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Mexico: A New Gateway of Opportunity for Investment in the Emerging Markets

New York Times Columnist Thomas Friedman declared earlier this year that Mexico will become a “more dominant economic power in the 21st century” than China. He noted how Richard Fisher, president of the Federal Reserve Bank of Dallas, argued that the Mexican economy’s vital signs look a lot healthier. “The U.S. deficit is 7 percent of gross domestic product,” said Fisher. “Mexico’s deficit is about 2 percent of their G.D.P.” Meanwhile, he added, America “is growing slowly, weighed down by debt and the pervasive uncertainty caused by our nation’s fiscal imbalances and growing regulatory complexity. Mexico, in contrast, is growing robustly, and, in contrast to their Washington counterparts, Mexican policy makers are demonstrating remarkable commitment to fiscal discipline.” The Financial Times also reported back in September that “today, Mexico exports more manufactured products than the rest of Latin America put together.”

With this growing investor sentiment, the question that continues to be raised by followers of Capital Link’s Closed-End Fund Forums has been, how do international investors tap into this viable, attractive emerging economy without having to go through the tedious steps of investing in individual Mexican equities?

To answer this question, we sought after one of the leading experts of the Mexican Economy, who has their “finger on the pulse” of the Mexican Capital Markets with a tremendous track record of investment performance. We are delighted to be interviewing Ms. Maria Eugenia Pichardo, President and General Partner of Pichardo Asset Management (PAM), a position she has held since 2003. PAM is the Adviser to the Mexico Equity & Income Fund, listed on the New York Stock Exchange under the ticker “MXE.” Since the fund’s inception in 1990, Ms. Pichardo has been the Fund’s Portfolio Manager and in 2004, she was elected as the Fund’s President. Ms. Pichardo has more than 25 years of financial expertise, which includes serving as managing director of an investment bank and the portfolio manager of several funds.

Q: Thank you for joining us today. Can you give us a bit of background on Pichardo Asset Management and your role as Adviser to the Mexico Equity & Income Fund?

A: Pichardo Asset Management (PAM) was incorporated in 2003, and is an Independent Investment Advisory Firm, based in Mexico City, specializing in long-only equities. As a boutique firm with an extensive presence in Mexico, PAM brings 22 years of experience in the Mexican capital market, and is able to provide to investors a local perspective, as well as a dedicated, experienced independent portfolio manager. Our mission at PAM is to provide our clients with an independent advisory service that aims to maximize the returns of their investments in the Mexican stock market through ethical and responsible asset management, and by adhering to pre-established portfolio investment strategies based on our in-depth knowledge of the financial market. To achieve this mission, our vision is to continue to outperform the market benchmark and provide our clients with the highest return by offering a professional and unbiased Independent Advisor service, as well as, strengthen the academic qualities and experience of each member in our team.

As the founding Partner and President of The Board of Directors of PAM, I am responsible for the systematic factors of the investment strategies and equities percentage allocation, as well as risk management. Additionally, I am the President and Portfolio Manager of the Closed-End Fund listed on the NYSE, The Mexico Equity Income Fund, Inc. (MXE). Our team at PAM has had the privilege to advise MXE for 22 years since its inception in 1990. To give you a snapshot of MXE’s performance, let us take a comparison of the MXE and the MSCI Mexico- Index (the benchmark for all emerging markets) over the last three years. At an annual average, the MXE has outperformed the MSCI by 853 basis points and offered higher returns.

Interview: Maria Eugenia Pichardo



As shown in the chart below, PAM's team continued to produce an excess dollar return for the Fund compared to the MSCI Mexico-Index:

FUND	Total Annual Average Dollar Return (dividends reinvested)						
	1 Month	6 Month	1 Year	3 Years	5 Years	10 Years	Since Inception In August 30, 1990
MXE NAV	6.41%	25.54%	41.92%	25.35%	5.63%	23.31%	15.85%
MXE Market Price	10.53%	31.79%	45.75%	29.06%	9.18%	25.35%	14.89%
MSCI Mexico Index	5.51%	16.46%	26.76%	17.61%	6.73%	20.56%	13.37%
Excess Return (bps)	90	908	1,516	774	-110	275	248

At the close of the Fund's six-month period ended January 31, 2013 - Source: U.S. Bancorp, Bloomberg, and Thomson.

