The BCRA is firing its last shells to defend the FX framework. The Government aborted the fiscal consolidation in 1Q23 and has been fighting a costly battle to restore fiscal discipline since May. The IMF deal seems muddled. The economy gives creditors few signs of solace other than having clipped the July coupons. The politics story is a little more supportive in a context where Kirchnerism is not fielding a natural candidate, Mr. Milei's support seems to wane, and the three remaining candidates, Messers. Massa, Larreta, and Mrs. Bullrich, all seem acceptable outcomes for creditors. In this context, it is unsurprising that idiosyncratic drivers

explain little of the recent rally. We decompose the total return of the ARGENT curve since mid-April into four components: (i) the carry, (ii) the effect of the UST yield curve (benchmark effect), (iii) the effect of the CCC spread (global EM peers), and (iv) the compression of the idiosyncratic Argy spread. We find that the idiosyncratic compression of the Argy spread explains, on average, 1032bp of the 3461bp total return, or 30%. The carry explains 168bp or 5% of the total return. A rebound in the global appetite for risk explains the remaining 65%, or 2316bps. On average, while the benchmark effect is negative, subtracting from the total return, the past three months have been extremely favorable for high-yield EM credit. The valuation of the average Argy CCC peer improved by 2300bp since mid-April, buoying Argy's assets with them. In other words, after decoupling from the EM space in 2H22, Argentina seems to have recoupled with its CCC peers during 2Q23, driving the rally.

Figure 3: Pure Argy risk-premium compression explains nearly 30% of the rally, with global drivers explaining almost 65%

	Since the start of the Rally				
	Carry (bps)	Δ Clean PX (bps)			Total Return (bps)
		Δ US Yield Curve	Δ CCC Spread	Δ Argy Spread	
PDI 2029	94	497	2,286	896	3,773
Argent30	46	573	2,280	926	3,826
Argent38	302	-614	2,757	524	2,968
Argent46	144	-26	2,933	164	3,215
Argent41	308	-691	2,194	1,415	3,226
Argent35	150	-104	1,448	2,264	3,759

Source: TPCG Research based on TPCG Trading Desk

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Last week's speedbump was the easiest way to assess how much of the Argy rally was global-driven. A few days in which the global market went risk-off pummeled Argy bonds. This week provided substantial evidence to our thesis that the recent Argy rally was EM-driven. The global appetite for risk stumbled this week, with EM spreads widening 205bp, dragging the Argy curve. The ARGENT curve weakened by almost 4% over the past week, while the Bonar curve suffered a twin 4% drop. In other words, a risk-off global market pummeled Argy bonds, wiping out about 11% of the gains of the previous three months. Domestic conditions didn't change much. They are ugly, but not uglier than a week ago, when bonds rallied unstoppable. The main change was global market conditions. In this context, the big question is how different is today's 30c from April's 24c? Adjusting for EM conditions, the answer seems not much. The second question is: could the election trade decouple Argentina and drive an overperformance relative to its CCC peers? Could the fundamental deterioration drive an underperformance? We'll look into these two questions in the rest of the piece.

Figure 4: Argy bonds suffer from a lower global appetite for risk

	Δ Clean PX (bps)		
	Last week	Since the start of the rally until last week	YTD until the rally
US Law Securities - ARGENT curve			
PDI 2029	-412	4316	-1121
Argent30	-445	4446	-1147
Argent38	-354	3243	-1395
Argent46	-488	3804	-1154
Argent41	-463	3673	-1478
Argent35	-444	4318	-1456
Argy Law Securities - Bonar curve			
PDI 2029 AL	-580	3733	-939
Argent30 AL	-435	3717	-1388
Argent38 AL	-419	3564	-2380
Argent41 AL	-361	3730	-2225
Argent35 AL	-426	4587	-1837
EMBI	**-163**	**171**	**38**

