
Brazil 2026: The Compressed Spring

Playing Against the Crowd: Brazil 2.0 Fundamental Analysis
Weekly Analytical Report | Deep Dive into the 2026 Bifurcation Point

1. Executive Summary

While Brazil may still look, at first glance, like a peripheral emerging-market story, we believe it is anything but. In our view, it represents one of the most asymmetric investment opportunities on the table for 2026. The country is standing at a rare crossroads where three forces meet: peak monetary tightening, deep political uncertainty, and unusually attractive valuations (see Figure 1).



Figure 1. Playing Against the Crowd: Brazil 2.0 (cover overview)

Key takeaway: Brazil enters 2026 at a rare crossroads of peak monetary tightening, deep political uncertainty, and unusually attractive valuations.

That combination has created an environment in which visible risks sit on the surface, while substantial underlying potential remains overlooked. For investors willing to engage seriously with the story, this is precisely the kind of setup that can generate meaningful alpha outside the crowded mainstream trades.

Our core thesis is captured in the “compressed spring” analogy. Markets have already priced in a large amount of fiscal and political risk: Brazilian equities trade at roughly a ~35% valuation discount to the

broader emerging markets index. That discount reflects years of concern about policy volatility, fiscal slippage, and governance.

What the market has mostly ignored, however, are two powerful, emerging catalysts:

- A credible monetary easing cycle, made possible by inflation returning to the central bank’s target band
- The possibility of a more market-friendly or at least market-tolerable political outcome after the 2026 election

The tension between this heavy discount and these underappreciated tailwinds has created a significant store of potential energy. Our view is that 2026 is when much of that energy is likely to be released (see Figure 2).

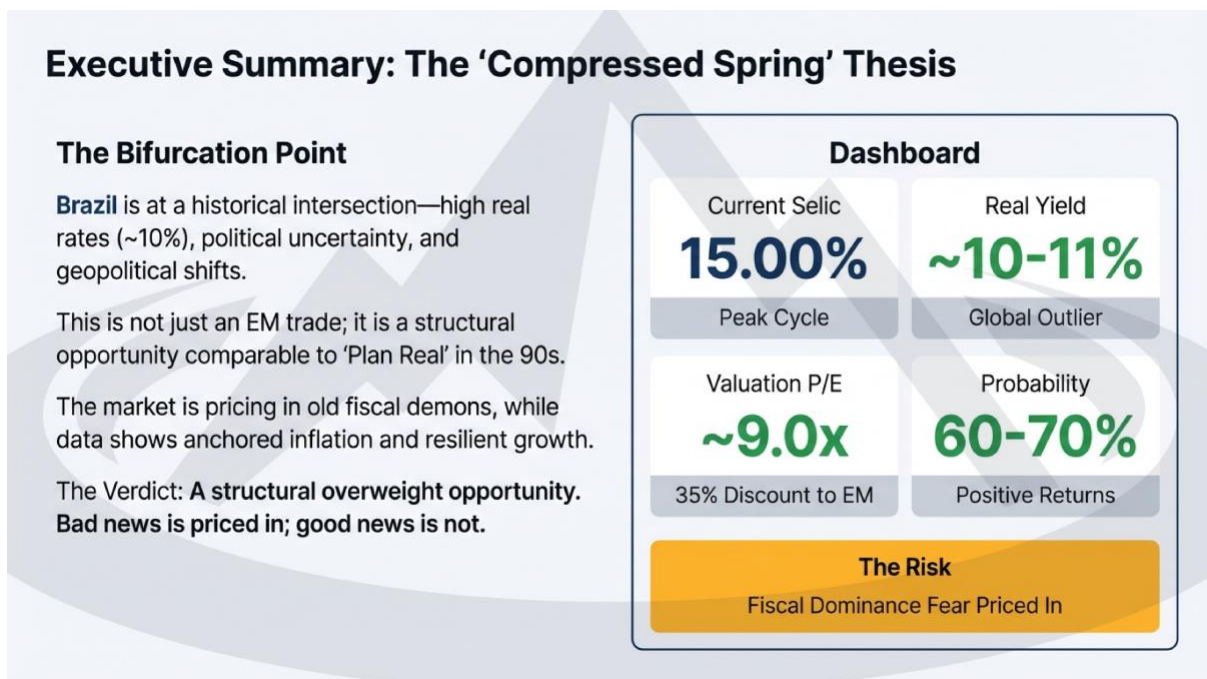


Figure 2. Executive summary dashboard and thesis framing

Key takeaway: A deep valuation discount reflects visible risks, while easing and a market-tolerable election outcome are underappreciated catalysts for re-rating.

The year 2026 is therefore not just another point on the calendar; it is a genuine bifurcation point. From here, Brazil can move in one of two broad directions:

- It can unlock a decade of stronger growth and asset re-rating, echoing the stabilization and wealth creation that followed the “Plano Real” reforms of the mid-1990s.
- Or it can slip back into a now-familiar pattern of fiscal overreach, market disappointment, and higher risk premia.

Which path Brazil takes will depend above all on the interaction between monetary policy normalization and the outcome of the presidential election. A disciplined, transparent easing cycle

paired with a government that respects basic fiscal constraints could pull the country onto a more sustainable, investor-friendly trajectory. A spending-heavy, populist turn would do the opposite.

For serious investors, our central conclusion is straightforward but non-trivial: Brazil offers a rare mix of high carry, deep value, and genuine re-rating potential. It is not a “free lunch”—it comes with clear, visible risks—but the compensation for those risks is unusually high.

Unlocking this value requires more than a simple bullish call. It demands a nuanced, risk-managed approach that starts by identifying the specific triggers—monetary, political, and economic—that can release the tension in this compressed spring. To understand those triggers properly, we first need to examine how developments in Brazil spill over into the world’s largest pool of capital: the U.S. market.

2. Impact on U.S. Markets

Brazil’s monetary policy used to be a local curiosity for most global investors. That is no longer the case. The country’s impending policy pivot now has direct implications for global capital flows and for how U.S. fixed income stacks up against international alternatives.

For U.S.-based investors, the relevant question is not just, “What happens in Brazil?” but, “How do those shifts affect the relative appeal of U.S. bonds, the behavior of global risk capital, and the construction of a resilient portfolio?”

Capital Flow Dynamics

Today, Brazil’s exceptionally high real interest rates—on the order of +10–11%—have turned it into a kind of “bond paradise” for yield-hungry global investors. For several years, this has drawn in capital that might otherwise have remained in developed-market duration (see Figure 3).

