



# HEDGEYE

**IS IT TIME TO BUY BRAZIL?**

**DARIUS DALE: MACRO TEAM**

FEBRUARY 27, 2014

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# TABLE OF CONTENTS

- **Slides 4-22:** A quick review of our **bear case** on Brazil (and emerging markets broadly)
- **Slides 23-56:** Debating the **bull case** on Brazil
- **Slides 57-68:** Proprietary valuation work on Vale (VALE) and Petrobras (PBR)
- **Slides 69-71:** Summary of actionable investment ideas

**A Brief Review of our  
#EmergingOutflows Theme:**

**4/16/13:** 2Q13 Macro Theme:  
#EmergingOutflows

**4/23/13:** Presentation: “Emerging Market Crises: Identifying, Contextualizing and Navigating Key Risks in the Next Cycle”

**4/29/13:** Expert Call w/ Carl E. Walter: “Will China Break?”

**6/12/13:** Presentation: “Are You Short China [and Other] Emerging Markets Yet?”

**7/15/13:** 3Q13 Macro Theme:  
#AsianContagion

**8/30/13:** Presentation: “Long Weekend Reading Material: 65 Charts To Help You Own the Debate On Emerging Markets”

**12/21/13:** Presentation:  
“#EmergingOutflows: More Pain to Come?”

# “GET OUT OF BRAZIL IF YOU HAVEN’T ALREADY” (2/6/13)

## KEY EXCERPTS

*“Not much else needs to be said other than the fact that it has recently become clear to us that Brazilian policymakers refuse to address the country’s growth/inflation imbalance – which they themselves have perpetuated through currency debasement – with an adequate amount of exchange rate appreciation (we already know Dilma won’t budge on rates).”*

➤ **Losing the “war” at home:** Brazil is flat-out losing what Finance Minister Guido Mantega dubbed in SEP 2010 as the “Currency War” – mostly because of Brazilian policymakers’ own doing. The ~2yrs of capital controls (which are now slowly being reversed) did little to boost economic growth; 2012 real GDP should come in at roughly +1% YoY – the slowest since 1999 outside of the -0.3% YoY decline in 2009.

➤ **Inflation is not growth:** The weak BRL did, however, boost inflation, which has exceeded the median central bank’s 4.5% +/- 200bps target for 29 consecutive months! The aforementioned bastardization of international capital also contributed to a drop in investment, which shrank to ~20% of GDP last year (vs. ~48% for China), according to preliminary IMF estimates.

➤ **Small measures won’t cut it:** Now, in order to combat the now-obvious ramp in CPI that has stemmed from burning the BRL over the past ~2yrs, the Brazilian government has just resorted to scrapping all taxes on the basket of staple foods (after Rousseff herself vetoed a similar measure back in SEP). This latest counter-inflation measure out of the Brazilian government is in addition to their recent use of forceful negotiation tactics with Brazilian utilities in order to drive down energy tariffs for Brazilian consumers and businesses.

➤ **Mantega doesn’t get it:** The breakdown was confirmed by Mantega’s latest statement on the BRL: “The government is ready to block exaggerated gains in the currency... the exchange rate isn’t an instrument to control prices and a weaker currency helps to protect the domestic industry from foreign competition.”

➤ **Pigheadedness ≠ policy:** With a hint of arrogance, these comments show Brazilian policymakers haven’t learned anything from the past ~18-24 months of “exaggerated” policy failures.”

# NEGATIVELY DIVERGING

HEDGEYE MACRO ASIAN & LATIN AMERICAN EQUITIES DIVERGENCE MONITOR

BLOOMBERG TICKER	COUNTRY NAME	INDEX NAME	LAST PRICE	1D % CHANGE	1W % CHANGE	1M % CHANGE	3M % CHANGE	6M % CHANGE	1Y % CHANGE	18M % CHANGE	3Y % CHANGE	% CHANGE SINCE 2/6/2013	MTD % CHANGE	QTD % CHANGE	YTD % CHANGE
REGIONS															
MXAP	ASIA	MSCI AC Asia Pacific Index	137.86	-0.2%	1.6%	2.3%	-2.2%	5.1%	3.5%	15.1%	0.7%	3.5%	2.3%	-2.5%	-2.5%
MXLA	LATIN AMERICA	MSCI Emerging Markets Latin America Index	2,901.11	-0.7%	-0.8%	0.0%	-11.3%	-3.6%	-23.6%	-19.4%	-34.7%	-25.8%	0.2%	-9.4%	-9.4%
SPX	USA	S&P 500 Index	1,845.16	0.0%	0.3%	3.6%	2.1%	13.2%	21.7%	30.8%	39.8%	22.0%	3.5%	-0.2%	-0.2%
SXXP	EUROPE	STOXX Europe 600 Price Index EUR	336.15	-0.5%	0.4%	4.4%	3.7%	12.4%	17.1%	24.9%	18.3%	18.1%	4.2%	2.4%	2.4%
ASX	UK	FTSE All-Share Index	3,644.72	-0.2%	-0.3%	3.9%	2.8%	6.3%	9.4%	21.4%	17.2%	10.2%	4.2%	1.0%	1.0%
MXEE	EMEA	MSCI Emerging Markets Europe Middle East and Africa Index	310.20	-1.2%	0.4%	2.5%	-5.5%	2.0%	-9.8%	-6.2%	-19.6%	-12.8%	4.2%	-5.5%	-5.5%
MEAN				-0.5%	0.3%	2.8%	-1.7%	5.9%	3.1%	11.1%	3.6%	2.6%	3.1%	-2.4%	-2.4%
COUNTRIES															
MERVAL	ARGENTINA	Buenos Aires Stock Exchange Merval Index	5,828.44	0.1%	-2.5%	4.0%	4.1%	51.5%	84.5%	136.9%	69.7%	77.2%	-3.2%	8.1%	8.1%
AS30	AUSTRALIA	Australian Stock Exchange All Ordinaries Index	5,421.01	-0.5%	0.0%	3.2%	1.8%	5.7%	7.3%	24.0%	10.1%	9.7%	4.1%	1.3%	1.3%
IBOV	BRAZIL	Ibovespa Brasil Sao Paulo Stock Exchange Index	47,008.49	0.9%	-0.6%	-1.5%	-9.4%	-6.2%	-17.9%	-19.1%	-29.7%	-20.3%	-1.3%	-8.7%	-8.7%
IPSA	CHILE	Santiago Stock Exchange IPSA Index	3,682.75	0.2%	1.1%	4.6%	-0.9%	3.5%	-18.5%	-11.4%	-15.8%	-19.9%	7.1%	-0.4%	-0.4%
SHCOMP	CHINA	Shanghai Stock Exchange Composite Index	2,047.35	0.3%	-4.3%	0.7%	-7.0%	-2.7%	-11.5%	-0.4%	-28.9%	-15.9%	0.7%	-3.2%	-3.2%
IGBC	COLOMBIA	Indice General de la Bolsa de Valores de Colombia	12,162.19	0.0%	-2.3%	1.0%	-7.3%	-10.4%	-18.0%	-14.3%	-17.5%	-19.8%	1.5%	-7.0%	-7.0%
HSI	HONG KONG	Hong Kong Hang Seng Index	22,828.18	1.7%	1.9%	3.9%	-4.1%	4.4%	1.1%	15.3%	-0.8%	-1.8%	3.6%	-2.1%	-2.1%
SENSEX	INDIA	S&P BSE SENSEX Index	20,986.99	0.0%	2.2%	1.3%	2.8%	16.8%	9.6%	18.7%	18.6%	6.9%	2.3%	-0.9%	-0.9%
JCI	INDONESIA	Jakarta Stock Exchange Composite Index	4,568.94	0.8%	-0.6%	5.7%	7.5%	15.1%	-3.1%	10.2%	32.7%	1.6%	3.4%	6.9%	6.9%
NKY	JAPAN	Nikkei 225	14,923.11	-0.3%	3.3%	-0.6%	-3.4%	10.2%	32.6%	64.3%	41.8%	30.2%	0.1%	-8.4%	-8.4%
FBMKLCI	MALAYSIA	FTSE Bursa Malaysia KLCI Index - Kuala Lumpur Composite Index	1,831.66	0.5%	0.2%	3.0%	1.8%	7.7%	12.8%	11.1%	23.0%	13.5%	1.5%	-1.9%	-1.9%
MEXBOL	MEXICO	Mexican Stock Exchange Mexican Bolsa IPC Index	38,605.62	-1.1%	-2.6%	-5.5%	-7.8%	-2.6%	-11.8%	-3.4%	4.7%	-15.3%	-5.6%	-9.6%	-9.6%
NZSE	NEW ZEALAND	New Zealand Exchange Ltd NZX Ordinaries All Index	1,039.64	-0.2%	0.8%	1.4%	2.8%	7.4%	12.3%	29.4%	35.7%	13.7%	1.1%	4.1%	4.1%
IGBVL	PERU	Bolsa de Valores de Lima General Sector Index	15,366.18	0.1%	-0.7%	-2.7%	1.3%	-6.9%	-25.6%	-24.2%	-32.5%	-29.4%	-0.6%	-2.5%	-2.5%
PCOMP	PHILIPPINES	Philippines Stock Exchange PSEI Index	6,354.79	0.5%	0.0%	4.5%	5.0%	7.4%	-4.0%	23.6%	70.0%	-1.2%	5.2%	7.9%	7.9%
FSSTI	SINGAPORE	Straits Times Index STI	3,096.74	0.3%	0.3%	1.8%	-2.4%	2.1%	-5.0%	1.7%	2.4%	-5.5%	2.3%	-2.2%	-2.2%
KOSPI	SOUTH KOREA	Korea Stock Exchange KOSPI Index	1,978.43	0.4%	2.5%	3.6%	-2.5%	4.9%	-1.3%	3.2%	0.8%	2.2%	1.9%	-1.6%	-1.6%
TWSE	TAIWAN	Taiwan Stock Exchange Weighted Index	8,639.58	0.5%	1.3%	2.1%	4.1%	10.5%	9.4%	15.7%	0.5%	9.3%	2.1%	0.3%	0.3%
SET	THAILAND	Stock Exchange of Thailand SET Index	1,318.05	1.0%	1.1%	2.3%	-4.0%	1.9%	-13.2%	6.8%	33.7%	-12.2%	3.4%	1.5%	1.5%
VNINDEX	VIETNAM	Vietnam Ho Chi Minh Stock Index / VN-Index	584.79	-0.9%	2.4%	5.1%	15.0%	20.4%	25.6%	51.4%	25.2%	19.7%	5.1%	15.9%	15.9%
IBVC	VENEZUELA	Caracas Stock Exchange Stock Market Index	2,768.28	1.8%	0.3%	-1.9%	9.8%	109.0%	347.3%	848.2%	3993.9%	389.6%	-2.1%	1.2%	1.2%
MEAN (EXCLUDING ARGENTINA & VENEZUELA)				0.2%	0.3%	1.8%	-0.3%	4.7%	-1.0%	10.7%	9.1%	-1.8%	2.0%	-0.6%	-0.6%

Source: Bloomberg data; Hedgeye Risk Management calculations. Bolded cells denote values in excess of [1] standard deviation from the respective mean.

# STILL BROKEN

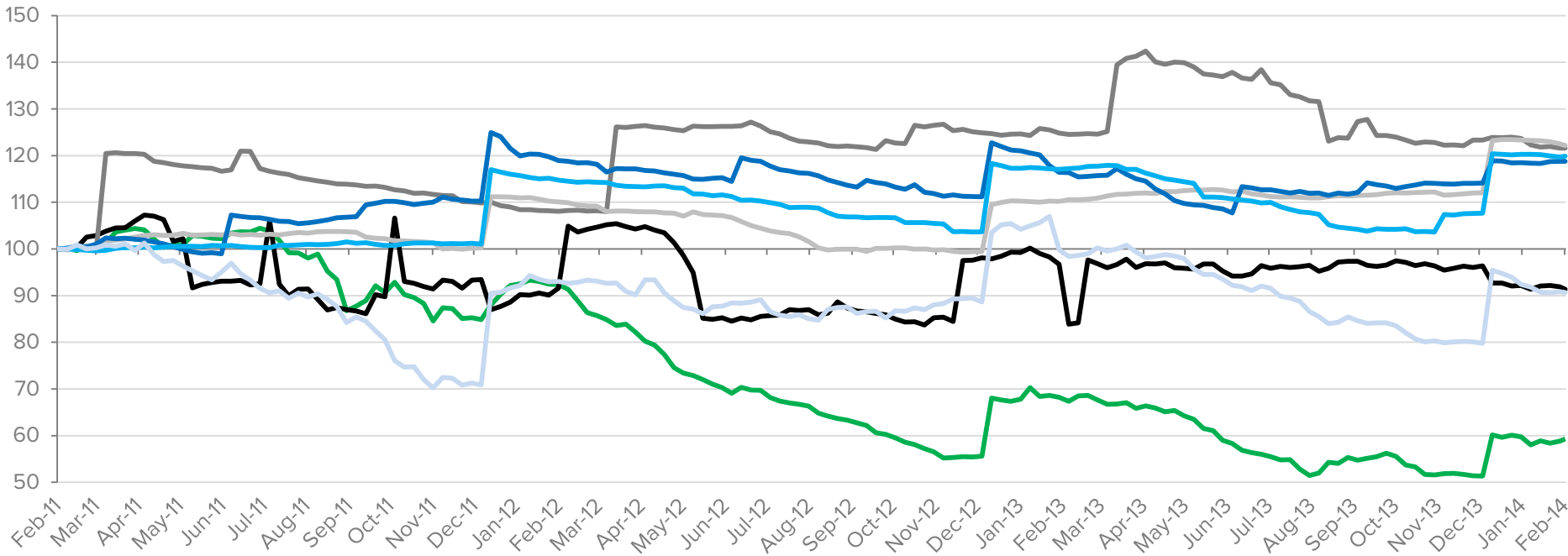
## HEDGEYE QUANTITATIVE SETUP: BRAZILIAN EQUITIES



# IDIOSYNCRATIC HEADWINDS MATTER

## BLOOMBERG CONSENSUS NTM EARNINGS ESTIMATES (INDEXED TO 3Y AGO)

MSCI Brazil Index    MSCI Russia Index    MSCI India Index    MSCI China Index  
MSCI South Africa Index    MSCI Indonesia Index    MSCI Mexico Index



# LONG-TERM UNDERPERFORMANCE

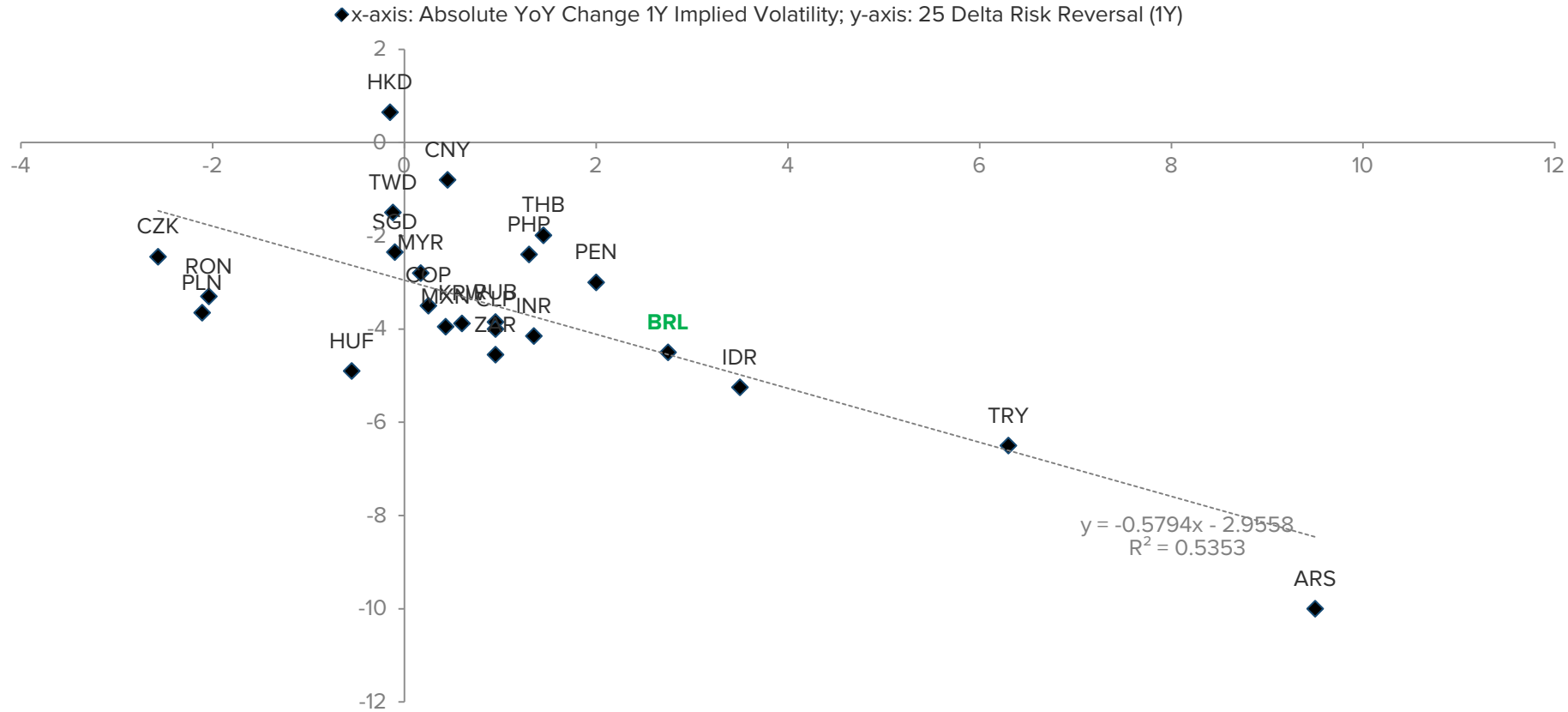
## HEDGEYE MACRO ASIAN & LATIN AMERICAN FX DIVERGENCE MONITOR

BLOOMBERG TICKER	COUNTRY NAME	INDEX NAME	LAST PRICE	1D % CHANGE	1W % CHANGE	1M % CHANGE	3M % CHANGE	6M % CHANGE	1Y % CHANGE	18M % CHANGE	3Y % CHANGE	% CHANGE SINCE 2/6/2013	MTD % CHANGE	QTD % CHANGE	YTD % CHANGE
REGIONS															
ADXY	ASIA	Bloomberg JP Morgan Asia Dollar Index	115.24	0.0%	-0.2%	0.2%	-0.5%	1.1%	-2.2%	-0.1%	-0.8%	-2.2%	0.2%	-0.7%	-0.7%
LACI	LATIN AMERICA	Bloomberg JP Morgan Latin America Currency Index	91.15	0.1%	0.1%	1.0%	-4.3%	-4.5%	-13.8%	-12.5%	-21.1%	-13.9%	1.0%	-3.5%	-3.5%
FXJPEMCI	EMERGING MARKETS	JPMorgan Emerging Markets Currency Index	86.27	0.0%	0.3%	0.6%	-3.3%	-1.4%	-9.8%	-8.9%	-16.8%	-10.6%	1.0%	-2.5%	-2.5%
DXY	USA	US Dollar Index	80.43	0.0%	0.2%	-0.1%	-0.4%	-0.9%	-1.4%	-1.5%	4.1%	0.9%	-1.1%	0.5%	0.5%
EURUSD	EUROPE	EUR/USD	1.37	-0.1%	-0.3%	0.0%	0.7%	2.1%	4.1%	9.4%	-0.6%	1.1%	1.4%	-0.5%	-0.5%
GBPUSD	UK	GBP/USD	1.67	0.0%	0.1%	0.5%	2.4%	7.2%	10.0%	5.5%	3.4%	6.4%	1.4%	0.7%	0.7%
		MEAN		0.0%	0.0%	0.3%	-1.5%	-0.7%	-4.7%	-2.7%	-7.1%	-5.0%	0.5%	-1.3%	-1.3%
COUNTRIES															
ARSUSD	ARGENTINA	ARS/USD	0.1267	-0.2%	-0.9%	1.4%	-22.6%	-28.5%	-36.1%	-41.5%	-49.0%	-36.8%	1.5%	-17.4%	-17.4%
AUDUSD	AUSTRALIA	AUD/USD	0.8938	-0.3%	-0.8%	2.3%	-1.6%	-0.5%	-12.7%	-13.8%	-12.2%	-13.4%	2.1%	0.2%	0.2%
BRLUSD	BRAZIL	BRL/USD	0.4269	0.3%	1.2%	3.3%	-0.5%	1.3%	-15.7%	-13.3%	-29.1%	-15.0%	3.0%	0.9%	0.9%
CLPUSD	CHILE	CLP/USD	0.1775	-0.3%	-1.4%	-2.6%	-6.2%	-8.7%	-16.0%	-14.6%	-15.6%	-16.0%	-1.4%	-6.7%	-6.7%
CNYUSD	CHINA	CNY/USD	0.1632	-0.1%	-0.7%	-1.3%	-0.6%	-0.1%	1.6%	3.7%	7.3%	1.7%	-1.1%	-1.2%	-1.2%
COPUSD	COLOMBIA	COP/USD	0.0487	0.0%	-0.5%	-2.4%	-6.2%	-5.6%	-11.7%	-11.3%	-7.5%	-12.8%	-1.9%	-6.1%	-6.1%
HKDUSD	HONG KONG	HKD/USD	0.1289	0.0%	-0.1%	0.1%	-0.1%	-0.1%	0.0%	-0.1%	0.4%	-0.1%	0.1%	-0.1%	-0.1%
INRUSD	INDIA	INR/USD	0.0161	0.0%	0.0%	2.1%	0.6%	7.6%	-13.5%	-10.3%	-27.1%	-14.5%	0.6%	-0.4%	-0.4%
IDRUSD	INDONESIA	IDR/USD	0.0857	-0.3%	1.2%	4.9%	2.0%	-2.6%	-17.0%	-18.4%	-24.4%	-16.8%	4.7%	4.3%	4.3%
JPYUSD	JAPAN	JPY/USD	0.0098	0.2%	0.1%	0.4%	0.0%	-5.0%	-9.7%	-22.9%	-20.0%	-8.3%	-0.1%	3.1%	3.1%
MYRUSD	MALAYSIA	MYR/USD	0.3047	0.0%	0.7%	1.8%	-1.4%	1.3%	-5.5%	-5.2%	-7.1%	-5.5%	2.0%	0.0%	0.0%
MXNUSD	MEXICO	MXN/USD	0.0752	0.3%	-0.2%	0.5%	-1.3%	-0.5%	-4.0%	-0.7%	-8.8%	-4.6%	0.4%	-2.0%	-2.0%
NZDUSD	NEW ZEALAND	NZD/USD	0.8365	0.6%	0.7%	1.6%	2.7%	7.3%	1.1%	3.4%	11.3%	-0.4%	3.5%	1.8%	1.8%
PENUSD	PERU	PEN/USD	0.3567	0.2%	0.2%	0.7%	-0.1%	0.2%	-7.8%	-6.8%	-1.0%	-8.1%	0.7%	-0.3%	-0.3%
PHPUSD	PHILIPPINES	PHP/USD	0.0224	-0.1%	0.2%	1.5%	-2.2%	-0.2%	-8.9%	-5.7%	-2.3%	-9.0%	1.6%	-0.8%	-0.8%
SGDUSD	SINGAPORE	SGD/USD	0.7900	0.1%	-0.1%	0.8%	-0.8%	1.3%	-2.3%	-1.1%	0.5%	-2.1%	0.8%	-0.2%	-0.2%
KRWUSD	SOUTH KOREA	KRW/USD	0.0935	0.1%	0.3%	1.0%	-0.4%	4.5%	1.4%	6.1%	5.1%	2.0%	1.1%	-1.5%	-1.5%
TWDUSD	TAIWAN	TWD/USD	0.0330	0.0%	0.1%	0.1%	-2.1%	-1.1%	-2.1%	-1.1%	-1.9%	-2.3%	0.1%	-1.6%	-1.6%
THBUSD	THAILAND	THB/USD	0.0307	-0.1%	-0.2%	0.9%	-1.6%	-1.4%	-8.6%	-4.2%	-6.1%	-8.7%	1.2%	0.2%	0.2%
VNDUSD	VIETNAM	VND/USD	4.7417	0.0%	-0.1%	-0.2%	0.1%	0.2%	-1.2%	-1.2%	-1.0%	-1.3%	-0.2%	0.1%	0.1%
VEFUSD	VENEZUELA	VEF/USD	0.1589	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	-31.7%	-31.7%	-31.7%	0.0%	0.0%	0.0%
		MEAN		0.0%	0.0%	0.8%	-2.0%	-1.5%	-8.0%	-9.1%	-10.5%	-9.7%	0.9%	-1.3%	-1.3%

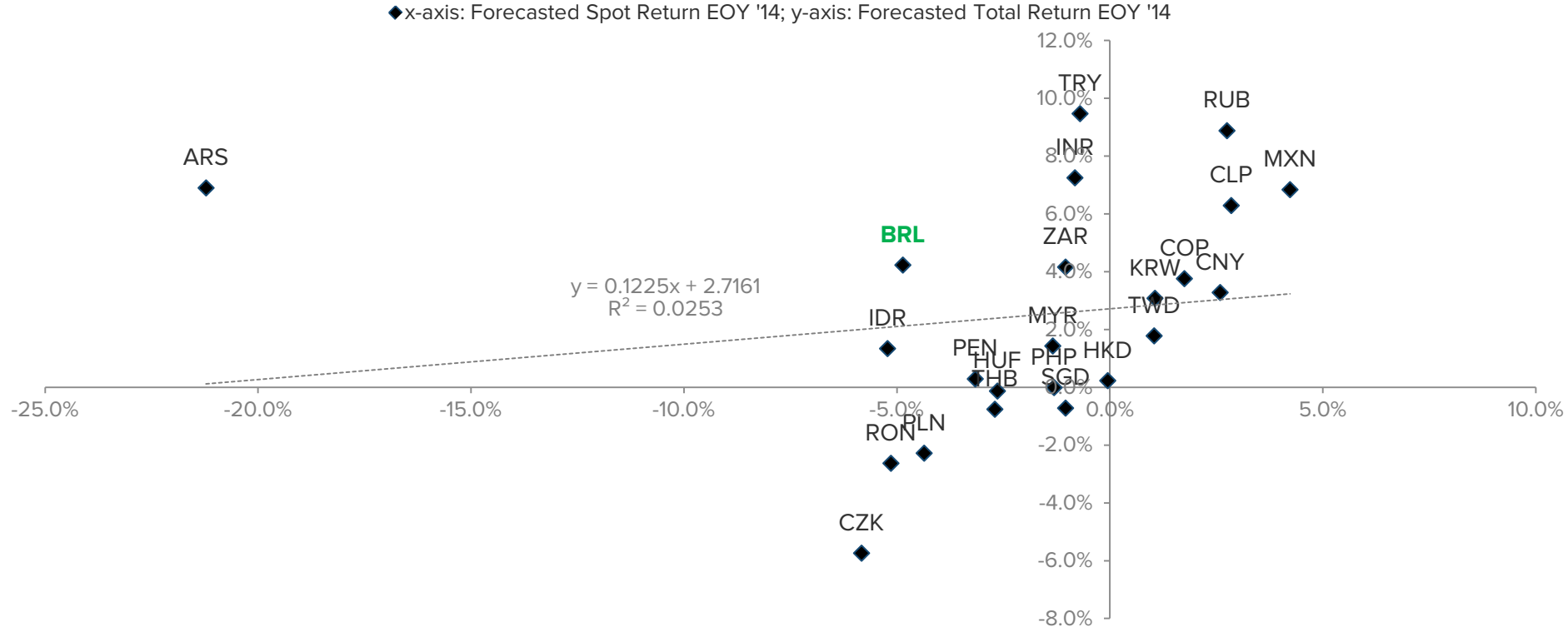
Source: Bloomberg data; Hedgeye Risk Management calculations. Bolded cells denote values in excess of [1] standard deviation from the respective mean.



