

FCL *Capital*

2Q 2021

200 Years Under the Buttonwood Tree

“Standing here
The old man said to me
Long before these crowded streets
Here stood my dreaming tree
Below it he would sit
For hours at a time
Now progress takes away
What forever took to find”

(From “The Dreaming Tree”, by The Dave Matthews Band)

In immemorial times a group of coffee merchants used to meet by the shades of a Buttonwood tree to quote their prices, buy and sell coffee, tea, sugar and spices to and from each other.

It was only a decade or so since the United States of America had declared independence and for some unknown reason that tree, in the distant and unimportant southern tip of the island of Manhattan became the gathering spot of those traders in the messy and brutal 18th century New York City.

If Boston and Philadelphia had political activists, the mostly Dutch and Germans who settled in New York City, many of them gangsters, were only interested in business, of the legal kind or not.

Eventually, it was under the shades of that Buttonwood tree, where those traders had gathered for years, that on May 17th, 1792, the so called “Buttonwood Agreement” was signed. The Agreement established the first trading rules for that group and is now remembered as, in essence, the founding document of the New York Stock Exchange. In other words, those coffee and tea traders were, without knowing, giving birth to what is today the beating heart of the modern economy and global finance. The center of the financial world.

In the beginning there was, of course, chaos. Few rules, most of them only customary, lots of defaults and problems. The reason for the agreement was, in reality, a market crash that had happened due to a leveraged trader who was short the market and was unable to honor his positions.

This crash made the other traders realize that some functioning mechanisms were necessary for the market to function properly. So, if to quote Howard Marks, the market moves in what can be called a pendulum between euphoria and despair, we can tell for a fact that those extreme cycles existed even before the existence of the market itself!

So, there were those traders back in 1792, forming their “club” with the assumption that following rules would be favorable for their trading in the long run even if, in the short term, it denied each one of them the opportunity to renege or default on unprofitable

positions. To join their club, each one would have to follow the same set of rules and procedures.

So, in this set of circumstances, in a street that used to have a slave market by a wall (and was thus simply called “Wall Street”) the planet’s most important market was born.

But make no mistake, those were humble beginnings. If in the present thousands of companies are traded and billions of dollars change hands every day in the New York Stock Exchange, back in 1792 there were basically only three tradable securities: an insurance company; the bank of New York (known today as BNY Mellon); and Treasury bonds issued to help fund the debt incurred in the war against the British, usually referred to as Hamilton Bonds, after the then Treasury secretary Alexander Hamilton. And so, the traders would meet under the shades of the tree (or, if it was raining, at a nearby coffee shop) to quote their prices to each other.

But here is the most incredible fact: if we change the scenery and imagine a time and a world powered by horses instead of computers and electricity, the general nature of what those men did hasn’t really changed that much. Since the dawn of those immemorial times, investors have been trying to figure out what was the secret behind those prices that would go on to fluctuate and, in the process, either make fortunes or leave people in penury. And thus, what is until this day one of the greatest puzzles of human society, one that so many great minds have tried to figure out, was created: how to get ahead of competition and foresee where those prices are heading? In other words, how to understand, gain an edge and, therefore, “beat” the market?

And so the mystery of finance begins.

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Countless legends, methods and tricks were used, to varied degrees of success, over the course of those two centuries. In the 1930s a legendary operator named Jesse Livermore became famous for his uncanny ability to “read” where stock prices (that back in those times were shown in giant placards carried and changed by humans) were going.

Over the same period a Columbia School of Economics professor named Benjamin Graham had the idea, relatively unexplored at the time, to treat stocks as parts of a company and the market as a hypothetical partner that was making buy or sell offers for different business interests, some of them too high and some too low. Thus, the discipline of value investing was born, influencing generations of investors including Graham’s most famous student, Warren E. Buffett.

But the mystery was (and still is) far from solved.

Trend following, technical analysis, top-down macro investing, and many other schools of thought are just a few of the thousands of methods different investors have used to try to get ahead of competition. Some are head scratching like the ones used by the mysterious and amazing team of mathematicians and PhDs employed by Renaissance, a secretive upper New York hedge fund that uses sophisticated mathematical models to

automatically predict in real time where stocks are going. Renaissance is maybe the most prominent example of a method called Quant Investing and has achieved remarkable success and almost unbelievable returns over the past few decades, making the founders of the firm billionaires.

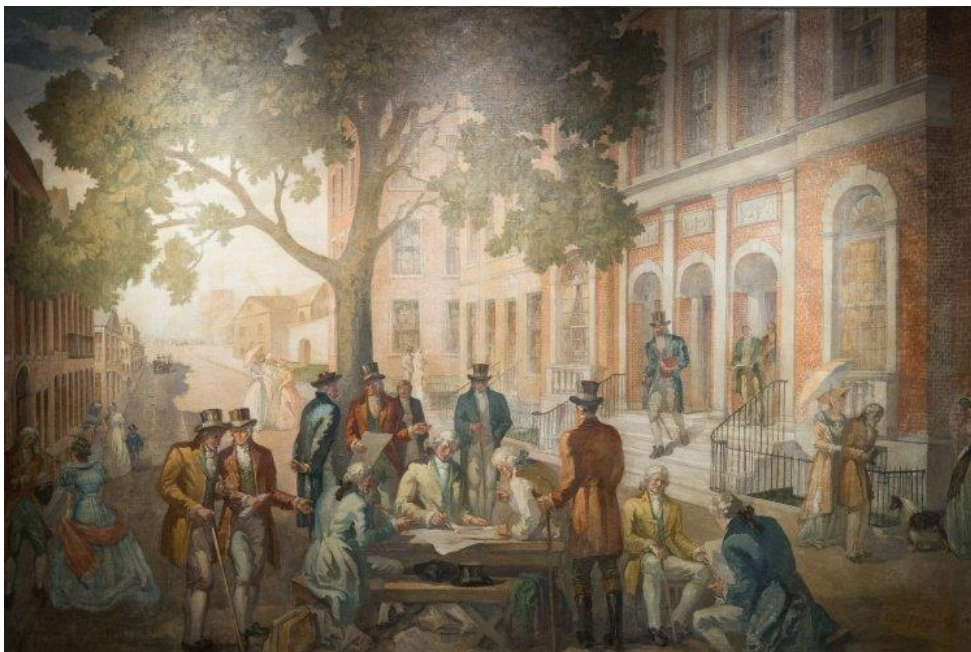
So the jury is still out and there seems to be more than one road for success. But at the same time, if this house can say one thing with conviction in this debate, no road is easy or certain. Markets, are, after all, made of people.

As a physics teacher once remarked, “if atoms had feelings, physics would be much harder”. After all, if you turn on a light switch, atoms don’t decide to strike, don’t get angry, don’t get scared and so they will always do the predictable thing. Well, guess what, markets are made of people, and people have feelings.

The theme of this letter will be an exploration of anomalies. Since markets are functioning and living mechanisms made of irrational human beings, over time they will tend to show manias, biases, panics, crashes and euphorias. This was true two centuries ago under the Buttonwood tree and is still true in the globalized world we have in 2021.

Some thought that with the advent of modern computers, advanced financial techniques and machine learning, the “pendulum” from despair to euphoria Howard Marks alluded to would be tamed and controlled. It would eventually stop its violent swings.

It is amazing how wrong this theory was. Because boy, swing it did.



