

FCL *Capital*

4Q 2023

The Future

This was the year AI shocked the world. As 2023 comes to an end, the advent of numerous new technologies promises to amaze us just like AI did, from Apple's new Vision Pro, which promises to change the way humans interact with each other, to the medicine revolution that can potentially cure obesity, one of the biggest health harms of the century.

Given this scenario and as new actors and politicians enter the scene promising to shake things up, this house decided that for our 4Q 2023 letter we wanted to bring a panoramic view of themes and technologies that have our attention in these times of change. The list is by no means exhaustive but aims to discuss some events that we think might shake investment portfolios in 2024 and beyond. As always, please beware that none of what is discussed below is investment advice of any kind.

The list should be seen as some themes we have been studying and discussing internally that we think have the potential to change this decade, the 2020s, from an investment point of view.

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1) AI - Power and Potential

When computers first came to be, we used to program them with 0s and 1s so they could form their codes and lines. Increasingly, as Wired famously put it¹, we are now training them, like dogs. And increasingly, they are training themselves.

AI has the potential to be the most significant, dangerous, important and transformative technology ever created by mankind. Let's try to understand why it can be so crucial.

Maybe a good place to start would be the famous 1997 chess match between the Russian chess master Garry Kasparov, one of the greatest players in history, versus IBM's Deep Blue, at that point the most advanced chess program ever created. It was the first time machines beat humans in this game that has been played for millennia.

It should be noted, with the exponential advancement of computers, today's chess programs can easily crush current chess masters.

¹ <https://www.wired.com/2016/05/the-end-of-code/>



But at that point we all knew the miracle that IBM performed with Deep Blue. There are a few million possible situations in a chess game, and Deep Blue at its core was just an amazing calculator: it quickly calculated, at superhuman speed, the opponent's positions, the value of each situation and so forth. An incredible accomplishment, but at least one we could understand.

That's why for a long time the holy grail of artificial intelligence, when it comes to games, was considered a board game that is very popular in Asia called Go.

Why is that so? Because there are more possible moves and situations in Go than there are atoms in the universe. A virtually infinite number. So no computer will ever be able to calculate its way to victory. Instead, the computer has to learn the game, playing billions upon billions of times, improvising, understanding strategies, basically doing what a human would do but only with superhuman speed.

An amazing documentary called AlphaGo shows the immense challenge a British company faced in building an ultra-advanced artificial intelligence machine able to play top level Go against the world's best player, a Korean named Lee Sedol.²

² https://en.wikipedia.org/wiki/AlphaGo_versus_Lee_Sedol
https://www.youtube.com/watch?v=8tq1C8spV_g



This house enthusiastically suggest our readers to watch the film, but trying not to give major spoilers we will only say that it is impossible not to root for Sedol as the representative of the human race and to ponder and wonder if truly, our species days as the smartest, brightest, as the top dog in this planet are numbered.

At one point in game 2 of the series, the computer does a bizarre move and quickly commentators claimed it “made a mistake”. Later in the game that bizarre move seemed to make some sense in what has since been recognized as one of the most creative, beautiful and celebrated moves in Go history, the so called “move 37”. The computer didn’t calculate anything. It showed intuition, creativity, adaptability.

And even worse, newer versions of AlphaGo essentially train themselves by playing trillions of real and simulated games. They learn from and by themselves. They train.

Of course, games are just a silly start. The underlying and terrifying fact is that AI will change everything. If robots surpassed us in chess, GO and more, what happens when they surpass us in discovering new medicines? Making science breakthroughs? Understanding the laws of physics? Writing amazing poetry and incredible new songs and books? When – and of course this is especially terrifying – when they surpass humans in investing? And finally, when they are so far ahead, since they are also accelerating faster, that our species intelligence will feel like the intelligence of an insect? It is, for all purposes, an alien life form, not from outer space, but created here and with unpredictable values. It will, eventually and for all purposes, be divine, since we won’t be able to fully understand it.

At this point, things get really weird. No one knows when general artificial intelligence³ will truly arrive. But let’s first understand why it is so transformational. The current generation of intelligent machines really train themselves only with programmers inputs. Just witness ChatGPT4’s evolution to its predecessors. No one knows when this day will

³ https://en.wikipedia.org/wiki/Artificial_general_intelligence

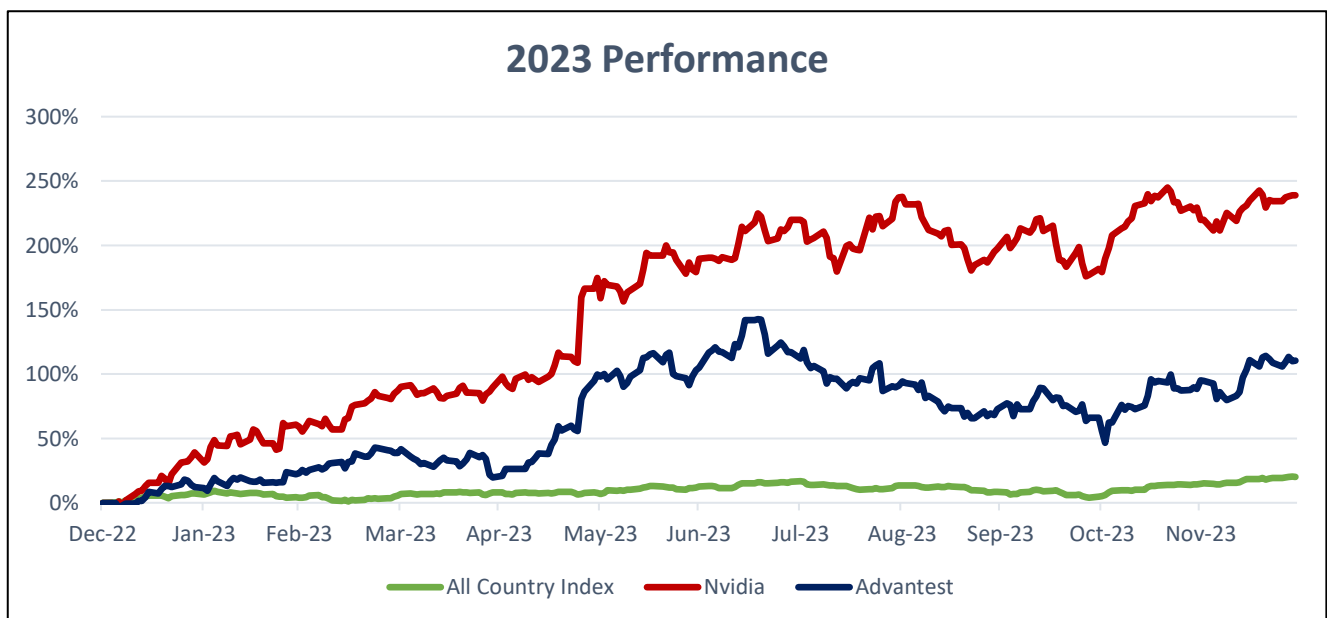
arrive, but someday we will have a machine that is more intelligent than us and can keep improving itself, meaning that this will literally be mankind's last invention.

If something is not only more intelligent but also improves faster than us what is left for the human race? Certainly, at least at first, a few domains, like interacting with one another, contemplating things, but those will probably decrease with time.

At first, every company or individual that doesn't use AI will be left behind. And of course all of this has the potential to produce terrible things and quite possibly even finish our species.⁴ But probably not because it will become evil, like in Frankenstein, Terminator or 2001. More plausibly, because if you program a superintelligent being with a goal, we could be collateral damage.

Say, a computer that wants to maximize energy output would wipe out humanity if it perceives us as slowing its goal, much the same way a human in a car that crashes an ant doesn't hate the ant, that was just collateral damage on our way to work.

When it comes to the AI investment landscape, this house research has been focused on chip companies, like Nvidia and a Japanese company called Advantest. But increasingly, we analyze all our portfolio and potential investments through an AI prism: will that company benefit from AI, will it be harmed by it?



