

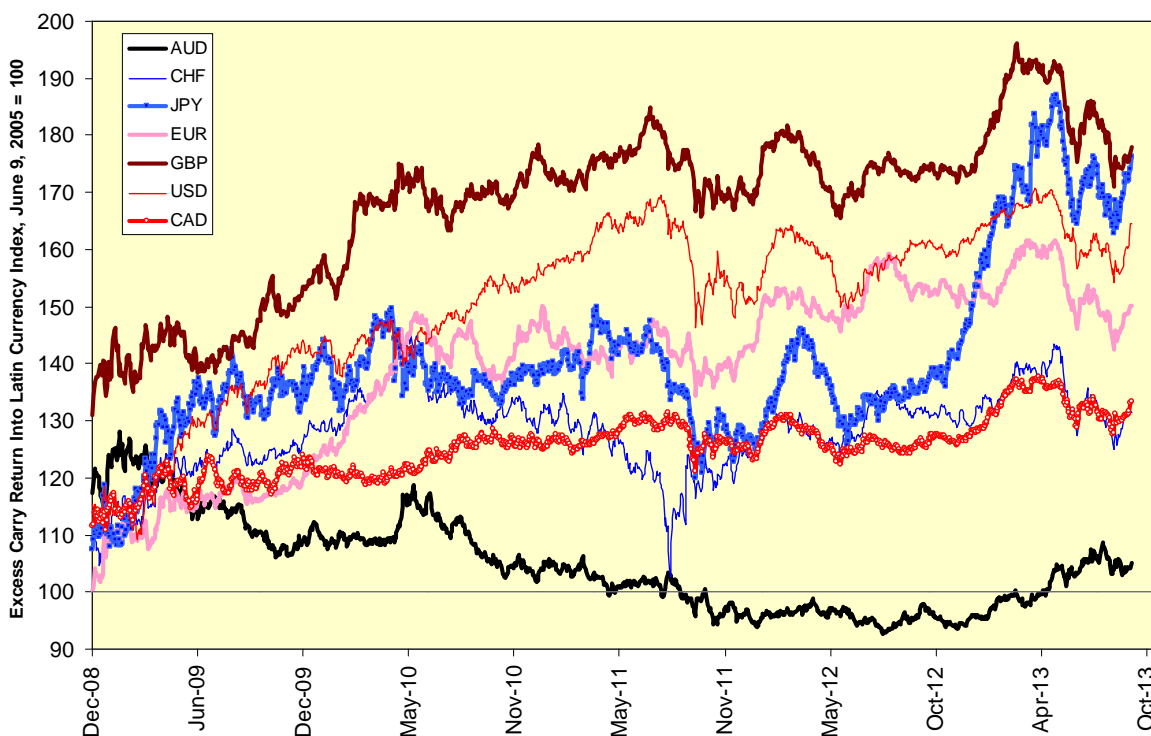
Latin American Markets Were Already Dollar-Dependent

Every now and then you run into someone who seems spoiled by success only to find out he or she was a complete pill before they became rich and famous. So it is with Latin American markets; last Wednesday's post-FOMC catapult higher did not establish a dependency on the dollar carry trade, it simply highlighted what was already the case.

Let's take a look at the Bloomberg-J.P. Morgan index of Latin American currencies, a counterpart to the Asian currency index discussed in [July 2011](#). This index is 33% each the Brazilian real and Mexican peso, 12%, 10% and 7% the Chilean, Argentine and Colombian pesos, respectively, and 5% the Peruvian sol, not to be confused with the 1964 bubblegum classic [A Little Bit O' Soul](#).

The excess carry returns of various major currencies into this index from the U.S. adoption of zero interest rate policies in December 2008 are depicted below; the actual index begins in June 2005. The abrupt decline and rebound of the key carry trade currencies such as the U.S. dollar and Japanese yen over the past five months is easy to spot.

