

Quake Does Little to Change Chile Outlook

The massive earthquake in Chile on Feb. 27 that left about 800 dead will do little to derail the mining- and resource-rich economy's long-term prospects, as the rebound in the Chilean stock market since the disaster clearly demonstrates. The IPSA blue-chip stock index in Santiago now stands at 3,790, about where it was before the earthquake, after dipping more than 3 percent on the news.

"Chile should be fine," said Michael Schreiber, president of Wellesley-Mass.-based registered investment adviser Michael Schreiber and Associates. "They're far more prepared for this than, say, Haiti." Schreiber manages about \$150 million, and has some investment exposure to Chile using emerging market mutual funds.

The Chilean economy is anchored by natural resources, primarily copper, where the country supplies one-third of total global production. Copper is used in everything from electrical wiring to plumbing pipes, and is in high demand in rapidly growing regions such as Asia.

Chile's role in the copper economy was made evident as the iPath Dow Jones-UBS Copper Subindex Total Return ETN (NYSEArca: JJC) jumped about 2.5 percent in the first trading session after the quake; the note is now trading almost 4.5 percent higher than a week ago. ETNs are debt issues—this one backed by the good faith and credit of Barclays. The bank guarantees that JJC returns will match the performance of copper futures on the COMEX, before expenses.

The only direct Chilean equity ETF—the iShares MSCI Chile Investable Market Index ETF (NYSEArca: ECH)—initially fell about 4 percent on the news, but has recaptured all of the loss and then some. The ETF was trading on Friday at about \$57.70 a share, or more than 2.5 percent higher on the day and 1.6 percent higher than before Chile was jolted. The quake measured 8.8 on the Richter scale, making it among the five biggest

earthquakes of the past century.

ECH is diversified across many industries, with utilities, materials and industrials topping the list at 28.78 percent, 20.57 percent and 19.92 percent, respectively. The ETF's single-biggest holding is a 13.58 percent stake in energy and resources company Empresas Copec SA.

The main copper mining company in Chile, Codelco, is a state-owned firm.

An Island In Asia

Chile's biggest challenge—and its biggest asset—is its geographical isolation. It occupies a long and narrow 2,700-mile coastal strip between the Pacific Ocean to the west and the Andes mountains to the east, which effectively cuts it off from the rest of Latin America and the region's volatile politics. But that also leaves it a long way from its most important markets in the U.S., Europe and Asia.

"For Chile to be successful, it has to continuously do everything right because it's so far from anything else—they do not have a major population center; they're on the wrong side of the planet," said Peter Zeihan, vice president of analysis at Stratfor, an Austin, Texas-based global intelligence firm. "So if you ever see fiscal irresponsibility or failure to invest in education in Chile, they're going to fall off the map."

Chile's challenge as its economy adds higher-value goods to its export mix, such as wine or computer and auto parts, is to control the costs of labor—no small feat for a country that Zeihan said doesn't attract enough immigration to meaningfully slow the pace of increasing wages.

"They are an island in Asia, is how I think about it," Zeihan said. "They have to find ways to make themselves stand out," he added, noting that Chile's wine industry is a perfect example of how Chile can get the world's attention. It's now the fifth-largest wine exporter on the planet.

Overpriced For Now?

Whatever near-term price movements the earthquake has caused, some investors can't ignore that securities such as JJC and ECH have risen 102 percent and 83 percent, respectively, since global markets hit their lows in March 2009. ECH's 83 percent return pales in comparison with some neighboring countries: the iShares MSCI Brazil Index Fund (NYSEArca: EWZ) is up 119 percent over the same period, while the iShares MSCI Mexico Investable Market Index Fund (NYSEArca: EWW) has jumped 123 percent.

Some brokers are waiting for a bigger pullback in stock prices before investing too much more of their clients' money in emerging market countries.

"The structural growth is there," Tyler Mordy, director of research at Toronto-based HAHN Investment Stewards, said about emerging markets in general. "But economic growth doesn't always translate into investment growth. I think people are overpaying for future growth. We want to buy investments below fair value." Mordy, who builds portfolios using only ETFs, said he doesn't have any investment exposure to Chile.

While emphasizing the broad scope of human tragedy unfolding in Chile, particularly in the hard-hit south-central city of Concepcion, Stratfor's Zeihan said areas most important to the country's economy, including its capital Santiago, were largely spared.

"I think the market was overreacting. The earthquake was pretty far south and almost all the copper production is in the far northern region. So, aside from having some power disruption, there was no damage to the mines."

ECH has gathered more than \$380 million in assets since its November 2007 launch and charges an annual fee of 0.65 percent. The iPath copper ETN has attracted about \$143.3 million in assets since its rollout in October 2007. It has a 0.75 percent expense ratio.