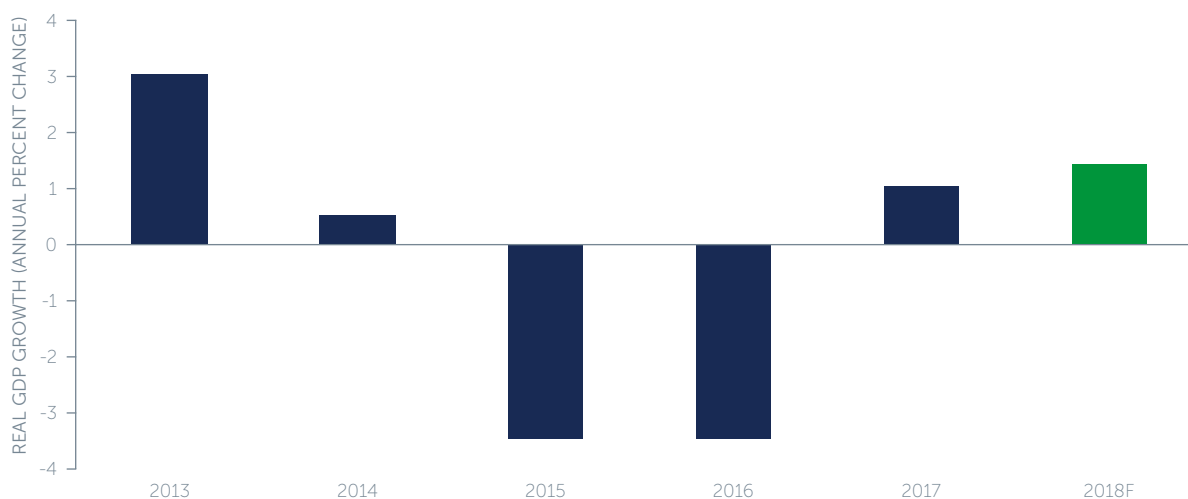


## BRAZIL: A NEW FRONTIER?

Jair Bolsonaro's election as Brazil's president in October 2018 was momentous: this was the first time since the establishment of the country's 1988 constitution that a clear right-leaning mandate had won a national vote. Many market commentators have recognized that his appointment has the potential for positive economic transformation, however, we expect President Bolsonaro and his team to face some challenges in attempting to achieve their goals.

Brazil has experienced one of the most severe recessions in its history with three years of uninterrupted economic decline. While the economy has been able to register a moderate recovery, this remains well below expectations, with unemployment remaining in excess of 10% and the recovery to date has been narrow in nature, with the country's agribusiness the key contributor. Corruption has also featured predominantly in recent years with the "Lava Jato" (translated as car wash) bribery scandal which embroiled successive governments under the leftist Workers' party, or PT, whose founder and former president Luiz Inácio Lula da Silva was jailed for corruption earlier in 2018.

GDP GROWTH IN BRAZIL IS STARTING TO RECOVER FROM A DEEP RECESSION (%)

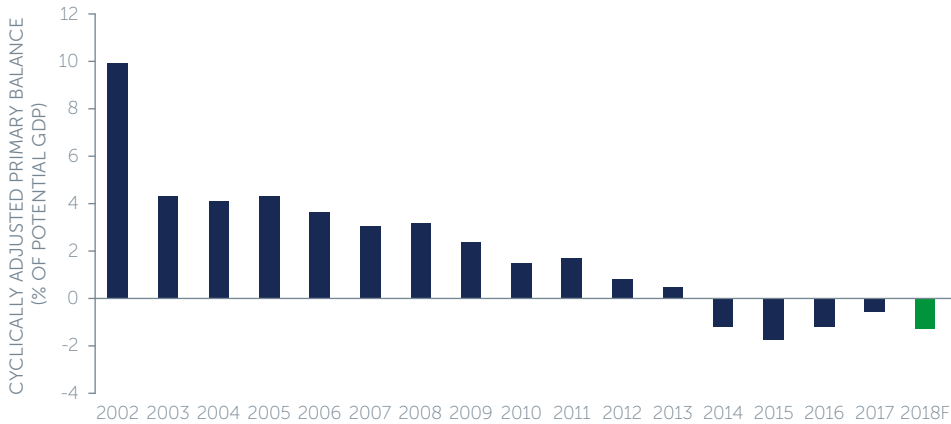


SOURCE: IMF. AS OF OCTOBER 31, 2018.

