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MIRABAUD

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MIRABAUD WEALTH MANAGEMENT

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INTERNATIONAL

SO LONG, FAREWELL, AUF WIEDERSEHEN, ADIEU

I recently heard some people claiming that paradise is to live in Europe and invest in the US. Seldom has this been as evident as in 2024.

Indeed, with markets in Europe barely positive in USD this year, a dismal Euro and the current struggles of the German and French governments, it has never seemed more relevant for investors to shun European markets in favor of the US.

Whilst Summer holidays are preferably spent in the Alps, Mykonos, Sardinia or teeing off on a golf course in the Algarve, you will tend to avoid investing in companies headquartered on the continent.

Last month we praised Switzerland so to avoid any confusion and, as the Swiss love to remind everyone, Switzerland is in Europe, but it is not part of the European Union.

Take a list of the top twenty companies in the world by market cap and you will see that not one of them is European.

The first European company appears in 21st place (Novo Nordisk from the non-Eurozone Denmark, thanks to its obesity drug Ozempic which has the US as its largest sales market).

The Eurozone company with the largest market cap is the Dutch semiconductor company ASML and currently ranks as the 28th largest member of the MSCI World index.

Take a list of the top ten banks in the world and yet again, no European on the list.

« IT IS DIFFICULT TO IMAGINE THAT THIS GAP WILL BE CLOSED WITHOUT SIGNIFICANT CHANGES IN THE EUROPEAN MINDSET AT THE GOVERNMENT, CORPORATE AND INDIVIDUAL LEVEL.»

European politicians do not seem to have a sense of urgency to tackle some of the regulatory and bureaucratic hurdles to promote sustainable growth in the region. As a result, Europe has slowly but surely dug itself into a hole and will have a long road ahead to climb out.

Germany was once one of the industrial driving forces of the world. Yet, poor political decisions such as closing down its nuclear energy plants (the three last ones were wound down in 2023) and over-regulation across many sectors have seen the country dive into economic recession and its companies increasingly unable to compete, especially against China.

Volkswagen, for the first time ever, announced the closure of one of its German factories. To make matters worse, the start of the war in Ukraine have actually made things even more dire for its population whilst Russia has ironically outshone the rest of Europe in terms of GDP growth.

As we showed in last month's letter, Germany's economy has not grown in real terms since the end of 2019, i.e. 5 years! Germany still risks struggling with energy supply as it has closed its doors to Russian gas and has bet its future on other sources of energy that are less reliable and more expensive.

Meanwhile, on the other side of the pond, the US has seen the return of Mr. Trump with promises of lower regulation, higher tariffs, lower taxes and of course DOGE, the Department of Government Efficiency in an attempt to bring corporate efficiency to government departments and agencies. The latter is easier said than done, but at least there is a discussion on the subject.

The gap between European and US financial markets has increased further with the US Dow Jones Industrial Index up over 21% year to date and the Euro Stoxx50 up by a mere 4.8% in USD. We use the Dow Jones in this example as it is less tech-heavy and has a closer resemblance to the European index.

For US Dollar based investors, the Dow Jones has outperformed the Euro Stoxx 50 by an annualized 4% in the past five years and by 6.4% per annum in the past ten years. The annual outperformance compounds over time. The total return including dividends for the past ten years is 75% for the Euro Stoxx 50 and 215% for the Dow Jones. In this period, the Nasdaq has returned 344% and the S&P 500 is up by 250%.

It is difficult to imagine that this gap will be closed without significant changes in the European mindset at the government, corporate and individual level.

In short, Europe has consolidated itself as tourist destination for those looking to admire the Old Continent. But not all countries in Europe will benefit from this tourism boom. If anything, Germany will most certainly miss out on the inflow of tourists looking for good wine, sandy beaches and spaghetti alle vongole. In essence, we prefer to be exposed to US assets while searching for competitive European assets.

Market Review November

We had expected a Republican sweep in the US and this is indeed what happened. We increased our exposure to mid-cap US stocks and reduced exposure to EUR in our USD accounts. Furthermore, we also reduced 7 to 10 years USD denominated bonds, taking profits on our longer-dated bond positions.

We believe the US will continue to be the country with the best innovating companies and the best risk reward for equities and fixed income even with equity valuations at very high levels.

We maintain our overweight position in gold as we expect central bank purchases to continue.

Below you can see the main markets' performances in November (the table speaks for itself as a picture is worth a thousand words). The US performed very well and even gold lost a bit of its luster in November although it is rising almost 30% versus the US Dollar and over 33% versus the Euro in 2024.

