The funds Vista Hedge FIM and Vista Multiestrategia FIM returned 3.45% and 10.06% in May 2020.

The result is based on previously discussed positions. The gains were concentrated on (i) commodities, with emphasis on oil; (ii) domestic equities (long in exporters vs. short in companies that benefit from domestic activity); and (iii) short in Real. The losses had come from the position in international currencies, used as hedge in this period.

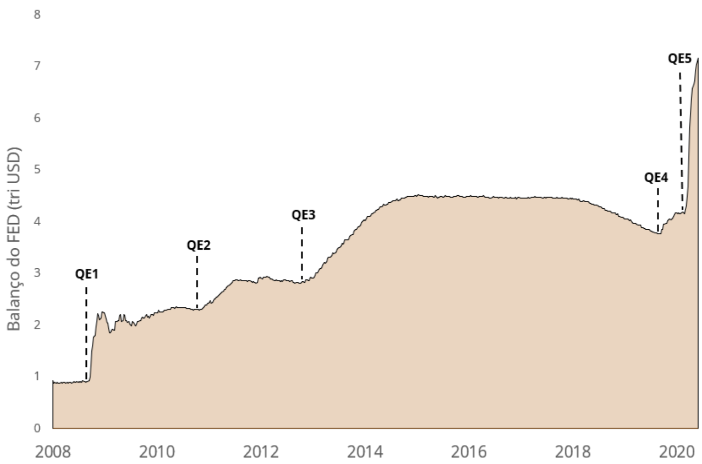
* * *

There was no change in our expectations for the medium and long term: the fall in real interest rates around the world will lead to assets appreciation, especially the so-called real assets.

In quick retrospect, back in 2018 we were short in the stock market, even in the face of a coordinated economic recovery. In 2019, we were long in the stock market despite the trade war between U.S.A. and China. Both positions were based on a change in monetary policy and our perception that the global real interest rates factor is dominant in asset pricing dynamics.

Since the "end" of the 2008 crisis, developed countries have made a fiscal effort focused on reducing their deficits and, at the same time, their central banks have tried very sparingly to withdraw the stimulus granted during the crisis valley.

"Phase out" has not been simple and we are in 5th cycle of the FED's quantitative easing since then.



This time, signs of a different path were seen in the last minutes of the FED meeting, even with stimuli remains: *"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."*[1]

A week later, John Williams (New York FED) delivered a speech in the same direction: *"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*

1 Minutes of the FED meeting held on May 20, https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20200429.pdf

actions (...) we, obviously, are thinking very hard about. We are (...) also how it may work in the United States".[2]

Gradually, more financial repression is expected, with the interest rate curve control by central banks as a solution for the gigantic public debt. Even in Brazil, the topic is discussed.

This is not an unprecedented process. On April 30, 1942, the USA instituted the first interest rate curve control in order to finance the inflated public debt during the Great War.

The 90-day rate was set at 0.375% (vs. a range between 2.0% and 4.0% in the peace period) and the 1-year rate at 0.85%. In addition, the FED implicitly set a 2.5% cap on long rates, placing any market surplus at that rate via currency issuance.

One way or another, maximum interest rate limits were valid until 1951. Real interest below the economy's real growth rate brought down the debt/GDP ratio in the medium term.

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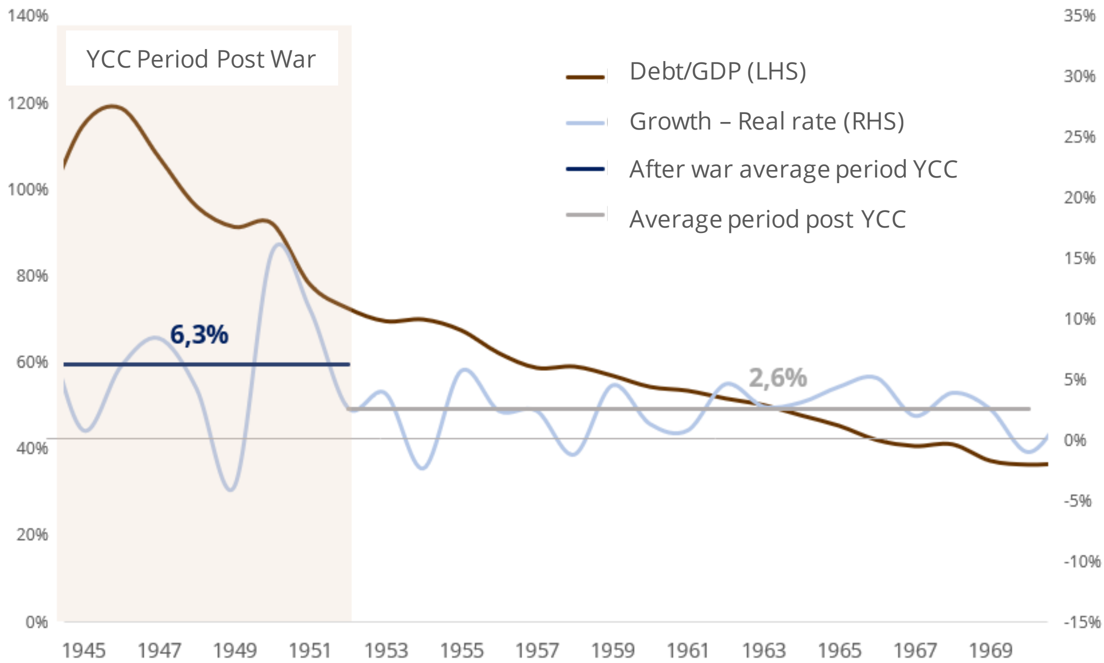

