MONTHLY STATEMENT

JUNE 2021

Redwood

REDWOOD ASSET MANAGEMENT

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One should always tread lightly on… muddy ground!

Proxy of a popular Brazilian saying that reflects the current political situation.

Over the past two years numerous pillars of the Bolsonaro Administration have fallen down, one by one. However, recent accusations about corruption have attracted greater attention given its importance and possibly one of the remaining pillars standing before full-out collapse. It should come as no surprise, especially after Messias' turn towards greater proximity with the Centrão – it was a matter of "space-time", but the deformities presented in reports are impressive due to the magnitude and intensity described. In any case, everything "must" be properly verified with the "maximum" rigor and care.

The facts, however, point to a black hole in our politics. It all looks like a photograph seen from different angles that does not differ from what was observed in the past, especially with no such problems as the information paradox that physicists faced in understanding black holes, and which it seems, will not apply to Covid's Congressional Inquiry. The similarity between both types of holes, though, is enormous: they pull in everything around them. When approaching the black hole and crossing its border, the government may not find "hair" to hold on against the horizon of explicit events. Information is coming in, jumbled and chaotic, but we won't need physicists and astronomers to decipher it.

There really could be no other background. A health crisis of this size led by a biker steering a spaceship is not surprising that, in aiming for the Moon, ended up hitting another star. Scandals were and are still to be expected, and perhaps this whole mess makes logical sense, albeit hard to break down at first glance. The vaccination scenario in Brazil is a disaster in terms of the timing of purchases of vaccines, quantities and prices; but not necessarily so if denial is included in the analysis. These are different points of view, without sticking to merits of the fatal victims of Covid-19, and that opportunists always on alert, many now close to the government, do not hesitate to "cash in" – it is in the nature of these "beings".

Amid all of this crisis, society watches, in astonishment, the leadership of the country enthralled with delusions and disorientation of all sorts. Institutions clash, politicians fail to compromise, and vocal minorities breed polarization. Conjunctural and structural variations are underway, but the delay in the appearance of a convincing third way threatens its competitiveness, given that the major contestants are already effectively campaigning for 2022.

VACCINATION OVERVIEW IN BRAZIL (Jun/21)

Total vaccinated with at least one dose: 73.6 MM | 34.74% pop.

Total vaccinated 100% immunized (two doses or single dose): 26.3 MM | 12.41% pop.

Total doses applied: 99.8 MM

VACCINES PURCHASED BY THE BRAZILIAN GVNM'T

Astrazeneca[1] | FIOCRUZ
12 MM doses | USD 5.25 p/ dose

Astrazeneca | FIOCRUZ
150 MM doses | USD 3.16 p/ dose

Coronavac | Butantan
100 MM doses | USD 10.3 p/ dose

Astrazeneca and Pfizer | Covax Facility[2]
42.5 MM doses | R$ 18.17 p/ dose

Pfizer | Biontech
200 MM doses | USD 10-12 p/ dose

Janssen | Johnson & Johnson
38 MM doses | USD 10 p/ dose

Covaxin[3] | Bharat Biotech - Precisa
20 MM doses | USD 15 p/ dose

Sputnik V[3] | Gamaleya - União Química
10 MM doses | USD 13 p/ dose

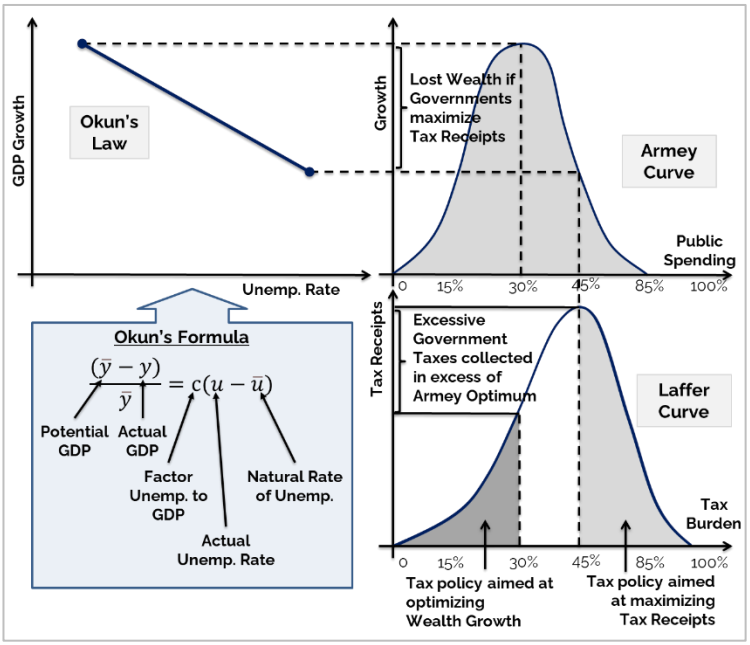
[1] Contract settled with India's Serum Institute
[2] Contract settled with Covax Facility
[3] Contract with unfulfilled conditions or temporarily suspended by the Ministry of Health

