

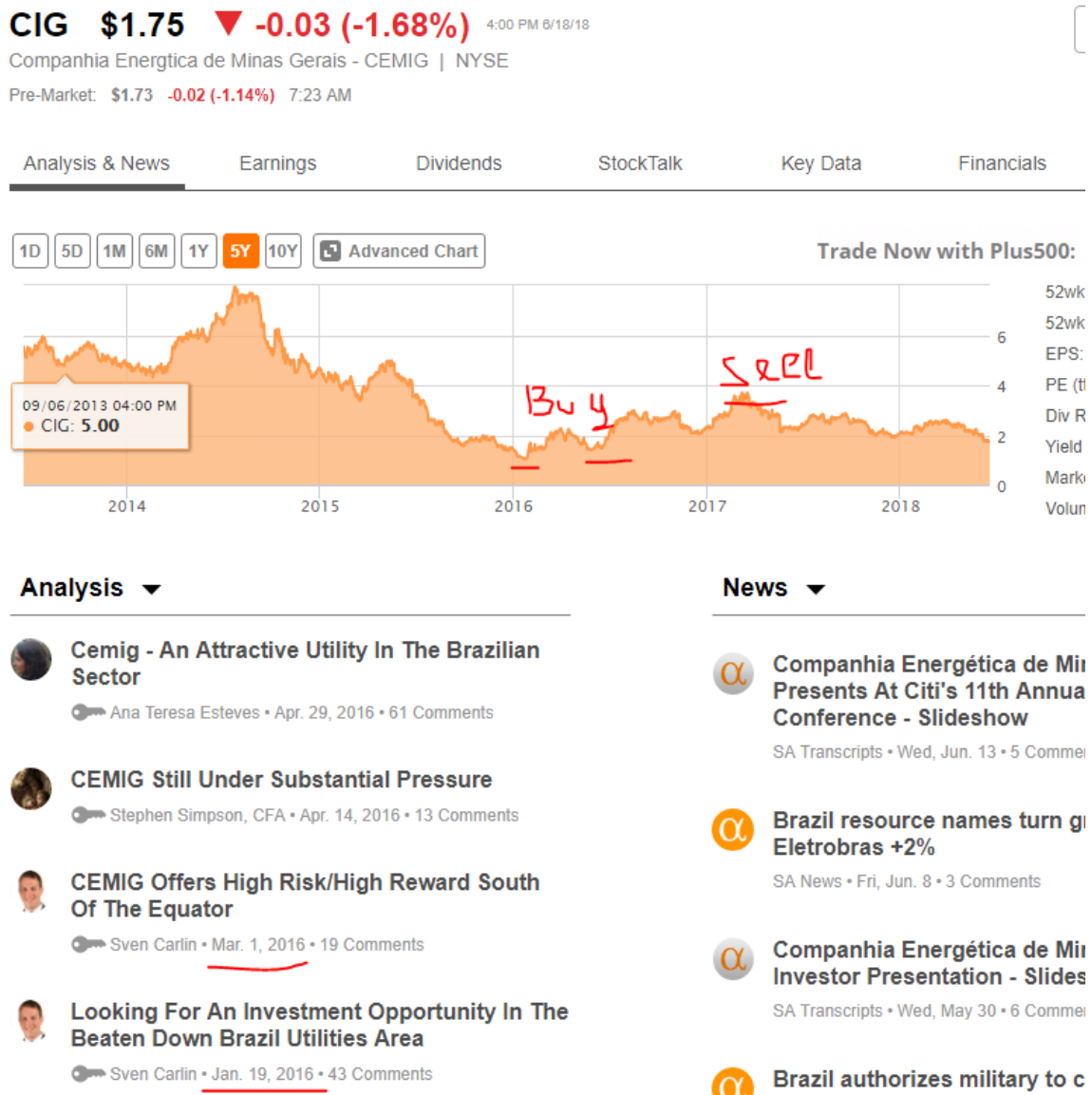
Brazil – investing environment

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I've been looking at my screens and, apart from solar stocks, another sector deep in the red has been Brazil. I made such nice returns in 2016 and 2017 from Brazilian stocks that when I see all that red, I start to smile again as opportunity knocks. I hope to share with you the strategy that produced the returns I had enjoyed. One example:

Figure 1 My articles on SA on CEMIG – “Be greedy when others are fearful.”



