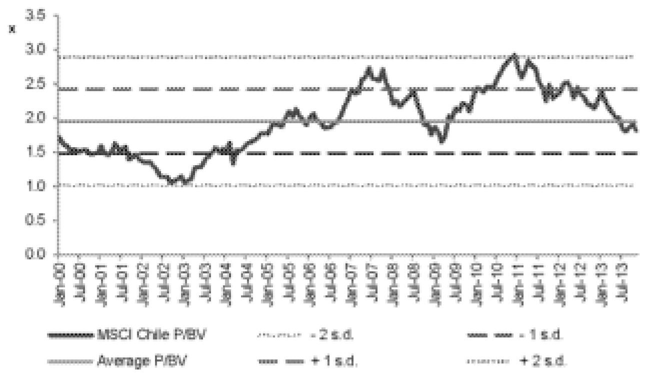
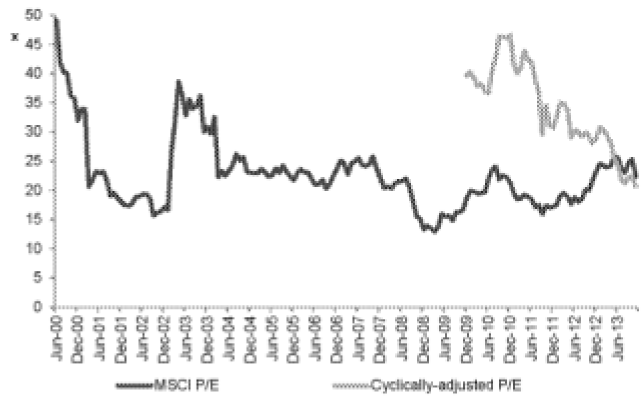
Chile – continued breakdown of the neo-liberal model

Figure 62: MSCI Chile – P/BV (x) since 2000



Source: Deutsche Bank, Bloomberg Finance LP

Figure 63: MSCI Chile – P/E (x) and CAPE (x) since 2000



Source: Deutsche Bank, Bloomberg Finance LP

Chile has been the worst performing emerging equity market over 2013 for two main reasons. First is the continued bearish outlook for the copper price, which is the most important external driver for the Chilean economy and has been highly correlated with the historical performance of Chilean equities, despite the absence of direct plays on the metal. Second, the equilibrium between capital and the state, which had survived twenty years of government by the leftist Concertacion, has been disturbed by the widespread popular agitation against the current education system and other policies which are deemed by much of the electorate to favour business and the top 10% of Chilean society. The almost inevitable (re)-election of Michelle Bachelet is quite certain to be accompanied by a much more leftist agenda, which will redistribute resources away from capital to the state and labour.

The most important question for investors is the extent to which these two factors are discounted in the current level of the equity market. There has been a big de-rating over the past eighteen months (Figure 62 and Figure 63), which probably discounts the changes to the corporate tax system which are almost certain to take place in the early stages of a new Bachelet-led administration. Nevertheless, the overall level of valuations both in absolute terms and relative to GEM is still not cheap, and neither a further big deterioration in the demand for copper, nor the potential inability of the new administration to withstand further pressure for even more redistributive policies, are priced in to the market.