

FCL *Capital*

2Q 2022

The day the music stopped

“Bobby Lehman is 85 years old...he’s still dancing the twist! In America if you don’t dance you’re out. In 1969 the last of the Lehman brothers dies, still dancing the twist!”

This house enthusiastically recommends our investors and friends who live or plan to travel to New York City to watch “The Lehman Trilogy”, a new Broadway play by director Sam Mendes (from American Beauty) and interpreted by three magistral actors.

The play recounts in three acts the story of the three German-Jewish immigrant brothers who arrived in America in the 19th century: when they first settled in Montgomery, Alabama where they opened a dry goods store that would eventually become Lehman Brothers (Act I); the company’s dark days during the 1929 financial crisis, when a wave of suicides terrified the trading floor of the firm (Act II); and, finally, and most obviously, the days leading to the implosion of their financial empire during the crisis of 2008 (Act III).

Many amazing lessons for long term global investors could be extracted from the play and its dissection of one of Wall Street’s most crucial institutions.

The recount of the story leaves no stone unturned: it follows the decay of the firm culture and simplicity. As it’s so often the case with family-run businesses, after the first-generation founders stepped down, the eventual rise of a new generation no longer attuned to the firm’s original culture allowed for the rise of greed and short-term thinking, the same two factors behind so many financial crises over the past two centuries.



A scene from “The Lehman Trilogy” play

After the death of the last original member of the Lehman family to lead the institution, one of the rising stars of the “new generation” was Dick Fuld, a financial wonderkid that would eventually rise to the top as CEO of the company.

One of the major initiatives of his tenure, as the world would eventually find out, was a major push into credit structured products, like CDS and CDOs that would eventually demolish the whole bank and, for frighteningly little, the whole global financial system.

A few months before the start of the market meltdown, when investor’s euphoria was at its peak and real estate prices were believed to only go up, a Wall Street Journal reporter asked the CEO of a major US bank about the giant systematic exposure that the US financial system had to the real estate sector and if he believed that such exposure could turn out to be dangerous. His reply was what is now probably the most (in)famous quote from the global financial crisis:

“It is true that when liquidity dries up things will get complicated. But, you know, as long as the music is playing the players have to keep on dancing. We are still dancing.”

Knowing the quote somehow would show up towards the end of the play this manager held his breath. But instead of doing the obvious thing and having a character utter these words, the play treats the audience to a higher regard and the show takes a different turn: suddenly, in an obvious, but unspoken reference to the quote, a game of musical chairs starts playing. Then after the music, dancing, and many more memorable lines, they sing not the quote itself, but in a subtle reference, the citation at the start of this section. Until the very last minute, everyone was still dancing.

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The past few quarters were, just like the dark days of 2008, a tough time for global investors. Many found themselves still dancing when the music suddenly stopped.

This house has argued several times in this space that, when we finally saw a generation of Brazilian investors accessing global markets for the first time, despite being happy with their progress, we warned that their narrow view of what “global markets” were could turn out to be a problem. And indeed, Brazilian investors got caught up in the same hype as many in Wall Street, believing that no harm could ever befall the powerful FAANG stocks - Facebook, Google, Amazon, Apple, Netflix and a few other tech darlings¹. They were the future, they were unstoppable and whoever didn’t believe it just didn’t get it. In other words, investing abroad was, to this new generation of retail investors, by and large, investing in the FAANGs.

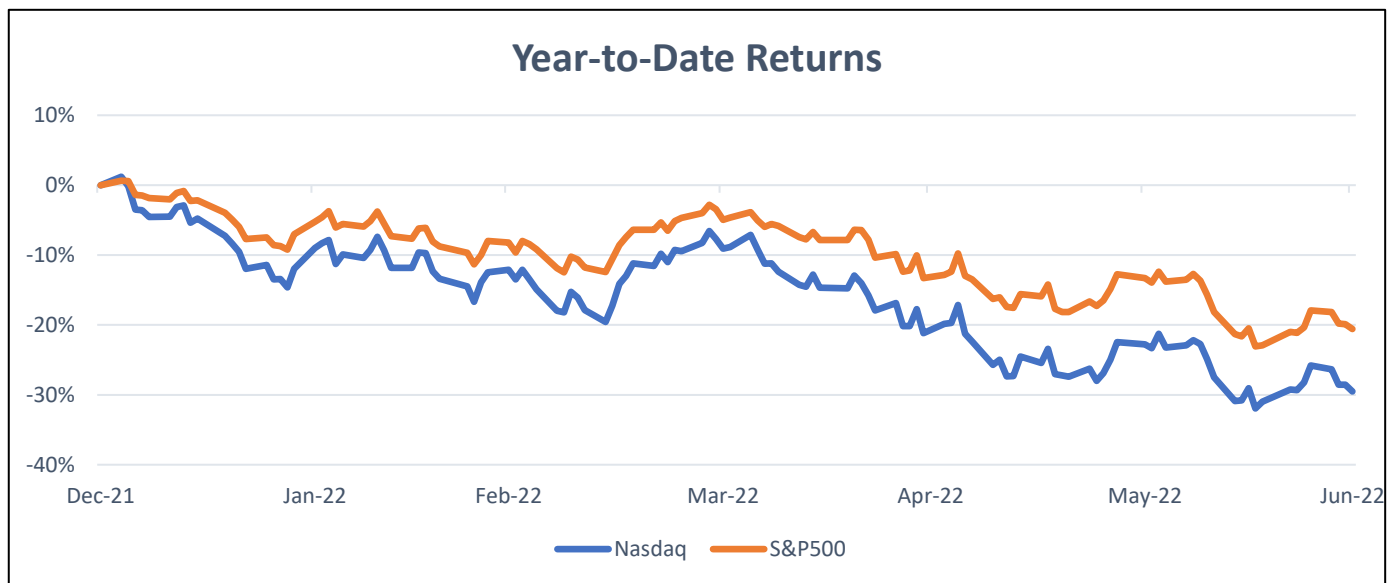
Cathie Wood and her ARK fund, that basically bet in speculative tech companies, were at the top of Wall Street. Nasdaq multiples, as we argued in this space before, were

¹ To this house it always felt weird to have Google, in our opinion the most fantastic company ever created, be put in the same league as the other ones. In our view, a company as fantastic as Google cannot be compared with Meta, for example, they are clearly not in the same league in any way we look at it.

completely out of line. Indeed, this manager publicly called, although early in retrospect, a “bubble” in US tech stocks.²

Over the past 6 months, a new generation of investors were, for the first time, caught still dancing when the music stopped. Although certainly painful, it can always be a very instructive experience if, of course, the right lessons are learned.

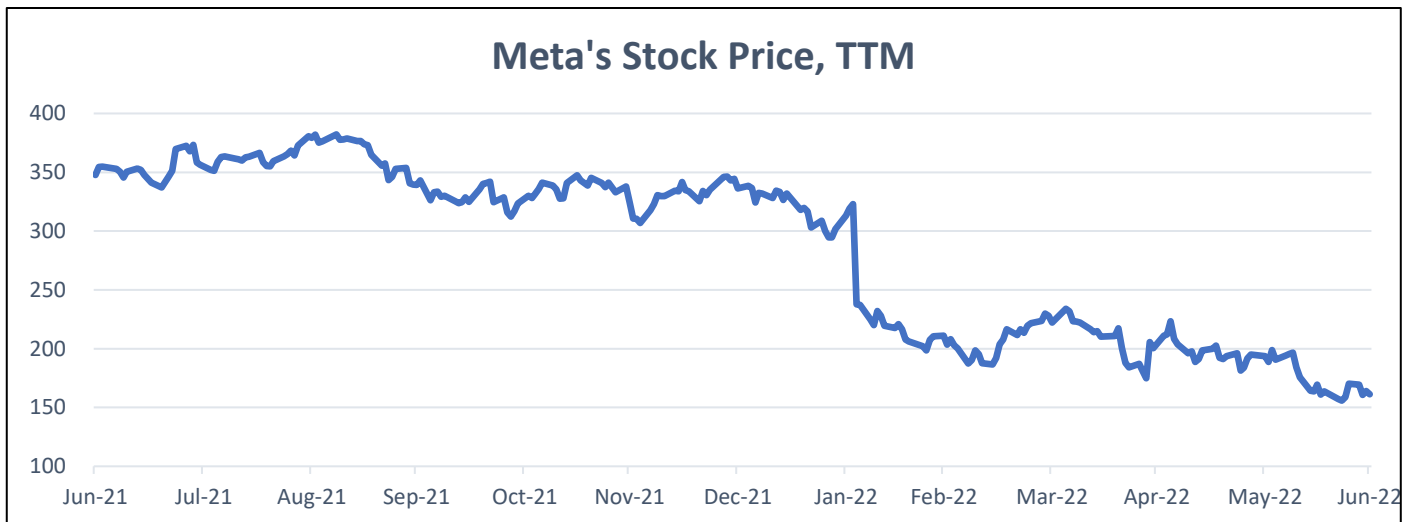
First, the Nasdaq hit its height in November 2021 and, at the time we write this letter, it is trading at around 30% down from that point. The same happened to the S&P500 on January 3rd now down by more than a fifth and both deep into a bear market territory.



