

PAINTBRUSH

Back in February 2014 we identified a vulnerable subset of countries that fall in the 1 and 2 star Stratton Street NFA ranking categories and have net foreign liabilities in excess of 50% of GDP. We dubbed the group “Paintbrush”, because it looks much better than “Brtpahsiun” which is how they nations appear on our presentation slides! The nations are Poland, Australia, Indonesia, New Zealand, Turkey, Brazil, Romania, Ukraine, South Africa and Hungary.

Anyway, we thought it would be worthwhile to share with you what an investor gets paid for taking risk on board. The following statistics are taken from our Relative Value Model, which in the case of our US Dollar universe, looks at our universe of bonds and works an average out for a given rating and duration. So for example, the current “fair value” spread of an A2 rated bond with a 5 year duration is 74 basis points over US Treasuries. When we say that a bond is trading 3 notches cheap (+3), in this example it would be trading as if it were rated Baa2 (i.e. 3 rating notches lower), and have a spread closer to 139 bps. Two notches expensive (-2) would imply a Aa3 rating, with a spread closer to 49 bps

Back to “Paintbrush”. Taken as an average, the group trades close to fair value, i.e. no extra “cushion” in the spread. If we look at all nations rated either 1 or 2 stars (excluding Greece), the numbers dip into negative territory. So not only are the countries poor from an NFA (net foreign asset) perspective, they are also “expensive” to boot!

Individual countries, along with their respective notches.

Poland	-2.7	
Australia	+2.2	(Mainly banks)
Indonesia	-0.3	
NZ	N/A	(No foreign debt)
Turkey	+2.1	
Brazil	+0.7	
Romania	-1.5	
Ukraine	-0.1	
South Africa	+0.7	
Hungary	-2.7	

Contrast to what’s on offer for our 7 star rated countries, of which there are nine (where NFA stands in excess of 100% of GDP), the average for this group stands at +2.1 credit notches cheap.

For those interested in currencies, the basket of 10 countries have lost 31.4% vs the US\$ since we have been writing about the “Paintbrush” countries in Feb 2014. Poland was the “best” performer at down -19.6% whilst Turkey (-61.7%) & Ukraine (-64.7%) were the worst.

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