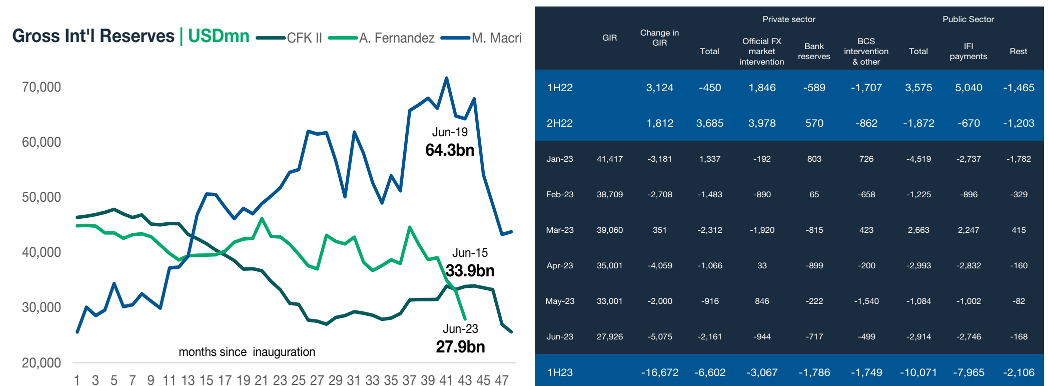
Source: TPCG Research based on TPCG Trading Desk

Worsening fundamentals: Reserves drop to rock bottom as the Government plays chicken with the IMF

The Net International Reserves position has turned deeply negative in a context where the BCRA private sector drew USD6.5bn from reserves since March, and IFI payments (including IMF) totaled USD4.3bn.

The Net International Reserves position has turned deeply negative in a context where the BCRA private sector drew USD6.5bn from reserves since March, and IFI payments (including IMF) totaled USD4.3bn. Since March, gross reserves have dropped by USD10.7bn to USD27.9bn, the lowest since December 2015. The fourth Kirchnerist Government is ending with a busted Central Bank balance sheet, just like the third. Except that the Fernandez Administration still has about five months to go. By June 2015, gross reserves stood at USD33.9bn, USD6bn more than currently. Net reserves dropped to -USD4bn by the end of June after the Government paid the IMF USD2.7bn. If we exclude payments, the private sector has been, on average, drawing USD2bn per month from the BCRA reserves. In June, the BCRA sold USD944mn in the highly-regulated and restricted official cash-based FX market, sold about USD500mn in BCS, and lost USD717mn in bank reserves as bank deposits continued to drop. In May, the BCRA purchased USD from the official market on the back of the differentiated FX for grain exporters but sold about USD1.5bn in BCS. In other words, the private sector keeps finding soft spots in the FX control frameworks to draw about USD2bn dollars from the BCRA reserves.

Figure 5: Gross reserves dropped to an 8-year low as private demand drains almost USD2bn per month from the BCRA



			Private sector				Public Sector		
	GIR	Change in GIR	Total	Official FX market intervention	Bank reserves	BCS intervention & other	Total	IFI payments	Rest
1H22		3,124	-450	1,846	-589	-1,707	3,575	5,040	-1,465
2H22		1,812	3,685	3,978	570	-862	-1,872	-670	-1,203
Jan-23	41,417	-3,181	1,337	-192	803	726	-4,519	-2,737	-1,782
Feb-23	38,709	-2,708	-1,483	-890	65	-658	-1,225	-896	-329
Mar-23	39,060	351	-2,312	-1,920	-815	423	2,663	2,247	415
Apr-23	35,001	-4,059	-1,066	33	-899	-200	-2,993	-2,832	-160
May-23	33,001	-2,000	-916	846	-222	-1,540	-1,084	-1,002	-82
Jun-23	27,926	-5,075	-2,161	-944	-717	-499	-2,914	-2,746	-168
1H23		-16,672	-6,602	-3,067	-1,786	-1,749	-10,071	-7,965	-2,106

Source: TPCG Research based on BCRA

With gross reserves at eight-year lows, net reserves have become moot. The focus should move to how many usable reserves are left in the BCRA's balance sheet.