Source: Bloomberg, FCL Capital

But if there is a definitive moment when everyone felt things were changing, it came on February 3rd when Meta, up to that point one of the darlings of the era, announced a disappointing set of results and, for the first time, admitted it was being hurt by the rise of Tik Tok and its intensifying competition. One after another, analysts were trying to understand the new scenario. Meta’s shares ended that day 26% lower.

² Stock Pickers Episode 60, minute 24:03 onwards – <https://open.spotify.com/episode/35peUbeeTGjoJXGOQN3Pza?si=PAO3fOYjRi-8Imd5c0LMdQ&nd=1>



Source: Bloomberg, FCL Capital

Were professional analysts any good in foreseeing the change of winds? Meta is, after all, one of the most followed and covered companies on earth. This house did a rapid, nonscientific study and found no less than 62 different professional sell side analysts covering the name. Is it possible that none of them foresaw a decrease in the number of users in Meta's platforms?

Interestingly, among the 62 analysts, only two had a sell rating on the stock. Perhaps not surprisingly, both of them were Europeans. Sometimes it just helps to be away from the hype. And funnily enough, investors and endowments around the world still equate "investing globally" with "being based in New York City or London", ignoring the additional insights that can be gained by boots on the ground on different parts of the planet even when looking at US/European companies. The multitude of US based analysts covering the stock, exactly the ones that were closer to the action, were particularly blind to see the comet approaching earth.

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So what lessons should investors take from this very tough time?

The first one, as this house always argues, is a continuous focus on market history, psychology, and cycles. From the 1929 darlings, to the 1970's Nifty Fiftys³ there is always this human tendency to extrapolate the recent past to forever into the future.

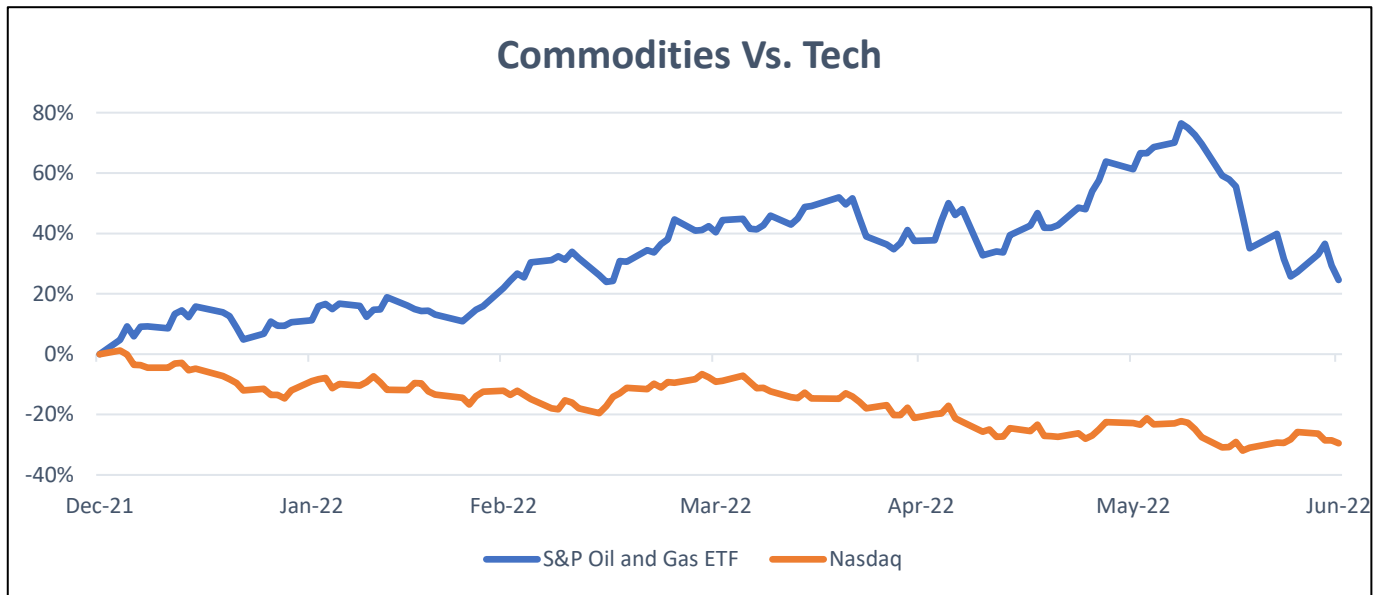
Investors always chase the winners of yesterday, invest in the best fund managers of the past year, and feel whatever has just happened will keep on happening forever⁴. In other

³ The most similar era to the FAANGs hype in this house's opinion

⁴ As for fund managers there is this eternal maxim that: in bull markets assets under management keep pouring in even beyond desirable levels, since it is hard to find many investments at attractive valuations, while in bear markets you feel hungry, full of good ideas but can't find enough capital to invest. At the moment, we are definitely in the second camp.

words, investors always invest looking backwards, running to where the ball has been, not to where it will be.

To any smart observer, it will come unfortunately as no surprise that once again, the wrong lessons will be learned. A new chorus of people that “knew all along” that tech companies held no promise will sing and praise the virtues and wisdom of investing in commodity companies or the superiority of traditional value investing (chasing low multiples and metrics among traditional large cap companies in established sectors) versus searching for less conventional and potentially life changing ideas.



Source: Bloomberg, FCL Capital

Then we will reach an extreme point in the current cycle where commodities and value companies will start to trade at ridiculously high prices which in itself will result in a new cycle away from such safe but expensive sectors in favor of more risky but cheaper assets, giving rise to a new wave of greed and fear of missing out. Until, again, this new cycle ends, like it has been since the days of the Buttonwood tree⁵.

So we don't know how long this new cycle of skepticism about tech, emerging markets discount and traditional style value investing outperformance, with a constant chase for low multiples with short duration, will last, but we do know for certain that it won't last forever.

Internally, we worry about how some companies, especially in the real estate sector, will behave in this higher interest rate environment. But as of now, the market is immersed in the tech skepticism narrative and enamored with cash generating, low growth traditional companies and doesn't seem to care about any opportunity that doesn't fit into this narrative. It might be to a different tune, but there are always people still wanting to dance.

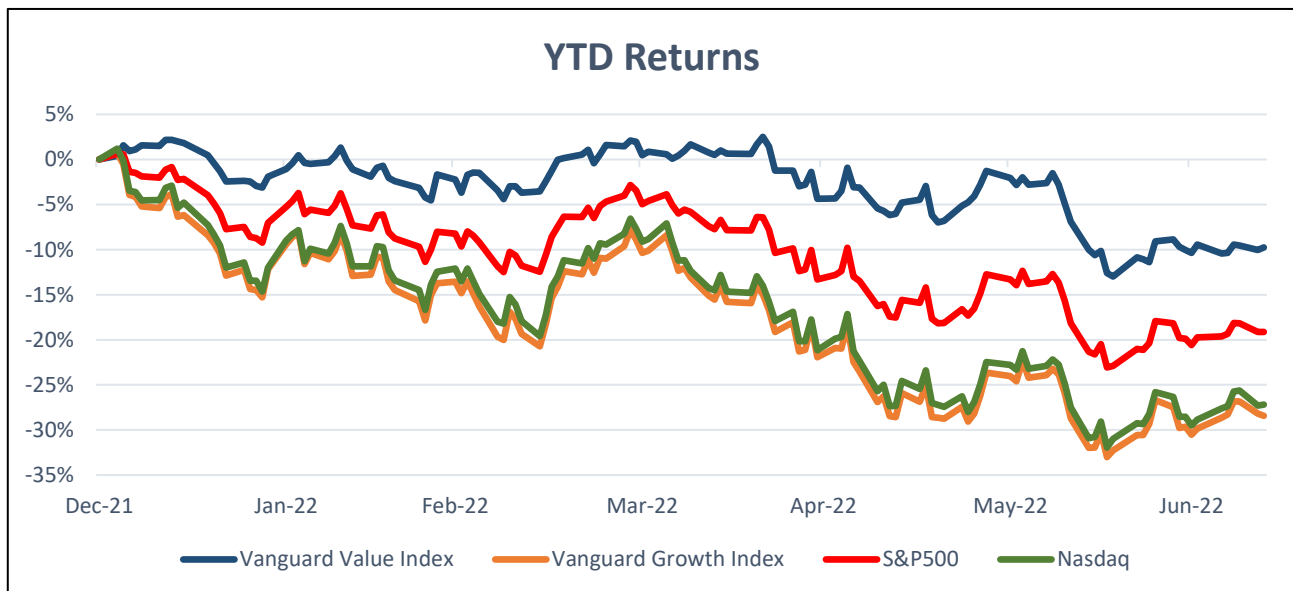
⁵ See our 2Q 2021 letter about market cycles - https://84471c97-e192-4d57-a61f-283398a4101f.usrfiles.com/ugd/8d6b17_f85fe96800b44c45bc1ad8a35086d3f3.pdf

