

Re-Rating Ahead? Brazil's Election and the Equity Opportunity at the Fork in the Road

White Paper
October 19, 2026



SUMMARY

One vote, two roads, and a stock market that has been waiting years for a reason to re-rate.

Brazil's presidential election runoff on October 25 is a very tight contest between President Luiz Inácio Lula da Silva, the left-leaning incumbent, and Senator Flávio Bolsonaro, the right-leaning challenger. Emerging markets investors are watching closely because these elections are widely regarded as a key catalyst for unlocking value and triggering a meaningful re-rating in Brazilian equities. The first round, on October 4, showed why: Bolsonaro finished narrowly ahead with about 47% of the vote to Lula's 45%, and the next day the MSCI Brazil Index jumped nearly 13% and the real gained about 4%.

The election tips the first of a row of dominoes: the fiscal path, then the central bank's room to cut rates, then local savings returning to stocks, and finally market performance. The starting point is not strong. Debt is heading to 83% of GDP, mostly because of interest costs, and fixing it takes constitutional reform, a willing president and an equally willing Congress. Rates have stayed above 10% for nearly five years. The central bank has begun to ease, but it is unlikely to move decisively until the budget gives it the confidence to do so.

Those high rates have pushed Brazilians out of their own stock market and into bonds that pay double digits, leaving many well-run domestic companies arguably cheaper, yet unloved. If investors come to believe the budget is on a credible path, lower rates, returning savings and a re-rating could follow, and in a market this small, a little flow goes a long way.

Because the outcome is still binary, the risks are real. But so is the opportunity. Much of it sits beyond the index heavyweights, in smaller domestic-oriented companies where deep, on-the-ground knowledge separates the survivors from the pitfalls. That is where a local specialist is best placed, finding those companies and building a portfolio balanced for either outcome.

KEY HIGHLIGHTS

- **One ballot, two roads.** A very tight race and a binary outcome, with a market that has already begun to price what each scenario could mean for Brazil's economic future. Politics matters because it will decide the fiscal path that drives everything that follows.
- **The budget bind.** The government borrows mostly to pay interest on what it already owes, and stopping that means running a surplus before interest, which means spending less. Most spending is locked in by the constitution, so fixing it takes reform, a willing president and an equally willing Congress.
- **Foot on the accelerator, foot on the brake.** Inflation has come back near its target range, yet rates never followed. Spending keeps pushing the economy forward while the central bank holds rates high to offset it. A cut is long overdue, and the cuts so far are only a start until the budget gives the central bank a reason to act more decisively.
- **The great escape to bonds.** With safe bonds paying double digits, Brazilians had little reason to own risk assets and left their own stock market. Many good companies were left unloved, cheap and without buyers, and the savings parked in bonds are what could one day flow back.
- **Market re-rating.** If rates fall and savings return, even small flows can make a splash in an under-owned market. It starts as a sentiment trade that lifts all boats, then differentiation follows, and the real structural winners should be the well-run domestic stocks that have been ignored for so long.
- **Navigating the fork.** A binary event with risks alongside the opportunity. Deep knowledge of the companies, and of where the pitfalls are and are not, is essential, as is building a portfolio balanced to perform on either road.



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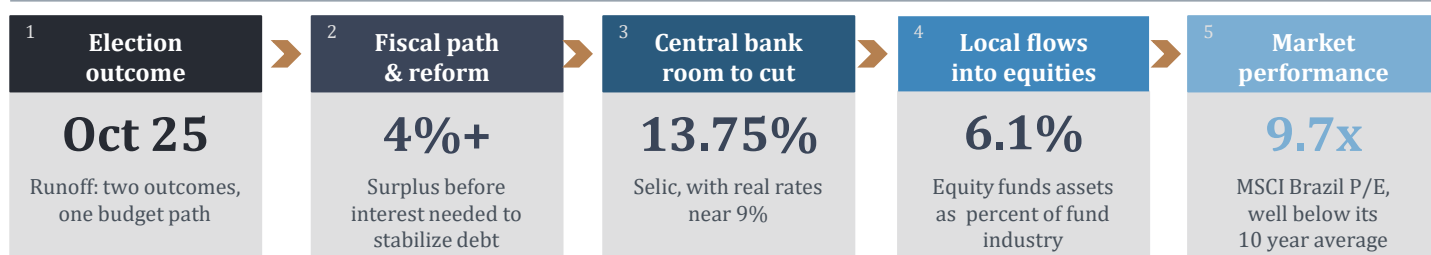
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THE FIRST DOMINO: ONE BALLOT, TWO ROADS

