"FROM A HEROIC PEOPLE, THE RESOUNDING CRY"[1]

Contemporary society lives immersed in a paradox. Technology advances at an almost inevitable pace, measurable in falling infant mortality, rising life expectancy, increasing literacy, improved disease control and many other metrics. Yet political and social organizations insist on moving in circles. Long-established democracies yield to authoritarian impulses, newly conquered freedoms are reversed, and the promised *end of history*[2] proves itself to be false. Technical progress is mistaken for some alleged moral evolution. Hence the frustration: the more effective we become at mastering nature, the more evident our failures in dealing with the human condition itself. History does not move forward; it merely returns in new disguises. The challenge is not to believe in a redemptive collective destiny, but to recognize the coexistence of technical achievements and political setbacks – accepting public life, in its essence, as the art of managing recurring tragedies.

Brazil is a case study of this mismatch. Our politics rarely settles conflicts through institutional means. It prefers the choreography of rupture followed by amnesty. A coup is announced, attempted and consummated; then responsibility dissolves in generous pardons. In the 1920s, the *Tenentismo* movement had already set the tone. The *Revolta dos 18 do Forte*, the *Coluna Prestes* and other uprisings were not isolated military adventures – they were symptoms of a country without effective channels for opposition within the rules of the First Republic. The rebellions failed, but planted the idea of the coup as an instrument of reform. The insurgents would later be pardoned and reintegrated.

The 1930 Revolution was also a coup. Claiming electoral fraud, it precluded the inauguration of Júlio Prestes – who never took office – and brought Getúlio Vargas to power. In 1932, the Constitutionalist Revolution attempted to overthrow Vargas; finding itself defeated, it ended in conciliation. In 1935, the *Intentona Comunista* served as pretext for the regime's authoritarian turn in 1937 with the *Estado Novo*[3], imposed by Vargas.

In 1945, Vargas was deposed by the military and retreated in silence. It was neither a heroic act nor a popular uprising – merely a surrender. The *Estado Novo* collapsed from exhaustion, not institutional maturity. Thus the Fourth Republic was born: a fragile democracy where the popular vote coexisted with military tutelage and fragmented parties. Dutra, Café Filho and others embodied this transition, in which each institutional advance came paired with a setback. The economy grew on the verge of imbalances. Vargas would return five years later, elected, in yet another chapter that blurred the lines between rupture and forgiveness[4].

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[1] National anthem of Brazil.

[2] The concept comes from the essay "The End of History?" (1989) by the Japanese-American political scientist Francis Fukuyama, who argued that human history, understood as the struggle between ideological systems, had finally reached its end point with the victory of democratic liberalism after the fall of the Berlin Wall. Today it seems history has not ended, but merely entered a hiatus.

[3] The Cohen Plan was the pretext used to establish the *Estado Novo*. Forged in 1937 and presented as a communist plot, it allowed Vargas to declare a state of war, expand censorship and repression, and prepare the coup that shut down Congress. It was later proven that the document was a forgery.

[4] We recommend reading the masterful autobiography of Samuel Wainer, *Minha Vida*, which narrates in detail his trip to São Borja, from where he returned with the historic interview of Getúlio Vargas. This journalistic piece would mark the ex-president's return to politics and the beginning of his campaign for his first democratically elected term. Later, with Vargas's support, Wainer would found

Juscelino Kubitschek, elected in 1955, immediately faced a military conspiracy, which was only contained by a legalist counter-coup. But the plot never truly disappeared; as usual, it was dissolved in conciliation. If the Fourth Republic was a hesitant laboratory, JK was the exception. His government (1956–1961) offered the country a clear project for the future. “Fifty years in five” was more than a slogan – it was a narrative that aligned capital, labor and politics around a common objective. Brasília materialized that ambition and shifted the country’s center of gravity.

Without Juscelino, the Fourth Republic would have been merely an unstable bridge between dictatorships. With him, Brazil experienced – even if briefly – the confidence that it was capable of dreaming big and delivering[5]. He proved that leadership and vision can alter a country’s destiny.

But the cycle continued. Then came Jânio Quadros’ resignation in 1961, the 1964 coup and two decades of dictatorship. The 1979 Amnesty Law pardoned both the opposition and the agents of repression, paving the way for the regime’s end in 1985. In the New Republic[6], the script repeated itself: Collor’s impeachment in 1992 and Dilma’s in 2016 were both followed by the political reintegration of the defeated[7].

