Brazil: A Conservative Tidal Wave in the 2018 Presidential Race
VICTORY OF MAVERICK CANDIDATE BOLSONARO SPEAKS OF A MASSIVE SWING AWAY FROM THE LEFT

- Bolsonaro: 55% of valid votes
- Haddad: 45% of valid votes

- Bolsonaro’s campaign cost: R$1.7 million
- Haddad’s campaign cost: R$34 million

- Bolsonaro’s “share of GDP”: 83%
- Haddad’s “share of GDP”: 17%

Source: Superior Electoral Court (TSE), Arko Advice, IBGE, Tendencias Consultoria, Bruno Ganschagen, Marcus Andre Melo and Patria Investments.
Brazil: The End of a Political Era

VOTES FOR WORKERS‘ PARTY PRESIDENTIAL CANDIDATES (1ST BALLOT; PERCENT OF VALID VOTES)

The leftist Workers’ Party (PT) has built a powerful political machine and ruled Brazil for most of the 21st century.

Yet the party had been steadily losing ground in almost all regions and income brackets since 2006.

Popular protests that erupted in 2013 along with ill-fated Rousseff administration depleted the party’s political capital.

Downfall of the Workers’ Party upends the political system that emerged in the mid 1980s after the end of military ruling.

Source: DIAP, Arko Advice, Tendencias Consultoria, Bruno Garschagen, Marcus André Melo and Patria Investments.
Brazil: Opening of a New Era

REAL GDP GROWTH (4-YEAR MOVING AVERAGE IN PERCENT) VS. BREAKTHROUGH REFORMS & EVENTS

- Comprehensive corruption probe is reshaping the political system and goes hand in hand with fresh batch of fundamental reforms

Source: IBGE, IPEA, Arko Advice, Inter-American Development Bank, World Bank and Patria Investments.
Brazil: Understanding the Car Wash Corruption Probe

“The world’s largest investigation to date uncovering cases of state capture and corruption”

Petrobras graft scandal: Operation “Car Wash” (key facts and numbers)

- Estimated stolen funds (includes fines): R$39.9 billion
- Defendants face charges of corruption, conspiracy to defraud, bribery, financial fraud and money laundering
- 140 individuals convicted (entrepreneurs, corporate executives, politicians and top government officials)
- In total, individuals found guilty were sentenced to over 2,036 years in prison
- R$3.2 billion of stolen funds frozen (reparation purposes)
- 45 countries cooperating with Brazilian prosecutors
- 176 plea bargain agreements signed with individuals
- 11 leniency agreements signed with corporations

Former president Lula is one of dozen prominent politicians put behind bars by Federal Judge Moro, who heads the “Car Wash” probe

- “Car Wash” ramifications are hitting hard the Workers’ Party and other traditional parties

Source: Arko Advice, Federal Police, Tendencias Consultoria, Transparency International and Patria Investments.
**Brazil: No Crisis of Representative Democracy**

CONFIDENCE IN DEMOCRACY HAS NEVER BEEN STRONGER

![Graph showing confidence in democracy from 1989 to 2018](image)

**The right-wing shift speaks of a crisis of the Left, not of political institutions**

**Mandate from the ballot box:**
- Leadership renewal
- Clean-slate politicking
- Improved policies

<table>
<thead>
<tr>
<th>Year</th>
<th>Collor</th>
<th>Cardoso</th>
<th>Lula</th>
<th>Rousseff/Temer</th>
<th>2018 latest</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989-94</td>
<td>89</td>
<td></td>
<td>51</td>
<td>48</td>
<td>144</td>
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<tr>
<td>1995-2002</td>
<td>108</td>
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<td>48</td>
<td>59</td>
<td>61</td>
</tr>
<tr>
<td>2003-10</td>
<td></td>
<td>128</td>
<td>128</td>
<td>2011-18</td>
<td>144</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2018 latest</td>
<td>69</td>
</tr>
</tbody>
</table>

Brazilian voters (million)

"Democracy is the best form of government" (% of total answers)

Source: DataFolha, Sergio Abranhex, Arko Advice and Tendencias Consultoria.
Brazil: What Reforms?
ECONOMIC PROGRAMS AND OTHER REFORMS PROPOSED BY PRESIDENTIAL CANDIDATES

Fernando Haddad
Ex-mayor of Sao Paulo and former Education minister

- Rebuild state institutions to strengthen welfare network
- Privatization is a no-no; concession of public assets should continue
- State activism needed to revive CAPEX; SOEs to have a greater role
- Abide but higher tax burden drives drive budget deficit reduction
- Undo labor reform and deregulation of key industries (e.g. oil & gas)

Key Themes

- Administrative reform
- Privatization/Concessions
- State activism/deregulation
- Fiscal discipline
- Pension plan reform
- Other reforms

Jair Messias Bolsonaro
Retired military, federal representative for Rio de Janeiro

- Cut number of ministries by half and downsize other federal entities
- R$2 trillion privatization program; speed up concession of public assets
- Keep essential SOEs and change regulation to energize private CAPEX
- Hasten budget deficit reduction with expenditure cuts & privatization
- Axe civil servants’ entitlements; move to individual capitalization system
- Emphasis on bills to support anti-crime and anti-corruption programs

