SEPTEMBER - 2020

MONTHLY STATEMENT

PLANNER REDWOOD ASSET MANAGEMENT

planner Redwood

> ***"Rhetoric is the art of ruling the minds of men."***
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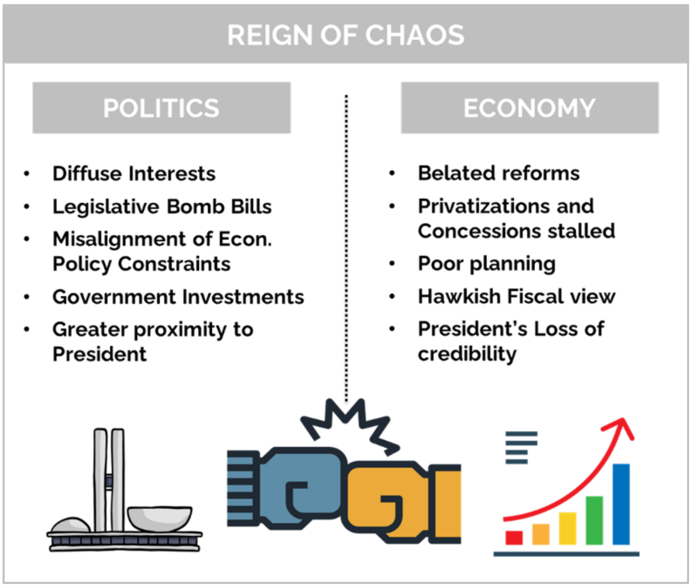
> ***Plato – Greek Philosopher and Mathematician***

The lack of leadership combined with disconnected plans and objectives is an explosive recipe, especially for those who, like Brazil, viscerally depend on urgently ordered solutions. The establishment of a new political coordination, healthy in its conception, does not seem to be in line with the principles of liberalism and, with some "autonomy" and endorsement by the President, they formulate crazy ideas and drag the debilitating economic credibility into a ditch.

The recent shift of the Commander-in-Chief in the direction of political conduct, coupled with the opportune moment to develop his social brand, keeps him further away from the pragmatism and demands of a liberal plan. The financing of the cash-transfer program *Renda Cidadã* proposed, in the presence of Paulo Guedes, widely pleases the masses, but miserably overlooks basic concepts be they legal or economic. A presumptuous rhetoric, which led to an absolutely unnecessary debate and instilled an unforeseen risk until then.



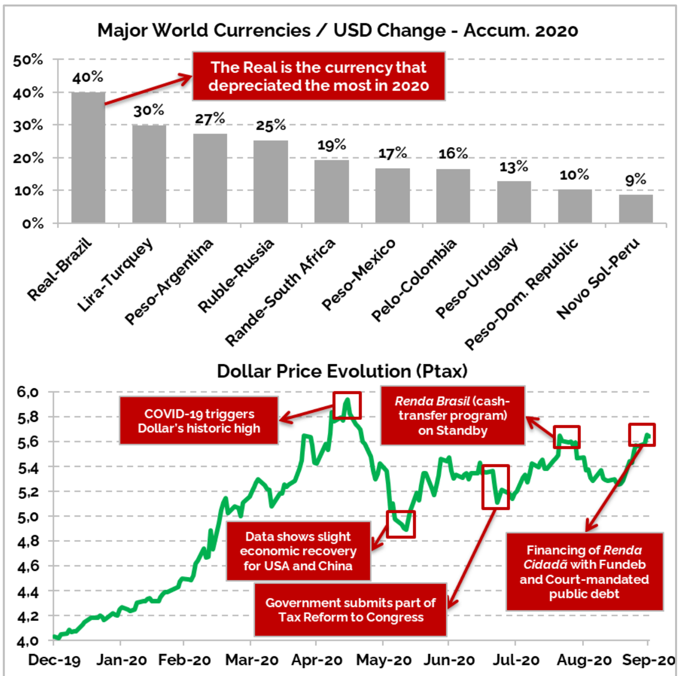
Although Paulo Guedes was "redeemed" two days later, the episode did not go unnoticed. Markets have stressed and part of this risk has been priced, because now everyone knows that something of this nature can be effectively tried, at least once Paulo Guedes is no longer with the team. President and Minister of the Economy seem to respect each other, but their convictions are quite different, and the President's needs are not consistent with the response timing of economic policies, nor even with the efforts to implement them. Thus, any plan fails to materialize, the determination vanishes and the results do not appear. A vicious cycle that is looming at every moment with the mishaps of lack of command, clear guidelines and grit/focus.

