

FCL *Capital*

1Q 2023

The Magic Box

"If you're not willing to react with equanimity to a market price decline of 50% two or three times a century, you're not fit to be a common shareholder and you deserve the mediocre results you're going to get..."¹

- Charlie Munger

Since the dawn of time, humans have been searching for a magic solution to find wealth and fortune. Alchemists, miners, fraudsters, gold diggers, salesmen, businesspeople, investors, we are all after the lightbulb, the abracadabra, the life changing idea through which we will swim in gold like Uncle Scrooge.

In this letter we explore the best wealth creation solution ever invented by mankind. One which we dedicate our lives exploring and trying to understand. We will call it the magic box. Our purpose will be to dissect it and discuss the perils, limitations and possibilities of this special box. And above all, we will try to explain why, being this box so incredible as we claim it to be, so many are scared, or even repulsed by it.

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The magic box is, obviously, the stock market. And why is it magic?

Think of someone who deposited \$100 in the magic box a century ago, back in 1922, did nothing else for a century, and then he (or more likely his grandkids) opened the box in 2022 and took the money out. Well, after a century the magic box transformed the initial \$100 into \$1.875.213,40 (yes, almost two million dollars), or an annual return of about 10,34%². That's exactly the S&P 500 performance during the 1923 – 2022 period.³

Mathematically, a 10,34% annual return compounded for a century multiplies the invested capital by more than 18.000 times, as we've seen in the example above. But to illustrate a more realistic scenario, the exact same amount invested at the exact same rate of return kept for "only" 50 years, maybe made by someone in his younger years and taken out from the magic box for retirement, would still multiply the original capital by 117 times.⁴

And we are talking about the returns of the planet's most important stock index, not some exotic or impossible to replicate product.

¹ https://youtube.com/shorts/XOh_ryk1r-s?feature=share

² All performance calculations in this letter assume reinvested dividends

³ <https://www.officialdata.org/us/stocks/s-p-500/1993?amount=100&endYear=2022>

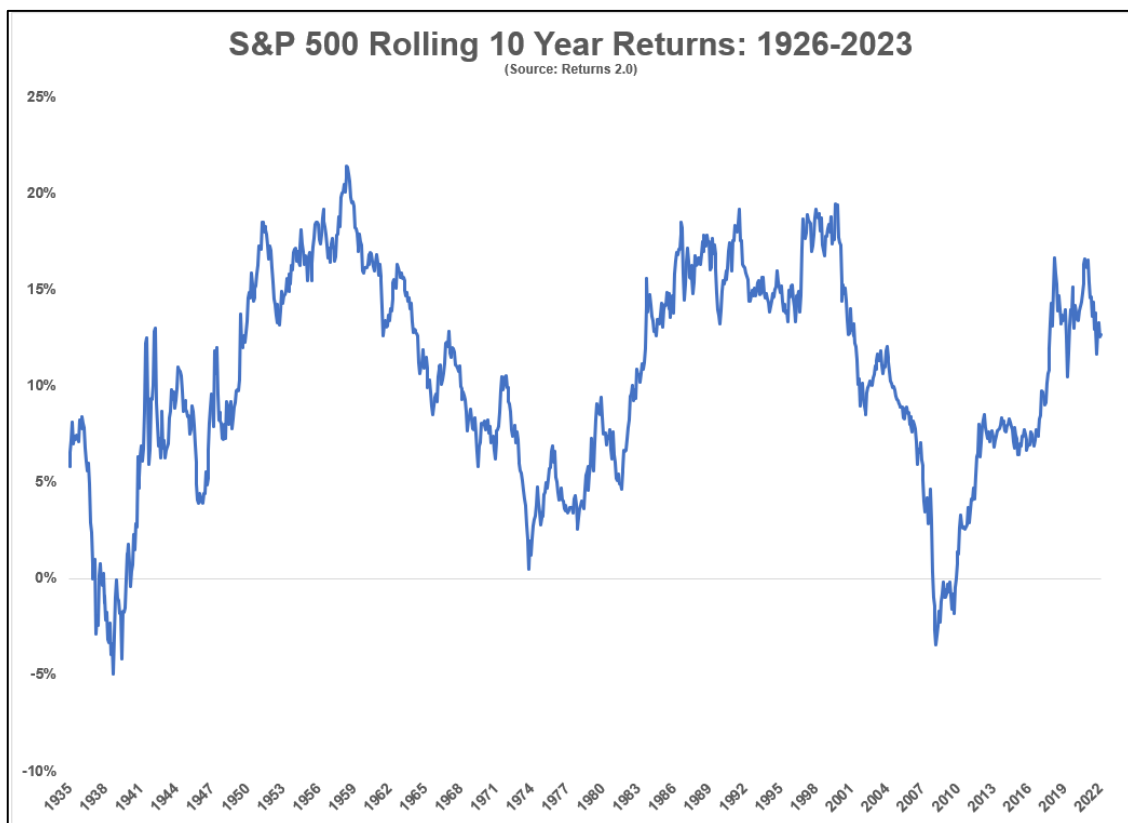
⁴ To keep things in perspective, Warren Buffet's Berkshire Hathaway, possibly the most successful investment vehicle of all time, has compounded its book value at close to 20% annually over the past 58 years.

But things can't be as good as it seems or else everyone would do it, our investors might protest. After all, those are returns for investors who put money in the S&P 500 a century ago, before the age of computers and fast information. Things are surely not as easy nowadays and there are no flying \$100 bills.

Well, the beauty is, in recent decades, returns have been just as good as the compounded annual return enjoyed in the past 100 years. Stock returns are not decreasing. For example, if you invested the same \$100 on January 1st, 1993, exactly 30 years before the end of the experiment, and kept the money for 30 years until December 31st, 2022, instead of the 100 year period between 1923-2022, your annual return would have been 9,70% annually, pretty close to the 10,34% annual returns enjoyed by the centenarian investors.

Well, the stock market is very volatile and we never know if today or tomorrow might be a good time to invest in it.

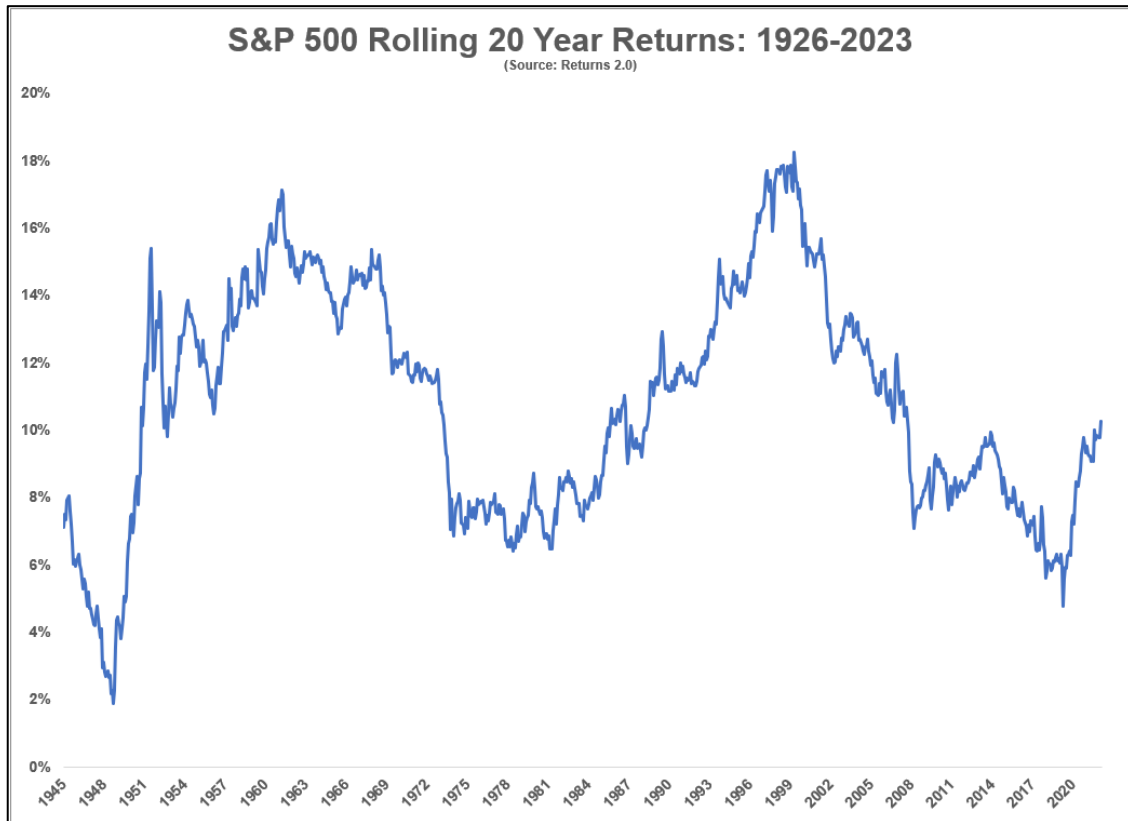
There is some truth in this argument. We indeed never know if tomorrow or next month or next year will be a good period for any stock market. Let's look at some charts made by a blog this house follows regularly called "*A wealth of common sense*".