From the *Tenentismo* to impeachment, the sequence is almost invariant[8]: rupture, amnesty, reintegration. We rarely resolve conflicts through institutionalization; we prefer oblivion. Occasionally, a leader like Juscelino or Fernando Henrique points to a different path: vision, project and pact. Yet, we insist on returning to this baroque dance of sin and forgiveness.

Today, in 2025, the dilemma returns. Our democracy is more resilient than in 1945, but remains fragile. Fragmented parties, unstable fiscal pacts, and constant political noise undermine trust in institutions, deepening our inferiority complex. We need leadership capable of articulating the present and future with clarity of vision.

International experience is unambiguous: democracies consolidate when public finances find an anchor. In seventeenth-century England, the Glorious Revolution (1688–1689) limited the Crown’s access to credit, placing it under Parliamentary control. This was not merely a change of monarch, but the foundation of a constitutional order that sustained liberalism and enabled the industrial leap. In 1789[9], the United States

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Última Hora, an innovative newspaper that combined editorial quality with mass appeal, and which thrived until it was struck down by the military coup.

[5] By the end of Juscelino's government, Brazil had accumulated high foreign debt and scarce reserves. As is often the case in the country's history, the *Plano de Metas* generated growth but left behind fiscal imbalances, high inflation, and a high current account deficit. Maintaining the Brazilian tradition of leaving the adjustments for the next administration.

[6] The New Republic is Brazil’s sixth republic and runs from 1985 to the present. It succeeded the Fifth Republic – 21 years of military dictatorship marked by economic modernization efforts and political repression. Launched by Tancredo Neves and José Sarney, it consolidated re-democratization with the 1988 Constitution and a cycle of civilian governments. It has seen no institutional coups but impeachment has been used as an instrument of change, combining institutional advances with recurring crises of governability.

[7] The contrast between 1992 and 2016 highlights the political nature of impeachments in Brazil. In 1992, Collor faced both removal and immediate ineligibility. In 2016, a procedural amendment accepted by the then-president of the Supreme Court and current Minister of Justice, who presided over the session, preserved Dilma’s political rights. This maneuver was an early sign of the politicization of the higher courts, reflecting the specific balance of power at that moment.

[8] And then came Lula: convicted in multiple instances and imprisoned, only to benefit from the annulment of his sentences by a politicized court. His return to the presidency reaffirmed the Brazilian pattern of transmuting punishment into forgiveness.

[9] To be faithful to the dates: in 1789 the Treasury Department was created; in 1790, with the First Report on the Public Credit and the Funding Act, Hamilton federalized the states’ Revolutionary War debts. Southern states resisted because they had already repaid part of their liabilities. The Compromise of 1790 enabled the plan, with Southerners persuaded by the choice of Washington – farther south – as the capital instead of New York. Fiscal reforms in democracies advance through regional pacts and concessions. There is a major lesson here.

federalized war debts and created a reliable Treasury. Postwar Germany rebuilt itself on the bedrock of solid institutions. Spain, in its transition after Franco, stitched together broad consensus. Israel tamed hyperinflation in 1985 through a tripartite pact between government, unions and the private sector. Chile, since 2001, has tied fiscal policy to the long-term price of copper, shielding itself from populist cycles. In every case, these nations traded the choreography of crisis for the disciplined rhythm of a pact.

Brazil has flirted with this path in the past. The Real Plan (1994), the Fiscal Responsibility Law (2000), and the spending cap (2016) were attempts to build guardrails – real advances that, unfortunately, buckled under subsequent political shocks. We lack an agreement that endures across administrations.

The fiscal arithmetic is simple. When debt grows persistently faster than GDP, the debt-to-GDP ratio spirals out of control. To stabilize it, primary surpluses must cover the difference between the average cost of debt and economic growth. If interest rates exceed growth and a fiscal surplus fails to materialize, government debt enters an explosive path. Each additional percentage point of debt increases interest payments, reducing the capacity to invest in productivity and inclusion, weakening confidence in the currency and raising risk premiums. What is sold as social policy becomes a silent tax on the poor via inflation and stagnation.

