MONTHLY STATEMENT

AUGUST 2021

Redwood

REDWOOD ASSET MANAGEMENT

"Independence or Death!"

Exhortation on the banks of the Ipiranga River by D. Pedro I, Prince Regent of Brazil.

A more appropriate cry these days is: Peace and Harmony!

An appropriate expression indeed, but certainly innocent and useless, given the institutional vandalism, the generalized riot and the premeditated actions aiming at this purpose. Yes, no need to speak of a probable breakdown of the Institutions, as this has already happened. What we are currently reaping, and increasingly so, are the consequences of this fact. The nation's main turmoil seems endless, and the inconsequential actions are added to reactions by other branches of government, in a continuous motion that threatens democracy and mutually invests in institutional conflicts.

The political dynamic is perverse and, in anticipating 2022, it breeds explosive behavior. We have reached a situation where everyone is to blame and everyone is right. In an incremental sequence of brush-off attacks, raptures and advances, coming from all branches, it generated a huge sum of "deviations", and rupture ensued. That's what the original culprit wanted; and he got it. Now a peaceful and fair solution is barely on the table. Confusion is so rampant that it is not possible to reconstitute the strand of "offenses" so as to ascribe responsibilities. And is it really necessary? Does anyone want that?

Independence or Death!

Source: Picture - Jornal Estado de Minas; Painting – Pedro Américo Independência ou Morte

The politics continues to override markets and the perception on Brazil. If the federal administration maintains a "Teflon" rhetoric, to which no wrongdoing sticks to a dwindling share of the population, markets tend to price this predicament, and the key to this understanding is called "distrust". As we have pointed out, some indicators are improving, albeit passively, but with inflation and interest rates on the rise, unemployment at high levels, the population perceives the effects of economic activity as ephemeral. Increases in basic inputs for the population, such as food, cooking gas, gasoline and electricity, are disproportionately heavy burdens on the poorest. They do not go unnoticed, and already reflect on the President's popularity.

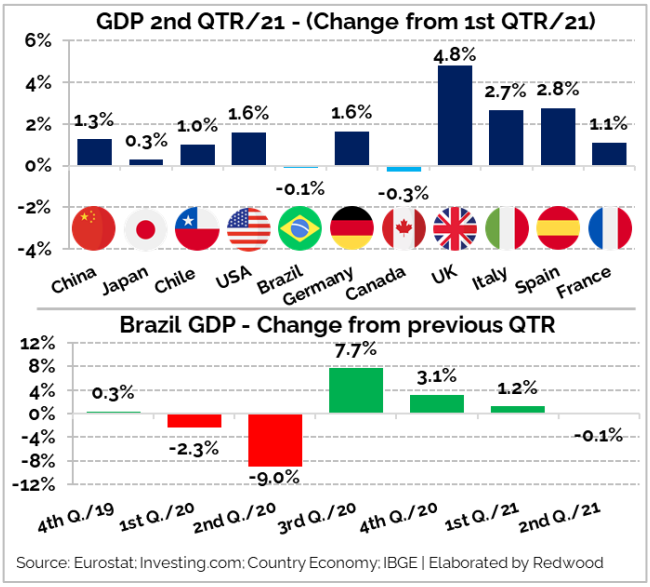
Measures to fight inflation, for example, are not at all popular; by increasing basic interest rates, they will strongly cool down economic growth next year. This situation is yet more harmful to the President's popularity, who is about to run a campaign in association with the Centrão, which does not show the slightest concern with increasing public spending, will "explode" the Expenditure Cap, and flushing down fiscal responsibility. Doing away with our only anchor implies the usual "evil" spiral: pressure on the exchange rate, more inflation, less growth and more pressure on BACEN to adjust monetary policy accordingly. All of this for re-election? It doesn't matter, the bill will be paid by the next government, whichever it is. We will pay... dearly so!

It didn't have to be that way, but the Ministry of Economy, with his constant "ineloquence", doesn't help those who understand even less of the turmoil besetting the country – namely, the President –, who insists on his tantrums. Without intellectual integrity and honesty, competence does not settle down. Disregard for crucial matters amid even more arrogant - if not ignorant - statements has immediate repercussions on confidence and asset prices. Brazil's interest rate curve has exploded, just as some economic achievements start to appear! Could this be so? Sure! Careless communication, combined with political unpreparedness and surrender to the reelection project, encourages delays and the smooth processing of reforms. And Centrão, Bolsonaro's "ally", loves it. It embarks on every adventure and will do anything, not for the President's re-election, but for its own convenience... and yet he believes in it naïvely!

