



mar

asset

letter: january, 2025

Preaching in the desert

We need to address the most important question regarding our portfolio and the markets: will there be a trigger to halt the deterioration of Brazil's macroeconomic and financial asset landscape in the near future? Yes, we believe so.

We believe we are facing a scenario of political dominance. The current economic challenges result from a political order—or more specifically, its constraints. Therefore, the solution must also come through politics, likely involving a change in leadership within the executive branch.

Our perception is based on two pillars. We see a cyclical inflection in the economy, a result of an exhausted economic cycle with a prospect of deterioration in the coming years. At the same time, we identify a structural change in Brazilian society, marked by the growth of the evangelical population, which has influenced a change in the average voting profile towards conservatism and moved the Brazilian political pendulum to the right.

This combination, in our view, undermines the probability of President Lula's re-election, something that should be anticipated by the markets at some point in 2025.

## Fiscal policy as a political instrument

To address the current economic issue, we like to turn to history. The umbilical relationship between politics and economics helps us understand the current environment.

One of the main objectives of economic policy is to promote growth and contain the volatility of GDP, that is, to smooth out economic cycles. Acute cycles of "booms and busts" periodically generate intense social pain, popular dissatisfaction, political instability, and uncertainty for investments, making it impossible to achieve sustained growth that structurally improves the lives of the population.

Organized societies have been debating for centuries the challenge of maintaining growth while reducing the intensity of economic cycles – at certain times, through the improvement of agricultural, industrial, and commercial efficiency; at others, through the protection and reduction of wars. In the last century, we highlight the evolution of instruments of economic intervention by the State.

The great novelty in this theme was the development and introduction of John Maynard Keynes' ideas in macroeconomics. The English economist proposed the use of government spending as a temporary buffer tool against major negative movements in the economic cycle. In constructing his original idea, Keynes aimed to mitigate the economic and social hardships imposed on Germany by the Allies after World War I.

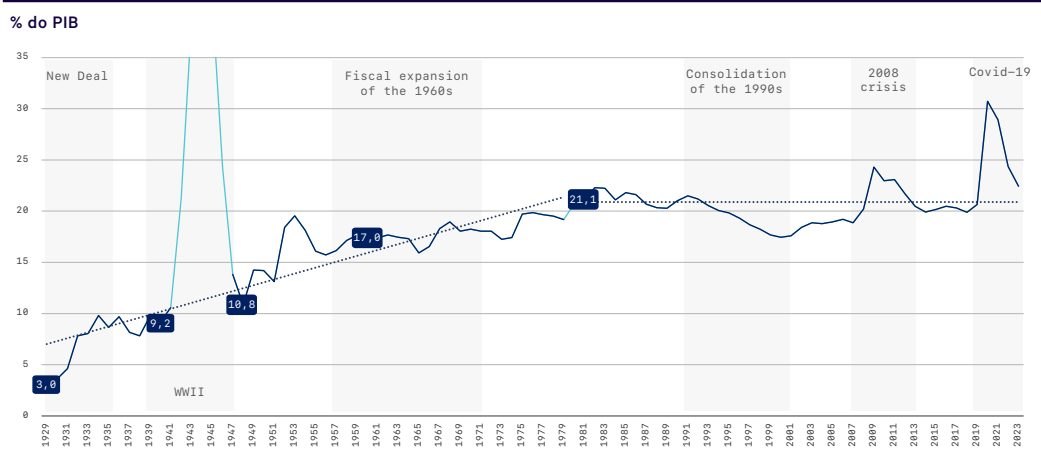
During his participation in the British delegation at the Treaty of Versailles, Keynes realized that the economic pain to be experienced by the defeated German society could result in enormous popular dissatisfaction and greater political instability. The economic impositions defined by the victorious countries were so harsh that they would lead to a riskier environment for the European continent.

Two decades later, elements of his ideas were finally reflected in Franklin Roosevelt's policies during his first presidential term (Chart 1). The objective was to reduce the American economic suffering generated by the 1929 crisis.<sup>1</sup>

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1 [Keynes' letter to Roosevelt in 1933 suggesting the application of his ideas.](#)

Chart 1:  
Government spending in the USA



Source: Federal Reserve St. Louis, Mar Asset Management

The recovery of the American economy after Roosevelt's election was remarkably successful. He was re-elected three times, and the political world experienced the popular power of the fiscal tool.

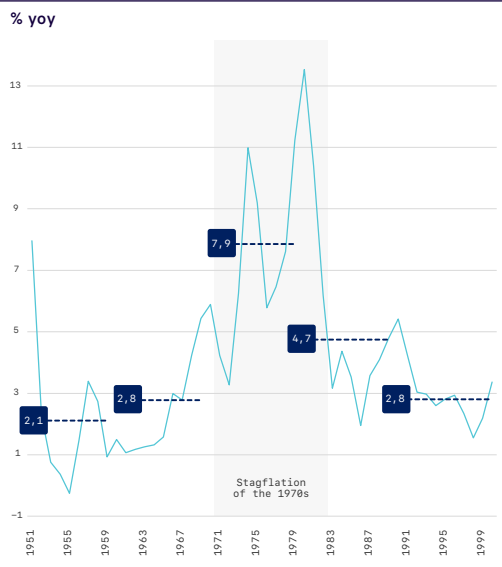
Initially conceived and used to smooth the economic cycle, the fiscal tool also proved to be instrumental in boosting the popularity of a ruler and, consequently, became a powerful influence on subsequent electoral results.

The experience was so successful that, after Roosevelt's death early in his fourth term, American legislation was amended to limit the presidency to only two terms, thereby preventing the perpetuation of highly popular politicians in power.

The political world recognized the popular effect of the successful economic use of the fiscal instrument. From then on, this tool began to be used frequently, with the objective of increasing political popularity. It was no longer primarily a mechanism to smooth economic cycles, as originally conceived by Keynes.

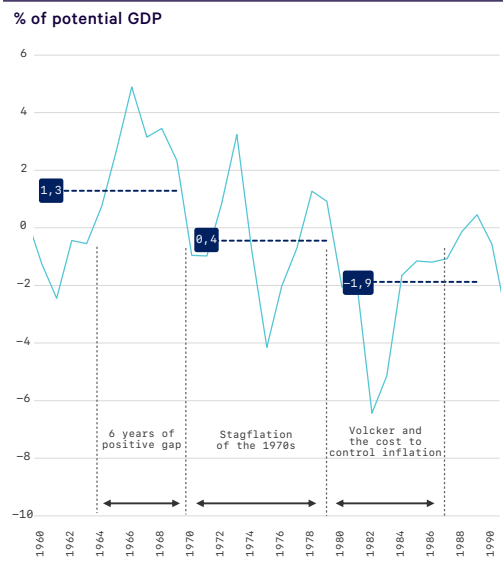
Its use for political purposes ended up generating more GDP volatility instead of reducing it. In the USA, the 1960s were marked by strong fiscal expansion amid an economy already close to full employment. Policy makers believed that achieving lower unemployment rates was possible without causing macroeconomic imbalance. However, in the 1970s, stagflation emerged – an unprecedented economic phenomenon at the time – in which inflation continued to accelerate even without demand growth (Charts 2 and 3).

Chart 2:  
CPI inflation in the USA



Source: BLS, Mar Asset Management

Chart 3:  
US output gap



Source: CBO, Mar Asset Management

As Friedman aptly coined at the time, "there is nothing more permanent than a temporary government program." This comment summarized how dependent American politics had become on fiscal tools and how their misuse, without regard for economic cycles, disorganized the economy.