Source: Bloomberg, FCL Capital

On a macro level, it is plausible that AI adoption will increase global potential GDP in the coming decades, the same way the world experienced an amazing productivity increase because of prior inventions like the steam engine and, especially in the 1996 - 2004 period, the internet.⁵

⁴ <https://www.youtube.com/watch?v=Yd0yQ9yxSYY>

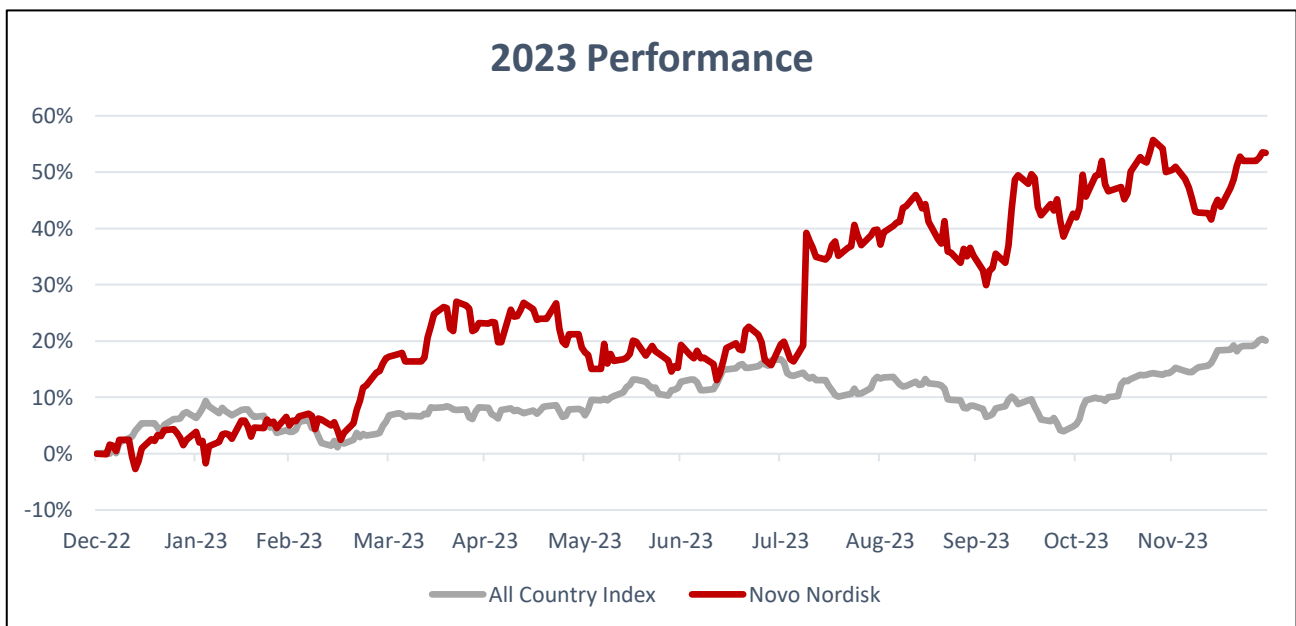
⁵ As discussed in episode 3 of FCL Capital podcast series.

2) Health, Synthetic Biology, the Ozempic Generation

In an increasingly affluent world, “rich countries diseases” that affect an overweight and unhealthy population, like cholesterol, heart problems and cancer become evermore pressing health issues.

For centuries, overweight-related diseases are known and despite countless attempts to counterbalance it with diet fads and dangerous and useless medicines, only recently the first serious and revolutionary opportunity to end the overweight epidemic arrived. This breakthrough came from Novo Nordisk, a Danish company run by a foundation.

After some trials it is now clear that a substance called semaglutide, present not only in Novo Nordisk’s weight loss drug Seygov but also in a diabetes medicine called Ozempic, could inhibit people’s urge and compulsiveness to eat, and this with time can result in miraculous weight loss results



Source: Bloomberg, FCL Capital

As our long term investors know, this house has made a few investments in the healthcare sector, since it is poised to grow as a result of the ageing demographics of the world’s population and its increasing affluence.

Traditionally, we have made investments in the more conservative, service related parts of the chain, like our Brazilian investments in Fleury and Hypera.

Gradually, this house is starting to feel more comfortable in venturing a bit in the more cutting edge parts of drug research and lab services and a major investment in these areas outside Brazil is a possibility for our Opportunities fund in 2024.

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3) Argentina - The Forgotten Country

It was a scene that normally could only have happened in one of the world's most important and interconnected global cities: a crowd of people walking and talking in countless different languages. Then a group of Nigerians start an impromptu music show and some South Korean girls stop to watch. Laughs. They exchange some quick words in English. Nothing out of the ordinary to see in New York City or London. Also maybe in Dubai.

The fact that this scene happened in this manager's native Rio de Janeiro is what makes it out of the ordinary. Logically, the event happened in 2016 during the Summer Olympics that was hosted by the city and made it, for two weeks, as cosmopolitan a place as those above mentioned global cities normally are, with their melting pots of tastes, cultures and interactions

South America unfortunately became one of the least dynamic parts of the global economy. This is evident when one walks its cities where, apart from some affluent and charming neighborhoods in cities like Rio, São Paulo and Buenos Aires, what we mostly see is a series of wasted opportunities and amazing potential that is subutilized.

Argentina in particular is probably the most painful story of the continent. From a GDP per capita on par with that of Switzerland in the beginning of the 20th century, the country became, after a series of devaluations, monetary confiscations and economic confusions, a financial pariah that is not even counted as an emerging market today.

Since our fund's launch in 2017, we haven't ever looked at the local companies and never remotely considered the possibility of investing there, due to the level of economic uncertainty and volatility.

That is why this house is fascinated and cautiously optimistic about the recent election of the libertarian Javier Milei to the presidency. The first signals seem to indicate that he wants to change course from the route that condemned his country to the terrible situation it finds itself in. He is currently engineering a smart unification of Argentina's several official exchange rates, an obvious place to start if one has to entertain serious economic reforms there.

The route certainly won't be smooth, but for the first time ever, this house has been looking at opportunities in Argentinean companies, listed in Buenos Aires and New York.

So far, some interesting opportunities in the banking, financial, real estate and agribusiness sectors emerge as candidates for a deeper dive by our team in 2024.

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4) Metaverse

We all miss Steve Jobs. His record of completely creating or transforming whole industries like Apple did in the early 21st century with music, the cellphone, the app economy, the iPad and more speaks for itself in the argument he may well be the greatest CEO of all time.

In the past decade, the leadership of Tim Cook continued Jobs legacy and transformed Apple in the first company ever to break the \$1 trillion market cap value and, to this day, Apple is the most valuable company on the planet. As tough an act to follow as Steve Jobs is, by almost any metric he seems like a great following up act.

That is, apart from one single metric. Even though the iWatch was a success, it never had the wow factor we all had when Apple completely revolutionized the world again and again. It still lacks a killer app to make it indispensable, although its suite of health monitoring systems does look promising. Also, the iWatch was partly envisioned when Jobs was still alive.

Enter the Vision Pro, which Apple will release this year and is clearly the company's most ambitious new vertical since the iPad. Its major competitor will be Meta's Quest.

In both devices the killer feature will probably be a new generation Facetime where it will be possible to talk with people not looking at a monitor, but looking at a codec generated version of them that will give the sensation and feeling they are next to us in the same room.

The metaverse, which at its basic level is the ability of putting us in a different reality, combined with augmented reality also seems to be a great combination to the cryptocurrency experimentation, another field this house has in the past dipped its toes on.⁶

Certainly, many promising companies, from Silicon Valley and beyond, will launch apps and ideas tailored for this ecosystem and we will be watching and waiting in 2024 for them.

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5) Convergence versus Divergence

Finally one of the topics that is dearest to our hearts might make a comeback in 2024: convergence versus divergence.

In this context divergence might be understood as the ability of the frontier economy – for most purposes the United States, as it is the most dynamic and the richest major economy of the world – to continuously pull ahead from the rest, while divergence is the ability of the rest to decrease the difference, in GDP per capita and market value as well as in the creation of investment opportunities.

If we look at the history of convergence versus divergence in the past few decades it is in retrospect fairly easy to spot a few long cycles, each of them invariably at the time was seen as “the end of history” where things would forever continue to follow the logic they were following at the particular time:

- In the early 1980's, Japan was all the rage. It was the leader in many crucial aspects of the technology industry. Sony had created the walkman. Nintendo had

⁶ https://84471c97-e192-4d57-a61f-283398a4101f.usrfiles.com/ugd/8d6b17_1a6e28a251404cf7acc9a9a495295f50.pdf

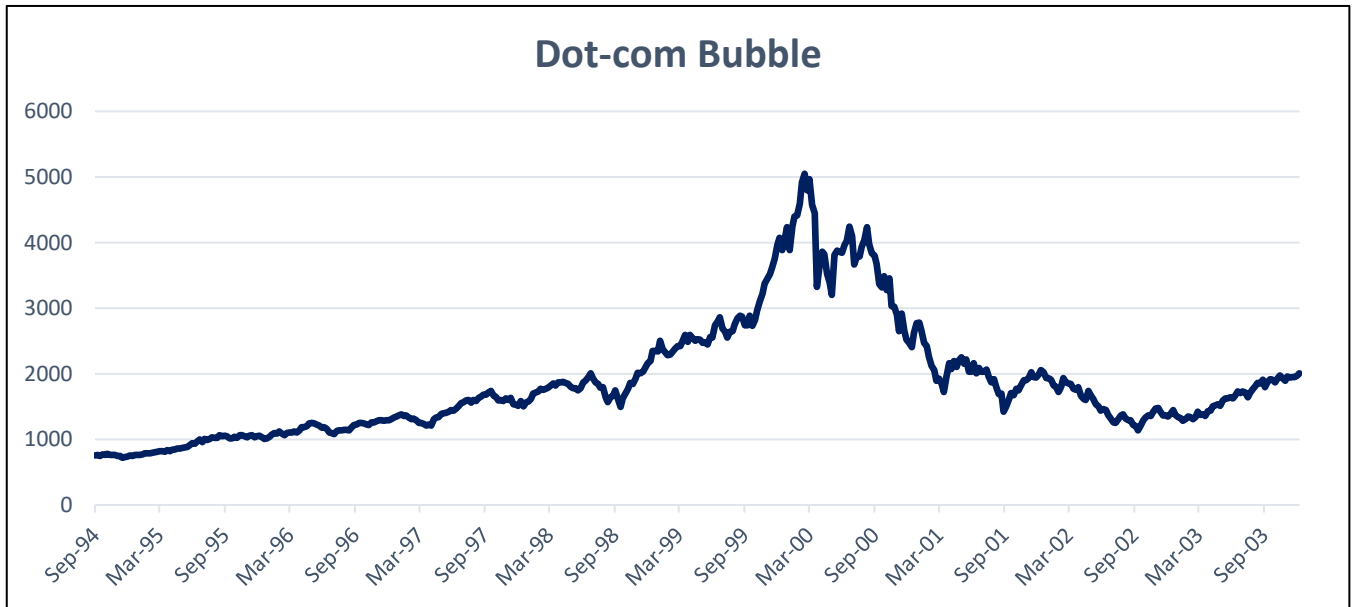
made videogames a cultural phenomenon. Japanese cars were conquering America. And so on. Managers went to Japan to learn just-in-time production and it was widely assumed the 21st century would be Japanese;

