



Time to invest in Cuba?

There are signs that the economic embargo imposed by the US more than 50 years ago may soon end. Investors might consider getting in ahead of the changes.

By: Michael Brush – January 22, 2013

Is this the year we finally say hasta la vista to the five-decade-old Cuban trade embargo?

Tom Herzfeld, a Miami-area fund manager who studies Cuba-U.S. relations, thinks so. This is an unconventional view. But stranger things have happened in the past few years, like the Arab Spring. Besides, it's often the unexpected that provides the best returns in investing.

And here, the investment implications could be big, for several companies.

Herzfeld thinks the policy change would boost companies as diverse as cruise line operator Carnival (CCL +0.60%, news), cargo shipper Seaboard (SEB -1.42%, news), regional airline Copa (CPA -0.70%, news), soft-drink distributor Coca-Cola Femsa (KOF -0.46%, news) and even Watsco (WSO +0.26%, news), which likely would sell more air conditioners in Cuba.

These stocks are all big holdings in the Herzfeld Caribbean Basin (CUBA +4.21%, news) fund, which Herzfeld says he has positioned to benefit from embargo elimination.

"Now, more than ever, the pieces are falling into place where the embargo could be lifted this year," maintains Herzfeld.

Why now?

Index funds vs. managed funds

Herzfeld cites President Barack Obama's view that economic relations with Cuba should be liberalized -- and the president's greater freedom to pursue this goal now that the election is behind him.

Herzfeld points to the nomination of Sen. of John Kerry, D-mass., who shares this view, to lead the State Department, as well as to steps by Cuba to improve human rights, such as the recent loosening of travel restrictions for Cubans.

Then there's the shaky health of Cuban dictator Fidel Castro, whose demise could lead to big changes.

"I believe if he were to die, that would be the single event that would lead to the lifting of the embargo," says Herzfeld.

A possible leadership transition in Venezuela, which we'll get to in a moment, could also be a factor in the embargo coming down.

Cuban experts I surveyed don't think much of Herzfeld's theory. "It won't happen anytime soon," predicts Ted Piccone, a senior fellow and deputy director for foreign policy at the Brookings Institution.

Riordan Roett, the director of the Latin American Studies Program at the Johns Hopkins School of Advanced International Studies, puts it more bluntly: "What's he smoking?"

Cuba experts cite two main obstacles. First, the embargo is in place because of a law passed by Congress, which Obama can't just overturn on his own. Next, Cuban-American congressional leaders, who have a big say, strongly oppose any change. Top among them: Sen. Robert Menendez, D-N.J., who may be taking over the Senate Foreign Relations Committee; Rep. Ileana Ros-Lehtinen, R-Fla., former chairwoman of the House Foreign Affairs Committee; and Sen. Marco Rubio, R-Fla.

"They are just not going to budge on this," says Roett.

As an investor, Herzfeld is nonplussed by these challenges. He thinks the companies his fund owns as Cuba plays will do well regardless of whether the embargo is ended. Many of the stocks have recently hit all-time highs. An end to the embargo would be just one more catalyst for these names, he says.

There are two other reasons investors may want to avoid getting too put off by the Cuba experts. First, in investing, it's the out-of-consensus plays that can do the best -- when things occur that most people did not foresee.

Plus, I can make the case that it's not too crazy to think that the embargo is on the way out. It would not be the first time "the experts" missed a big change. How many of them predicted the Arab Spring?

Even if an Arab Spring doesn't sweep Cuba, there are plausible reasons to think the trade embargo could be gone sooner than the experts believe. Here are the three big ones:

1. The embargo doesn't make any sense anymore.

Sure, Fidel, 86, and his brother Raúl Castro, 81, are bad hombres. They've confiscated a lot of property -- much of it owned by U.S. companies -- since seizing power in 1959. Worse, they stomp on human rights and oppose democracy. This is why the 1996 Helms-Burton Act blocks most U.S. trade with Cuba until the country has free elections, releases political prisoners and respects human rights.

It is a commendable policy but, sadly, hypocritical. If this were consistent U.S. policy, we'd have no political or trade relations with Vietnam, Myanmar or even China, says Juan Carlos Hidalgo, a Latin America policy analyst at the Cato Institute, who notes that each of these countries fails to clear the Helms-Burton hurdles applied to Cuba.

Thus, the Cuba embargo is a pretty glaring anomaly, which makes it vulnerable. "The only advantage of the embargo is that it allows the Cuban regime to blame the miserable Cuban economy on 'the blockade' as they call it," says Hidalgo.

The embargo is also vulnerable because it's an obvious failure. After 50 years of embargo, the Castro brothers still rule Cuba, notes Tomas Bilbao, the executive director of the Cuba Study Group, a lobbying organization whose goal is "empowering" Cuban people by helping them start businesses and sell goods abroad. "I think we need to shift from an obsession with hurting the regime to an obsession with helping the Cuban people," he says.

2. Political support for the embargo is eroding.

Another problem for embargo aficionados is that younger Cuban Americans in Florida, the all-important next generation of voters, just aren't as passionate about it as their parents and grandparents were. "When I lecture down there, they couldn't care less about Castro and the embargo," says Roett.

A recent poll by Florida International University in Miami bears this out. It found that just 50% of Cuban-Americans still support the embargo, and 80% think it has failed. It's also worth noting that Obama got a lot more of the Cuban-American vote in Florida in the 2012 election, despite the awareness that he is more willing to lift the embargo, says Hidalgo.