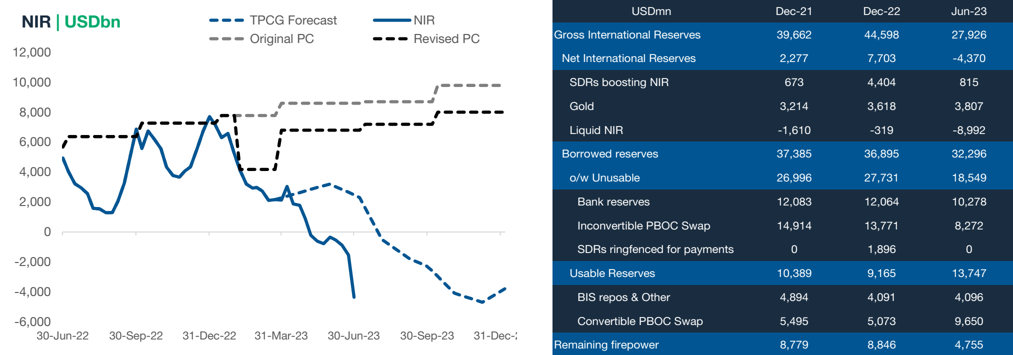
With gross reserves at eight-year lows, net reserves have become moot. The focus should move to how many usable reserves are left in the BCRA's balance sheet. As a concept, net reserves allude to ownership: whose monies are the BCRA dumping into the market? As long as net reserves stood in positive territory, the CenBank sold proprietary reserves. Since they turned negative, authorities have propped the FX market using borrowed monies. With gross reserves at USD27bn and net reserves at -USD4bn, the question is no longer whose monies the BCRA sells but how many borrowed reserves are usable. We assume that the USD10.6bn in bank reserves fall into the category of unusable reserves, as draining them would risk triggering a new wave of deposit flight. From the CNY130bn PBOC swap line, the Government has agreed with Chinese authorities that CNY70bn would be convertible. In that context, the remaining CNY60bn (USD8.4bn) would also fall into the category of unusable reserves. Finally, the BCRA holds about USD3.8bn in gold, which, for some reason, hasn't been used yet (maybe it's collateralizing something?). Adding these, we find that, from the USD27bn in gross reserves, the BCRA holds USD23bn in indisposable assets, leaving about USD4.8bn in firepower to defend the current FX framework (see Figure 6 below).

The remaining reserves are barely enough to cover debt payments, leaving almost no firepower to defend the FX framework.

The remaining reserves are barely enough to cover debt payments. If Mr. Massa can't finalize a deal before July 31st, the BCRA would end the month with USD1bn in firepower to defend the FX framework in August. Between the convertible tranche of the PBOC swap (CNY70bn or USD9.6bn), the BIS repo, and other liquid monies that the BCRA has in different pockets throughout its balance sheet (like SEDESA premiums), we estimate that the Government built a USD13.8bn cache of borrowed reserves to muddle through the election. The problem is that the BCRA has already burnt almost USD9bn of the cache to finance its interventions in the official FX market and the BCS, leaving about USD4.8bn remaining. With over USD1bn in coupon payments due to private creditors on July 10th and about USD2.6bn due to the IMF due by July 31st, the Government needs to secure a new IMF deal before the end of the month. If it didn't, the BCRA would need to use about 80% of its remaining firepower to cover debt services, leaving

USD1bn in liquid assets to keep the FX framework running in August. With the private sector drawing USD2bn a month, it would mean about two weeks' worth of firepower.