Signing of the “Buttonwood Agreement” in 1792¹

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¹ <https://time.com/4777959/buttonwood-agreement-stock-exchange/>

Attention bias is the process of cognitive human beings consciously or unconsciously prioritizing certain types of information, usually specific evidence that fits a narrative above others that don't. Several things might be true at the same time in a complicated world, but we tend to decide where to focus our attention and it usually is with people, reports and data that fit our own worldview.

If historians usually quote that people that don't know their own history tend to repeat it, in finance we would say that history might not repeat but it sure does rhyme.

To stay in one example, by the 1970s investors were already a lot more sophisticated and had learned by then that quality was the most important thing when picking a stock. Capitalism is brutal, companies go bankrupt all the time so owning the best companies, the ones able to resist the test of time, the ones with the best prospects, would give an investor an edge over the market.

It was a correct point. The problem was that, in some ways, it was oversold. The prevailing mentality changed dramatically: from a complete disregard for the fact that stocks are a part of companies, to the thought that "one should look for the best companies", to, finally, the thought that "no matter the price, an investor should always own the highest quality companies".

The problem, as we know, is that a great company and a great stock investment are two different things. And then the so called "Nifty Fifty" euphoria began.

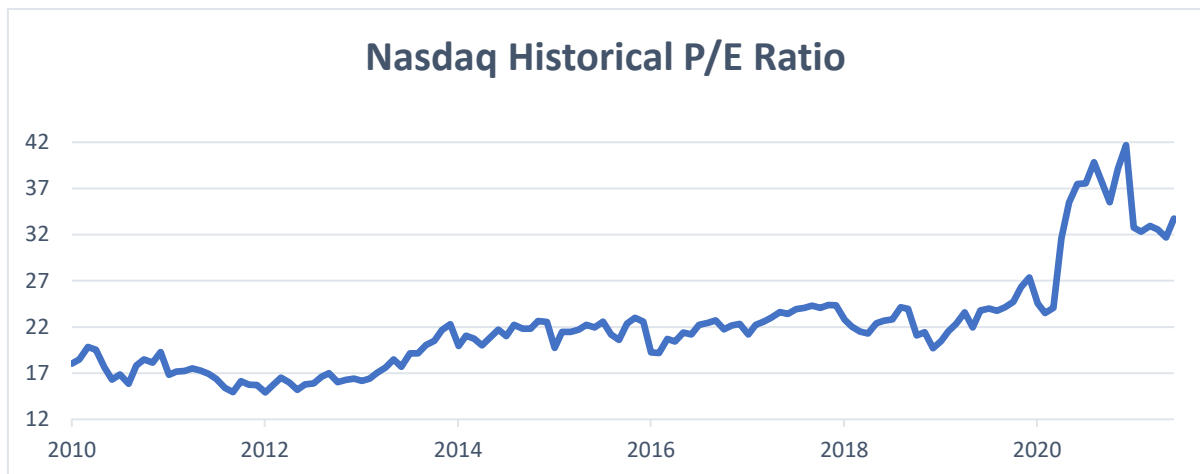
The result, quite predictably, was that despite their superior quality and higher growth prospects, the nifty fifty stocks, as this group of superior quality companies used to be known, endured severe underperformance throughout the 1980s since they started the decade in a bubble with stratospheric valuations.

Bringing back the conversation to modern times, technology companies are, of course, in a league of their own for their capacity to move minds and make investors hearts beat with their eternal promises to change the world. Over the past 30 years alone, the Nasdaq has gone through two periods of extreme overperformance, first in the 1990s in the advent of the internet and then in the past few years when the thought that the so called FAANGs (Facebook, Amazon, Apple, Netflix and Google) were invincible came in vogue, giving birth to a new form of a very similar phenomenon experienced by the Nifty Fifty investors of the 1970s. History, in other words, does rhyme.

This house is not arguing that technology companies in general are not a fantastic group of potential investment opportunities and that the FAANGs are not among the most amazing companies ever created by mankind. They definitely are.

Our point instead is a more subtle one: investors' attention, group thinking biases and the market behavior changes over time in surprising ways.

Take the tech industry we were talking about: this house does not deny that, despite the amazing quality some of the most prominent US tech companies undeniably have, Nasdaq multiples have reached what we think are extreme levels that will inevitably lead to a decade of lower-than-average returns for many companies in that index.



Source: Bloomberg, FCL Capital

But look a little closer. Is every company in the Nasdaq overpriced?

Over the last year our Opportunities fund has built a position in GoDaddy, world leader in the web registrar and web hosting business along with a series of other supportive web services.

If a business wants to set up a website, have an email service, increase its online marketing and so on, GoDaddy is one of the global leaders in this domain.

This mission sits at the heart of the mission of our Opportunities fund of empowering the 21st century champions: if the past few years have proven something is that the drive for the higher efficiency and connectivity of the internet is a global and irresistible one.

This house envisions and dreams of millions of fruit sellers in Indonesia, massage parlors in Thailand, small cement stores in Brazil, coffee growers in Africa, all of them realizing that the future of their small businesses is going online, setting up a website, facing the future.

In other words, the global rivers that propel GoDaddy ahead are not so different from the same ones that propelled the FAANGs. But, obviously, GoDaddy is not as exciting. It is not as talked about, discussed, not as much loved or hated, not as present in people's imagination.

The result is, well, in the price.

Company	Free Cash Flow Yield (2022 consensus)
Amazon	2,70%
Netflix	0,50%
Alphabet	4,03%
Apple	4,08%
Facebook	4,20%
GoDaddy	6,90%

But if intersectoral tech carries many discrepancies, what happens if we expand our analysis globally like this house, as our long-time readers know, loves to do?

If one of the two major global trends is the relentless rise of technology in our lives, the other one is the rise of China. The world hasn't even started to grasp with the implications of inserting two additional United States into the global economy, that is, after all, what the growth of the Chinese economy will add to global GDP over the next 30 years.

The consequences are obvious to this house: a new breed of Chinese companies, based on an unprecedented level of consumption that the world is yet to experience, will emerge.

But by now you are, dear reader, probably familiar with what happened to Jack Ma over the past 6 months: for unknown reasons, the Chinese Communist Party decided he was shining too much and embarked on a tightening regulatory scrutiny first of Alibaba more specifically and then gradually to countless other technology and service companies. In other words, the Chinese government, always a control freak, decided that the leash was to loosen and decided to tighten it a bit.

Apart from a few particular companies and circumstances, things should not change too much. The Chinese government is not crazy and wouldn't completely scare away Chinese and global investors. Jack Ma may be lying low and not seen frequently in public anymore, but he still flies in his private jet and is worth some US\$70 billion. Chinese companies are still going to dominate major areas of the future of global business and its unicorn² count should surpass US levels in this decade.

So, since their companies will grow faster and are better positioned one might expect that Chinese tech companies enjoy even higher multiples than their US counterparts, right? Wrong.

Beliefs and allegories change with time and the current market attention bias is simply believing in the invincibility of US tech companies and nothing else.

² Private tech companies worth more than US\$1 Billion.

Company	P/E Ratio	Free Cash Flow Yield (2022 consensus)
Vipshop	9,4	12,90%
Joyy	30	9,60%*
Alibaba	17,2	4,20%

*Adjusted for the company's net cash

Vipshop is one of this houses' most important positions and since March its stock price had a terrible run. First, an important New York based investor imploded for reasons completely unrelated to the company, forcing a sudden unloading of his position. Then, due to its terrible momentum, some momentum-based hedge funds shorted the stock not for fundamental reasons but to use it as a funding to buy another tech company.



