Market Update: December

International:

Most financial assets lost value in December, paring back some of the strong gains seen in 2024. Both the year and the month were defined by U.S. exceptionalism, with the dollar appreciating by 2.7% in December, accumulating an 8% gain over 12 months against a basket of trade partner currencies (DXY). Investors face a conundrum: on the one hand, there is strong momentum in the United States, both in the economy and in the performance of financial assets, with high prices in stocks, corporate bonds, and the currency.. On the other hand, there are more attractive return prospects in markets outside the U.S. (Figure 1). However, as the year transitions, the prevailing narrative still favors U.S. allocations due to the economy's dynamism and expectations regarding policies to be implemented by the incoming Republican administration, leaving no clear signal yet as to when allocators should reposition in light of the risk of a potential reversal.

Among the key economic events in December were monetary policy decisions in the U.S., the Eurozone and Japan. Markets also experienced volatility spikes in response to Donald Trump's statements regarding the key measures he plans to implement, particularly in sensitive areas such as immigration policies, import tariffs, and deregulation. Investors are expected to remain in a wait-and-see mode until the new president's inauguration on January 20th. Additionally, China signaled new fiscal and monetary stimulus measures, adopting a more assertive stance not seen since 2010.

The U.S. economy performed better than expected in 2024, closing the year with 2.8% GDP growth—approximately 1.5% higher than initial forecasts. However, the continued decline in inflation allowed the Federal Reserve to cut interest rates once again in December, bringing them down to the 4.25%-4.50% range. The major surprise came in the Fed's updated projections, which now anticipate only two additional rate cuts in 2025 (down from four in the previous meeting). Despite still-elevated interest rates, inflation hovering around 2.5%—with slight upward pressure—and uncertainty regarding the inflationary impact of Trump's proposed policies led the Fed to adopt a more cautious stance, which helped strengthen the U.S. dollar.

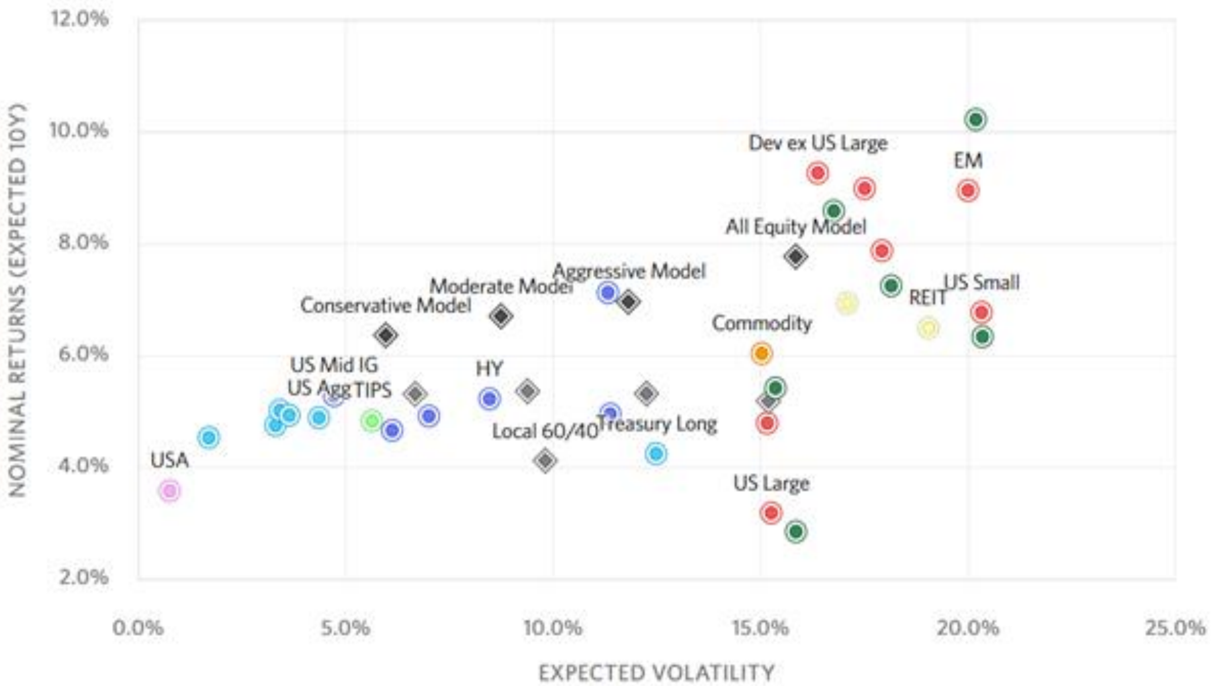


Figure 1: Expected Nominal Return and Volatility Across Various Asset Classes. Source: Research Affiliates

