KNOSSOS ASSET MANAGEMENT
AN AFFILIATED COMPANY OF MIURA

Venezuela/PDVSA Monthly Report
June 2019

Ending June, Venezuelan debt market reaches five months practically paralyzed due to OFAC sanctions put in place on January 28th when the Treasury Department included PDVSA and Venezuela on the SDN list, banning US citizens and corporations from Venezuelan debt trading.

Since then illiquidity and spreads turned almost worthless any price and yield curve analysis. Prices available at the end of June remain misleading, as they don't reflect reasonable prices to close an operation under the current market conditions.

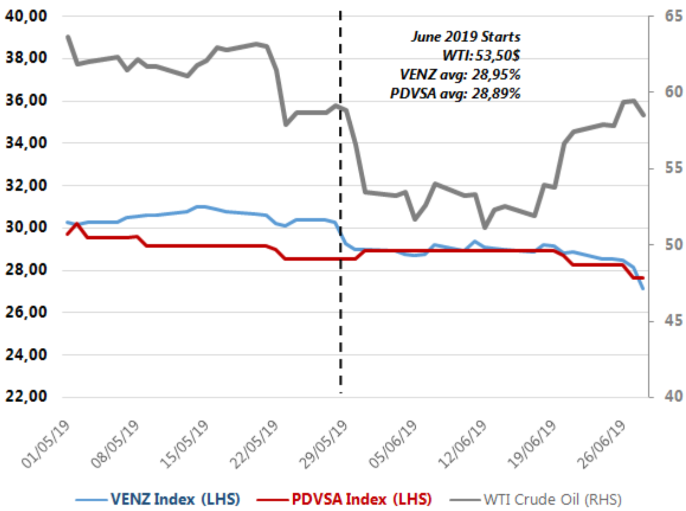

Chart N°1: VENZ/PDVSA bond indexes and oil prices, May-Jun 2019.
Source: Bloomberg, Knossos Asset Management.

According to our indexes, Venezuelan debt average prices were around 28 cents at the close of June, with monthly average near to 29 cents. Nevertheless, Bloomberg News reports JPMorgan Chase and Jefferies quoting around 20 cents for the sovereign debt, and around 15 cents for PDVSA, at the end of June.

These price levels appeared in Bloomberg terminal with some delay, during July's second week. They would have resulted after a sharp selloff related to the portfolio rebalances carried out by traders trying to anticipate Venezuelan bonds exclusion from JPMorgan EMBIG Diversified Index, in which this debt represents 1%.

At the moment there's no information about volumes negotiated, or who participated in the trades. We can only assume that they were transactions between non-US persons, or involving an US person on the sell side, and a non-US person on the buy side.

Security	31/05/2019	28/06/2019	Total Return	Total Return (2019 YTD)
VENZ 13 5/8 08/15/18	31,10	31,10		+31,53%
VENZ 7 12/01/18	28,30	28,30		+32,41%
VENZ 7 3/4 10/13/19	28,30	27,75	-1,94%	+16,86%
VENZ 6 12/09/20	28,60	25,70	-10,14%	+11,51%
VENZ 12 3/4 08/23/22	28,80	27,20	-5,56%	+13,87%
VENZ 9 05/07/23	29,45	27,15	-7,81%	+17,88%
VENZ 8 1/4 10/13/24	28,50	26,95	-5,44%	+16,72%
VENZ 7.65 04/21/25	28,80	27,75	-3,65%	+21,24%
VENZ 11 3/4 10/21/26	29,00	26,75	-7,76%	+8,82%
VENZ 9 1/4 09/15/27	29,85	26,65	-10,72%	+14,70%
VENZ 9 1/4 05/07/28	28,40	26,65	-6,16%	+15,93%
VENZ 11.95 08/05/31	28,80	26,75	-7,12%	+13,71%
VENZ 9 3/8 01/13/34	29,15	27,35	-6,17%	-3,75%
VENZ 7 03/31/38	28,10	26,85	-4,45%	+18,11%
PDVSA 8 1/2 10/27/20	89,80	89,20	-0,67%	-4,71%
PDVSA 9 11/17/21	27,55	22,45	-18,51%	+21,93%
PDVSA 12 3/4 02/17/22	27,30	27,00	-1,10%	+40,92%
PDVSA 6 05/16/24	24,75	22,60	-8,69%	+50,12%
PDVSA 6 11/15/26	23,30	22,45	-3,65%	+49,31%
PDVSA 5 3/8 04/12/27	24,25	22,35	-7,84%	+48,39%
PDVSA 9 3/4 05/17/35	28,70	23,35	-18,64%	+22,14%
PDVSA 5 1/2 04/12/37	22,70	22,10	-2,64%	+46,66%

