MONTHLY STATEMENT

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Redwood

REDWOOD ASSET MANAGEMENT

"Everyone has a plan until they get punched in the face". Mike Tyson – American professional boxer

Mike Tyson's famous quote can be compared to the economic policies of the Workers' Party (PT) in Brazil, particularly during economic crises. The party always positions itself as the "savior of the nation," presenting an ambitious plan for inclusive growth, reduction of inequality, and social justice. However, when confronted with reality or any kind of shock – such as the 2008 financial crisis – or even internal challenges, like the more evident need for spending control, incompetence and lack of courage prevail. Add to this corruption and economic disarray, and everything collapses. Just as a punch from Tyson disrupts a fighter's strategy, crises and reality expose the vulnerabilities of PT's weak and incoherent policies, which, either unwilling or unable to address these issues, lead the country and society to hardship – as was seen during Dilma's administration. In the end, reality exacts a huge price, forces deep adjustments, and reveals the divergence from the original ideals. We are on the eve of this stage once again.

Source: Internet | Adapted by Redwood

In truth, leftist ideology – as we are currently experiencing – creates idealized and disconnected worlds and, much like schizophrenia, drifts away from concrete reality. The country's current economic situation, especially regarding the need for public budget control, reveals various sectors trying to reconcile multiple versions of reality, typically denying the natural order while always advocating for individual freedom alongside state control. Nothing could be more contradictory! This denial, for some, albeit belatedly, seems to be nearing an end, as reflected in Minister Tebet's statements this month. However, the distorted vision of the future, where the ideal clashes with the real, does not seem to resonate with the one who ultimately makes all decisions: the President. Thus, frustration, for those who already see the impracticality and destructive potential of these (in)actions, is unfortunately insufficient to convince the one who truly matters. At this moment, ideology, blind to factual reality, imposes new utopian solutions and reconstructs fragmented and unrealistic narratives, ignoring the limitations of the practical world.

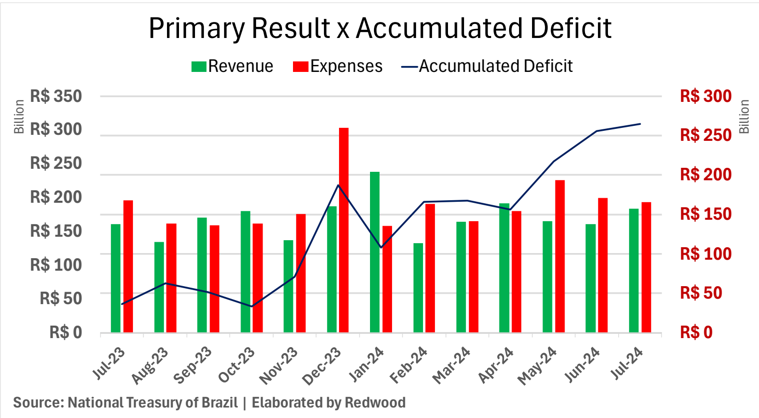
In such a scenario, when reality is not faced head-on, there is little left except to circumvent it in every possible way: simulating, omitting, lying, and evading as much as possible in an attempt to "push" the problem forward. This is what is called gaslighting, where one seeks to manipulate perceptions of reality by distorting facts and/or imposing a "special" narrative. We saw this not too long ago with the defense of the New Macroeconomic Framework, *creative accounting* practices, and an entire structure of untruths. Our own destructive experiences should not delegitimize the current opposing voices, which loudly warn of the disaster that awaits us. Disregarding a plurality of perspectives – especially when reality resembles an old (horror) movie – means, once again, positioning the "us versus them" mentality, a binary view of the world, in the realm of economic and financial sanity itself.