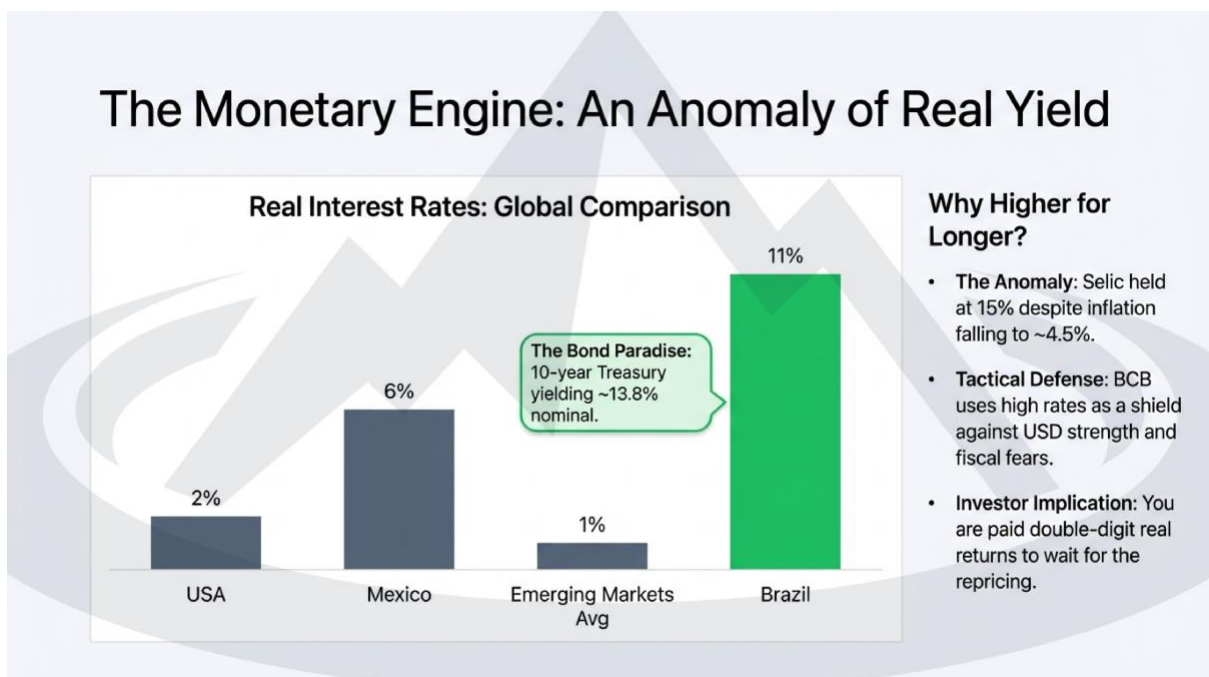


Figure 3. Brazil real rates in global context

Key takeaway: Brazil's +10–11% real rates have made it a global yield magnet; the key inflection is how easing reshapes capital flows and risk appetite.

We expect a meaningful monetary easing cycle to begin in early 2026. That does not simply mean “rates go down, yields fall.” The transition is likely to be more nuanced and, for asset prices, more powerful.

As the central bank begins cutting from a 15% Selic rate, two investor behaviors tend to appear simultaneously:

1. Investors who are already in Brazil look to lock in high carry while it is still available.
2. New capital arrives, seeking not only carry but also price gains from falling yields, as bond and bill prices rise in response to lower policy rates.

Forecasts from major institutions such as BBVA and BofA currently project the Selic ending 2026 in the 11.25–11.5% range. A move of that magnitude can materially change the global yield landscape:

- Brazilian fixed income may look even more attractive on a risk-adjusted basis, as investors realize they can earn high real returns with a credible central bank behind them.
- Capital that would otherwise be parked in U.S. fixed-income vehicles such as \$TLT or \$IEF may rotate toward Brazil, especially for allocators who explicitly target real yield rather than nominal safety.

From a U.S. allocator's perspective, Brazil is no longer an exotic side bet buried in an EM sleeve. It is a direct competitor to U.S. duration for global, yield-seeking capital.

Geopolitical and Trade Implications

The U.S.–Brazil relationship is a complex blend of long-term strategic alignment and episodic political risk. Both components matter for investors trying to understand how resilient this opportunity really is.

Strategic Alignment:

Washington is actively working to reduce its dependence on China for critical minerals and inputs essential to the energy transition, advanced manufacturing, and defense. Brazil, with its rich resource base, is central to this effort.

A concrete illustration is the U.S. International Development Finance Corporation (DFC) committing \$465 million to Serra Verde, Brazil's first large-scale rare earth elements project. This is not a one-off curiosity; it is a clear signal that the U.S. sees Brazil as:

- A long-term partner in the global energy transition, and
- A strategic supplier of rare earths and related materials that support U.S. industrial resilience.

Potential for Friction:

On the other side of the ledger, the political climate in Washington can shift rapidly. A future Trump administration could seize on Brazil's past purchases of Russian diesel as a pretext for tariffs, sanctions, or other trade measures.

On the ground, the situation has already changed markedly:

- Russian diesel once made up about 60% of Brazil's diesel imports.
- By December 2025, that share had fallen to less than 15%, as Brazil diversified toward suppliers in the U.S., India, and the Middle East.

However, politics do not always follow data. Old narratives can be revived and weaponized when it is politically convenient. For U.S. companies and investors with Brazilian exposure, this implies periodic headline risk—episodes of volatility and uncertainty—even when the underlying fundamentals remain largely intact.

The U.S. Dollar Relationship

The trajectory of the U.S. dollar is one of the most important external variables that can amplify or impair the Brazil trade.

A forecast from Deutsche Bank envisions a weaker dollar, roughly -6% by the end of 2026. If this plays out, it would be a powerful tailwind for Brazilian assets: local-currency gains would be magnified when translated into dollars, boosting returns for U.S. investors.

The opposite scenario—a sharp and sustained dollar rally—is the key macro risk. A strong dollar can force a rapid unwind of the popular BRL carry trade, where investors borrow in low-yield currencies to invest in Brazil's high-yield assets. A disorderly unwind would:

- Hit returns in Brazil, even if local fundamentals remain sound.
- Inject instability into broader global markets, as leveraged positions are liquidated and risk is rapidly reduced.

This interplay between global capital flows, trade relationships, and dollar dynamics underlines a crucial point: Brazil's domestic policy choices now feed directly into the broader macro environment that U.S. investors must navigate. The Brazil story is no longer a sideshow—it is increasingly part of the main act.

3. Impact on Europe and Global Markets

Brazil's role extends far beyond the Western Hemisphere. It matters for commodity prices, emerging-market sentiment, and the strategic supply chains that both the U.S. and Europe are racing to secure.

From a global asset-allocation perspective, Brazil is no longer just a cyclical play on risk appetite. Given its valuations, cash flows, and resource base, it has become a critical piece of the puzzle for investors thinking about inflation, energy security, and diversification away from China-centric supply chains.

Brazil as an EM Bellwether: A Defensive Stance

Counterintuitively, Brazil is currently trading more like a “defensive” asset within the EM universe than a high-beta risk vehicle. This defensiveness does not come from an absence of risk, but from the depth of its valuation discount, which provides a meaningful margin of safety.

The numbers are telling:

Metric	MSCI Brazil	MSCI Emerging Markets (EM)
Forward P/E Ratio	~9.2x	~13.5x

This ~35% valuation discount means investors are being compensated in two ways while they wait for the thesis to play out: (see Figure 4).

