

# PRIMARY DRIVERS TO BRAZIL OVERWEIGHT – Q1 '21

## POSITIONING RATIONALE AND RECENT EVENTS

- The Covid-19 outbreak disproportionately affected the commodity sensitive country through 2020, with daily new cases near peak values as of February 2021.
- Economy Minister Guedes is spearheading the congressional effort to extend emergency aid, but only if they include measures to curb mandatory spending growth in coming years. The country's dual deficit and continued political uncertainty leave the country vulnerable to negative shocks, but this austerity-focused legislation is in line with Brazil's history of implementing reform efforts and showing better fiscal management in the wake of recessions.
- Domestic economic growth and credit availability are improving and economic data have been surprising to the upside relative to overly dour expectations.
- While President Jair Bolsonaro recently lost ground in the municipal elections, he has been gaining more centralized support in Congress.
- The government's economic agenda has the potential to provide a positive catalyst if Congress can successfully resume reform efforts to overhaul the country's tax system and improve the fiscal situation in Brazil by keeping the budget constrained within the spending ceiling.
- The ousting of Petrobras' CEO Roberto Castello Branco weighs on investor confidence, but President Bolsonaro has a history of introducing extreme rhetoric to improve his popularity, but often reverses course to realign with the reform agenda of Paulo Guedes, the Economy Minister.
- The severity of the market reaction indicates investors are pricing in a very bad if not worst-case scenario, which often overshoots reality in Brazil. Practically every sell-side analysts downgraded Petrobras and Brazil in response to Bolsonaro's action.

## BRIEF COUNTRY SUMMARY

Brazil is the fifth largest weight in the MSCI Emerging Markets (EM) index. The country's index weight has decreased considerably over the past decade, having once been one of the largest EM country constituents. The rise of China, South Korea and Taiwan have decreased the country's importance in the MSCI EM over time though Brazil remains the largest Latin American country constituent within the index by a large margin. (Exhibit 1) Brazil's market exposure has changed modestly in the past decade, but the three largest weights have consistently been Materials, Energy and Financials. The primary shift has been to Financials, the largest sector component of the benchmark today. (Exhibit 2)

Exhibit 1: Brazil Weight as total of MSCI EM LatAM

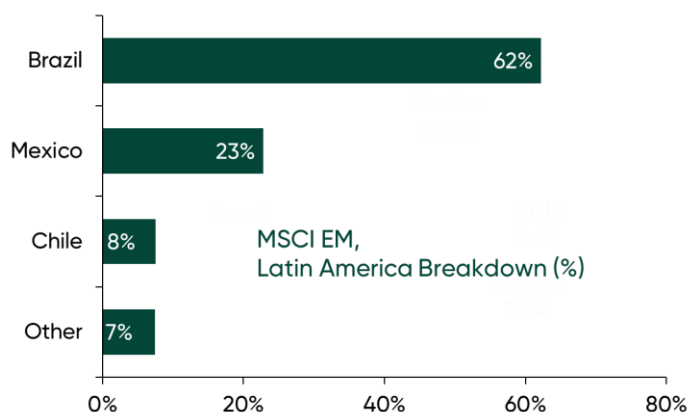
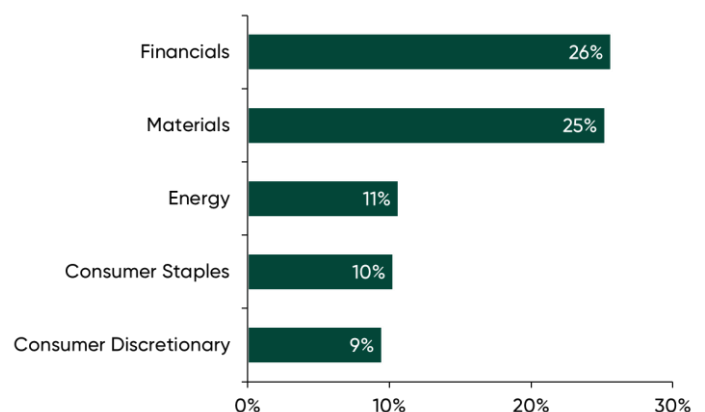


