

“It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so.” (Mark Twain)

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Highlights

-FCL Capital Investment Club ends its existence after five and a half years with a compounded annual return of 20% in US Dollars (20.67% in Brazilian Reais);

-From April 3rd 2007 to November 21st, the club's total return was of 189.36% in Brazilian Reais, against 21.50% from the Ibovespa index and 76.47% of the Brazilian CDI;

-Starting in November 21nd 2012, our main product is now a long-biased equity fund, called FCL Equities FIA. That continues our first product, the FCL Capital investment club.

1) Intro: Still down in the rabbit hole

First published in 1865, the eternal "Alice's adventures in the wonderland" starts with Alice imprudently following every note sent in her direction: First she discovers a bottle on a table labeled "DRINK ME", the contents of which cause her to shrink too small to reach the key which she has left on the table. A cake with "EAT ME" on it causes her to grow to such a tremendous size her head hits the ceiling.

Much the same way, lots of foolish things were done by bankers and investors in the past few years down to 2008: from lousy collateralized debt obligations in the US, to fiscal imprudence in Europe to investors who thought they would get rich overnight flipping IPOs in Brazil, to politicians too sure to request the spoils of victory in a booming economy and then to blame bankers if things went nasty. Much the same way as Alice, who found herself in a bizarre world after her imprudence we are all also paying the price. The good news, as our 2012 annual report will try to show is we believe this past year was a turning point and things could get a lot better. The bad news is that the recovery is still fragile.

At a certain point in the story Alice stops in front of a Cheshire cat and asks: "Would you tell me, please, which way I ought to go from here?" "That depends a good deal on where you want to get to", was its answer. Much the same way, lots of important players in the financial system are still very confused about where they really want to get. From a reluctant Germany, afraid of bailing out the European periphery to a Brazilian government nervous to accept capitalism when it entails things it dislikes, such as foreign competition, imports, bad results for its trusted ones, etc.

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The story ends with Alice's sister waking her up for tea and she is left wondering about the possible outcomes and happenings she experienced. Likewise, we have been saying loudly that the world's stock markets experienced a lot of healing in the past few years and will be left with a decade of above average returns ahead, and a great deal of new knowledge to meditate about in the future.

2) The year of 2012

Four years into the greatest recession of the past few decades, markets had entered 2012 with a few big risks in mind: the US long term fiscal outlook and political gridlock, China's deceleration and especially Europe's Euro crisis.

Starting by Europe, we witnessed a reluctant Germany continue to write checks only when it was extremely urgent to broke Greeks. Portugal, Spain and overall everyone, including Greece, managed to stay in, and the Euro may remain intact after all. In this and in many other instances, the investors who were betting in euro's disintegration had a wrong assumption: they were thinking in simplistic/binary terms and not recognizing how invested European politicians and populations were in the European project.

Outside of Europe, Barack Obama was re-elected as US president, the Arab spring took some nasty turns, but thanks to the fact that it (still) hasn't happened in big oil exporters, the bad turns had limited effect in Oil's price. Meanwhile, gold enthusiasts were a little bit puzzled after its object of cult had lackluster performance and lost the title of preferred safe assets to bonds and dividend paying stocks this year.

In China, Xi Jinping was appointed the country's next leader and China decelerated somewhat from its previous growth but should continue to grow at a still very respectful 7-8% clip in the next few years. All in all it was a disappointing but not terrible year for global growth: world GDP should grow by around 2.4% in 2012 with Europe's GDP decreasing 0.4%.

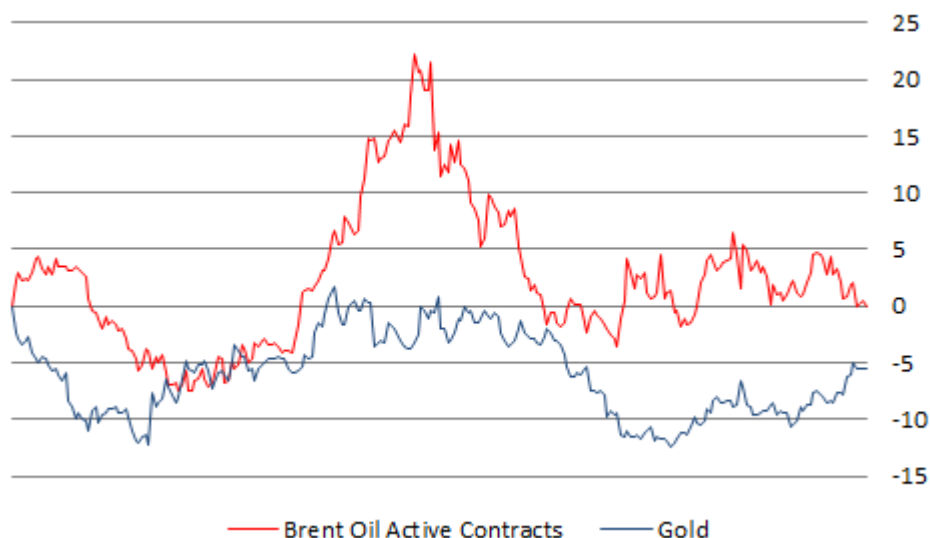
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| Region | Real GDP - % over one year ago (USD) | | | Consumer Prices - % over one year ago (USD) | | | |
|----------------------|--------------------------------------|------|------|---|------|------|------|
| | 2011 | 2012 | 2013 | 2Q12 | 4Q12 | 2Q13 | 4Q13 |
| Brazil | 2.7 | 1.0 | 3.4 | 5.0 | 5.6 | 5.9 | 5.5 |
| United States | 1.8 | 2.2 | 1.7 | 1.9 | 2.0↑ | 1.7 | 1.4 |
| China | 9.3 | 7.6 | 8.0 | 2.9 | 2.0 | 3.0 | 3.5 |
| Euro Zone | 1.5 | -0.4 | 0.0 | 2.5 | 2.3 | 1.8 | 1.7 |



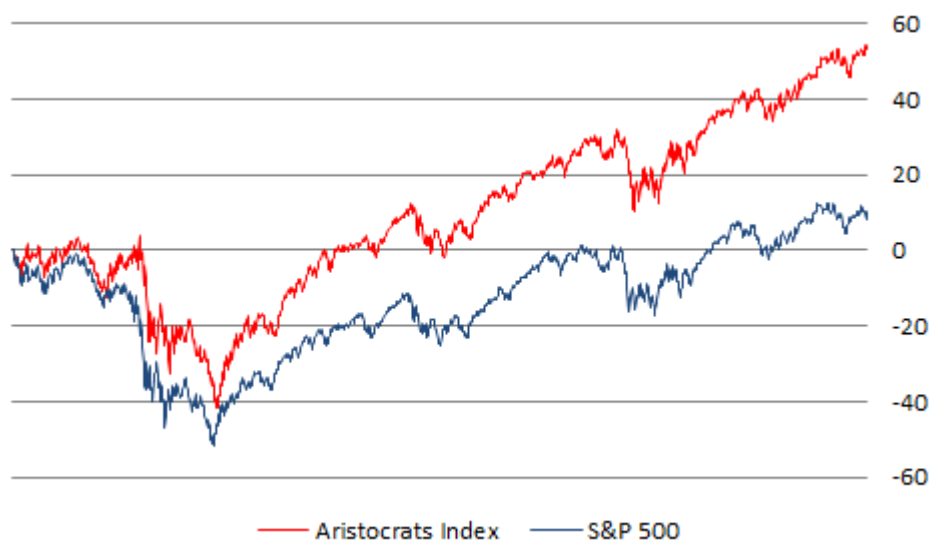
With 2008's heavy losses still fresh in investor's minds, equities were mostly flat for most of the year, in spite of progress at least to some extent in all the big global risks we mentioned above. Bond markets, on the other hand, were euphoric. The return of holding any asset that yielded anything was fabulous this past year, and consequently, bond yields and stock dividend yields, inversely correlated with the assets returns, plunged (see chapter 5).