Cabinet nominations so far have showed promise with notable selections for the Ministries of Finance (Paulo Guedes) and Justice (Sergio Moro). Guedes, a University of Chicago PhD economist, takes inspiration from the reforms instigated in Chile during the 1980s, pledging to reduce Brazil's legacy of overbearing bureaucracy while ushering a more American style of capitalism to South America's largest economy. Moro is a prevalent and well respected judge who has led the "Lava Jato" investigations, placing former president Lula in jail for corruption. We believe his appointment is intended to send a clear message that this administration wants to rebuild trust with voters.

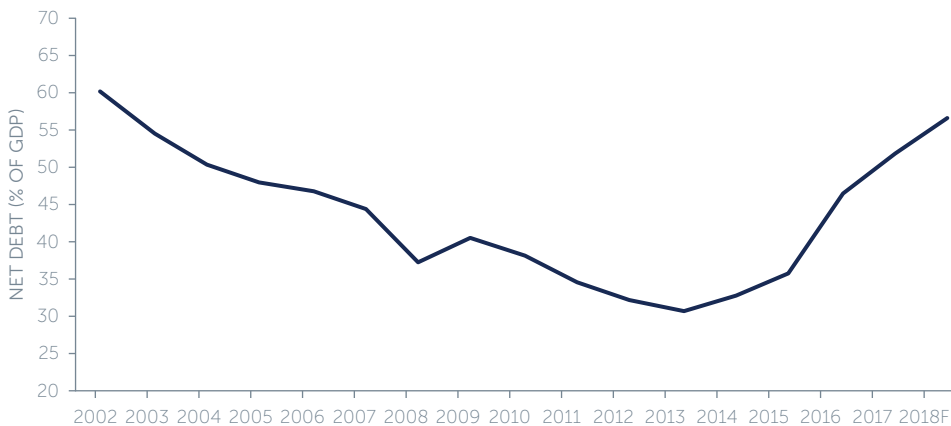
The most immediate task for the administration is successfully addressing the economy, with the country's sizeable fiscal deficit standing at 7% of GDP. The economic recession, together with ill-managed policies from the previous administrations, allowed the primary surplus to sink into a deficit in 2014. Given such high level of spending, net debt as a percentage of GDP has almost doubled from 30% in 2014 to 54% in 2018.

BRAZIL SUNK INTO A PRIMARY DEFICIT IN 2014 AS TAX RECEIPTS DIDN'T MATCH SPENDING



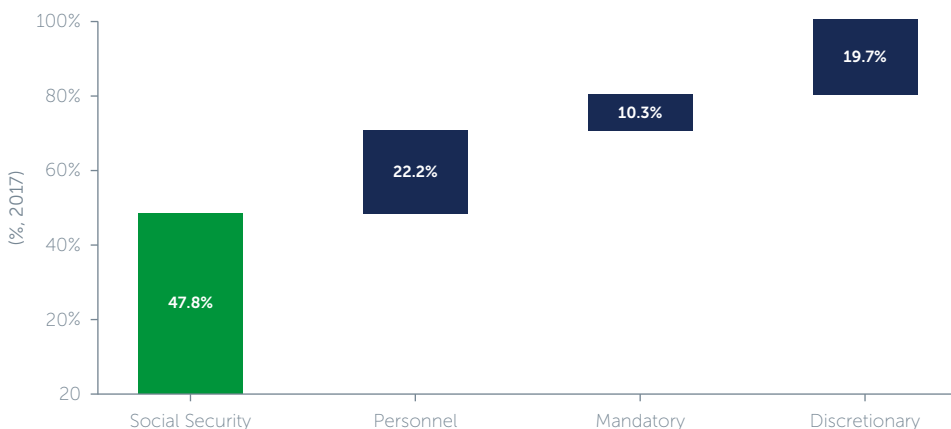
SOURCE: IMF. AS OF OCTOBER 31, 2018.

BRAZIL'S NET DEBT AS A PERCENTAGE OF GDP HAS SURGED ABOVE 50%



SOURCE: IMF. AS OF OCTOBER 31, 2018.

