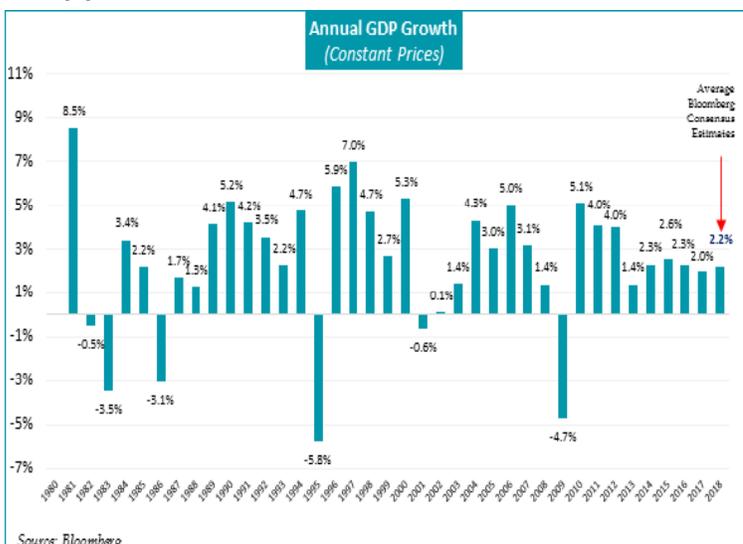


## THE MXE'S SEMI-ANNUAL REPORT ON THE ECONOMY JANUARY, 2018

### The Economy

In the second half of 2017 Mexico faced a difficult economic situation due to: (i) the impact of major natural disasters, including two strong earthquakes and a hurricane in the Gulf of Mexico; (ii) monetary policy tightening in order to deal with ongoing high inflation during the year; (iii) a complicated North American Free Trade Agreement (NAFTA) renegotiation process and its reverberations; and (iv) a more volatile US dollar—Mexican peso exchange rate. Nevertheless, in 2017, Mexico managed to register real annual growth of 2.0%, its fifth consecutive year at or above 2.0% (*Exhibit 1*). Annual growth rates for the third and fourth quarters were 1.6% and 1.5% (*Exhibit 2*), respectively, reflecting a slowdown of the Mexican economy due to relatively weaker consumption and private local investment, which could continue in the first half of 2018, given the uncertainty surrounding the NAFTA negotiations in March and April, and the July 1st elections for the Presidency, Congress, the Senate and nine states. However, the Bloomberg analyst 2018 growth consensus is 2.2%.

*Exhibit 1*



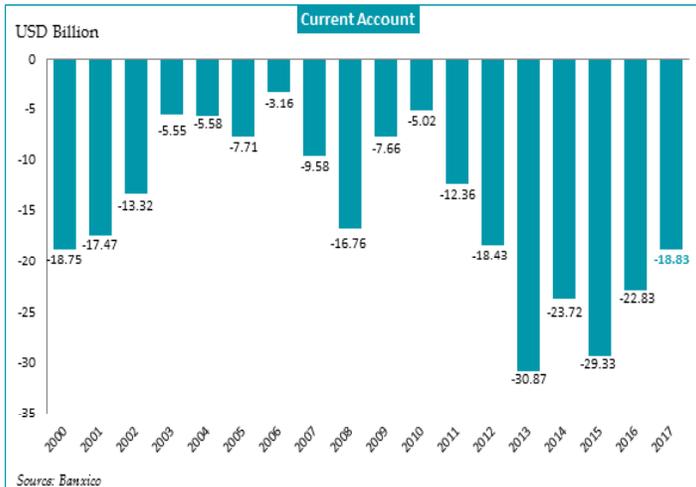
*Exhibit 2*



### Foreign Investment and External Accounts

Among factors favoring the Mexican Economy in the second half of 2017, external accounts and foreign direct investment deserve special mention. In 2017, Mexico's current account deficit corrected from US\$ 22.8 billion in 2016 to US\$18.8 billion in 2017 (*Exhibit 3*), a significant 17% reduction, due to (i) a smaller trade balance deficit (*Exhibit 4*)—which includes an increase in Mexico's substantial trade surplus with the U.S. to more than US\$ 70 billion dollars; and (ii) a new historical record of more than US\$ 28 billion in remittances from Mexicans living abroad (*Exhibit 5*). Even with the uncertainty generated by the NAFTA negotiations, preliminary foreign direct investment amounted to US\$ 29.7 billion in 2017, an increase of 11.1% compared to US\$ 26.7 billion in 2016 (*Exhibit 6*). No clear conclusions can be drawn regarding the impact that US fiscal reform could have on traditional foreign investment directed to the manufacturing sector; however, new foreign investment arising from the energy reform has proven to be overwhelming with a commitment of more than US\$ 144 billion to be deployed over the coming years (*Exhibit 7*); of that amount, almost US\$ 93 billion dollars were committed during the deep waters auction that took place on January 3, 2018.

