"THERE ARE NO ATHEISTS IN TRENCHES, *NOR IDEOLOGUES IN A FINANCIAL CRISIS*"[1]

Lenin was accurate in defining history as a boring monotony followed by bouts of unrest and turbulence[2].

Capitalism, due to its inherent characteristics, unfolds through a winding path and, in most cases, feeds the concentration of wealth. The march in this direction is natural, or even inevitable. Periodically, this movement is eased by a pacific and political redistribution, usually after economic crises. This happens through a mixture of tax hikes, increased government spending, antitrust regulation, among other factors. Nevertheless, sometimes exogenous shocks intensify previous imbalances, making the expected itinerary rather uncertain.

For the past 10 years, the global financial market enjoyed low volatility. Despite small obstacles along the way, assets have steadily risen in prices each day and the higher they rose, the greater the sense of safety in the world economy. Any hint of skepticism or insecurity was quickly dismissed by the image of caring Central Banks willing to fulfill on their promises of protection[3]. To everyone's amazement, all of this would suddenly end in a single week.

This party was coming to end on February 28, 2020. A week that ended with most of the global indices falling by more than 10%, the sharpest weekly decline since the 2008 crisis. Pari passu, the 10-year US Treasury immediately plunged to record lows, signaling the potential end of a global cycle of rising stock prices that had lasted since the end of the Great Recession.

The grinding halt of the long-lived rally caused an across-the-board crash, and as market agents tried to make sense of the impact of the coronavirus on the prospective returns of their portfolios, they were repeatedly surprised by sequential declines and by a number of circuit breakers that hindered their decision making.

This significant decline in the market hit us at a constructive moment in relation to both the country's economy and, especially, towards local companies' prospects. After a long and dark winter, Brazil was heading - not out of predestination, but out of merit - towards an economic recovery coupled with low real interest rates in all tranches of the curve. Something completely unusual in the country of rent seekers. In turn, the surviving business were positioned to finally reap the benefits of operational leverage. As a result, we entered this acute crisis without protection and with minimum cash.

We always see ourselves as value investors with expertise in Brazilian equities. At Atmos, the choice to not invest in this asset class implies a strong opinion about a disconnect between prices and fundamentals in the local market. During the fund's initial years, we found significant asymmetries among asset classes in Brazil. In this period, the opportunity to allocate capital in good businesses and navigate through different instruments reduced the risk of permanent loss to the portfolio, while still delivering a good result. The limited drawdown and low volatility were unexpected but pleasant byproducts. In other words, we were somewhat heterodox when orthodoxy in Brazilian equity investments seemed to us excessively rigid to allow the correct expression of our

[1] The italicized section refers to an addition by economist Jeffrey Frankel to the original phrase by US WWII veteran William Thomas Cummings

[2] Taken from the original phrase by Lenin: "There are decades where nothing happens, and there are weeks where decades happen"

[3] Reasserted by the most recent mantra from the Central Banks: "We'll do whatever it takes"

views on the portfolio. An attempt to repeat the strategy in different market cycles would be comfortable but unproductive. Defense only makes sense in periods of mediocre payoffs.

Exactly amid this moment of optimism we were hit by the unpredictable: a new pandemic on a global scale, spreading at breakneck speed. Although the virus is referred to under the moniker Covid-19, determining its origin in the year 2019, the effects seemed hard to predict. Looking back, our lack of experience in this subject made us minimize the extent and length of the problem and have a limited foresight of how governments would react to a health crisis. Operating at extraordinary speeds, the markets did not allow us the possibility to further our knowledge on this subject in time for a meaningful reaction. We are now left to assess the long-term effect of the pandemic *vis-a-vis* the valuation and companies' prospects.

The economy has been disorganized in a manner that we have never experienced before. This will culminate in a near-permanent loss of organizational capital that was previously mainly allocated to smaller businesses. Rebooting this system and reorganizing the hibernating production chains will be a daunting challenge for the government and civil society.

However, a stark difference between this crisis in relation to that of 2008 has been the speed at which public authorities have acted. In hindsight, measures considered unorthodox at the time facilitated the creation of expansionist policies, which were used during the last few weeks.

"IF YOU"RE GOING THROUGH HELL, KEEP GOING"[4]

It is terrible to take advice from one's rambling thoughts during a night of unease. Likewise, a crisis of this scope crushes any perception that something positive may arise amidst the sea of negativity. Our brains tend to fall into the trap commonly known as informational overload. *There is nothing either good or bad, but thinking makes it so*[5].

Just as a negative catalyst might push us into an eerie abyss, positive surprises might arise to rescue us from the depths of darkness. Hard-to-predict factors pop up as new medicinal solutions are discovered, reorganizations of the current personal-isolation dynamics are enacted (contact-tracing and/or social distancing solutions that are less aggressive than a lockdown), or even pertaining to the effective transmissibility of the virus. Normally, we link "unknown unknowns"[6] to negative surprises, but they work both ways.

From a pathological point of view, this crisis has a finite narrative and may come to an end in countless ways: either through human ingenuity in dealing with global challenges pragmatically in the most difficult moments, or simply as the mathematical result of any logistic curve reaching its end[7]. Regardless of the path, any increase in the probability of an end to the crisis and the subsequent clarity on the resumption of activity, will positively influence asset prices.

[4] Winston Churchill

[5] Extracted from Hamlet's conversation with his childhood friends Rosencratz and Guildenstern, during Act 2, Scene 2 of the famous play

[6] Reference to former US Secretary of Defense, Donald Rumsfeld's, phrase: "(...) There are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns—the ones we don't know we don't know."

