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## Return of the Strongman: Part II

The populist wave has officially made its way to Brazil. In a blow to the establishment, Brazilian voters have elected former military officer Jair Bolsonaro as president. As Brazil continues to struggle with its recovery from the country's worst recession in its history, the public has turned its back on the mainstream political parties. A recent poll showed that 60% of Brazilians wanted a political outsider as president. Growing resentment for the traditional parties is likely due to corruption scandals, a historically high unemployment rate and a rising murder rate which set back-to-back records in 2017 and 2018.

To the chagrin of the establishment, Bolsonaro was able to wield his brash and antagonistic rhetoric as an asset, gaining popularity for his blatant disregard for political correctness. For example, he has been quoted as saying the following: the military's only mistake was that it did not kill enough people; residents of Quilombo shouldn't be allowed to procreate; and he would shut down the government the same day he is elected president.<sup>1, 2</sup> Bolsonaro's victory is seen by some as a threat to Brazil's democracy. As a result, we would expect anti-Bolsonaro protests throughout Brazil. That being said, while some people found his victory frightening, investors

<sup>1</sup> <https://www.bbc.com/news/world-latin-america-45965925>

<sup>2</sup> <https://www.express.co.uk/news/world/1037819/brazil-election-2018-president-jair-bolsonaro-far-right-full-dictatorship>

seemed relieved as the markets still preferred Bolsonaro to any member of the Workers' Party (PT). The chart below shows the Brazilian real strengthening against the dollar.



(Source: Bloomberg)

In Part II of this report, we will discuss Jair Bolsonaro's background and ideology, along with why markets find him appealing. As usual, we will conclude with potential market ramifications.

### Background

Jair Bolsonaro was born on March 21, 1955, to a modest family in Sao Paulo. At the age of 19, Bolsonaro enrolled in Academia Militar das Agulhas Negras, a well-known military school in Rio de Janeiro. While the country was under military rule, Bolsonaro decided that attending military school was the best way to climb the social ladder. During his time in school, Bolsonaro's tenacity helped him rise through the military ranks to army captain in 1983.<sup>3</sup>

Following the end of military rule in 1985, Bolsonaro became a vocal critic of the new

<sup>3</sup> [https://www.ebiografia.com/jair\\_bolsonaro/](https://www.ebiografia.com/jair_bolsonaro/)

democratic government. He was particularly angered by the government's fiscal restrictions that were implemented to fight inflation and lower the deficit. In 1986, Bolsonaro complained that the salaries for military workers were too low after the government refused to adjust military salaries for inflation. A year later, he was arrested for revealing sketches of a plan to set off bombs at the Agulhas Negras Academy in order to draw attention to his cause. He later claimed that he did not draw the sketches and was subsequently given 15 days in prison. The stunt made Bolsonaro popular among those sympathetic to the military and he was able to leverage his newfound fame into public office.

In 1987, Bolsonaro was elected to City Counsel in Rio de Janeiro, and in 1990 he was elected to the lower chamber of Congress as federal deputy. During his time in office, he primarily focused on raising military wages. In addition, he developed a reputation for being something of a loose cannon. He frequently espoused extreme right-wing views and made disparaging remarks about women and minority groups.<sup>4</sup> In 1993, he called for the abolition of Congress, and in 1999 said he wished that the military had assassinated newly elected President Fernando Henrique Cardoso. In 2003, Bolsonaro made his most outlandish remark by stating to a congresswoman, on camera, that she was not worthy of being raped.<sup>5</sup> His attacks forced him to the fringe of Brazilian politics until recently. Nevertheless, Bolsonaro was able to maintain his position as federal deputy for over three decades.

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<sup>4</sup><https://www.nytimes.com/2018/10/28/world/americas/brazil-president-jair-bolsonaro-quotes.html>

<sup>5</sup><https://www.theatlantic.com/international/archive/2018/01/the-evangelical-takeover-of-brazilian-politics/551423/>

### **Ideology**

Outside of his pro-military and anti-democratic views, Bolsonaro has never fully articulated a policy position. During his time in Congress, he was known more for his inflammatory comments than his voting record. After 30 years in government, he managed to pass two bills. At campaign events, Bolsonaro routinely blames target groups for the shortcomings of Brazil. For example, he blamed welfare payments to minority groups for the bloated deficits, specifically mentioning the residents of Quilombo. Given his inability to express an ideology, it is likely he will pass laws that appease his base, which primarily comprises farmers, military sympathizers and conservative Christians – also known as the “bull, bullet and bible” bloc.

### **Brazilian Farmers**

The "bulls" of the voting bloc represent the agribusiness sector, specifically cattle herders, miners and loggers. This group supports reduced farming and environmental regulations, the removal of protections for indigenous groups and their land and more freedom to mine and log in the Amazon. These measures would likely make it easier for landowners to have more land to farm and find more resources to sell, which is why they support Bolsonaro.