# BRL: PUNISHED



# ... AND EXPECTED TO CONTINUE



# HEDGEYE'S EM CRISIS RISK MODEL

## STILL THE MOST PREDICTIVE MODEL ON THE STREET

Hedgeye Macro Emerging Market Crisis Risk Index	
Pillar I: External Sector	Pillar II: Fiscal Policy
1. Real Effective Exchange Rate: # of Standard Deviations from Trailing 10Y Mean	<b>1. Sovereign Debt as a % of GDP</b>
2. Short-term External Debt as a % of International Reserves	<b>2. Sovereign Budget Balance as a % of GDP</b>
3. International Reserves, In Months of Imports	3. Average Term to Maturity of Outstanding Sovereign Debt (Years)
4. Total External Debt as a % of Exports	4. 2013 Total Sovereign Financing Need as a % of GDP
<b>5. Current Account Balance as a % of GDP</b>	5. Sovereign and Publically-guaranteed External Debt as a % of GDP
<b>6. Commodities as a % of Total Exports</b>	6. Short-term External Sovereign Debt as a % of Total External Sovereign Debt
7. Short-term Debt as a % of Total External Debt	<b>7. Subsidies and Other Transfers as a % of Sovereign Expenditures</b>
8. External Debt Service as a % of International Reserves	8. Taxes on Income, Profits and Capital Gains as a % of Revenue
<b>9. Terms of Trade Ratio (a)</b>	9. Average Number of Hours To Prepare and Pay Taxes
10. Cyclically-adjusted Current Account Balance as a % of GDP (b)	10. Effective Corporate Tax Rate
Pillar III: Financial Sector	Pillar IV: Political & Regulatory Risk
1. Bank Capital to Assets Ratio	<b>1. Ease of Doing Business Index (Lower is Better)</b>
2. Bank NPL Ratio	2. GINI Coefficient
<b>3. Broad Money as a % of GDP</b>	3. Share of Income Earned by Top 10%
<b>4. Domestic Credit to the Private Sector as a % of GDP</b>	4. Unemployment Rate
5. Market Capitalization of Listed Enterprises as a % of GDP (c)	<b>5. Youth Unemployment Rate</b>
<b>6. Gross Fixed Capital Formation as a % of GDP</b>	<b>6. Poverty Headcount Ratio at \$2/day PPP</b>
7. Money and Quasi Money, YoY Growth	7. Number of Procedures to Register Property
8. Real Interest Rate (d)	8. Number of Procedures to Enforce a Contract
9. Equity Market Turnover Ratio (e)	9. Average Amount of Days to Enforce a Contract
10. Latest Real GDP Growth, Deviation from 10Y Trend	10. Average Amount of Years to Resolve Insolvency
<p>a: ratio of export prices to import prices</p> <p>b: normalizes the current account balance for a balanced terms of trade environment</p> <p>c: higher values assume financial bubble risk</p> <p>d: lower values assume risk of adverse selection</p> <p>e: higher values assume risk of speculative activity</p>	
BOLDDED indicators have been assigned a higher weighting within the sub-samples based on our analysis of the most significant metrics for crisis prediction.	

# HOW THE MODEL WORKS

1

## HISTORICAL CONTEXT

Sampling scores of written works that analyzed emerging market crises both at the time of crisis and well after, we carefully indentified ten key economic indicators across four key categories (i.e. “Pillars”).

2

## MATH

At the single indicator level, each country is ranked according to its length of standard deviations from the sample average. A higher deviation always indicates greater risk, so for indicators where a higher value is healthy (like a current account balance or budget balance), we inverted the signs. Each country’s deviations are then averaged and multiplied by a constant to produce a composite score at the Pillar level.

3

## ANALYTICAL INSIGHT

Certain indicators were given a higher weighting in the average based on both historical precedent and what we viewed as the eminent areas of risk in the current cycle. The aggregate risk score is a arithmetic mean of the four Pillar-level scores .

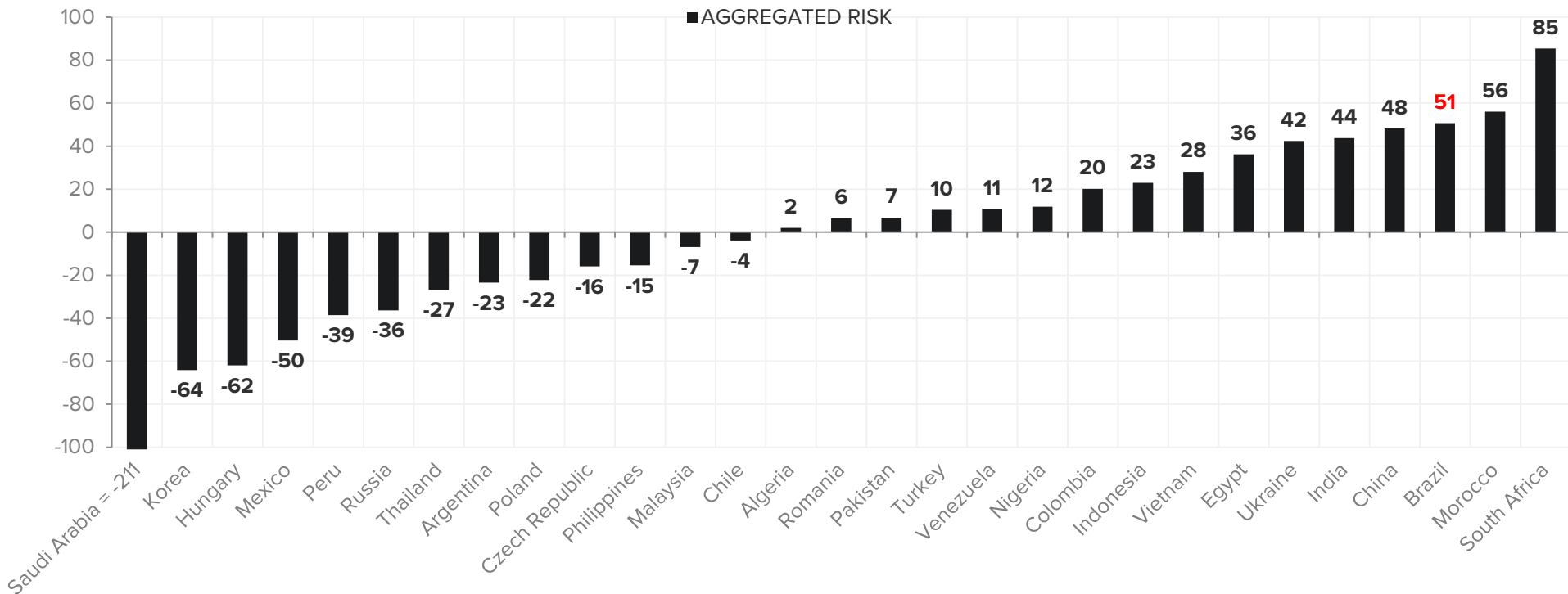
# CHARTING THOSE IDIOSYNCRASIES

Hedgeye Macro Emerging Market Crisis Risk Index									
Pillar I: External Sector		Pillar II: Fiscal Policy		Pillar III: Financial Sector		Pillar IV: Political & Regulatory Risk		Aggregate Score	
Country	Risk Level	Country	Risk Level	Country	Risk Level	Country	Risk Level	Country	Risk Level
Algeria	-142	Algeria	13	Algeria	14	Algeria	122	Algeria	2
Argentina	-11	Argentina	-12	Argentina	-75	Argentina	4	Argentina	-23
Brazil	36	Brazil	91	Brazil	-25	Brazil	101	Brazil	51
Chile	93	Chile	-82	Chile	9	Chile	-36	Chile	-4
China	-66	China	8	China	278	China	-27	China	48
Colombia	110	Colombia	0	Colombia	-64	Colombia	35	Colombia	20
Czech Republic	-65	Czech Republic	65	Czech Republic	1	Czech Republic	-64	Czech Republic	-16
Egypt	-41	Egypt	145	Egypt	-11	Egypt	52	Egypt	36
Hungary	-163	Hungary	18	Hungary	-44	Hungary	-59	Hungary	-62
India	59	India	-29	India	52	India	94	India	44
Indonesia	95	Indonesia	-44	Indonesia	-42	Indonesia	83	Indonesia	23
Korea	-198	Korea	-56	Korea	165	Korea	-168	Korea	-64
Malaysia	-74	Malaysia	68	Malaysia	112	Malaysia	-132	Malaysia	-7
Mexico	-3	Mexico	-28	Mexico	-95	Mexico	-75	Mexico	-50
Morocco	121	Morocco	39	Morocco	63	Morocco	1	Morocco	56
Nigeria	-2	Nigeria	-77	Nigeria	-53	Nigeria	179	Nigeria	12
Pakistan	39	Pakistan	58	Pakistan	-101	Pakistan	30	Pakistan	7
Peru	64	Peru	-102	Peru	-80	Peru	-36	Peru	-39
Philippines	-72	Philippines	-11	Philippines	-75	Philippines	97	Philippines	-15
Poland	-74	Poland	45	Poland	-22	Poland	-38	Poland	-22
Romania	27	Romania	61	Romania	-14	Romania	-47	Romania	6
Russia	24	Russia	-95	Russia	-26	Russia	-49	Russia	-36
Saudi Arabia	-654	Saudi Arabia	-128	Saudi Arabia	-45	Saudi Arabia	-16	Saudi Arabia	-211
South Africa	125	South Africa	43	South Africa	21	South Africa	153	South Africa	85
Thailand	8	Thailand	-76	Thailand	121	Thailand	-160	Thailand	-27
Turkey	122	Turkey	-14	Turkey	-32	Turkey	-34	Turkey	10
Ukraine	240	Ukraine	27	Ukraine	-66	Ukraine	-32	Ukraine	42
Venezuela	56	Venezuela	-1	Venezuela	-65	Venezuela	53	Venezuela	11
Vietnam	-3	Vietnam	34	Vietnam	118	Vietnam	-36	Vietnam	28

Source: Hedgeye Macro. A higher value indicates higher risk. Colored values indicate in excess of one standard deviation (+/-) relative to the sample mean.

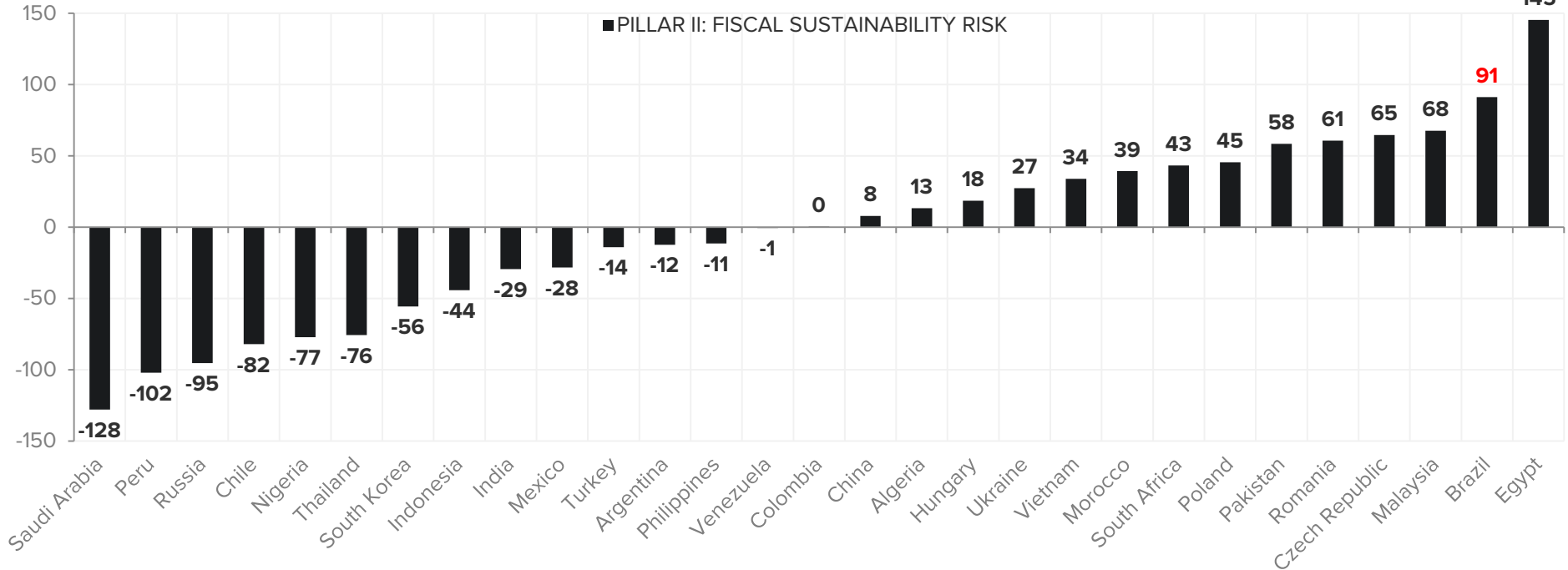
# BRAZIL: THIRD RISKIEST EM ECONOMY

## HEDGEYE MACRO EM CRISIS RISK INDEX (HIGHER SCORE = **MORE RISKY**)



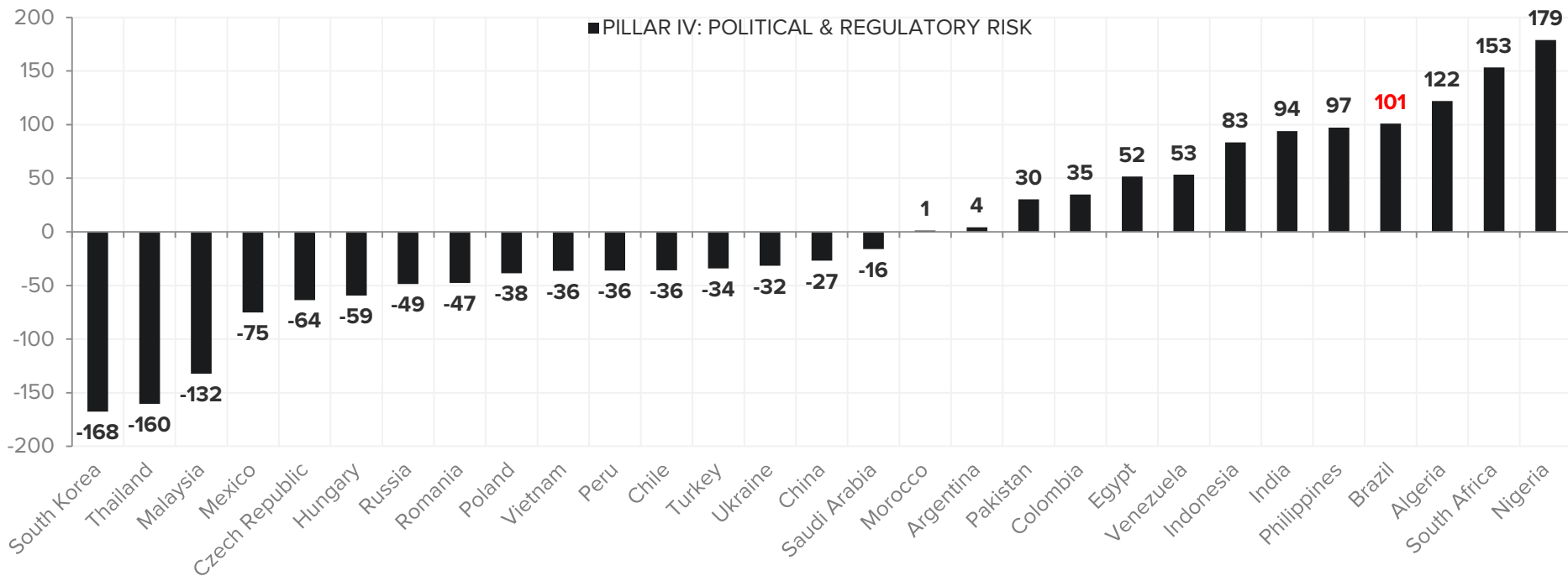
# DRIVEN BY AWFUL FISCAL POLICY

## HEDGEYE MACRO EM CRISIS RISK INDEX (HIGHER SCORE = **MORE RISKY**)



# AND BAD SOCIOECONOMIC POLICY

## HEDGEYE MACRO EM CRISIS RISK INDEX (HIGHER SCORE = **MORE RISKY**)

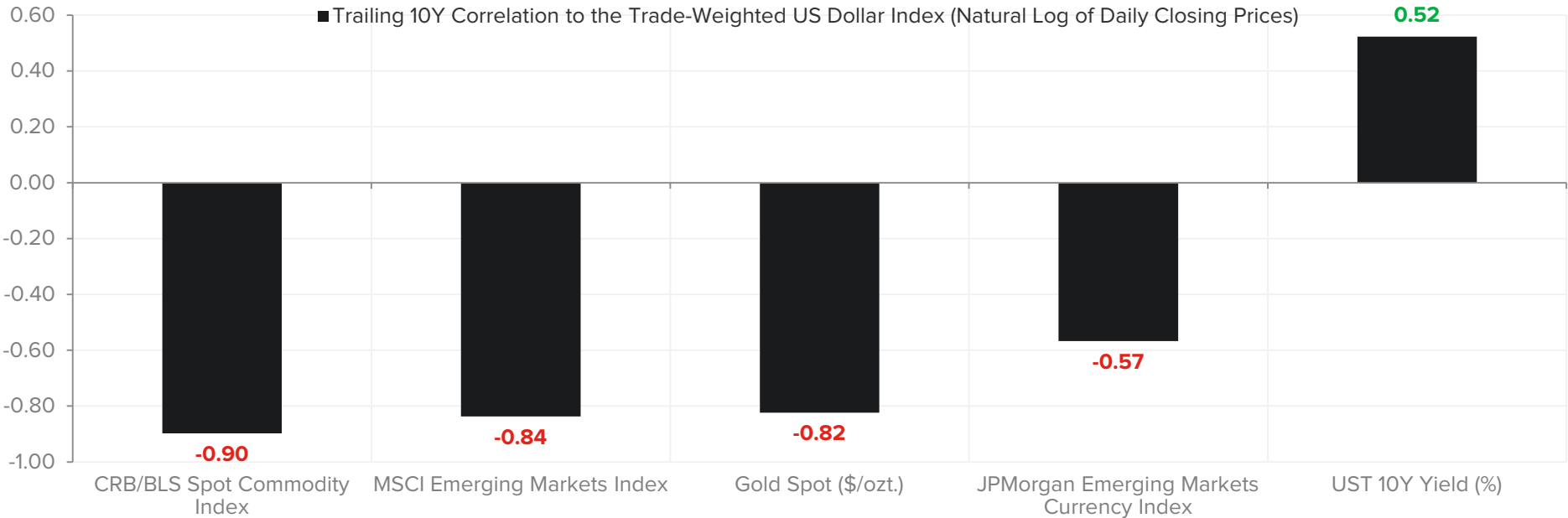




# A BROAD CARRY TRADE EXPOSED

**MATH DOESN'T LIE; INVESTMENT FUND PROSPECTUSES DO**

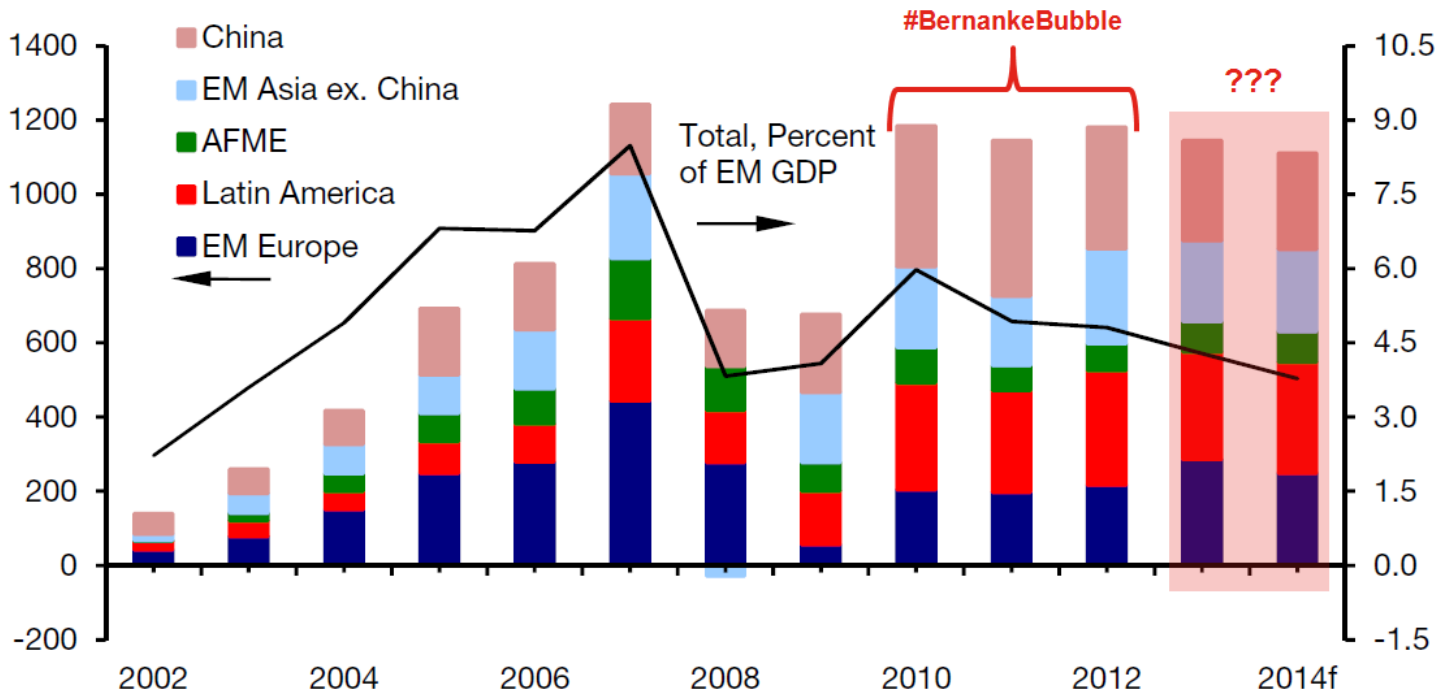
**EM EQUITIES, EM FX, BONDS, GOLD, COMMODITIES... IT'S ALL THE SAME  
CARRY TRADE BORN OUT OF SUSTAINED US DOLLAR DEBASEMENT!**



# THE THREAT OF THE UNWIND REMAINS

REMEMBER, THE 2010-12 #EMERGINGINFLOWS WERE HUGE

Emerging Market Private Capital Inflows, Net  
\$ billion

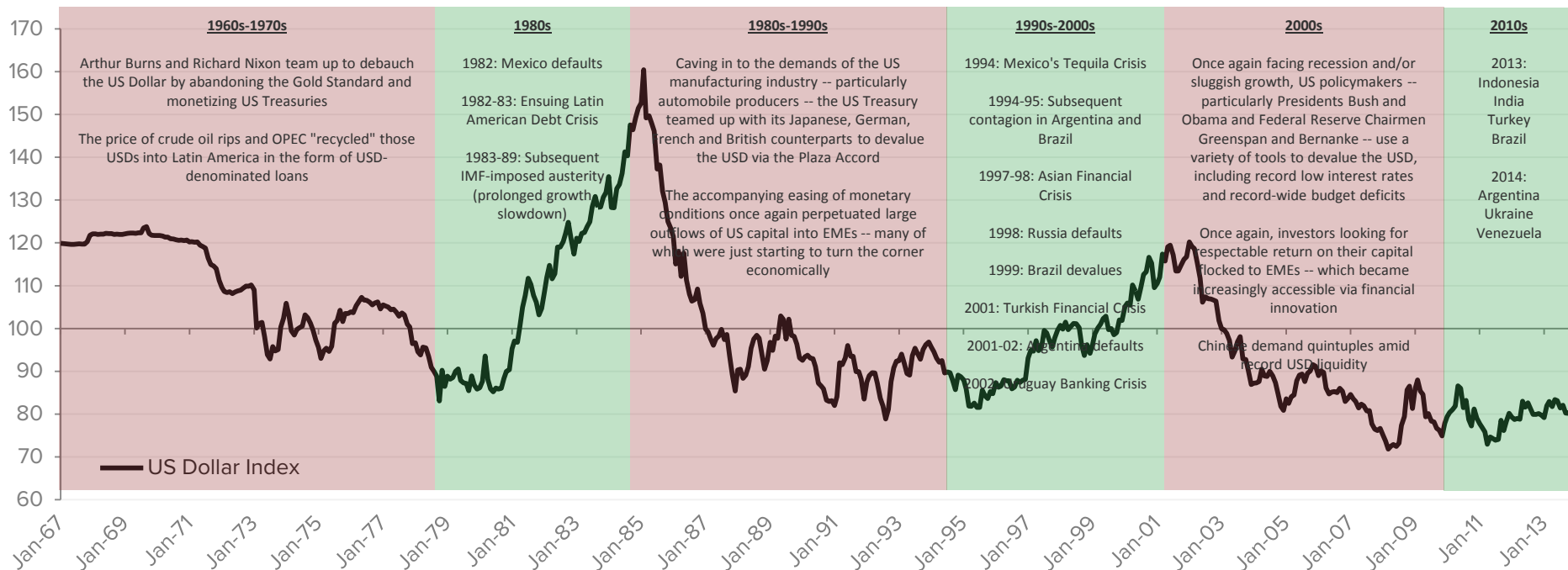


Source: Institute of International Finance; shaded area = IIF estimates.