This first chart shows the rolling 10-year returns enjoyed by investors over the past 100 years. In other words, it shows the annual returns that investors who held the stock market for 10 years ended up with at every moment since 1935. Note that there are only two periods, around 1938 at the end of the great depression and in 2000s thanks to the combination of the dot.com burst in 2000 and the great financial crisis in 2008, where the compounded 10-year annual returns fell below zero. Therefore, 10-year compounded

annual returns below zero are fairly uncommon in the stock market of a developed country but still possible. And by the way, the best 10-year annual return so far happened in 1959 at around 21,4% annually⁵. There is, evidently, a lot of volatility in stock market returns.

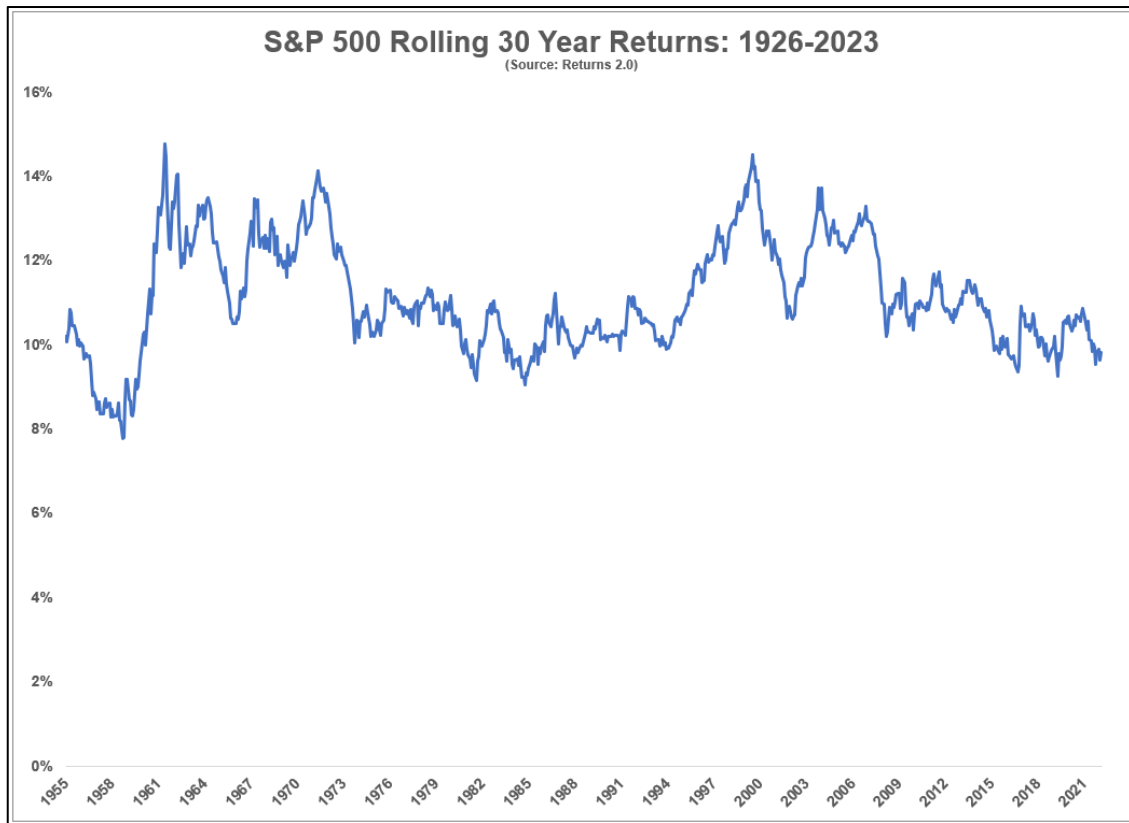
Now let's look at compounded 20-year annual returns:



The best 20-year compounded annual return was around 18% annually in the 1979-1999 period. The worst was a positive 2% annually in 1929-1949. **Therefore, there was not a single negative 20-year period for the S&P 500 in the past century.** There were, obviously, very negative years but they are cancelled out by the good ones. And note that the longer we are exposed to the stock market, the more the volatility decreases. Overall, stock returns were above 10% annually for 56% of the time and above 8% annually in US dollars terms (!) more than 75% of the time in all 20 year observations.⁶

⁵ Which means that a lucky investor who put his money in the S&P500 in 1949 would have compounded his money by 21.4% annually over the following 10 years.

⁶ <https://awealthofcommonsense.com/2023/02/deconstructing-10-20-30-year-stock-market-returns/>



Finally, the 30-year compounded stock market returns. Note the straight line, signaling very little volatility. In other words, if you take a 30 year perspective the common question “is now a good time to invest in stocks?” is almost meaningless. Every 30 year period had very similar returns. Every single 30 year period was “a good moment to invest in stocks”. The lowest annual return for any 30 year period in the past century was 7,8% annually in dollars (remember over the whole century average performance was 10,34%) and the best 30-year annual return was 14,8% annually in the 30 years ending in 1968. In other words, the worst 30-year period ever for the stock market brought gains of more than 850% in dollars, multiplying its investors capital by almost 10 times.

The following chart shows the mathematical odds of having a positive return in the S&P 500 depending on the time you first invested in it.

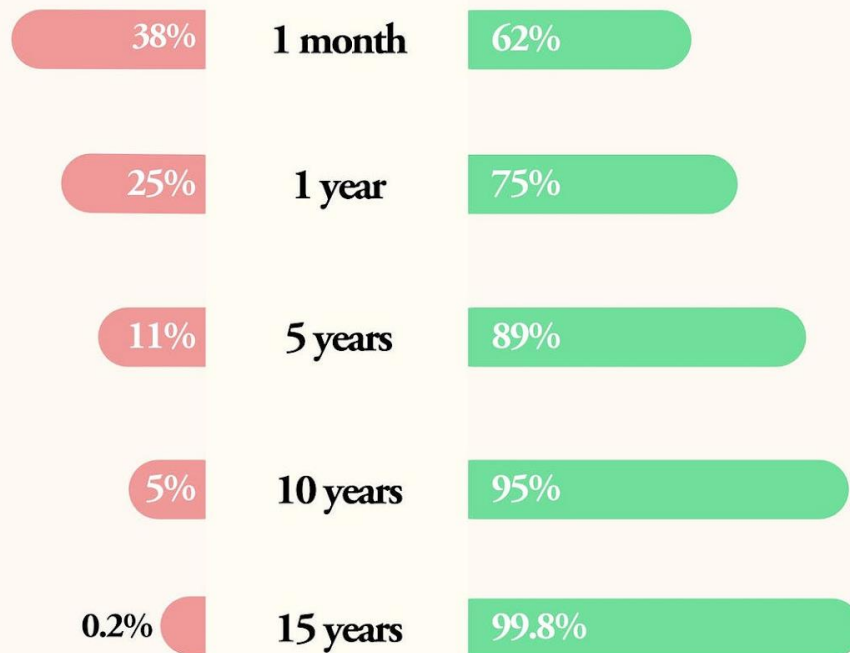
Investing \neq Gambling

**Odds of
losing money**

**Odds of
making money**

Time Horizon

US Stocks represented by S&P 500 and the IA SBBI US Large Cap Index



Sources: Blackrock, Morningstar, Forbes

treytondevore.com

If we get to 20 years, as we saw above, at least historically, the chances of making money go up to 100%.

But hold on, this is the American experience! The 20th century winner after all. What if we expand this experiment to more places? After all, especially in emerging markets, there are wars, revolutions, sovereign defaults etc.

Well, first of all, we took the S&P 500 simply because it is by far the world's most important stock market and a major reference for every global investor including this house. Indeed, when it comes to the most volatile emerging markets, complete ruin and overexposure to a single market are risks that have to be taken into consideration. Once more, we raise the case for international diversification and against excessive home bias.