In Europe, the European Central Bank (ECB) also disappointed market participants expecting significant stimulus through rate cuts. While manufacturing indicators have been in contractionary territory for some time, inflation—particularly in services—has been slow to decline. This led the ECB to take a more cautious approach, conditioning future moves on a clearer downward trajectory in inflation. ECB projections estimate 2024 GDP growth at approximately 0.7%, with an expected acceleration to 1.1% in 2025. Meanwhile, inflation is projected to reach 2.4% in 2024 and 2.1% in 2025.

In China, the displayed 2024 GDP growth was close to 5%, and although a slight slowdown is expected in 2025, the Politburo's year-end statements were emphatic in affirming continued fiscal and monetary support to maintain growth around 5% in the coming year. Nevertheless, the structural problems and a potential tariff conflict with the United States could make this plan unfeasible. In Japan, the central bank kept interest rates unchanged, surprising markets by expressing less confidence than in previous statements about future rate hikes, which led to further depreciation of the yen against the U.S. dollar.

Local:

In Brazil, the unexpectedly strong economic growth in 2024 (3.5% GDP growth) did not translate into gains for financial assets, which continued to depreciate in December and ended the year with significant losses (IBOV -10.3%, IFIX -5.9%, IMA-B -2.4%, and BRL/USD -21.7%). The Brazilian real stood out as the most depreciated emerging market currency in 2024. Following the Brazilian Central Bank's (BCB) commitment to raising the Selic rate to at least 14.25%, market rates are now pricing levels above 16%. The primary driver behind this underperformance is the growing distrust in the government's fiscal management, with public debt expected to increase by over 10% during the current administration.

The president's reluctance to balance the budget—despite strong economic growth—has led investors to assign a higher probability (even if still relatively low) to the risk of a disorderly fiscal adjustment. In countries with high local-currency debt, such adjustments typically occur through a combination of high inflation, negative real interest rates, and some form of capital control, which almost invariably results in economic recession. While historical experience suggests the need for fiscal adjustments, the political landscape and the ideological stance of the ruling Workers' Party make it unlikely that measures in this direction will gain traction. However, ignoring the problem does not prevent a deterioration in business confidence and has not yielded political dividends for the ruling party—suggesting that some level of fiscal restraint may eventually be necessary, even if structural reforms are postponed until 2027.

The legislative calendar, combined with the president's temporary medical leave, meant that no official acknowledgment of the need for fiscal adjustments occurred, leaving Brazilian assets unanchored as the year ended. In response, the central bank sold nearly 10% of its foreign exchange reserves to mitigate the impact of capital outflows on the exchange rate. However, these interventions had only a limited effect, as risk premiums on interest rate curves and credit default swaps (CDS) widened (Figure 2). With fewer USD reserves, Brazil's ability to meet external debt obligations in the future has diminished. Since legislative activity will only resume in February, the year is set to begin with significant policy uncertainties.

In local currency portfolios, asset allocation has been heavily concentrated in private and public bonds indexed to the Selic rate. However, historical experience from countries that have resorted to debt monetization (such as Turkey and Argentina) suggests that real assets— such as equities and real estate—tend to preserve value better in extreme scenarios.