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In the business world Apple became the most valuable public company ever (surpassing the valuation Microsoft enjoyed at the top of the tech bubble a decade ago). Facebook's IPO was a flop not because it is a bad company but because investor's expectations were too euphoric. Also, Ivan Glasenberg and his partners at Glencore are on track to create a unique company that combines the trading and commodities business with its merger with Xtrata.

In Brazil, the economy experienced slow speed due to:

- a) International environment;
- b) Government and policy mistakes;
- c) Gloomy mood by the country's businessmen.

At the same time, Ambev surpassed Petrobras and became Brazil's biggest company by market value, in a testimony both of Ambev managers' excellence and Petrobras' limitations since it is still a company controlled by the government. As for our portfolio, the economy cycle proved benefic to some of our business (like Minerva) and challenging to others (like Gerdau and Braskem), but we managed to navigate the turbulence well and had a substantially superior performance than our benchmark, the Ibovespa index.

| Market Cap in 01/03/12 | |
|------------------------|-----------------|
| Apple | 513,486.13M USD |
| Petrobras | 261,371.50M BRL |
| Ambev | 266,989.81M BRL |
| Minerva | 1,640.11M BRL |

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Last but not least, in popular culture, Google's most popular search queries worldwide were "Whitney Houston" (famous singer that passed away this past year) "Gangnam Style" (YouTube's most popular video ever) and, of course, "Kate Middleton naked pictures released".

3) Investment outlook

By definition, the most profitable investment strategy in the market will always be contrarian investing. But true contrariness does not require to always place bets that go against what most investors say they believe in. Instead, true contrariness requires only that we place bets against investors' distorted expectations, because they were too euphoric or too gloomy, as shown in financial assets prices. Sometimes prices diverge from what everyone says they believe in, and it is in the prices we should focus on. With that in mind, once again, the most profitable strategies this past year were the bold ones against failed market consensus in a handful of themes:

a) Greek bonds: in the first half of the year, investors were too certain of the Euro's imminent collapse and believed firmly (implied by Greek, Portuguese and Spanish bonds yields) that the bloc would come apart. That didn't happen and a few brave investors won huge sums by betting in a recovery. There were a number of ways to make this trade but probably the most profitable one was simply buying Greek bonds, that were priced for a default, and yielded almost 100% return in the space of a few months to some investors.

b) European equities and specially, European bank equities: due to the above mentioned reasons, European equities were also heavily discounted. The financial sector most of all. Investors who bought European bank shares were hugely compensated for their risk this past year.

c) US mortgages: another contrarian trade, the housing market started to recover in 2012 and with it; some distressed mortgages were among this year's highest return instruments.

As for equities, which is the main focus of this house, 2012 was a very unequal year: depending on where you were in the globe, and specially, depending on which currency you measure your returns in, results were totally different:

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Indexes Returns in 2012 (USD)

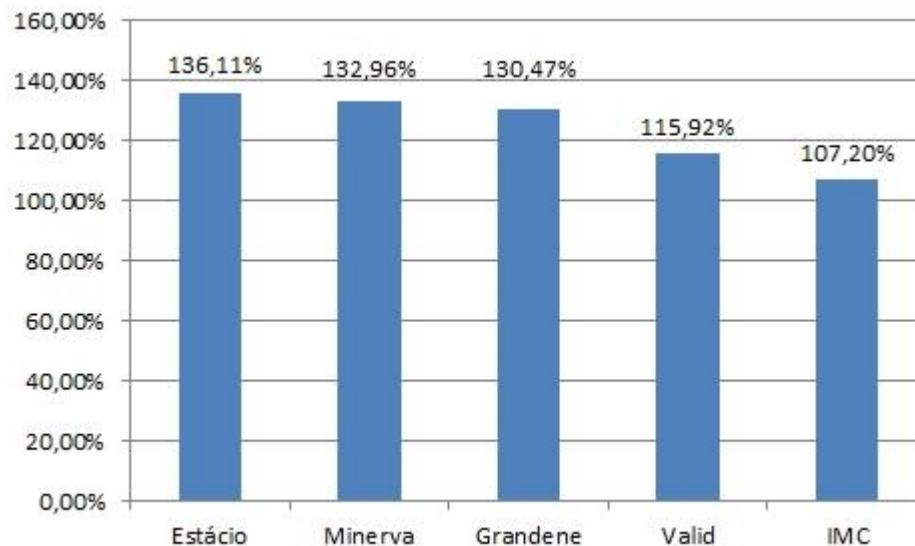
| | |
|-----------------------|----------------|
| S&P 500 | +13.29% |
| FTSE | +5.84% |
| DAX | +29.01% |
| Ibovespa | +2.47% |
| Ibovespa (BRL) | +7.40% |

And the best way to navigate these circumstances, as always, was to be very selective on which sectors and specially which companies to invest.

Bovespa Sectorial Indexes' Return in 2012 (USD)

| | |
|--------------------------------|----------------|
| IEE – Eletric Power | -15,95% |
| INDX – Basic Industries | +8,49% |
| ICON - Consumption | +21,48% |
| IMOB – Real Estate | +5,56% |
| IFNC - Financial | -2,85% |
| IMAT – Basic Materials | +0,52% |
| UTIL – Public Utilities | -18,63% |

Best performing brazilian stocks in the last 12 months:



We managed to have above average returns being exclusively exposed to Brazilian equities by being able to pick some winners and avoiding most of the losers, like utilities and electricity companies, companies with a heavy government influence, like Petrobras and Vale, and the overvalued consumer sector.

Over time, we expect the composition of the Ibovespa index to

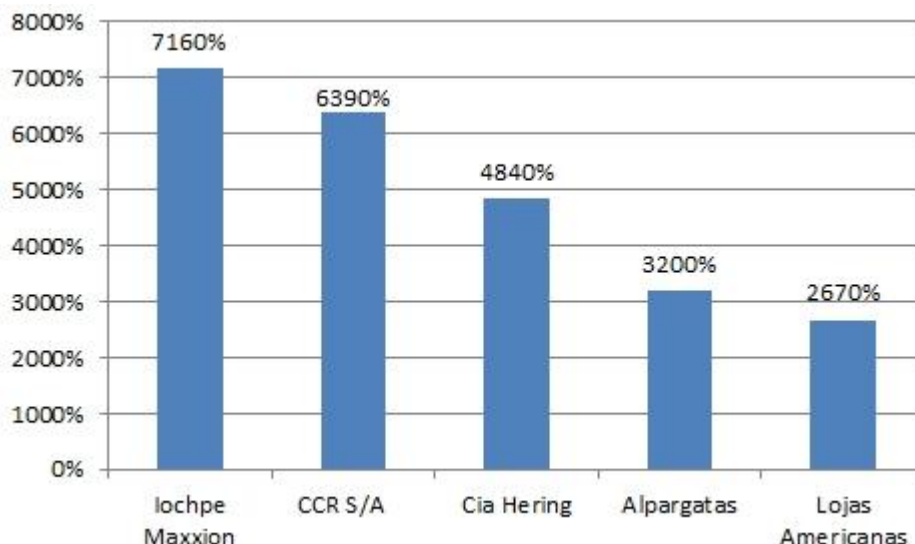
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gradually change and be a bit less commodity intensive to reflect a little bit more the reality of the Brazilian economy: a middle class country with lots of good domestic focused companies, especially in the retail and services sector. That being said, we are not bullish right now in this sector because we see it as (mostly) overvalued. An additional exercise is to chart the best performing Brazilian stocks of the past 10 years.



We can see several sectors in this exercise, both domestic and exports focused. It is a little bit skewed to small caps, but also with larger caps having a presence, and absence of the most obvious names, their presence on the list is due more to a low valuation back in 2002 than to exponential growth afterwards.