For emerging markets investors, politics is where the fiscal path is decided, and the fiscal path shapes interest rates, savings flows and equity valuations. Brazilians will choose between President Luiz Inácio Lula da Silva, the left-leaning incumbent, and Senator Flávio Bolsonaro, the right-leaning challenger, two candidates seen as offering different approaches to spending and reform. It is a very tight race. In the first round, held on October 4, neither candidate cleared the 50% needed to win outright. Bolsonaro finished first with about 47% of the vote and Lula second with about 45%, a margin of less than two points, so the two meet in a runoff on October 25.

The market reaction showed what is at stake. The next day, the MSCI Brazil Index jumped nearly 13%, the real gained about 4%, and interest rate futures fell by more than a percentage point¹. Nothing in the economy had changed overnight. What changed was what investors expect for Brazil's economic future, now that it hinges on a binary choice between two paths. Every re-rating needs a trigger, and in Brazil the potential trigger is the election. Like a row of dominoes, the election tips the first domino, the fiscal path. That then sets off the next domino, how much room the central bank has to cut interest rates and whether local savings return to local stocks, and finally how the market performs.

Why Brazilian Elections Matter: The Domino Effect



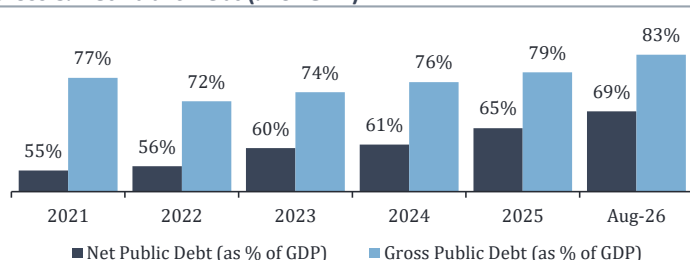
Source: Bloomberg, MSCI, Anbima, Brazil Central Bank and JP Morgan as of September 30, 2026. Surplus before interest needed to stabilize debt estimated by JP Morgan as of June 2026. See footnote 4 for further details. Graph is presented for illustrative purposes only and should not be relied on to make an investment decision.

THE FISCAL LINK: THE BUDGET BIND

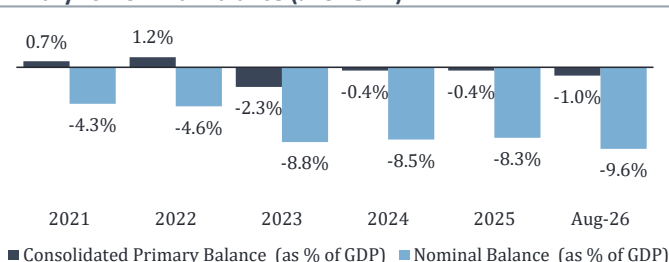
Where the debt stands

Brazil's gross debt is forecast to reach 83% of GDP this year and net debt 69%, up from about 72% and 56% in 2022 and well above the government's own projections. The striking part is that the day-to-day budget is not far from balance. The primary balance, revenue minus spending before interest, is a small deficit of about 1.0% of GDP. The nominal balance, which includes interest, is a deficit near 9.6%². The difference is almost entirely interest. Brazil is borrowing mostly to pay interest on what it already owes, and the bigger the debt, the bigger the bill.