- The 1990s witnessed the first dot com boom. It was an American decade. Japan began its long stagnation from which only now it shows the first signs of surpassing;
- The first decade of the 21st century had a new set of superstars: emerging markets. Brazil, India, Russia, China and the BRICs acronym was created. A new idea came in vogue: a commodities “supercycle” that would last forever. The urbanization of China would be such a transformative event and would take so long that commodities prices would almost permanently find new price levels;⁷
- Finally, the past ten years were of renewed American (and more specifically Californian) dominance when the world was transformed by amazing technologies like the iPhone, Zoom, Uber, Cloud Computing, Artificial Intelligence and more.

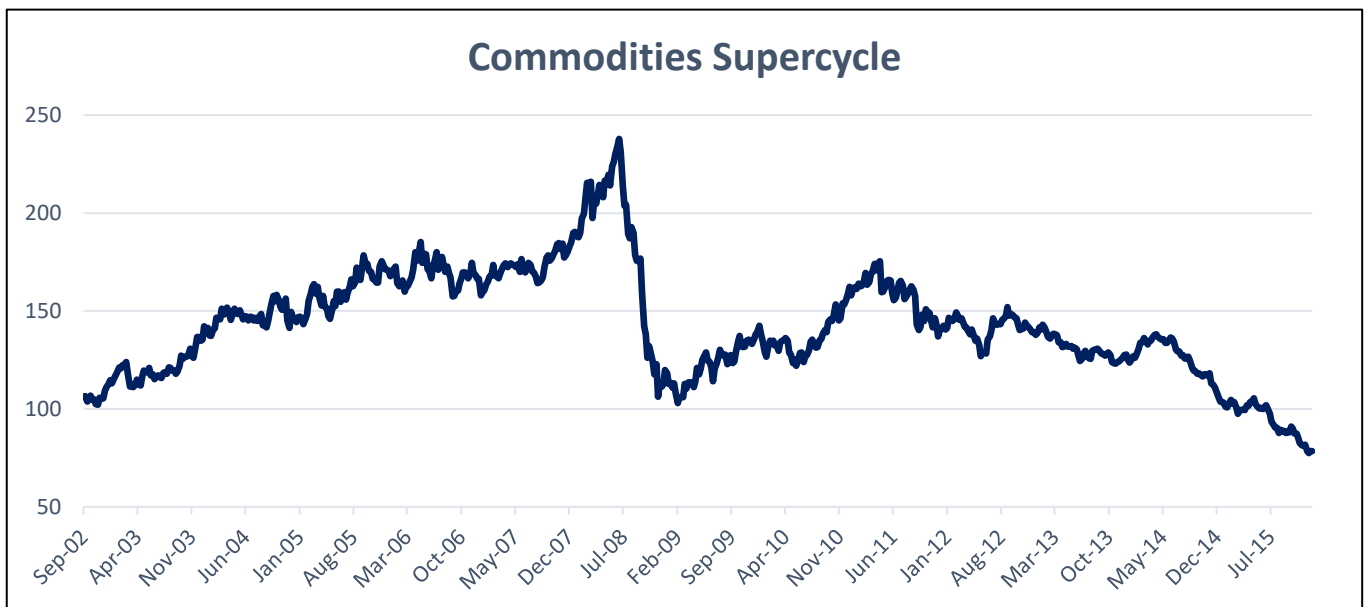


The Japanese Bubble of the 1980s

⁷ Any similarity to the famous “permanent high plateau” that equities would find as predicted by an analyst just before the 1929 crash is not mere coincidence.



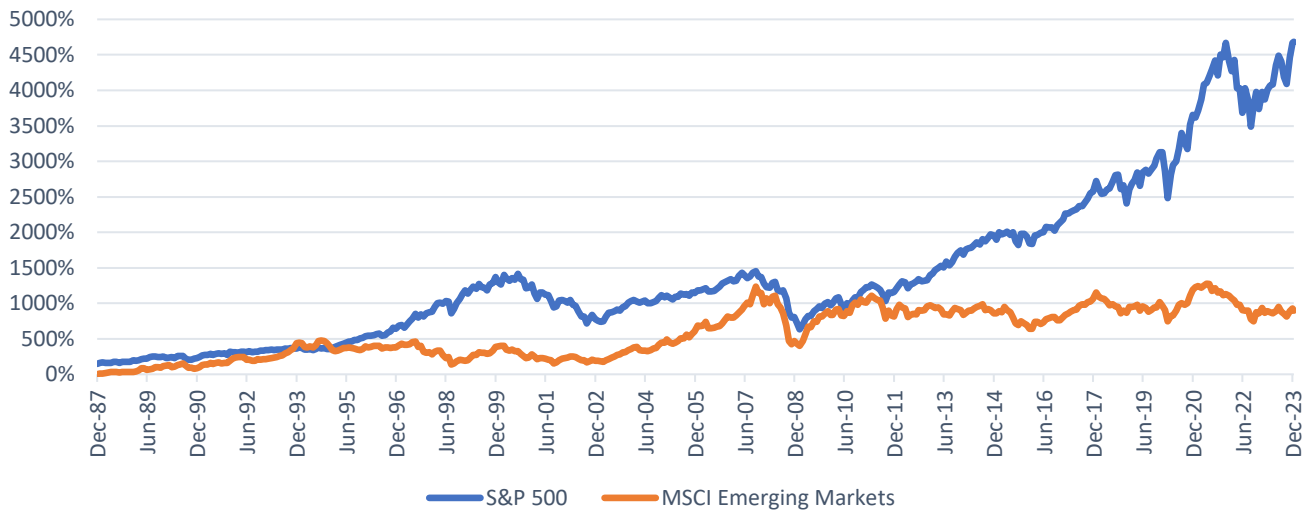
Source: Bloomberg, FCL Capital



Source: Bloomberg, FCL Capital

Then, technology from silicon valley changes the world.

