JUNE - 2020

MONTHLY STATEMENT

PLANNER REDWOOD ASSET MANAGEMENT

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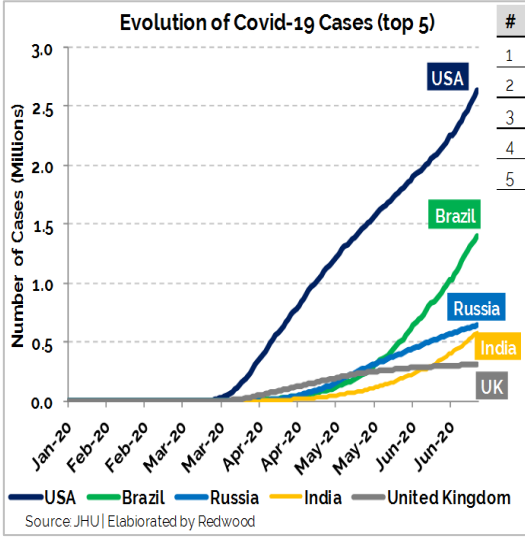
"The wise man knows his own limits."

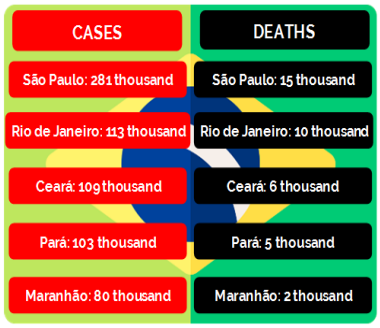
Socrates – Greek Philosopher

It is often said that economics and politics go hand in hand. Politics in Brazil has largely revolved around the President's family environment and its problems, with direct and indirect effects on the way the Commander-in-Chief governs. In the last few weeks, this point of the triple crisis that we are experiencing has gained prominence, bringing risks to the President's hold of office, causing him not only to change his mind as to the so-called "old politics", but also to cool his "belligerent" stance, in the daily management of Government issues.

This new attitude is good in a certain way, but it is certainly ephemeral, given the profile of the President, and reveals the gravity of the situation. The economy, in the face of the pandemic and its consequences, suffers harshly, and stumbles with no horizon favorable to the resumption of reforms. In fact, not even in an adequate phase-out of the epidemiological crisis can we move forward. Thus, in a process of reopening on the basis of "trial and error", we are in serious risk of being hit by a second wave of Covid-19 without even leaving the first.



#	Países	N. of cases	N. of deaths	N. of recovered
1	USA	2,635,417	127,417	720,631
2	Brazil	1,402,041	59,594	788,318
3	Russia	646,929	9,306	411,973
4	India	585,446	17,400	347,979
5	United Kingdom	314,160	43,815	1,370



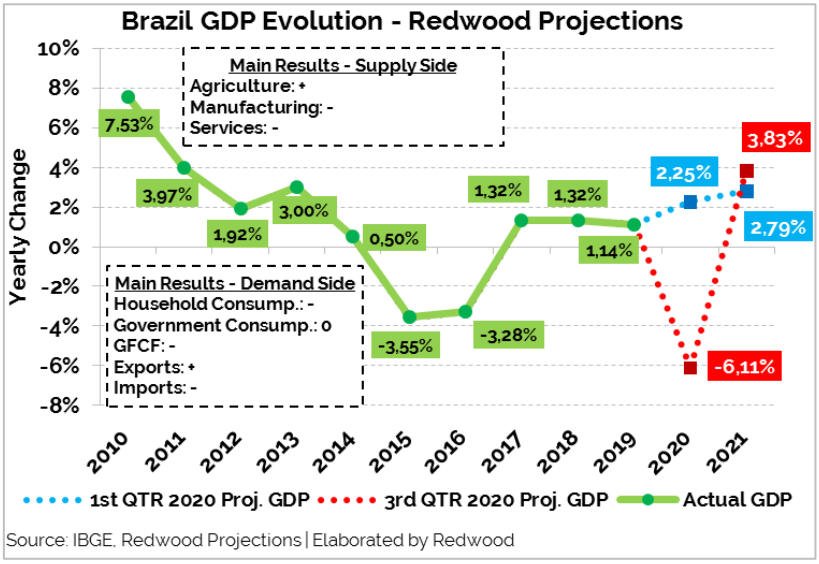
Unfortunately, the death toll in Brazil by Covid-19 may reach 150,000. A pity, since our models (Monthly Statement – Mar/20) estimated 242,000 deaths in the "no action" scenario. In other words, our efforts have not been sufficient and efficient at any level of government, including the ineptitude and inertia of the federal administration, whose "justification" lies in the incorrect interpretation that the Supreme Court (STF) forbade him to "act" in the State and Municipal - as if cooperation and unity for the common good could be exclusive at such a critical moment.