In this line, chaos is the new game in town. In politics, with their own pace and interests, they lead (or not!) in the absence of a compass imagined by economic policy, with extremely severe impacts on the country's economic and financial health. In the economy, limitations are growing, the space to develop alternatives is constrained by diffuse interests, and the implementation of measures is delayed and/or rejected. We watched the Ministry of Economy go from an all-powerful entity to having their dignity questioned.

The pillars of the economic field, despite recent losses, remain solid in liberal economic thought, but suffer setbacks every day. The rapport with the self-referring Centrão may give more "access" to the National Congress (CN), but the consequences are the inconvenience of the recent episode of using Court-mandated Debt and Fundeb to finance the cash-transfer program. In a moment of possible economic recovery and the need to return to the basics of fiscal consolidation, investors prefer to wait for the "next chapters". In plain English; politics hinders rather than helping. What a mess!

In the end, it is good not to test the investors' patience, opportunities are huge worldwide after this pandemic. We need private capital coming here. The financial market showed signs of distrust in the stock market and in interest rates. It is advisable to reorganize the house and align with Congress, making appropriate use of this approach with Centrão. Rhetoric alone convinces no one who matters.

The financial market in September reeled and fell and, as always, anticipated movements reflecting the executive's internal fights, the split between the so-called "political wing" informing the President and his economic team, and the resulting failure to maintain the Expenditure Cap. Thus, the Ibovespa fell by 4.80% this month, moving towards an annual drop of 18.20%. In the yield structure, interest rate movements also reflect the perception of public finance deterioration, and expanded premiums especially for the longest maturities. DI1F21 ended the month at 1.98% (against 2.015 in August) and DI1F25 closed at 6.42%, with an increase of 0.51 point compared to last month. The slope is also accompanied by a larger fluctuation for longer maturities: 0.11 and 1.3 points for DI1F21 and DI1F25, respectively. Brazil risk, measured by the 5-year CDS, escalated significantly to 248 points, a 15% change only in September. For this reason, the final dollar quote (Ptax) ended the month at BRL 5.64 – amounting to an additional 3% devaluation of the Real, for the third consecutive month. This is the worst performance among the major currencies in the world.



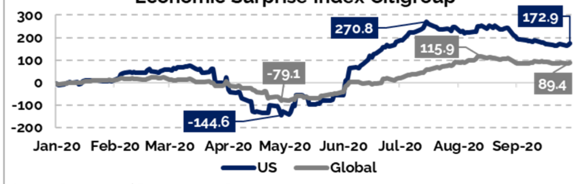
Sourcee: Broadcast | Elaborated by Redwood

With the loosening of restriction measures on urban mobility, the economy "takes a breath" and shows some advances. There is rekindling of activity in several sectors and a certain upbeat reflected in the confidence indexes that reach levels close to those seen prior to the pandemic. If some points play in favor, such as the drop in household indebtedness, commodities exports and the record sale of corrugated cardboard (8.13%) since August 2015, the beginning of the economic recovery is also seen in the increase in tax collection. Federal taxes and contributions in August, discounting the extraordinary effects of the pandemic, reached the best result for the month since 2014. However, if the current forecast is better than months ago, it is a "refreshment" in the face of the stress experienced. Furthermore, this break needs to be accompanied by fundamental economic measures and alignment of purposes in the government, so that this recovery is strengthened and consolidated.

Only the recovery of the economy and the generation of jobs will consolidate the return of the economy in V. There is no point in placing greater expectations that government incentives will guide this recovery, even though support is needed in the transition for those most in need. The failure to manage this pandemic crisis is so great and profound that it requires assistance in this transition, especially for the discouraged. We have alerted in this space that a huge mass of people will look for jobs again and will not find them. The extremely challenging scenario for the job market is not a hypothesis, but a certainty, the reality of which is already seen in an unemployment rate reaching 13.8%. Therefore, the development of a social assistance plan will be mandatory. Orderly and time-limited, without electoral purposes and adjusted to the possibilities with legal sources. Escaping the politicization of this issue and dealing with it with transparency as to the fiscal situation will be fundamental for the credibility of the management of public finances and, therefore, the solvency of public debt.