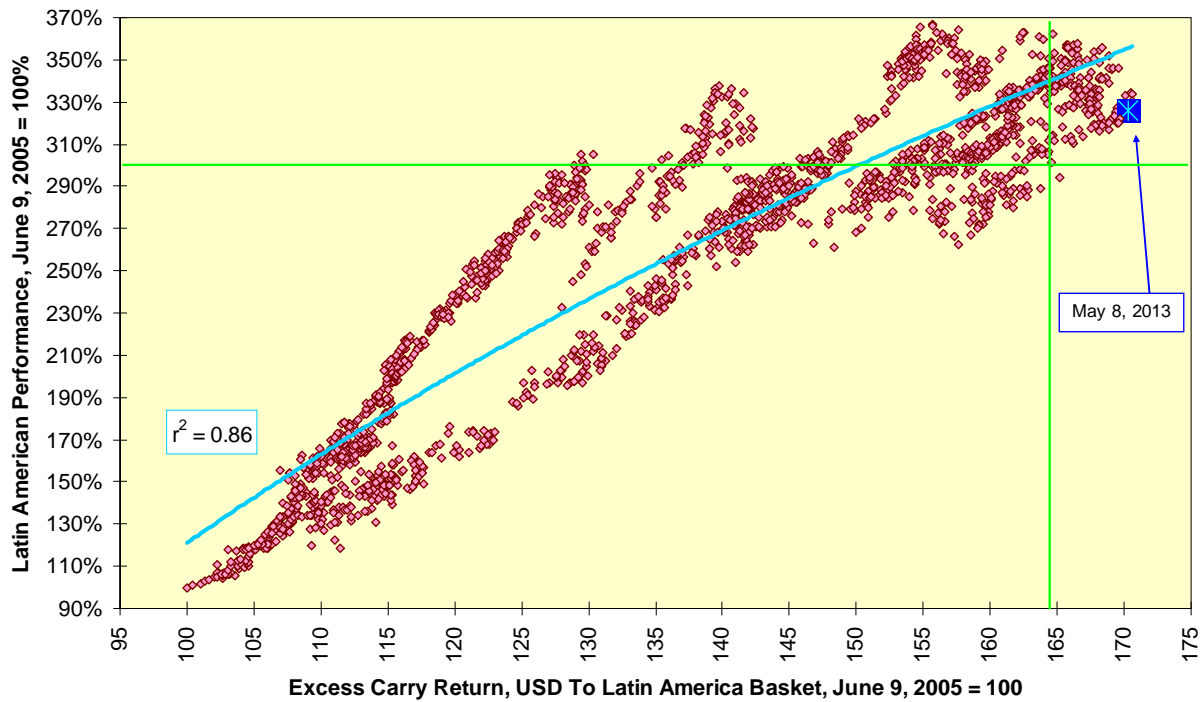
Excess Carry Returns Into The Latin America Currency Index



Equity Performance

Is the performance of an index of Latin American stocks weighted per the currency index linked to the dollar carry trade? If we map this index' returns in U.S. dollar terms against the excess carry return of the dollar into Latin American currencies, we get a very powerful relationship. The r^2 , or percentage of variance explained, is a robust 0.86.

Latin American Equities As Function Of USD Carry Trade Absolute Return



I highlighted the May 8, 2013 datum marking the start of the currency index' downturn in blue and noted last Wednesday's environment with a green bombsight. If money starts to flow back into Latin American currencies, it also will start flowing back into Latin American stocks. As I expect other major central banks to follow the Federal Reserve's lead in the game of competitive devaluation, I expect the next few months to be clear sailing for Latin American stocks.

ETFs such as the iShares Brazil (EWZ), Mexico (EWW) and the S&P Latin American 40 (ILF) funds all are excellent ways to play this trend. Keep one thing in mind about free money, though: Those who give it to you without warning can take it away without warning. This is a trade, not an heirloom investment.