South of The Border To Head South Soon

Wasting away in Margaritaville sounds like appealing to those who have not yet availed themselves of the opportunities to do some serious goofing off so far in 2002. Judging from returns so far this year, the irrepressible American spirit must be finding solace in other spirits: The top performing groups in the S&P 500 include metal & glass containers, up 15.0%, brewers, up 15.8%, distillers & vintners, up 12.4%, and casinos & gaming, up 8.4%.

The mutual fund industry, never shy about hopping on the latest fashion, has responded predictably: Mutuals.com is launching its Vice Fund on September 3, the first "socially irresponsible" fund with a charter to focus on alcohol, tobacco, gambling and weapons manufacture. Why get tech'd when you can get wrecked? Party on, dudes!

Elsewhere on the good-times-roll front and within the Dow Jones Industrial Average, Philip Morris is up 7.8%. Procter & Gamble, which makes Pringles, has risen 11.9%, while Intel has fallen 45.5%. The conclusion is inescapable: At this stage of the bear market Americans far prefer potato chips to microchips.

Ain't It (Rio) Grande?

No matter how we splice and dice the American market to prove the obvious appeal of 1930s-style escapism, the simple fact remains that the U.S. market has not been the place to be. As we turn the pages on the calendar to autumn, let's follow the sun southward to Mexico, the home of tequila and thus the spiritual home of Margaritaville. It is also the place where the financial history of the late 1990s really began.

Say what? Let's turn the clock back to December 1994, when in the finest tradition of the Mexican political and economic cycle, the peso collapsed as the new president, Ernesto Zedillo, took office. Mexican interest rates shot higher, and in what was to become a pattern, Robert Rubin engineered a bailout. Remember Tesobonos?

Some would say Rubin really bailed out U.S. investors who forgot that the interest rates on emerging market paper were so high because the risks are considerable, but let's not quibble over such unpleasantness. The cycle of easier credit, moral hazard and global interventionism on behalf of markets began and continued through the Russian default in August 1998. You know the rest.

Bolsa Booster

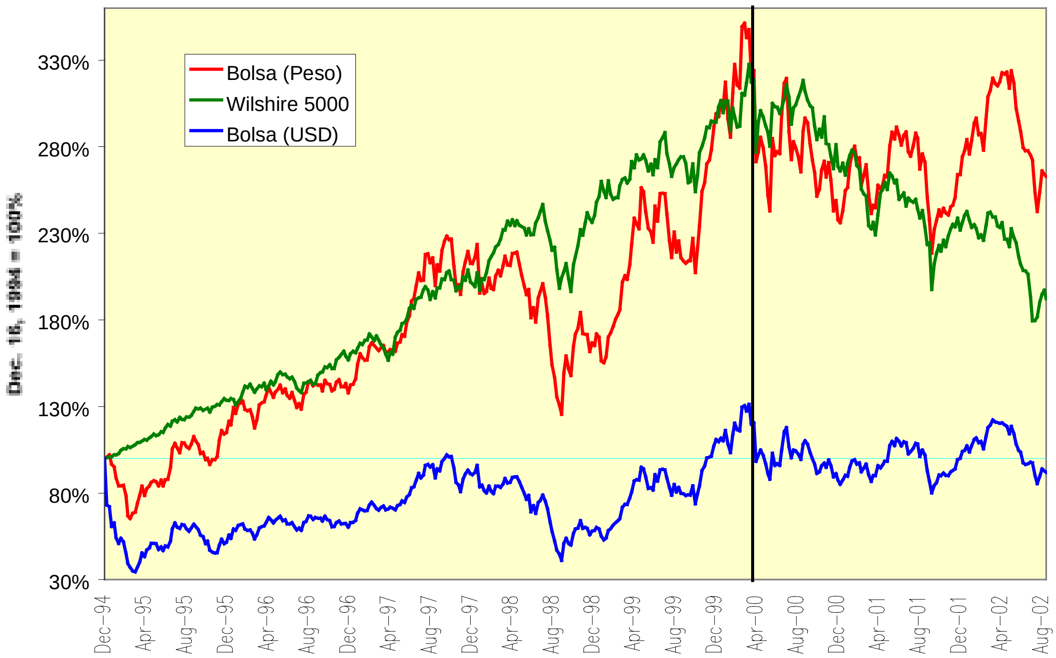
The Mexican Bolsa index has been a strong performer by world standards ever since, both in absolute and currency-adjusted terms. The benefits of NAFTA to Mexican exporters have been large, as was the first peaceable transfer of power from the dominant Institutional Party of the Revolution (PRI) to Vicente Fox' National Action Party (PAN). The Bolsa boasts a large number of stocks whose peso-denominated performance has been stellar so far in 2002:

Savia:	This agro-technology and financial services firm has risen 123.8%
Grupo Industrial Saltillo:	This industrial conglomerate with interests in automotive products and building materials is up 97.4%
Industrias Penoles:	This mining group is up 88.0%
Alfa:	This industrial conglomerate with interests in steel and petrochemicals in up 69.0%

The peso, one of the strongest performers against the dollar all through 2001, has fallen 8.4% in 2002, so the above-noted returns have to be adjusted accordingly. Overall, the Bolsa index has lost 3% in peso terms and 10.4% in dollar terms.

