STEPSTONE
inside private markets

Private Equity in Latin America: Strong Opportunities Amidst Soft Economies

"A Río Revuelto, Ganancia de Pescadores"

- Mexican Proverb

Private equity investors in Latin America ("Latam") today stand to learn a valuable lesson from an old Mexican proverb that is well known to fishermen – there is good fishing in troubled waters.

As with many of the emerging markets, Latam economies are experiencing significant headwinds. The five Latam countries in which private equity is largely concentrated, Brazil, Mexico, Colombia, Peru and Chile (collectively the "Principle Latin American Economies" or "PLAE"), have experienced cuts in their 2015 and 2016 GDP forecasts of 0.5%-2%. These countries, highlighted in **Figure 1**, are home to private equity investors because they offer some combination of investor-friendly policies, economic and political stability, and scale. With a population of 428 million, the PLAE currently represent approximately 6% of the global population. Its combined GDP of US$4.5 trillion is equivalent to approximately 6% of global GDP, up from 4% in 2004.[1] Further, over the last decade, the PLAE have become increasingly integrated with the global economy – this process continues at an accelerated pace, particularly through the Pacific Alliance, which excludes Brazil and includes Costa Rica, and has earned the nickname of "Pacific Pumas."

While macroeconomic issues create near-term turbulence in these economies, StepStone believes that longer-term growth in consumer demand, driven by demographic realities and supported by sound economic reforms, will yield pockets of strong, sustainable growth, creating unique opportunities for private equity investors. The region is home to a number of experienced, well-funded private equity managers, and StepStone believes that these managers will be able to recognize these opportunities and craft innovative solutions to capitalize on them.

October 2015

FIGURE 1 | PRINCIPLE LATIN AMERICAN ECONOMIES

Brazil, Mexico, Colombia, Peru and Chile form the core of private equity in Latin America.

Macroeconomic Backdrop

After experiencing a decade of strong growth, Latin America is now traversing difficult economic times. Across the PLAE, 2015 GDP growth estimates are lower than they were at the beginning of the year. In general, policy is shifting from excessive stimulus towards more austere monetary policy and supply-side investment focus. The region, similar to most emerging markets, is generally suffering from devalued currencies, lower fiscal collection, and reduced hard currency revenues from commodity exports. Non-commodity exports, on the other hand, are benefiting from the weaker currencies and becoming more competitive.

While Latam countries share many cultural, demographic and developmental characteristics, it is important to keep in mind that different parts of the region are experiencing very different economic realities. Although slower global growth and depressed commodity prices are impacting each of the PLAE countries, the current economic health and outlook for each of Mexico, Brazil and the Andean region (Peru, Chile and Colombia) is quite different.

Mexico, which should grow over 2% in 2015 despite lingering sluggishness in domestic demand, is benefiting from a "zip code boost" – a reference to Mexico's proximity and correlation to the US economy – created by the US recovery and from recently implemented investor-friendly structural reforms.

Brazil's economy, by contrast, is expected to shrink by approximately 3% in 2015. The country is suffering from rising unemployment and inflation as the government struggles to balance the budget, compensating for overly loose fiscal and monetary policies during the first mandate of President Dilma Rousseff.

The Andean countries are least impacted, having implemented more prudent policies over the last four years; these countries are poised to grow at 2% to 3% despite the significant drop in copper and oil prices.

[1] The World Bank Data, 2014 World Development Indicators.

WELL POSITIONED TO FACE HEADWINDS

Sound fiscal and monetary policies implemented in the late 1990s and early 2000s, combined with increased Chinese demand, resulted in budget surpluses, declining inflation, increased foreign direct and portfolio investment, debt reduction and a rapid accumulation of foreign reserves across Latin America. The recent declines in commodity prices and Chinese slowdown, however, have begun to affect capital flows. Nonetheless, the PLAE are better equipped than at any time in the last three decades to withstand these economic headwinds. Brazil, which was too generous with its counter-cyclical economic policies in 2010-14, will see another 12 to 18 months of GDP contraction as corrective measures are put in place. But even Brazil is faring much better today, despite these missteps, than it did in the recurring financial crises of the 1980s through early 2000s.

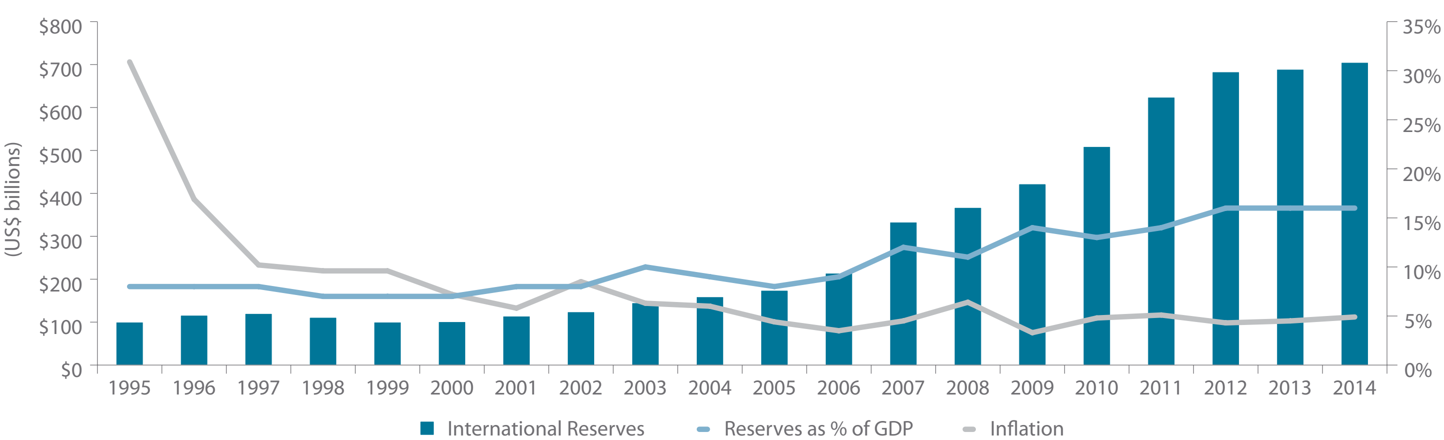
Exchange rates are an obvious cause of concern – as in all emerging markets – but current levels combined with balanced investment pacing should provide an attractive entry point. In addition to cheaper assets, weak currencies also suggest more globally-competitive economies. PLAE foreign reserves are at or near record levels, as shown in **Figure 2**, giving governments more leeway to pursue growth-oriented policies.

