MONTHLY STATEMENT

MARCH 2024

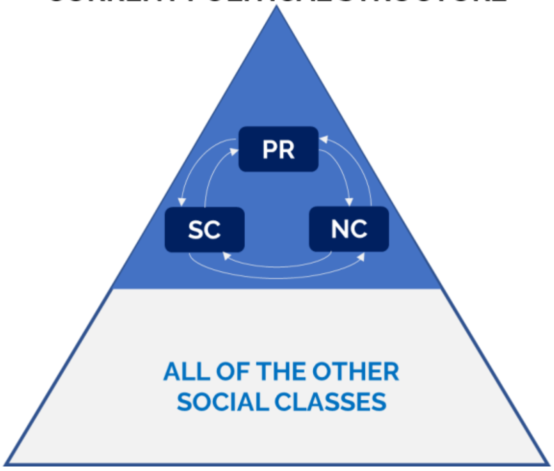
Redwood

REDWOOD ASSET MANAGEMENT

"Tell me who you walk with, and I will tell you who you are."
Popular saying inspired by the Holy Bible

For Max Weber, social stratification happens in three dimensions, namely: the economic, social and political order, which are represented by social classes, the government and political parties, respectively. In Brazil today, we are witnessing widespread confusion even in this segmentation, with special emphasis on a caste that seems to dominate everything and aims to impose its view onto the rest. The (re)systematization and (re)organization of society requires approval by this top echelon of society. Worse, there is no way to assess the good intentions of this group that today truly rules and reins in the country. In the pusillanimous collusion subliminally accepted by the clique, curiously there are no true leaders, but only followers who, patchily, follow a random path without focus and determination – this is a romantic vision, not necessarily real.

CURRENT POLITICAL STRUCTURE



Through this identified image, the environment in which we choose to be defines who we are, what we believe in and what we defend. It influences and seals our destinies because, as a rule, we tend to bundle with people with the same objective. The Commander-in-Chief, therefore, becomes a puppet, where the hypocrisy and schizophrenic attitudes of those in power summarize his administration's agenda. All that is left is to lead the country in fits and starts, with a rhetoric that is routinely dishonest and painful, when not downright hateful and cruel, by deploying various subterfuges to save time – who knows what for?

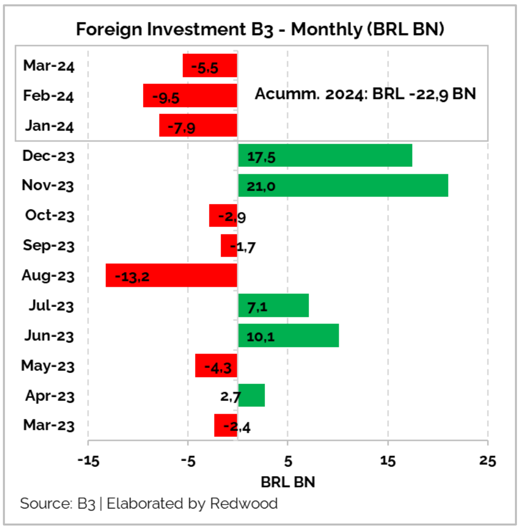
Such a picture is not presented with the sheer aim of offending or tarnishing the image of one another, no. It is also not about demonizing an individual or class, but about describing what we have and where we are going. There is so much confusion that anyone presents themselves as a genius – but an embarrassing kind of brilliance. Examples abound in different areas, almost always guided by the superb and behavioral similarity to the President. More recent statements range from that by Min. Alexandre Silveira saying that the Market was left with a crooked mouth, especially in the last years of the Bolsonaro administration (a criticism of Petrobras' "exorbitant profits"), and even by Minister of Labour, Luiz Marinho's snark about the BACEN's board - which just won the award for best central bank in the world – needing to update their basic knowledge of economics.

While it is difficult to interpret where you want to go with such a stance, it is quite easy for investors (domestic and foreign) to make their resource allocation decisions. Foreigners flee and withdraw resources from the Stock Exchange, with an irremediable impact on prices. Investors react very badly to the Government's ideas of interfering in State-owned companies and companies in which it has a relevant shareholding stake. As examples, we can cite Vale considering hiring a "political figure" stamped with an incompetence badge, while in Petrobras wants to change the mechanism regulating domestic fuel prices, and in Eletrobras aiming to reduce the electricity bill (by force – hello, Dilma?) with resources extracted from Petrobras. Do you think it is not enough? In addition to the political injunctions, the profit of the main federal state-owned companies goes melting down... but don't worry, because there is more: in fiscal terms, the Central Government (TN, BACEN and Social Security) registered a BRL 58.44 billion deficit for February, a record figure in the time series since 1997.