PERFORMANCE OF THE MAIN FINANCIAL INDICES:

	Nov.	Nov.$	2024	2024 $	2023	2023 $	2022	2022 $	2021	2021 $
S&P 500	5.87		28.1		26.3		-18.1		28.7	28.7
Stoxx 50	-0.32	-3.02	9.8	4.8	23.2	27.3	-8.5	-14.0	24.1	24.1
MSCI EM	-3.58		8.1		10.1		-19.9		-2.3	-2.3
SMI	-0.24	-2.03	9.1	3.9	7.1	17.6	-14.3	-15.0	23.7	19.5
Euro - USD	-2.82		-4.2		3.1		-5.8		-6.9	
US Dollar Index	1.69		4.3		-2.1		8.2		6.4	
Gold Spot - USD	-3.67		28.1		13.1		-0.3		-3.6	
CHF - USD	-1.92		-4.5		9.9		-1.3		-3.0	
Global Aggregate	0.34		0.5		5.7		-16.2		-4.7	
US Aggregate	1.06		2.9		5.5		-13.0		-1.5	
US Treasury	0.78		2.2		4.1		-12.5		-2.3	
US T Bills	0.39		4.9		5.1		1.3		0.0	
Global High Yield	0.82		9.8		14.0		-12.7		1.0	
Euro Aggregate	1.96		3.7		7.2		-17.2		-2.9	

Eric Hatisuka
CIO Mirabaud Brazil

BRAZIL

"BRAZIL NEVER MISSES AN OPPORTUNITY TO MISS AN OPPORTUNITY"

The phrase above, by the liberal economist and scathing essayist, minister, diplomat and federal deputy, Roberto Campos (1917-2001), has once again proved to be an unfortunate truth. In a year in which the economies and markets of most countries, including emerging ones, are experiencing a positive and even euphoric moment, as in the case of the United States, whose main stock exchange is up just over 28 per cent for the year (November close), we find ourselves, here in Brazil, debating issues that have been over for more than a century in the rest of the world, notably whether or not excessive public indebtedness can cause a country's economic ruin (spoiler: yes, it can).

The Brazilian economy is coming off three years of expressive results in terms of growth, as a result of the anti-cyclical fiscal policy implemented since the pandemic, but which has also come at a high cost in terms of an increase in the public deficit. So, it's only fair that, with GDP rising and unemployment falling, we should expect a return to the fiscal balance, even more so when all the countries in the world acknowledge that they also need to recover this agenda for the sake of public debt stability.

The unemployment rate, for example, has reached the all-time low: just over 6% of the economically active population is not finding formal work. This suggests that the Brazilian economy is strong enough to withstand any reduction in public spending without significant losses in social welfare. However, the opposite is also true: with the economy hot and running at full employment, the government's refusal to take its foot off the fiscal accelerator should bring back the old ghosts of infrastructure bottlenecks, labour shortages and low productivity. And all of this, of course, results in higher inflation.

It was against this backdrop that, on November 27th, the government announced its long -awaited fiscal adjustment plan, with a view to maintaining the fiscal framework and getting the public debt back on an even keel.

However, contrary to expectations, the package of spending cuts was accompanied by a measure to waive revenue: the increase in the ceiling for exemption from personal income tax from R$2,824 to R$5,000 per month.

As a result, the tax waiver is now expected to reach between R$ 35 and R$ 45 billion under this heading, an amount that will be financed by, in the government's own words, a 10-percentage point increase in income tax for individuals earning more than R$50,000 a month.

On the other hand, the package itself, which is expected to cut R$70 billion in spending, mixes unquantifiable points of a "comb-over of social programmes and Bolsa Família" with points that are likely to cause tension in Congress, such as the reduction or cancellation of parliamentary amendments and tax exemptions defined by Congress for specific sectors.

The problem is that these measures, because they are very specific in nature, are fragile and have great potential to be denatured during the legislative process, while revenue waiver measures, because they are popular (and populist), always prosper more easily.

However, in fairness, there was one important structural proposal, the restriction on the automatic adjustment of the minimum wage based on inflation in the previous year and GDP two years ago, a rule that had already been abolished under the Temer government, but which was revived at the start of the current administration. In the new rule, which has yet to be approved, the adjustment will always be limited to the limit on the growth of spending in the Fiscal Framework.

In any case, what could have been just another frustrating communiqué from the government took on the shape of a crisis in the markets, since the agents' interpretation was that the measures to cut spending tend to be desiccated, while the tax waiver measures should be approved.

« IF THE GOVERNMENT DOESN'T REARRANGE ITS DISCOURSE (..), WE'RE IN FOR TWO VERY DIFFICULT YEARS, WHICH MAY WELL RESULT IN AN ECONOMIC AND FINANCIAL CRISIS.»

In other words, the spending cut package has within it the potential to eventually not cut any spending at all.

The financial market, anticipating the disastrous consequences of the more than well-known (and admittedly failed) economic prescription of the Latin American left, desperately rushed to buy the dollar, causing it to break through the psychological barrier of R$6 and consolidate at historic highs.

As for interest rates, the market has raised its expectations and now expects the Selic to reach 15 per cent p.a. in the medium term, also betting that Copom will have to speed up the pace to 75 basis points (or up to 1 percentage point) from the next meeting.

Real interest rates expressed in NTN-Bs, government bonds indexed to the IPCA, have also risen, consolidating above the level of 7 per cent a year, an extremely high level that should impose a severe increase in the economy's cost of capital.