Our main task right now is to pick some of the stocks that will be in a table like this in 2022. We will try our best to do so. But notice that airlines (a growth industry in 1950) or tech stocks in 2000 were absent for almost all of these kinds of lists. The reason behind this is the same one why we don't expect education companies and consumer sector companies to make the year 2022 list of Brazilian best performing 10 year stocks, bar of course for a few exceptions.

And the reason is the fact that probably the most common mistake investors make is to equate future profits growth with future stock performance. They are not really correlated. Instead, evidence shows that investors frequently pay too much for future growth. Investors should try to buy decent companies at low prices. That would almost guarantee them a ticket to some of the future winners in lists like these.

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4) Investment Diary

Our main assumptions entering 2012 were:

- a) The Brazilian real was overvalued;
- b) The consumer sector and mostly everything related to the Brazilian domestic markets was too expensive;
- c) The Brazilian economy had deep problems still unrecognized by most investors;
- d) The world economy would improve.

Over the past 12 months, we did a better job of identifying the underlying trends that would take place in 2012 (except for letter d above) than in capturing the gain by being correct in those trends.

Our rationale was simple: be invested in exporters, which were not as exposed to the problems in the Brazilian economy, and were able, on the other hand, to exploit the country's comparative advantages and would benefit from a weaker real, which we were expecting would come sooner or later.

Overall it was a good year and we did significantly better than the Ibovespa index (our benchmark) and the Brazilian CDI, although our performance was good but not brilliant due to one big factor: we had too much exposure to companies that were seen (rightly or wrongly) as having too much exposure to the world economy, that is also not going that well.

Our investors should be aware that going into 2013 we will maintain the same strategy: we will try to have exposure to exporters (we think most investors still haven't figured it out how much their margins will improve with a weaker domestic currency and the stronger global economy that we are expecting) and be neutral to short to the retail/healthcare/education sectors which we think are approaching bubbly valuations.

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| Longs | Reasons |
|---|---|
| Exporters | With a weaker currency and a stronger global economy, margins should improve fast. It is also the cheapest sector in the Bovespa right now. |
| Sectors where Brazil has a comparative advantage | The chance of a government interference is always smaller in sectors where the companies don't need the government in the first place. |
| Shorts | Reasons |
| Retail, healthcare and educational sectors | Bubbly valuations. |

5) The yield bubble

"History doesn't repeat itself but it does rhyme" has been a time tested cliché of wisdom. It is also said that "the seeds of the next bubble are almost always planted in the previous crisis".

In our vision, the events of the past decade couldn't be more faithful to these words:



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So we reach the present: after been burned by their faith in stocks, investors search for yield and safety in any form they can encounter, accepting even negative yields and without making many calculations. Almost by definition, every time investors “need” to buy something without even making calculations we are entering a bubble, albeit in this case a reverse one, since it is a run-from-risk bubble.

But is there danger in a bubble where people are desperate not to buy the latest stock but want to buy anything that yields income (bonds and dividend paying stocks) and stay away from anything, even great companies that are not producing yield and that carry any amount of risk? The answer, sadly, is yes, for a few reasons.

First, many fixed income investors, disappointed by the low returns equity markets have yielded in the past decade are becoming poor not at once as it can happen when they invest in a bad stock, but slowly and surely, as they watch their savings being eaten away by inflation (all that has to happen is fixed income returns producing lower returns than the rate of inflation as it is the case in most of the world right now).

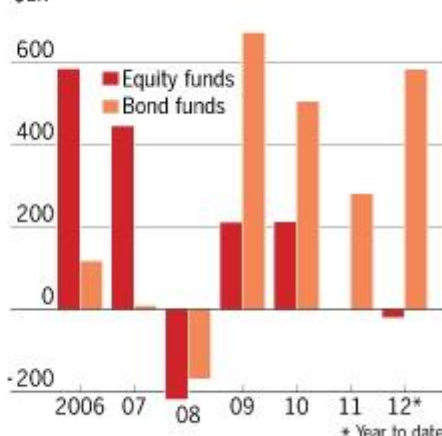
And why do people invest in something that in the end will make them poorer in real terms? The answer is that the financial crisis was so scary to so many people that they prefer the certainty of a small negative return than the volatility of riskier markets for now.

Mixing it up

Global portfolio weightings of fixed income



Global equity and bond fund flows



There is a deeper reason for the rush to invest in bonds and away from equities: investors unfortunately chase past performance. And the fact is that with the crisis, equities tumbled while bonds rose.

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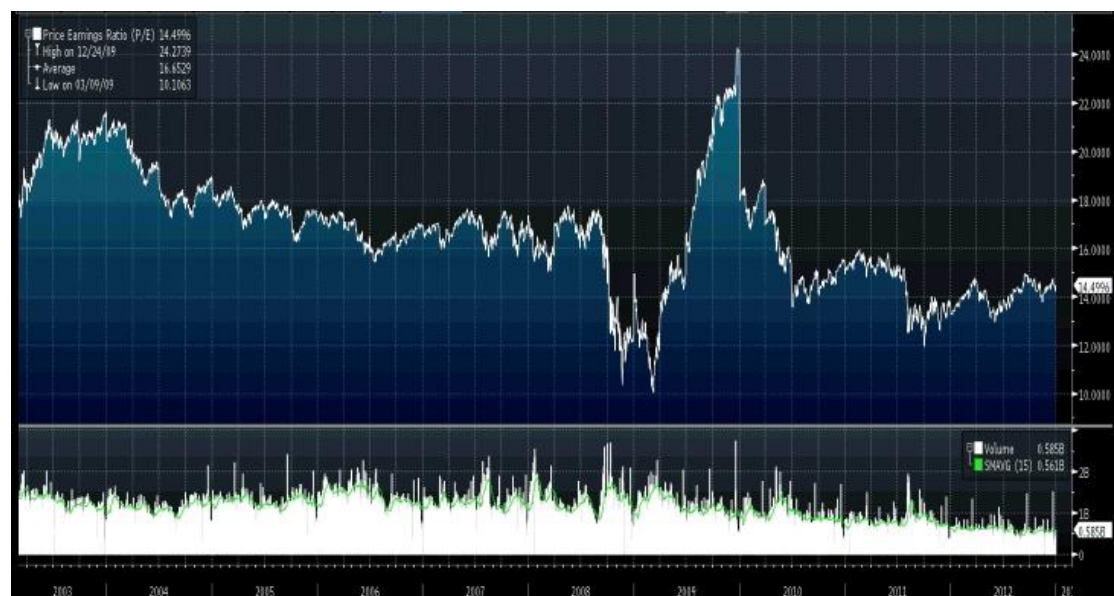
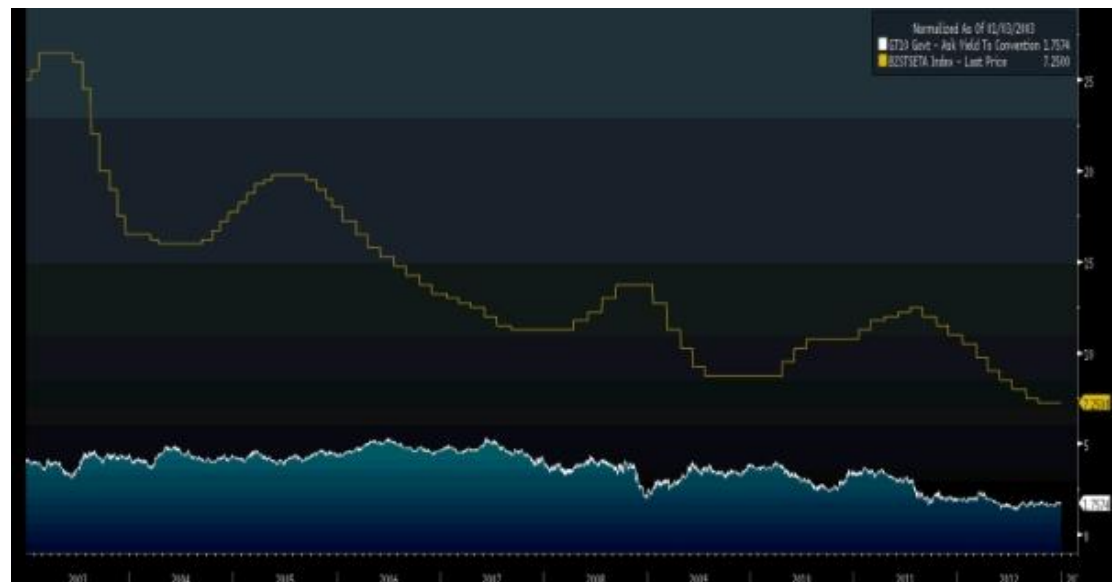
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The problem, however, is the shortsightedness of this framework: investors should be aware that the only asset class where they will, in the long term, have a return greater than inflation is equities and that is where most of their assets should be right now.

