FCL *Capital*

2Q 2025

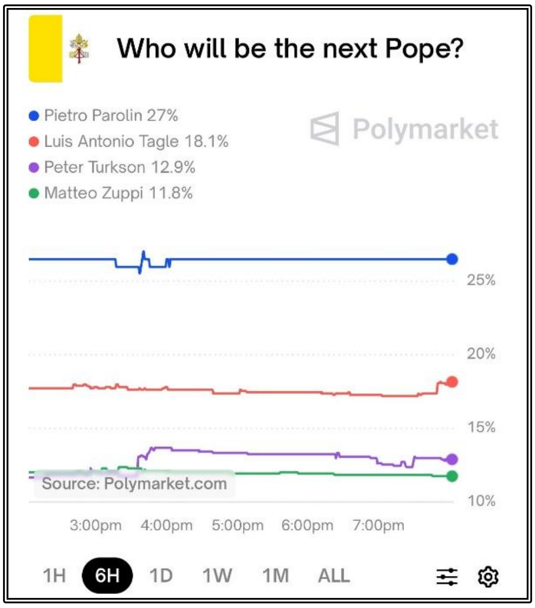
Groups and Markets

An amazing fact, not related to religiosity but to global financial markets, occurred during Pope Leo XIV's election in the historic papal conclave in May 2025.

On Polymarket, one of the largest crypto betting exchanges on the planet and which was being widely used by market participants to bet on the papal election, Italian Cardinal Pietro Parolin was considered the favorite. In the days leading up to the conclave, the market priced Parolin's chances at around 30% among the 252 cardinals in the conclave.

It was a very reasonable assumption: Parolin was a very influential cardinal, the Vatican's secretary of State and, according to many, former Pope Fracis' right hand man. It would be, above all, a vote for continuity. An obvious vote.

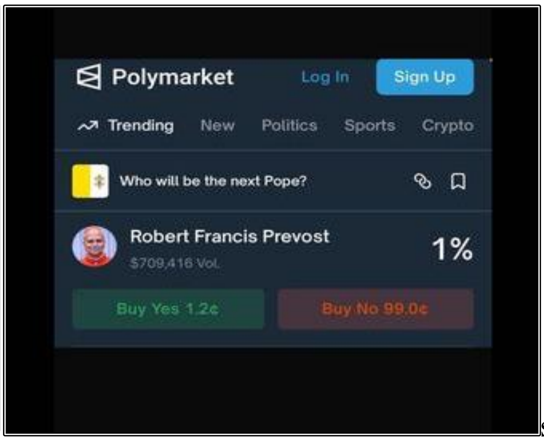
On the other hand, and this house is very far away from having any special insight in Vatican's inner workings, there is the long time saying that "whoever enters the conclave a pope, leaves it a cardinal". All in all, for common folk who didn't have insider knowledge, the Polymarket odds of 30% for Perolin, by far the highest among all popes, seemed reasonable.



Suddenly, after a few non conclusive votes, during the late afternoon of May 8th, 2025, white smoke suddenly appeared above Saint Peter's Square. A new pope had been elected! The world - every news anchor, every television host and, of course, all of the Polymarket bettors - kept their eyes and ears glued for new information.

Perhaps surprisingly, in what seems to be a rare feat these days, no new information leaked. Minutes passed. An hour passed. No further information emerged from inside the Vatican. Saint Peter's Square started to fill. The world was ready- and excited- to see the new pope for the first time.

Then, something bizarre started to happen on Polymarket. For completely inexplicable reasons, Parolin's chances shot up like a rocket. Betting volumes were going parabolic and his odds, from the original 30%, started shooting up. 40%. 50%. 60%. At its peak, his odds surpassed 70%, and were giving the impression that he would quickly reach 100%. Did Polymarket's investors know something that the rest of the world did not?



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Today, we of course know that this was not the case - due to a complete lack of information, probably coupled with anxiety, investors began to suspect that someone knew something they did not and began buying Parolin's name - until the very moment when news of who was the new pope came out and the bet on the American cardinal Robert Prevost, which was worth almost nothing, proved to be the right one, and his name quickly went from almost zero to 100%, as he would be the new pope.

In global markets, as in life, the adage that there are years where almost nothing happens and days where decades happen proved once again to be true.

What important financial lessons can we take from this episode?

First of all, that this house agrees with Howard Marks who would say that "the only way to profit in the market is to be outside the consensus and to be correct at the same time", a feat that, of course, is incredibly difficult.

Secondly and above all, a reminder about a common trait of all successful investors, of different schools like value, growth, quant and more: independent thinking. If the market, with its manias, afflictions and hypes, creates something, it is up to each astute investor to wait, analyze, process the information, and if necessary, take the other side of the bet.

What is the consensus? What is in the price? And what is it not? Maybe an overlooked geography? Maybe a long forgotten small-cap stock? Or maybe, just maybe, a certain and seldom-talked-about cardinal from the south side of Chicago?

When a price moves, it affects how people think. If something is going up, we feel inclined to buy more, an exact contradiction with what financial theory would expect from us. The opposite is of course also true. That is the reason some astute investors decide to only have major portfolio decisions during the moments markets are closed: they are aware of their own humanity and try to create ways to mitigate it. A very simple and imperfect trick for sure, but one which can be helpful in some circumstances.

In finance, feedback loops are the phenomena where market participant's behavior is influenced by the movements of the markets, be they rational or not, and then act in accordance with this loop, themselves fueling the fire of the same feedback loop.

From market clashes to manias and euphorias, from GameStop in 2021, the dot.com boom in the late 1990s all the way back to the Tulip mania in 16th century Amsterdam to countless other stories, the intersection between psychology and finance, and in particular, investor's behavior when faced with fear, greed and uncertainty, has been a permanent theme and fascination for us since this house was founded and, consequently, one of the main themes of our letters for the past 15 years, featuring very prominently in this space and, according to some of our investors, has given birth to some of the best moments in this space. In one of our past letters this house even suggested it might be one of the few uncovered frontiers in finance for the 21st century.

This subject first appeared in our very first FCL Letter[1] back in august 2012 where we stated that this house's mission was to "... be a very long term, aggressive, value obsessed, contrarian investor". It is an interesting reflection that since those early years it was already clear for us to strive to be away from the consensus. To put distance between us and the prevailing market beliefs.

