APRIL - 2019

MONTHLY STATEMENT

PLANNER REDWOOD ASSET MANAGEMENT

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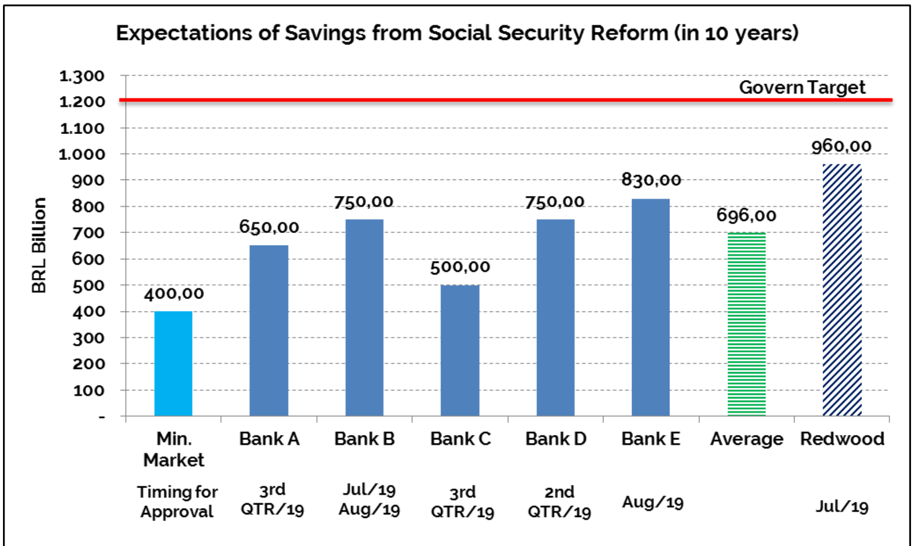
"IT ALWAYS SEEMS IMPOSSIBLE UNTIL IT IS DONE."

Nelson Mandela – Former South African President

The BRL 1.2 trillion total expected savings in the next ten years built in the pension reform proposed by Minister Paulo Guedes seems a fabulously large number, but it is not. As Minister Guedes himself points out, we spend annually USD 100bn, equivalent to a Marshall Plan - which was "sufficient" to rebuild Europe after the Second World War. This is an astonishing number, and we need to revert its course into better quality spending and investment. Moreover, the trajectory of our public finances leaves no doubt as to the total and imminent disaster and even a reversal of this nature will still leave daunting challenges ahead.

No less relevant in this process are other actions proposed in the set of a new economic "model" proposed by Minister Guedes. The most liberal aspect of this new economic team, with all the changes proposed, whether on the macro or microeconomic agenda, will be consolidating measures of this first and most important reform: the Social Security. However, the proper sequence must necessarily be as follows: cutting and closing expenditure bottlenecks (eliminating injustices and imbalances), and sequentially using assets to "decrease" the public debt and reverse expectations - this effect will be maximized if applied in this sequence - otherwise we will run the risk of selling assets without eliminating the original problem. The challenges, especially the political ones, are enormous, and everything seems not aligned to the extent necessary and proposed - here taken as the timing of the approval of the reform and the volume of the intended savings. However, the determination and responsibility of all, like the recent rapprochement of Presidents Bolsonaro and Rodrigo Maia, show that there is a strong possibility for the Executive and Legislative to be united to overcome difficulties, and thus make possible what seems almost impossible!