S&P 500 Vs. Emerging Markets, past 40 years



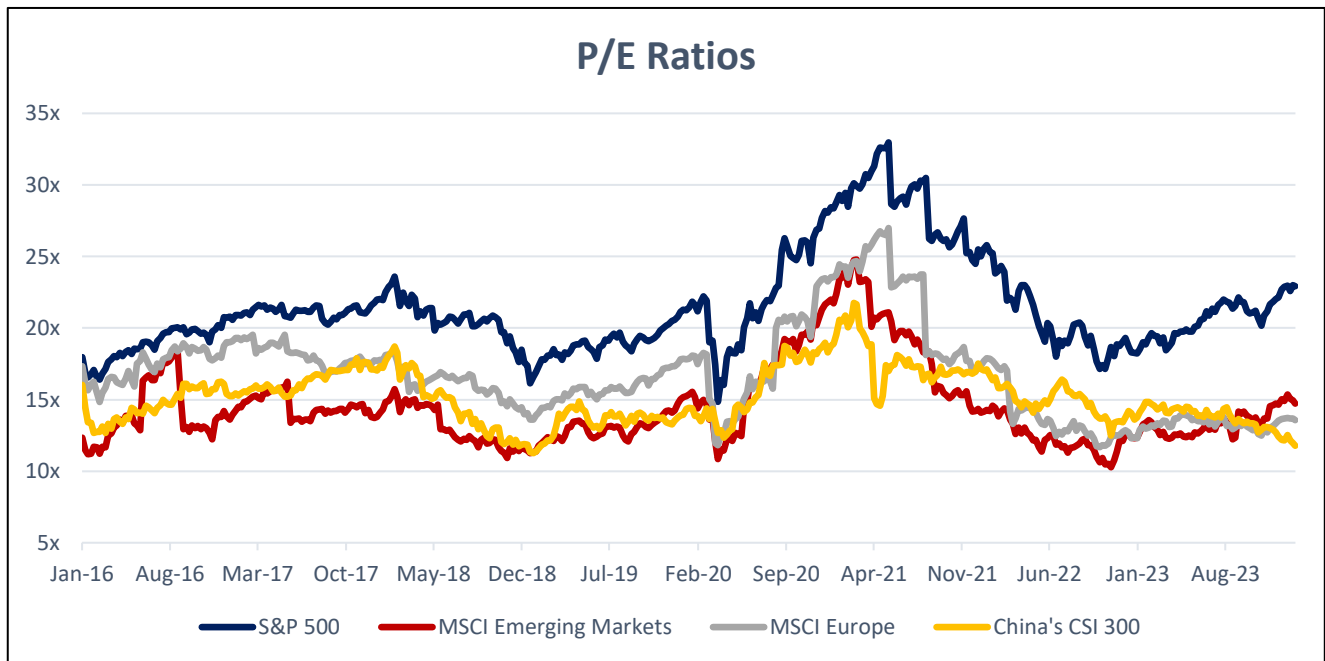
Source: Bloomberg, FCL Capital

U.S. Dollar Index (DXY), past 60 years



Source: Bloomberg, FCL Capital

What will 2024 and the following years entail? Although no one knows for sure, one dictum this house likes is “if something can’t go on forever it won’t. Trees don’t grow to the sky.” Most of the US outperformance in the past ten years against European and emerging markets stocks has less to do with American companies having their earnings grow faster (although there was also some of that) and more about US market valuations reaching higher levels and bigger premiums compared to their foreign peers.



We suspect those imbalances will somewhat converge in the next few years and a different era will, sooner or later, be upon us.

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A Tale of Two Car Companies

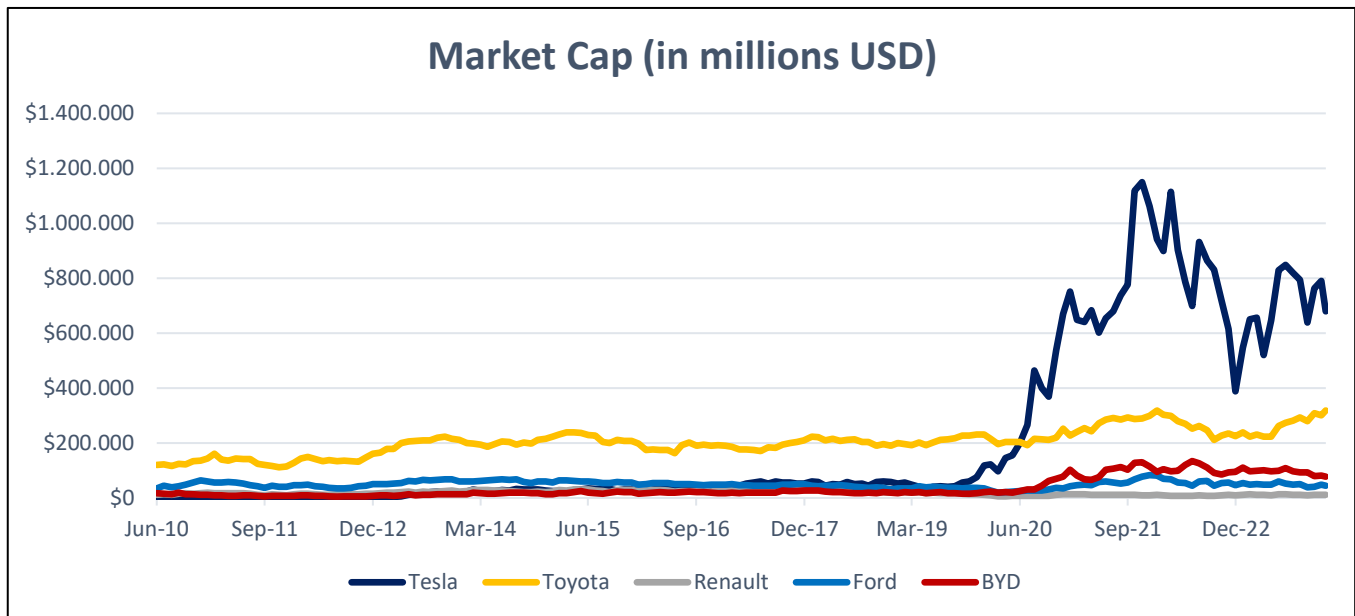
In our last letter, this house disclosed for the first time our investment in BYD.⁸ This time, we decided to dig a little deeper since it is an important investment that touches on a series of crucial strategies for our Opportunities fund: our China strategy, our assessment on the evolution of technology, batteries and electric cars and who will dominate these important markets.

It is hard to do any long term analysis and thinking about the current global electric vehicles industry without first mentioning the name of Elon Musk.

Tesla's history is extensively covered and Elon Musk is correctly considered as one of this era's greatest entrepreneurs. When he founded Tesla his vision of electric powered vehicles was considered an eccentric dream and the company was once on the verge of bankruptcy.⁹ Fast forward to the present day and Tesla became not only the world's most valuable car maker by far, but at one point, at the peak of Muskmania, the company was worth almost as much as all other car makers in the world combined.

⁸ https://8d6b179e-dfa9-4146-86f7-763a65725bc5.usrfiles.com/ugd/8d6b17_65483da817ff41cc9df53da21e1e2bb1.pdf

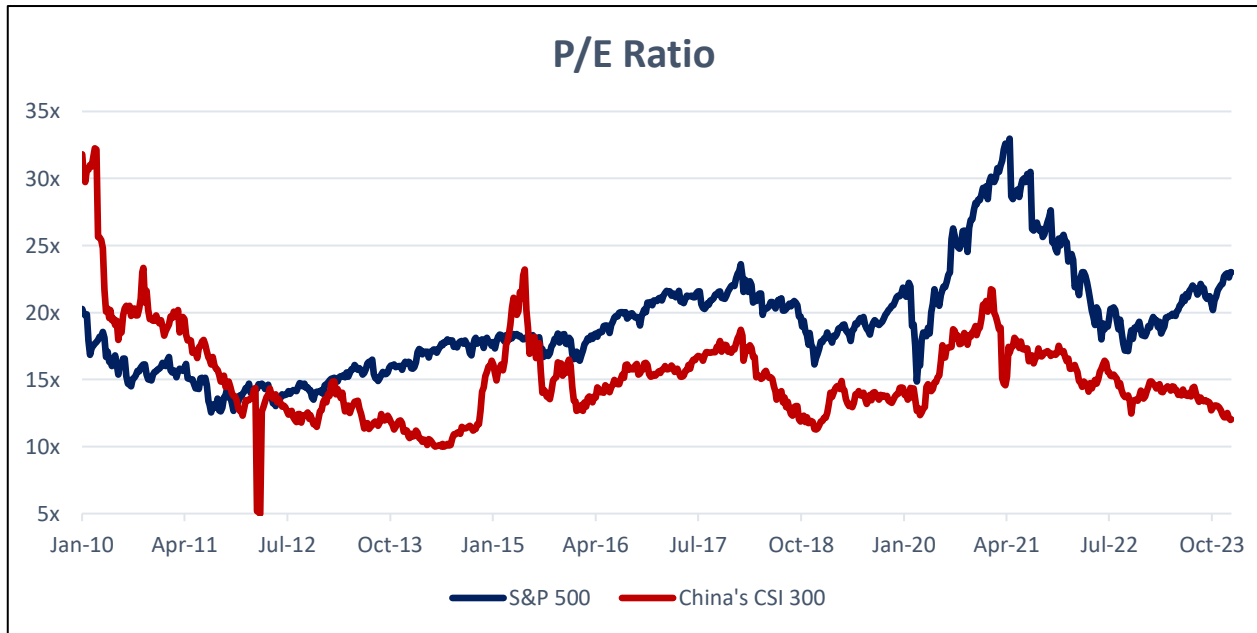
⁹ <https://edition.cnn.com/2020/11/04/tech/elon-musk-tesla-once-got-near-bankruptcy/index.html>



Above all, Elon Musk is an incredible salesman. Over the past twenty years he went from being considered the nuttiest one from the celebrated “PayPal mafia” to the greatest visionary of all.

Somewhere along those two extremes things might have gotten out of hand.

At this space this house frequently discusses the US valuation premium and the China discount. At no pair of companies we think this premium might have gotten more out of hand than with BYD and Tesla.



