

Chile Goes Backwards

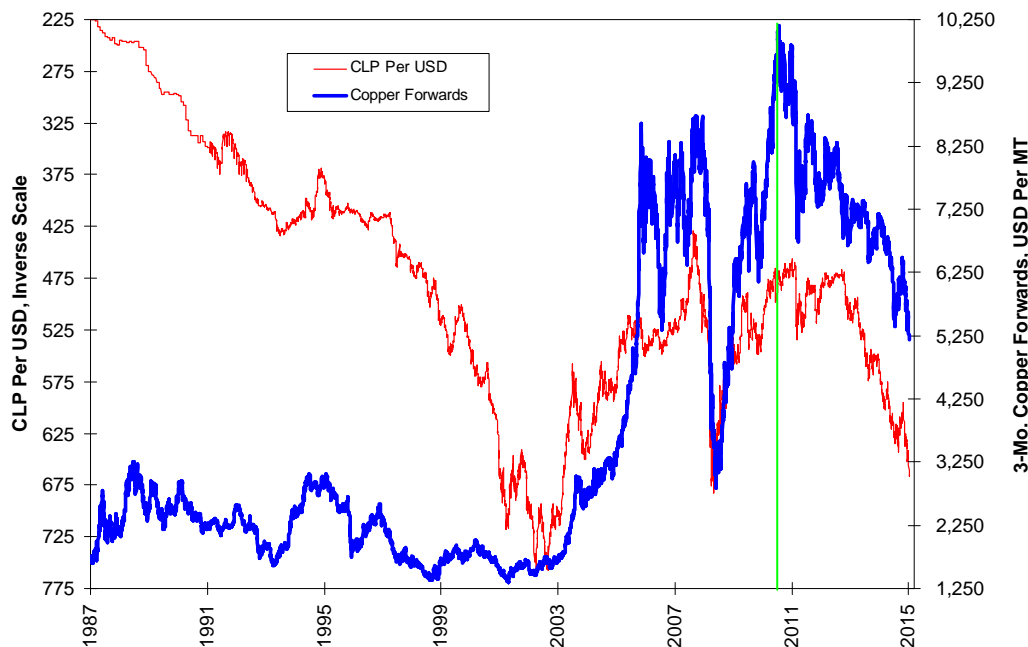
It is one thing to watch a commodity downturn as an investor from afar and quite another to live in an economy dependent on that commodity while it happens. You start to understand those New Deal-era newsreels of dairy farmers spilling milk out on the highway.

You can have a mature and resilient economy or you can have a resource-dependent economy, but you cannot have both simultaneously. Let's take Chile, a country long dependent on copper prices but one that seemed to turn the corner during the latter part of the twentieth century with various free-market reforms. It since has backtracked as so many of its South American neighbors have under the more left-wing policies of the Bachelet government. About the best you can say in that regard is Chile has not reached the level of self-destruction seen in Venezuela, Bolivia, Argentina or now Brazil.

Peso Linkage

The excess carry return from borrowing the dollar and lending into the Chilean peso (CLP) has moved to a new low on the year and stands 23.04% below its breakdown level reached on May 7, 2013. The long-term relationship between the CLP and copper prices remains surprisingly weak; with an r-squared or percentage of variance explained of 0.024, the relationship has grown stronger since copper prices peaked in March 2011 (green vertical line). The beta, or relative variance, is a near-unitary -1.056 and the r-squared has increased to 0.69.

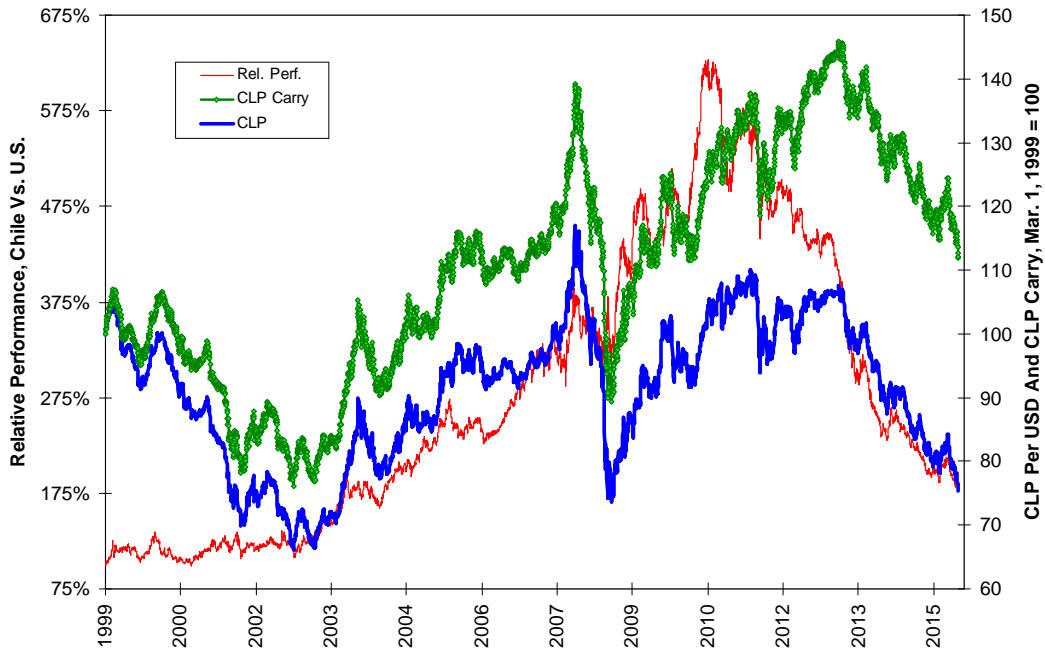
Chilean Peso Increasingly Linked To Copper During Downturn



Relative Performance

The relative performance of Chilean equities in USD terms vis-à-vis the U.S. peaked almost five years ago, in October 2010. While the increasing convergence in downtrends between the CLP and relative performance since the start of the tapering era in May 2013 should be viewed as coincidental and non-deterministic within the context of longer-term history, we cannot deny its increasingly strong relationship. The post-May 2013 r-squared between the USD:CLP excess carry return and relative performance has been an extremely strong 0.935, but it was only 0.650 between March 1999 and the start of the tapering era.

Chilean Relative Performance And CLP Increasingly Linked



Chilean relative performance led copper by three months on average closely between September 2008 and February 2013; it disconnected to the downside since then. Chile's deteriorating relative performance and its increasing linkages to both the CLP and to copper prices represent a historical backslide for an economy once viewed as escaping resource-dependence.

Until Chile returns to more market-oriented policies, this commodity/currency/equity vicious circle will continue, hopefully without your participation as an investor.

Chilean Relative Performance Leading Copper Lower