Mark my words, Brazil!!!

The financial market, notably the exponents of "Faria Lima", seems to have thrown in the towel, pricing the galloping inflation, the fiscal risk that arises and the political risk that finally engulfs spirits and confidence. How much of each is reflected in prices, and the intensity yet to come, is not easy to parse out. However, if the "mathematization" of this expectation exposes limits to its accuracy, especially due to unobservable variables, it does not require much to map the potential persistence of this situation. Political tensions tend to intensify, and with it the economic and financial contamination of the country bring all its consequences.

As a result, the Ibovespa dropped once again this month, down -2.48% to 118,781 points. The yield curve shift last month was intensified, with higher rates throughout the term structure, with an important increase in all maturities. The signaling of "all" risks is present, those that manifest themselves in the short and long terms. The DI1F22 ended the month up in relation to July (6.31%), at 6.735%; and DI1F25 closed at 9.53%, almost 10% above last month's mark (8.70%). The oscillations between highs and lows showed important variations this month, with emphasis on the DI1F25 at 1.57 pp, and the shorter vertex DI1F22 at 0.575 pp. These same variations were for both vertices, in July, of 0.68 pp. The theme is recurrent and BACEN is aware of and committed to, as it is incumbent upon it, better addressing the matter, but it counts on "friendly fire" with unnecessary and harmful declarations and manifestations.



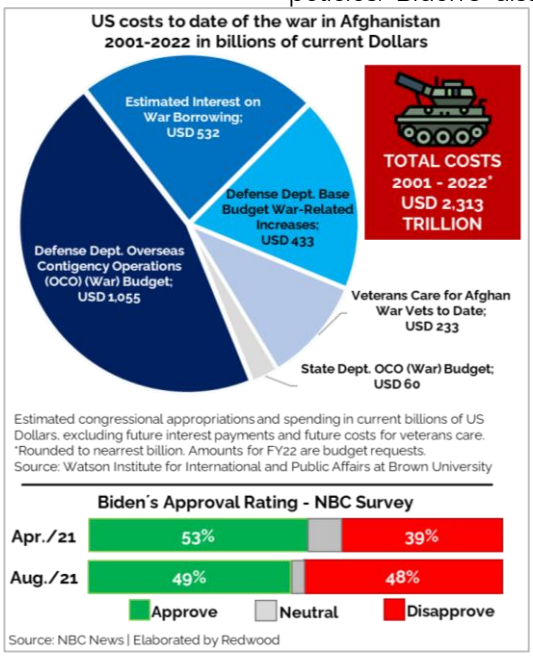
The Brazil risk main indicator, the 5-year CDS, in line with its recent behavior, has remained at 176 points last month – signaling a possible lag in the perception of country risk. The Dollar, in turn, rose little, ending the month at BRL 5.1433 (Ptax), with a variation of +0.42% – a small devaluation of the Real, for the second month. The financial market, therefore, clearly points in that direction and our analyzes confirm the volatile trajectory.

In the economy, some indicators need to be celebrated, but they fail to raise much enthusiasm in markets. Our balance of payments is not bad. The Trade Balance presents gorgeous surpluses and the Current Account enjoys "comfortable" levels. The Public debt-to-GDP ratio also remains at better-than-imagined levels, and the unemployment rate itself has dropped by almost 0.5 pp. It is no small feat, given the crises we are going through, but we do not have the slightest ability to "capitalize" our "achievements". Quite the contrary, if the latter are dismissed, the focus becomes another, and true commitment reveals itself. This makes room for a meager economic performance, although already expected, to gain more salience. In fact, economic performance is strictly within our expectations, but below market's – especially for end-of-year projections. It doesn't mean it's any good - far from it - and the "stagflation" (stable economy + inflation) that is currently talked about (today) could be a serious problem in 2022. Economic management is horrible, and at every moment it "creates" a disaster due to carelessness and/or unpreparedness: last month it was the "default solution" of the Court-ordered public debt and now, a fictitious budget!