Figure 6: BCRA's firepower at minimum levels



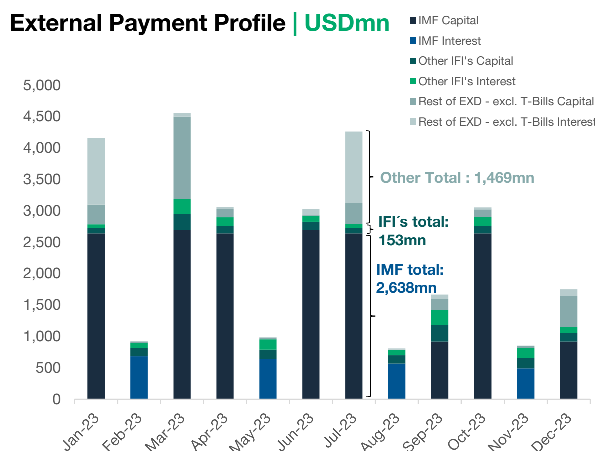
USDmn	Dec-21	Dec-22	Jun-23
Gross International Reserves	39,662	44,598	27,926
Net International Reserves	2,277	7,703	-4,370
SDRs boosting NIR	673	4,404	815
Gold	3,214	3,618	3,807
Liquid NIR	-1,610	-319	-8,992
Borrowed reserves	37,385	36,895	32,296
o/w Unusable	26,996	27,731	18,549
Bank reserves	12,083	12,064	10,278
Inconvertible PBOC Swap	14,914	13,771	8,272
SDRs ringfenced for payments	0	1,896	0
Usable Reserves	10,389	9,165	13,747
BIS repos & Other	4,894	4,091	4,096
Convertible PBOC Swap	5,495	5,073	9,650
Remaining firepower	8,779	8,846	4,755

Source: TPCG Research based on BCRA

The Government and the IMF seem locked in a dangerous game of chicken involving the conditionalities attached to a net new money loan.

The Government and the IMF seem locked in a dangerous game of chicken involving the conditionalities attached to a net new money loan. On average, the IMF board takes between 15 and 20 days to green-light a deal after an SLA is finalized. The clock is ticking for both sides. Mr. Massa is trying to secure (i) a USD10bn disbursement with (ii) a set of conditionalities consistent with his election needs. At the top of his list is preventing a politically costly REER correction. The deal Mr. Massa seeks would involve increasing IMF exposure to Argentina by a little under USD3bn, considering that Argentina faces SDR5.4bn (USD7.1bn) maturities with the IMF until year-end. On the other hand, the IMF reportedly offers a re-write of the program's target to dilute the need for discretionary actions to compensate for the accumulated deviations, maintaining the scheduled disbursements, but little in the way of new money. The rumor since late March has been that the IMF would be willing to flex its position and chip in some net new money providing that the Government commits to a series of adjustments. At the top of the IMF's list is a one-step REER correction, and therein lies the problem. The Staff is probably making even finer math than we are and coming to the same conclusion: navigating the weeks between the primaries and the generals without a samaritan bailing out the Government will be extremely challenging. To compensate for his position of weakness, Mr. Massa deferred the IMF payments due July 7th until the month's end, effectively subordinating the IMF payments to those due to private creditors. Under the original schedule, the IMF was due USD1.4bn on July 7th, making a massive dent into the BCRA's GIR position. The accelerated drainage of reserves from private demand, combined with the IMF maturities, risked putting the July coupons at risk. By deferring the IMF payments until the end of the month, Mr. Massa has put private creditors and local private demand in front of the IMF in the drainage queue, probably seeking to argue that the BCRA won't have enough reserves to pay the IMF without the new program in place and the disbursements. All in all, Government and IMF are playing a dangerous chicken game.

Figure 7: Monthly treasury EXD maturities, including IFIs



Source: TPCG Research based on the Treasury

We see three paths out of the current standstill. The most positive one for international creditors is the one where Mr. Massa blinks and acquiesces to the IMF conditionalities in exchange for a net new money loan that makes the muddle through until December viable.

