FCL *Capital*

1st Quarter 2024

Matt and the global investment scenario

In world affairs, the headlines have not been favorable for the optimists and globalists lately. In global investments, any investor who sticked to the obvious large capitalization names, especially in the US, did relatively well while the less explored corners of the market and smaller capitalization companies that this house specializes in, suffered.

With all the noise about geopolitical blocs, a fragmented internet, the questioning of global diversification and the fracturing of globalization, this house thought that revisiting another era might be helpful.

Back in 2005 broadband internet was still becoming popular around the world, showing to millions of people for the first time the incredible possibilities of social networking and video.

In February of that same year, YouTube was born, crafted by three former PayPal employees[1].

Back then, nobody was talking about banning Chinese social apps in the US, or there was any talk about "friendshoring." On the contrary, countries were all envisioning a future that was bright, open, and totally interconnected. The belief was all about picturing a connected global community where the coolest ideas could flourish.

When YouTube was founded, one of its earliest viral videos was uploaded by a Seattle native named Matt Harding. After coming into possession of a considerable sum of money—whether inherited or earned through hard work, depending on the version of the story— he spent the better part of two years (2003 and 2004) travelling around the world.

For some reason, Matt would record himself in different world locations and, as to have a trademark move, he would in every circumstance do a silly and goofy dance move zig with his arms.

The video of him dancing alone and badly in countless locations and showing the possibilities of global travel and openness in that hopeful era was then edited and played alongside Deep Forest´s Sweet Lullaby, a major hit by a French world music band that was originally recorded in the 90s.

The song itself became associated with world travel and started to be played in countless graduation ceremonies around the world. It used a sample of a traditional folk song from the Salomon Islands that was sung many years before by a local Salomon Islands singer called Afunakwa.

The video may appear technically simple by today's standards, especially as we've become accustomed to super-fast internet connections. However, at the time, it was considered a technical marvel, showcasing the newfound possibilities introduced by video on the internet.

In 2007, Jawed Karim, one of the founders of YouTube, even stated that Harding's video was his favorite on YouTube at that time.

[1] Like many amazing Sillicon Valley creations, the "Paypal Mafia" a group of more than a dozen former Paypal executives that went on to fund an unbelievable quantity of world changing companies is to this day one of the most palpable demonstrations of the power of networking. Among former Paypal executives in a non-exhaustive order that found incredible success later on are: Peter Thiel, Elon Musk, Red Hoffman and Max Levichin, who created companies like Tesla, Space X, Palantir, Youtube, Yelp, Linkedin and more.

By 2008, Matt from "Where the Hell is Matt" had become a global sensation, a long time before today's TikTok and Instagram influencers. However, unlike many of today's internet celebrities, Matt appeared to have a strong sense of responsibility and ethical obligations.

In his travelling blog at the time, he even detailed his stop at the Salomon Islands, where he looked for Affunakwa and discovered she had passed away a decade before, possibly even unaware that his voice was used by a western band in a major global hit. Touched by this revelation, he decided to cover a year of her grandson's school tuition, which in total, according to him, cost less than his annual cable bill[2].

In 2008, he released another video using a song called "Praan," custom-made for him, which talks about "the stream of life that unites us all." Notable highlights of this video included scenes of Matt at the Korea demilitarized zone and even in North Korea itself, a feat that amazed many observers. However, Matt revealed that achieving this wasn't as challenging as it seemed; he simply traveled to China and joined a group tour from there.

Yet, despite Matt never explicitly stating the purpose behind his videos or how they should be interpreted, many got the sense he was trying to send a message. Interestingly, in each location, he avoided saying anything or presenting a grand motive for his travels. Instead, all he did was turn on the camera and break into his silly dance, leaving viewers to ponder the meaning for themselves.

