

## Pax Americana

March 2025

### Dear investors,

On January 20th, Trump assumed his second term as President of the United States and set off a management shock that is rattling the world. The attention is well justified. The American gross domestic product (GDP) accounts for ~25% of global GDP, the United States is the world's largest importer (USD 3 trillion), the second largest exporter (USD 2 trillion), and 58% of foreign exchange reserves are held in dollars. Beyond its economic relevance, the US is the political leader of the West and the world's greatest military power, responsible for ~38% of global defense spending.

Trump signed more than 70 *executive orders* in his first 45 days in office. Analyzing the impact of this set of actions is quite complex, both due to its breadth and because several orders may remain in effect only temporarily. The best we can do is seek to understand the philosophical thread behind these actions, imagine which scenarios this philosophy will likely lead us to, and investigate what risks may arise for our investments.

### Historical Context

The global geopolitics we are accustomed to was shaped after World War II, when the ideological dispute between capitalist and revolutionary communist countries emerged. The Soviet Union became a military superpower and aspired to convert the entire world to its political model, either militarily or by supporting communist revolutions in vulnerable countries. To counter this plan, the West created a large bloc of allied nations that would cooperate economically and militarily to defend the "free world."

On the economic front, the costs of the war had forced most countries to abandon the convertibility of their currencies into gold, which disrupted international finances and trade. The solution was the Bretton Woods Agreement, signed in 1944, which created a new international monetary system in which the US dollar would serve as the reference currency and maintain its convertibility into gold. Other currencies would have fixed exchange rates against the dollar, adjustable only in cases of imbalance. The Agreement also established the IMF and the World Bank, with the mission of supporting post-war reconstruction and the development of poorer countries.

In 1945, the UN (United Nations) was established with the goal of promoting international peace and security, fostering cooperation for economic, social, and humanitarian development, and defending human rights and fundamental freedoms. Originally, 51 countries were members. Today, the UN has 193 members and continues to serve as a major multilateral forum for discussing and coordinating efforts that transcend national borders.

On the military front, the main concern was preventing the Soviet Union from advancing into Europe, which had been weakened by the wars and divided among several countries far smaller than the Soviet Union. The defense strategy was the creation of NATO (the North Atlantic Treaty Organization) in 1949, a military treaty in which allied nations would cooperate to protect any member country that came under attack. Despite differences in military power among member states, NATO adopted the principle that each country's sovereignty would be respected and that major decisions would be made by consensus, so that no country would be compelled to act against its will.

All of these agreements were negotiated under strong American influence, as Europe was indebted by the costs of the war, faced with the arduous task of rebuilding its infrastructure, and unable to invest heavily in

defense and development. The United States, far less affected by World War II and already the world's largest economy, took on the bulk of the burden of protecting and developing the West. Through its navy, the US began guaranteeing the security of maritime trade routes worldwide to enable the growth of international commerce (before the war, cargo ships risked being attacked by pirates or rival nations' navies), and engaged in wars far from its own territory, such as the Korean and Vietnam Wars, to prevent the advance of the communist bloc. The trade-off for all these initiatives — borne by the United States and beneficial to all allied countries — was maintaining the dollar as the global reserve currency, turning many countries into creditors of the American government.

This arrangement persists to this day. The United States still bears the largest share of NATO's military budget, accounting for ~70% of defense spending despite representing ~50% of the total GDP of member countries; the dollar remains the primary international reserve currency; and international relations among Western countries still follow the tradition of making major decisions multilaterally.

### **Where Does “America First” Come From**

The foundational principle behind Trump's policy changes is “America first.” Trump argues that the United States is in an unnecessarily disadvantaged position in various international agreements, subsidizing other countries in trade relations, bearing disproportionately high defense spending, and funding numerous projects around the world without any return for Americans.