2Bloomberg article as of May 27 with John Williams, president of the NY FED https://www.bloomberg.com/news/articles/2020-05-27/williams-says-fed-thinking-very-hard-about-yield-curve-control

Along with the macroeconomic discussion, a social phenomenon unfolds. The protests related to the black movement seem to be driven by the increase in inequality in the USA, which has been enhanced by the appreciation of assets in recent years. "*Fuck the rich*" was an expression painted on walls, cars and posters.

The temporal proximity can make the issue even more dominant in the political agenda and in the American election.

The political pole on the left has the pocket solution: increased taxes paid by the rich, with taxation on inheritance, transactions, dividends, large fortunes, etc.

The proposals are, in general, of low economic efficiency and face a lobby that until now has proved insurmountable.

Another way - which has not been noticed or does not fit into the political narrative - is to distribute money to the poorest. The effects are more relevant for reducing inequality. In a systemic way, the idea of a universal minimum income has not yet come off the table in any country, but the pandemic has spread it across the four continents.

The Brazilian version was called *Emergency Aid*, an important measure in the midst of the crisis that receives support from government base and the opposition.

"Nothing is so permanent as a temporary government program." **– Milton Friedman**

But nothing comes without costs. In Brazil, the indiscriminate increase in public spending is likely to be paid for by inflation and currency devaluation. At the end of the day, there is a disguised tax and an inflationary risk.

In the developed world this fear no longer exists. Large deficits and an increase in the quantity of money do not have the same weight.

In summary, in a simplistic way:

- <u>Fiscal and monetary stimulus</u> reduces the value of the currency, since the increase in the supply of an asset reduces its value;
- <u>Control of the interest rate curve</u> reduces the value of the currency, since the only escape valve is currency devaluation;
- <u>Reduction of the inequality by means of increasing public expenses</u> is a disguised tax, therefore the increase of the fiscal deficit and the debt reduces the value of the currency.

Since currencies are a bilateral asset, and the world coordinated in such practices, even the dollar loses value. What's left? Real assets.

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Our main concern with Brazil is the possibility of a credit crisis and its political effects.

In the current crisis, the FED and other institutions around the world had been active and fast, also acquiring low quality corporate debt and helping small and medium companies. They followed Ben Bernanke's thesis, whose basic framework is to prevent crashes from happening and the crisis to become drastic and irreversible, as occurred in 1929 and 2008.

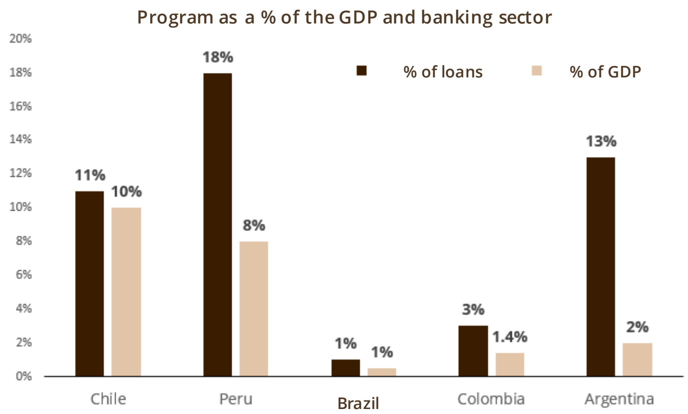
In Brazil, it did not happen, or was nothing beyond a nice speech. Assistance to small and medium-sized companies was a disaster. Whether due to legal difficulties or a reduction in bank risk appetite, the reality is that the Brazilian credit market has "stalled" for small and medium-sized companies.