- Income, via higher yields and dividends
- Value, via low starting multiples that leave room for sentiment and earnings to re-rate

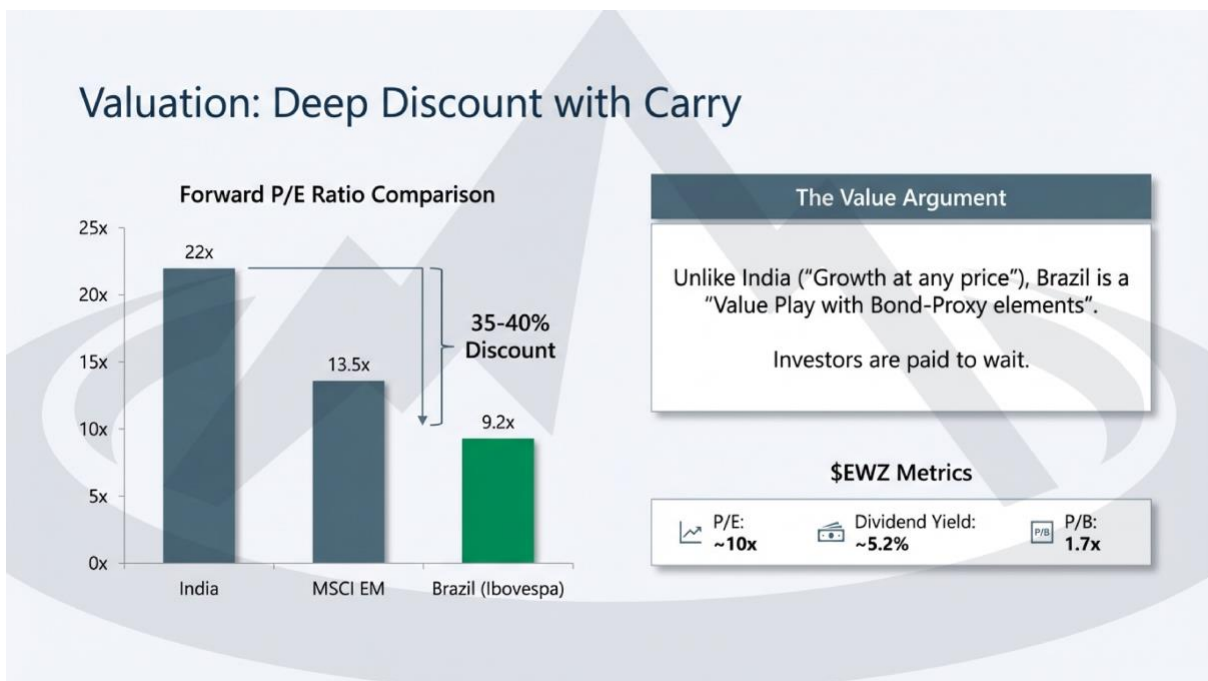


Figure 4. Brazil valuation discount versus EM with carry

Key takeaway: The ~35% valuation discount provides margin of safety, compensating investors through both income (carry/dividends) and value (multiple re-rating potential).

In practice, this makes Brazil less of a pure, high-beta “risk-on” trade and more of a high-yield, deep-value core holding within an EM allocation. It can sit alongside, not merely underneath, more expensive growth stories, providing ballast in the form of cash flow and valuation support.

Commodity and Energy Market Linkages

Brazil is central to several key commodity and energy narratives that shape global markets.

Global Industrial Proxy: Mining giant \$VALE functions as a barometer of global industrial health. Its fortunes are tied to demand for steel and to key metals such as copper and nickel, which are essential for renewable energy, electric vehicles, and large-scale grid upgrades.

Crucially, \$VALE is driven more by the global growth cycle and China's industrial and property policies than by the daily political noise in Brasília. For investors, this makes Vale a relatively clean way to express a view on global industrial demand and the energy transition, with Brazil serving as the platform rather than the main source of risk.

Shifting Energy Flows: On the energy side, Brazil has quietly but decisively re-engineered its diesel import mix. Where Russian diesel once represented roughly 60% of its imports, by December 2025 that share had fallen below 15%.

The slack has been taken up by suppliers in the U.S., India, and the Middle East, reshaping not just barrels on a spreadsheet but also the geopolitical map of energy flows. For investors, this signals Brazil's ongoing adjustment toward a more diversified and geopolitically aligned energy portfolio.

Strategic Importance for Europe

For Europe, the story around Brazil is strikingly similar to that of the U.S.: reduce excessive dependence on China for critical inputs and secure alternative, reliable partners.

Projects like Serra Verde matter greatly for the European Union's industrial security. Brazil hosts one of the largest rare earth endowments outside of China, and those resources are central to Europe's:

- Green transition
- Digital infrastructure
- Next-generation manufacturing and defense technologies

As a result, Brazil is positioned to become a key long-term strategic partner for Europe over the next decade—not just as a cyclical commodity supplier, but as an integral pillar in the EU's de-risking and diversification strategy.

With this global context in place, we can now zoom in on the sectors and companies that carry the Brazil investment story inside a portfolio.

4. Sectoral Deep Dive and Key Tickers to Monitor

The "Brazil 2.0" story is not a rising tide that lifts all boats equally. The opportunity set is uneven and concentrated. Capturing the best risk/reward therefore requires a targeted, sector-by-sector lens, rather than a broad, indiscriminate bet on the entire economy.

4.1 Financials: The Bedrock of the Index

Banks account for a substantial share of the Ibovespa and sit at the core of most Brazil allocations. They are unusual in that they can benefit twice over the coming cycle:

1. In the present, from wide net interest margins in a high-rate environment

2. In the future, from a new credit cycle as rates fall and loan demand accelerates

\$ITUB (Itaú Unibanco): The Quality Anchor

\$ITUB is the quality anchor of a Brazil portfolio. Its Q3 2025 results highlight its resilience and best-in-class execution, with a 23.3% ROE and record profits. Itaú’s diversified and robust business model allows it to earn well today, while positioning it to grow credit volumes safely when the easing cycle begins.

Itaú is effectively a levered play on the upper leg of Brazil’s K-shaped economy—formal-sector workers and upper-income households with stable employment, savings, and access to credit. As such, it offers exposure to the healthiest and most resilient part of domestic demand.

\$BBD (Bradesco): The Deep Value Option

By contrast, \$BBD (Bradesco) is the deep value option in the banking sector. It trades at roughly 0.6x price-to-book (P/B) and offers an expected dividend yield of 10%+, squarely in classic deep-value territory.

The discount exists for good reason: Bradesco has faced pressure on asset quality and credit costs and is more exposed to the riskier parts of the cycle than Itaú. In simple terms, \$BBD is a high-beta bet on normalization. If the easing cycle is orderly and credit quality stabilizes, it has significant room for re-rating. If shocks hit the system, it will feel them more acutely than its higher-quality peers (see Figure 5).

