



Monday, February 18, 2008 - Vol. 10, No. 41

Amid Global Credit Crunch, It's "Business as Usual" in Brazil

Today's comment is by Mike Burnick, Senior Editor and Global Markets Analyst and editor of Market Shock Trader.

Dear A-Letter Reader,

The U.S. credit crunch is far from over as vulture-investors, and Warren Buffett, now circle the troubled monoline insurers. These distressed insurers, including Ambac and MBIA, are the latest victims of the "repricing of risk" as the Oracle of Omaha calls it.

However, several thousand miles and worlds away from Wall Street, the credit crunch appears to be having little spillover impact on South America's biggest economy.

"Brazil's credit markets are shrugging off the effects of the U.S. sub-prime mortgage debacle and maintaining business largely as usual," according to a recent story in the *Financial Times*.

This is a significant statement considering how much of a fiscal basket-case this country has been in the past. Brazil was once the poster-boy for financial miss-management. Spiraling inflation, massive debts and a chronic history of currency devaluation is Brazil's legacy from the 1970s and 1980s. But not anymore.

From Fiscal Basket Case to Paragon – in Under 20 Years

Today, Brazil looks like a paragon of fiscal virtue compared to the United States. Brazil has paid down its foreign debts significantly in recent years. Inflation is low and has been falling, while interest rates are steadily coming down too.

Even the Brazilian real is one of the world's strongest currencies. It's appreciated about 8% against the greenback over the past year. That's quite a reversal of fortune for Brazil.

Credit Crunch: *Don't* Blame It on Rio – Where It's Business as Usual

Business conditions in Brazil have slowed somewhat this year, as is the case around the world. However, "overall credit markets are calm." For one thing, bank lending in Brazil continues at a steady pace, even while the big European and U.S. banks are scared to lend.

Brazil's total "stock of credit" stands at just 35% of GDP. That means Brazil is much less leveraged than many other financial markets. Brazilian firms carry much lower debt loads than many foreign competitors too.

The reason Brazil appears relatively insulated from the Wall Street credit crunch offers more evidence of financial "decoupling" at work. That's also the case in Asia right now. The main source of Brazilian credit has been a steady advance in the domestic savings rate. This has been driven by "investments in fixed income securities that are, in effect,

closed to foreigners” due to taxation issues. Brazilian domestic savings are more than enough to take up the slack.



Brazil's fast growing economy may slow somewhat this year, in the face of a global downshift. "But many companies are betting on the domestic market to make up the difference. For them, investment capital is still available."

Perhaps the Brazilians would be willing to bail out MBIA...

There are other signs that Brazil has weathered the credit storm that has hammered many global markets. In fact, while the MSCI Emerging Market Index is down

about 17% from its high last year, Brazil has declined just 8%. The blue-chip S&P 500 Index by contrast is still down about 13%.

Decoupling seems to be alive and well in South America's largest and most vibrant economy. That's a great indication of more potential gains ahead when global markets rebound. Brazil is certainly one market that I'll be watching closely.

MIKE BURNICK, Senior Editor & Global Markets Analyst

P.S. I'll be flying to St. Kitts tomorrow for our all-investment, all bear market strategies event, our Emergency Money Summit. Please look for our onsite reporting, by our conference correspondent starting on Wednesday.

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Offshore:

South Africa: A Major Basket Case

Last week, I commented on the lamentable state of passports issued in the Republic of South Africa.

It seems that corrupt RSA government officials have been selling passports to unqualified crooks. It's gotten so bad that the Brits are going to demand all South Africans carry visas to enter the U.K. Up until now, South Africans have enjoyed visa-free travel to the U.K., but the British policymakers say the passports "are not worth the paper they are written on."

In the past, South Africa has been a favorite country for tourism and investment. It's the leading economy on the African continent. This country has been relatively stable since the peaceful transition from white rule to Nelson Mandela's ascension in 1994. But in recent years, the government under president Mbeki has been embroiled in a series of corruption scandals and just plain stupid policies. For example, the RSA government denied drug treatment to those suffering AIDS because officials don't believe AIDS is a virus.

But in recent weeks, poor planning for future electricity needs has resulted in massive

rolling blackouts. These power outages have grinded the nation to a halt.