From that point, the relationship between finance and psychology was to some degree a subject in nothing less than 39 of this house's past letters and counting.

In our 3Q 2021 Letter, a personal favorite for us and, we heard, from many of our investors, we detailed our search for the unexpected champions of tomorrow, which we called our "Search for Supernovas".

In our 4Q 2022 Letter we asked whether amid all the hype and excitement of technology champions, if there was space for some hidden gems and different kinds of companies to reach the top.

In our 1Q 2024 Letter entitled "Matt and the global investment scenario" another one very dear to us, we investigated the current investment and global finance landscape to ask if global diversification still made sense.

Finally, among many other letters and themes we will omit for brevity reasons, in our most recent letter from the previous quarter, we investigated if psychology was partly responsible for the huge premium global investors attribute to the so called "American exceptionalism"

A common theme among all of these discussions and analysis over the past 15 years is our deep-rooted belief that, in a 21st century where information is instantaneous and

[1] There were monthly letters in our "investment club years" way before FCL was a proper company from 2007 to 2012, but those letters were written only in Portuguese. Once we converted into a proper fund the current harvest of FCL Letters starting in august 2012 began.

globally available, investor´s ability to dissect it, process it, and properly react to it is the new differential.

We started the letter with the story of the most recent papal conclave because to us it seems to be a perfect metaphor of how financial markets behave. First, participants are set in a game of information competition, trying to know more than others. Rumors and speculations naturally form a heavy sauce to this dish.

At first when prices start to drift to reach a new level there is often some justification for it. If there are no news about who the new pope is does it mean there was no big surprise and the most likely candidate won? Maybe some positive change in Parolin's chances was justified at all.

But then, animal spirits take things to another level. Investors don't like losses. They hate falling behind. How can you be so stupid and not bet in Parolin like everyone else is doing? How can you be so stupid not to bet in AI and NVidia? How can you be so dumb not to see that diversification away from the US markets is futile? You should put all of your money in the US. Or in dot.com stocks. Or in Parolin. Or in bitcoin. Or…

Let's face it, once a consensus is formed it takes guts to take the other side of the bet. As the saying goes, it is better for reputation to fail conventionally than to succeed unconventionally. But what was consensus telling us? The consensus by definition is the market price. So, what were the prices telling us? Were Parolin chances at some point on that afternoon of being elected the new pope really 70% against 30% for the other 251 cardinals combined according to all available public information that was available at that exact moment? Or, in a separate but related question, is the US market really deserving to be almost 70% more expensive than the British market and more than twice more expensive than the Chinese and Brazilian stock markets in 2025? Should a dollar made in Brazil be worth just half of a dollar made in the USA?

And if not and if there is an opportunity, why does it exist? What do you see that no one else sees? Or, as Peter Thiel likes to ask in job interviews "what fundamental truth about reality have you realized that most people haven't"? To come back to Howard Marks, to make money you have to be against consensus but also, to be right.

So, we reach our central point: how right is the consensus at any time? And we don't only mean in stock prices. How right is the consensus about AI, Crypto, American exceptionalism and any other theme?

If there is any opportunity why is consensus discarding it?

To answer that question is the ultimate job of a financial analyst, be it in crypto, global stock markets, macro forecasts, venture capital and more.

A related phenomenon that makes consensus go wrong is recency bias, a well-researched phenomenon by some behavioral investing authors. It basically means that we give more input and importance to something that happened recently than to something that may be more consequential, but is not "readily available", in other words, is less recent, or even less discussed.

Since we started writing in this space many hypes and fears have come and gone. Back in 2012 when this house published its first letter, Greece was on its way to defaulting on its debt and the very real possibility that it would have to leave the eurozone was being discussed. The consensus was that the Euro as a currency and quite likely the European Union as a bloc wouldn't last. Fast forward to 2025 and the Euro is predicted by some to supplant the dollar as the world´s most important currency[2].

Back when we published our "Digital alchemy" letter in October 2017, any self-respecting analysis of the future and new disruptive industries would start with crypto. It's now 2025 and any long-term predictions about the future will start and end talking about AI. It is not that AI didn't exist in 2017. It is in fact a much older industry than crypto. It's not also that crypto has gone anywhere. It is just that since Chat GPT came along it is the most discussed and - not without reason- hyped technology. Again, recency and availability bias in action.

If someone predicted in 2012 that in the year 2025 the so-called PIGS, the terrible acronym for difunctional economies in the Euro represented by Portugal, Italy, Greece and Spain would in fact form the best performing economies in the bloc this person would be laughed at and not considered seriously. But that's what happened. The future after all is not only a continuation of present trends. It is also, just as often, a sudden break from prior trends, giving birth to something new.

So, the million-dollar question is and will always be- what predictions would an investor be laughed at now and considered not even serious but would turn out to be fundamental truths. Which predictions will be completely out of consensus of even out of what is considered serious and also will be right?

Trying to answer this and act on it is, after all, the fundamental mission this house has.

As our investors know, we do not shy away from being completely away from consensus, nor could we. It is, certainly, one of our main competitive advantages when faced with the amazing competition we have in the investment management industry: we don't need to look as professional or conventional. Over the years, some successes (as well as some misses) came from this positioning, like our early investments in the luxury fashion industry, back then long considered a sleepy corner of the consumer industry but now more seriously followed and some overlooked tech companies across the globe. Time will tell if other out of consensus opinions we hold will turn out to be fundamental truths or not, like our (current) underweight position in American stocks and overweight position in emerging markets, especially Brazil and China, that set us apart from many other investment houses.

Among all our out of consensus positions over the years, surely, no other was even close to being as criticized as our bullish call on China.

We understand that the theme of Chinese markets (and its economy, but probably above all, its geopolitical future) instills passion and has ferocious advocates on both sides.

