Brazil And Colombia Take Opposite Paths

Guilt by association is bad enough when it comes to dealing with people, but when it comes to markets where I might be involved, it is truly execrable. This used to afflict me back in the days when I wrote a Mexican peso letter and it would get clobbered whenever Argentina went off on one of its many escapades into fiscal irresponsibility. As the late Warren Zevon might have sung, "*pobre, pobre de mí lamentable*." As an aside, I spoke to a gathering of Latin American wheat buyers once and I can assure you from the body language at lunch they did not consider each other to be interchangeable.

Two Countries, Two Decisions

It is worth noting, therefore, the opposite decisions taken last week by Brazil and Colombia. The Brazilians have been concerned with rising inflation and a downturn in the real (BRL) and intervened to support it while the Colombians have been concerned with the strength of the peso (COP) and intervened against it with the intention of driving it significantly lower. Colombia cut its benchmark interest rate to 4%, the lowest in Latin America; such a thing is possible when your consumer price index comes in lower than expected.

Opposing moves of this nature are reminiscent of those undertaken in the early 1990s by the U.S. and Germany; we were cutting our rates, allegedly to stimulate the economy, while the Germans were raising theirs to fend off inflation resulting from reunification. Markets trumped both central banks by weakening the dollar against the Deutsche mark and by having our yield curve steepen while Germany's inverted. If last week COP per BRL exchange rate is any indicator – and if you do not have this on your screen, put it there right now – the peso will weaken against the real.

Stock Market Response

What should we expect from their respective equity markets? Brazil enjoyed a huge run between 2002 and 2007 and it met the Number One criterion for inclusion in many investors' portfolios: It was the 'B' in BRIC, and there is no better reason to invest in anything than a catchy acronym. However, it did not duplicate that experience coming out of the financial crisis as the BRL's strength appeared to reduce the competitiveness of Brazil in global markets. Should they succeed in boosting the BRL, you will be better off in U.S. stocks.

Once again, the picture is diametrically opposite for Colombia. Their market was a world-beater, literally, between 2001 and 2010; they were right up there with Indonesia in the mega-return department. Their market has languished since October 2010. A weaker COP should put Colombia in position to outperform the U.S.

You can access Colombia through vehicles such as Market Vectors Colombia (COLX); long ETFs on Brazil include iShares MSCI Brazil (EWZ). I should add, given my negative relative opinion on Brazil, there are short ETFs such ProShares UltraShort MSCI Brazil (BZQ), but let's just say I am not a fan of leveraged short vehicles.

Finally, it is important to remember the whole guilt by association comment. Just because we get lazy and attach broad labels on disparate markets that does not make all "emerging markets" act like a monolith. Latin American, South and East Asia, Eastern Europe and the so-called frontier markets are very different from each other. Even within a region such as Latin America, Brazil and Colombia can and have gone their separate ways.