BlueLine
ASSET MANAGEMENT

MONTHLY LETTER | September 2020

Results of the month. The Blue Alpha Feeder fund posted results of -153bps in September, with a negative contribution from equities (-82bps) and rates (-30bps) books, and a slightly positive result in FX (+5bps). The cash and expense account was negative in September (-46bps), influenced by a depreciation in the price of cash instruments available on the market, which were affected by the country's increased fiscal risk. As we emphasize in our letters, we have gradually reduced exposure to Brazil's risk and increased global risk diversification, but this strategy also resulted in losses in September due to the correction in the global stock exchanges mentioned below. The rates result was greatly affected by the positions that bet on Mexico cutting interest rates and a small flattening position in the Brazilian curve. On the other hand, the FX result was mainly favored by positions in Asian currencies.

International. Elections in the United States. This is September's theme across the international markets. By the end of August, the more positive news from the cyclical side and vaccines was boosting global markets. Not even the loss of fiscal stimulus in the U.S. was enough to change this positive trend in the markets. The approaching elections, alongside a less favorable technical position, caused the second correction in the American stock market, following the steep drop in March. Here we must distinguish between a technical correction and a valuation problem per se. While the latter refers to a perception that assets are expensive, the former relates more to a healthy short-term effect. This is how we see it. The U.S. market is still very attractive for investments in the medium term, even though some think there may be a bubble in the technology sector. Our understanding is that after the election cycle, regardless of the outcome, the situation will be very favorable in the U.S., both fiscally and monetarily, with negative real interest rates and very interesting growth prospects in 2021.

Therefore, we have not changed at all the orientation of our global stock portfolio, which favors investments in the U.S. as well as Asia.

We have a very diverse portfolio with quantitative analyses supporting our decision-making process, which makes us very comfortable for a horizon of 6 to 18 months. We believe that the US elections are headed for a Democratic victory, and that we will not necessarily have a dubious outcome, like what happened in 2000 with Bush and Gore. Current polls show that the Democratic candidate has an interesting lead, which has been expanding on the margin. This scenario favors cyclical companies such as those in infrastructure, home building, small caps, industries, ESG. In addition to this local factor in the U.S., Asia also stands to benefit from a possible Biden victory, both from a currency and an equity point of view. This is due to a reading that the geopolitical scenario will be much better with Biden than with Trump. The harmful effects of the Trade War

observed since 2018, with the U.S. government in intense and constant clash against China, tend to decrease, which will bring benefits to international trade and positive impacts for emerging markets, especially for countries that are well positioned in macroeconomic terms, notably those more connected to China. Therefore, our portfolio maintains a more global focus, in light of the difficulties faced in Brazil, a topic that we will discuss below.

Brazil Scenario. The country seems to be heading for a fiscal and debt crisis characteristic of a post-global shock period. This somewhat resembles the deterioration process in Europe after the global financial crisis in the U.S. in 2008. The difference in Brazil is the significant strain between the main agents, either within the government itself and/or with congress. What has been calling our attention the most is the change in the Minister of Economy's posture and resilience. Fiscal populism ideas, with a clear anticipation of the 2022 election debate, have worn down the Minister of Economy substantially before the government itself and congress, and this has raised concerns in the market. The interest curve is under intense pressure, just as the National Treasury has had difficulty rolling over public debt. The great difficulty of operating in Brazil at this time is the fact that the assets are already too discounted, whether foreign exchange, interest, or equities, which is in line with the very challenging scenario that lies ahead. This has led us to have minimal risk in Brazil right now. However, our orientation in Brazil has been to operate more on the negative side, although we think some assets are already in very cheap price territory, as is the case of some securities on the Stock Exchange.

Mexico Scenario. It is interesting to compare what is happening in Mexico with the situation in Brazil. Economic activity in Mexico has suffered much more than in Brazil during the pandemic, because the AMLO administration was ultra conservative on the fiscal side. This has a downside, but on the other hand it also puts Mexico in a more favorable position to face the post-pandemic period. And this has a clear reflection both on the interest curve and the currency. Therefore, our orientation in Mexico has been for more optimistic positions, both in the currency and in the interest curve. We believe that Banxico still has considerable room to cut interest rates, mainly because we understand that the huge gap that exists today in the Mexican economy will dredge inflation in the medium term to the center of the 3% target. Short-term uncertainties, such as U.S. elections, may even slow the process of monetary easing, but it will come in time. The currency tends to benefit from a Democratic victory in the U.S., the end of a more aggressive relationship with the Trump administration, as well as the carry component and a fairly solid position of both foreign and fiscal accounts.

Positions. As we mentioned above, our interpretation is that much of the September correction was technical, enhanced by noise surrounding the American election. The economic fundamentals are still robust, and we hope that the end of the election event will bring, with a Democratic victory, a major reduction in geopolitical risks. In this sense, after reducing the fund's risk to mitigate September volatility, we are undergoing a gradual process of increasing exposure, already preparing for the U.S. post-election scenario. These changes have resulted in a global equities portfolio more concentrated in Asia and specific sectors of the U.S. economy. The equities risk in Europe remains limited and, in Brazil, our position is in a few securities on which we have medium-term conviction, but with protection in the index. Following the same line of reasoning, the FX book is also leaning towards Asian currencies, both because of long-term fundamentals and a perception of post-election improvement. In rates, in addition to maintaining interest-receiving positions in Mexico, we have small positions taken in the Brazilian curve, in addition to a longer flattening.

Av. Brigadeiro Faria Lima, 3477 - Torre A - 5° andar - sala 52
Phone: +55 (11) 4280-7442
blueline.com.br