

Good starts to the year, but internal risks prevail.

The beginning of 2019 has been favorable for Mexican financial markets; as of Friday, January 11, the Mexican Stock Exchange (Mexbol) accumulated gains of 4.61% and the spot exchange rate is at MX\$ 19.15 pesos per dollar, which implies an interesting appreciation of 2.64%. Moreover, the Ministry of Finance announced an oil price hedge that matches oil price estimates within the federal budget for 2019 (55 dollars per barrel). The latter strengthens market confidence regarding prudent management of public finances; thus, supports the recent appreciation of the Mexican currency.

For Mexico, the primary external risk factor is US economic growth which is likely to slow in 2019, as well as concerns on the divergence on the estimate in global economic growth.

Jerome Powell, president of the FED, has indicated that the FED could be "patient and flexible" to observe the evolution of the economy and does not perceive risks of an economic recession. In this context, it is likely that the FED moderates its upward trend this year, and only raises its main reference interest rate two times. Therefore, expected rate hikes in March and June could be postponed further.

Moreover, the commercial dispute between China and the United States and the monetary policy of the Federal Reserve seem to follow a positive drift. After the first meeting between the presidents of China, Xi Jinping, and the United States, Donald Trump, held on January 7, 8 and 9, the Trump administration and the Chinese Ministry of Commerce declared that negotiations are on track agreement before the end of the "tariff ceasefire" that will end on March 1st.

Perhaps the most relevant risk factor comes from internal factors, especially the economic and financial effects of public policies established by the new federal administration. The 4.74%-peso depreciation coupled with the 15.38% loss in the Mexbol Index observed during the fourth quarter of 2018 was detonated by the cancellation of the NAIM; a decision that capital markets considered as arbitrary and lacking any logic in terms of costs and benefits. Besides, an initiative was presented before Congress to eliminate banking commissions – which was finally suspended due to the seriousness of its implications- and questions about what the new government's energy policy will be.

In this context, collateral effects of the measures adopted to avoid fuel theft in the pipelines of state-owned oil company PEMEX could hamper the recent positive performance in local markets.

Undoubtedly, this is a significant problem, as the loss for this concept, recognized by PEMEX, in 2018 was 66.3 billion pesos per day. Unfortunately, the government's decision to radically deal with this problem was accompanied by the interruption in the supply of gasoline and other petroleum products in several important cities including Mexico City. The government has not provided any specific date for the regularization of the supply of fuel, but this situation that has already lasted several days implies direct losses for the economy of 1.2 billion pesos estimated by the Mexican Employers Confederation (COPARMEX).

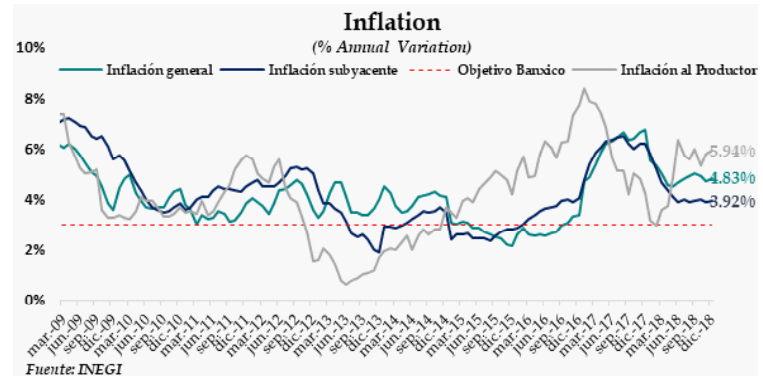
The main stock markets in the United States had positive results due to the advances on the trade agreement between China and the US, coupled with a reassuring tone of the federal reserve that rules out a possible recession and will wait calmly for the economic development for the gradual adjustment of its monetary policy. Thus, the Dow Jones, Standard & Poor's and NASDAQ indexes posted weekly gains of 2.58%, 2.42% and 3.46% to leave a cumulative advance of 2.93%, 3.63%, and 5.09% respectively in the year.

Economic Indicators

Oil Coverage

The Ministry of Finance (SHCP) agreed upon oil hedges to ensure the average price of the Mexican Oil Mix (MM) at 55 dollars per barrel; an amount that matches the Federal Budget estimates for 2019. The above eliminates the budget risk due to falls in oil prices (last year Mexican Mix dropped 43% between October and December, along with the international prices of reference). The hedge strategy includes the purchase of put options –the right to sell at an established price - and the creation of an account within the Budgetary Income Stabilization Fund (FEIP). At the end of the third quarter of 2018, the FEIP had 247 billion pesos to protect the soundness of public finances.

