BlueLine
ASSET MANAGEMENT

MONTHLY LETTER I **August** 2020

Results of the month. The Blue Alpha Feeder fund posted a positive return of 10bps in August, with favorable contributions of 50bps from equities and 12bps from FX. Rates positions showed negative performance of 52bps. With respect to equities, despite the poor performance of Ibovespa, our portfolio with high geographical diversification allowed us to capture the favorable global scenario and maintain risk under control. The FX strategy was based on the weakness of the U.S. dollar versus more tactical positions in European currencies and more structural positions in Asian currencies. The rates market made a negative contribution in Mexico as well as in Brazil, although the positions of the latter have been reduced throughout the month, greatly reducing the volatility of the fund.

Global Vision. Reflation trade—this was the hot topic for the month of August on international markets. Otherwise, we can see: the 5Y UST rate climbed 7bps, while its breakeven inflation (BE) for the same period increased by 27bps, which implies that the real 5Y interest rate in the U.S. dropped by 20bps. The downturn in real interest ultimately boosts risk assets around the world, especially international stock exchanges, but also helps bring down the U.S. currency against its major peers in the G4. This market logic was largely reinforced by the important annual meeting of the Fed, at the virtual event usually held in Jackson Hole, Wyoming. The Fed committed to adopting a system called Average Inflation Targeting (AIT), which aims to make monetary conditions more relaxed to compensate for periods when inflation fell below the original target. Not even the delay in the roll-out of the fiscal stimulus package to be adopted by the U.S. Congress was able to affect the performance of the main international assets. There is a belief that, as the U.S. elections approach, this causes global agents to minimize the possible "fiscal cliff", given that we will most likely have a new administration in charge of the American economy next year, which would be the case with Joe Biden's victory, and clearly the Democrats are more inclined to inject greater fiscal stimulus into the U.S. economy. Looking further ahead, we believe that the topic of the U.S. elections will, from now on, be the major factor influencing the markets from here until November. We remain optimistic about the external scenario, and we have a global allocation in stocks, especially concentrated in the USA and Asia, and with a very interesting sector diversification, which also aims to benefit from the U.S. election event.

Brazil Scenario. In contrast to the world, local markets in Brazil experienced a substantial worsening in August. Falling stock market, rising interest rates, and a more depreciated currency. All of this is due to a very worrying factor that is happening in the country right now, which is the undue anticipation of the 2022 electoral calendar to a time when the country is still recovering from a serious public health crisis and, as a consequence, a no less serious deterioration of its fiscal accounts. The president, benefiting from a rise in his popularity entirely linked to the extension of emergency aid to the classes most affected by the pandemic, is looking to increase public spending, along with congressional wings. This is extremely untimely, since what the country needs at this time, in addition to caring for the health crisis problems, is the exact opposite, i.e., signaling to local and international agents that the control of fiscal accounts is on the agenda and will

not be abandoned. In light of this complex situation that will be difficult to resolve in the short term, we reduced our allocation in Brazil as much as possible, preferring to allocate our investments in international markets. We have more negative positions in currency and interest, but we maintain more positive allocations in the Brazilian stock market, in securities of greater medium-term conviction selected by our fundamentalist analysis team.

Mexico Scenario. The country remains in a very fragile cyclical position, especially as President AMLO refuses to use more aggressive fiscal stimulus policies to boost the economy at this critical time in the health crisis. This situation is aggravated by the excessive conservatism of the monetary authority, which maintains an extremely high interest rate level, both in absolute and relative terms, when compared to other emerging markets that have already made their fiscal and monetary policies more flexible. The lack of confidence in the private sector also hinders a stronger resumption of economic growth—and this is due to the government's erratic measures, especially with regard to foreign investments in the energy sector. As a result, we sustain our vision of receiving interest on the short side of the Mexican curve, and we also like the profile of the Mexican currency, especially when compared to the Brazilian real, in view of the fiscal crisis explained above in the Brazilian context.

Positions. In rates, we continue to receive interest on the short side of the Mexico curve and operate tactically with small positions in Brazil. In equities, we maintain a diversified global portfolio both in geographical and sectorial terms. The highest concentrations are in the U.S. market, followed by Asia. The positions are of a small magnitude in Europe, Brazil and Latam ex-Brazil. FX positions seek to capitalize on the weaker U.S. dollar compared to other currencies, especially those from developed countries and Asian emerging nations. With respect to the Brazilian real, we have been operating more on the short end.

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