The Rest of the Americas: Reprise
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We are continuing our review of what has happened since we laid out our expectations in our Perspectives at the beginning of the year. We had a view that one could find all manner of investment opportunities, long and short, without moving beyond the continents of the Americas. Given the volatility of the markets and the currency and commodity movements since then it is time to take a fresh look—particularly at the rest of the Americas. Below is a reprise of our expectations and our update of how the expectations have changed. Commodity and Currency movements as well as specific governance issues may cause a greater dispersion in results for the rest of the year.

JAN. 2016 VIEW: The Rest of the Americas: Still some Economic Issues but an Improving Picture as One Moves from North to South

Canada, in many ways, is a large natural resource company. Until the energy picture improves, there remain issues as a new and different government starts to grapple with the current environment. In addition, while the Canadian banks avoided much of the turbulence experienced in the US from the mortgage fiascos, their housing market has gotten somewhat extended from growth that occurred under the umbrella of high energy prices in the early part of this decade.

On the other hand, we see elements of reform and a better competitive environment globally in Mexico. Lower energy prices have slowed development and reform in this sector, but other sectors continue to move forward. This remains a good story of growth, reform and development.

Moving further south, if the project stays on schedule, by mid-year the expanded Panama Canal should be in operation with the ability to receive the Post-Panamax cargo ships that carry two to three times the previous loads that could make it through the canal. This will change patterns of traffic to the east and west coast ports of the US from East Asia, reduce transportation costs, and, most likely, produce a shift of traffic via the Suez Canal back to Panama. It could likely result in some increased infrastructure spending for some of the US ports as well as the supporting rail and truck traffic from these new patterns of shipping. An under-the-radar change that could have some unintended consequences positive and negative.
With the **Argentina** election leading to major change combined with elections in **Venezuela** and pressure on **Brazil** to change, the center of gravity on reform and a better investment environment in South America may be moving in the right direction. There is no question that the overall economic situation in South America is quite dependent on exports of hard and soft commodities. Until the commodity supply/demand picture improves, it may be difficult for the overall investment environment to improve significantly. We may be entering an environment where some prices are falling below operating breakeven. Let’s keep in mind, though, that energy is a big part of the cost of extraction and refining for most hard commodities. Miners and refiners will keep producing if there is a dollar contribution toward fixed costs. With the metals priced in dollars for the most part, the currency weakness many of these countries have seen is a further reduction in costs. It is possible as we get later into the year modest increases in demand combined with reductions in supply may shift the patterns. At the same time, it is highly unlikely that we will see major improvements in governance and economic results early in the year in these three countries mentioned. However, the tone has shifted. This is an opportunity for the US to affect the rate and quality of change in these three important South American countries with an impact on the whole continent.

While the change in our relations with Cuba gets media attention, a similar reaching out by the current administration to change relationships with the three countries is a real possibility. One will be able to find all of the varieties of investment opportunities within the Americas with similar risk characteristics as exist throughout the rest of the world. This is a slight overstatement, of course, but just saying…

One does have to be careful of what is going on with capital flows. The countries in South America are dependent on export growth primarily tied to commodities. While Argentina may be coming out the other side of its ability to access the capital markets, it is not clear that other countries can make it through this period without some degree of financial stress. But, the Americas represent an unusual somewhat isolated set of investment opportunities across the equity, fixed income, and fixed asset markets, both public and private.

**CURRENT VIEW: Commodity Movements push much of the Americas to Unsustainable Levels—too Fast, too Soon**

Below are three bar charts showing returns in local currency and dollar-based YTD for most of the capital markets worldwide as well as a specific focus on the Americas and commodities.
2016 Americas Equity Market Performance
January 1, 2016–May 13, 2016

Source: Bloomberg
2016 Global Market Equity Market Returns
Total Returns | January 1, 2016–May 13, 2016

Source: Bloomberg
In part, the commodity run has to do with the weakness of the dollar against many currencies. Gold and possibly other precious metals are primarily moving because of the dollar, but also because they can act as sources of real returns against an expectation of rising inflation, low interest rates, and, maybe low equity returns. Our expectation had been a likely shift occurring on the commodity front as we moved into the second half of the year. In part, this was based on a step-up by China on the fiscal side which would increase demand and prices for a variety of commodities as infrastructure and support of inventory building took place. It would appear that China has already started that process. Unfortunately, I think this could lead to some disappointment later as China backs away from this fiscal push, much as they did after the 2008-2009 debacle. China did keep things going with prices peaking in 2011. There has been some slowdown on the supply front, with much uncertainty about OPEC and Saudi Arabia, specifically regarding oil, but other supply slowdowns elsewhere including the fires that rage in the Canadian oil sands region. Of course, the rise in prices could reflect concern about the Cushing Fault—one of our cocktail conversation expectations. Even 60 Minutes is now talking about earthquakes in Oklahoma.