That being said, rigorous academic studies have shown that the US stock market success is not an aberration, if anything the US wasn't even the top performing market over the past century, a position occupied by Australia.⁷

So, to sum it up, the experiment wouldn't be so different if we took almost any major developed country index instead of the S&P 500. Any reasonably diversified portfolio seems to bring, over the very long term, almost certain gains.

But what about the future? Why is investing in the stock market almost guaranteed to have a positive return in the future as it was the case in the past?

Because, over the long term, investing in stocks is investing in human ingenuity. It might be hard to say for certain that Google, or Uber, or PayPal will conquer the competition and grow their business. But it is a fairly safe bet that, as a whole, we humans will continue to create, innovate and get better as we have been doing for centuries. There are certainly kids in garages somewhere in the planet hungry for a chance, ready to disrupt, ready to change the world.

The gains of the past were brought by things like the advent of aviation, fast trains and moderns manufacturing although no one knew exactly which ideas would be successful. Likewise the gains of the future might arrive because of AI, crypto, 3D printing or maybe from ideas we haven't even dreamt about yet.

The one thing that seems certain is that human beings, this restless species, will continue to try to outcompete and outsmart each other in the name of fortune and success.

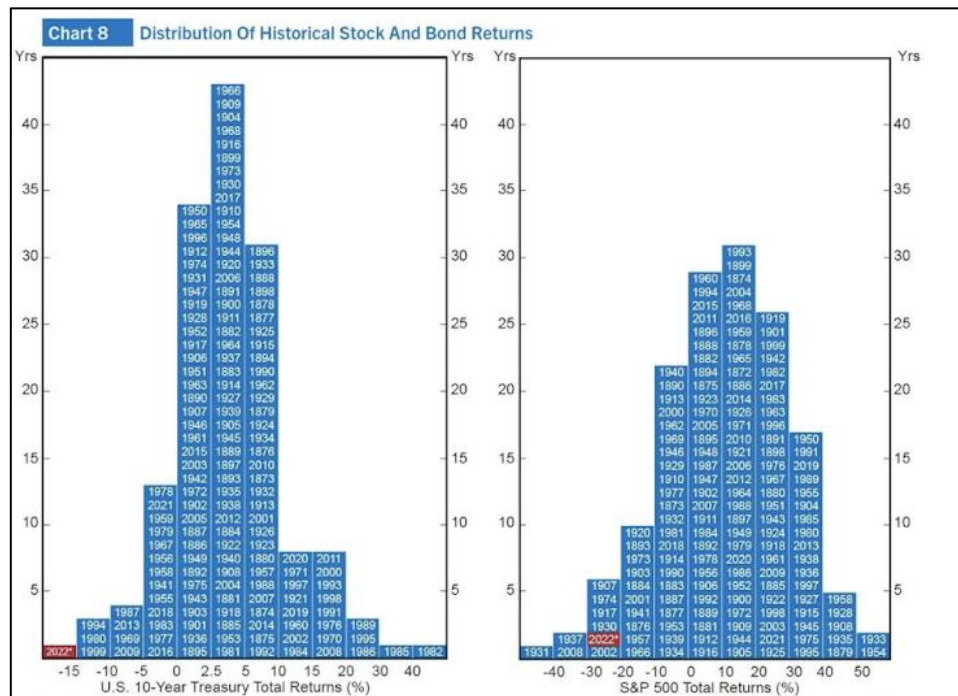
So it just seems too good to be true. Park your money in a simple stock index and wait a few decades to be almost guaranteed that the magic box will do its work and your money will be multiplied by hundreds of times.

Why doesn't everyone do it?

Because, to keep the answer short, the magic box is very cruel.

It betrays you, it fools you, especially when you are overconfident and think it is your friend. The box can do terrible harm if you are not smart enough to realize it.

⁷ <https://www.quantifiedstrategies.com/best-performing-stock-markets-in-the-world/>



Source: Alpine Macro

Above the same chart we published in our last letter with the annual stock market returns since 1931. Note that it might not feel as much of a consolation for an investor that lost some 40% of their money in a single year, like it happened in 1931 or 2008, to think that over the very long term things will be fine.

To make matters worse, we live in a fast paced world, meaning that all the time, investors have many incentives to constantly buy and sell, get desperate, get euphoric. For long term investors, like this house, the higher the turnover and desperation of other stock market investors, the better.⁸

Obviously, we are not making the case that other asset classes are useless. Fixed income has a crucial function in any capitalist economy: it makes companies able to operate, the banking system possible and so much more. For any individual or institutional investor with short term or midterm liabilities (which means almost everyone) fixed income is a necessary part of their portfolio to a greater or lesser degree. As for global macro, it keeps the global markets efficient and functioning. But it should be stated, for a very long term investor, the optimal portfolio is basically 100% equities (as understood by public traded equities and also private ones like personal business, buyouts and venture capital).

Why? Because equities not only outperform bonds over the very long term as has been empirically shown all over the world, but, as the seminal work of Jeremy Siegel in his book "Stocks for the Long Run" has shown, stocks might also be (whisper it) safer than bonds if we take the very long term view.

⁸ A 2003 quote from Warren Buffet we love: "We bought some Wells Fargo shares last year. Otherwise, among our six largest holdings, we last changed our position in Coca-Cola in 1994, American Express in 1998, Gillette in 1989, Washington Post in 1973, and Moody's in 2000. Brokers don't love us."

The trick is separating risk from volatility like classical value investors try to do. Yes, stocks are way more volatile than bonds. The above chart proves it.

But also, bonds are claims on debt (be it corporate or government debt) while stocks are claims on the real economy. It is easy to think of an unlikely black swan event, like a sudden bout of hyperinflation, that would essentially decimate a bond's value, but since stocks are claims on the real economy, no single conceivable event could bring them, in aggregate, to zero.

Bonds, on the other hand, have fixed coupons and the real value of those fixed coupons or fixed amount of claims could be essentially wiped out by inflation. Can a stock investment also go to zero? Sure, it could happen and it does happen to lots of individual companies, but not to a major economy as a whole.

It is conceivable that, say, Disney or Apple will someday go broke. But this house can't even come up with a bizarre enough scenario, in which the value of the whole S&P 500 goes to zero. And if it someday does, we will probably have worse problems to think about as humanity.

Could US bonds on the other hand go to zero? Well, while no one thinks a default by the US government is a likely scenario, at least it belongs within the realm of possibility.⁹

In this sense, flipping on its head the argument that bonds have lower return because of lower volatility, we might even argue that the lower return and higher risk bonds have could be a premium investors in bonds are paying due to their lower volatility. They sleep soundly knowing that at any given day or year their returns will vary a lot less than stock returns. But over the very long term they will enjoy lower returns and in quite a few ways even higher risk.

That being said, any portfolio that goes from 100% stocks to some composition of stocks and bonds will have a lower expected return, but also a much lower volatility at any given time.

The following chart shows the worst stock market years in the past century and how long it took to achieve new all-time highs once again:

⁹ And that is not even including the endless "debt ceiling" US Congress ordeals into the argument.

S&P 500 Worst Returns Since 1928					
Year	Return	+1 Year	+3 Years	+5 Years	+7 Years
1931	-43.8%	-8.6%	35.4%	162.1%	119.1%
2008	-36.6%	25.9%	47.6%	126.1%	160.2%
1937	-35.3%	29.3%	14.2%	18.7%	76.7%
1974	-25.9%	37.0%	57.8%	99.2%	150.1%
1930	-25.1%	-43.8%	-23.0%	11.6%	-4.8%
2002	-22.0%	28.4%	49.0%	81.7%	45.2%
1973	-14.3%	-25.9%	25.7%	24.5%	94.5%
1941	-12.8%	19.2%	77.4%	120.6%	145.3%
2001	-11.9%	-22.0%	10.9%	34.4%	-10.0%
1940	-10.7%	-12.8%	30.0%	110.2%	102.5%
Averages		2.7%	32.5%	78.9%	87.9%

Data: NYU

As it is shown, there were some terrible years and although in some of them it took quite a while to achieve new records, at some point the market got there.

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The alpha paradox revisited

“here comes, in our opinion, the paradox: since we live in a market that tends to efficiency (as opposed to an efficient market), any strategy that is too explainable and replicable will also be arbitrated away. How do we reconcile that?”

(Excerpt taken from FCL Capital December 2013 Letter)¹⁰

A decade after our “Alpha Paradox” letter, from our Jurassic days, alpha is as hard and as elusive as ever. Over these past 10 years the market is now a lot more dominated by passive funds and fast trading. As for long term value investors like this house, we view this as an additional opportunity to explore the market’s idiosyncrasies and blind spots.