# AS DOES MATERIAL DRAW-DOWN RISK

## OUTFLOWS PERPETUATE UNINTENDED CONSEQUENCES

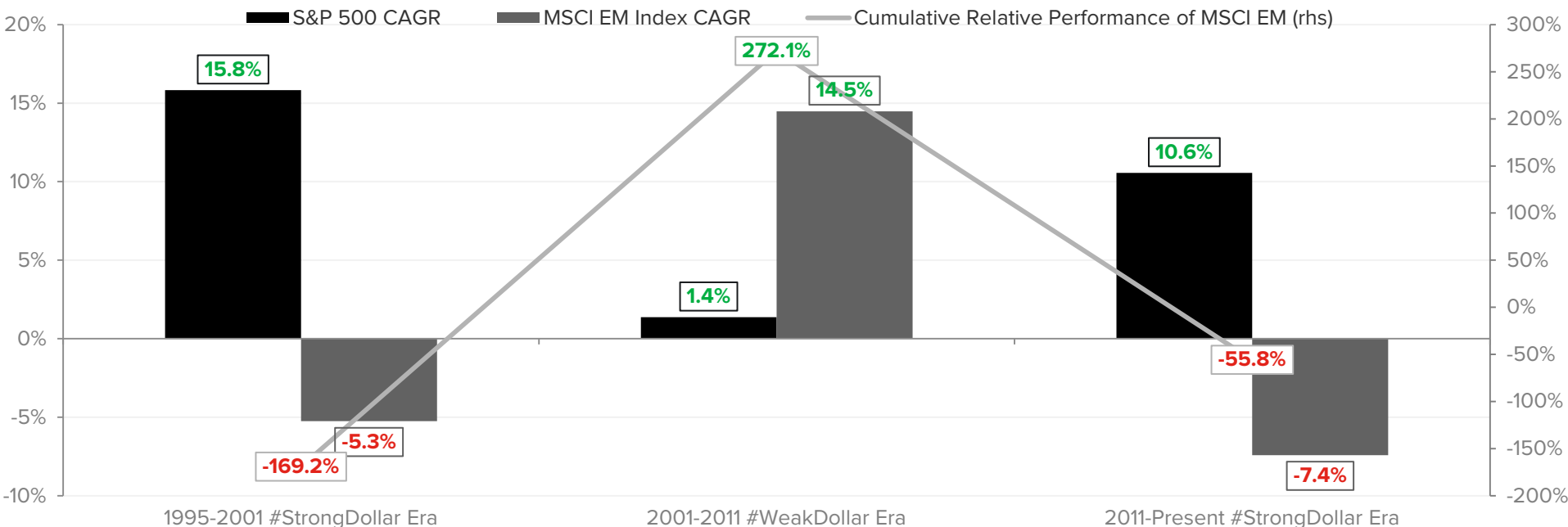
### #STRONGDOLLAR ERAS EXPOSE EMERGING MARKETS TO A VARIETY OF RISKS



# UNDERPERFORMANCE CAN LAST

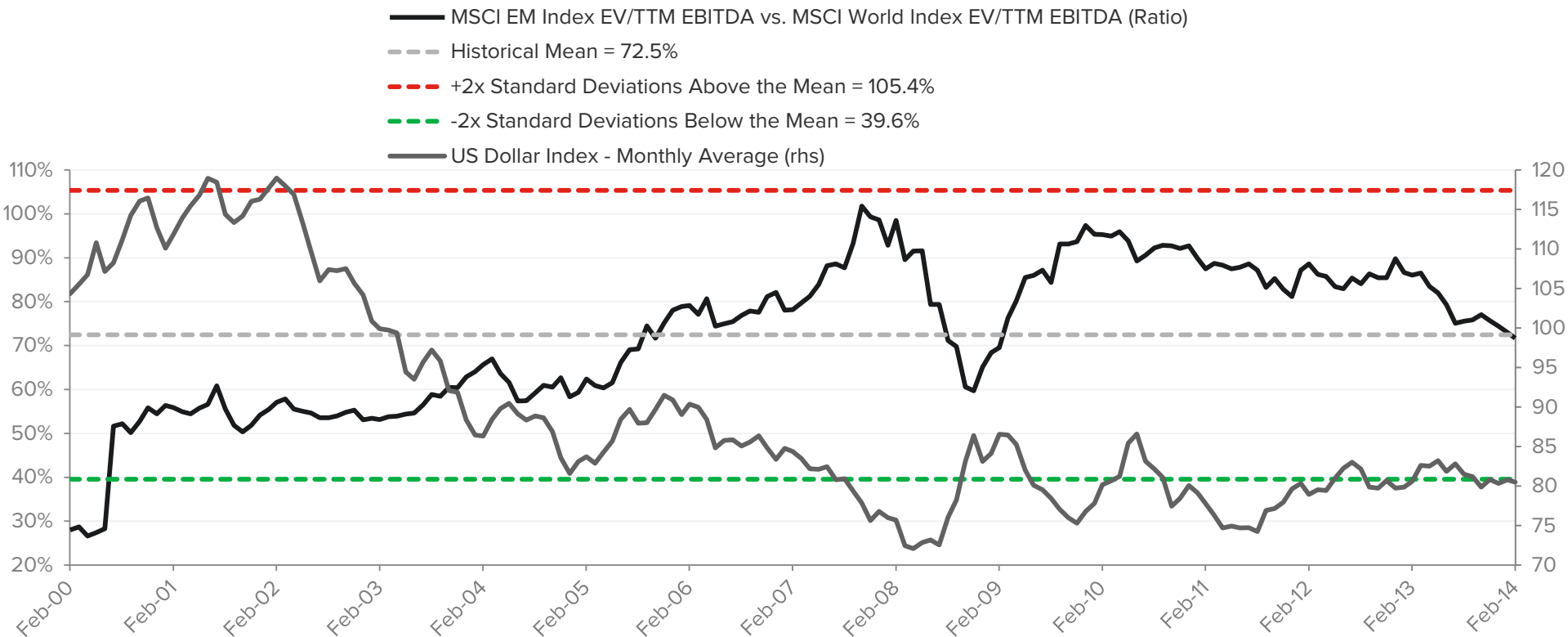
IF WE'VE TURNED THE CORNER ON US GROWTH, THEN...

**DON'T FIGHT THE TAPE:  
THE #STRONGDOLLAR ASSET ALLOCATION SHIFT IS UNDERWAY**



# “CHEAP” CAN GET A LOT CHEAPER

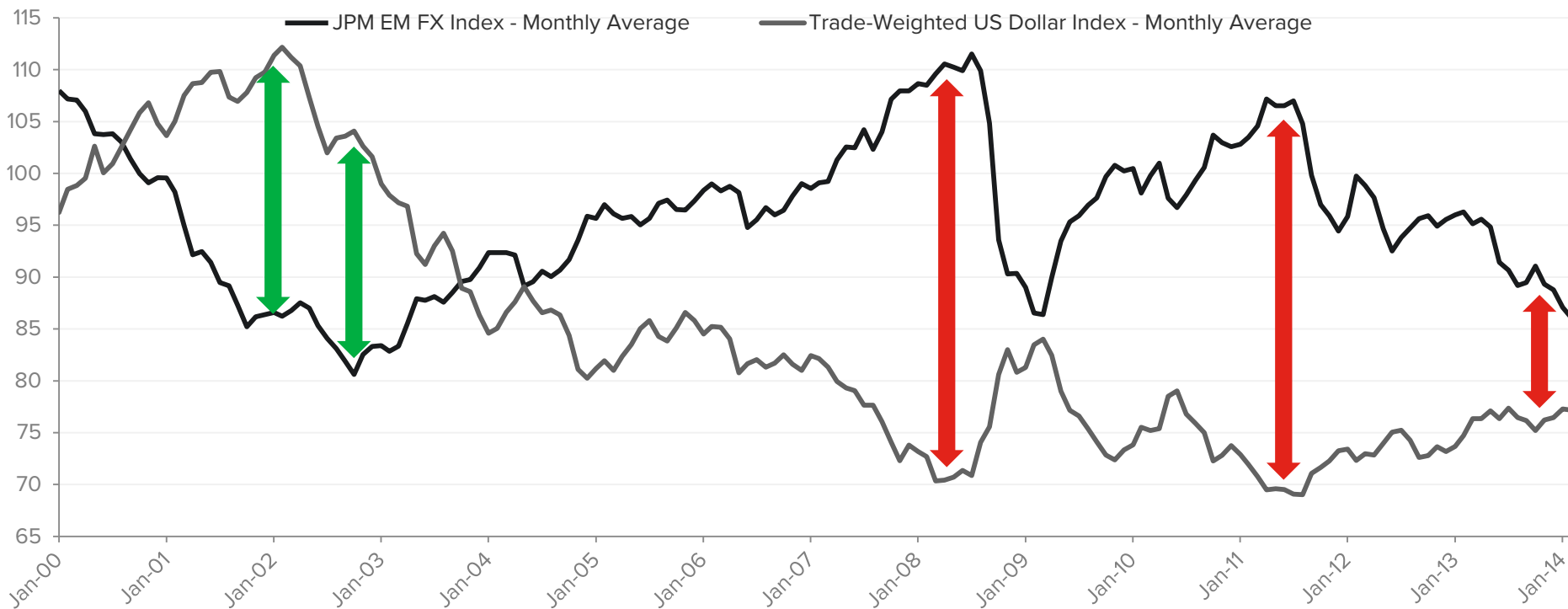
## VALUATIONS APPEAR SUPPORTIVE; THEY DID 3M AGO TOO



# ESPECIALLY AMID AMPLE SPREAD RISK

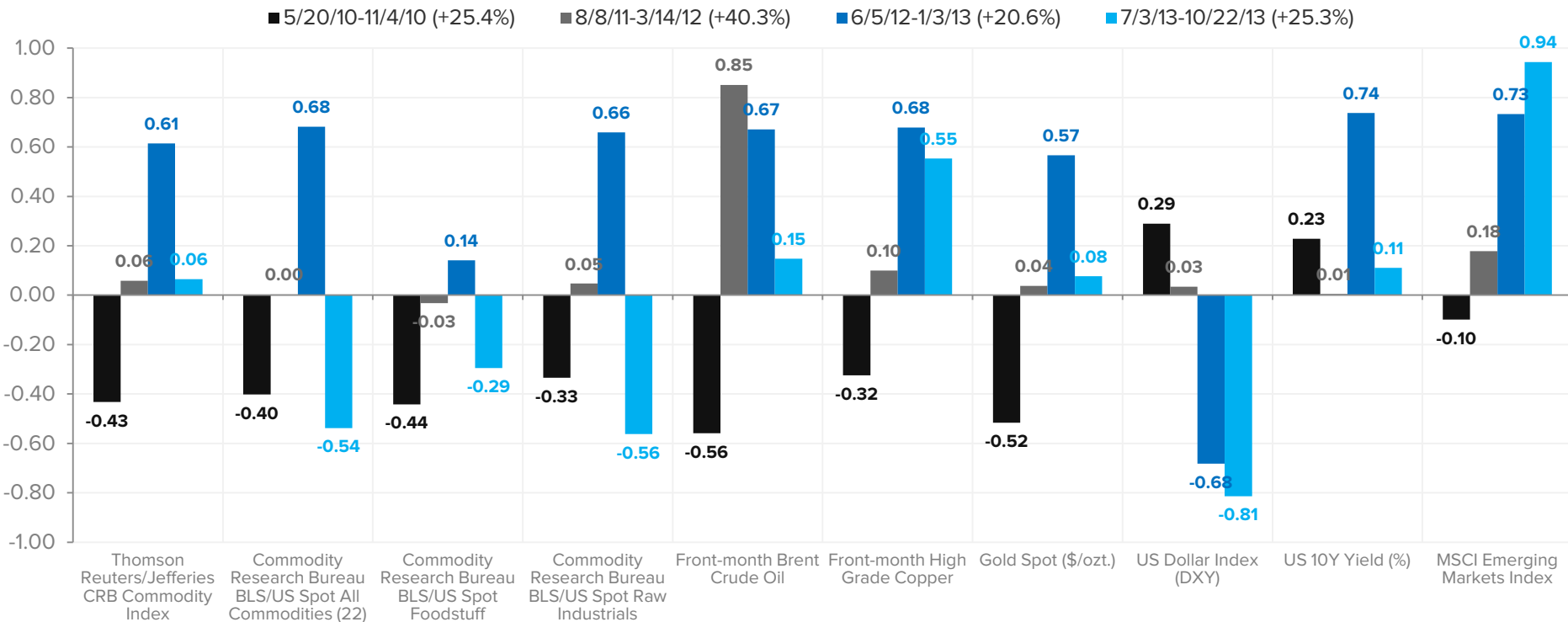
MARKETS CAN MEAN REVERT MUCH FURTHER FROM HERE

**THE EM FX CARRY TRADE IS STILL RIFE WITH SPREAD RISK**



# SO WHY BUY BRAZIL?

## MULTI-DURATION CORRELATIONS TO THE BOVESPA INDEX (IN USD TERMS)



# THREE REASONS TO BE **BULLISH ON THE BRL**

**1**

## **A WIDENING REAL INTEREST RATE SPREAD**

We believe Brazilian fiscal and monetary policy will remain tight, at the margins, over the intermediate term, while slowing economic growth in the US will cause the Fed to ease – at least rhetorically – at the margins. That should lend support for a relief rally for once-popular EM carry trading strategies.

**2**

## **A LIKELY NARROWING OF THE CURRENT ACCOUNT DEFICIT**

At the present moment, the threat of social unrest renders the World Cup an underappreciated catalyst for broad macroeconomic improvement in Brazil.

**3**

## **UNDERVALUED WITH A POLITICAL CATALYST: REFORM**

Our proprietary valuation models show that the BRL is anywhere from 12% to 30% undervalued vs. the USD. Our analysis suggests the OCT 5<sup>th</sup> election will be much closer than investors think. The potential for opposition parties to gain material traction is not at all insignificant. Political gridlock would be very positive to slow the pace of fiscal deterioration; new leadership would be even better in terms of promoting economic reforms.



# US GROWTH IS SLOWING

## U.S. ECONOMIC INDICATOR SUMMARY

		MOST RECENT DATA					LAST PRICE vs.			QoQ Chg	Y/Y Chg
		Period	Latest data	Last Price	Prior	MoM Chg	3M Ave	6M Ave	TTM Ave	(1q14)	(QoY)
CONSUMPTION	Personal Spending (Real PCE), YoY %	Dec-13	Better	2.5%	2.4%	0.09%	0.2%	0.4%	0.5%	-	-
	Personal Income, YoY %	Dec-13	Worse	-0.8%	2.3%	-3.08%	-2.4%	-3.5%	-3.6%	-	-
	Real Disposable Income (per capita), YoY %	Dec-13	Worse	-3.4%	-0.1%	-3.26%	-2.6%	-3.1%	-3.1%	-	-
	Retail Sales, YoY %	Jan-14	Worse	2.6%	3.6%	-1.06%	-0.8%	-1.2%	-1.6%	-1.3%	-1.6%
	Consumer Credit, YoY %	Dec-13	Better	6.2%	6.1%	0.11%	0.0%	0.0%	0.0%	-	-
	NFP Employment, MoM Chg	Jan-14	Better	112	74	38.0	-41	-65	-74	-82.3	-93.0
	Initial Claims, NSA, YoY %	Feb-14	Worse	-3.4%	-10.8%	7.3%	1.9%	5.9%	5.3%	0.8%	-3.2%
	Consumer Confidence	Feb-14	Worse	78	79	-1.3	-0.2	1.5	2.3	4.8	16.0
	Consumer Comfort	Feb-14	Worse	-31.5	-30.6	-0.90	-1.0	0.4	-0.7	1.9	3.6
	Real Weekly Earnings, Y/Y %	Jan-14	Worse	0.4%	0.4%	0.00%	-0.3%	-0.5%	-0.3%	-0.6%	0.1%
	Auto Sales, Millions Units	Jan-14	Worse	15.2	15.3	-0.14	-0.4	-0.4	-0.3	-2.7%	-0.5%
	Gas Price	Feb-14	Worse	3.34	3.30	3.90%	0.04	0.01	-0.13	1.2%	-6.8%
INVESTMENT	Industrial Production, YoY %	Jan-14	Worse	2.9%	3.3%	-0.36%	-0.1%	-0.3%	0.3%	-0.4%	0.5%
	Capacity Utilization	Jan-14	Worse	79	79	-0.40	-0.2	0.0	0.3	-0.3%	0.6%
	Durable Goods New Orders, YoY %	Dec-13	Worse	0.4%	10.1%	-9.75%	-5.4%	-6.0%	-4.9%	-	-
	Capital Goods - NonDefense Ex-Air, YoY %	Dec-13	Better	7.4%	6.1%	1.35%	1.4%	0.1%	2.1%	-	-
	ISM Mfg	Jan-14	Worse	51.3	56.5	-5.20	-3.6	-4.3	-2.5	-5.4	-1.0
	ISM Mfg - New Orders	Jan-14	Worse	51.2	64.4	-13.20	-8.5	-9.7	-6.0	-11.8	-1.5
	ISM Mfg - Employment	Jan-14	Worse	52.3	55.8	-3.50	-2.2	-2.3	-0.8	-2.9	-0.4
	ISM Services	Jan-14	Better	54.0	53.0	1.00	0.3	-0.8	-0.6	-0.1	-0.7
	ISM Services - New Orders	Jan-14	Better	50.9	50.4	0.50	-1.4	-4.3	-4.6	-3.3	-4.5
	ISM Services - Employment	Jan-14	Better	56.4	55.6	0.80	0.9	0.9	2.0	1.0	1.6
	Mfg & Trade Inventories, YoY %	Dec-13	Better	4.4%	4.0%	0.4%	0.4%	0.8%	0.4%	-	-
	Business Inventories I/S Ratio	Dec-13	Worse	1.30	1.29	0.01	0.01	0.01	0.01	-	-
INVESTMENT (Residential)	Housing Starts	Jan-14	Worse	880	1048	-168	-130	-67	-50	-13.4%	-8.1%
	New Home Sales	Jan-14	Better	468	427	41.0	22	38	37	6.1%	4.3%
	MBA Purchase Apps	Feb-14	Worse	162	183	-20.9	-11	-18	-30	-4.9%	-14.7%
	NAHB Survey of Home Builders	Feb-14	Worse	46	56	-10.0	-7.0	-8.0	-5.5	-4.0	5.3
	FHFA HPI, NSA YoY %	Dec-13	Better	7.7%	7.3%	0.44%	0.0%	-0.4%	0.0%	-	-
	Case-Shiller 20-City HPI, YoY %	Dec-13	Worse	13.4%	13.7%	-0.30%	-0.2%	0.2%	2.1%	-	-
	Corelogic HPI, YoY %	Jan-14	Worse	10.2%	11.1%	-0.85%	-0.7%	-1.0%	-0.9%	-1.1%	2.2%
GOVERNMENT	Construction Spending, YoY %	Dec-13	Worse	5.3%	5.4%	0.0%	-0.6%	-0.3%	-0.2%	-	-
	Monthly Budget Balance, Bil \$'s	Jan-14	Worse	-10.4	53.2	-63.6	20	32	37	47.45	91.97
EXTERNAL	International Trade Balance, Bil \$'s	Dec-13	Worse	-38.7	-34.6	-4.14	-1.3	0.0	0.6	-	-

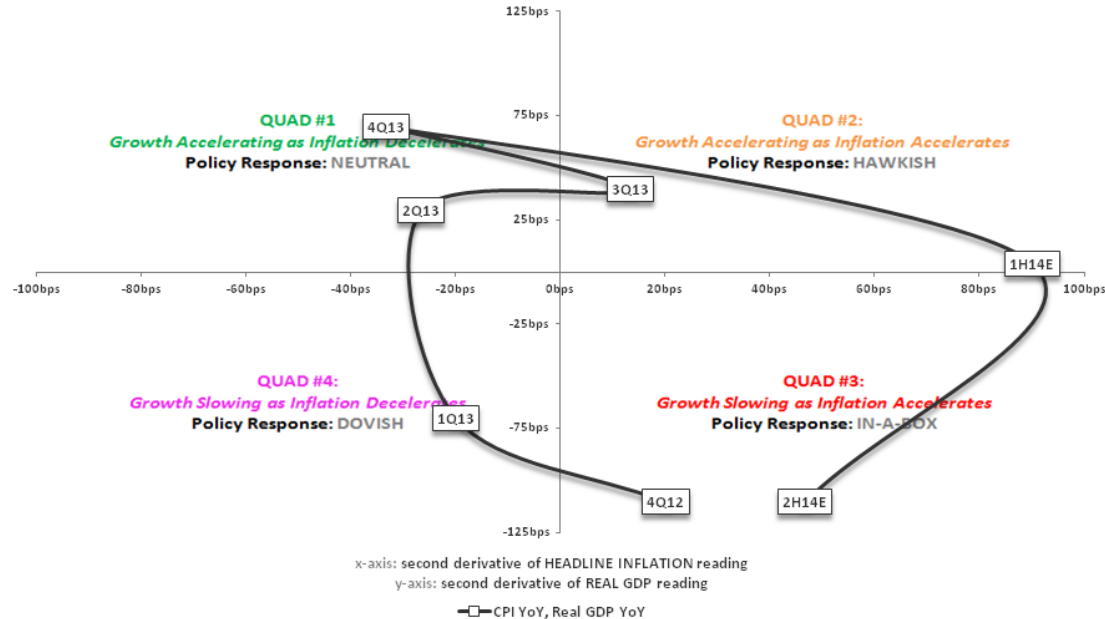
Source: Bloomberg, BLS, BEA, Census, NAR



# BECAUSE INFLATION SLOWS GROWTH

UNITED STATES	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	Hedgeye Macro GIP Model		
Real GDP QoQ SAAR	4.9%	3.7%	1.2%	2.8%	0.1%	1.1%	2.5%	4.1%	3.2%	GIP = Growth/Inflation/Policy		
Real GDP YoY	2.0%	3.3%	2.8%	3.1%	2.0%	1.3%	1.6%	2.0%	2.7%	Full-year Estimates		
2Y Average	2.4%	2.7%	2.4%	2.3%	2.0%	2.3%	2.2%	2.6%	2.4%	Bloomberg Consensus Real GDP YoY		
3Y Average	1.5%	2.3%	2.5%	2.5%	2.3%	2.2%	2.1%	2.2%	2.2%	Hedgeye Predictive Tracking Algorithm		
CPI YoY	3.3%	2.8%	1.9%	1.7%	1.9%	1.7%	1.4%	1.6%	1.2%	Full-year Estimates		
2Y Average	2.3%	2.5%	2.7%	2.7%	2.6%	2.3%	1.7%	1.6%	1.6%	Bloomberg Consensus YoY YoY		
3Y Average	2.0%	2.4%	2.4%	2.2%	2.2%	2.2%	2.3%	2.3%	2.1%	Hedgeye Predictive Tracking Algorithm		

Source:  
Bloomberg data;  
Hedgeye calculations  
Color-coded data in  
the adjacent table  
represent actual  
reported figures  
unless otherwise  
noted.