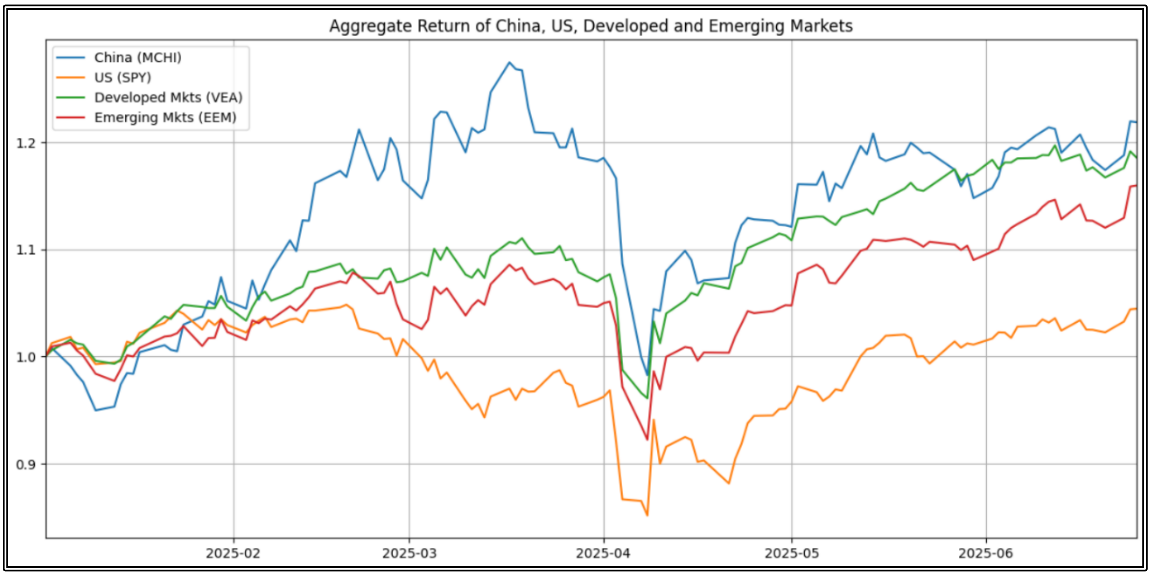
[2] https://www.bloomberg.com/opinion/articles/2025-06-05/reserve-currencies-euro-elevation-doesn-t-depend-on-dollar-demise

First, it is natural (and correct) to put a discount on any asset class (or really, anything) that is less understood. China is certainly a market that is less familiar to most investors than the American or European ones.

There is also some discount to the "likeness" factor, i.e. investors don't "like" China and just prefer to own different stocks. As in papal conclaves, consensus is formed and does not always turn out to be correct.

Interestingly, China is by far the market where the most money has been made for our fund. Since our inception our combined exposure to China was less than 20% but this market was responsible for more than a third of our fund's profits so far.

So, is the Chinese market now part of the consensus? Does its rise in the year of 2025 already make it look more like a Parolin than a Prevost? Some media reports state that China in 2025, amid the Trump trade wars, is becoming once again a respectable market. A few of the same investors who swore the country "uninvestible" seem to be recent converts. That being said, if we do a quick glance at long term valuation and compare the Chinese markets to some of its peers from the developing world, let alone European or the US markets, we can see that in terms of investment opportunities and valuation differential, we haven't scratched the surface.



Source: Yahoo Finance

Thesis: Daikin

In our 2Q 2024 Letter, this house discussed our CIO's recent trip to Japan, where he had the opportunity to meet many fund managers, investors, experts in the country and, crucially, visit many companies that were possible and prospective investments for our fund.

In this letter we disclose our new position in Daikin Global.

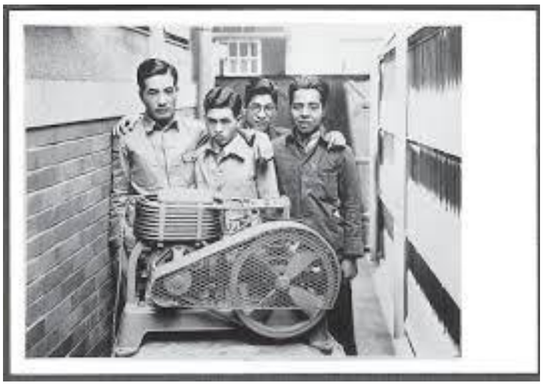
Daikin was founded in the city of Osaka, Japan in 1924 and it still headquartered in Japan's second largest city.

In the early years Daikin was called Osaka Kinzoku Kogyosho and manufactured metals, radiator tubes and parts for aircraft.

Crucially, in 1951 at the height of post word war 2 reconstruction in Japan, Daikin entered a then nascent market that defines it today: air conditioning.

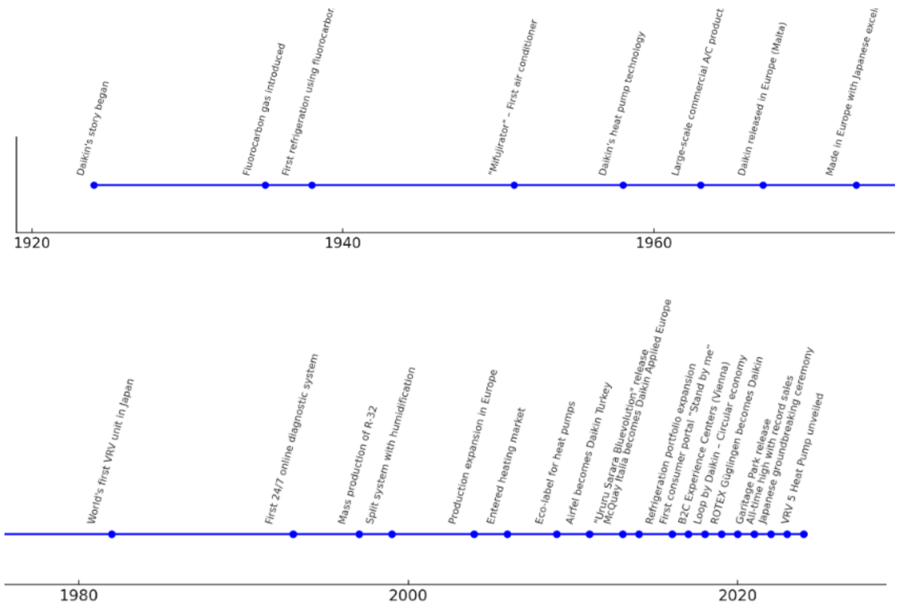
Over the following decades Daikin came to redefine its industry and lead its global push, being constantly ahead of its time, like when it introduced environmentally friendly models as early as the 1980s and for its focus on emerging markets early in this century, becoming not only the largest air conditioning company in the planet but being by far the most globally diversified

In 2004 Daikin entered the north American market and since then it has acquired a number or regional American companies, especially in the consumer segment. Southeast Asia and India expansions followed not long after.