Source: Bloomberg, FCL Capital

Over these past three months the stock has fallen 32,75% while the consensus estimate of analysts for the company's free cash flow in 2022 hasn't changed a single cent. In other words, the consensus free cash flow yield for 2022 which was 9,4% last quarter, went to 12,9% which this house thinks are insane levels to a prominent tech company with amazing prospects ahead.

All of this in the same sector of the insanely valued FAANGs.

So, to conclude these observations, we alert our readers that the timing of crashes, manias, depression and euphoria is always uncertain. But cycles have come and gone and make no mistake, attention will eventually move away from FAANGs to elsewhere and then somewhere else again countless of times in this endless loop and endless cycle of the mysterious wheel of finance that was started by those tea merchants, beneath the shades of that Buttonwood tree.

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Thesis: Ambipar

Over the past four and a half years, since we launched our Opportunities fund to explore the trends that will shape the future for financial investors, this house has repeatedly mentioned that, so far, we have spotted two ongoing events that we think will each bring unbelievable opportunities and unique possibilities in this century.

The first one is almost consensual: technology. It has for the past 200 years, since the advent of the industrial revolution, changed humanity's fate in miraculous ways. We live longer, we conquered the globe, we transformed the planet in a global village and, with the advent of the internet, biotechnology, the Crypto revolution, artificial intelligence and so much more, this is only the beginning.

The second major trend we have invested in, perhaps more controversially, is the realization that increasingly, and despite the fact that the first trend makes location somewhat irrelevant, the future will be shaped especially by the region where more than half of humanity lives in, Asia.

More specifically, by a country that for many centuries in the past, used to be the center of global culture, commerce and business and is now reclaiming its former power and prestige: China. It will be the most important country for global business in the next few decades, being responsible not only for the bulk of the planet's middle class consumption growth but also for many of the world's greatest ideas, new business models and amazing investment opportunities.

The thesis of this letter is the story of this house's first investment in which we think, could even possibly be a third major global trend for this century.

We are going to live in a technological world with constant change, we are going to live in a society shaped by Asian consumption and ideas, but what if humanity also firmly decided to embark on a journey that, for the next 50 years, will completely change and redesign the planet's environment issue, and along with it its energy matrix, its dealings with the planet's nutrients, products and how they are disposed, its environmental risks.

What if this journey leads us to a new level of responsibility when corporations are accessing environmental risks and long-term cost benefits inside their own operations? Are we prepared to redesign and reboot our energy companies, the largest and most basic sector of the global economy? What if younger generations really decide to put the environmental issue at the heart of the global debate and business can't really continue to ignore anymore how they treat the issue? Could this be a third revolution we are starting to witness before our eyes?

This, to be sure, is not a given or small task: the oil industry alone, which is a minor part of the total energy complex and a tiny slice of global CO2 emissions, has annual revenue output of almost US\$4 trillion. But if we do embark on this journey, the result will be nothing short of a complete rearrangement of winners and losers in the global commodity industry, many leading industrial and service companies, utilities and a lot more.

If we add to that environment aggressors like the coal industry, and producers of materials capitalizing on the transition like copper and nickel, plus the logistical changes there are needed, the infrastructure that has to be created, the new solutions that have to be dreamt of, then the result, if we are successful in this task, would be nothing short of a planet that will look unfamiliar to us and be a very different place in fundamental ways.

As one economist recently put it, it would be no exaggeration that, in 2000 years, future archeologists will call the homo sapiens living in the present time “homo hydrocarbonate” the same way we call our ancestors “homo herectus” (the first ones to walk standing up), “homo abilis” (the first ones who built tools to hunt) and so on, since our vehicles, our buildings, our materials and pretty much everything that make our current society is based on the current polluting energy matrix.

The way we produce energy and other commodities and inputs for our operations to the way we dispose them is a flow of value and procedures that was constructed over the past centuries and certainly won't be going away in the blink of an eye.

But still, could this transition be another of this century's revolutions? Will this be our “man on the moon”? Our legacy for future generations? Only time will tell.

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Ambipar had its Initial Public Offering in the Brazilian Stock Exchange on July 13th, 2020, but it is still a relatively small and unknown company.

It was founded in 1995 and has consists of two major divisions:

- 1) Environment: responsible for dealing with special environmental and waste management projects and serving companies needing a partner to help them manage their operations disposals in a sustainable and compliant way.
- 2) Response: focused on the emergency care segment, serving clients in sometimes emergency situations, like ones involving accidents with chemicals and pollutants.

In other words, Ambipar is a solution for corporate clients in their environmental and waste disposal process.

Since shortly after its IPO, this house has been dedicated to gather evidence and information on this peculiar, still misunderstood and promising company.

First, its 152-page offering prospect was dissected and then our work began in trying to understand the sector, its clients (that include some very well-known Brazilian and global names, even some companies this house has previously invested in without knowing they were Ambipar clients), its competitors, and above all, the prospects of this fascinating and promising industry, that brought us some interesting insights about where the future is going for Ambipar.



Part of Ambipar's fleet.

The primary stock offering comprised around R\$1 billion reais and what followed surprised not only this house but probably almost every external observer apart from the company's management itself.

In addition to using very quickly all of its IPO proceedings in the following 12 months (in fact the IPO value was already more than fully used), Ambipar turned itself into an incredible acquisition machine that made the company more robust and way more global. Even after those developments, there is still no sign that the transformation is slowing down or that the management is becoming any less ambitious.

Ambipar acquisitions, past 12 months:



Legal, risk and compliance monitoring systems with a focus on sustainability and traceability – Belo Horizonte, Brazil



Hazardous chemical emergency, routine asbestos abatement, or ongoing facility support – Alabama, USA



Specialized in emergency care – Tampa, USA



Specialize in legal, risk and compliance monitoring systems with a focus on sustainability and traceability – Belo Horizonte, Brazil



Specialized in emergency care – Denver, USA



Provides complete services aimed at developing and implementing technologies in clients' processes – Recife, Brazil



Emergency response and industrial services – Wrexham, UK



Emergency response and industrial cleaning services – Alberta, Canada



Collection and transportation of hazardous materials – Rondonópolis, Brazil



Integrated solutions for environmental management in Chile, Peru and Paraguay – Santiago, Chile



