Perpetually Undervalued?

Brazil presents a paradox for investors: a land of significant potential weighed down by enduring structural challenges. Core issues such as poor governance, administrative inefficiency, systemic corruption, high levels of violence, entrenched poverty, excessive bureaucracy, ineffective regulations, and persistent legal uncertainty erode both citizen trust and investor confidence. Problems are compounded by the unpredictability of judicial decisions, frequent political instability, and abrupt shifts in economic policy, all of which create a volatile operating environment that hinders sustainable growth.

The structural flaws are not merely operational but institutional. A lack of consistent commitment by Brazil's key democratic pillars—the executive, legislature, and judiciary—to uphold and reinforce a "rules-based" state exacerbates uncertainty. This undermines the credibility of the system, discourages long-term investment, and raises the risk premium investors demand to compensate for perceived instability.

For Brazil to unlock its undervalued assets and capitalize on its economic potential, a renewed focus on institutional reforms is essential. Enhancing governance, streamlining bureaucracy, improving regulatory efficacy, and fostering judicial transparency would not only stabilize the investment environment but also rebuild trust among its citizens and the global financial community. Without these foundational changes, the risks will continue to outweigh the opportunities, keeping Brazil's considerable economic promise perpetually undervalued.

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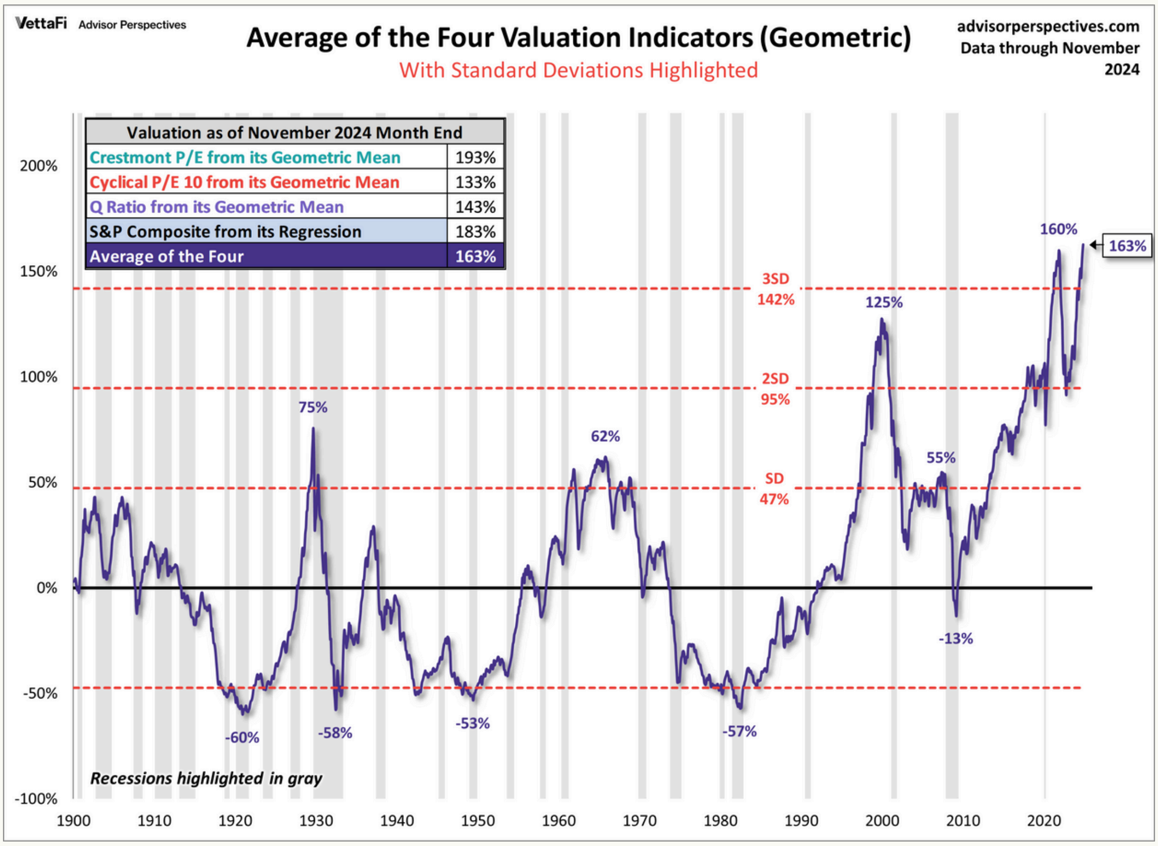
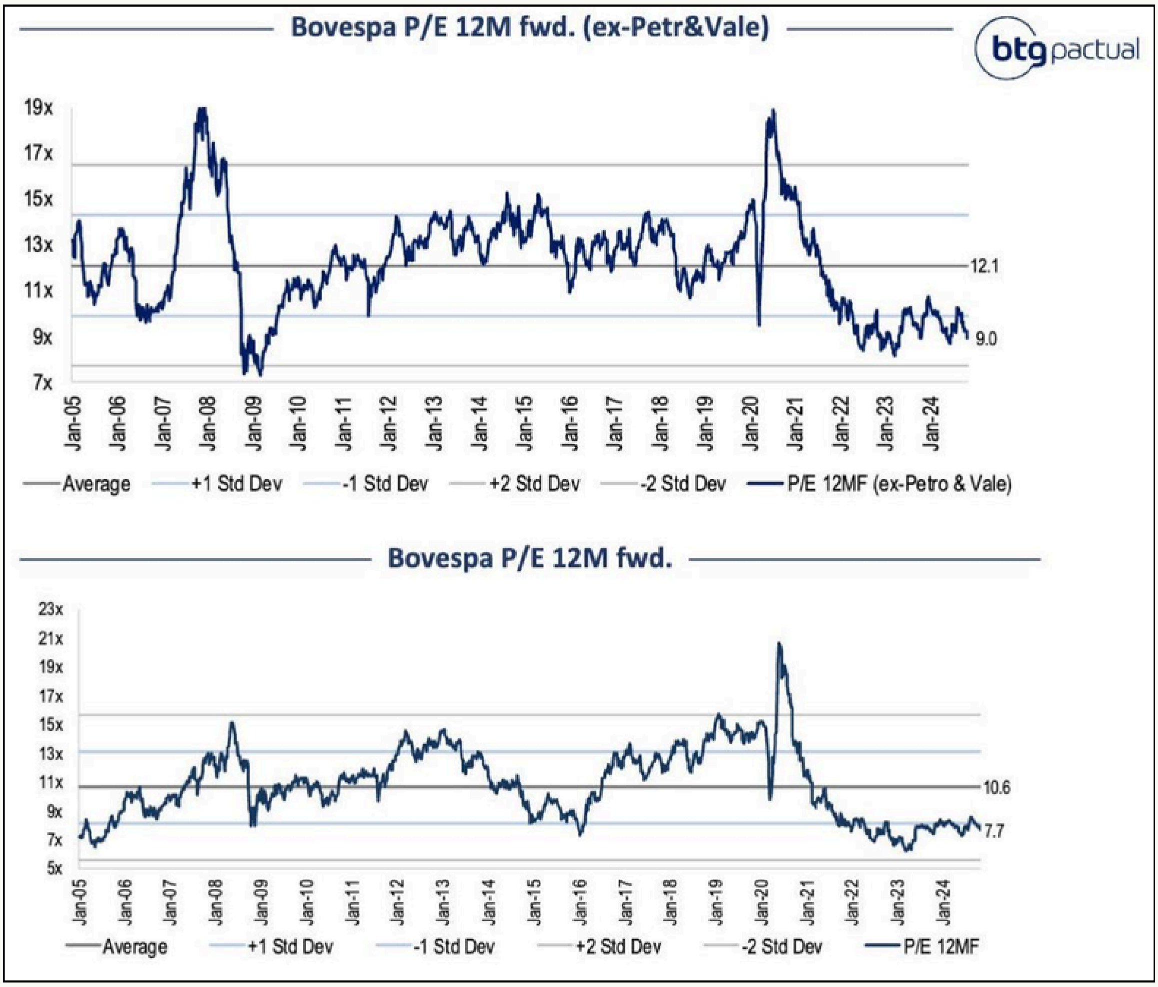
Fundamentals, Flows and Positioning

Exacerbating these challenges is the risk posed by global financial markets, particularly the U.S., where valuations, flows and sentiment are at historical extremes. The average of the four valuation indicators for the S&P Index (as measured by Advisors Perspectives) has reached 163% above its historical mean. This places U.S. valuations beyond three standard deviations above their long-term average, signaling levels of exuberance last seen during major market peaks. Historically, such stretched valuations have been followed by periods of correction to the mean. A downturn in the U.S. market is likely to reverberate globally, driving all other markets—including Brazil—lower. This potential contagion effect amplifies the risk environment for Brazilian assets, regardless of their undervaluation.



