DECEMBER - 2019

MONTHLY STATEMENT

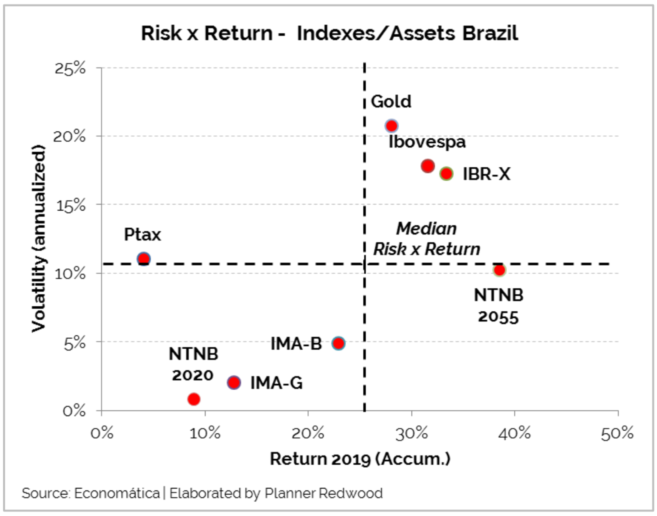
PLANNER REDWOOD ASSET MANAGEMENT

planner Redwood

"I like the dreams of the future better than the history of the past."

Thomas Jefferson – 3rd President of the United States of America

We started 2019 with unflinching optimism and ended with the hope that we could have a sustainable recovery for our economy. Brazil has already "broken down" a few times, being the 1980s the most famous episode. When Minister Ernane Galvêas communicated the situation to the sitting President Gen. João Batista Figueiredo, this latter is said to have replied in his own unique style: *"God Damn it! And son of a B... Geisel's put me here for six years!"* The situation was indeed very daunting. In that which is considered the "Lost decade" (1981-1990), Brazil grew at yearly average real rate of 1.6%, while in the 1901-1940, 1941-1980 and 1981-2010 periods, average real growth was approximately 4.33%, 7.03% and 2.63%, respectively. If all goes well, in this decade from 2011 to 2020, we will grow at an annual average of 0.85%, almost half of what has become known as the "Lost Decade".



Source: Economática | Elaborated by Planner Redwood

Well, it must be said, it was the dismal PT party that has put us in this situation. President Figueiredo left the government in 1985 asking the people to forget him, and now a large part of the population is asking the PT to forget about Brazil. Today, the situation, of course, is very different from the 1980s. Brazil is an entirely different country, without the vulnerabilities it faced in the past, but with plenty of difficulties to tackle and to allow for the argument that the situation is even more difficult, just check the level of unemployment. In the last ten years, except for the "extraordinary" growth of 7.5% in 2010, we had two declines of 3.5% and 3.3% in 2015 and 2016, respectively - in the deepest recession in the country's history.

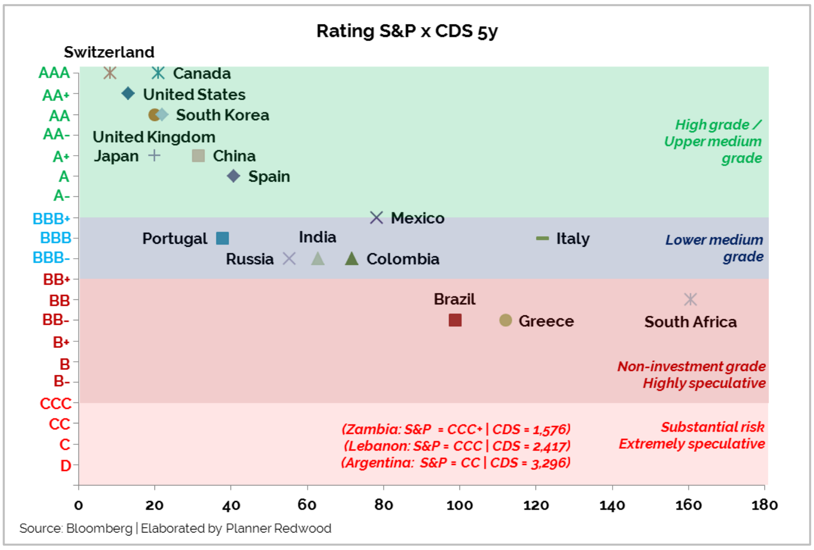
In the meantime, we are overcoming this wound; in fact, albeit timidly, this is a process in motion since 2016, and, most strikingly, since the inauguration of the current President and the appointment of a new economic team headed by Minister Paulo Guedes. The situation has changed a lot, but still falls short of what is needed. The structural changes are fundamental, and the main one, the Social Security Reform, was approved with praise. In addition to this, we also had the approval of the new regulatory agencies bill, the approval of the credit Fair Credit Reporting Act (*Cadastro Positivo*), better management of public finances, falling basic interest rates and the possible stabilization of public debt in 2020, among others.

