

Institutional and regulatory changes may have severe economic damage

Mexican Stock Exchange

During the week, multiple relevant initiatives were presented, affecting the normative and regulatory framework of essential institutions for the economy's proper functioning. In this context, Mexbol had a flattish behavior during the week (-0.07%) as it assimilates the complexity of the proposed measures' changes, which we detail below.

Changes in the institutional framework: Reform to Banxico's Law

The Senate approved an amendment to articles 20 and 34 of Banxico's Law. The objective is to create a more suitable environment for the administration cash transactions in US dollars. The proposal has faced various criticisms because it reduces the central bank's autonomy and opens the possibility of new money laundering mechanisms. Noteworthy its approval is still pending in the Chamber of Deputies; the main changes were:

1. The installation of mechanisms that allow the reception of dollars (cash) in businesses located in tourist areas and the border.
2. It only affects currencies collected in cash. Noteworthy, only those foreign banknotes and metallic coins captured by credit institutions that cannot be repatriated to their country of origin will be accounted by Banxico to the international reserves.

Most foreign currency transactions in the country that commercial banks operate are electrical, and approximately only 1.0% are in cash (the total for the year is about US\$413 million). Therefore, it is surprising that the Senate created changes to Banxico's law and administrative complications for such a low amount. Oil Hedges

Changes in the institutional framework: Reform to the Law of the Retirement Savings System

The Chamber of Deputies approved the reform, which is pending ratification by the Senate. The most significant change was establishing a limit of 0.54% on the commission rate of the Retirement Fund Administrators (Afores). Currently, the average commission of the Afores in Mexico is 0.92%, so that this change would imply a (-)41.30% reduction in the fees charged.

Even though the average fee charged in Mexico is high in comparative terms, such a drastic reduction negatively alters the Afores' incentive scheme. The above because, according to CONSAR, the Afores spend approximately 54% of their commissions on operating expenses. Such a substantial reduction could cause the Afores to have a considerable decrease in their returns since it would weaken their analysis team.

Changes in the institutional framework: Reform of the Federal Labor Law

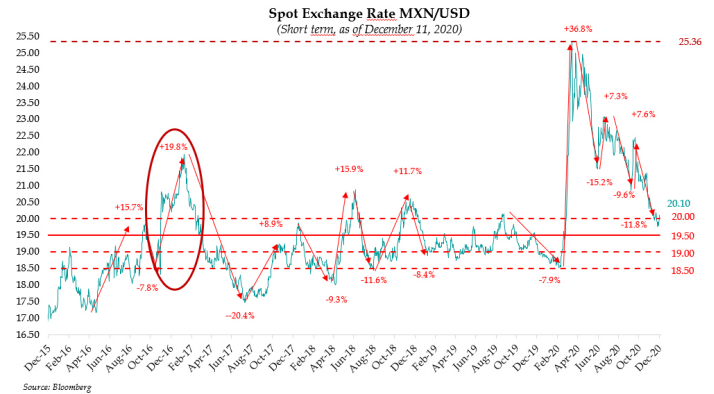
Despite the intention to approve a reform to the Federal Labor Law to modify outsourcing for this year, the Federal Government and some private initiative members agreed to postpone the reform's approval until February 2021. The main changes that this reform intends are:

1. Regulate outsourcing to reduce the discretionary use by companies to avoid the payment of workers' social security.
2. An increase of 15% to the minimum wage and a guarantee that the future's annual rises cannot be less than the observed yearly inflation.
3. Employers will have to pay for the consumption of electricity and telecommunications of their home office employees.

These modifications decrease the Mexican labor market's flexibility, which currently has the great challenge of reincorporating more than 4 million workers who lost their jobs due to the COVID-19 crisis.

Exchange Rate

The spot exchange rate closed at MX \$ 20.09 per USD for a (-)1.51% weekly depreciation; thus, the Year-to-Date ("YTD") depreciation stands at (-)6.16%. The doubts that some of the changes referred to in the previous section, especially concerning Banxico, could explain the currency's depreciation. The changes to the Banxico Law could have significant implications for the Mexican peso since the reform makes changes to international reserves.