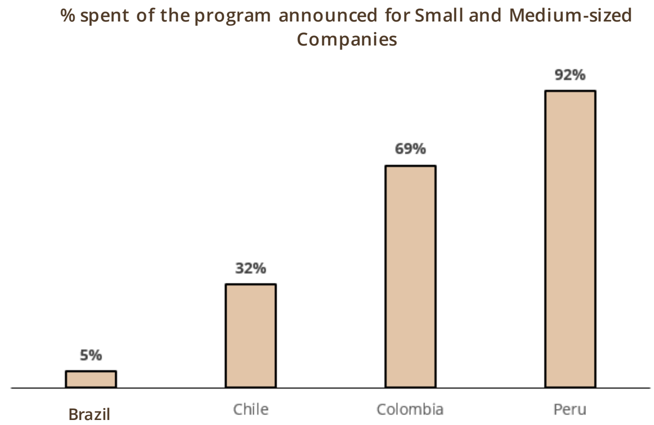
For now, we are lucky to have immense liquidity worldwide, but balance sheets crises take years to be resolved.

If it weren't enough, we are experiencing a critical phase in our ongoing and well-known political crisis.

We remain concerned with the dynamics in Congress. The government is on its way to choosing a side in the next election of president of the Lower House, an expedient used by Dilma in 2015.

We also wonder what the political reaction will be to a timid growth in the economy when elections appear on the horizon again.





On this point, we recall the Argentine case. Certainly, foreigners are still digesting the huge default.

Macri ran a liberal government, with a Treasury Minister from the financial market and the Social Welfare Reform approval in the first half of the government. He decided to postpone more profound and other reforms hopping to strength himself in the Congress.

He ended up being hit by an exogenous crisis (the biggest drought in Argentine history and the withdrawal of liquidity from the FED) that made his government unfeasible for the next two years. The rest of the government was marked by unsuccessful attempts to regain confidence that insisted on falling with electoral proximity. In the end, the once orthodox Macri used all kinds of unorthodox devices, from capital to price control.

Brazil's situation is very different from Argentina, especially since we have our debt in local currency. However, there are similarities in politics. In 2009 and 2014, for example, PT – the Worker's Party – abandoned the bit of orthodoxy it held to seek re-election.

History teaches that the expenses of the second half of the government are superior to the ones of the first half. What will we do in 2021 if unemployment remains high? The only certainty is that structural reforms will have no relevant effect on expectations with an election in the short term.

Anyway, they don't seem to be issues for today. The significant reduction in the cost of capital is the (great) incentive of the time to enter the capital market, a movement that could be enhanced by the post-COVID reopening process and by the war budget valid until the end of the year.

* * *

This month we reserve a space of our communication for commentaries on the portfolio, updated as of the date of this letter.

External Scenario

The scenario identified is a global currency debasement process, combined with massive stimulus from central banks.

The portfolio has remained the same in recent months, a long position on the US stock exchange and in gold through shares in mining companies. Real assets that will benefit from the process.

New movements from the FED were the main mapped risk. An early signaling of stimulus reduction can lead to a Taper Tantrum, as we had in 2013, raising real interest rates and dropping the stock markets and gold.

The protection was a short position in currencies of emerging countries that, with the drop in local interest rates, are now more vulnerable.

Internal Scenario

We avoid directional short positions in Brazil, but it seems that the best scenario for the country is a change in the economic model, as discussed previously.

The portfolio that materialized the scenario is a long position in stocks of exporters against bank stocks.

Update

In its last statement, the Fed confirmed our expectations, reinforced the expectation of low interest rates over a long period, and the real interest rates on American bonds effectively fell.

However, the movements of our assets did not confirm our expectations. The main risk was not a directional movement, but significant mismatches, as occurred at the beginning of June.

On one hand, there was a significant appreciation of emerging countries currencies, combined with the fall of gold miners and the stock market.

On the other hand, domestic positions have completely lost their correlation. Even in a period of global risk worsening, companies exposed to foreign exchange rate performed worse than companies in the banking sector.

We do not know how to explain the reasons for the movement nor the relevant loss of correlation (new agents in the market; remembrance of March when defensive assets fell along with the stock market; just a trend correction, amplified by high volatility, etc.).

In this kind of situation, our reaction is always the same: to reduce risk. Currently, the fund uses less than half of its risk limit, holds reduced positions only in gold and oil and further reductions will be made if the correlations remain erratic.

We remain at your service.

Vista Capital