With these actions and expectations soaring, confidence levels have improved somewhat, and the outlook is generally that we will have a better GDP performance by 2020, albeit below potential. At any rate, the real economy seems poised to take off. Job creation has been strong and formal job creation tends to outperform informal employment. The financial market, which always anticipates everything, also sends out clear signs of consistent improvements, whether in the yield curve, country risk or the stock market.

However, it is not all good. Several companies face financial and credit constraints. Manufacturing is at even lower levels of output than it had at the beginning of the decade. Inequality is huge, and the number of unemployed, discouraged and other classifications of the matter exceeds 17 million people. But the worst, of course, was the failure to address other structural reforms that should be done by mid-2020, or else their chances of success will diminish greatly as municipal elections dominate the agenda.

Anyway, we are about to conclude a lost new decade, unfortunately. The good news is that we are facing a new and much more credible and sustainable future!

As for markets, optimism has surfaced this month. The Ibovespa closed at 6.85%, ending 2019 with a 31.58% return. Interest rates DI1F20 and DI1F25, in turn, varied -0.26 and -0.07 points, respectively, closing the month at 4.4% for DI1F20 and 6.44% for DI1F25 - this movement was verified across the entire yield curve in December. The Brazil risk, measured by the 5-year CDS, was a highlight of the month, mainly because it closed below 100 points, at 98.8. The Dollar (Ptax) also did not lag behind and had a significant reduction, leading the price to 4.0307 with negative change of 4.58%, although momentarily, moving away from the definitive break of 4.20.



Source: Bloomberg | Elaborated by Planner Redwood

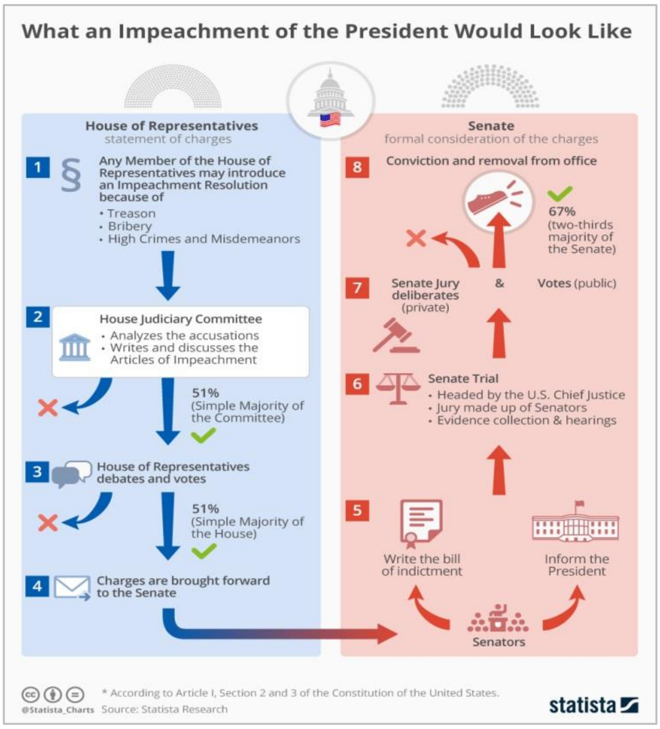
Economic activity in 2019 seems to confirm that we will grow just above 1%. However, given the momentum perceived in the released Q3 2019 national accounts data, in particular in October data for manufacturing - but also from services and consumption - 2020 GDP could be much better, more than double the growth rate observed in 2019. Better and easier credit conditions (the release of funds trapped in the FGTS and PIS-Pasep account were of great help!) led the economy to gain some traction. In this line, construction has everything to be a protagonist in 2020, with low interest rates and innovative financing methods, such as fixed rates. Unemployment, although still very high, shows signs of continued cooling. By 2019, around 1 million new jobs should have been created. CAGED figures have shown job creation successively higher than estimated, and above the mark compared to recent periods. More importantly, there has been a greater growth in formal than informal job creation recently.