[2] https://youtu.be/BiHTh6NnoWo?si=OQU05CiRf2ETz_M0

His 2012 video is certainly our favorite. It features an original song called "Trip the light" that states:

Remember we're lost together
Remember we're the same
We hold the burning rhythm in our hearts
We hold the flame
We're gonna trip the light
We're gonna break the night
And we'll see with new eyes
When we trip the light

The references to travel and its transformative effect on broadening one's perspective are clear to this house.

What's more, it might be his most politically inclined video, though in a very subtle way. Unlike his usual goofy dance, Matt jumps into different dance traditions worldwide, highlighting diverse cultures. The video features a dance school for disabled students in California and one in Syria, where dancers' faces are blurred, probably to respect their privacy in a conservative society.

Among the locations, Matt dances in both Israel and Palestine and, in North Korea, instead of showing the usual gulag-like scenes the country is famous for, Matt takes "the radical and scary step of showing North Koreans smiling at his silly dance, behaving as fellow humans"[3].

During the greyest days of the pandemic when the planet went from dancing in an open world to being trapped in a closed one this video repeatedly made this fund manager weep.

[3] https://ethanzuckerman.com/2012/06/20/when-the-world-is-your-dance-teacher/

Let’s now leave Matt and his dances behind and focus on the present.

Unlike during the promising days of 2005, the planet no longer believes in an open world, whether politically, culturally, or crucially for the theme of this letter, when it comes to financial investments.

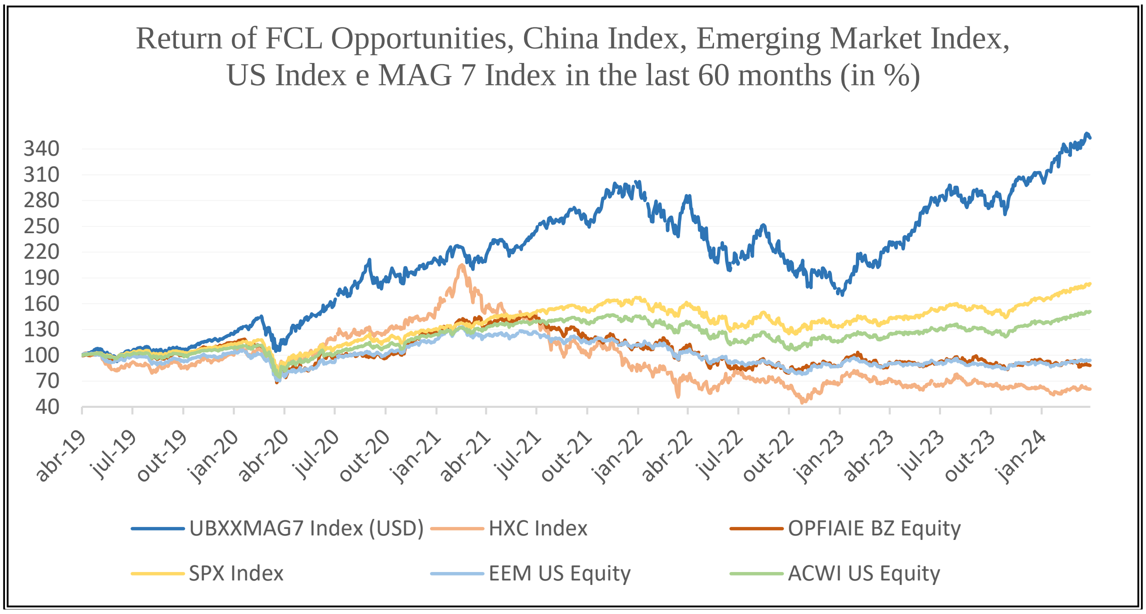
On the internet, different governments and investors discuss “walled gardens” and there is chatter of restricting investments and even banning apps in different countries[4].

The world's two biggest economies, China and the US (or vice versa, depending on the metric), are clearly trying to take steps to reduce risk from each other.

How should global investors like this house respond to this complicated scenario?