Specialized in emergency response – Santiago, Chile



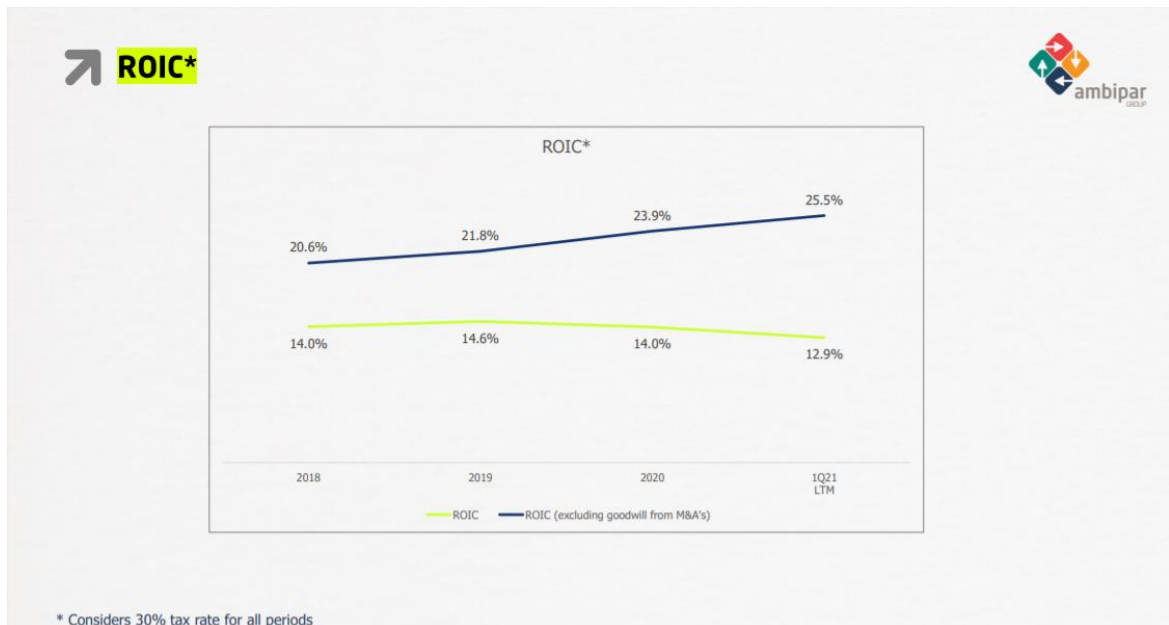
Management, handling and treatment of waste with a main focus on the mining sector – São Paulo, Brazil



Focus on environmental emergencies and soil remediation – NY, USA

This house always had a healthy suspicion of companies that grow through acquisitions, forming sometimes disjointing parts, lacking focus. Witnessing some disasters after a wave of failed IPOs in Brazil back in 2007, with some companies opportunistically raising money in the market without clear plans and necessity, it became our *modus operandi*, our usual temperament, not to pay upfront for projects and promises for the future, especially ones that should be achieved with consolidation and acquisition.

Well, the IPO is only a year old, but so far, Ambipar's acquisition machine is notable for such a newcomer to the market. The acquisition targets show a clear focus, discipline and remarkably, the company's ROIC has been growing even with so many new pieces to be integrated. What this shows us is, in the opinion of this house, a taste of the remarkable possibilities in Ambipar's industry.



Ambipar's 1Q 2021 Results Presentation

Interestingly, unlike some technology companies, Ambipar's stock is trading at multiples we judge to be very conservative for such a promising company.

A fair question our investors might ask: why does this opportunity exist at all? If the company is so promising, why haven't investors bid up its shares after all? And why does this house think it is going to happen eventually?

Well, there is a web of reasons for this. First, it was an underfollowed, relatively small offer (under US\$200 million) for a company that still has a sub US\$1 billion market cap.

Second, there were a number of companies accessing the Brazilian market that quarter and Covid was still scaring the planet. It's leading coordinator, if we take a list of recent companies that accessed capital markets led by it, is not usually the one with the most overhyped and overpriced companies after an IPO. This, it should be noted, is not completely negative: there is academic and anecdotal evidence that Brazilian entrepreneurs, when compared to their US and European counterparts, leave "less on the table" when first accessing the market. This "short termism" might seem smart at first (founders and management get a higher price) but creating a positive channel of communication and karma with the investment community, in other words, "leaving something on the table", is not something that should be minimized either and many successful companies deliberately take this route.

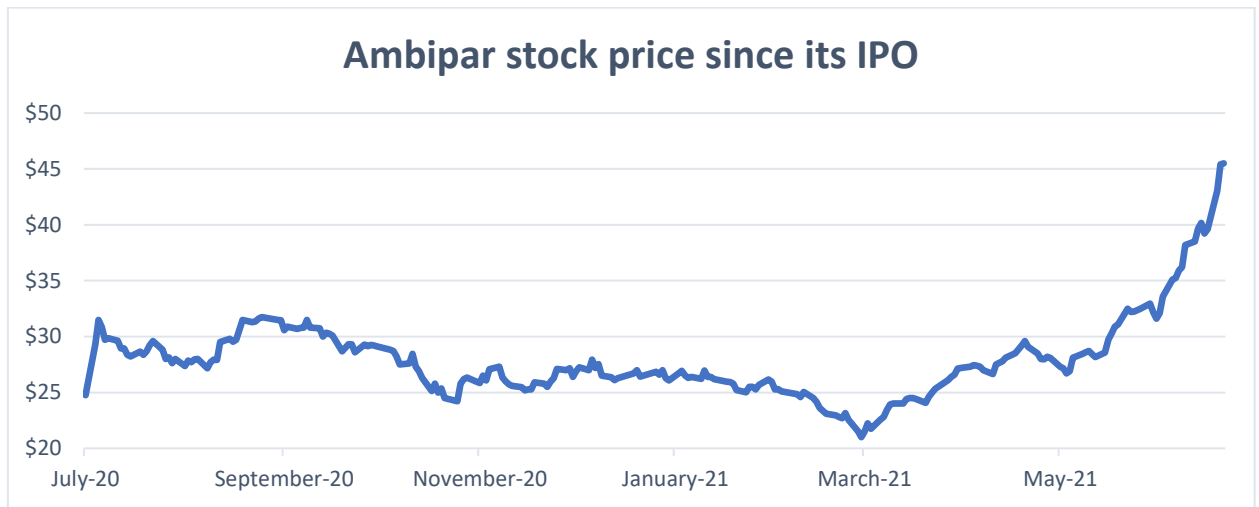
Finally, due to its size and the offer characteristics, Ambipar hasn't opted to list its shares in the New York Stock Exchange, or even opt for a dual listing as many Brazilian companies do, usually accessing markets in São Paulo and New York. As a matter of fact, increasingly, some Brazilian companies (XP, Stone, Patria, Vinci) do not even bother to list in the Brazilian markets anymore, preferring, for various reasons, to be listed in the world's deepest and most prominent pool of liquidity.

The consequence of this sum of ingredients was that Ambipar seems an underfollowed security any way we look at it. A relatively recent and small offer, a small and not so attentive sell side coverage, a misunderstood company with lack of comparables on global stock exchanges. In other words, the kind of company this house specializes in.

So how to try to do some educated guesses and assessments when it comes to valuation? Due to the lack of direct comparables we added, just for argument's sake, two other young and promising Brazilian companies that recently went public: the service marketplace website GetNinjas and the e-commerce operation Enjoei.com.br

Company	2022 consensus		
	Price/Sales	P/E Ratio	Free Cash Flow Yield
GetNinjas	6,35x	Negative	Negative
Enjoei	7,15x	Negative	Negative
Ambipar	3,94x	28,9	12,80%

An even more relevant point: Ambipar is a unique asset. Management has been constantly stating, first to very incredible ears, but now to gradually more attention by the investment community, that no company in the world can match Ambipar's scale, readiness of response and capacity to fulfill its clients' needs in the environmental management industry. The facts seem to give reason to this claim, as the company progressively enter new markets and acquires more competitors.



Source: Bloomberg, FCL Capital

Of course there are risks, as always. It is a sensitive industry, full of different regulations, complexities and potential liabilities. Adding to that the fact that Ambipar is becoming a multinational and we multiply the complexity of the operation. Certainly no small task for a management team also having to learn how to first navigate the moodiness of public markets for the first time.

