OCTOBER - 2019

MONTHLY STATEMENT

PLANNER REDWOOD ASSET MANAGEMENT

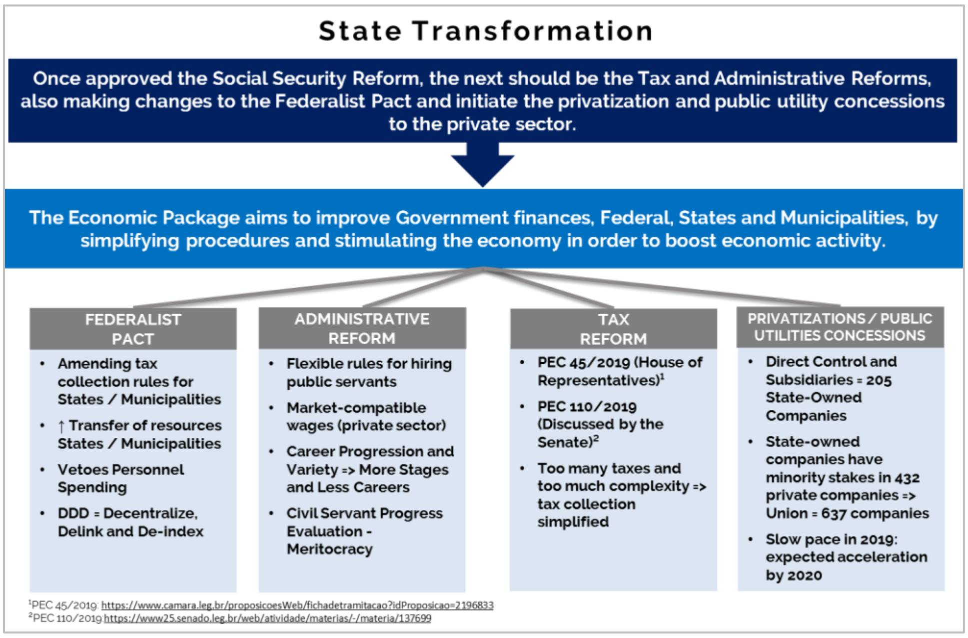
planner Redwood

"...and we have lift-off!"

Usual afterword following countdown in US rocket launches.

There is no doubt that the world is going through tough times in many countries have been concerned about the quality of their democracies. However, there is also no way to confuse the wave of conservatism sweeping the planet with authoritarianism or, what is now conventionally called, the "new normal." In Brazil it has been no different, we are under a "new normal", but the forces against this overwhelming movement tend to confuse one with another. Against these positions we count on the solidity of our institutions.

The tone of our "new normal" has been the relationship of executive branch with the other branches of government, but although quite frictional, the results have been far from poor. The achievements have not been few, much less unimportant. Given this, the president's style and the campaign promises, we should not expect a change in course. Anyway, it is for the good that the chairmen of House, Senate and Supreme Court all seem to be aligned (we hope!) in a larger reformist project of the Brazilian state.



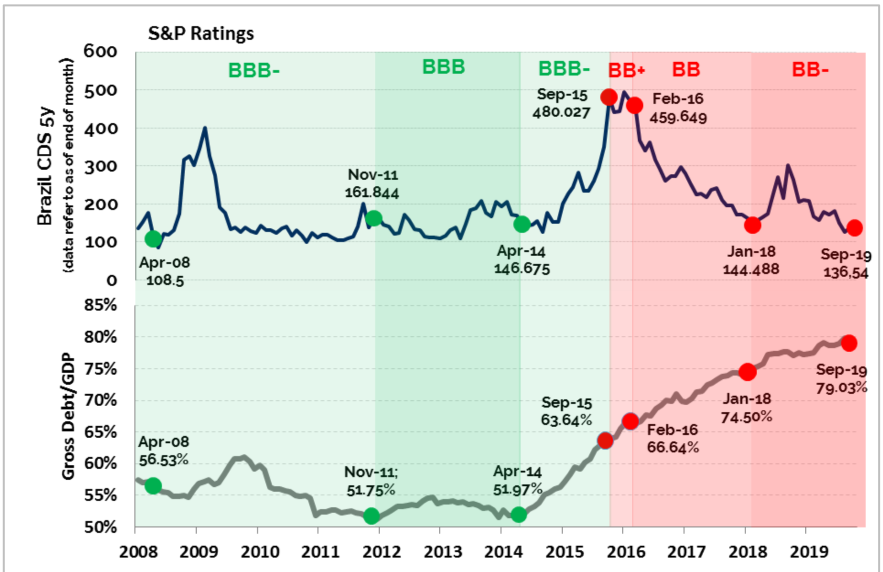
This potential alignment is a huge acquired "advantage", although it does not guarantee automatic bill approvals. Not really, especially since the maturation timespan for the approval of Social Security Reform was much longer than the next ones - it cannot be taken as a standard. Thus, for our coalition-based presidentialism in this "new normal" we should not expect easy rides until actual approvals. And herein lie the dangers, as each of the new reforms is an important challenge to overcome and add to the framework of measures to "complete" our homework.