However, we must highlight in this analysis two events that are not mutually exclusive, but entail different impacts: a new wave of contagion of Covid-19, as is the case in Europe, and the discovery of an effective vaccine. Both alternatives face great probabilities and we hope for the best combination.

Monetary Policy remains firm in its purpose of providing elasticity for better economic performance (maintenance of low Selic, foward guidance - who knows how long it will last -, and cuts in reserve requirements), mainly due to inflation falling short of the target to the relevant policy horizon. However, for a country with an inflationary memory such as Brazil, price variations accompanied by high rates of diffusion cannot be ignored. Inflation has the power to return very quickly, and the last thing any economist wants to face is stagflation. It is not irrelevant to point out that if the IPCA has been "quiet", the IGPM (60% - wholesale prices influenced by the dollar) has already skyrocketed, and eventually "contagion" may set in. In exchange rate policy, the monetary authority must no longer know what to do. The Chairman of BACEN recognizes that there was a "coincident rise" between the market volatility in the exchange rate and the mini-dollar contracts, but ruled out that there is "necessarily a causal relationship". Foreign exchange swap operations, which aim to offer hedge, recorded a negative result once again in September, totaling losses for the year in the order of BRL 60 billion. In addition to less intervention, fomenting the discussion so that the Bill 5.387 moves forward in Congress is important, because it bring modernization, simplification and efficiency of the foreign exchange market.



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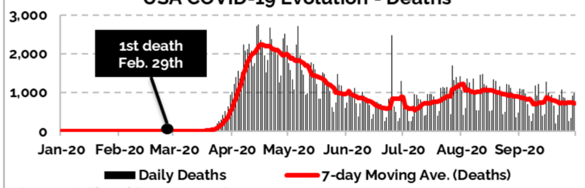

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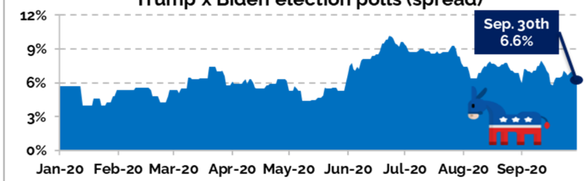

Source: Real Clear Politics | Elaborated by Redwood

In finance, markets begin to see the fiscal not properly priced. Compliance with the Expenditure Cap, a dogma until then, seems to gradually become more flexible in the ideas and proposals conveyed. The public sector had a BRL 87.6 billion deficit in August. We project a primary deficit above 12%, and the Gross Debt-to-GDP ratio nearing 100%, which puts us on a trajectory that is difficult to reverse if rigorous measures are not taken. The tightening of financial conditions due to fiscal uncertainty, in addition to the breach duly identified by facing the pandemic, also feeds into the "head banging" between the political wing and the economic team. The stress seen in the LFT market this month, a federal public bond considered "safe", speaks volume, and may continue the movement if conditions do not change. The market clearly begins to signal little willingness to finance the government, other than on a transitional basis.

It is not credible to admit that the government could do without some form of aid for the disenfranchised in 2021. This year, it is estimated that the aid will add to some BRL 300 billion, something unimaginable for next year at this value. However, it is essential to define the cost of this program and its sources now, because investors (especially foreigners) will not take action before this definition, and further speculation will only bring more volatility.

Worldwide, the new wave of Covid-19 and the American presidential election are taking over the news. In Europe, the ECB chairwoman assumed the *Orloff effect* ("*choose right and avoid setbacks*") in relation to the FED: she indicated that she would allow more monetary stimulus to face the pandemic (overshooting inflation), like the American AIT (average inflation target). In China, the economy is beginning to show signs of vigor, which gives a boost to several economies in the world, especially in the region. In neighboring Argentina, despite attempts to reach a deal with the IMF, the prognosis is very poor - even affecting trade with Brazil. In the US, the graphs above speak for themselves ... but Trump has already shown what he is capable of in 2016. If it is impossible to reduce the current unemployment rate of 8.4% by another 5% until the elections, it is up to Trump to demonstrate the likelihood of a stronger economy in 2021.

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