Source: Arko Advice, Tendencias Consultoria, Sergio Abranches and Patria Investments.
Brazil: The Challenges Looking Forward
UNPRECEDENTED PARTY FRAGMENTATION AS A RESULT OF TECTONIC POLITICAL SHIFT

• Turnover rate in the Congress was nearly 50%: new political leaderships emerged in both Houses
• Newly elected president will have to carefully build up a ruling coalition: selection of signature legislation legislatures is critical

Source: Goldman Sachs Global Investment Research, Sergio Abranches, Arko Advice and Superior Electoral Court (TSE).
Brazil: Descent into Authoritarianism Is Exceedingly Unlikely

MORE PLAUSIBLE RISK IS INADEQUATE POLITICAL COORDINATION LEADING TO POOR POLICY IMPLEMENTATION

<table>
<thead>
<tr>
<th>Russia: United Russia</th>
<th>Turkey: Justice and Development Party</th>
<th>Hungary: Fidesz</th>
<th>Poland: Law and Justice</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federation Council</td>
<td>Grand National Assembly</td>
<td>National Assembly</td>
<td>Sejm (Lower House)</td>
</tr>
<tr>
<td>128 of 170 seats</td>
<td>289 of 600 seats</td>
<td>117 of 199 seats</td>
<td>237 of 460 seats</td>
</tr>
<tr>
<td>State Duma</td>
<td>District municipalities</td>
<td>European Parliament</td>
<td>Senate</td>
</tr>
<tr>
<td>341 of 450 seats</td>
<td>800 of 1,351 seats</td>
<td>11 of 21 assigned seats</td>
<td>63 of 100 seats</td>
</tr>
<tr>
<td>Governors</td>
<td>Provincial councilors</td>
<td>County Assemblies</td>
<td>European Parliament</td>
</tr>
<tr>
<td>75 of 85</td>
<td>779 of 1,251 seats</td>
<td>245 of 419 seats</td>
<td>16 of 51 assigned seats</td>
</tr>
<tr>
<td>Regional Parliaments</td>
<td></td>
<td></td>
<td>Regional assemblies</td>
</tr>
<tr>
<td>3,091 of 3,980 seats</td>
<td></td>
<td></td>
<td>254 of 552 seats</td>
</tr>
</tbody>
</table>

- Regimes deemed authoritarian feature an overwhelming hegemonic party with the ability to reshape institutions at its leader’s will
- Bolsonaro’s hard-core support in the Congress is small and political acumen will be required to prevent his agenda from stalling

Source: Goldman Sachs Global Investment Research, Sergio Abranches, Arko Advice and Superior Electoral Court (TSE).
Brazil: Outlining a Constructive Agenda

BOLSONARO’S ECONOMIC PROGRAM ENJOYS BROAD SUPPORT; CONTROVERSIAL CIVIL RIGHTS AGENDA DOESN’T

Estimated predisposition of Brazil’s new Congress to market-friendly economic reforms

- The newly elected president can build up a solid (>70%) majority to pass key items of his economic program
- Central Bank’s formal independence could pass even before Bolsonaro’s inauguration in early January 2019
- The picture is entirely different for his civil rights agenda, which is deemed divisive and politically costly
- Emphasis on controversial civil rights agenda should spark institutional reaction (Judiciary branch, media)

Source: Arika Advice, Tendencias Consultoria, DIAP and Patria Investments.
• Fiscal consolidation basically signifies addressing entitlements and taxation

I. Social Security: very ambitious original draft: estimated savings of R$140 billion over five years, stepping up to R$740 billion after 10 years

a. set a minimum retirement age of 65 for men and women (under the present system they can respectively retire at 54 and 52)
b. reduce transfers to public employees pension plans
c. disassociate social security benefits from minimum wage annual rises

II. Tax reform: objective is to simplify the tax code, merging duties, levies and contributions into a nationwide VAT, but short-term goal is

a. Modify PIS + Cofins taxation, which is the most cumbersome, bringing it closer to a non-cumulative VAT burden
b. Eliminate incongruous tax breaks granted by former President Rousseff

Source: Arko Advice, Tendencias Consultoria, and Carlos Melo.
Brazil: Slowly Declining Budget Deficit and On-Target Inflation

**FISCAL AND MONETARY DISCIPLINE AFTER ROUSSEFF’S IMPEACHMENT RESTORED SHORT-TERM STABILITY**

• Only 6% of government debt is US dollar-indexed or denominated in foreign currency; non-residents hold a slim 12% of outstanding stock

• Needed primary fiscal effort needed to stabilize gross government debt: +3% of GDP (past two years = +1.8% of GDP)

Source: IBGE, IpeaData, Central Bank of Brazil, Instituciao Fiscal Independente, Tendencias Consultoria and Patria Investimentos.
Brazil: External Accounts Are Doing Just Fine