That being said, since we promoted the magic box so far, here comes our note of caution: investors who can keep calm and carry on their way to fortune in the market are and will always be a rare breed. The level of patience, calmness and long term thinking necessary for that is simply beyond what most humans can tolerate.

¹⁰ https://84471c97-e192-4d57-a61f-283398a4101f.usrfiles.com/ugd/84471c_de9929d85e7d4827b6f24f1a8d7579d0.pdf

The urge for action, the thinking that “this time is different”, either in the sense that the world might really end this time or, conversely, that some specific opportunities are too amazing and deserve more leverage or concentration than prudence would advise, will always be pitfalls in the journey.

As for the brave ones who try to beat the market, a path of value traps, false dawns and confusing signals are as certain as a new sunrise the next day.

One of the simplest reasons of why it is so hard to beat the S&P 500: the median stock in the index has a much lower performance than the index itself, since a few star performers carry the market average up. This was aggravated over the past decade with the fact that the traditional small cap premium no longer worked: large cap tech companies outperformed pretty much anything else, as everyone knows.

For example, while in the 20 years ending in 2019 the index went up on average 6,29% per year (with dividends making the remainder of the performance) the median stock in the index only went up 2,12% each year.¹¹ This phenomenon is called a positively skewed distribution, in this case, of returns. The skew occurs because, while the most a stock can lose is 100%, potential positive returns are well above 100%. In a positively skewed distribution, the average is higher than the median.

Now, two good news for investors:

- 1) This phenomenon should not last forever. If the small cap premium returns as it should (in other words if small cap companies once again beat their larger cap peers in the US), beating the S&P500 will become easier;
- 2) Across the world, especially in emerging markets, indexes tend to be misconstrued, sometimes too concentrated in a few companies and sectors and it is relatively easier to outperform them over time. Brazil’s Ibovespa is possibly the prime example of that with a large proportion of local equity managers outperforming the index.

With all that being said, this house named four possible sources of alpha we relied upon to try to beat the market back in our “Alpha paradox” letter a decade ago when we were still formulating our investment framework:

1. Concentrating in less efficient niches of the market;
2. Being able to take advantage of other firms’ limitations of time horizon, sector concentration and knowledge;
3. A proprietary capital mentality;
4. Having a focus on the big picture instead of focusing too much on a day by day or quarter by quarter basis;

¹¹ <https://www.forbes.com/sites/johnjennings/2020/08/28/why-its-so-hard-to-beat-the-market/?sh=39a5cc08106d>

Amazingly, a decade later, we look back at this letter and, although our framework has evolved a lot and new sources of alpha seem clearer now, the list seems very current and we still try to take advantage of those four sources of alpha.

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A warning about trying to time the market.

To end this section, a very important note of caution, we dread the phrase: “is now a good time to invest in stocks?”.

There are several reasons for this. For one, as shown above, over the very long term it is always a good time to invest in stocks. And second, for the short term, don’t fool yourself: no one really knows it.

Are there some sophisticated macro investors capable of making good judgements and inferences and therefore able to generate consistent alpha in their timing of going in and out of their exposure to the market (mainly though indexes)? Yes, but they are extremely few and far between.

For the average investor, it is virtually impossible to “be out of the market in the worst moments and be back in time to enjoy the gains of the best moments”, no matter how hard he tries.

But this whole discussion on when to change your exposure is not only useless, but dangerous.

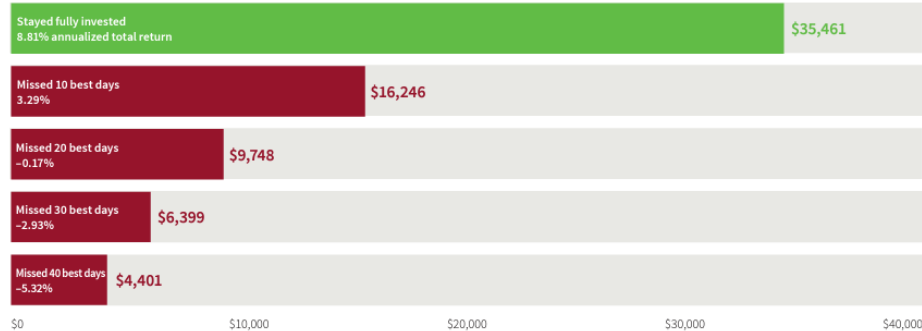
Let’s do an exercise: for the 15 years from December 31st, 2007, through 2022, the S&P 500 generated a compounded annual return of 8,81% in US dollar terms. Again, not that far from the long term performance this house was alluding above.

Now, let’s just suppose that during those 15 years an investor misses (that is, had no exposure to the market) in:

- a. The best 10 days
- b. The best 20 days
- c. The best 30 days
- d. The best 40 days

Stay invested so you don't miss the market's best days

\$10,000 invested in the S&P 500 (12/31/07–12/31/22)



By staying fully invested over the past 15 years, you would have earned \$19,215 more than someone who missed the market's 10 best days.

Data is historical. Past performance is not a guarantee of future results. The best time to invest assumes shares are bought when market prices are low.

Source: Putnam Investments¹²

Just missing the best 10 in a total of more than 3,000 trading days in the 2007–2022 period would bring the compounded annual return down to 3.29% per year and the final total amount owned by the investor would fall by more than 75%.¹³

Well, but that's why we try to time the market, to avoid the bad moments and be back in time for the good ones, right?

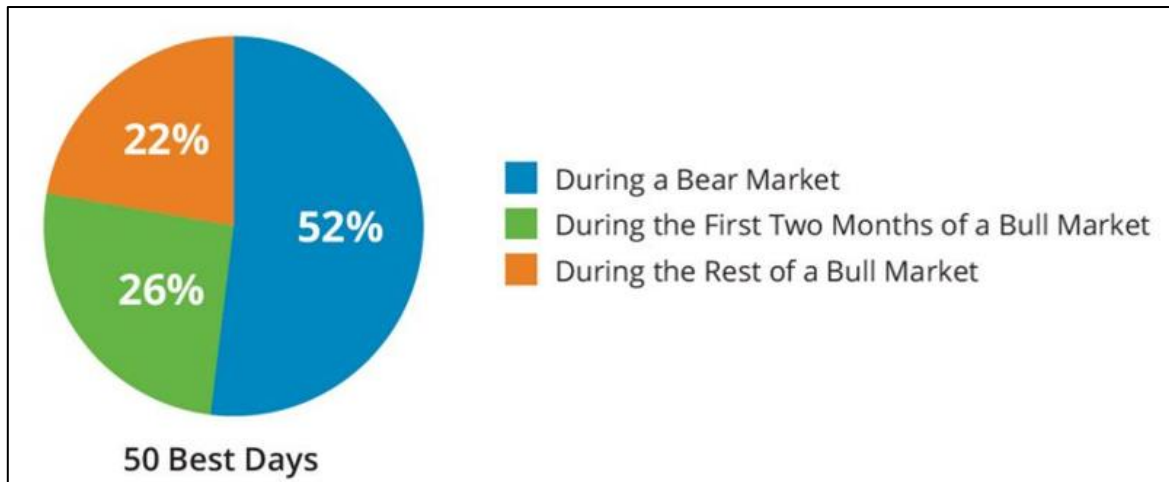
Wrong.

As it turns out, most of those really outstanding trading days, the ones that you don't want to miss and really make a long term difference to an investor's return occur not only in completely unpredictable moments but, even worse, they usually happen right next to the very worst trading days.

In other words, the best trading days for the stock market tend to occur right next to the very worst ones and they are sometimes literally the day after some of the very worst days. Not to mention that very often they occur during bear markets.

¹² <https://www.putnam.com/literature/pdf/II508-ec7166a52bb89b4621f3d2525199b64b.pdf>

¹³ This reasoning also works in terms of which markets to be over and underexposed to, as this house knows only too well: the reason that 2021 was our worst year in relative terms to the MSCI All Country Index is that in that year we were overexposed to Chinese and emerging market shares (that went down) and underexposed to American equities that went vigorously up.



Source: <https://www.hartfordfunds.com/practice-management/client-conversations/managing-volatility/timing-the-market-is-impossible.html>

Therefore, the mantra that “I will come back to the market when things are calmer” is almost guaranteed to make you have worse long term returns than simply staying invested the whole time, through the ups and downs. The reason it is not much practiced is due to the same human biases as ever: being overconfident in one’s own abilities, feeling the urge “to do something”, being dominated by one’s emotions, and so forth.

