SEPTEMBER 2024

MIRABAUD

MONTHLY NEWSLETTER
MIRABAUD WEALTH MANAGEMENT

Guilherme Barbosa
Investment Director

INTERNATIONAL

THE (MIS)POLITICS IN OUR WORLD

We start our monthly letter, as we often do, by looking at the past, convinced that we can draw lessons from it for better shaping our future.

Exactly one year ago, the yield of a 1-year US Treasury bill reached its decade peak of 5.49%. Today the same instrument gives you a return of only 3.98%. The past has never looked so good.

With equities and gold at all-time highs and lower yields on the fixed income side, how should we invest now? Before answering that question, let's take a moment to recap what happened in markets in September.

Equities rose, the dollar weakened, gold climbed and yields decreased during a month in which the Fed lowered its interest rate by 50 bps, starting its rate-cutting cycle 14 months after its last rate hike in July of last year.

The Fed believes that inflation is now under control and sees more risks of deterioration in the jobs market than in the reacceleration of inflation.

Yields are now considerably lower compared to one year ago and may fall further as the rate-cutting cycle continues. The market now expects between two and three cuts of 25 bps until the end of the year followed by approximatively 5 rate cuts throughout 2025.

The Fed's decision was crystal clear to the market. The central bank is calibrating its policy and is now focused on employment rather than on inflation.

« IF PEOPLE LOSE CONFIDENCE IN THE SYSTEM, THE VICIOUS CYCLE OF DEVALUATION ONLY GETS WORSE. IT IS ALL ABOUT TRUST! »

PERFORMANCE OF THE MAIN FINANCIAL INDICES SINCE 2021:

	Sep.	Sep.$	2024	2024 $	2023	2023 $	2022	2022 $	2021	2021 $
S&P 500	2.14		22.1		26.3		-18.1		28.7	28.7
Stoxx 50	0.93	1.82	13.9	14.7	23.2	27.3	-8.5	-14.0	24.1	15.6
MSCI EM	6.68		17.1		10.1		-19.9		-2.3	
Brazil Bovespa	-3.08	0.69	-1.8	-12.3	22.3	33.1	4.7	10.1	-11.9	-18.1
Euro	0.79		0.9		3.1		-5.8		-6.9	
US Dollar Index	-0.90		-0.5		-2.1		8.2		6.4	
Gold Spot	5.24		27.7		13.1		-0.3		-3.6	
Brazilian Real	2.92		-11.0		8.9		5.4		-6.8	
Global Agg. Bond	1.70		3.6		5.7		-16.2		-4.7	
Latam Bonds	2.48		11.0		11.1		-13.2		-2.5	
Global High Yield	1.95		9.6		14.0		-12.7		1.0	
US T Bills	0.45		4.1		5.1		1.3		0.0	
CDI	7.99	-2.60	8.0	-2.6	13.0	24.8	12.4	18.4	4.4	

Yet, there is another topic which neither the Fed nor any other central bank in the world talks about. The growing fiscal deficits across the world.

Fiscal deficits of "developed economies" continue to surge with the US fiscal deficit as a percentage of GDP expected to reach 7.0% in 2024 whilst France's former finance minister recently announced that his country's fiscal deficit could reach 5.6% of GDP this year, significantly higher than the European Union's limit of 3%. The impact was such that the French 10-year sovereign yield was briefly higher than Spain's for the first time since 2007.

Fiscal deficits obviously mean higher debt which are already at worrying level for many of the world's economies. For example, the US debt now stands at a staggering $35 trillion.

This never-ending leveraging helps to explain the rise of gold prices which is, in fact, a fiat-currency devaluation, as printing money inevitably reduces its value and leads to a loss of confidence in the currency.

If people lose confidence in the system, the vicious cycle of devaluation only gets worse. It is all about trust!

You may rightly think that trust has been shaken recently not only by the fiscal deficits, but also by the politics in our world.

We have now a stagnating war in Ukraine and an escalating war in the Middle East. Unfortunately, nobody knows how and when any of them will end nor whether other conflicts will flare up in the world. On a more ironic note, we even have Christmas being celebrated in October in Venezuela – our readers that follow the news on the Bolivarian state will know what I am talking about. These examples of political instability will once more hamper people's trust in governments.