POLITICAL STABILITY

Latin America has no ethnic, religious or cultural divides. The region emerged from the dictatorship model in the 1980s and, for the most part, consists of maturing democracies. The PLAE have demonstrated clear commitment to prudent, orthodox economic policies. They also have well-established judiciary systems and functioning rules of law. In most cases, power has alternated between center-right and center-left governments with minimal interference on long-term economic policy, the private sector and free flows of capital.

By contrast, the political "outliers," which include countries such as Venezuela, Ecuador, Nicaragua, Argentina and Bolivia, have received very little foreign investment over the last decade. Although populist and left leaning, the governments in these countries have little propensity to export their political models – particularly given the troubled state of their economies.

FIGURE 2 | TRENDS IN PLAE FOREIGN EXCHANGE RESERVES AND INFLATION



Source: IMF & World Bank data.

Positive Elements for Private Equity

There are a number of circumstances in Latam that are contributing to a favorable environment for private equity investing in the region.

ATTRACTIVE DEMOGRAPHICS

Although maturing gradually, Latin America's demographics, as shown in **Figure 3**, ensure a steady supply of new entrants to the work force over the foreseeable future, and compare favorably with North American demographics. The relative youth of the population guarantees labor force expansion, which will drive wealth creation, a dynamic similar to the US after the Second World War, where an expanded labor force resulted in a sustained period of strong economic growth. Herein lie the key drivers that have been and will continue to create private equity opportunities in the overall region and particularly in the PLAE.

GROWING MIDDLE CLASS

The policy reaction to multiple debt crises, aided by the commodity super cycle fueled by Chinese demand, brought on improved macroeconomic management and performance throughout the PLAE. These policy reforms created much-needed stability and economic growth, which in turn drove increases in standards of living.

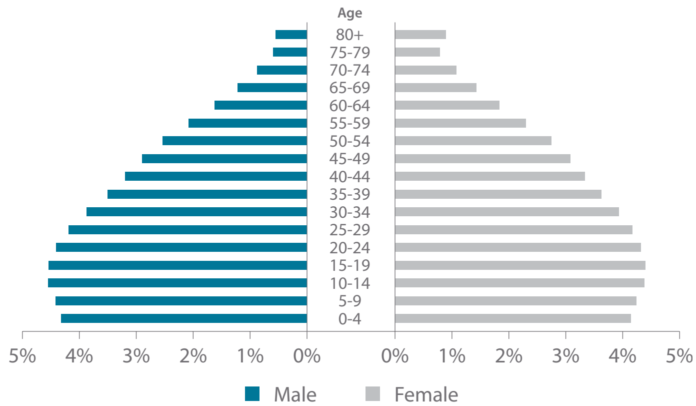
The turn of the century witnessed rapidly diminishing unemployment and a general improvement of purchasing power for PLAE citizens. As economies improved, almost 70 million people transitioned from poverty and the low-income range to the middle class.[2] Between 2000 and 2010, the middle class increased from approximately 50% to 70% of the population. This trend is expected to continue through 2020. **Figure 4** shows the declining poor and low income classes relative to the affluent and middle classes across the PLAE.

Peru, and to a lesser extent Colombia, the economies with the lowest real GDP per capita in the PLAE, have posted the highest growth rates in the last few years and are expected to continue to grow their lower middle classes over the course of this decade and generate a degree of local consumption unseen to date. Brazil and Mexico,

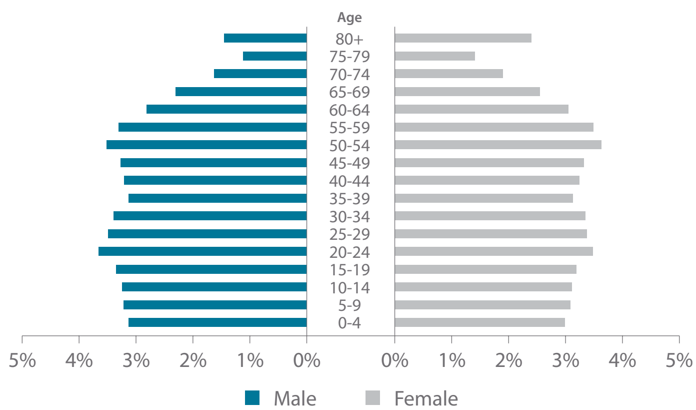
[2] BBVA.

