MONTHLY STATEMENT

APRIL 2023

Redwood

REDWOOD ASSET MANAGEMENT

¿Por qué no te callas?
"Why don't you shut up?" (free translation)
King Juan Carlos I of Spain

The various erratic movements of the new federal administration are scandalous. Led by the Commander-in-Chief, the PT never disappoints, but even by its standards, there is nothing that obscures our economic, social and financial horizons more than its outdated ideas made possible in dyslexic behavior, which is mirrored by its well-trained supporters. The panacea of this beginning knows no limits, and the ability to talk nonsense is only matched by the ability to act on it. So much nonsense and false choices profusely spread around the world. Paraphrasing Immanuel Kant, *out of the crooked log of the archaic and always outdated vision of PT's ideology and approach, nothing truly straight can be done.*

Has the current President transitioned from conservative to radical, or has he always been like this? It seems that he descended to the bottom of the well of ignorance, drank as much as he could, and emerged with all his strength. Wearing a fanciful mantle of moral superiority, whose factual reality blocks and downgrades any serious discussion about it, the administration does not seem to launch. Slow, disjointed, and without proper coordination between the Executive and the other branches, the conditions for governance are not established. In the broader administration's team, messiness makes it difficult to identify who is to blame for one thing or another. It is a parody of a foretold disaster. In this vein, we will have four years of scourge, unless someone within the government opens its eyes while there is time to curb the monstrosities we have been witnessing.

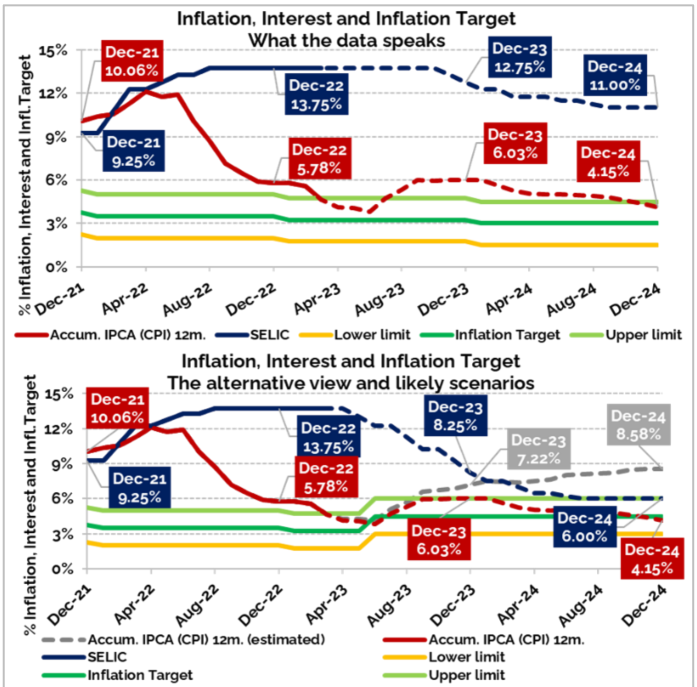
Organizing this governmental limbic system is not trivial, but it is necessary and urgent. In these few months of the new federal administration, we have not only lost opportunities to attract a great volume of investments, but we have also pushed away some important ones. Maintaining this bellicose political posture has cost us dearly, whether for convenience or the affirmation of a polarization that has not yet cooled down. That's enough. The election is over and the government will not have it easy. It will be smart to recognize this and change course, as well as offer some healthy longevity for the government and the nation. Pragmatism, objectivity, technical stance and orientation are tools that need be taken forward and change attitudes regarding our domestic issues, and how we appear to the world. Believing and giving credit to Institutions that are not under the "control" of the Executive while focusing on discussions that are actually worthwhile and abide by the rules of intellectually honest debates. We need to reason about and interpret not only the arguments presented, but above all the assumptions that support the arguments - see the subject of the ridiculous clash over Selic/Central Bank/RCN.