Any high-impact political act tends to have deeper roots than press conferences suggest. There are enormous teams of politicians and experts debating the best course of action, from their perspective, before the conclusions of that internal process reach the public through the political leader who acts as the group's spokesperson. With that in mind, what analysis could result in the “America first” principle? One possibility is the interpretation that the geopolitical order designed after World War II is no longer suited to the current situation.

During the Cold War, the great question was which economic and social model would prevail in the world. If the United States stopped helping Europe and underdeveloped countries, they would be vulnerable to the influence of the Soviet Union's communist revolution. If communism spread across the entire world, at some point the communist bloc would become militarily superior to America and would dominate it. Under that threat, sustaining the West's military defense and offering aid to underdeveloped countries was not an act of American altruism — it was a strategy of self-preservation. Today, the picture is quite different.

After the fall of the Soviet Union, there is no longer a dispute over which economic model is superior. Russia itself opened its economy and adopted market dynamics similar to those of Western capitalism. The popular appeal that the communist promise of prosperity for all once carried no longer exists. The main difference today is in the political model: while the West remains predominantly democratic, Russia and China — the new Eastern superpower — are governed by authoritarian regimes, legacies of the revolution made under the communist promise.

The authoritarian model of government has far less potential to spread through popular support, and military expansion today is unlikely in highly strategic territories due to the existence of nuclear arsenals, which have created the dynamic of Mutually Assured Destruction: if one nuclear power were to attack another with atomic bombs or with excessive aggression, the act would trigger a nuclear war leading to the annihilation of both sides. The possibility of this catastrophic outcome acts as a barrier against major conflicts between superpowers.

Today, the Western way of life seems far less threatened by Eastern powers. This interpretation, combined with the fact that the United States currently holds USD 36 trillion in public debt, may have led Republicans

to question whether it still makes sense to maintain the military protection policies and subsidies offered to other countries since the Cold War.

## **Main Actions of the Trump Administration on the Economy**

The United States today faces a fiscal problem. In 2024, the American fiscal deficit was USD 1.8 trillion, equivalent to 6.4% of GDP, and the American debt of USD 36 trillion equals 124% of GDP (by comparison, Brazil had a fiscal deficit of 8.4% in 2024 and ended the year with a debt of 76% of GDP). The American fiscal situation has been deteriorating rapidly since the subprime crisis in 2008. Before that, at the end of 2007, the American debt stood at 63% of GDP — nearly half the current level. As a result, there are growing discussions about the sustainability of the dollar as the global reserve currency.

The Trump administration's response has been a plan to reduce public spending through the Department of Government Efficiency (DOGE — for those interested, we recorded a discussion on the topic, available at [this link](#)), and a prioritization of American economic development through deregulation projects and the abandonment of environmental agendas. An illustrative example is the return of incentives for fossil fuel exploration to lower American energy costs, announced by Trump under the mantra “drill, baby, drill.”

In international trade, the United States has announced that it will increase import tariffs on goods from various countries, under two principles. The first is reciprocity, with American import tariffs being aligned to the tariffs other countries charge on American products. The second is the use of tariffs as a pressure instrument in specific situations, such as in the case of countries that refused to take back illegal immigrants deported from the United States.

The tariff issue is quite delicate. While many countries denounce this measure as protectionist, almost all of them adopt similar measures themselves. In cases where the tariff increase is based on reciprocity, we find it difficult to argue why the imbalance should continue. There are three possible scenarios for each bilateral relationship.

The first is that the affected country simply accepts the new tariff and adapts its trade relations with the United States to the new reality. In this case, American inflation would increase alongside the federal government's tax revenues. Under Trump's proposal, this increase in revenues would be used to reduce the public debt and, subsequently, to lower the American tax burden. Ultimately, the result could be a shift in the source of tax collection toward tariffs and greater protectionism for American industry.

The second is that the affected country negotiates with the United States a reduction in its own import tariffs to prevent its exports from being impacted by the American tariff increase. This would tend to boost American exports to that trading partner and thus stimulate domestic industry. American revenues would increase due to the growth in export volumes, but the impact tends to be more limited.