Thesis: Brazilian small caps

As our performance section in this letter will show, our series of non-correlated defenses for the tech correction we foresaw back in 2021 didn't offer the protection this house envisioned, hence our fund's unsatisfactory performance in the first half of 2022.

In particular, because of the way they are constructed, we feel that global equity indexes do not show the true extent of the "tech carnage" that has taken place over the past months.

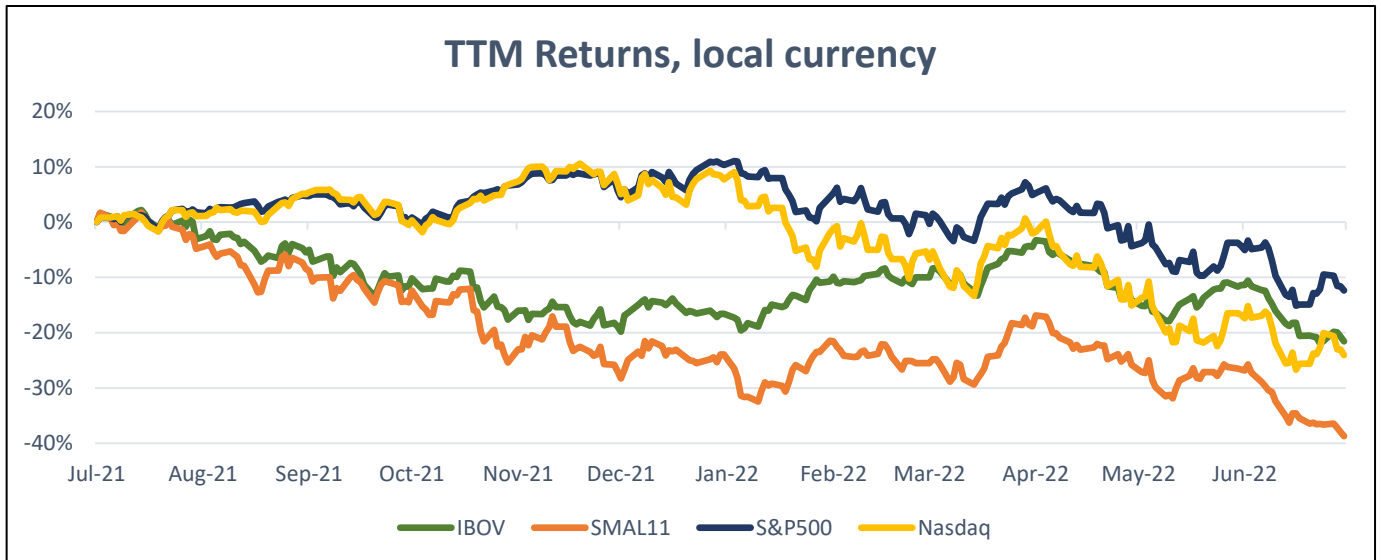
For example, in the US during the first half of 2022, large cap value significantly outperformed small cap growth equities. This way, even the 20% - 30% correction the S&P500 and Nasdaq Index suffered is masqueraded by the relatively resilient performance of a few crucial large cap value securities. In fact, the median tech growth company in the US experienced price decreases in the order of 70% - 80%. The median Nasdaq listed company (not cap weighted) for example, experienced a near 50% correction in the first half of the year.



Source: Bloomberg, FCL Capital

Brazil is a chapter in itself. For many years global investors haven't known how badly constructed the local Ibovespa index is: it is, very uncommonly among global equity indexes, volume weighted instead of market cap weighted, like, say, the S&P500.

This composition made the index an apparent positive outlier so far in 2022, since it is heavily represented by large cap banks (classic value, dividend paying plays that are in vogue these days) and, crucially, commodity companies. The Ibovespa not only decoupled from the other global stock indexes, but also from the better constructed and more informative Brazilian Small Cap Index (SMAL11), that is represented by dozens of domestic leaning Brazilian companies that trade in the São Paulo Stock Exchange.

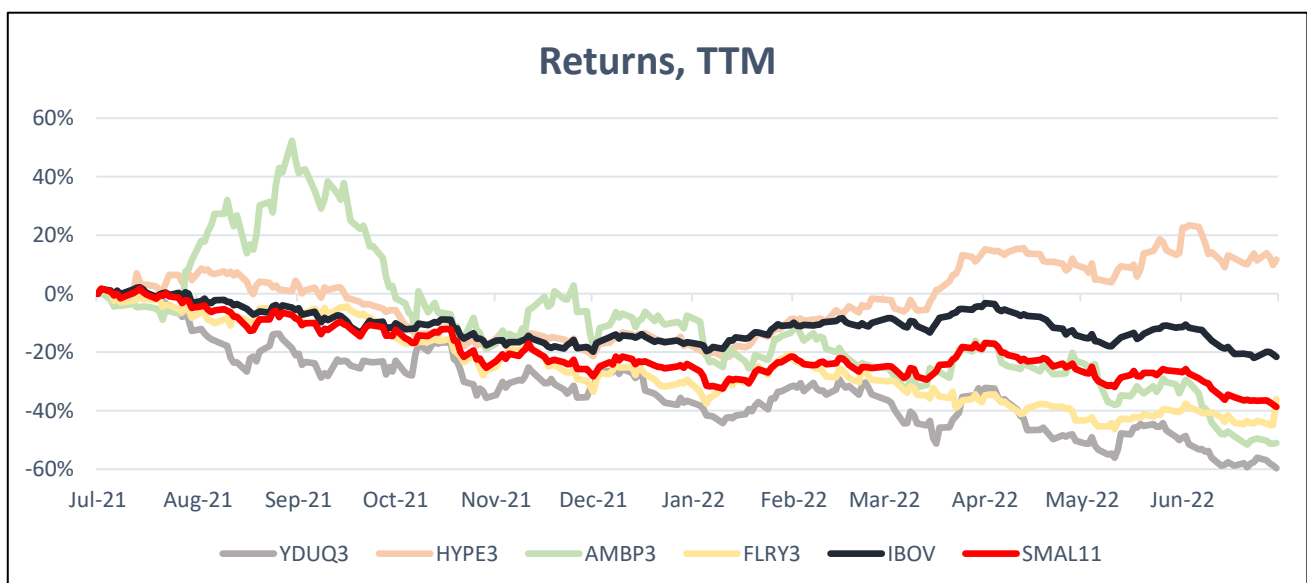


Source: Bloomberg, FCL Capital

That was truly disappointing to this house because we were counting on our Brazilian exposure to be one of the pillars of our strategy to diversify away from US tech companies. Unfortunately, this exposure was made basically in stock related to the local economy, not the global commodity producers that eventually ended up outperforming.

We will dedicate this letter's thesis section to analyze our Brazilian investments, some of which were already previously discussed in this space, like the education company Yduqs (owner of education brands like Estacio and Ibmecc), the lab provider Fleury and the environmental services company Ambipar, as well as disclose a new position in the pharmaceutical company Hypera.

As we will explain in our performance section, contrary to what we had expected, our exposure to those companies didn't protect our fund, and these stocks as a group performed even slightly worse than the Small Cap Brazilian Index.