Source: [SA](#)

It is time to take another look at what is going on in Brazil, what the investment opportunities are and what the best investment strategy to minimize risk and maximize returns.

### Brazilian stocks – general overview

Following the FED's interest rate hikes, the first cracks started showing up in emerging markets. Countries and companies that are burdened with U.S. denominated debt, but book revenues in their weakening domestic currencies, are squeezed by the two headwinds.

Further, crucial to emerging markets is sentiment. Volatile sentiment creates extremes, presenting opportunities for contrarians. More about that later.

Take a look at how volatile the Brazilian ETF has been. It was a 15-bagger from 2002 to 2008, only to drop 70% in the final year of that bull run. There was another bull run in 2009, followed by a long

decline that ended in January, 2016. Since then the Brazilian stock market boomed again, only to drop 30% over the last six months.

Figure 2 Brazil ETF (EWZ) historical chart



Source: [iShares](#)

I don't know where the bottom of the current decline will be. The only option we have is to look at the fundamentals of possible investments and their relation to what is going on in Brazil. This leads to finding out their risk versus reward and intrinsic values. The goal is to find a good business that we can feel confident about averaging into if necessary.

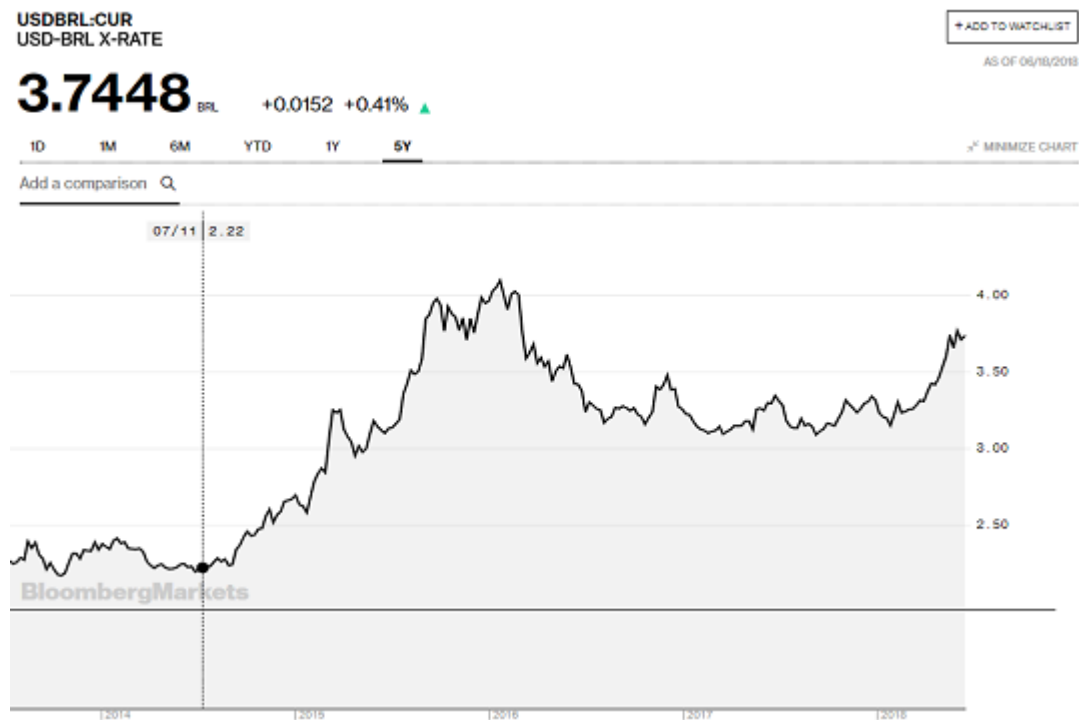
### [Brazil – economic overview](#)

There are two ways to look at an economy. One is to follow the headlines that are spreading panic or enthusiasm, depending on what appears to sell and lead to clicks. The other is to take a deep dive into key indicators and long-term trends. Let's start by discussing the news.