The numbers expose the asymmetry. The government recently proposed an income tax exemption for earners up to R$5,000 – touted as the mandate's great achievement of tax justice – at a benefit of R$30 billion to middle income taxpayers, and a real 2% increase in the minimum wage which translates into roughly R$15 billion to workers and a similar amount to INSS retirees. By contrast, individuals earning up to three minimum wages hold roughly R$1.2 trillion in debt. If the real interest rate remains six points above equilibrium due to lack of confidence in the government – 10% versus 4% – the additional annual cost for this group reaches R$72 billion. At the other extreme, the *private wealth* and high-net-worth retail segments hold around R$4.5 trillion in financial assets, mostly in short-term fixed income. Assuming 15% taxation, this higher interest rate adds approximately R$230 billion per year in financial income to their portfolios. The math is clear: specific gains are concentrated, while scattered relief measures do not offset them. Populism is expensive and concentrates wealth.

There is also a perverse federative effect. When fiscal adjustment relies on tax increases, the resulting revenue is shared with states and municipalities, causing their expenditures to rise in tandem. Estimates show that in the first three years of the current government, real federal primary spending grew 4% while state and municipal spending rose 6% – building on an already inflated post-pandemic baseline. In this environment, high interest rates act as a counterweight. They restrain credit but weigh disproportionately on the indebted low-income population, while higher-income groups tend to capture the interest gains. Meanwhile, mid-sized companies lose access to credit and postpone investments. The result is a vicious cycle of low investment, low growth, rising debt and increasing inequality. The current government inherited the country with gross debt at 72% of GDP and is on track to end its term near 85%. This trajectory is a ticking time bomb that could explode if markets conclude that only an inflationary surge can stabilize the debt.

A lasting solution demands a pact that survives electoral cycles. The Real Plan was not born of consensus, but of a temporary majority forged by pragmatism and urgency. That was enough to sustain the transition until the results spoke for themselves. The same applies to the social programs that followed – product of specific agreements on priorities, not ideological unanimity.

Today, however, convergence is absent. Energy is wasted on assembling patchwork majorities to approve parochial agendas and the demands of organized minorities. Hardly any time is spent on what could truly change the country. The Executive branch seems intent on climbing the wrong mountain. The Legislature, having seized its independence through party funds and mandatory budget amendments, remains increasingly clientelistic and self-centered. The Judiciary behaves like a weathervane, shifting with political winds – not to say it inhabits a parallel universe where it imagines itself a monarchy to be courted by society.

The country must recover an axis of rationality to rebuild a fiscal consensus: a multi-year target with bands; inflation-adjusted spending rules with rare, dated exclusion clauses; and periodic review of tax exemptions with expiration dates and impact assessments. Without this, the country trades immediate relief for a poorer future.

A *mea culpa* is in order. At the beginning of the Lula government, there was a clear window for a modest fiscal adjustment – curbing expenses outside the electoral cycle – to lower the interest rate curve and anchor the debt trajectory. We believed this rational course was a likely outcome, but the opportunity was wasted.

The phrase so often misattributed to Einstein comes to mind: "insanity is doing the same thing over and over again and expecting different results." The quote actually originates from Narcotics Anonymous, which makes far more sense and ironically describes the pattern repeated by the current government, as in Lula II and Dilma I. At the peak of Brazil's previous debt crisis, an economist plotted the exponential debt curve and recalled the obvious:nothing grows exponentially forever; it is either corrected, or it hits a wall. The American historian and philosopher Will Durant summarized it masterfully when he wrote that "economic history is the slow heartbeat of the social organism, a vast systole and diastole of concentrating wealth and compulsive recirculation." It is the tension between energy and exhaustion, building and destroying, civilization and barbarism. Brazil currently stands at a crossroads. Either next year's election brings political change anchored by a credible pact, or we will witness the reenactment of a familiar script: socially generous rhetoric followed by emergency orthodox adjustments when the bill comes due, as seen in 2015 with Joaquim Levy.

If the government is re-elected and continues to neglect the fiscal problem, the floating exchange rate channel – devaluation and subsequently inflation – will impose a much harsher adjustment. Without correction, the risk of repeating the Argentine script grows, with successive disillusionments and no sustainable way out.

