KNOSSOS ASSET MANAGEMENT

AN AFFILIATED COMPANY OF MIURA CAPITAL

Venezuela/PDVSA Monthly Report
December 2019

As 2019 closed, we assess it as one of the most volatile and interesting years for the Venezuelan debt. Even when the last quarter was mostly quiet and prices seemed to be stabilized in the 8 – 12 cents, it's worth to have a look to Chart N° 1 to remind how this year started with Venezuelan debt trading near 34 cents (1) amid a high optimism about regime change, with Juan Guaidó being recognized as interim president by the US and other 50 countries. Since then different measures of pressure started to be applied to the Nicolás Maduro administration, including sanctions on the Republic and PDVSA that halted the bond market (2).

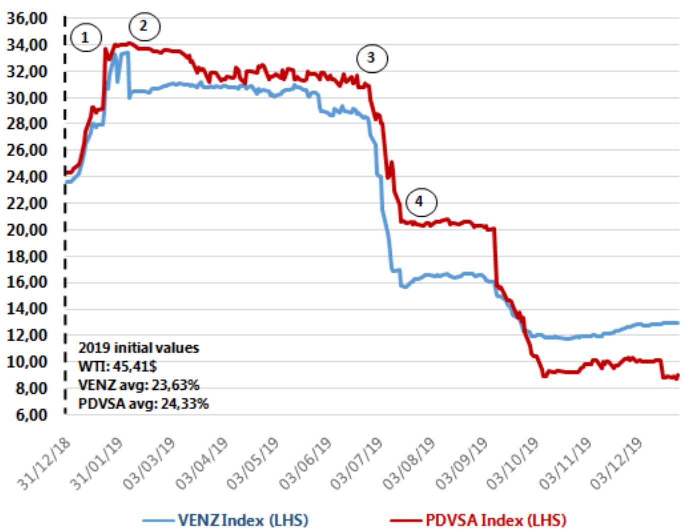

Chart N°1: VENZ/PDVSA bond indexes, 2019.
Source: Bloomberg, Knossos Asset Management.

Other relevant developments that shaped Venezuelan debt prices also include the decision of JP Morgan to reduce its weight from EMBI indexes (3) and the effect of OFAC General License 5A (GL 5A) (4) that prevents creditors to seize CITGO shares. JP Morgan action caused the forced selling that sent prices from 30 cents to below 22 cents in July, as passive funds were rebalancing their portfolios to meet the new composition of the indexes.

GL 5A was issued in August but had a lagged effect, as the market took some time to figure out what that meant for PDVSA 2020 bond and the coupon payment expected for October. Previously in April, US authorized a coupon payment from PDVSA 2020 bond that required the use of funds in frozen accounts and avoided a potential demand for CITGO shares. After GL 5A this kind of support wasn't necessary anymore so PDVSA 2020 –the last current bond– defaulted the coupon payment, and now the interim government is taking advantage of this protection to manage negotiations with creditors.

Security	29/11/2019	31/12/2019	Total Return	Total Return (2019 YTD)
VENZ 6 12/09/20	11,00	**11,85**	+7,73%	-48,65%
VENZ 12 3/4 08/23/22	11,90	**11,80**	-0,84%	-50,63%
VENZ 9 05/07/23	11,40	**11,85**	+3,95%	-48,65%
VENZ 8 1/4 10/13/24	11,60	**11,75**	+1,29%	-49,00%
VENZ 7.65 04/21/25	11,45	**11,90**	+3,93%	-47,96%
VENZ 11 3/4 10/21/26	11,80	**11,90**	+0,85%	-51,72%
VENZ 9 1/4 09/15/27	11,45	**12,00**	+4,80%	-48,46%
VENZ 9 1/4 05/07/28	11,85	**11,85**	-	-48,40%
VENZ 11.95 08/05/31	11,80	**11,95**	+1,27%	-49,20%
VENZ 9 3/8 01/13/34	11,80	**11,80**	-	-58,55%
VENZ 7 03/31/38	11,30	**11,65**	+3,10%	-48,67%
PDVSA 8 1/2 10/27/20	31,95	**17,35**	-45,70%	-81,45%
PDVSA 9 11/17/21	7,90	**8,05**	+1,90%	-56,22%
PDVSA 12 3/4 02/17/22	7,70	**8,15**	+5,84%	-57,53%
PDVSA 6 05/16/24	8,00	**8,10**	+1,25%	-46,10%
PDVSA 6 11/15/26	7,60	**8,00**	+5,26%	-46,72%
PDVSA 5 3/8 04/12/27	7,60	**7,60**	-	-49,50%
PDVSA 9 3/4 05/17/35	8,25	**8,20**	-0,61%	-57,06%
PDVSA 5 1/2 04/12/37	7,85	**7,95**	+1,27%	-47,13%