Now the chief economist at First Bank, Cees Bruggemans, says that the apparent large-scale rise in talented professionals wanting to leave South Africa is a major threat to the South African economy – especially when combined with the impact of the electricity crisis.

Along with productivity and output losses, the blackouts could severely strain South Africans' spending and output growth outlook over the next few years. Instead of 6% GDP growth, he thinks this may cut their growth in half to 3%.

"Economic growth comes about through capital formation, labor absorption and technological progress. We are raising our investment-to-GDP-ratio to over 25% by 2010, we enjoy technological progress even when sourced overseas, but our main weakness is limited availability of skilled, educated, talented, experienced people," explains Bruggemans.

He points out that instead of gearing for faster growth, as predicted by the government, the politicians seem determined to undermine growth potential. The politicians are destroying their growth potential by frightening away its most precious national resource: skilled professionals.

"People from all walks of life are daily deciding to uproot and go elsewhere. That doesn't happen without good reason. Every 30,000 highly skilled individuals who make this step probably reduce South Africa's GDP by 1% or more, starving it of critical support, thereby undermining ongoing employment of double their number." he says.

"And many more than that seem of late to be jumping ship. Wild tales of record car auctions and real estate property market flooding abound. If everybody knows somebody preparing to emigrate, the condition is presumably dire," points out Bruggemans.

BOB BAUMAN, Legal Counsel

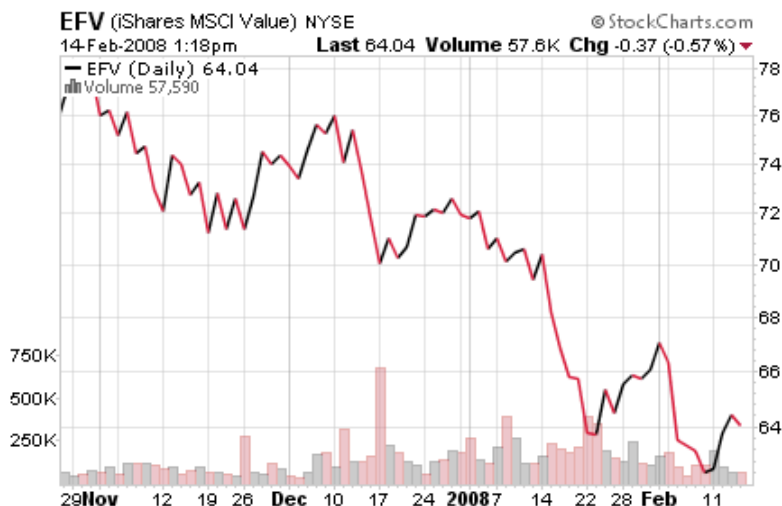
P.S. It seems the wealthy, skilled South Africans are heading for greener pastures abroad. Do you also find yourself wanting to move to safer, freer nations abroad? [Click here](#) for my best strategies to move (and secure a passport) in dozens of regions around the world.

Wealth:

The Battle Between Growth and Value Rages On

The battle between growth and value continues in global investment circles.

Value investing got trashed last year. And this year value investors continue to struggle as global equities try to break free from the shackles of an earnings slowdown. But recent data, courtesy of Morgan Stanley Capital International (MSCI), points to some big bargains now available in its proprietary value index.



EAFE, which is Europe, Australia/New Zealand and the Far East, includes industrialized markets outside of North America. The Pacific component also includes Hong Kong and Singapore. The largest country components in the index are the United Kingdom, Japan

and Germany.

According to MSCI, the EAFE Index now trades at just 11.7 times trailing earnings. It stands at 7.3 times price-to-cash-flow and pays a 3.6% dividend yield. In other words, this EAFE index is performing well compared to other indexes around the world

In the United States, the S&P 500 Index trades at 18.2 times trailing earnings and yields just 2.1% in dividends.

Compared to the MSCI EAFE Growth Index, the MSCI EAFE Value Index trades a significant 36% discount. That same differential also applies to the American broader market. But dividends for the Value Index are impressive at a 50% premium to the Growth Index and 42% more than the S&P 500 Index.

In the last bear market from 2000 to 2002, value investing actually posted a cumulative three-year gain while growth stocks got massacred.

This year could be another great opportunity for long-term value investors seeking quality, high-yielding global companies following a big market rout since last November.

ERIC ROSEMAN, Investment Director

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