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# Latam Strategy Bulletin

## Brazil Goes to the Polls in General Elections

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### Lula and Bolsonaro Headed for a 30-October Run-Off

- Lula and Bolsonaro are headed for a 2<sup>nd</sup> round vote on 30 October. With nearly 100% of the votes counted Lula led the results with 48.4% while Bolsonaro had 43.2% of the votes. Lula would have needed over 50% of the votes for an outright win on Sunday. A run-off led by Lula was predicted by the most recent polls -- some even suggested a 1<sup>st</sup> round victory. However, this result is somewhat of a surprise given that they were showing Bolsonaro with around 35% of voting intentions.
- The remaining 8.2% of the valid votes for president were split among the next four candidates, highlighting the degree to which this was a two-horse race.
- Brazilians also voted for 513 lower house seats and 27 senators (1/3 of the 81-member upper house). Given Brazil's complex legislative power dynamics -- a center coalition with majority control -- the results of these congressional seats deserve very close attention, if not as much as the main presidential vote as they will condition the scope of action of either presidential candidate.
- Both Lula and Bolsonaro propose to govern under their own brand of populism to fulfill their promises to voters. But they each offer very different paths and strategies to tackle social and economic challenges. Whoever wins, investors can expect at least one common denominator: government spending and fiscal stability will continue to dominate the legislative debate. The lack of full control or support from congress is also all but guaranteed.
- A risk factor to consider when the 2<sup>nd</sup> round plays out is that Bolsonaro has repeatedly suggested the election results could be rigged. The much narrower margin relative to the polls could increasingly embolden Bolsonaro to attempt to reject the results if he loses.
- Investors have benefited from the fact that this election presented little in terms of surprises, since both Lula and Bolsonaro were "known knowns" in terms of their personalities and views. Brazil's currency and equity market have outperformed (+2.86% and +1.92%, respectively, year-to-date in USD terms) every other major market in the world. Meanwhile, the economy has grown more than forecast -- despite an uber aggressive central bank hiking rates to 13.75% -- unemployment is off the highs, inflation is decelerating, and external accounts are supported by a strong export sector.
- Polls give Lula the advantage for the run-off. Investors can expect a potentially volatile October as political rhetoric is likely to remain highly polarizing and global markets deal with 3Q22 earnings in the coming weeks.

## Expect Brazil markets to continue to outperform

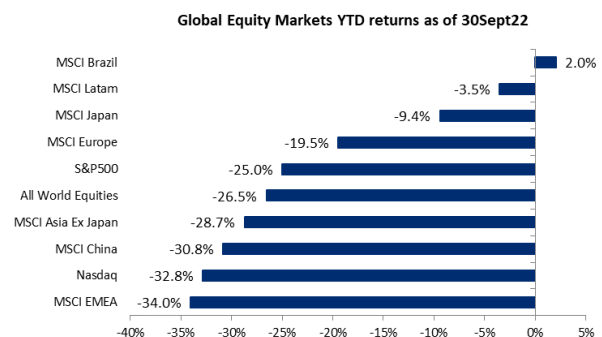
We have long taken the position that a Lula-Bolsonaro election would be a non-event for markets. However, we do recognize that there is a non-zero probability of a disruptive transfer of power if the 2<sup>nd</sup> round results favor Lula in a tight race, which we expect. Having said that, we do not believe Brazil's democratic status is at risk. Congressional results should show that the "Centrao" (ruling coalition that can align with the incumbent in exchange for resources) remains in control of both houses, limiting the power of the executive. Meanwhile, left- and right-wing coalitions are closely represented also in both upper and lower chambers.

On the economic front, positive surprises are likely to be more muted as global economic activity decelerates more sharply in 2023. Global financial conditions are tightening and commodity prices are softening, presenting headwinds for Brazil. Domestic factors could partially counter this effect. Inflation is decelerating, nominal rates are high, and the central bank is likely done tightening. Equity multiples suggest attractive valuations as earnings have recovered to 2012 levels, but prices remain 35% below pre-pandemic levels. International investors could see value in local rates, equities and selected corporate bonds. The Global Investment Committee has maintained a fully invested benchmark exposure to Brazilian equities in 2022. Investors with more tactical, opportunistic exposure could, however, consider the attractive risk-reward profile of Brazilian equities and the local bond market once the 2<sup>nd</sup> round results are confirmed and accepted.

**Figure 1: An unusual electoral "menu" did not translate into high political - or market - uncertainty**



**Figure 2: Policy orthodoxy combined with attractive valuations and lower than usual election result risk = outperformance**



Source: Bloomberg 30 September 2022. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Past performance is no guarantee of future results. Real results may vary.

**Figure 3: Calmer political expectations meant that household and corporate confidence remained high, sustaining economic activity**



**Figure 4: Household confidence has also driven demand for consumer credit**



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