The historical turning point that addressed this issue was the appointment of Paul Volcker as Chairman of the Federal Reserve and his implementation of a monetary shock. The Fed Funds rate was raised to nearly 20% until the monetary contraction led to a deep recession in the following years, but it ultimately brought inflation under definitive control. From then on, society and market agents became convinced that inflation would remain controlled, and the Fed gained greater independence of action from the government, even while implementing unpopular short-term policies.

The misuse of the fiscal tool as a political instrument was recognized by American society, which shifted the management of economic cycles to monetary policy. This was now overseen by technicians and economists with specific goals and mandates unrelated to the political cycle. Additionally, the use of the fiscal tool by politicians was curtailed through strict budget restrictions. Thus, economic policy became centered on the monetary tool, while the fiscal tool took on a limited supporting role.

The result of this arrangement was highly effective, and the 30 years following the 1980s became known as "The Great Moderation". This economic policy

model, centered on monetary policy, was widely adopted around the world, even in many developing countries.

However, in emerging economies, where volatility is higher and institutions are less developed, this framework is implemented less rigorously. Fiscal activism remains the dominant force, often leaving central banks with a subordinate role under political influence.

In Brazil's case, it experienced a significant turning point during the fiscal crisis of President Dilma Rousseff's administration. The country learned the hard way about the economic costs of fiscal policy that prioritized short-term political goals over sound economic management. The artificial maintenance of high growth during that period fueled inflation, eroded credibility among society and market participants, and resulted in one of the deepest recessions in modern history for a nation not at war.

The political consequence of this painful process was the implementation of a spending cap in 2016, introduced in the Constitution through Constitutional Amendment No. 92, and a clear path toward a formally independent central bank. Brazil was finally moving toward an economic policy arrangement resembling that of developed countries, aiming for greater predictability and smoother growth cycles.

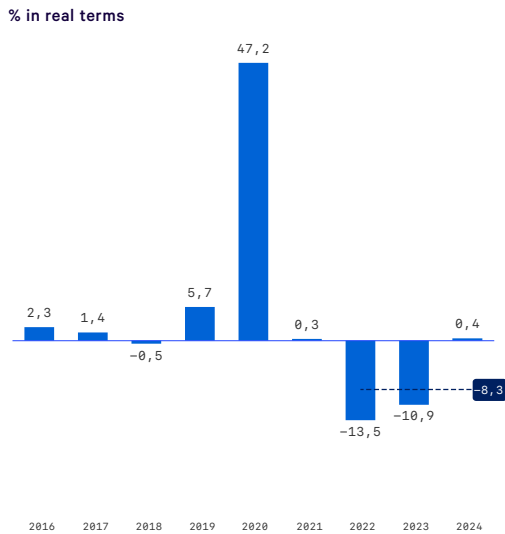
However, the Covid-19 pandemic forced countries – developed and emerging economies – to reinstate the fiscal tool as the central economic instrument, given the potential economic pain caused by social isolation.

The use of the powerful fiscal tool became necessary and was highly effective in mitigating the effects of the crisis and the political volatility that could have emerged globally. Instead of widespread economic collapse, the world endured an event of biblical proportions without significant bankruptcies of large multinationals or national industries, which could have triggered mass unemployment. In this sense, the goal of alleviating economic pain was achieved through fiscal expansion.

The challenge, as Friedman highlighted, is to undo government income transfer programs once they are no longer economically necessary. Countries that gradually abandoned the fiscal tool after the pandemic, along with its political benefits, and returned economic management to independent central banks, signaled to society and markets the

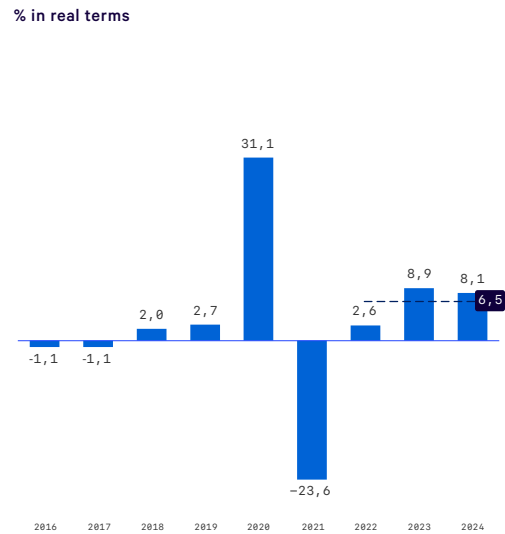
normalization of their policies and a healthier, more predictable economic environment ahead.

Chart 4:  
Growth of primary spending – USA



Source: CBO, Mar Asset Management

Chart 5:  
Growth of primary spending – Brazil



Source: National Treasury of Brazil, Mar Asset Management

## Political Dominance

It is in this background that President Lula's third term was inaugurated in 2023. While developed countries, respecting the economic cycle, were withdrawing their fiscal stimuli, the transition from the Bolsonaro government to Lula's administration was marked by the implementation of the PEC da Transição (Transition Constitutional Amendment) proposed by the newly elected president and his team. This PEC was referred to by us at the time as "Lula's Rubicon," as it revoked the 2016 Spending Cap and authorized an increase in the budget for permanent and indexed expenses by 2% of GDP, already indicating an inevitable fiscal imbalance.

The main objective of the PEC da Transição was to meet a political need of the newly elected government. President Lula, who could have adopted the traditional strategy of slowing down activity in the first half of his term – thus respecting the economic cycle to reduce inflationary risk and seek re-acceleration in the second half – opted for political urgency. The need for immediate growth in his popularity, after a virtually tied victory, prevailed.

Faced with a large, conservative, and hostile popular opposition, a center-right Congress, and the smallest Workers' Party (PT) bench in the Legislature, the Lula government concluded that political restrictions could put its term at risk. Therefore, increasing short-term popularity became the priority tool to face the difficult political negotiations that would follow. Despite the economic risks, the government consciously decided to assume fiscal policy as its political tool. This idea is discussed in detail in our letter from February 2023<sup>2</sup>.

Fiscal policy achieved what was expected in the last two years. GDP growth significantly surprised markets, unemployment reached the lowest historical levels, and inflation remained at a historically low level. The photograph at the end of 2024, well summarized by the infamous misery index – which is the sum of inflation and the unemployment rate – at the lowest levels in our history, reflects exactly what the government intended to achieve.

However, at this moment, two serious problems arise for Lula. The first is cyclical in nature, as we believe we have already reached the peak of the economic cycle during the current term. The second is structural, since, despite the misery index being at its lowest level in history, its positive effect on presidential popularity has disappointed (Chart 6).

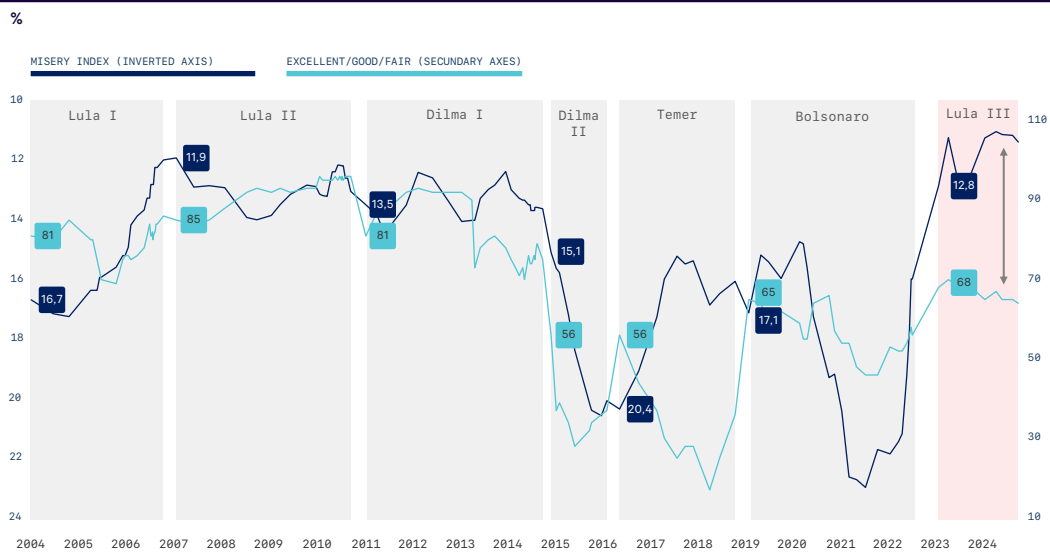
The economic success achieved due to fiscal expansion in the first half of the government did not fulfill its main objective, which was to increase presidential popularity. President Lula is currently experiencing his lowest level of popular approval among his three terms, comparable to what President Bolsonaro recorded during the same period of government, and there is no room left for the continuation of expansionist fiscal policies in the coming years.

