Dear Clients,

Vista Capital announces a new partner: Alexandre Maia will be chief economist and member of the investment team. Before joining Vista, Maia was a senior economist at Gávea Investimentos between 2015 and 2020. Between 2002 and 2014, he was chief economist and partner at GAP Asset Management, positions also held at Kyros Investimentos between 2014 and 2015. He started his career in 1999 at Unibanco Asset Management in the macroeconomic research area. He holds a Master in Economics from EPGE-FGV / RJ.

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Vista Hedge FIM and Vista Multiestrategia FIM returned -3.27% and -9.69% in June 2020 and had cumulative returns of 5.01% and 11.96% respectively.

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In June, the funds' performance was impacted by the loss of correlations that had behaved well for 12 months - except for the rare week that marked the beginning of the COVID crisis.

The portfolio consisted of long positions in gold (commodities and mining companies), Petrobras and the American stock exchange; and short positions in currencies of emerging countries.

The thesis presented in the last letters and translated into the portfolio: *"assets, especially the real ones, will benefit from the new level of American and global real interest rates."*

What did appear to be the main risk? An early withdrawal of stimuli by the FED causing a tantrum, as occurred in 2013 and 2018.

The structural and also tactical hedges, made in correlation with the mid-month FED meeting, were short positions in currencies from emerging countries (the usual suspects: Turkish lira, South African rand, Brazilian real and Mexican peso).

In summary, a portfolio focused on assets benefiting from liquidity, hedged in emerging currencies whose fundamentals are precarious and highly dependent on global excess liquidity.

From risk management point of view gold has a defensive feature, unlike oil and the stock market. Risk-off or risk-on shocks are expected to generate antagonistic results between such assets.

A priori, our analysis pointed out as potential risks: (i) a negative risk shock, with losses in the US stock exchange and Petrobras, offset by gains in gold and currencies; and (ii) a shock of liquidity withdrawal, with losses in the US stock exchange, Petrobras and gold, offset by high gains in currencies.

A posteriori, the reality was quite different. One possible mistake was to have imagined that historical correlations would remain faithful for so long in a chaotic year like 2020.

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At the April meeting, the Fed was extremely dovish and the risk of a change in the path of monetary policy seemed to have dissipated. We removed the hedge in currencies, given that gold would play the appropriate protective role for the remaining risk event. In the following days, the expected correlations were lost. Even in the face of a strong closing of the American real interest rate, gold and miners stocks fell along with the American stock exchange.

In the domestic portfolio, we carried a long position in exporting companies (with a positive result) and a short position in shares of companies benefiting from local economic activity. Throughout May, we reduced the scope of the position, based on valuations, for a long position in Petrobras and Vale and short in a basket of banks. In this way, we would reduce the negative exposure to Brazil, given Petrobras' participation, and would invest in shares that composes Ibovespa index, benefiting from a possible rally. As for banks, the credit issue mentioned in the last letter and the competition challenges gave us comfort regarding the difficulties that the sector will face in the coming years.

Again, assets did not behave as expected. At the beginning of the month, a major bank rally was fueled by a sharp slope in the global interest rate curve.

Given this scenario, we reduced the Fund's exposure in those stocks.

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Petrobras, reinforced by oil prices in reais that returned to its highs, negotiates with a significant discount compared to its historic and the majors.

An important step was taken in the process of selling refineries with the delivery of firm acquisition proposals for the first and largest plant. The event is essential for the company since it reduces the risk of political intervention in the price of fuels at the same time that helps deleveraging. In parallel, the recent voluntary dismissal program reaches almost 22% of employees.

There were further reductions in oil inventories, especially marine, and a resumption of gasoline consumption. More importantly, there is no sign of a resumption of American shale production, contrary to market expectations.

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With regard to gold and the long position in the US stock exchange, the FED's public statement about the complete absence of expectations to raise interest rates strengthens our confidence in real assets. The minutes also indicated something we had hoped for some time as a catalyst for our positions.

"We're not even thinking about thinking about raising rates."

– Jerome Powell, FED Chairman

Nominal interest rates = Real interest rates + Inflation.

Historically, the correlation between implicit inflation and real interest rate has been positive.

During periods of recession, inflation was expected to fall and the central bank to cut real interest rates. The opposite is true. Times of strong economic recovery generated higher expectations of inflation and increase of real interest rates. Such dynamics affects assets price on the market.