In Monetary Policy, inflation boxes BACEN in with a decisive and inflexible position: interest rate hikes! Why so? Because it will be louder and more persistent. Inertial inflation is increasingly present and growing, as well as "adaptive" and "extrapolative" inflation, soon, with a diffusion index approaching 80%, will change the expectations of economic agents. These changes change the parameters of economic models and it becomes difficult to model the formation of expectations and thus coordinate to anchor down these expectations. Furthermore, recent price

increases, such as electricity, have the potential to trigger several other price adjustments. The rise in prices is no longer one-off and transitory, we reached 8.99% accumulated inflation in 12 months ending in July. The exchange rate policy should display a more appreciated currency, due to the upward trend of the Selic rate and some favorable economic indicators mentioned before; but it does not. There is a risk premium born out by mistrust and political and fiscal uncertainty – yes, the risk of breaching the expenditure cap is also present here. Also, BACEN does not always help. The institution repeatedly states that it does not seek any target "level" for the exchange rate, but rather the control of volatility when there is a "dysfunction" in the market. Nothing else is more far-fetched, and it does not achieve any of its goals. Its actions in relation to foreign exchange swap operations, "always with the purpose of offering hedge to the market", registered a new loss of BRL 13.2bn this month, after a BRL 8.9bn loss in July.

On the fiscal side, the public sector primary deficit came in better than expected, but still far from a lasting sign of a new downward trajectory towards surpluses. In fact, both stocks and flows do not point to a favorable dynamic, and the ghosts that weaken this condition appear all the time, whether by reforms that fall short of expected or by populist measures perpetrated by the Executive and Legislative branches. But not even that reality has affected or impacted the newly proposed Budget Bill – a veritable work of fiction. There are still too many uncertainties. However, the signaling of a primary deficit of approximately BRL 46 billion for 2022 is based on a 2.51% projected growth and a strong revenue collection. Unfortunately, this projection is quite outdated, especially after the Selic hike to control soaring inflation - the transmission of monetary policy, as we always warn, takes some time and higher interest rates will greatly affect the performance of the economy in 2022. This scenario of crises and the behavior of macro variables leads our simulations to a GDP growth below 2% in 2022.



Across the world, attention has turned to the withdrawal of US troops from Afghanistan, not only for its geopolitical importance, but also because the matter fuels rumors of President Biden's real capabilities in running the country. The exit, after 20 years and more than USD 2 tri spent, was widely supported by the population, but the execution demonstrated a very great ineptitude. This "inaptness" couples with other issues that are very dear to Americans, such as the issue of borders (irregular immigrants), tax increases, controls and the change in social policies. Biden's disapproval rate spiked almost 10% from April to August 2021, but although far from a more radical outcome or even resignation (which some already demand), his Vice-President fails to "delight" the rest of the world.

In China, a lower Industrial PMI reinforces forecasts of a slowdown in demand for commodities and, as a result, for economic activity as well. Therefore, the Chinese State Council decided to intensify financial support to small and medium-sized companies, as they account for more than 90% of job creation and 60% of GDP. For the balance-sheet recovery of these companies, the financial aid this time will be almost USD 50 billion, in credit transfer quotas.

In Europe, the ECB is expected to end its Pandemic Emergency Procurement Program soon, as the economy resurfaces from the crisis and inflation gradually returns. Along these lines, the advance of the PPI in the Euro Zone is undisputed: 12.1% in July/21 on July/20. On the other hand, the PMI fell to 61.4 in August, but still well above the 50-mark, which is inkling of the bloc's manufacturing expansion. Politically, the 26th of September will be the dispute for the succession of Angela Merkel in Germany. Is anyone able to fill her shoes? Europe really needs it!

DISCLAIMER

This material has been prepared by Redwood Administração de Recursos LTDA. (Redwood) and is for information purposes only and does not constitute a recommendation for investment, offer or solicitation of an offer to acquire securities or any financial instrument. The information, opinions, estimates and projections refer to the present date and may contain information about future events and these projections / estimates are subject to risks and uncertainties related to factors that exceed our ability to control or estimate accurately, such as market competitive environment, fluctuations of currency value and inflation, changes in regulatory and governmental entities, as well as other aspects that may differ materially from those projected without prior notice. The information herein contained is based on the best available information collected from public, official or credible sources, which we believe to be reliable and of good faith. However, they have not been independently verified and, neither express nor implied warrant is given as regards their accuracy. We are not responsible for any omissions or errors, and even as we have taken all precautions to ensure that the information contained herein is not false or misleading, Redwood is not responsible for its accuracy or completeness. The opinions expressed solely reflect our opinions at the moment. We reserve the right at any time to buy or sell such securities. These projections and estimates should not be construed as a guarantee of future performance. Redwood undertakes no obligation to publish any revisions or update such projections and estimates in light of events or circumstances that may occur after the date of this document. This material is provided for the exclusive use of its recipients and its contents may not be reproduced, redistributed, published or copied in any form, in whole or in part, without the express permission of Redwood.

Redwood

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