FIGURE 3 | 2014 POPULATION AGE BREAKDOWN

Latin America and The Caribbean

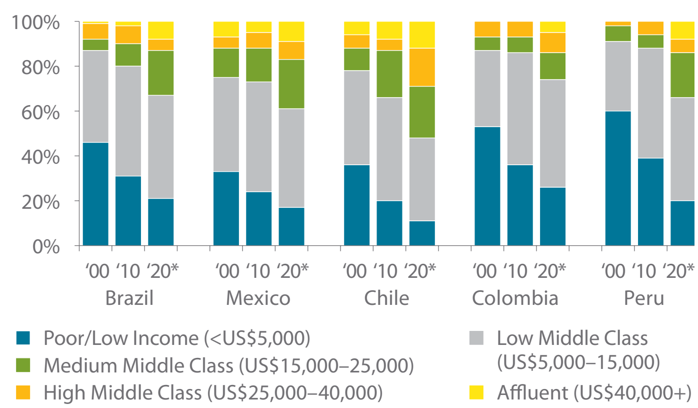


North America



Source: U.S. Census Bureau.

FIGURE 4 | EXPANDING MIDDLE CLASS IN PLAE



Source: BBVA.
*Projected.

the two most populous countries in the PLAE, are expected to experience a boost in their middle and affluent classes, reaching approximately 80% and 85% of their respective populations by 2020. Chile, slightly ahead of the pack, already made notable progress in the early 2000s.

Regardless of economic cycles, the new middle class has established itself as an important driver of the PLAE with its particular and increasingly sophisticated consumption patterns. The Industrial and Service sectors are prioritizing the new middle class to capture growth in excess of the overall economy. The new middle class comprises increasingly educated voters that will look to defend their newly acquired status. It is unlikely this genie will go back in the bottle.

As we have seen in other emerging economies, increased consumption has caused a shift in spending patterns and is expected to continue to drive greater demand for services across the PLAE. These tectonic shifts in consumption patterns create opportunities to tap into growth within defensive sub-sectors or strategies, even when the macro-economy is sluggish.

INCREASING DISPOSABLE INCOME

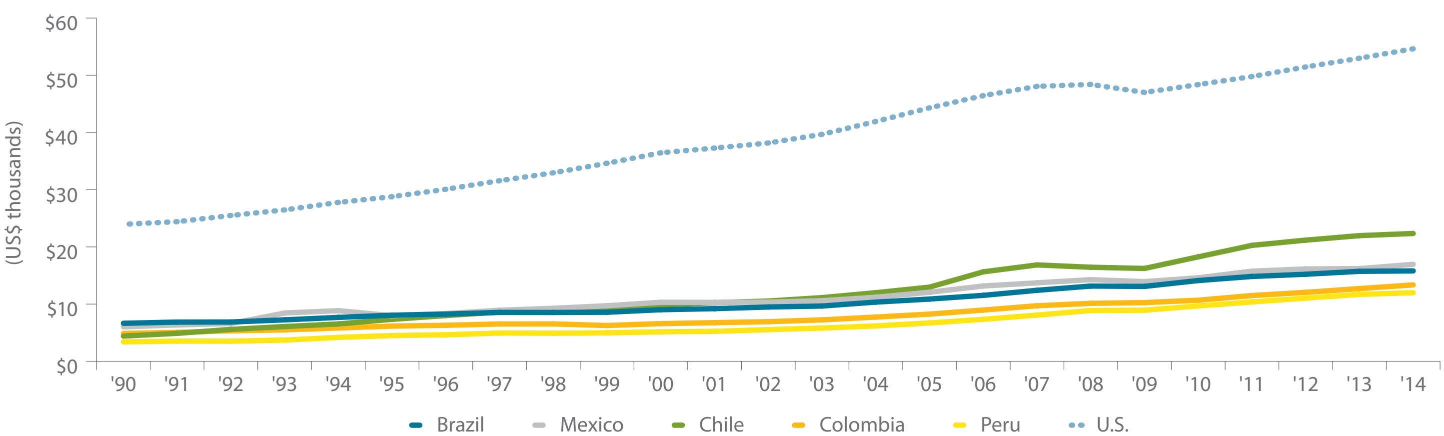
The evolution of per capita GDP in the region has been impressive even though it is still a fraction of US per capita GDP, as shown in **Figure 5**. Higher disposable incomes have created demand for not only increasingly sophisticated consumer products, but also services, such as health and education, for which government-provided alternatives are weak. Additional demand and continued growth in per capita GDP will require major investments that will create direct and indirect private equity opportunities.

INFRASTRUCTURE DEFICIT

The World Economic Forum's Global Competitive Report ranked Brazil's quality of overall infrastructure 114 out of 148. Colombia and Peru also ranked in the bottom half at 117 and 101, respectively, while Mexico was placed 66 and Chile came in at 45. Overall, investments in infrastructure in the region have not kept pace with demand, resulting in a significant deficit.

This repressed demand is likely to provide substantial gains for private equity and infrastructure investors. High levels of expected regional infrastructure investment

FIGURE 5 | GDP PER CAPITA BASED ON PURCHASING POWER PARITY



Source: World Bank data.

are also likely to drive tangential opportunities among infrastructure service providers. As projects are executed, other businesses will benefit from more efficient infrastructure, enabling Latin American businesses to become more competitive globally, which will drive further growth.

Completed infrastructure projects are of high political value to local governments. The recognition of the need to attract capital for these investments is driving reform, making the environment for foreign direct investment ("FDI") more attractive.

The obvious questions to ask when the public sector is involved are whether effective investments will be made, and over what timeframe. Specific initiatives across the PLAE and the point of the economic cycle in which the region finds itself suggest that great efforts are being made and will likely continue to be made on both the regulatory and bureaucratic fronts to secure and streamline infrastructure investments, with increasing emphasis on FDI.