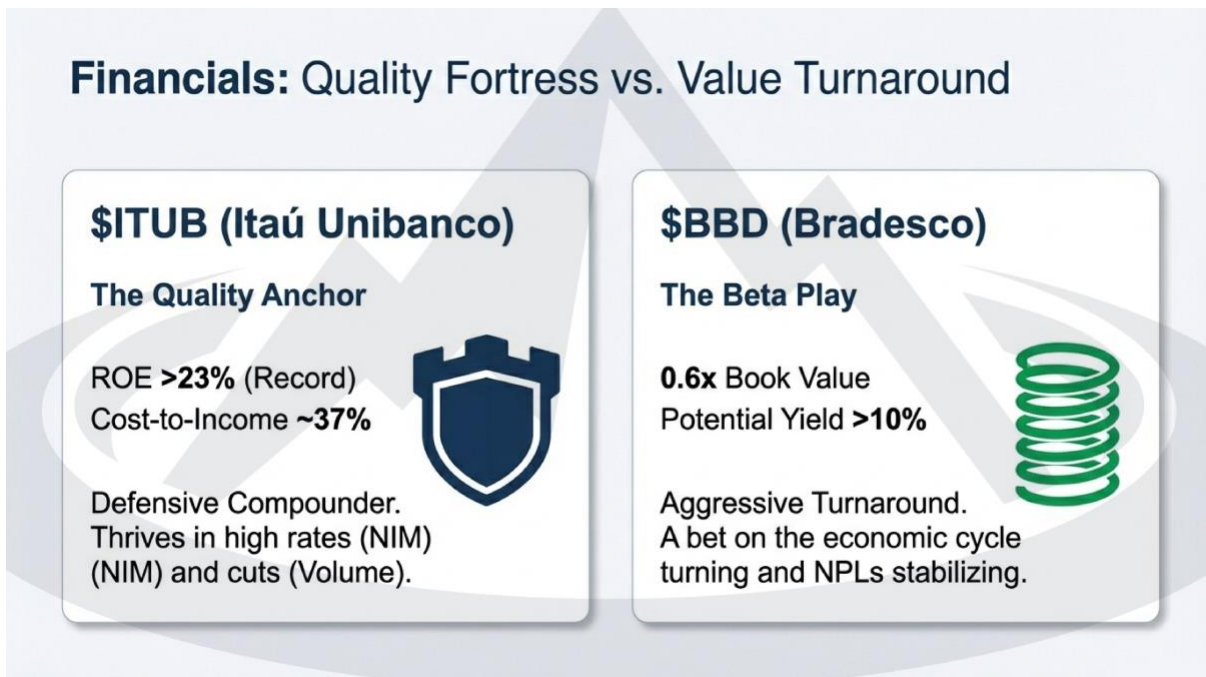


Figure 5. Banking: quality anchor vs. turnaround value

Key takeaway: Financials are central: \$ITUB is the quality anchor tied to resilient upper-income demand, while \$BBD is the higher-beta turnaround with more credit sensitivity.

4.2 Commodities & Energy: Global Proxies with Local Risks

This sector sits at the intersection of global macro trends and domestic political risk. It offers substantial upside but demands careful position sizing.

\$VALE (Vale): The Free Cash Flow Machine

\$VALE is best understood as a geared play on the global commodity cycle and a true free cash flow machine. Depending on the level of iron ore and base metal prices, Vale can deliver a 6–14% free cash flow yield, a large portion of which can be returned to investors via dividends and buybacks.

Its upside is closely linked to two macro themes:

- A potentially weaker U.S. dollar, which would generally support commodity prices
- A prolonged global infrastructure and energy transition cycle, which lifts demand for iron ore, copper, nickel, and related metals

\$PBR (Petrobras): The High-Yield, Politically-Charged Pseudo-Bond

\$PBR is not a straightforward growth story. It is better described as a high-yield, politically-charged pseudo-bond. Historically, Petrobras has delivered a 15–18% trailing-twelve-month dividend yield, but this headline yield comes wrapped in significant political risk.

The Lula administration has made it clear that it is willing to influence Petrobras's:

- Dividend policy
- Capital allocation
- Domestic fuel pricing

Owning Petrobras is therefore a bet not only on its impressive cash generation, but also on how much of that cash will actually reach shareholders, versus how much will be redirected toward state priorities and industrial policy (see Figure 6).

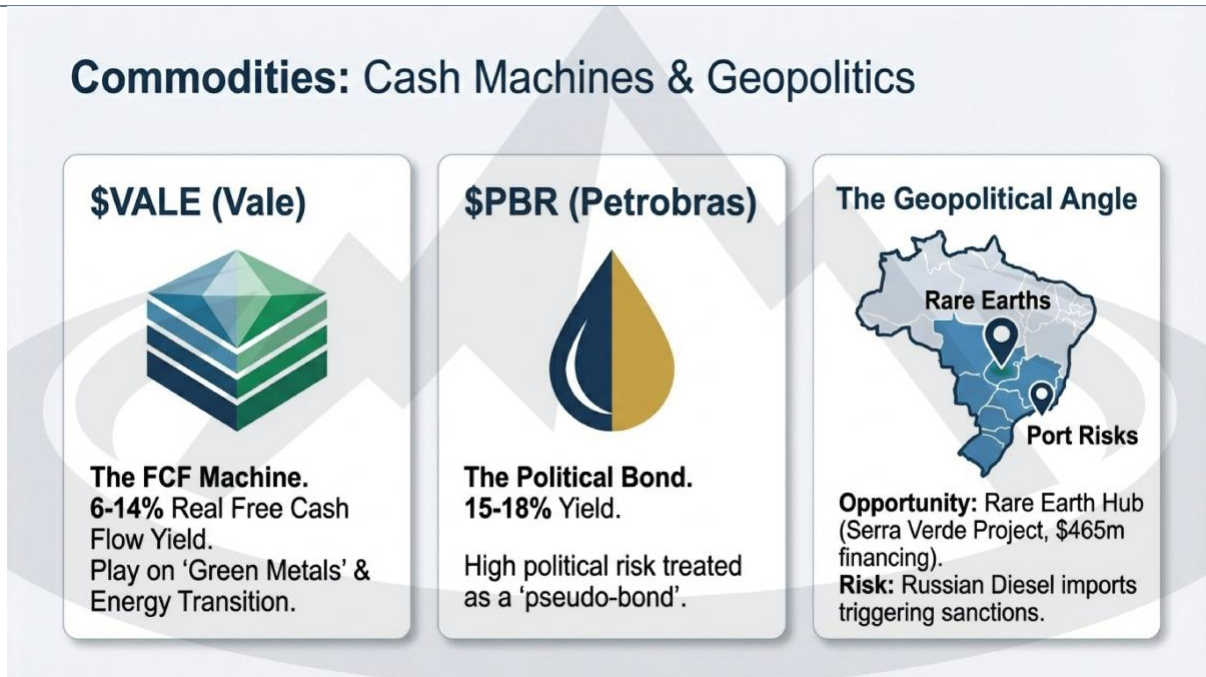


Figure 6. Commodities and geopolitics: cash machines and key risks

Key takeaway: Commodities and energy provide global-macro leverage—\$VALE as a cash-flow-rich commodity proxy and \$PBR as a high-yield pseudo-bond where politics drive payout risk.

4.3 Real Estate: The Purest Play on Monetary Easing

The Brazilian real estate sector is perhaps the cleanest expression of a bullish view on falling interest rates. Developers currently trade at a forward P/E of just 5–6x, which is about a 50% discount to the already cheap Ibovespa.