Source: Bloomberg, FCL Capital

Number of total passenger cars sold by company per year

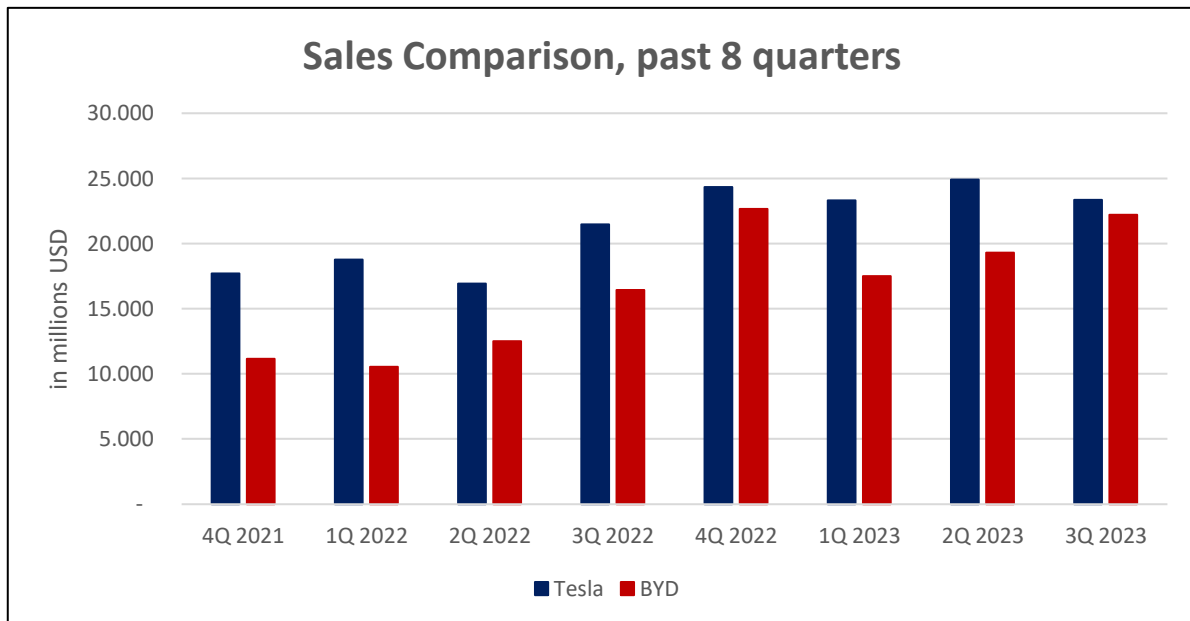
(in thousands)	2018	2019	2020	2021	2022	2023	
Tesla	246	368	500	936	1.313	1.809	
Ford	5.982	5.386	4.187	3.942	4.231	3.261	*until 3Q 2023
Renault	3.884	3.754	3.884	2.696	2.051	2.235	
Toyota	10.594	10.742	9.528	10.496	10.483	10.222	*until November 2023
BYD	221	402	388	713	1.797	3.024	

	Forward P/E*
Tesla	54x
Ford	7x
Renault	3x
Toyota	9x
BYD	14x

* 2024 Bloomberg Consensus

	Market Cap per Car Sold
Tesla	\$ 386.443
Ford	\$ 10.407
Renault	\$ 4.530
Toyota	\$ 24.593
BYD	\$ 25.808

Then, in the fourth quarter of 2023, something remarkable happened. BYD, a Chinese company that 10 years ago was scorned by Musk himself¹⁰ as not having a great product, surpassed Tesla as the world's top selling electric car maker. In reality, BYD already had surpassed Tesla when we also account plug in hybrids which will have a fundamental role in the energy transition for decades to come. But true to form, western media mostly ignored this feat. Then, this past quarter, BYD also beat Tesla even if we only count fully electric cars.



Source: Bloomberg, FCL Capital

What is even more fundamental, we think this difference will only increase. The future of electric cars will be multifaceted and to win, carmakers will increasingly need a diverse fleet of vehicles catering to different tastes and needs, while Tesla only sells two different models to its *aficionados*.

Also, while the US government electric vehicles subsidy program was designed to hurt China and preventing that country to lead the energy revolution, we think the company that will be hurt the most by those measures is precisely Tesla, since its models run on batteries provided by the Chinese firm CATL that will no longer enjoy tax breaks.

Meanwhile, BYD is gaining praise and respect in auto shows around the world. Even if Europeans put tariffs against its vehicles, its main routes for growth in the future seem to be Southeast Asia, where BYD is already a leader in Thailand, and also Latin America, with Brazilian sales growing fast.

As we expected, the conversation changed once again and Tesla fans mostly dismissed the new market leader as “just a car company” while Tesla is, according to Musk, “really an AI and robotics company disguised as a car company”.

¹⁰ <https://www.investorsalley.com/more-woes-for-elon-musk-as-this-competitor-is-beating-tesla/>

Global Motor Vehicle Sales By Country

China is the world's leading vehicle sales country. As of 2021, China's motor vehicle sales were 26.3 million units, accounting for 32.34% of global sales. The top five countries account for 65.07% of it. Total global vehicle sales are expected to reach 81.2 million units in 2021.

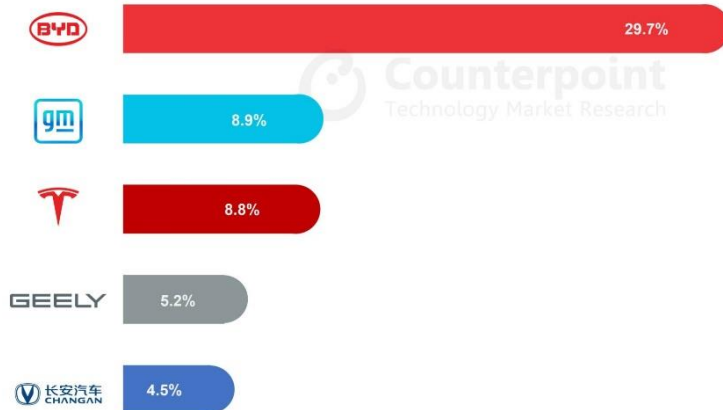


(in units)

China	26,274,820	Malaysia	508,911
USA	15,406,565	South Africa	464,493
Japan	4,448,340	Belgium	462,536
India	3,759,398	Taiwan	422,000
Germany	2,973,319	Chile	415,582
France	2,142,284	Netherlands	405,061
Brazil	2,119,851	Argentina	370,283
United Kingdom	2,044,091	Sweden	343,880
Russia	1,741,965	Austria	306,176
South Korea	1,734,581	Israel	306,012
Canada	1,704,850	Philippines	286,734
Italy	1,664,483	Egypt	277,805
Australia	1,049,831	Switzerland	272,249
Mexico	1,046,705	Vietnam	260,850
Spain	1,034,063	Pakistan	237,424
Indonesia	887,205	Czech Republic	236,221
Türkiye	772,722	Colombia	229,493
Thailand	748,580	Denmark	221,937
Saudi Arabia	556,559	Norway	217,572
Poland	554,613	UAE	188,844

SOURCE: International Organization of Motor Vehicle Manufacturers
www.rankingroyals.com

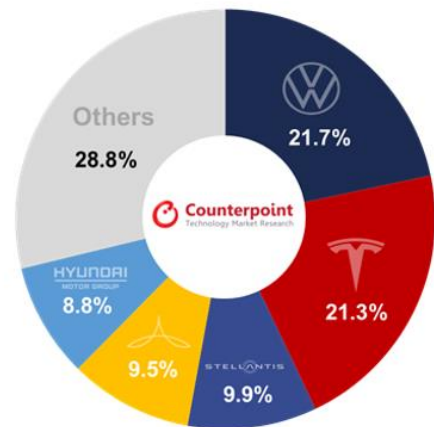
China Top 5 EV Groups' Sales Share, 2022



*Note: GM includes SAIC-GM-Wuling JV

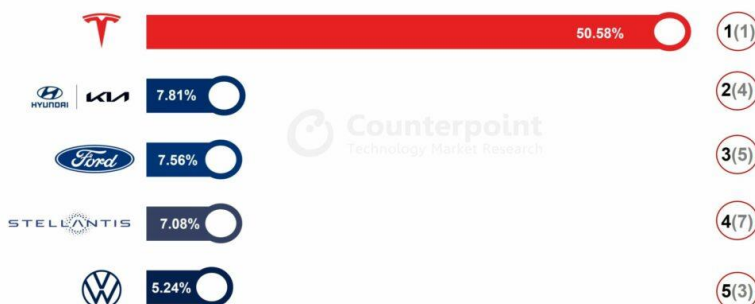
Source: Counterpoint's Global Passenger Electric Vehicle Model Sales Tracker, Q4 2022

Europe Top 5 Automotive Groups' BEV Sales Share, Q1 2023



Source: Counterpoint Europe Passenger Electric Vehicle Model Sales Tracker, Q1 2023

US Top 5 EV Automotive Groups' Sales Share, 2022



Ranking 2022 (2021)

Source: Counterpoint Global Passenger Electric Vehicle Model Sales Tracker, Q4 2022

Source: Counterpoint Research

BYD is now one of the top ten holdings in our FCL Opportunities fund. For now, this house thinks BYD is a better company, in a faster growing market, with better engineers, with an undisputed leadership in its manufacturing process that allow it to have greater margins than everyone else even accounting for multiple price cuts imposed by its competitors in China and, above all, it has an amazing CEO in Wang Chuanfu.