FEVERISH CURRENCY HEDGING HAS DRIVEN THE REAL LOWER

- Trade surplus in 2017 was a record-high US $64 billion and remains strong in 2018
- Current account deficit is a slim 0.8% of GDP
- International reserves very close to at all-time high: US $381 vs. US $382 billion
- Record US $101 billion net foreign credit position (foreign assets - external debt)
- Net FX inflow of US $21 billion YTD 2018: US $37 billion from merchandise trade
- US $16 billion financial outflow YTD speaks of deleveraging (2017: -US $52 billion)
- Escalating demand for currency protection outpaced net FX inflows until recently
- Currency hedging speaks of concerns about global gyrations and local political woes

Sources: Central Bank of Brazil, IpeaData and Patria Investments.
Brazil: Preserving the Economic Recovery

PACE OF BUDGET DEFICIT REDUCTION SHOULD SET THE TONE OF LONG-TERM ECONOMIC GROWTH

- The economy is recovering from a deep downturn and output gap is still sizable
- A modest economic growth rate (~2% p.a.) in 2019-20 is viable even without CAPEX revival
- Stronger growth requires robust investment and thus a constructive reform mix
- Fundamental issue is reduction of fiscal imbalance, preferably without raising taxes
- Further microeconomic reforms to improve business environment would be welcome
- Optimistic scenario: long-term economic growth rate speeds up to around 3.5% p.a.
- Base case scenario: long-term economic growth rate around 2.5% p.a.
- Worst case scenario long-term economic growth rate slowing to 1%-1.5% p.a.

Source: Tendencias Consultoria, IpeaData, IBGE and Patria Investments.
Brazil: Large Fluctuations around Equilibrium FX

ESTIMATING REAL EFFECTIVE EXCHANGE RATE DEVIATION (IN PERCENT) FROM ESTIMATED LONG-TERM PPP EQUILIBRIUM

- Statistics report very strong mean reversion: the Brazilian currency in Sep-18 (R$4.12 per US $) was substantially undervalued

Source: Central Bank of Brazil and Patria Investments.
### Brazil: The Economy over Presidential Terms

**ACTUAL AND FORECASTED PATH OF KEY MACROECONOMIC VARIABLES**

#### Brazil: The Economy over Presidential Terms

<table>
<thead>
<tr>
<th></th>
<th>Real GDP growth (% p.a.)</th>
<th>Inflation IPCA (% p.a.)</th>
<th>Policy rate Selic (% p.a.)</th>
<th>Primary fiscal result (% of GDP)</th>
<th>FX change (% p.a.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cardoso (1995-98)</td>
<td>2.3</td>
<td>1.5</td>
<td>-16.4</td>
<td>3.1</td>
<td>9.3</td>
</tr>
<tr>
<td>Lula (1999-2002)</td>
<td>4.1</td>
<td>5.8</td>
<td>7.0</td>
<td>3.1</td>
<td>14.8</td>
</tr>
<tr>
<td>Rousseff (2003-05)</td>
<td>6.9</td>
<td>0.3</td>
<td>0.3</td>
<td>11.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Temer (2006-18)</td>
<td>1.3</td>
<td>3.5</td>
<td>8.2</td>
<td>1.3</td>
<td>2.5</td>
</tr>
<tr>
<td>Next government (2019-22): Consensus</td>
<td>2.5</td>
<td>8.1</td>
<td>1.6</td>
<td>-1.9</td>
<td>-0.7</td>
</tr>
</tbody>
</table>

- Benign electoral cycle could easily lift expected growth: +0.5% p.a.

#### Key Points:

- Realistic scenario for pending social security and tax reforms: multi-year process that will roll over into future administrations
- xx

**Source:** Tendências Consultoria, Arko Advice and Pátria Investimentos.
Brazil: The Fiscal Challenge

Consolidated public deficit is narrowing but long-term imbalances persist

- Rousseff’s awkward policies increased public spending and reduced tax proceeds: public deficit peaked at nearly 11% of GDP
- Budget discipline has been restored and the only key adjustment still pending is in the social security system

World: A Tale of “Deglobalization”

GLOBAL ECONOMIC INTEGRATION GOING INTO REVERSE SINCE THE 2008-9 FINANCIAL CRISIS

Global exports as share of world’s GDP: 1960-2017

- Other indicators (e.g. ratio transnational foreign direct investment to global GDP) also report deterioration

EMERGING MARKETS AND DEVELOPED ECONOMIES’ EXPOSURE TO FOREIGN CONDITIONS VARIES CONSIDERABLY

<table>
<thead>
<tr>
<th>Country</th>
<th>2007</th>
<th>2017</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td></td>
<td>12</td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>20</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EU</td>
<td>16</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>14</td>
<td>13</td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td>11</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td>25</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Argentina</td>
<td>11</td>
<td>21</td>
<td></td>
</tr>
<tr>
<td>Latin America</td>
<td>24</td>
<td></td>
<td></td>
</tr>
<tr>
<td>World</td>
<td>18</td>
<td>29</td>
<td></td>
</tr>
</tbody>
</table>

• Net impact of deglobalization likely to be slower world growth (not recession though) along with wider dispersion of real exchange rates

LatAm: Commodity Prices are Bouncing Back
A FAVORABLE SHOCK TO ASSET PRICES AND ECONOMIC GROWTH

- The drop in world commodity prices from 2012 until 2016 was worst than that recorded after the global financial crisis
- Since 2017 realignment of global supply & demand for commodities and a better world growth outlook have been lifting prices
- As a norm, better terms of trade boost asset prices and speed up economic growth in the region above potential

Source: IMF, Patria Investments and World Bank.
Purchasing power parity (PPP) theory rules that inflation differentials set the tone of currency changes over the long haul.