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2 Letter: [\*There shines a star ... a falling star?\*](#), February, 2023.



Chart 6:  
Misery Index and evaluation of the presidential government as excellent/good/fair



Source: Datafolha, IBGE, Mar Asset Management

We and the market have exhaustively discussed the Brazilian fiscal issue, as it is truly worrisome. But while current inflation remained low and growth high, the consensus among analysts was that any macroeconomic problem could be resolved.

The question we always asked ourselves was: how long could the combination of extraordinarily rapid growth driven by fiscal expansion with low current inflation last? More than that, how was such an equilibrium possible in the first two years of the Lula government when the economy at the end of the Bolsonaro administration was already close to its full potential?

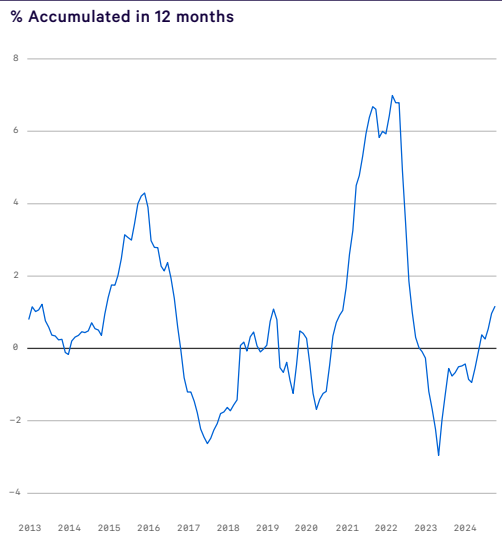
Our answer came in the Macro study of May 2024, in which we developed the idea that low inflation in Brazil was temporary.<sup>3</sup> The normalization of global supply chains had triggered significant global disinflation. The importation of this disinflation repeatedly led to downward revisions in Brazil's IPCA inflation projections, creating a sense among some analysts—and even the Central Bank—that Brazil's potential GDP had increased, allowing for stronger structural growth without triggering inflation (Chart 7).

<sup>3</sup> Letter: [Soft Landing in Perspective: The Case of Brazil](#), May 2024.

We never saw solid foundations for this argument, but we always reserved the right to be wrong and diligently followed this process. What we end up seeing was a slow deterioration of current inflation, which led to a significant upward revision and pricing of long-term inflationary expectations (Chart 8).

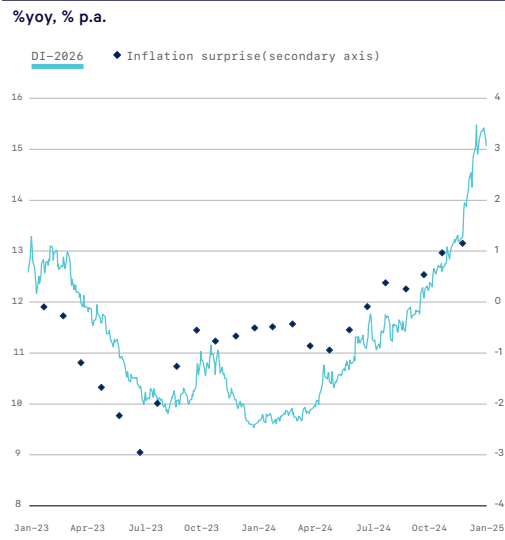
The market, which had initially given the benefit of the doubt to the Lula government with the approval of the new fiscal framework and even applauded the BCB when it began an early cycle of interest rate cuts,<sup>4</sup> gradually realized that the government's priorities were political rather than economic.

**Chart 7:**  
Inflationary surprise – IPCA observed vs. projected by the market three months earlier



Source: BCB, Mar Asset Management

**Chart 8:**  
Inflationary surprise and CDI future contract maturing in Jan 26



Source: BCB, BBG, Mar Asset Management

The perception that the government would not be willing to slow down economic activity in the second half of the presidential term was the catalyst for the loss of credibility of economic policy and the de-anchoring of inflation expectations in the short, medium, and long term. For this reason, we prefer to define our current situation as one of political dominance, and not fiscal dominance.

If economic policy obeys the electoral cycle through the political use of the fiscal tool, as we discussed throughout the letter, volatility and uncertainty about the economic cycle set in.

<sup>4</sup> See, for example, our letter: [Not necessarily about monetary policy](#), from June 2023

Recently, we have seen the BCB trying to leave the environment of political dominance by leaving the supporting role of economic policy to assume its protagonism.

We disagree with the BCB when it described fiscal policy as the reason for the de-anchoring of inflation expectations. Although fiscal policy is indeed a problem for inflation control, for an independent central bank, it should be treated as an input for the monetary policy decision. That is, monetary policy must take fiscal policy into account so that economic policy achieves inflation control and its objective of smoothing GDP.

Obviously, the optimal economic policy is when both tools - fiscal and monetary - seek the same objective, but, when they diverge, there is no other decision for an independent central bank than to calibrate monetary policy restrictively enough to compensate for the expansionary effect of fiscal policy, so that the result finds economic stability.

Given the moment of the current cycle, the re-stabilization of the economy will essentially occur through a cooling of demand. It is necessary for GDP growth to be below potential, causing an increase in unemployment, which would finally lead to a drop in inflation. This process would indicate to markets and society the commitment of policy with the equilibrium of the economy and not with the next elections. However, the collateral effect of this commitment, at least in the short term, is popular dissatisfaction and pressure on the already low popularity levels of the current administration, which, at this point, would jeopardize the current president's re-election project.

The recent attitude of the BCB of raising the Selic by 100 bps and pre-announcing at least two more increases of the same magnitude is an unequivocal and welcome sign of its commitment to the economic cycle and the deceleration of domestic demand.