However, even though we have not yet resumed investments, the new moment we're living is undeniable. The clear and objective translation is that we are on the right track. Yes, perhaps greater control of statements by the president and his children, reducing political noise, could further propel and accelerate this process, but society and the institutions will be able to "prune" excesses and preserve our democracy. This is because political-institutional stability is key at this moment.

The time has come for the state reform. Our current liberal democracy has everything to launch and better serve the democratic order. The winds blow on our favor, markets anticipate this potential improvement and, even with lagged cycles in relation to the economy with still timid lead indicators, the takeoff is imminent. In fact, what we have today is absolute focus and consistency of purpose, without any ambivalence or pusillanimity on the side of our leaders. Gradually, the results are already showing up!

Marketwise, indicators continue to show, jointly and consistently, important performances in each sector. Ibovespa closed at 2.36% this month, accumulating 22% in 2019. Interest rates DI1F20 and DI1F25 were, once again, vertices representative of interest rate movements along the yield curve, closing the month at 4.76% and 6.04%, respectively. The Brazil risk, measured by the 5-year CDS, varied 15 points within the month, with a minimum of 117 points and ending the month at 121.7 points. The Dollar (Ptax) ended the month at BRL 4,0041, a significant 3.85% drop nearing the “psychological” break of BRL 4,00 - which is in line with our projections and trends for the currency.

Economic activity, undermined in recent years and facing difficulties in gaining momentum, seems to confirm expectations and shows signs of takeoff. Not least, the government's excess effort in addressing the reforms, especially the approval of Social Security, already paints Brazil with a “different” brush in the eyes of investors who are now waiting to unfold the other set of reforms that will orchestrate the initiatives to transform the Brazilian state. These structural reforms will put us in the spotlight, with a long-awaited modernity and a momentous scenario for us. Investors see this and are already taking action and analysts and economists are already starting their revisions for 2020 growth.



Source: Bloomberg.; IBGE; S&P | Elaborated by Planner Redwood

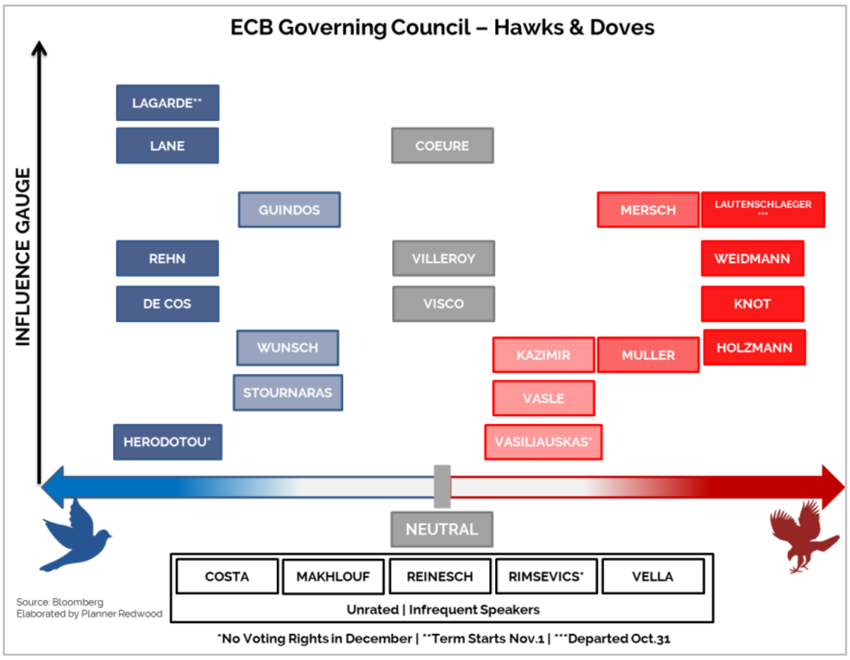
However, Brazil is a place where things can change quickly. Thus, although the signs indicate confirmation of a recovery, caution is binding, especially as can be seen in the confidence indicators, which do not show strong movements by this trend; understandably so, because the “political environment” factor, inseparable to foster good expectations, acts as a specter haunting investors' convictions. Politics and economics do not usually run apart and, while there is an order for effective transformation of the state, the political environment of confrontation between the powers serves as banana peel on the way. Powers may have reformist intentions, but coordination under the "new normal" fails.