Akira Yamada, founder of Daikin industries, with an HVAC prototype in the 1940s

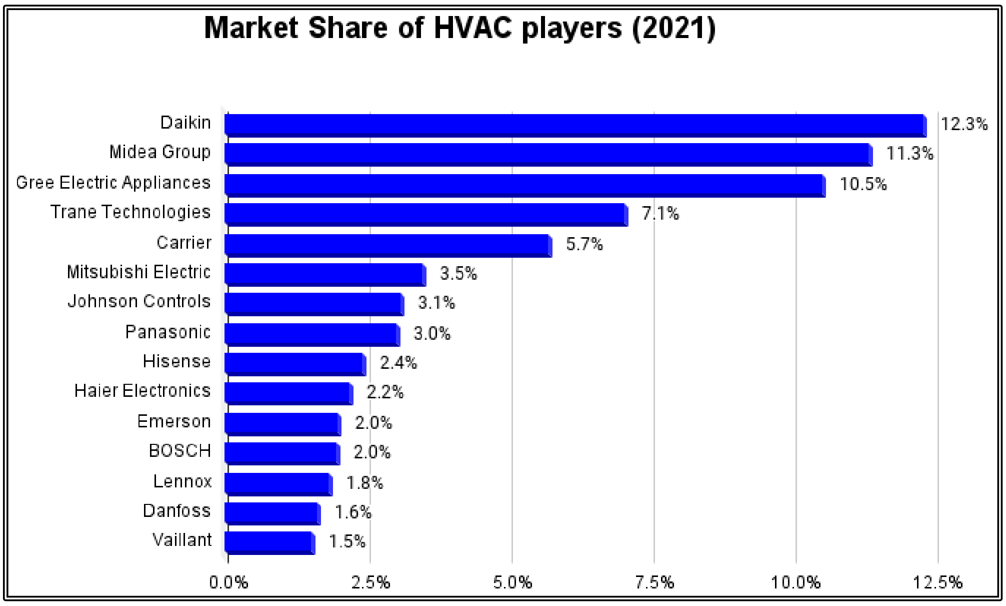
Daikin Milestones



The global air conditioner market

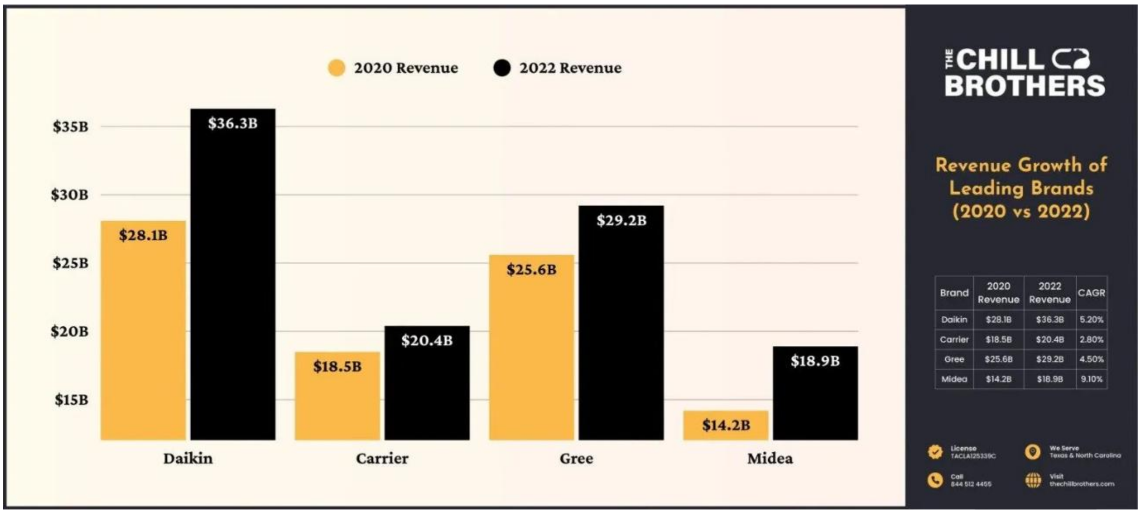
Doing a general panoramic analysis, the global HVAC market (Heating, Ventilation & Airconditioning) is a roughly $ 320 billion annual industry. In total, demand was around 110 million individual HVAC units in 2022. Overall, besides warming global climate, the major trend we see supporting demand increase is global economic growth and rising incomes, with China & India leading the growth in the market globally. If in the past our species was at the mercy of geographical and climate conditions, today, at least for those of us who can afford it, we can feel comfortable inside private and public spaces throughout the four seasons of the year.

The major players in the industry are Daikin, the theme of this thesis, and the number 1 player by revenue and units sold globally, a few major American companies like Carrier and Trane and also a couple of younger Chinese players like Gree and Midea