Bolsonaro's embrace of this group can be seen in his attacks on minority groups as well as his push for smaller government. On the campaign trail, he stated that the push for protected land for indigenous people is a Western plot by the United Nations to create separate Amazonian states within Brazil. In addition, he has had issues with environmental agencies after he was fined for fishing illegally. Consequently, Bolsonaro campaigned on closing the environmental agency or, at a minimum, reining in its ability to enforce laws.

Bolsonaro has also stated that he would like Brazil to follow the U.S. out of the Paris Climate Accord, citing the U.S. departure as proof that the agreement was faulty.

### **Law and Order**

The "bullets" portion of Bolsonaro's voting bloc represents a group that would like the restoration of law and order in Brazil. This group includes military sympathizers and those impacted by gang violence. They would like police officers and military officials to have more funding and increased discretion to take on drug cartels. For example, this group does not want police officers to be punished harshly for shooting suspected criminals. In addition, they would like to bring back capital punishment and lower the age at which a juvenile can be tried as an adult. This group finds Bolsonaro appealing because they believe the present government's insistence on being politically correct has been counter-productive to reducing the crime problem.

The bullets group has embraced Bolsonaro because of his lengthy history of supporting the military as well as his no-nonsense approach to fighting crime. In an interview, Bolsonaro stated that police officers should be given more liberty to shoot criminals and suggested the military could be deployed to take on drug cartels. In addition, he has advocated for sending highly armed security forces into poor slums to control crime.

### **Conservative Christians**

The "bible" portion of the voting bloc represents conservative Christians. This group is primarily composed of Evangelicals and conservative Catholics. These supporters believe that Brazil's acceptance of Western values such as tolerance of homosexuality and gender equality have come at the expense of the family. Therefore, they support an end to gay rights,

a ban on abortion and oppose equal rights for women. This group supports Bolsonaro because he adamantly defends Christian values and is a self-professed born-again Christian.

The bible group embraces Bolsonaro because he provides a blunt and unapologetic defense for his views. For example, he questioned the fairness of equal pay because women can get pregnant. In an interview, he stated that he would rather have a dead son than a gay son. In short, he has the support of Christian conservatives because they believe he will openly challenge Western views and promote Christian ones.

### **Market Appeal**

Investors like Bolsonaro because he appears to have embraced economic liberalism. He has campaigned on increased deregulation, a smaller government and an independent central bank. At the same time, Bolsonaro is by no means an economic policy expert. In an interview, he was asked how he would shrink the federal deficit, maintain low inflation and manage a floating exchange rate. He responded, to the delight of the markets, that he will leave it in the hands of his finance minister, Paulo Guedes.

Paulo Guedes, Bolsonaro's economic policy advisor and likely finance minister, graduated from the highly reputable University of Chicago. His involvement has led to comparisons of the Chilean Chicago boys during Augusto Pinochet's rule. Guedes is expected to privatize many of the state-owned companies, excluding Petrobras and utility firms, and use the profits to pay down the country's rising debt. In addition, Guedes will be expected to rein in Brazil's bloated pension plan and present a simpler tax code. Although it is unlikely that Guedes can deliver on all these reforms, especially

pension reform, a modest improvement in the aforementioned areas will likely be enough for investors to claim a win.

Although markets have generally accepted Bolsonaro's word that he will allow his finance ministers to guide economic policy, we would not be surprised if he reneges. Bolsonaro has long been suspicious of establishment-types like Guedes since the IMF encouraged the Brazilian government to self-impose austerity in the early '90s. Therefore, it is likely that Bolsonaro may try to undermine economic policies that are unpopular with his base. Last month, Guedes's plan to reinstate the financial transaction tax was shunned by members of Bolsonaro's inner circle. If this happens, we expect the markets to respond defensively.

### **Ramifications**

While we are confident that markets will initially view Bolsonaro's victory positively, we suspect the love affair will not last.

Bolsonaro appears to be an impulsive figure and therefore may be less inclined to relinquish power willingly. If Guedes's policies start to receive backlash from core supporters, we expect Bolsonaro to take over and possibly abandon economic liberalism in favor of economic populism. It is worth noting that the previous military dictatorship's acceptance of economic liberalism had little to do with core beliefs and more to do with the global trend. There is growing sentiment that economic liberalism is responsible for growing social inequality. As a result, we are not convinced that economic liberalism in Brazil will succeed. If we are correct, we expect investors to seek refuge abroad. Therefore, we conclude that Bolsonaro's victory will be bearish for Brazilian equities in the long run.

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*This report was prepared by Thomas K. Wash of Confluence Investment Management LLC and reflects the current opinion of the author. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.*

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