However, with the always evident natural lags of the financial and economic cycles, financial market “signals” anticipating the likely good economic times to come. Country risk level (5-year CDS) is an excellent indicator of market perception of Brazil, but it does not mean that regulators would drop their main solvency indicator (Gross Debt/GDP) to revise their ratings - notably in the short term. Like confidence indices, this attitude requires some time and robustness evaluation of the measures in the medium-long term. In this case, once again, government actions are aligned in an attempt to improve our solvency ratio. Many investors do not even consider investing in Junk-rated countries. The combination of good CDS risk assessment and the effective reversal of the growth trend of the Gross Debt/GDP ratio may not (immediately) lead us to Investment Grade, but at least progressively move towards it.

Monetary policy follows its expected course, but more “intense” and more “in line” with market perspectives than ours. Thus, while our estimations project a SELIC around 4.5% at the end of the monetary easing cycle, several financial market economists project basic interest rates at 4% or even less. This means, for example, practically “zero” real interest rates for the year 2020, which have huge consequences (good and some bad), especially if some reversal is required. The effects of monetary policy transmission take months to reach full impact, with SELIC looking somewhat expansionary (short of the structural interest rate) and inflation properly anchored.

Fiscal measures are perhaps the biggest commitments with macroeconomic stability and economic modernization in Brazil. The current plan is ambitious, with measures intended to help the Union, states, and municipalities comply with fiscal standards - as few currently do - and thus balance their finances and create jobs. There are several amendments that are far-reaching, but with "immediate" effect. The Federalist pact will create the Fiscal Council of the Republic, to oversee all levels of the federation and propose the decoupling of the public budget. The Emergency Amendment will create mechanisms and an effective structure for compliance with the Expenditure Cap and the Golden Rule. The so-called Mansueto Plan will help states in financial crisis have access to loans guaranteed by the National Treasury, and the Administrative Reform will reorganize the entire structure of public service careers – including job stability rules. Last but not least, the review of all existing constitutional and infraconstitutional funds is also underway. It's no small feat, and it will bring us to a new level as a nation! The challenge to congressional approval is set!

In financial markets, the 'boat' faces tailwind and forecasts are promising - though caution must always be present. The term yield curve prices the good winds and wholesomely promotes innumerable moves by market managers to offer more sophisticated products in the face of the most challenging lower interest rate scenarios. The time has come to "do finance" and the market will purge those not fit for it. Great news is this "natural selection" (and the consequence of this transformation) in the upcoming months.



In the stock market, as a reflection and fixed income escape channel (too!), the Ibovespa ended the month at 107,220 points. It reached its all-time high in BRL on 30th October 2019 (intraday) at 108,407 points. Although with its P/E ratio at 16.12, no further upward movements and good prospects for profitability (albeit selectively) are ruled out.

The foreign exchange market, with its usual disturbing volatility and despite BACEN's actions, points to a natural strengthening of the BRL. In the same vein, the 5-year CDS continues its downward trend, albeit with lower volatility - from 3.10% in September to 1.65% in October.

Worldwide, two geopolitical risks have cooled down (though far from a solution) and thus impacted markets. The possible US trade deal with China has fueled successive highs in the NY stock markets, and the BREXIT momentum also seems to have contributed to the positive performance of the markets. As recessionary news prevails for many economies on the planet, although "inconsistent", we may be facing tactical movements that suggest great caution. In this sense, the ECB seems to be "armed" and ready for a more defensive and dovish position under a new presidency... quite convenient. In Asia, the apparent "idleness" of Central Banks, especially Chinese interventions in its markets, is simply a "truce." There is no doubt that they will act equally strong with every possible tool. It is but a matter of (little) time.

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