Source: Ministry of Health; Media Press Association; Various Media Websites | Elaborated by Redwood

The narrative war is no longer limited to politics and the health crisis. It also reaches other fields, such as the Ministry of Economy, previously essentially technical, meticulous and focused on its purposes. Two years later, without major achievements to display on its main projects on the liberal economic agenda, the year 2021 is also the last year to present any results. Thus, it appears that the Economy has gone on "anything goes" mode. Quality seems not to matter as much as having anything at all to show next year. As a result, we will see privatizations in any way, tax and administrative reforms poorly done and other advances as pale imitations of what was originally envisioned. Has the Minister bowed down and caved in to politics? Would reelection secure another four years to pursue the abandoned liberal agenda? Or is there really no other path possible?

For any of the analyses, Brazil discourages. Even worse, our future does not project the new but, on the contrary, it signals the likely return of what has sunk us in the past. The change, however, will depend on how we will tread these muddy trodden trails while avoiding the return of those who have already gone by.

The financial markets have been unaware of the deteriorating situation, particularly in Brazil's political situation, but find support in some factors. The (i) voluminous international liquidity provided by governments and central banks, (ii) rising commodity prices (first due to Chinese demand, and now with widespread vaccination, the growth of other countries) and, (iii) low international interest rates which, added to the two previous arguments, make investors less risk-averse and more daring. However, it is advisable not to overlook political risk and, to some extent, the political tension that begins to overcome the above factors and imposes caution on markets. The tension comes, of course, from the accusations of corruption in the purchase of vaccines, the drop in the President's popularity and, as a consequence of the existing polarization, the rising chances of Lula winning the 2022 elections. Markets may be soon to price in the real risk of "going down" for good.

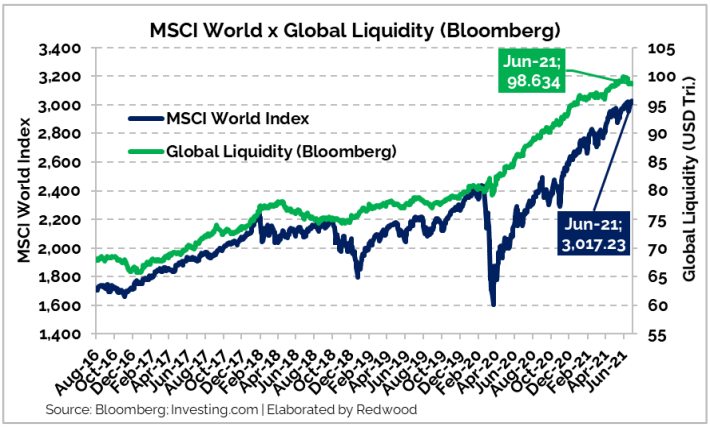


In this line, the Ibovespa walked sideways last month, changing only 0.46%, reaching the 126,802-point mark. The yield curve movement of last month continues, with higher rates in the short term, and some increase for the longer maturities, with clear pricing distinction along the curve. The DI1F22 ended the month up in relation to May (5.09%), at 5.68%; and the DI1F25 closed at 8.06%, just above last month's mark (7.90%). The range registered between highs and lows showed greater variations this month, with DI1F22 going from 0.43 point in May to 0.735 point in June. The DI1F25 oscillated even more, and with greater intensity in June, 0.75 points. BACEN's attention is increasingly focused on the yield curve structure, which it carefully monitors for a proper reading of the market and an eventual adjustment in monetary policy. Brazil risk's main indicator, the 5-year CDS, displayed a small 6-point drop, ending the month at 165.57 points. The Dollar ran in the same direction, dropping to BRL 5,0022 (Ptax), with a -4.40% change – another appreciation of the Real, for the third consecutive month, confirming the expected downward movement.

