BlueLine
ASSET MANAGEMENT

MONTHLY LETTER I **June** 2020

Results of the month of June. The Blue Alpha fund posted a positive performance of 92 bps in June, with 77 bps coming mainly from rates, followed by equities with 39 bps and -21 bps of FX. Cash and costs added -3 bps. In rates, we managed to capture the latest Selic cutting movements by the Brazilian Monetary Policy Committee (COPOM), but mainly we have been taking advantage of the dropping rates trend in Mexico, which should continue in the next few months. Equities gains, in turn, were predominantly focused on the local market, considering the spike in volatility in the foreign market – particularly in the U.S. The local equities portfolio was built based on a bottom-up analysis, focusing on positions with more consistent medium-term gains and slightly less correlated to the index (low-beta).

Overview. Along with the month of June came yet another wave of upsetting factors, such as the upsurge in Covid-19 cases in Southern U.S. states, amidst more optimistic prospects suggested by economic indicators. In our view, the positive trend in economic data should carry on, since although the rising number of new Covid-19 cases in the U.S. has been slowing down the economic reopening process, harsher isolation measures have been avoided. In addition, positive surprises in the economic front have spread across several regions, indicating that the fiscal and monetary stimuli rolled out to fight the crisis are working. Even in Brazil – which disappointing results in term of economic growth – is now showing signs that the recession may not be as deep as initially thought. On the political front, institutional clashes seem to have toned down, which could help relieve some economic uncertainties and spur growth and market results.

Market Overview. On the international front, we should continue to see stronger economic results amidst the risks of a looming second Covid-19 wave. Another positive factor is the technical position, in which short positions have not yet been fully covered. On the other hand, the approaching U.S. elections and the current price rate recommends some caution in positioning.

In the local scenario, the political-institutional scenario seems to have toned down, which has helped the interest market, but not so much the foreign exchange market. The stock market has its own dynamics, positively impacted by individual flows. The Brazilian Real's underperformance is attributed to the lack of attractiveness both in terms of carry and prospective growth of the country. This places the Brazilian Real as a hedging currency, which vastly increases the currency's volatility and puts it at a poor carry-to-vol ratio. In terms of rates, it is our opinion that the monetary policy is approaching the end of the loosening cycle, but the curve still shows very high premiums.

Positioning. The global deflationary scenario and high economic idleness should keep inflation under control in Brazil and in Mexico, but the recent indication that the COPOM is much closer to completing the interest rate cut cycle than Banxico leads us to secure higher positions in the frontal part of the Mexican curve, rather than in Brazil. In the stock market, despite consistent signs of growth in the U.S. economy, price levels and lingering uncertainties surrounding Covid-19 have prevented a stronger appreciation of S&P. Therefore, we have been focusing on a broader geographical diversification in the foreign portfolio, mainly in sectors such as technology, pharmaceuticals and commodities, including oil. In the regional stock market, we have a bottom-up portfolio focused on financial services, energy, transport, e-commerce and banks in Latin America. Our foreign exchange positions are currently neutral, due to the current high volatility and poor direction in these markets.

LatAm

In Brazil, political-institutional pacification initiatives initiated in May advanced significantly in June, both regarding the government's relationship with Congress and the bickering with the Supreme Federal Court. This led to some positive developments, such as the long-awaited regulatory framework for sanitation and the extension of the BRL-600 emergency aid for a limited period of time. This political truce comes along with more optimistic economic data, indicating that the country's recession may not be as strong as the current market consensus. The big question is whether this short-term recovery will gain momentum towards sustained growth in 2021, which we believe is a little too early to assume. In this context, we believe the main stock market bargains have already settled and we are focused on building a medium-term bottom-up portfolio with a lower beta compared to Ibovespa. The possibility of a stronger growth also makes the front of the interest curve slightly less attractive. However, we still believe COPOM will make another 25-bps cut in its next meeting. The continued political pacification trend, however, creates opportunities to extend deadlines in active interest positions. In FX, we have adopted an opportunistic stance, with no structural positions.

In Mexico, contrary to Brazil, the economic crisis has been much stronger than initially anticipated by the market and the monetary authority, while the public health issue has improved recently. Banxico is still cautiously loosening the monetary policy, without any indication that it is nearing the end of such process. The problems already faced by the country before the crisis and the lack of fiscal support for the economy lead us to believe that the recovery process will be much more troublesome than in other countries of similar size. We remain confident that the terminal rate should be much lower than current levels. Therefore, we still see value in short interest contracts. We also have a position in the financial sector of the Mexican stock exchange. In the Mexican currency, on the other hand, we have more tactical positions.

In Colombia, June was a busy month for Colombian economic authorities, with the suspension of fiscal targets for the coming years due to emergency spending to combat Covid-19, and Banrep reducing the pace of interest rate cuts to 25 bp. The suspension of fiscal targets due to the pandemic makes a lot of sense, but the recently released fiscal adjustment plan is shrouded by uncertainties that could cause the country to lose its Investment Grade seal in the near future. On the monetary side, the slowdown in the rate of cutting was justified as a cautious approach, at a time when the basic interest rate (2.5%) already flirts with negative ground in real terms. On the other hand, inflation under control and massive economic idleness indicate that there is some room for further cuts at such cautious pace.

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