From the gold perspective, a finite asset regarded as a store of value, inflation exerts a positive force on its price. In return, higher real interest rates exert negative pressure while assets with similar characteristics start to offer higher yields.

For equities, the negative force is exerted by the cost of capital, the only variable in the denominator of the present value equation impacted by the level of real interest rates. The numerator, in turn, is composed of future cash flows and impacted by several vectors, with economic recovery being a positive force. The present value is the result of the interaction between these fraction terms.

For gold, an asset without yield, the effect of the real interest rate is dominant, considering that it is naturally exclusive.

With the possible new FED policy, this positive correlation between real interest rates and implicit inflation may change and the effects will be relevant on asset prices. The event is highly relevant to our portfolio. We talked about it here in the last month's letter:

"Several participants remarked that a program of ongoing Treasury securities purchases could be used in the future to keep longer-term yields low. A few participants also noted that the balance sheet could be used to reinforce the Committee's forward guidance regarding the path of the federal funds rate through Federal Reserve purchases of Treasury securities on a scale necessary to keep Treasury yields at short- to medium-term maturities capped at specified levels for a period of time."

A week later, John Williams from the New York FED: *"'Yield-curve control, which has now been used in a few other countries, is, I think, a tool that could complement, potentially complement, forward guidance and our other policy actions (...) we, obviously, are thinking very hard about."*

In the recently announced June minutes, the discussion continues:

"Nonetheless, many participants remarked that, as long as the Committee's forward guidance remained

credible on its own, it was not clear that there would be a need for the Committee to reinforce its forward guidance with the adoption of a YCT policy. (...) In addition, various participants noted that clear communications with the public are central to the efficacy of all policy tools and that, therefore, the Committee should complete its monetary policy framework review in the near term."

It is becoming increasingly clear that the FED is looking for ways to prevent the nominal interest curve from rising. If the direct curve control (*YCC*) with effective purchases loses strength in recent communications, the firmer forward guidance and the concept of average inflation are gaining momentum.

The latter seems the most likely and also the most important. In a nutshell, the discussion of the FED involves the inability to place expected inflation on target.

If the goal is 2%, why is the curve always below 2%? Apparently, there is a simple mathematical question: if the cap is 2%, but with no floor, the value will always be below the cap and, therefore, outside the target.

The solution is to convert the annual inflation target into a multi-period integral. If inflation runs below 2% in one or more years, it will be acceptable that it will be above 2% in the following period.

There is no definition yet on the secular limits that will be used. However, as levels in recent years have been quite low, the Fed says it will accept higher inflation ahead. In other words, we will be living with zero interest rates longer than expected.

Otherwise, *Real interest rate = Nominal interest rate + Inflation.*

If inflation will be higher and the nominal interest rate will not rise, the result will be lower real interest rate.

In the most common correlation, higher inflation correlated with higher real interest rates. With the new FED framework, the opposite is true: higher inflation leads to lower real interest rates.

The effects on assets price tend to be significant. As an example, a company that is able to repass prices. With higher inflation, the company's returns are equal or higher but the discount rate on cash flow will be lower. If previously the numerator went up and the denominator smoothed the positive movement of present value, now we can have numerator going up and denominator going down.

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For the first time since 2008, monetary and fiscal levers are operating in parallel. During the years after the crisis, although the FED maintained an encouraging stance, the government sought convergence on the fiscal side.

Trump's election gave strength to the fiscal stimulus, but there was compensation for monetary policy, with the withdrawal of liquidity and the increase in interest rates by the FED.

The COVID-19 crisis pulled the two levers together.

The framework also creates a very benign environment for asset prices.

It is not different in Brazil. We left a Temer government marked by fiscal and monetary consolidation for a scenario of double expansion. Our case is one of ever greater risks, given our inflationary history, but also interesting for asset prices in reais.

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For the first time during the COVID crisis, we believe it is possible to discuss whether the market's balance of risks is no longer tilted to one side.

Today it seems unlikely that, even in the face of an increase in new cases, any western society will return to a lockdown.

As for a potential vaccine, although the formal date of release will only be confirmed after the end of this year, several clinical tests are underway with large control groups and the results should be informally known in the short term.

It is possible that in the next 60 days the vaccines will prove to be functional, pending confirmation of their safety, given that the biggest problem is the potential side effects.

If that is the case, the market will certainly anticipate a definitive and safe reopening, as well as its effects, and possibly also that consumers have been retracted for so long.

We are looking for companies that can benefit from this movement.

We remain at your service.

Vista Capital