# HOUSING MARKET MOMENTUM: GONE

## HEDGEYE HOUSING COMPENDIUM

					TRADE/TREND/TAIL			Rate of Change		
					Short Term	Intmed Term	Long Term	Short Term	Intmed Term	Long Term
Most Recent Data										
		Period	Latest Data	Last Price	Prior Period	3M Ago	12M Ave	MoM Chg	3M Chg	vs 12M Avg
Home Prices	Case-Shiller 20 City HPI YoY NSA	Dec-13	Worse	13.4%	13.7%	13.3%	11.9%	-0.3%	0.2%	1.5%
	Case-Shiller 20 City HPI MoM SA	Dec-13	Worse	0.8%	0.9%	1.0%	1.1%	-0.1%	-0.3%	-0.3%
	Corelogic HPI - NSA YoY % Chg	Jan-14	Worse	10.2%	11.0%	11.6%	10.9%	-0.8%	-1.4%	-0.8%
	Corelogic (Ex-Distressed) HPI - NSA YoY % Chg	Dec-13	Better	9.9%	9.8%	9.8%	9.3%	0.1%	0.1%	0.6%
	FHFA HPI - NSA YoY % Chg	Dec-13	Better	7.6%	7.2%	8.2%	7.6%	0.4%	-0.6%	0.0%
Supply & Demand: Existing	MBA Purchase Apps (Index)	Feb-14	Worse	162	183	187	193.1	-11.4%	-13.2%	-15.9%
	NAR: Pending Home Sales (Index)	Dec-13	Worse	92.4	101.2	102.7	105	-8.7%	-10.0%	-11.8%
	NAR: Existing Home Sales (SAAR)	Jan-14	Worse	4.62	4.87	5.13	5.0	-5.1%	-9.9%	-8.3%
	NAR: Existing Home Inventory (millions units)	Jan-14	Worse	1.90	1.86	2.11	2.0	2.2%	-10.0%	-7.1%
	NAR: Existing Home Inventory: Months Supply	Jan-14	Worse	4.94	4.58	4.94	4.9	7.7%	0.0%	1.3%
Supply & Demand: New Homes	NAHB: HMI	Feb-14	Worse	46	56	54	51	-10.0	-8.0	-0.1
	Census: Total Starts	Jan-14	Worse	880	1048	899	927	-16.0%	-2.1%	-5.1%
	Census: SF Starts	Jan-14	Worse	573	681	600	618	-15.9%	-4.5%	-7.3%
	Census: Total Permits	Jan-14	Worse	937	991	1039	962	-5.4%	-9.8%	-2.6%
	Census: SF Permits	Jan-14	Worse	602	610	621	613	-1.3%	-3.1%	-1.8%
	Resi Construction Spending (in Billions)	Dec-13	Better	357	349	346	336	2.4%	3.3%	6.3%
	Census: New Home Sales	Jan-14	Better	468	414	463	433	13.0%	1.1%	8.2%
	Census: New Home Inventory (000)	Jan-14	Worse	184	170	185	168	8.2%	-0.5%	9.5%
Miscellaneous	Interest Rates (30 Year FRM)	Feb-14	Better	4.5%	4.6%	4.4%	4.3%	-0.1%	0.1%	0.2%
	NAR: Affordability Index (Composite)	Dec-13	Worse	168.1	170.9	165.1	178.6	-1.6%	1.8%	-5.9%
	ITB Price (EOP)	Feb-14	Better	24.82	24.34	22.49	23.2	2.0%	10.4%	7.1%
	XHB Price (EOP)	Feb-14	Worse	32.07	32.11	30.99	30.4	-0.1%	3.5%	5.3%

# DOLLAR DOWN + RATES DOWN = EM RELIEF RALLY?

**HEDGEYE QUANTITATIVE SETUP: US DOLLAR INDEX**

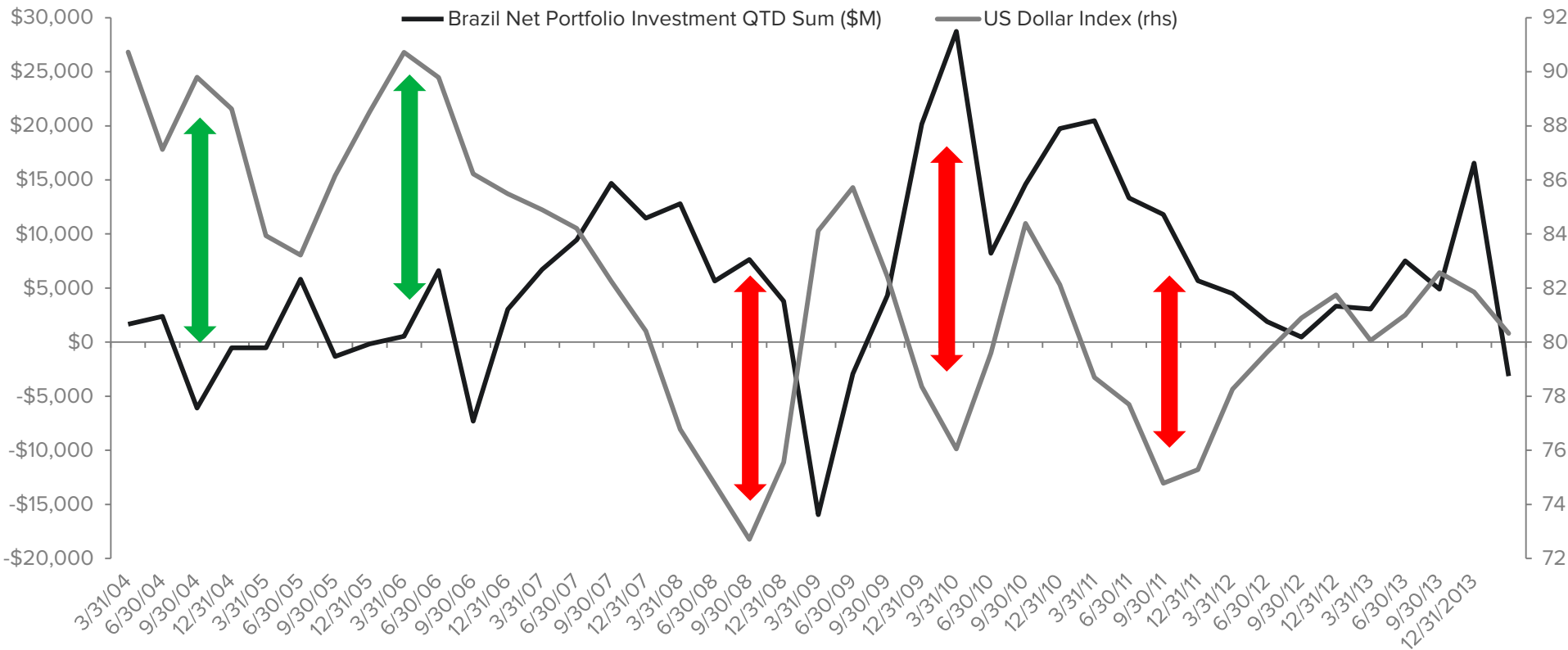


**HEDGEYE QUANTITATIVE SETUP: UST 10Y YIELD**



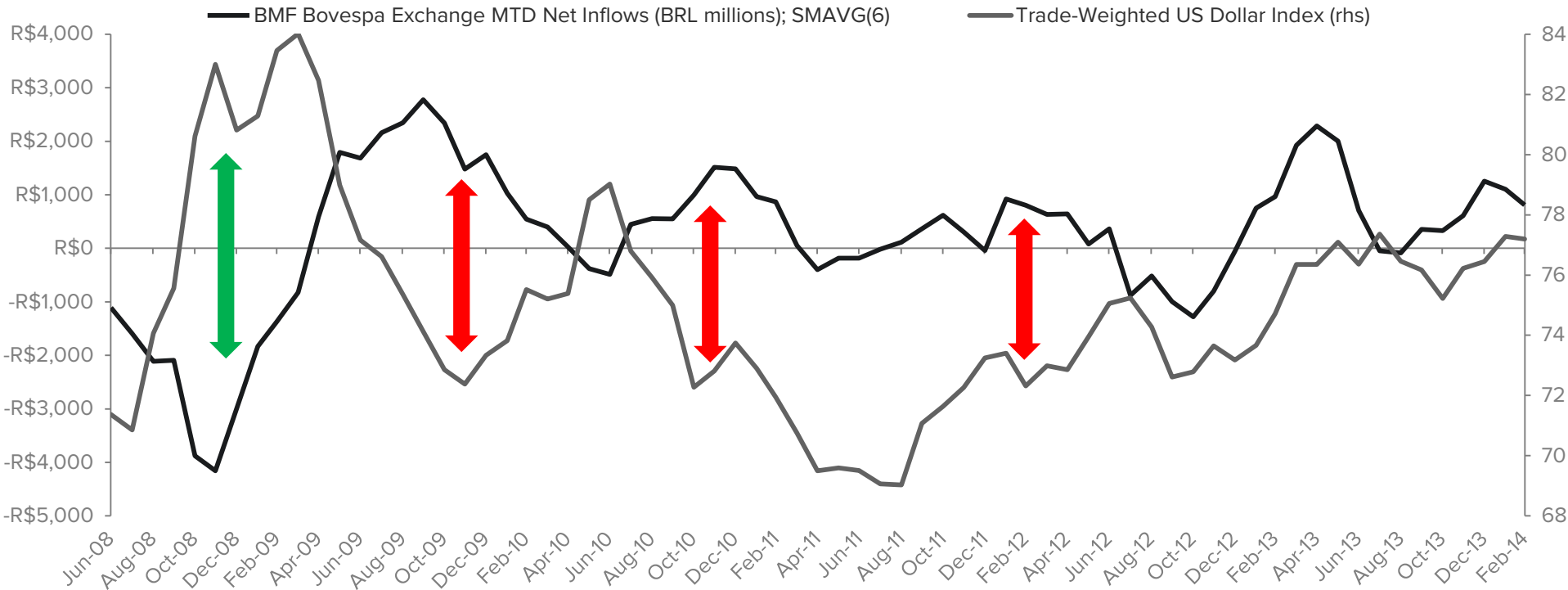
# THAT WOULD BE POSITIVE FOR BRAZIL

**GLOBALIZATION AND DIVERSIFICATION HAVE MADE THE USD A KEY FACTOR IN DETERMINING CROSS-BORDER INVESTMENT IN BRAZILIAN FINANCIAL ASSETS**

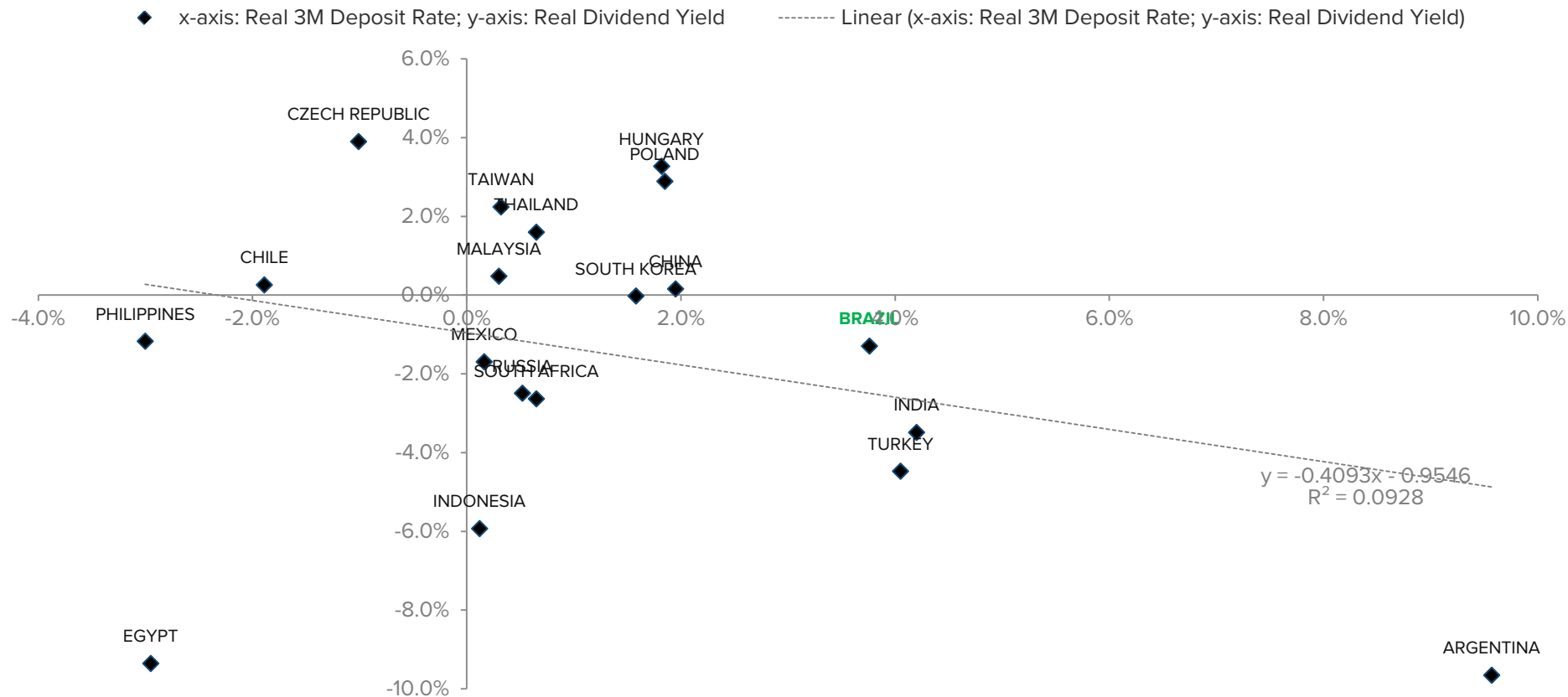


# ESPECIALLY BRAZILIAN EQUITIES

**HISTORICALLY, THE BOVESPA HAS ESPECIALLY FAVORED A WEAKER USD**

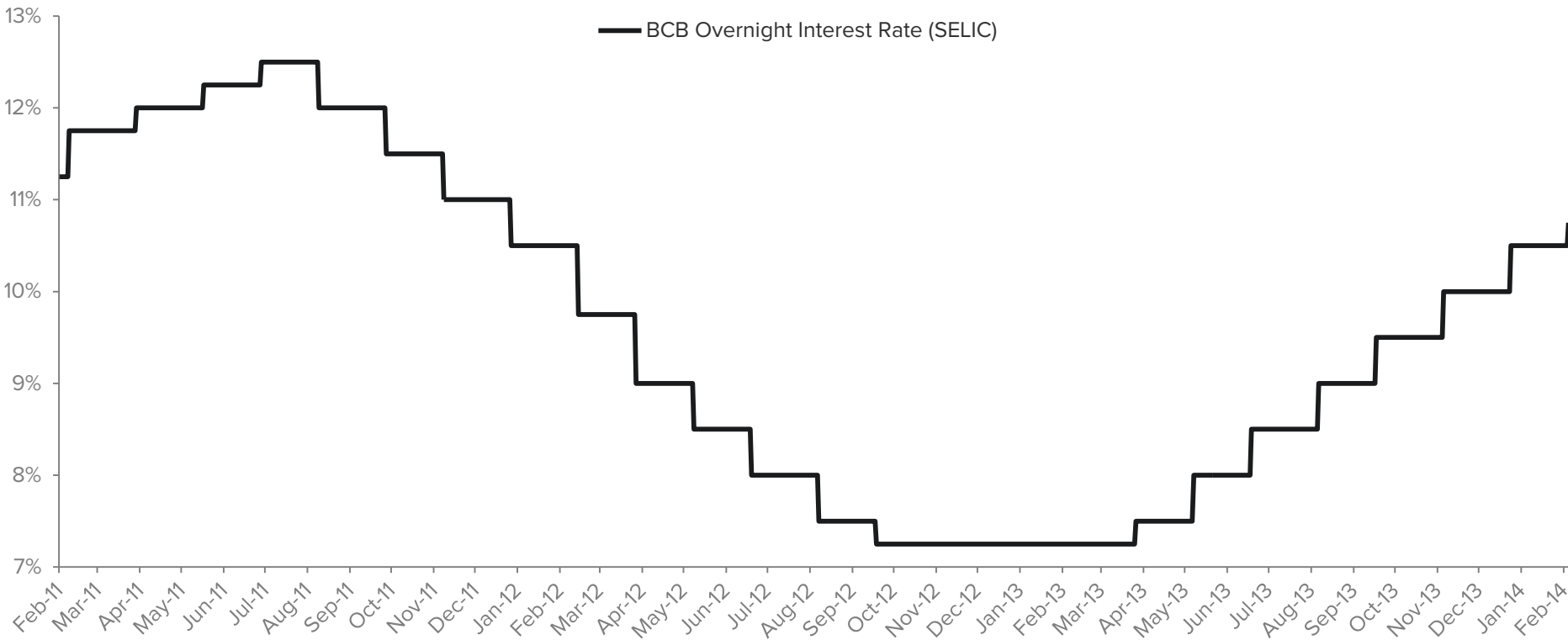


# IS THE EM CARRY TRADE BACK “ON”?



# THE BCB'S HAWKISHNESS IS HELPING

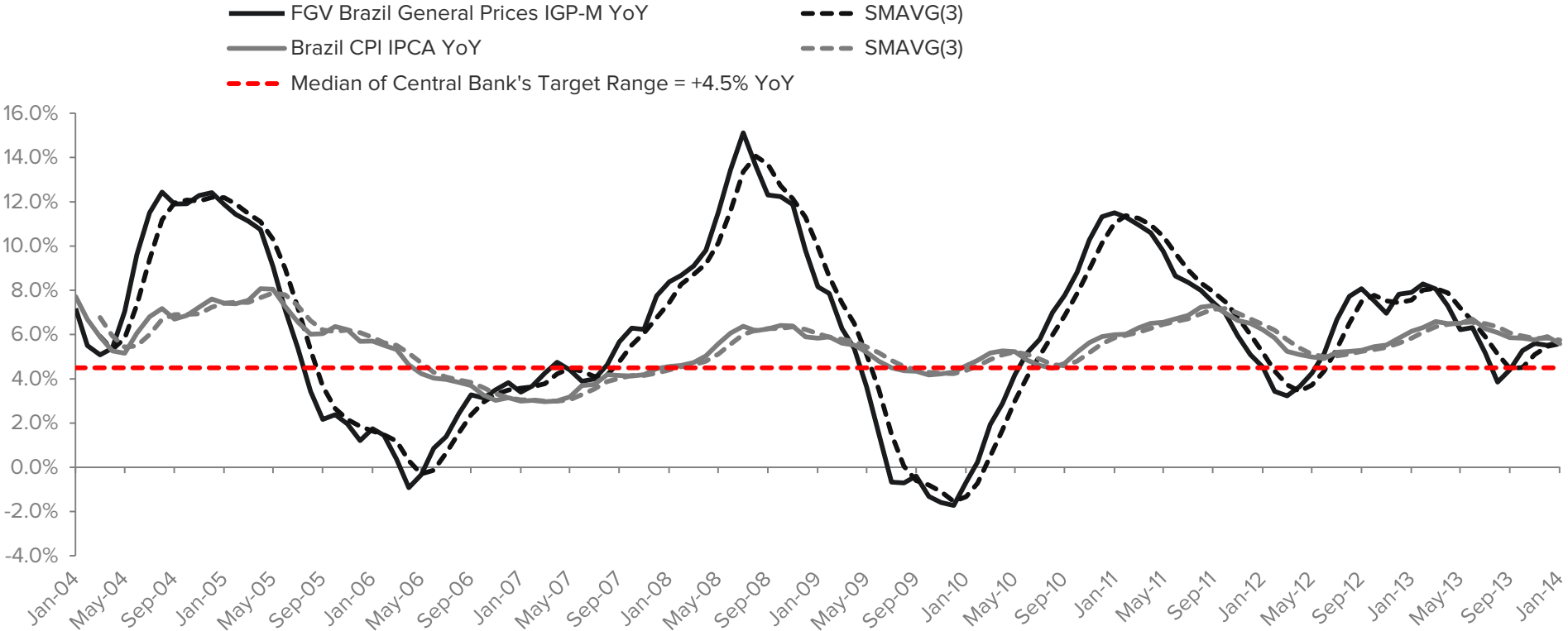
## WILL ROUSSEFF AND MANTEGA CONTINUE TO ALLOW TOMBINI TO REMAIN VIGILANT ON INFLATION?





# THEY WILL NEED TO DO MORE

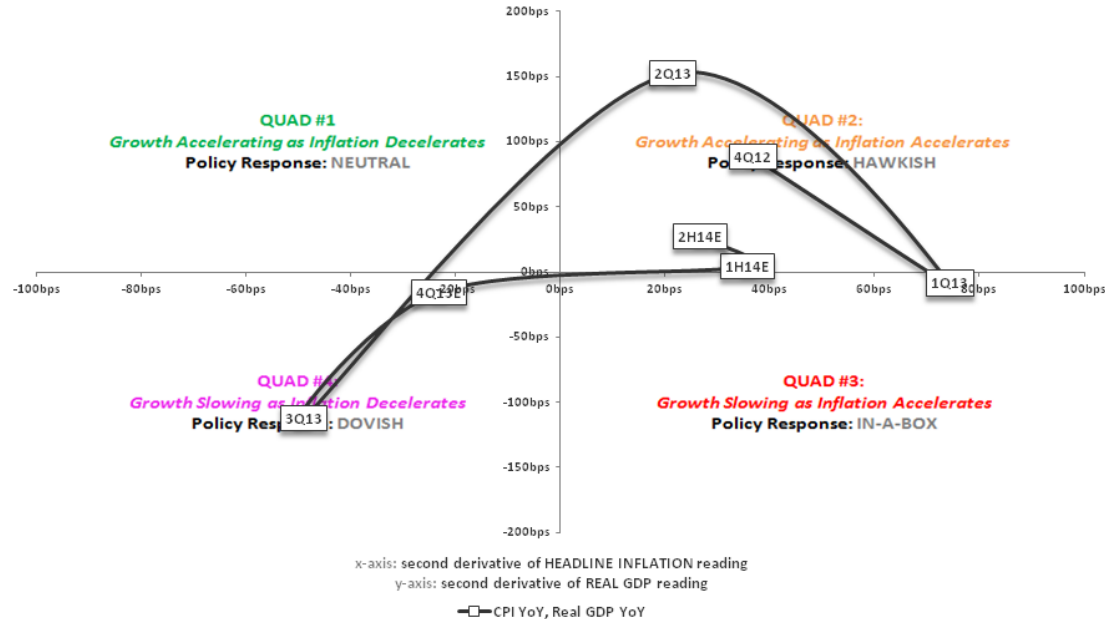
**WHOLESALE PRICES, WHICH TYPICALLY LEAD CONSUMER PRICES BY 4-6M IN BRAZIL, HAVE INFLECTED AND ARE NOW ACCELERATING WELL IN ADVANCE OF BCB'S TARGET BEING MET**



# INFLATION WILL REMAIN STICKY

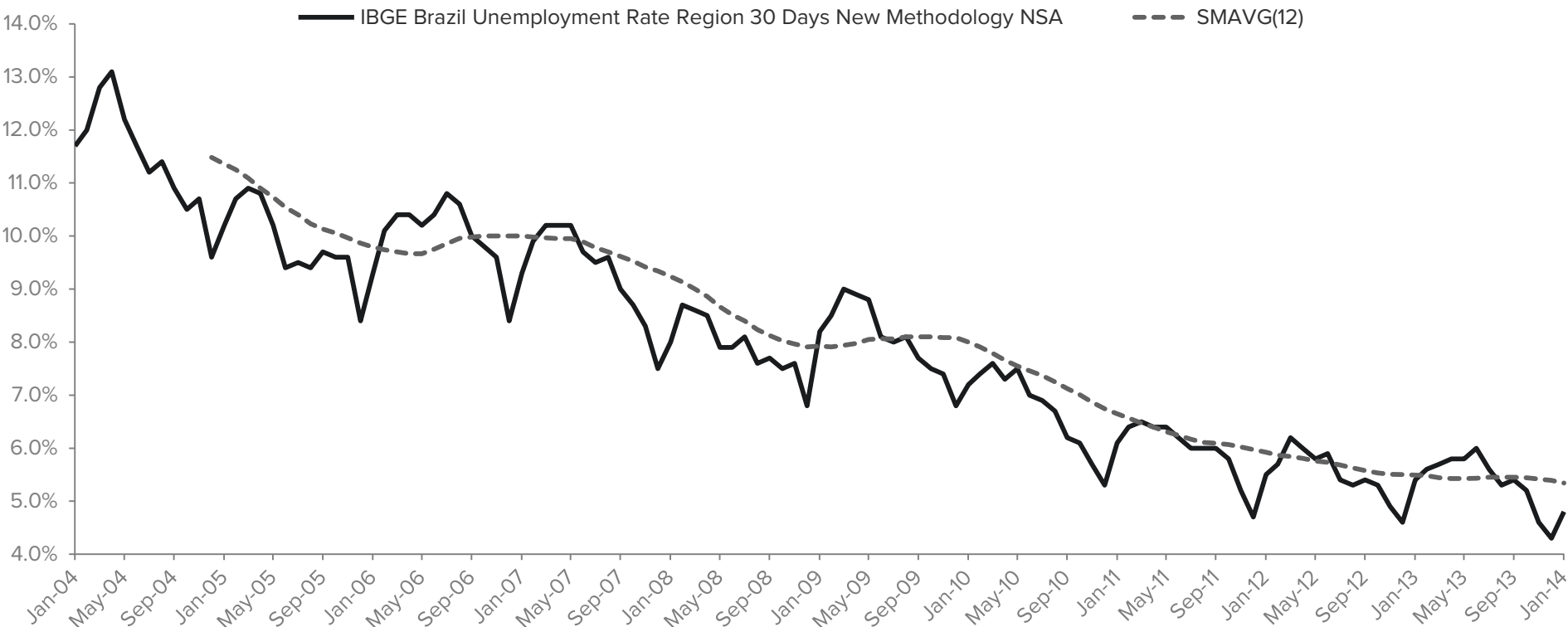
BRAZIL	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	Hedgeye Macro GIP Model		
Real GDP YoY	2.1%	1.4%	0.8%	0.6%	0.9%	1.8%	1.8%	3.3%	2.2%	Full-year Estimates		2013E 2014E
2Y Average	4.5%	3.4%	2.5%	1.9%	1.5%	1.6%	1.3%	1.9%	1.6%	Bloomberg Consensus Real GDP YoY		2.2% 2.0%
3Y Average	2.5%	4.0%	4.8%	4.2%	3.3%	2.8%	2.3%	2.4%	1.7%	Hedgeye Predictive Tracking Algorithm		2.3% 2.3%
CPI YoY	7.1%	6.7%	5.8%	5.0%	5.2%	5.6%	6.4%	6.6%	6.1%	Full-year Estimates		2013E 2014E
2Y Average	5.9%	6.1%	5.9%	5.8%	6.2%	6.2%	6.1%	5.8%	5.7%	Bloomberg Consensus YoY YoY		6.2% 5.9%
3Y Average	5.4%	5.5%	5.6%	5.6%	5.7%	6.0%	6.1%	6.1%	6.2%	Hedgeye Predictive Tracking Algorithm		6.2% 6.2%

Source:  
Bloomberg data;  
Hedgeye calculations  
Color-coded data in  
the adjacent table  
represent actual  
reported figures  
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noted.



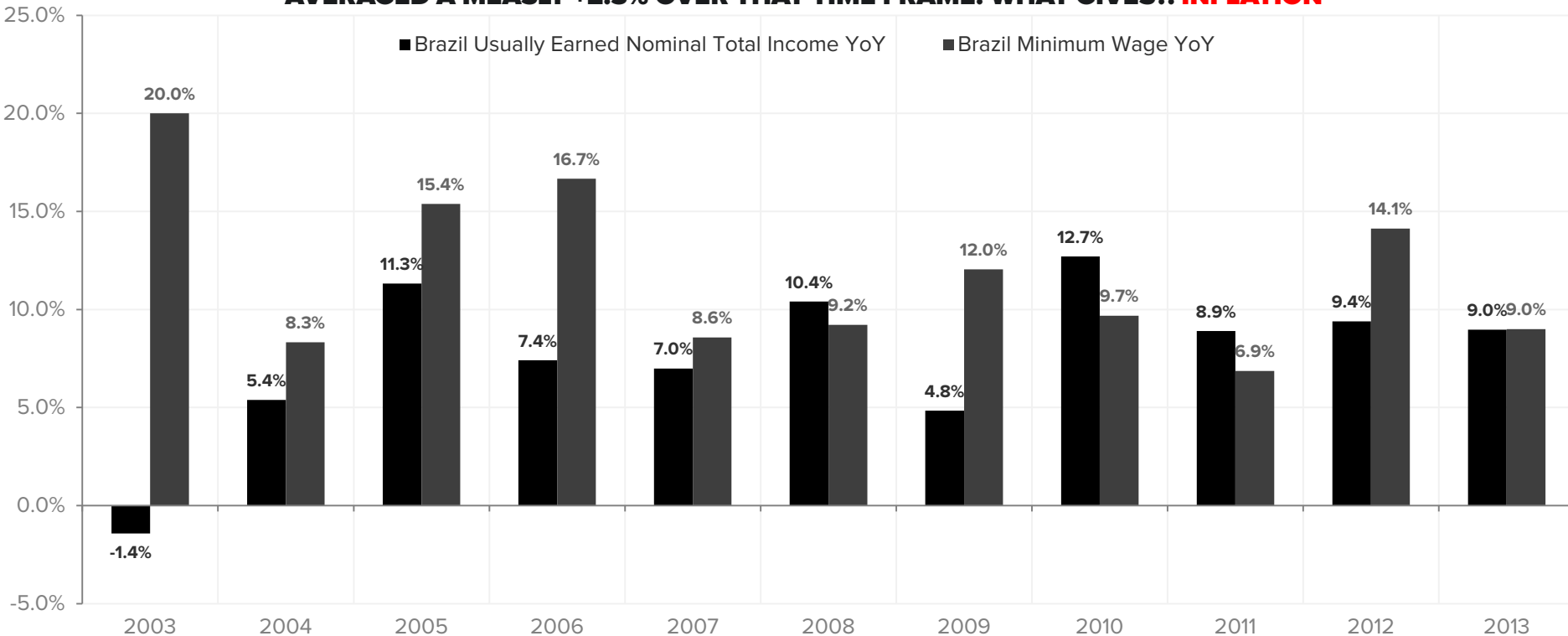
# A TIGHT LABOR MARKET EQUALS...