We see three paths out of the current standstill. The most positive one for international creditors is the one where Mr. Massa blinks and acquiesces to the IMF conditionalities in exchange for a net new money loan that makes the muddle through until December viable. While Mr. Massa has been adamant in rejecting a REER correction before the election, he's negotiating with the IMF from a weak position. Mr. Massa has a long history of announcing bailouts that never materialize. At the start of his tenure, he announced negotiations with international banks for a repo line to aid the BCRA. Later, he revealed negotiations with a sovereign wealth fund. In January, he revived the repo line to finance the repurchase. A week ago, he announced that the deal with the IMF would be announced "in the coming hours." But the white knight remains elusive. As the BCRA runs out of firepower to maintain the current FX framework running, the Government's need for a samaritan grows daily. At the end of the day, Mr. Massa's candidacy can't decouple from the economy. If the prospect is a train wreck, the Government may be driven to accept the Staff's terms. That would involve a one-step devaluation before the October generals and the commitment not to increase fiscal impulse during the campaign. In our view, this would be the best scenario for creditors. The consensus would jump to assuming that (i) the risk of a BoP blowup and arrears would dilute on the back of the inflow of the IMF's new program, (ii) the chances of Peronism winning the election would plummet, and (iii) the outgoing Administration did the dirty work, easing the path of the next Administration by lowering the political cost of the economy's stabilization. Under this scenario, which we believe has a 30% of materializing, we expect bonds to extend the rally into the low-40s.

An alternative path is the one where the IMF blinks, granting the Government the net new money line it seeks without the conditionalities. We believe that this is the scenario that the market is currently pricing.

An alternative path is the one where the IMF blinks, granting the Government the net new money line it seeks without the conditionalities. We believe that this is the scenario that the market is currently pricing. The IMF's position is marginally stronger than Mr. Massa's, but not by much. By subordinating the payments due in July to the IMF, the Government has considerably diluted the IMF's position. Without a deal, the risk of Argentina entering arrears on its 2018 SBA is significant, which, combined with the political pressure that the Government is trying to put on the Staff, could result in the IMF blinking. That would involve the deal Mr. Massa is seeking, with the IMF disbursing the net new money that the Government needs to make until December, albeit without introducing significant changes to the policy mix. In our view, this scenario is consistent with the current valuations in a context where most risks would dilute. Still, the next Administration would need to pay for the entire political cost of the stabilization program, reducing its probability of completing a successful regime change. We assign this scenario a 20% probability.

The primaries might give the FdT a chance to gain some separation from the Government to improve the efficacy of its campaign message.

Our baseline scenario assumes both stand their ground, leading to an underwhelming IMF deal. In that scenario, the Government would need to go from intervening in the BCS by selling reserves outright to selling bonds, hurting valuations. A third path, which we believe has a 50% chance of materializing, is one where neither side blinks. That would open two possibilities, a no-deal outcome, where Argentina messily falls into arrears with the IMF. The more likely alternative is an underwhelming deal, where the Staff and the Government agree on new targets, and the IMF disburses only the USD7bn required to keep Argentina current throughout the rest of the year. The problem with that scenario is that while it would dilute the risk of the Republic entering arrears, such a deal would leave the Government with almost no firepower to intervene either in the official FX market or the BCS. The logical response for the Government in this scenario (assuming as a prior that Mr. Massa was willing to reject a net new money deal to avoid a REER correction) would be to lock down the official FX market even further, at the cost of higher inflation and a deeper recession, and to continue to intervene in the BCS by selling bonds. Despite announcing its intention to sell bonds from the Anses and BCRA holdings to intervene in the FX market, the Government has limited its intervention to selling reserves outright via BCS over the past few months. Defined as the ratio between the ARS price and the USD price of dollarized bonds, the BCRA has been intervening in the market by quoting the market better offers for bonds against ARS and better bids against USD. In this context, authorities have intervened both in the numerator and the denominator of the ratio, keeping the BCS premium contained. The BCRA's approach has an advantage; by repurchasing the bonds against dollars, authorities can intervene in the BCS while backstopping bond prices. It also has a disadvantage; it costs the BCRA reserves. If authorities run out of reserves they can part with; we would expect the Government to continue intervening in the BCS, albeit limited to selling bonds against ARS, operating through the numerator of the ratio. That would allow authorities to continue intervening but would also trigger a drop in bond prices on the back of the supply risk and the glut created by the BCRA dumping bonds into the market.