The market is effectively pricing in a scenario of “high rates forever.” That stands in clear contrast to the operational reality: many leading developers have continued to grow project launches and profits despite the challenging rate environment.

Sectoral Thesis: If our base case for a sustained monetary easing cycle plays out, the sector is well positioned for a sharp re-rating as:

- Mortgage costs fall
- Housing affordability improves
- Demand from higher-income buyers accelerates

Key Players to Watch: Developers such as \$CYRE3 (Cyrela) and \$DIRR3 (Direcional) are prime examples. Both have reported strong results, including record launches and growing profitability. Their focus is the upper-middle class, the group that:

- Benefited from the 2025 tax reform
- Enjoys relatively stable income
- Drives a large share of discretionary spending and housing demand in the K-shaped recovery

Under a credible easing cycle, we see 50–100% upside over a 2–3 year horizon as a reasonable possibility. These names function as “options on a monetary pivot”, but unlike financial derivatives, they are backed by tangible assets, real customers, and proven earnings power (see Figure 7).

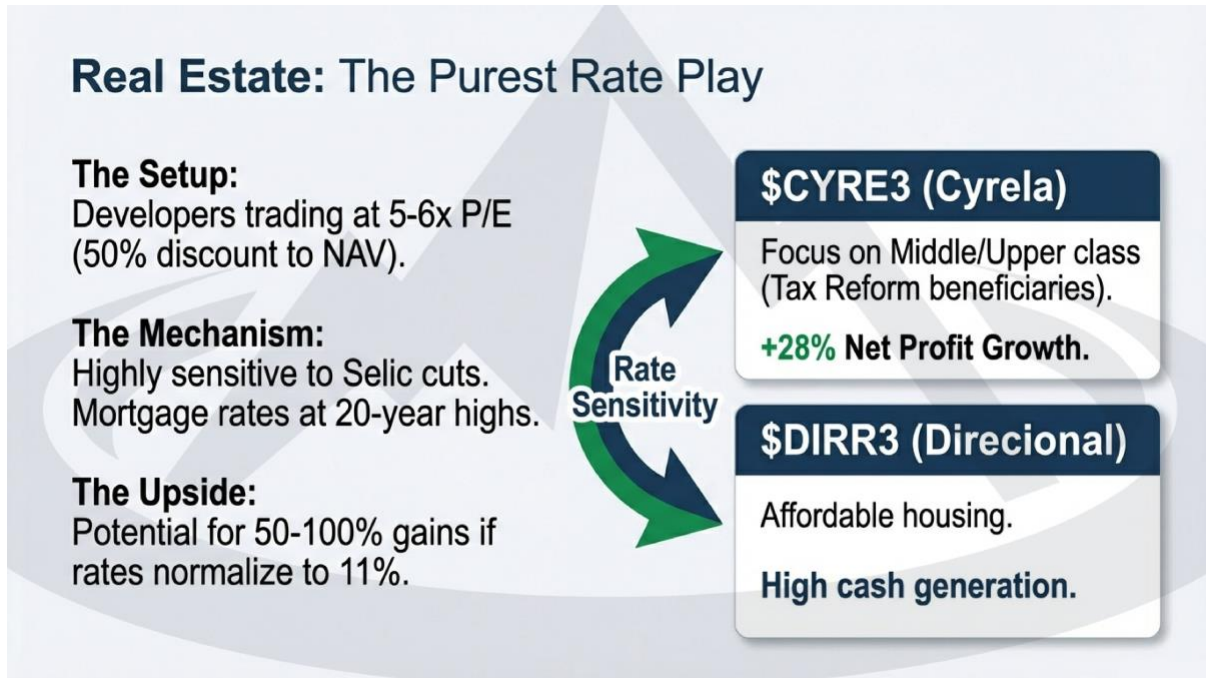


Figure 7. Real estate: rate sensitivity and easing upside

Key takeaway: Real estate is the cleanest easing expression: developers are priced for “high rates forever” despite meaningful upside if the Selic cycle turns.

These sectoral opportunities illustrate the diversity of ways to gain exposure to the Brazil thesis. They are, however, all subject to a common set of macro risks that could derail the story if they materialize in the wrong way.

5. The “Grey Rhinos”: Overlooked Macro Risks

At MoatPeak, we start from the downside using an “Inversion” mental model: rather than asking only, “What could go right?” we first ask, “What must not happen?” If we understand how the thesis could fail, we can position more intelligently.

We focus on “grey rhinos”—large, slow-moving but high-impact risks that are visible yet often underweighted when optimism builds. In Brazil’s case, three stand out (see Figure 8).



Figure 8. Grey rhinos: macro risks and invalidation triggers

Key takeaway: Our key "grey rhinos" are fiscal dominance, a carry-trade unwind, and geopolitical pressure—risks that can keep rates high and hit BRL/asset prices.

Primary Internal Risk: Fiscal Dominance

The single largest domestic threat is a drift into Fiscal Dominance. In such a regime:

- The government's spending and debt needs begin to dictate interest-rate policy.
- The central bank (BCB) is forced to keep rates high, not primarily to fight inflation, but to attract funding for the state.

A pre-election spending spree in 2026 by the Lula government could tip Brazil in this direction, preventing the "Plano Real 2.0" scenario from materializing. Instead of cutting, the BCB would be forced to keep the Selic anchored near 13-15%, suffocating the expected bond rally and capping growth.

In this downside scenario, we would likely see:

- The Brazilian real (BRL) weakening toward 5.8-6.0 per USD
- 10-year bond yields rising back to the 14-15% range

External Vulnerability: The Carry Trade Unwind

Brazil's high rates have made the BRL carry trade extremely popular. At the same time, the country runs a current account deficit of -3.1% of GDP. For now, this deficit is comfortably covered by steady Foreign Direct Investment (FDI), but the structure introduces vulnerability.

A global risk-off shock or a sharp, unexpected dollar rally could trigger a rapid exit from BRL-denominated assets. Such a carry-trade unwind would likely cause:

- A rapid currency depreciation, eroding returns for foreign investors
- Losses on broad instruments such as the \$EWZ ETF, as both FX and local asset prices adjust

The K-Shaped Economy: A Segmented Recovery

The 2025 tax reform, which raised the tax-free income threshold and eased the burden on the middle class, has contributed to a distinctly K-shaped recovery (see Figure 9).

- The Upper Leg: The upper-middle class, with formal employment and financial assets, is thriving. They benefit from lower taxes and high returns on their savings, driving demand for durable goods, travel, and housing.
- The Lower Leg: Many lower-income households, especially those in informal work, face high borrowing costs, limited access to credit, and ongoing pressure from the cost of living. They have seen far fewer direct benefits.