Gross & Net Public Debt (% of GDP)



Primary vs Nominal Balance (% of GDP)



Source: Brazil central bank as of August 30, 2026. Data as of the date presented herein. Past returns are not a guarantee of future results. Graphs are presented for illustration purposes only and should not be relied on to make an investment decision.

What it would take to stabilize it

How big a swing would it take to stabilize the debt? The government must run a surplus before interest large enough to offset the gap between what it pays on its debt and how fast the economy grows. The higher the debt and the interest rate, the larger that surplus must be. According to J.P. Morgan, with debt near 80% of GDP, a real interest rate of 3% requires a surplus of under 1% of GDP, 5% requires about 2.4%, and 7% about 4%. Brazil's real bond yields sit near 8%, so the requirement is above 4% of GDP, against a small deficit today, a gap of four to five points³. The arithmetic also works in reverse: the lower rates fall, the smaller the effort required. Credibility and falling rates reinforce each other.



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A surplus of that size must come from somewhere. Revenue can help at the margin, but a swing this large means spending less than the budget currently commits. Deciding what to cut, and how fast, is a political choice, and that is where the election enters the story.

Why spending is hard to cut

Why can't the government simply spend less? Because about 90% of federal primary spending is mandatory or constitutionally earmarked. Social security is the largest line and grows as the population ages. Health and education have constitutional floors that rise with revenue. Pensions and benefits are tied to the minimum wage. Public payroll, the judiciary and court-ordered payments add to the fixed base. That leaves only about 10% to cut, and most of that is public investment. Squeezing the 10% cuts public capex, not entitlements. That is what has happened, and it is why investment contributes close to zero to 2026 and 2027 growth in most economists' forecasts.

The bottom line: fixing Brazil's fiscal position means changing the constitution, because that is where mandatory spending is written. It takes three-fifths of both chambers, voting twice, roughly 308 of 513 deputies and 49 of 81 senators. No president can do that alone. It needs a willing executive and an equally willing Congress, which is why the coalition and cabinet formed after the vote matter as much as the result. The first round was encouraging on that front, strengthening right-leaning parties in Congress, which markets read as a supportive first step.

Federal primary spending is close to fully committed



What sits inside the mandatory block?

- *Social security*: the largest line, growing as the population ages
- *Health and education*: constitutional minimums that rise with revenue
- *Minimum wage-linked benefits*: pensions and the BPC benefit rise with the wage
- *Payroll and courts*: public salaries, the judiciary and court-ordered payments
- *Congressional earmarks*: lawmakers' budget amendments, today effectively non-discretionary