Besides, sooner or later risk aversion will decrease and when it happens, we predict a massive flight away from bonds, leading some investors to terrible losses, especially the ones positioned in the long parts of the curve. We know it is somehow counterintuitive to argue that there is a bubble in one of the safest corners of finance, but a bubble can happen anywhere, and it makes perfect sense that after a terrible crisis the next bubble would occur exactly where investors think is safer to park their money.



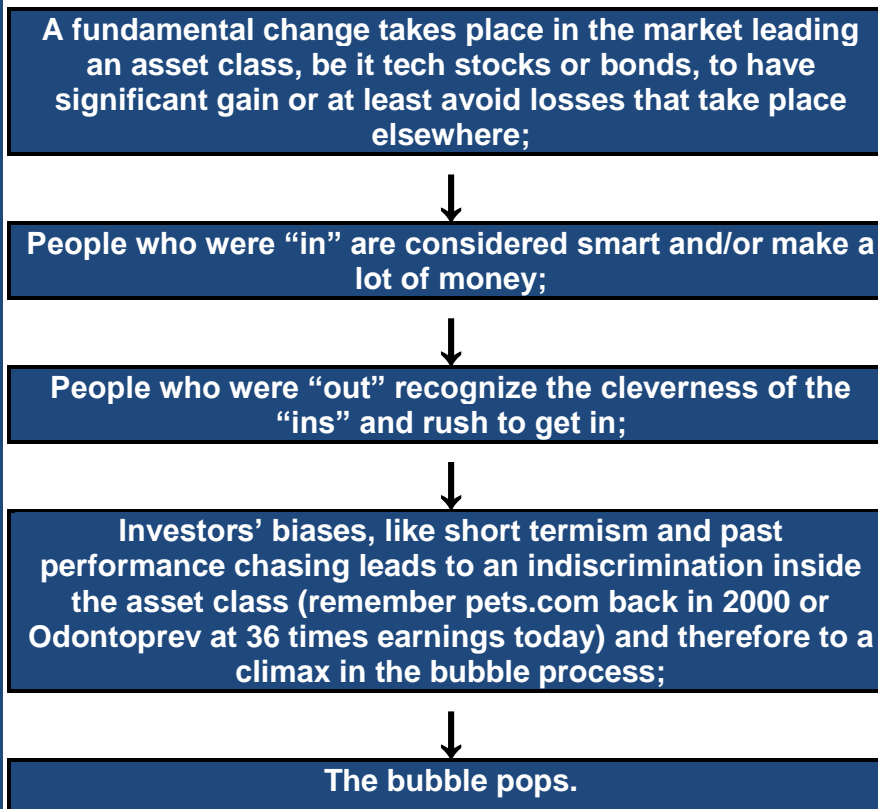
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Lets us review the basic process of a typical bubble:



I would say we are between stages c and d in the “safety” bubble right now.

And one interesting fact: so far we’ve talked about bonds, since they are the classical yield generating instruments, but essentially the same process was seen in the stocks thought of as “quality” or “dividend paying”. Many CFOs around the world have rushed to increase dividends, in many cases cancelling good expansion projects because everyone by now has realized you can pretty much double your valuation just going from a “no dividend” company to a “dividend paying” one.

The S&P “dividend aristocrats”, a basket of 51 companies that have regularly increased their payments for at least 25 years, touched an all-time high in October. That crowned a gain of 164 per cent for the index since stocks plumbed their financial crisis low in March 2009. The performance of the top dividend-paying stocks outstrips the broader S&P 500’s rise of 117 per cent to its high this September from its low set more than three years ago.

In Brazil, the Ibovespa was one of the cheapest and worst

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performing stock indexes in the world for the past few years, but even in it, we can see crazy valuations in stocks like Ambev, Souza Cruz and our absolute favorite, Odontoprev (see our June 2012 letter), that have absolutely nothing in common except one single fact: they always managed to have a dividend yield of at least 2% to its investors.

| Company | P / E | EV / EBITDA | Dividend Yield |
|------------|-------|-------------|----------------|
| Ambev | 27,50 | 18,24 | 2,89 |
| Souza Cruz | 28,23 | 19,01 | 3,02 |
| Odontoprev | 37,99 | 26,78 | 3,17 |
| Braskem | - | 6,88 | 4,46 |
| Gerdau | 16,59 | 9,14 | 1,67 |
| Minerva | - | 7,62 | 2,55 |

The reasoning is easy to grasp: dividend yield paying stocks also tend to be solid companies with strong cash flows. Many are from the utility and telecom sectors. These sectors are seen as being a bulwark against a weak economy. But this is also a simplistic assumption. If the management can push up its share price just by deciding not to pursue any expansion project anymore and instead distributing its cash back to shareholders, something is certainly wrong.

In the long term, investors will be worse off because no one can run from the fact that if you bought a super expensive company, dividend paying or not, you will end up with terrible long term results. The economy will also be worse off because companies are getting an incentive not to expand and instead give cash back immediately to shareholders.

So, to sum it all up, adding to the framework we outlined in chapter 4, we add a new item:

Long: cheap and good quality companies, while trying to avoid “value traps” (as always);

Short: Hyper expensive bonds and dividend paying stocks that disguise itself as “good quality and stable companies”.

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6) The inexistent value in investment banking

Continuing our 2012 retrospective, one of the first things we did as soon as our fund was built was to search for value ideas all over the world. It was the first time we could do that. With the transformation of our investment club into a fund, our investors approved a regulatory provision allowing us to deploy up to 10% of our capital outside Brazil.

So our worldwide search for ideas started. And where was the first place we took a serious look at? Well, it had to be somewhere cheap, discredited. Yes, the first time we could look outside of Brazil for investment ideas, the minute a global search for alpha started, we took a hard look at the global investment banks.

Overall, it was not a terrible year for global investment banks: The 81-company Standard & Poor's 500 Financial Index (S5FINL) is up 27 percent this year, its largest annual increase since 2003, led by a 104 percent gain in Bank of America Corp. The index beats the broader S&P 500 Index for the first time since 2006.

There are certainly many merits in these companies: global champions that were traded substantially below their (admittedly dubious) book values and waiting for a new breath of optimism usually are great value stories. We came close to opening a position in Goldman Sachs, before its stock surged significantly towards the end of the year. After much studying however, we must say we decided to stay put as we don't judge global investment banks a sound investment proposition just yet.

Investment banks are the ultimate black boxes when it comes to earnings and expenses. Even if its management is totally and absolutely correct, in many instances when and how to book a profit and an expense is somewhat arbitrary at best and left to judgment at worst. This means that it is easier to "massage", for lack of a better expression, the earnings in this sector than almost anywhere else. And why do we worry about this, since it is a reality almost anywhere in the financial sector?

Because after the vast study we did about global banks this past year, we were left with the feeling that these institutions are (mostly) still managed by insiders for the benefit of insiders, with shareholders and, to a smaller extent, bondholders, still being the outsiders, who can be pleased if there's money left after every one of the insiders get more than its share.