And to put it in even starker terms: as our investors know, our open framework, where we look for opportunities across the globe simply didn’t work in the past three years. Cycles and fashions come and go in finance, but in Brazil the Ibovespa and the local companies simply were left in the dust by the CDI. Even worse, when we take a global perspective, the one thing that really worked was being positioned in large cap US stocks, or at least in the American stock indexes. And that was the one big exposure our fund didn’t have in large scale[5].

[4] https://en.wikipedia.org/wiki/Restrictions_on_TikTok_in_the_United_States
[5] Although our investments in technology and communications in the US now represent about 22% of our fund, more than in this period, they are still below global benchmarks.



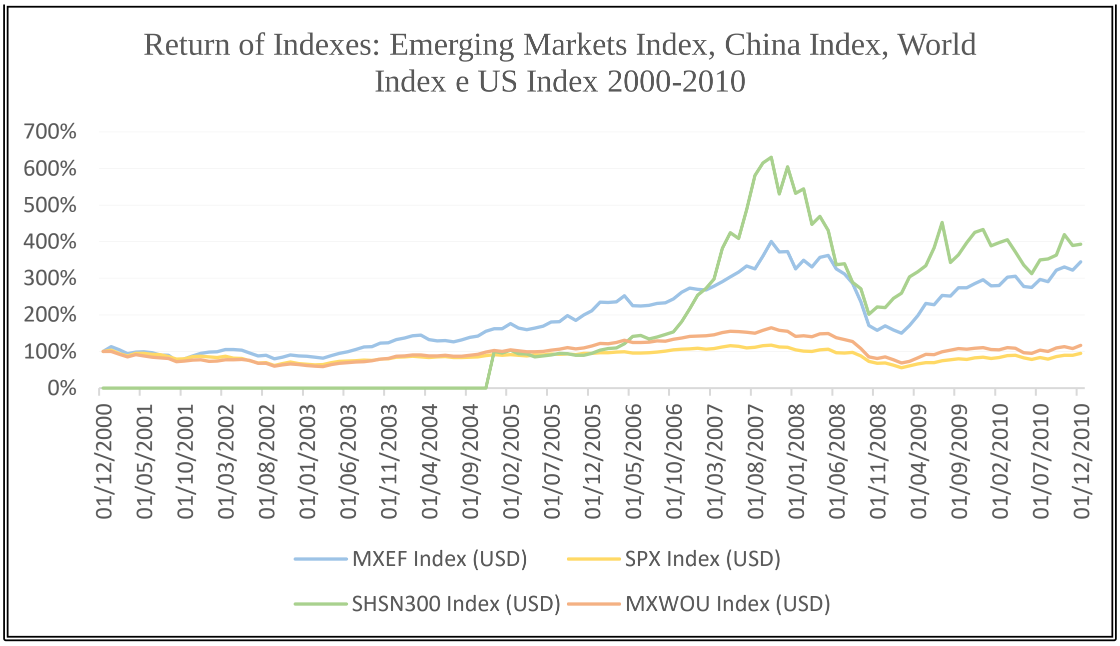
A fund like ours that spreads its bets across geographies and sectors in search for asymmetric and uncorrelated ideas went nowhere: our shares are roughly flat in the past three years (although our longer-term investors have doubled their money in the three years before).

So, is a globally diversified portfolio still useful? Or just like "Where the Hell is Matt" videos it had its time, but it is now unnecessary in a world of US stocks dominance and high yields?

Among the many physiological biases that humans have, recency and availability are some of the most interesting. They remind us that we have this tendency of giving more value to the recent past, to whatever information comes to us, instead of looking at the statistics. We fail to separate ourselves from the cold numbers.

Recency bias makes us more afraid to board planes when a recent plane crashed occurred somewhere in the world. It makes us more prone to invest in whatever stock or Index has gone up recently and avoid the ones that came down when we should logically do the opposite.