Exhibit 2: Brazil Sector Composition



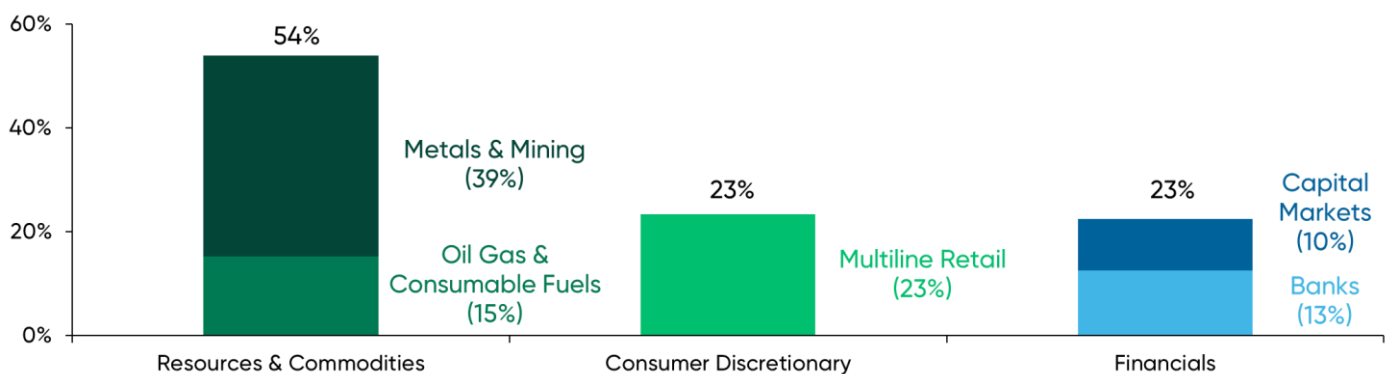
Source: FactSet, as of 31/01/2021.

## BRAZIL WITHIN THE EM PORTFOLIO

At a country level, Brazil is one of the largest relative overweight positions within the Fisher Investments Emerging Markets Equity portfolio. Positioning within Brazil is based on both country fundamental convictions, as well as broader sector preferences within the Emerging Market universe. The overweight is based on three main convictions, deployed across four primary sectors: Energy, Materials, Financials and Consumer Discretionary. (Exhibit 3)

- **Resources and Commodities:** Exposure to Energy & Materials is based on our expectations that global economic activity will resume and continue the sectors' recovery while also acting as a value counterstrategy to our broader portfolio growth overweight.
- **Financials:** Exposure to Financials also acts as a value counterstrategy and is based more on the sectors sensitivity to country performance rather than a bullish outlook on the broader sector. Brazilian banks tend to do well when the country index is doing well and optimism is high.
- **Consumer Discretionary:** Exposure to Consumer Discretionary is part of a more secular growth-oriented conviction tied to the under penetrated and rapid growth of e-commerce in the country.

Exhibit 3: Industry Allocation, as total of absolute Brazil weight in Representative Fisher EM Portfolio



Source: Eagle Investment Systems, as of 28/02/2021. Industry weights are based on the Fisher Investments Emerging Markets Equity representative portfolio as of the date shown, and may differ from actual client accounts.

## RESOURCES & COMMODITIES

Roughly half of our target exposure to Brazil is made up of Vale, a metals & mining firm and the largest producer of iron ore and nickel in the world, and Petróleo Brasileiro (Petrobras), a state-owned oil gas & consumable fuels firm. While the broader Emerging Markets portfolio maintains a neutral and underweight relative weight to Energy and Materials, respectively, exposure to these names within the Brazilian allocation of the portfolio serve a dual purpose, as outlined below.

### EXPECTED COMMODITY & RESOURCES RECOVERY

Prior to the Covid-19 pandemic and large scale government mandated shutdowns to much of global activity, commodity demand was healthy, with the global economy continuing to expand, a trend we expect to resume relatively soon as governments begin to reduce lockdown measures. (Exhibit 4) China's shift toward consumption and away from investment-led growth likely prevents a demand surge from driving most commodity prices significantly higher on its own. With commodities accounting for 80% of Brazil's exports, it should be well positioned to benefit from this expected recovery.

## VALUE COUNTERSTRATEGY

We remain convinced that fundamental indicators favour growth over value, and that we are in a late market cycle where the former style category should outperform. Brazilian commodities and resources typically correlate with value outperformance, (exhibit 5), which allows us to maintain an element of counterstrategy within the portfolio, one that has duly benefitted relative returns during value counter-rallies.