There have been several signs, for some time now, that we are on a very misguided path. We've been focusing on the present picture and have given little importance to future indicators. These are numerous, but the most compelling of all – and consistently demonized by the left – is the financial market. The stock market, exchange rates, interest rates, and Brazil risk clearly indicate where we are heading to. The narrative that this is an environment for the wealthy and, therefore, one should not pay attention to, is a stupidity that becomes more prominent in this government's rhetoric these times. Nothing could be more misleading, as market fluctuations, albeit indirectly, impact everyone's daily life, given that these shifts can lead to an increased cost of living in various ways.

Just as Tyson's "punch" dismantles any plan, schizophrenic behavior and gaslighting attempt to disrupt the reality we are facing. We need to keep our sanity, understand how to confront gaslighting, identify the true "madman-in-chief," and fight like Tyson.

In the financial market, it is absolutely clear that we need a positive fiscal shock. There is still no consensus among the economic team on: where to start, the intensity, and, above all, how to convince the Commander-in-Chief. This last point is the biggest challenge, as he is unfamiliar with key concepts and is determined not to learn the distinctions between *expenditure* and investment. Furthermore, he has repeatedly stated that Brazil's culture regarding what is considered expenditure needs to change. The market, which has no obligation to educate or accommodate anyone, prices in these presidential outbursts – and consequently, on the lack of new spending control measures.

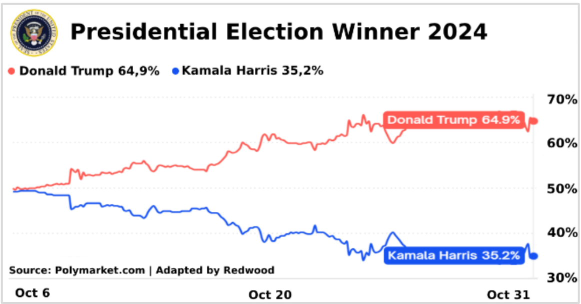
In this context, the Ibovespa continued to trend negatively, closing at 129,713 points this month, representing another negative result of -1.60% for the month and extending its annual decline to -3.33%. In the interest rate segment (ETTJ), there was pressure across all maturities analyzed, reflecting increasing stress. The shorter DI (DI-25) rose from 11.005% to 11.29%, the 2026 maturity moved from 12.325% to 12.825%, and the 2031 maturity increased from 12.48% to 12.94%. These adjustments thus represent variations of +0.285, +0.50, and +0.46 points for the 2025, 2026, and 2031 maturities, respectively. If the market has indeed set the stage for a new cycle of Selic rate hikes, the questions remaining are how far (maturity) and at what intensity (rate) agents will operate. This continuous, systematic rise across the ETTJ reflects the market's significant distrust in government policies, particularly fiscal policy.



Regarding Brazil's risk, as measured by the main indicator—the 5-year CDS—another notable increase was observed this month, closing at 158.30 points, or +3.99%. Indeed, there seems to be a stark asymmetry when comparing the context and statements with the actual risk appetite for Brazil. The Dollar, likely abandoning any short-term possibility of returning to the R$5.30 – R$5.40 range, has possibly consolidated its floor for this year at R$5.50 and is now flirting unabashedly with R$6.00. As a result, it closed the month at R$5.7779 – an impressive monthly gain of 6.05% and a year-to-date increase of 19.35%. Causes? External factors… perhaps they play a role, but the main issue is the government's inaction on fiscal matters. The government's delay in announcing a spending cut package – clearly due to the reasons mentioned above – justifies the growing market skepticism, which drives up the Dollar, impacts the ETTJ, and affects numerous other assets. However, our view is that the market will react to the mere announcement of the cuts in a particular way: if the package is sufficiently large, the market will wait for effective cut measures; if it is inadequate in scale (regardless of any effective cut measures), the stress will persist – ruthlessly

In economics, far from being "pessimists and chaos-mongers," we aim to assess more than just the "snapshot"; rather, we consider the entire context, the evolution, and the dynamism of various indicators. The economy is indeed growing above most initial forecasts, unemployment shows favorable numbers, and both are possibly results of recent reforms (labor and tax). For 2024's GDP, we should not be deceived; there is a strong push from the government (expansionary fiscal policy), but this dynamic will end. If we assess productivity and structural growth, we are in a poor position. Similarly, other indicators show signs of an "overheated" economy, with inflation not receding (possibly due to a still low neutral interest rate) and a vicious cycle stemming from the lack of structural advancements. Moreover, with the likely rise in interest rates and the expected cooling of the labor market, we anticipate an economic slowdown. At best, it will return to growing at the potential GDP level, approximately 2% per year. We thus foresee a "chicken flight" scenario.