Let's look at the 21st century in stock markets so far:



If you started investing in 2012 or later then yes, diversification set you back. Why being adventurous? Why researching about the world? Large caps outperformed small caps and US stocks, especially large US tech companies, did all the job globally and any diversification only hurt your returns.

But the tricky thing is, when it comes to finance, the past is no guarantee for the future. If we take the 2000-2012 period or even the whole 2000-2024 timeframe then the benefits of diversification, once again, become clear.

As Clifford Asnes, one of the most astute investors on wall street, recently said:

"The problem is you have no other choice; no one knows the future. So, you allocate what you think is the right amount of risk to things, because the secret is the whole stock market is just as susceptible. Maybe the most interesting example is US versus non-US developed markets. Famously, the US has crushed everyone [in the past 15 years]. During the 15 years prior to that it was: why invest in the US?
It tells you something that the stories can change so much. The US was cheaper than the world in 1990. Now the US is far more expensive than the world. Almost all the US's victory was from getting more expensive. You can argue if it's justified, but you tend not to get a repeat — another 30-year relative tripling of the valuation ratio. I tell any US investor with some international diversification: you're doing the right thing. It's just the timescales these things work on"[6].

So, if we think a global and diversified portfolio like our Oportunities fund tries to create is still the way to go, let us address frontally the other main reason our portfolio has underperformed in the past three years: China.

As we shown in our FCL Day last year[7] this house's stock selection worked very well: our positions outperformed their respective benchmarks in the US, Brazil and especially China. In fact, most of the positive return our fund had since inception comes from this country (China) where we judge to have a special edge against competition.

[6] https://www.ft.com/content/50188553-1aa2-4704-ad9e-ef1e5cf0389e
[7] https://youtu.be/kMkl6TfaKt4https://youtu.be/7WmMcqp670s?si=uSTjcYax4w_D1NNQ

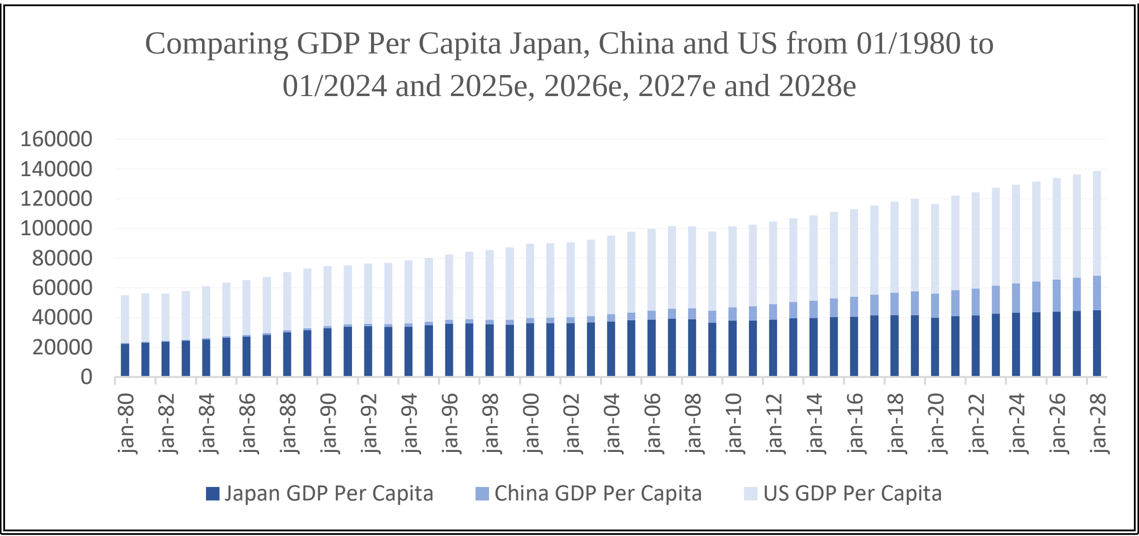
It was not stock picking, but asset allocation that harmed us: our fund was 30% weighted in China, and the Kweb index that tracks Chinese internet companies listed in the US, fell some 70% from its highs in that period. This horrible result nullified our best performers elsewhere, like Uber.