Actual currency changes in LatAm follow PPP very closely: de facto trend line deviates slightly from theoretical prescription.

Longer-term horizons (20-year) usually produce better fits than shorter-term (10-year).

Brazil and Argentina are exceptions because they did not have floating FX regimes until 1999 (Brazil) and 2015 (Argentina).

Annualized 12-month FX volatility is not an accurate indicator of the forward currency path in the long haul as it overestimates depreciation.

Most of the short-term FX volatility dissipates over time and fundamentals eventually have the upper hand.

Best predictor of long-term FX path for LatAm currencies is CPI differential against the U.S.

CPI gap between major LatAm economies and the U.S. has been narrowing lately: actual currency depreciation should slow.
LatAm: Mixed Exposure to Gyrations in the U.S.

ESTIMATING THE IMPACT OF HIGHER PROTECTIONISM AND INTEREST RATES

Protectionist bias to foreign trade & investment

✔ In Latin America Mexico, Venezuela and Central America would be hit the hardest by a more hostile U.S. stance

✔ Brazil, Argentina and most of South American countries have diversified exports and foreign investors and depend less on the American market

Expansionary fiscal policy and higher interest rates in America

Rising T-bill rates in America hurt, but Latin American economies are not highly leveraged and their external financing needs are manageable

➢ External debt service to GDP = 27% below EM’s average
➢ External debt amortization to GDP = 31% below EM’s average

Goods exports to the U.S.
(% share of GDP in 2017)

Mexico: 28
Nicaragua: 26
Honduras: 23
Haiti: 11
Costa Rica: 8
Dominican Republic: 7
Ecuador: 7
Colombia: 5
Venezuela: 5
Chile: 4
Peru: 3
Bolivia: 3
Brazil: 2
Uruguay: 1
Argentina: 1

Recent stress in global financial markets rekindled the discussion about Emerging Markets vulnerability to a sudden stop of capital inflows.

Traditional metrics of vulnerability focus on foreign ownership of local assets and total external financing needs.

Economic and political disarray in Venezuela (not in the chart) makes it extremely vulnerable to deteriorating external financing conditions.

Mexico is another exposed economy in Latin America: non-trivial external financing needs and large nonresident holdings of local assets.

Brazil reports measured vulnerability, lower than the average of Latin America and Emerging Markets in general.

Poland, Turkey, and Malaysia report the highest risks in the EM space, further aggravated by relatively low levels of international reserves.

Distress in global financial markets would bring LatAm’s short-term FX volatility to the forefront, but long-term effects are likely to be limited.

LatAm has sizable room to implement macro-prudential regulation to mitigate systemic risks in financial markets and in the banking industry.

Sources: Patria Investments, International Monetary Fund and Bank for International Settlements.
**LatAm: Shift towards Market-Friendly Governments**

**LATIN AMERICAN STOCKS (MSCI US $) SINCE LATE 2015**

- Governments with controversial, oftentimes market-unfriendly, economic policies are being replaced (exception is Venezuela)
- Better economic teams with stabilizing reforms are reshaping the business landscape, notably for private investment
- Key electoral cycles in 2018: Colombia in May, Mexico in July and Brazil in October

Source: MSCI, Inter-American Development Bank, LAECO and Patria Investments.
## Appendix: Brazil

### KEY DATES AND DEADLINES OF THE 2018 GENERAL ELECTIONS

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>7-Apr-2018</td>
<td>Deadline for candidates to comply with political party registration if they want to run in the 2018 general elections</td>
</tr>
<tr>
<td>7-Apr-2018</td>
<td>Deadline for putative candidates that hold public offices to step down</td>
</tr>
<tr>
<td>20-Jul to 5-Aug 2018</td>
<td>Party conventions to appoint candidates</td>
</tr>
<tr>
<td>15-Aug-2018</td>
<td>Deadline for parties to register their candidates and coalition tickets</td>
</tr>
<tr>
<td>16-Aug to 6-Oct-2018</td>
<td>Electoral campaigning (free TV &amp; radio slots from 31-Aug to 4-Oct)</td>
</tr>
<tr>
<td>7-Oct-2018</td>
<td>First ballot</td>
</tr>
<tr>
<td>28-Oct-2018</td>
<td>Runoff</td>
</tr>
</tbody>
</table>

**What is at stake in 2018?**
- Brazilians will vote for
  - President
  - Federal deputies
  - 2/3 of senators
  - State governors
  - State representatives