### [Brazil – short term view](#)

The Brazilian general elections are coming this October and the Central bank has been having [issues](#) trying to keep the Real stable.

Figure 3 BRL to USD 5-year chart



Source: [Bloomberg](#)

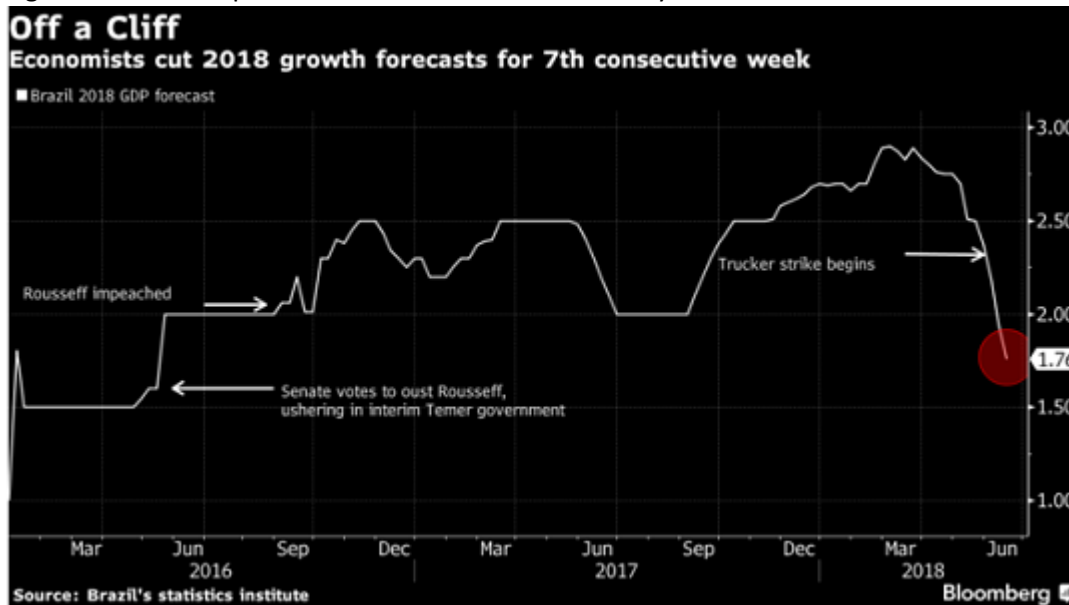
Versus the dollar, the Brazilian currency depreciated 50% from mid-2014 to January 2016, then stabilized for about two years. As it became clear that interest rates would continue to rise, the Real has lost ground again during 2018. Currency volatility has a significant impact on our investment returns and has to be watched carefully.

The Brazilian currency has been weakening due to the current emerging market sell-off that usually creates a selling spiral because nobody can see a bottom; thus the trend is self-reinforcing. Further, the weaker currency leads to lower economic expectations that, in combination with shallow financial markets, creates an extremely volatile environment. And, as we know, markets do not like volatility and uncertainty.

The Brazilian Central Bank is protecting the currency with foreign exchange swaps and has offered \$26 billion in the previous week. As always, investors wonder how long the Central Bank will be able to do that.

The above, in combination with a truckers' strike that brought to a weekly transportation stop in the whole country during May 2018, has led many economists to cut their growth expectation for the remainder of the year.