The Brazilian government alone has identified over US$300 billion of private sector infrastructure investments to be executed over the next five years, including 12,000 kilometers of railways, 7,000 kilometers of roads, 15 ports, 32,900 gigawatts of power-generation capacity and 23 kilometers of transmission lines.

The Mexican Ministry of Finance announced a 2014-2018 infrastructure plan worth US$596 billion, of which 40% is to be funded by the private sector. In Colombia and Peru, US$46 billion of private sector infrastructure projects have been identified for prompt execution.[3]

The potential for corruption in greenfield concessions, of course, is always a concern for investors. In light of the highly public Petrobras scandal – and its very real consequences among business leaders and politicians – the trend is clearly towards greater transparency.

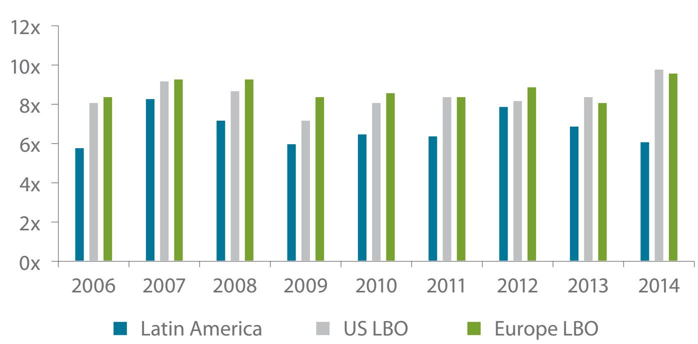
The dislocation caused by the Petrobras corruption scandal has affected major players in the sector, who are selling a significant number of assets, including performing assets, causing downward pricing pressure on the sector and region as a whole. Petrobras alone is expected to sell over US$60 billion in assets over the next fund cycle. StepStone believes that private equity investors have a unique opportunity to lock in attractive risk-adjusted returns in infrastructure investments in the region, particularly in Brazil.

ASSET VALUES

Equity valuations have historically been relatively attractive in Brazil. The 10-year average forward price-to-earnings ratio on the BOVESPA stock exchange is 9.9x compared to 11.0x for the MSCI Emerging Markets Index, 13.0x for the MSCI All Country World Index, and 13.8x for the S&P 500 Index.[4]

StepStone compared data on private equity entry multiples from 139 Latam transactions in its proprietary SPI database from 2006-2014 to LBO entry multiples in the US and Europe tracked by S&P Capital IQ. On average, Latam managers have transacted at significant and consistent discounts to both markets, as shown in **Figure 6**. Currently multiples of 4x to

FIGURE 6 | AVERAGE PRIVATE EQUITY ENTRY EV/EBITDA MULTIPLE



Source: StepStone SPI database, S&P Capital IQ, Leveraged Buyout Review 1Q 2015.

[3] McKinsey Global Institute, Macquarie and Ashmore.
[4] MSCI, JP Morgan Market Insights Research – Brazil First Quarter 2015.

6x EBITDA are not uncommon in Middle Market transactions, and leverage is significantly lower than developed markets, seldom going over 3x EBITDA.

The Brazilian recession has ushered in higher inflation and interest rates, a closing of the IPO window and rising unemployment; it is having a sobering effect on pricing expectations of private equity sellers, creating a buyer's market. Considering that Brazil has been historically responsible for 60% to 75% of private equity investment in Latam, it tends to dictate asset value benchmarks for the rest of the region.

We have seen what happens when recessionary macro-economic factors make capital scarce: top quartile private equity funds do extremely well. **Figure 7** shows that in the US, recessions tend to generate multiple vintages of top quartile returns greater than 15%. Lower entry valuations, tighter credit markets, and greater opportunity for GPs to add value are key reasons why investors in top quartile private equity funds are more highly rewarded in a recessionary environment. While past results are no guarantee of future performance, StepStone thinks that there is little reason to believe that the situation in Latam should be any different. Prices tend to be down when uncertainty is high; but patient capital, that can be active in managing assets better, is usually rewarded for fishing in these troubled waters.

CURRENCY

While hedging private equity currency risk is generally not worthwhile in emerging markets, the recent appreciation of the US dollar against Latam currencies – particularly the Brazilian real and the Colombian peso, which StepStone believes were most overvalued – suggests an attractive entry point in the currency cycle. Many managers use the strategy of staging their investments against the achievement of milestones, which also helps dilute foreign exchange risk by "dollar cost averaging" on entry. The majority of Latam's assets under management ("AUM") is in US dollar-based funds, which ensures that managers are sensitive to currency risk.

FIGURE 7 | UNITED STATES TOP QUARTILE BUYOUT IRR

Source: Thomson Venture Economics data.

REGULATION

Private equity is a highly desirable foreign investment because, unlike "hot money," it is capital that stays for the long term and also tends to bring expertise with it.

Regulators have, therefore, proven eager to create an enabling environment for investors and the industry. Multiple private equity friendly initiatives by regulators and development finance institutions ("DFIs") have benefited the industry and strengthened the manager base over the last 20 years, as illustrated in **Figure 8**.