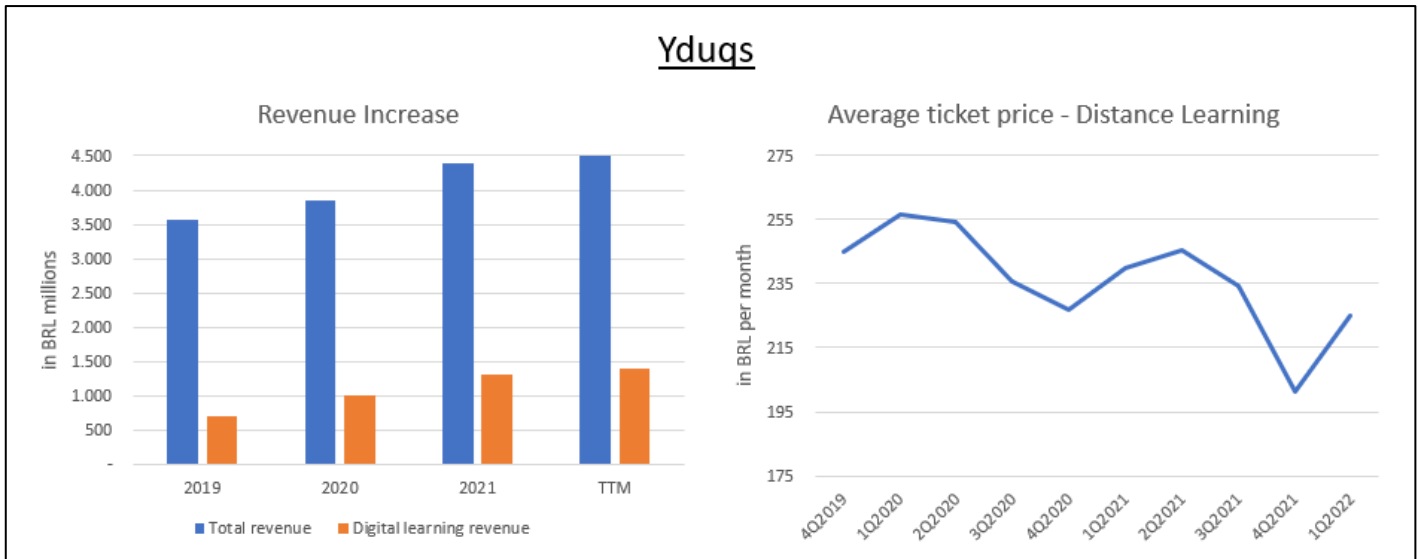
Source: Bloomberg, FCL Capital

Therefore, we decided to update our investors on our Brazilian investment thesis and what we expect from such companies for the coming years:

Yduqs

Yduqs is to us a classic case of multiples compression. Its results were resilient in the first quarter of this year, with the company taking advantage of the gradual reopening of the economy to record its best enrollment of new students (vestibular) of the past few years.

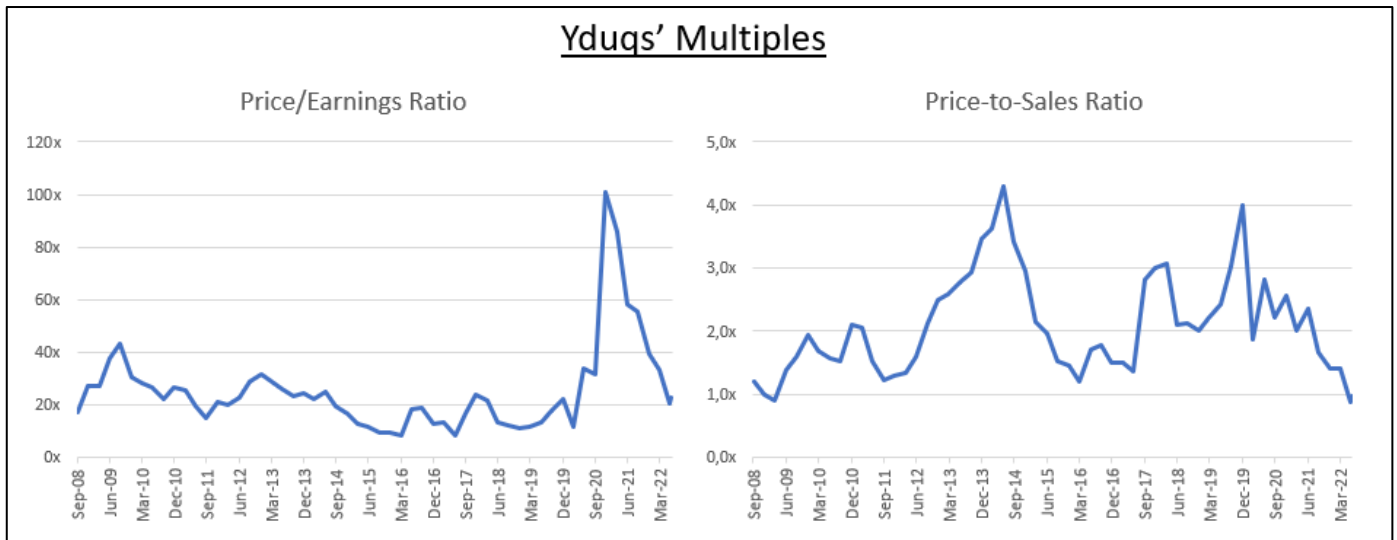
The average ticket price per student is facing some headwinds, especially on its distance learning division due to the intensifying competition environment, but overall we see a total disconnection between the company's results and its share price.



Source: Yduqs' Earnings Releases, FCL Capital

Yduqs has at least three promising growth verticals: 1) its increased number of medicine seats (the most lucrative ones in the market since the average price of a medical seat in Brazil is close to R\$ 9.000); 2) the Ibmecc brand, focused on high price - high quality business courses; 3) its digital learning systems and courses.

Although Yduqs has been one of the worst performers for our fund over the past year, we see its multiples at the lowest point since the company went public many years ago and feel that a turning point could be very near.



Source: Bloomberg, FCL Capital

Fleury

Our team recently held a conference call with Fleury's new CFO and we left the meeting very impressed: this house has the (admittedly polemic and out of consensus) view that Brazilian investors have been misled to a set of false beliefs when it comes to the promising Brazilian healthcare sector.

First, in the 21st century, the basic platform for health care will increasingly be labs and not hospital providers, medicine will become a preventive endeavor and not a responsive one. Lab providers don't face the same regulatory risks their counterparts do and offer more interesting avenues for growth.

Second, even when it comes to lab providers, verticalization has been an overhyped concept. At the very least, when it comes to higher income patients, more interested in having access to a physician of their choice than in being directed to a specific hospital or lab by their insurance plan, verticalization doesn't offer the same obvious benefits as compared to more price sensitive costumers. And Fleury caters exactly to this niche.

We feel that the current sell side preference for hospital providers and, inside the lab sector, vertically integrated operators, comes from the fact that many players in the above-mentioned sectors accessed the market more recently, and are, therefore, attractive fee-generating costumers to the major investment banks.

This house sees Fleury as having the correct exposure and correct structure to become one of the champions of the coming wave of Brazilian healthcare consolidation and its recent results (despite its stock price) are, in our view, a testament to this⁶.

⁶ Precisely on the last day of the semester, just as we were finishing this letter, Fleury announced the acquisition of rival lab provider Hermes Panini, in a cash-and-stock deal. Of course it is still early to tell, but at first glance the deal looks very positive for the company, allowing it to further expand in the local market and potentially achieve relevant synergies. We look forward to writing more about this topic in future letters after we have thoroughly analyzed the terms of the deal.

Ambipar

Profiled for the first time in our 2Q 2021 letter, Ambipar has been one of our most recent Brazilian investments.

The company is a rare IPO success story, it drove a wave of acquisitions in its sector, but was caught up by the recent reversal of cycles in the market from one that privileged fast growth promising companies to one more interested in traditional value plays.

We believe once the dust settles and the market stabilizes, investors will be able to reassess Ambipar's promising prospects with several avenues of growth, both in Brazil and abroad.

Oddly enough, we felt a pause in its acquisition pipeline might even be a blessing in disguise: the company could really use some time to reorganize its structure after so many acquisitions and to prove to the market once and for all that it is capable of showing organic growth even without acquisitions⁷.

Hypera

This house has long been fascinated by the story behind Hypera's founder. Practically coming out of nowhere, he single handedly built an amazing brands powerhouse (Arisco) before selling it and after a hiatus, repeating the same story once again with Hypermarchas.