Fundamentals, Flows and Positioning

The stark contrast between U.S. valuations and those in Brazil, where the Ibovespa's forward P/E ratios are trading well below historical averages, underscores an opportunity for equity investors to rebalance portfolios. With the U.S. market showing signs of exuberance, the risk-reward dynamics increasingly favor markets with valuation discounts, provided macroeconomic stability can be achieved.

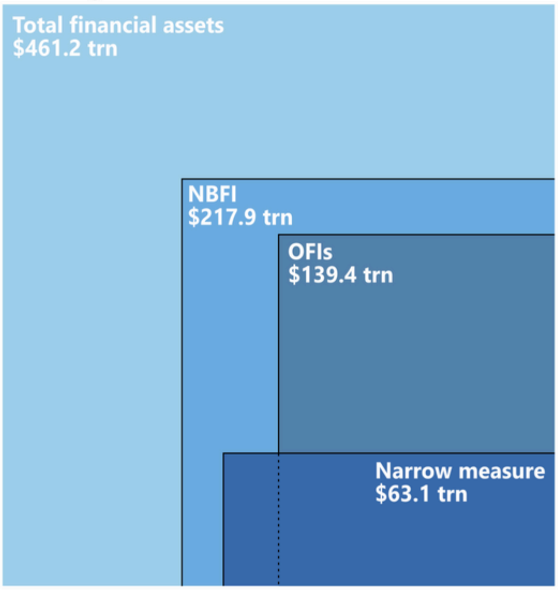


CONSULTORIA DE INVESTIMENTOS
Emanuel Pontes Pinto Jr

Money Flow

At the end of 2022, global financial assets totaled $461.2 trillion, significantly outpacing World GDP ($150 trillion). This disparity highlights the financial markets' outsized scale compared to the global economy. Within this context, emerging markets excluding China saw cumulative net inflows of $21 billion since 2019, indicating a selective appetite for investment in these regions. Brazil, however, experienced a net outflow of $1 billion over the same period, underscoring a divergence in regional investor preferences and potentially reflecting concerns over its macroeconomic environment, political stability, or structural challenges.

Narrowing down to the narrow measure[1]



Monitoring aggregates

The following monitoring aggregates are referenced throughout this report:

(i) The **NBFI** sector is a broad measure of all non-bank financial entities, composed of all financial institutions that are not central banks, banks, or public financial institutions.

(ii) **Other financial intermediaries (OFIs)** are a subset of the NBFI sector, composed of all financial institutions that are not central banks, banks, public financial institutions, insurance corporations (ICs), pension funds (PFs), or financial auxiliaries. OFIs include money market funds (MMFs), hedge funds (HFs), other investment funds (OIFs), captive financial institutions and money lenders, central counterparties (CCPs), broker-dealers (BDs), finance companies (FinCos), trust companies (TCs), and structured finance vehicles (SFVs).

(iii) The **narrow measure of NBFI** is composed of NBFI entities that authorities have assessed as being involved in credit intermediation activities that may pose bank-like financial stability risks (i.e. credit intermediation that involves maturity/liquidity transformation, leverage or imperfect credit risk transfer) and/or regulatory arbitrage, according to the methodology and classification guidance used in the FSB's annual NBFI monitoring exercise.

[1] Total financial assets, NBFI and OFIs include participating jurisdictions and all of the euro area countries, whereas the narrow measure includes only participating jurisdictions. The semi-dashed area in the LHS graph showing the narrow measure represents assets that were not from OFIs and that correspond to ICs included in EF4 and to other financial auxiliaries unallocated to the five economic functions. This graph does not include data for Russia.

Source: Jurisdictions' 2023 submissions (national sector balance sheet and other data); FSB calculations.