Table N° 1: Venezuela/PDVSA bond performance, December 2019.
Source: Bloomberg CBBT, Knossos Asset Management. ***Note: Returns were adjusted to account for the accrued interest lost, per EMTA resolutions.**

Anyway, creditors and bondholders keep putting efforts to get the best place in the queue to recover value from CITGO, in case the interim administration can't find a solution and the protection of the refinery vanish at some point in the future. If this was the case, we see the interim government facing a significant risk of hostile negotiations, because holdouts have probably increased their positions in Venezuelan debt.

Regarding the strategy outlined by Juan Guaidó to oust Maduro from power (cessation of the usurpation, transition government and free elections), among most notable events we can find the attempt to introduce humanitarian aid to Venezuela through the borders with Colombia and Brazil late in February, that was carried out by Guaidó and international allies to challenged Maduro authority, who had always denied the humanitarian needs of the country. This action was intended to fracture the military coalition surrounding Maduro, but even when some soldiers escaped to Colombia and Brazil, the army stayed loyal to him. Later in April there was a coup d'état attempt that resulted in the release of Leopoldo López, one of the most prominent opposition leaders who was under military custody, but this event neither achieve the fracture of the military coalition.

In early March a national blackout sharpened the already critical situation and made clear how weak the power system is. As this weakness is common with almost all public services, in July the interim government issued the "Guidelines for the renegotiation of the public external debt inherited from the Chávez/Maduro period" and stated that payment of the debt would be contingent to the economic recovery of the country. Guaidó administration had received advice from Lee Buchheit and expects to receive support from the IMF at the time of the restructuring, which is expected to begin after regime change.

On January 5th Guaidó was confirmed as president of the National Assembly for the next one-year period, which means he will continue in his role as interim president. Also on that date deputy Luis Parra and others tried to establish new authorities for the National Assembly, excluding Guaidó. This action was disowned by the international allies of Guaidó and US issued sanction on Parra and his helpers on January 13th.

What we expect to hear from Venezuela in 2020?

As negotiations continue their way, the consensus in the market seems to be strengthening around the scenario where Maduro stays leading the executive branch of the government, with Guaidó leading the legislative branch, until any kind of agreement is achieved. According the Venezuelan constitution, 2020 is an electoral year as the members of the National Assembly are to be elected. Given that electoral authorities have to be endorsed by the National Assembly before those elections, and this is a focal point in the negotiations between Maduro and Guaidó, we expect some actions from both parties in this direction.

Meanwhile, we are closely monitoring news and identifying drivers for debt prices increases as current price levels seems attractive considering historical recovery values. We expect changes in the oil sector and accordingly we maintain our positive view regarding the potential effects of easing the sanctions on the industry, and the upside it represents if lighter sanctions reach the secondary debt market.

Such an event could take prices to above 25 cents (pre-sanctions levels seen in January 2019). On the other hand, we could see prices around 5 cents if Venezuelan debt trades at the same level as Cuban debt for example. However, we consider the downside limited because trading Venezuelan debt is already under sanctions, so current price levels are probably the worst case scenario, leaving plenty of room to be constructive about Venezuelan debt in the years to come.

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