



Report of Pichardo Asset Management (“PAM”), the Investment Adviser to Investors.

President Peña Nieto’s first official statement on U.S. rising protectionism, as of January 23, 2017.

I. OBJECTIVES OF THE MEXICAN GOVERNMENT IN THE NEGOTIATION WITH THE UNITED STATES

The two guiding goals for the dialogue are:

- a) Diversify political contact, trade and cooperation, and seek bilateral trade agreements with different countries and regions of the world.
- b) Build a new relationship with the U.S.

The Five main principles are:

First: National Sovereignty. Mexico is a sovereign nation and will act as such. Exercising sovereignty implies that we will act as such in the negotiation process, as our only interest is that of Mexico and of the Mexican people. Mexico and the U.S. will hold a dialogue as sovereign nations. Mexico will do it with firmness, security, dignity, and by trusting in its own strengths, while always bearing in mind that while Mexico considers its relationship with the U.S fundamental, it is just as important for the U.S.

Second: Respect for the Rule of Law in Mexico and the U.S., is and will continue to be the basis for our interaction.

Third: Constructive and Purposeful Vision. This must be a win-win negotiation, requiring the adoption of a creative and open stance involving pragmatic and innovative solutions that consider the new reality in the U.S. and the international environment.

Fourth: The Integration of North America. Our region is formed by three countries Canada, the U.S. and Mexico, whose dynamism and competitiveness depends on what we do together.

Fifth: A comprehensive, integrated negotiation. Mexico will discuss openly and thoroughly, each of the topics comprising the relationship. We will discuss trade, but also immigration and security, including border security, terrorist threats, and illegal drug trafficking, firearms and cash.

The objectives must be clear. As such, Ten main objectives for building a new era of dialogue and negotiations in the bilateral relationship are as follows:

1. A commitment from the U.S. government to guarantee the human treatment of Mexican immigrants and respect their rights. The President said he had instructed the Minister of Foreign Affairs, particularly the Embassy and the consular network, to redouble protectionist efforts and assist, defend, and support Mexicans with respect to their rights in accordance with the law.
2. Any repatriation process for undocumented immigrants carried out by the U.S. government, must be coordinated and orderly; the protocols and agreements reached must be maintained and improved, and always procure a dignified and respectful treatment.

3. The U.S. government must assume a concrete commitment to work jointly in promoting the development of Central American countries. This commitment is becoming increasingly important. While Mexican immigration to the U.S has declined each year for the last three years, the flow of undocumented immigrants across the U.S. border grew by 100%.
4. Assure the free flow of remittances from Mexicans living in the U.S. by avoiding obstacles and higher costs. Up until November of 2016, remittances from Mexicans living abroad totaled US\$ 24 billion dollars.
5. The U.S. government must assume the commitment to work alongside Mexico to stop the entry of illegal weapons and money from illicit sources.
6. Preserve free trade among Canada, the U.S., and Mexico. Trade within the three countries must be exempt from any tariff or quotas, as has been the case since 2008. Procure the competitive strengthening of North America and its regional supply chains; increase Mexican exports to the U.S. and Canada through healthy competition and the development of sectors with the highest value added.
7. Modernize North America's trade framework, which requires governments to include new sectors, such as telecommunications, energy, and e-commerce.
8. Any new agreement with the U.S. must translate into higher salaries for workers in Mexico. Mexico doesn't compete in the world of low quality jobs or cheap labor. Mexico must participate in international trade to boost productivity and complementarity, and thereby protect current jobs, create new ones, and improve wages.



9. Protect investment flows to Mexico. The government will assure that our country continues to be a trustworthy and attractive destination to invest in. We will procure agreements that give assurance to current investment and trade between Mexico, Canada, and the U.S. Local and foreign investments that decided to believe and invest in Mexico, will be protected.
10. Work for a united not a divided border. Mexico recognizes the rights of a nation`s sovereignty to guarantee security, but does not believe in walls. Our country believes in bridges, in highways, and railroad conjunctions, and in the use of technology as the best allies for fostering neighborliness. Our border must be the best space for coexistence, a secure space of prosperity and shared development.

Source: <http://www.gob.mx/presidencia/articulos/the-mexican-government-s-10-goals-in-the-negotiation-with-the-united-states?idiom=en>

<http://www.gob.mx/presidencia/articulos/five-principles-that-will-guide-negotiations-with-the-us-government?idiom=en>



II. CHALLENGES & OPPORTUNITIES FOR THE AUTO PARTS INDUSTRY IN MEXICO

Alberto de Icaza, counselor of INA (National Auto Parts Industry) and Director of Mexico for ZF TRW (auto parts company) discussed with PAM the challenges and opportunities for the auto parts industry in Mexico.

Highlights:

- The automotive industry in the United States creates about 750,000 jobs by auto parts companies and 150,000 jobs through the automakers.
- Mexico had a trade surplus with the United States of US\$ 60 billion in 2015 and US\$58.8 billion from January to November of 2016 in accordance to figures released by the U.S. Department of Commerce.
- On January 24, President Donald J. Trump met with the main U.S. automakers (General Motors, Ford & Chrysler) where he had a low tone with the industry and spoke of lowering the tax rate to build more plants in the United States. In the last ten years, no new automotive plant has been built in the United States.
- Recent announcements by Ford and General Motors of canceling their investments in Mexico are due more to an industry issue rather than to a political one.
- In the case of Ford, the industry has observed a change of trend and the American consumer has now begun to buy more pickup trucks than light vehicles, mainly due to the lower costs of gasoline. During 2016, Ford's U.S. light vehicle sales fell 13% while pickup truck sales rose 7%.

- Sales of pickup trucks generate greater profits for Ford and the production of these vehicles is done at plants in the U.S.
- The cancellation of the San Luis Potosí plant was due more to a change of trend in the industry towards the pickup trucks. The San Luis Potosí's production was planned for the Fusion model, which is now going to be manufactured in Ford's already existing plant in Hermosillo, where that same model is already being manufactured.
- In the case of General Motors, American Axle lost a part of the business it had with General Motors for full-size pickup trucks, and now General Motors is going to do this business at its Michigan plant.
- So far, the plans of investment of the other manufacturers in Mexico have not changed.
- Mexico is the 5th worldwide supplier of auto parts and it is estimated that by 2020 it will produce 5 million units in the country, compared to the current 3.8 million units.
- There are 2 initiatives that are of concern to the automotive sector:
 - VAT (Value Added Tax) which is being talked about, that could be of 20% which per some calculations, if this tax is applied, the cost of the vehicles would increase by nearly US\$ 3,000 and would have an impact on the consumer.
 - Fees for crossing the border and would be the pretext to fund the building of the wall.
- NAFTA must be renegotiated since it is a 20-year-old treaty that does not consider certain subjects such as telecommunications, energy and electronic commerce.



- The Mexican government in the renegotiation of NAFTA will put on the table issues such as migration, energy, weapons, among others.
- The Mexican government wants the renegotiation to be equitable but could be playing the NAFTA exit letter. Ildefonso Guajardo who is the Secretary of Economy of Mexico and who will be in negotiations, was one of the team members when the NAFTA was created back in the 1990s.
- The objective of the TPP was the United States market.
- If NAFTA would be canceled, China could be one of the countries most interested in having bilateral relations with Mexico.
- Korea, Taiwan and Thailand also showed interest in joining the TPP and there could be bilateral agreements with Mexico in the event of a NAFTA cancelation.