Markets have already put a price on all of this, but the pernicious influence of this posture is nowhere near priced in. Why? Because globally, there is no positive or negative light on us. But the way we proceed needs to pass the test of evidence and logic. Any attempt to control freedoms, silence or suppress civil rights, notably in a digitized world that is "dominated" by Big Techs, will enter the international public opinion's radar. Should we succumb then? Of course not! Combating and promoting competition, transparency, free access and letting the individual, as a master of oneself, decide what is appropriate or not. Is this naïve? No, it's about being free to choose. Difficult concepts indeed for the ideology of the current government, mainly because the population elected it that way.

However, to undermine the notion of a free country will be to annihilate our chances of entering the club of more developed nations – at least those that respect the democratic rule of law. It's time to hold the tongue, feed the spirits, control the crowd. It's time for the President to remember his previous terms in office.

Financial markets saw a landscape much warmer than expected. Political dislocations have direct effects on portfolios that are sensitive to the economy, and the reflexes necessarily end up with Faria Lima and its managers. The "single-note samba", namely, the attacks on the CB and the pressure for Selic cuts are now also based on the anticipation of this unraveling due to the approval of the fiscal framework (who knows how) by mid-year, as Minister Tebet claimed. It's relying on the egg being "inside" the chicken itself. The market does not buy this at all!

In any case, the Ibovespa interrupted its consecutive declines and rose 2.5% in April, retreating to an accumulated -4.83% change in 2023, reaching 104,432 points. A one-off improvement in our view, which does not reflect the fundamentals, in particular, for an environment with interest rates at the levels practiced today in our market. In this segment, the yield curve had timid adjustments along the curve, an inkling that the initial impacts resulting from the interpretation of the new fiscal framework has already been largely priced in. Thus, the shortest DI contracts even increased, rising slightly from 13.20% to 13.295%, while those maturing in 2025 remained practically unchanged, from 12.035% to 12.070% and, for 2031, some reduction was noted from 12.80% to 12.32%. The next step involves monitoring the policy stance until the proposal passes, and the magnitude of intended changes and their respective impacts – nothing "better" is expected on this front, i.e., this is what we have and no wishful thinking regarding fiscal austerity.



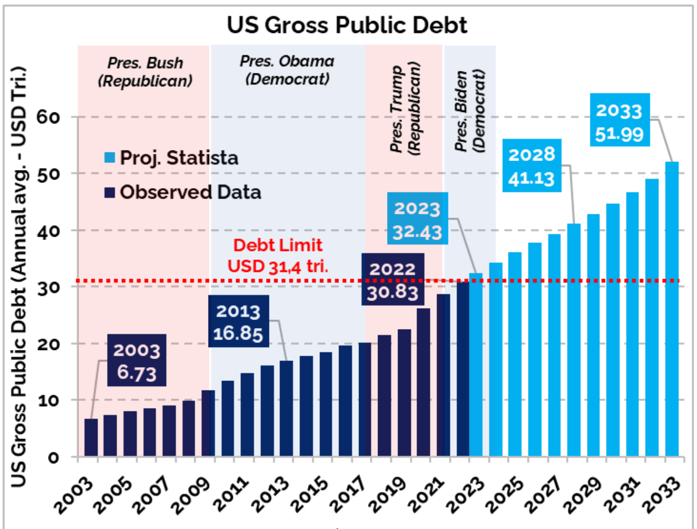
Source: IBGE; Central Bank of Brazil | Elaborated by Redwood (Proj. starting in April/23)

The Brazil risk, priced by the 5-year CDS, pointed to a reality not too different from the one analyzed above, but closed the month at 221.10 points, lower than last month's 226.13 points – an important stability which the rating agencies will certainly take into account when reassessing our credit rating. The Dollar, along the same lines, fell and closed at BRL 5.00, against 5.08 last month, a -1.57% variation in the month and -4.16% within the year. A significant highlight was that, unlike last month, which stretched the peak to BRL 5.3316, this April had a ceiling at BRL 5.0894 and with a trough at BRL 4.9034! It is no exception to the rule of "unpredictability" of the Dollar.