Q: Can you please elaborate on the idea behind long-only equity investing and how this ties in with PAM's investment strategies?

A: Since the post-global economic recession in 2009, PAM's team has taken a bottom-up investment strategy approach that integrates quantitative and qualitative research with in-depth fundement analysis. We have more than 10 years of experience in creating portfolio investment strategies based on the classification of asset categories. The investment strategy is rooted in the policies and restrictions that confine the investment decisions of the Portfolio Manager and the Investment Committee.

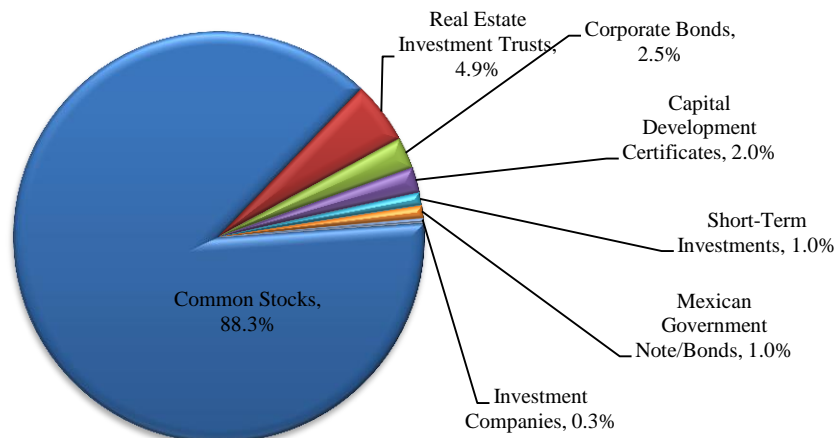
In a top-down investment strategy approach, investments are chosen based on the macro view of the global economy, otherwise known as the "big picture." It is then broken down into the most promising sectors, in which companies that are forecasted to outperform the market are selected into the portfolio. Based on this approach, the fund is exposed to the risk of selecting under-performance companies from an attractive sector.

The Fund's exposure to risk is reduced with a bottom-up investment strategy approach. This allows the Fund to diversify and narrow its focus on the most attractive asset class categories, regardless of the sector's performance.

The three asset class categories PAM invests in are as follows:

- High Total Annual Return Companies
- High Growth Companies
- Special Situations Companies

Allocation of Portfolio Assets



Interview: Maria Eugenia Pichardo



From our perspective, the following factors were decisive to the Fund's outperformance:

- PAM's systematic investment strategy factors.
- An investment strategy based on three equity class categories, as classified by PAM (Alpha, Beta and Special Situations) set up at the beginning of 2009, as well as PAM's adherence to systematic investment strategy factors.
- A highly diversified portfolio.

As of January 31, 2013, the Fund portfolio's composition by equity class and companies' market cap was as follows:

Category	% Overall Portfolio	Sectors and Equity Class Categories as classified by PAM
Small	12%	Financials, discretionary consumption and car insurance
Medium	26%	Discretionary consumption and industrials
Large	56%	Materials, industrials and discretionary consumption
Alpha	23%	High total return, dividend + share purchase + capital increase
Beta	47%	Infrastructure related with internal free cash flow
Special Situation	17%	Value-oversold stocks. Below its intrinsic value and determined by PAM. Less than 1 times P/BV

Most importantly, we have included two alternative investments in the portfolio, high yield real estate investment trusts and Private Equity trusts, which are listed in the Mexican market in the form of CKD's (Development Companies).

Q: Why is Mexico the smart investment alternative? What is the cause and implication of this trend?

A: I am glad you asked this question. Mexico presents a tremendous opportunity for growth and development. Despite global crises, Mexico undoubtedly has a solid economy – with an average GDP growth of 2.7% for the past 15 years.

