

**INVESTMENT NOTE**

**2 December 2014**

**HERMES: SAMBA SLOWDOWN AS BRAZIL LOSES ITS RHYTHM**

*In October, Brazilians rejected economic reform by re-electing Dilma Rousseff of the Workers' Party (PT) as president. Following this, the Hermes Emerging Markets team visited the country to assess the economic outlook. In the November issue of [Gemologist](#), Gary Greenberg Head of Hermes Emerging Markets and Lead Portfolio Manager, watches the last samba dancers leave the floor and asks whether Brazil's lucky streak has run out.*

"Brazil's recent presidential elections represented a clear choice between reform and regression, and voters chose regression. Not that many voters, actually: of those who voted, 51% voted for the incumbent Dilma Rousseff and 49% for Aécio Neves, the reform candidate; 40%, however, didn't vote at all. Measured by regional GDP, voters in regions representing a mere 20% of Brazil's GDP voted for the PT candidate Rousseff.

"Over the past thirty years, opportunities to shore up the economy were squandered as few Brazilians paid attention to the nation's manufacturing base. High growth in wages and therefore benefits, a strong currency, and a lack of infrastructure development steadily eroded the country's competitiveness. Manufacturing quietly decamped to Asia, where wages were low and benefits nonexistent. At first this seemed like a good thing: the infrastructure that Brazil should have been building was being developed by China, which imported unprecedented amounts of commodities. Iron ore rose from \$30 a ton to, at one point, over \$150 a ton. Brazil's terms of trade rocketed...and then Chinese demand peaked out.

"And now, with commodity prices falling (though still higher than a decade ago), Brazil has a problem. Labour costs on the coast are high and benefits remain awesome, so manufacturers need to cut costs in order to be globally competitive. Relocation to low-cost areas, following the Chinese initiative to relocate manufacturing to the interior, is mandatory. But infrastructure is expensive now, since commodity costs have reset so much higher due to China's rise. And because of droughts (as well as Chinese demand), energy costs are also much higher compared to a decade ago. Energy independence, apparently within sight when the 'Lula' oil deposit was discovered, remains a distant prospect.

"Brazil finds itself between a rock and a hard place. The economically illiterate majority of voters have chosen to continue to back handouts, although they are unaffordable in the long run. As the ruble's recent skydive demonstrates, politics cannot remain divorced from the laws of economics for long. The sobering task of austerity, creating a pool of savings to fund a revival of competitiveness and to find a niche in value-added services and production (as opposed to commodity exports), was even going to be difficult for the reformist candidate Neves.

"At the end of November, Rousseff appointed Joaquim Levy, a hard-core orthodox economist from the Chicago School and former treasury secretary under Lula, as finance minister. Levy is a disciplined economist who should help Brazil avoid the otherwise imminent loss of its investment-grade rating on sovereign debt and, if he survives in his new role, could make the hard decisions needed to rebuild public finances. On November 21, when unconfirmed reports of his appointment broke, the Ibovespa rose 5% while the real strengthened 2.3% against the dollar. His long term survival however is not guaranteed.

"Even if Brazil's party dies out completely, all is not lost. State-owned enterprises, constituting a large part of the benchmark, may languish, but private companies have been dealing with adverse conditions for decades and have the tools to cope. For example, Itaú Unibanco, one of Brazil's largest and best-run private banks, has 'de-marketed' risky borrowers and is focusing on low-risk, high-return payroll lending.

“The politics look dark right now but the winds can shift – and Brazil is home to a few excellent companies. The samba can resume, but only after a lot of hard work. Its return will be found by listening for the faint but vibrant rhythms of commerce in the ruas of Brazil’s cities and favelas.”

**You can read the November issue of the Gemologist in full on the Hermes Investment Management website [here](#).**

**-ENDS-**

Follow us on Twitter: [@Hermesinvest](#)  
Website: [www.hermes-investment.com](http://www.hermes-investment.com)

**For further information, please contact:**

**Hermes Investment Management**

Jeannie Dumas  
+44 (0)20 7680 2152  
[jeannie.dumas@hermes-investment.com](mailto:jeannie.dumas@hermes-investment.com)

Melanie Bradley  
+44 (0)20 7680 2218  
[melanie.bradley@hermes-investment.com](mailto:melanie.bradley@hermes-investment.com)

**Notes to Editors:**

**Hermes Investment Management**

Hermes is focused on delivering superior, sustainable, risk adjusted returns for our clients – responsibly.

Hermes manages assets on behalf of more than 200 clients\* across equities, fixed income, alternatives and real estate, with £27.9 billion\* assets under management. In Hermes Equity Ownership Services, we have the industry’s leading engagement resource, advising on more than £120.3 billion\* of assets.

We believe in **Excellence, Responsibility** and **Innovation**

- **Excellence:** We aspire to excellence in everything we do. This manifests itself most visibly in our investment performance. We will only offer products to our clients where we believe there is a strong investment thesis and where we can deliver sustainable alpha.
- **Responsibility:** We believe it is our responsibility to lead discussion and debate about the fiduciary responsibilities of fund managers to our clients, their stakeholders and, ultimately, society at large. We have always sought positive engagement with the firms in which we invest.
- **Innovation:** We have the entrepreneurial culture to identify forward-looking products that meet those needs, along with the resources and speed-to-market mentality to develop them rapidly.

Our structure gives clients globally the benefit of access to a broad range of specialist, high conviction investment teams operating within an established and robust operating platform.

Hermes' investment solutions include:

- **Equities:** Global, Emerging Markets, Small & Mid Cap, Europe, Asia Ex Japan, Greater China
- **Fixed Income:** Inflation-Linked, Government Bonds, Investment Grade, High Yield
- **Real Estate:** Segregated, Unitised, Debt, UK, US Residential, European, UK PRS
- **Alternatives:** Multi Asset, Infrastructure, Private Equity

\*Please note the total AuM figure includes £3.6bn of assets managed or under an advisory agreement by Hermes GPE LLP (“HGPE”), a joint venture between Hermes Fund Managers (“HFM”) and GPE Partner Limited. HGPE is an independent entity and not part of the Hermes group. £0.4bn of total group AuM figure represents HFM mandates under advice. Source: Hermes as at 30 September 2014.