

## From Russia With Crude

*"We took some pictures of the native girls, but they weren't developed."* -- Groucho Marx

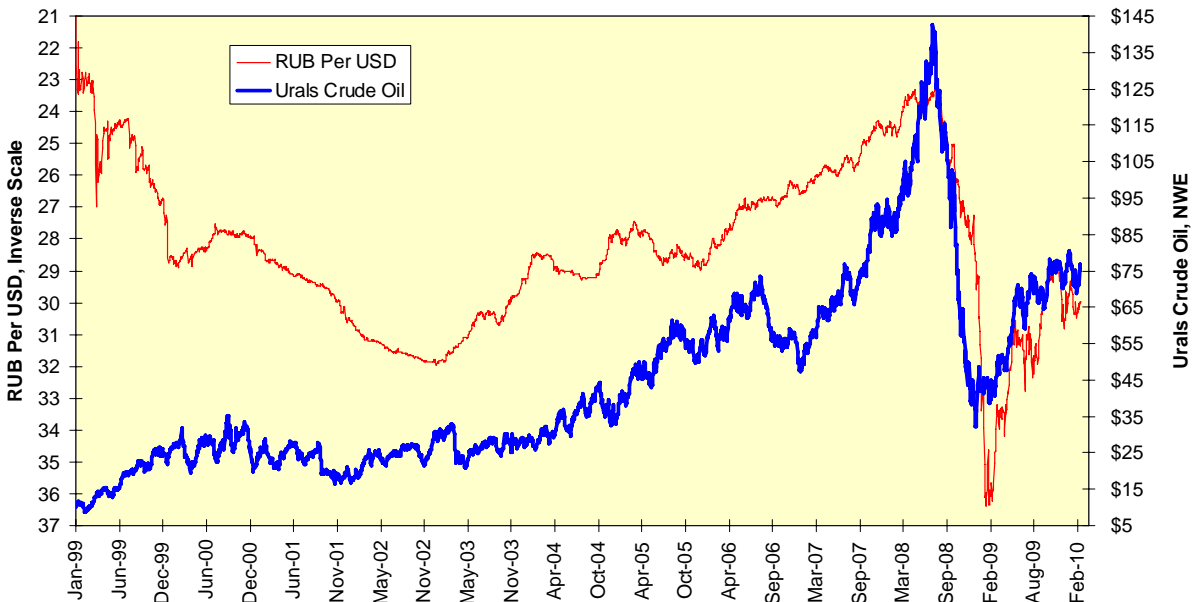
Remarkably, there are no hard-and-fast definitions of what a "developing nation" is; I prefer to believe the United State falls into this pejorative category for no reason other than countries, like people, are blessed with one life to live and to squander it by ceasing to grow is quite simply a crime against God.

Still, most of us should agree a country whose economy has been distorted by excessive dependence on the exports of extracted commodities such as crude oil is in a state of arrested development. Russia, the lynchpin of "back in the USSR" back in the day, is not as distorted as, say, Venezuela, by its exports of various extracted commodities, but its dependence thereon is quite striking. Who knows; it may one day cease to be the 'R' in 'BRIC,' leaving us with nothing but BIC, and how fortunate we should count ourselves neither Paraguay nor Peru became the Latin American success story ahead of Brazil.

### The Ruble Link

We can illustrate Russia's excessive and growing reliance on crude oil prices in two ways. The first is the tightening correlation between the ruble and the price of Urals crude oil delivered to refining centers in Northwest Europe. Prior to the Federal Reserve's first war on deflation in May 2003, this correlation was negative; it then became increasingly positive as the bull market in crude oil and the resulting revenue stream made the currency commodity-dependent. By the July 2008 peak in crude oil, the correlation became positive and increasingly tight. The ruble now is a close play on a single commodity.

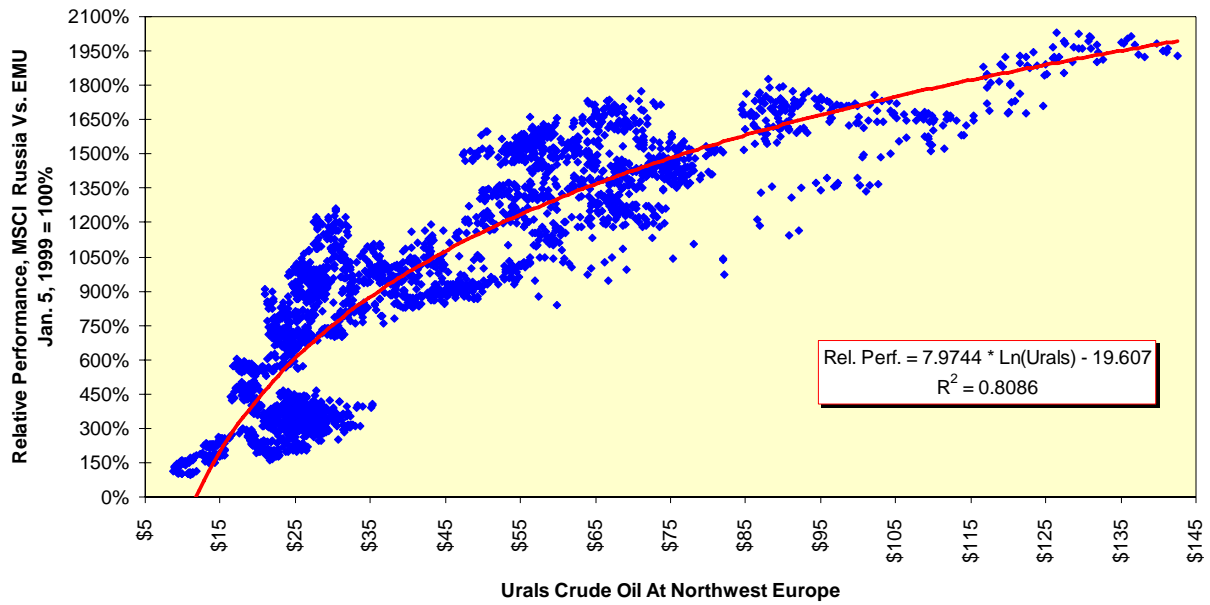
The Ruble/Dollar Rate And Crude Oil



### The Stock Market Link

Next, let's map the incremental performance of the Russian stock market relative to that of the European Monetary Union while there still is a European Monetary Union. This incremental performance – I hesitate to say "alpha" lest someone thinks I am organizing a conference of institutional investors – is a strong logarithmic function of crude oil prices. As prices rise, Russia outperforms the EMU, but as a decreasing rate. As prices fall, Russia underperforms Europe at an increasing rate. If this is not dependence, what is?

### Russian Equity Relative Performance A Function Of Crude Oil



If crude oil prices stay in their present range, a statement and not a forecast, Russia will be in something of a sweet spot. The 2007-2008 surge did what a commodity boom always does, and that is make the seller sloppy. As an aside, the Swiss franc got very strong relative to the euro during this period as funds from Russia and the Middle East made their way into those models of fiscal rectitude, the Swiss banks. The rising franc pinched Eastern European mortgage borrowers who had decided that normal mortgages were not sufficiently risky; no, they wanted to borrow in a different currency.

For now, however, base your exposure to Russia on whatever you base your outlook on for crude oil. That should be easy enough; in thirty-five years, I must have met someone who forecast crude oil prices correctly, and as soon as I recall their name, I will let you know.