Exhibit 4: Oil Consumption Recovery

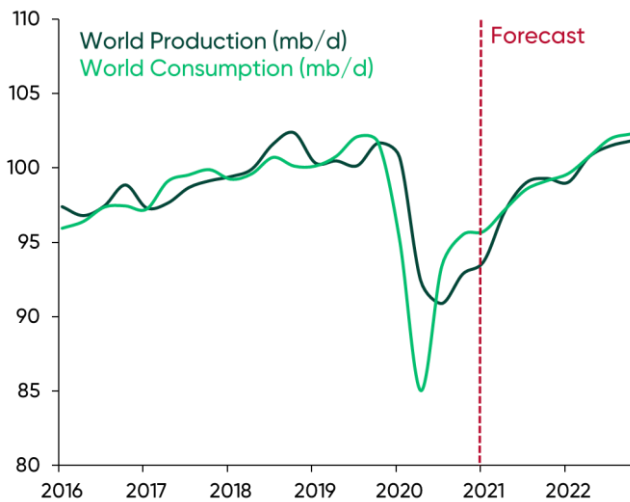


Exhibit 5: Brazil & Value Tend to Move Together



Left chart source: U.S. Energy Information Administration, *Short-Term Energy Outlook*, February 2021. Data past Q4 2020 are forecasts. Right chart source: FactSet. Shows relative performances of MSCI Brazil to MSCI EM and Russell 3000 Value to Russell 3000 Growth. Based on daily data points indexed on 31/12/2018 to 24/02/2021.

## FINANCIALS

Roughly a quarter of the portfolio's absolute weight to Brazil is made up of Financials, more specifically, two banks; Banco Bradesco and Itau Unibanco, as well as one equities exchange operator, B3 Bolsas. While the broader Emerging Markets portfolio maintains a significant relative underweight to Financials, exposure to Brazilian Financials is not primarily driven by our current outlook for the sector, but rather, that Brazil will surprise to the upside relative to overly dour expectations. EM banks are among the highest correlated category to their respective country of any sector. Many almost exclusively do business in their domestic markets and are one of the best ways to obtain country exposure.

## OVERLY DOUR SENTIMENT

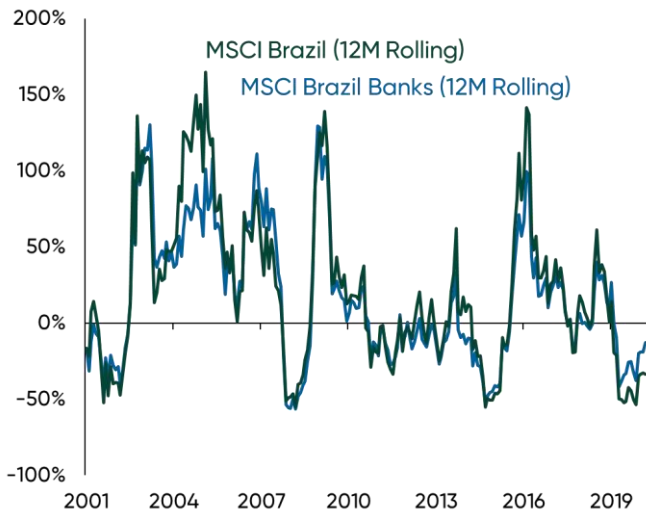
Equities in Brazil have a long history of bouncing out of EM bear markets, (exhibit 7), as recession tends to drive reform efforts and better fiscal management in the subsequent recovery. Current sentiment is overly dour tied to geopolitical risk, the country's dual deficit and budget issues, and Brazil's status as a COVID-19 hotspot. These fears are likely to abate in the months ahead, potentially providing a tailwind to equities.

Prior to the Covid-19 outbreak, Brazil was emerging from one of its worst recessions in history. While 2019 GDP growth was only modestly positive, recovery in business activity, investment and consumption was gaining momentum. Consensus expectations for GDP are proving overly dour and are being revised upward and surprising to the upside. Additionally, while the vaccine rollout has been slow to start, improvement in vaccine distribution plans and a continued resumption in activity and employment should mean the economy continues growing in the first half of 2021 as activity improves globally.

**VALUE COUNTERSTRATEGY**

Similar to Brazilian commodities and resources, Brazilian financials also correlate with the broader country index and value outperformance, making up an additional element of counterstrategy within the portfolio.

