BlueLine
ASSET MANAGEMENT

MONTHLY LETTER I April 2020

Results for the month of April. The Blue Alpha posted a positive performace of 140 bps in April, with 190 bps coming from rates, -17 bps from equities and -36 bps of from FX. Cash and costs added 3 bps.

International. After the sharp, rapid and unprecedented declines across global markets in March due to the Coronavirus pandemic, government officials worldwide, and especially in the U.S., have also made unprecedented proactive efforts to respond to the crisis. The Fed has rolled out several liquidity programs, loans, purchases of government and private-sector bonds, credit lines for other central banks, spanning practically the entire fixed-income spectrum, from Treasuries, repos, commercial papers, municipal bonds, including high-grade and high-yield. This was on top of an equally massive fiscal stimulus provided by the Treasury Department and supported by Congress, featuring tax expenditures that can reach the impressive mark of 10% to 15% of the U.S. GDP. Finally, we had at least two more events that, together, were key to improving the outlook in April, namely: a very "oversold" technical position of investors in general, and the numbers from the health crisis, with Europe and the U.S. likely to have see already seen the peak of new coronavirus infections. As the month came to a close, we had the comforting news that researchers may be close to finding an effective treatment for the disease. That said, we don't think the environment is going to be a rosy one from now on. The impression is that the market is taking a very technical approach, respecting certain limits within an expected range. The basic idea is to try to find value within the U.S. economy, in sectors that benefit from the new world order, and/or sectors that are over-discounted in terms of price, always relying on protections in Latin American countries that face greater economic, political and institutional volatility in the post-crisis era.

Brazil. As we have already insisted quite a bit in this monthly letter, Brazil is currently going through a critical moment of an economic and political-institutional crisis, which runs parallel to the global health crisis. The economic crisis features critical points such as the risk of cutting the fiscal anchor loose, having already reached a double-digit nominal deficit, and a gross national debt that is about to exceed 85% of GDP. The political-institutional crisis is aggravated by the public dispute between the Executive, Legislative and Judiciary branches of government. The last episode of this crisis began with the unexpected departure of former Federal Judge Sergio Moro from the government, which only deepened the crisis, especially given that the president now faces the risk of facing impeachment. To compound the situation, the country is currently dealing with the results of inadequate preparation for the COVID crisis, seeing a tragic spike in the number of new cases, especially in Rio de Janeiro and São Paulo. The only market for which we feel comfortable about having a more optimistic outlook is the front-end rate of the local yield curve. All other markets face extremely difficult conditions, which has led us to take on an approach based on negative allocation.

LatAm

In Mexico, the situation differs from Brazil. The country also faces an economic and trust crisis between the private sector and the AMLO government, but does not face a fiscal crisis or any political-institutional turmoil. That does not mean we are comfortable with the overall picture in Mexico. On the contrary, we also have a very negative outlook towards the country, leading us to adopt a similar strategy as in Brazil. The health crisis notwithstanding, Mexico also suffers from plummeting oil prices, which have a major impact on the government's tax revenues, and which could lead to a major recession, with prices falling by an alarming 8%-9%. The Mexican inflation today is slightly below 3%, and on a downward path. If the major recession mentioned above strikes, we believe that the terminal interest rate in Mexico will be below 4%, offering a glimpse of opportunity in Mexico's yield curve. This is also why we do not like the outlook for the local stock market or the Mexican peso.

In Chile, as we had anticipated in a previous letter, the country now stands out relatively positively in the region, especially when it comes to the local currency, as the Chilean peso saw the lowest level of depreciation among its Latin American peers. Ironically, this is due to Chile's close economic ties with China, since China – which was the epicenter of the global health crisis – is now one of the first countries to emerge from the most critical period of the disease. Nonetheless, we still hold a negative outlook on the Chilean peso, especially considering the impact that the global recession is having on the commodity market and, in Chile's case, more specifically on copper. Unlike Colombia, Brazil and Mexico, where we still see good opportunities in yield curves, the same cannot be said of Chile.

In Colombia, falling oil prices have a major impact on the local economy, as much of its exports (around 50%) are oil-related goods. This puts the country at high risk of losing its "Investment Grade" rating, which would have negative implications in terms of external flows into the country. This undoubtedly puts the Colombian currency under pressure. From a health perspective, the country reaped the benefits of a more cautious approach towards the disease, which lessens the negative impact on economic growth. Even so, Colombia's Central Bank has already cut its base interest rate by 100 bps, bringing it down to 3.25%, and the curve is pricing at least another 70-bps cut in the coming months, something the Central Bank has already confirmed as a real possibility. Like Mexico and Brazil, Colombia is part of the same strategy adopted across the region, namely: receiving short-term interest and selling local currency.

In Peru, as is the case around the world, inflation has been extremely benign. April's readings were all muted, with 12-months inflation coming in below the center of the target range (2%), which also applies to core inflation readings. This is largely explained by the sharp drop in demand experienced in the country, with the demobilization of the workforce resulting from the social distancing measures that were appropriately implemented by the Peruvian government. On the political front, recent tensions have eased, and President Vizcarra is benefitting from rising approval ratings due to the preemptive measures adopted by his government. As of now, we do not see any compelling opportunities in Peru.

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