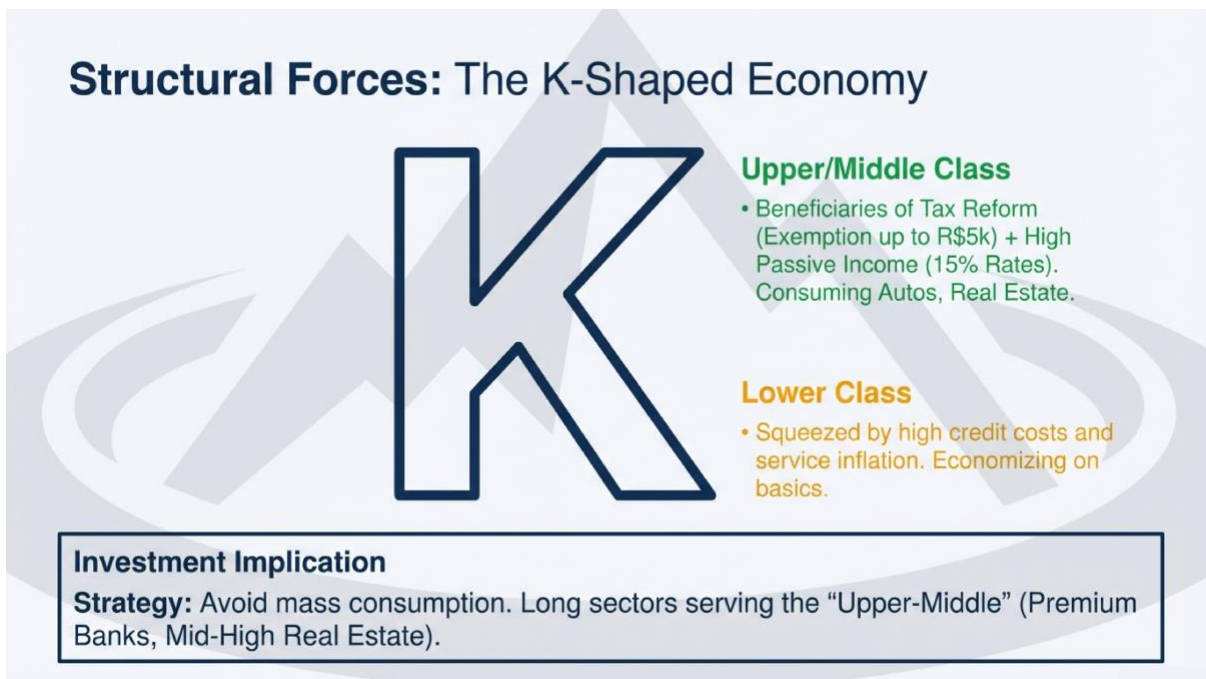


Figure 9. K-shaped economy and structural segmentation

Key takeaway: A K-shaped recovery argues for focusing on companies serving the resilient upper-income segment rather than broad mass consumption.

The key insight for investors is straightforward but crucial: investment theses should focus on companies serving the resilient upper-income segment, not on broad, mass-market consumption. Bets on the average Brazilian consumer are less compelling than those centered on the groups where income and wealth are actually growing.

By confronting these risks head-on, we can move from a fragile, single-outcome forecast to a more robust, scenario-based framework.

6. Our Scenarios & Probabilities for 2026

Faced with deep uncertainty, our approach at MoatPeak is not to insist on one precise forecast. Instead, we define a set of plausible scenarios, assign probabilities based on current evidence, and monitor signposts that indicate which path the market is taking.

This scenario-based method keeps us both flexible and intellectually honest.

Monetary Policy Scenarios

The path of the Selic rate is the main engine of the Brazil thesis. Our analysis highlights three central scenarios: (see Figure 10).

Scenario Name	Probability	Key Triggers	Outcome for Selic Rate & Bonds
Base Case: Gradual Easing	60%	Inflation stabilizes below 4.5%; fiscal policy remains contained.	Selic rate falls to
Upside: Accelerated Easing	25%	Inflation falls below 4.0%; USD weakens; fiscal discipline holds.	Selic rate drops to
Downside: Fiscal Dominance	15%	Pre-election spending surge; loss of policy credibility.	Selic remains near

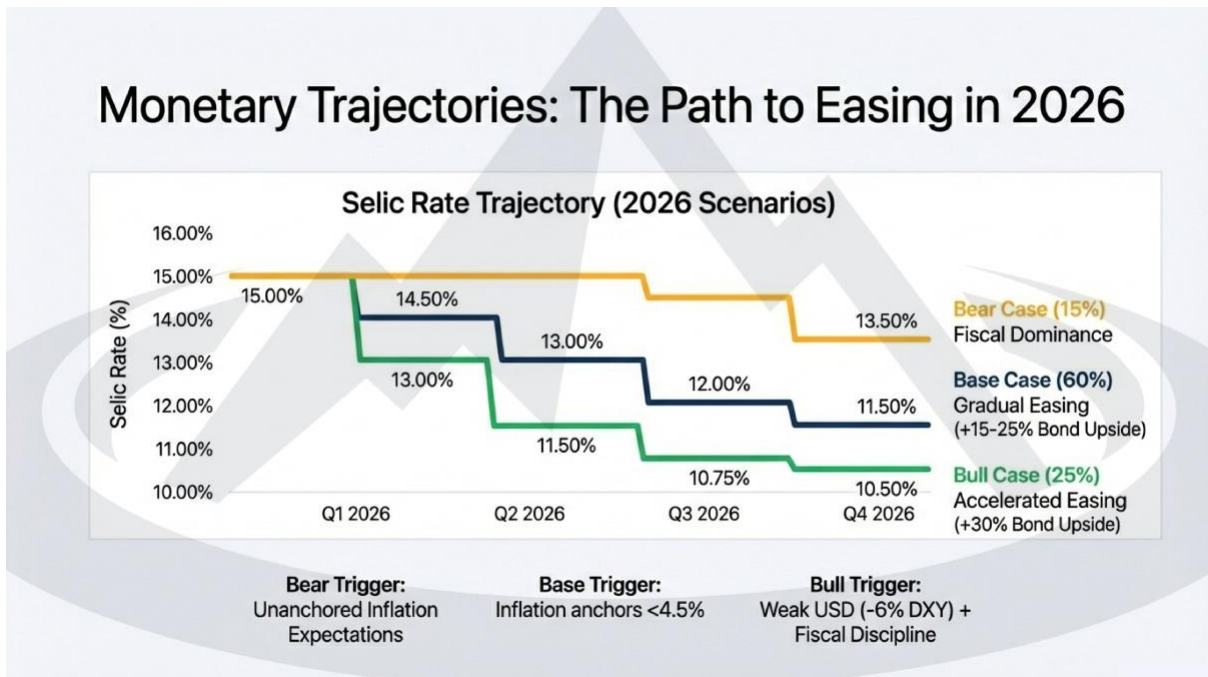


Figure 10. Selic rate scenarios and easing path in 2026

Key takeaway: The Selic path is the engine: our base case is gradual easing, with upside and downside scenarios tied to inflation, FX, and fiscal discipline.

Political Election Scenarios

The October 2026 presidential election is the defining political catalyst. It will shape Brazil’s risk premium and policy trajectory for years (see Figure 11).

