

## Brazil – taking a pause for breath

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**We are taking some profits off the table in Brazil, reducing its weight within Rexiter's global emerging markets portfolios. What a year and what a breathless ride it has been!**

In US Dollar terms, the Brazilian equity market touched bottom almost exactly one year ago (21 November 2008). In the intervening year, the market has returned 180% from this low, with a gain of 135% in 2009-to date. This year, the Brazilian Real has been the best performing of the world's major

currencies against the US Dollar with a gain of 32% and is only beaten to the accolade of "world's best performing currency" by the Seychelles Rupee. Rexiter owns stocks within Brazil that have recorded four-fold gains during this time. To us, it seems prudent to lock in some of these gains. Valuations have gone from bargain basement levels to a premium to the country's own historical levels... although we view this as merited and reflective of the economy's development.

The relative resilience of the Brazilian economy through the credit crunch has given rise to these stellar returns – the market should not have fallen as much as it did in 2008. Hence we have seen the rebound as investors realised that their first instinctive reaction from previous crises (SELL Brazil!) was a mistake this time around. Fifteen years of sounder monetary and fiscal policies laid the foundations for resilience, and swift and decisive policy action was successfully implemented. This is the first "crisis" in which Brazil has had the credibility and ability to cut interest rates and loosen fiscal policy to stimulate the economy, without destroying its currency. In the "old" Brazil, the first sign of international trouble would see the central bank forced to hike interest rates to defend the value of the currency... with the resulting crunch in economic activity a nasty side effect.

In fact, today the Brazilian authorities face the opposite problem – too much foreign capital seeking to buy Reals to buy equities or take advantage of 8.75% interest rates is pushing the currency stronger versus the Dollar. The unwelcome side effect of currency strength is feared loss of export competitiveness. Hence, the recent government imposition of a 2% tax on new foreign purchases of Reals destined for the fixed income or equity markets. Whether this measure is successful or not in slowing the appreciation of the Real, it will act as a headwind on the currency. We would tend to agree with the government that their currency looks expensive.

Brazil's continued ascent onto the global stage, exemplified by the selection of Rio de Janeiro to host the 2016 Olympics, will throw the spotlight onto the challenges ahead. There is still much work to be done on issues common to developing the country and delivering the Games – improvements in security and infrastructure are paramount. This will only be achieved if the country can raise its level of investment (to over 20% of GDP) and keep it there. 2010 sees the end of President Lula's term and a corresponding political transition. All the prospective candidates seem to agree on maintaining the broad policy objectives and economic direction in place now. However, candidates have differing philosophies and viewpoints and the devil is as ever, in the details. Brazil's investment needs are such that it would be unwise to spook domestic and foreign sources of capital. Yet, we feel the market consensus is very (too?) relaxed about the election and the risks, however small, that lie within.

The investment party in Brazil goes on and can continue for many years if the right choices are made. It's in full and colourful swing but just a little noisy and crowded at the moment so we are stepping outside to pause for breath... but we will no doubt be going back.