JANUARY - 2021

MONTHLY STATEMENT

PLANNER REDWOOD ASSET MANAGEMENT

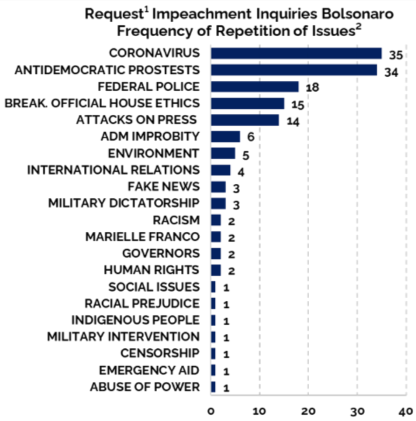
planner Redwood

"I think; therefore I am."

René Descartes – French philosopher, physicist and mathematician.

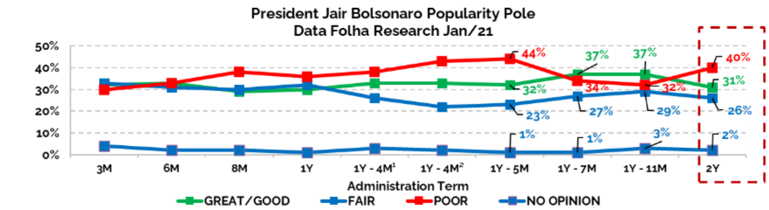
2021 has barely begun and our feeble hopes show no signs of strengthening, especially in terms of its health, regarding vaccination and its harmful political, economic and social consequences. However, doubts are not unfounded, and it is this certainty that makes us think, evaluate and, therefore, exist. Thus, a landscape mired in absolute political polarization does not have a balanced, mature and competent situation to circumvent a fierce and often sordid opposition, falling into its "traps" and without greater power to react.

The result, of course, is an opposition that will do anything to remove the President. The latter, on the other hand, will do everything to prevent this from happening, including possibly compromising his most important stances and the main asset that brought him to power.



[1]Requests registered up to 31 JAN 2021 are considered - totaling 64 orders, among them requests already filed, repeated and addendums, with double counting. [2]Issues created from Redwood analysis
Source: apublica.org | Elaborated by Redwood

Source: Lowy Institute | Elaborated by Redwood



[1]Research date: April, 27, 2020; [2]Research date: May, 25-26, 2020. Source: Data Folha | Elaborated by Redwood

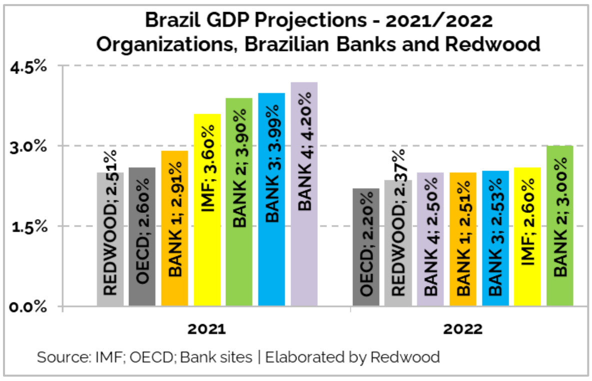
Unfortunately, the abandoning of previous promises, in various ways, is already happening, either due to pressure and protection for his family, or through a political realignment in the face of the resounding failure to stay away from *quid pro quo* politics. In this new political composition, there is hope a revamped governance of the Executive may enable it to move forward with the liberal agenda, while at the same time removing any possibility of impeachment. The risk and the cost are very high, and they can seal not only the fate of Bolsonaro, but of an entire decent and hard-working nation that does not want to see the return of the policies of a not so distant past. In our view, the asymmetry is very large, and the chances of the President's new friends taking advantage now and abandoning him at the slightest confirmation of unpopularity (loss of political capital) is enormous. This is hardly the best way.

The combination of some important factors, mostly economic ones, has devastating power. Although global liquidity is and seems to remain strong, it has a limit and does not guarantee a strengthened economy, especially with our public finances in shambles. Inflation shows its face and, for other reasons too, will soon cause interest rate increases. Unemployment will rise, especially without robust emergency cash transfers, like that of the recent past, thus compromising household income and the wage bill. In this scenario, economic activity is unlikely to take off.

