

## Latin America: Cloudy Today, Sunny Tomorrow



## Microscope

Stocks in Latin American become more and more attractive because earnings yields in the region have risen near 10-year highs while yields of sovereign debt tumbled, according to Bloomberg. The earnings yields in dollars of companies on the MSCI Brazil stock index have rallied since June, while yields of the country's sovereign debt have held steady. The MSCI Brazil index's earnings yield, or profits divided by market price, is at 12.7%, near the October peak. At the same time, the average yield on Brazilian dollar-denominated debt dropped to 6.78% from 10.35% on October 23. Within the region, Brazil and Peru's dividend yields are the highest in Latin America, while the average for the region is 4%, the highest since September 2002. Brazil, the largest country in the region, is expected to lower interest rates this month to boost the slowing economy. Policy makers will cut the benchmark rate by a half percentage point from the current 13.75% on January 21, according to a central bank survey of 100 economists taken January 2, 2009. The region is helped, to a larger extent, by the continuous liquidity flow as well as the government stimulus plans. Certainly, it's a matter of time. 

No countries can immune from the current economic downturn cycle, even Latin America, where treasures basic commodities. Commodities, from Venezuelan oil to Peruvian minerals, Argentine soya and Brazilian iron ore and orange juice, make up a big chunk of the region's exports. On the other hand, banks in Latin America have turned cautious. Many foreign banks are cancelling credit lines to the region, or renewing them for shorter periods or at higher rates. That may be to shore up their battered finances at home, but local banks seem to be following suit. Nevertheless, it is expected that the economic instability will only last for a while due to the strong fundamentals in this region. Brazil, Latin America's largest market and the world's tenth-largest economy in GDP terms, has spent 176 billion reais (US\$77 billion) to battle the impact of the crisis -- 106 billion reais (US\$46 billion) to

increase market liquidity and 70 billion reais (US\$31 billion) to reestablish credit in other sectors of the economy. The central bank still has more than US\$200 billion in foreign reserves. Above-average GDP growth in Brazil will allow real incomes to increase over the forecast period. Income inequality will continue to decline on the back of income support programmes. Further consolidation of macroeconomic stability and enhanced opportunities in a large domestic market will prevent the country from losing ground in global and regional rankings. What's certain is that many investors feel that Brazil is still attractive even during this financial crisis. Recently, the Central Bank of Brazil raised its projection for foreign direct investment in Brazil from US\$ 35 billion to US\$ 40 billion last year, a record-high figure. Up until

November last year, inflow of this sort of capital totalled US\$36.926billion. In November alone, the total was US\$2.179billion. Global investors begin to differentiate Brazil from China, highlighting Brazil's strong finances, impressive agricultural and oil output and anchor status in Latin America. During the first week of January, the benchmark index posted the strongest record of any major index, augmented for US investors by a strengthening in the real against the dollar. The key to Brazil's success lies with Central Bank policy. In January 2003, at the beginning of President Lula's first term, real interest rates were almost 30%. A declining trend set in during Lula's first year, but average real rates remained high, in the mid-teens, before declining to a 10% currently. In fact, low inflation fuels consumption. 

### MARKET BRIEFING


YTD % (local curr)

<b>US DJ</b>	8,599 (-2%)
<b>Nasdaq</b>	1,571 (-0.3%)
<b>Euro Stoxx 50</b>	2,486 (1.4%)
<b>HSI</b>	14,377 (-0.1%)
<b>Japan NK225</b>	8,836 (-0.3%)
<b>China Shanghai Composite</b>	1,904 (4.6%)
<b>Singapore</b>	1,806 (2.5%)
<b>India BSE30</b>	9,406 (-2.5%)
<b>Brazil BOVESPA</b>	41,582 (10.7%)
<b>Aus All Ord</b>	3,680 (0.6%)
<b>US-10yr Bond</b>	Yield 2.39%


As at 09/01/09

## Insight: "High Yield Bond"

Although the macro outlook for 2009 is cautious, this is a different story for high yield bonds. The outlook for defaults is good - they are not expected to reach the very high levels seen in the 2000 era when defaults exceeded 10%. Traditional default rates are about 2%. That rate may rise, but is not expected to approach the extraordinary rates reached at the start of the decade. However, once the high yield bonds become low yield during 2H of 2009, you might realize the economic recovery is in the making. On the marginal analysis, sizeable interest rate cuts during 2008 will hit savers, particularly those who depend

on high interest rates as a means of income. Further co-ordinated responses from governments during 2009 will be necessary to encourage economic activity and their actions will be main the driver for asset prices this year. However credit markets are presently taking the most pessimistic view and factoring in significant defaults of around 20% in the high yield market. This situation assumes a worse economic downturn than the 1930s, but the world is now different, especially the transparency in securities prices. Those high yield bonds have 1,000 bps above Treasury rate now. On average, these bonds are expected to yield around 400-450 bps above the Treasury. In the past, periods when the spread has gotten excessive have proven to be opportune times for locking up very high rates. 

## A-Z Financial Tools

**January Effect** is the tendency of the stock market to rise between December 31 and the end of the first week in January. It is possibly because investors choose to sell their stock right before the end of the year in order to claim a capital loss for tax purposes. Once the tax calendar rolls over to a new year these same investors quickly reinvest their money in the market, causing stock prices to rise. 



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