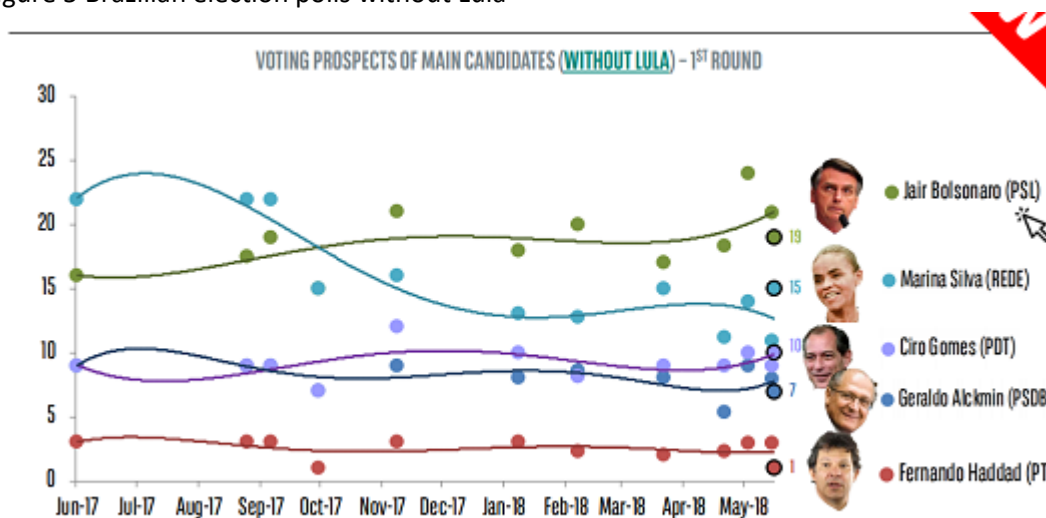
Figure 4 Growth expectations for the Brazilian economy



Source: [Bloomberg](#)

Regarding the elections, markets hate, which is exactly what we have. The leader in the polls is the jailed former president, Lula. Without him, the highest number of votes would go to a right-wing candidate. Regardless, there is no clear outcome.

Figure 5 Brazilian election polls without Lula



Source: [BNP Paribas](#)

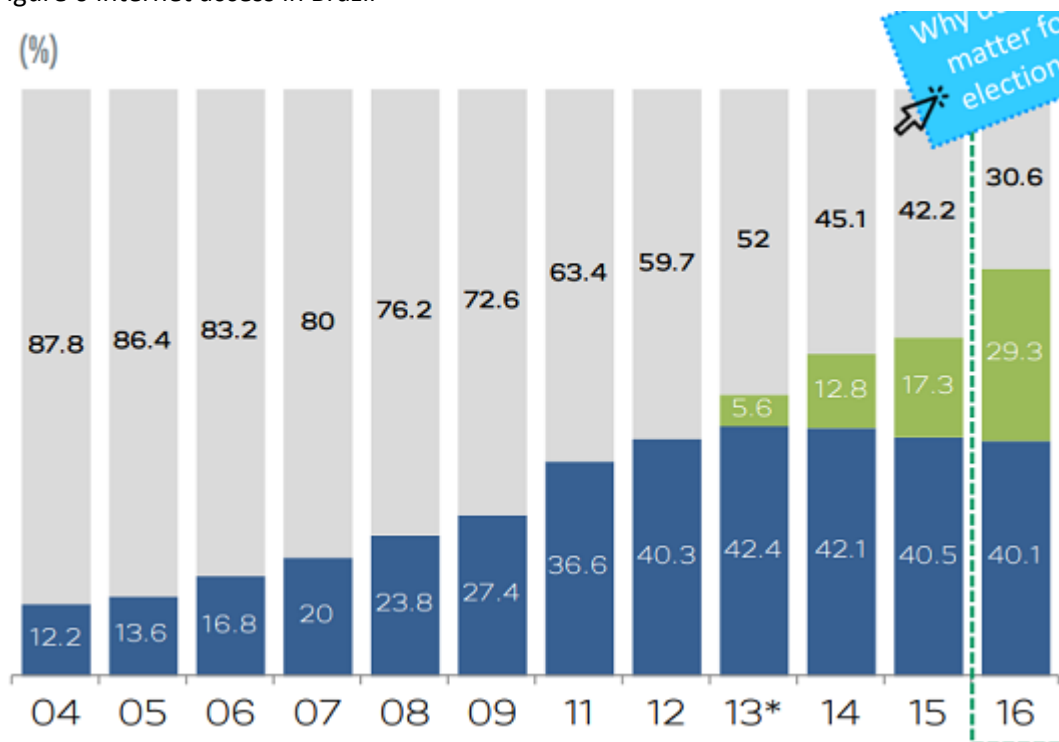
Because nobody knows what will happen, I like to make my investment analyses as if the worst will happen. This means that economic growth stagnates (perhaps to the point of recession), the currency loses another 25% of its value and then next political leader is from a business-unfriendly party. If I find a stock that would still deliver a nice business return, perhaps even a dividend, in such an environment, then I have a strong buy. Before digging into stock analyses, let's evaluate the long term economic perspective.