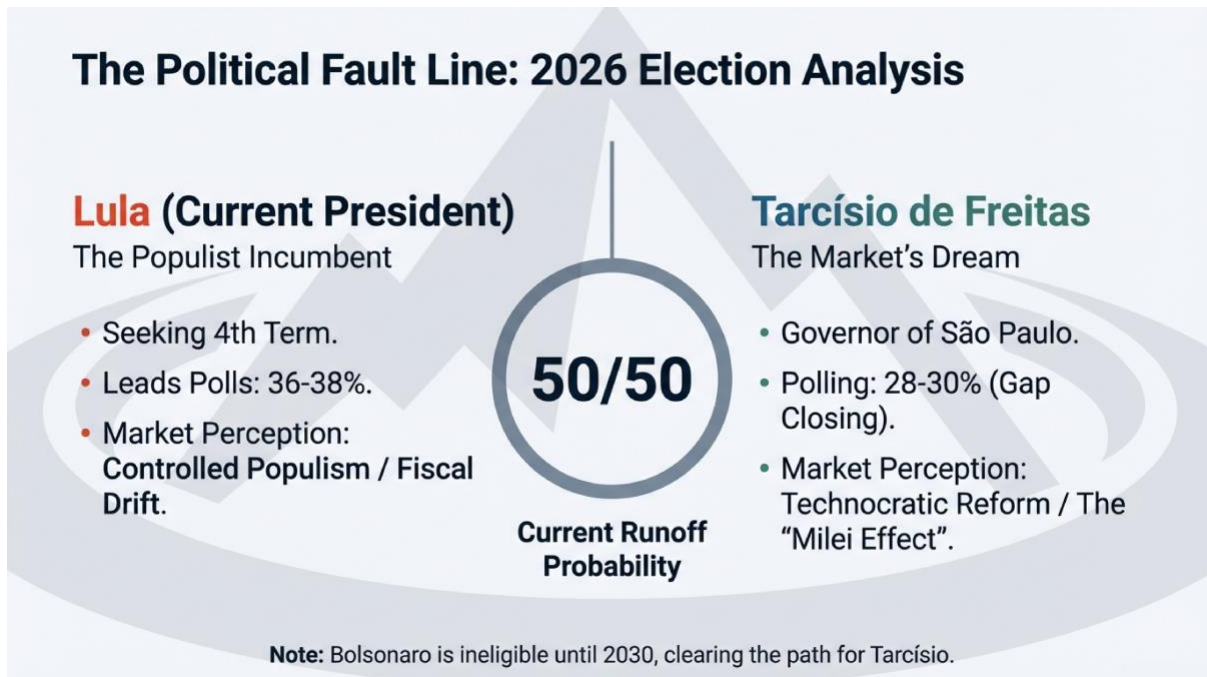


Figure 11. 2026 election setup and runoff framing

Key takeaway: The 2026 presidential election is the defining catalyst; outcomes determine Brazil’s risk premium and whether the market starts pricing a more market-friendly turn.

Scenario Name	Probability	Key Triggers	Outcome for Ibovespa & BRL
Base Case: Controlled Lula Continuation	45%	Lula wins narrowly; fiscal policy remains soft but not extreme.	Ibovespa targets
Upside: Market-Friendly Pivot	35%	Tarcísio de Freitas wins with a credible consolidation agenda.	Strong re-rating: Ibovespa targets
Downside: Populist Explosion	20%	Large pre-election giveaways; markets lose patience.	BRL weakens to

Institutional Alpha

Political Scenarios & Asset Price Implications

Scenario A: Controlled Lula	Scenario B: Pro-Market Turn (Tarcísio)	Scenario C: Populist Explosion
Prob: 45%	Prob: 35%	Prob: 20%
Fiscal: Soft, deficits near zero.	Fiscal: Consolidation (Primary Surplus 2-3%).	Fiscal: Pre-election spending spree.
Ibovespa Target: 170-180k (+5-12%).	Ibovespa Target: 190-210k+ (Massive Re-rating).	Ibovespa Target: Negative in USD terms.
Insight: Relief rally. Worst case avoided.	Insight: Bull-flattening of yield curve. BRL strengthens to 5.0.	Insight: USD/BRL spikes to 6.0+. The 'Grey Rhino'.

Figure 12. Political scenarios and asset-price implications

Key takeaway: Political scenarios map directly to asset prices—controlled continuity supports a measured re-rating, a market-friendly pivot drives a larger re-rating, and a populist shock risks BRL weakness.

Key Triggers to Monitor

To move from static scenarios to dynamic, updated views, investors should track three primary signposts:

- Inflation data: Consistent readings below 4.5% will give the central bank room to cut and validate the easing thesis.
- Fiscal policy tone (H1 2026): Budget proposals and rhetoric will reveal whether the government is leaning toward discipline or populism ahead of the election.
- Polling trends: Any sustained rise in support for Tarcísio de Freitas or other market-friendly options could prompt markets to start pricing in the upside scenario well before votes are cast.

These indicators provide a real-time dashboard for adjusting probabilities, rather than relying on static assumptions (see Figure 13).

Investment Dashboard: Scenarios & Sensitivities

Scenario	Probability	Selic Target '26	FX (USD/BRL)	Ibovespa Target
Bear (Fiscal Dominance)	15%	13-15%	6.00+	<150k
Base (Soft Landing)	60%	11-12%	5.45-5.60	170-180k
Bull (Reformist)	25%	10.5-11%	5.00-5.25	190-210k

Valuation Drivers

- EPS Growth (Internal Demand) + Multiple Expansion.

Catalysts

- Q1 2026 Easing Start, Tarcísio Polling Numbers.

Figure 13. Scenario dashboard: probabilities and sensitivities

Key takeaway: Scenario probabilities should be updated via a real-time dashboard: inflation, fiscal tone, and polling are the signposts that shift expected Selic, FX, and equity outcomes.

7. Our Insights: Connecting the Dots

So far, we have focused on what is happening. In this section, we address what it means. We connect monetary policy, politics, and valuation into a coherent narrative and draw a clear line between observable facts and our own interpretation.

The “Plano Real 2.0” Thesis

Our central argument is that today’s Brazil looks strikingly similar to the country in the aftermath of the “Plano Real” reforms in the mid-1990s.

Back then:

- Hyperinflation had been brought under control.
- Policy frameworks had begun to work, but investor psychology lagged.
- Assets continued to trade as if another crisis were just around the corner.

That disconnect between improving fundamentals and deeply skeptical valuations created a powerful opportunity for patient investors.

We see a comparable pattern today:

- Inflation has been pushed back into the target band by a tough central bank.
- The policy stance, while painful, has been broadly effective.
- Yet markets still price in a heavy “crisis discount” for future fiscal and political missteps.

This is the essence of the compressed spring: most of the bad news is already in the price, while much of the potential good news is not.

Distinguishing Facts from Our Assessment

The Facts:

- The policy rate (Selic) stands near a cycle peak of 15%.
- Annual inflation has fallen to roughly 4.5%, within the official target range.
- Real 10-year government bond yields are around ~9–10%, among the highest in the world.
- MSCI Brazil trades at about a ~35% valuation discount to the broader MSCI EM index on a forward P/E basis.

Our Assessment: We believe the market is anchored to outdated narratives of Brazilian fiscal blow-ups and is slow to incorporate the reality of a credible, disciplined central bank and fully FDI-funded external deficits. In our view, this gap between perception and reality is one of the richest sources of potential alpha in today's emerging markets.

