"NOTHING IS MORE OBSTINATE THAN A FASHIONABLE CONSENSUS"[1]

The 20th century is deservedly regarded as The Age of Extremes[2] - on one hand marked by shortsighted nationalism, on the other by mass democracy. It was the century of totalitarianism, but also of science and technology. Liberalism, though not legitimized as a universal ideology, was acclaimed as the big survivor of a century laden with experimentation within the political and social fields.

The path was not linear. Flirtations with interventionism and the belief in the State as a protagonist were present during most of this time period. In the Soviet Union, the State took a central role as the sole organizer of economic and social affairs, promising to hold the key to a more equitable development. In return, the reaction of liberal humanism was centered on a market economy with heterodox interventions. The Soviet example, coupled with the crippling crisis of 1929, led even the United States, a bastion of liberalism since its founding fathers, to incorporate into its national project a greater participation of the government. In the case of the U.S., the federal government became present mainly in social/humanitarian[3] activities and in large infrastructure projects[4].

In the Latin periphery of the Americas, governments initiated a more complex movement where the State was to intervene in the economy as an inducer of development, setting up banks and managing entire industries. In Brazil, Getúlio Vargas represented the creed of "Developmentalism" until the Military Intervention of 1964[5]. But it was the military government which effectively leveraged the State as the principal driver of the economy's capital allocation process. The intervention in the production of goods and services peaked during this period, and in 15 years approximately 300 state-owned companies[6] were founded.

The multiple oil crises of the mid-1970s jolted the capitalist countries involved with the statist playbook and only then did the interventionist utopia start to be questioned. It was reality colliding with the utopian ideology borne by a generation of western baby boomers who believed centralized governments would save us from the collapse of an egotistical and unequal humanity.

At the beginning of the 1980s, Ronald Reagan and Margaret Thatcher rose to power in the United States and in Great Britain; both strong proponents of a liberal agenda for a western economy that a few decades earlier had almost succumbed to more autocratic alternatives[7]. The tax structure was simplified and government's size reduced. The idea that when privatizing a company the profit-seeking behavior should lead to cost cuts and subsequent productivity gains, was pivotal to the resumption of the liberal agenda. In one representation of this playbook called "Washington Consensus"[8], it was understood that a government less involved in the production

[1] Margaret Thatcher
[2] Eric Hobsbawm
[3] Mostly social welfare systems initiated in the country in 1935 with the signing of the Social Security Act by President Roosevelt. More information at http://bit.ly/2vuPEy2
[4] Such as in the construction works managed by the Public Works Administration created by the New Deal
[5] Getúlio was responsible for the creation of: (i) Companhia Vale do Rio Doce and CSN (in his first mandate), and (ii) Petrobrás and BNDE (in his second mandate)
[6] For more information, please see: "O Estado da Arte da Avaliação de Empresas Estatais," by Hamilton Luiz Corrêa
[7] As in every cycle, the 180-degree turn in the economic policy of developed countries in the western world seems to have been hyped too far. Since the 2008 crisis, embarrassment in questioning the current model has diminished. A general critique is available at https://read.bi/2MdiXvW
[8] The "Consensus" encompassed 10 economic pillars that would help Latin American countries solve the significant debt problems plaguing them in the 1980s. It was formally brought to light by John Williamson in 1989 at the Institute for International Economics in Washington, D.C.

of goods and services had greater capacity to focus on activities that level the access to opportunities (education, health and public security), all of which central to the correct functioning of social democracy and therefore the market itself.

The global success of privatization initiatives influenced Brazil, culminating in the sale of Usiminas in 1991[9]. Since then, the process spread to other industries and climaxed with the privatization of the utilities sector, - starting with the auction of Escelsa in 1995, - the concession of federal roads, and the sale of the telecommunications segment.

"THERE ARE MORE THINGS IN HEAVEN AND EARTH, HORATIO, THAN ARE DREAMT IN YOUR PHILOSOPHY"[10]

Since the enactment of the 1988 Federal Constitution, Brazil has been experiencing a structural problem of growing expenses. Government spending in relation to GDP (excluding transfers to states and municipalities) rose from approximately 11.1% in the early 1990s to nearly 16% at the end of the administration of president Fernando Henrique Cardoso[11].

Recently, the Lula[12] and Dilma administrations doubled down on "Developmentalism"[13]. The illusion of wealth created by the rise in the price of commodities during this period enhanced the government's managerial proactivity, removing budgetary discipline from the government's list of top priorities. Our structural problems seemed irrelevant and the path towards the developed world just a matter of time.