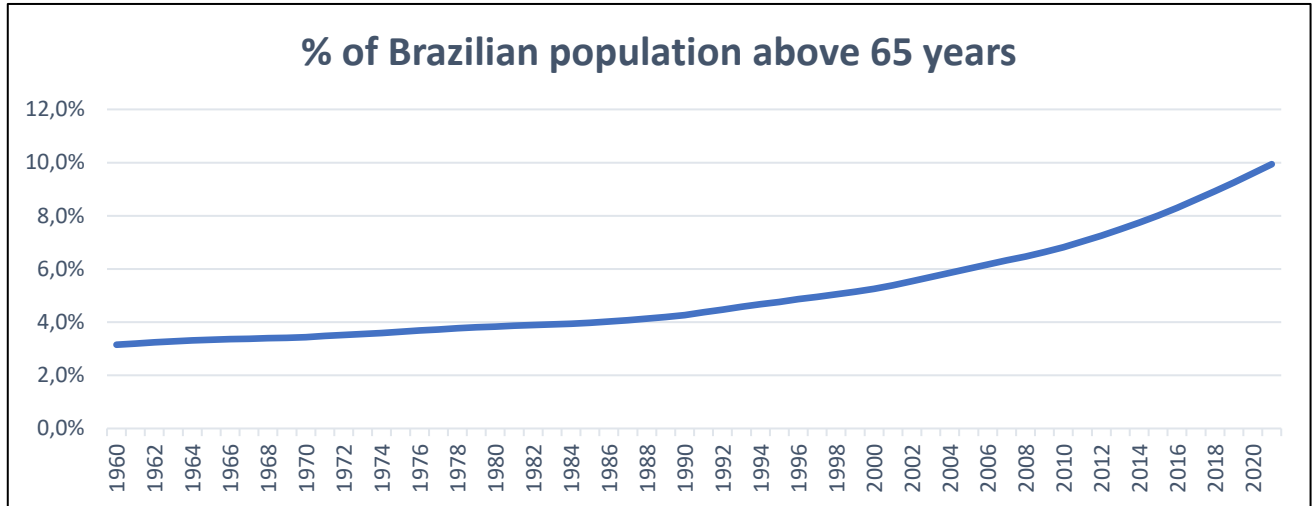
Hypera, the new incarnation of Hypermarchas, is focused on the Brazilian healthcare sector. It produces and sells a series of iconic local pharmaceutical branded medicines, all of which are off patent and far from the cutting edge of pharmaceutical research. In other words, instead of focusing on complex and critical lifesaving drugs, Hypera specializes in run of the mill, off patent, everyday medicines, exactly the niche where branding power is imperative.



Some of the brands in Hypera's portfolio.

⁷ Just like with Fleury, as we were finishing this letter, Ambipar announced that its environmental emergency response unit, Emergência Participações, agreed on a business combination with US-listed Spac HPX Corp. We still need to go over the details of the deal, but, as of now, the most likely consequence is that Ambipar's acquisition machine just received a reasonable amount of fuel to keep on going for some months or even years.

The company is clearly focused on its roots and tradition: it is basically a brands management company disguised as a pharmaceutical one. It has many of the key brands in a sector that is not only resilient but almost assured to have an amazing secular growth thanks to the fast-ageing Brazilian population.

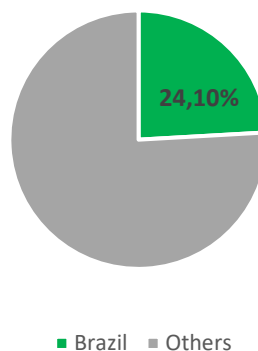


Source: World Bank, FCL Capital

Hypera is (so far) our only major new investment in 2022 and one we couldn't be more excited about. Just like the rest of the market, its shares experienced a multiples compression this year and this house took the opportunity to finally buy a stake in this incredible company that we had been admiring at a distance for so many years.

We hope to write more extensively about Hypera and our other Brazilian investments in the next quarters and years.

FCL Opportunities - Brazil as a % of invested capital



December 2020	Ambipar	Fleury	Hypera	Yduqs
EV/EBITDA	13,4	12,1	15,8	10,8
Price/Sales	4,3	2,9	5,3	2,6
Free Cash Flow Yield	0,3%	5,4%	3,4%	9,4%

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June 2022	Ambipar	Fleury	Hypera	Yduqs
EV/EBITDA	7,9	6,8	11,9	6,3
Price/Sales	1,1	1,3	4,0	1,0
Free Cash Flow Yield	-	8,9%	3,9%	12,9%

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Performance

FCL Opportunities	
Year to Date, 2022, in BRL	-29,89%
Year to Date, 2022, in USD	-25,68%
12 Months, in BRL	-38,21%
12 Months, in USD	-41,58%
MSCI All Country Index, 12 Months, in USD	-17,11%
Since Inception (30/01/2017), in BRL	83,10%
Since Inception (30/01/2017), in USD	8,56%
Avg Annual Return, since inception, in BRL	11,59%
Avg Annual Return, since inception, in USD	1,50%

FCL Hedge	
Year to Date, 2022, in BRL	-15,08%
Year to Date, 2022, as % of CDI	-278,38%
Since Inception (01/02/2017), in BRL	4,06%
Since Inception (01/02/2017), as % of CDI	10,48%

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

Position	Country	% Fund NAV
Capri Holdings	USA	12,87%
Go Daddy	USA	12,84%
Fleury	Brazil	12,01%
Entain	UK	10,40%
Vipshop	China	9,13%

FCL Opportunities Portfolio Composition on June 30th, 2022:

Geographic Distribution	
Europe	27,85%
USA	27,76%
Brazil	23,65%
China	17,52%
India	1,32%

Portfolio Concentration	
Top 5	57,2%
Top 10	89,7%
Top 15	98,1%

Portfolio Composition by Sector	
Consumer Discretionary	45,51%
Technology	25,57%
Healthcare	13,62%
Education	6,94%
Financials	3,38%
Industrials	3,08%

Currency Exposure	
USD	31,24%
BRL	25,37%
EUR	16,34%
GBP	10,40%
HKD	8,40%
CNY	6,94%
INR	1,31%

On June 30th, 2022, FCL Hedge portfolio composition was⁸:

FCL Hedge	
Stocks and ETFs	73,63%
Fixed Income	0,00%
Cash	26,37%

On the first half of 2022, FCL Opportunities had a negative performance of -29,89% in Brazilian Reais and -25,86% when measured in US Dollars, slightly underperforming the MSCI All Country index's 20% slide over the same period.

There is a lot that could be said to justify this disappointing performance - global stock markets are, after all, experiencing a bear market - but at this house we don't believe in making excuses. Our investors can be certain that we are even more disappointed than you with this year's first semester performance. Therefore, the focus of this section will be to expose what went wrong over the period and, more importantly, to communicate what we are doing to turn things around for the second half of 2022.

Starting with what was to us the most disappointing aspect of this semester: we were basically correct in our market assessment but failed to build the proper hedges and defenses for the volatility we were foreseeing.

As shown in our past letters⁹ and public appearances by this manager, we had a high degree of conviction that the US market overall, but US tech Nasdaq-listed in particular, were trading at near bubbly territory, with extremely overoptimistic valuations.

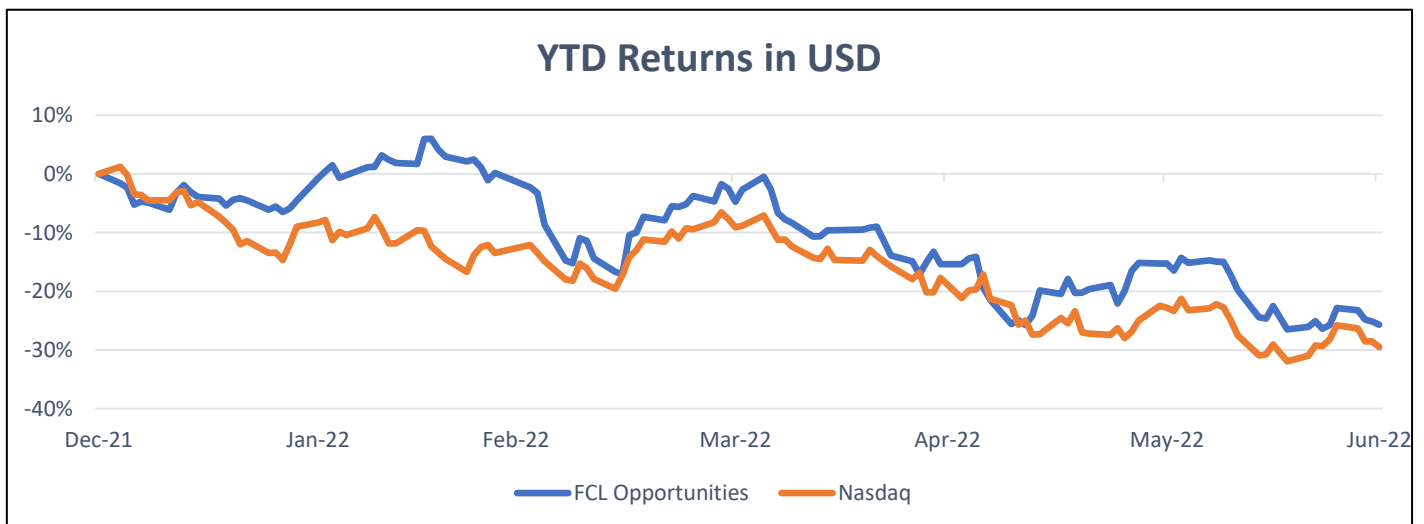
With that in mind, this house's strategy, as exposed in this space throughout the year of 2021, was to build four building blocks of defense and leave our portfolio as uncorrelated with the Nasdaq index and US tech companies as possible. In particular, our four strategies, as outlined to our investors, were:

⁸ Our FCL Hedge fund is in the process of being liquidated at the end of June, therefore part of its portfolio has already been sold.

⁹ 1Q2021 - https://84471c97-e192-4d57-a61f-283398a4101f.usrfiles.com/ugd/8d6b17_ef06dafa74244bf4b8bfd4d3018f35b.pdf ; 3Q2021 - https://84471c97-e192-4d57-a61f-283398a4101f.usrfiles.com/ugd/8d6b17_1a6e28a251404cf7acc9a9a495295f50.pdf

- 1) Avoid overvalued large caps stocks and seek exposure in smaller caps, especially in Brazil which we saw as a cheaper market that was already pricing the country's political risk and is, for most of the time, uncorrelated to major market events. So, we built a portfolio of small, non-commodity related Brazilian companies, like Yduqs, Fleury and Ambipar;
- 2) A bet on specific themes not correlated to the overall market, like European luxury companies, that in our eyes are one of the last "free lunches" in global markets, since they are a play for the ongoing wealth creation and higher income levels seen in emerging markets, especially Asia, while still trading at European multiples;
- 3) An overweighted exposure on China. The US is around 20% of global GDP, but accounts for more than 40% of the global market capitalization, while China, at a similar size of GDP, is responsible for less than a third of the US market capitalization share. Although there are reasons to believe the US financial leadership will remain for the rest of the century, over the long run, with China's economic rise, we feel its stock markets offer a compelling opportunity;
- 4) Having a globally diversified portfolio with underexposure to the US and overexposure to emerging markets and Europe.

So, in retrospect, we were right that US public equities valuations, especially tech companies, were completely out of line and showed speculative characteristics. Why then has our fund suffered just as much as, and in some moments even more than the Nasdaq over the past months?



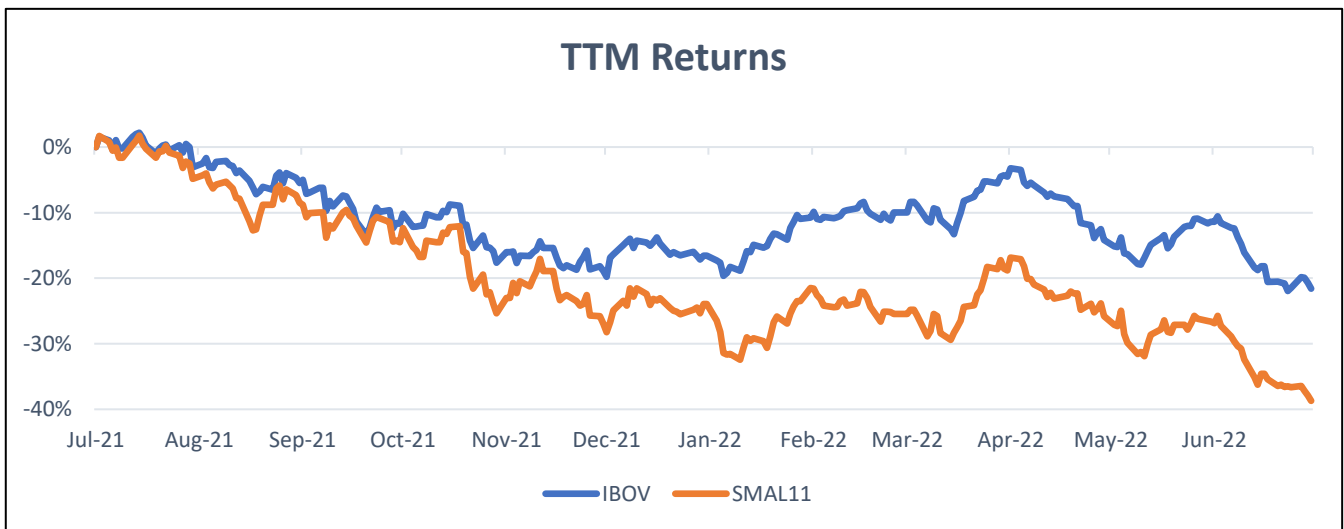
Source: Bloomberg, FCL Capital

Funnily enough, the correction happened broadly as we expected although stronger in magnitude. But crucially, our specific defense themes didn't work as the intended hedges we hoped. One by one, our four seemingly uncorrelated building block of defenses, that we thought were bringing robustness to our portfolio, took a hit and crumbled in the first half of the year:

First, in Brazil, small caps had a good operational performance, even surpassing our profit and revenue internal estimates, but, unlike the larger Ibovespa index, had their prices slumped in the global sell-off.

In times of stress, small caps sometimes suffer simply because they provide a “narrower exit door” to investors, and therefore, their share prices fall regardless of fundamentals. So, our small cap Brazilian investments experienced a surprising correlation with larger global equities, something this house wasn’t expecting.

Even more distressing, the larger Ibovespa index, heavily exposed to large banks (classical value plays with cheap multiples) and commodity companies, was somehow a positive outlier in the global sell-off during the semester.



Source: Bloomberg, FCL Capital

The European luxury thesis, with our position in Moncler and other European fashion houses, discussed many times in this space, was going well, until, of course, the February 24th invasion of Ukraine.

Since those companies are based in Europe, their shares understandably had a very nervous reaction to a war happening next door. Moreover, affluent Russian clients accounted for a high single digit share of their sales, considering the revenue from the (now closed) Russian stores. Currently, on this front we feel a bit more relaxed: geopolitical risk seems to be, at least, stabilizing, with no further escalations and, more importantly, these companies prospects remain very strong for the next few years.

China was a chapter on its own. One of our reasons for being overweight in the country was to be “as far as we could” from overvalued US tech companies.

Unfortunately, for reasons of their own, the news feed coming out of China for the past year was very negative: a “tech crackdown” by the Chinese government on its most celebrated entrepreneurs meant that the breathing space in which Chinese companies could operate definitely got smaller. From strict video game restrictions to a complete crackdown on the ED Tech sector, the CCP clearly felt that Chinese tech companies were

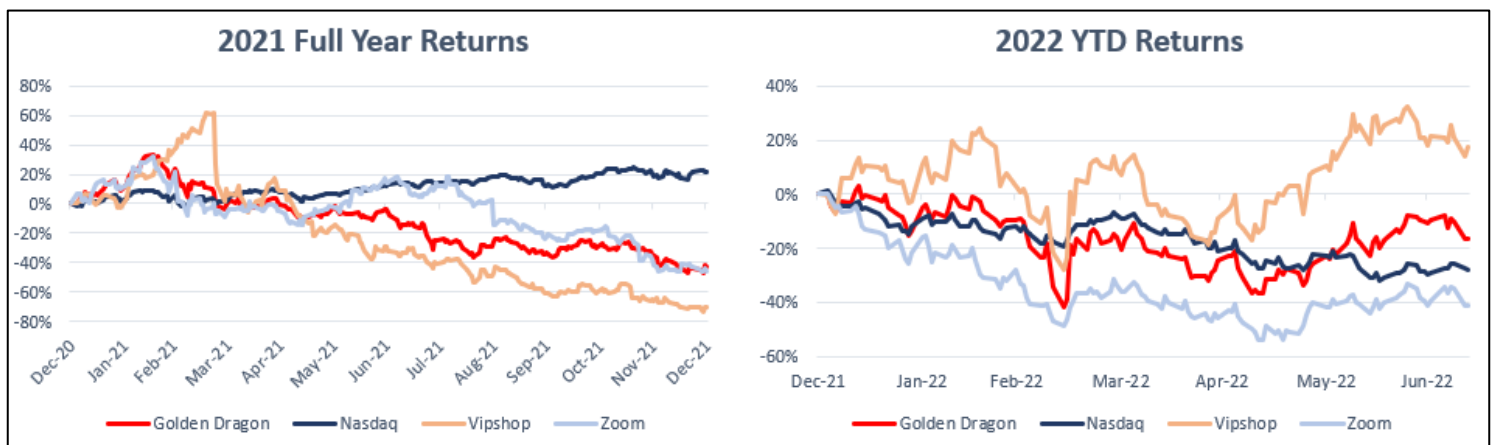
operating too freely. Not to mention the very restrictive lockdowns the country continues to experience.