Mexico's manufacturing sector is regaining competitive cost against China, with higher manufacturing wages and increase of exports. We believe that with this continued momentum and the rapid pace at which Mexico's economy is growing, it is possible, that by 2048, Mexico will be growing at the same rate as China.

From a long-term perspective (two to three years), we believe that the appeal Mexican equities are currently enjoying among the global investment community is warranted, given the following:

- Mexico's undisputed story of macroeconomic stability for more than a decade.
- Support the Peña Nieto administration mustered from all three political parties to launch the "Pacto por Mexico" on December 2, 2012. The Pact details long-awaited structural reform initiatives (labor, education, public administration, telecommunications, fiscal, financial and energy) that will be voted on in Congress in accordance to a specific timetable as follows:

Executive's Reforms passed to the House of Representatives

	2009		2012				2013						2014	
	Dec	Aug	Sep	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Second Semester	First Semester	
Political Reform	Proposed	Approved												
Federal Labor Law Reform			Proposed	Approved										
Educational Reform					Proposed		Approved							
National Anti-corruption Commission					Proposed			Possible Approval						
Government Accountability Reform						No need to pass through the House of Representatives								
Telcos Reform								Proposed				Possible Approval		
Energy Reform									Possible Proposal			Possible Approval		
Competition Law Reform									Possible Proposal			Possible Approval		
Police Reform									Possible Proposal			Possible Approval		
Fiscal Reform												Possible Proposal	Possible Approval	

Source: Mexican Congress, Accival estimates.

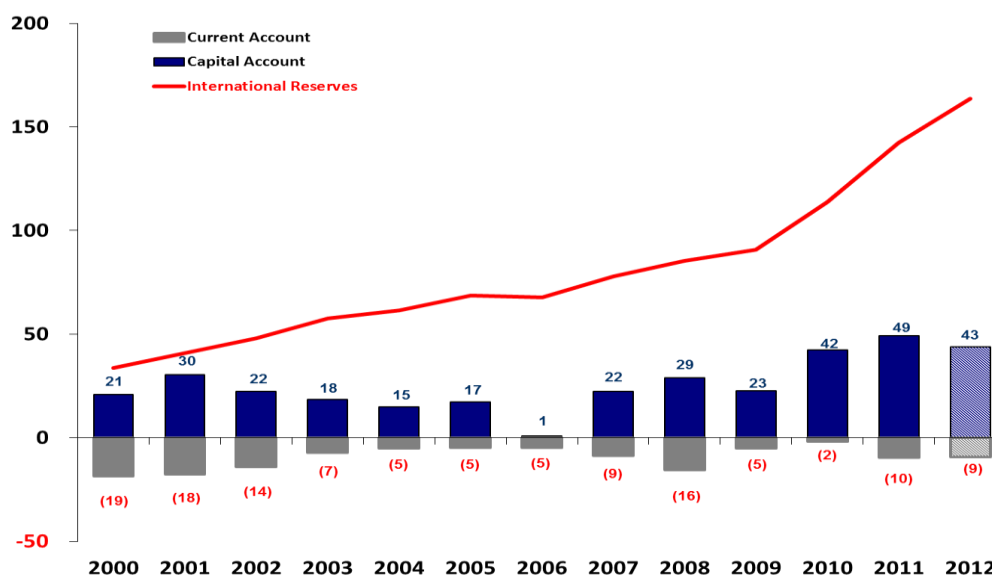
Interview: Maria Eugenia Pichardo



The energy sector in Mexico is currently state-controlled and not open to foreign investments. President Enrique Peña Nieto is currently in talks to open the state-controlled energy industry to private and foreign investments. If the reform is approved, Mexico will have the energy sector listed on their stock exchange for the first time.

Over the past three years, Mexico has been showing consistent reduction in deficit and an inflow of foreign investments higher than \$40 bn. annually. The combination of those two factors becomes an important acquisition of assets in Mexico's Central Bank. These assets allow portfolio investments to cash out, while at the same time, the economy will have enough resources to finance itself.

México: Strong External Accounts (US\$ Billions)



Source: Accival with Banxico data.

