

Chile And Copper

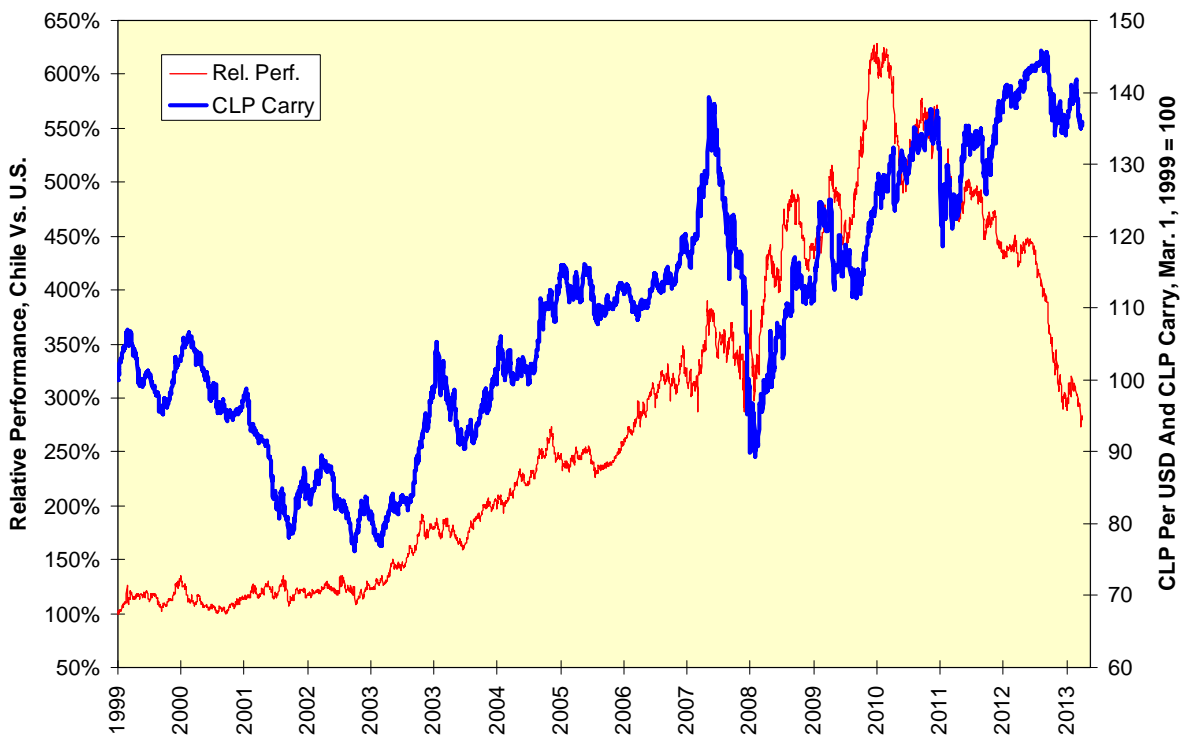
If, in a long-lost moment of your youth a significant other was staring up at a star-filled night and getting all gooey about the vastness of the universe and all you could think about was the subduction of the Pacific Plate under South America at the Chile-Peru trench and how it propelled dissolved metal chlorides and sulfides into rock fissures in the Andes, then you probably are a geologist or certainly someone with a passing interest in all things copper.

Even if you are not, you have to marvel at how Chile's citizens will be returning leftward-leaning Michelle Bachelet to the presidency next month and how Chile's central bank has felt it necessary to cut its base lending rate at each of its last two meetings in an effort to "stimulate" the woebegone Chilean stock market and the languishing Chilean peso (CLP). The MSCI-Barra Chilean index, accessible to you via the iShares MSCI Chile Capped Equity fund (ECH) has declined almost 19.8% in USD terms so far in 2013.

Lower Carry

Lower interest rates in Chile are a double-edged sword. The average annual interest rate spread between Chile and the U.S. has been 4.35% during the entirety of the post-QE2 era going back to the Jackson Hole meeting in August 2010. This spread acted to maintain the spot CLP up until April 2013, at which point rising expectations for a change in U.S. monetary policy overwhelmed the interest rate spread and reduced the carry return for borrowing dollars and lending pesos. Chilean relative performance, already on the ropes, broke even further and faster.