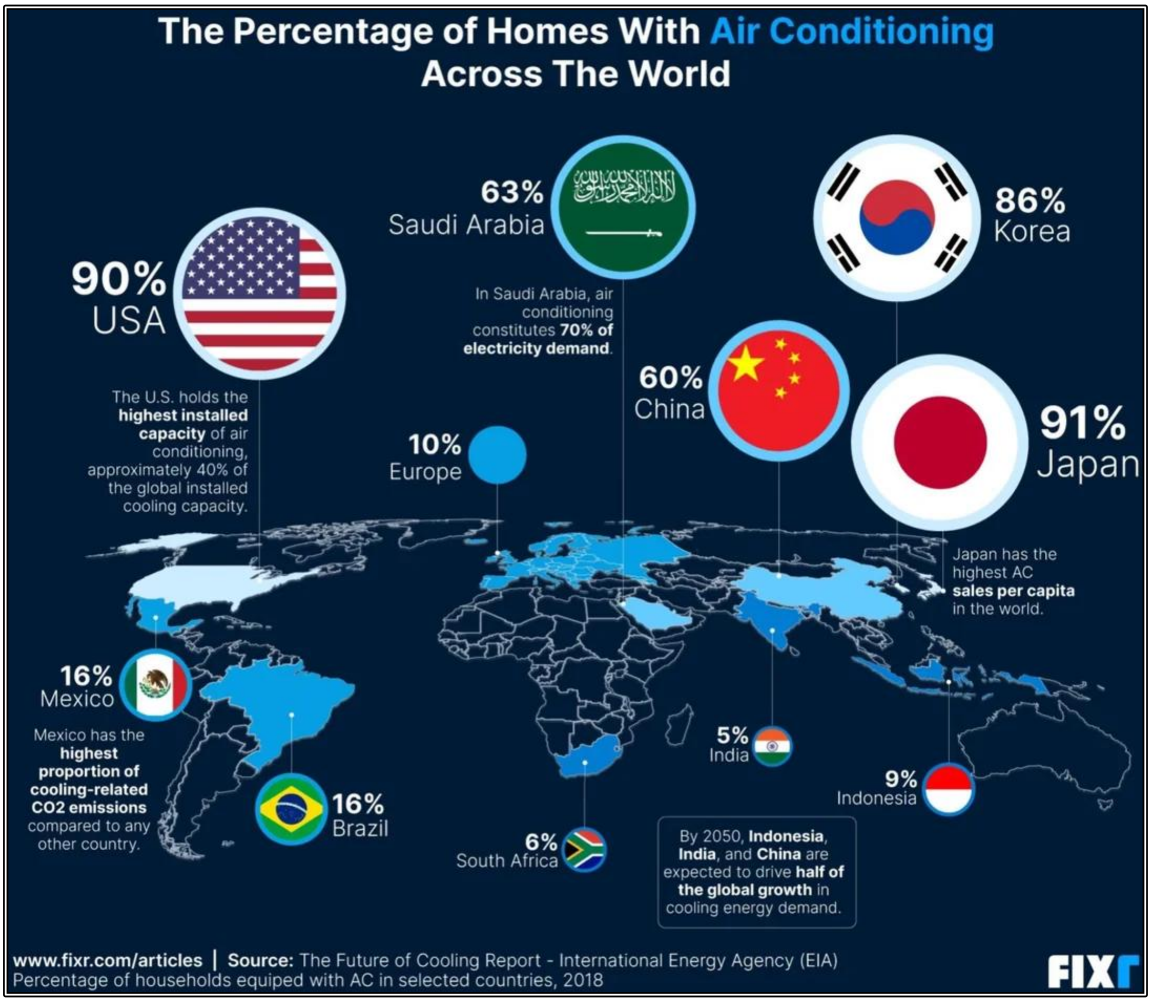
Source: Deallab

The vast majority of them are present both in the retail side of the business (which sells to final individual customers) as to commercial buyers (they sell their units to buildings, offices shopping malls and so forth) and for industrial uses (factories and industries).



Overall, the industry is still fragmented, with many local and regional players and the largest company, Daikin, comprising only around 15% of the global market.

All in all this house things there is still a giant growth avenue ahead for all the players in the industry: while in the rich markets of the USA, Japan and Korea AC penetration is around 90% (meaning almost every home already has an AC or heating equipment keeping temperatures comfortable all year round) in many markets with extreme heat, like Brazil, Africa, the Middle East, China and India, that by the way houses most of the planet's population, the majority of households still has to endure summer without an AC.



It is hard to overstate the positive impact the advent of air-conditioning has brought to the world. In the USA ACs completely changed the patterns of internal migration and the economic development of the country, allowing cities like Phoenix, Arizona and Houston, Texas to be livable all year around and become major centers of economic activity. Today, those cities are among the most successful in America[3].

Globally, cities like Dubai and Singapore, arguably the two most successful international expat hubs of the 21st century, were able to produce their respective economic miracles thanks to this modern miracle invention. Just spend a few seconds thinking about what would be living or visiting Dubai before the advent of ACs and one would easily conclude that this city would never have become the one the world now knows and visits if not for that.

Certainly, with billions of consumers in Africa, India, Latin America and China still not able to afford their first AC, there is still a long journey of penetration and growth across most global markets.

[3] https://www.nytimes.com/2017/08/04/upshot/the-all-conquering-air-conditioner.html

The players

Mostly, as in most industries, the US companies enjoy the highest multiples and valuation.

At first glance, this might seem fair: when compared head-to-head, Daikin, with its conservative and consensual Japanese management culture and lack of aggressiveness simply doesn't enjoy the same level of margins as Trane or Carrier. In a recent conference call, a sell side analyst berated the company, flatly telling them they "would never" enjoy the same multiples as the US players if their remained unable to reach the same level of margins.

Excerpt from Daikin's 4Q2024 Earnings calls, February 5th, 2025:

Analyst: .... *First, let me ask a question related to Mr. Sasaki's question. As for applied service solution ratio, the Company aims to achieve 45% this fiscal year and 60% next fiscal year. The company strongest in applied air conditioners in the US is TRANE, but according to their data, I believe the solution sales ratio is the same as your company's. Despite this, why is the profit margin of your air-conditioning business not at a level similar to TRANE's 15%? When do you think such a figure is likely to be achieved?*

Company: *As for profitability, we are still investing, so even if our service solution ratio reaches 60%, I don't think we will catch up with our rivals' operating profit margins of 15% or 20%. Also, as Mr. McDonald is well aware, we spend a lot of money, including investments. So, the ratio of SGA is probably higher than that of our rivals, and it will be difficult to catch up with the profit level of our rivals in one or two years.*

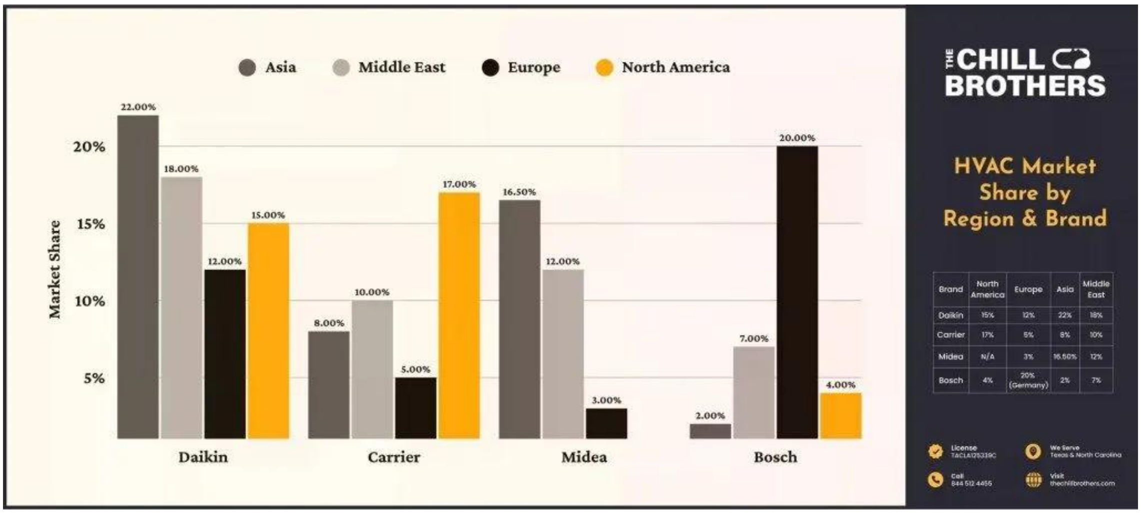
Analyst: *I understand Mr. Isayama also asked about crisis awareness. Profit margins have been declining for a long time, when can you turn around profit margins? Otherwise, I don't think institutional investors, especially in the US, would buy Daikin's stock. Profitability and ROE are not improving well, even though sales are increasing properly; when will you produce results?*