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A simple study we did was to look at the compensations of these institutions and the profits they were generating:

| Company | Expected Earnings in 2013 | Market Value | Book Value | Compensations / Earnings |
|---------------|---------------------------|--------------|------------|--------------------------|
| Goldman Sachs | 6301 M | 63,455 M | 68,337 M | 206% |
| JP Morgan | 20776 M | 169,428 M | 169,635 M | 75% |
| Barclays | 13841 M | 54,176 M | 87,702 M | 39% |

It is very hard to observe the amount of compensation paid by these institutions and not think that shareholders are an afterthought, and not the main reason these well paid people are working.

Sure, this subject comes and goes often, and this past year alone the question “wouldn’t it be better for shareholders if the total level of compensation was lower?” was, with small variations, asked by analysts at the conferences we listened to, from Goldman Sachs, UBS and Barclays.

The answer, of course, has even fewer variations than the question: “We can’t do that, because if we did, we would lose much of our talent. And this is a business based on the talent you have. This is the only competitive advantage here. So it is in the interest of our shareholders to maintain this level of compensation”.

In our opinion, a lie.

If what every investment banking CEO said was the truth, we would then be able follow with two basic assumptions:

-They are saying the truth: there’s a brutal war for talent and they can’t afford to lower their pay.

Well, basically this means that their industry is bad. If this is true, the bankers made the industry hostage, since the talent will all go elsewhere with any amount lower than what they currently receive. So, there’s no value in the industry anyway, because what will happen is what has always happened: most value will go to the

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employees when times are good and no value at all will go to the shareholders when times are bad.

But, of course, now it is time to assume they are lying, as we think they are.

-It is a corporativist sector that looks after its employees and has its shareholders as an afterthought.

In fact, if we look at any table of compensation to profits in the global investment sector, we can see that:

1) When times are good remuneration goes through the roof because the CEOs say the sector is “booming”, “very competitive” and “talent is mobile”, to stick to expressions given to analysts in the past few years;

2) When times are bad, they can't lower their pay because otherwise they would lower their talent.

This leads us to our assumption about the sector, and yes, this also applies to BTG Pactual in Brazil, although as a new institution with a strong CEO, much of the vices are still not in place there:

It is a sector run by and for its insiders. When times are good, earning will be “massaged”, strongly enough so shareholders will be happy, but most of the value will go to key employees anyway. On the other hand, when times are bad, shareholders will be really squeezed, insiders will still make a lot of money (although a lot less, of course, than when the economy is booming) and no one else will be happy.

So, FCL's team took a hard look and with resignation decided to stay away from the sector.

7) Performance:

7.1- FCL Capital investment Club

From April 3rd 2007 to November 21st 2012 the FCL Capital invest club had a total return of 189.36% in BRL, comparing favorably with a performance of 21.50% of the Ibovespa Index and of 76.47% of the Brazilian CDI in the same period.

The club's annualized performance was of 20.67% in Brazilian Reais and 20.0% in US dollars, again comparing favorably with the

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performance of the Brazilian CDI, the Ibovespa and S&P500 indexes during the same period.

One thing we are especially proud of: our returns were consistent throughout the club's existence: In the past 12 months (until November 21st) our return in Reais was of 25.16% against -1.11% of the Ibovespa and 8.60% of the CDI. In the past 24 months it was down 1.11% against -16.93% of the Ibovespa Index. In the past 36 months it returned 29.90% against -16.11% of the Ibovespa Index.

It is with some sadness that we watched the story of our first product ending, but also with a lot of pride. We hope its successor, FCL Equities, will match this level of success in terms of performance and compounding of our investor's capital.

7.2- FCL Equities FIA

According to the rules issued by CVM # 409 for Advertising Investment Funds (with changes introduced by the instructions 411, 413, 450, 456 and 465).

Article 75. Any disclosure of information on the results of the fund can only be done by any means, after a grace period of 6 (six) months from the date of first issuance of shares.

The fund started on 21/11/2012, therefore we will begin disclosing information relating to the share value and performance on 22/05/2013. Thank you for understanding.

8) The year ahead – 2013

John Authers, FT columnist, always jokes that he's the manager of the best performing hedge fund in history: Hindsight Capital, dedicated to investigate the past year's best investment ideas and returns. So, in hindsight, we can say that the best investment ideas involved keeping the faith that the Eurozone would remain in one piece: buying Portuguese and Greek bonds (although an investor could do even better if he shorted Greek bonds until the middle of the year and then bought them aggressively).

Apart from the Eurozone, equities performed well, although not fantastically and not in Brazil, but if someone bought banks and US homebuilders, the two most battered sectors by the financial crises, they would do superbly well. Gold would not be in the list so

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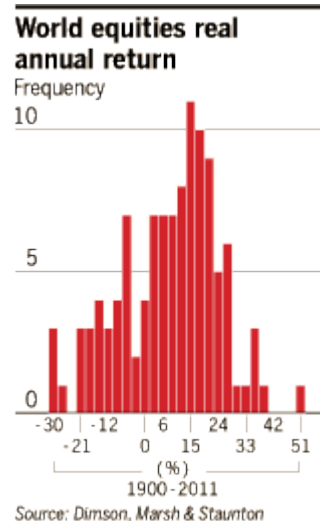
far in 2012: the bullion performed only +6% until the last week of the year.

The best performing commodity was soybean, and even it, lead to a modest 19% gain. Currencies also did not experience huge dislocations upside or downside. The best performing major index was the DAX (+32% in US dollars) and the worst performing in dollars were the Ibovespa (-3%) and Madrid's Ibex (-1%).

As we always do, we offered a lot of predictions in our 2011 annual report. Some were right on the spot, some were way off: we predicted that the Eurozone would remain intact, that markets would sooner or later start to recover, as they are doing right now, and that homebuilders would lead us all out of the crisis. We also made a section in our 2011 report explaining why Minerva was our single biggest position (it turned out as one of the 2012 huge winners in the Bovespa) and why we were short in Odontoprev.

On the other hand, we predicted that 2012 would be the year that micro fundamentals, as opposed to macro, would once again dictate the markets (false, not yet) and that the Real would stay near 2011's level (we were not counting on Mr. Mantega's protectionism) All in all, we will give ourselves a B+ for last year's predictions. What are yours for 2013? Here is ours:

- World economy recovering a bit, to something like 2.5% GDP Y/Y;
- Major currencies, including the Real, roughly unchanged, apart maybe from the Yen, that we think is going down in the long term;
- Brazil's economy growing around 3% Y/Y;
- World bond markets will experience terrible returns and world's stock markets will experience above average returns in the next few years.



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One big caveat is in order: predicting short term returns for any asset is probably not worth the effort anyway. Over such a short period like one year, chance dominates, as the extreme variations of returns suggest. Only just over two-thirds of the time was the one-year real return on world shares between minus 12 and plus 23 per cent in the past 112 years. It is the long term returns that count, and amazingly investors almost don't pay attention to them, forever trying in vain to time the market.

If there's one definitive proof that stock returns are uncorrelated to how the economy is doing, just look at Greece's stock index, actually up this year. It is beating the (in this case catastrophic) expectations that count. We also think that the US economy growth and the Brazilian stock index may surprise on the upside, due to the US competitiveness and China's rebound respectively. Below, some possible surprises we are contemplating with various degrees of confidence (ranging from improbable to almost certain):

- A strong rebound in China's and the world's economy, with Europe showing positive GDP in 2013;
- Great returns for stock pickers in Europe (even with the crisis, many of the world's best companies are based there);
- Great returns in the out-of-favor Brazilian stock markets;
- England (and not Greece) leaves the EU;
- Massive outflows from fixed income into equities worldwide.

We'll be back in 12 months, discussing this year's predictions and offering new ones to our readers. Meanwhile, we would like very much to receive your views about our predictions and your own predictions and takes on the world in 2013.