Economic Indicators

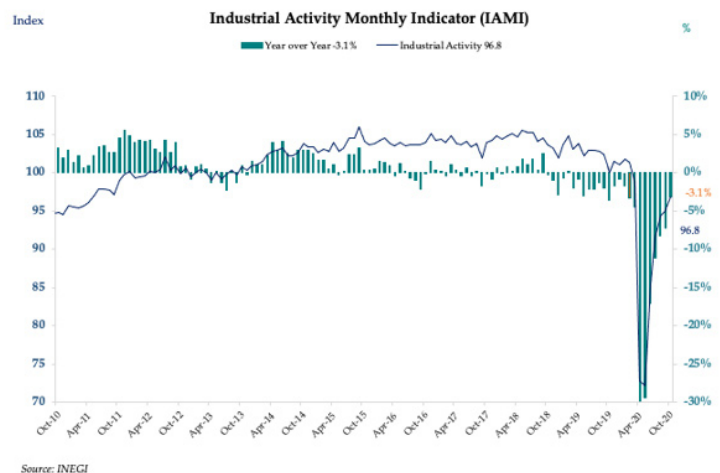
The Department of Commerce of the US released October's international trade figures. Mexico remains as its second trading partner with a US\$91.26 billion surplus, which is 8.85% higher than the same figure of 2019. Besides, the trade volume between the two countries was US\$435 billion, only US\$7 billion less than the volume of China and the United States. The data becomes relevant since the president-elect of the United States, Joe Biden declared that he would not review the partial agreement phase one between China and his country until the COVID-19 crisis has concludes. The preceding could lead to an advantage for Mexico for 2021.

Industrial Activity

The Industrial activity indicator had a 2.0% monthly increase in October, reducing the annual fall to only (-)3.1% (in April, this figure was approximately -30.0%). By components, the results were as follows:

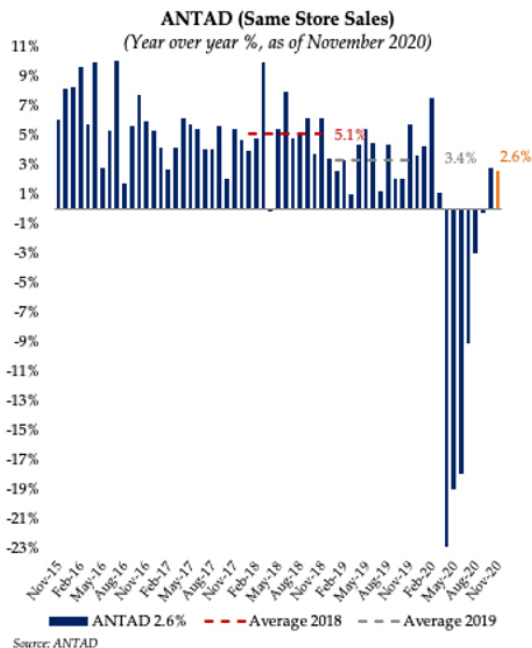
1. Construction increased 3.6% in monthly terms, although its annual fall amounts to (-)9.7%.
2. The manufacturing industry rose 1.8% compared to September; its annual decrease is only (-)1.0%.
3. The generation, transmission, and distribution of electricity, water and gas supply improved 1.8% in its monthly comparison, and in annual terms, it shows a contraction of (-)4.3%.
4. Mining grew 1.0%, and its annual fall is only (-) 1.1%.

The above figures show that the secondary sector leads the economic recovery. The above is mostly the result of a recovery in manufacturing exports to the United States.



ANTAD Same Store Sales

ANTAD's Same Store Sales (SSS) had an annual growth of 2.6% in November, and for the second consecutive month. The data was driven by the extension from 4 to 12 days of the "Buen Fin" campaign this year. Department stores had the best performance with an annual growth rate of 7.4%. Although the data is positive, SSS growth is expected to slow down in December due to the government's new restrictions.

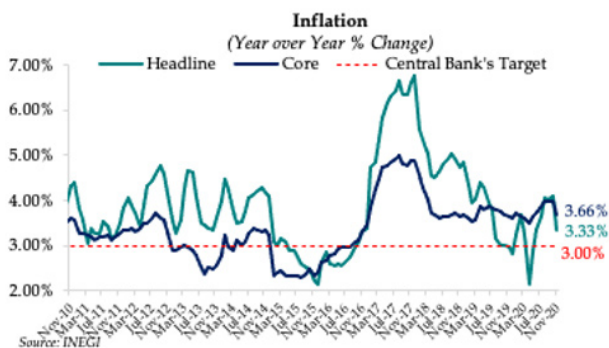


Inflation

Inflation was 3.33% in November, again within the target range of Banco de México (3.0% +/- 1.0%). By components, the results were as follows:

1. Annual core inflation was 3.66%, mainly due to low inflation in service prices (2.22%).
2. Annual non-core inflation totaled 2.33% since the price of energy and the tariffs authorized by the government had a yearly deflation of (-)1.13%.