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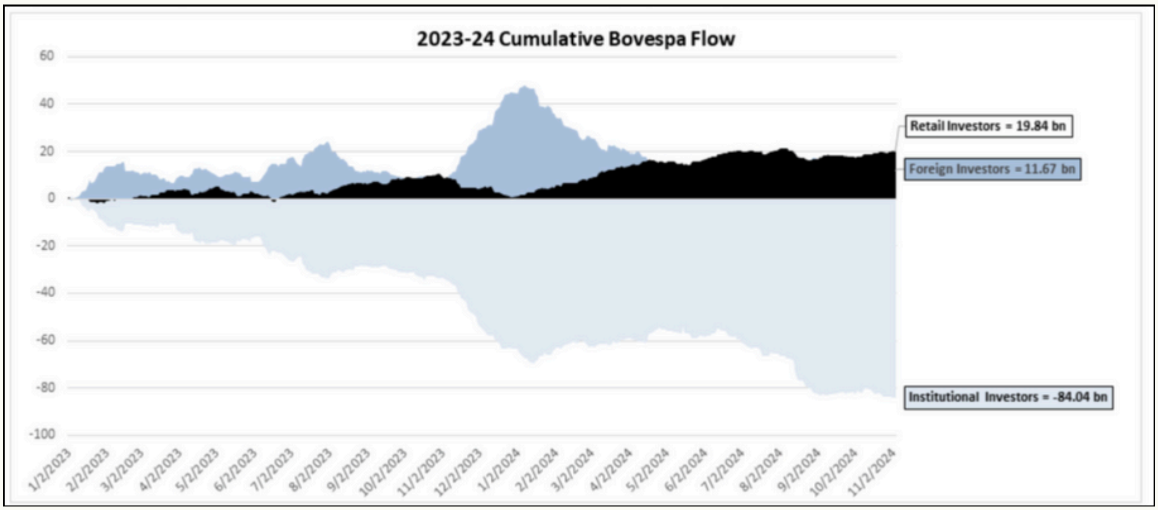
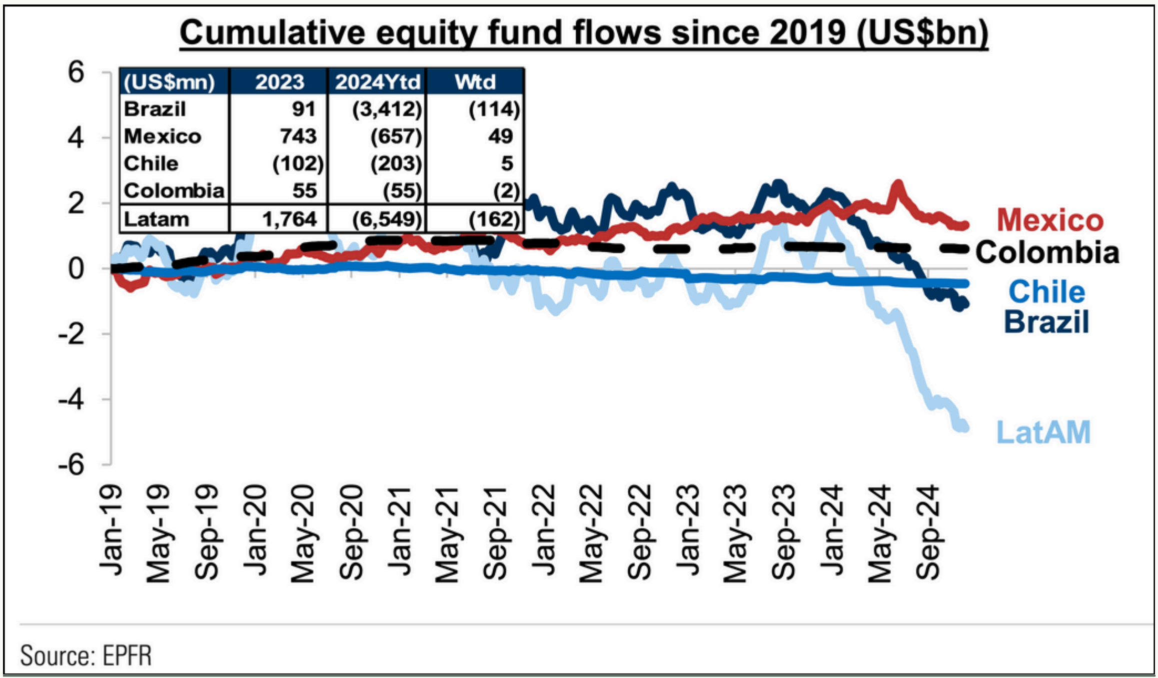
Money Flow

The broader trend of outflows from LatAm reflects a regional challenge but highlights that Brazil's issues may extend beyond regional trends to local, structural factors.The money flow data for Brazil's Bovespa market in 2023-2024 reflects significant divergence in behavior among different categories of investors. Institutional investors have been the largest net sellers.