FIGURE 8 | REGULATORY CHANGES IN THE PLAE

Brazil	Mexico	Andean Region	Initiative	Effect
✓			» In 2005, new bankruptcy laws (Law 11,101/2005) were put in place, replacing 60 year-old laws.	» The new laws are closer to the US model and provided continuity for the going concern.
✓			» In 2000, the BOVESPA created a new classification for companies that had better governance practices.	» Improved liquidity and exit paths for private equity controlled companies.
✓			» In 2003, a regulated private equity fund structure (FIP) was created.	» Enabled Brazilian pension funds to invest in private equity and foreign investors to avoid payment of capital gains at the fund level.
	✓		» In 2009, following the Global Financial Crisis, a structured vehicle (CKD) was created that allowed investment in private equity through a publicly-listed vehicle.	» Allowed Mexican Pension Funds (AFORES) to invest in private equity, which created a significant source of potential funding for local managers.
		✓	» In 2011, the Colombian, Peruvian and Chilean stock exchanges were consolidated.	» Improved liquidity.
✓	✓	✓	» Generalized adoption of arbitrage as a method of resolving conflicts.	» Streamlined the process of resolving conflicts.
✓	✓	✓	» DFIs, such as BNDES, Bancoldex, Nafinsa, Corfo, MIF, IFC, CAF and DEG, adopted initiatives to accelerate the growth of private equity by supporting local GPs.	» Anchor investments became available for new funds.

Source: StepStone analysis.

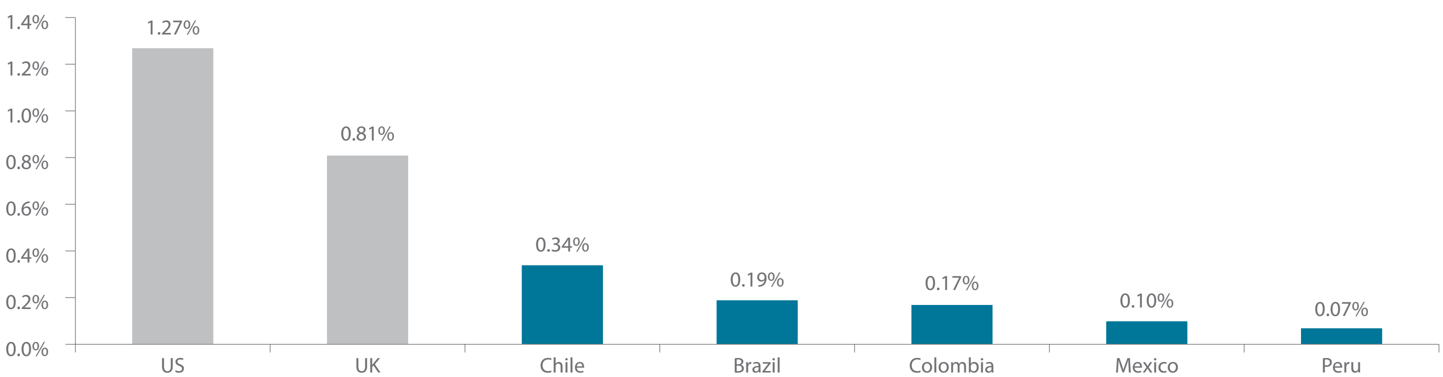
LOW PRIVATE EQUITY PENETRATION

The low penetration rate of private equity in the PLAE relative to more developed countries, as shown in **Figure 9**, illustrates the potential for growth of private equity in the region. Moreover, private equity investments in Latam still represent a fraction of total M&A value in the region – 6% in 2014.[5] This points to the strong potential for expansion relative to both GDP and market share.

Low penetration combined with the fragmented nature of the economies effectively translates into low levels of intermediation. Being primarily a growth equity industry, private equity deals tend to be about partnerships with entrepreneurs rather than auctions. In this context, the purchase price is often not the only consideration; therefore, the intermediary's role is diminished. This means that successful GPs must dedicate significant resources to sourcing deals and building relationships with families and entrepreneurs, a dynamic that favors truly local managers, who have teams on the ground and spend 100% of their time focusing on their local markets.

Long term fundamentals make Latam an attractive destination for private equity investors.

FIGURE 9 | PRIVATE EQUITY PENETRATION AS A PERCENTAGE OF GDP



Source: Empea, LAVCA Industry Report 2015, World Factbook.
As of 2014.

[5] LAVCA, Mergermarket Group.

Maturing Private Equity Market

There are over 200 private equity managers in Latam, many of which have been in existence over 15 years and are on their third, fourth or fifth fund. In Brazil there are over 20 firms with four or more funds; of these, 17 raised their first fund ten or more years ago.[6]

As shown in **Figure 10**, Latam experienced its first cycle of private equity investments in the mid 1990s, a time when local managers were being formed and certain international managers made their first commitments to the region. By 2001, many of these players began to shy away from raising new funds and making new investments as a result of the Asian and Russian crises, the dot com bubble, the Argentinian default crisis and the Worker's Party victory in Brazil in 2002.