Recently, China made the front page by precisely trying to enhance trust as its leaders announced a stimulus package to try to boost the economy and asset prices. The stock market immediately reacted as the main local index CSI 300 increased by 27.7% since the news came out, but the index is still far from the 2021 highs. Nobody in the media is now talking about a possible invasion of Taiwan.

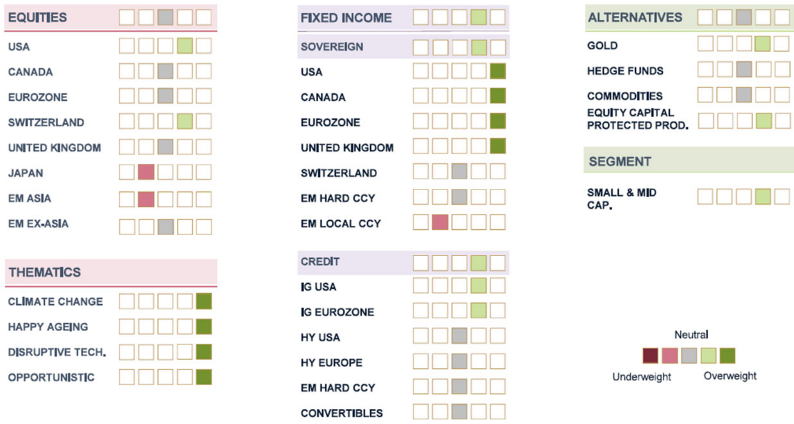
In this context of lower confidence in governments, we decide to remain overweight on gold and neutral on equities despite both trading at all-time highs.

Governments' credibility is low, but our trust in profitable companies with growing earnings remains high. Consensus estimates global earnings to increase by 8% in 2024 and 15% in 2025 which will give support to equities.

On the macroeconomic side, we still expect a soft landing followed by an early-cycle recovery in developed economies.

In these circumstances, we recommend our readers to stick to their equities and gold allocations, not to hesitate to buy longer-dated bonds from high quality issuers and to ignore the noise you can hear from the streets. In a nutshell, *"Don't follow the crowd, let the crowd follow you"* (Margaret Thatcher).

CURRENT ALLOCATION (30/09/2024)



Eric Hatisuka
CIO Mirabaud Brazil

BRAZIL

A BRIEF HISTORY OF BRAZIL'S SOVEREIGN RATING

This week Moody's upgraded Brazil's sovereign rating. But what is a sovereign rating? Who is Moody's? And why does the sovereign rating matter?

What we commonly refer to as a 'sovereign rating' is actually the expression of the credit rating assigned by a rating agency to a country (sovereign rating) or company (corporate rating).

The credit rating aims to condense into a single summary measure all the variables that impact on a country's (or company's) likelihood of defaulting on its debt. The highest rating is known as "AAA" and denotes a very low risk of default.

The 3 main credit rating agencies are Standard & Poor's, Moody's and Fitch and their credit rating tables are listed below.

	Moody's	S&P	Fitch
Investment Grade	Aaa	AAA	AAA
	Aa1	AA+	AA+
	Aa2	AA	AA
	Aa3	AA-	AA-
	A1	A+	A+
	A2	A	A
	A3	A-	A-
	Baa1	BBB+	BBB+
	Baa2	BBB	BBB
	Baa3	BBB-	BBB-
Speculative Grade	Ba1	BB+	BB+
	Ba2	BB	BB
	Ba3	BB-	BB-
	B1	B+	B+
	B2	B	B
	B3	B-	B-
	Caa1	CCC+	CCC
	Caa2	CCC	CC
	Caa3	CCC-	C
	Ca	CC	DDD
	C	SD	DD
	D	D	D

Fonte: rating agencies

The so-called (and desired) Investment Grade qualifies those countries whose risk of default is low and are therefore highly solvent. On the other hand, the so-called Speculative Grade qualifies those countries whose risk of insolvency is higher and are therefore riskier to invest in.

« IN THE CASE OF THE RECENT MOODY'S UPGRADE, IT IS NOTEWORTHY THAT (...) IT WAS NOT ACCOMPANIED BY A REDUCTION IN THE LEVEL OF INDEBTEDNESS...»