Unfortunately, the principle devised by Japanese businessman Akio Morita, Sony's president for decades, went unheeded: "Three things matter for development: grey matter in the brain, deepwater ports, and a threat to survival." Japan, formerly a fishermen's village devoid of natural resources and devastated by World War II, is an example of resilience. The threat of extinction aligns priorities, creates a boost of energy and stymies dangerous economic experiments.

In Brazil, complacency mixed with excessive fearlessness were ingredients for an unprecedented debacle. Heterodoxy was practiced on the most diverse occasions, with little attention paid to distortions in incentives. The list of "economic favors" is long: discretionary tax breaks, breached regulatory frameworks in consolidated industries, interest rate cuts without the appropriate compensatory fiscal policy, multibillion-dollar capitalizations of state-controlled banks, subsidized credit for higher education, price controls via the State apparatus, indiscriminate lending to states and municipalities, and more. It was not surprising that the GDP, unrealistically inflated, plummeted 8% in two years, bringing the government primary deficit to a negative 2.5% in 2016[14].

Adding to this situation the unsustainability of the current welfare regime, a so-called "management shock" is a pre-condition for anyone who ends up heading the country. For now at least, the ghost of economic volunteerism recently represented by our friends from Unicamp[15] seems distant.

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[9] It is worth noting the famous photo where a unionist kicks an investor at the Usiminas privatization auction https://glo.bo/2KnIbWS
[10] Hamlet, William Shakespeare
[11] Currently this number is hovering at around 20% of GDP
[12] Especially during his second term
[13] This occurred amid an environment in which any additional tax increase was difficult, given that the tax burden had jumped from close to 20% of GDP in 1988 to about 35% in 2010
[14] From an average surplus of 3.5% during the first term of President Lula
[15] University that simbolizes heteredox economic thinking in Brazil

Latin American history is shrouded in governmental activism. While at risk of wearing the "costume of hope", we believe that the doses of intervention might be small during this new cycle. Even if the elected candidate eventually becomes aligned with heterodox economic thinking, the space for tinkering is limited.

"MANUAL DEL PERFECTO IDIOTA LATINO-AMERICANO"[16]

Part of Brazilian society views subsidized loans and state-controlled companies as important to increase gross fixed capital formation. We have heard multiple times that the Lula administration raised investment and consumption. However, in order for investment to result in long-term growth it needs to be productive, contrary to what happened during PT's administration.

What happened to Petrobras is a clear example of the damaging effects an incompetent state management might produce. The company reached US$40 billion in annual investments following the discovery of the pre-salt oil fields, at a time when a barrel of oil cost more than US$100. Simultaneously, the government controlled local market prices, resulting in stagnated production and a debt level that almost steered the company to bankruptcy[17].

Petrobras invested heavily under a policy framework that required all procurement to be done nationally, thus stimulating the local supply chain to try and service the artificially created demand. Little attention was paid to potential side effects. Local companies were not able to comply with the new requirements, causing delays and higher-than-expected costs[18]. At the end of the cycle, when Petrobras was forced by reality to cut CAPEX by more than 60% to under US$15 billion, all this accessory industry collapsed.

Economic dirigisme is almost always preceded by one's (generally false) belief in the existence of something akin to superior strategic thinking when it comes to economic affairs. However, even if experience has demonstrated the foolishness of such ethereal creeds, once created they tend to sustain themselves as collective utopia[19]. For example, the government typically earns 60%-70% of the operating profits of big oil fields[20]. Wouldn't it be better to have a large number of companies investing and eventually paying more taxes perennially than to sponsor opaque, state-controlled companies in the name of an antiquated sense of national interest?

Privatization is not the solution to all problems. There are several examples of bad allocation of private capital. The difference is that in the private sector, with a diversity of companies operating in the same industry[21], if one agent misallocates capital structurally, that same agent will end up losing business to more efficient players. However, the more concentrated an economy is, the greater the negative impact that might be effected by a single unproductive company. In our view, the goal of the policymaker should always be, before any other noble consideration, to diminish the risk of future capital misallocation.