If, on the one hand, the Coronavirus remains a "mild cold" that still requires no Minister of Health, in the economy the Minister recognizes that his dream team loses some games. The "championship" will end with -6% performance (economic activity) this year according to our projections - much less than the IMF and World Bank forecasts, with -9% and -8%, respectively. It will be the worst recession in our history, with a fantastic increase in the number of unemployed and a possible increase in the already unsustainable inequality, unprecedented. We can "lean" against the statistics, saying that we will be near average or even better than some of our peers ... but it is not reasonable. Worse yet, with political leaders being as careful as a monkey in a crystal shop, our future is blurred and the chance of a strong and rapid economic recovery is averted. It didn't have to be this way.

As with any stressful situation, we desperately need strong leadership. We cannot demand from people what they cannot deliver, but they have a duty to recognize their limits and ask for help. The greatest sense of responsibility of our Representative must lie in his humility and recognition of any incompetence without the aid of other branches. It is not a matter of cowardice or shirking his responsibilities, but uniting and asking for collaboration to achieve better overall performance. The political problems of his family members must not lead the President to the ropes, but they should alert him. React, Mr. President!

Financial markets remained "exuberant" this past June, disregarding the effects of the pandemic on the real economy in the short term. As a result, the Ibovespa climbed once again by 8% (+ 8.76%), reducing the 17.80% drop within the year. In the yield curve, interest movements of DI1F21 and DI1F25 showed smaller oscillations in June compared to May, with the difference between highs and lows situated at 0.31 and 1.15 points, respectively. DI1F21 ended the month at 2.075%, with a minimum of 2.01%, and DI1F25 dropped to 5.476%. Brazil risk, as measured by the 5-year CDS, fell from 286.18 points to 251.99 points, a sharp 30 points variation, but which did not impact the final Dollar price (Ptax), which ended the month at BRL 5.476 - practically the same value as in May BRL 5.426 - but reaching a minimum of BRL 4.871.

The economy is still very weak, with very low aggregate demand and a huge level of idle capacity. However, although uncertainties breed on all sides, shorter-term information begins to consolidate - and thereby limit, at least in part - the projections for 2020; in other words, it seems that the situation has stopped getting worse, thus the scenarios may start to clear up. Nothing that keeps us from a tragic scenario but, without major stumbling blocks, we may be approaching rock bottom (depending on the evolution of contagion). Thus, under the assumptions of our Probabilistic Scenario, the Brazilian economy will decline slightly more than 6% (below the projections of large institutions), but the average unemployment rate projected for DEC/20 will be 14.58%. A disaster, just in the quarter ended in May compared to the same period last year, there was destruction of 7 million jobs. However, it is important to highlight government actions such as the temporary wage reduction and the furlough program that benefited thousands of workers. The dampening effect came from layoffs, but job creation will be slow, thus maintaining the unemployment rate on the rise for a while, not to mention the huge portion of discouraged workers. The good news, if we go back to the pre-covid-19 directions, is that the expected reaction (for economic activity) will start in the middle of the Q3 2020, advance in the Q4 2020 and stabilize in 2021. Under this hypothesis, we would have a recovery, albeit timid in the face of the 2020 fallout, above our long-term potential GDP, reaching almost 4%. At this rate, we would possibly be back to our pre-Covid-19 GDP in two years and, hence, employment levels will react.