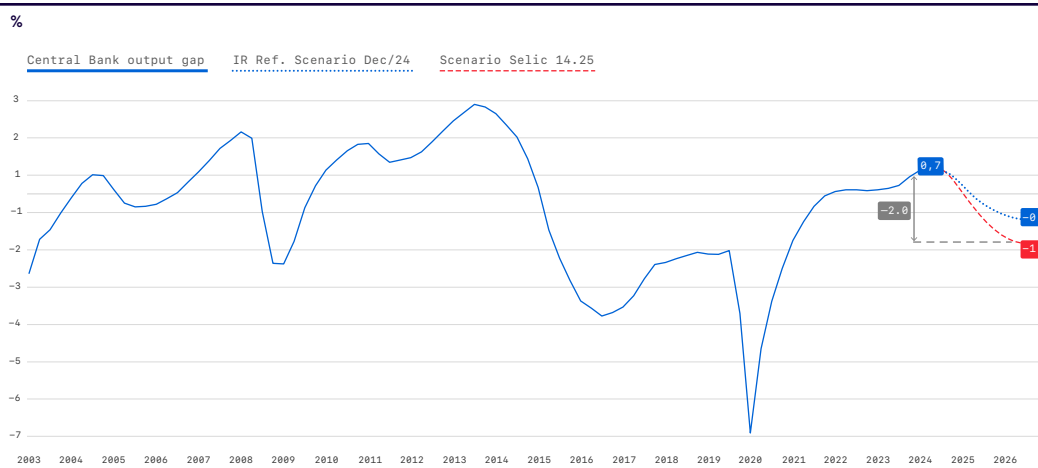
The consequences of the current monetary tightening process will be fully felt in 2026, exactly in the year of the presidential elections<sup>5</sup>. The usual time for the effect of the interest rate hike to be fully transmitted to the

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<sup>5</sup> The small-scale model suggests that a terminal rate of 14.25% in 2Q25 would be sufficient to bring the IPCA to the target in the relevant horizon at the time (4Q26), if it remains at this level until mid-2026.

economy is 6 to 8 quarters. The BCB's small model, which serves as the basis for the institution's projections, suggests that the current strategy of the Monetary Policy Committee (Copom) would lead to a contraction of the output gap of 2 percentage points by the end of 2026 (Chart 9). Such a contraction has only been seen in moments of economic recession, and it would hardly not be accompanied by a sharp increase in the unemployment rate. That is, the Central Bank foresees the need for a "hard landing" to guarantee the control of inflation.

**Chart 9:**  
**Projection of the BCB's gap in a scenario with a terminal Selic rate of 14.25% p.a.**



Source: BCB, Mar Asset Management

Although the economic situation is already a significant hindrance to prospective presidential popularity, there is another structural variable that plays a particularly important role and increases the complexity of President Lula's re-election prospects.

## Patterns / Evangelicals

When we are asked how we analyze the markets, we like to describe it as observation and identification of patterns. Patterns shape history, societies, companies, collective and individual behaviors, and consequently, market expectations and prices. Patterns are the basic mortar for social consensus.

Market prices are the most ephemeral social consensus of modern societies. A flexible consensus like any other, but in this case with a speed and aggressiveness in its variations much higher than the consensus we observe in general, such as rules and laws.

If patterns are the essential mortar for the formation of consensus and the movement of prices, it becomes clearer to think that our function as portfolio managers means identifying, monitoring, and anticipating changes in patterns.

The correct identification of consolidated patterns helps to understand the behavior of market prices and, in general, good opportunities for capital allocation. There are patterns with very short terms, such as correlation between assets, which occasionally present temporary distortions that can generate opportunities.

However, it is in the identification of changes in long-term patterns that the great risks and opportunities for fundamentalist investors lie.

Social patterns are closely related to the most important and profound values. The change in relative importance between them has the power to produce profound changes in society.

The expansion of different religions throughout history has served as an important guiding thread for the ordering of these values. It is in this context that we investigate the breakdown of the correlation between the economic situation and government popularity - which worked so well during the last decades - and we look to explain the reason for the current government's low popularity.

In this investigation, we came across the idea of the evangelization of Brazilian society as a reducer of the population's sensitivity to the economic situation. The idea of a structural change in the religious segment has major short and long-term implications. For this reason, together with this market analysis, we are releasing an in-depth study on the traits and growth of the evangelical population, which our research team has investigated intensely during the last quarters<sup>6</sup>.

This slow, consistent, and silent change challenges the dominant thesis accepted by political analysts: of polarization or social calcification.

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6 Study: *Keep the faith! The electoral impact of the growth of evangelicals.*

The thesis of social calcification explains very well the situation in the USA, where politics is bipartisan, society is well divided between Republicans and Democrats, including geographically, and its presidential elections are decided by a few states called swing states. Even in the 2024 election, in which Trump won both the electoral college and the popular vote, the variation in the popular vote between Democrats and Republicans has been quite smooth over the years.

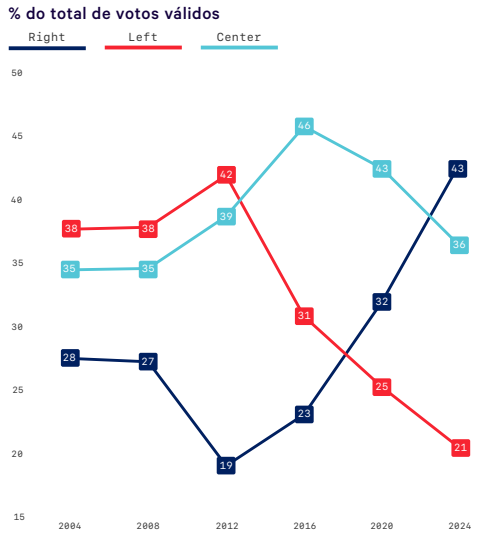
What we have observed lately in the USA is a radicalization of the already consolidated poles.

In the Brazilian case, we disagree with the thesis of political calcification. What is happening in the country is not merely a deepening of divisions, with limited voter mobility between political spectrums. Instead, there is a clear shift toward the right end of the political spectrum.

The evolution of election results clearly shows this movement of the Brazilian political pendulum. We built a Political Position Index (IPP) that summarizes the total vote for right, center, and left parties. The index shows a clear movement of the Brazilian political bias from the left to the right, especially in the last decade.

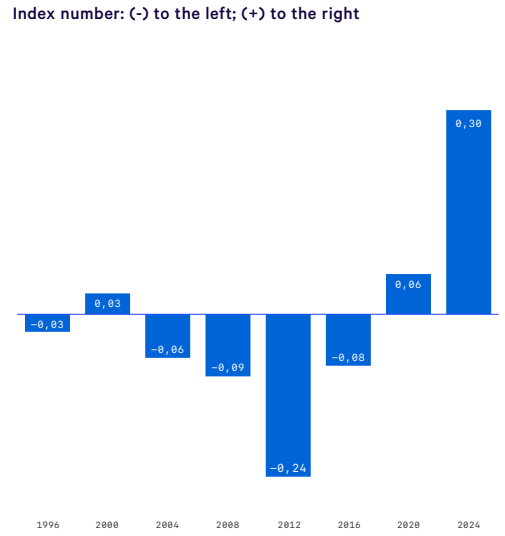
In 2004, 38% of the total votes in the municipal elections were for left-wing parties, while 27% were for right-wing parties and 35% in the center. The best performance of the left in the municipal elections occurred in 2012, when it reached 42% of the total votes, while the right obtained only 19.2%. In the 2024 elections, we observed a situation perfectly inverse to that of 2012. Only 20% of the votes were destined to left-wing parties, while right-wing parties won 43% (Chart 10). Last year's municipal election reflects a political position to the right similar to the best moment of the left in the past decade.

**Chart 10:**  
**Voting in municipal elections in the first round according to the party's bias**



Source: TSE, Mar Asset Management

**Chart 11:**  
**Political Position Index of first-round votes – municipal elections**

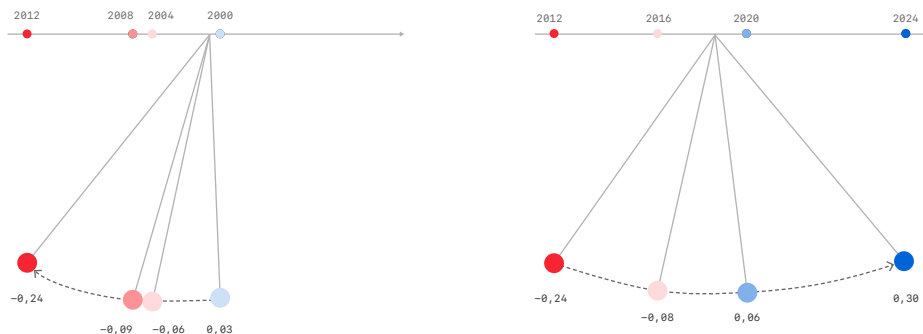


Source: TSE, Mar Asset Management

This Political Position Index, calculated for several elections, whether for the Executive or for the Legislative, indicates an expressive movement of the political pendulum in the interval of 12 years. (Charts 11 and 12).