Apart from the ever present “China Discount” one frequent point analysts make is that BYD models lack autonomous driving technology and the company has to rely on third parties for that. A fair point. Tesla, on the other hand, lacks battery technology and has to rely on CATL for its most crucial technology that sits at the heart of the industry. BYD makes its own batteries and is the largest battery maker apart from CATL. Its vertical integration is a key element in its moat, when after a series of price cuts by Tesla, it kept making more money per car sold than almost all its competitors. In other words, a truly defensible champion in this nascent industry that Tesla couldn’t knock out.

At some point this house thinks the obvious leadership of BYD will make the market realize the ridiculous differences in valuation between the two companies and, at the very least, drastically decrease this discount.

(in millions USD)	TTM		
	Sales	Profit	Market Cap
Tesla	95.924	10.756	695.834
BYD	79.256	3.928	78.029

Performance

FCL Opportunities	
Year to Date, 2023, in BRL	0,03%
Year to Date, 2023, in USD	8,96%
MSCI All Country Index, 2023, in USD	20,1%
Since Inception (30/01/2017), in BRL	90,40%
Since Inception (30/01/2017), in USD	22,27%
Avg Annual Return, since inception, in BRL	9,74%
Avg Annual Return, since inception, in USD	2,95%

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

Position	Country	% Fund NAV
Pinduoduo	China	15,0%
Uber	US	13,6%
Anta Sports	China	10,2%
Moncler	Italy	7,5%
Fleury	Brazil	6,3%

FCL Opportunities Portfolio Composition on December 29th, 2023:

Portfolio Composition by Sector	
Consumer Discretionary	38,6%
Technology	23,0%
Healthcare	13,8%
Financials	11,2%
Industrials	6,1%
Telecom Services	3,0%

Currency Exposure	
USD	30,6%
HKD	16,3%
BRL	15,2%
CNY	15,0%
EUR	13,4%
Others	9,5%

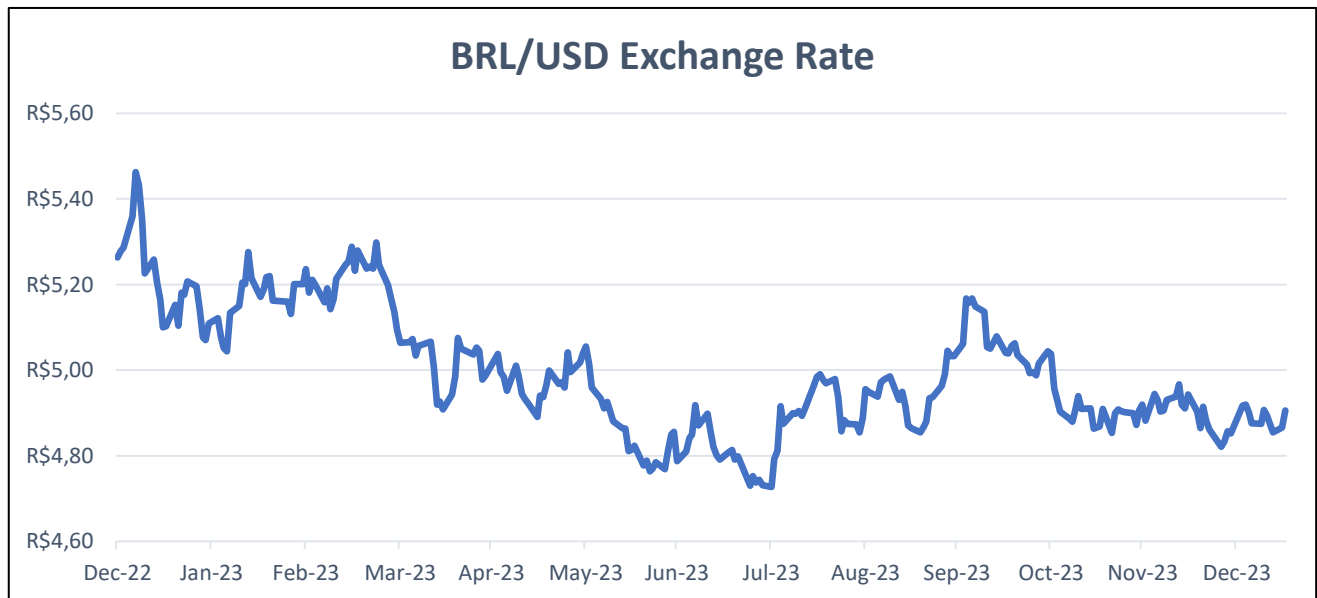
Geographic Distribution	
China	31,3%
USA	20,6%
Europe	19,4%
Brazil	14,5%
Others	9,9%

Portfolio Concentration	
Top 5	52,6%
Top 10	78,4%
Top 15	95,3%

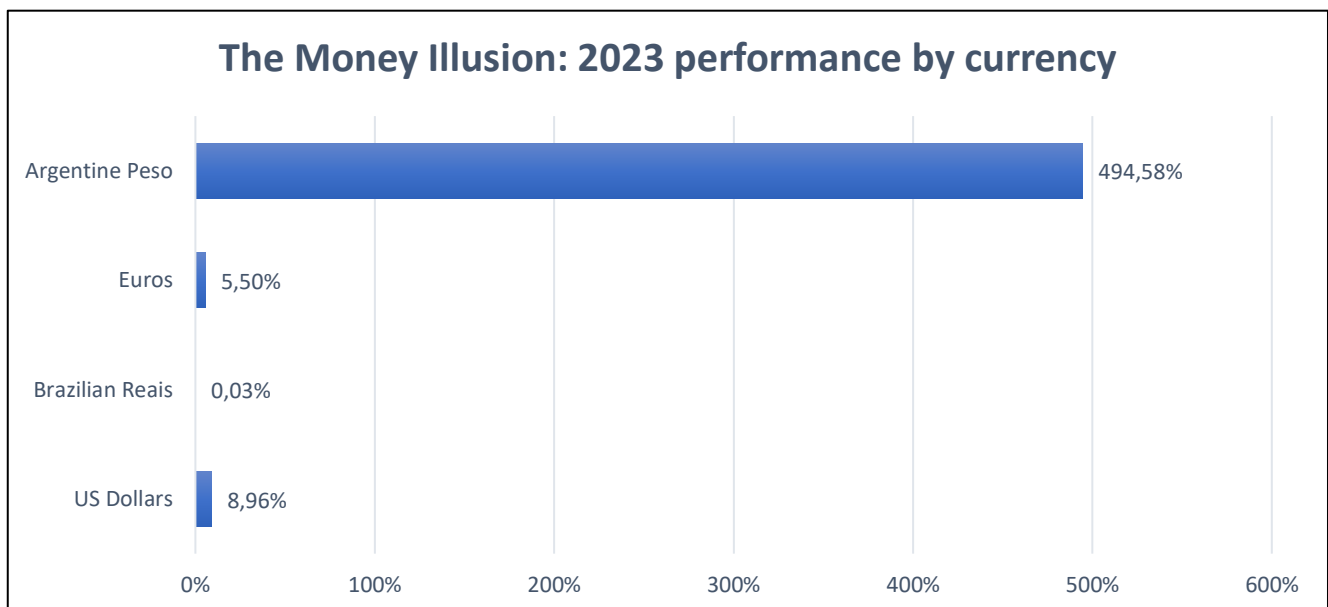
In 2023, FCL Opportunities had a positive performance of 8,96% in US dollars, bringing the fund's accumulated performance to 22,27% in USD terms since our inception on January 30th, 2017.

The performance in Brazilian Real was also positive but quite small, at 0,03% and this result occurred thanks to what is known in finance as the “money illusion”, or the fact that returns are completely different when measured in different currencies.

Since the Real outperformed other major currencies in 2023, any returns from global and dollar based assets was smaller when translated to the Brazilian currency. The BRL to USD exchange rate went from R\$5,28 per USD at the start of the year to R\$4,85 on December 31st.



Source: Bloomberg, FCL Capital



Source: Bloomberg, FCL Capital

Since our inception, our accumulated performance in Brazilian Real stands at 90,4% or a compounded annual return of 9,74%.

As we always said, we judge long term compounded annual returns in USD as the most appropriate metric to internally judge our performance since we hold a globally diversified stock portfolio composed of companies and assets of different natures, domiciled in several jurisdictions and from diverse industries. That being said, we will keep reporting our daily share price both in US dollars and Brazilian Real and will let our investors judge our performance as how they see fit.

If we can suggest anything on your assessment of our performance, we urge you to compare our fund at least in a consistent manner: a portfolio that gained 9% in US dollars

in the past year should be compared in an apples to apples fashion against offshore portfolios in USD terms and not to other Brazil based equity funds that only invest domestically.

Even though this house is relieved to finally show positive performance again after two down years, we know we are still quite far from the fund's highs achieved in mid-2021 and that since many of our investors joined our partnership in that period, they are still "underwater".