MOST OF BRAZIL'S PRIMARY EXPENDITURES COME FROM SOCIAL SECURITY SPENDING

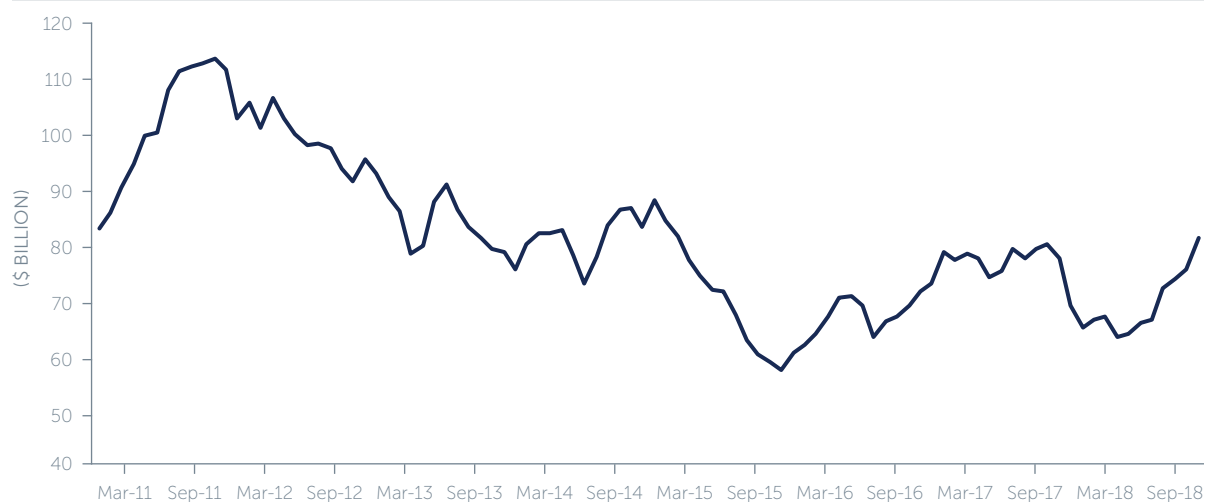


SOURCE: BRAZILIAN MINISTRY OF FINANCE. AS OF DECEMBER 31, 2017.

Reform of the country's pension system remains a central issue, with the system allowing many people to retire in their mid-50s, especially career public servants. Social security and continuous cash benefit programs currently represent nearly 50% of all primary expenditures and are expected to continue growing. Outgoing President Temer had attempted to pass pension reform, however, as with other previous attempts, he was unsuccessful in getting Congressional approval. Speculation that President Bolsonaro may succeed where others have failed takes hold from the view that he was voted into government under a reformist mandate. It is also expected that Bolsonaro will attempt to pass these reforms in his first year of government when success rates for reforms are by far the highest, and his congressional representation is at its most robust.

If reforms are enacted, these positive changes could revert a current trend of decreasing foreign direct investment (FDI) in to the country, in our view. This in turn, could be the catalyst needed to reignite economic growth and revive capital markets that are poised to grow following a period of stagnation. The recession has had some positive effects, however, with companies adapting their business models to be increasingly efficient and cost effective, while deleveraging balance sheets to be able to navigate through the cycle. This has enabled many companies to be well positioned for growth from increasing consumer demand, while benefiting from margin expansion from their leaner operations.

## FOREIGN DIRECT INVESTMENT MAY INCREASE IF ECONOMIC REFORMS ARE IMPLEMENTED



SOURCE: CENTRAL BANK OF BRAZIL. AS OF DECEMBER 31, 2018.

The last 12 months have proven to be a challenging period in the global equity markets and we recognize the potential for this to extend into 2019 given the macro headwinds. Nevertheless, at Barings, we continue to unearth exciting opportunities in companies which exhibit unrecognised growth with well-established or improving business franchises, balance sheets and management.



### Luis Alves de Lima

#### Analyst

Luis is an Analyst in the Latin American Equity Team. Luis joined Barings from Nest Investimentos in Sao Paulo, Brazil, where he was a Partner and portfolio manager. Prior to Nest, Luis was a senior equity research analyst at Fator Administracao De Recursos and Sulamérica Investimentos where he was also a portfolio manager. He also held roles as a financial analyst for two private equity firms: Bioenergy Development Fund (BDF) and Angra Partners. He holds an MBA from the Leonard N. Stern School of Business, New York University and a Bachelors degree in Business Administration from Fundação Getulio Vargas, Brazil. Luis is fluent in Portuguese.



### Michael Simpson, CFA

#### Investment Manager

Michael is Head of Barings' Latin American Equity Team. He joined Barings in October 2011. Prior to joining Barings, Michael worked for Wells Capital Management in San Francisco where for over four years he was a senior equity analyst / associate portfolio manager with responsibility for the Latin American components of four Global Emerging Markets portfolios. He previously held analyst roles at Merrill Lynch, Seven Global Research, Lehman Brothers and Salomon Smith Barney, focusing primarily on Latin American Equities. Michael started his career at PricewaterhouseCoopers in 1998 as a Senior Associate in the Latin American Transaction Advisory Services Team. Michael has a BA in Economics and a BSc in Business Administration from Boston University and a Masters in Business Administration from the University of Texas. He was awarded the CFA designation in 2005. Michael speaks fluent Spanish.

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*\*As of September 30, 2018*

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