So, is investing in China a good idea at all?

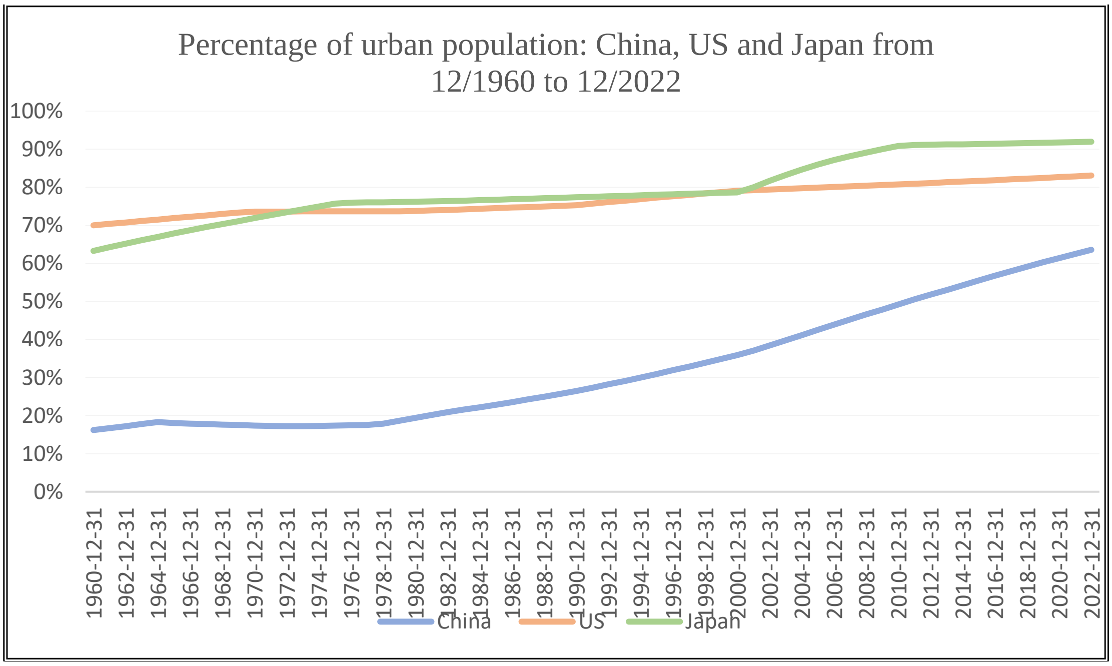
A fashionable comparison, when not even declaring China as "investible'' that has surfaced recently is comparing China to Japan.

Both have declining populations, they are ''demographic time bombs'' and therefore don't offer growth prospects.

First, let's look at Japanese, US and Chinese levels of GDP per capita.



Now, let´s compare the three countries urbanization ratio.



One crucial point that global commentators keep forgetting: it's not the total population of a country that matters or even the total work age population. Every single year, China's urbanization ratio (meaning, the ratio of Chinese people that live in cities as opposed to in rural farms) increases by roughly a point. Mathematically speaking, this means that every single month around one million people in China move from farms and rural areas to cities. There's a lot to talk about this, such as the fact that the process would be smoother with Houku reforms, problems Chinese migrants face and a lot more.

But the basic essential fact is that it is not the total population or even working age population that matters. What matters is urban population because an urban worker that is part of the global economy is several times more productive than a rural farmer that basically does subsistence farming.

Indeed, China's population is projected to decline in the coming decades. However, it's the urban population that holds significance, as it represents the number of workers integrated into the global economy, possessing greater purchasing power, and more. This urban population is expected to grow with the current urbanization rate of approximately 62% (around 800 million people) to potentially 1.2 billion people by 2050, constituting around 90% of its total population. This increase is far greater than that of the US or Japan.