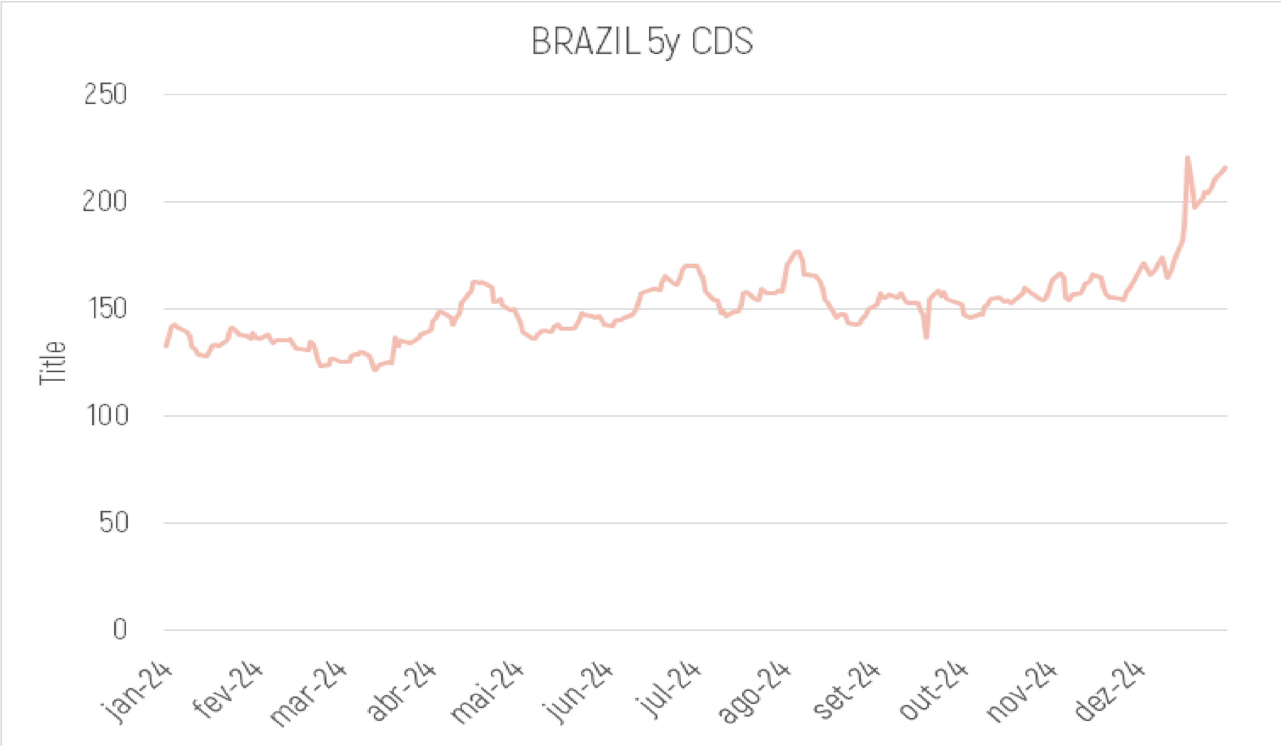
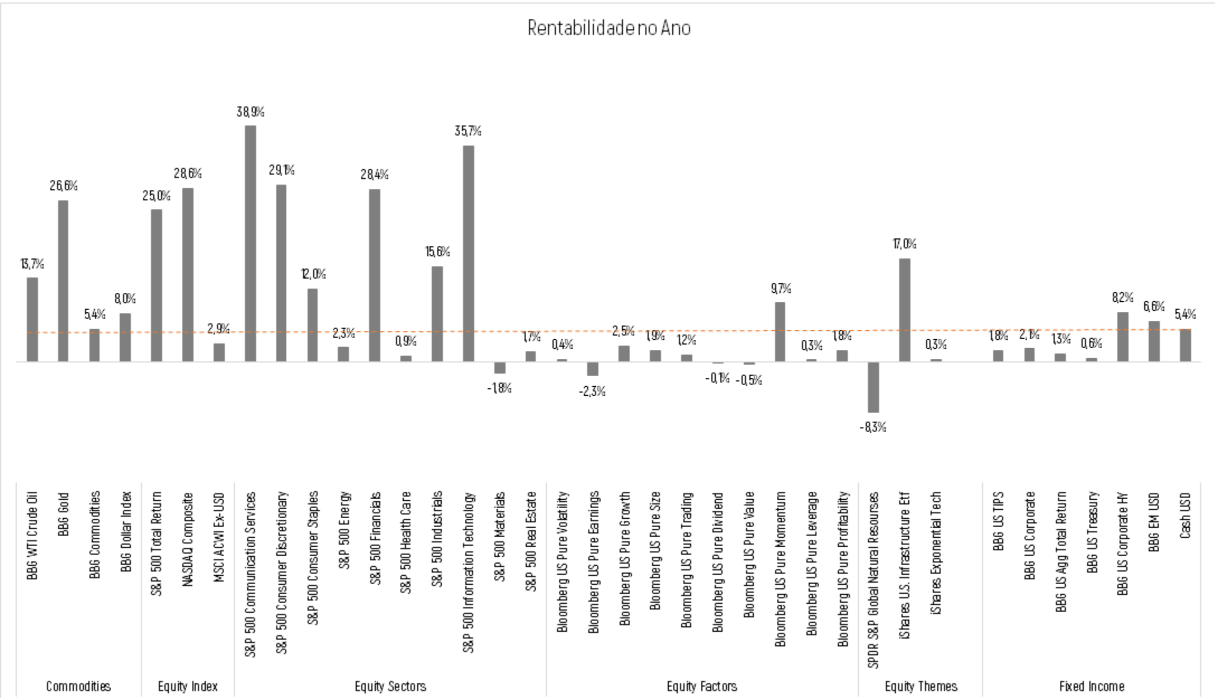


