

MONTHLY LETTER | July 2019



Monthly results. In July, we had positive returns, with realized annualized volatility of 4%. Alpha generation came mostly in the equity book, due to stock picking. Despite our positive macroeconomic view in Brazil, we think micro foundations will remain as the driver ahead. In July, 84% of our result is explained by our positioning in the equity market, 6% in rates, and 6% in FX.

Global Markets. Asset management requires constant scenario evaluation, there will never be one indisputable truth. Maybe that is where the motivation is. In the international scenario, our reading was that the “liquidity” factor would dominate the “anti-globalization” one. While the former refers to the preemptive action taken by central banks, including those of the largest economies - the FED, PboC, and the ECB - the latter is related to nationalist movements or by ideologies that are spreading across the globe. Trade war, immigration issues, tech disputes, and currency war all reflect a worrisome scenario for the global economy, as they go against the recent productivity gains from globalization. Yet, this is the stage where we are at. Until what point will the liquidity factor continue to dominate over other global risks? We don’t have the answer at this point, and that is why we have decided to take a cautions position in relation to the global/external environment. This position is also reinforced by the strong rally in asset prices since the beginning of 2019.

Brazil. The country is certainly moving in the right direction. Following the institutional gains from the “Car Wash” (“Lava-Jato”) operation, we are now entering in a phase of structural reforms, led by the important first-round approval of the social security reform. This approval was, in all aspects, better than initially anticipated by the market. Total savings, approval date, the fact that opposition parties also voted in favor of the reform, those were all positive signs and, therefore, constructive for the country. Despite this, all asset prices ended the month exactly where they started, except rates that declined 40 bps. This raises an interesting debate in Brazil: until what point the positive macro view of the country will keep driving asset prices? We understand that the macro developments will remain relevant, but micro, or “bottom up” analysis will gain relevance from now on.

LatAm



In Mexico, our view remains negative. The country is in a fragile cyclical position, with the economy in recession and inflation close to the upper range of Banxico's inflation target. This resilience in inflation is explained mostly by the high wage gains from Peña Nieto and Lopez Obrador's administrations. We think that both the CDS and the Mexican stock market remain vulnerable. Issues related to Pemex cash flows should also add pressure to rating agencies. Given all this, we see rates holding high levels, while the currency should remain relatively strong given the high carry.



In Chile, there is a real possibility of more rate cuts. The economy is decelerating, and the Central Bank, after a rapid change in its monetary stance from rate hikes to cuts, could extend the easing cycle. The country's exports are not diversified, which increases its exposure to the cyclical changes in the economy, especially considering Chile's fragile external position. All of this has been driving the currency depreciation, which is in line with our view. The strong link to China is also not helping in the current context.



In Colombia, it seems there is a mismatch in terms of the country's economic cycle and the rest of the world. The country's economic indicators improved up to July, despite the decrease in oil prices. This, added to the fragile current account position, has made BanRep to consider rate hikes. This is very odd given the current global context, since interest rates are moving down across the globe. We don't believe BanRep will hike rates, but we remain negative with the currency.



In Argentina, we are approaching the primaries. We see two important price drivers in the country. In March, there was an important deterioration in local markets given the smart and unexpected move from former president Cristina Kirchner to put herself more on the middle of the political spectrum by inviting Alberto Fernandez to run as president in a ballot with her as vice-president. President Macri also moved to the center, getting closer to the Peronists, moving further away from his party's Cambiemos ideologies. This last move led to an increase in Argentinean asset prices. Low liquidity and the binary scenario ahead puts us on hold since at BlueLine we value liquid assets and clearer future perspectives.



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