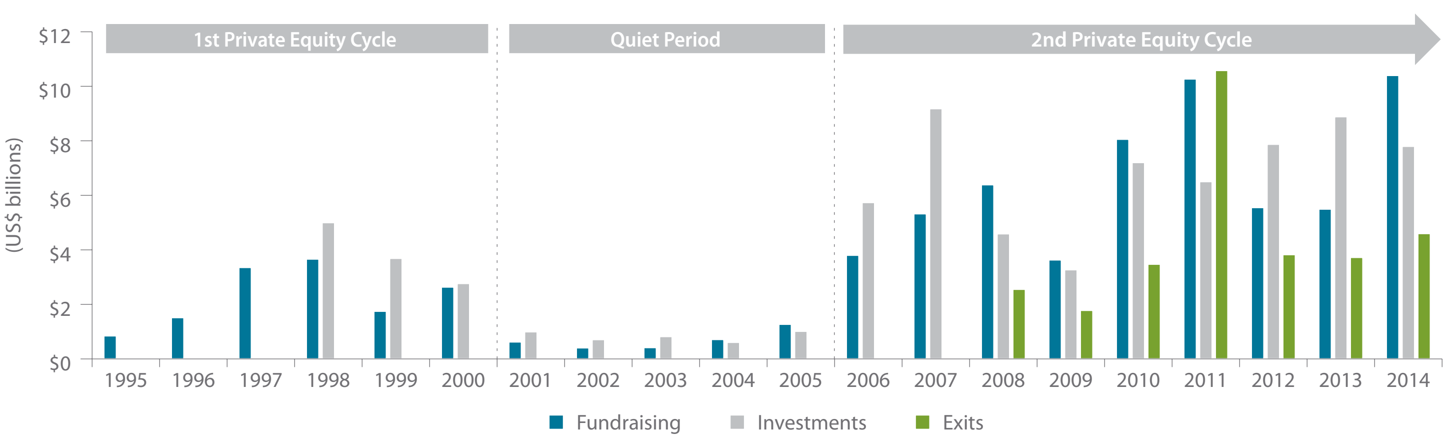
By 2006, however, private equity made a comeback as the commodity super-cycle kicked in and the region demonstrated resilience to multiple crises. The second cycle of private equity, which was marked by the return of international managers and local players raising new funds, was the result of significant GDP growth, an expanding middle class leading to strong consumption, and a more stable political and economic environment relative to the previous decade.

Private equity is particularly relevant for gaining exposure to Latam because public equity market alternatives are somewhat limited. The stock markets in Brazil and Mexico represent a relatively small share of the national GDP, 42% and 35%, respectively, compared to 141% in the US, 155% in the UK, 77% in Korea, and 75% in Japan.[7] The remaining unlisted GDP includes thousands of family-owned businesses, which often operate in highly fragmented industries, many of which are ripe for consolidation. The Latam private equity industry can point to multiple examples of successful execution on this strategy.

FUNDRAISING

Before 2005, annual Latam private equity fundraising was well below US$1 billion per year. Over the last five years the range has been US$5-10 billion. The region raised over US$10 billion in 2014 and as of the third quarter of 2015, there were 59 funds in various stages of the fundraising process seeking combined commitments of over US$13 billion. These amounts exclude global funds that invest in the region, underscoring the extent to which private equity has evolved in the region.

FIGURE 10 | MATURING PRIVATE EQUITY IN LATIN AMERICA



Source: LAVCA data.

[6] Minardi, Kanitz, and Basani, "Private Equity and Venture Capital Industry Performance in Brazil: 1990-2013," The Journal of Private Equity (2013).
[7] MSCI, JP Morgan Market Insights Research – Brazil First Quarter 2015.

WIDE VARIETY OF INVESTMENT APPROACHES

With private equity evolving in Latam, many managers focus on strategies where they have been most successful. This allows investors to select strategies that are the best fit for their portfolios. Investors can choose among managers that are regional or country specialists, generalists or sector-focused; pursuing equity or debt strategies; Large or Middle Market players; Buyout or Growth Equity experts, or passive minority or hands-on majority-interest seekers.

Selecting the most qualified managers within each chosen strategy is critical to generating differentiated returns. A pan-Latam portfolio should ideally grow to include both regional and local strategies to best capture pricing inefficiencies and dislocations across the region.

EXITS

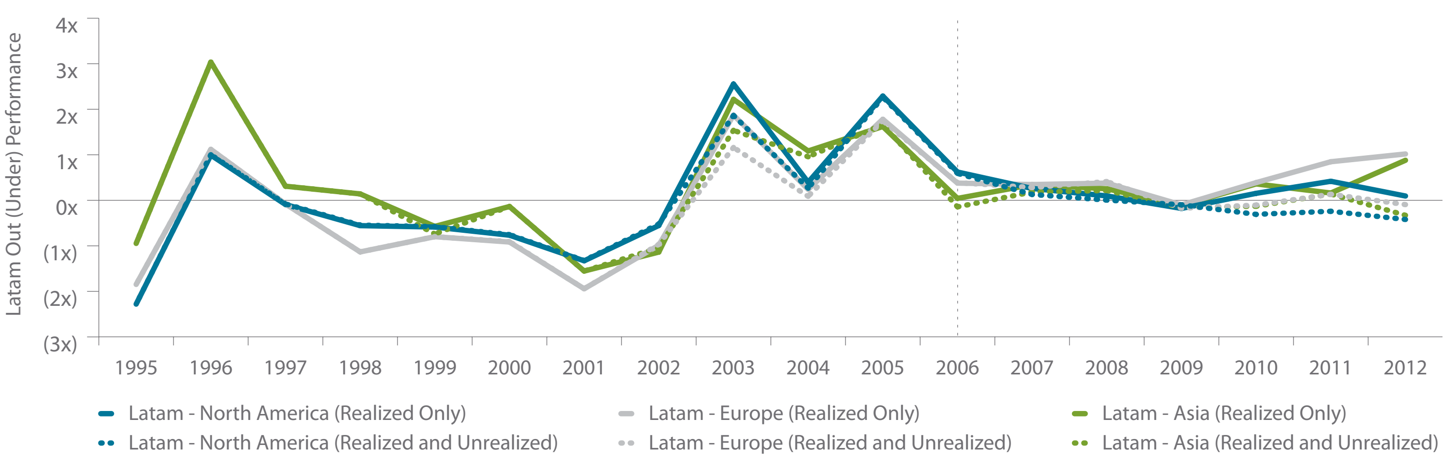
Although there have been many successful private equity-backed IPOs in the last decade, it is a window that opens and closes. In addition to strategic exits, which have been abundant, the growing aggregate AUM and number of industry participants (including foreign-based GPs) is paving the way towards increased-sponsor to-sponsor transactions, establishing a clear third exit alternative.