Goldman Sachs



(US$mn)	2023	2024Ytd	Wtd
Brazil	91	(3,412)	(114)
Mexico	743	(657)	49
Chile	(102)	(203)	5
Colombia	55	(55)	(2)
Latam	1,764	(6,549)	(162)

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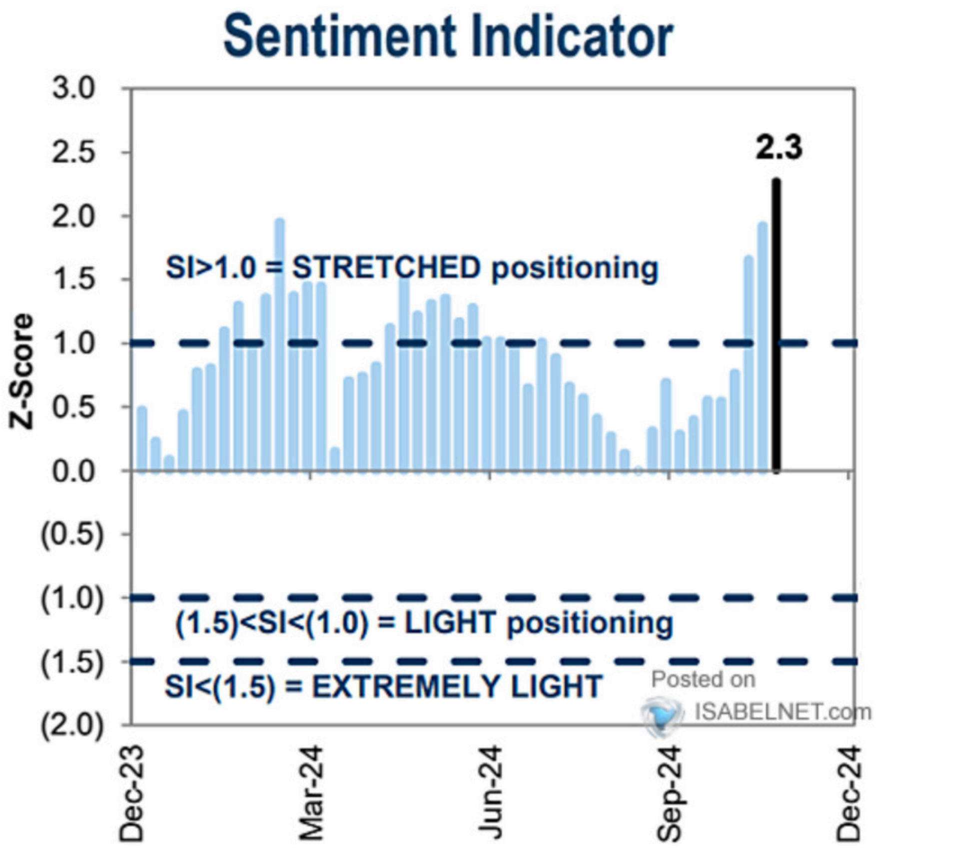
The Opportunity in Contrarian Positioning

Sentiment in the U.S. market demands caution. Elevated valuations, higher interest rates, and geopolitical uncertainties are rising concerns about the sustainability of recent market highs. Historically, sentiment shifts have often preceded capital outflows from overvalued markets, further amplifying downside risks. Conversely, investor sentiment towards Brazil is depressed, showing yet no signs of improvement. This factor creates a foundation for a sentiment-driven recovery especially as expectations for macroeconomic conditions stabilize.



Note: Sentiment Indicator measures stock positioning across retail, institutional, and foreign investors versus the past 12 months. Readings below -1.0 or above +1.0 indicate extreme positions that are significant in predicting future returns.

Source: Haver, EPFR, FactSet, CFTC, and Goldman Sachs Global Investment Research.