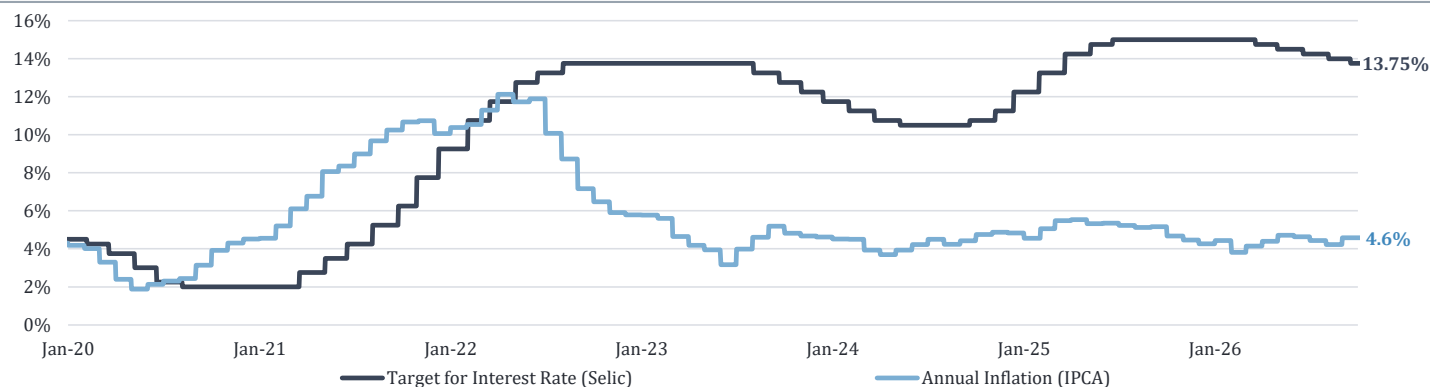
Where politics enters

This is where politics enters. Reform is possible under either outcome, and Brazil has done it before, but investors expect a right-leaning government led by Bolsonaro to move faster on spending control and market-friendly reforms, and the current administration led by Lula to take a more expansionary stance. That expectation is why sentiment responded so strongly to the first round. It describes how markets are pricing the event.

THE INTEREST RATE LINK: ONE FOOT ON THE ACCELERATOR, ONE FOOT ON THE BRAKE

Brazil's rates were raised for good reason. After the pandemic, inflation surged, peaking above 12% in 2022, and the central bank lifted the local rates (known as the Selic rate) from a record low of 2% in early 2021 to 13.75% in 2022. Inflation has been back near its target range since mid-2023. As of September, it stood at 4.6%, against a 3% target with a tolerance of 1.5 points either side. Yet rates never came down with it. The Selic has stayed above 10% since early 2022, nearly five years, and never fell below 10.5%. After inflation, real rates are near 9%, among the highest in the world. Under normal circumstances, most economists would agree that a rate cut is long overdue.

Interest Rates Remain High Despite Moderated Inflation



Source Brazil Central Bank and IBGE as of September 30, 2026. <https://www.bcb.gov.br/en/statistics> <https://www.bcb.gov.br/en/publications/focusmarketreadout> and IBGE <https://www.ibge.gov.br/estatisticas/economicas/precos-e-custo>. Data as of the date presented herein. Past returns are not a guarantee of future results. Graphs are presented for illustration purposes only and should not be relied on to make an investment decision



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What is stopping the central bank? Mainly the country’s budget. Brazil is driving with one foot on the accelerator and the other on the brake. Fiscal policy is the accelerator: government spending keeps demand, and inflation pressure, high. Monetary policy is the brake: the central bank has to hold rates up to offset it. Without a visible fix for the budget, the central bank is hesitant to cut materially, because it fears lower rates would unanchor inflation expectations, which remain above target. Although escalating global geopolitics and energy price concerns have raised further flags along the way, the key block to cutting rates is Brazil’s fiscal position. A credible fiscal adjustment, or even plan, would let the accelerator ease, allow the brake to release, and shrink the government’s interest bill as rates fall.

The easing cycle already began in 2026, but only just: five 25 basis point cuts in 2026, to 13.75% in September, after holding at 15% from mid-2025. It is a start. It is unlikely to be meaningful, deep or fast until the budget gives the central bank the confidence to act more decisively.

Years of higher rates inevitably ripple through the economy. Companies hold back on investment, and those that borrow refinance at punitive spreads. Households have borrowed anyway: a record 82% of families carry debt, debt payments take roughly 30% of income, and delinquency on household loans has hit record highs⁵. With companies cautious and consumers stretched, economic growth becomes more challenging.