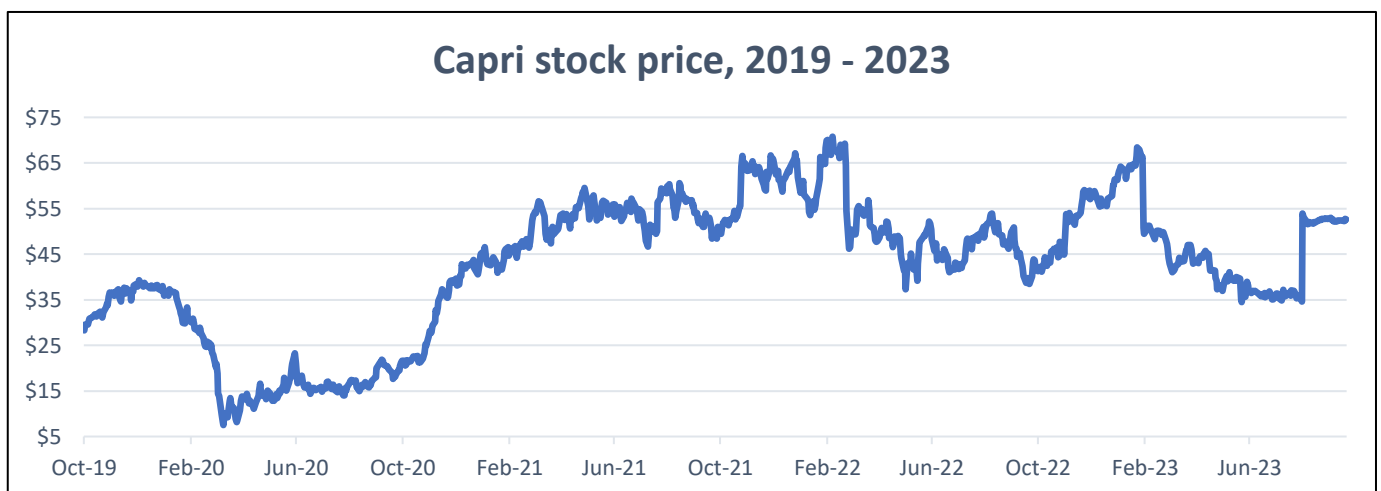
While we can make no promises, we have faced similar periods before and each time we eventually regained and surpassed the previous all-time highs. Moreover, our firm's strategy, somewhat dissimilar to what is most common in the market, is by design intended to have irregular performance, with a few down years and some spectacular ones. We do this not because of any special "trill seeking nature" on our part but because we believe the only way to outperform the market is to deviate from the consensus, holding contrarian views and concentrated positions.

Therefore, since its beginning, our product has shown relatively little correlation with the overall market, especially considering our global and niche strategy. Consequently, we maintain extremely confident that we can regain our all-time highs sooner than what might be expected.

The mildly positive performance was admittedly not spectacular and doesn't leave this house entirely satisfied. Overall, the year was composed of a few home runs and several mistakes. We are constantly reassessing and, to use a poker analogy, we don't think we played the hand the market has given us that well in the past few years.

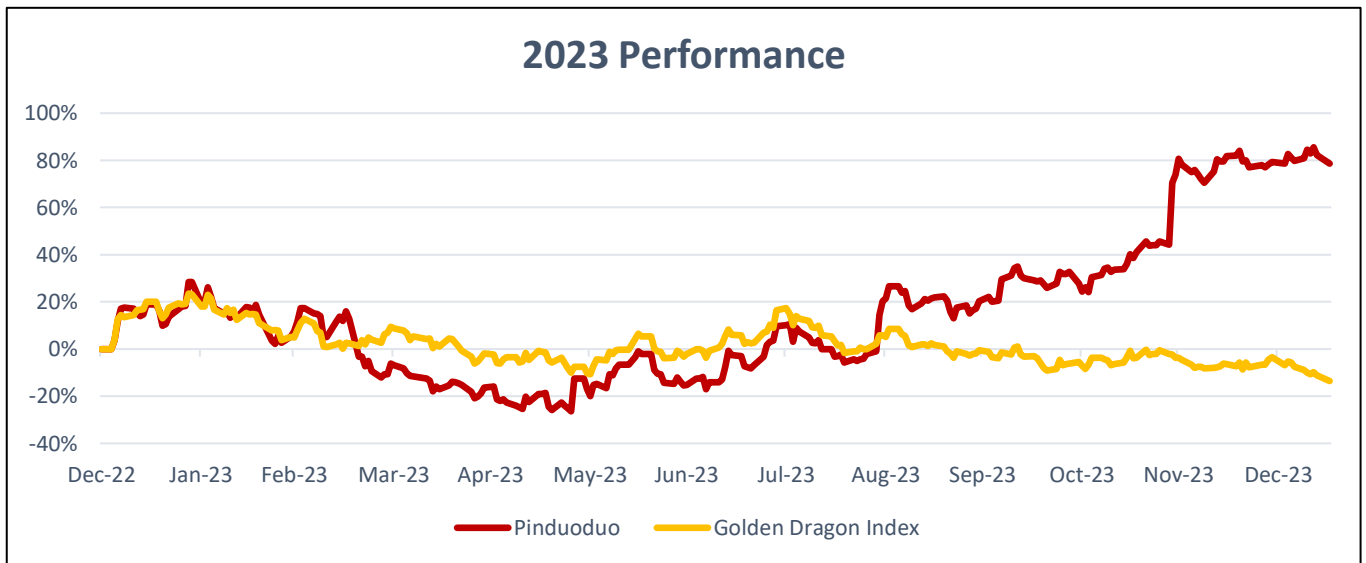
The home runs were Uber, Pinduoduo and Capri.

Capri was already discussed in this space and several of our public appearances before. It is a holding company of three fashion houses: Michael Kors, Versace and Jimmy Choe. Our investment lasted for almost four years and in the first half of the year Capri was acquired at around a 40% premium to its stock price by Tapestry, a rival. This house joined the other minority investors and sold its shares the day the offer was made public.



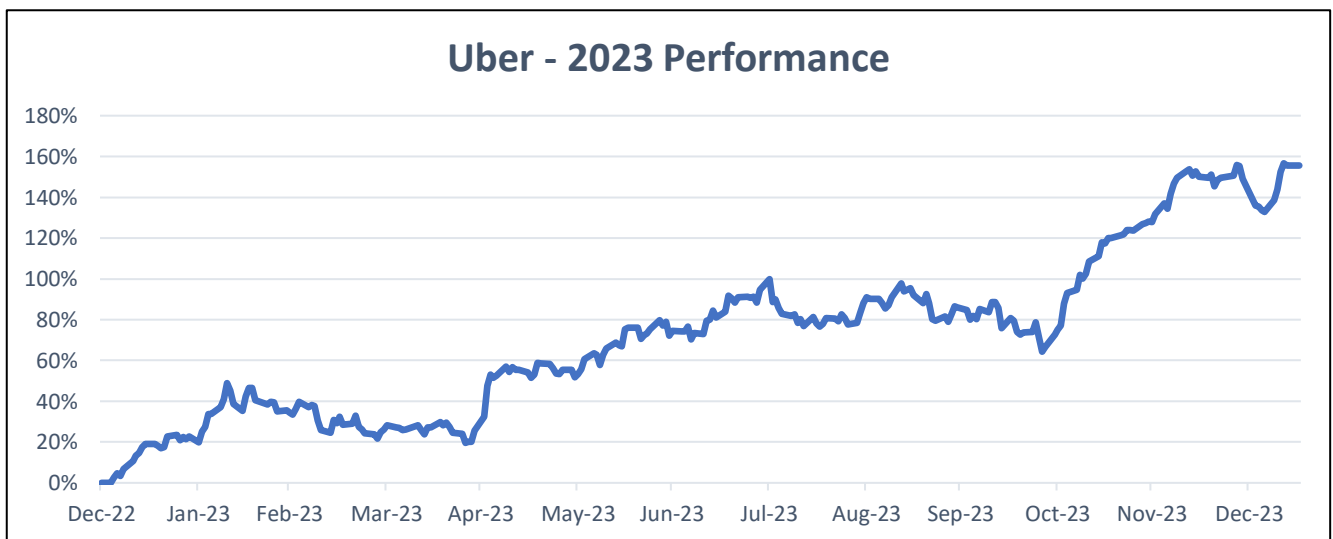
Source: Bloomberg, FCL Capital

Pinduoduo was a star performer despite the long bear market in Chinese equities. Throughout the year it was our fund's largest position and its biggest positive contributor. Recently, Pinduoduo even overtook Alibaba as the most valuable Chinese e-commerce company, which led to an incredible internal memo sent to Alibaba employees from none other than Jack Ma himself where he praised his competitor's execution and management.¹¹



Source: Bloomberg, FCL Capital

Finally, when it comes to Uber, we think the market is gradually accepting our view that, under the direction of CEO Dara Khosrowshahi, the company has graduated from a cash burning and unprofitable enterprise to increasingly one of the tech darlings and most fantastic companies ever created by Silicon Valley. Uber is finally showing its full potential and the market is gradually recognizing it.



Source: Bloomberg, FCL Capital

¹¹ <https://fortune.com/asia/2023/11/29/jack-ma-stuns-alibaba-employees-memo-calling-firm-co-founded-correct-course-china/>

Now, we don't want to sugarcoat things. There were painful mistakes that made our fund underperform the S&P500 (more on that later).