That aside, as we pointed out in our Perspectives piece, China is the biggest source of supply and demand in the hard commodities, and effectively, controls the markets. Higher prices may lead to bad economic decisions regarding maintaining or even increasing production in response to the prices. These increases will likely end when China stops supporting the price and/or the dollar begins
strengthening as it becomes clearer that a recession is unlikely—slow growth, but growth, wage increases and hiring pushing up consumption but not necessarily profits. Last month, for example, total compensation for all those employed was actually up 0.7% March to April. That’s a pretty healthy annual rate.

So what does one do now? The Americas look a bit ahead of themselves. While we are seeing change in Latin America, there will be some major hurdles for the major countries on governance and fiscal budgets. Commodity prices could continue to provide a lift if what is going on in China continues. I think we will start seeing more dispersion in the results in Latin America as the year unfolds.

We have already indicated that we expect the slower growth of the global economy to produce dispersion among country and company results. Below are two tables that show what has happened in the US specifically by industry with the energy industry as a poster child.

**S&P Dispersion 2016 Year-to-date: By Sector**

*As of May 13, 2016*

<table>
<thead>
<tr>
<th>Sector</th>
<th>Total</th>
<th>Average Return (%)</th>
<th>Number of Stocks</th>
<th>Average Gain (%)</th>
<th>Number of Stocks</th>
<th>Average Loss (%)</th>
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<tr>
<td>S&amp;P 500</td>
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<td>0.13%</td>
<td>328</td>
<td>12%</td>
<td>181</td>
<td>-12%</td>
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<td>Basic Materials</td>
<td>20</td>
<td>11%</td>
<td>16</td>
<td>17%</td>
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<tr>
<td>Communications</td>
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<td>20</td>
<td>9%</td>
<td>12</td>
<td>-10%</td>
</tr>
<tr>
<td>Consumer: Cyclical</td>
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<td>-2%</td>
<td>38</td>
<td>10%</td>
<td>40</td>
<td>-13%</td>
</tr>
<tr>
<td>Consumer: Non-cyclical</td>
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<td>71</td>
<td>11%</td>
<td>33</td>
<td>-18%</td>
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<tr>
<td>Diversified</td>
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<td>3%</td>
<td>1</td>
<td>3%</td>
<td>0</td>
<td>N/A</td>
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<tr>
<td>Energy (sector detail below)</td>
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<td>10%</td>
<td>26</td>
<td>26%</td>
<td>15</td>
<td>-16%</td>
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<td>Financial</td>
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<td>1%</td>
<td>45</td>
<td>9%</td>
<td>44</td>
<td>-8%</td>
</tr>
<tr>
<td>Industrial</td>
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<td>8%</td>
<td>51</td>
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<td>-7%</td>
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<tr>
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<td>-1%</td>
<td>27</td>
<td>8%</td>
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<td>-13%</td>
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<td>Telecom</td>
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<tr>
<td>Utilities</td>
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<td>17%</td>
<td>29</td>
<td>17%</td>
<td>0</td>
<td>N/A</td>
</tr>
</tbody>
</table>

*Source: Bloomberg*
This does require a broader and more specific look across more asset classes and more managers to take advantage of the dispersion and the spread we could likely see between the liquid markets and those with an ability to buy into less liquid sectors. The opportunity set is getting broader and requiring a real understanding of risk and a real understanding of liquidity requirements.

Lastly, so much of what I discussed depends on what happens here in the US as well. As my colleague, Lara Magnusen, recently pointed out in Bloomberg, any positive economic data out of the US may convince investors that the Fed will indeed raise rates at their next meeting. The knock on effect here is that you could see some real strength in the dollar, and thus reversals in commodity markets generally. The rest of the Americas are thus dependent on a highly correlated set of variables affecting commodity markets, and, ultimately, the broader economic landscape.

Source: Bloomberg
Bloomberg.com, May 1, 2016, Gold Keeps Shining as Funds Miss Out on the Best Rally in Two Months

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