All of this led to sharp falls in Chinese tech shares, which in turn hit our fund hard in the second half of 2021. The good and ironic news is that now the government is finally showing the first signs of reversing course and Chinese shares are starting to outperform the wider market.

Finally, the US has shown the world once again that even when dealing with internal problems, it is still the leading market: when it sneezes the rest of the world catches a cold. So, what ended up happening is that what should have been a normal market multiples correction fairly localized in US markets and growth companies in general (the ones with frothy valuations) turned out to be a major rout away from global equities. Therefore, our geographical diversification strategy turned out not to be of much use. As it happens, a painful lesson for global investors: unlike other countries, you can't really geographically diversify your risk away from the US.

As always, in all of those cases there are, after all, silver linings:

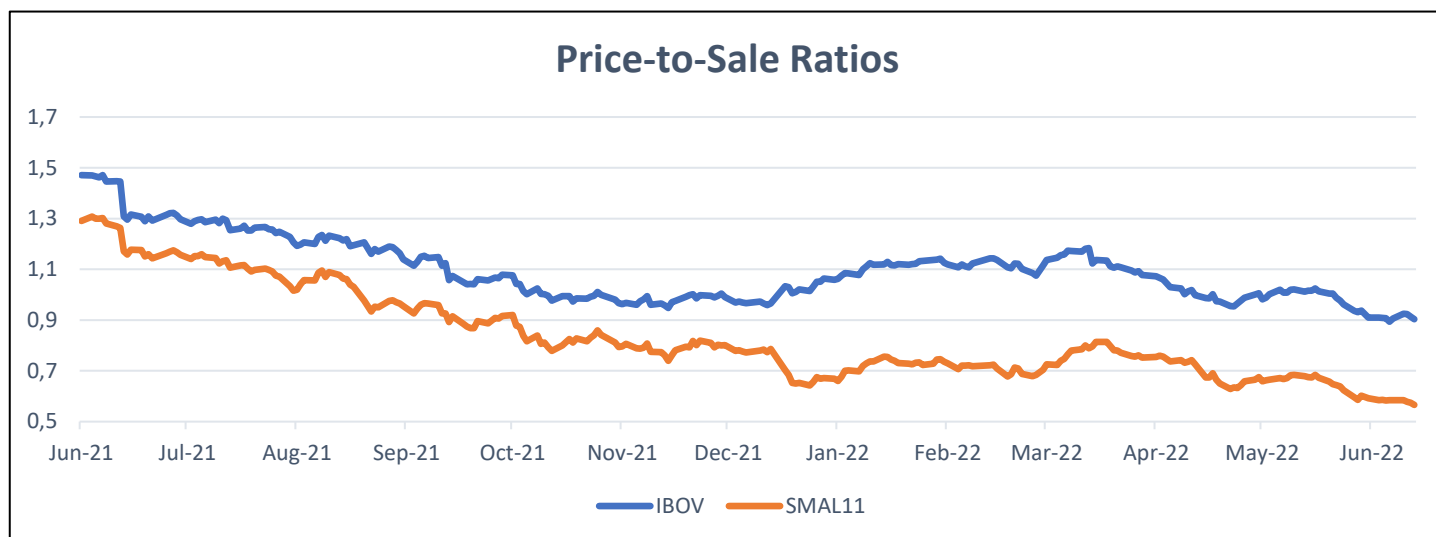
As we said, apparently the CCP leadership was finally able to recover its senses and realized how much harm the so called “tech crackdown” campaign was inflicting on China’s credibility with the financial community and, more importantly, in its capacity to grow its GDP at the rate desired by the party. There is currently even talk that the Ant IPO, which was abruptly cancelled in late 2020 as the first casualty of the crackdown campaign, will be given the green light by authorities. Some analysts already see China as the only major safe haven in a world of rising interest rates and recessions in developed markets. As it turns out, over the past few months the market seems to have agreed with this reasoning and the country’s stock markets started, after a very long while, to outperform.



Source: Bloomberg, FCL Capital

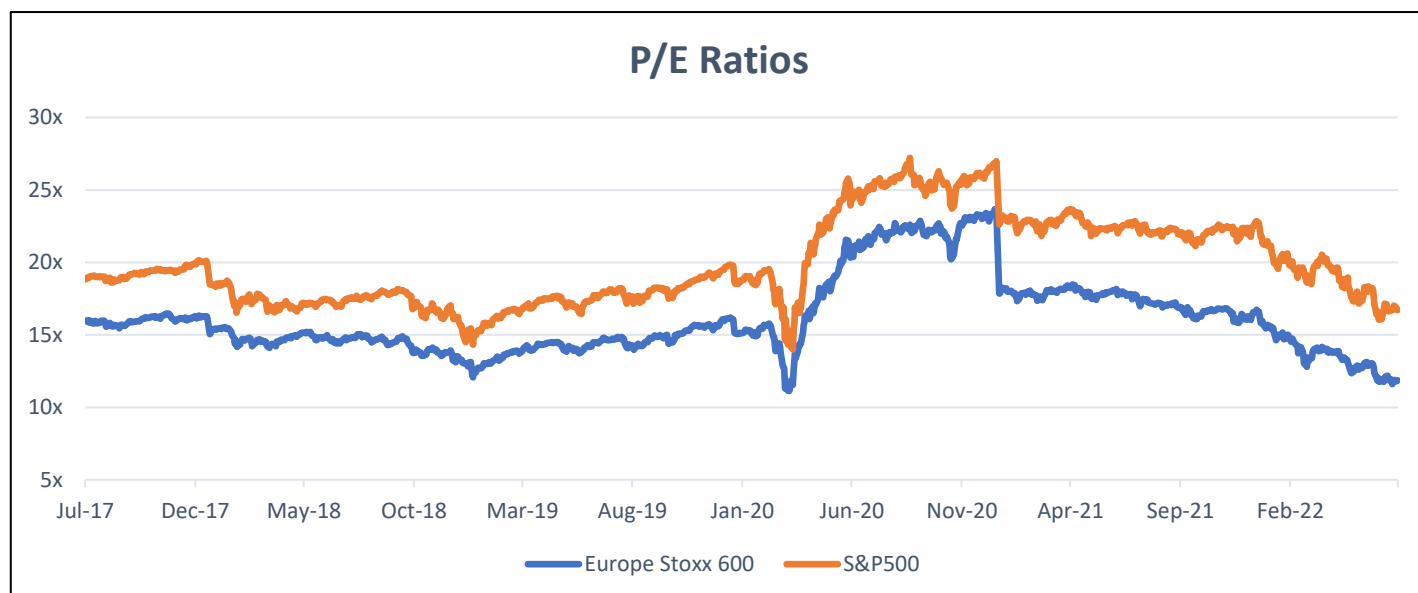
As for the other fronts:

Brazilian equities are, in many metrics, even cheaper than during the 2014 - 2015 period when Dilma Rousseff's administration flirted with financial disaster.