Figure 2: Brazilian 5-Year CDS. Source: BBG/Tera

Ativos Globais	1m	3m	6m	12m	24m	36m
Commodities						
BBG WTI Crude Oil	6,05%	8,32%	-4,47%	13,75%	11,51%	39,32%
BBG Gold	-1,11%	-0,47%	12,40%	26,62%	42,86%	41,81%
BBG Commodities	1,02%	-0,45%	0,23%	5,38%	-2,96%	12,66%
BBG Dollar Index	2,72%	7,10%	3,16%	7,98%	5,06%	11,61%
Equity Index						
S&P 500 Total Return	-2,38%	2,41%	8,44%	25,02%	57,88%	29,29%
NASDAQ Composite	0,48%	6,17%	8,90%	28,64%	84,50%	23,43%
MSCI ACWI Ex-USD	-2,04%	-7,84%	-1,06%	2,92%	15,84%	-5,36%
Equity Sectors						
S&P 500 Communication Services	3,49%	8,60%	10,15%	38,89%	114,38%	27,73%
S&P 500 Consumer Discretionary	2,33%	14,06%	22,72%	29,13%	82,12%	13,68%
S&P 500 Consumer Staples	-5,24%	-3,84%	4,12%	11,98%	9,56%	6,10%
S&P 500 Energy	-9,56%	-3,20%	-6,21%	2,31%	-2,60%	54,91%
S&P 500 Financials	-5,58%	6,67%	17,56%	28,43%	41,19%	23,75%
S&P 500 Health Care	-6,36%	-10,67%	-5,62%	0,90%	1,21%	-2,38%
S&P 500 Industrials	-8,10%	-2,74%	8,11%	15,64%	34,19%	24,66%
S&P 500 Information Technology	1,12%	4,67%	6,18%	35,69%	112,21%	50,86%
S&P 500 Materials	-10,91%	-12,82%	-4,80%	-1,83%	8,22%	-7,00%
S&P 500 Real Estate	-9,15%	-8,75%	6,12%	1,73%	10,13%	-21,19%
Equity Factors						
Bloomberg US Pure Volatility	-0,27%	1,55%	2,26%	0,38%	2,96%	-2,99%
Bloomberg US Pure Growth	0,35%	2,86%	2,02%	2,52%	2,67%	-1,65%
Bloomberg US Pure Size	0,47%	0,50%	-0,25%	1,87%	6,04%	4,89%
Bloomberg US Pure Dividend	0,08%	-1,47%	-0,57%	-0,09%	-2,66%	-0,07%
Bloomberg US Pure Value	-0,65%	-0,54%	-1,90%	-0,46%	0,18%	9,80%
Bloomberg US Pure Momentum	-1,11%	1,83%	2,38%	9,70%	7,37%	8,45%
Equity Themes						
SPDR S&P Global Natural Resourses	-7,00%	-11,39%	-8,50%	-8,27%	-5,57%	4,07%
iShares U.S. Infrastructure Etf	-9,87%	-0,98%	11,01%	17,02%	32,72%	28,32%
iShares Exponential Tech	-2,83%	-1,64%	1,79%	0,29%	27,39%	-8,06%
Fixed Income						
BBG US TIPS	-1,58%	-2,88%	1,12%	1,84%	5,80%	-6,73%
BBG US Corporate	-1,94%	-3,04%	2,62%	2,13%	10,82%	-6,64%
BBG US Agg Total Return	-1,64%	-3,06%	1,98%	1,25%	6,85%	-7,05%
BBG US Treasury	-1,54%	-3,14%	1,45%	0,58%	4,65%	-8,39%
BBG US Corporate HY	-0,43%	0,17%	5,47%	8,19%	22,74%	9,01%
BBG EM USD	-1,19%	-1,47%	4,26%	6,58%	16,27%	-1,48%
Cash USD	0,40%	1,20%	2,60%	5,40%	10,89%	12,78%



