"THE SECRET OF TRUTH IS THE FOLLOWING: THERE ARE NO FACTS, ONLY STORIES."[1]

Do expectations matter? Scientific medicine has been publishing empirical studies for decades on what they have dubbed the "placebo effect". Self-healing catalyzed by innocuous substances, usually ineffective medications, produces a positive sensation that catalyzes the patient's recovery since the times of Hippocrates[2]. Various trials expand on the topic: the way the doctor communicates and acts, the effect of online information, news reports about the illness. The effects are cascading.

This is just one example of how our expectations can influence reality[3]. Brain scans reveal that price and expert reviews can influence the perception of the quality of a wine, impacting brain activity in reward centers when the aspiring oenophile takes their first sip. Athletes surpass their maximum performances solely by believing they have consumed performance-enhancing substances. In the realm of virtual reality, research has explored the correlation of individuals using avatars more attractive than their own beauty, tending to act with higher confidence, and consequently, being more successful in the game of seduction.

In the cases mentioned above, expectations become tangible but with certain limitations. The ability to influence is stifled when confronted with reality. Placebos do not cure cancer tumors and athletes have physical limitations. However, conditioned effects, subtle in their nature, can bring about lasting changes. In certain domains, expectations indeed influence reality.

The new government won the election by the narrowest margin since the creation of the Federative Republic of Brazil. The decision was a kind of electoral snapshot. It exposed a divided country and reinforced a divisive geography, with a clear line through the center of Minas Gerais - a Brazilian Equator Line.

The Bolsonaro administration, despite significant setbacks in managing key areas essential for building a just and productive society and numerous assaults on democratic institutions, delivered an acceptable economic accomplishment. The breath of liberalism, even if somewhat primitive at times, continued the well-executed work of the Temer administration. It implemented reforms[4], established decent regulatory frameworks, ran the BNDES (National Bank for Economic and Social Development) at a level close to a corporate gold standard, and above all, removed from the economy an activist hands-on government that clings like an octopus to the arteries of private enterprise. Growth in 2022 beat initial expectations, with GDP advancing close to 3% and the unemployment rate starting a downward trend. Inflation remained under control and on the decline, contrasting with the trends in

[1] Epigraph to “Viva o Povo Brasileiro” by João Ubaldo Ribeiro

[2] Hippocrates, the father of Western medicine, acknowledged the power of suggestion and belief in the healing process, which is considered a precursor to the modern concept of the placebo effect

[3] The investor/philosopher George Soros has influenced generations of investors with his Theory of Reflexivity, which partially addresses these points within the financial market context. It explores the relationship between thought and reality, inspired by the philosopher Karl Popper, who courageously questions empirical truth as being distant from absolute certainty

[4] We can cite, as an example, the Legal Framework for Sanitation (Law 14,026/20), the Privatization of Eletrobras (Law 14,182/21), the New Gas Law (Law 14,134/21), and the Economic Freedom Law (Law 13,874/19). It is important to make it clear that although these topics were sanctioned during the Bolsonaro administration, the work that led to them was initiated before his tenure

developed countries. Even in face of existential negative externalities, such as Covid and the Ukraine War, public debt returned to pre-pandemic levels.

Critics rightly point out that there is an imminent need to increase spending to support the less privileged members of society. Inflation is not dead, and interest rates are very high. Additionally, the traditional obsession of every Brazilian politician with re-election has also led to an inefficient and misdirected spree of spending by President Bolsonaro. Not to mention that the last budget approved in 2022 by the legislative houses is a work of fiction. However, the situation seems far from the dire picture being repeated ad nauseam by the traditional Lulista campaign claiming to inherit a "cursed legacy." It echoes a seemingly Freudian dilemma experienced two decades ago, a critical obsession stemming from classic narcissism with traces of historical populist traits.

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The clumsy Dilma government continues to be the subject of denial by PT (Worker's Party) supporters. The overwhelming popularity of the Lula I and II administrations, coupled with the positive momentum experienced by commodity-exporting countries, allowed every textbook idea of government-led development to be tested between 2010 and 2014. The proven and easily interpretable catastrophic results, especially with the benefit of time, should serve as a map to an abyss that one should never approach again[5].

A political campaign shouldn't serve as a platform for confessing guilt, especially for those claiming a monopoly on virtue. As Schumpeter noted, "the first thing a man will do for his ideals is lie." However, the steadfast denial of recent history, even after winning the election, is alarming. The presence of politicians responsible for the 15-16 shipwreck, holding active positions and exuding the arrogance of those who were engulfed by a storm, rather than the captain who led us close to collective suicide, is haunting. Ultimately, when demagogic speech transcends rhetoric and transforms into technical and practical proposals, it becomes terrifying. Using classic populist methods, creating invisible enemies[6]—sometimes portrayed as speculative rentiers, other times framing the "market" as an organized union seizing the country's wealth—echoes age-old tactics used by religions[7] and historical figures that didn't truly care or protect society's well-being.