*Exhibit 3*



*Exhibit 4*

Exports							
	2016	% of Total	Annual Change	2017	% of Total	Annual Change	Dec-17
<b>Total Exports</b>	<b>373,939</b>	<b>100.0%</b>	<b>-1.7%</b>	<b>409,494</b>	<b>100.0%</b>	<b>9.5%</b>	<b>35,825</b>
Oil	18,818	5.0%	-18.54%	23,608	6%	25.3%	2,857
Crude Oil	15,575	4.2%	-15.59%	19,930	5%	28.0%	2,351
Others	3,243	0.9%	-30.24%	3,678	1%	13.4%	306
<b>Non-Oil</b>	<b>355,122</b>	<b>95.0%</b>	<b>-0.65%</b>	<b>385,886</b>	<b>94%</b>	<b>8.7%</b>	<b>33,168</b>
Agricultural	14,672	3.9%	13.12%	15,974	4%	8.9%	1,511
Mining	4,368	1.2%	-3.02%	5,427	1%	24.2%	476
Manufacturing	336,081	89.9%	-1.15%	364,485	89%	8.5%	31,181
Automotive Industry	113,316	30.3%	-1.03%	126,671	31%	11.8%	10,747
Others	222,765	59.6%	-1.20%	237,814	58%	6.8%	20,435
Imports							
	2016	% of Total	Annual Change	2017	% of Total	Annual Change	Dec-17
<b>Total Imports</b>	<b>387,064</b>	<b>100.0%</b>	<b>-2.1%</b>	<b>420,369</b>	<b>100%</b>	<b>8.6%</b>	<b>35,982</b>
Oil	31,566	8.2%	-6.3%	42,010	10.0%	32.4%	4,388
<b>Non-Oil</b>	<b>355,498</b>	<b>91.8%</b>	<b>-3.7%</b>	<b>378,359</b>	<b>90.0%</b>	<b>5.1%</b>	<b>31,593</b>
Consumption Goods	40,374	10.4%	-6.6%	42,207	10.1%	4.8%	3,679
Intermediate Goods	275,005	71.0%	-0.7%	294,638	70.1%	7.1%	24,190
Capital Goods	40,120	10.4%	-3.8%	41,414	9.9%	3.2%	3,725
Trade Balance							
	2016	2017	Dec-17				
Trade Balance	-13,125	-10,873	-157				

Sources: Mexico's Ministry of Economics  
Amounts in Millions of Dollars

## THE MXE's SEMI-ANNUAL REPORT ON THE ECONOMY JANUARY 31, 2018

Exhibit 5.

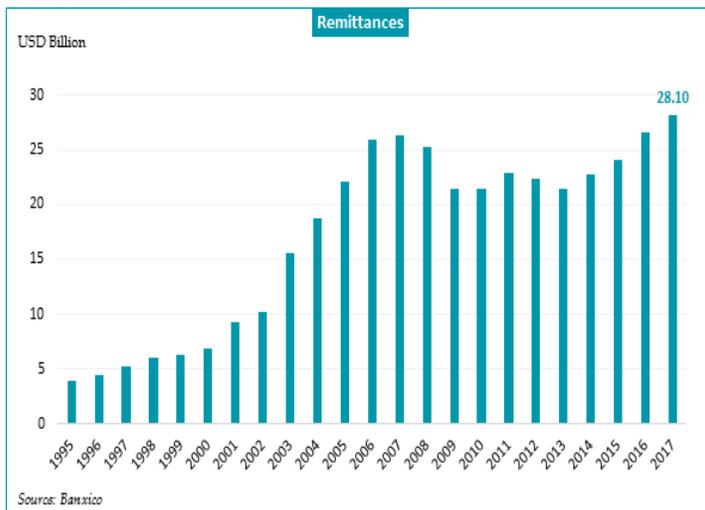


Exhibit 6.