Performance

To analyze the performance of private equity in Latam in the absence of robust fund-level data, StepStone compared the performance of Latam private equity deals completed by both global and regional funds to private equity deals completed in other major geographies. For this analysis, StepStone leveraged its proprietary SPI and Direct Access databases, which included 337 Latam deals (231 realized and 106 unrealized) completed between 1995 and 2012. The dataset included Private Equity, Real Estate and Real Assets (including Infrastructure and Energy) deals but excluded Venture Capital deals. Deals completed after 2012 were excluded as they were too young to have meaningful performance.[8]

Figure 11 shows the difference between the gross total value multiple ("TVM") of Latam deals and those of other regions.[9] Before 2005, Latam investments showed mixed results relative to other regions. Latam's private equity market was still young and fewer investments were completed compared to more recent years. Latam investments outperformed the other regions in 1996, 2003 and 2005 largely due to outliers — a 1996 Mexican investment returned nearly 20x the invested capital; a 2003 Brazilan investment returned nearly 14x invested capital; and another 2005 Brazilian investments returned 8x invested capital.

FIGURE 11 | LATAM PRIVATE EQUITY PERFORMANCE RELATIVE TO OTHER REGIONS



Source: SPI, Direct Access, StepStone analysis.

[8] The databases also provided 12,235 North American deals (9,050 realized and 3,185 unrealized), 4,164 European deals (3,228 realized and 936 unrealized) and 1,600 Asian deals (1,087 realized and 513 unrealized), for the same time period.

[9] Average TVM is calculated on an equal-weighted basis; weighted average TVM show a similar trend unless otherwise indicated.

For the most recent six-year period from 2006-2012, which represents the ongoing second private equity cycle in Latam, fully realized Latam deals outperformed fully realized deals in other regions in all vintages except 2009, when Latam performed only marginally worse than the other regions. Results including unrealized deals are more mixed but are more in line with other regions than they were in the past.

Finally, as shown in **Figure 12**, Latam's loss ratio has declined meaningfully, falling from 47% from 1995–2005 to 14% after 2005, from being the highest compared to other regions to being the lowest, suggesting decreased risk levels.

StepStone believes that the outperformance of Latam deals starting in 2003 is attributable to a combination of factors, including lower entry multiples, high-growth businesses, and less competition given the lower penetration of private equity in the region, as previously shown in Figure 9.

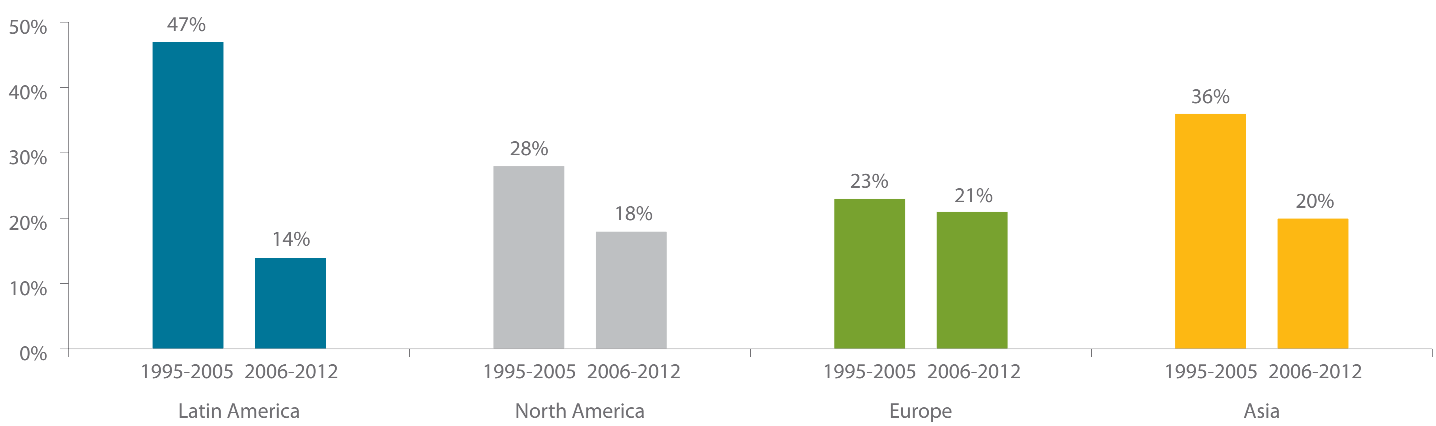
Since our performance calculation was based on deal-level information, there is no assurance that individual funds would have performed at this level. It does show, however, that barring some negative bias at the GP level, on average, Latam private equity should be as attractive — or even more so — than other geographies.

This comparative analysis is not intended to diminish the attractiveness and importance of any of the other geographies as an investment destination. Instead, our intent is to demonstrate that the Latam region has been consistently competitive with other geographies in terms of returns. As in all geographies, sectors and strategies, manager selection is key to returns ultimately achieved.

Compelling Investment Theses

2015 brought with it weaker Chinese demand, lower growth, and currency devaluations throughout the region. While growth in the middle class has not disappeared, the rising tide will no longer lift all boats. The growing middle class, with expanded but slower growing disposable income, is becoming more prudent, moderating its use of leverage and being more selective with regard to its expenditures.