A confident discussion regarding a sustainable fiscal budget seemed like an obvious initial step for the new president. The expectation was for a small intervention in public spending during the first year, whilst ensuring social assistance. Long-term fiscal responsibility, even if initially just a rhetorical one, would facilitate currency appreciation, reduce inflation, and ultimately allow an independent Central Bank to anticipate interest rate cuts—shaping a narrative into history and transforming the populist into a statesman. For a country that has faced more challenging economic situations in the past, the starting point didn't seem catastrophic.

However, the elected President chose a different path. The potential of a positive economic narrative quickly faded. Outdated rhetoric resurfaced, beleaguered public enterprises were lauded, and privatizations were criticized as unpatriotic, all under the guise that the solution lies in politics. The painstakingly established governance to combat

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[5] The Brazilian GDP dropped by 3.8% in 2015 and 3.6% in 2016, one of the largest drops in GDP ever experienced by the Brazilian economy

[6] Bolsonaro's villainous Supreme Court is replaced by the "insensitive" Central Bank. The "Chinese Vaccine" makes way for rhetoric against "Yankee imperialism"

[7] The construction of the Devil as an opposition to God has been a constant theme in preaching for centuries and is identified as far back as Zoroastrianism, the oldest known monotheistic religion. Similar representations include the serpent in the Garden of Eden, Satan in the Hebrew Old Testament, Lucifer, and other characters

corruption came under attack. Misguided international financing, disguised as diplomatic acumen, returned, and specific primary sectors were deemed “strategic”. Lastly, rudimentary taxes[8], already tested and rejected in dozens of experiences worldwide, were introduced. The state's role is once again idealized as the essential mechanism for solving our problems and achieving the long-awaited prosperity for all.

At this moment, one naturally wonders whether the perception of a pragmatic Lula arises solely from the circumstances of his distant first term[9], with the assistance of the economic team from FHC's government during the transition period[10], or from a legend constructed post hoc based on a positive outcome. After all, if he were pragmatic, he would leave the Central Bank alone and focus on abolishing the willful misdirection of the previous government, understanding that only economic growth on solid foundations can sustainably reduce poverty.

Investing in Equities in this environment

In light of recent events, we can observe protectionism, low economic productivity, and state intervention in specific sectors.

This agenda should be relevant for defining companies capable of surviving in this hostile and challenging scenario. In a country with low economic growth and high capital costs, choosing assets with sufficient quality to withstand the cycle becomes essential for achieving a good return. On the other hand, we will likely return to a context of capital scarcity and consequently restrained competition. The capital market ceases to fulfill its role, favoring well-established and capitalized companies that are expected to continue growing and gaining margin even in an inhospitable environment.

Unfortunately, Brasília returns to being the gravitational center of the country where it is highly valued to be a friend of the king. Due to this government's voluntarism, along with the inclination to make the state a protagonist, it becomes inevitable to continually reflect on government programs and potential subsidies. Certain sectors will be disproportionately affected by the potential tax reform, especially as the government aims to increase revenue under the new fiscal framework. The impact is likely to be heterogeneous in terms of scope and depth.

After decades of tax disputes and a growing tax burden to sustain an increasingly costly state, the time for tax reform seems to have finally approached. The long-term benefits are undeniable. However, the Brazilian economy has balanced itself on two groups of companies - micro-enterprises surviving in informality or under the Simples regime, and large companies benefiting from subsidies, whether in terms of capital or special tax regimes. There are practically no large companies without these benefits, as they were extinguished by the crushing cost of capital and the suffocating tax burden. They perish in the absence of instruments to fight in an unfair battle. Obviously, this significant change will overturn, shift, and shake manufacturing, fiscal, and operational structures built to adhere to the previous logic. It won't be simple, especially for service and retail companies. These seem to be the accessible preys to achieve tangible results quickly. In practice, today, any Brazilian company with a tax burden below 34% has a target on its back.

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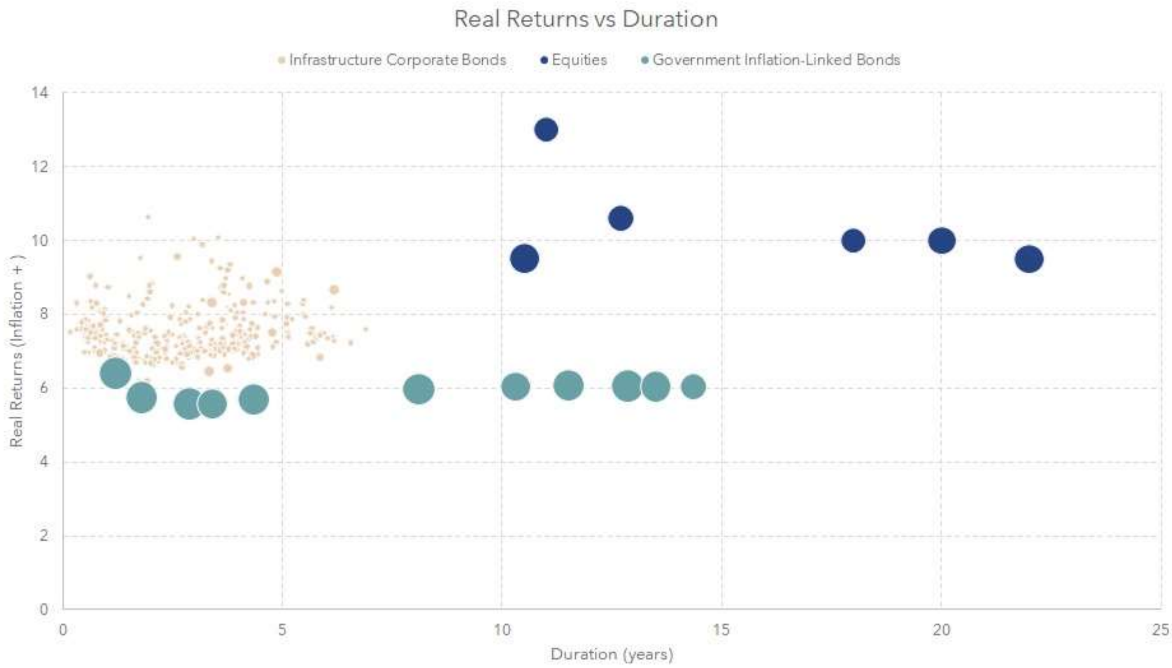
[8] Temporary tax on oil exports