At any rate, despite all the optimism about the stronger economic recovery, with a lingering positive output gap, companies facing much idle capacity and high unemployment, foreign investors remain reticent when it comes to Brazil. In fact, in our opinion, this "exaggerated" caution on the part of foreigners is really more related to the insecurity and volatility of our "political environment". There is also much to say about the instability of our neighboring countries - with political dysfunctions and economic upheavals - and the geopolitical issues around the world that naturally bring risk aversion. However, with the evolution of reforms and evidence of the seriousness of the changes and their continuity, the return on foreign investment is a sure thing - and it will be huge. The consequences of this, of course, will be widespread increases in asset prices. Opportunities by the thousands will make Brazil the next big move.

Monetary policy has put inflation under control and properly anchored (despite acceleration in November and December 2019) and, with the economy showing signs of “stronger” recovery and the CAGED (employment) data (not counting the external environment), it seems to have found its bottom level at a 4.5% basic interest rate. And this is the level to last throughout 2020, but certainly tightening from 2021 on. Should this likely future cycle be well calibrated and adequately conducted, it will impose little impact on markets. As for the conduct of the exchange rate policy, it divides opinions, but we maintain our unwavering opinion: Central Bank, as a rule, harms more than it helps. To be fair, this government has “improved” a bit (we didn't need Minister Guedes's views on the exchange rate!), especially regarding spot currency auctioning. Thus, disregarding currency volatility (and the cost of swaps directly impacting public finances), the Real depreciated less than many other emerging country currencies, so that we ended with a "small" + 4.02% change in the accumulated 2019.

On the fiscal front, namely our Achilles heel, public finances seem to end 2019 much better than we had expected earlier this year – except for Minister Guedes himself. The primary deficit will be close to half of the BRL 139 billion target, and the austerity guideline for states and municipalities, especially for pension reform, has risen to mantra status. In this line of adjustments, although dangerously belated, the Government should send, early this year (at the cost of losing its timing), proposals for administrative and tax reform. The focus and zeal for the country's fiscal management are unquestionable and the reflexes are from monetary policy to Brazil's perception of risk.

In financial markets, the month of December and the rest of the year 2019 was quite fortunate. With expectations and optimism renewed, the forecasts remain favorable. The country risk level (CDS 5 years) clearly already puts us in a better position compared to our current rating by the major agencies. Returning to Investment Grade is a concrete yet distant reality. This is a rank that, although critical to risk rating agencies, is mandatory for large investors to reinvest their resources in Brazil. The yield curve today is largely at its historical lows, and also with diminishing room for arbitrage. The Stock Exchange (Ibovespa), in turn, has risen to 115,645 points – a historical record - but in the last ten years it loses out to inflation. Thus, the financial market festival tends to continue in 2020, but the macro-allocation of assets must necessarily be different if reasonable returns are desired.



The Ibovespa in Dollar terms is still "cheap", and the coming of foreign investors can boost its rally. In the Fixed Income world, life has already changed. Indeed, the Investment Funds industry (which celebrates 2019) is likely to undergo significant changes towards more sophisticated and/or alternative products. Direct purchases of Federal Government Securities, for example NTNBs, should no longer perform as well. The gist is, therefore, that several opportunities will appear, but will require more sophisticated financial instruments and analysis. Professionalization needed in selection, management and analysis of individual or institutional portfolios rises to a whole new level. Portfolio risk management is given absolute prominence. In summary, this is a new environment: more challenging and competitive.

Overseas, President Trump's impeachment - a clear political move to get him out of the 2020 election - reigned over the news in December 2019, but for the year at large, the focus fell on the US-China trade war, a conflict that has troubled the world but that seems to come to an end. Indeed, the WTO maps the intensification of restrictive measures among its members annually, and over the past two years there has been a significant increase in such behavior. In the UK, BREXIT finally looks like it is ready to go until January 31st 2020, putting an end to this impasse and starting a new moment for everyone involved. In Asia, China's indicators suggest a rapid economic downturn. In Latin America, we highlight the inauguration and the economic promises made by the new Argentine government. Should he carry out his promises, disaster will find them shortly. It is quite a pity for the Argentine people, and other countries of the region, unfortunately.

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