Despite the worsening fundamentals, the election trade looks increasingly attractive.

While fundamentals have worsened considerably, the outlook of the election trade has improved materially over the last couple of weeks. Creditors fretted about Kirchnerism taking a central role in the election and Mr. Milei's chances of winning. Both risks seem to have diluted.

While fundamentals have worsened considerably, the outlook of the election trade has improved materially over the last couple of weeks. Creditors fretted about Kirchnerism taking a central role in the election and Mr. Milei's chances of winning. Both risks seem to have diluted. If we look at the snapshot of the race that creditors were seeing a month ago, fetters gravitated around the likelihood of a competitive Kirchnerist offering and the rise of Mr. Milei. Since then, Mr. Massa wrestled the Peronist candidacy from Mr. De Pedro, leaving Kirchnerism unrepresented in a federal election for the first time since 2001. On the other hand, Mr. Milei's star seems to be losing his brightness after a string of dismal showings in provincial elections and a drop in approval ratings following his pivot towards controversial social issues and a campaign financing scandal. In other words, the election has gone from a three-way race with Kirchenrism on one side, JxC in the middle, and the libertarians on the other end to a more traditional two-way race ordered around a Peronist coalition seeking continuity and a non-Peronist opposition. Moreover, the three leading candidates, Mrs. Bullrich and Mr. Larreta on JxC's side and Mr. Massa on the Peronist corner, all look like acceptable outcomes to creditors.

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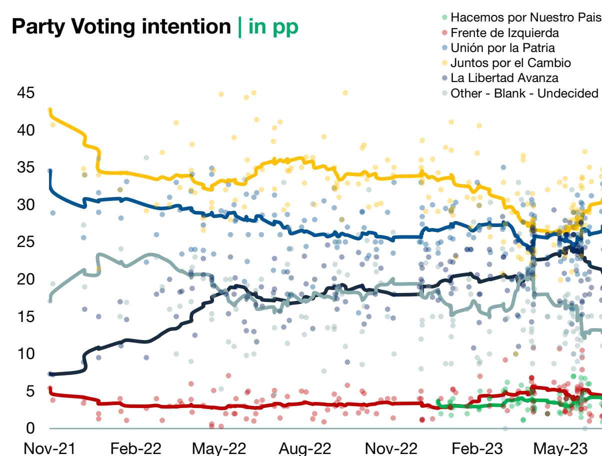
In our view, weaker support for Mr. Milei is the most important development of the last few weeks. After peaking past 20% in May, the latest batch of polls suggests that the Libertarians dropped around 5pp, back into the high teens. In our first in-depth piece about the election, we argued that Mr. Milei risked peaking and losing voter support rapidly. Our rationale for it was that his path to the Presidency required him to poach a substantial share of Kirchnerist votes to beat JxC, and while he had been quite successful earlier in the year at building his support at the expense of CFK, his campaign's pivot towards social issues risked alienating this voters. Adding to Mr. Milei's woes, a scandal erupted two weeks ago, as the Libertarian leader was accused of financing his campaign by selling spots in the ballots, violating campaign financing rules. The monies of politics have always been a sordid affair in Argentina, but Mr. Milei's problem is that he campaigned on his immaculate record and being different. When you're fully dressed in white, stains jump out considerably more. In this context, the latest batch of polls reflects a substantial weakening of voter support for the Libertarians. After peaking close to 25% a month ago, Mr. Milei's support has plummeted by almost 5pp back into the high teens, looking less threatening.