**A HUMAN CAPITAL DEFICIENCY AND A LARGE BLACK MARKET ARE THE ROOT CAUSE FOR BRAZIL'S TIGHT LABOR MARKET -- NOT ECONOMIC GROWTH**



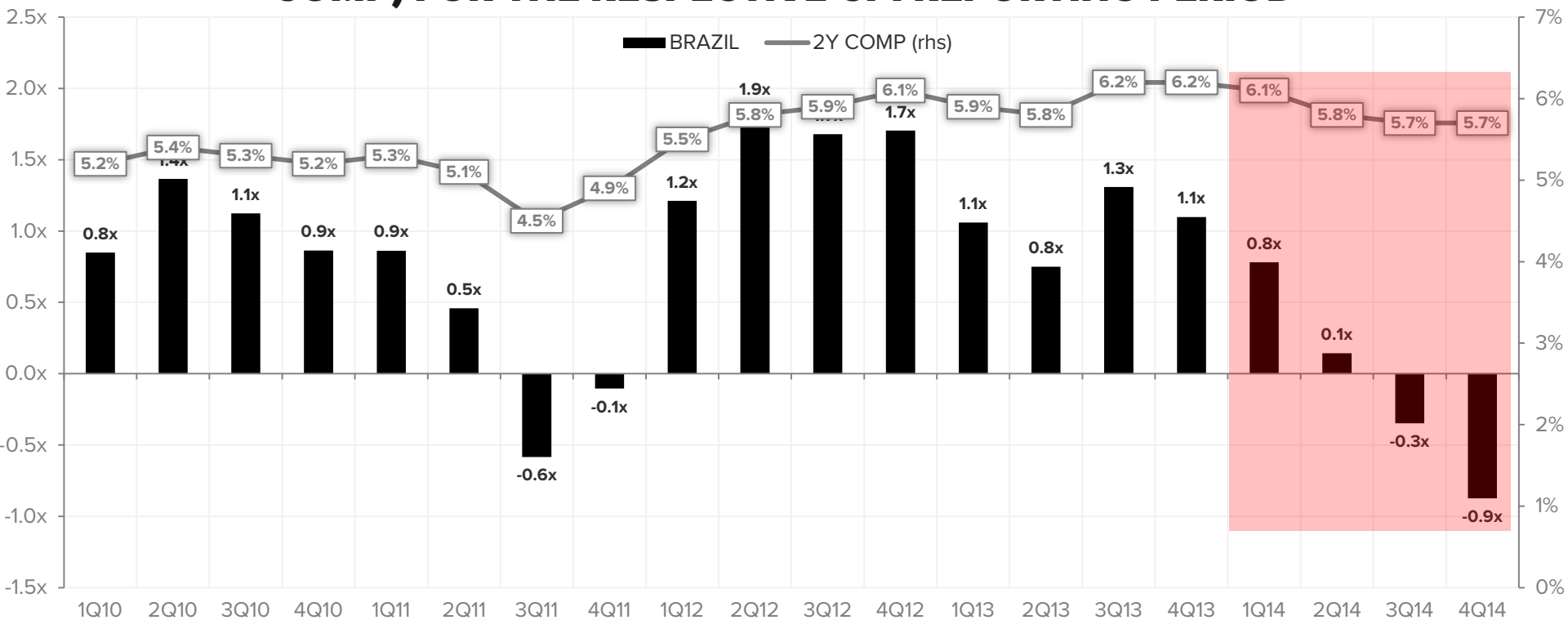
# UNCHECKED WAGE INFLATION

**WAGE GROWTH IN BRAZIL HAS AVERAGED +9-10% Y/Y OVER THE PAST 3Y, HELPING BOOST NOMINAL GDP GROWTH TO A SIMILAR AVERAGE. MEANWHILE, REAL GDP GROWTH HAS AVERAGED A MEASLY +2.3% OVER THAT TIME FRAME. WHAT GIVES?: INFLATION**

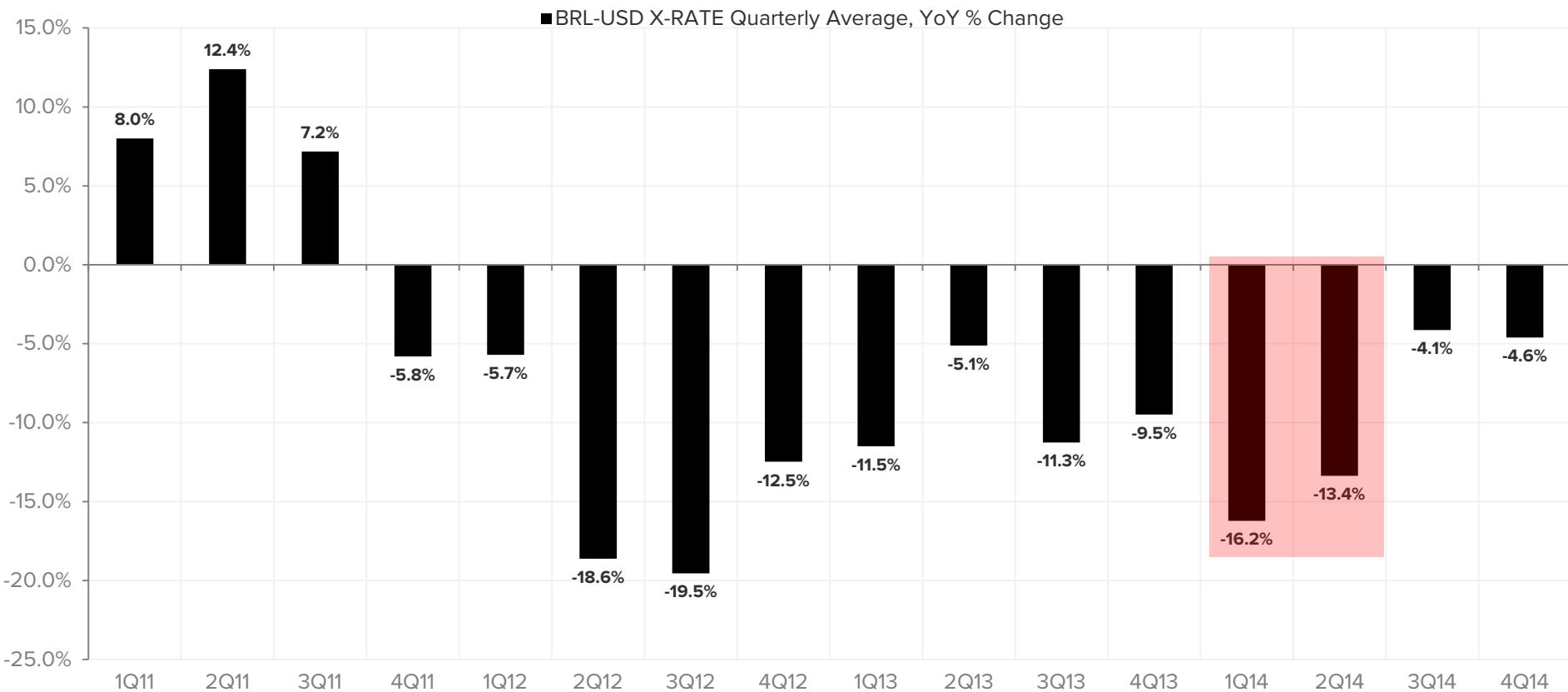


# PLUS, CPI COMPARES GET EASY

## Z-SCORE (TRAILING 3Y) OF SELECTED COMPARATIVE BASE (2Y COMP) FOR THE RESPECTIVE CPI REPORTING PERIOD



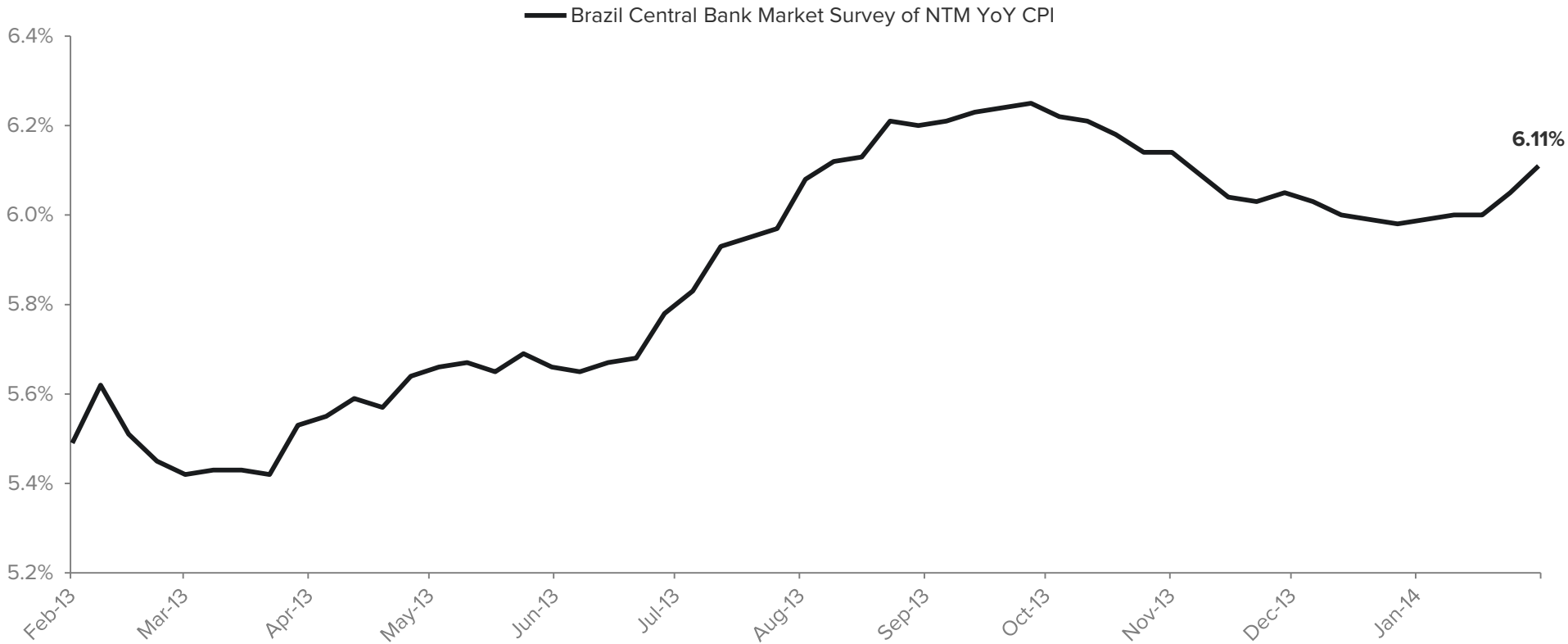
# AMID ANNUALIZED FX WEAKNESS



Forecasts assume no change in prices from current levels.

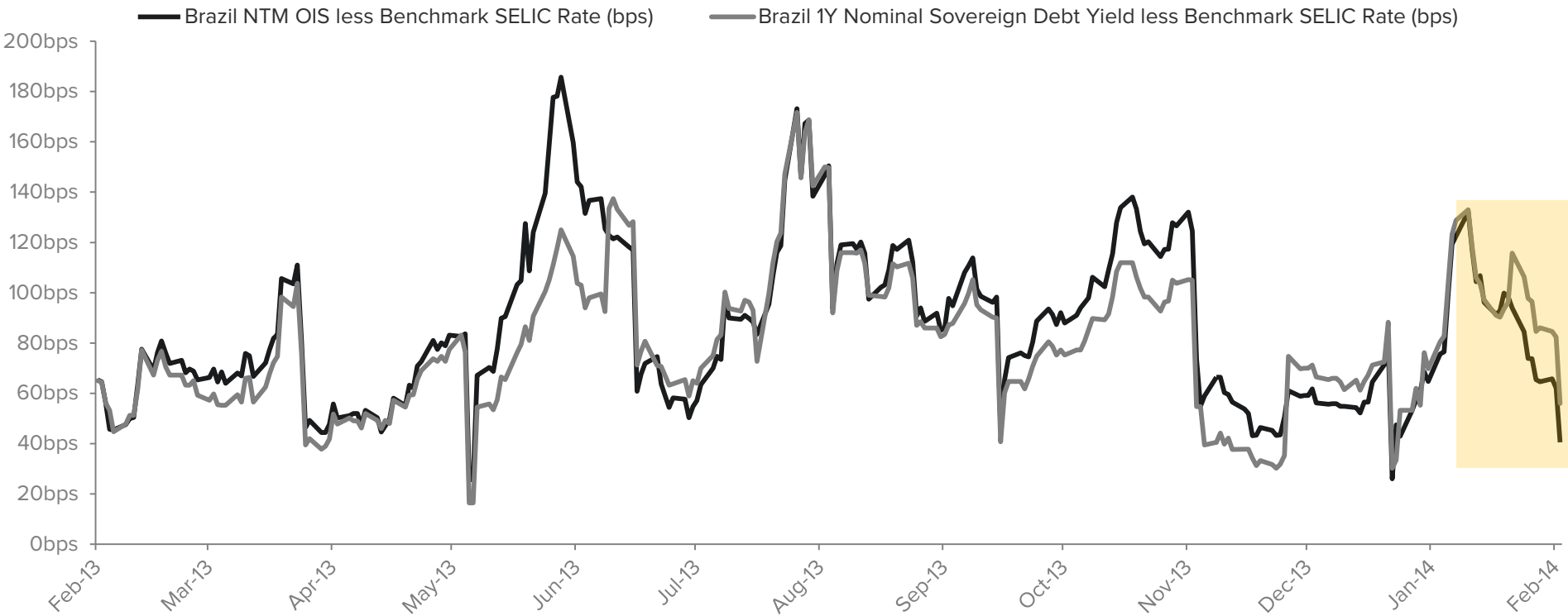
# ECONOMISTS GET IT

## INFLATION EXPECTATIONS HAVE INFLECTED RECENTLY



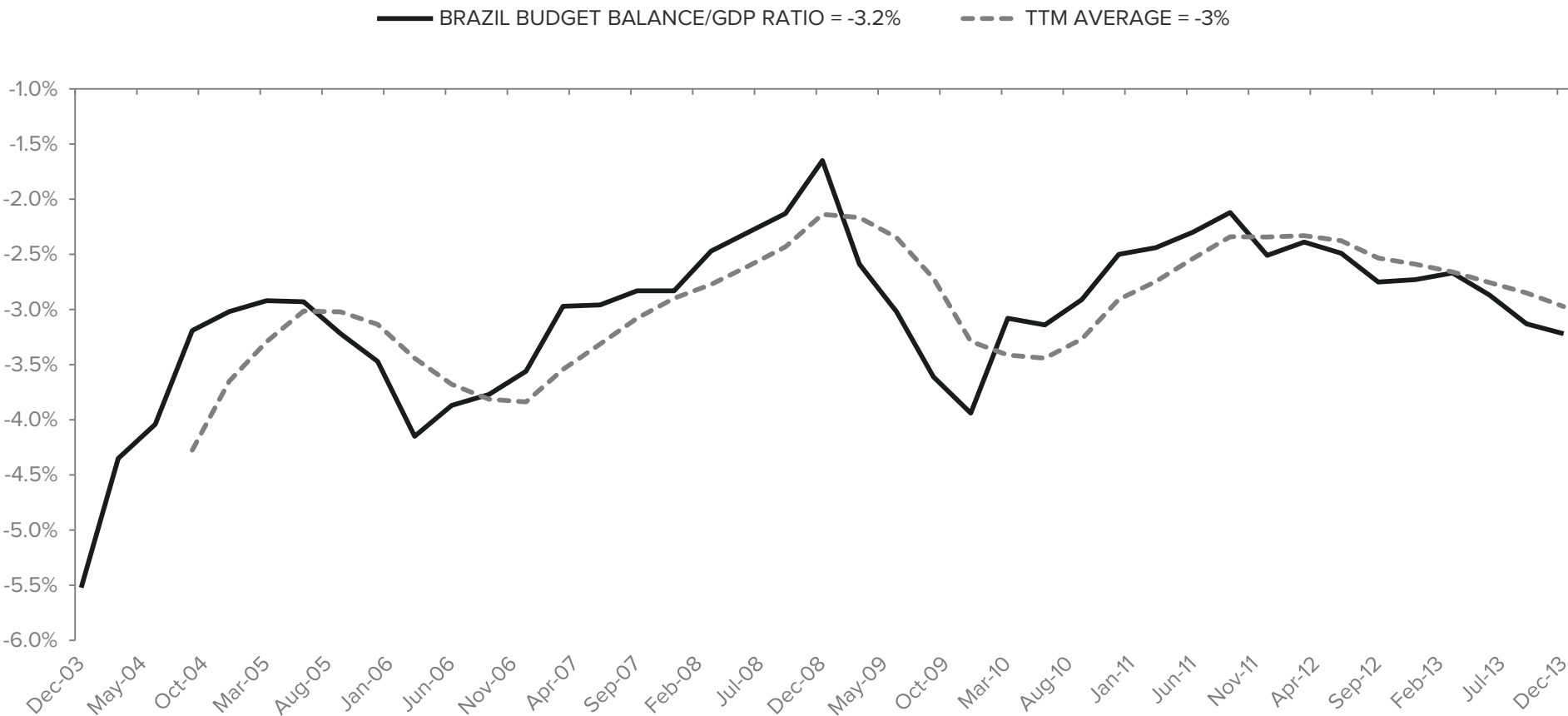
# WHILE TRADERS OVERREACT

**EXPECTATIONS FOR BCB MONETARY POLICY HAVE INFLECTED  
RECENTLY... IS THAT A GOOD OR A BAD THING?**



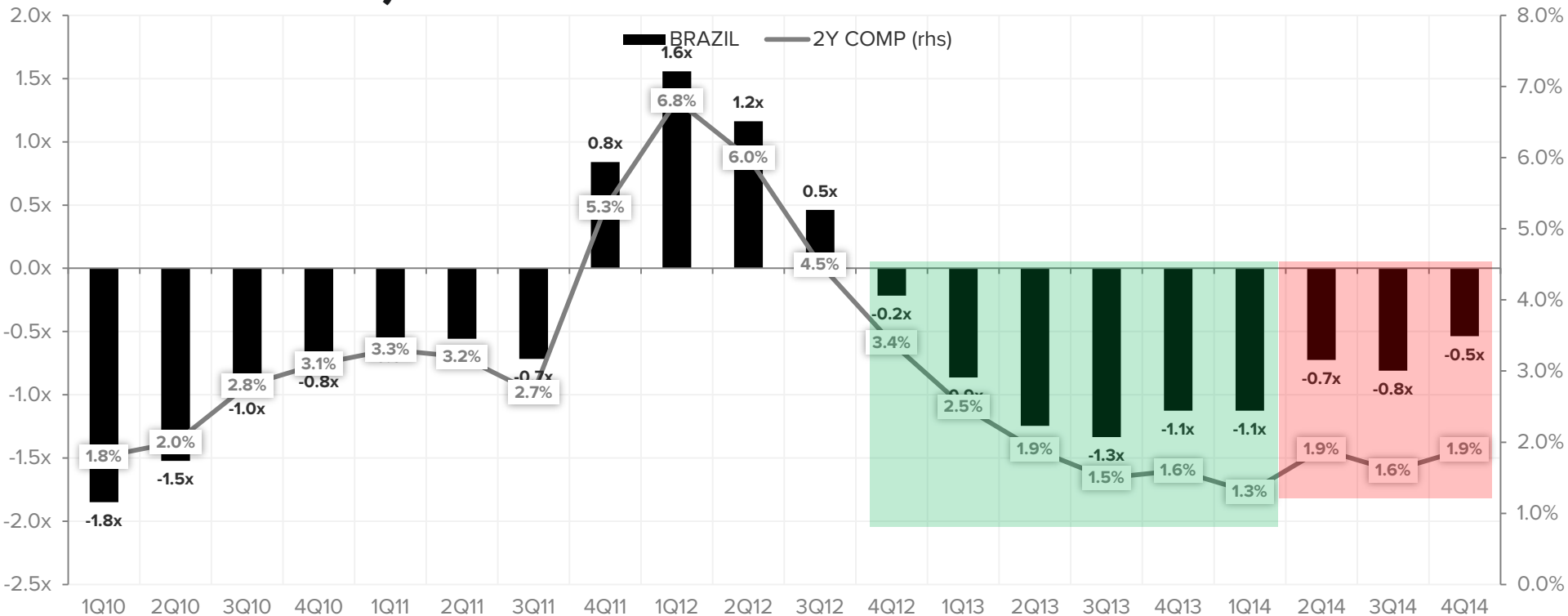


# FISCAL POLICY marginally supportive

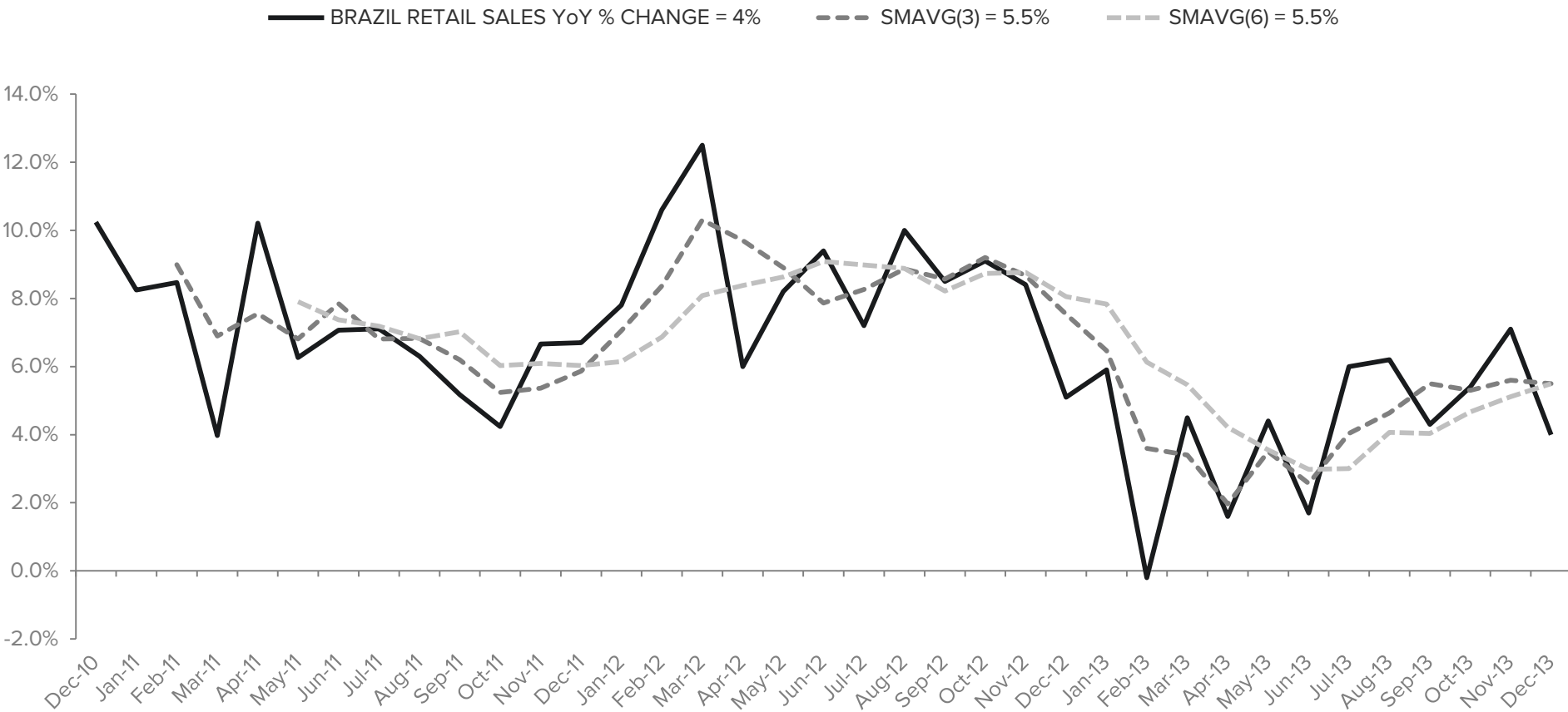


# GDP COMPS NO LONGER A TAILWIND

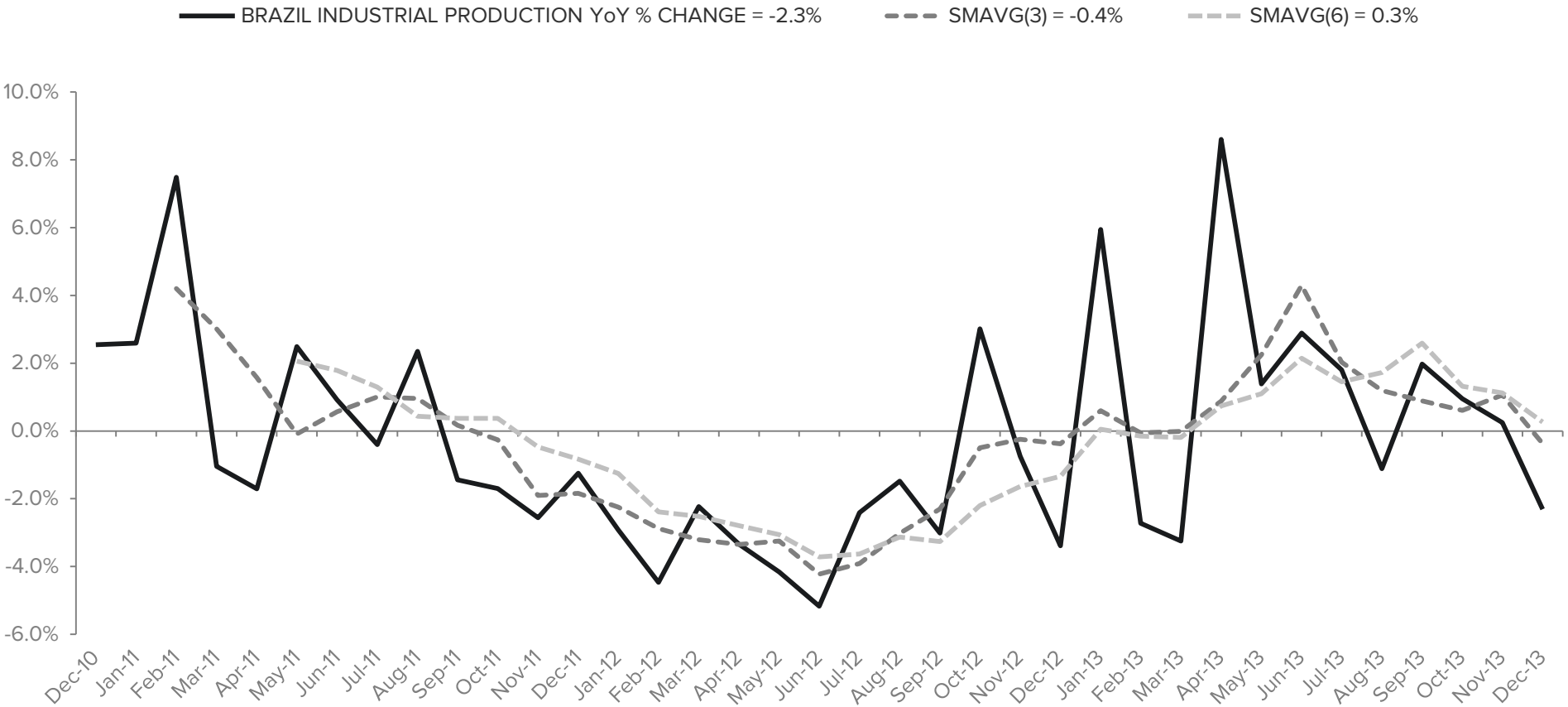
**Z-SCORE (TRAILING 3Y) OF SELECTED COMPARATIVE BASE (2Y COMP) FOR THE RESPECTIVE GDP REPORTING PERIOD**