In Monetary Policy, the future President of the Central Bank and current Director of Monetary Policy is expected to maintain the rigor seen during Campos Neto's tenure. Galípolo's early nomination was important, allowing for a gradual transition and minimizing potential noise, especially in a stressful scenario where a lack of confirmation could lead the President to intensify criticism of Campos Neto, triggering further de-anchoring of interest rate and inflation expectations. We therefore project that the Central Bank will continue raising the Selic rate up to 12.5%, assuming some fiscal restraint; however, we do not expect inflation to decrease quickly, though maintaining the Selic at this level in the medium term could stabilize prices. We note that even if spending control does not materialize, the Central Bank will likely avoid exceeding a 12.5% Selic, due to insecurity over potential "intervention" by the Commander-in-Chief. The immediate implications are known, but it remains to be seen how the government will interact with the Central Bank, now operating in an independent status.



In the realm of Exchange Rate Policy, many market analysts associate the recent appreciation of the Dollar (and the consequent depreciation of the Real) with the international scenario, especially when comparing the Brazilian currency with a basket of "similar" economies' currencies. We share the perception that the Central Bank (BACEN) adopts this view, which would explain its limited intervention in the Dollar spot foreign exchange market. However, our analysis differs; we attribute the main cause of the depreciation observed in recent weeks to domestic fiscal imbalances. Nonetheless, we consider it unlikely that the monetary authority will remain inactive if the exchange rate approaches R$6.00, given the potentially severe economic impacts. It's worth recalling Simonsen's saying (in crises): *inflation cripples, but exchange rates kill!*

On the fiscal side, it is clear – even to government supporters – that the fiscal imbalance (see chart on the previous page) will not be resolved solely by maximizing revenue. Structural reform of public spending is mandatory and urgent. A realistic assessment of public finances means that no budget item can be off-limits for adjustments, no prohibitions can be imposed, and all alternatives, with no exception, need to be considered. Cuts below R$50 billion will be poorly received, and a lack of immediate action will also result in additional loss of credibility. We need effective fiscal consolidation, reversing the current Gross Debt/GDP ratio trajectory by stabilizing it and establishing a downward path. Tebet and Haddad face two enormous challenges: (i) structuring a credible cutback plan and (ii) convincing the President that his economic beliefs are of little value. The first challenge lies in the realm of technical expertise and rational persuasion, while the second in addressing a pathological approach to an ideology that has never succeeded, yet whose populist appeal speaks volumes. Are the Ministers qualified for such tasks, or do they themselves think the same way?

Worldwide, markets have been pricing in that a potential Trump victory would pose a greater challenge to emerging economies compared to a Harris presidency. This is because Trump is associated with a possible return of inflation and increases in Treasuries, impacting monetary policy with effects on those with greater external vulnerability. Although in a different context and now with new challenges, this is not what Trump delivered previously. Unlike the Democrats, the group surrounding the Republican seems more oriented and focused on the real issues of the U.S. It is assumed that countries aligned with Republican principles and that have done their "homework" will have free access and grow alongside the U.S.

Additionally, this month we had the BRICS Summit with Vladimir Putin as host, now including four new members (Egypt, Ethiopia, Iran, and the United Arab Emirates). The bloc has turned into a gathering of leaders attempting to "dethrone" the U.S. as the world's leading country. What was meant to be a group highlighting investment opportunities has become ineffective, promoting much talk of little relevance. As Jim O'Neill puts it: *"The BRICS still don't matter."* He's right!

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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