



Returns. The Blue Alpha fund posted a positive performance of 53 bps in March, with 148 bps coming from rates, -6 bps from equities and -98 bps of fx. Cash and costs added 9 bps.

The crisis in 3 stages

The March monthly letter will take a slightly different approach from the previous letters, where we usually comment on each Latin American market. This time, we'll cover these 3 topics: the evolution of the current crisis, the risk management adopted by the Blue Alpha fund and prospects for the future.

1- The Evolution of the Current Crisis

Although I've been working in the market for 31 years and have experienced several types of crises, I confess that I've never seen anything like what's happening right now. That does not necessarily mean that it is worse or better than other crises I have experienced. It's just very different, and quite complex as well. Let's take a look at this crisis from three perspectives: (i) the Coronavirus crisis, (ii) the oil crisis and (iii) the political/institutional crisis in Brazil.

Coronavirus Crisis: due to being characteristic of a natural disaster, in theory, this should be a problem that can be resolved rather quickly. It is now becoming clear that the impact on the labor market will be greater and longer lasting, which means the duration of the crisis will certainly be longer than previously expected. That is the first uncertainty of this crisis. The second is what impact the near-total lockdown of global economic activity can have on global credit markets. The third uncertainty concerns the amount of fiscal and monetary stimulus that will be needed to contain the crisis, as well as the future implication of this spending on the government's public accounts, when the crisis dissipates.

Oil Crisis: a double demand/supply shock is running parallel to the Coronavirus in the global oil market. The demand shock is a direct result of the Coronavirus crisis, due to the social distancing measures correctly adopted by governments. The supply shock arises from an untimely dispute between Russia and Saudi Arabia, which ironically resulted in an increase in oil production, at a time when demand is scarce. In the medium term, the drop in oil prices acts as an income injection for the population, although credit uncertainties increase in the short term, especially in the sectors most affected by the oil price downturn.

Political/Institutional Crisis in Brazil: Disagreements between the executive and legislative branches are somewhat common in Brazil, whether in this or previous governments. The problem is that such disagreements have surpassed the point of reason, raising uncertainties regarding the fiscal anchor and the risk of the country having to undergo another long and painful impeachment process, something that we still consider as unlikely.

2-Risk Management of the Blue Alpha Fund during the crisis

Early 2020 backdrop

The year 2020 began with an interesting outlook for Brazil, considering an unprecedented low in the interest rate and a very competitive exchange rate for the country. In addition, there were strong prospects of continuity in the process to pass structural reforms. This substantiated a relatively high equities position, at around 30%. We also always thought that the rates curve continued to present an interesting premium, especially the short part of the curve. We chose to sell Latin American currencies, such as BRL, COP, and CLP, as protection for these two equities and rates positions.

Risk reduction

We decided to drastically reduce the risk in the week prior to Carnival, in light of the spread of the Coronavirus to areas outside of China, as was notably the case in Italy and Iran. At that time, we reduced the equities position from its then 30% to 8%. The final reduction came after the Fed's unexpected interest rate cut, where the market's reaction was unexpectedly negative. At that time, we brought the equities position to zero and the FX position to close to zero, also cutting NTNB positions and maintaining only the short rates positions in Brazil, Chile and Mexico. And that is where we remain at this point.

3-Perspectives for the Future

Due to the complexity described throughout this text, especially in understanding the Coronavirus crisis, we are preferring to only maintain conservative positions, applied in short interest rates in Latin America. We are, however, already conducting interesting studies with our equities group to explore future opportunities, both in Brazil and in the USA, as we understand that we are able to buy shares of interesting intrinsic value and at lower costs during times like these. Regarding the future of the crisis, we understand that the most critical points to be monitored at this time are: (i) stabilization of the virus in Europe, the USA and Brazil; (ii) fiscal and monetary stimulus measures by the governments and their impact on fiscal accounts; (iii) impacts on credit markets resulting from the health crisis as well as the oil crisis; and (iv) an understanding of the different markets' technical positions.

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