Although this house knows this advice will, like ever, fall on deaf ears, the bottom line of this whole exercise is simple: once you feel calm enough and excited enough to come back to the stock market it is a pretty safe bet that the best returns the market has to offer in this cycle will already be gone. So, to the vast majority of global long term investors, holding a globally diversified basket of public and private equities indefinitely, not trying to time the market, seems like the best bet for achieving higher long term returns than almost any other available alternative.

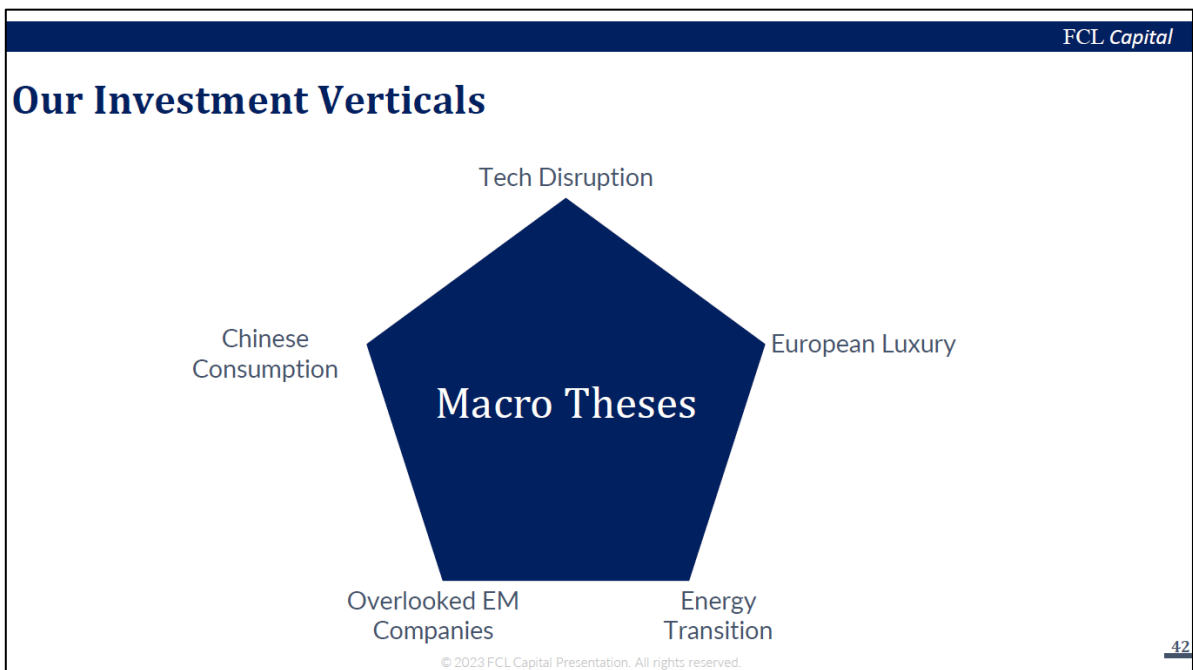
To summarize, the magic box might be cruel, unpredictable, scary. But it is, indeed, magic. No other mechanism ever invented by mankind has created more wealth and none ever will. The box asks a lot from us, including many things that completely go against human nature: high levels of patience, a proper temperament to avoid the extremes of greed and fear, a focus on delayed gratification, but for few ones able to conquer it and tame it, it also brings unmatched rewards.

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An Update on FCL Opportunities Verticals & Macro Theses

As our regular readers know, in most middle sections of our letters, this house usually dedicates the space to a particular investment thesis and, occasionally, to a comprehensive update in a past theses.¹⁴

In this letter however, we decided to dedicate some space to an update of our investment verticals themselves and how excited we have been about our different macro theses.



Source: FCL Capital 2023 Institutional Presentation

European luxury vertical

Starting by our European luxury vertical, this past earnings season (4Q2022) that has just ended brought drastically different results for our two largest investments in the luxury industry: the Italian fashion house Moncler and the US-based Capri, a holding company comprised of Michael Kors, Versace and Jimmy Shoo.

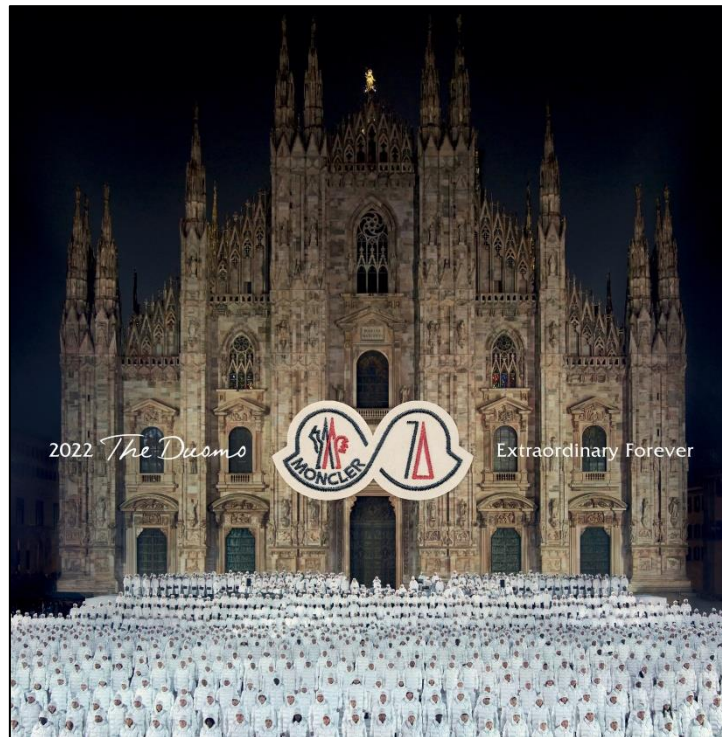
Moncler has shown once again why it is one of the investment cases this house is most proud of in all our history and also that its incredible management team, led by its CEO Remo Ruffini, is one of the very best we ever came across.

The company became ingrained in the conscious of its wealthy, cosmopolitan clientele and has shown an incredible capacity to maintain its pricing power even with the scary economic scenario the rich world is currently in. Year over year increases in sales with

¹⁴ These are often necessary since this house tends to hold investment positions for several years and that's why we dedicated a lot of space to those.

stable margins and a flawless integration of Stone Island, a recently acquired brand that, just like Moncler, used to be a family owned forgotten Italian company but with lots of personality and originality, are a testimony of the ability of Moncler's management.

In a beautiful ceremony, Moncler celebrated its 70th anniversary in a historical event in Milan's Duomo.¹⁵



Source: Moncler

Our investment in Capri has always felt complimentary to our investment in Moncler. While the latter is more of a traditional hardcore European luxury company, the former is also a turnaround story, but one heavily related to the US market.

A quick historical perspective is in order, generally speaking European fashion houses command significant valuation premiums over their US or emerging markets counterparts. First, the Europeans have very hard to replicate features: stronger and older brands, the best and most sought after distribution channels, their exclusivity image and a focus of a very high net worth clientele that make them more protected to economic downturns. On the other hand, US fashion houses tend to sell to the upper middle classes (as opposed to the affluent) and are more dependent on wholesale channels.

Capri sits somewhere in between: while its main brand in sales terms is still Michael Kors, an American brand that has the US as its largest market, it is gradually becoming a fashion holding by acquiring two European luxury houses, most notably Versace, an ultra-premium brand with a very exclusive clientele.

¹⁵ <https://www.moncler.com/en-gb/stories/70thanniversary.html>

While Moncler enjoys multiples that don't sit anywhere close to what would traditionally characterize it as a "cheap company", Capri is very clearly a value investing story.¹⁶

	2023E		
	Free Cash Flow Yield	EV/EBITDA	P/E
Capri	11,6%	7,9x	6,7x
Moncler	3,7%	14,9x	28,1x

It is obvious to this house that there should be a significant multiple difference between the pair for the above mentioned reasons. Our investment in Capri comes from the fact that this house just thinks the company is trading at unjustified distressed levels.

The most recent trigger for that was the 4Q 2022 earnings season when Capri presented disappointing results and the stock tanked more than 25% in the following sessions.

While it is true that Capri won't ever have the same pricing power as Moncler, we feel it should have a huge premium against other US peers, like Tapestry, since Capri is in the middle of the road between a pure blood European luxury house and a traditional American retailer. But, surprisingly, Capri is trading just like its American rivals.