But overall this house judges the possibilities in the industry, the management's track record and talent, the company's position and reputation as more than convincing. We think the company is only scratching the surface of where a possible consolidation in this globally fragmented and rapidly evolving industry could lead. In other words, Ambipar could be a champion and consolidator in the next few decades. A company in the right place at the right time, surfing and leading a major global transition. A business the world needs.

So where could this journey lead us? It is undeniably too early to tell for such a young company. But judging by its track record of acquisitions and investment, our best guess is that the recent primary offering will certainly be followed by more market activity relatively soon.

We think it is entirely plausible to think of Ambipar as being a dispersed capital corporation in the not-too-distant future, leading the consolidation in this fast expanding and global market category few cared about or even knew it existed not so long ago.

Over the long term, this house envisions a multinational company able to service its clients in multiple jurisdictions with the same level of quality and predictability and being an indispensable partner of their operations, be they mining companies, healthcare operators, and a lot more.

We are only testing the waters in our investment in Ambipar. Over the course of the second quarter both of our funds initiated positions in the company for the very first time. We look forward to spending more time in front of the company's numbers and projections and, above all, interacting with Ambipar's management.

Likewise, this house also feels Ambipar itself is only testing the waters in term of what kind of public company it will be, how far it can go and where its vision and mission could take us.

Performance

FCL Opportunities	
Year to Date, 2021, in BRL	8,45%
Year to Date, 2021, in USD	13,34%
MSCI All Country Index, YTD, 2021, in USD	12,33%
Since Inception (30/01/2017), in BRL	196,32%
Since Inception (30/01/2017), in USD	85,84%
Avg Annual Return, since inception, in BRL	27,67%
Avg Annual Return, since inception, in USD	15,00%

FCL Hedge	
Year to Date, 2021, in BRL	2,01%
Year to Date, 2021, as % of CDI	157,52%
Since Inception (01/02/2017), in BRL	42,09%
Since Inception (01/02/2017), as % of CDI	152,23%

In the first semester of 2021 FCL Opportunities performance was +8,45% in BRL and 13,34% in USD, bringing our compounded annual return since our inception on January 30th, 2017, to + 27,67% in BRL and 15,00% in USD.

The positive performance came especially from our positions in the Brazilian and European markets, while China-related positions detracted the semester's performance.

Many investors ask us about the BRL X USD exchange rate and if a potential rise in the Brazilian currency would mean a bad entry point in our fund.

First, we are a thesis driven long-term investment partnership, and, therefore, daily or quarterly exchange fluctuations have only a minor long-term effect for our compounded returns. In other words, this house's long-term success will depend on our ability for find unique and unconventional ideas in global markets, not the exchange rates these markets operate on.

That being said, we would like to propose the following exercise: a comparison between the second quarters of 2020 and 2021.

In the second quarter of 2020, we experienced a COVID related rise in the US dollar against the real. As the Brazilian currency approached R\$6 per US\$, our fund took advantage of its global positions and was able to rise 22% in US dollars, but even more, almost 29%, in BRL.

Fast forward to the second quarter of 2021, when the Brazilian currency appreciated past the level of R\$5 per USD. Our fund did experience a small drop in the quarter of -4,95% in BRL impacted by a series of Chinese positions, especially Vipshop (more on that later), but rose almost 8% in USD.

In other words, at least in the past two years, we were able to capture the upside when the Brazilian currency depreciated and protect the downside when it appreciated.

That's exactly how it should be, since we always maintained that our most important metric of internal evaluation is the long-term compounded annual return in US dollars.

At the end of the semester, FCL Opportunities top 5 positions were:

Position	Country	% Fund NAV
Entain	UK	12,40%
Capri Holdings	USA	9,99%
Yduqs	Brazil	9,56%
Vipshop	China	9,00%
BRF	Brazil	7,48%

FCL Opportunities Portfolio Composition on June 30th, 2021:

Portfolio Composition by Sector	
Consumer Discretionary	40,75%
Technology	20,53%
Consumer Staple	10,33%
Education	9,99%
Healthcare	6,78%
Basic Materials	6,65%
Crypto	1,12%
Industrials	1,00%

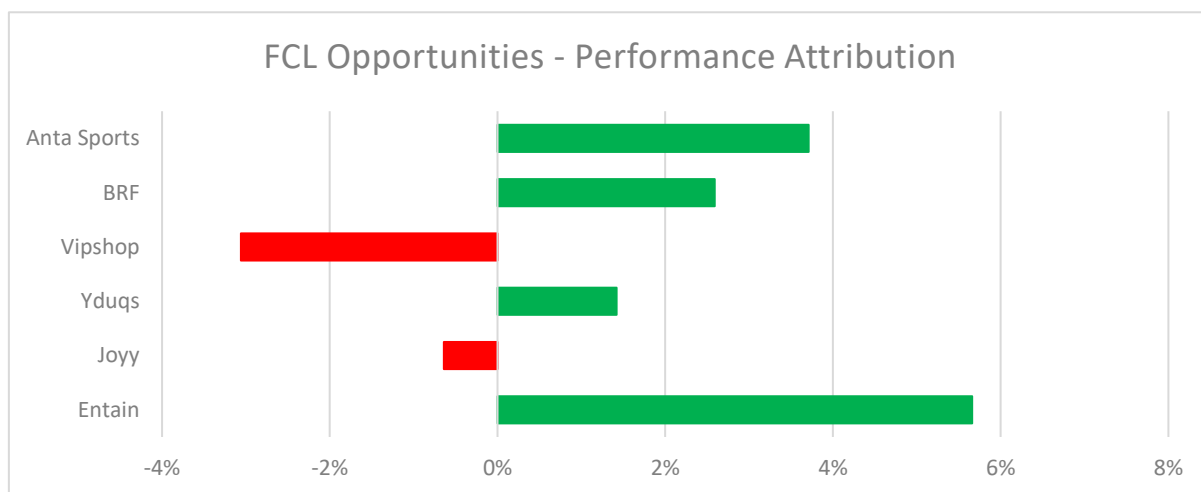
Geographic Distribution	
Brazil	31,46%
China	29,45%
Europe	18,96%
USA	16,15%
Global	1,12%

As for FCL Hedge, its performance in the semester was 2,01%, or 157,52% of the Brazilian CDI, its portfolio composition on June 30th, 2021, was:

FCL Hedge	
Stocks and ETFs	67,32%
Cash and Fixed Income	21,67%
Other Positions	11,01%

In the first half of the year our Opportunities fund's performance came basically from three of our core holdings: the British online gaming company Entain, the Brazilian food company BRF and the Chinese sports maker Anta.