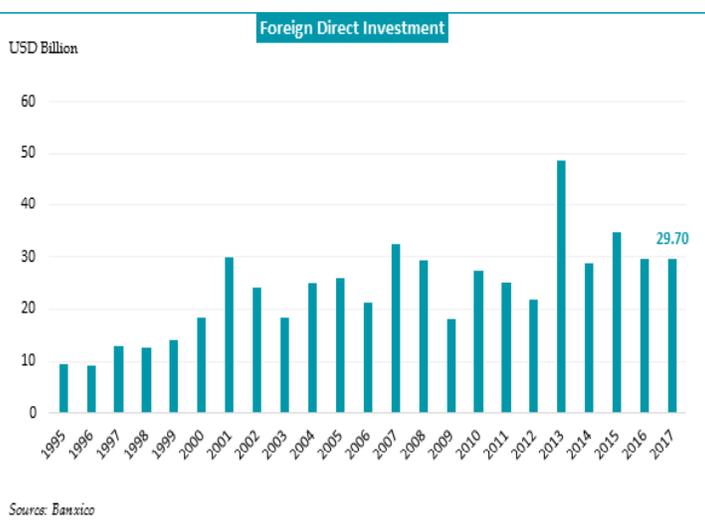


Exhibit 7.

Foreign Investment Linked to Energy Reform					
ROUND ONE AUCTIONS, 2015-2016					
Date	Auctions	Contractual Area	Committed Investment (Million Dollars)	Estimated Production (Thousand barrels per day)	Assigned (%)
15-Jul-15	1.1	Shallow waters in the Gulf of Mexico	2,709	79	14%
30-Sep-15	1.2	Shallow waters in the Gulf of Mexico	3,148	124	75%
15-Dec-15	1.3	Onshore areas	1,141	70	100%
5-Dec-16	1.4	Exploration and extraction areas in deep waters	34,352	732	80%
<b>SUBTOTAL</b>			<b>41,350</b>		
ROUND TWO AUCTIONS, 2017-2018					
Date	Auctions	Contractual Area	Committed Investment (Million Dollars)	Estimated Production (Thousand barrels per day)	Assigned (%)
19-Jun-17	2.1	Exploration and extraction areas in shallow waters	8,193	186	67%
12-Jul-17	2.2	Onshore areas	1,100	69	70%
12-Jul-17	2.3	Onshore areas	964	102	100%
31-Jan-18	2.4	Deep Waters	92,794	1,500	66%
<b>SUBTOTAL</b>			<b>103,050</b>		
<b>TOTAL</b>			<b>144,400</b>		

Source: Ministry of Finance

## Inflation & Monetary Policy

In January 2017, the liberalization of gasoline prices triggered a major jump in the consumer price index that lasted the entire year. By the end of 2017, consumer inflation was 6.77% and core inflation 4.87% (Exhibit 8). To address this problem, Banco de México (Banxico, the Mexican central bank) adopted a restrictive monetary policy consisting of six hikes in its reference rate, the last two in the second half of the year. Consequently, in 2017, Banxico's reference rate increased from 5.75% to 7.50% (+175 basis points) (Exhibit 9). By January 2018, consumer inflation had eased to 5.55% (-122 basis points); the monetary authority believes that the annual inflation target of 3.00% will be achieved in the first quarter of 2019. There is the possibility of further increases in Banxico's reference rate if inflation remains high and/or if Banxico decides to follow the increases in the FED's reference rate expected for this year in order to preserve peso stability against the U.S. dollar.

Exhibit 8.