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[16] Title of a 1996 book by Álvaro Vargas Llosa, Carlos Montaner and Plinio Apuleyo, critical of the victimization tactic utilized by the Latin American left to justify local backwardness

[17] Petrobras's net debt rose from U$36.7 billion at the end of 2010 to U$100.4 billion at the end of 2015. In the same period its oil production in Brazil rose just 6%: from 2,004 million barrels a day to 2,128 million. For comparison purposes, the company's 2011 strategic plan forecasted production in 2015 at 3,070 million barrels a day, a volume 44% greater than actually delivered

[18] Sete Brasil, an extreme example of this situation, went bankrupt. Not to mention the emblematic (and overpriced) delays in construction works such as the Abreu e Lima refinery and the Comperj petrochemical complex

[19] Bolstered by manipulative propaganda, such as the old and often rehashed slogan: "O Petróleo é Nosso" ("The Oil is Ours")

[20] The government's share includes: signing bonus, royalties (5 to 10% of revenue), special participation (10 to 40% on net production value), and income tax (34% on pre-income tax profit)

[21] Or at least facing threat of external competition

Again – the errors in capital allocation explain to a large extent the size of Brazil's recent crisis. It is not only a matter of the relative size of public debt to GDP, nor about the lack of confidence in fiscal accounts. From 2002 to 2003, for example, Brazil's CDS[22] hit more than 3,500 points and for one whole year remained above 1,000 points while GDP remained unchanged. In the current crisis, the country's CDS didn't even reach 500 points and nonetheless GDP retreated by 8%.

Just like the emblematic capital destruction that went on in the oil sector, an enormous sum of wealth was equally destroyed in various industries, such as: the auto sector, real estate (influenced by the active management of Caixa Econômica Federal), sugar and ethanol, to name a few. Business leaders invest when they foresee demand. They do not consider that the ongoing expansion is based on continued government spending that will slowly lead to a deterioration of fiscal accounts and an excessive expansion of credit.

The debate around the country's inability to gain productivity during the past 15 years has become commonplace. Brazil has multivariate problems in regulation, corruption and violence, limiting the economy's capacity to gain efficiency. However, it is worth noting that many countries face similar challenges and yet managed to raise per-capita income at faster rates in the past decade[23].

In our view, one should not minimize the influence that PT's excessive tinkering with the economy exerted over Brazil's disappointing performance in the past few years. Capitalism only works appropriately when the cycle of creative destruction is allowed to unfold. When the government artificially sustains demand, confining labor and credit to unproductive investments[24], good projects are crowded out.

"CHANGE IS INEVITABLE. CHANGE IS CONSTANT"[25]

For the first time in a very long while we see state-controlled companies making sensible decisions. Petrobras changed it pricing policy, sold assets and cut costs[26]. Eletrobras is trying to sell subsidiaries, has implemented a large-scale incentivized retirement plan and is now discussing long-term funding solutions. Banco do Brasil has rationalized its credit-concession model and corrected old procedural distortions.

As described in the outlook at the beginning of the letter, interventionism in economic and social policies have a beginning, middle and end. We are exiting a cycle in which heterodoxy had again established itself as the only solution to the nation's social ills. For a while it seemed very expensive to leave this system given the social costs of adjusting artificially low prices, increasing interest rates, and generating short-term unemployment. However, after the 2014 elections, it also became extremely clear that there is a huge medium-term cost associated with implementing an economic policy excessively based on the discretionary participation of the government.

The current economic conditions are still reflected in an unemployment rate near 12% and a rate of inflation that has stayed stubbornly below its target. It would make little sense to revert to a model heavily borne by the state apparatus. We have no doubt that humankind's potentiality for ignorance and madness is infinite. However, a

[22] Credit Default Swap – Contract that transfers credit risk between parties. The swap buyer pays the seller until the security's maturity. If default occurs during this time period, the seller is obliged to bear with the principal and interest owed until maturity. The higher the institution's credit risk is, the higher the premium paid for its CDS

[23] For more information, see: "A Década Perdida" ("The Lost Decade"), 2003-2012, by Vinicius Carrasco, João M. P. de Mello and Isabela Duarte at http://bit.ly/2LWRC4k

[24] It is worth noting that during this whole period BNDES was capitalized by the Brazilian Treasury by more than R$500 billion

[25] Benjamin Disraeli - Writer, aristocrat and prime minister of the United Kingdom twice during the second half of the 19th century

[26] In complex adaptive systems such as an economy a strong reaction might occur when entrenched practices such as subsidies for a determined class are altered. However, irrespective of the short/medium term obstacles, the change in direction that seems to be budding, is far more important

more orthodox economic policy has never been so cheap. The implementation of a more liberal playbook will probably bear fruit for the president elect, crowning him, irrespective of ideological affiliation, as the nation's grand savior.