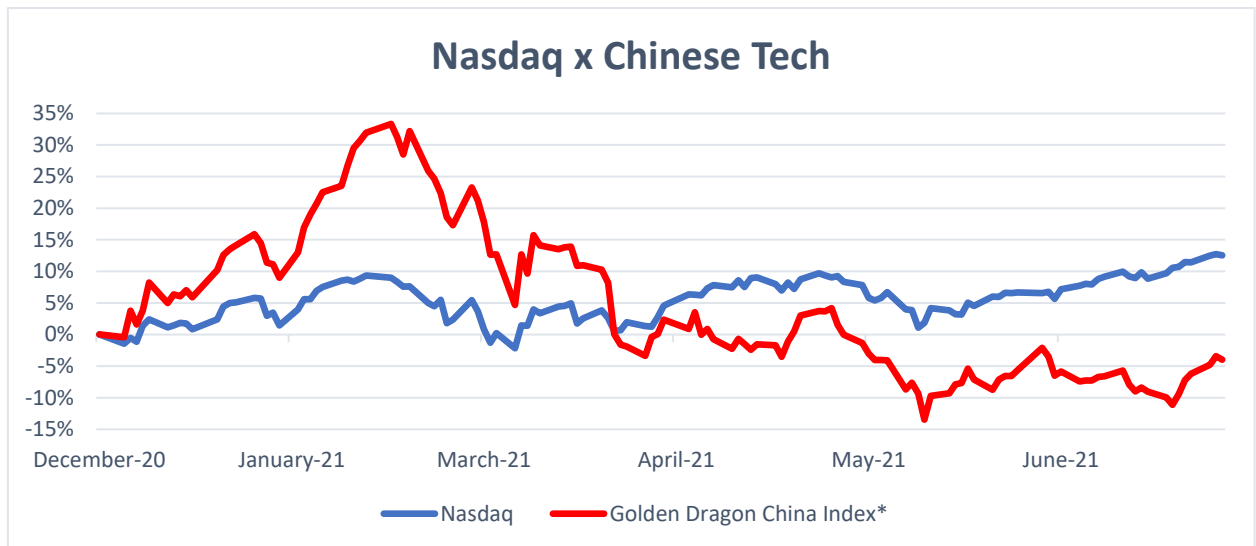
The detriment to our performance came basically from Chinese tech companies, especially Vipshop.



But why are Chinese tech companies underperforming?

A lot has been written, including by this house, about the overvaluation of tech companies, but this is basically a US phenomenon. Chinese tech companies never experienced multiples as euphoric as the ones given to US tech.

Even taking that into account, in late February, US listed Chinese tech companies started to experience dramatic underperformance.



*Index that tracks some of the biggest Chinese firms listed in the US
Source: Bloomberg, FCL Capital

Interestingly, this phenomenon has been very specific: Chinese markets in general are not experiencing any kind of rout and not even Chinese tech companies listed in Chinese markets including Hong Kong are experiencing significant declines.

In fact, Chinese names with dual listings were able to be more protected from the volatility.

So, what is happening exactly?

First, the Chinese Communist Party, always a control freak, started freaking out about its billionaire tech executives. The party has felt an urge to command and subordinate anything inside their country that not only challenges their grip on power but even people or organizations that are deemed too powerful and influential. Since China is arguably the world's most innovative economy and is currently experiencing a boom in wealth creation (to the point that Beijing now has more dollar billionaires than New York City), this meant that the CCP started worrying about billionaire's existence, independence and the increasing cult following around them.

The trigger of this new, more hostile phase towards business came after a speech in Shanghai by China's most famous entrepreneur, Jack Ma, where he criticized financial regulators in China for protecting a status quo led by Chinese banks who had a "pawnshop mentality" that was inhibiting the growth of more innovative tech companies like Ant, partly owned by Ma's Alibaba.

The result was the sudden interruption of what would be the world's largest IPO by Ant just days before its stock offering and a complete overhaul in its business with a stringent set of new regulations aimed at fintech companies in general.

This was followed by severe new regulations towards Education and Tutoring companies, and now more scrutiny and control towards Chinese companies that list in overseas markets, like New York City, using a so called VIE (variable interest entity) structure to bypass the country's prohibition of foreign ownership of technology companies.

This year's most prominent US listing by a Chinese company, the stock offering of Didi, "China's Uber", was a tragedy. Days after raising US\$4.4 billion in the New York Stock Exchange, Chinese regulators ordered the company to take its app out of smartphone stores while it rectifies several concerns about its handling of data of hundreds of millions of Chinese users, since the company was partly owned by foreign shareholders.

So what does this house think about the current situation?

First, some turbulence is certainly warranted. The regulatory environment in China got harder to navigate and, in the future, there might even be some discount for Chinese companies listed in foreign exchanges. A worst-case scenario would be the CCP simply declaring the VIE instrument void and thus making the shares of most Chinese companies trading offshore basically worthless.

We don't think such a nightmare scenario would come to pass. The VIE structure has been around for over two decades and has been tolerated by the party all this time. Furthermore, from Alibaba to Tencent to Vipshop to hundreds of other prominent names, almost every Chinese company listed abroad uses exactly the same structure. To simply declare it void would be a severe blow to China's credibility over the long-term, a cataclysmic event to global financial markets and maybe even the official end of the "reform and opening up" phase that has been leading China's economy ever since Deng Xiaoping's reforms. All in all, the country certainly didn't have the fantastic rise it did over the past 40 years by not being pragmatic. It would have nothing to gain from such a drastic move.

A more probable scenario would be, from now on, a new set of rules and controls towards companies willing to use the structure in a case-by-case analysis before future offshore stock offerings in New York or Hong Kong.

Such a scenario would not be all negative: it would mean the explicit acceptance of the structure by the CCP and, in our minds, a reason for the discount of listed Chinese companies in the US to narrow, even if new emissions became harder and more cumbersome from now on.

So, is it really winner takes all?

The main reasons our fund didn't have a good second quarter were, therefore, our Chinese positions in the New York Stock Exchange, and most especially, one of our fund's main positions, Vipshop.

In our past letter we discussed the Archegos' debacle, which was one of the reasons behind Vipshop's underperformance this year.

The broader underperformance of Chinese tech companies discussed above was certainly an additional factor.

But the third and final factor deserves, in the opinion of this house, further scrutiny.

Over the past decade an idea came in vogue preaching the “winner takes all” mindset, meaning that in most industries, but especially in tech, almost all value to be captured and profits to be made would flow to the leaders.

This idea was certainly magnified by the success of the leading US tech platforms like Google (search), Facebook (social networking), Amazon (retail), Netflix (entertainment) and so on.

In other words, “be a leader or die” became accepted wisdom.

Is this notion correct?

Well, first of all, to analyze and predict where the river of value will flow to in different industries is certainly among the most fascinating tasks for a financial analyst. We certainly think there is some truth to the notion, as evidenced by the astronomical success of some leaders, especially the above mentioned US tech platforms over the past decade. They got most of the (many) dollars to be made by the advance of tech in the past 10 years.

That being said, we do think the notion is starting to feel overused.

Take Vipshop, one of our core holdings. It is the third largest Chinese online sales portal, behind Alibaba and JD.com, admittedly by a huge margin.

Vipshop not only has a China discount, warranted or not, but it also trades at a much lower valuation than its Chinese peers despite the fact that it thrived over the past five years. In other words, being a smaller competitor didn’t prevent Vipshop from growing and flourishing.

