



**TENZING
PACIFIC**
INVESTMENT MANAGEMENT

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HOLDING: ISHARES MSCI BRAZIL CAPPED ETF (EWZ)

What the bulls say:

- After 3 years in deep recession that shrank the national GDP by approximately 27% by the end of 2016, this year Brazilian economy has been showing signs of picking up. The GDP is forecast to grow by 0.7% this year, and the outlook for 2018 is positive with an expectation of 2.3% growth.
- Brazil's manufacturing PMI has been consistently above 50, the expansion threshold, since April '17, the longest streak in history, and increasing over the last 4 months. This is critical as it reflects the confidence of business owners on the economy's productivity, demand and profitability.
- The administration is promoting a progressive economic agenda toward a more liberal economy with privatization of state-owned enterprises and spending cut, especially in pension payments that accounts for 57% of primary spending and 13% of the GDP)

What the bears say:

- The most prominent risk of investing in Brazil is the looming political risk with both the parliamentary election and the presidential election held in October '18. The current poll-leading candidate is the former leftist president, Lula Da Silva, who still awaits the final verdict on his 10-year-in-prison sentence due to the conviction of corruption.
- The credit rating below investment level from all major credit rating agencies is another major concern for investors. It requires companies in Brazil to offer higher promised returns on their debts in order to raise sufficient capital from investors.

Risks:

- Almost 40% of the fund's total AUM are holdings in the financial sector. It implies a remarkable credit risk that investors have to bear when they invest in the fund because of the sub-investment ratings from all major credit rating agencies.
- In order to sustain the growth of the economy, major reforms in fiscal policies, especially the pension payments, are needed as the country is expected to move toward a more market-oriented and dynamic economy that has to rely much less on commodity exports. However, with the new elections in the parliaments and presidency looming over politicians, they are expected to be more reserved in pushing these proposed reforms by the current administration.



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4 reasons to buy/sell:

- iShares MSCI Brazil Capped ETF (EWZ) is designed to track MSCI Brazil 25/50 Index and has a YTD approximate return of 16% this year. However, the current P/E of the EWZ is 20.19 that makes its valuation still lower than that of the US equity market. With the positive outlook of Brazilian economy for 2018, it provides an opportunity for handsome return as the fund is exposed to all biggest public firms in the country. In addition, its AUM as of 12/2017 is \$7.14 Billion guarantees its liquidity and price efficiency.
- Brazil economy has showed signs of recovery, though just slightly positive, in 2017 after 3 years of deep economic recession and political turmoil. The economy is expected to strengthen and grow over the next 2 year as the forecast consensus of GDP growth is 2.5% annually.
- The current low inflation level, 2.21% for first ten months of 2017, allows central bank to further drop interest rate and stimulates lending to private sectors and personal consumptions. The investment in new facilities, inventories and new machines ticked up by 1.6% Q-o-Q in 3Q17, highest figure since 2Q13 while consumer spending increased by 1.2% quarterly in last 2 quarters.
- The ongoing crackdown with several corruption charges on senior government officials and the impeachment of the former president is a key factor in restoring confidence from participants in the economy and foreign investors, especially when the current administration is pushing for a more liberal market and privatization of giant and influential state-owned enterprises in backbone sectors of the economy.

Recommendation:

We recommend a BUY rating on EWZ.

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