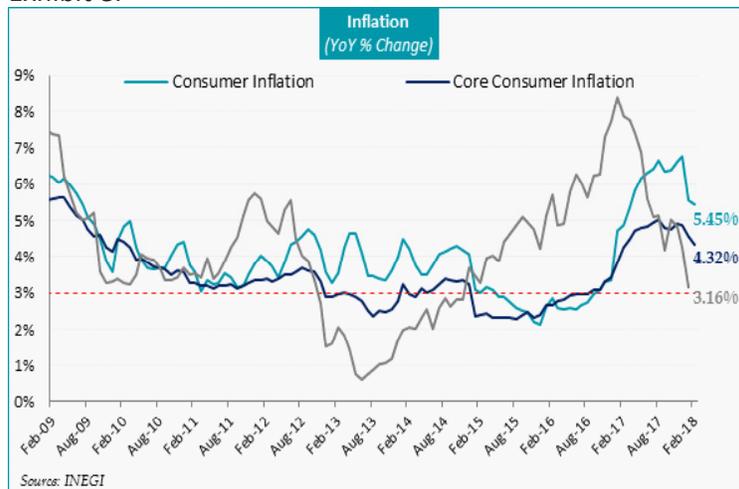
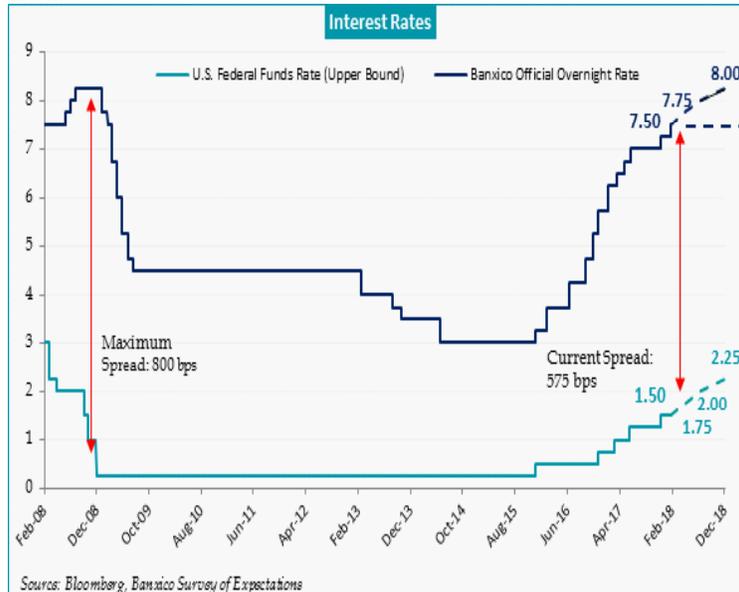


Exhibit 9.