## Long term economic view on Brazil

It is very easy to lose sight of what is important when there is so much news about things that don't matter. The important thing is that life in emerging markets goes on no matter what, gets better year by year and people continue to live as always (except for Venezuela). Plus, people in emerging markets are much more used to volatility than people in developed economies. Let me show you a few charts.

Despite the Brazilian stock market still being 65% below its 2008 peak, things have improved there during the last 10 years. For example, households' internet access went from 23% to 70% and is still increasing.

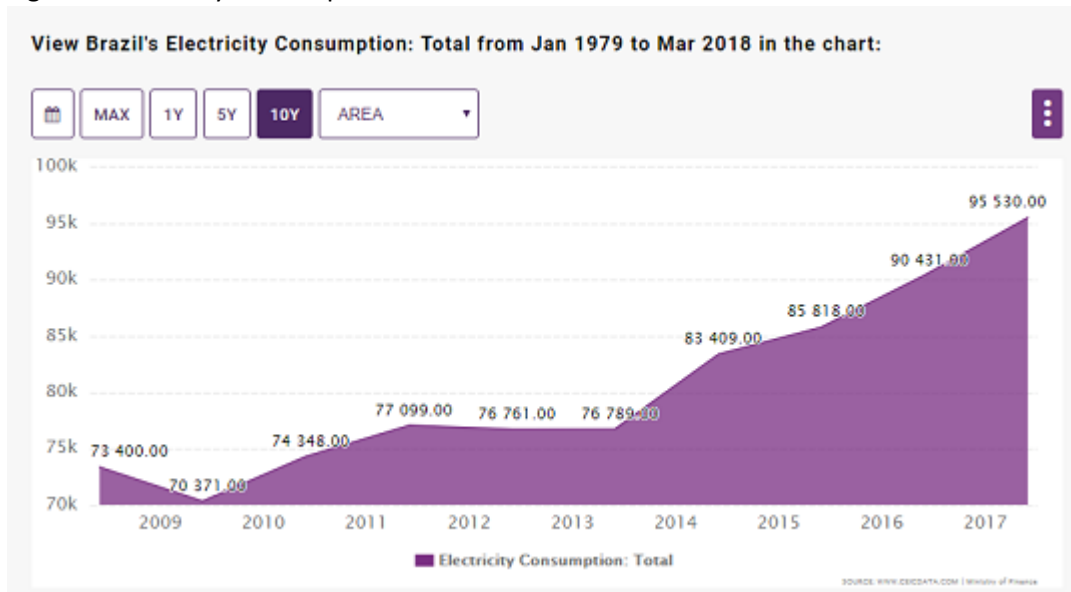
Figure 6 internet access in Brazil



Source: [BNP Paribas](#)

An indicator I like even more is energy consumption. It shows how the real economy is developing independent of the temporary economic swings and market sentiment.

Figure 7 Electricity consumption in Brazil



Source: [CEIC](#)

Let's evaluate investing opportunities while keeping in mind the volatility and possibility of extreme negative sentiment that can hit such markets.

### Investment opportunities

The Brazil ETF (EWZ) already has better than average fundamentals, but it is important evaluate its holdings.

Figure 8 Brazil ETF fundamentals

### Portfolio Characteristics

P/E Ratio ⓘ as of Jun 15, 2018	14.18	P/B Ratio ⓘ as of Jun 15, 2018	1.56
Equity Beta (3y) ⓘ as of May 31, 2018	1.26	Standard Deviation (3y) ⓘ as of May 31, 2018	34.48%
Distribution Yield ⓘ as of May 31, 2018	0.23%	12m Trailing Yield ⓘ as of May 31, 2018	1.93%
30 Day SEC Yield ⓘ as of May 31, 2018	2.30%		

*This information must be preceded or accompanied by a current prospectus. For standardized performance, please see the Performance section above.*

Source: [iShares](#)

The stocks are divided into those directly traded on the NYSE or NASDAQ and on OTCPK.