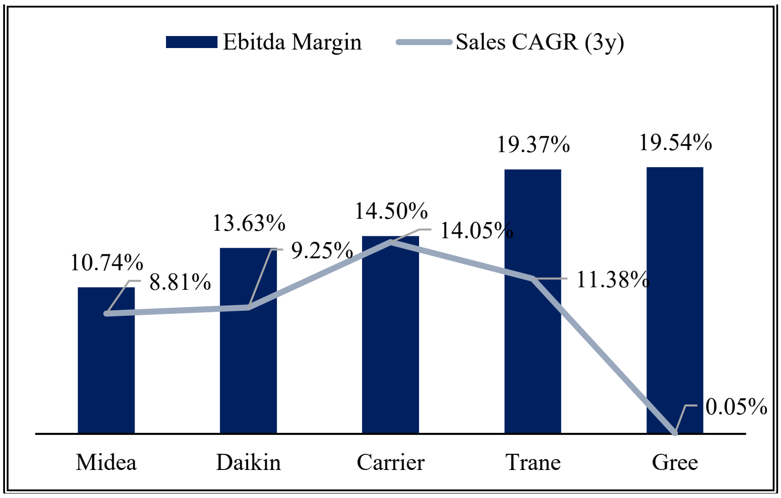
This house will take the other side of this view.

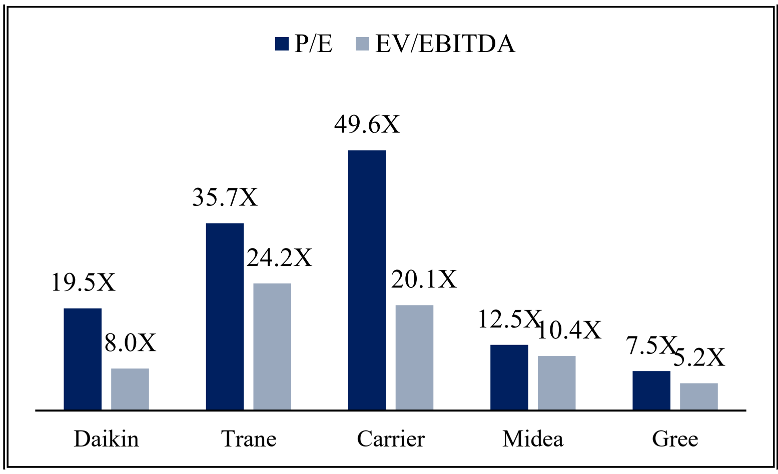
Yes, it is unlikely that in the medium term, when confronted to their peers in the US or European markets head-to-head, Daikin will have the same margins and aggressiveness for the above-mentioned reasons. A consensual Japanese style management that favors continuity, lack of aggressiveness, etc.

But if someone is willing to take the really long term, Daikin might not even need this infusion of American style capitalism: it is the only real global player in the industry. The American players are very weak when competing away from their home market. The Chinese carriers for their part were never able to really enter the US market. The Europeans companies on the other hand seem to be with an even weaker hand, looking completely cornered in their own market. The only player with double digit market share in every region in Daikin.
And even more important, while Daikin might never be number 1 in the parochial if huge US market, something Wall Street is so focused about, it is the undisputed number 1 in

the markets of tomorrow, that might not make a difference in the company's balance sheet now: Africa and India. Talk about mixing the forest for the trees.







So, what does the future hold for the global HVAC industry in general and for Daikin in particular?

While projections for the industry and its major players vary[4], our internal projections imply that the industry will grow from the $ 320 billion figure to around $ 380 billion in 2030.

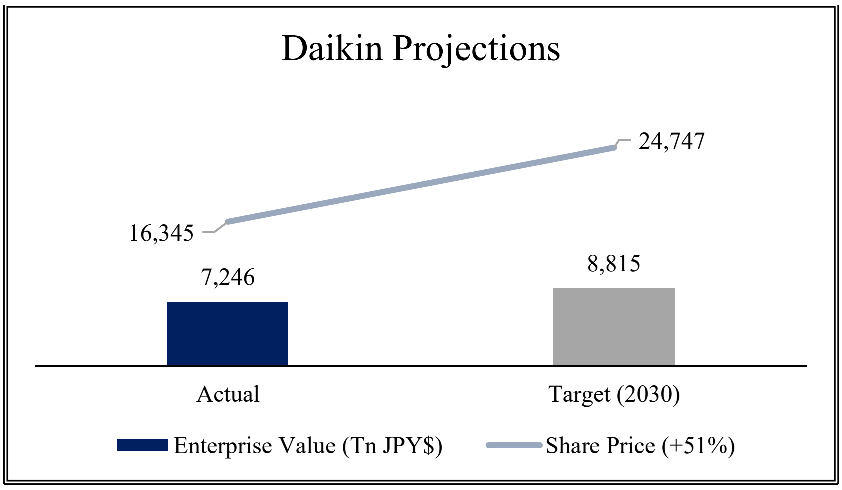
Asia pacific, as in so many industries, will lead this growth, reaching almost 50% of total sales by revenue in 2030. North America and Europe should follow, leading to around $ 100 billion and $ 60 billion annual revenue in the same period.