Chilean Markets Declining



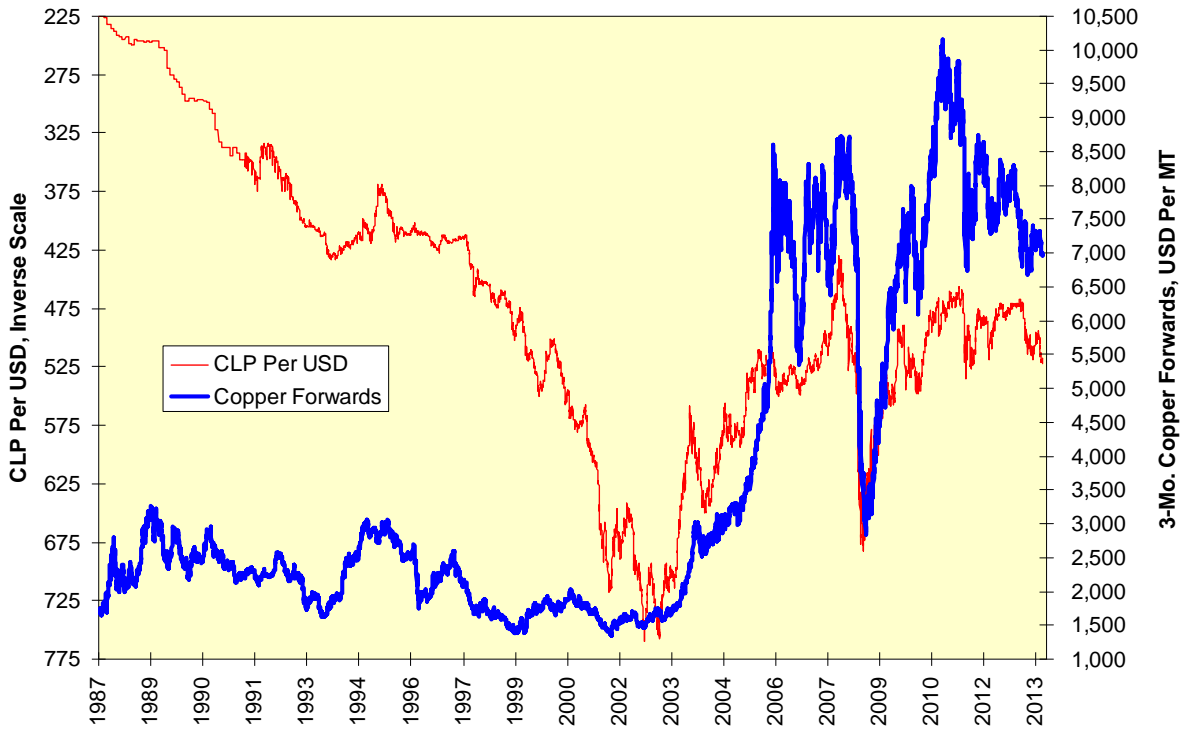
The hope, and "hope" is a word investors should use sparingly if at all, is lower interest rates will arrest some of the decline in Chile's relative performance and induce fund inflows into Chile. Markets will require time to judge the direction of the incoming Bachelet administration and any investment decisions made in relation to Chile will have to make in comparison to global alternatives.

Copper

Chile is more than a copper mine, of course, but the metal has dominated Chile's export mix for years. The CLP has been able to move independently of copper prices since the aftermath of the financial crisis. Moreover, the massive downturn in Chilean relative performance has exceeded the softness in copper prices significantly in 2013. If the total return on the Dow Jones-UBS copper subindex has been -33% since February 2011, blame a slowdown in Chinese imports and mine capacity expansions more than anything related specifically to Chile. However, markets

do look forward, more or less, and it is unlikely Chilean equities would be underperforming so badly without some anticipation of lower copper prices.

Chilean Peso Not Linked Strongly To Copper



The resource cycle always peaks with over-capacity and this always takes years to be absorbed. The case will be no different for copper, with negative implications for Chilean equities.