Figure 9 Brazilian stocks traded directly on American Exchanges

				PE	PB	Comment
1	AMBEV S.A	ABEV	NYSE	Beverages	34.32	5.99 GOOD COMPANY - EXPENSIVE COMPANY
2	Azul	AZUL	NYSE	Airlines	46.95	2.48 BRAZILIAN AIRLINE TO CHECK
3	Banco Bradesco	BBD	NYSE	Banks	9.82	1.49 A look at banks in general necessary
4	Banco Santander Brasil	BSBR	NYSE	Banks	26.44	2.44 A look at banks in general necessary
5	BrasilAgro	LND	NYSE	Real Estate Inv&Serv	5.89	1 Small cap to watch on volatility and value
6	Braskem	BAK	NYSE	Chemicals	10.19	4.91 Potential deal with Lyondell
7	BRF S.A.	BRFS	NYSE	Food Producers	-	1.46 Operation weak flesh - nasty meat scandal! - nevertheless check
8	Centrais Eletricas Brasileiras	EBR	NYSE	Electricity	-	0.4 Suspended privatization process - look into!
9	Comp. Paranaense de Energia-COPEL	ELP	NYSE	Electricity	5.3	0.38 Cheap again - make long term earnings model.
10	Companhia Brasileira de Distribuica	CBD	NYSE	Food &Drug Retailers	29.76	1.93 COMPARE ALL UTILITIES AGAIN WITH EARNINGS MODELS
11	Companhia Energetica de Minas Gerais-CEMIG	CIG	NYSE	Electricity	6.38	0.56 COMPARE ALL UTILITIES AGAIN WITH EARNINGS MODELS
12	Companhia Siderurgica Nacional-CSN	SID	NYSE	Indust.Metals&Mining	6.61	1.53 Volatile steel - take a look
13	Cosan Limited	CZZ	NYSE	bioethanol, sugar and energy	10.17	1.16 sugar - complex stock - check
14	CPFL Energia	CPL	NYSE	Electricity	13.81	2 COMPARE ALL UTILITIES AGAIN WITH EARNINGS MODELS
15	Embraer	ERJ	NYSE	Aerospace & Defense	27.33	1.17 Check the long term outlook and new planes
16	Estre Ambiental	ESTR	NASDAQ	Waste Management	55.41	81.49 Fresh IPO check - severely down
17	Fibra Celulose	FBR	NYSE	Forestry & Paper	25.07	2.62 Loved it below \$10
18	Gafisa	GFA	NYSE	HouseGoods&HomeConst	-	0.59 economy related, look
19	Gerdau	GGB	NYSE	Indust.Metals&Mining	23.2	1 steel
20	Gol Linhas	GOL	NYSE	Travel & Leisure	-	look when comparing airlines
21	Itau Unibanco	ITUB	NYSE	Banks	10.14	1.99 Itau Unibanco
22	Nexa Resources	NEXA	NYSE	Mining	15.38	0.77 check it out from a mining perspective
23	Netshoes	NETS	NYSE	Shoes	-	0.76 Fresh IPO check - severely down
24	Oi	OIBR	NYSE	Fixed Line Telecom.	0.08	0.09 probably wrong data on platforms
25	Petroleo Brasileiro-Petrobras	PBR	NYSE	Oil & Gas Producers	21.79	0.74 oil is not my thing - plus corruption :-)
26	SABESP	SBS	NYSE	Gas,H2O&Multiutility	6.47	0.87 utility check
27	Telefonica Brasil	VIV	NYSE	Fixed Line Telecom.	16.556	1.11 not really a telecom lover
28	TIM Participacoes	TSU	NYSE	Mobile Telecom.	22.88	1.68 not really a telecom lover
29	Ultrapar	UGP	NYSE	Gas,H2O&Multiutility	20.33	2.84 utility check
30	Vale	VALE	NYSE	Indust.Metals&Mining	14.73	1.73 not related to Brazil

Source: Compiled by author from various web sources

Check the cost of owning an OTCPK traded listing. I will also look at those for better specific sector analyses within Brazil.