These differences in management styles are no small matter, for they generate irreconcilable crises in the country's risk perception, and establish what they should do with their investments. We have already seen this statist fetish in the past and we know where it will lead, but also as long as we are enmeshed in this ideological rubble (read Lulopetism and radical Bolsonarism), without access to a modern democracy that defends liberal principles, the country will be doomed to produce embarrassments and encounters that are at least awkward. Emmanuel Macron's visit is a strong inkling of this – there is no bigger fiasco.

In financial markets, Brazil has fallen short of being investors' sweetheart, especially foreign ones. Despite the more troubled world outlook, the more devalued Real and relatively much better than some neighbors like Argentina and Venezuela, foreigners turn their noses (not their mouths!) when it comes to believing and investing in the country. The retraction also affects Brazilian investors, given the slowdown in IPOs that stems, among other things, from an unstable political-economic scenario, scarce credit and the perception of an imminent crisis. The undisputed fact is that the economic model (or the absolute lack thereof) contrasts head-on with what is expected to make the economy thriving and a healthy financial market.

Along these lines, the Ibovespa drop 0.71% this month, resuming the year-to-date drop at nearly 5% (-4.53%) and closed the month at 128,106 points. In the interest rate segment, the market showed small fluctuations, once again "marginally" impacting the term structure. The shortest DI (DI-25) went from 9.955% to 9.92%, the one maturing in 2026 moved from 9.78% to 9.90%, and for 2031, it rose from 10.65% to 10.92%. Thus, the changes this month were at -0.035, +0.12 and +0.27, for the DI maturing in 2025, 2026 and 2031, respectively. Although market economists have clearly predicted a slowdown in the pace of interest-rate cuts, we stand by our assessment of the interest-rate-cut trend of the same magnitudes predicted in our last Scenarios (SELIC terminal rate at 9.25%). However, we always emphasize caution, but there rising likelihood of a return with immediate liquidity, despite the volatility and, therefore, for those who can take the risk, the opportunity remains to reevaluate and eventually rebalance the portfolio.

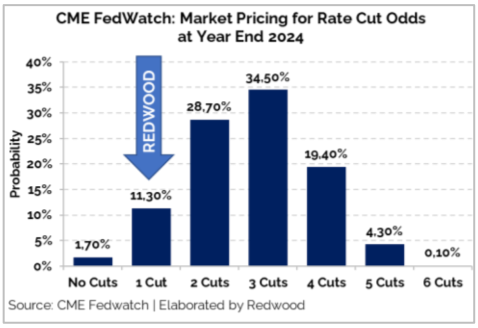


Source: B3 | Elaborated by Redwood

As for the Brazil risk, priced by the 5-year CDS, the performance outpaced expectations and the behavior of the other assets mentioned, with a significant advance, ending the month at 137.87 points, a 11.97-point hike, or approximately 9.51%. The Dollar, in turn, showed a small variation, closing the month at BRL4.9962 – which meant a +0.26% change in the month and +3.20 in the year. Overall, these numbers "are getting worse", but still within the range forecasted for the period. What sets off the warning signal, as shown in the graph on the side, is the foreign outflow in the quarter: R$ 22.9 billion. There is no way to separate this movement from the political situation described above and the "atrocities" that have been attempted against companies in which the government has a stake.