The third scenario is that the United States and the affected country enter a trade war and escalate tariffs to levels higher than those currently practiced by both countries. This would lead to a reduction in bilateral trade flows and would tend to harm both countries.

The final outcome of Trump's tariff policy is impossible to predict because it depends on each country's response. We believe the first two scenarios are more likely than the third, since trade wars, being harmful to both sides, tend to be temporary and to end with the negotiation of some more beneficial agreement.

In general, what we have seen in the Trump administration's recent actions is a pragmatism well known in the business world. There is considerable noise in the announcements — amplified particularly by Trump's style — but it seems to us that the strategy is to comb through the major existing agreements in search of terms that can be improved. These efforts are likely to bear fruit, even if below expectations, and the final impact on the American economy is likely to be positive.

## Shift in Geopolitical Strategy

For the past 80 years, since the post-war treaties were designed, the United States had been leading the West through the dynamics of multilateral negotiations and collaboration with allied countries. Now, the Trump administration appears to be breaking with that tradition and pursuing unilateral strategies that prioritize American interests over a shared worldview with allied nations.

The central issue in this sphere is the war between Ukraine and Russia. Since its outbreak in 2022, the stance of NATO member countries has been one of solid support for Ukraine. They stopped short of sending their own combatants, to prevent the conflict from escalating into what could become World War III, but they financed the war and supplied military equipment that has allowed Ukraine to hold out against Russia to this day. The main reason for this support is to prevent a precedent being set for territorial expansion into Europe through military action, which could lead Russia to advance into additional territories in the future.

Trump arrives with a different interpretation. He believes the United States is financing a war far from its own territory, with no immediate benefits for Americans, and that the best solution is to negotiate an end to the war — even if the principle of not allowing any territorial expansion through military force is not fully preserved. Ukraine, and European countries in general, accuse the United States of betraying the NATO mutual defense agreement, and the Trump administration retorts that allies are taking advantage of the disproportionate American support to prolong a war that is not in their economic or humanitarian interest.

The United States is also distancing itself from the European bloc on other issues: it withdrew from the WHO (World Health Organization), withdrew from the Paris Agreement (on combating global warming), and sharply criticized the immigration policies adopted by Europe over recent decades.

The path the Trump administration appears to be charting should drive the development of the American domestic economy and improve its fiscal balance, but it is also likely to shake political relations with Europe, at least in the near term. How these relations will evolve is unpredictable. If Europe predominantly elects right-wing governments in its upcoming elections, a realignment of European countries with the United States may occur. Otherwise, Europe may become a less aligned bloc for a longer period of time.

There is also an expansionist tone in Trump's statements. Some acts are merely symbolic, such as renaming the Gulf of Mexico the Gulf of America, but the ideas of incorporating Canada and Greenland and retaking control of the Panama Canal signal practical intentions to expand, if not American territory itself, then at least the zone under strong American influence.

The intention may seem strange in modern times, but this expansionist impulse is the standard behavior of empires throughout history. The Macedonian Empire of Alexander the Great was born in Greece and expanded all the way to northwestern India (and only stopped due to Alexander's premature death from illness). The Roman Empire was born in present-day Italy and came to dominate nearly all of Europe and the other territories bordering the Mediterranean Sea. The Mongol Empire of Genghis Khan was born in Mongolia and came to dominate almost all of Asia. Portugal and Spain launched the Age of Exploration to expand their territories to lands beyond the Atlantic Ocean. The British Empire, at its height, had more than 70 colonies. Present-day China and Russia also behave as empires.

The multilateral geopolitics established after World War II and followed by the United States until now is what constitutes an exception in the longer historical arc. It would not be surprising if the United States began to exercise its power and influence more overtly, as past empires did and as other current empires still do.

Even if this is the path taken, it is still difficult to predict whether the results will be good or bad for the world. There have been both tyrannical and virtuous empires. There is also the fact that, in the modern democratic world, everything can change in the next election.