	2023E		
	Free Cash Flow Yield	EV/EBITDA	P/E
Capri	11,6%	7,9x	6,7x
Tapestry	8,5%	8,6x	10,3x

We still like the case in spite of the disappointing surprise of the 4Q 2022 results and feel encouraged by the fact that management seems to agree with us, with its CEO Bob Idol buying millions of dollars of Capri stock out of his own pocket due to the company's current share price.

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The China vertical

In our China vertical, over the past year we switched positions in our flagship internet retail investment. For many years one of this house's major investment positions was Vipshop, a discount retailer with a stable growth trajectory and a significant moat in an interesting niche within the broader Chinese e-commerce space. In fact, since our FCL Opportunities fund inception, VIPS is among the top 3 contributors to its historical performance.

¹⁶ More about our Capri thesis here: <https://www.youtube.com/watch?v=jDpolkNCOMM&t=14s>
 More about our European luxury thesis here:
<https://open.spotify.com/episode/6YUcgQt5D1440HLjEelMtU?si=fbf0dcf361df47d7>

That being said, over the past year this house has been progressively invested in the thesis that Pinduoduo will gradually become the major star in the Chinese e-commerce ecosystem, potentially even displacing giants like JD.com and (whisper) maybe even Alibaba from its leadership position.

Pinduoduo has many things in its favor: a revolutionary “social commerce” model, astute management (with its wildly successful Temu App that is being rolled out in major western markets a case in point) and consequently a growing share of the market.

So we decided to switch from a super cheap and defensible company that brought us a lot of joy over the years to a super promising new investment idea. Only time will tell, but after a few months our Pinduoduo thesis and its size in our fund has been growing.

Anta Sports is a core position for our FCL Opportunities fund since its first day back in January 2017. We won't dwell in too many details since this house has discussed the company many times and published many thesis in this space about Anta. Suffice it to say that we are very pleased with the historical milestone Anta recently achieved of having for the first time, albeit for a brief period, taken China's sporting market leadership position from Nike.

Meanwhile, Amer's turnaround story is going according to plan and the company is poised to have a record year in 2023, aided by the Chinese reopening.

Last year a relative new position recently disclosed by this house was Luckin Coffee. Luckin has a very colorful history: it was launched by a Chinese entrepreneur to compete with Starbucks in China. After a few years, however, it turned out that the company was cooking its books and a short seller report uncovered that Luckin was basically a fraud.

The logical conclusion would be for a bankruptcy. However, destiny had other plans: a consortium of investors bought the company and made it survive. The accounting books are being reinstated and the last remaining hurdle is the “all clear” by the SEC in the US, where Luckin is traded. After all this is trough, it will once again be considered a “normal” company.

Luckin has many particular attributes that make it a formidable competitor to Starbucks: its products are cheaper (the average cup selling for RMB 19 versus Starbucks' RMB 39); it has more flavors and customization, more attuned to Chinese particular tastes; it is more heavily skewed to Tier 3 and Tier 4 cities as opposed to Starbucks' Tier 1 and Tier 2 focus; and finally is more connected to online shopping and online coupons to which the Chinese became more accustomed to during the pandemic.

Indeed, all signs are pointing to the fact that Luckin is gaining share from Starbucks in China. Meanwhile, the country can absolutely change the pattern of coffee consumption around the world. Unlike countries like the USA or Brazil, coffee is not ubiquitous and very consumed in China. Indeed, this manager has witnessed many times when Chinese are given coffee for the very first time, which is usually followed by them almost spitting it back in protest, arguing that the drink seems too bitter to be drunk.

Gradually, however, coffee is being adopted by urban and affluent consumers and more and more by the middle classes in China. Its consumption per capita is still less than one

twentieth the Brazilian or American levels. Just imagine the possibilities if the Chinese per capita consumption gradually closes part of this gap while Luckin grabs internal market share from Starbucks.¹⁷

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IP: a new search

Finally, some thoughts and words about a brand new vertical just being built inside our FCL Opportunities fund.

Over the past few years our team has been gradually becoming more interested and started building a framework to look for hidden value in global financial markets inside the intellectual property space: overlooked physical assets or powerful brands that belong to unprofitable companies. We believe that this vertical has the potential to become a new set of opportunities for our fund, on par with macro theses which we have been developing for years like the rise of tech, European luxury and China.

To start, a personal anecdote. This manager was a comic nerd in his teen years. For a long time as he was growing up he zealously kept his vast collection of comic books. That's why he considers not having invested in Marvel an unforgivable mistake.

In the 1990s Marvel was on the verge of bankruptcy, a series of high profile entrepreneurs¹⁸ had bought control of the company and tried to turn it around to no avail. By 1999 Marvel Entertainment market cap was less than \$50 million dollars.

You don't have to be a comic book nerd to know that brands like the X-Men, Silver Surfer, Captain America, The Avengers, Incredible Hulk and so many others, are each worth at least multiples of times that amount. The company not only owned several global brands but also, though its chronological stories¹⁹, an incredible amount of intellectual property.

Finally in the 21st century, Marvel found a way to efficiently monetize its amazing intellectual property through the blockbuster movies that brought hundreds of millions of viewers to cinemas all around the world.

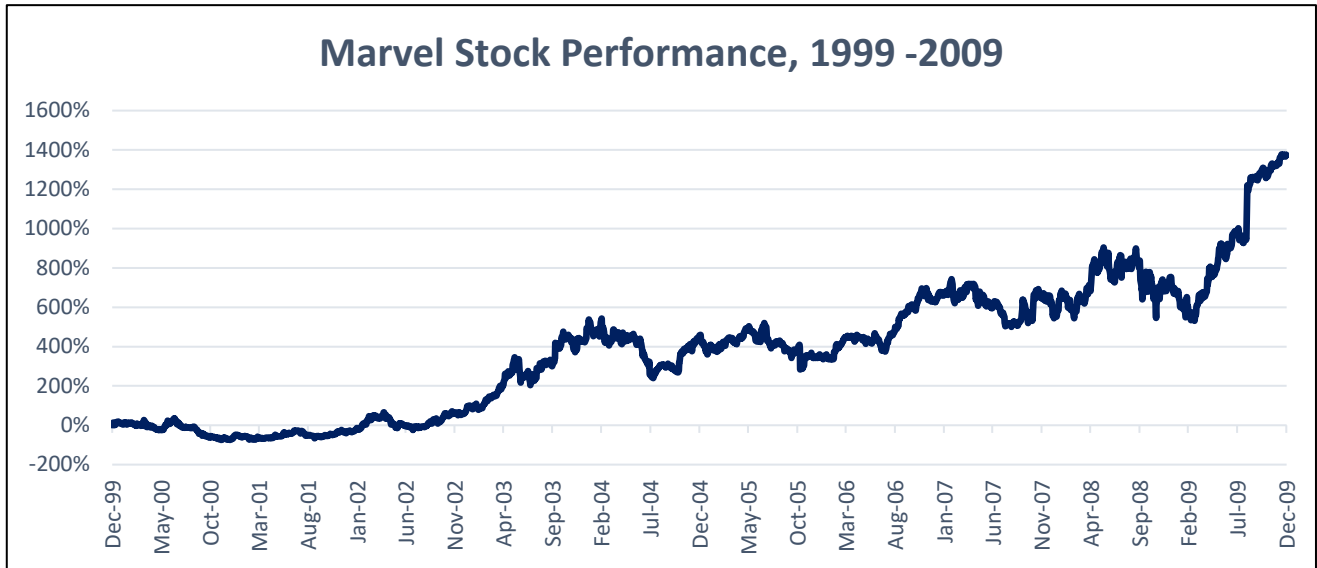
Besides using the company's many characters, the movies were also invariably adaptations of plots that were previously created by the comic book authors for the Marvel comic books.

¹⁷ More about all of this house's Chinese theses can be found on the 4th episode of our recent official podcast: <https://open.spotify.com/episode/3tOyis28X3pC2ROnvLr2PE?si=affacab4cb244cc6>

¹⁸ Including one of the most famous Wall Street investors, Carl Icahn, among some prominent others.

¹⁹ Since every marvel comic book is part of the same continuum, it is part of one single giant story that has been going on for many decades. It is probably the biggest story and work of fiction ever created by mankind.

Nowadays, Marvel is owned by the Disney Group, maybe the company that owns the most amazing entertainment intellectual property on Earth. Overall, Marvel's journey from near bankruptcy to where it is today, is probably the most remarkable turnaround story when it comes to monetization of hidden assets, brands and intellectual property.