In the economy, the external environment remains a major threat to our stability, both economic and financial. For a large part of the market, the Brazilian economic performance at the beginning of 2024 already reinforces a better growth projection than originally outlined, that is, several economists are already bringing their calculations closer to something like 2%. On our side, GDP in 2024 remains with poor projections, with growth slightly below potential GDP – precisely due to the negatively affected Agribusiness and also the lagged effects of Monetary Policy. The unemployment rate, at 7.8% closed in February, shows a small deterioration (in line with our projections – gradual deceleration), but the real average income of the worker rose 4.3% in relation to the same period in the previous year (quarter ended in February), as well as the usual real income paid to employed persons amounted to BRL307.3 billion, or a 6.7% increase. At first, one can imagine some contradiction with lower GDP projections this year against 2023 and an employment/unemployment trajectory like this, but there is nothing of the sort. One reason is precisely the much meager performance by Agro, and whose sector employs few workers. On the other hand, better performance can be seen in more labor-intensive sectors, such as the manufacturing industry (more difficult) and construction (more likely). On the demand side, we cannot forget, the administration is full of economists whose view favors consumption as an engine, and there is no chance the government will avoid pushing on that lever in the face of a low GDP.

In Monetary Policy, despite political pressures, the state of the economy and even the external environment, we maintain our opinion regarding both pace and intensity of interest-rate cuts for this year. This is because, among the set of variables, the main one that BACEN (with the current board composition with RCN as chairman) analyzes is inflation rate, and this, in our understanding, despite some "de-anchoring" of expectations, presents disinflation in line with our forecasts. In any case, withdrawing the forward guidance (regarding the June meeting) serves as a warning, but does not change our perceptions. Despite the "tight" job market, high salaries and the (upward) revision of GDP by BACEN, among other tweaks, poor economic activity, in our opinion, anchors inflation expectations. The process of inflation convergence for the current BACEN Board is an intractable issue, and its methods are very clear and objective.



Source: CME Fedwatch | Elaborated by Redwood

In exchange-rate policy, reassessments and market perceptions of the FED's path in its process of cutting interest rates have caused pressure on the exchange rate, and some criticism of BACEN. We don't see it that way yet. After all, our forecasts have always pointed to more resilient inflation in the US and that is why we only project one Fed cut in interest rates in 2024. Even so, the interest rate differential (trajectories that we simulate) remains high enough to avoid greater pressure. Consistently, we mentioned Director Galípolo's statement last month that it is reckless to make significant changes to exchange rate policy in the middle of an interest rate cut cycle. In any case, BACEN cannot "escape" its DNA as an eternal intervener in the foreign exchange market and promises to hold swap auctions... but swears that it is not to control price levels, just to "correct" some dysfunctionality... it's just a coincidence that the intervention occurs at a time of high exchange rate level, of course.

On the fiscal side, a watershed that we claimed would be the Revenues and Expenditure Assessment Report, when we also said that "*'to embellish' the assessment report of the government finances – with revenues that will not be sustained – would not actually be a surprise, and it would please many and 'buy' them some time.*" Well, it seems that some time has been gained (revenue collection came in better), but the route is unchanged, because pursuing spending cuts is not, by far, a priority for the administration. A lot was done, by the way, with the help of the National Congress, such as taxation of exclusive and offshore funds, online sports betting, votes in CARF, etc., however, from its side and scope, such as spending cuts, nothing! Not surprisingly, the fundraising campaign continues, now back with the "re-burden" of the payroll and the end of PERSE. With a projected primary deficit (Central Government) near BRL58.4 billion for February, we will have the worst balance for the month within the time series (beginning of 1997) – much of which are court-ordered debt payments. The trio of Haddad, Tebet and Dweck do need to be optimistic and defend zero deficit, but they need to do so with coherence, and not blame other (Congress) for their managerial incompetence and bad model (Fiscal Framework).

Overseas, the issues of war (Russia x Ukraine and Israel x Hamas), the behavior of CBs and the presidential election in the USA remain put, but diplomatic negotiations to address regional conflicts and the threats of the use of nuclear weapons have gained prominence.

As for the Central Banks, the head of the ECB, François Villeroy de Galhau, signaled that they will start cutting interest rates in the European spring, but at a "moderate" and "gradual" pace – a much more optimistic perspective, in terms of deadline than we anticipated. The CPIs in France and Italy, key economies, point to advances in March, but insufficient to warrant interest cuts. China, during the Boao Economic Forum for Asia, presented a scenario for the country that was beyond optimistic, overlooking the real estate crisis and displaying strong confidence in growth targets. Can it play out like this?

In the US, the PCE for February showed that inflation stabilized in 2.5%-3% range, hence above target. "Strong" economic performance, resilient inflation and a tight job market, it seems that we were right from the beginning regarding the FED-Fund-Rate cuts. Opportunities! To be seen.

DISCLAIMER

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