What about GDP per capita? Let's remember, mathematically speaking, if China ever gets to the GDP per capita levels of Portugal, its economy will be almost twice as big as the American one. This happens due to the simple fact that its population is four times larger.

When it comes to purchase power parity, which is the best way to compare different economies, China's economy is already some 25% larger than the American and European ones. Will China continue to converge to US levels of GDP per capita?

In every simple metric, it seems very hard for this house to believe it will not. China (including Hong Kong) is home to 53 of the world's 100 tallest buildings. It produces a lot more science graduates than any other country, it is filling more patents and investing more in cutting edge R&D, it has the world's fastest supercomputer and dominates some key 21st century industries, like electric cars, renewable energy and more.
When Elon Musk was first asked about BYD in 2011, a company this house has a stake in, he basically laughed the reporter out of the room, mentioning the terrible quality of Chinese cars. Now he is publicly crying out for trade barriers because according to him, the rest of the world otherwise won't be able to compete[8].

Let's forget about stock indexes for a moment. Is this a country we would bet it will not achieve Portuguese levels of GDP per capita?

But there's an additional and more overlooked way of why we must diversify. Because the world is unpredictable and we should lift every stone possible to avoid competition and find the best ideas whereas they might be.

How to outperform?

The blogger Ben Carlson in a recent post raised an interesting story about the fishing industry in the past 25 years in the Indian state of Kerala.

[8] https://www.businessinsider.com/elon-musk-tesla-warns-chinese-ev-firms-could-demolish-rivals-2024-1#:~:text=%22The%20Chinese%20car%20companies%20are,the%20world%2C%22%20he%20added.

Back in 1997, when almost no one had interconnected cellphones, there was a wide price dispersion among different villages in Kerala. Traders had to rely on world of mouth for information, leading to several crashes, panics and euphories[9]. Some could make a fortune while some could lose everything. Sometimes fish would spoil, sometimes they were selling for small fortunes because the market didn't have proper information to function.

A generation later, with the advent of widespread of global connectivity, as one would imagine, the fish market in Kerala is a lot more efficient, with a lot less dispersion of prices from village to village. Consumers are faring better and the market as a whole, inclusive its fishermen is faring better.

But of course, it is harder for any fish trader, someone well connected with an information advantage to stand out since now everyone has access to real time information.

The same is true for the stock market. As a whole, we never had it better. With our Bloomberg Terminals, iPad subscriptions and more, a trader in poor parts of Africa, at least in theory, has almost the same information as someone in London or New York. But at the same time, the market is more efficient, and it is harder to outperform, as the relentless rise of passive investing attests.

This is also true without mentioning that the more people there are in a competition, whether it's tennis tournaments or stock trading, the more competitive and fairer the playing field becomes. Clearly, and fortunately, we've never seen so many stock traders from all corners of the globe, equipped with fast internet connections and access to flawless information all trying to outcompete each other.

So, should we all buy indexes and head to the beach?

Well, this house thinks being passive is a smart thing to do. But it is not the whole story. There are still corners of the market, niches and areas where competition is not yet as ferocious. Some areas still resemble Kerala in 1997 instead of Kerala in 2024, if only investors could be a little more like Matt, a little less afraid, a little more daring and curious, to look beyond the obvious, to unturn every stone, to celebrate the things and places they are not used to.

Yes, Meta, NVidia and Amazon are incredible companies. But they are certainly not inefficiently priced or overlooked.

If there is a blue ocean nowadays, where competition is a lot less fierce, this house thinks it can be found in one of these places: China and emerging markets in general, in value companies far away from the AI hype and finally in smaller companies in general that haven´t traded this cheaply compared to larger peers in many decades.

Our focus on all these areas has cost us a lot in the past three years and we can't guarantee when cycles turn in finance. But our investors should know our fiduciary duty wouldn't allow us to buy hot stocks we think that are trading above their fair value.