9) Management letter

Many great new books and exiting ideas were launched in 2012. In fiction, we had from tales of ancient Somalia ("The Wandering Falcon"), discussions of violence ("Gone to the Forest"), to new releases by authors such as Salmon Rushie and Ian Mcwian. In journalism, we had the fantastic Steve Jobs biography by Isaac Samuelson and an Open and honest book about the life of tennis champion Andre Agassi.

But one book in particular caught our mind in 2012 although we vehemently disagreed with it: a Virginia economist called Tyler Cowen released a book called "The Great Stagnation: How

America Ate All the Low-Hanging Fruit of Modern History, Got Sick, and Will (Eventually) Feel Better”.

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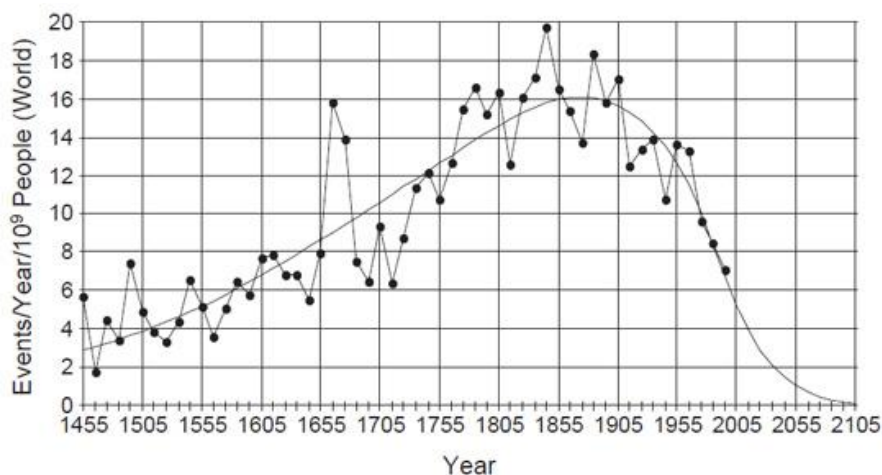
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To sum it up, the book brings an interesting theory: it starts by looking at humanity’s technology development in the past few centuries and it concludes that humanity in general (and America in particular, since it is still the world economy’s efficient frontier) has picked up all the “low hanging fruits” in the economic development, and that from now on, progress will be significantly slower, costlier and bring less spectacular results. A consequence, the book argues, is that we should expect lower growth from now on, since it is human progress that ultimately drives economic growth.

“But look at all the recent progress” is the first reaction to many of the readers of the book. “There’s internet, IPADs, smartphones...”. Yes, but does it compare to the advent of electricity, telephones, automobile and airplanes like it happened between late 19th century and early 20th century? The author proposes an experiment: would you rather live without anything invented in the past 30 years -the internet, Facebook, laptops- or would you rather not live with the things invented in the centuries before -functioning bathrooms, energy, etc.-? Most people would surely prefer the “medieval” inventions.

And there’s more: as human kind becomes more educated and more productive there’s a clear limit on how far we can go: in early 20th century only 6% of American graduated from high school, now it is at 75%. It clearly can’t go past 100%. And so it happens in many areas. The emergence of Asia, the ingress of women in the workforce, and many of the past “tail winds” are in the same logic, “one off” events. And so the book makes a compelling case that the “golden age” of progress is now approaching its end.



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A nice piece was written recently by the economist Kenneth Rogoff, rebutting the book by somehow inadvertently amplifying it, arguing that humanity is not achieving the end of progress but it is vested monopolies and oligopolies that are imprisoning it. A case in point, the internet economy is today dominated by basically four companies: Amazon, Apple, Google and Facebook. In times past many people with amazing ideas would join this pantheon, but today the ones that succeeded were quickly acquired by one of the four giants, just think of Instagram (bought by Facebook this past year) or YouTube (bought in 2009 by Google). So, with the possibility of a new era of stagnation on one hand, and vested oligopolies in the other is there really a possibility that the old assumption that in the long term technology will improve no matter what is wrong? We don't think so, for a few reasons.

First, let us not forget, even if professor Cowen was right, most of humanity lives in places far away from the productivity frontier (America). So, one way or another, the rest of the world will approach its level of development, and so in our lifetimes we will have significant economic growth even in places closer to the frontier, which are a small part of humanity, stagnating. China's output per person is after all only one fifth of US levels and India's one tenth of US levels.

Second, many people lose sight of this, but technology has never evolved in a linear way. We have eras of rapid progress followed by eras where the resources are more allocated to improving the ways previous ideas can be used and applied. In this sense, as recent innovations are still not used to their full potential, the book undersells them. Computing and the internet are amazing inventions after all. Every bit as transformative as the steam engine or electrification, and society is only beginning to reorganize itself around these technologies and huge changes will follow, many of which will produce rapid growth in output and jobs.

Finally, we think there's an intellectually dishonest framework with the book: comparing innovations that already realized its full potential with new ideas still in their infancy. Instead, a better use of time would be to walk around the world's labs and drawing boards and in this environment, talk about a permanent stagnation would be risible. They are too busy producing tomorrow breakthroughs: 3D printing, nanotechnology, biotechnology and genetics. We may someday reach the end of the fast lane in technological progress. But we still have a long way to go.

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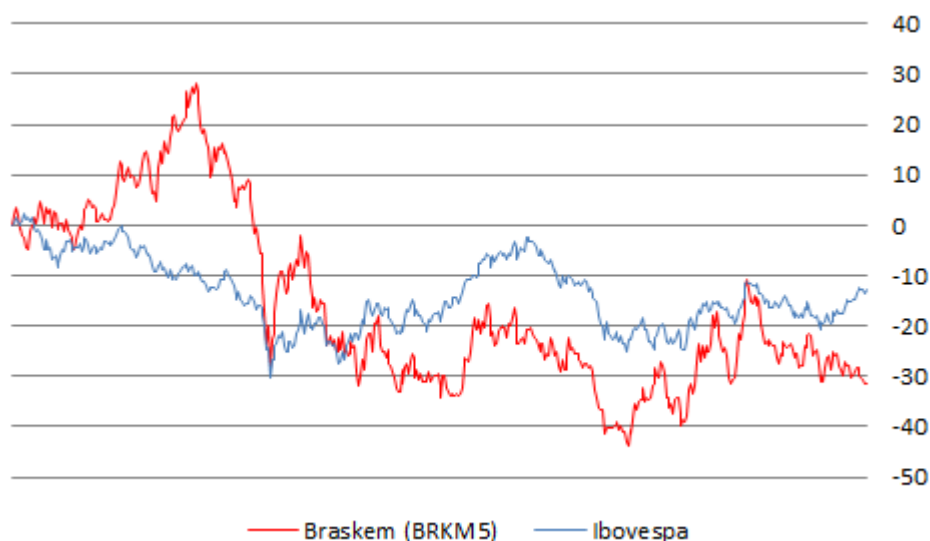
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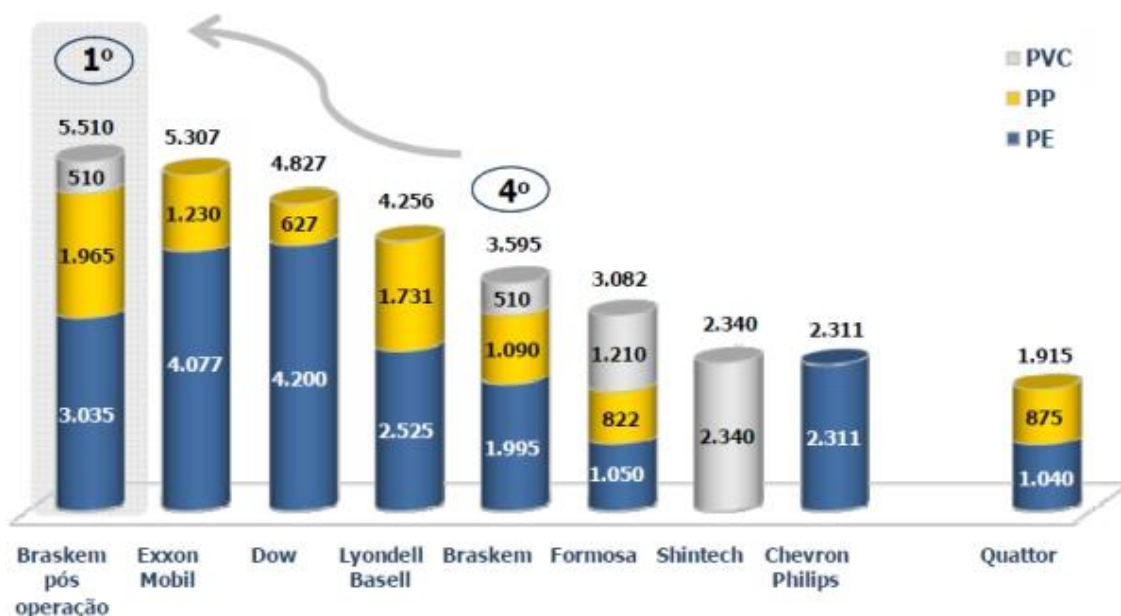
10) Manager's dossier