The concept of calcification or the geographic/income-based analysis of voting patterns is insufficient to explain this shift. In our view, the most plausible explanation emerges when approached through a religious lens. The signs of accelerated growth in the evangelical population, coupled with the values of this segment of society, suggest that the shift to the right could be explained by the growth of Protestantism.

**Chart 12:**  
**IPP of municipal elections showed a pendulum movement between 2000 and 2024 and is currently at its most right-wing level**



Source: TSE, Mar Asset Management

It is natural to imagine that Protestant Christians are more conservative than non-religious or even Catholics on a variety of social issues. In a Pew Research survey conducted in 2014, Catholics who converted to Evangelism cited reasons such as the search for greater closeness to God, helping others, personal prosperity, among other motivations for converting to Protestantism.

On behavioral issues, evangelicals take more conservative positions than Catholics. For example, while half of Catholics oppose same-sex marriage, this figure rises to 83% among evangelicals. Similarly, the proportion of evangelicals who oppose premarital sex (76% vs. 44%) and divorce (39% vs. 17%) is nearly double that of Catholics.

We believe the concept most representative of Brazil's current social moment is the Prosperity Theology embraced by many evangelicals. This doctrine links faith in God with material success, health, and emotional well-being. It emphasizes that professional success is part of a spiritual journey and that advancement is a blessing from God for the faithful. As a result, this belief weakens the connection between personal life improvements and the government in power.

The latest official number of the size of the evangelical population is from the 2010 Census. In that survey, conducted 15 years ago, only 22% of the Brazilian population declared themselves evangelical. To understand its growth since then and project this dynamic ahead, we resorted to an ingenious solution proposed by Araújo (2023) and De Negri et al (2023)<sup>7</sup>, which consists of monitoring the opening of Pentecostal churches by tracking the creation and cancellation of CNPJ registrations for temples with the Federal Revenue Service.

This solution made it possible to build a robust microdata base, detailed down to the municipal level and updated monthly, allowing the crossing of the number of evangelical temples with the evolution of votes throughout

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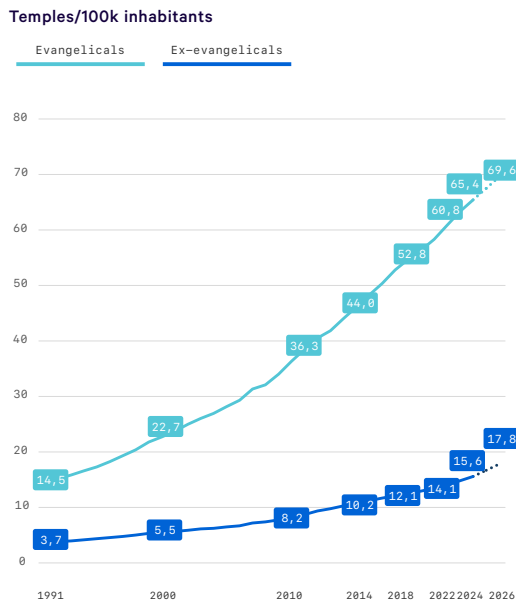
7 Araújo, V. *Pentecostalism and anti-PTism in the Brazilian presidential elections, 2023*. De Negri, F; Machado, W; Cavalcante, E. *Growth of evangelical establishments in Brazil in recent decades, 2023*.



the elections. This database suggests that, in the last decade, there have been 5,000 evangelical temples opened per year (Chart 13).

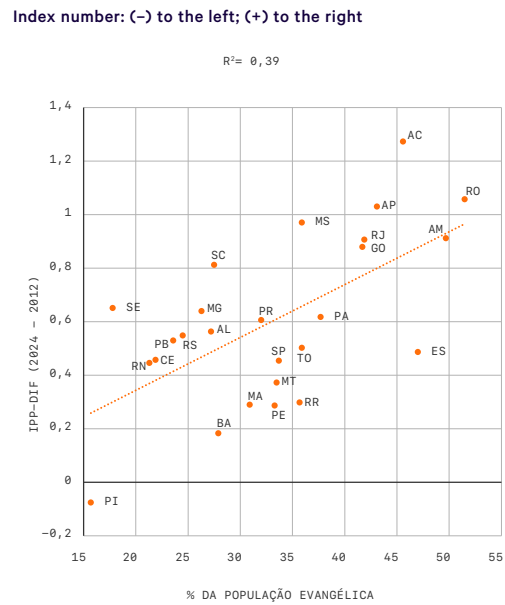
In addition, it was possible to test if there is a relationship between the growth of Protestantism and the migration of votes to right-wing parties. In fact, as more temples were opened, the greater the migration of votes in a region to right-wing parties<sup>8</sup> (Chart 14).

Chart 13:  
Religious temples per capita – evangelicals vs. other religions



Source: Federal Revenue, Mar Asset Management

Chart 14:  
Change in IPP between 2012-24 in municipal elections vs. % of evangelical population by state



Source: TSE, Mar Asset Management

## How do evangelicals vote?

The PT has had a representative in the second round of presidential elections since 2002. Therefore, it is possible to analyze, based on pre-election polls, how the party's electoral pattern has evolved over time. We were able to see these votes through a religious lens.

<sup>8</sup> More robust econometric tests are presented in our study:  
*Keep the faith! The electoral impact of the growth of evangelicals.*

In 2010 and 2014, the PT won the presidential elections with about 55% of the votes from non-evangelicals and 50% of evangelicals. Since non evangelicals were majority of the population, the PT won these elections with some ease (Chart 15).

From 2016 onwards, we noticed a structural change in the way evangelicals vote. The protagonism of the progressive agendas defended by the PT governments, combined with the corruption scandals of Lava Jato, led the faithful to reduce their support for the PT to only 30% of their population.

In the 2018 presidential elections, in Bolsonaro's victory, the PT, through Fernando Haddad, even obtained more votes among non-evangelicals, but won only 31% of the votes among evangelicals.

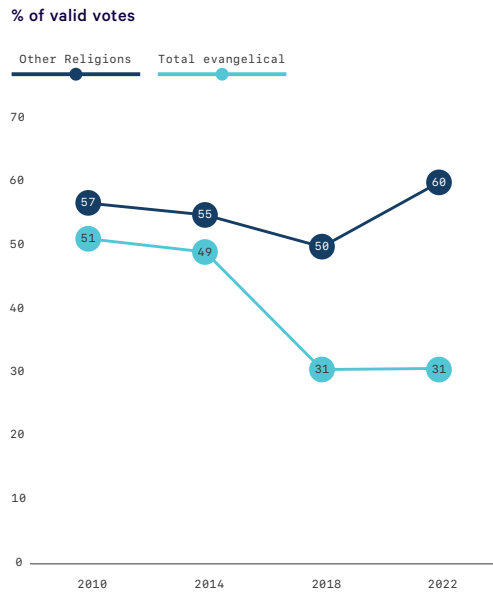
In the 2022 elections, which sealed Lula's victory by the smallest margin in our history, the conversion of the evangelical electorate by the PT candidate remained at the same 31% achieved by Fernando Haddad in 2018. However, among non-evangelicals, Lula obtained an impressive 60% of the votes, which was decisive to ensure his narrow victory. We interpret that President Lula was able to convert a relevant portion of moderate voters who defined their vote by the lowest rejection between Lula and Bolsonaro.