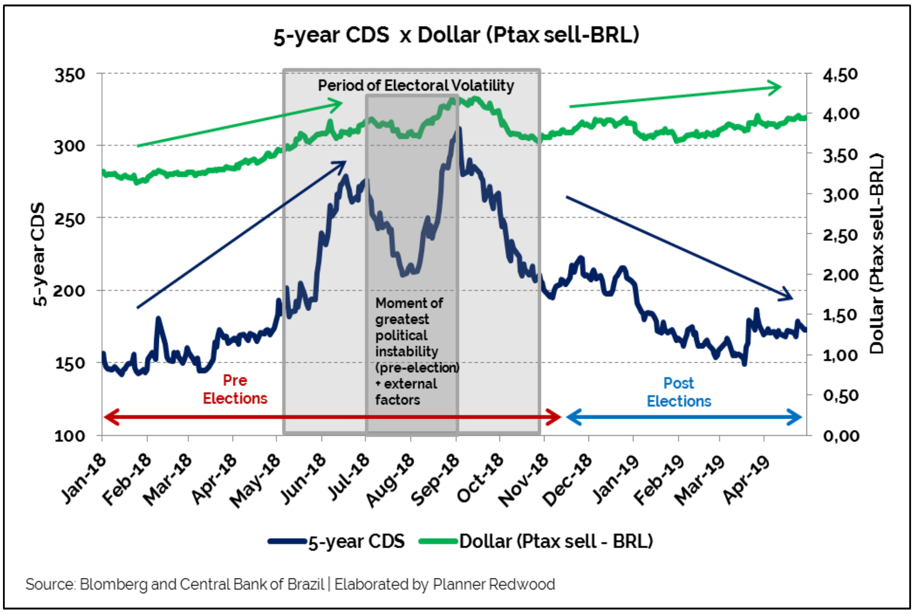
Source: Public Data | Elaborarated by Planner Redwood

We used the Midpoint for data of banks due to the variance of estimates.

Of all sorts, although optimistic about the outcome in relation to the proposal submitted to Congress and the expected savings, the timing of its approval seems increasingly compromised. In this way, its beneficial effects are behind schedule and the good expectations for the year 2019, especially for GDP and the level of employment, are already present with significant reversals. In markets, optimism is not unconditional. The Ibovespa closed up 0.98% at 96,353.33 points, while the yield curve displayed differential behavior across vertices, but closed the month at 6.51% (DI1 F20) and 8.22% (DI1 F23). Brazil's risk, as measured by the 5-year CDS, kept last month's levels reasonably near 173 points, but the Dollar "flirted" several times with the BRL 4.00 heights - "eluding" once again our projections and expectations. The error in our models has always been strongly influenced by the volatilities impacted by political stress, but whose reversion is expected in the medium term, when these noises will be wiped out from projections.

In the economy, however, the prognoses remain and, given the seasonal issues, still evolve unfavorably. The unemployment rate for the quarter ended in March was 12.7%, according to data from the National Survey by Continuous Household Sample (PNAD) published by IBGE. In relation to the quarter ended December 2018, the number of discouraged people increased by 180 thousand, reaching 4,843 million people in March 2019.

Monetary Policy, *coeteris paribus*, became a "hostage" to the outcome of the Social Security reform. All that can be done is wait, being sure that the time is the crucial factor for the beginning of the BACEN's attitudes; in one word: the wait can not be very long. The reason for this is that any delay in the definition of the reform will inexorably lead to deterioration of market expectations and this will lead to consequences in the "real" economy. Therefore, BACEN does monitor the evolution of this variable and its impacts, notably the reflexes over its tasks and mandate... this mandate (of informal autonomy) that the president has not yet disrespected... should remain this way.



Source: Blomberg and Central Bank of Brazil | Elaborated by Planner Redwood

On the fiscal side, the result of the public finances is the second worst for the month of March within the time series, begun in 1997. The federal government accounts registered a BRL 21.1 billion gap, casting doubts (albeit prematurely), at the beginning of this year and the government, as to the feasibility of eliminating the primary deficit this year (target projected at BRL 139 billion for 2019). More than the expected auctions would be needed (as in the Pre-Salt oil auction, estimated to raise around BRL 72 billion), since the tax collection is very low. Not least, the GDP longs to recover (high idle capacity), and in fact the reductions must even come from the expenses, especially those that the Social Security reform will adjust.