In other words, the solution in times of very efficient competition is not trying to be the best but trying to be the only one.

We are more frustrated than anyone else by the mediocre returns our fund has shown in the past three years, with our shares roughly flat. This happened because of the emphasis our fund has in the factors cited above.

[9] https://awealthofcommonsense.com/2023/09/how-to-outperform/

Attribution Table	Performance (in USD)
Brazil	-31,20%
China	18,86%
US	20,35%

From 04/2019 - 03/2024

If there is a silver lining, we couldn't be more excited about our current portfolio of investment ideas. As David Einhorn, a famous value investor said in a recent podcast: "although there is a lot of talk of a very expensive market (in the US) for our niche and the ideas we specialize in, companies are very, very cheap"[10].

Clusters

One last argument for global investment diversification rather than focusing solely on a single country, whether it's the US, Brazil, or elsewhere, lies in the strength of economic clusters.

Clustering is a theme this house frequently revisits and with good reason: it intersects with what we call macrotrends and the framework we use for our investment ideas.

Since a 15th-century observer once realized that the best and biggest marble companies were located in Firenzi, he famously asked "Why not setting a marble company somewhere else away from the competition?"

It might sound counterintuitive but the clustering economy, as Harvard Business School calls it, has flourished since those days. Competition tends to create a strange kind of synergy where different places tend to create stronger companies in different industries (according to the theory of comparative advantage) and then those companies, contrary to what might seem logical, tend to cluster in the same cities, usually being located very close to their rivals.

There are countless obvious examples, such as the fact that Puma and Adidas originate from the same small German town, the fact that New York city and London tend to originate most global financial companies and banks, and the same can be said for chemicals in Germany, the luxury industry in France and Italy (a frequent theme of our letters and part of our thesis in Moncler), while the same phenomenon happens for microchip and hardware companies in Taiwan, the manufacturing industry in China, agribusiness in Brazil and countless other examples.

[10] https://www.youtube.com/watch?v=QuGQ0LDWUt8

In global stock investing, clusters are a helpful map that guides astute investors find promising companies and ideas. A company like Suzano couldn't have emerged anywhere except for Brazil, a land where one pulp tree takes only 6 years to grow to full size instead of the usual 30 years in Scandinavia. A company like Moncler couldn't have emerged anywhere except Europe, with its history, brand image and tradition or skilled artisans. A company like Google couldn't have emerged anywhere except Silicon Valley, with its ecosystem of venture capitalists, tech entrepreneurs, universities, engineers and so forth.

So, in conclusion, this house still believes that, just like Matt, investors shouldn't be lazy couch potatoes, they should go out and see the world a bit. This will help them diversify the risk factors in their stock investments, it will help them achieve alpha with uncorrelated ideas and even increase the quality of their portfolios with the power of different clusters. Above all, this will help them find less efficient niches in today's highly competitive global stock markets.

PDD Holdings

On March 20th 2024, our team was focused on a result that would be released in China during the middle of the night for the western hemisphere.

Pinduoduo, one of this houses' biggest positions, was poised to release its crucial fourth quarter 2023 financial results.

Naturally, we stayed awake into the wee hours to analyze and process the company´s results as it is our job, and we normally do it in these important financial releases from our portfolio companies scattered around the globe[11].

The results were, by any metric, completely astonishing.

To be certain, the market was expecting strong numbers from Pinduoduo, especially because of its western offshoot, Temu, which is currently the most downloaded e-commerce app in the US. Some analysts were talking of revenues growing between 30% and 50% against 4Q2022 numbers. Also, some of the more optimist followers predicted profits of around 15 billion yuan for the quarter, representing growth of more than 50% compared to the prior year.

As soon as the numbers were released, we had to double check to believe our eyes: Pinduoduo reported sales of 89 billion renminbi, a full 123% above the (very strong) prior year quarter. Its profits more than doubled, to 23 billion renminbi. What's even more remarkable is that despite the incredible growth of Temu, which some analysts believe still incurs losses of around $30 per order in the US, the company's margins actually increased.