**Vote is mandatory in Brazil; low turnout is not in the cards**

**Campaigns usually heat up in the second half, even more so this year**

Sources: Arko Advice, Tendencias Consultoria, and Carlos Melo.
Appendix: Brazil

REFORMS PASSED AND IMPLEMENTED IN 2016

Microeconomic Reforms

I. Legislation strengthening corporate governance in state owned enterprises to enhance operational performance, fight corruption and minimize political interference in management

II. New electric utility regulation to speed up privatization or concession of public assets

III. Legislation opening up pre-salt oil fields to private investors by scrapping Petrobras obligation to be the area’s sole operator

IV. Regulation overhaul concerning concessions of public assets & programs attached to PPPs to attract private investment (domestic & foreign)

Macroeconomic Reform

I. Constitutional reform reducing federal, state & municipal budget earmarked expenditures by 30% up to 2023

II. Constitutional reform limiting federal primary spending to the previous year’s budget values adjusted for inflation only for the next 10 years, with the option to extend arrangement for a further 10 years

Privatization and Concessions

✓ 14 slots of power transmission lines auctioned on 13-Apr (committed CAPEX= R$7 billion)

✓ Privatization of CELG-D power distribution utility in the Mid-Western state of Goiás on 11-Nov: (proceeds = R$2.2 billion)

Source: Tendências Consultoria, Arko Advice and Pátria Investimentos.
Appendix: Brazil

REFORMS PASSED AND IMPLEMENTED IN 2017

Microeconomic Reforms

I. Education (secondary/high school public system): restructuring of the educational model for Brazilian public schooling: updating of national curriculum, adopt full-day arrangement, enhance role of technical schools

II. Labor: over 100 alterations in existing regulations aiming at eliminating outdated dispositions (e.g. mandatory contribution to unions regardless of actual unionization), reducing overhead costs, increasing the room for arbitration in negotiations (which should reduce litigation), building a proper legal arrangement for outsourcing and temporary work contracts

Political Reform

Performance clause: parties must have at least 1.5% of vote at national level (stepping up to 3% until 2030) in at least a third of the Brazilian 27 states to tap the federal party fund that finances most of their activities (aiming at reducing party fragmentation, this measure is expected to cut political organizations in the Congress by half over the next few years)

Party coalitions: forbidden for the election of federal deputies, state representatives and municipal councilors (this measure also aims at reducing party fragmentation and is expected to further halve the number of political organizations)

Campaign financing: in addition to the federal fund financed with budgetary resources, parties can collect contributions from individuals (up to 10% of the income reported to the IRS) but not from firms/corporations

Source: Tendências Consultoria, Arko Advice and Pátria Investimentos.
Appendix: Brazil

RECENT REFORMS PASSED AND CONCESSIONS AUCTIONED

I. New long-term interest rate TLP to benchmark BNDES credit operations: gradual elimination of subsidies (an estimated R$231 billion since 2007; annualized R$48 billion in 2017) embedded in National Development Bank’s - BNDES loans that used the TJLP rate as benchmark via its substitution by the TLP rate, which will converge to the yield of Treasury’s 5-year floating rate bond indexed to inflation (NTN-B)

- 4 regional airports on 16-Mar-17 (proceeds = R$3.7 billion)
- 5 port terminals (Para, Rio de Janeiro, Santa Catarina & Maranhao; total proceeds = R$1.5 billion) from 23-Mar to 21-Sep-17
- Petrobras’ southeastern gas pipeline (NTS) sold on 4-Apr-17 (proceeds = US $4.2 billion)
- 35 slots of power transmission lines on 24-Apr-17 (committed CAPEX= R$12.7 billion)
- 14th auction of exploratory oil & gas fields on 27-Sep-17 (proceeds = R$3.8 billion)
- Concession of 4 hydroelectric power plants formerly owned by Cemig electric utility on 27-Sep-17 (proceeds = R$12.1 billion)
- 2nd and 3rd auctions of pre-salt offshore oil fields on 27-Oct-17 (proceeds = R$6.2 billion)
- 11 slots of power transmission lines on 15-Dec-17 (committed CAPEX= R$8.7 billion)
- 15th auction of exploratory oil & gas fields on 29-Mar-18 (proceeds = R$8 billion)

- Exploration areas of CPRM (coal, zinc, lead, copper and phosphate)
- 3 railway routes (North-South SP/MG/GO/TO, Fiol BA and Ferrogrão MT/PA)
- 3 power generation plants
- 6 power distribution utilities
- 13 regional airports
- 4th auction of pre-salt offshore oil fields
- Sale of controlling stake of Eletrobras electric utility holding along with retention of golden share

Source: Tendências Consultoria, Arko Advice and Pátria Investimentos.
Appendix: Brazil

STARTING POINT: CORRUPTION PROBE HAD THE FORMER PRESIDENT LULA INDICTED ON SEP 20, 2016

Jul 12, 2017: Judge Moro pronounces Lula guilty

Court of Appeal (TRF 4): 3 Appellate Judges

The majority of Justices finds Lula guilty (2 x 1)

Defense to issue legal injunction challenging the essence of verdict

Disagreement on the sentence to be imposed

Unanimity on sentence imposed

Lula was unanimously found guilty (3 x 0)