This snapshot leads us to question the traditional prejudice concerning government-controlled assets. With the previous cycle still fresh in everyone's minds, and a population quite tired of seeing public companies utilized for political purposes, future capital allocation should improve.

Our increased tolerance towards investing in state-controlled companies, which stems from a more constructive view concerning the current political-economic cycle, inevitably makes us rethink the odds of success and failure of such investments. However, this by no means changes the fact that the potential loss of these investments in a negative scenario remains extremely high.

When expected returns still ponder very depressed states of nature, we generally prefer to lose opportunity rather than to incur the risk of effective loss of capital. Notwithstanding, we expect our preemptive diligence makes us ready to alter course as visibility increases.

In the meanwhile, we have decided to live by Howard Mark's recent mantra[27] (altered for our purposes): "(When dealing with public companies facing managerial restructurings)[28] move forward, but with caution."

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[27] Developed during the period of Quantitative Easing, when the yields on Junk Bonds flattened excessively, but there were specific pockets of outsize returns

[28] Alteration by Atmos

ATMOS AÇÕES FIC FIA

July 2018

Atmos CAPITAL

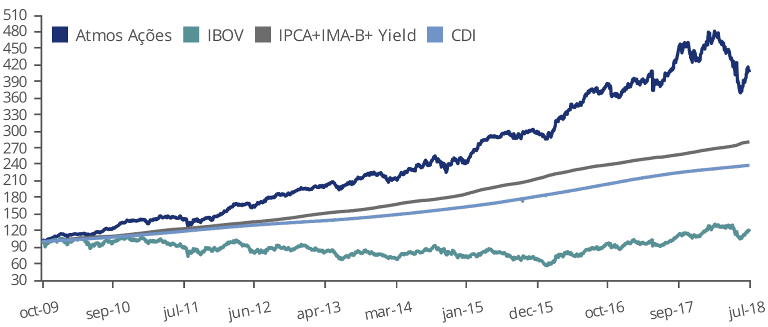
HISTORICAL PERFORMANCE

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2009	Atmos Ações										-0,04%	5,91%	5,74%	**11,95%**
	Ibovespa										-7,73%	8,94%	2,30%	2,83%
2010	Atmos Ações	-1,40%	1,42%	1,65%	0,07%	0,16%	1,67%	6,52%	0,15%	5,31%	4,13%	1,83%	0,66%	**24,23%**
	Ibovespa	-4,65%	1,68%	5,82%	-4,04%	-6,64%	-3,35%	10,80%	-3,51%	6,58%	1,79%	-4,20%	2,36%	1,04%
2011	Atmos Ações	-2,26%	2,42%	4,07%	0,37%	-0,12%	-0,60%	-2,26%	-2,80%	0,04%	3,63%	0,30%	3,76%	**6,42%**
	Ibovespa	-3,94%	1,21%	1,79%	-3,58%	-2,29%	-3,43%	-5,74%	-3,96%	-7,38%	11,49%	-2,51%	-0,21%	-18,11%
2012	Atmos Ações	4,40%	6,71%	0,46%	2,07%	-2,31%	3,42%	4,00%	0,95%	2,65%	-0,06%	3,06%	2,73%	**31,61%**
	Ibovespa	11,13%	4,34%	-1,98%	-4,17%	-11,86%	-0,25%	3,21%	1,72%	3,71%	-3,56%	0,71%	6,05%	7,40%
2013	Atmos Ações	-0,09%	1,94%	1,43%	0,90%	1,34%	-3,34%	2,51%	1,29%	3,43%	4,19%	1,46%	-0,46%	**15,39%**
	Ibovespa	-1,95%	-3,91%	-1,87%	-0,78%	-4,30%	-11,31%	1,64%	3,68%	4,66%	3,66%	-3,27%	-1,86%	-15,50%
2014	Atmos Ações	-6,19%	1,73%	3,74%	1,59%	0,92%	3,24%	1,07%	6,59%	-5,96%	0,54%	4,85%	-0,28%	**11,58%**
	Ibovespa	-7,51%	-1,14%	7,05%	2,40%	-0,75%	3,76%	5,01%	9,78%	-11,70%	0,95%	0,17%	-8,62%	-2,91%
2015	Atmos Ações	-2,61%	8,87%	4,96%	2,97%	0,56%	0,65%	2,90%	-3,17%	0,06%	2,68%	-0,18%	-0,87%	**17,50%**
	Ibovespa	-6,20%	9,97%	-0,84%	9,93%	-6,17%	0,61%	-4,17%	-8,33%	-3,36%	1,80%	-1,63%	-3,92%	-13,31%
2016	Atmos Ações	0,17%	3,91%	5,37%	4,18%	2,09%	2,14%	6,02%	0,81%	-1,53%	4,32%	-4,54%	0,93%	**26,04%**
	Ibovespa	-6,79%	5,91%	16,97%	7,70%	-10,09%	6,30%	11,22%	1,03%	0,80%	11,23%	-4,65%	-2,71%	38,93%
2017	Atmos Ações	2,97%	2,31%	0,51%	1,64%	-3,59%	1,32%	3,54%	4,94%	4,96%	0,28%	-4,32%	5,05%	**20,85%**
	Ibovespa	7,38%	3,08%	-2,52%	0,65%	-4,12%	0,30%	4,80%	7,46%	4,88%	0,02%	-3,15%	6,16%	26,86%
2018	Atmos Ações	5,96%	-0,36%	-2,44%	-3,97%	-7,89%	-7,41%	7,42%						**-9,38%**
	Ibovespa	11,14%	0,52%	0,01%	0,88%	-10,87%	-5,20%	8,88%						3,69%