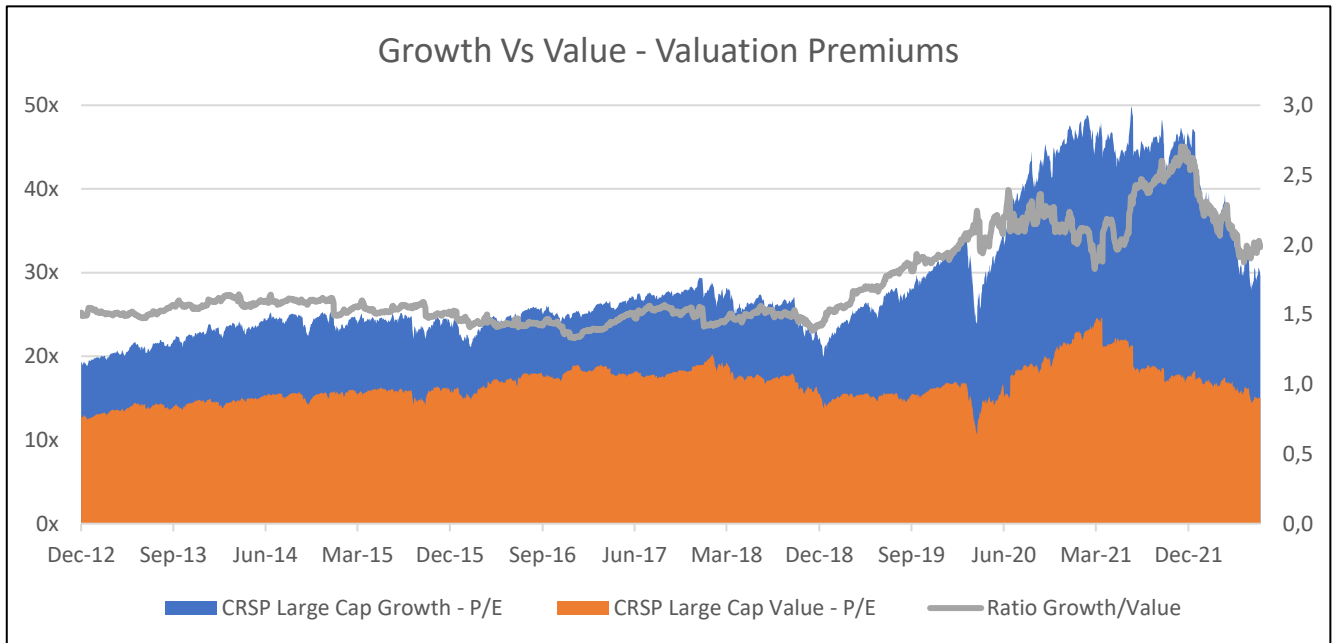
Source: Bloomberg, FCL Capital

And our European companies are as promising and exciting as ever and just like their US peers, their valuations have retreated to some of the lowest multiples shown over the past decade.



Source: Bloomberg, FCL Capital

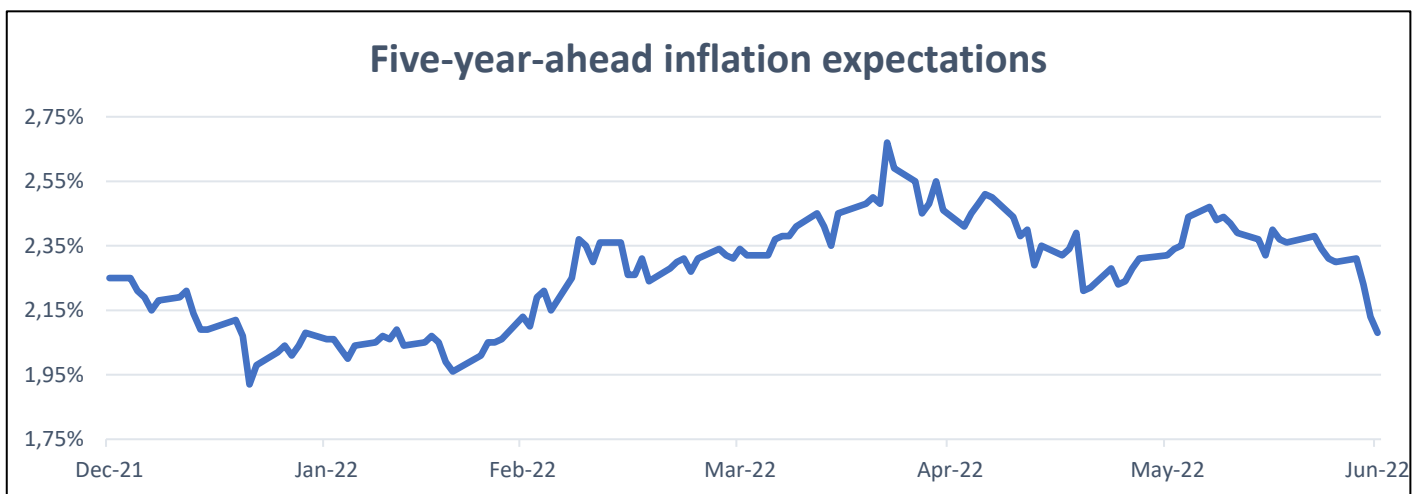
Perhaps most importantly, in only one semester, promising growth stocks gave away pretty much all of their abnormal valuation premium when compared to value stocks and, at the very least, seem to be trading at quite reasonable valuations according to their long-term premium.



Source: Bloomberg, FCL Capital

So, in short, despite a painful year and a nasty bear market, all is not lost. In this house's opinion it is only a temporary setback. Painful, indeed, but far from life threatening. Maybe more importantly, after the dramatic sell-off in a very short period of time, most, if not all, of the excesses incurred over the past years seem to have been cleared of the system.

Finally, inflation expectations appears to be finally getting back under control in the US, creating room for smaller interest rate increases by the FED in 2023.



Source: Bloomberg, FCL Capital

So much for the past. Clearly, our risk prevention strategies failed us on the first half of the year. So what are we changing and what will this house do differently from now on?

First and most importantly, our risk committee was totally reformulated. Since the start of this year, our house has a formal monthly risk committee presided by our partner Guilherme Temke, however, unlike in the past, in the new risk framework setting, we not only monitor our companies and its geographical exposure, but also give a lot more focus on factors, sectors and different kinds of risks our fund might be incurring. It is still early days, but so far we are feeling increasingly confident in our fund's robustness to cross future bear markets like this with even stronger foundations without letting go any potential for alpha.

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At the time we write this letter, our management team is very intrigued by two particularly interesting market phenomena: First, US and global retail stocks, that are trading at very distressed valuations, apparently already pricing in a heavy US and global recession, and secondly, quality growth companies that are long-term winners and continue to show increase profits and sales, but nevertheless saw their shares slump by some 70% - 80% in the past year.

We will end the section with one intellectual exercise: it is obviously very painful to watch global stocks and financial assets in free fall. It is an understandable human impulse to want to sell to make the pain go away. But would it be useful? Would it be rational and a good fiduciary action towards our investors to sell everything right now (we could, after all, do just that and stop worrying)?

To this house, the answer is a firm “no” and for several reasons.

But above all for the fact that, timing the market, that is, selling your position at exactly the top and getting back in precisely at the bottom, just in time to reap most of the profits, is virtually impossible. There is ample academic evidence suggesting that market returns are clustered, meaning that the very worst days tend to be followed by the very best days. So, when a hypothetical investor waits for everything to be OK to return to the market, chances are, the best gains will already have passed.

Then what do we have to guide us? Like our investors know, historical perspective and long-term valuation metrics are one of our main compasses.

Bellow, a chart of our FCL Opportunities full year returns compared to the year-end P/E multiple of the MSCI All Country Index since our founding in January 2017. Usually, a P/E multiple increase from one year to the next means higher valuations.

	ACWI Trailing P/E	Δ% ACWI P/E	FCL Opp - BRL Performance
2016	20,89x	-	-
2017	20,64x	-1,2%	28,52%
2018	15,1x	-26,8%	-0,81%
2019	19,91x	31,9%	47,51%
2020	30,61x	53,7%	45,30%
2021	20,13x	-34,2%	-4,43%
jun/2022	15,79x	-21,6%	-29,89%

To conclude, over the long run, the market will, as always, keep experiencing ups and downs and our fund's performance will, in some way or another, be affected by the changes in the overall market sentiment. However, even though our four "macro trends" were unable to protect us in this current market environment, we remain convicted that our investment thesis will start to bear fruit in the coming years and, as a consequence, that our FCL Opportunities fund will once again start to overperform.

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On other news, our house recently decided to liquidate our FCL Hedge fund, which has never been open to outside investors. We realized that we couldn't fully express our investment philosophy within the fund under current restrictions by market regulations, but we had been waiting for CVM, Brazil's security market authority, to lift some of the restrictions concerning investments abroad so that we could reformulate the fund. Since this change has been taking longer than anticipated, we decided to go through with the fund termination. We hope to relaunch FCL Hedge in the future with a different structure, but more on that in the coming years.