Lula is found not guilty

Verdict to be unveiled in two-three quarters

Defense issued legal injunction challenging the wording of verdict

Defense’s embargoes dismissed (3 x 0): key topic is Lula’s incarceration

Verdict to be confirmed in two to three quarters: key topic is incarceration

The majority of Justices finds Lula guilty (2 x 1)

Lula is found guilty: key topic is incarceration

Lula’s condemnation challenged in the Supreme Court: Justices upheld Court of Appeal’s verdict and thus paved the way for the arrest order

Lula would run for president

Jul 12, 2017:

Source: Arko Advice, Tendencias Consultoria, Luciano Dias and Patria Investments.
Appendix: Brazil

ESTIMATING CURRENCY RISK: STATISTICAL EXERCISES WITH DAILY FX QUOTES 1994-2017 AS PUTATIVE ENTRY POINTS

- In the short-term (up to 2 years), the BRL is quite unpredictable
- Swings of up to 40% occur almost regardless of the entry FX rate
- Over time, however, the BRL becomes more predictable (PPP)
- Estimates of currency swings after 5 years or more yield very good fits

- No FX hedging and judicious entry points best suit long-term investors
- Best entry FX rate is almost always contrarian to market sentiment
- Rate of depreciation follows inflation differential Brazil vs. USA
- Continuously compound rate of depreciation since 1994: 4.4% p.a.

Source: Central Bank of Brazil and Patria Investments. Note: exercise consists of picking daily FX rates and tracking actual appreciation/depreciation over different time horizons.
Appendix: Brazil

ESTIMATING CURRENCY RISK: EXERCISES WITH MONTHLY CPI INFLATION AND FX CHANGE 1980 - 2016

• CPI beats currency depreciation 57% of the time in 1-year windows but 91% of the time in 15-year windows

• Staged capital deployment to average FX rates and allow inflation to work is a good proxy for full CPI indexation

Source: Central Bank of Brazil, IPEA and Patria Investments. Note: CPI is IPCA consumer price index and currency depreciation refers to BRL against US $.

Confidential
Appendix: Brazil

MASSIVE TRUCK DRIVERS’ STRIKE CHALLENGED PETROBRAS’ AGGRESSIVE FUEL PRICE POLICY

• Petrobras monopolistic position allowed the company to catapult domestic fuel prices and sharply improve its earnings
• Petrobras’ dividends paid to its controller (Treasury) help reduce fiscal gap; new management to adopt a less ambitious pricing policy

Source: Global Petrol Prices and Petrobras.
Sizable financing subsidies provided by the previous government inflated Brazil’s truck fleet and increased competition among drivers.

High fuel prices lifted operating costs in the transportation industry at a time it was still struggling to recover from deep downturn.

Source: IBGE, ANIT and Petrobras.
Appendix: Latin America

LOOKING GOOD OVER THE LONG-TERM: BASIC ECONOMIC DEVELOPMENT INDICATORS 1967-2016

- Latin America offers a mix of vast natural resources, reasonable growth and medium-high per capita income (deep domestic markets).
- Even with sharp currency depreciation after 2012, the region has the Emerging Markets’ highest per capita income.
- Latin America lifted over 70 million people out of poverty and expanded the middle class by more than 50% in 10 years.

Appendix: Latin America

QUALITY OF INSTITUTIONS MATTER: BERTELSMANN’S TRANSFORMATIONAL INDEX 2006 VS. 2016

- BTI evaluates the quality of democracy, a market economy and political management in 129 developing and transition countries
- LatAm’s institutions compare well with other emerging economies and have been evolving in recent years (towards the “Northeast”)

Source: Bertelsmann Stiftung (2016) "Latin America and the Caribbean Regional Report: in the Wake of the Quiet Revolution".
Appendix: Latin America
MAPPING RESILIENCE TO REAL SHOCKS FROM ABROAD

Response to a 1% permanent decrease in China’s real economic growth

Projected average real GDP growth in Latin America under alternative commodity price scenarios

- Impact of China’s slower growth in LatAm varies considerably from country to country owing to their diversified commodity exposure
- The region can growth even with adverse commodity price conditions, but country performance would vary considerably

• LatAm economies depend more heavily on commodities than the world average, however they are typically less open to trade flows.
• Foreign drivers: commodity prices are more relevant than international interest rates; in Brazil local interest rates matter the most.
• Crime is an issue in many urban areas but massive violence or warfare in the region is fairly low
• Likelihood of Latin American investment theses being adversely affected by geopolitical gyrations is quite small

• Progress in fighting petty bribery is fueling broader anti-corruption campaigns and changing LatAm’s political landscape


Note(*): taken from the 2014 Eurobarometer survey.
• Recent economic slowdown in the region seemed to be cyclical and spoke of a combination of less benign foreign environment along with domestic issues affecting a few large economies, notably Brazil, Argentina and Venezuela (the latter still facing a deep crisis)

• LatAm’s real GDP growth bottomed in 2016 but bounced back in 2017 and is expected to further speed up from 2018 onwards thanks mostly to improved policy frameworks and first benign developments of structural reforms recently implemented by several countries

• Terms of trade have somewhat recovered after the demise of the commodity super-cycle in 2012-13 but are still considerably below their historical peak and should play a secondary role compared to internal growth drivers

• Better-quality education, infrastructure, logistics and health services have become part of the core demands of the rising middle class and are expected to underpin domestic market expansion over the long haul

• Low level and poor quality of investment (in human capital as well) are the major factors hindering faster growth in the region
Characterized by large and well-developed agricultural, mining, manufacturing, and service sectors, and a rapidly expanding middle class, Brazil seeks to strengthen its economy over the long-term by protecting local businesses and investing in human capital & infrastructure.