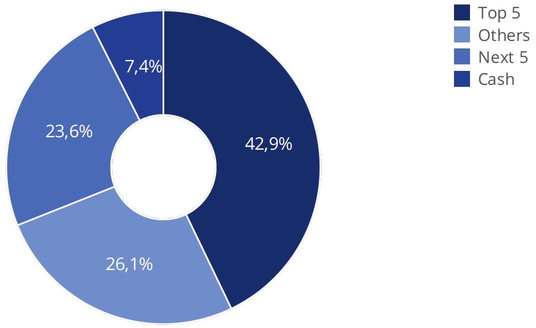
	Year		12M		24M		36M		60M		Since start*	
	Profitability	Volatility	Profitability	Volatility	Profitability	Volatility	Profitability	Volatility	Profitability	Volatility	Profitability	Volatility
Atmos Ações	-9,38%	17,23%	0,61%	16,01%	9,26%	14,45%	35,89%	13,08%	99,50%	12,36%	306,76%	11,53%
Ibovespa	3,69%	20,39%	20,18%	18,86%	38,24%	20,27%	55,75%	23,01%	64,24%	22,95%	18,77%	22,66%

PS: Historical performance in R$, net of all fees. Volatility calculated only to trading days.
*The fund started in: October 15th, 2009

PERFORMANCE CHART



PORTFOLIO CONCENTRATION



PORTFOLIO

Breakdown by Sector	%
Consumer Discretionary	15,6%
Consumer Staples	12,1%
Energy	4,0%
Financials	22,9%
Health Care	2,2%
Information Technology	0,4%
Real State	14,2%
Utilities	21,1%
Cash	7,4%

Cap Size		% Portfolio
Small	under R$1bi	0,72%
Medium	from R$1 to R$10bi	46,13%
Large	above R$10bi	53,15%

Liquidity	% Portfolio
Cash	7,4%
> 10 MM	75,9%
3 MM a 10 MM	11,2%
1 MM a 3 MM	5,4%
< 1 MM	0,0%

Obs: Average trading volume of the last 20 days.

NAV	R$
Current NAV / Average NAV - FIC FIA**	506,0MM / 605,1MM
Current NAV / Average NAV - Master FIA**	2.536,4MM / 2.670,4MM
Total AUM***	4.466,7MM

PS: Average NAV last 12 months

ADDITIONAL INFORMATION

Inception Date:	15/10/2009
Minimum Investment:	R$50.000,00
Minimum Subsequent Orders:	R$10.000,00
Minimum Balance:	R$20.000,00
Subscription Day	NAV of the following business day
Redemptions	13 days after redemption date (NAV of the 10th business day after request)
Income Tax:	15% tax over nominal returns
Bloomberg:	ATMOSAC <BZ><Equity>
Bank Account:	BNY Mellon Banco S.A. | Ag 001 | C/C 1208-4

Management Fee:[1]:	2,0% a.a. of fund's NAV
Performance Fee:	10% of returns exceeding IPCA+IMA-B Yield* payable annually with high water mark. (*) Detailed description on memorandum.
Manager:	Atmos Capital Gestão de Recursos Ltda.
Administrator[2]:	BNY Mellon Serviços Financeiros S.A.
Prime Broker:	BNY Mellon Banco S.A.
Auditor:	Deloitte Touche Tohmatsu Limited
ANBID Class:	Ações Livres
Fund's CNPJ:	11.145.320/0001-56

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