The Index From Ipanema

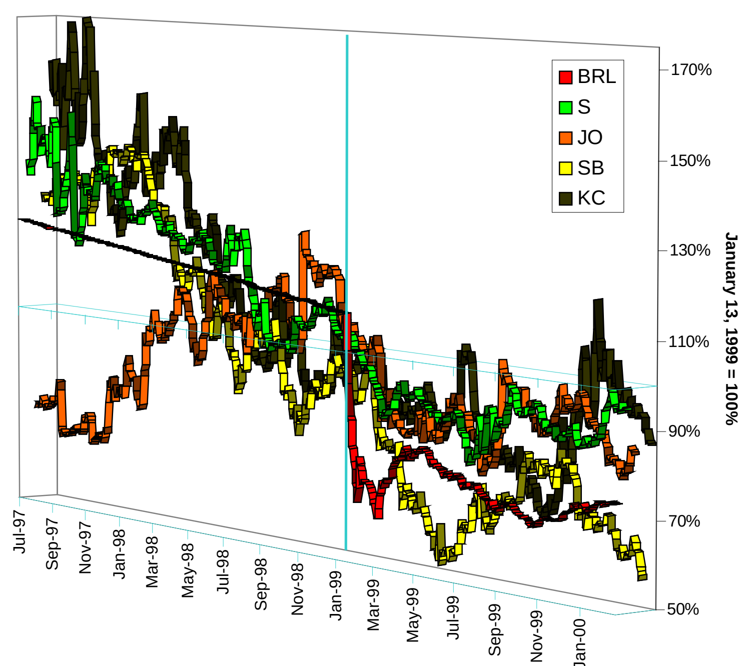
Ah, Rio! Where Amazon is just a river! Sunny skies, beautiful beaches, the spirit of Carnival, and a chance to rub elbows with the rogue traders who got away! [LEGAL DISCLAIMER: Your actual extradition experience may vary.] It wasn't too long ago -- January 13, 1999, in fact -- that a massive devaluation of the Brazilian *real* (BRL) threatened to snowball into the third leg of the global currency crisis. The logic seemed impeccable, what had started in South Asia in 1997 and spread to Russia in 1998, would end in Latin America in 1999. Unlike South Asia and Russia, however, Brazil mattered by its sheer size; it is the world's eighth largest economy and a major trading partner of the U.S.

The selloff in the U.S. was severe enough to last for hours.

Brazil's status as a major player in such diverse commodity markets as soybeans (S), sugar (SB), orange juice (JO), and, of course, coffee (KC) led to severe disruptions and multiple-year lows in those markets as the cash-strapped country exported everything it could. Since the devaluation, world sugar and soybean prices have remained below pre-devaluation levels, while coffee and orange juice have bounced higher on brief occasions. Just as the previous crises had done, Brazil's troubles led to lower import costs for U.S. consumers, particularly in the volatile food sector.

The inverted chart of the BRL is included along with the commodity prices to highlight the extent of the currency's catastrophic break following a long period of planned devaluation. The government had operated on the premise a controlled weakening of the currency would allow for greater certainty in planning for multinationals and locals alike. The chart speaks to the policy's success, and underscores, one more time, how badly broken the world's currency markets are.

Commodity Deflation From Brazil



Internet Stocks In Emerging Markets…
…Are not suitable for widows and orphans. Brazil's social compact allows for periods of runaway inflation and financial calamities that affect the masses more than the elites. As a result, it is always too soon to call