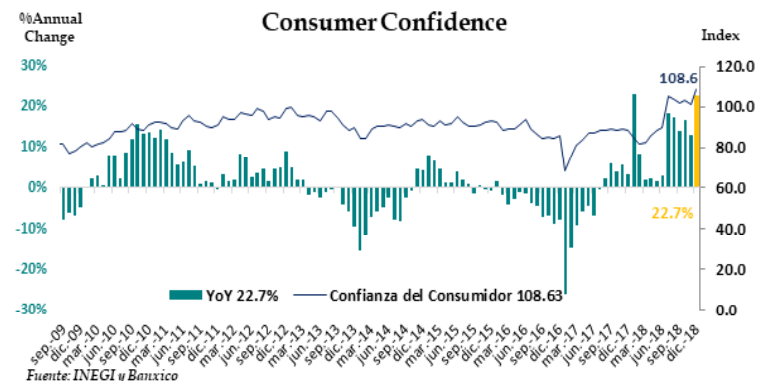
Monthly Inflation



During December, general inflation was 4.3% at an annual rate, and the underlying inflation was 3.92%. This increase was driven by an increase in the non-core component of 8.40% mainly due to an increase in transportation prices, medical services, and education. Annual producers' inflation – which seems to be ahead of the consumer price index - was 5.94% in the same period.

Consumer Confidence Index

In December, consumer confidence reached its highest level since 2006, increasing 22.7% compared to 2017, due to the change in federal administration and the announcement of a notable salary increase for 2019. This figure represents a double-digit increase per six consecutive months and uninterrupted advances for 17 months. The five components that make up the indicator reported improvement during the last month of the year.



Production, export and domestic sale of vehicles

Overall 2018 has not been a good year for the automotive industry, especially for domestic sales, which recorded the worst December in 4 years (-10.6%) and accumulated 19 consecutive months of falls. The companies that have presented the most significant contractions during 2018 are Honda, Nissan, and Ford. In 2018 the sale of vehicles in Mexico decreased by 7.11% compared to 2017, with this figure adding two consecutive years to the decrease.

In December the production of vehicles presented a fourth consecutive drop and the sixth in the year (-9.7%), driven by the close of almost five months of a Honda plant, as well as decreases in the production of Ford and Nissan. In the year, the production presented its first fall (-0.61%) since 2009. Exports were the only favorable component (+2.3%), which reached a historically high level during December, as well as its annual production with an increase of 6.0% compared to 2017. General Motors and Chrysler mainly drove this growth.

Industrial Production

The industrial production registered in November a decline of 0.6% compared to October. The contraction in mining activities (-2.3%) and construction (-1.9%) stands out, as well as the increases in energy and public services (+1.4%) and manufacturing (+1.0%).



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Definitions

NAIM: New International Airport of Mexico City

Mexbol: The S&P/BMV IPC seeks to measure the performance of the largest and most liquid stocks listed on the Bolsa Mexicana de Valores. It is not possible to invest in an index.

PEMEX: The state-owned oil company in Mexico.

COPARMEX: The Employers Confederation of the Mexican Republic, is a voluntary membership business organization, looking through representation in the workplace and society.

Consumer confidence Index: the index information generated by the INEGI, measures how optimistic or pessimistic consumers are with respect to the economy in the near future.

SHCP: Secretaria de Hacienda y Credito Publico, is the Ministry of Finance.

FEIP Budgetary Income Stabilization Fund: The Oil Revenues Stabilization Fund was created as a policy tool for adequate risk management of the tax and oil royalty revenues of Mexico's Federal Government. In particular, the Fund is used for compensating reductions in oil and non-oil tax revenues during a fiscal exercise

Industrial Production Index: The industrial production index (IPI) is a monthly economic indicator measuring real output in the manufacturing, mining, electric and gas industries, relative to a base year.

Mexican Mix Mexican crude is classified into three types: the Maya, Isthmus and Olmeca. This variety make up what is known as a Mexican mix.

Dow Jones: The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the Nasdaq. The DJIA was invented by Charles Dow in 1896.

S&P 500: The Standard & Poor's 500 Index - S&P 500 is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies by market value. The S&P 500 is a market value or market-capitalization-weighted index and one of the most common benchmarks for the broader U.S. equity markets

NASDAQ: The Nasdaq Composite Index is the market capitalization-weighted index of over 3,300 common equities listed on the Nasdaq stock exchange. The types of securities in the index include American depositary receipts, common stocks, real estate investment trusts (REITs) and tracking stocks, as well as limited partnership interests.

Consumer Price Index (CPI): Measures the weighted average of prices of a basket of consumer goods and services. It is not possible to invest in an index.

Disclosures

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