In the real economy, the predictions we have been making are in line with a recent IMF study. The Brazilian economy this year, and also in the next ones, will grow short of its potential and, in this line, will have its smallest share of the global economy in the last decades – in fact since 1980: we will answer for 2.3% of the global economy. This loss of relevance is even more highlighted when compared to emerging economies, and one of the main causes of this delay is the quality of the education system. We have overcome difficult moments, such as the inflationary process, and have made great progress with the Real Plan, but the recurrent "chicken flights", resulting from mistaken policies, throw us into a low-growth trap against which consistent long-term public policies can no longer suffer discontinuities. The roadmap follows three pillars, namely: reforms, reforms and reforms.

In Monetary Policy, the onslaught attacking the Selic level borders on the intellectual dishonesty of the discussion. The tables above try to describe how we think about it, and what we deduce from what government members want and expect. They want CB to fulfill its multiple objectives (in an optimal situation, alone – impossible!), and they hope that their demands are contained within an adjusted reality. Thus, even under disguise, they seem to admit that a little inflation can put us in a better general position than we are today – notably greater economic activity and lower unemployment.

This magic would happen through faster Selic rate cuts with simultaneous greater upward "elasticity" of the inflation target. The effects on economic activity (greater), unemployment (lower), credit (wider and better), etc., would act to "turn the wheels" of the economy. It doesn't convince minimally educated people. The economy is sensitive above all to expectations and, before the expected impacts, the reflections interest rate cuts with higher inflation targets in an environment of absolutely unanchored future inflation, as well as a rigorously unsolved fiscal policy, the spike in inflationary expectations would be immediate. They would frustrate all the government's hopes, not to mention the even greater disorder while rendering more difficult any later adjustment. There is no magic and there are no shortcuts; playing with this is irresponsible! In sum: it is not difficult to decide what to do with your investment in each situation.



Source: Fred-St. Louis; Statista | Elaborated by Redwood

As for exchange rate policy, BACEN is "grateful" for recent market movements. The truth is that the external sector has shown a favorable dynamic, despite external conditions and the countless uncertainties in our domestic market. Along these lines, the total foreign exchange inflow this year through April nears USD 13.53 billion, against USD 15.35 billion last year – lower, but better than expected. Big numbers: the financial channel registered net outflows of USD 5.10 billion and in foreign trade surplus of USD 18.64 billion. With this position, CB maintained coherence in its intervention policy - which we vehemently disagree with.

On the fiscal side, the government tries to convey a focus on normalizing the fiscal scenario – at least that is the message Minister Haddad has been sending. But the task is not easy, because "everything" in the new fiscal framework presented relies on tax increases, exemptions (see example income tax changes) need to be accompanied by compensating tax revenues. Therein lies the danger: releasing tax change proposals without further discussion (which then need to be revised), while some ideas should clearly integrate the tax reform bills. The lack of planning and organization leads to violations, which takes a toll at credibility and hinders any approval by the National Congress. Another point that is consolidated in the evaluation of the proposal for the new framework, and which will need to be adjusted, is the fact that it is an ordinary bill of law, that is, non-compliance would not characterize an impeachable offense. Without strong enforcement guideposts, there is no guarantee promises will be fulfilled? No credibility at all!

Overseas, the economic optimism that collapsed last year shows no signs of a turnaround, despite China's "comeback". Financial conditions in the US and Europe are extremely difficult, and constantly aggravated by geopolitics. The banking crisis in the US and Europe is in fact not over, and experts point out that the weaknesses in the system are important and no less challenging than those of the 2008 crisis. After several years of overflowing liquidity (low interest rates), when many risky operations and long-term loan operations were carried out, the strong and rapid reversal of this environment breeds events such as the recent bank failures - whose counteractions preventing systemic spillovers brought the *déjà-vu* feeling of 2008.

In the IMF view, the crisis in the banking sector and the slowdown in the economies of the US and Europe may promote demand shortage in Asia, thus compromising the region's growth prospects. The organization also reduces the growth forecasts for India, Japan and South Korea in 2023 and 2024. Last but not least, the USA is again dealing with its debt ceiling. This is pure politics. It will be sorted out like it was in many occasions, namely: a increase of its limit. It seems that the concept of budget constraint over there (what they stand for) *looks* different.

DISCLAIMER

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