Source: Bloomberg, FCL Capital

So this house started a hunt. Are there any other “Marvels” around the world?

The first place we looked for were Japanese videogame softhouses. Nintendo, a \$40 billion market cap company, is not only a lucrative and incredible durable company, but it traces its roots back to 1889 Kyoto, when it was founded. Over its 134 year history, the company went from producing handmade hanafuda cards to having changed the world with the advent of mass market videogames and characters like Mario Bros and The Legend of Zelda.

A study in the 1990s among American (!) children found that Mario was more well known to that focus group than Mickey Mouse, reportedly freaking out Disney's board at the time.

Japanese characters, from videogame, anime and manga are part of its cultural cachet and reputation. To stay in one example, when prime minister Abe Shinzo came to Rio de Janeiro to take the Olympic torch at the end of Rio's Olympics and as the next host of the event, he entered the stadium dressed as Super Mario. Think about it for a minute: when the Japanese prime minister had an opportunity to show the world a little bit about his own country in a global event like that, dressing as Super Mario, the instantly recognizable character known to billions, was the way he choose to show the world who the next Olympics host was going to be.

After reviewing dozens of Japanese videogame softhouses we also explored some interesting ideas, like Playboy enterprises, a company that has a current market cap of around \$140 million.

Playboy was once a global media powerhouse and to this day its brand alone is worth a lot more than the company. Sure, no one buys a magazine to see pictures of naked women anymore. The company has been trying to change its business model, to licensing clothes to opening night clubs and other endeavors. So far, nothing successful.

We are not investors in any of these investment ideas discussed above. All of this is just to show that there are many examples of companies with treasuries inside them and just in need of a change in direction and an improvement in monetization strategies.

Sometimes it is a struggling retail operator with stores located in plots of land that are worth more than the business, sometimes it is a company like South Africa's Naspers with its Tencent stake that is alone worth more than the rest of the company, and there are many, many other situations like those.

Some of our current portfolio investments already resemble the idea behind this vertical. Moncler, for example, used to be a powerful but neglected brand when Remo Ruffini first bought it back in 2003. Pinduoduo also has a yet hard to evaluate asset, since its very promising Temu App is not yet featured in any the sell side financial models. This common theme is an effort to go beyond current numbers to a holistic view of optionalities and different possibilities.

Like all of our macro theses, the objective behind a group of ideas with some common feature is an effort to generate replicable alpha and explore some market inefficiency that the rest of the market has not yet realized. As our investors know, our investment process starts with looking for a market anomaly that is somewhat replicable and can be found in several different assets as opposed to looking for just a single company that might reveal its greatness through some bottom up process. A theme, instead of a single event.

We haven't investment in any idea inside this macro thesis yet. But we are more and more convinced that this vertical can be as important to this house and bring as many profitable ideas as other macro theses we focused on over the past years.²⁰

We are excited for this new beginning and are working hard to be able to continue to generate differentiated and alpha positive new investment ideas while not dropping the ball in monitoring our current portfolio and investments. As Herman Hesse once said: "in every beginning dwells some magic".

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²⁰ About possible verticals and themes that might interest us in the future: we see a combination of ingredients making the Middle East, a region which historically was once the most open and advanced in the planet, to gradually end centuries of isolation, resource curse and oil dependency as well as strict religion customs to flirt with the idea of becoming once again the cosmopolitan, economically diversified, forward looking and tolerant place it once was. But that is a story for another day. Some other themes and ideas, even more farfetched and untested are sometimes discussed internally by this house in its permanent search for overlooked investment opportunities.

Performance

FCL Opportunities	
Year to Date, 2023, in BRL	0,72%
Year to Date, 2023, in USD	5,13%
12 Months, in BRL	-9,45%
12 Months, in USD	-15,22%
MSCI All Country Index, 12 Months, in USD	-7,44%
Since Inception (30/01/2017), in BRL	91,72%
Since Inception (30/01/2017), in USD	17,98%
Avg Annual Return, since inception, in BRL	11,11%
Avg Annual Return, since inception, in USD	2,71%

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

Position	Country	% Fund NAV
Moncler	Italy	10,6%
Go Daddy	USA	10,5%
Entain	UK	9,8%
Uber	USA	9,7%
Capri Holdings	USA	8,5%

FCL Opportunities Portfolio Composition on March 31st, 2023:

Portfolio Composition by Sector	
Consumer Discretionary	43,7%
Technology	30,0%
Healthcare	9,9%
Telecom Services	6,6%
Financials	4,7%
Industrials	2,9%
Basic Materials	0,4%

Currency Exposure	
USD	39,4%
EUR	18,4%
BRL	13,7%
GBP	9,8%
CNY	8,5%
HKD	8,4%
INR	1,9%

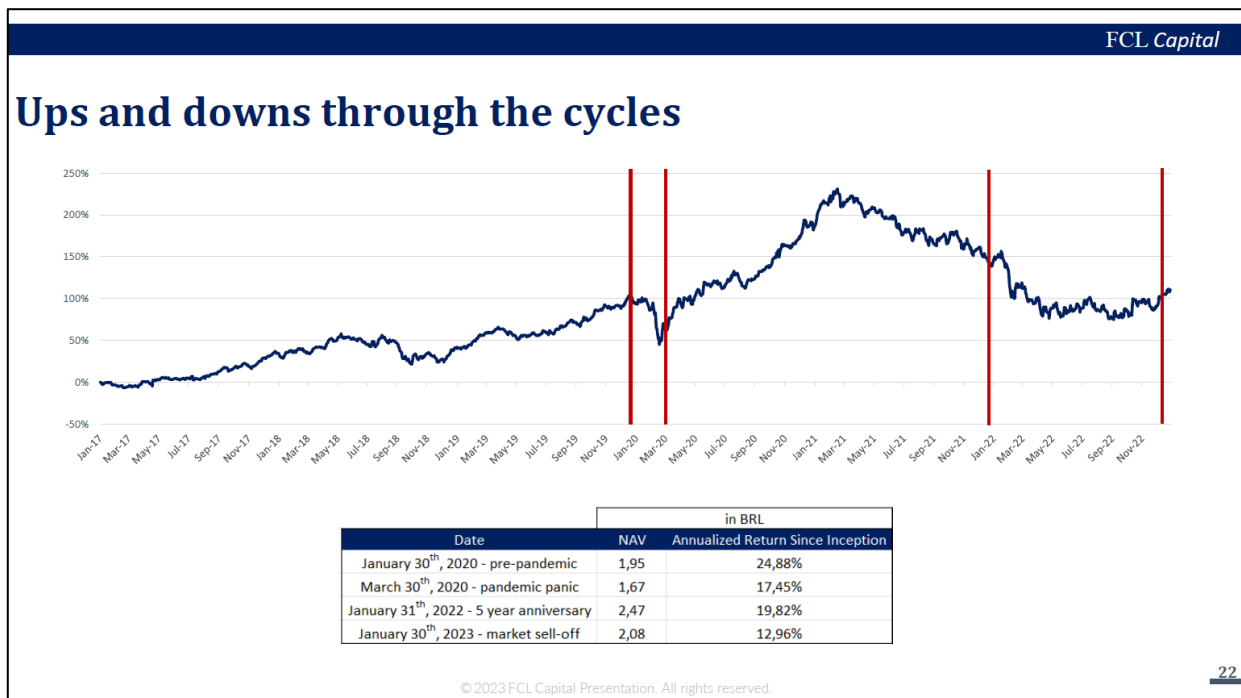
Geographic Distribution	
USA	31,4%
Europe	28,2%
China	16,9%
Brazil	13,2%
Others	8,6%

Portfolio Concentration	
Top 5	49,1%
Top 10	84,9%
Top 15	97,8%

FCL Opportunities performance in the first quarter was a positive 0,72% in Brazilian Reais and a positive 5,13% when measured in US Dollars.

This performance translates to a compounded annual return of +11,11% in Brazilian Reais since our fund's inception on January 30th, 2017.

Like this house constantly says, we judge annual compounded return as our most important internal metric of performance. That said, after bull markets, we hope and expect to see our compounded return closer to 20%, while after strong sell offs, like the one we had in 2021-2022, our compounded return will momentarily stay below our long term goals.