[7] Phenomenon also known as "herd immunity."

The 20th century was marked by contrasts that demonstrate humankind's capacity to be infinitely wise or stupid when faced with obstacles. For that matter it was characterized by Eric Hobsbawm as “The Age of Extremes.” The turn of the century started with the great Einsteinean scientific discoveries, almost simultaneously accompanied by the Freudian pseudo-scientific paradigm, endured two world wars that could have possibly been avoided, saw a human genocide during the Communist Revolution in Russia, lived the creative and political rebelliousness of the hippie movement in the 1960s, suffered a potentially devastating Cold War, and witnessed the moon landing, while Latin America was haunted by the darkness of dictatorship. All of this ended in a fictitious convergence of ideals at the close of the Cold War, followed by arrogant clamoring from the gullible ideologues of Neoliberalism that we had reached the “End of History.”[8]

As one might note, the world can be everything but linear. The same can be said of capitalism and its highest-quality product - big business - which expands exponentially for decades, although cycle and trend stubbornly dissociate from each other brutally at certain periods. Only by being intellectually distant, watching from a disinterested perspective, allows one to appropriately see that while some will drown in this process, others will wisely navigate the choppy waters and reach the river bank solitary and victorious.

Troubled periods re-shuffle the cards for new participants and financially ill-structured companies in a very hostile fashion. This crisis shouldn't be different and due to its initial severity, it can provide a historical opportunity for well-established and capitalized companies to increase their market shares.

Amid this environment, the marginal propensity to take risk and act upon new ideas may be shaken, and a relevant reduction in the supply of funding for new businesses may come by as a natural consequence. It is only reasonable that the current euphoria should be postponed, thereby shrinking the optimistic activity of fostering businesses with low or negative profitability. Even low interest rates, which sent investors sewing heterogeneous risk categories as if they were cuts from the same cloth, should not keep feeding aggressive instincts indiscriminately. Behavior will change: first and foremost, the risk of losing capital, and only then considerations pertaining to potential return.

This overwhelming recession initially stimulates the concentration of income and wealth. This occurs in a world where inequality was already the unbearable goat in the living room (elephant in the room?), represented as electoral criticism in the most pro-market democracy in modern history.

Established companies have more oxygen in the tank to survive, and even benefit from the breakdown of the economic system. On the other hand, the survivors will have to foot the pandemic bill, probably becoming targets of an eventual need to increase taxes. Monitoring the tug of war between these two forces should be one of our main activities in the coming years.

“THE LONG AND WINDING ROAD...”[9]

There is an obsession for seeking positive consistence in relation to the market in the short term. Investors become addicted to this endorphin and fed by the illusion of victories, end up trying to hit too many balls. After falling 50%, the mathematical need of an 100% gain in order to return to the entry point is repeated ad nauseam. However, history shows that high-quality businesses have optionalities that are hard to measure a priori. Through time, they have the potential to more than offset an initial loss of 50%. Utilizing the past as a proxy, hyperactivity appears to be counterproductive in the patient game of investing in shares with a long-term horizon.

[8] As symbolized by Francis Fukuyama's book: The End of History and the Last Man, written in 1992

[9] Excerpt from the song “The Long And Winding Road,” by Lennon-McCartney

Moreover, events that seem predictable ex-post were not always easy to interpret as they unfolded. The lightning attack on Pearl Harbor makes for a good example. Retrospectively, several signs pointing to an imminent attack are perceptible. But by analyzing prospectively and monitoring the events progressively, the feeling of inevitability quickly dissolves. In Pearl Harbor, in addition to the military reports there was a huge amount of useless information. Each week, hoards of new messages surfaced, ranging from the alarming to the mysterious. Many of them later proved to be flawed or insignificant. Even those who concentrated on the few pieces of information that were actually proven true *ex-post* later, would have been refuted at the time by alternative explanations that could be deemed solid in light of the expected values of the moment.

Similarly, one can build a narrative that all existing signs at the beginning of the pandemic made it "predictable." This looks like an *ex-post* exercise engendering the risk of one believing excessively in his/hers own predictive capacity. Just as in the caricature of the individual who aimed at a pigeon but ended up hitting a Jumbo jet. It is noteworthy that we had similar signs in other recent epidemics, without any of these crises triggering such a cataclysm.

The pandemic tipped the previous, fragile balance of the real and financial worlds. The effects are new and their extent enigmatic. However, throughout the past few months stocks devalued significantly and at an unprecedented speed. We decided for a quick reopening of the fund. Our investor base's appetite was higher than expected, showing the maturity and courage to invest during potentially correct moments, with the aim of fetching long-term returns. The possibility to park capital in high-yield, low-volatility fixed income is part of the past. Allocation via long-duration assets such as stocks or long-dated fixed-rate securities seems to us as the only viable alternative at present to build wealth through time.

However, it is important to note that the road won't be easy, nor monotonous. Patience, discipline and a careful distinction of which might be the winning businesses of this new cycle will prove to be valuable characteristics. Along the road, volatility should be an ally of anyone building a portfolio capable of weathering the storms that potentially lie ahead. Maybe it is not yet the time to hunt for big game, but rather to fill up the canteen to cross the desert. What is no longer possible is for one to sit still, smirking while observing the whole mess from outside, consequently running the risk of losing equity in a slow albeit steady manner.