Countries with an Investment Grade tend to pay lower interest rates when rolling over their debt and to be more frequent (and safer) destinations for foreign investment, while Speculative Grade countries, on the other hand, need to offer higher returns on investors' capital, in the form of higher interest rates, in order to compensate for their higher risk of default.

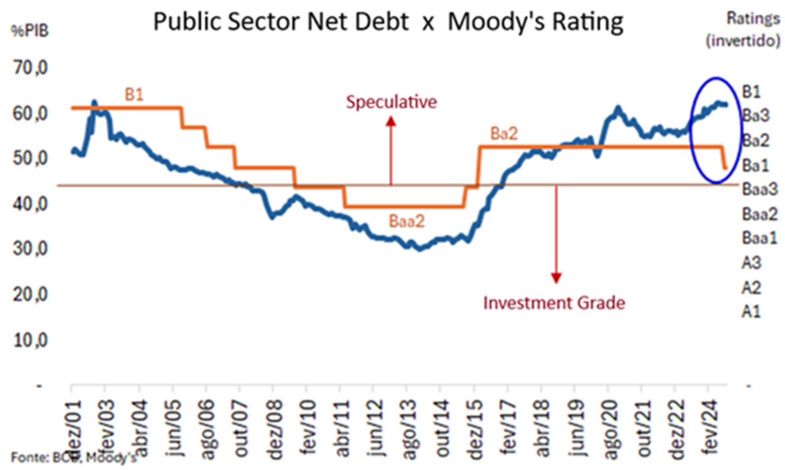
In short: countries with the Investment Grade label see their debt control efforts rewarded through friendlier financing conditions, while countries with a Speculative Grade tend to live on a "tightrope", running the risk of investors turning their backs on them when they need them most, especially in the event of economic recessions or various global crises.

Like everything else involving Brazil, our history with sovereign ratings is also picturesque. After the last moratorium on the payment of public debt in 1987, Brazil pursued liberalizing and modernizing reforms, mainly during the FHC government (1995-2002), but which were maintained by the Lula government (2003-2010) and resulted in the country being awarded an Investment Grade by all three agencies in 2010.

However, following the Dilma government's "developmentalist policy", which imposed on the state the burden of acting as the main engine of the economy, between 2011 and 2015, the country's solvency indices regressed, losing the Investment Grade in 2015.

The graph below tells a little of the history of the evolution of Brazil's sovereign rating by Moody's, and shows how the upgrading and downgrading of ratings are highly correlated with the level of public debt, measured here as a percentage of GDP.

In fact, this correlation makes sense because it is quite logical that countries with higher indebtedness tend to need more resources to roll over their debt, making their financial situation more vulnerable in general.



In the case of the recent Moody's upgrade, it is noteworthy that, unlike previous events, it was not accompanied by a reduction in the level of indebtedness; on the contrary, public debt increased during the same period in which the rating was improved.

However, it should be remembered that the level of indebtedness is not the only factor to be weighed up in the credit rating. In fact, we can understand that Moody's recent upgrade may be reflecting GDP growth, which also translates into a lower risk of insolvency for the country, and which has recently been the subject of repeated upward surprises.

The scales of Osiris

In Ancient Egyptian mythology, Osiris, the god of the realm of the dead, weighed the heart of the deceased against a feather. If the heart was heavier than the feather, the soul would not be able to enter the realm of the dead for their eternal dwelling, and would be condemned to wander restlessly through a formless and lifeless world.

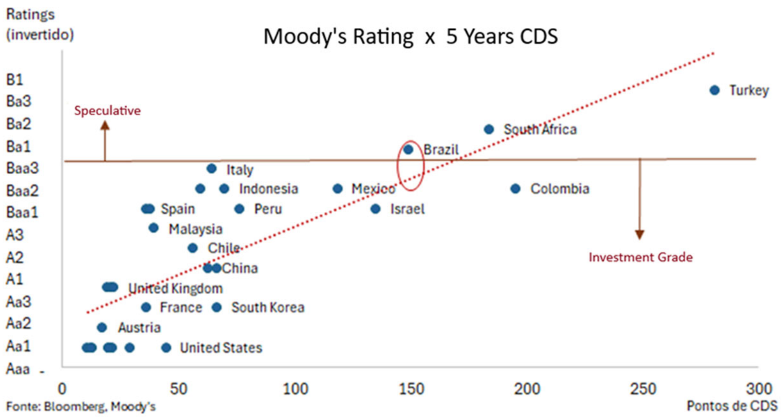
In the modern world, we don't have an Osiris scale, but we do have a very effective scale for measuring the price and risk of investments: it's called the financial market.