[9] We must not forget that the person responsible for PT's economic program before the first term was Celso Daniel, who was replaced due to very particular circumstances by the Ribeirão-Pretano doctor Antonio Palocci, responsible for the turnaround strategy towards greater economic orthodoxy

[10] In this sense, we recommend reading the book ““Eles não são loucos: Os bastidores da transição presidencial FHC-Lula” by João Borges

On a more constructive note, the tax reform is expected to translate into future productivity gains. The simplification of the tax structure allows for a reduction in bureaucracy in fiscal management, addressing the desired combat against regressive taxation, and ultimately prompting a necessary reflection on state reform. A country's tax system should mirror societal priorities, and these movements should encourage a more profound contemplation. Additionally, coupled with a credible fiscal framework and the confrontation of historical tax exemptions, it becomes possible to finally balance the trajectory of public debt, guiding interest rates on long-term government bonds – a benchmark for high-duration assets like stocks – to a level lower than the current one.

This movement can be a significant catalyst for the repricing of Brazilian stocks. If the cycle from 2019 to mid-2021 led to an increased exposure to equities as a percentage of savings, the current cycle has favored fixed income. Especially tax-exempt securities – CRI, CRA, and infrastructure bonds – which, rightfully, have become the "plat du jour." In the graph below, we have compiled the size of the issuance of these securities, represented by the size of the bubbles, and compared their duration[11] and expected return with the main stocks in our portfolio and inflation-linked government bonds (NTN-Bs).



The impact of a potential interest rate drop should be significantly higher on stocks compared to fixed-income instruments, even those linked to inflation with long maturities, as a portion of the principal is repaid over time.

Finally, in addition to the potential impact of interest rates, we must remember that domestic savings rises during periods of high interest rates. When the cycle reverses, and a reduction in interest rates becomes inevitable, this larger wealth stock tends to flow back into purchasing stocks. Adding an epilogue to the famous comment on the smallness of the Brazilian stock market: If the exit door for stocks in Brazil is narrow, the entrance door is not too far different.

The construction of the portfolio has followed the perceived risks and opportunities outlined above. The portfolio can be divided into three groups. The first group is represented by the obsession with capitalizing on the abundant

[11] Duration represents the average time for the investor to receive his invested amount adjusted for interest. In a slightly more simplified form, it is a metric that measures the sensitivity of assets to changes in the interest rate. In theory, the longer the duration, the greater the positive impact of falling interest rates on asset prices will be

and rich Brazilian carry. These are utility-like companies with protected returns from a regulatory perspective, trading at a yield premium to similar-duration NTNBs, and also benefiting from the optionality to allocate capital in this economy during a period of capital scarcity. The second group includes technology companies with substantial competitive differentiators and exponential growth potential, accompanied by increasing marginal returns. In these cases, it is important to be disciplined in determining the price to be paid, avoiding incorporating all optionalities into the current valuation. When these assets increase in prices rapidly, we can sell options on the position to increase the carry, taking advantage of market volatility and limiting the downside of the investment. Lastly, there are the reliable Brazilian oligopolies that are not heavily dependent on GDP growth and benefit from benign competition in a challenging economic environment. Recent years have seen significant local players expelled and multinationals deterred. The potential for growth in peripheral regions with market scale often carries fierce competition – as seen in the Telecom sector in Latin America over the past twenty years – negatively influencing the economic equilibrium. In hostile environments, survival is the most meritorious act. Woody Allen summed up the matter well: "80 percent of success in life is just showing up." Sometimes, all you need is patience and perseverance.

Regarding the macro perspective, it is expected that the attachment to recklessness will be softened or that the political center, with a physiological inclination, will protect us from all this erratic activism. If they do not allow us to be propelled towards sustainable development when the winds blow positively, let them at least serve as a barrier to all this primitive ignorance.