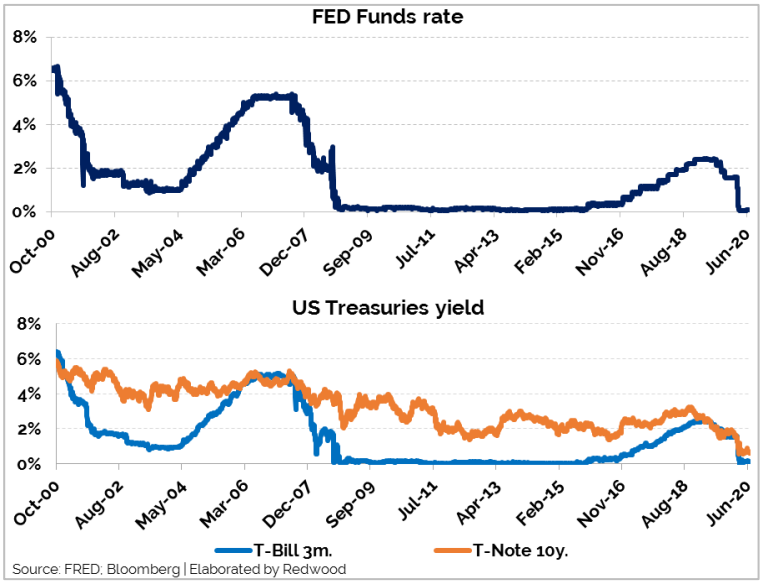


Source: IBGE, Redwood Projections | Elaborated by Redwood

The new Coronavirus has not only had a devastating effect on people's lives, it also affects fiscal discipline with austerity implemented until the epidemiological crisis, which has been aborted (for good) and this year's fiscal planning has been destroyed. The primary deficit until May (BRL 131.4 billion) is equivalent to the projection, made at the beginning of the year, for the whole fiscal year of 2020 (BRL 132 billion), with this target expected to be overcome by BRL 75 billion. Today, our projections are at least BRL 800 billion for 2020. This makes a primary deficit of 11.9% of the projected GDP, with a Gross Debt on the way to 100% of GDP. Everything is very justifiable and correct, but the main doubts are: (i) will we be able to halt part of these expenses and (ii) will society (and our government officials/legislators) have the patience and stomach to take on the fiscal challenges and demands ahead? The fear is for the conjunction of factors, especially the political, and to move towards more heterodox alternatives. The year 2020, in this regard, needs to be seen in "isolation" so we can resume treatment as we were doing before, otherwise we will be subject to

difficulties in financing ourselves with an eventual increase in the premiums requested by investors to roll over our debt. We currently have a huge advantage of very low interest rates, but this reality in an environment of distrust (the country's insolvency risk) changes rapidly.

In effect, the Monetary Policy has been well delivered by BACEN with reductions compatible with the level of inflation expected for this year and 2021 and, also, with the overall economic landscape. The recent SELIC cut by 0.75% should not be repeated, but a new - and possibly last - reduction by 0.25% is not ruled out. In addition to the long-term effects of monetary policy, a more optimistic recent reading of activity, as in manufacturing output, energy consumption and diesel sales (reflect more production of goods than services), endorse the halt on rate cuts. On the services side, there is a clear pent-up demand that could be resumed soon. In summary, SELIC at the current levels is in a stimulating field and in view of the balance of risks (including the fiscal, which raises the neutral interest rate!), is suitable for the relevant horizon for monetary policy. In exchange rate policy, the statements by BACEN's Economic Policy Director, Fábio Kanczuk, express the conduct well, stating that "the monetary authority has been paying close attention to the exchange rate volatility in recent weeks", and that "... we are trying to identify what is the cause of this increase in volatility, and in what sense it is efficient or not." It must be in this way that market "dysfunctionality" is interpreted and informs decisions to "act". The same reasoning should prevail in this new aspect of intervention in the private securities market.



In finance, we have seen markets evolve "out of step" with the economy. Central banks in a way "dominate" the markets (domestic and international), imposing a very strong bias with their interventions. The existing liquidity is enormous, and there is no prospect of change at sight. For markets, this intervention (much larger than normal) tends to infuse biases into agents' behavior. Aside from the traditional mechanisms pushed to the limit (interest on the Lower Bound?) and others recently developed/authorized (transactions in the private securities market), for the Brazilian case, it will not be surprising, if the scenarios change for the worse, to see forward guidance strategies and QE adopted by the Brazilian monetary authority. In other words, the interest in "meddling" in the markets has always been great and the "agenda" now supports this momentum, with medium and long term impacts inducing misallocations of resources and imbalance of free market forces... hummm... "dysfunctionalities", again! Understanding this economic and market dynamics is fundamental for financial asset managers. It is quite helpful.

Overseas, Covid-19 is still the scourge of countries, even though some in Europe sustainably start to reopen their economies. In China, where information is always doubtful, it seems to control the outbreak and thus advances economic stimuli. There we can also see a major problem with an explosive potential: Hong Kong. In the USA, which at first "ignored" the pandemic (but reevaluated!), they also resumed reopening, thus displaying the strength and flexibility of their market. However, they are bitter with the opportunistic politicians on duty who incite and quibble the population towards issues as important as the Black Lives Matter movement, undermining principles, challenging law and order and trying to "rewrite" history. With massive media support, one more virus for the Trump administration to tackle.

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