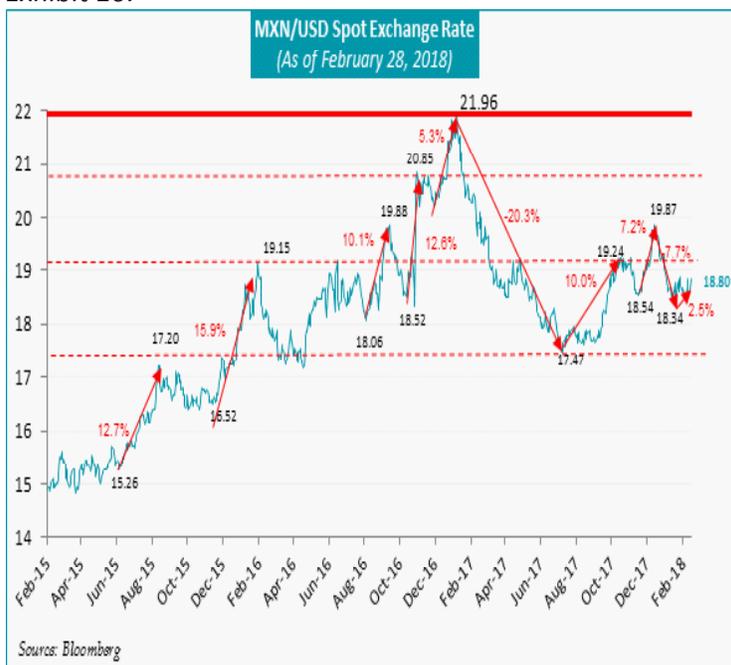


## THE MXE's SEMI-ANNUAL REPORT ON THE ECONOMY JANUARY 31, 2018

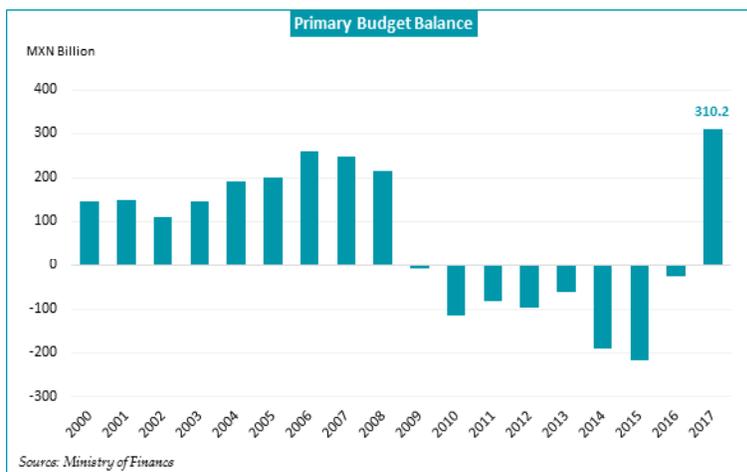
### Exchange rate

During 2017, the Mexican peso appreciated by almost 5% against U.S. dollar closing the year at MX\$19.66 (*Exhibit 10*). However, this appreciation doesn't tell the whole history; since the beginning of the year through July 14th, the Mexican peso recorded a remarkable 15% appreciation against the U.S. currency reflecting solid economic performance, an upward revision to growth forecasts and the sound correction of public finances that led Standard & Poor's and Fitch rating agencies to withdraw their negative outlook on Mexico's sovereign debt rating. Mexico's Primary Budget Balance registered a US\$ 310 bn surplus in 2017 (*Exhibit 11*), compared to a US\$ 25 bn deficit in 2016. Likewise, for the first time in the current administration, there was a reversal of the uptrend in Public Sector Financing Requirements, which closed 2017 at 46.2% of GDP (*Exhibit 12*), and is moderate compared to countries with higher sovereign debt ratings. Consequently, Mexico's sovereign risk measured as the 10-year spread between Mexican and US bonds, has remained stable (*Exhibit 13*). In the second half of the year, the Mexican peso depreciated by more than 10%, mainly because of the hardening of the U.S.'s stance on NAFTA. By March 1st, 2017, the exchange rate had reached MX\$18.86 per dollar, an interesting 4% appreciation in the first two months of the year, most likely due to Mexico's solid external accounts and a successful deep-water oil field auction. Further exchange rate volatility can be expected in the first half of the year linked to the NAFTA negotiations and the July 1st elections.