Figure 10 Brazilian OTCPK investing opportunities

1	Advanced Digital Health Medicina Preventiva S.A.	ADHMY	HealthCareEquip.&S
2	AES Tiete Energia	AESTY	Electricity
3	Banco do Brasil	BDORY	Banks
4	BB Seguridade	BBSEY	Financial Services
5	Bombril-Cirio	BMBPY	HouseGoods&HomeI
6	BR Malls Participacoes	BRMSY	Real Estate Inv&Serv
7	Cielo	CIOXY	Financial Services
8	Comp. Energetica de Sao Paulo-CESP	CSQSY	Electricity
9	Comp. Paranaense de Energia-COPEL	ELPVY	Electricity
10	CR2 Empreendimentos Imobiliarios	CREIY	Real Estate Inv&Serv
11	Cyrela Brazil Realty	CYRBY	Real Estate Inv&Serv
12	Cyrela Commercial Properties	CYRLY	Real Estate Inv&Serv
13	Dommo Energia	DMMOY	Oil & Gas Producers
14	Duke Energy	DEIWy	Electricity
15	Duke Energy - Pref	DEIPY	Electricity
16	ENEVA	ENEVY	Electricity
17	Engie Brasil Energia S.A.	EGIEY	Electricity
18	Equatorial Energia	EQUEY	Electron.&ElectricEq
19	Estacio Participacoes	ECPCY	Support Services
20	Hypera	HYPMY	Food Producers
21	Iochpe-Maxion Com	IOCJY	Automobiles & Parts
22	JBS	JBSAY	Food Producers
23	JSL	JSLGY	IndustrialTransport.
24	Klabin	KLBY	General Industrials
25	Kroton Educacional S.A.	KROTY	Support Services
26	Light	LGSXY	Electricity
27	Localiza Rent A Car	LZRFY	Support Services
28	Lojas Renner	LRENY	General Retailers
29	Lupatech	LUPAQ	Industrial Engineer.
30	Marfrig Global Foods	MRRTY	Food Producers
31	Mills Estruturas e Servicos	MILTY	Construct.&Material:
32	Minerva	MRVSY	Food Producers
33	MMX Mineracao e Metalicos	MMXMY	Indust.Metals&Minir
34	MRV Engenharia	MRVNY	Real Estate Inv&Serv
35	OdontoPrev	ODPVY	HealthCareEquip.&S
36	OLEO E GAS PARTICIPACOES	OGXPY	Oil & Gas Producers
37	OSX Brasil	OSXRY	Oil & Gas Producers
38	Paulista	CTPTY	Electricity
39	PDG Realty	PDGRY	Real Estate Inv&Serv
40	Prumo Logistica	PRMLY	IndustrialTransport.
41	Qualicorp	QULRY	Nonlife Insurance
42	Raia Drogasil	RADLY	Pharma. & Biotech.
43	SLC Agricola	SLCJY	Support Services
44	Suzano Papel e Celulose	SUZBY	Forestry & Paper
45	Usiminas	USNZY	Indust.Metals&Minir
46	Usiminas	USDMY	Indust.Metals&Minir
47	Valid Solucoes e Servicos de Segura	VSSPY	Support Services
48	Via Varejo	GBXPY	General Retailers
49	Weg	WEGZY	Electron.&ElectricEq

Source: Compiled by author from various web sources

Both tables are downloadable on my [Research Platform](#).

My next step is to readjust all my earnings models for the stocks I have covered in the past and to analyze the other stocks from a risk-reward perspective. There are 79 stocks to evaluate. - If we find one, I'm happy; two would be a miracle.

### Investment strategy

The investment strategy that has worked in the past was to find companies that will continue to grow business no matter what, find their average future earnings, and invest when the business return appears satisfying. Find investments where you can continue to invest if the stock drops to average down.

You can find the detailed analyses on my selected stock picks on my [Research Platform](#).