Mexican Stock Exchange

Regarding the Mexican Stock Exchange, it registered a record high EV/EBITDA multiple of 9.7 times during the Fund's six-month period ended January 31, 2013, situating it at the 95th percentile (in the last four years this multiple has only risen above 9.19 times 5% of the time). The Mexican Bolsa Index was a leading performer within the Latin American region with a 16.89% dollar gain for the Fund's six-month period, ended January 31, 2013.

Total public offerings, including IPOs, secondary and block trades (mainly in the financial and industrial sectors) amounted to approximately US \$9 bn. for the Fund's semi-annual period ended January 31, 2013. At that point, the Mexican Stock Exchange's market capitalization was US \$372 bn., and an average daily turnover of US \$455 million as of January 31, 2013.

Strong Fundamentals: Low and Stable Inflation

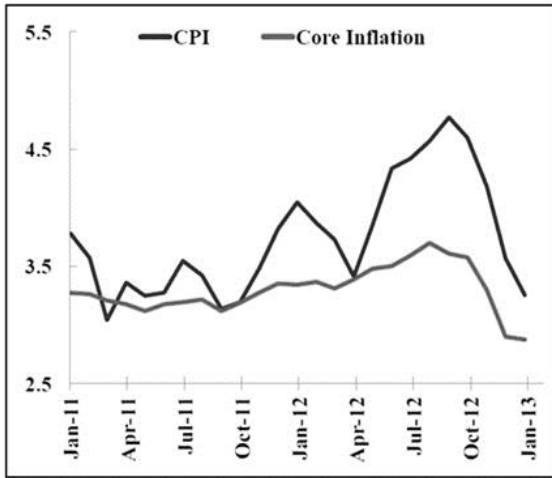
The Mexican economy began 2013 with solid fundamentals and a promising long-term outlook based on fiscal and energy reforms.

Annual GDP growth was 3.9% for 2012 and the International Monetary Fund estimates 3.5% growth for 2013.

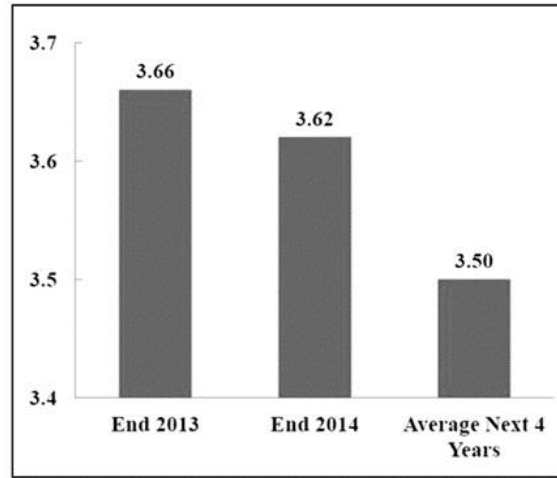
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Consumer Price Index (Annual growth, %)



Annual Inflation Forecasts (%)

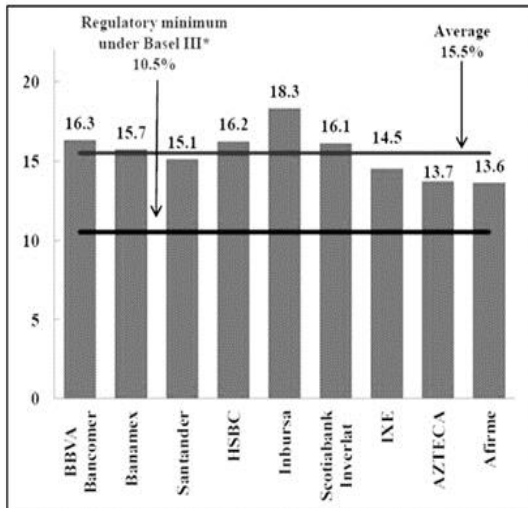


Source: Central Bank, INEGI, SHCP, SHF.