Figure 8: With support for the Libertarians plummeting, the election looks increasingly like a traditional two-way race between JxC and Peronism



Source: TPCG Research based on the pollsters

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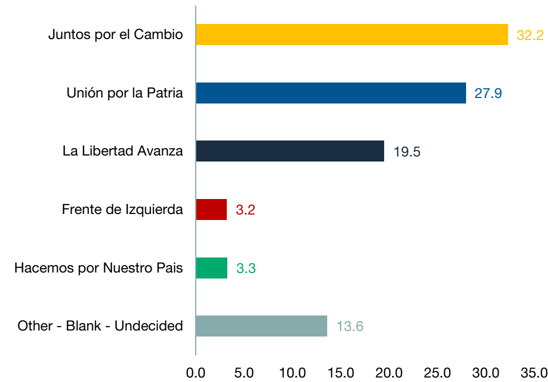
The election has a less uncertain outlook after the Libertarians tripped, with JxC clearly in front and Peronism comfortably in second place. Though still unlikely, a JxC first-round win is back within the realm of possibility. The Libertarians' growth during 2Q had come at the expense of JxC and Peronism. Many Juntos voters were disaffected by the leading opposition coalition's centrist approach, seeking a more disruptive opposition to Kirchnerism. On the other end of the spectrum, Mr. Milei added Peronist voters who were distraught over the shape of the economy. In this context, JxC dropped into the low-30s and Pernism into the high-20s as Mr. Milei grew into the mid-20s, briefly turning the election into a three-way race. Over the past month, the

two leading coalitions bounced back as Mr. Milei's support weakened and the number of undecided voters dropped. JxC is polling back in the mid-30s, and Peronism stands shy of 30%, with about 10pp of voters undecided. In other words, the race looks more akin to what voters expected earlier in the year. A substantial lead from JxC, putting either Mrs. Bullrich or Mr. Larreta very close to building a Congressional majority, and with the chance of winning in the first round in the deck of cards.

Figure 9: The current snapshot of the election according to polls



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On the Peronist side, Mr. Massa sidelined Mr. De Pedro's bid for the candidacy, leaving Kirchnerism unrepresented. Over the past few months, CFK's strategy seemed crystal clear: Kirchnerism was gearing up for a three-way race where galvanizing her hardcore base was the best path toward securing a place in the runoff. Consistent with that strategy, Mrs. Kirchner propped the candidacy of the Interior Minister (home secretary), Eduardo De Pedro. Mr. De Pedro filled all the checkboxes: founding member of La Campora, a high-ranking job in the CFK II Administration, and son of a couple tortured and executed in the late 1970s by the military—his credentials as a pure-blood Kirchnerist beyond any reproach. To Mrs. Kirchner, Mr. De Pedro ensured the retention of the left-wing, hardcore Kirchnerist voter. To the market, he meant Kirchnerism remaining relevant for at least another election cycle, probably more if the voter tally turned out better than expected. To Governors, however, he meant the prospect of losing their local elections. While Mr. De Pedro was expected to do well among the Kirchnerist faithful, his chances of wooing independent voters were nearly zero. In an electoral cycle where voters have shifted, on average, 12-15pp away from Peronism, fielding an uncompetitive candidate to an independent voter could mean losing many regional races to JxC. In this context, something unexpected occurred: Peronism revolted against Mrs. Kirchner's strategy, forcing her to withdraw Mr. De Pedro from the race and accept Mr. Massa's candidacy. CFK didn't even get a VP choice this time, like in 2015 or 2019, in a context where Mr. Fernandez demanded the running mate spot as a condition to scrap a primary competition. All in all, for the first time since 2001, the Peronist presidential ticket doesn't have a Kirchner (or a representative of them) in it.

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Peronism's competitiveness will depend on Mr. Massa's ability to woo independent voters while securing CFK's hardcore vote. The market consensus believes his chances of success are low, cementing the expectation of a JxC win. Whether CFK or the governors were right remains to be seen. Under Mrs. Kirchner's thesis of a three-way race, there seemed to be little independent voter to woo, supporting the De Pedro strategy. With support for the Libertarians waning and space to grow, Peronist governors hope to have made the right call. In our view, however, the strategy change risks leaving Peronism exposed. The hardcore Kirchnerist voter sees Mr. Massa suspiciously. Unlike Mr. De Pedro, he's built his political career over the last ten years around being different from CFK. To the left wing of Kirchnerism, Mr. Massa is cozier with the IMF, bankers, and businesspeople than in the Greater BA area slumps where most of the Kirchnerist hardcore dwells. In that context, Mr. Massa's candidacy risks seeing voter slippage to either the left or absenteeism. Mr. Grabois' candidacy seeks to shore up the left-wing vote within the space in the primaries, but the question is whether those votes will follow Mr. Massa once Grabois is out of the picture. On the other hand, Mr. Massa's appeal among independent voters remains an open