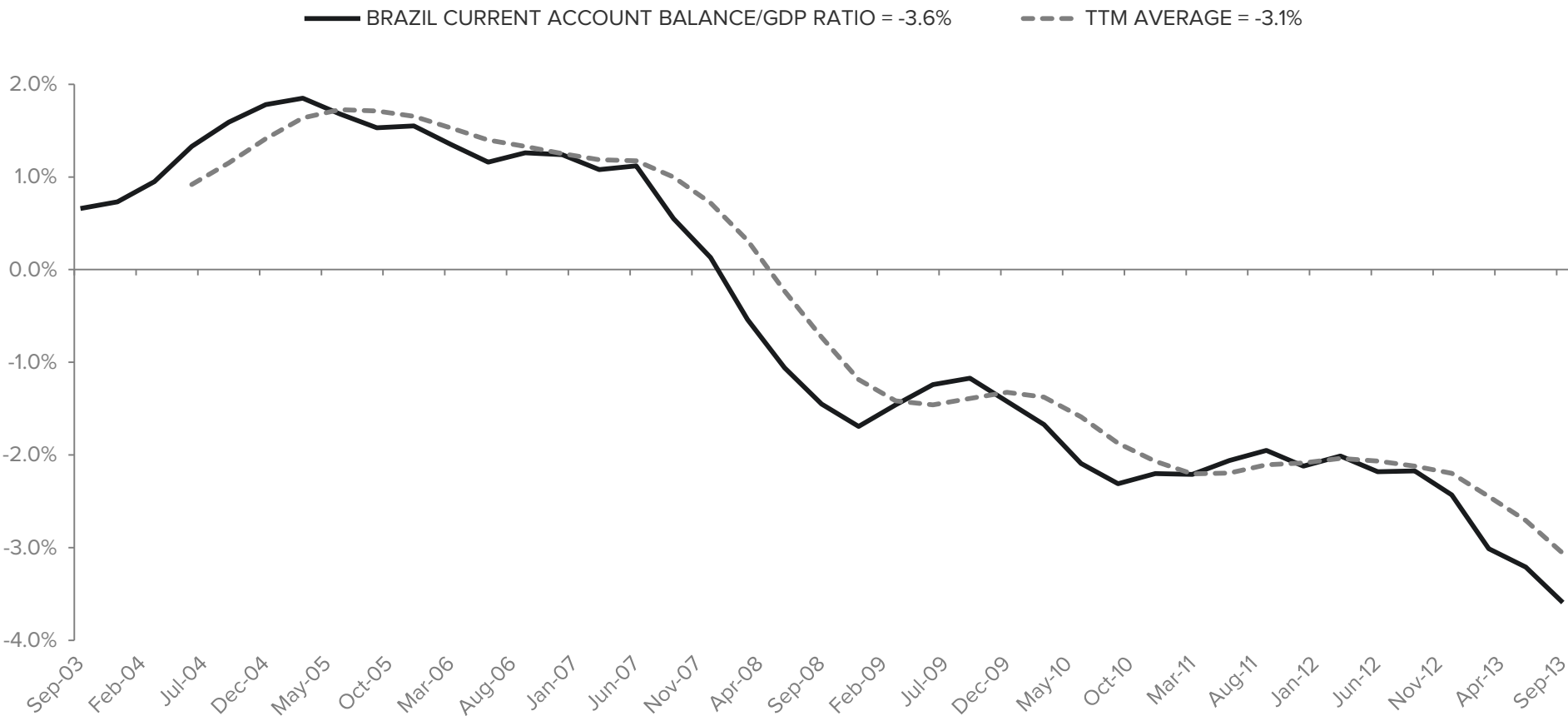
# RETAIL SALES TRENDS STILL POSITIVE



# BUT PRODUCTION IS CRASHING



# AS IS THE CURRENT ACCOUNT BALANCE

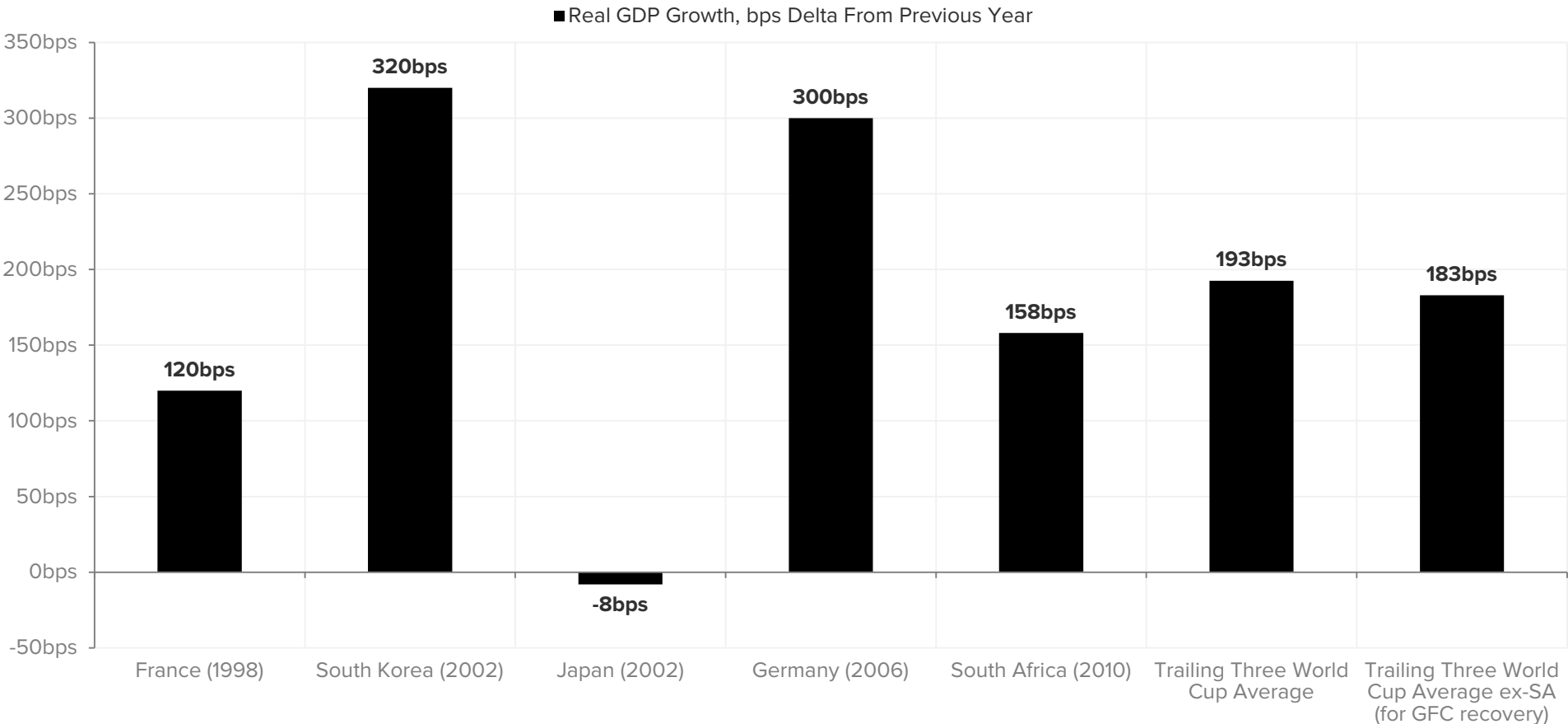


# “BROWNOUTS”: BAD FOR GROWTH

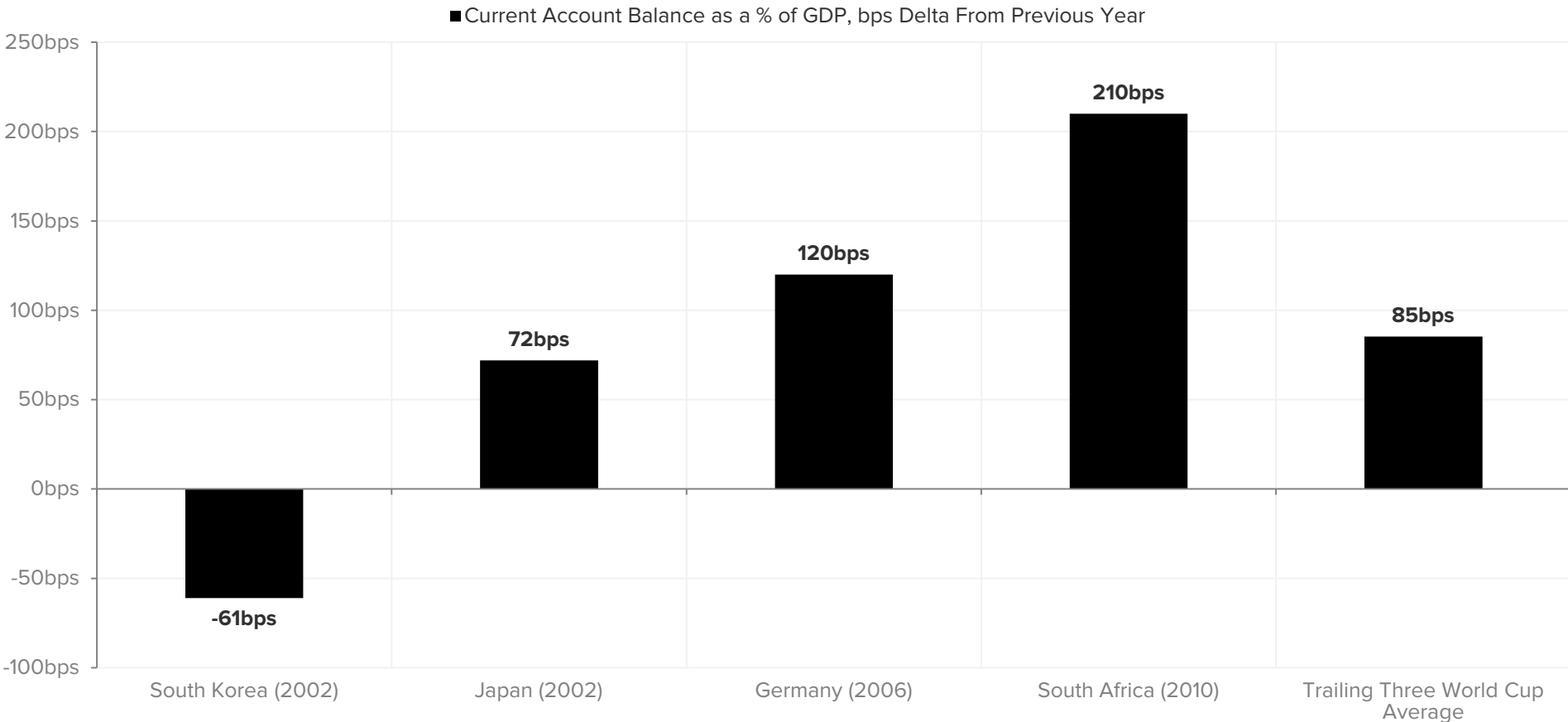
## WILL ENERGY BILLS RISE BY +4.6% Y/Y IN 2014?

- Hydropower, which generates 80% of electricity in Brazil is being constrained by an unusually dry rainy season... JAN '14 was the second driest in 80 years
- In early FEB, water levels in the southeast and central western regions – home to 70% of the country's reservoirs and half of the population – dipped to 37% of capacity, the lowest since 2001
- Meanwhile, electricity usage is running up +10% Y/Y (JAN) and peak demand reached an all-time high of 86GW in early-FEB... that compares to a YTD average of 66.8GW
- Total installed energy capacity is a robust 126.7GW, but assured energy capacity is around 63GW – i.e. below average demand... peak demand should cool from here, but there is rising risk of brownouts
- To fill the gap, utilities must burn fossil fuels, etc... that is costly in the context of 2012's energy price cuts, forcing the government to set aside a total of R\$9B to plug operating holes... ratings agencies believe another R\$5.6B will be needed – unless a +4.6% price increase is implemented (Fitch)

# WORLD CUP: GOOD FOR GROWTH



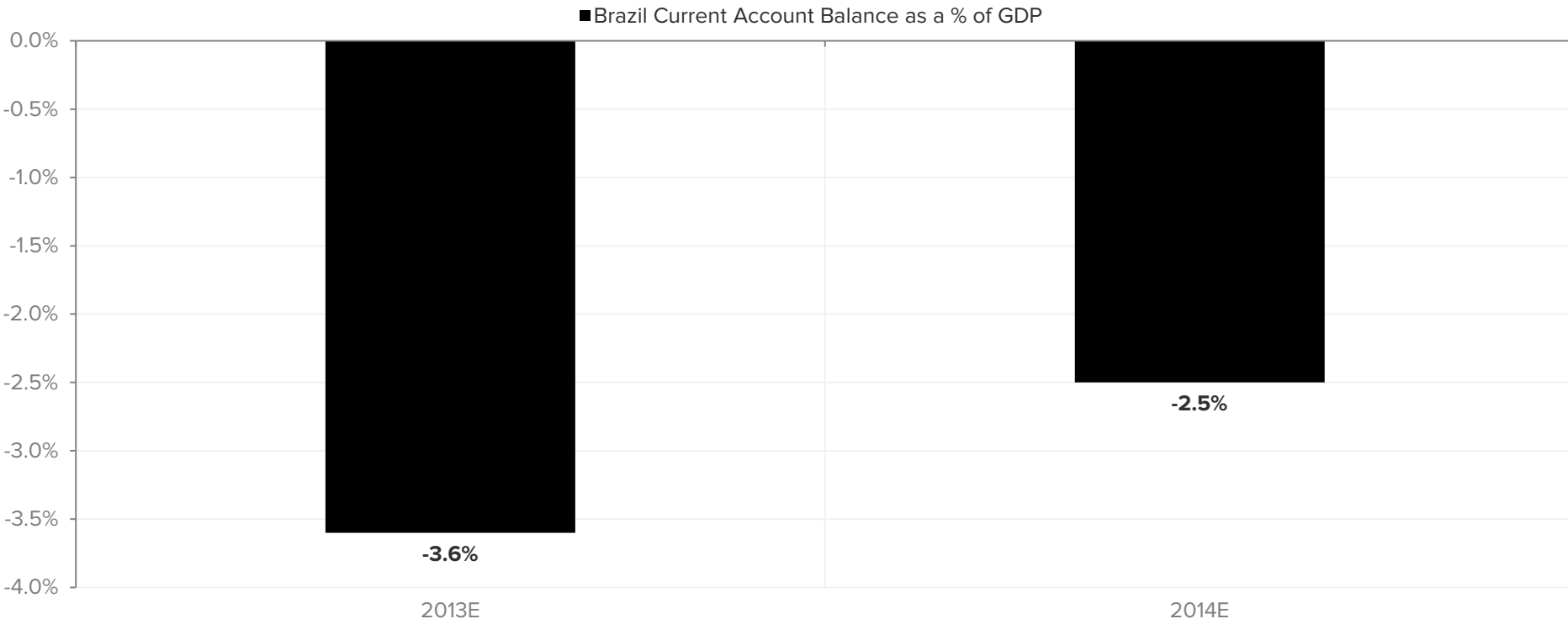
# AND THE CURRENT ACCOUNT





# WILL BRAZIL PULL AN INDONESIA?

**DECENT IMPROVEMENT IN THE SERVICES SECTOR DEFICIT COULD NARROW THE BROADER CURRENT ACCOUNT DEFICIT BY ~100 BASIS POINTS**

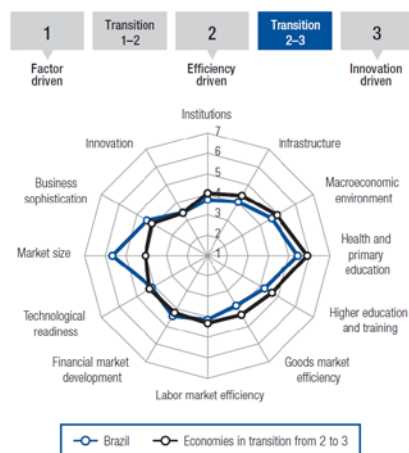


# POLITICAL REFORM AHEAD?

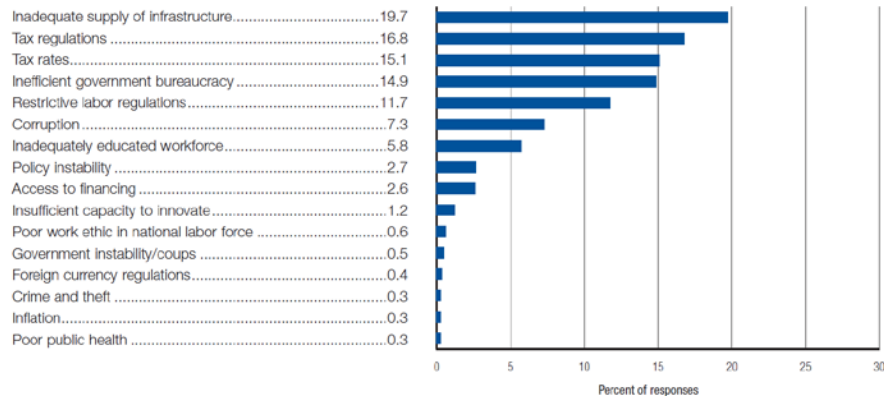
## Global Competitiveness Index

	Rank (out of 148)	Score (1-7)
GCI 2013-2014 .....	56	4.3
GCI 2012-2013 (out of 144).....	48	4.4
GCI 2011-2012 (out of 142).....	53	4.3
<b>Basic requirements (32.3%).....</b>	<b>79</b>	<b>4.5</b>
Institutions .....	80	3.7
Infrastructure .....	71	4.0
Macroeconomic environment .....	75	4.6
Health and primary education.....	89	5.4
<b>Efficiency enhancers (50.0%).....</b>	<b>44</b>	<b>4.4</b>
Higher education and training.....	72	4.2
Goods market efficiency .....	123	3.8
Labor market efficiency .....	92	4.1
Financial market development .....	50	4.4
Technological readiness.....	55	4.1
Market size.....	9	5.7
<b>Innovation and sophistication factors (17.7%).....</b>	<b>46</b>	<b>3.9</b>
Business sophistication .....	39	4.4
Innovation.....	55	3.4

## Stage of development



## The most problematic factors for doing business



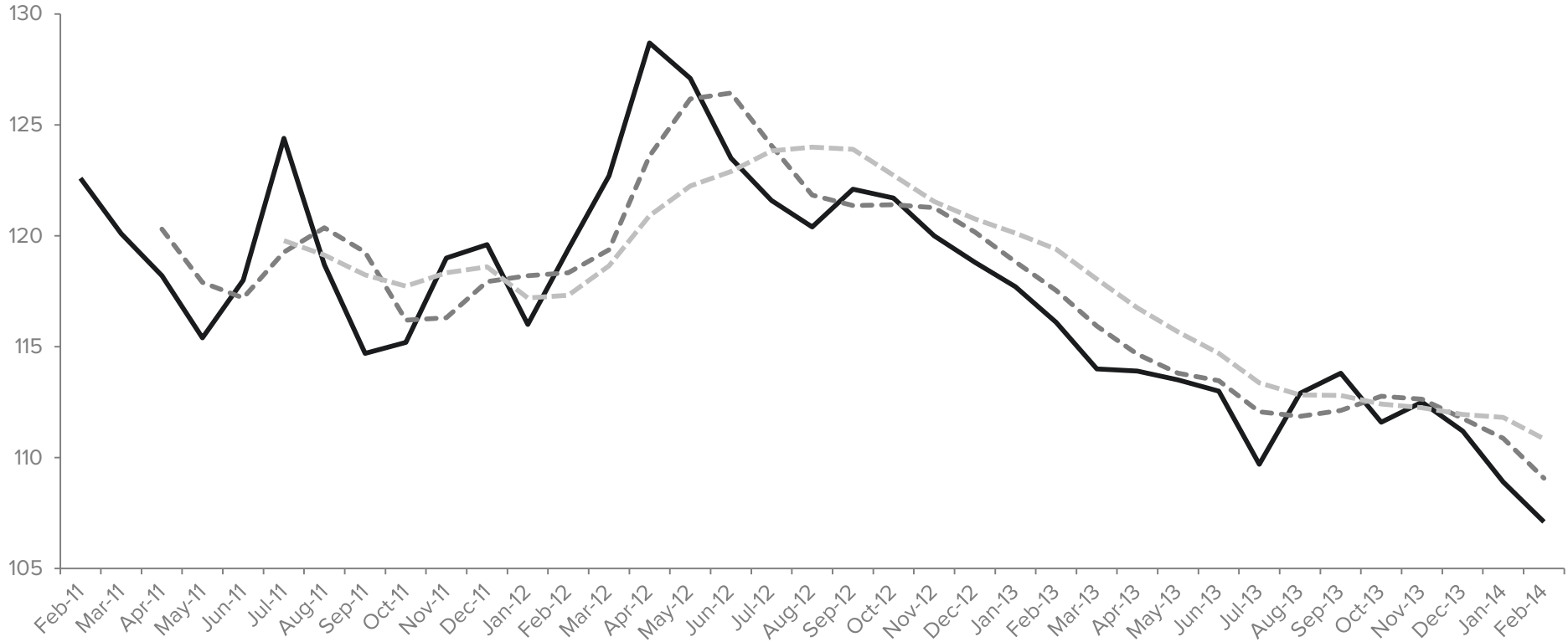
Note: From the list of factors above, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.

Poor institutions and a lack of adequate infrastructure remain key headwinds to Brazil's structural economic growth outlook.

As our EM Crisis Risk Model highlights, the biggest risks to investing in Brazil are generally associated with the inefficient and overbearing government sector.