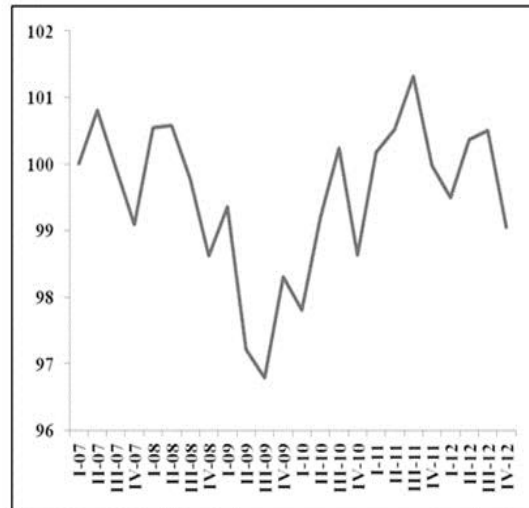
Medium-term inflation expectations are anchored around Banco de Mexico's 3 (+-1%) targets.

Strong Fundamentals: Financial Sectors

Capitalization Index of Mexican banks (Jan-12, %)



Housing Relative Prices (relative to the CPI, index / -07=100)



Source: Central Bank Survey, SHCP.

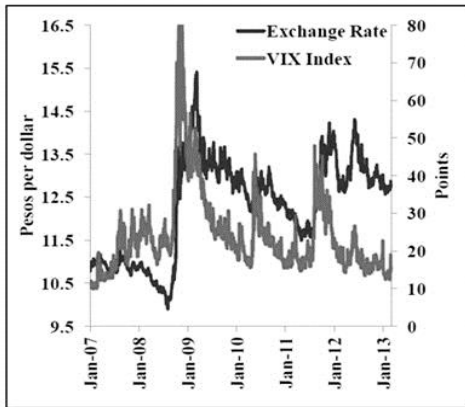
The Mexican banking system is well capitalized, in full compliance with Basel III requirements and does not show signs of asset price bubbles.

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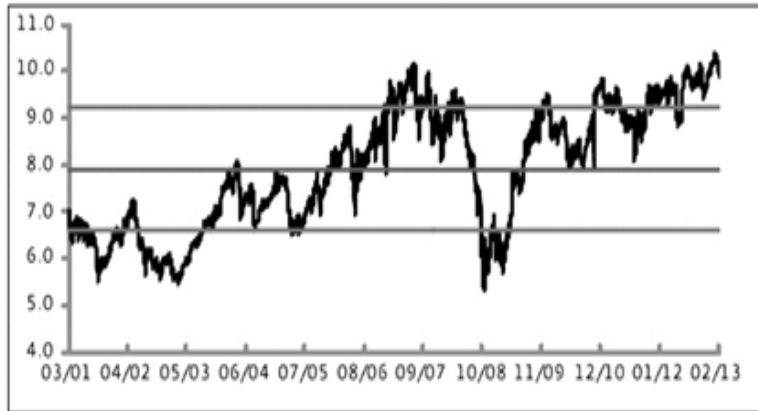
Strong Fundamentals: Exchange Rate

USD Dollar-Mexican Peso Exchange Rate and VIX



Source: Central Bank, SHCP.

Mexican stocks' 12-month forward EV/EBITDA



Source: Central Bank, Bloomberg, SHCP.

Q: This has all been tremendously informative; it seems that Mexico is truly making a comeback, and the Mexico Equity & Income Fund seems to be a key investment vehicle for what appears to be a terrific entry point!

A: Thank you. I believe Mexican stocks are primed to outperform expectations in the coming years. Truly one of the best ways for long-term investors to gain exposure to Mexico is through the Mexico Equity and Income Fund.

In closing, I will say that Mexican Companies are very well positioned to benefit from the structural reforms discussed. We believe that the portfolio investment thesis within the Mexican Economy is viable, and that continues to produce returns for our investors. PAM's team has the unique ability to provide this prospective, because we live and work in Mexico. We are able to see the reforms being passed and its effectiveness. The Mexico Equity & Income Fund presents a unique opportunity due to its discount of approximately 8% to the fund's net asset value. MXE continues to have a de-indexed portfolio - highly diversified in equities, debt and alternative investments, including REITs and development companies (private equity.)

MXE: 1 Year Share Price (6/13/12-6/13/13)

The Mexico Equity and Income Fund, Inc.