Brazil overextended the emergency policies used to steer the economy away from the global recession of 2008-9: excessive fiscal spending combined with the fast growth of credit facilities provided by state-owned banks and a host of tax breaks and subsidies eventually undermined productivity, lifted inflation to double-digit rates and generated the country’s worst downturn ever.

A deep political crisis (Petrobras graft scandal – “Lava Jato”) further imperiled governability and led to the impeachment of President Rousseff in 2016.

Vice President Temer took over and successfully built a broad political coalition to support a market-friendly stabilization program centered on fiscal consolidation, disinflation, micro-macroeconomic reforms (e.g. labor market) along with an ambitious privatization/concession of state-owned assets.

A cyclical recovery is taking place due to vigorous exports, ample spare capacity and joblessness but long-term growth requires further progress on fundamental reforms chiefly to address fiscal primary deficits (a byproduct of social security imbalances) and poor productivity.

Mexico’s government emphasized ambitious economic reforms in 2012-14, passing and implementing education, energy, financial, fiscal and telecom reform legislation, among others, with the long-term aim to improve competitiveness and economic growth across the economy.

These reforms, combined with a solid policy framework, allowed economic activity to grow at a steady rate and inflation to remain low, despite the foreign-induced increase in FX and asset price volatility since the global financial crisis of 2008-9.

Steady economic growth is now under jeopardy owing to President Trump’s hostile stance towards Mexican exports (nearly ¾ of them go to America) and emigrants, which imperils the country’s integration into the NAFTA.

Ongoing economic and social domestic concerns: low real wages, high underemployment, unequal income distribution, rampant violence, pervasive corruption and few advancement opportunities for the largely indigenous population in the impoverished southern states.

The newly elected President Andrés Manuel López Obrador vowed to address the social malaises listed above while pushing ahead new economic reforms, for instance, a more solid fiscal footing (approximately 30% of government revenue still comes from the state-owned oil company, Pemex).

Bouncing back from the 2001 sovereign debt collapse, the country has focused on economic development with social inclusion, having invested heavily in health and education and specific programs, including the Universal Child Allowance, which reaches approximately 9% of the population.

The government relied extensively on expansionary policies for several years, along with state intervention in strategic industries, which have kept inflation in the double digits and created several microeconomic distortions.

A new administration, headed by President Mauricio Macri, emerged from the November 2015 general elections, its priorities being to preserve social inclusion but also restore sound economic policies and normalize relations with the international financial community to speed up economic growth.

Having ended the external debt moratorium, the government is implementing a wide-ranging reform agenda whose main items are achieving fiscal stabilization (now with help of an IMF stand-by program), shoring up domestic savings and stimulating private investment.

The main structural challenges for long-run growth and sustainable development are related to tenuous macroeconomic foundations, shortcomings in the business environment, limited technological innovation and integration, along with regional income and sectoral development gaps.
Colombia’s consistently sound economic policies and its longstanding strategy to bolster its commercial ties and boost investment at home have produced perhaps the most consistent economic growth story in the region.

A five-decade-long conflict between government forces and antigovernment insurgent groups, principally the Revolutionary Armed Forces of Colombia (FARC) funded by the drug trade, has ended and a peace agreement is being enacted.

On the other hand, Venezuela’s escalating economic and social crisis has produced an exodus to Colombia (870 thousand refugees up to July 2018), thus putting a burden on the government as authorities are struggling to absorb the influx and provide the migrants with food, medicine and shelter.

Faster economic development is stymied by inadequate infrastructure, income inequality, poverty, underemployment and residual narco-trafficking along with the still uncertain security situation in some regions.

Colombia still depends heavily on energy and mining exports, making it vulnerable to commodity price decline; furthermore the country needs to progress further in increasing productivity; strengthening public institutions and increasing social mobility.

Chile has a market-oriented economy characterized by a high level of foreign trade and a reputation for strong financial institutions and sound policy that have given it the strongest sovereign bond rating in South America.

In 2014 the government introduced a structural reform agenda to reduce social inequity by providing broader access to education and health care.

To fund this agenda a controversial tax reform was implemented and is expected to generate additional fiscal revenues equal to 3% of Chile’s GDP, mostly by increasing corporate tax rates.

The measured rate of economic growth after 2012 reflects the adverse impact of the end of the commodity super-cycle combined with uncertainties and adjustment costs from the reform agenda, which has been materially higher than originally expected and thus dented business confidence.