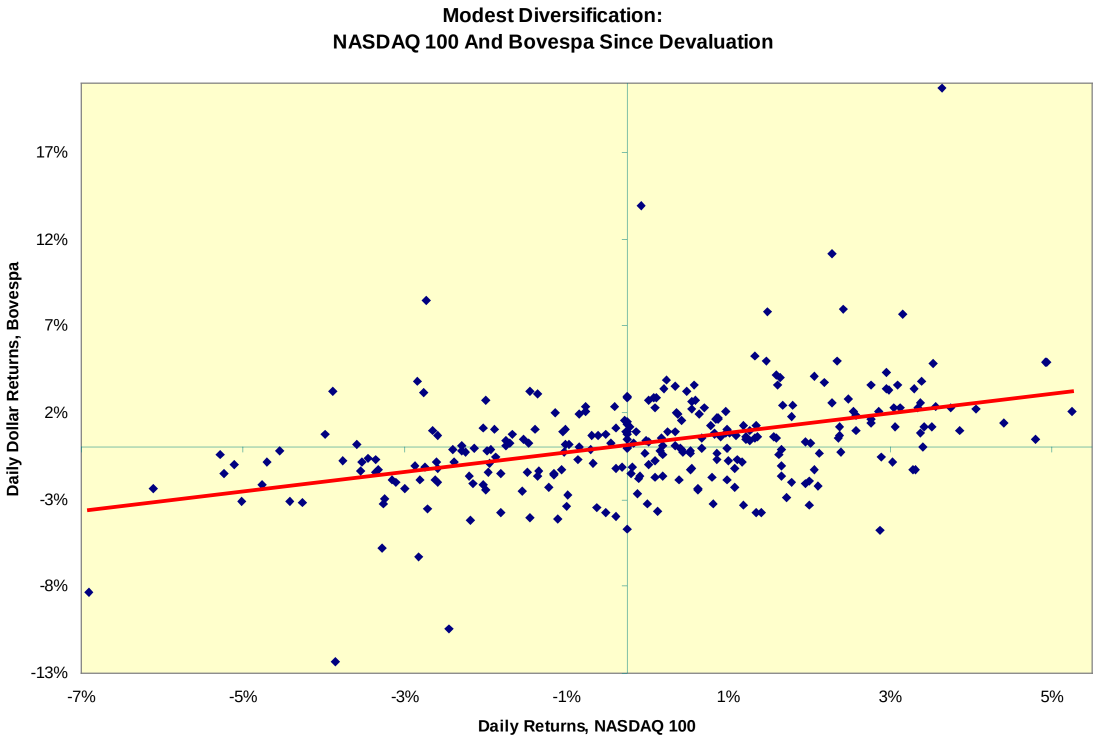
a permanent turnaround in Latin America's largest economy. A bet is offered to one and all: Come back in one hundred years, and we'll still be calling Brazil an emerging market. But it is clear Brazil not only managed to fend off a disaster in 1999, but it has been a pretty rewarding place to invest ever since. The Bovespa, Brazil's stock index, has been on a tear since the late summer of 1999 that would do the NASDAQ proud. In dollar-adjusted terms, it is up over 7% so far in 2000. As they would say in Brazil if they spoke Spanish instead of Portuguese, que pasa?

The answer, in one word, is Telebras, the Brazilian telecommunications giant. The Bovespa is an index of 44 stocks, and has a 7.453% weighting in Telebras common and a whopping 36.546% weighting in Telebras preferred. Petrobras, the state oil company, account for another 10%. This is even more lopsided than the combined weights of BCE and Nortel in the Toronto 300 index (see "Canada Rally," December 22, 1999).

Telebras is only one of the stocks in the Brazilian Internet surge. Globo Cabo, the country's largest cable TV operator, is up over 1,400% in the past year on speculation that its fat pipes will become the Web transmission medium of choice. Other Brazilian telecoms include Telemig, Telemar, Tele Centro Sul Participa, and Embratel, a unit of MCI Worldcom. The Internet-related rally in Brazil is more speculative than comparable rallies elsewhere given that these companies still earn far more from voice traffic than from Web traffic; Tele Centro Sul Participa's data revenue, for example, was only 4.7% of its total revenue during 1999.

What, say you, have fundamentals ever done for technology investors? The name of the game in Sao Paulo is the same as in New York, and that is momentum. And, let's not forget portfolio diversification, which may consist of adding a few Brazilian Internet stocks to your portfolio of other Internet stocks. Yes, you will have currency risk, but one interesting side effect of the January 1999 devaluation is that a similar earthquake is unlikely for a while. Since the cost of hedging the BRL is high -- the benchmark interest rate is 19% -- selling the BRL forward to hedge your portfolio is probably more trouble than it is worth.

If we compare the daily returns of the Bovespa in U.S. dollar terms to those of the NASDAQ 100, we find adding Brazilian stocks to your U.S. portfolio will reduce both your risk and return modestly. The correlation is positive and weak (r^2 = .173 for you statistics buffs).



The Bovespa is cheap compared to the NASDAQ 100. At the time of this writing, the P/E ratio for the Bovespa is a modest 20.82, with a dividend yield of 3.05%. The comparable figures for the NDX are 140.97 and .03%, respectively. The decision of which investment is riskier will be left to you.