The financial market, faced with the need to try to protect itself from the risk of default, which always looms like a lost soul haunting investors, invented a contract called “Credit Default Swap - CDS”, whose main feature is to serve as credit insurance against default by companies and countries.

Without going into technicalities, the idea of the CDS is to allow the risk of default to be negotiated and passed on to third parties, at a cost defined by the market, so that its holder can, at a cost, protect themselves from the event of a default on the assets they hold.

In simple terms, we can say that the higher the risk of default, the higher the CDS price and vice versa, so that the CDS price can also provide a measure of the credit quality of a debt issuer, just as the rating assigned by credit rating agencies does.

In the graph below, we have plotted several countries on the base date of October 3, 24, with the abscissa indicating the CDS price in points and the ordinate indicating the country's Moody's rating scale, inverted (from least risky to most risky) for analysis purposes.



In the same graph, we also plotted a simple linear regression to try to indicate a statistical relationship between the CDS level and the Moody's rating of the various countries analyzed in the sample.

In general, we can see that Brazil's CDS already anticipated to some extent the rating upgrade recently promoted by Moody's, as the CDS x Moody's rating ratio for Brazil is very close to the value recommended by the linear regression (dashed red line).

In fact, there are many other countries in the chart whose rating does not correspond to the CDS value and the other way around, making the case of Brazil quite trivial in this sample.

Therefore, we can say that the market, in a way, also recognized some improvement in the country's economic indicators, despite the fact that these indicators are not translating into a reduction in indebtedness.

However, we must recognize that if we don't have a final answer that translates into control over the upward trajectory in public debt, we could still have problems rolling over the debt if the market becomes more hostile.

In the short term, with the United States and Europe reaffirming their interest rate reduction campaigns, the country's credit rating upgrade is great news.

PERFORMANCE OF THE MAIN FINANCIAL INDICES:

Renda Fixa		30/09/24	MTD	3M	YTD
CDI	-	83,72	0,83%	2,51%	7,99%
IMA-B	-	9.988,18	(0,67%)	1,76%	0,82%
IMA-B 5	-	9.452,81	0,40%	1,93%	5,30%
IMA-B 5+	-	11.301,11	(1,42%)	2,19%	(2,62%)
IRF-M	-	18.642,98	0,34%	2,05%	3,90%
IMA-S	-	6.914,14	0,87%	2,60%	8,20%
Índices Globais	**País**	**30/09/24**	**MTD**	**3M**	**YTD**
Ibovespa	BRL	131.816,44	(3,08%)	4,90%	(1,77%)
Dow Jones	USD	42.330,15	1,85%	7,69%	12,31%
S&P 500	USD	5.762,48	2,02%	4,07%	20,81%
NASDAQ	USD	20.060,69	2,48%	(0,62%)	19,22%
Euro Stoxx 50	EUR	5.000,45	0,86%	0,70%	10,59%
FTSE 100	GBP	8.236,95	(1,67%)	0,81%	6,51%
MSCI Emerging	World	45,86	5,74%	5,55%	14,84%
MSCI World	EM	3.723,03	1,69%	4,51%	17,48%
Moedas	**País**	**30/09/24**	**MTD**	**3M**	**YTD**
Dólar/Real	USD	5,45	2,80%	1,86%	(12,20%)
Euro	EUR	1,11	0,79%	3,24%	0,87%
Franco Suíço	CHF	0,85	0,47%	6,61%	(0,50%)
Libra Esterlina	GBP	1,34	1,89%	4,97%	5,06%
Bitcoin	BTC	63.785,09	8,03%	7,12%	52,10%
Hedge Funds	**País**	**30/09/24**	**MTD**	**3M**	**YTD**
Ind. de Hedge Funds	BRL	5.201,41	1,08%	3,10%	3,62%

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Autorregulação ANBIMA
Gestão de Recursos

Autorregulação ANBIMA
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