President Sebastián Piñera took over in 2018 vowing to revive the economy through a simplification of the tax code and enhanced infrastructure.

Heavy dependence on mineral exports makes the economy vulnerable to fluctuations in world commodity prices while the increase in the frequency and intensity of natural disasters affecting the country raises the likelihood of adverse supply shocks.

VENEZUELA`S GRAND NARRATIVE

- Venezuela has benefited from the historically high international oil prices of the past decade, which have enabled increased government spending on ambitious programs, notably to address social malaises (Misiones), and secured support for the “Bolivarian socialism” among the very poor.

- The government also nationalized several private companies in sectors such as hydrocarbons, mining and metallurgy, cement, banking and telecom, a move that caused material resource misallocation, depressed investment spending and fueled capital flight.

- Rampant hyperinflation caused growth to collapse, there is widespread shortage of goods and central bank international reserves are being depleted.

- The economic crisis is likely to worsen and, under the present administration, the Venezuelan government’s response has been to increase state control over the economy, blaming the private sector, domestic political opposition and foreign conditions for the calamities.

- President Nicolás Maduro’s highly contested reelection in 2018 speaks of the executive branch exercising increasingly authoritarian control over other branches of government, which should speed up the deterioration of democratic institutions and worsen political polarization.

- The international community has moved to isolate Venezuela, while imposing increasingly broad and stringent sanctions.

Appendix: Latin America

PERU’S GRAND NARRATIVE

- Peru remains one of the best performing economies in Latin America, with solid macroeconomic fundamentals, strong policy frameworks, impressive gains in poverty reduction and the persistent application of structural reforms to secure private investor confidence
- Peru suffered an economic slowdown with the end of the commodity super cycle: the sharp drop in hydrocarbon and mineral prices, falling external demand and reduction in private investment associated with mining projects resulted in a lower rate of growth after 2013
- Moreover, the country has navigated roiled political waters: facing impeachment after evidence surfaced of his involvement in a vote-buying scandal, President Pedro Paulo Kuczynski Godard offered his resignation in March 2018
- Leading indicators speak of a growth revival as a result of robust recovery of formal employment, household consumption and business investment
- Despite Peru's strong macroeconomic performance, dependence on primary exports, notably minerals and metals, and on imported foodstuffs makes the economy particularly vulnerable to fluctuations in world commodity prices
- Regional inequality persists (poverty in rural population is three times higher than in urban population) along with very high rates of informality

## Appendix: Latin America

### STRUCTURE OF ECONOMIES COMPARED: EXPENDITURE APPROACH (% OF GDP)

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## Basic Economic Data and Forecasts

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## Data Source

World Bank, Inter-American Development Bank, and Patria Investments.
Appendix: Latin America

KEY BIBLIOGRAPHIC REFERENCES

- International Monetary Fund (2017) “Regional Economic Outlook - Western Hemisphere: Tale of Two Adjustments”, International Monetary Fund.
- International Monetary Fund (2014) “Regional Economic Outlook - Western Hemisphere: Rising Challenges”, International Monetary Fund.
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Unless otherwise indicated, all internal rates of return and multiples of invested capital (“Gross MOIC”) are presented on a "gross" basis (i.e., they do not reflect management fees, "carried interest," taxes, transactions costs and other expenses borne by investors, which reduce returns and, in the aggregate, are expected to be substantial) and reported in US Dollars. Any such Gross MOICs used herein represent the total value (realized or unrealized) of an investor’s investment as a multiple of invested capital prior to the payment of any expenses. "Net MOIC" represents the total value (realized or unrealized) of an investor’s investment net of expenses as a multiple of invested capital. "Gross IRR" and "Net IRR" shall mean an aggregate, annual, compound, gross or net, as applicable, internal rate of return on investments, calculated based on daily investment inflows and outflows reported on an annual basis. Gross IRRs present the gross annual internal rate of return to the Partnership after the effects of debt financing (at either the Fund or property level) is taken into consideration. Net IRRs are after all management fees, carried interest, transaction costs and other expenses (other than management fees borne by investors) and are generally substantially lower. Net IRRs present the net annual internal rate of return to the investor after the effects of debt financing (at either the Fund or property level) is taken into consideration.

Projections and/or future unrealized values of currently unrealized investments will depend on, among other factors, future operating results, the value of the assets and market and other conditions at the time of disposition, legal and contractual restrictions on transfer that may limit liquidity, any related transaction costs and the timing and manner of sale, all of which may differ from the assumptions and circumstances on which current unrealized valuations are based and many of which are difficult to predict and are beyond Pátria control. Furthermore, subsequent to the preparation of certain of the valuations or economic information contained herein, the global economy, and in Brazil, the financial and economic conditions may have experienced periods of significant market volatility. Such volatility may have had a material adverse impact on the valuation of certain unrealized investments. If these unrealized investments were to be liquidated under current market conditions, the values obtained and economic information could be, with respect to such investments, materially lower than those indicated in the projected returns shown because the business plans upon which projections are based generally assume the stabilization and improvement of market conditions at the time of disposition. Accordingly, the actual realized returns on unrealized investments may differ materially from the returns indicated herein.

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