Although the share of converted votes of the PT candidate among evangelicals remained stable in the 2018 and 2022 elections, the number of Protestants in the Brazilian population continues to grow at a rate higher than that of the total population. Our estimates, based on the opening of new temples, suggest that the 22% of Protestants measured by the IBGE in the 2010 census would be 29% in the 2018 election, 32% in 2022, and 36% in 2026, that is, approximately 78 million Brazilians.

With this rate of Protestant growth, a repeat of the conversion of votes obtained by Lula in the last election by religious criteria, which showed record adherence among non-evangelicals, would no longer be enough for him to win re-election (Chart 16).

In fact, the space for the conversion of national votes by progressive parties is decreasing every day.

**Chart 15:**  
Intention to vote for the PT in the 2nd round by religion



Source: Datafolha, Mar Asset Management

**Chart 16:**  
Relationship between conversion rate, evangelical population and presidential election results

	2010	2014	2018	2022	2026*
Proportion of Evangelicals	22.2%	25.4%	29.0%	32.1%	35.8%
Evangelical Conversion	51.0%	49.0%	31.0%	31.0%	31.0%
Non-Evangelical Conversion	57.5%	52.5%	50.5%	60.3%	60.3%
Result	56.1%	51.6%	44.9%	50.9%	49.7%

Source: IBGE, Federal Revenue, Mar Asset Management

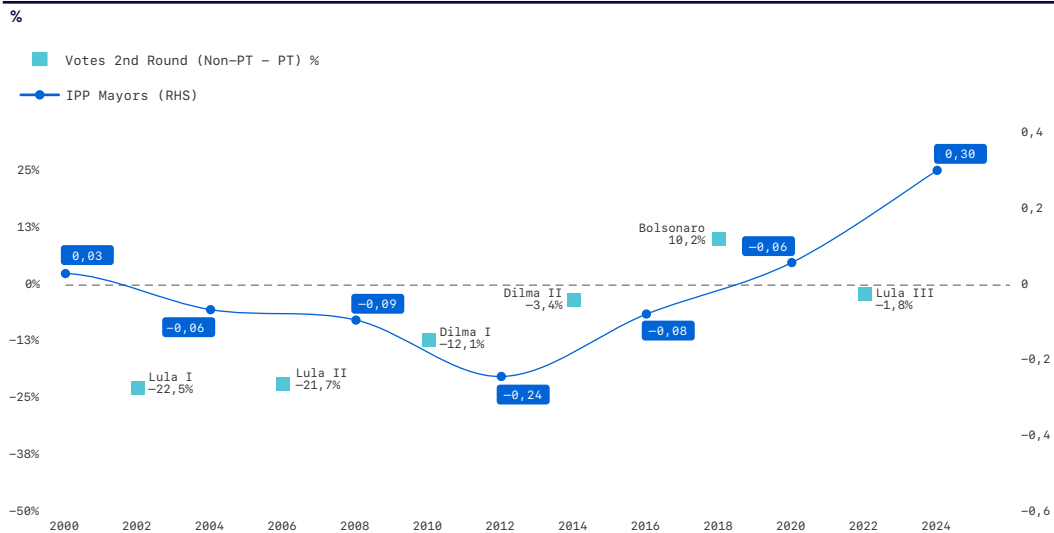
The same analysis applies to municipal and state elections and for executive and legislative positions. Recently, in the second round of the 2024 São Paulo election, we observed Guilherme Boulos securing the same 31% of votes among evangelicals, replicating the performance obtained by Haddad and Lula in previous presidential elections. This indicates solidity in the rejection of this group of voters towards progressive candidates, regardless of the name that appears on the ballot. In other words, it is a general pattern and not just specific to one type of election.

A common assertion among political analysts is that the results of municipal elections are completely unrelated to presidential elections. We disagree with this view. When analyzing the municipal elections of the last 20 years and their respective Political Position Indexes, we observe a relevant indication for the following presidential election, contrary to what is defended by the press and political analysts<sup>9</sup>. In general, a movement to the right in a municipal election is accompanied by a reduction in the vote for the PT in the second round of the following elections, and vice versa.

9 See our study: [Keep the faith! The electoral impact of the growth of evangelicals.](#)

In the most recent period, the 2020 municipal election was the only one in which the left/right political bias did not anticipate the winner of the subsequent presidential election. We believe that President Lula's victory in 2022 was a deviation from the course, since the movement to the right pointed out by the municipal elections maintained in 2020 and 2024 the same trend to the right observed since 2016 (Chart 17).

**Chart 17:**  
**IPP of municipal elections and votes for the PT in presidential elections (second round)**



Source: TSE, Mar Asset Management

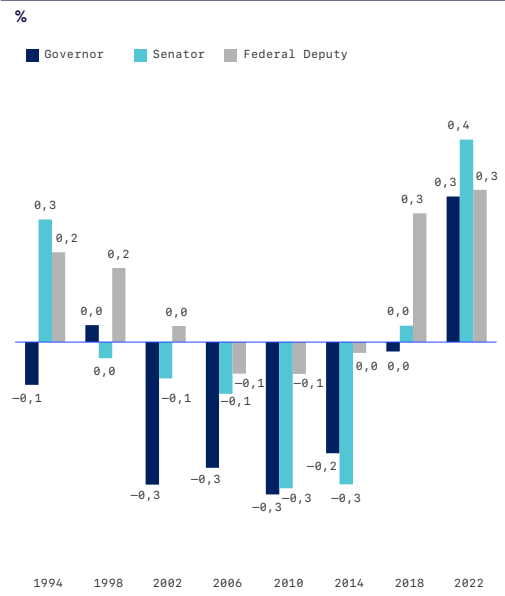
The 2022 presidential elections were marked by the high rejection of President Bolsonaro. Even so, the electorate's right-wing bias was evident in the elections for governors and legislative positions, such as federal and state deputies (Chart 18).

The recent 2024 municipal elections further deepened the rightward shift observed since 2016, once again suggesting the likelihood of a conservative candidate's victory in the 2026 presidential elections.

When examining the growth of Protestant temples from a geographical perspective, a clear expansion trajectory emerges—starting in the Southeast, advancing to the South, continuing to the Midwest, reaching the North, and more recently, beginning to gain ground in the Northeast (Chart 19). From a geographical standpoint, the concentration of Northeastern votes for PT candidates is starting to face challenges due to the expansion of evangelical religion in this region.

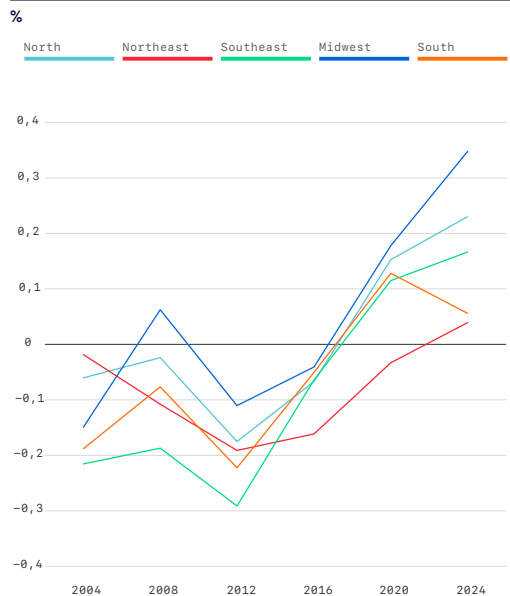
This shift in behavioral patterns and social values is expected to continue having a significant impact on Brazil's political dynamics in the future.