THE FLOWS LINK: THE GREAT ESCAPE TO BONDS

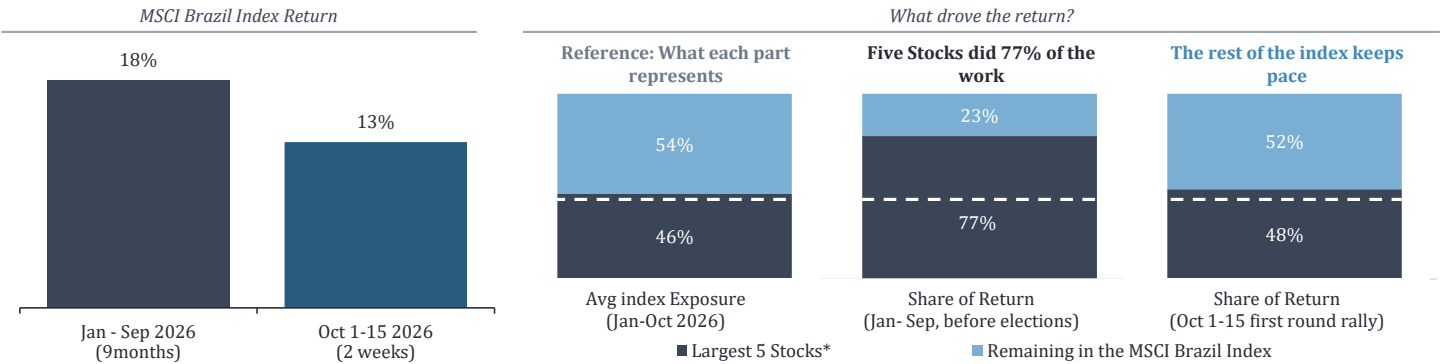
Lower rates tip the third domino: local savings. Brazilians have largely left their own stock market because bonds pay so well, and it is hard to blame them. If a money market product pays double-digit returns with almost no risk, why not park your savings there? There is little incentive to own risk assets when safe ones pay so much. Equity funds just represent 6% of fund industry assets, down from 15% in 2007⁶. That money returns when the carry becomes less attractive.

THE RESULT: A MARKET RE-RATING

Flows back into equities would lift the market and could trigger a meaningful rally. Brazilian stocks are so under-owned, and the tradable market so small, that a little flow can make a splash. The equity flows could come from two directions. Locals could rotate back into equities as rates fall, and foreigners could return because they see a better environment, with a stronger economic and investment outlook, lower debt burdens, and companies able to thrive without the hurdles they have worked around for years.

The first round offered a preview. In the first two weeks of October, MSCI Brazil gained 13%, nearly as much as in the previous nine months (18%), but this time the gains were broad. Before the vote, five stocks delivered 77% of the index’s return while representing 46% of the index’s exposure. The October rally, the rest of the index has contributed 52%, in line with its weight.

The first-round rally: nearly as big as nine months of gains, and this time it was a broad rally beyond the index heavyweights



Source: Bloomberg, and MSCI as of September 30, 2026. * Note 5 largest stocks exclude ADRs (in this case Nubank). Past returns are not a guarantee of future results. Graphs are presented for illustration purposes only and should not be relied on to make an investment decision



That is how a sentiment-driven rally starts, with the rising tide lifting all boats. But differentiation will surface. Who benefits most? Domestic-oriented stocks beyond the index heavyweights. Petrobras and the big banks have already led the market, helped by foreign money that flowed into Brazil's largest companies. The domestically oriented companies beyond those names were left behind, even though they are the most geared to an economic recovery and the rate story: real estate and housing, retail, smaller banks and domestic cyclical.

These stocks are also cheap. MSCI Brazil trades at an attractive discount to its 10-year average P/E, and the gap widens once the largest names in the index are stripped out. But cheap does not mean weak. Many of these companies are well run, led by strong management teams, and have survived years of punishing rates in a difficult economy. As conditions ease, they have the most room to catch up.

LESSONS FROM COLOMBIA AND PERU

Latin America's political pendulum swung left earlier this decade and has been swinging back in what many have called a receding pink tide. Chile, Colombia and Peru each chose a new government over the past year, and Brazil, the region's largest market, would solidify the story.

The market response is instructive. Colombia's equity market is up almost 50% this year, and its currency is about 15% stronger over the past year. Peru is up about 39% in dollar terms through September. Both rallied before and after their votes. Three lessons follow. Markets move before elections and judge delivery afterward. Currencies and rates react first, with stocks following. And the strength of a new government's support in the legislature matters more than the label on the winner. Brazil could do much more. It is far larger, it has far more room for rates to fall, 13.75% against 4.25% in Peru, it has a deep pool of local savings waiting in fixed income, and it is increasingly on investors' radar.