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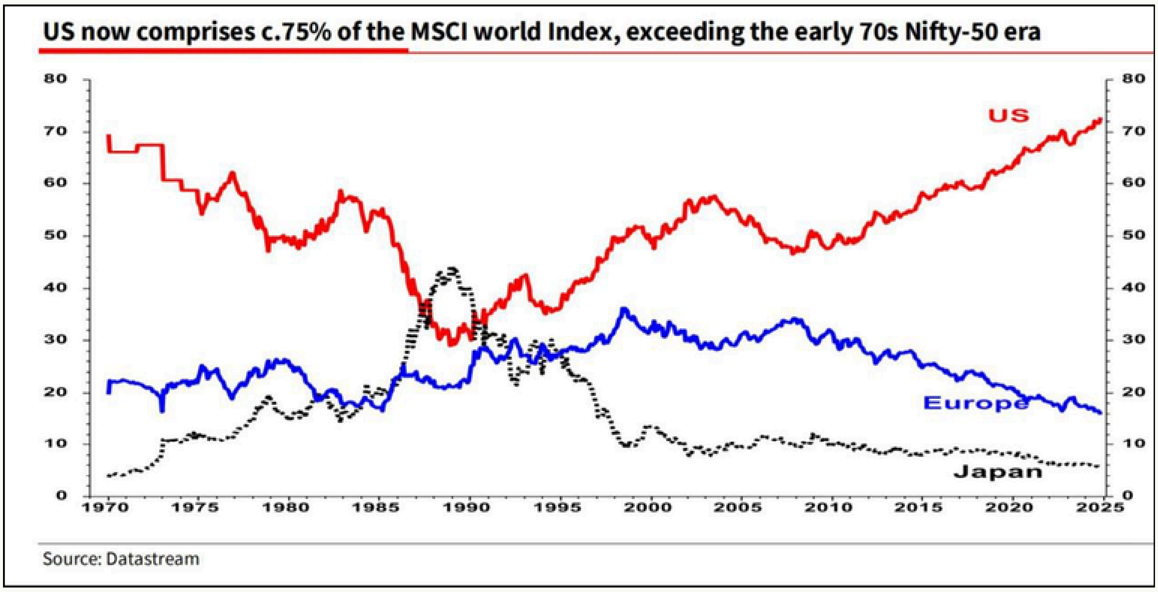
The case for a long Brazil, short U.S. equities strategy is supported by a combination of valuation disparities, contrasting capital flow dynamics, and shifts in investor sentiment.

Brazilian equities are trading at historically low valuations, both on an absolute basis and relative to their U.S. counterparts. U.S. equities, on the other hand, remain elevated, with stretched valuations driven by a concentrated rally in technology and growth stocks.

Despite recent outflows, Brazil's equity market has seen some stabilization, with a narrowing gap in foreign institutional investor (FII) flows compared to prior years. U.S. equities have experienced sustained inflows over the past decade, creating overcrowded positioning.

Negative sentiment towards Brazil is largely reflected in current valuations, offering an asymmetric risk-reward profile. Key risks, including fiscal concerns and political instability, are well-known and arguably priced in.

U.S. equities face mounting headwinds, including tighter monetary policy, potential stagflation, and slowing economic growth. Overly optimistic sentiment in the U.S. market, particularly around technology, leaves it vulnerable to a correction, supporting the short trade.



Brazil presents a compelling contrarian opportunity for investors prepared to navigate near-term volatility in exchange for potential long-term gains.

- The Ibovespa is trading significantly below its historical valuation averages, underscoring its appeal to value-driven investors. With forward P/E ratios of 7x, Brazil's equity market offers deep discounts relative to its historical norms and global peers.
- In stark contrast, the S&P Index, is trading at 163% above its historical mean, placing valuations beyond three standard deviations from the average. This signals heightened risks of correction and limited upside potential.

The narrative of a transition into Brazil's market is further supported by trends in flows and sentiment.

- Institutional investors have pulled BRL 84.04 billion year-to-date, reflecting persistent skepticism and risk aversion among major domestic and foreign players. However, there are signs of renewed interest, with foreign investors contributing BRL 11.67 billion in net inflows and retail investors adding BRL 19.84 billion, demonstrating resilience and confidence in undervalued opportunities. While sentiment and news flow around Brazil remain cautious, momentum is gradually shifting as the country's discounted valuations particularly in commodities and infrastructure, attract selective inflows.
- Meanwhile, in the U.S., investor sentiment remains exuberant, supported by booming money flows, but this optimism is built on stretched valuations, reinforcing Brazil's positioning as a high-risk, high-reward alternative for global investors seeking value and diversification.