# CONSUMER CONFIDENCE SAYS, “YES”

— Brazil FGV Consumer Confidence SA = 107.1    - - - SMAVG(3) = 109.1    - - - SMAVG(3) = 110.9

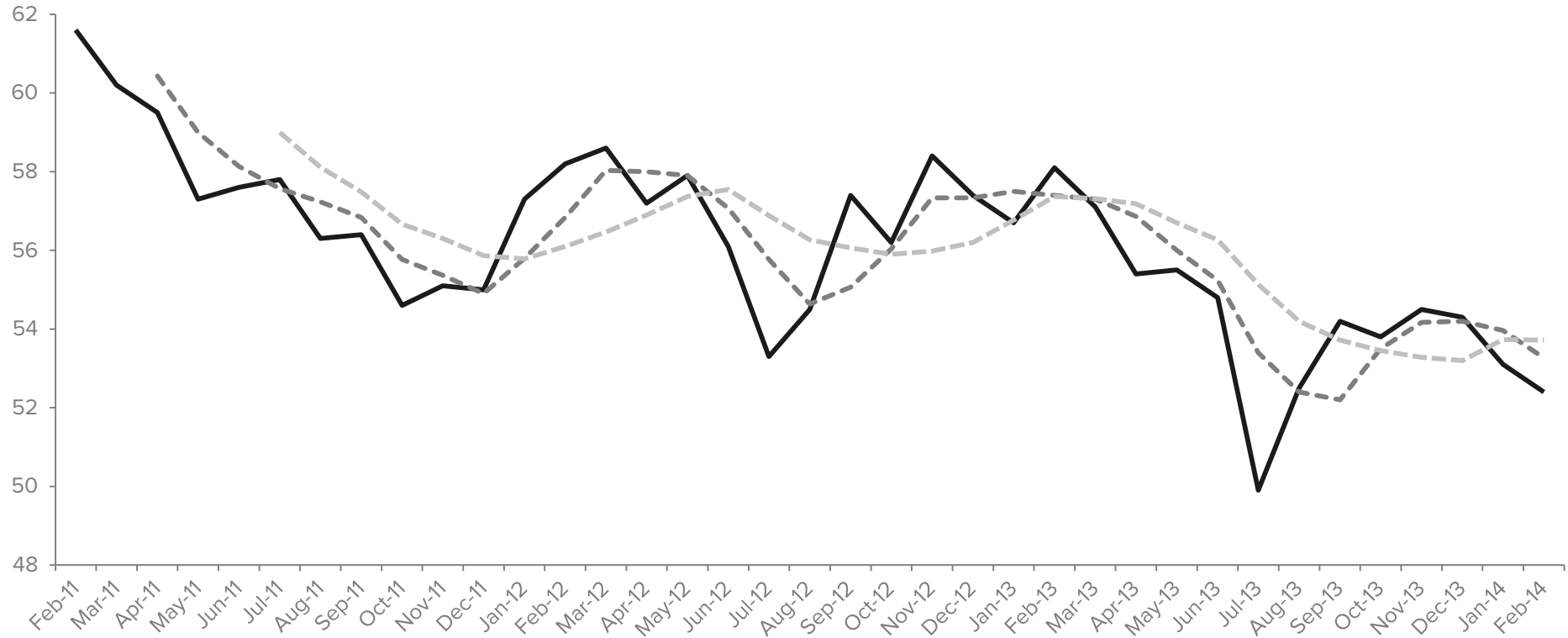


# SO DOES INDUSTRIAL CONFIDENCE

— CNI Brazil Industrial Confidence General = 52.4

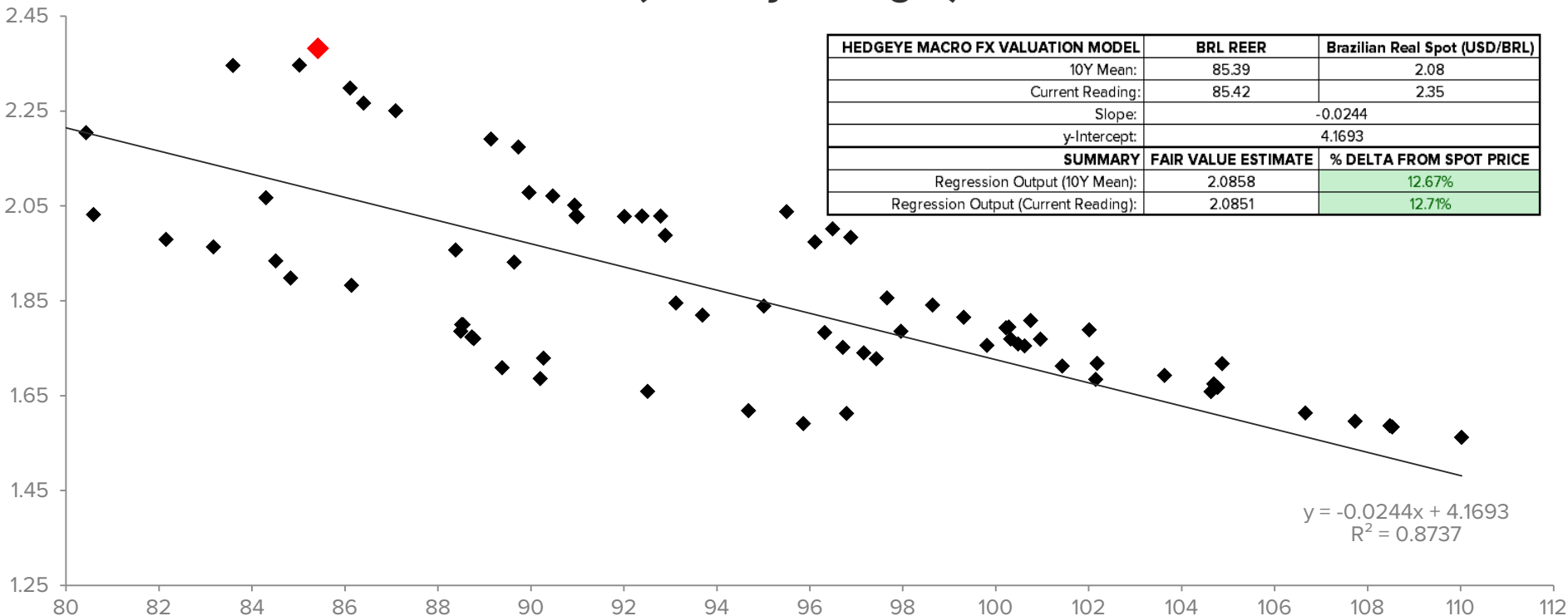
- - - SMAVG(3) = 53.3

- - - SMAVG(3) = 53.7



# BRL REER VALUATION

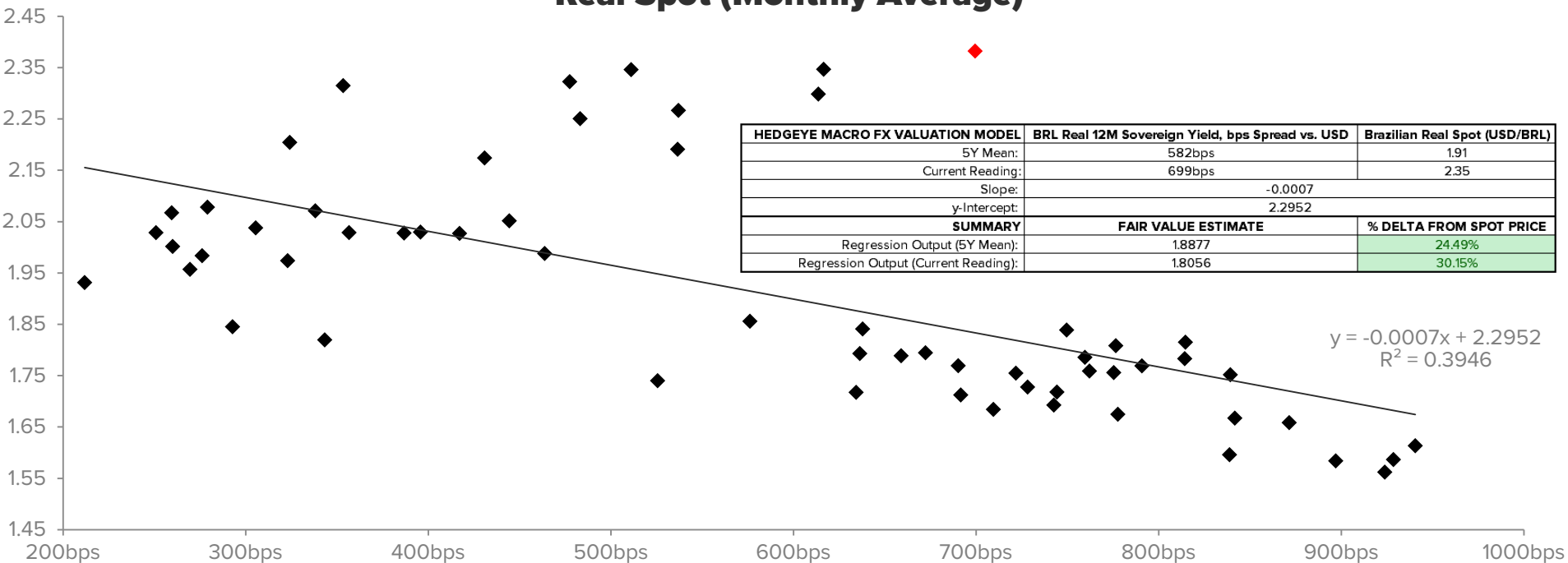
**x-axis: Brazil Real Effective Exchange Rate Broad; y-axis: Brazilian Real Spot (Monthly Averages)**



Red dot indicates current reading. Trailing 10yrs of data.

# BRL REAL INTEREST RATE VALUATION

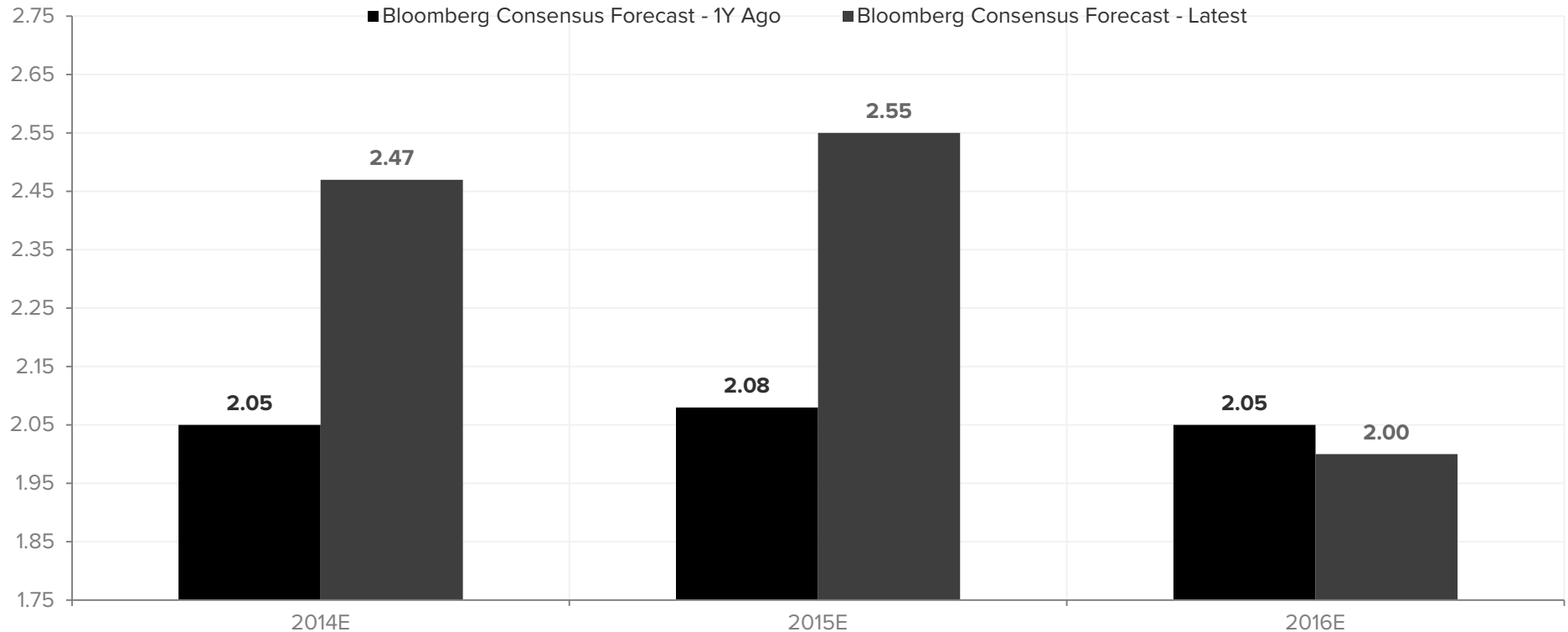
**x-axis: BRL Real 12M Sovereign Yield, bps Spread vs. USD; y-axis: Brazilian Real Spot (Monthly Average)**



Red dot indicates current reading. Trailing 5yrs of data.

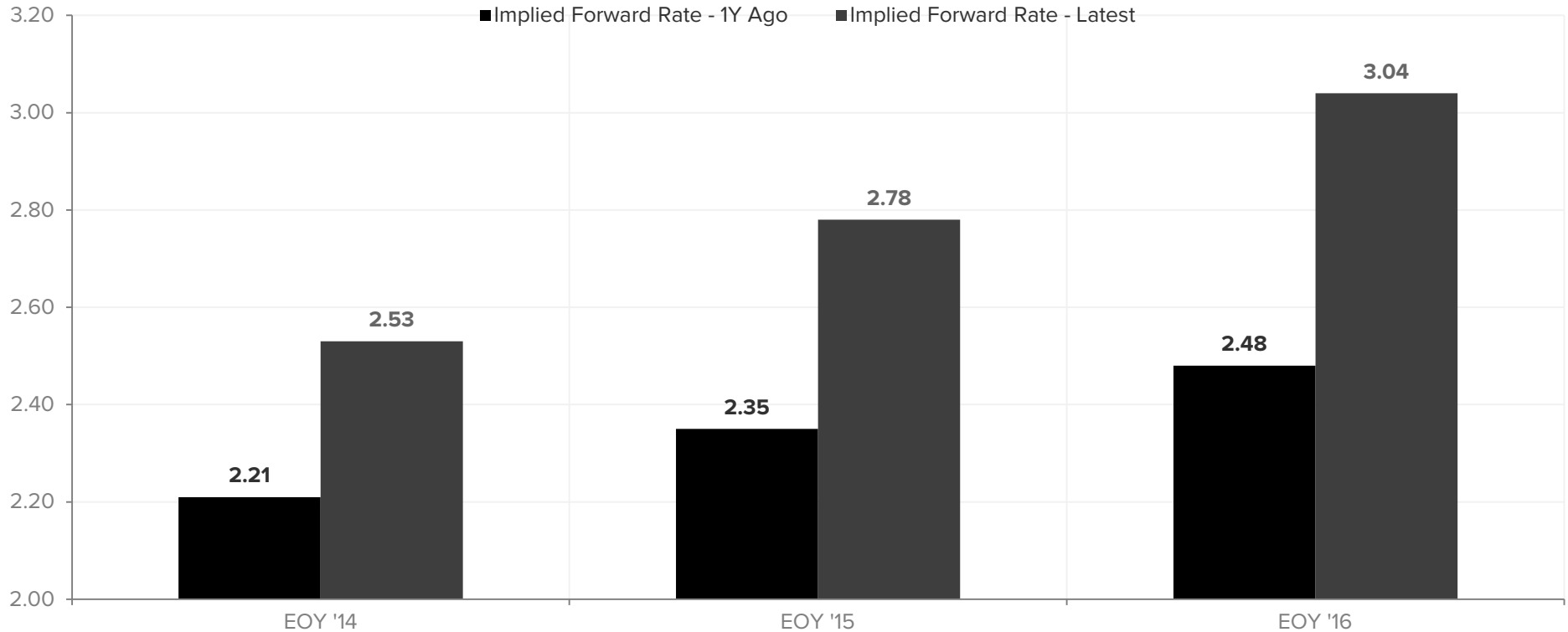
# CONSENSUS DOESN'T CARE

## USD/BRL SPOT



# NEITHER DO INVESTORS

## USD/BRL SPOT

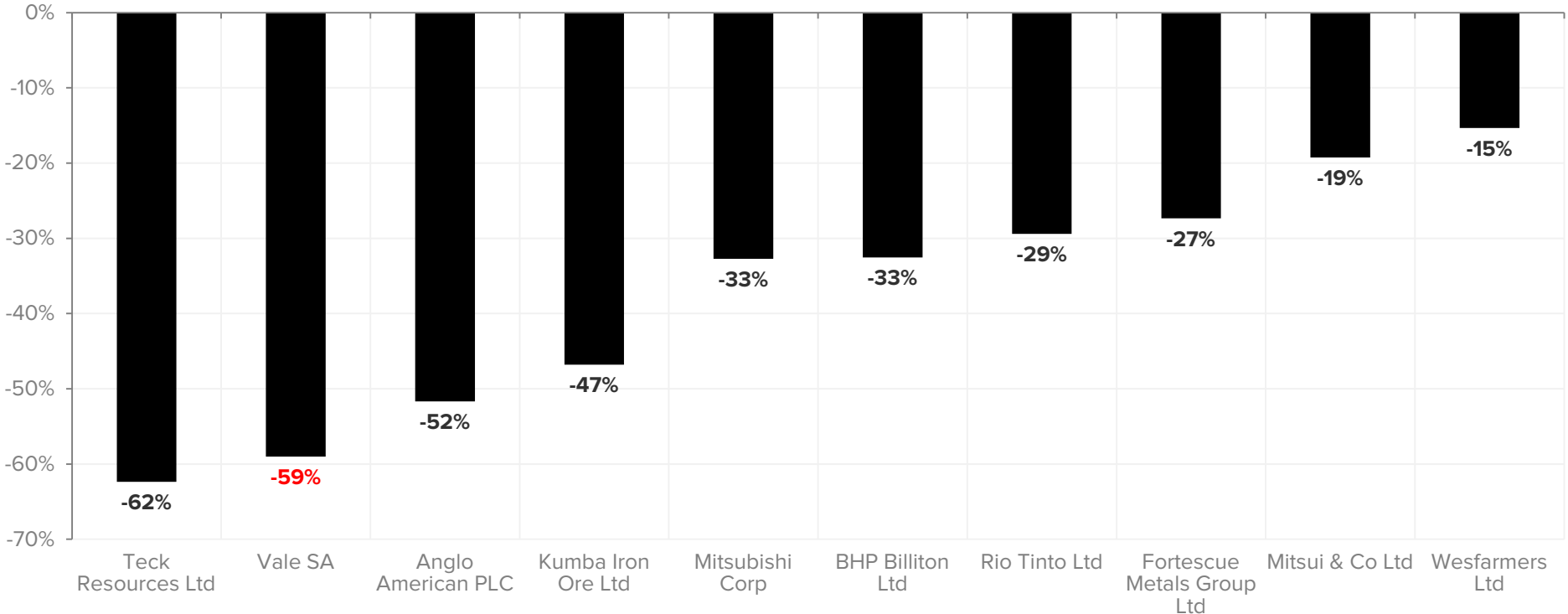




# THE “BRAZIL DISCOUNT”

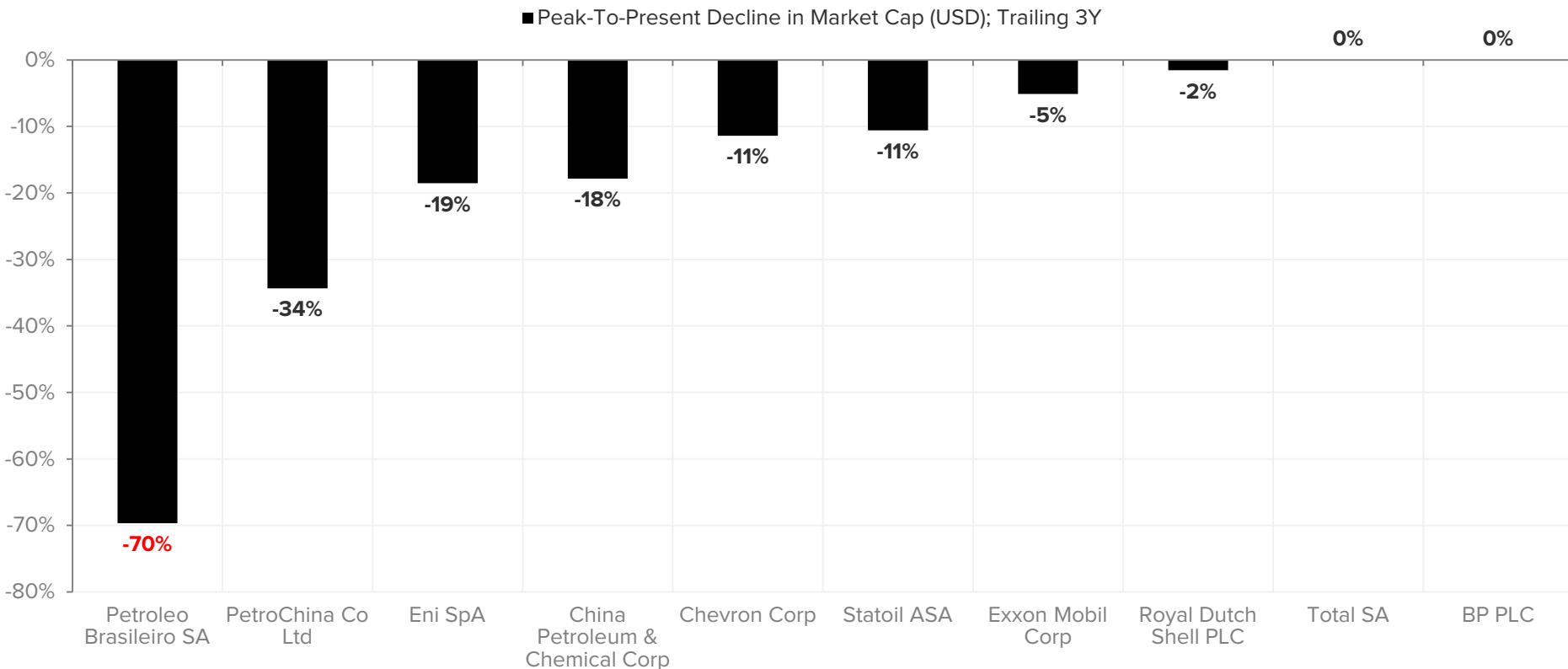
## THE “BRAZIL DISCOUNT” HAS NEGATIVELY IMPACTED VALE

■ Peak-To-Present Decline in Market Cap (USD); Trailing 3Y

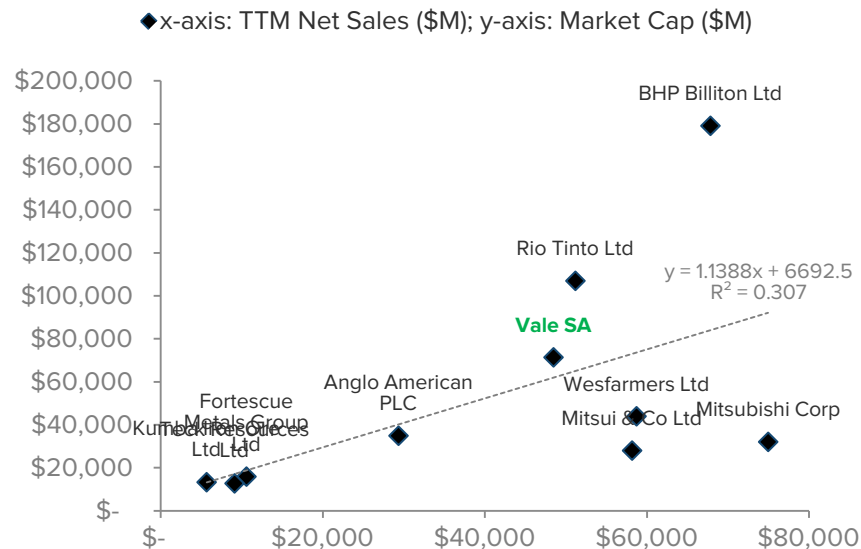


# EVEN WORSE HERE

## THE "BRAZIL DISCOUNT" HAS CRUSHED PBR

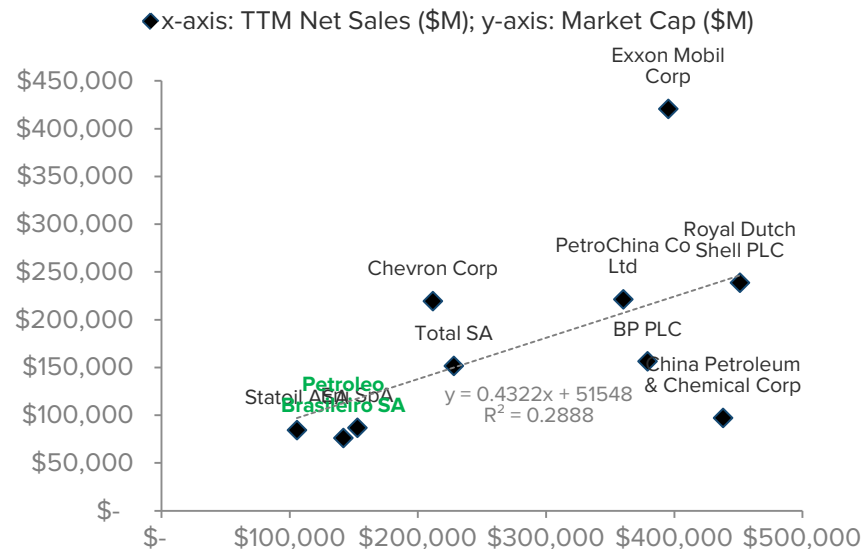


# MARKET SHARE VALUATION



**VALE**

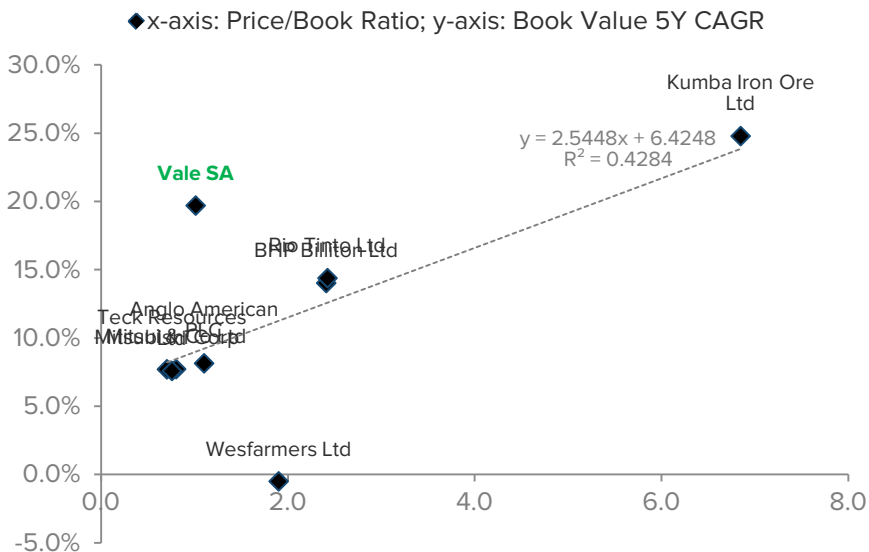
Not particularly cheap or expensive.



**PBR**

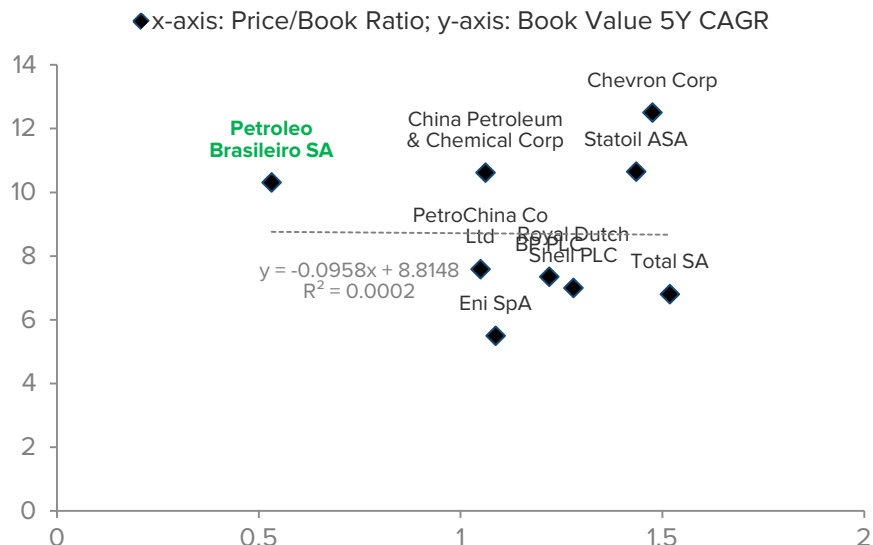
Not particularly cheap or expensive.

# PRICE/BOOK VALUATION



## VALE

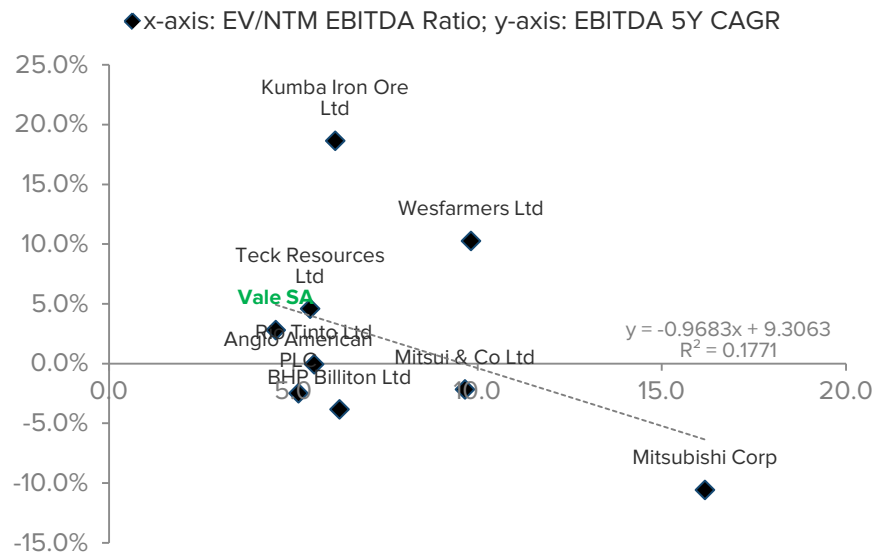
The market is not paying for VALE's book value growth.