The costliest ones were:

- HelloFresh, where the market is increasingly pessimistic the company will ever achieve its 2025 targets and, therefore, started giving it a distressed valuation;
- Entain, where for most of the year the company lost market share and had execution missteps until finally, in November, a shareholder revolt started to turn things around, and;
- IHS, where a spat between the company management and its major client led to an increase in uncertainty and a decrease in the share price.

In the case of HelloFresh, we doubled our bet. We simply disagree with the way the market is assessing the company's potential. As for Entain, we are on wait and see mode to check if the new board composition (with the recent appointment of some famous activist investors) will be able to turn things around¹² and, finally, in the case of IHS we judged the uncertainty too great and are gently decreasing our holdings.

So what does the future hold for our portfolio?

To summarize, we are confident that what went right still has great potential ahead – with Uber and Pinduoduo in particular still far away from their true possibilities – and, most importantly, we believe that many of the mistakes that subtracted from our performance won't be repeated.

IHS really was a one off case, with a very specific situation in a market we had never invested before but above all a case of bad luck, a falling out between the company and its largest client. In retrospect, this house admittedly made a crucial mistake – we didn't think the relationship between IHS and MTN could be a risk since we believed MTN would act solely in its economic and rational interests.¹³

Entain is an exciting question mark, will 2024 be the year when the much awaited MGM-Entain merger (or buyout) finally happen? And what will the activist investors bring to the table? Overall, we don't see any reasons to sell our shares just now. Most of what could go wrong already did and there are lots of different ways where we envision a turnaround in this investment.

Finally, HelloFresh is the one that makes us scratch our heads the most. The company clearly had a post covid deceleration since the US and European populations largely went back to their old pre-pandemic habits but with one crucial distinction: the share of adults that work from home part or all of the time is a lot higher than before 2020 and will possibly keep gradually increasing over time.

¹² Entain really had an “annus horribilis” in 2023, with gradual loss of market share, execution missteps by its management that culminated in a number of activist investors joining the board and dismissing the company's CEO in late 2023.

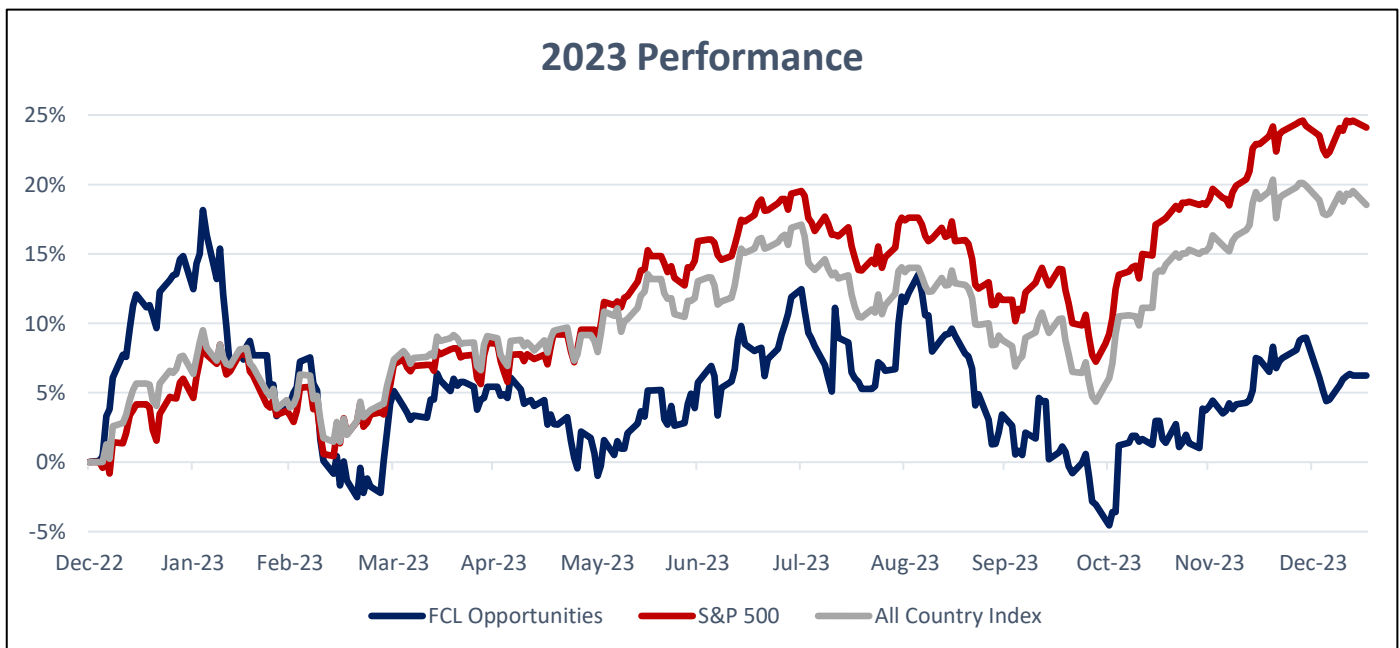
¹³ More about this investment and our discussion about the HIS-MTN relationship in our previous letters

But even with this back to old ways rhythm, HelloFresh maintained its level of sales and, if their 2025 plans are to be believed, should get close to \$1 billion in EBITDA and \$10 billion in sales next year.

Meanwhile the market increasingly values the company as it could cease to be a going concern, at less than a third this year sales and only three times next year's EBITDA. We don't see any valid reason for that and, after this past year's decrease in share price, are once again increasing our position in the company.

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A word about performance measurement.

At first blush, it might seem a little disappointing to register a 9% positive performance and lose both to the S&P 500 and All Country Index in 2023:



Source: Bloomberg, FCL Capital

But let's dig those indexes performances a little deeper. Since the S&P 500 is a market capitalization weighted index, by definition the largest companies have a larger share in explaining the ups and downs moves of the index, for better or worse. In other words, in years where the largest companies perform well it is hard to beat the index (since these big companies will carry it upwards) and the exact opposite happens in years when those big companies perform poorly.

It has been widely reported in financial media that while the median US stock in the S&P 500 has done relatively poorly, a strange phenomenon occurred, with the spectacular performance of the so called "magnificent seven", the seven largest US companies that carried those indexes.¹⁴

¹⁴ <https://www.cnbc.com/2023/12/24/magnificent-seven-stocks-led-2023s-market-what-happens-next.html>

If we use the equal weighted S&P 500, the median stock inside the index, it performed 11,56% withing spitting distance to this house's 8,96% USD performance.

But two additional phenomena also occurred in 2023:

First, US stocks outperformed their global peers and emerging markets, particularly Chinese stocks, making 2023 a relatively bad year for our globally diversified and emerging market heavy strategy.

Secondly, large companies outperformed small ones, another frequent theme in our letters that we think will reverse sooner or later and that also creates a headwind for us since we tend to focus in small and midcap names.

If we take the median company listed in the All Country Index, which although it is somewhat skewed to larges names and developed markets also comprises emerging and smaller companies, it appreciated 8,88%, slightly below this house's performance this past year. And since only around 25% of our investment are US based, the All Country Index is a much better (although still imperfect) benchmark for our fund than the S&P 500.

All of this is not to say that we think our fund had a brilliant performance. Like we mentioned above, we still have a lot of ground to cover until we can once again reach our higher water marks. But it puts our performance in perspective in an unbiased way.

2023 Performance in USD	
S&P 500	24,2%
All Country Index	20,1%
S&P 500 - equal weighted	11,6%
All Country Index - equal weighted	8,9%
MSCI Emerging Markets Index	7,0%
Golden Dragon Index	-3,4%
FCL Opportunities	9,0%

Finally, the year ahead seems a promising one for risk assets. At last the battle in the US and other developed markets to anchor inflation seems to be almost won, with 3 month and 6 month US core CPI already very close to the FED's 2% annualized target.

If things keep progressing the way they currently are, we should see some gradual loosening of monetary policy in the US over the course of 2024 and this is a scenario which historically leads to overperformance of emerging markets, small cap companies and niche/exoteric assets like the ones this house specializes in.

To our investors who believe in our mission and are with us in this journey through the ups and downs with your unwavering support, our very grateful thank you and we wish you a very happy year.

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A Celebration of Charlie Munger

Finally, a word of celebration to one of our greatest inspirations. Charlie Munger had many fascinating facets in his long life, from being a distinguished Harvard educated lawyer to becoming the “sidekick” half of the world’s greatest investment partnership and a permanent source of inspiration and knowledge.

This house has since its first days discussed internally and externally his many contributions to the activity of investing and how we could use his insights and apply them to our job of investing our client’s capital in the best possible way¹⁵. We will certainly miss him.

¹⁵ The book “From Darwin to Munger” by Pete Belevin and Munger’s 1995 speech at Harvard “The Psychology of Human Misjudgment” (<https://fs.blog/great-talks/psychology-human-misjudgment/>) are both obligatory material for our analysts.