As for individual units, numbers are sparse and difficult to gather, even after a deep field analysis and after our team spending a few months talking to different players of the industry, we think the global total should go from 151 million units in 2025 to around 190 million units in 2030, with Asia Pacific sales alone reaching more than 115 million units in 2030.

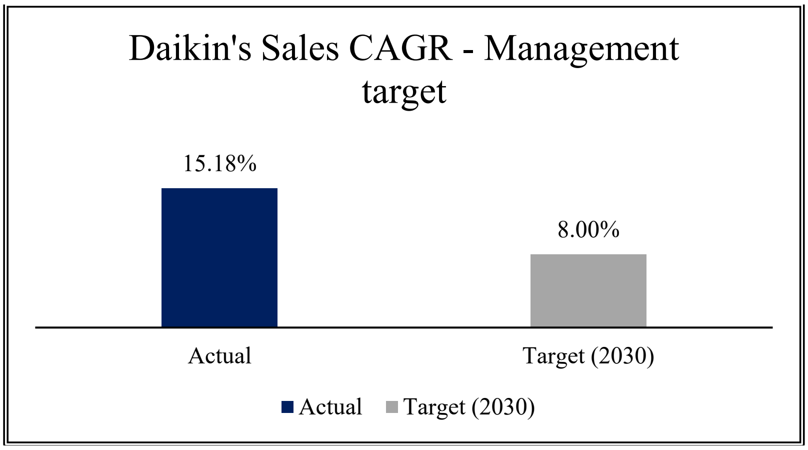
Of this grand $ 320 billion total, residential sales should be a little over half, with commercial around $ 100 billion annually and industrial the remaining 10% or so.

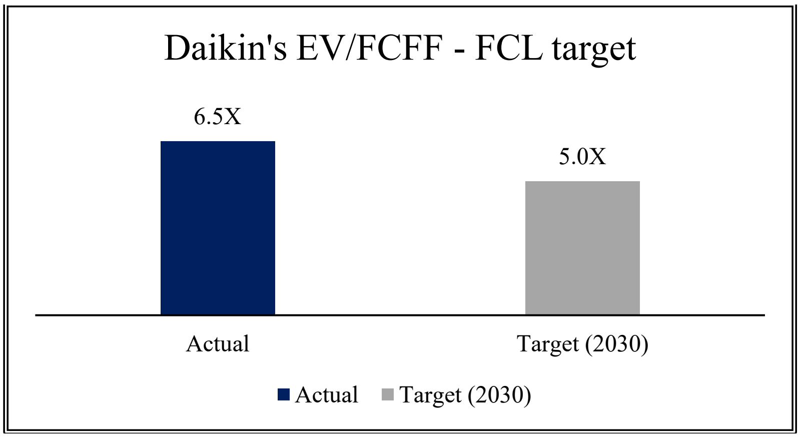
To sum it up, Daikin might be the best positioned player due to its brand and distribution strength in the key geographies where growth will be seen.

Assuming a 8% annual growth until the end of the decade, a very conservative projection in this house's opinion considering the fact that emerging markets should experience explosive growth for the next few decades, and also considering the company's 7% Enterprise Value to free cash flow yield, we reach a target multiple of 5x without taking into account the optionalities of a possible convergence of margins of Daikin with the major American players in the US market of possible M&A opportunities.



[4] While some projections consider only equipments which would lead to a market size of around $150-160 billion this house's projections also comprise systems and services, leading to the full $320 billion figure.





As our regular readers know, this house does not put too much emphasis on target prices and mathematical upsides since most of our work falls on the qualitative side. Still, it is a market truism, and investors seek stories in times of euphoria and mathematical margin of safety and numbers in times or worry. So, both when it comes to its long-term story and in its multiples, we see a compelling case in the company.

Performance

Sector Distribution	% AUM
Consumer Discretionary	27.16%
Industrials	16.57%
Financial	14.32%
Miscellaneous	10.95%
Consumer Durables	8.99%
Communication Services	5.81%
Staple	5.60%
Commercial Services	5.14%
Cash	3.11%
Healthcare	2.35%

Returns	
Year To Date (BRL)	2.03%
Year To Date (USD)	15.97%
12 Months (BRL)	9.66%
12 Months (USD)	13.25%
Since Inception (BRL)	112.02%
Since Inception (USD)	21.64%
Annualized Rate of Return (BRL)	9.33%
Annualized Rate of Return (USD)	2.35%

Geographic Distribution	% AUM
China	29.68%
Europe	25.93%
Brazil	15.97%
India	11.12%
US	8.12%
Japan	3.97%
UK	3.20%
Miscellaneous	2.01%

Currency Exposure	% AUM
RMB	29.68%
EUR	24.20%
BRL	15.97%
INR	11.12%
USD	10.13%
JPY	3.97%
GBP	3.20%
NOK	1.73%

Top 5 Concentration	% AUM
BYD	12.60%
ANTA	12.42%
HDFC Bank	11.12%
Technogym	8.99%
Moncler	8.68%

Portfolio Concentration	% AUM
Top 5	53.81%
Top 10	78.37%
Top 15	94.07%

FCL Opportunities performance was 2.03% in BRL in the first half of 2025. Over the past 12 months, our performance was positive in 9.96%. As a reminder, the US dollar has experienced a significative decrease in value over the past 6 months against the Brazilian real, and this was the main factor detracting our performance when measures in BRL.

In USD dollars our performance was a positive 15.97% in the first half of 2025 and 13.25% over the past 12 months a performance we judge satisfactory.

Our accumulated performance since our inception date of January 30th, 2017, sits at 112.02% in BRL and 21.64% in USD, translating to a compounded annual performance (our preferred internal evaluation metric) of 9.33% BRL and 2,35% in USD as of June 30th, 2025.

