Brazil: Ready for take-off

Market Insights by Alexandre Silverio, Chief Investment Officer AZ Quest, Senior Leader Azimut Group Global Investment Committee

Can you describe the current political landscape in Brazil and your view on the rise and the victory of the Mr. Jair Bolsonaro in the Presidental Elections?

The year of 2019 marks the beginning of a new political cycle in Brazil through the election of Mr. Jair Bolsonaro as president. Bolsonaro defeated both left wing and center right candidates based on an anti-establishment political platform and relying heavily on social media presence given that he did not had exposure on traditional media such as television and radio. To understand this new political environment it is also important to highlight that a vast majority of Bolsonaro's voters decided to pick him as their favorite candidate in the last minute, in order to prevent a victory of Worker's Party (which ran the presidency from 2003 until 2016, when president Rousseff was impeached).

In our opinion, this was a signal that Brazilians rejected politicians strongly linked to corruption scandals. In addition, one can say that a return to an old model of increasing public expenditures and denying the structural fiscal problems (the main reason for collapse of economic activity since 2014) was defeated.

Following his electoral triumph, what were the top issues President Bolsonaro is set out to tackle in the first 100 days of his Presidency? And how.

During the campaign, Mr. Bolsonaro showed a preference for an economic liberal model, defending privatizations, less taxes and control over public expenditures. To tackle the fiscal problem, President Bolsonaro formed a high-level economic team, led by Minister Paulo Guedes, who already sent a very ambitious pension reform to the Congress. The reform outlook is the single most important subject to watch in 2019, given that its approval is a necessary (and perhaps sufficient) condition to unleash a sustainable growth for several years to come.

Given the fragile state of the Brazilian economy despite recovering from a 2015-2016 recession, what is your assessment of the action plan and the reform agenda put forth by the new economic team with the aim to boost the economy?

We believe that the current administration has the correct diagnosis of Brazilian structural problems and accurate measures to solve them, meaning that our long-term thesis implies a positive trend for Brazilian assets. However, it is important to recognize that the political strategy of Bolsonaro's government (one of his strongest promises) is very different from the traditional model that the former presidents relied to get Congress support.

With uncertainties still lingering over the Brazilian economy, what is the projected timeline of the expected recovery as driven by the initiatives and measures taken by the government?

After 4 years of contraction, Brazilian economy is in a cyclical point that will allow a long recovery without pressuring inflation and thus interest rates. Several measures put in place since 2016 will allow that CPI and Selic rate will be kept low in a structural manner. For instance, one novelty this time is the spending cap bill, which implies that the government share of GDP will decrease for at least 10 years, meaning the private sector will crowd-in and lead to more intense productivity growth going forward.

Up to May 2019, markets presented a high volatile performance reflecting a still unstable political equilibrium between President and the Congress. With this uncertainty in place, the activity recovery is still very slow for 2019 (we now expect just 1.1% growth this year, from 2.3% previously) since long-term decisions from private agents are almost suspended, delaying the capex and employment recovery - which will happen just after pension reform approval.

The political situation is still fluid, but our current base case is that Congress will agree in a softer than proposed version of the reform (saving R$ 500-700 billion in 10 years) in the second half of this year, after a lengthy discussion. We think this is an important first step to solve the fiscal sustainability problem, being followed by several other measures that do not need a strong majority on Congress and, thus, much easier to implement. As this happens, we think that Brazil will be ready for take-off.

Alexandre Silverio

Alexandre Silverio is the Chief Investment Officer of AZ Quest, the fund management company of Azimut Group in Brazil, and a Senior Leader of the Azimut Group Global Investment Committee. He currently oversees investments in excess of R$ 18 billion managed by a team of 23 investment professionals who have 15 years of average experience. AZ Quest's investment process combines a profound fundamentalist analysis rooted in an in-depth macroeconomic assessment. AZ Quest investment expertise deploys over 4 pillars: 1) macro, which produces scenarios and identifies global and local trends based on macroeconomic and political fundamentals; 2) Equities: contributes to sectoral analysis and valuation of companies; 3) Credit: contributes to the assessment of the credit conditions of the economy and companies; 4) Arbitrage: important in the analysis of technical factors, which are considered during the construction of the portfolio

Before joining AZ Quest, through 2003-2011 Alexandre was at Santander Asset Management Brazil, where in 2007 he was appointed Chief Investment Officer responsible for AUM in excess of R$65bn, heading up the Equities, Multi-markets and Equity Research teams. Prior to that, he was Partner and Co-Head of Equities Fund management at GAP Asset Management through 1999-2003 and fund manager at Fleming Graphus Asset Management through 1995-1999. Alexandre has a bachelor degree in Production Engineering from PUC-RJ, an MBA in Finance from IBMEC, and specialized in "Advanced Investment Management" at London Business School and "Program of Leadership Development" at Harvard Business School.

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