In this way, the month of April ends with the everlasting expectations translated in the "historical phrase" for May: Sell in May and Go Away. Apart from any superstition (including the scanty analyzes of "May" good and bad quantities), April did not bring any momentum into the markets until May. The yield curve had a very peculiar behavior, with short-term DIs fluctuating in the opening weeks of the month of more or less at 0.10 pp and ending at 7.12% (DI1 F21), while the longest vertices (DI1 F26) wiggling widely of 0.18 pp between the peak and low within the month. These movements seem to be in tune with the uncertainty we are experiencing, and thus require caution for the next few days, perhaps weeks.

The Ibovespa, in essence, did not deviate from this scenario. With a P/E ratio of 14.52 in April 30th, with -0.13 and 2.52 points off within-2019 and historical means, respectively. Net outflow of BRL 745 million in foreign resources was also registered, while the USD-denominated Ibovespa closed the month at 24,573 points, still far from its peak of approximately 45,000 points, or even the expectation of closing the year 2019 at USD 28,900 points.

The currency market, on the other hand, shows its true colors much more forcefully than all the others. Being the most difficult forecast variable, it reflects with absolute speed any change in scenarios, taking into account historical variables, new ones, to a greater or lesser extent (and with its "own" dynamics!), but always instantaneously.

Thus, sometimes "misunderstood", it is the best thermometer of the short and very short runs, as a precise translation of market "feelings". Therefore, what was observed with the behavior of the Dollar in April consolidates the evaluations of other markets, that is, of absolute caution and "protection". Dollar around BRL 4.00 seems strictly the expression of "unease" regarding this somewhat troubled start of the current administration and also reflecting the exaggerated optimism at the end of 2018 with the entry of the new administration. However, we do not shy away from the expectation that the effective Dollar pricing range is far from the current one, and that a major reversal may occur by the end of 2019.

Last but not least, the level of country risk, as measured by the 5-year CDS, was again slightly up, ending the month at 173 points. This indicator, whose trajectory since January 2016 has been mostly downward, stabilized in the last 86 days with an average of 170 points - within the range between 148.89 to 206.04 points. Far from any prospect that Brazil could default on its debt, the variation of this indicator profoundly affects the appetite of international investors, and correlates with several other indicators.

Across the world, we witnessed Guaido's frustrated attempt to take power in Venezuela this month. With the support of the military (especially high-ranking) that did not materialize, the Maduro regime remains "in command". The population, in absolute misery and discouragement, desperately seeks to survive this crisis that already enters the history as one of the most brutal regimes. In the limit, what is evaluated are two countries on opposing points to support and criticize the Venezuelan situation: on the one hand, the US wishing to push Guaido into power and, on the other, Russia to encourage Maduro's stay... in the crossfire the Venezuelan people suffers.

In general, in Europe, BREXIT's endless “soap opera”, coupled with the global weakening of economic activity and the commercial war with the US, point to more challenging scenarios for the Old Continent. At the beginning of the year, however, some good news comes from the (although modest) growth of French GDP by 0.3% in the Q1 2019/Q1 2018 comparison, and the 1.1% increase between January and March of this year. Even positive movement was observed in Spain, with GDP growing at 2.4% in the Q1 19/Q1 2018, while registering an increase of 0.7% in the 1st Q1 2019/Q4 2018. Apart from these occasional cases, the Euro Zone also registered a 0.4% growth in Q1 2019 over Q4 2018, while the annualized comparison stayed at 1.2%. The results exceed our expectations and also the projections of market analysts.

In the US, the FOMC unanimously decided to keep interest rates (FED Funds) in the range of 2.25% and 2.50%, but decided to cut the interest rate on excess reserves (IOER) by 0.05% (an exclusively technical movement), from 2.4% to 2.35%. All this "patience" is backed by strong growth of the US economy, with low unemployment and inflation close to the 2% target. The phenomenon is grounded on the possible growth of American productivity, based on the evaluation of current and alternative scenarios according to Fed Chairman Jerome Powell. In other words, high US productivity may be fueling vigorous growth and low inflation.

In China, attentions turn, again, to the trade war with the United States. The not always predictable behavior of Donald Trump holds surprises... after all, we are entering the month of May.

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