**Exhibit 6: High Correlation, Banks & Brazil**



**Exhibit 7: Brazil's Bounces Following EM Bears**

Brazil/EM Relative Performance Following EM Bears								
-24M	-18M	-12M	Trough	+3M	+6M	+12M	+18M	+24M
-80%	-64%	-46%	1/16/1991	24%	79%	137%	178%	122%
5%	-12%	-18%	3/9/1995	33%	50%	40%	72%	129%
7%	-4%	-10%	9/10/1998	18%	-17%	-30%	0%	38%
12%	-1%	-10%	9/21/2001	7%	3%	-35%	-22%	-14%
-32%	-42%	-34%	10/10/2002	32%	37%	68%	82%	119%
13%	7%	0%	10/27/2008	12%	17%	49%	36%	34%
-14%	-12%	-9%	10/4/2011	6%	-1%	-15%	-18%	-25%
-29%	-31%	-24%	1/21/2016	41%	61%	82%	61%	80%
3%	13%	12%	10/29/2018	1%	-11%	2%	-34%	-50%
-18%	-11%	-21%	3/23/2020	15%	-6%	?	?	?
-13%	-16%	-15%	Avg.	19%	24%	33%	39%	48%

Left chart source: FactSet. Shows rolling 12-month performance of MSCI Brazil & MSCI Brazil Banks from 31/01/2001 to 26/02/2021. Right chart source: FactSet. Shows the relative performance of MSCI Brazil to MSCI Emerging Markets in monthly periods before and after EM bear market troughs. Based on daily figures from 31/12/1987 to 02/03/2021. Note averages exclude latest bear market.

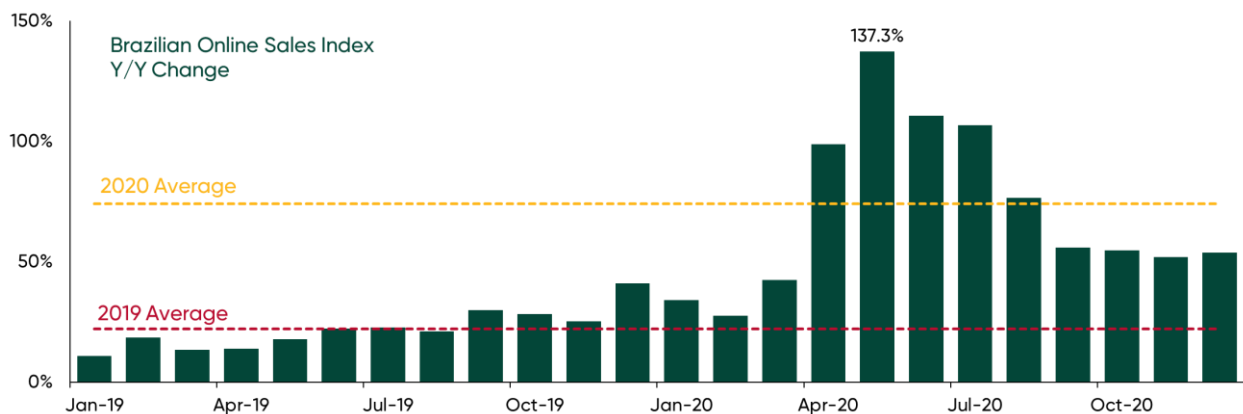
**CONSUMER DISCRETIONARY**

The last approximate quarter of the portfolio's absolute weight to Brazil consists of Magazine Luiza, a large Multiline Retailer with a strong physical and virtual presence in the country. The exposure to Consumer Discretionary is a growth-oriented theme in line with our current outlook that the style category will continue to outperform through this late market cycle stage.

**RAPID E-COMMERCE GROWTH**

COVID-19 led lockdowns and social distancing measures are increasing consumer adoption of online shopping, with quantity of online sales rapidly growing in the first half of 2020. (Exhibit 8) Latin American E-commerce names including Magazine Luiza should benefit and contribute to portfolio outperformance.

**Exhibit 8: Growth of Brazilian E-Commerce**



Source: MCC-ENET, accessed 24/02/2021. "Índice de Vendas Online e Variações – Brasil". Shows value of index (2017 = 100) against the value of the same month of the previous year. Online sales based on quantity of products sold over given period as opposed to total value.

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