question. With the economy continuing to do badly, Mr. Massa's chances of securing votes beyond the Kirchenrist hardcore seem low, cementing the market's expectation of a JxC win.

For creditors, it's still a win-win situation. If Mr. Massa loses, they expect a JxC Administration with beefy Congressional caucuses. If he wins (or loses by little), the consensus is likely to read it as the end of Kirchnerism.

For creditors, it's still a win-win situation. If Mr. Massa loses, they expect a JxC Administration with beefy Congressional caucuses. If he wins (or loses by little), the consensus is likely to read it as the end of Kirchnerism. Ultimately, the election has turned from an uncertain event into a price catalyst in a context where the field of players looks much more attractive from creditors' point of view. Under their base view, Mr. Massa is competitive enough to displace the Libertarians from the runoff, taking that wildcard out of the deck, but not competitive enough to win. In this context, the scenario of a JxC government with a Congressional majority or falling just short of a majority has increased over the past few weeks, making the story more attractive. On the other hand, creditors aren't reacting negatively to a more competitive Peronist offering. Mr. Massa, be as he may, is good enough for many market participants. Whereas the market would fret if a Peronist ticket led by Mr. De Pedro became more competitive, creditors believe that if Mr. Massa does well (be it that he wins or loses by little), he will challenge CFK's leadership of the Peronist party diluting Kirchnerism. In other words, investors see an opportunity in CFK's weakness after being strongarmed by the rest of Peronism. Not to rain on anyone's parade, but expectations about Kirchnerism's demise seem rash in our view. From her position of extreme weakness, Mrs. Kirchner got more than she gave. She conceded all representation in a presidential ticket that she expected to lose in exchange for an oversize representation in the Congressional caucus. There's a case to be made that on December 10th, Messers. Massa, Rossi, Kicillof, & Co. will be unemployed, while Mrs. Kirchner's closest allies, including Messers. Kirchner and De Pedro will have comfortable Congressional seats and budgets from which to rebuild.

Strategy: Fundamentals vs. the election trade. Timing the OW.

From a positioning point of view, Argentina continues to poise the challenge of having bad news front-loaded and good news after them. While we remain MW, with the election trade closer to materializing, we're getting close to the point where we'd switch to OW.

From a positioning point of view, Argentina continues to poise the challenge of having bad news front-loaded and good news after them. While we remain MW, with the election trade closer to materializing, we're getting close to the point where we'd switch to OW. Positioning in Argy hasn't been easy, YTD. We moved to UW in the mid-30s after the repurchase was announced in January and back to MW in March, with bonds hitting the mid-20s. Back then, we were expecting bonds to hit the low-20s on the back of deteriorating fundamentals to go back OW, but we were blind-sighted by the April rally. In other words, we missed the latest rally at MW. With 20-20 hindsight, we didn't see the EM rally materializing. With the election trade looking increasingly attractive, the question is whether the time is right to move to OW, even at current valuations. In our view, the likelihood of the Government running out of reserves and the IMF deal not including enough net new money to prevent the BCRA from needing to dump dollarized bonds into the market to intervene in the BCS before the primaries remains substantial. In this context, we remain at MW for now. If the Government secured a better-than-expected IMF deal or Mr. Massa blinked and agreed to the IMF terms, taking off the table the risk that the BoP problems might spill over to valuations, we would move OW in the coming weeks. Stay tuned; with IMF negotiations entering the final stretch, we're very close to the election trade being the sole driver of valuations.

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