Brazilian equities are in demand

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Brazil is locked into a severe recession in 2016, the year of the Olympic Games in Rio de Janeiro. After negative growth of 2.5% last year, the economy will be shrinking by more than 3% in 2016. Political crises and corruption scandals in connection with the oil company Petrobras have badly affected the country. But still, the country, shaken by crisis, is in strong demand from investors.

The importance of Brazil has declined

Especially in the equity segment, the relevance of Brazil has declined in recent years. A few years ago the BRIC economies (Brazil, Russia, India, and China) were hugely popular among investors. Mismanagement and the unfavourable development of international commodity exchanges have eaten into the weighting of Brazil in the global …

… equity index (MSCI World All Countries) and reduced it to now only 1%.

Source: Thomson Reuters Datastream; Data as of 4th August 2016; the chart does not include any kind of fees or taxes; past performance is not a good indicator for future developments.

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A new hope: the interim government

At the launch of the impeachment proceedings of President Dilma Rousseff around mid-May of 2016, an interim, pro-business government headed by Vice President Michel Temer was appointed for the period until the next election in 2018. One of the biggest challenges is the high budget deficit, which increased to about 10% under Rousseff's cabinet. In order to tame this deficit, the new government announced several reforms; among them a reform of the loss-making social and pension insurance, which represents the biggest item of the public budget. Also, plans are for the energy sector to be opened to private investors, and for the indexation of wages and social benefits to be lifted. The government also intends to do away with the minimum spending constitutionally stipulated for education and healthcare, to simplify taxes, and to improve the rule of law for investors. In addition, the government wants to privatise public bodies such as the aviation regulatory authority. Overdue infrastructure measures are to be financed by pubic-private partnerships (PPP). The government wants to grant private companies licences for airports, ports, and motorways. Overall, all of that sounds very reasonable.

Brazil's problems are of a structural nature

Brazil's problems are of a structural nature. The high dependence on its natural resources is the biggest problem in this context. In spite of all the diversification measures taken, the development of the country still depends on the international commodity markets. Not all sectors are currently facing the same difficulties as the oil and ore industry. For example, the agricultural sector and the cellulose industry currently benefit from favourable exchange rates.

The Brazilian equity market

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Brazil overweighted in equities

The current weighting of Brazil in the MSCI Latin America index accounts for slightly more than 50%, which makes the country the biggest equity market in Latin and South America. In our global emerging equity markets equity fund we have slightly overweighted Brazil due to the new pro-business economic policy and the historically low valuation. In terms of sectors, we currently favour financials, property developers, and private education institutions. In the energy sector, especially when it comes to Petrobras, we advise caution. The highly indebted oil

group might tear a hole worth billions into the public budget. The group is faced with potential settlement payments due to investment fraud, as a result of which the partially state-owned company might then have to fall back on a bail-out from the government, i.e. a cash injection.

Commodity prices and politics determine Brazil's sustainable comeback

Brazil's comeback depends largely on the development of commodity prices. Foreign investors will be cautious about their commitment as long as the political crisis has not been fully overcome.

LINK to our global emerging markets equity fund: http://www.erste-am.at/de/private_anleger/unsere-fonds/suche/1-34301/overview

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Gabriela Tinti took over the position as Head of Desk Equities Austria at Erste Asset Management in November 2020. Prior to that, she was Senior Fund Manager in Erste Asset Management's Equities team since 2008. She focuses on companies from the global emerging markets and on property companies. Gabriela Tinti has worked in finance since 1988.

At the beginning of her career, she was with a commercial bank, where she gained a wide range of experience in capital markets, retail and institutional banking, international finance, and corporate finance. In 2002 she moved to the asset management industry.