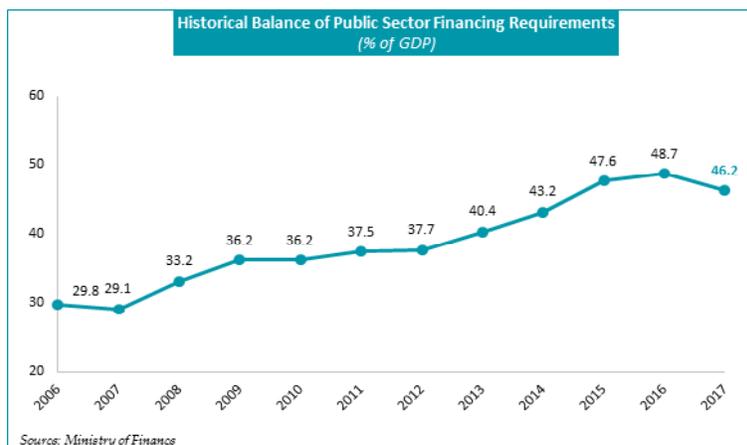
*Exhibit 10.*



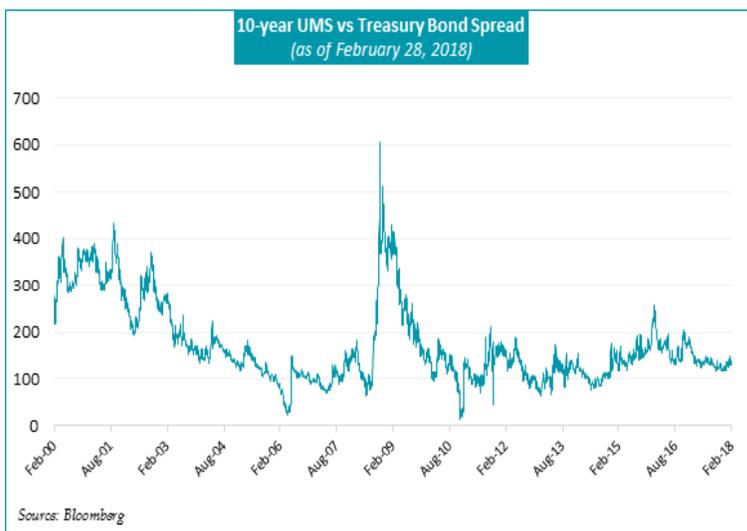
*Exhibit 11.*



*Exhibit 12.*



*Exhibit 13.*





## THE MXE's SEMI-ANNUAL REPORT ON THE ECONOMY JANUARY 31, 2018

### **DISCLOSURES**

*Pichardo Asset Management, a registered Mexican and U.S. Independent Investment Advisor has prepared this report based on sources it believed to be accurate and reliable. However, the figures are unaudited and neither the Fund, Pichardo Asset Management (the Investment Advisor), nor any other person guarantee their accuracy. Investors should seek their own professional advice and should consider the Fund's investment objectives, risks, changes, and expenses before acting on this information.*

*Total return figures with distributions reinvested at the dividend reinvestment price are stated net-of-fees and represents past performance. Past performance is not indicative of future results, current performance may be higher or lower. Holdings are subject to change and are provided for informational purposes only and should not be deemed as a recommendation to buy or sell the securities shown.*

**All investments involve risk. Principal loss is possible. Investing internationally involves additional risks such as currency fluctuations, currency devaluations, price volatility, social and economic instability, differing securities regulation and accounting standards, limited publicly available information, changes in taxation, periods of illiquidity and other factors. These risks are greater in the emerging markets. Stocks of small-and-mid-capitalization companies involve greater volatility and less liquidity than larger-capitalization companies.**

#### **Considerations and risks involved in investing in Mexican securities**

1. Market volatility in a global context.
2. The Mexican economy continues to be classified as an emerging economy. Mexican industrial production is highly correlated to that of the U.S.
3. Mandatory IFRS (International Financial Reporting Standards) accounting since the year 2011. All Mexican companies reporting IFRS in 2012 with 2011 financials adjusted accordingly (Source: Mexican Stock Exchange).
4. The portfolio securities are denominated in Mexican pesos. As a result, the portfolio return in U.S. Dollars securities must increase in market value at a rate in excess of the rate of the decline in the value of the Mexican peso against the U.S. dollar in order to present an excess dollar return.
5. Mexico has experienced widespread bank failures, currency devaluations, high levels of inflation and interest rates. Nevertheless, inflation has been contained at below 4% as of December 31, 2013, for more than a decade and interest rates are currently at all-time lows (2.92% 3 month Treasury Bills "CETES") (Source: Bloomberg)
6. There is generally less governmental supervision and regulation of exchanges, brokers and issuers in Mexico than there is in the United States.
7. U.S. holders of portfolio securities may also experience difficulties enforcing U.S. laws or obtaining service of process against the issuers of the portfolio securities.

## THE MXE's SEMI-ANNUAL REPORT ON THE ECONOMY JANUARY 31, 2018

### ECONOMIC DATA

- **Gross Domestic Product (GDP):** According to INEGI, GDP grew annually 1.5% in **4Q17**. By components, primary activities increased by 4.1%, secondary activities decreased -1.0%, and tertiary activities 2.3%
- **Economic Activity Index.** According to INEGI, economic activity (IGAE, a Gross Domestic Product proxy) increased by -0.7% month over month (m/m) in **December**. In seasonally-adjusted terms, services sector activities increased by 0.5%, industrial sector activities 0.9%, while agricultural sector activities decreased -5.3% compared to the previous month.
- **Industrial Activity.** In **December**, industrial production increased by 0.9% m/m. Seasonally-adjusted data showed that mining decreased -0.5% and utilities -4.0% m/m, while manufacturing activities and construction increased by 0.1% and 3.7% respectively.
- **Gross Fixed Investment.** In **December**, gross fixed investment (GFI) increased 4.0%, m/m. Expenses related to machinery and equipment increased 2.7%, and those related to construction by 4.4%, m/m. GFI posted a 0.3% increase y/y.
- **Trade Balance.** The trade deficit for the first **first month** of the year was US\$4.408 billion, 21.3% above the US\$3.471 billion recorded in the same 2017 period.
- **Mexican Oil Mix.** As of **end-February**, the price of the Mexican oil mix was USD\$55.59 per barrel, translating into a -4.79% decrease in one month, and a 20.79% increase in one year.
- **Retail Sales.** Retail decreased -1.2% y/y in **December**. Retail sales decreased -0.5% in relation to the previous month.
- **Unemployment.** The **January** unemployment rate came in at a seasonally-adjusted 3.4%.
- **Monetary Policy.** On **February 08, 2017**, Banco de Mexico maintained its benchmark interest unchanged at 7.50%.
- **Inflation.** The **January** Consumer Price Index (CPI) increased by +0.38% month-over-month. Annual headline inflation came in at 5.34% and core inflation 4.27%.
- **Public Finances:** In January, Public Sector Financial Requirements (RFSP) registered a \$9.3 billion deficit vs. a \$16.8 billion deficit for the same period in 2016.