A tradition of every FCL Capital's annual report is to select a company in our portfolio and discuss with our investors the reasons and reasoning behind our investment.

This year our subject will be Braskem, a company that has not been getting much love from investors in the Brazilian stock exchanges for the past two years:



Let's start with the basics: Braskem is the biggest petrochemical company in South America (10x bigger than the second one) and one of the 10 biggest petrochemical companies in the world



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Over the past couple of years, Braskem's share price has been suffering for a few reasons:

- a) Tough macroeconomic environment made worse by a tough cycle in the petrochemical industry;
- b) Brazilian government interventionism that is affecting investor's confidence;
- c) A new reality in the industry, that will make shale gas more competitive in relation to crackers that use naphtha, like Braskem;

Let us examine each one of these reasons deeply:

a) The reality in the petrochemicals industry

Petrochemicals are called a cyclical industry for a reason. Building a new plant is a long term process and adjusting to demand takes time. So, it is true that we are currently in a low spread phase in the industry:



What is also true is that the same factor that makes this industry cyclical (supply takes a long time to adjust to demand) also makes it reasonably predictable: we will enter a high profitable cycle in

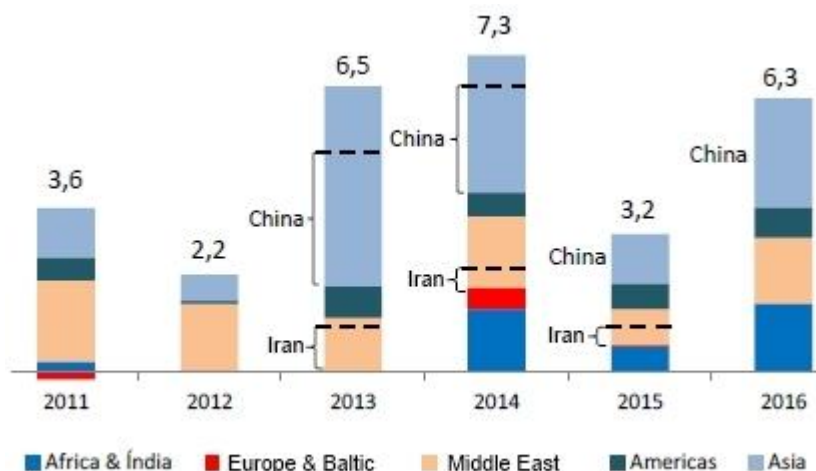
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2014-2016. How do we know that? By simple math, computing all the new capacity additions between now and then and forecasting, conservatively, the demand.



So it is a given that the industry will see better days, and it has always been the case. What has not changed is the ability of investors to analyze the industry correctly: they always assume the recent past will go on forever, in good times and in bad times alike. So, Braskem has been priced for total stagnation and not for a rebound in the cycle.

| In Millions | FY 2013 Est | FY 2012 Est | Current/LTM |
|----------------------|-------------|-------------|-------------|
| 12 Months Ending | 2013-12-31 | 2012-12-31 | 2012-09-30 |
| Market Cap | | | 9,268.80 |
| - Cash & Equivalents | | | 3,839.08 |
| + Preferred & Other | | | 261.45 |
| + Total Debt | | | 17,022.67 |
| Enterprise Value | | | 22,713.83 |
| Revenue | 38,623.31 | 36,301.08 | 35,534.78 |
| Growth %, YoY | 6.40 | 9.42 | 13.14 |
| Gross Profit | 4,586.52 | 3,548.43 | 3,143.88 |
| Margin % | 11.88 | 9.78 | 8.85 |
| EBITDA | 4,072.39 | 3,455.50 | 3,279.60 |
| Margin % | 10.54 | 9.52 | 9.23 |
| Net Income Before XO | 552.10 | -989.13 | -1,206.11 |
| Margin % | 1.43 | -2.72 | -3.39 |
| Adjusted EPS | 0.71 | -1.14 | |
| Growth %, YoY | | | |
| Cash from Operations | 3,240.37 | 3,328.16 | 2,308.39 |
| Capital Expenditures | -1,866.17 | -1,869.50 | -2,628.67 |
| Free Cash Flow | 1,374.20 | 1,458.66 | -320.28 |

If we are correct, Braskem shares will have a double tailwind in the next few years: margins will improve greatly due to the advent of the good phase in the cycle and multiples will increase even more,

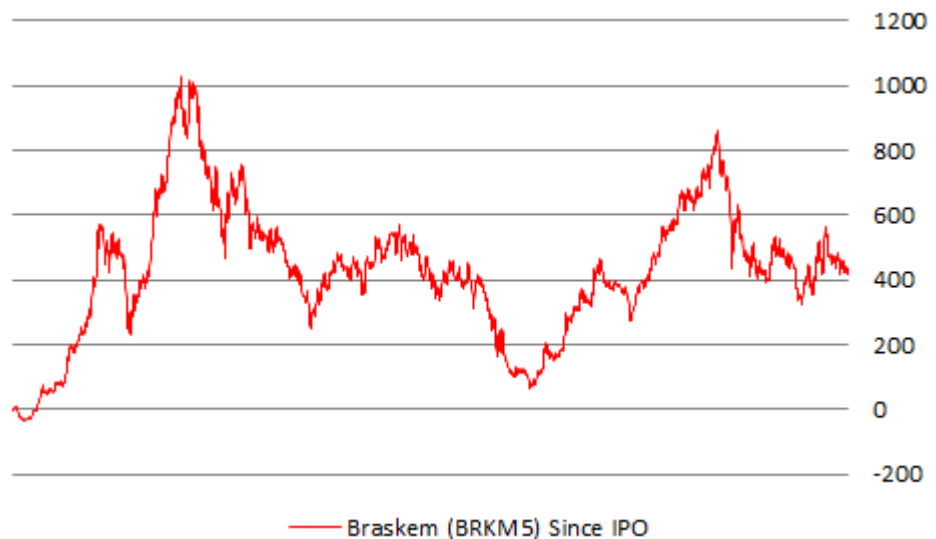
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due to investors propensity to forecast that the recent past will always go on. This has been the case for Braskem since it is a listed company.



b) The government

We don't believe investing activity should mix with ideology, except when it brings insights. Outside of work we hold a firm belief in the free market ideology. When analyzing companies, however, we try to leave all our dogmas outside. It is a fact that Brazil has right now an interventionist government that dislikes free trade. So how should we position ourselves given this unfortunate reality? Around the companies favored by the government, of course.

Braskem has been one of the most well treated companies by the Brazilian government in the past few years and evidence shows this fondness is even increasing. The government sees it as an industrial champion, job provider, and above all, realized that Petrobras, the oil champion, is the second biggest shareholder in the company.