In fact, the beginning of everything, given the atypical moment we live in, must be in the decisive and objective control of Covid-19. The unworthy attitudes of the Federal Government, coupled with the absurd statements of our President, put us in a shameful position in the fight against the virus. That must change. The fastest and most efficient way to return to "normal" is to face the epidemics with wide and massive communication to the population. The variants of the virus, as already detected, can be numerous and eventually without the effectiveness of the current vaccine, a greater reason for advancing, as soon as possible, in immunizing the population.

Anyway, we are walking on a knife-edge. Impeachment does not seem feasible to us, even though the country has already "learned" to do so. On the other hand, the route we are on leads to a fast-approaching perfect storm. I hope not. The ends do not justify the means, President!

The financial market, in a back-and-forth wave, began the year 2021 with a rather wary January, weighing the undisputed reality of our economy and the gravity of Covid-19 with new variants of the virus. A slow pace of vaccination, with direct effects on the recovery of the economy, and political uncertainties with impacts on the evolution of reforms, do not encourage investors and do not build better expectations. Thus, the IBOV closed the month at -3.32%, with some stocks performing quite poorly. The yield curve shifted upwards, with higher premiums and risk pricing. DI1F22 ended the month under bullish pressure in relation to December (2.865%), at 3.305%; and DI1F25 closed at 6.34%, with a 0.69 increase over last month. The swings were also important, with DI1F22 going from 0.44 points in December to 0.645 points in January. DI1F25 varied 1.24 points in January. Warnings were raised for both maturities, a clear sign of concern and uncertainty. The Brazil risk, as measured by the 5-year CDS, in line with that described above, advanced to 174.32 points, an expressive 22% change. In this line, the final Dollar quote (Ptax) ended the month at BRL 5.4759 - a devaluation of the Real, reflecting previous analyzes.



Brazil GDP Projections - 2021/2022
Organizations, Brazilian Banks and Redwood

Source: IMF; OECD; Bank sites | Elaborated by Redwood

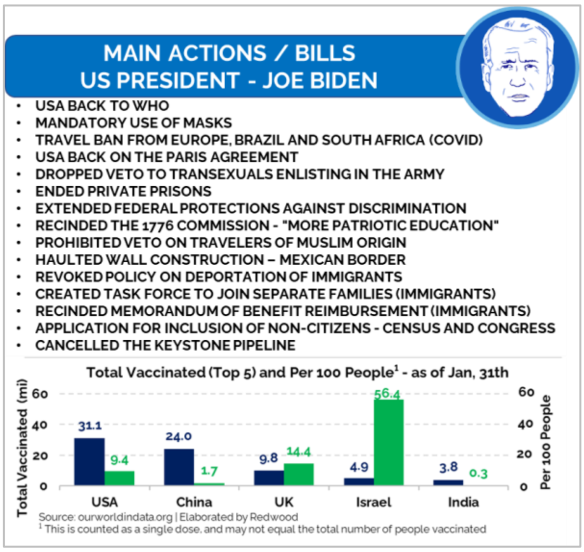
All of this instability is also supported by the policy of the new composition of the House of Representatives and the Senate, which may, if diligently carried out by the Executive, help to advance important reforms. Among the several ones that do not advance, one seems to gain prominence due to the hardships we have experienced in our public finances, which are in the process of bursting the Expenditure Cap: the Emergency Constitutional Amendment Bill (PEC). This PEC, although dehydrated in the Senate since it was sent by the government last November, has the power to "regulate" the growth in expenses with cuts/triggers, even if temporary, reaching all entities of the federation. With it, it will not be possible to create new mandatory expenses and even grant new tax benefits.

However, reforms are unpopular, and in particular the Emergency PEC, which promotes different views of its impact on economic performance. At a time when it is hoped that the activity has a V-shaped recovery, some claim that resources will be withdrawn from workers via reduced wages (public servants) and decreased consumption. As a result, tax collection is reduced, with a consequent worsening of the fiscal framework. We would enter a vicious cycle with a multiplier effect affecting production and employment.