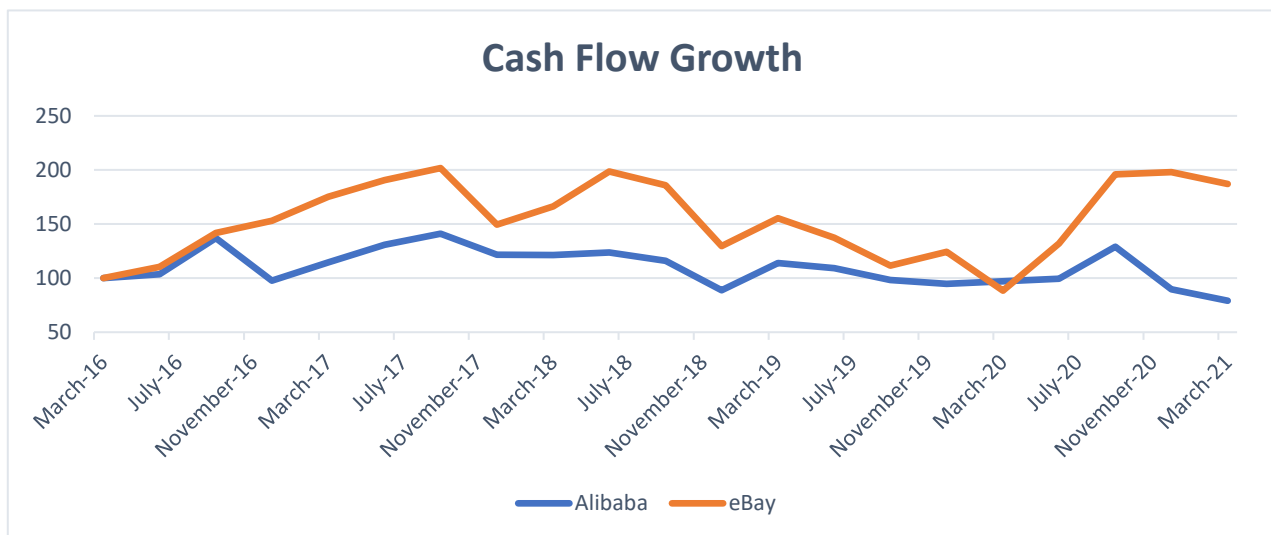
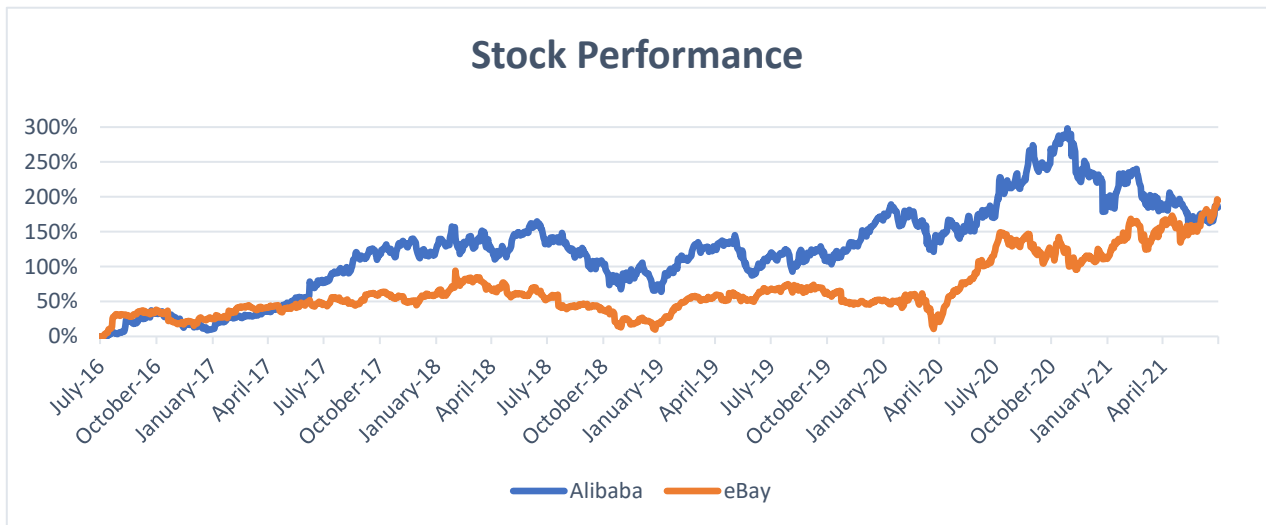
But reading the sell side reports, there is a lot of gloominess. Many analysts doubt the company will be able to survive, they think it’s going to be displaced despite what this house thinks is obvious evidence: the company almost tripled its sales over the past five years.

Company	Annual Sales Growth, past 5 years	Annual EBITDA growth, past 5 years
Alibaba	47,97%	18,80%
JD.com	32,70%	25,10%
Vipshop	20,44%	23,60%

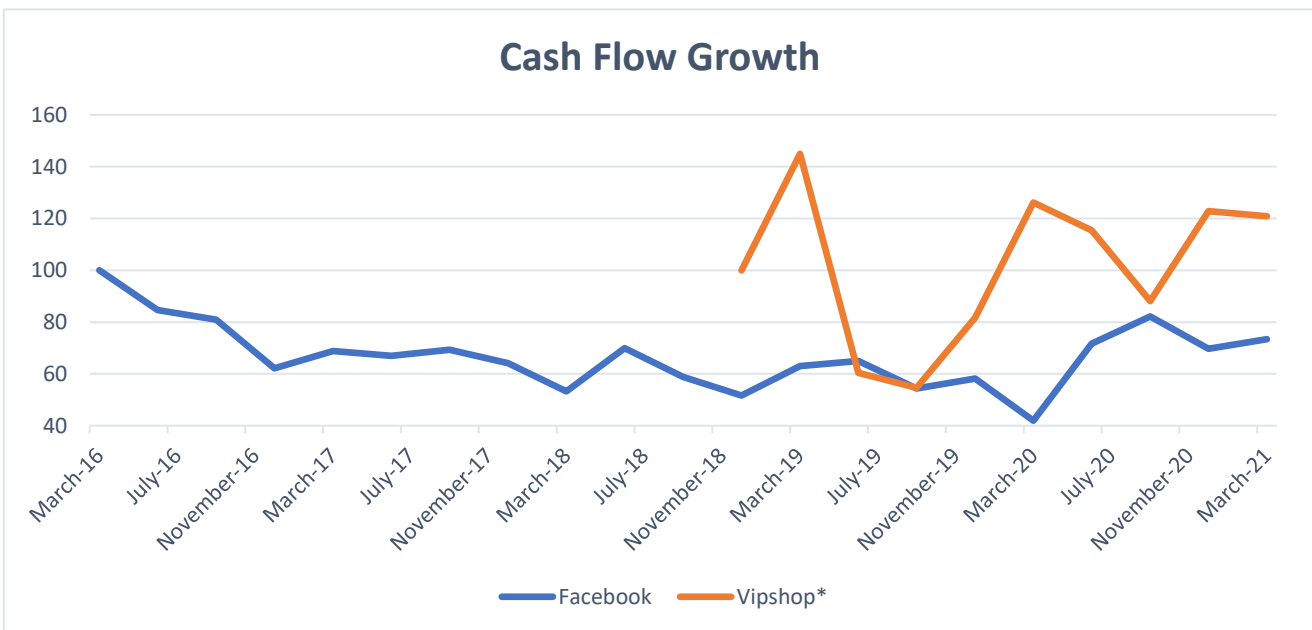
And this is just one extreme example of the “leader or nothing” mentality.

In an initial study we took three global leaders: Alibaba, Facebook and Google and three “mid-tier competitors”, eBay, Vipshop and GoDaddy. The result: not to deny the leaders greatness, but the competitors were able to growth their sales, profits and stock prices with time despite all the gloominess and low multiples surrounding them.