**Chart 18:**  
Political Position Index – elections for Federal Deputy, Senator and Governor



Source: TSE, Mar Asset Management

**Chart 19:**  
Political Position Index in municipal elections by region



Source: TSE, Mar Asset Management

## The government is aware of this movement

In a simplified way, there are two paths defended by members of the government on how President Lula's reaction to this structural change should be. The first, likely supported by Finance Minister Fernando Haddad, advocates for economic moderation, aiming to win over more non-evangelical voters. The second, likely backed by Chief of Staff Rui Costa, argues that the best way to attract evangelical voters while maintaining support among low-income groups is to expand public programs that are clearly identifiable as government initiatives.

We see a government aware of its political restrictions, witnessing a cultural change that reduces its social adherence. Even so, through economic policy and using the fiscal tool "at full throttle", it seeks to protect its popular base and advance on the evangelical electorate through the delivery of financial benefits. Even at the expense of macroeconomic balance.

## What now?

How will a president who has prioritized political constraints from the start of his term—and achieved the strongest economic performance without the expected boost to his popularity—respond, in the final stretch of his third term, to the need for a significant economic slowdown to bring inflation under control?

The best tool we have to answer this question is the observation of the patterns of government decisions already made so far.

Recently, the need for spending cuts has become present and the government agreed to debate the topic openly. This allowed us to experience and observe this decision-making process in action.

After weeks of discussions, presentations of different proposals and negotiations, what we saw, unfortunately, did not surprise us. The primary opponent of the spending cut package was none other than the President himself. Lula's political stance against even the sound proposals put forth by the economic team sent a clear message to both the markets and the political sphere about where his main priorities and limitations lie.

If there had been any uncertainties before this process about whether President Lula might say one thing publicly and act differently behind closed doors—a hallmark of his long political career—this instance left no doubt.

The priority was clear: maintaining GDP growth with income distribution to the population at the expense of greater fiscal imbalance. Lula followed the expected reaction function – the “Rui Costa” strategy – indicating that the limit to be respected is the effect on his popularity.

## Costs and Conflicts

The slowdown in activity is necessary for the rebalancing of macroeconomic variables. It is almost inevitable, especially if we reach the exhaustion of the economy's productive capacity – something that has already been reached or seems to be very close to happening. However, the way in which this slowdown will occur would have vastly different costs for society.

An organized slowdown – led by containment of government spending, commitment to fiscal responsibility, disinflation and falling interest rates – would have a much lower impact in terms of intensity and duration than a disorganized slowdown – caused by a shortage of products and services, accompanied by accelerating inflation and high interest rates. In other words, the sacrifice rate in the first case would be much lower.

In Dilma Rousseff's second term, the country experienced a disorganized slowdown, quite deep and accompanied by high interest rates. This scenario resulted in the collapse of tax collection and an increase in the cost of rolling over debt, causing the debt-to-GDP ratio to rise from 50% to 70%. On the other hand, in an organized slowdown, sustained by the anchoring of expectations, the necessary economic contraction is less intense. With falling interest rates, the cost of rolling over the debt also decreases, avoiding a sharp deterioration in the debt-to-GDP ratio.

While a disorganized slowdown drags us definitively into the scenario of fiscal dominance, an organized slowdown takes us back to the dominant monetary environment.

Considering the starting point, however, the slowdown in activity and the increase in unemployment is necessary in both cases. Therefore, any of the strategies adopted tends to negatively affect the government's popularity in a horizon of one to two years.

This implies that the best economic moment of the current term is behind us. On the eve of the 2026 presidential election, economic conditions will be worse than current ones, affecting the already low level of presidential popularity.

Short-term popularity is the metric that guides the president's decision-making process. For this reason, the reaction to the restrictive policy of the Central Bank will be the main economic and institutional conflict to be monitored in the next two years.

In summary, the economic situation is a significant element of difficulty for the political perspectives of the current government. At the same time, the strong and continuous growth of the evangelical population has been producing a structural shift to the right in Brazilian society. These are two powerful vectors that point in the same political direction: greater difficulty for a PT candidacy in 2026.

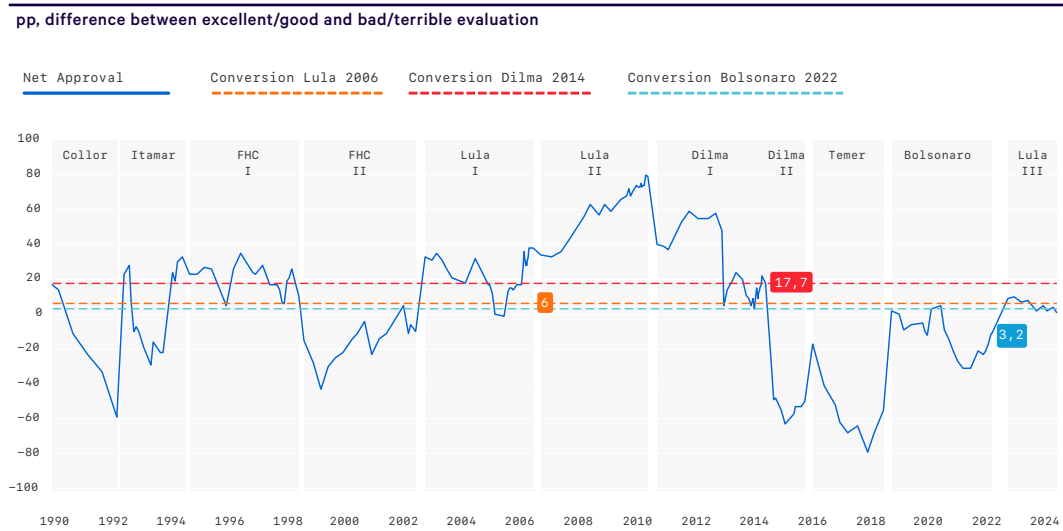
## Conversion

Although we are still far from the next election, it is inevitable for a pattern analyst to recognize the potential for breaks in correlations and the emergence of new forces capable of generating a rally of unusual magnitude, considering the current prices of Brazilian assets.

An accelerated deterioration of popularity in the short term would be the catalyst for the market to begin to anticipate the end of the current political dominance.

At current levels, popularity is already insufficient to guarantee Lula's re-election. A common exercise among political analysts is the conversion of a president's popularity into their vote share in a re-election race. Even if Lula managed to achieve the highest conversion rate of positive evaluations seen in the last presidential elections with an incumbent (Bolsonaro in 2022), his current popularity would still be insufficient for victory (Chart 20).

**Chart 20:**  
**Current net evaluation and minimum to win the election when assuming the conversion of the positive evaluation into valid votes observed in the elections of 2006, 2014 and 2022**



Source: Datafolha, Mar Asset Management

We are aware that there is still a long way to go until the presidential elections. For this reason, we have been extremely diligent in our homework and careful in the management of the portfolio, so that we are not prematurely expelled from an investment thesis that can be structural and last for many years. Or even to not "fall in love" excessively with our own ideas, reducing our ability to criticize them.



Our feeling is that, in 2025, we will enter a haunted house ride. Despite the potential for many scares along the way in the next two years, we are heading towards a promising exit at the end of it.