NAVIGATING THE FORK IN THE ROAD: WHY A LOCAL SPECIALIST IS BEST PLACED

The runoff is binary, and the opportunity and the risk arrive together. Two roads lead to very different market paths, and the vote is only the first test. What follows, the economic team, the first budget and the pace of reform, will decide whether cheap stocks stay cheap or re-rate. In an environment like this, the investor who knows the companies, not just the headlines, has the edge.

That edge is strongest beyond the index heavy weight names. A benchmark-driven approach will mostly own the heavyweights that have already rallied. The stocks with the most upside are smaller and less followed. The fact that valuations for these stocks are cheap can mean either overlooked or in trouble. A local specialist can tell the difference: which balance sheets are built to survive punishing rates and which depend on cheap refinancing, which management teams have proven they can allocate capital through a downturn, and where governance, tax or regulatory pitfalls sit. Those answers decide whether a low valuation is an opportunity or a trap.

Local expertise also helps with the fork itself. It means sizing positions so that neither outcome can do lasting damage, balancing rate-sensitive domestic names with businesses that hold up if rates stay high, keeping enough liquidity to act when volatility creates entry points, and stress-testing every holding against both roads. It also means reading Brazil's institutions, from coalition-building in Congress to the budget calendar and knowing how each step could reach specific sectors and companies.

CONCLUSION

Brazil's presidential election runoff on October 25 is binary and still uncertain, but the logic behind its impact is simple. The election shapes the fiscal path, fiscal credibility frees the central bank to cut rates that have been punishing for years, and lower rates draw savings back into a market they abandoned. Years of high rates have left domestic stocks cheap and under-owned, so flows meeting a small market can move prices quickly.

The risks are real. The race is tight, part of the first-round move is already priced, and if the reforms and budget disappoints the dominoes fall the other way. What happens after the vote, the economic team, the first budget and the coalition, will decide how much of the opportunity is realized. But the setup is asymmetric, and much of it sits outside the index heavyweights, in smaller domestic companies where deep local research makes the difference. The election will not fix Brazil's budget on its own, but it could start the process. The potential opportunity in Brazil is meaningful.



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¹ Source: MSCI and Bloomberg as of October 5, 2026

² Source: Brazil central bank as of August 30, 2026. Data as of the date presented herein. Past returns are not a guarantee of future results. Graphs are presented for illustration purposes only and should not be relied on to make an investment decision.

³ Source: J.P. Morgan LatAm Equity Strategy Reference Presentation (June 2026). Table shows the primary surplus, as a percentage of GDP, required to hold the debt ratio constant at each combination of debt level and real interest rate. Data as of the date presented herein. Past returns are not a guarantee of future results. Graphs are presented for illustration purposes only and should not be relied on to make an investment decision.

Debt / real rate	3.0	4.0	5.0	6.0	7.0
50%	0.5	1.0	1.5	2.0	2.5
60%	0.6	1.2	1.8	2.4	3.0
70%	0.7	1.4	2.1	2.8	3.5
80%	0.8	1.6	2.4	3.2	4.0
90%	0.9	1.8	2.7	3.6	4.5
100%	1.0	2.0	3.0	4.0	5.0

⁴ Source: Brazil Central Bank and IBGE as of September 30, 2026. <https://www.bcb.gov.br/en/statistics>
<https://www.bcb.gov.br/en/publications/focusmarketreadout> and IBGE <https://www.ibge.gov.br/estatisticas/economicas/precos-e-custo> .
<https://www.bloomberg.com/news/articles/2026-05-12/brazil-inflation-picks-up-again-nearing-top-of-target-ceiling> Data as of the date presented herein. Past returns are not a guarantee of future results.

⁵ Source: CNC, Brazil Central Bank and Agencia Brasil as of August 2026. <https://agenciabrasil.ebc.com.br/economia/noticia/2026-08/cnc-endividamento-das-familias-sobe-para-82-mas-inadimplencia-cai>

⁶ Source: Anbima as of September 2026



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