

A low-angle, upward-looking photograph of several modern skyscrapers with glass facades. The buildings are set against a pale, overcast sky. A large, semi-transparent red rectangular area is overlaid on the right side of the image, partially covering the buildings. The overall aesthetic is professional and modern.

MONTHLY STATEMENT

AUGUST 2023

Redwood

REDWOOD ASSET MANAGEMENT

"You can't handle the truth."

Jack Nicholson - A Few Good Men (motion picture)

That Brazil is no place for amateurs, anyone even remotely familiar with our land knows, but it seems that we are taking it too far. We have Congressional hearings CP(M)Is of all sorts, Supreme Court justices with bizarre attitudes and decisions, a dominated National Congress (NC) and a government that does not believe that the Brazilian citizen can be trusted with the truth, no. Government itself does not accept it. One could say it is not a good moment. It is an unprecedented decadence. Our Commander-in-Chief's ways, our Midas-in-reverse, are inscrutable. We have everything but shame in the office's decorum.

In a country torn apart by conflict, those who add more fuel to the fire tend to shine. Previously, even in the same administration, embarrassment was present and forced attitudes and positions "in the dead of night", but not now. The lack of any shame and the unequivocal objectives of revenge and (false!) reparation overcome any discomfort. The immorality of the idea of undoing Dilma's impeachment is just another affront to our democratic institutions, accompanied by many whose conviction amounts to no more than interested flattery. This collective mental decline goes further, extending and amplifying the already heated moods between the House of Representatives and the Executive: important agendas stall and the Brazilian people are humiliated.

How to get around all this? With the effective "management" of what used to be called Coalition Presidentialism or, in good Portuguese: quid pro quo. What was the outcome? Another Ministry is in the oven... to serve the public interest? Of course not! Pure and simple expansion of the State structure, but the President doesn't give a damn; that's his "weapon" and he usually uses it. Moreover, there is indeed an ideological basis for this, reinforced by the speech during the re-launching of the PAC by the radiant BNDES chairman, celebrating public banks' protagonism: "We need more State, and we came for that." Coherent. And he

concluded with: "Long live the militancy base that brought us here." To paraphrase the President, we cannot be frustrated for being poor. Definitely, that month's power outage, which once again scared us and fueled all sorts of low-level criticism of the privatization of Eletrobras, paled in comparison to the current blackout of common sense.

However, ineptitude, shamelessness and stellar retreats impact the nation. The regrettable episode of January 8th, the Day of Infamy, continues to provoke shudders, above all because the truth appears to be too harsh. Justice seems not to be served anytime soon or, at least, not everything will be cleared up. We have a gigantic apparatus of functioning cameras available at the Ministry of Justice – which can reveal more than flying saucers –, but the



Justice in Jurassic era.

images were erased because they have limited storage capacity. With all this spotlight and nobody thought to do an extra full back-up for this period under extreme scrutiny? It is surreal!

But misery likes company and our opposition is going around in circles while its main leader dodges prison. Yes, the mess in the case of jewels sale takes on *Fiat Elba* proportions... no one trips over mountains, but over stones. Some advocate absurdities; that perhaps the only and best way out for the former President and his movement is jail. Thus, he would rise from the ashes... a phoenix. Like a spring at the bottom of the well juggling its supporters' pride. For sure examples abound.

The bright side of the moment is that this Woke Wave tends to lose space in the world. And, as a matter of fact and fortunately for us, in Brazil the most heterodox economic ideas still haven't found space in the administration, and reflections in the NC. The latter, indeed, conservative, and always the result of municipal elections. The 2024 race will be fundamental to guarantee the continuity of a conservative NC. This is a sound analysis claiming that we need a strong and structured opposition, without mediocrities and fanfare.

Can we handle the truth?

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The financial market had a busy August, with heated discussions and opinions with different impacts. As examples, we had the submission of the budget proposal (PLOA 2024), the launching of New PAC, the Fiscal Framework with a zero deficit target, not to mention the numerous and scathing criticisms of the approved Tax Reform bill, among others. Everyone, at some point, to a greater or lesser extent, made a "price" throughout the month, but, in fact, a definitive "feeling" has not yet been consolidated. In fact, a little less favorable, as the stock exchanges in the world have not done well, China will increasingly need government stimulus, and here politics simply stands in the way of any glimpse of adjustment or understanding that could foster any ordering of affairs among ministries, such as cross-interference, unsupported statements and acknowledgement of undue responsibilities.

Along these lines, the Ibovespa fell 5.09% this month, and closed the month at 115,742 points, which represented a decrease in YTD return to 5.47%. The yield curve faced a more predictable scenario, as the month's movement followed the pattern of July and according

to our forecasts. The shortest DI fluctuated from 12.585% to 12.395, the one maturing in 2025 went from 10.615% to 10.545, and for those ending in 2031, yields rose from 10.75% to 11.12%. The downward shift of the curve on short side and an upward shift in the longer part were repeated, especially due to the inflation (lower) and fiscal (more difficult) perspectives for the short and long segments of the curve, respectively.

As for the Brazil risk, priced by the 5-year CDS, little change was observed, closing the month at 169.10 points, i.e., something like 2.4% or 3.95 points. On the other hand, the US Dollar responded to the foreign investors who fled in a stampede. The Dollar closed the month at BRL 4.9219, a 3.8% increase (near BRL 5.00!) and -5.67% in YTD change.