Source: SHCP, BANXICO, INEGI.

## THE MXE'S SEMI-ANNUAL REPORT ON THE ECONOMY JANUARY 31, 2018

### ECONOMIC PROJECTIONS

Economic Projections	2014	2015	2016	2017e	2018e
<b>National Accounts</b>					
Real GDP growth (y/y)	2.3%	2.5%	2.9%	2.0%	2.7%
GDP (US \$bn.)	1.288	1.139	1.076	1.159	1.234
Consumption (Chg. y/y)	2.0%	3.3%	2.4%	3.0%	2.8%
Investment (Chg. y/y)	2.3%	4.5%	1.1%	-1.3%	0.2%
Exports (Chg. y/y)	7.3%	9.4%	3.5%	5.8%	6.8%
Imports (Chg. y/y)	5.7%	6.1%	2.9%	5.6%	6.5%
<b>Monetary and Exchange Rate Ind.</b>					
CPI Inflation (year-end)	4.1%	2.1%	3.3%	6.8%	4.2%
US\$ Exchange Rate (year-end)	14.7	17.2	20.6	19.7	18.2
28Day Cetes Int. Rate (year-end)	3.00%	3.25%	5.75%	7.2%	7.5%
<b>Balance of Payments</b>					
Trade Balance (US\$ bn.)	-2.8	-14.5	-13.1	-10.8	-11.9
Exports (US\$ bn.)	397.5	380.8	373.9	409.5	424.5
Imports (US\$ bn.)	400.0	395.2	387.06	420.4	436.9
Transfers (US\$ bn.)	23.6	24.8	26.6	28.1	n/a
Current Account (US\$ bn.)	-24.8	-32.4	-22.8	-18.8	-27.8
Foreign Direct Inv. (US\$ bn.)	25.6	28.4	26.7	29.7	n/a
<b>Debt Profile</b>					
International Reserves (US\$ bn.)	193.2	176.7	176.5	173.0	175.0
Public Debt (gross % of GDP)	42.6%	46.6%	48.7%	46.2%	46.1%
External Debt (gross % of GDP)	11.9%	14.6%	18.3%	15.3%	14.9%

Source: SHCP, BANXICO, INEGI, Santander.

The projections on this page are based on industry estimates and are no guarantee of future outcomes.



## THE MXE'S SEMI-ANNUAL REPORT ON THE ECONOMY JANUARY 31, 2018

### DEFINITIONS

- **Basis point (BPS):** Refers to a common unit of measure for interest rates and other percentages in finance.
- **Banco de Mexico (Banxico):** The Central Bank of Mexico.
- **Consumer Price Index (CPI):** The Consumer Price Index (CPI) is a measure that examines the weighted average prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.
- **Gross Domestic Product (GDP):** Gross Domestic Product proxy. The monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is calculated on an annual basis. It includes all private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.
- **Instituto Nacional de Estadística y Geografía (INEGI):** Mexican National Institute of Statistics and Geography
- **Mexbol Index:** The Mexican Bolsa Index, or the IPyC (Indice de Precios y Cotizaciones), is a capitalization-weighted index of the leading stocks traded on the Mexican Stock Exchange. The index was developed with a base level of 0.78 on October 30, 1978.
- **MXN/USD:** Refers to Mexican peso / U.S. dollar exchange rate.
- **Secretaría de Hacienda y Crédito Público (SHCP):** The Mexican Ministry of Finance.
- **The North American Free Trade Agreement (NAFTA):** A regulation implemented January 1, 1994 in Mexico, Canada and the United States to eliminate most tariffs on trade between these nations. The three countries phased out numerous tariffs, (with a focus on those related to agriculture, textiles and automobiles), between the agreement's implementation and January 1, 2008. NAFTA's purpose is to encourage economic activity between the United States, Mexico and Canada.