

Commodity-Linked Currencies: Chile

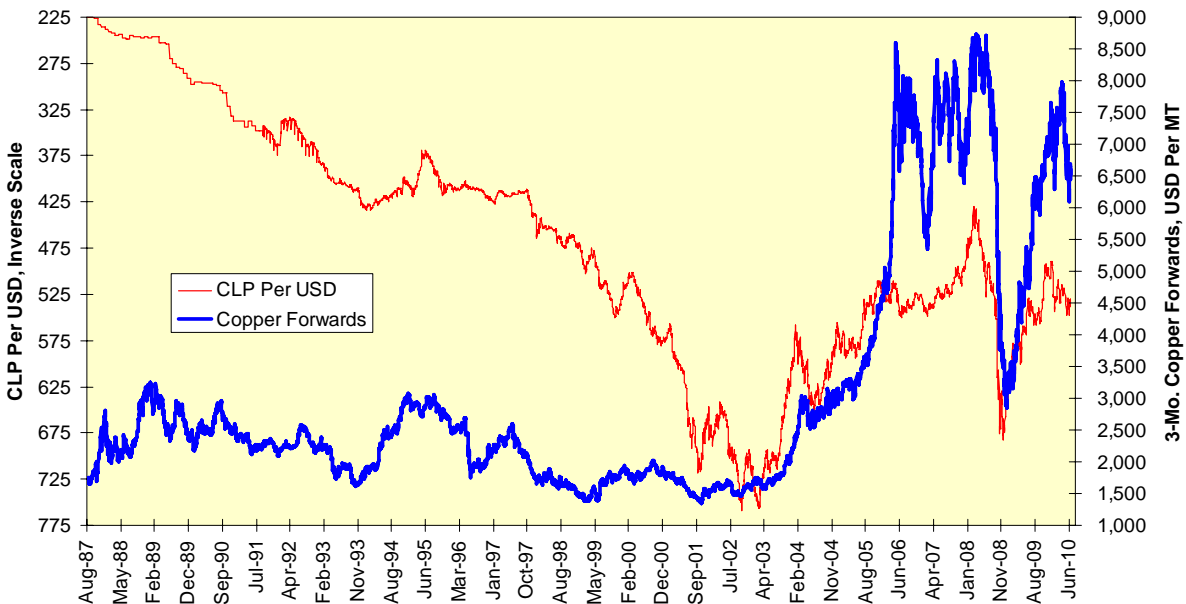
If you think the U.S. Congress passes some head-scratchers today, turn the calendar back to 1856 and consider the Guano Islands Act, which gave American citizens the right to claim for the U.S. otherwise unclaimed islands spackled with guano. Prior to the development of the Haber process for fixing nitrogen out of the air, guano was an important source of nitrates used for fertilizers and explosives.

Which brings us to Chile, whose sea cliffs had played host to eons of seabirds who treated the entire coastline much like a pigeon does your car's windshield. Chile had a good business going supplying nitrates to the world's arsenals, including those of European powers who made no pretenses to pacifism in the 19th century. Once you could make ammonia from air and any source of hydrogen, who needed guano? Not me. But everyone needed copper, and Chile soon had a better business mining that and sending it off to make brass shell-casings and bronze statues of generals who had the good sense not to give *Rolling Stone* interviews.

Chilean Peso

Does this mean the Chilean peso has become a prisoner of copper prices? Over short periods of time, such as 2004-2006 and again during the 2008-2009 drop-stop-and-pop that characterized so many markets, the answer appears to be, "Yes," but over time the peso moves to the beat of other drummers. These include agricultural exports from the country's thriving fruit and wine producers; it took several centuries of logistical developments for Chile to take advantage of its Southern Hemisphere location and begin exporting crops out-of-season in the U.S. and other Northern Hemisphere markets.

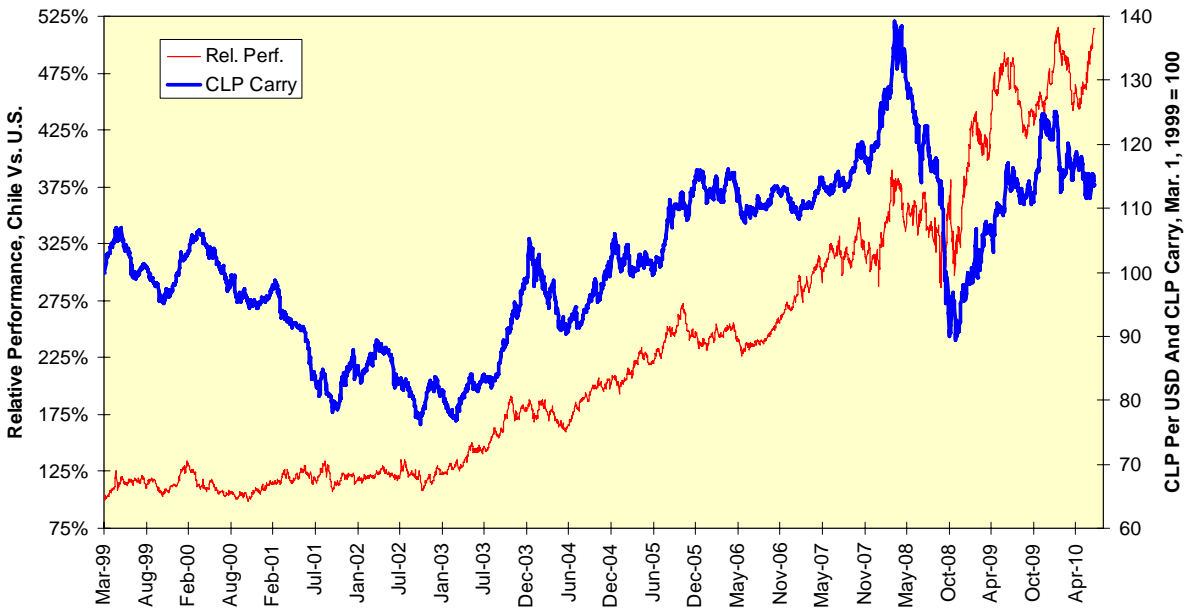
Chilean Peso Not Linked Strongly To Copper



Link To Chilean Stocks

The Chilean peso may be of great interest to currency traders, but does it have a dominant effect on the relative performance of Chilean equities? If we map the total return for borrowing USD and lending CLP against the relative total returns in USD terms of Chilean versus American stocks, we find a divergence somewhat unusual in the modern international investing sphere: Chile's stocks have broken the link to currency carry and have begun outperforming U.S. stocks intrinsically. As noted [last week](#), too much of international investing has turned into nothing more than an expensive way to trade currencies.

Chilean Performance Diverged From Peso In Mid-2008



The timing of this divergence is interesting; it began at the end of April 2010, the very time when the U.S. and other major markets started to peak, and it was driven by both markets. Chile has gained 2.15% in USD terms since April 26, 2010, while the U.S. has lost 11.2%. It seems as if Chile, famous for its University of Chicago free-market influence, has been able to buck the tide of investors fleeing never-ending government intervention and the so-far failed attempt to solve every problem with free money.

Oh, and about that copper; they barely put a whiff of it on pennies anymore as the U.S. Mint manages to lose money stamping them out. Some of us remember when you could buy things not only with pennies, but with nickels and dimes as well. That sounds today as quaint as the Guano Act.