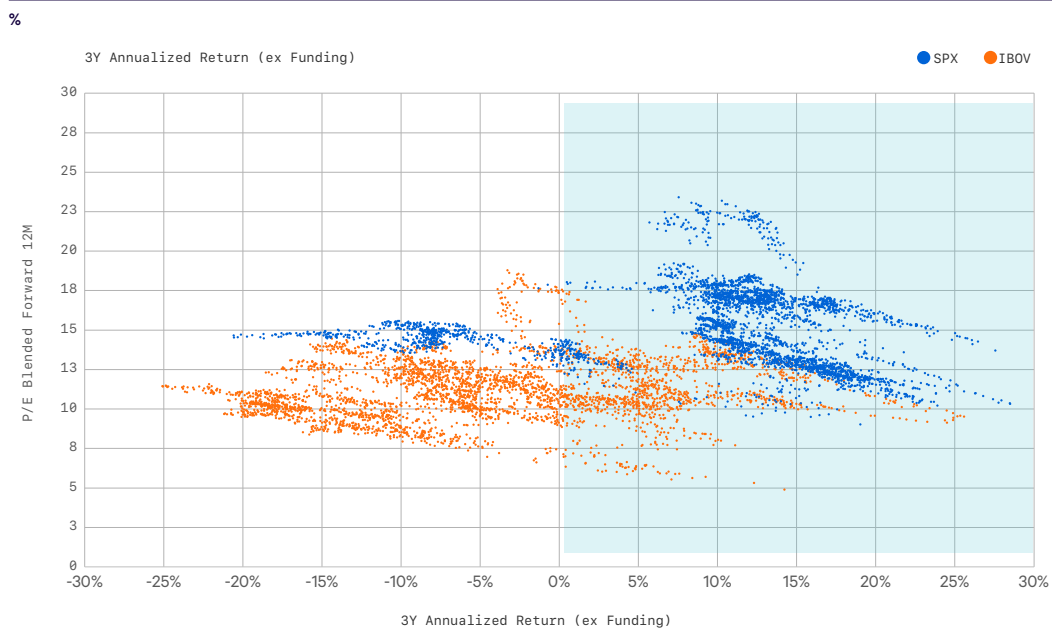
## Manager's Dilemmas – *timing vs value*

The central dilemma in the decision of risk allocation in the portfolio lies in the conflict between value and timing.

In developed and stable economies – or, as we described throughout the letter: economies in which the fiscal tool is contained and the monetary tool is the protagonist – the variations in cycles are less frequent, and good businesses persevere.

In these economies, the patience premium tends to be very well remunerated. If an investor buys good businesses at good prices, with adequate patience, the probability of achieving good returns is quite high. In the USA, since 2006, an investor who bought the S&P at any time and waited for three years obtained returns above the Fed Funds rate 85% of the time (Chart 21).

**Chart 21:**  
**Relationship between the return of the Ibovespa and the S&P above the cost of financing (CDI and Fed Funds) and implicit P/E between 2006 and 2023**



Source: Bloomberg, Mar Asset Management

In Brazil, stock picking and market timing, the latter related to the macroeconomic environment, are necessary variables to be observed in search of consistent returns over time. The same consistency exercise, done for investments in the Ibovespa, presents returns above the CDI only 35% of the time.

The ideal moment for risk allocation in the portfolio is when asset prices are “cheap” (asymmetrically positive) and on the eve of some powerful catalyst that makes market perception positive. In general, these catalysts are intimately connected to the political cycle.

In practice, the perfect combination is unattainable. That is why our process consists of giving up, to some extent, value or timing.

At certain moments, the value seems so good (cheap) that, even in an unfavorable macro environment and without a clear catalyst for improvement, the combination of business quality and price seems to be enough to compensate for short-term uncertainties. In others, the environment points to such a positive scenario that we can be less demanding with prices, as the environment serves as a great driver for assets in general.

During the year 2024, although we considered the timing bad, we believed that the prices of the best Brazilian companies that we have followed in depth for decades, already presented enough defense for an important allocation in these assets.

Once again, we were reminded that, in countries marked by an economic policy management focused only on the political cycle, the environment can be bad enough to generate significant losses, even with a positive micro scenario and great starting prices.

For 2025, we project a very troubled macro environment. We will have a clash between monetary contraction and fiscal expansion, an economy operating beyond full employment, and high inflation. All this combined with a confusing political scenario and the low popularity of a government in the final stretch for the 2026 elections.

Therefore, the prices of Brazilian assets, although cheaper than at the beginning of 2024, should continue to deteriorate until the market begins to anticipate political alternation.

We believe that the catalyst for this to happen is an acute reduction in presidential popularity, which would eventually come as a result of the deterioration of the macro environment itself. A rather delicate combination for decision-makers, but which should be the anteroom for a structural improvement ahead.

In clear terms, a strong moderation of President Lula, which seems to us to be of very low probability, or the resignation of his candidacy itself, indicating a more moderate politician, such as Haddad, would be enough to confirm the thesis of Brazil grade 6: a country that oscillates below average, but that, in the end, passes the year. In this scenario, some price decompression happens.

However, we believe that the Theology of Prosperity is the Zeitgeist of Brazilian society. A candidate who offers an uncompromising defense of democracy, a responsible economic proposal, with less government protagonism, promoting entrepreneurship, who carries profound conservative values and, at the same time, communicates effectively with the Protestant world, will have a great space for a presidential victory. In this case, the new government would find a social and political environment even more to the right than the current one, facilitating the adoption of unpopular economic policies in the short term, but fundamental for the long term. The adherence of presidential values with the majority of society would maintain his satisfactory popularity, a functional government, and with good prospects for the execution of two consecutive terms.

The effect on future expectations of agents and, consequently, on market prices, would be very powerful. Such a scenario would be accompanied by a rally of Brazilian assets that occurs infrequently.

Therefore, the backdrop for risk allocation in Brazilian assets consists of (i) cheap prices (positive asymmetry), (ii) a visible trigger for a rally (end of political dominance), but (iii) the timing to act on this trigger remains difficult to predict, as we are still far from the presidential election and, until then, the macro scenario may worsen before improving.

## Portfolio

The exercise of envisioning very positive scenarios is always quite dangerous for a portfolio manager. It is like a kind of "siren song". The most experienced sailors tend to cover their ears or tie themselves to the boat at the first sign of the song. However, given the strong vectors we pointed out above, we cannot ignore the possibility of a structural change in the Brazilian scenario.

The portfolio solution we found to get through 2025 is what we call the "Pedestrian Bridge" concept. It consists of having directional exposure to Brazil risk through the purchase of long-term calls on the iShares MSCI Brazil index (EWZ)<sup>10</sup> and, at the same time, releasing cash to be invested in CDI at very high rates. In this way, we obtain positive convexity in the event of anticipation of the most positive scenario, but, at the same time, we limit the maximum loss of the fund to the option premium.

In general, we are not fans of this type of strategy, as the cost of carrying options tends to be high in relation to their return. However, in the current environment, the potential return is very significant, both in the vector of Brazilian stocks and in a possible appreciation of the BRL. Given a "binary" political scenario and the high cost of holding stock positions due to the CDI, the EWZ calls strategy seems to us to be the most effective and protected way to pursue the fundamental thesis presented in this letter.

Until it happens, or at least becomes clearer, we will have an environment characterized by a fragile market, with investors skeptical of asset managers due to the poor performance of recent years, and a government that, increasingly pressured by the proximity of the elections, imprudently uses the fiscal tool.

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10 The iShares MSCI Brazil index, with the ticker EWZ, is a dollar-denominated ETF traded on the American stock exchange (NYSE) and composed of 49 Brazilian companies. It is one of the main instruments used by foreign investors to invest in Brazil, and its price fluctuates based on the performance of Brazilian stocks and the Brazilian Real ([link](#)).

## Trigger

The alternation between more left-wing or more right-wing governments is vital for the healthy functioning of a democracy. In our view, the current social and economic moment calls for more right-wing governments, in contrast to the more left-wing mandates that have predominated in the last two decades.

A candidate with a more right-wing and economically responsible project would find, in 2027, a more friendly political and social environment to govern, possibly for two terms.

In the ideal scenario, the anticipation of improvement would come through the indication that neither Lula nor Bolsonaro would participate in the next election.

A generational renewal in politics, with more moderate candidates on both sides of the spectrum, would have enormous potential for the institutional evolution of the country.

As we do not know when the markets will begin to anticipate this scenario, we will allocate portfolio risk cautiously, with controlled potential losses, but already with some exposure to this central thesis.

# mar asset

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