Today, the primary surplus needed to stabilize debt-to-GDP at current financing costs is a distant dream. The only adjustment that matters now is one that anchors expectations and allows for an orderly decline in interest rates. With credibility, the required spending cut can be smaller. A sophisticated reflexivity operates here, in which a consistent fiscal design and clear communication reprice risk and reduce the premium. For the equity investor, returns improve through two channels: the compression of the discount rate benefiting long-duration assets, and the reduced need for a tightening cycle that sacrifices economic growth, thereby preserving revenues and profits.

"THE GOOD SAILOR KNOWS HE NEVER DEFEATS A STORM – IT IS ONLY THE SEA THAT LETS HIM PASS."[10]

We build the portfolio with balance, maintaining the discipline of a single fund that concentrates all the partners' efforts and attention, rather than a business built on multiple selling products. Our proprietary capital is significant relative to total assets under management, meaning the return on capital matters far more to us than any fee. This is the true definition of "skin in the game" – a concept often cited but rarely understood. It is not measured only by the percentage of a partner's individual net worth[11], but by the absolute amount invested relative to the fund's total assets, and by the commitment to reinvest a meaningful portion of the firm's revenue back into the single fund. This structure guarantees real alignment and durability because the product's performance is, quite literally, the destiny of those who manage it.

In Brazil, where the carry is structurally high, survival is more important than taking unnecessary risks. The goal is not to be brilliant, but to avoid being stupid. The portfolio reflects these principles almost as if they were commandments.

Roughly 40% of assets are invested in public utility companies. These offer high carry due to elevated long-term interest rates, an equity risk premium rarely seen, and the optionality of being among the few players capable of deploying productive capital in a country starved for investment. These are businesses that combine governance, capital, and execution capacity – scarce attributes in a market where the public sector crowds out resources. Equatorial, Eletrobras, Auren, Eneva, Copel, Motiva, and Compass form this core. They provide the anchor that enables attractive prospective returns and the defensiveness needed to withstand adverse scenarios.

These companies seldom rank among top stock market performers in any single year, yet over longer horizons, they consistently appear among the winners. Our main positions are not those with the highest theoretical upside in a bull market, but those that best balance upside potential and downside protection.

High-growth companies today represent less than 20% of the fund. We have maintained our investment in Nubank due to its structural quality and a talent density uncommon in the region, combined with product consistency, organic customer acquisition, low cost to serve, and exposure to the economy's most relevant profit pool and most coveted consumer product: credit. Mercado Libre, although a consolidated leader by its own merits, now trades at a valuation that tolerates few negative surprises; accordingly, we have significantly trimmed the position.

Our exposure to international equities, which held a meaningful portfolio weight in recent years, was also reduced given Brazil's relative attractiveness and the narrowing margin of safety in developed markets.

The remainder of the portfolio, which completes the fund's 100% exposure, is concentrated in well-positioned leaders. Some face short-term noise, others simply the indifference of a market largely uninterested in Brazilian

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[10] Nautical proverb

[11] It is worth recalling that the value of a manager's annual performance option, when estimated using a Black-Scholes model, typically lies between 0.6% and 4.0% of assets under management – a calculation and discussion we presented in detail fifteen years ago in Atmos Letter 2 (in that letter we considered a 10% performance fee for our first feeder fund, but here we adjust the figure to reflect the 20% performance fee that has become market practice).

equities. Among them are Localiza, Stone, XP, Rede D'Or, Smart Fit, and Grupo Salta – companies with clear competitive advantages and the ability to preserve value through cycles.

From where we stand in terms of prospective returns, we believe we are being well compensated for the risks. Tailwinds seem to be forming – and if they fail, we have a scheduled reckoning with public accounts in 2027. There are times when one must remain standing even when almost everyone else has capitulated.

Investing in Brazilian equities has been no simple task. The long, often torturous stretches have driven a large portion of the investor base away. Even so, or perhaps precisely for this reason, the reward remains attractive. As Jerry Seinfeld said, "The blessing in life is when you find the torture you're comfortable with. That's marriage, it's kids, it's work, it's exercise. Find the torture you're comfortable with and you'll do well. You've mastered that, you've mastered life."

Investing is about accepting the right discomfort, moving forward without succumbing, and never perishing mid-crossing. Ultimately, it is not about beating the market, but about traversing time alongside it – and reaching the other side still standing.