The “Defensive EM” Concept

Labeling Brazil a “defensive” holding in EM may sound counterintuitive, but from a portfolio-construction standpoint it makes sense. Investors are being paid unusually well to take risk, thanks to three pillars:

- A 5–7% dollar dividend yield via broad instruments like \$EWZ
- Low starting valuations in the 9–10x P/E range
- Exceptionally high real rates, which produce strong carry

Together, these characteristics create a real margin of safety and a robust income stream while waiting for any re-rating to occur. That is a very different profile from expensive, growth-heavy EM stories, where investors often pay up for optimism and receive little protection on the downside.

These insights form the intellectual foundation for our practical framework: how a sophisticated retail investor might approach this opportunity.

8. What This Means for the Retail Investor

This final section translates our institutional analysis into a practical, non-prescriptive framework for a sophisticated retail investor. It is not individualized investment advice or a list of “buy now” stock picks. Instead, it offers a way to think about how and when to build exposure to Brazil through 2026.

A Phased Approach to Building Exposure

For most investors, the simplest and most efficient entry point into Brazil is the broad-market ETF \$EWZ. However, going all-in at once exposes you to unnecessary timing risk. We therefore favor a three-tranche, phased entry strategy that averages into the position and takes advantage of volatility rather than fearing it:

-
- Tranche 1 (Q1 2026): Initiate a position after the first confirmed cut in the Selic rate. This marks the transition from talk to action in the easing cycle.
 - Tranche 2 (Post-cuts): Add to the position after one or two additional cuts, once the market starts to price in a full easing cycle and the risk of a “false start” declines.
 - Tranche 3 (Pre-election volatility, Apr–Jul 2026): Deploy the final tranche during the noisy pre-election period, when political headlines may cause temporary dislocations and more attractive entry points.

This approach does not eliminate risk, but it helps convert a binary timing decision into a more controlled, probabilistic process (see Figure 14).

Structuring a “Core-Satellite” Portfolio

A useful way to structure a Brazil allocation is through a core–satellite framework.

Core:

The core holding should be \$EWZ, providing diversified exposure to Brazil’s financials, commodities, energy, and other key sectors in a single instrument. This reduces idiosyncratic risk and anchors the portfolio in the broader Brazil story.

Satellites:

For investors comfortable with higher volatility and company-specific risk, smaller satellite positions can be added around the core to express more targeted views:

- Quality Anchor: A position in \$ITUB for resilient exposure to high-quality banking and the upper leg of the K-shaped economy.
- Commodity Cycle: An allocation to \$VALE as a play on the global commodity cycle and a potentially weaker USD.
- Monetary Pivot Option: A tactical position in real-estate developers like \$CYRE3 or \$DIRR3 as direct, high-upside bets on falling interest rates.
- High-Yield/Political Risk Option: A cautious position in \$PBR for investors explicitly willing to trade higher political risk for very high dividend yields.

Position sizes should reflect each investor’s risk tolerance, time horizon, and comfort with Brazil-specific uncertainty.

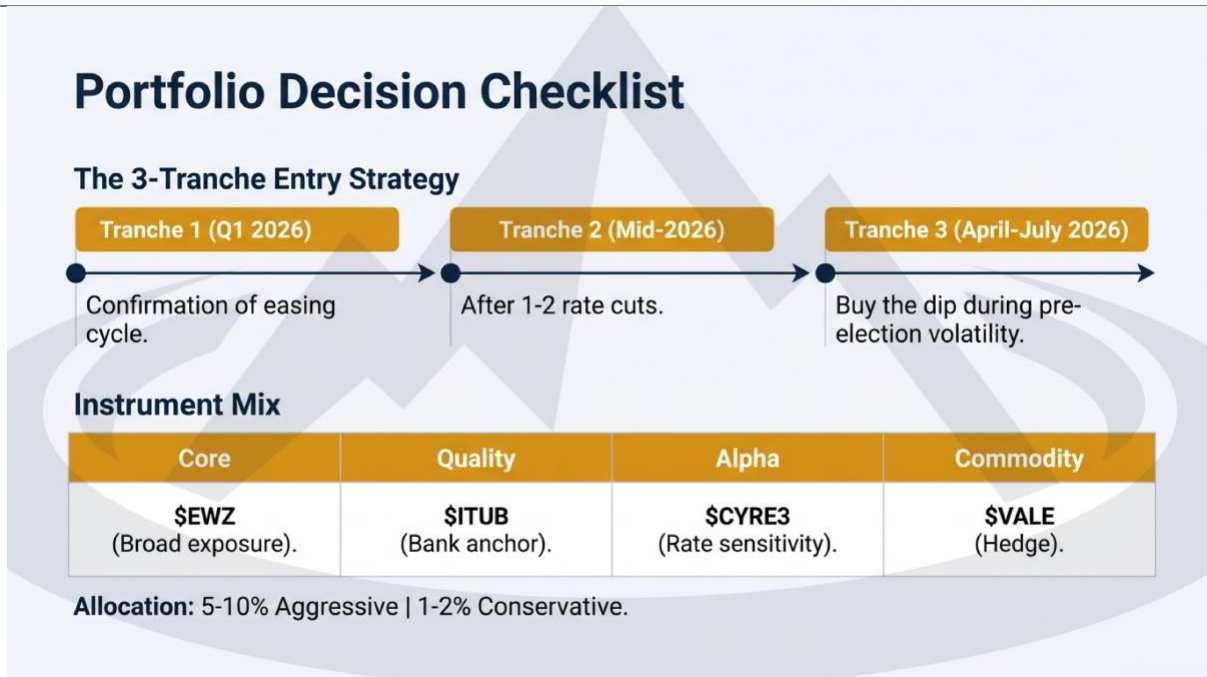


Figure 14. Portfolio decision checklist and tranche entry strategy

Key takeaway: We prefer a phased entry and core-satellite structure: build \$EWZ exposure in tranches and add targeted satellites only as signposts confirm the thesis.

Tripwires for Reassessment

An intellectually honest approach requires knowing, in advance, what would make you reconsider the thesis. We highlight three key tripwires—our primary risk dashboard:

- Runaway fiscal spending: Clear evidence that the government is abandoning fiscal discipline in a pre-election populist push. This would raise the probability of Fiscal Dominance and undermine the bond and currency thesis.
- Global dollar liquidity crisis: A sudden, sharp USD rally that triggers a broad carry-trade unwind and puts acute pressure on the BRL.
- Escalating geopolitical tensions: The imposition of U.S. tariffs or sanctions aimed at Brazil’s key exports or strategic sectors.

The activation of any of these tripwires should not automatically trigger panic selling, but it should force a fresh, rigorous review of the Brazil allocation, including whether the original risk/reward balance still holds.

Taken together, this framework allows a sophisticated retail investor to treat Brazil not as a speculative punt, but as a structured, scenario-driven asymmetric opportunity—one where the risks are real, but so is the compensation for taking them.



Figure 15. Conclusion: Plan Real 2.0 framing

Key takeaway: Brazil is not a free lunch, but the setup offers asymmetric upside if easing and policy discipline converge—best approached with a scenario-driven framework.

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Figure 16. Important disclosures and disclaimer

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