It does not have to go that way. The order of things matters; and a lot at that. Economic activity will not take off unless we have good expectations, robust and growing confidence indexes. Private investment will be the basis and leverage of our growth. However, it is known that each BRL 1.00 spent on public investment generates more return than the same BRL 1.00 spent on public servants, and with these cuts billions will be left to be invested in Infrastructure and other areas. In addition, with the adjustments to the Emergency PEC, we will curb debt growth (which will rise again with an increase in the Selic rate), a good sign for investors and the formation of expectations. As a short blanket, it will be difficult to meet the Spending Ceiling, forcing the government to cut back on essential areas, as it did in 2017.

The recovery of the economy in 2021, although coming from a smaller base, given the difficulties presented (lack of control of the virus, failure to advance fundamental reforms and our President's total lack of intellectual and leadership abilities), if the directions are not corrected soon, growth will fall short of potential GDP. To unlock Brazil's growth we need a combination of good factors, that the government should act diligently, insistently and appropriately, and take advantage of the new leadership in National Congress.

Taking from our analysis and communications by Central Bank (BACEN), monetary policy does not appear to have changed significantly since last month. However, it is important to highlight that the monetary authority showed lower tolerance to inflation, signaling a possible withdrawal of the forward guidance stance. Inflation is estimated to be near the 3.75% target, which is tighter than projected at the same time last year. With an inflation rate of 4.5% in 2020 under some acceleration, the impacts of the new wave of Covid-19 and the government's attitudes to face remain to be seen. Is this deflationary impact due to a slower recovery, or will it accelerate inflation due to a position of fiscal easing? We do not believe in a robust emergency aid as in the past, but we have registered in this space the impossibility of zero aid with restricted mobility and activities of the population. Thus, with high diffusion rates in the price index, a lower inflation target and diverse uncertainties, the space for accommodating inflationary shocks makes BACEN much more cautious at this time. It will not be surprising to see some anticipation in the interest rate cycle and also some increase in the Selic rate beyond the initial 3% projected for this year, despite the weak recovery and rising unemployment. In the exchange rate policy, no changes so far. We expect appreciation of the Real from several perspectives, in particular the international situation and commodity prices. Our domestic problems and their eternal non-solution play against this appreciation. BACEN will jump at any chance to intervene, under the excuse of curbing volatility, but nothing that has the strength to alter its course, given the result of the main drives.



On the fiscal side, with a better performance than we imagined in 2020, the usual mandatory government spending was in line with that of 2019: BRL 1.4 tri. However, spending on tackling the pandemic reached BRL 540 billion and raised the figure to almost BRL 2 trillion. With this amount, mandatory government spending consumed 150% of current net revenue and, even if we discount the pandemic effect, this percentage would reach 110%. This gives the exact dimension of where we stand and the declarations of the National Treasury at the end of January confirm: "The fiscal space that the country has to implement new measures to face the economic and social impacts of the pandemic is limited. Thus, it is recommended that the expenditure cap rule be maintained as the best strategy for resuming the fiscal consolidation process, ensuring that temporary expenses do not become permanent." Concerns are running high. With the largest deficit in the time series last year (BRL 743 billion), we cannot repeat this mark, by far, under penalty of disrupting and even contaminating our sovereign rating (now stable). For this year, our primary deficit projections are in line with those of the government (BRL 250 billion), which makes the situation very dramatic, if confirmed.

Worldwide, the USA was in the spotlight. With Trump's departure in the worst possible style (leaders are remembered, as a rule, how they come out of their mandates) and Biden's inauguration, his voters are pleased to see his promises come to fruition immediately. It is a true dismantling of Trump's achievements and a very strong turn to the left in that country. "Painting" Joe Biden as a moderate may be a way to get lost, but the essence of his platform and commitments are irrefutable. The results will come soon, both domestically and internationally.

Overseas, concerns revolve around the new Covid-19 variants. The vaccine race hogs attention in all countries, while several are closing in an attempt to prevent infection by other variants of the virus. An understandable but short-range attitude. Yes, it will be impossible for countries to remain shut down indefinitely, so "soon" a "solidarity" movement towards making vaccination a common good will gain strength. Simply out of goodness of hearts? No, interests only. In Europe and Asia, central banks are paying attention to the beginning of the year and the possible economic impacts of health-related issues. In Germany, a possible thermometer, as the least affected among large economies, businessmen expect normalization of activity only by Sep/21. In China, GDP growth is projected at 8%. Apparently, the antivirus is Chinese... and everyone accepts it... and now without Trump and with Biden. It is difficult to be optimistic, unfortunately.

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