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

The decision of JPMorgan, expected for June 28th, was released on July 9th when they announced Venezuelan debt weight is going to be gradually reduced, but it's not going to be excluded, within the next five months. We think this decision will turn Venezuelan debt market into a smaller a less liquid market.

It will also have significant impact on ETF's in comparison with mutual funds, which we expect to be less prone to reduce Venezuelan debt holdings. We also think Venezuelan debt sold by ETFs could be bought for more litigious and aggressive funds, which increases the risk of holdouts at the moment of the restructuring.

In an effort to recover control over CITGO Maduro's administration recently introduced a demand in a US court. Considering the relative success Guaidó and his team have had when safeguarding Venezuelan assets in US courts, we think this won't have any significant effects so the interim government will continue managing the refinery.

Negotiations promoted by Norway are expected to be resumed during the second week of July. These were deferred after a navy soldier, Rafael Acosta Arévalo, died under the custody of the DGCIM, a military counterintelligence agency.

Just one thing is for sure: more time spent is always lower recovery value

As we have said along the first half of 2019, expected recovery value of the Venezuelan debt is highly sensitive to time consumed by the political crisis, and its results. Passage of time plays against creditors' interests, given worsening economic conditions in the country increasing financing needs to rebuild the nation and return to the growth path translates in decreasing availability of resources for creditors.

However, passage of time has also narrowed the spectrum of possible outcomes for this situation, allowing market participants to discard some options while others are confirmed, or new clues about the restructuring process are revealed.

On July 1st Guaidó's administration through the Office of the Attorney General issued a document to let know its intentions to carry out a comprehensive, orderly and consensual restructuration. This document which can also be referred as "Guidelines for the renegotiation of the public external debt inherited from the Chávez/Maduro period" also stated that restructuring process will only begin after usurpation ends.

We would like to highlight some aspects of the guidelines. First, all liabilities will receive the same treatment, regardless the type of financial instrument that supports it. Second, there will be a reconciliation agent to perform an audit of the claims. At the moment it is unclear if the reconciliation agent is going to be a person or a team, nor the criteria to execute the assigned tasks.

Also, the guidelines clearly establish that claims guaranteed with assets belonging to the Republic or the public sector will benefit legitimate preferential treatment. This confirms the conditions in which PDVSA 2020 bond would be restructured.

Even thought there isn't any reference to the expected recovery value, guidelines point that debt refinancing will be influence by recommendations from an IMF assessment, to be done once the transition begins and an assistance program can be put in place. Finally, the document asks creditors to refrain from starting or continuing legal actions against Venezuelan issuers, since these will not give any advantage to those claims during the restructuring process.

This statement is far from constituting the "non-aggression agreement" we have suggested in previous reports, but it is a signal of the good faith of the transitional government to assume the task of renegotiate the debt. Nonetheless, we believe this action will be enough to please less hostile and larger holders, as in fact was confirmed by the statement issued on July 9 by the Venezuelan Creditors Committee.

It is in creditors' best interests that Venezuela keeps the assets that will facilitate its recovery, but in our opinion the document issued by the Attorney General is not sufficient to contain the attacks of the most aggressive creditors. The Attorney General seems to be aware of this, as he has declared that he expects an asset protection order to be issued by the time the next pay date of PDVSA 2020 arrives, revealing that the interim government will need to do more to protect the country's assets while getting around the uncertain road to transition.

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