Alibaba x eBay

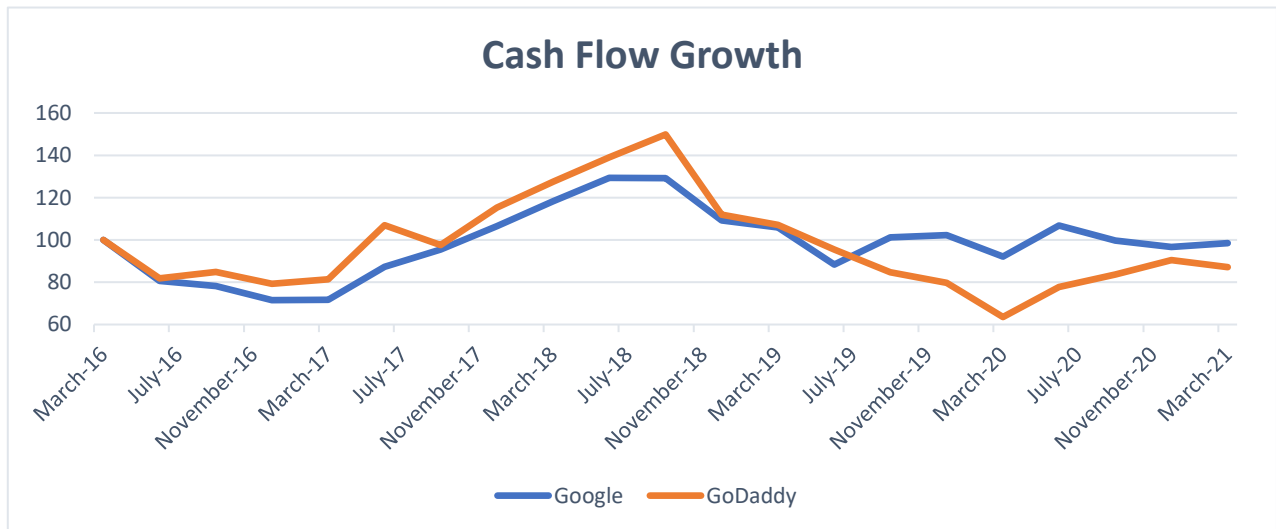
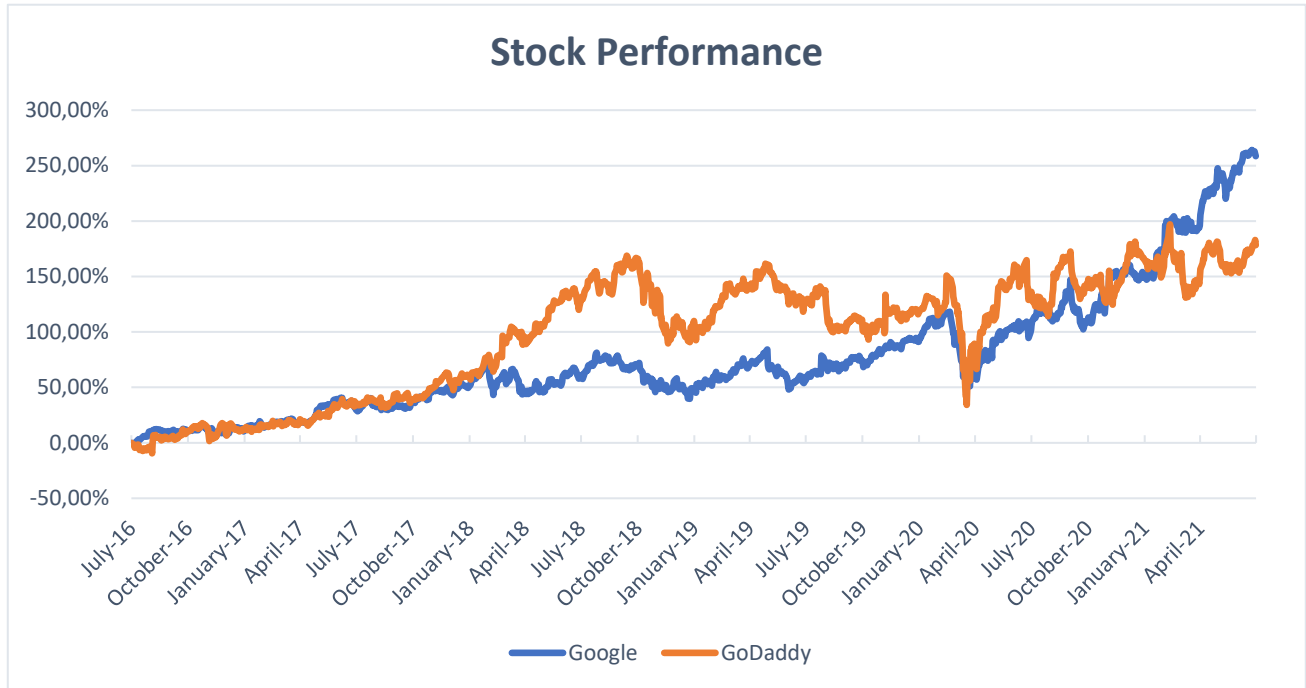


Facebook x Vipshop



*Vipshop's cash flow was negative before December 2018

Google x GoDaddy



Over the period, Google and Facebook had the best stock performance, with GoDaddy and eBay also experienced significant stock price increases. Vipshop, on the other hand, came last due to the recent severe stock underperformance. That being said, when instead of stock prices we judge cash flow, eBay and Vipshop have the highest cash flow growth, by far.

One of our most interesting findings: when analyzing a series of category leaders in tech, in most cases, both in the Chinese as in the US markets, being a leader in a specific tech category did not bring higher revenue or cash flow growth over the past five years, but it certainly did bring higher multiples for investors interested in acquiring the stock.

In other words, the “leader takes all” appears more than reflected in the stock prices and we would even guess that, possibly, second-tier tech competitors in China and the US might outperform the leaders over the next few years. This is certainly part of our Vipshop thesis.

This is obviously an initial, not all encompassing and not scientific study. But the point remains that the oversimplification of the leader or nothing mentality might lead to some surprising opportunities.

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On a separate note, in this past quarter we sold our last shares in Fu Shou Yuan, the Chinese death care company after five years of investment. We learnt a lot with Fu Shou and our involvement in the industry and think the companies’ management is doing a brilliant job in this still underpenetrated opportunity.

Overall the investment resulted in net positive returns of almost 40% or circa 7% annually.



Source: Bloomberg, FCL Capital

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Part of our growth journey, as discussed in our 1Q2021 letter, will be an effort to become a more institutionalized, secure and process driven company, while at the same time retaining our unconventional methods and *modus operandi*.

Over this past quarter a new step in this journey began with the creation of our formal monthly risk committee where we analyze our exposure, the liquidity of our funds and a series of other considerations, with the aim of reaching a more structured and formal risk assessment of our business.

The committee is led by our partner Guilherme Temke, who is responsible for monitoring risks and advising on possible remedies and precautions if necessary.

Overall, this house feels very excited about the second half of the year. We have been stating that we were spotting too much frothiness in stock market and with the current extreme selloff in some parts of the market, we can finally feel confident about valuations again and deploy our capital searching for new ideas or, preferably, increasing our stake in ideas we already hold and where our degree of confidence increases, and prices decrease.

Among many other opportunities currently being discussed internally, there are: the recent Chinese tech selloff in the US; the current global post-covid reopening that helps the luxury brands we hold in our portfolio, like Moncler and Versace; a stock that would mark this house's very first investment in Turkey; and, finally, the very interesting combination of higher commodities prices that could be taken advantage by Brazilian companies.

We do feel we are at a possibly great entry point and feel excited about both of our funds' prospects for the second half of 2021 and the years ahead. As always, we thank our investors for their partnership and trust over the years.