We judge this a perfect spot: a private company, with a profit maximizing administration at the same time protected by the heavy hand of the government. Let us quickly review a few measures taken by the federal government administration in the past year in favor of Braskem:

- 1) Import taxes on sales of petrochemical products (05/09/2012).
- 2) Lowering of energy tariffs.

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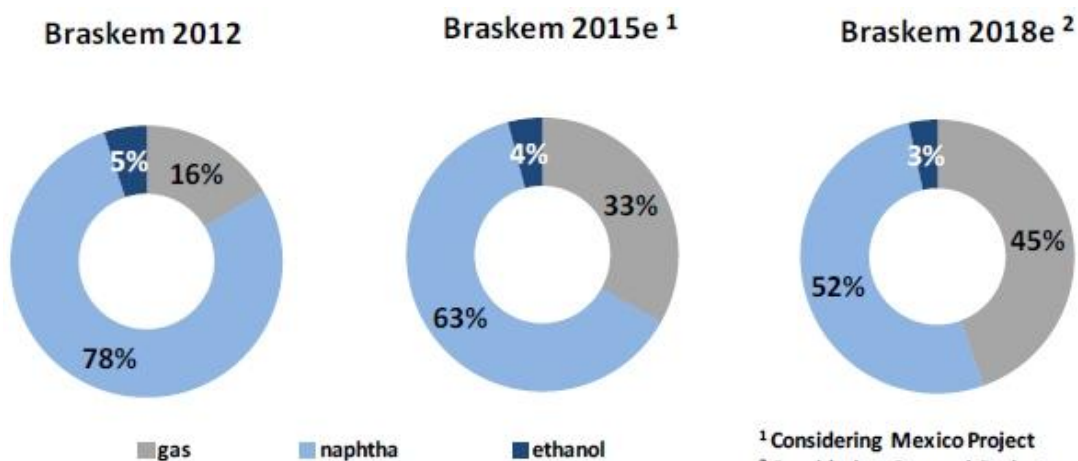
3) Unification of ICMS taxes and efforts to end the “port war” that was stimulating chemicals imports in the country.

These measures taken together would already be enough to greatly improve Braskem’s profitability in the medium term, even if the industry wouldn’t see a phase of higher spread in the future as it will. The shale revolution would impact the industry in the next decade.

It is true that chemical plants based by the new shale technology will have higher profitability in the future. But once again, investors are rushing to conclusions and not making a proper analysis of the situation. They rarely do because they tend to like to be invested in something “hot”, “new” and “exciting”.

First, as discussed above, we can forecast the capacity additions that use shale gas into as far as 2016, as it will remain a marginal supply: from around 1% of total capacity, it should jump to around 4% in 2016. It is an exciting new area and it will eventually change the industry, but it is nothing that will change the reality of the next cycle of the industry and presumably, it will have a negligible impact around the 2020s.

Second, that are many petrochemical products that can only be made by Naphtha, and as more capacity is diverted to shale, Braskem and other producers that use naphtha will have a natural hedge by focusing on those. Finally, Braskem will also change significantly its production matrix in the next few years, having a much more competitive production process than in the past, assuring its permanence among the top world petrochemical producers in the next few decades.



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So, we set ourselves a few premises for our investment in the company in the next few years:

- a) A return to Ebitda margins around 12% in the medium term (still significantly lower than the company has experienced in the past);
- b) Net revenues reaching R\$ 55 billion in 2017;
- c) Constant net debt;
- d) A return to a more reasonable multiple of ev/ebitda of 6,5;
- e) Dividends of R\$ 60 million/year on average.

We've reached, according to our internal calculations, an implied IRR of almost 29%, being in our opinion one of the ideas with most significant upside potential in our portfolio.

11) Graph of the Year: Real return of the Brazilian CDI



12) Appendixes

a) FCL Capital 2012 presentation:

<http://fclcapital.com/publicacoes/ApresentacaoFCLCapital2012.pdf>

b) Matéria Valor Econômico de 20/12/2012:

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“A sensação de que a bolsa não saiu do lugar nos últimos três anos quando se olha para o Ibovespa não vale para quem avalia o desempenho das carteiras de ações. Estudo realizado pela consultoria financeira TAG Investimentos com mais de 200 fundos de ações com histórico desde 2009 mostra que os ganhos de algumas carteiras chegam a superar em mais de oito vezes a variação do principal índice da bolsa no acumulado do período até novembro último.

Neste ano, o descolamento é ainda maior, com os melhores gestores entregando retornos de 20 a 50 vezes acima do Ibovespa. Ainda assim, e mesmo com os juros no menor nível da história, essa é uma classe que não chega a ter 10% de participação no patrimônio da indústria de fundos, e isso considerando todas as categorias de ações, inclusive os fundos indexados a índices e setoriais. Em 2012 até novembro, o segmento atraiu apenas R\$ 5 bilhões, enquanto os multimercados, por exemplo, captaram mais de R\$ 29 bilhões. Mas isso tende a mudar daqui para frente, já que a bolsa guarda o maior potencial de ganho entre as diversas classes de ativos, segundo os especialistas. Para os leigos, conforme destaca o levantamento da TAG - que considerou fundos de ações acessíveis a todo tipo de investidor e patrimônio líquido médio acima de R\$ 10 milhões, com exceção de carteiras passivas ou setoriais -, há bons gestores de ações.”.

Fonte: Valor Econômico

c) “Por IPOs que sejam âncoras para a Bolsa

Entendemos que o ano que vem permitirá desovar essa série de IPOs reprimidos por "condições adversas de mercado".

Não vai ser como um 2007 de 64 debutes, mas esquentaremos os motores para voltar com tudo.

Dá vergonha de ter apenas trezentas e poucas empresas listadas na Bovespa, quando mercados bem mais singelos que o nosso negociam na casa do milhar.

Não vai ficar assim.

É bem provável que comecemos 2013 com um IPO interessante, da BB Seguridade, talvez em torno dos R\$ 5 bilhões - que é um porte respeitável.

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Não é ainda o ideal, mas essa oferta já se aproxima do que classificamos como "âncora" para a Bolsa.

A popularidade de nosso mercado, principalmente junto às pessoas físicas, depende de ofertas-âncora.

A última delas foi do Magazine Luiza, marca conhecida, que reflete um negócio tangível, de fácil apelo público. Não à toa, trouxe vários novos investidores à Bovespa, mesmo num momento sistêmico pouco atrativo e mesmo entregando 1% de margem líquida.

O Boticário, por exemplo, seria uma bela oferta-âncora. E o mesmo vale para Habibs, Atacadão, Azul, Claro Brasil, Globo, Copersucar, Schincariol, Makro, CEF, Unimed, Leader, etc...

E quem sabe um dia os times de futebol, assim que conseguirem pagar seus jogadores de forma recorrente.

A oferta-âncora pode ser bombástica no sentido de expandir a demanda por Bolsa, mas implica cuidado especial. Se ela falha, falham com ela milhões de investidores prospectivos.

Veja o mau exemplo do Facebook nos EUA.

Não havia um só americano que não cogitasse participar do IPO. Taxistas, professores, vendedores de hot dog que nunca tinham pensado em Bolsa passaram a flertar com FB.

Deu tilt na Nasdaq, e as ações caíram de US\$ 33 para US\$ 17, só agora retomando o nível de US\$ 28.

O Facebook ainda pode dar a volta por cima, é claro. Mas sua primeira impressão foi traumática.

Precisamos de âncoras, não de naufrágios."

Fonte e autoria: Empiricus Research
(<http://www.empiricus.com.br/>)

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About FCL Capital

FCL Capital is an independent investment company, focused on portfolio management, free from conflicts of interest and multiple objectives that has for a mission the preservation and multiplication of its investors' capital, through a thorough financial analysis. Our goal is to generate absolute returns, staying solid and consistent through good and bad periods of the economic cycle.