In overheated economies, inflation rises and feeds back through the infamous price-wage spiral, weakening the purchasing power of the currency and causing it to devalue against the dollar (and other strong currencies), forcing the Central Bank to raise interest rates and keep them high for a while, affecting the economy through the liquidity and credit channels and, ultimately, promoting a recession so that inflation returns to target.

Brazil is currently experiencing a good moment, with GDP growth and low unemployment, but this was caused by the economic policy pursued between 9 and 12 months ago. On the other hand, the shock to the exchange rate and prices of imported goods, as well as the sharp rise in interest rates seen in the last six months due to the fiscal risk arising from the government's lenient stance, will still affect the economy in a few months' time, weighing on economic activity, employment and inflation, hurting the poorest the most, precisely those whom the government would like to help the most.

Roberto Campos also said that "the government can give nothing to the individual that it has not first taken from him". If, as an economist, he was little heard in Brazil, his phrases, on the other hand, live on and hit us like sharp arrows of fine and shrewd irony.

Crisis Mode: On

The events surrounding the announcement of the government's new fiscal package in the last week of November cannot go unnoticed. Nor can their impact on the market, especially the rise in the dollar and interest rates.

For electoral reasons, the government is deliberately choosing a risky path in which it creates significant difficulties for the package's passage through Congress and its full implementation, casting doubt on its real commitment to stabilising Brazil's public debt.

When the government chose, at the start of the new administration, to make a first year heavily in deficit, as 2023 was, it also restricted its margin of action for the following years, leading the subject of 'fiscal balance' to dominate the political-economic agenda for absolutely the whole of 2024.

With Donald Trump's re-election in the US and the 2026 election race beginning to emerge on the Brazilian political calendar, the margin for error is quickly running out. If the government doesn't rearrange its discourse (and its course) and make an unequivocal commitment to fiscal balance, we're in for two very difficult years, which may well result in an economic and financial crisis.

Faced with this gloomy scenario, we are forced to revise our scenario-anticipation and decision-making models to incorporate the growing risks that the government will lose control of the process of shaping economic agents' expectations and spend the second half of its term in open confrontation with the financial market.

With the imminent increase in the risk of shocks from the now unanchored exchange rate and already very high interest rates, as well as the risk of rising inflation and the likelihood of recession in the near future, we are forced to adopt a more defensive approach to investment management, with a view to managing risk and protecting capital first and foremost.

We are reviewing our allocations to reduce market risk assets, mainly multimarket and variable income, but also credit assets whose premium does not compensate for the risk incurred. The scenario that is now emerging recommends investing only in assets with sovereign risk, indexed to the CDI or IPCA, always with a short maturity.

As Brazilians, we are no strangers to rough economic seas and financial storms, and what we have learnt over the years is that a sensible and cautious approach always pays off.

PERFORMANCE OF THE MAIN FINANCIAL INDICES:

Renda Fixa		29/11/24	MTD	3M	YTD
CDI	-	85,17	0,79%	2,53%	9,85%
IMA-B	-	9.925,44	0,02%	(1,14%)	0,19%
IMA-B 5	-	9.556,60	0,36%	1,45%	6,46%
IMA-B 5+	-	11.088,49	(0,23%)	(2,99%)	(4,45%)
IRF-M	-	18.584,47	(0,52%)	0,07%	3,57%
IMA-S	-	7.039,94	0,83%	2,66%	10,16%
Índices Globais	**País**	**29/11/24**	**MTD**	**3M**	**YTD**
Ibovespa	BRL	125.667,83	(3,12%)	(6,85%)	(6,35%)
Dow Jones	USD	44.910,65	7,54%	8,05%	19,16%
S&P 500	USD	6.032,38	5,73%	6,80%	26,47%
NASDAQ	USD	20.930,37	5,23%	6,93%	24,39%
Euro Stoxx 50	EUR	4.804,40	(0,48%)	(3,39%)	6,26%
FTSE 100	GBP	8.287,30	2,18%	(0,92%)	7,16%
MSCI Emerging	EM	43,26	(2,68%)	(0,25%)	8,33%
MSCI World	World	3.810,14	4,47%	4,12%	20,22%
Moedas	**País**	**29/11/24**	**MTD**	**3M**	**YTD**
Dólar/Real	USD	5,97	(3,17%)	(6,29%)	(22,94%)
Euro	EUR	1,06	(2,82%)	(4,47%)	(4,19%)
Franco Suíço	CHF	0,88	(1,92%)	(3,33%)	(4,49%)
Libra Esterlina	GBP	1,27	(1,27%)	(3,13%)	0,03%
Bitcoin	BTC	97.460,39	39,35%	65,18%	132,41%
Hedge Funds	**País**	**29/11/24**	**MTD**	**3M**	**YTD**
Ind. de Hedge Funds	BRL	5.289,63	1,40%	2,73%	5,38%

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Autorregulação ANBIMA Gestão de Recursos

Autorregulação ANBIMA Gestão de Patrimônio