## **How Brazil May Be Affected**

Our country is a secondary player in global geopolitics. We are not involved in military conflicts. We do not participate in technological races. We are simply a large commodity-exporting country, with a peaceful people always occupied with their own internal problems. We are certainly not a threat to the United States and should not occupy the list of strategic priorities on the American agenda.

Of Brazil's exports, 12.0% go to the United States, while 28.5% go to China, our main trading partner. Of imports, 15.5% come from the United States and 24.6% from China. Furthermore, foreign trade represents only 25-30% of Brazilian GDP, compared to a global average of 50-60%. In other words, the impact of any potential increase in American tariffs would not be catastrophic for Brazil. It is not even clear whether we will be the target of any American protectionist measures, as Brazilian exports to the United States are predominantly mineral and agricultural commodities.

Should other countries' relations with the United States deteriorate, the effect for Brazil could be positive. If, for example, the United States and China enter into a trade war, a portion of Chinese exports would be redirected away from the Americans to other trading partners, causing the prices offered to the rest of the world to fall, while American inflation would rise. China could also decide to purchase products it currently buys from the United States from other countries instead. For example, China buys ~USD 15 billion in soybeans from the United States annually. Part of that demand could shift to Brazil.

Another effect could be the weakening of the dollar due to a reduction in dollar-denominated international reserves held by other countries. Today, roughly 30% of dollars in circulation are held as international reserves, so a potential reduction in those holdings could have a meaningful impact on exchange rates. Some countries are already increasing their gold reserves, motivated by these geopolitical concerns.

There is also a potential indirect impact from the new American policies. If the fiscal austerity being implemented there yields positive results for the United States, the case could become an example for other countries facing the same problem of fiscal deficits and rising debt. At the risk of being yet another wishful hope, perhaps the Brazilian government elected in 2026 will implement its own austerity plan and rebalancing of public finances.

## **Risks for Investments**

The most obvious risk lies in companies that depend on exports to the United States, as any increase in tariffs could suddenly affect their export volumes. If the tariffs are maintained over the long term, there would be the possibility of relocating production to American territory to avoid import duties, but this would likely entail increases in production costs, and demand from the United States could be reduced regardless.

Should Brazil enter into a trade war with the United States and raise import tariffs as a form of retaliation, companies dependent on American inputs would see their costs increase, potentially losing sales volume due to price pass-throughs or having to absorb part of those extra costs, reducing their margins. Trade wars with other countries could also harm Brazilian companies by redirecting products previously destined for the United States to Brazil at low prices, increasing competition with domestic industry and squeezing margins.

Another point of attention is the possibility of dollar depreciation mentioned above, which could affect dollar-denominated investments and, again, companies that export to the United States. Note that the dynamics of a dollar decline in this case would be different from what we typically observe in Brazil. Generally, it is the weakening or strengthening of the real against other currencies that drives the dollar's variation for us. In the case of the dollar weakening against other currencies, commodities priced in dollars, for example, would not necessarily become cheaper for Brazil. Their prices could rise in dollar terms at the same time that the USD/BRL exchange rate falls, neutralizing the practical effect. In other words, we might not see meaningful benefits from this dollar decline, beyond the cheapening of imports made directly from the United States.

This exchange rate risk should be considered with caution, as the strengthening of the American economy and fiscal balance could act in the opposite direction and appreciate the dollar. In the event of geopolitical turbulence, its effect is likely to be more immediate than that of economic strengthening, so we could see an initial depreciation followed by a recovery.

Despite these comments, our philosophy is not to invest based on projections of complex scenarios. We prefer to avoid the uncertainties tied to that degree of complexity and to keep our portfolio in simpler, more straightforward theses. Today, our portfolio companies depend primarily on domestic markets and are outside the line of fire of potential trade wars. We see a low risk that our investments will be harmed by the changes brought by the Trump administration thus far.