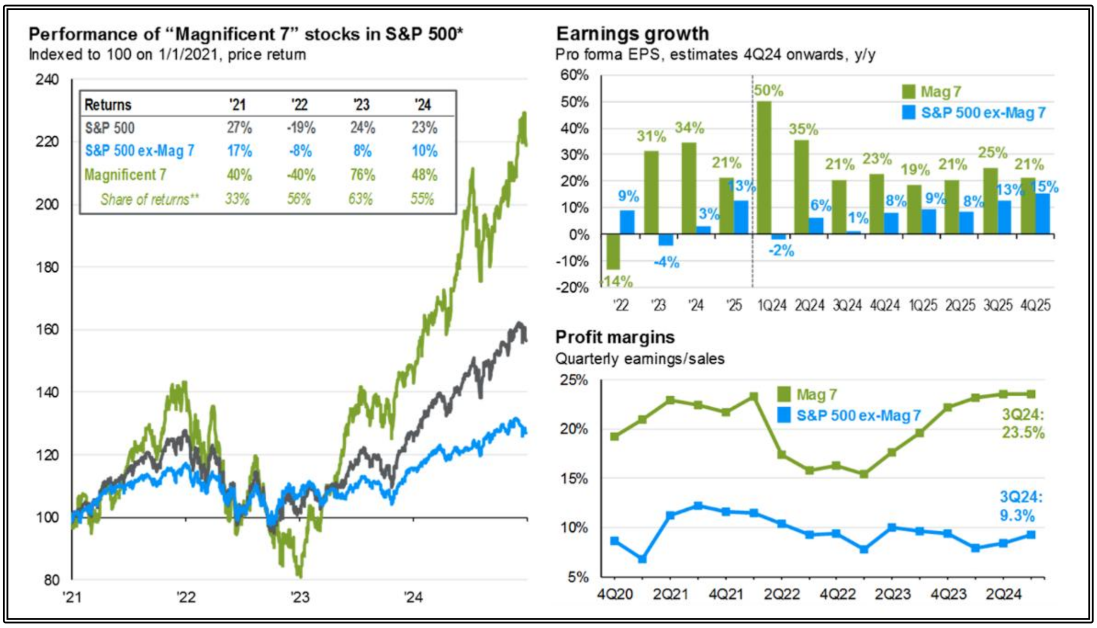
Overall, the main theme of the year so far when it comes to asset allocation for this house's FCL Opportunities fund is a cyclical change: our fund has, over the past few years, maintained an underweight exposure to US assets compared to the rest of the world, especially emerging markets, as explained previously in numerous other investment letter in this space.

This US underweight and emerging markets/Europe overweight exposure went from being a headwind over the past few years, where US based large cap companies like Apple and NVidia experienced massive outperformance, to being a significant tailwind in this semester, when Chinese, Brazilian and European stocks have significantly outperformed their US peers, favoring our FCL Opportunities fund's performance.

What about the future? Will the rest of the world continue to decrease the performance gap against their US counterparts, or will the US once again remain supreme?

After much thought and introspection, and with the risk of sounding like "a man with a hammer to whom everything looks like a nail" as Charlie Munger used to say, this house still has the opinion that the rest of the world should maintain its outperformance for a while.

The best argument we've encountered so far: the US outperformance was, to a large extent, driven by its tech sector in general and by the so-called magnificent seven companies in particular. They were the real outliers of the past decade. It is hard to overstate their importance and indeed, they are probably the most fantastic companies ever created by mankind.



Source: J.P. Morgan Asset Management

The S&P 500 falls flat without Big Tech

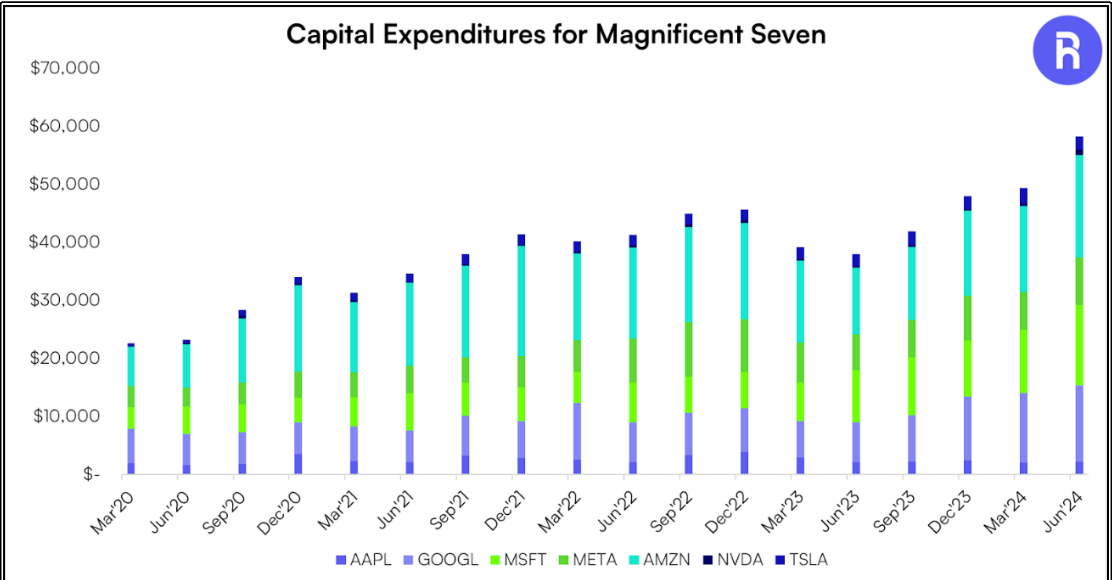
The benchmark index would have had mediocre years without the Magnificent 7, according to DataTrek Research.

Year	S&P 500	S&P 500 ex-Mag 7
2023	24.2%	4.1%
2024	23.3%	6.3%

Price return basis for 12-month returns 2023, 2024

Table: Phil Rosen, Opening Bell Daily • Created with Datawrapper

OPENING BELL DAILY



Source: Bloomberg. Data as of June 30, 2024. The "Magnificent Seven" are a group of seven companies commonly recognized for their market dominance in technological innovation.

Without them, the US market would have at the very least, looked a lot less exceptional.

Here is the thing: they are, on the margin, becoming a little less magnificent. First, you can't surprise the world twice, like you did over the past 10 years. When this house first launched its Apple thesis 10 years ago (a position we, sadly, didn't keep for that long) it was still an out of the box idea although already the largest component in the S&P500. It was seen as a "device company" that wouldn't ever have multiples near its software peers.

Fast forward to 2025: the world not only is enamored with the magnificent seven, the AI potential they explore and their endless possibilities and the seven companies respective valuations fully reflect that, but, after long being a high growth and low capex sector, US tech is turning, into a slower growth (although still very promising over the long term) and high capex industry (since no self-respectable magnificent seven will want to be left behind when it comes to AI , a sector that unlike online advertising and social networks, demands intensive capex in data centers).

FCL Team