## PBR

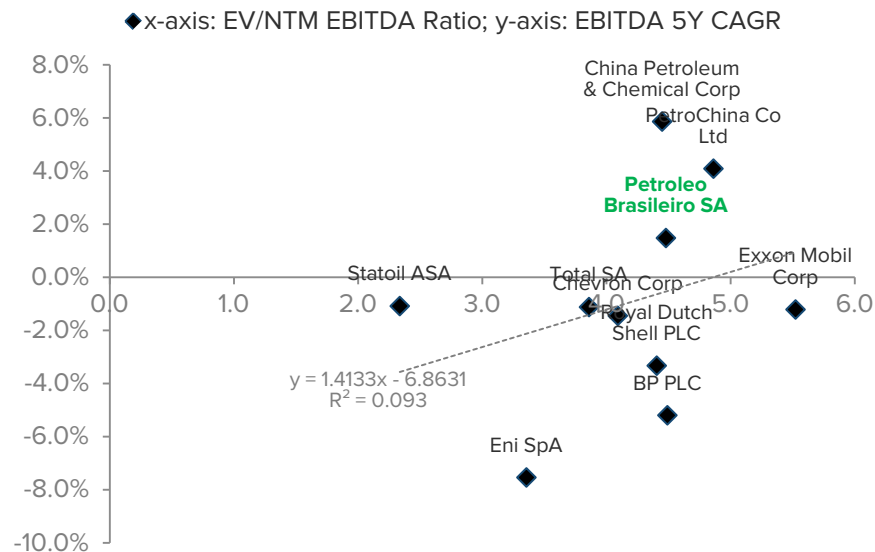
“What even is book value in this space?”, says the market.

# EV/EBITDA VALUATION



**VALE**

Appropriately valued on cash flows.

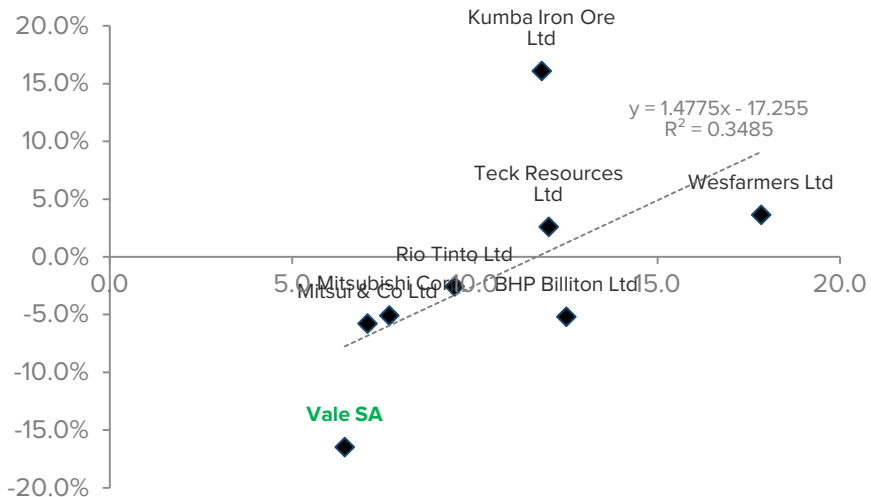


**PBR**

Slightly overvalued on cash flows.

# P/E VALUATION

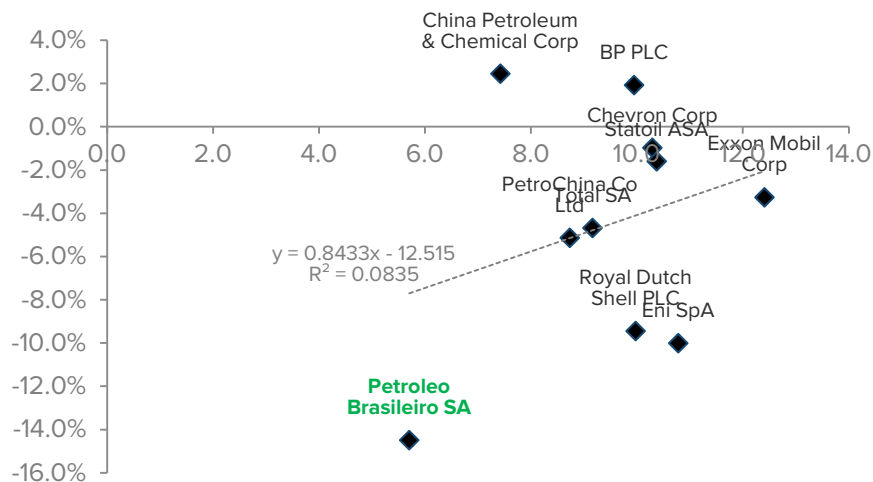
◆ x-axis: Price/NTM Earnings Ratio; y-axis: Adjusted EPS 5Y CAGR



**VALE**

Appropriately valued on earnings.

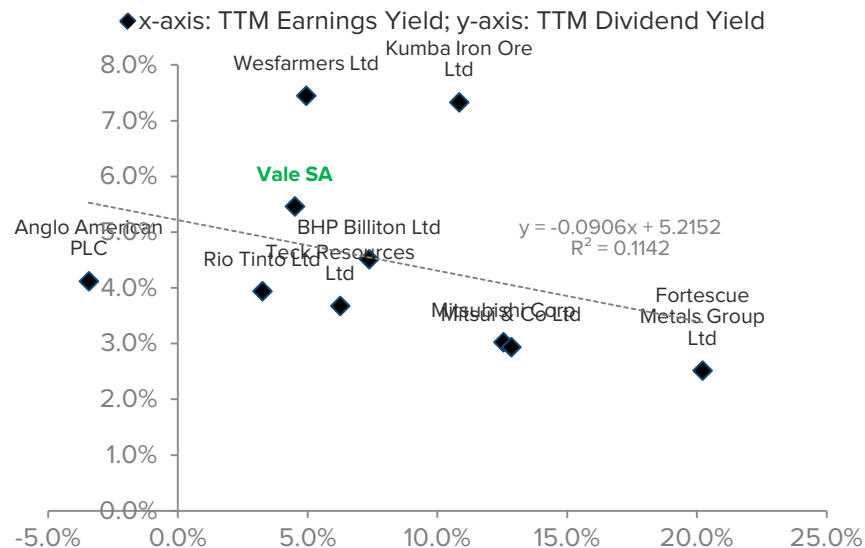
◆ x-axis: Price/NTM Earnings Ratio; y-axis: Adjusted EPS 5Y CAGR



**PBR**

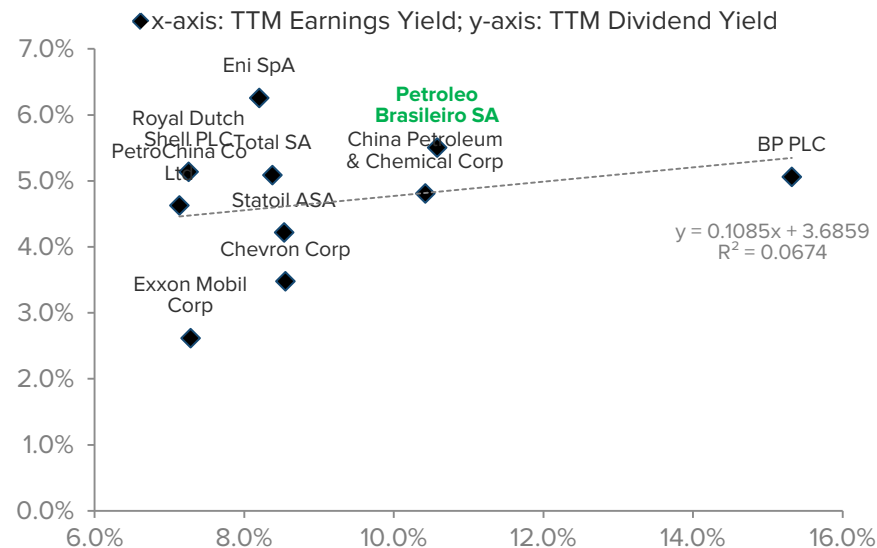
Appropriately valued on earnings.

# YIELD VALUATION



**VALE**

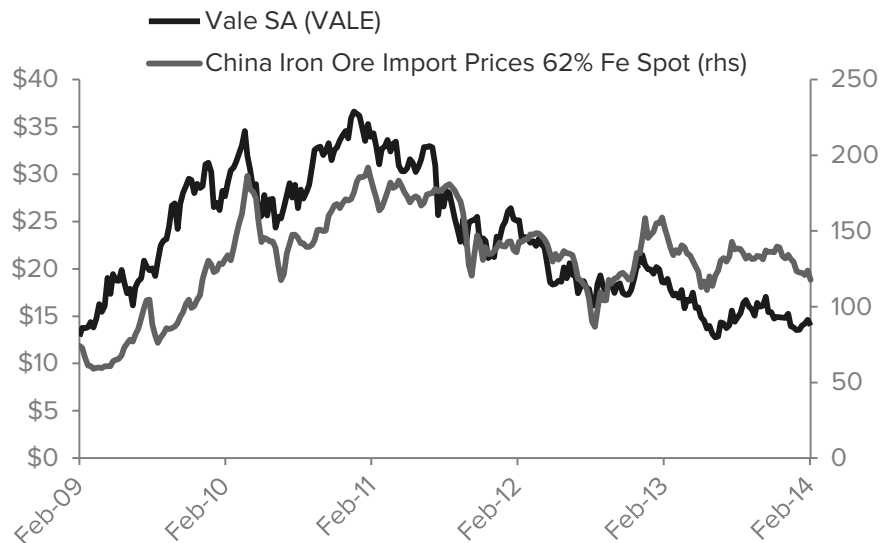
Decent yield support.



**PBR**

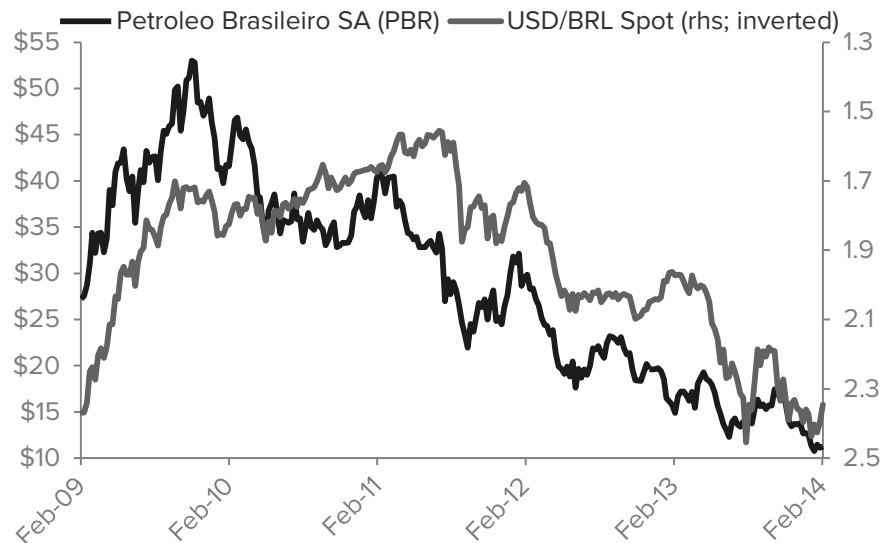
Very high-yielding. An appropriate target for a carry trade.

# DRIVERS



## VALE

Vale needs China. Even if China doesn't blow up, its structural rebalancing agenda and capacity reduction across materials-intensive industries bodes poorly for VALE's future.

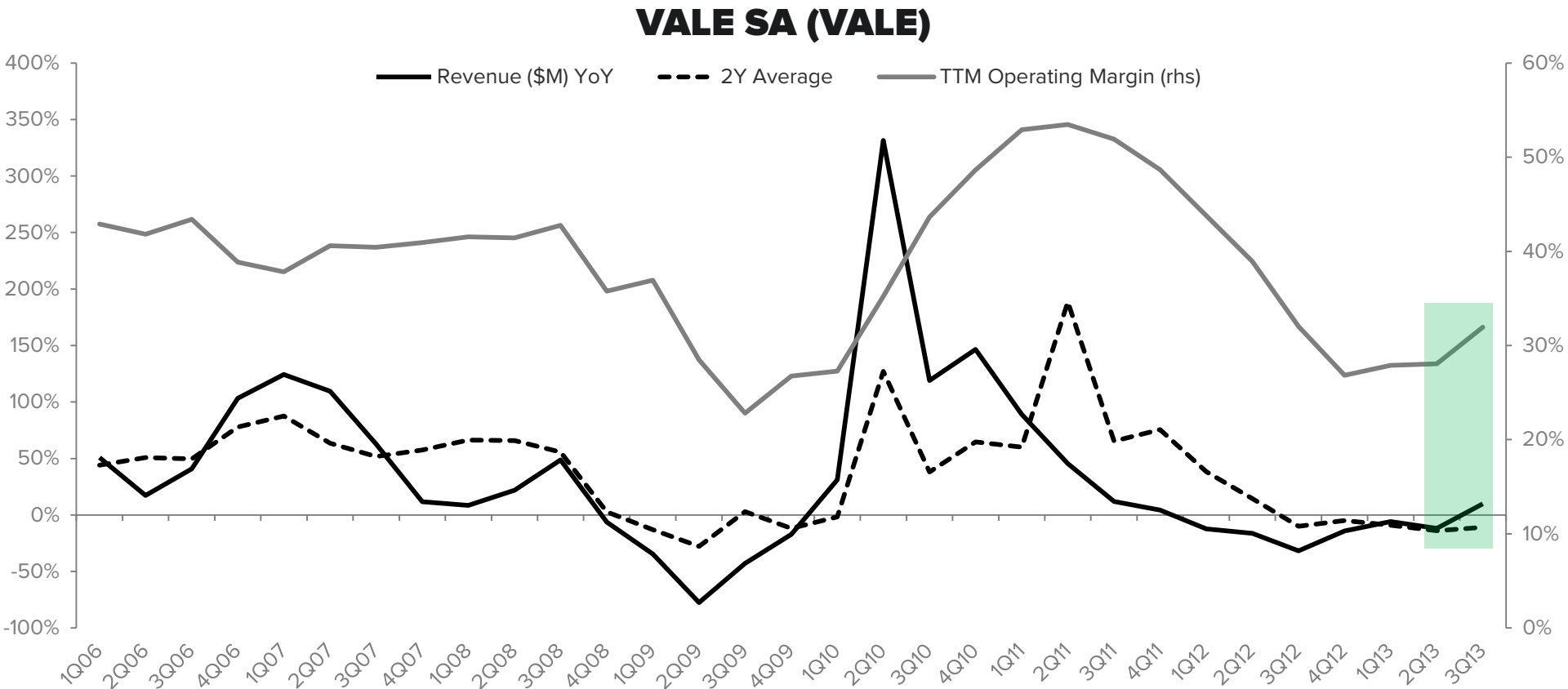


## PBR

Petrobras needs a stronger BRL – especially with the government forcing them to eat the cost of subsidies for refined products. PBR doesn't have enough upgrading capacity domestically, so it's often forced to import refined products or light sweet crude at huge operating losses.

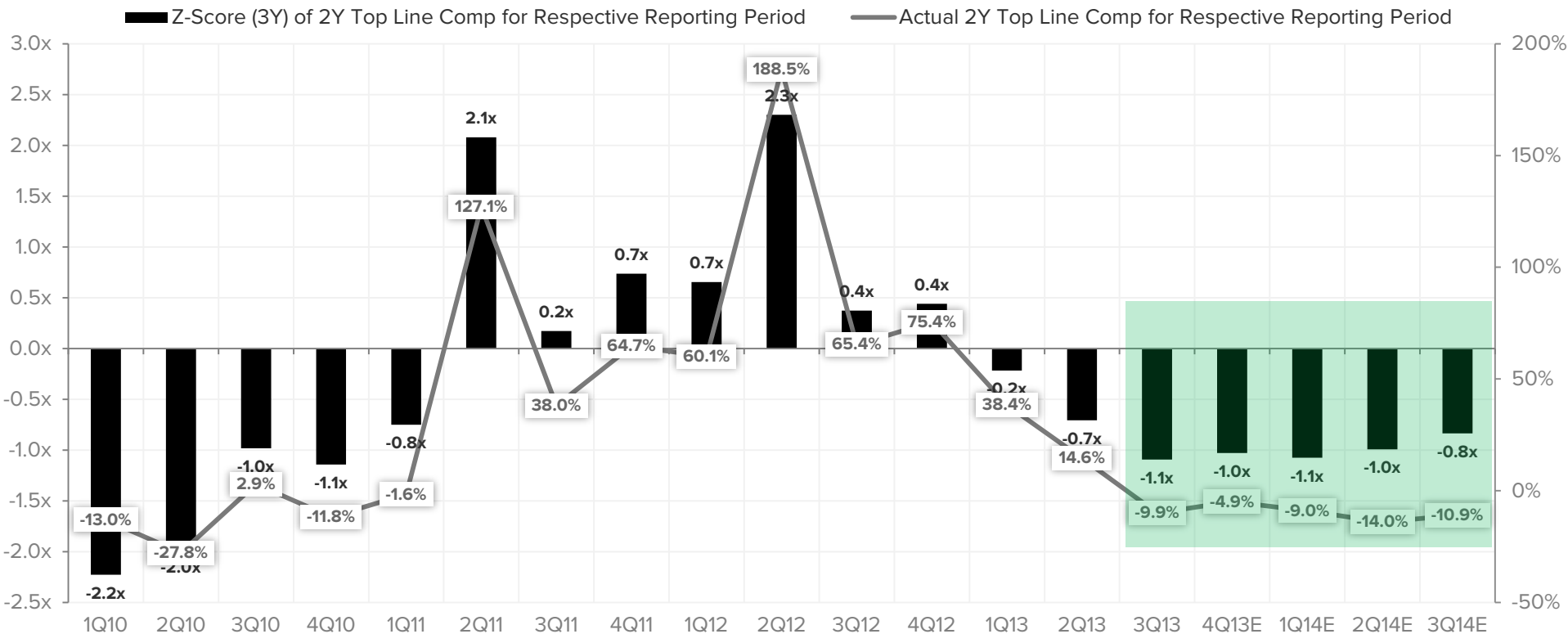


# OPERATING TRENDS ON THE MEND?



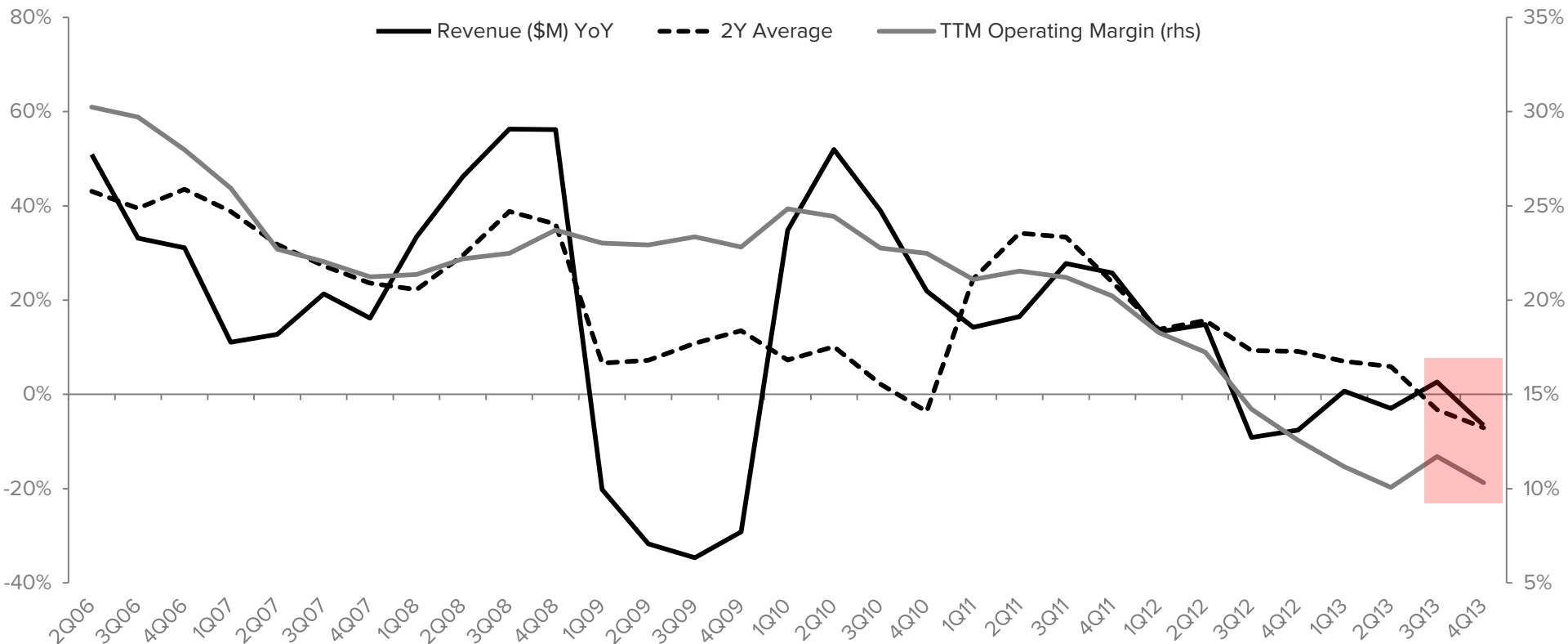
# EASY COMPS IMPLY, “YES”

## VALE SA (VALE)



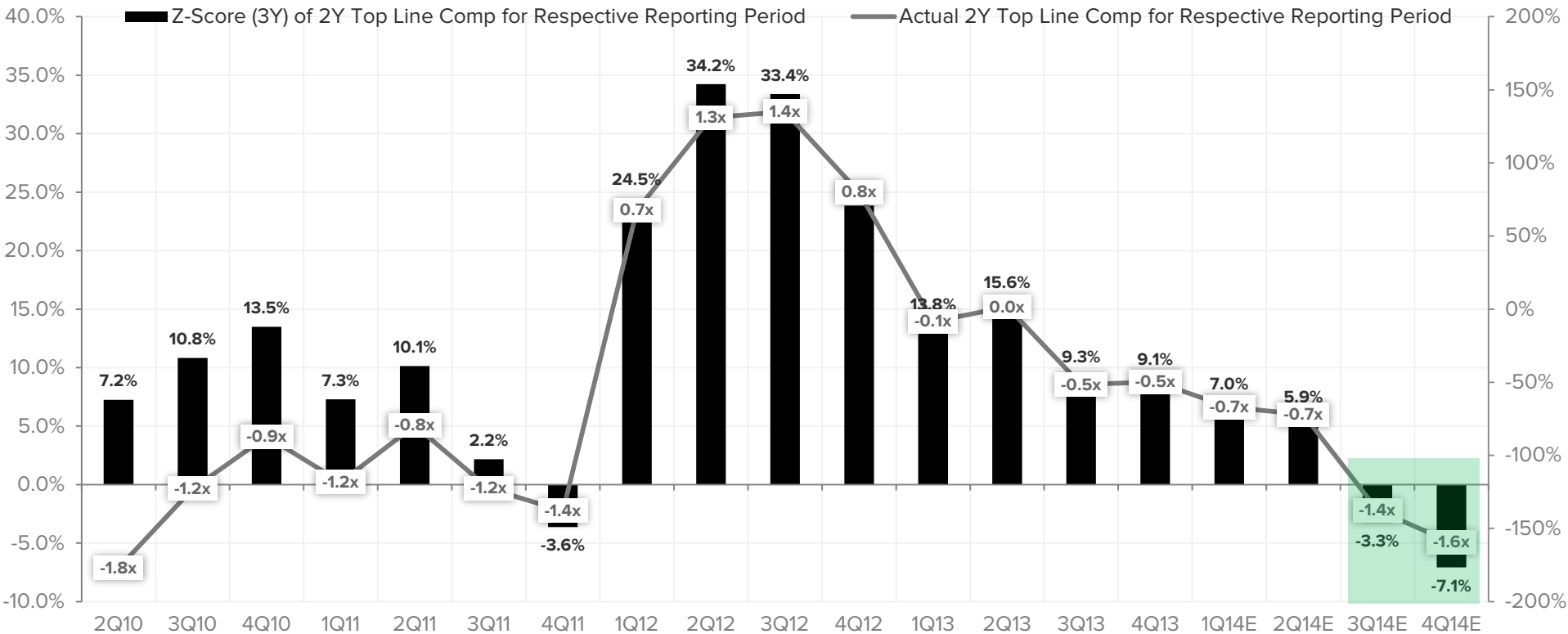
# STILL A DOG – THANKS TO PILLAR IV

## PETROLEO BRASILEIRO SA (PBR)



# BAKE IN A BACK HALF RECOVERY?

## PETROLEO BRASILEIRO SA (PBR)



# BEST IDEA: LONG BZF

LOTS OF UPSIDE IF YELLEN BECOMES HERSELF IN 3-6M

## HEDGEYE QUANTITATIVE SETUP: BRAZILIAN REAL (BZF)



# BEST-IDEA-IN-WAITING: LONG PBR

## BUY IT ON A BREAKOUT ABOVE THE TREND LINE

### HEDGEYE QUANTITATIVE SETUP: PETROBRAS (PBR)



# LONG PBR JANUARY 2015 OTM CALLS?

## ULTIMATE BEARISH SENTIMENT; VALUATIONS AT EXTREMES

### BEAR CASE

- Its current 3M decline of **-37%** is the steepest 3M selloff since 2008 and the stock remains broken on our quantitative signals
- Worst FCF generation of all 113 oil & gas producers tracked by Bloomberg over the TTM (\$15.4B loss)
- Its refining division has lost \$35B since 2011, when the gov't forced it to start subsidizing domestic fuel prices by selling imported gasoline and diesel at a loss – often at a ~20% discount to international prices

### BULL CASE

- If nothing else, it's an optically cheap way to play our #InflationAccelerating theme: PBR's market cap is less than half of what it was before it began exploring its pre-salt reserves (\$149B for the SEP '10 IPO; \$225B in APR '11; and \$71B currently)
- The planned introduction of six new platforms should boost production capacity by +680k barrels per day by EOY '14 (on a base of 2.54 mbpd)
- That would be very positive after 2Y of negative production growth... as would a policy to raise domestic fuel prices (is the OCT '14 election a catalyst?)
- Over the past five years, it's registered a negative correlation of **-0.70** to the USD/BRL spot rate, meaning that as the BRL *strengthens*, PBR's stock price also tends to increase in value

*Falling prices are giving us an opportunity to do more work here, but preliminary indications suggest a decent appreciation of the BRL vis-à-vis the USD would provide a much needed boon to PBR's cash flow dynamics.*

FOR MORE INFORMATION CONTACT:

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