The recent downward adjustment of inflation grants Banxico more freedom to make new reductions in its interest rate. Despite the above, we must consider that the "Buen Fin" discounts, which lasted the entire first half of November practically, could have temporarily reduced inflation.

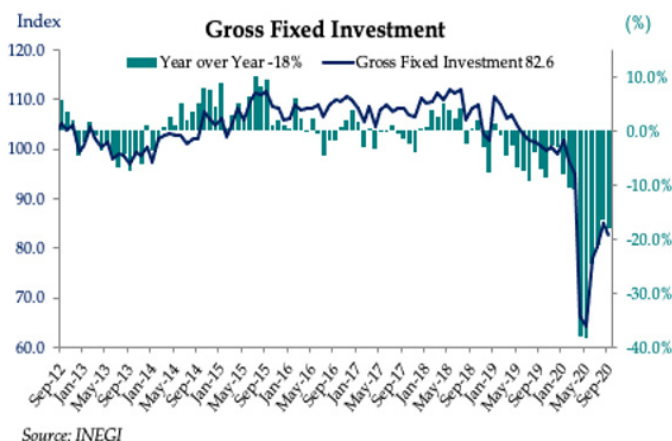


Gross Fixed Investment

The Gross Fixed Investment Indicator (IIFB) had a (-)2.87% monthly drop in September, which increased the annual fall to (-)17.9%; This broke a trend of three consecutive months with monthly recoveries after the COVID-19 crisis. By components, the results were as follows:

1. Investment in machinery and equipment increased 1.30% compared to last month, although at the annual rate still shows a (-)16.50% fall.
2. Investment in construction contracted (-)5.83% at a monthly rate, so the annual decline increased to (-)18.32%.

Unlike the vast majority of economic indicators, the IIFB did not sustain its recovery after the COVID-19 crisis. The above reflects the distrust of entrepreneurs to make new investments and the inability to recover a considerable number of companies.





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Definitions

National Association of Self-Service and Departmental Stores (ANTAD): Entity responsible of promoting the development of retail and its suppliers within the Mexican market.

Banco de México (Banxico): Is the central bank of Mexico. Its main function is to provide domestic currency to the Mexican economy and its main priority is to ensure the stability of the domestic currency's purchasing power.

COVID-19: The disease caused by the coronavirus, a family of viruses that were discovered in the 60s but whose origin is still unknown. Its different types cause different diseases, from a cold to a severe respiratory syndrome.

CONSAR: The National Commission of the Retirement Savings System is a decentralized administrative body of the Ministry of Finance and Public Credit whose fundamental task is to regulate the Retirement Savings System.

Gross Fixed Investment Indicator (IIFB): Describes the net capital accumulation during an accounting period for a country. The term refers to additions of capital stock, such as equipment, tools, transportation assets and electricity.

Law of the retirement saving system: The pension system in Mexico is largely based on mandatory, defined contribution (fully funded), individual accounts which are privately administered by various specialized pension fund managers. It has existed since July 1997 after the Social Security Law was reformed. This scheme applies to the private sector workers who are affiliated to the Mexican Institute of Social Security (IMSS)1. Government employees have a pension plan covered by the ISSSTE which is based on a pay-as-you-go (PAYG) system. Government agencies may set-up alternative pension plans and in the private sector a few companies (mainly multinationals) have developed incipient defined benefit programs, which are complementary to the mandatory private scheme.

Inflation: Is a quantitative measure of the rate at which the average price level of a basket of selected goods and services in an economy increases over a period of time.

The Consumer Price Index (CPI): Refers to core inflation which systematically excludes food and energy prices because, historically, they have been highly volatile and non-systemic.

Federal Labor Law. The FLL is the most important employment legislation in Mexico. It defines a 'labor relationship' as the rendering of a subordinated personal service by one person to another, in exchange for a wage.

International trade is the exchange of capital goods, across international borders or territories[1] because there is a need or want of goods or services

Spot Exchange Rate: Is the current price level in the market to directly exchange one currency for another, for delivery on the earliest possible value date.

The National Institute of Statistics and Geography (INEGI): Is a public body with technical and managerial autonomy, its own legal personality and assets, responsible for regulating and coordinating the National System of Statistical and Geographic Information.

Year to Date: (YTD): Refers to the period of time beginning the first day of the current calendar year or fiscal year up to the current date.

Monthly Industrial Activity Indicator (IMAI): Indicator to follow up on the evolution of the industrial sector, on the short term, providing valuable information for decision making.

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