

JVB Financial Group, LLC

CRONIN'S CORNER MONTHLY *A Perspective on the International Economy*

OCTOBER 2009

by Keith Cronin, JVB Senior Vice President of Sovereign Debt Trading

The town of Tequila in Mexico has one obvious claim to fame. The drink that has adopted the town's name has poured its place into many empty and full glasses the world over and left its impression long after the glass has been emptied. It was then — maybe as a token of appreciation of the beverage's strength, and its morning after imprint — that the economic crisis of 1994 bears its initials. Following the sudden devaluation of the Mexican Peso in December of that year, the resultant negative economic effects that permeated to South America were labeled generally as the 'Tequila Effect' — an allegory that served to not only represent the beverage's strength, but one that was also indicative of Mexico's influence upon the region itself. This year Mexico has experienced the steepest recession in the Latin American region but the tequila is noticeably absent. The economic and financial noise from further south continues to morph into the gentle strings of a symphonic salsa. If anything, Mexico's more southern peers are sipping from the flutes, the pastiche, of gentle champagnes.

The recession that evolved from last year's financial crisis has, as we have previously argued, not been distributed equally across the global theaters of economics and finance. Its breadth, however, has been immense, leaving no country untouched by its powerful antimatter. These events have tested the world's premier central banks to the nth degree and, even more so, provided the world's emerging economies with unprecedented challenges. Many pundits have argued that it would be these emerging economies that would destroy the foundations of this recession. The impetus to recovery would not come from the US, Europe or Japan but China, India and perhaps Brazil. Whilst we question the ability of these nations to resuscitate the global economy as a whole, their own economies seem to have decoupled from the developed paradigm and 'emerging markets' have again become the bumptious investors' Elysium.

Brazil's beaches now seem destined to bask in perpetual sunshine. This is not a meteorological observation but an economic

one. Latin America's largest economy, emerging from a very brief recession in the second quarter of this year, witnessed GDP growth at an annualized rate of seven and a half percent. In September, the country added over two hundred and fifty thousand new jobs marking the eight consecutive month of job growth for the Latin American giant. The country's financial sector was relatively immune to the global toxic asset blanket that smothered more industrialized nations and this was, we believe, a major contributing factor to the country getting bumped to 'investment grade' status by Moody's. The main equity index (Bovespa) has risen a meteoric sixty percent thus far this year, whilst the Real has appreciated over twenty five percent versus the beleaguered US Dollar as a result of a powerful shift in global investor attitudes towards risk. As the global economy has moderated we have seen commodity prices track significantly upwards. This has augmented commodity saturated Brazil's allure with its newfound global fan club whilst the selection of Rio de Janeiro to host the 2016 Summer Olympics is simply the icing on the cake for what has, thus far, been a remarkable year for Brazil. What helps give this particular purple patch for Brazil a tone of authenticity, we feel, is that the country has yet to encounter the specter of significant inflation. It was only in 1995 that the annual rate of inflation fell below four digits, and as recently as 2003 the rate was close to fifteen percent. A plague that has torn Brazil's economy apart in the past, this time seems more notably conspicuous by its absence. The rate has fallen from six percent earlier this year, helped by the strengthening Real, to just over four percent and will very likely be under five percent as the year draws to a conclusion. This puts Brazil's macro credentials in even better light if we compare it to India where inflation is just under twelve percent and to Russia where the rate is just under eleven percent. However, the recent spiral in Brazilian assets may be, in the short term, approaching an acme. The Real is benefiting not only from Brazil's own solid macro economic compounds but also from the

(Continued on page 2)

ABOUT KEITH CRONIN

Keith Cronin is Senior Vice President of Sovereign Debt Trading at JVB Financial Group, LLC. Beginning his financial career at Oppenheimer, where he worked with equity-related financial instruments, he has also held positions at Bankers Trust, Republic National Bank and HSBC. Mr. Cronin honed his experience in the FOREX markets working in an Emerging Markets Options group, and has traded an array of international bonds denominated in various currencies, most recently with an emphasis on USD Corporate Bonds. Mr. Cronin has a Masters degree in Economics from University College Cork.



(Continued from page 1)

overwhelmingly ubiquitous negative USD sentiment. If we see a retrenchment of global equities as we approach year end, we will inevitably see a stronger Dollar. Technically, the American unit is oversold not only versus the Brazilian currency but against a host of currencies across the globe. Currently, however, bullish economic sentiment and elevated levels of risk tolerance remain in accession to technicals (and perhaps even fundamentals). This sentiment though can switch quickly and, in some cases, somewhat violently. If we encounter any sustained equity weakness we will also likely see lower commodity prices as investors question the validity and character of the global recovery. Such circumstances would obviously be a resounding negative not only for the Real, but for Brazilian and emerging asset classes as a whole. Although, we think a weaker Real at this stage would not necessarily be a horrendous occurrence for the Brazilian authorities who, we feel, will not want their currency to continue to appreciate versus the Dollar without constraint. Whilst we see the possibility of some short term clouds on Brazil's horizon, we feel that a fundamental shift has occurred, not only for Brazil, but for many of her peers around the globe. In the early eighties countries like Brazil, China and India were commonly referred to as 'third world' nations. Then the term 'emerging markets' was coined which would frequently be punned to 'sub-merging markets' as a crisis would unfold. Now, these 'developing nations' have emerged and they have, significantly, we feel, managed to dilute their dependence upon trade with the US and to a lesser extent with Europe. With specific reference to the BRIC quartet, their intra trading ties continue to strengthen with firm plausibility as demonstrated by the fact that China has now overtaken the US as Brazil's main trading partner. While China and India seem to specialize as suppliers of

manufactured goods, Russia and Brazil are dominant in providing the commodities needed to make them. However, it seems absurd to suggest that these countries, and the whole developing nation matrix as a whole, have become completely intra dependent and no longer need to rely upon the world's premier economies. Whilst they have implemented performing market reforms, these countries still carry indigenous risks, not only economically but also politically and socially. India's ongoing strife with Pakistan or the protests in Vladivostok, Russia earlier this year or China's historic battle with Taiwan all serve as reminders to some of the risks still inherent to many developing countries. Brazil represents a paragon of progress and as one of the world's largest democracies and developing economies will begin to assert more and more influence upon global economics and politics. When Lula's term as President comes to an end in October of next year, the new President should inherit a humming economy and a population hoping that Lula's legacy remains the foundation for the future Brazil. Most of the rest of the world will be hoping for the same thing. •

*Keith Cronin
October 2009*

JVB FINANCIAL

JVB FINANCIAL GROUP, LLC
MEMBER FINRA - SIPC

2700 N. Military Trail, Suite 200 / Boca Raton, FL 33431
(561) 416-5876 • www.jvbfinancial.com

For Broker Dealer, Institutional, and Advisor Use Only

This material is intended for broker dealer, institutional, and advisor use only, and is not to be distributed to individual investors. This document has been furnished to you solely for your information and may not be reproduced in any manner or provided to any other person. The information contained herein is based on sources that we believe to be reliable, but we do not represent that it is accurate or complete. Nothing contained herein should be considered as an offer to sell or a solicitation of an offer to buy any financial instruments discussed herein. All references to prices and yields are subject to change without notice. Any opinions expressed herein are solely those of the author. As such, they may differ in material respects from those of, or expressed or published by or on behalf of JVB Financial Group, LLC or its officers, directors, employees or affiliates.