If financial market is keen on taking it slowly, the data for the economy, although on a fragile and depressed basis, show some encouragement. The GDP projections continue to rise and the results, especially tax revenues, promoted an improvement in the Gross Debt/GDP ratio, now in May at 84.5%. The net balance of formal employment at CAGED was also positive in May, and accumulated in the year 1.233 million new jobs, against a net job destruction in the same period last year of around 1.144 million. This result "conflicts" with PNAD data, which indicates an unemployment rate of 14.7% with almost 15 million unemployed. The re-enactment of the BEm (Emergency Benefit for the Maintenance of Employment and Income) at the end of April may be related to the result of the CAGED, but it still strongly relies on the change in the methodology applied to the index, which now includes temporary workers in the database, in addition to the change in the registration of data as a delay in the communication of layoffs. The picture of the labor market by the two indices is not clear, and points out that this inconsistency between job creation and the unemployment rate will continue, under penalty that this "inaccuracy" may have an impact on public policies for this purpose. In any case, counting on the "tax reform" proposed by the government, there is no doubt about its orientation. The maintenance of neutrality in the so-called

"reform" has eluded us, and the course, as explained in the graphs above, follows the option of maximizing revenue, with the expected consequences.

In Monetary Policy, changes in various price indices worry consumers purchasing power. Water crisis with power bills increases, gas and fuel price increases are just a few items with direct and lasting impacts to disseminate to all other prices. Thus, with an impressive speed, we witness this "contamination" and its reflexes on a daily basis. In this line, we are certain that the "independent" BACEN will stick to a policy of sharp Selic hikes towards the "neutral interest rate" or beyond, in the relevant time path for Monetary Policy – the only way to reverse inflationary expectations. In the Exchange Rate Policy, the expected increase in the Selic rate, a "better" fiscal and a calm external sector without major adjustments at the moment, may confirm the downward trajectory of the Dollar against the Real, but without major bets, given the political situation and the interventionist profile of BACEN on this front. On the fiscal side, the government's optimism does not fit our expectations and calculations. There will indeed be an improvement, but there are plenty of arguments supporting our caution stance in the projections, such as taking care of the fragile economy, the still existing risk of the health crisis, the truly necessary emergency aid, the failure to advance as expected and, last but not least, the risk of populism with elections ahead.



Source: Bloomberg; Investing.com | Elaborated by Redwood

Overseas, the recovery of large economies depends on mass vaccinations and, with the full reopening, the necessary adjustments will follow, given the disorganization of production structures and the transition to normality in the various markets. In Europe, signs are promising. The PMIs of Germany, France, Spain and Italy are at high levels, supporting the growth in the production of intermediate and capital goods, possibly sustaining employment growth. Indeed, the Eurozone (EZ) Industrial PMI rose to a record 63.4 in June, beating estimates. The unemployment rate in the EZ dropped from 8.1% in April to 7.9% in May. Inflation in the UK is not yet a ghost, but the BoE has already signaled that it will act with monetary policy instruments if it detects persistent inflation. The ECB, for its part, is not concerned about the balance of risks in the EZ, which it considers balanced out, but highlights the new Delta variant of Coronavirus as the main source of concern.

In China, its Industrial PMI fell to 51.3 in June, its lowest value in three months. It may be an indication that the momentum in manufacturing is fading, with price pressures easing and demand stabilizing. The PBoC warned that banks should expand credit to sectors that generate jobs and defends the use of a monetary policy that affects the real economy and that a cap is placed over the cost of debt. It is the economic recovery that is weakening there.

In the US, while international institutions are already impressing on the Fed the need to raise its interest rate at the end of 2022, we have moved away from this premise and, for obvious reasons of economic heating, tight labor market and the "unpredictable" course of inflation, believe some signaling will be followed by effective hikes in interest rates by the end of this year. FED officials are also more inclined towards starting tapering this year. The increase in wages indicated in Payroll data endorses this perspective. Our divergent market position is also based on the lower health risk the population bears, once it is widely vaccinated.

Global liquidity is helpful, and many understand that Governments and Central Banks are doing right in acting as a buffer in crises. OK. The bill will come... it will be delt with later... but overall, this is good news!

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Redwood

Avenida Brigadeiro Faria Lima, 3900 – 10º andar
São Paulo – SP | CEP 04538-132
+55 (11) 2172.2600
planner.com.br