The question, of course, is where can Mexican stocks go from here? The prognosis isn't bright. Let's compare the Bolsa to the U.S. market since the middle of December 1994, just prior to the peso's collapse.

Peso Still A Drag On Returns

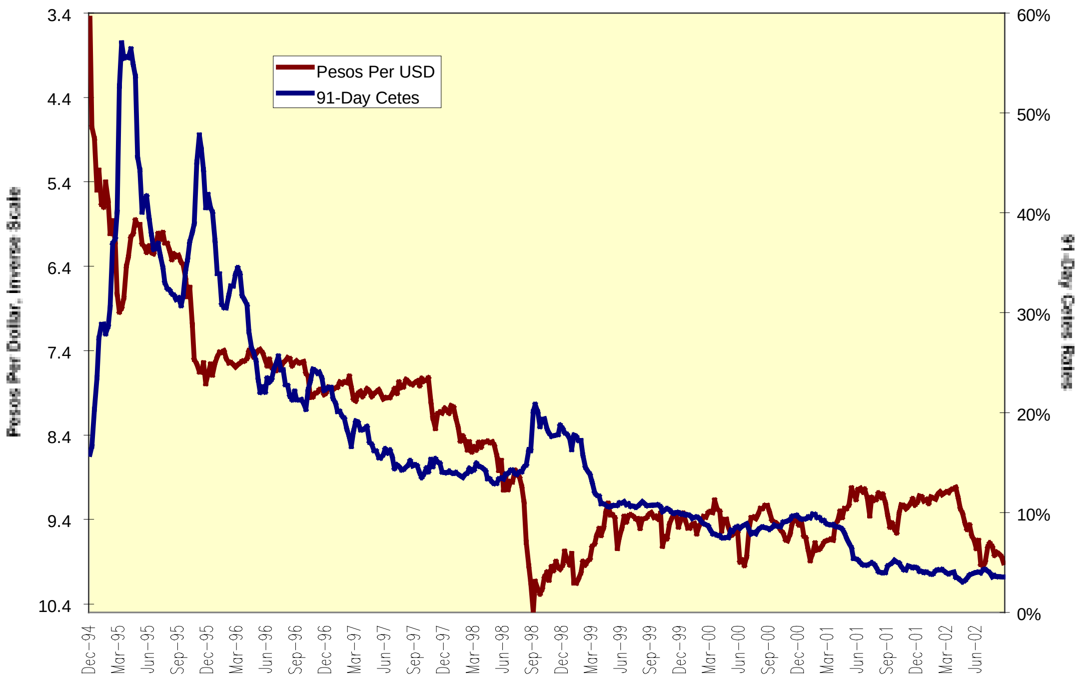


The Bolsa has outperformed the Wilshire 5000 in peso terms since that time - it was only an underperformer during the Asian/Russian crises of 1997-1998 - but in dollar terms it is pretty much where it was just prior to the peso collapse. The Bolsa's has been stable in dollar terms since the spring of 2000, while the U.S. market has remained in retreat.

Stocks And The Cetes

Much of the Bolsa's strength has derived from a strong disinflation trend as evidenced by the decline in 91-day Cetes, or Mexican Treasury certificates: When interest rates fall from 57% in March 1995 to 3.6% today, something good had better happen to your stock market. The lower interest rates pressured the peso lower over the same period, which further boosted the Mexican export sector.

The End Of The Line On Rates?



Of course, you can only go so far with this combination. The weaker peso, while supportive of exports, also raises the costs of imports and thereby dampens the disinflationary process. Higher interest rates, which would support the peso at the cost of economic growth, are seldom good for stocks unless accompanied by an earnings boom.

A common lament in Mexico is that it is so far from God and so close to the United States. Indeed, its fellow Latin American states look on Mexico with a strange combination of envy and pity for its unique status. Right now, it appears as if Mexican equities are stuck between a rock and a hard place: Their chief export market isn't growing, their interest rates have stopped falling, and their currency is weakening.

Maybe that person in the hammock next to you in Margaritaville will be a Mexican stockbroker.