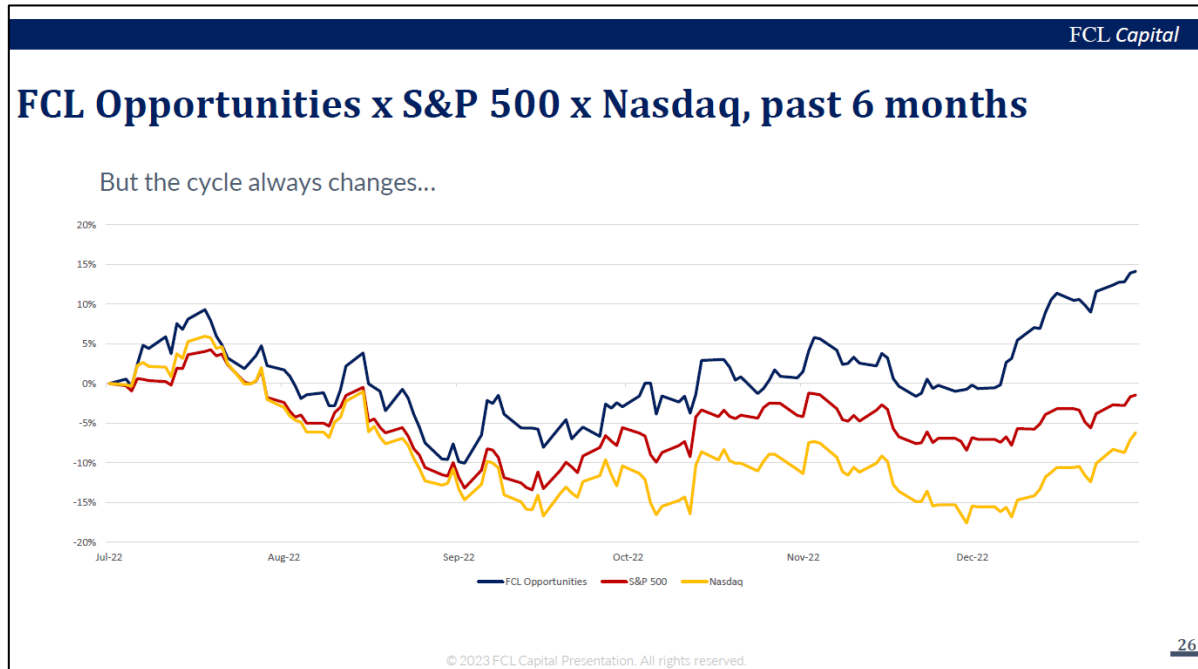
Source: FCL Capital 2023 Institutional Presentation

It is no surprise why global stock markets faced one of the fastest sell offs and strongest bear markets of the last few decades: a combination of inflationary pressures and supply chain issues led to subsequent necessary interest rate increases by the world's central banks. The combination of all those factors formed a heavy blow on companies valuations, practically guaranteeing that 2022 would be a bear market almost anywhere.

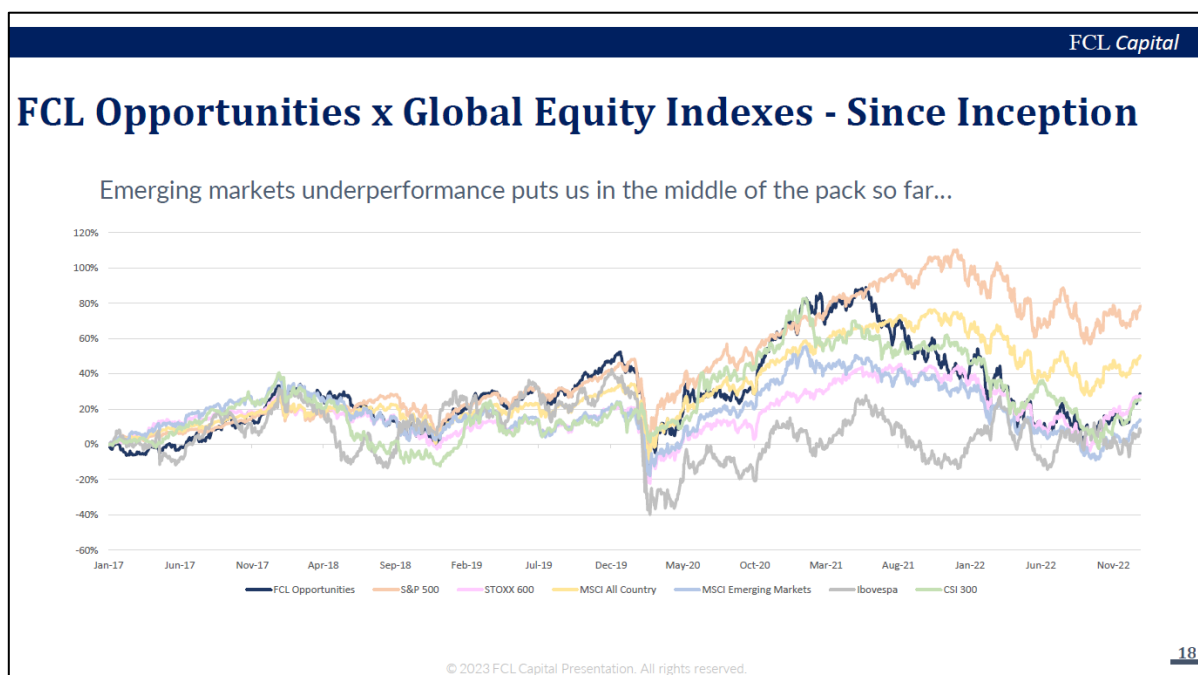
That's why, after an intense and painful correction, this house feels particularly encouraged to report a second positive quarter in a row. Granted, we know that many of our investors have joined our fund when FCL Opportunities' NAV was trading at higher values than now, in other words, many of our investors who joined FCL before the stock market sell off are still in the red.

We want to reassure our investors, especially the ones who joined at the highest NAVs in 2021 and 2022, that we are working hard to regain those levels and feel very confident we are on track to do so. These past two quarters give this house additional confidence this can happen sooner rather than later. In the past six months finishing March 31st, 2023,

FCL Opportunities performance was close to 9% in Brazilian Reais and more than 16% in US Dollars, signaling to us the possibly that last year's global bear market has come to an end.



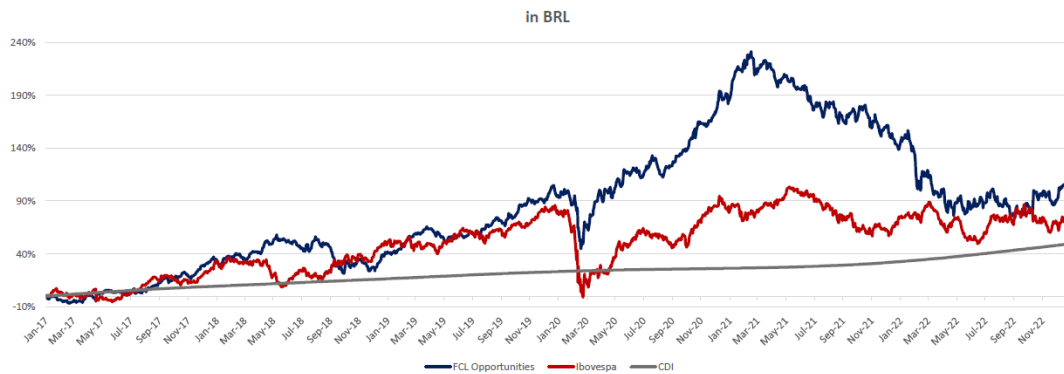
Source: FCL Capital 2023 Institutional Presentation



Source: FCL Capital 2023 Institutional Presentation

FCL Opportunities x Brazilian benchmarks - Since Inception

While comfortably outperforming Brazilian market references



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Source: FCL Capital 2023 Institutional Presentation

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We end this letter with an invitation to our investors to join us in this year's FCL Day, which will take place on Zoom on April 25th, 6PM Brazilian Time.²¹

FCL Day is one of the most special moments of the year for us. It is when we can meet our investors, listen to their questions directly, get to know new people and listen to feedback. It is for our investors that we do what we do and it is not only our obligation but also a joy to this house to have this direct line of communication with them.

The meeting is open to anyone who might be an investor, friend, collaborator or simply have an interest in FCL Capital or financial markets in general.

The link and password on Zoom are:

Event link:

<https://us02web.zoom.us/j/88160205460?pwd=ZlhKSm5md2pPZHg1Q1o2Z3BCQlI3UT09>

Meeting ID: 881 6020 5460

Password: FCL2023

²¹ The event will be held in Portuguese but the slides are in English and we will gladly take any question in both English and Portuguese.