FIGURE 12 | AVERAGE LOSS RATIO BY REGION (INCLUDES REALIZED AND UNREALIZED DEALS)



Source: SPI, Direct Access, StepStone analysis.

Outsized returns, however, can still be achieved by focusing on select regions, subsectors and themes. There are a number of secondary and tertiary cities throughout the region that, for a variety of reasons, have grown well in excess of the national averages. Consolidation strategies and defensive or scalable sectors, such as Healthcare, Education and Technology, as shown in **Figure 13**, should also continue to outperform.

Growth in Brazil was lower than expected in 2014. Even so, StepStone has seen a number of private equity firms that managed to create meaningful value in their portfolio companies, achieving double-digit year-over-year revenue and EBITDA growth. The sectors mentioned above have demonstrated resilience in the current recessionary environment.

Sectors that address the supply side of the equation, such as Logistics and Infrastructure de-bottlenecking themes, should continue to outperform as well. The BR-163, a new highway in Brazil that provides a shortcut through the Amazon to the waterways, serves as an exit route for soybean exports. Both the BR-163 and the newly awarded Colombian transnational highways will undoubtedly create numerous opportunities as they change the regional economics of transporting goods.

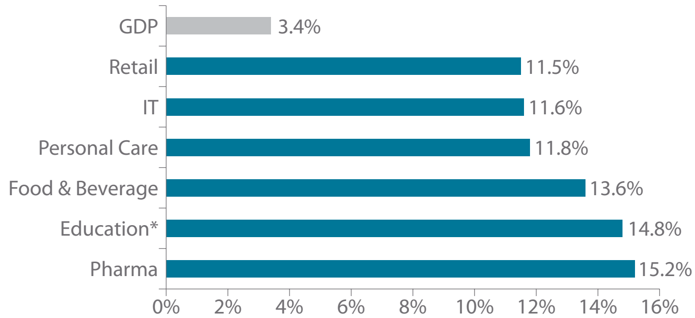
Finally, as mentioned before, the Petrobras scandal, combined with oil price declines, is causing a historical dislocation of major consequence in the Shipbuilding, Engineering and Construction industries and spreading out to their supplier bases.

Risks

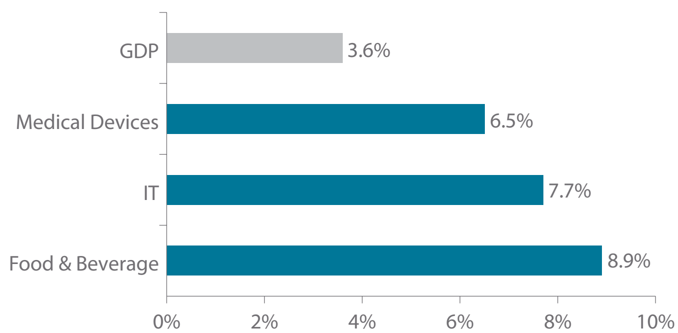
StepStone is comfortable – for the reasons cited above – that the overall level of business risk in Latam has greatly decreased over the last 15 years. Nevertheless, one must be careful when navigating in troubled waters; certain risks should be considered when making an investment in the region. Among them are currency risk, global macro risks that can affect capital flows to emerging markets, and individual country vulnerabilities, such as reliance on commodity prices or correlation with other economies (e.g. Mexico's correlation with the US economy).

FIGURE 13 | HIGH GROWTH SECTORS IN BRAZIL AND MEXICO

Brazilian Sectors CAGR 2007 - 2013



Mexican Sectors CAGR 2009 - 2013



Source: World Bank, Votorantim Research, ABIA, ABIHPEC, Euromonitor, Ipeadata, BMI Research, Canifarma.
*Education CAGR based on 2009-2012 data.

Proper manager selection is essential to minimize risks inherent to emerging markets.

All geographies have their inherent risks but, in private equity, top-quartile managers deliver good returns across all economic cycles. The risks inherent to Latam and Emerging Markets are to a large extent diversifiable; given the size of the PLAE market, a modest overweight allocation, with a skew toward longer horizon investments, makes good sense.

Conclusion

The Latam – and more specifically PLAE – investment thesis is an ongoing story. Macroeconomic storm clouds are roiling the waters in the region, but experienced anglers know that troubled waters can provide good fishing. In Brazil, a slow economy, high interest rates, and a reduced role for state-owned banks should usher in a period of lower purchase multiples, providing excellent opportunities for managers. Mexico will likely see opportunities in the Energy Oil Services, Financial Services, Manufacturing and Consumer sectors. The Andean region should continue to produce compelling infrastructure related opportunities and should reap the benefits of its macro outperformance and the relative good health of its public and household balance sheets.

While good fishing may be possible, troubled waters are not without challenges. Fortunately, there is a wealth of experienced hands to partner with. The rise of a qualified and experienced manager class over the last two decades provides LPs with options. A good grasp of the skill sets and track records of local sponsors is critical to navigate the currents. It is no coincidence that a number of global private equity managers, foreign pension funds and sovereign wealth funds have recently opened offices in the region. Despite the stormy weather, the combination of sound macroeconomic policies, attractive demographics, rising per capita GDP, fragmented industries, low private equity penetration, low entry multiples and strong absolute and relative returns over the past decade provide a compelling reason to consider incremental allocation to the region. It could provide for good fishing.

StepStone is a global private markets firm overseeing US$70 billion of private capital allocations, including approximately US$12 billion of assets under management.

The Firm creates customized portfolios for the world's most sophisticated investors using a highly disciplined research-focused approach that prudently integrates primaries, secondaries, and co-investments.

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