Brazil, as well as its financial market, are under extreme attention, notably due to this settling-down period of the

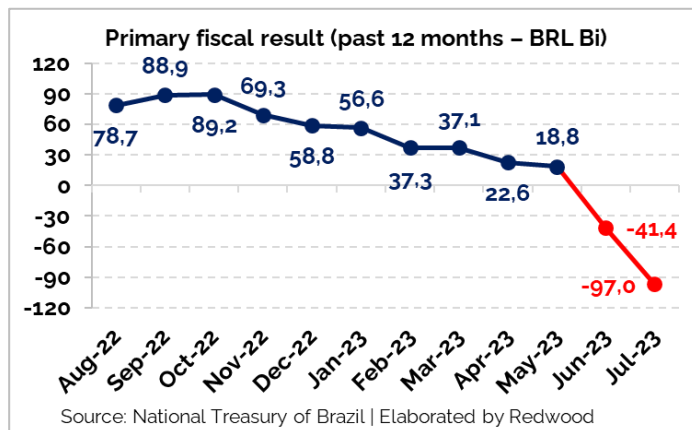
"new" administration. The endless "headbanging" on the one hand should not exist, as they are not rookies in charge of the country, but at the same time, disorganization and how poorly things are handled are part of this group's DNA. Not surprisingly, the market has been "tolerant" at various times and, despite this administration, it is advisable to reevaluate portfolio positions with great caution – always with careful allocations according to each investor's risk profile and needs.

In the economy, the highlight is the quarterly GDP growth, which registered an increase of 0.9% in 2Q 23 (margin). It was an excellent and surprising result, especially on the demand side where all components performed positively. Household consumption remains "resilient" (government measures helped: tax exemption on cars and

adjustment of Bolsa Família), although the GFCF had a very weak performance, which makes us pessimistic – since the latter is the true lead economic indicator. In any case, it is possible that the statistical "carry-over" of this performance will promote some increase in our GDP/23 growth projections, and also

marginally for 2024. The labor market, once again, shows reasonable resilience. In the moving quarter ending in July, IBGE states that the unemployment rate is 7.9%. Unfortunately, with a sluggish economic growth scenario ahead, chances are this movement will slow down. We need to remember that the labor market responds to economic growth with a lag.

In Monetary Policy, the beginning of the downward cycle is picking up pace and intensity: at each meeting, a 0.5% cut in the Selic. For how many meetings? That is the question! Spending, as shown in the table above, is a concern, but at the same time the decision to maintain the zero-deficit target for 2024 (although very difficult to achieve) was the right one. Score one for the government. Furthermore, economic activity and the unemployment rate seal this trajectory.



In its exchange rate policy, BACEN always highlights that both its swap operations (endless interventions) and its management of foreign reserves, its objective is always to provide hedging to the market in times of high volatility. However, the FX market – which undoubtedly exerts impact on this policy – keeps an eye on negative news on the fiscal front. This month was no different, and all eyes were on the project that restores the “quality vote” on fiscal mediation chamber (CARF), and the approval of the bill that extends payroll tax relief for several sectors until 2027. The new Monetary Policy director, Gabriel Galipolo, who also coordinates this area, for now simply sits still. Excellent!

On the fiscal side, there is total desperation to find revenue. The mental acrobatics has been intense, but the easy path always takes priority. Taxing the rich, for example, has become an unavoidable issue and, between us, why bother if, above all, the proposal is super coherent with the current ideology and based on international “experiences”? Of course, this measure tends to be absolutely innocuous or, at most, transitory. Exclusive Investment Funds? The group migrates to another fund with bank management... and what about Offshores? Country of residence changes and becomes a non-resident and adapts to new situations. Obviously, it is laudable to try to expand the tax base, smooth out distortions and recover tax revenues, but it is a shame to deal with this issue in such a rush, and at the price of sacrificing the “project” – if it is ever born. Minister Haddad has been making an effort, but dealing with the Senate and the House would require something more (which his boss is trying to do), and in the meantime focus should clearly be on spending control –but there's zero-chance of that happening!

Our forecasts for the consolidated public sector have fundamentally remained unchanged, especially after the July primary deficit of BRL 35.8 billion. The public sector deficit in the 12 months up to July/23 is the worst since August/21. Therefore, with an outcome larger than expected by the market, Brazilian public finance tends to continue to

deteriorate, with a subsequent increase in the gross public debt. Expansionary fiscal policy and the total repeal of any further spending control are at the heart of this problem. That is the truth.

Around the world, there were many highlights this month, but few received as much attention as the BRICS meeting and the newcomers. Daron Acemoglu's words sum it all up: *“The BRICS group's planned enlargement is a missed opportunity. The world does not need more countries to fall under Chinese and Russian influence, or to align against the United States; rather, it needs a genuinely independent third grouping that can provide emerging economies a counterweight against both camps.”* We cannot forget that the BRICS's bank is now led by none other than Dilma Rousseff, bringing *all* her experience and new ideas, such as a common currency for the group. Once again, total coherence... let's just

be aware of the likely repercussions here.

In China, the bleak scenario of a financial crisis seems to be looming. The situation is worrisome, as it has the potential to spread across the planet, perhaps with a force proportional to the last major crisis (2008). In this environment, the political side has

failed to be helpful in any way, to the point where associations among China, Russia and North Korea are recurring news, as well as Chinese leader Xi Jinping's refusal to participate in the G-20 amid tensions with India. Really bad timing.

In Europe, the ECB avoids any commitment in its statements and indications of its next steps. Accounting for that is the current situation of absolute uncertainty for the Euro Zone (ZE) economy. Inflation has cooled, but remains above target and showing significant underlying pressures. The unemployment rate is stable at 6.4%. Manufacturing and services sectors are losing steam and activity is stagnating, but there are still no signs of a strong recession.

In the US, a tight labor market and the economy growing above 2% do not change our projections for the country. In politics, on the other hand, Trump has become a *mad dog: everyone against him*. He takes it in. To be seen.



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