Ativos Brasileiros	1m	3m	6m	12m	24m	36m
Pós-Fixado						
Brazil CETIP DI Rate Accumulat	0,93%	2,67%	5,37%	10,87%	25,34%	40,85%
Anbima IMA-S	0,86%	2,69%	5,50%	11,11%	25,83%	41,86%
Anbima Debentures Index IDA DI	-0,10%	1,69%	5,18%	12,49%	26,78%	45,25%
Prêmio de Crédito	-1,02%	-0,96%	-0,18%	1,45%	1,15%	3,12%
Pré-Fixado						
Anbima IRF-M 1	0,70%	2,13%	4,74%	9,46%	23,96%	38,86%
Anbima IRF-M	-1,66%	-1,97%	0,34%	1,86%	18,67%	29,15%
Anbima IRF-M 1+	-2,96%	-4,20%	-2,02%	-1,81%	16,38%	25,01%
Indexado Inflação						
Anbima IMA-B 5	-0,28%	0,82%	2,75%	6,16%	19,03%	30,68%
Anbima IMA-B	-2,62%	-3,23%	-1,36%	-2,44%	13,22%	20,43%
Anbima IMA-B5+	-4,37%	-6,17%	-3,78%	-8,63%	8,98%	12,58%
Anbima Debentures Index IDA IP	-2,24%	-3,00%	0,24%	2,90%	14,53%	20,50%
Prêmio de Crédito (s/ média B5 e B)	-0,80%	-1,81%	-0,45%	1,02%	-1,37%	-4,03%
*Inflação IPCA**	0,39%	1,40%	1,98%	4,87%	9,78%	16,26%
Imobiliario						
Bovespa Real Est In Fund	-0,67%	-5,74%	-6,90%	-5,89%	8,69%	11,11%
Hedge Funds*						
Anbima Hedge Funds Index	0,36%	2,07%	5,55%	5,76%	15,61%	31,41%
Renda Variável						
BRAZIL IBOVESPA INDEX	-4,28%	-8,75%	-2,92%	-10,36%	9,61%	14,75%
BOVESPA Dividend Index	-4,89%	-6,59%	0,81%	-2,62%	23,51%	39,14%
BM&FBOVESPA Small Cap	-7,83%	-13,16%	-11,95%	-25,03%	-12,20%	-25,42%
BRAZIL Financial Index	-2,00%	-11,65%	-2,74%	-14,30%	15,37%	28,50%
BOVESPA Utilities Index	-5,32%	-10,13%	-0,63%	-7,12%	13,01%	26,43%
BM&FBOVESPA REAL ESTATE	-9,43%	-16,19%	-9,76%	-24,95%	15,02%	4,72%
BM&FBOVESPA Consumption	-7,28%	-12,77%	-9,92%	-22,56%	-17,15%	-38,16%
BOVESPA INDUSTRIAL INDEX	-3,81%	0,40%	10,59%	14,50%	29,74%	6,86%
BOVESPA Basic Mat Index	-5,91%	-4,69%	-2,47%	-11,90%	-4,89%	-10,14%
BRAZIL ELECTRIC.ENRGY IX	-5,63%	-13,76%	-12,27%	-18,43%	-1,56%	1,51%
FX						
USD-BRL Carry Return	2,89%	11,77%	7,71%	21,66%	4,85%	-10,22%