[11] Certainly an additional burden for global portfolio managers compared to single-country investors, but one that we accept with grace.

In Millions of CNY 12 Months Ending	FY 2023 12/31/2023	FY 2022 12/31/2022
Market Capitalization	**1.380.400,0**	**742.374,4**
- Cash & Equivalents	217.209,8	149.438,7
+ Preferred & Other	0,0	0,0
+ Total Debt	10.165,9	16.934,3
Enterprise Value	**1.173.300,0**	**609.869,9**
Revenue, Adj	**247.639,2**	**130.557,6**
Gross Profit, Adj	**155.915,6**	**99.095,3**
EBITDA, Adj	**—**	**33.194,3**
Net Income, Adj	**60.776,5**	**31.767,7**
EPS, Adj	**41,66**	**22,08**
Cash from Operations	**94.162,5**	**48.507,9**
Capital Expenditures	**—**	**-635,7**
Free Cash Flow	**—**	**47.872,1**

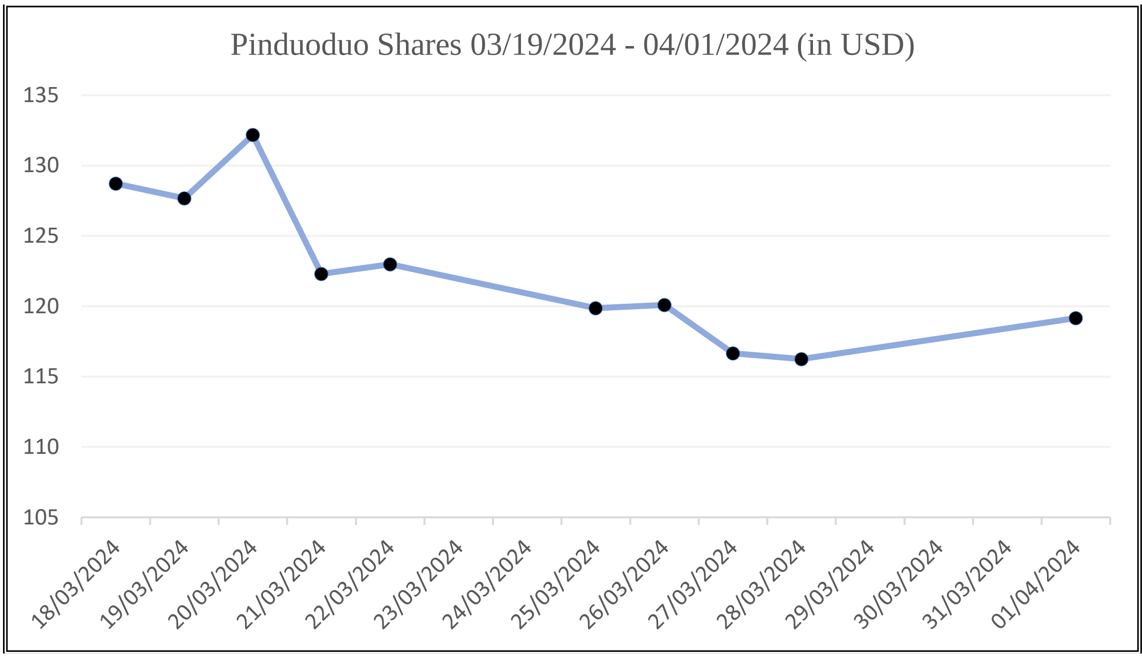
Since the beginning of our Opportunities fund back in 2017, this could be the most incredible result beat by one of our portfolio companies ever reported.

Since the company is listed in the New York Stock Exchange, we confidently waited the market opening and, just as this house expected, in a few minutes the stock was already up 17%.

But then something incredible started to happen. Without any news and even during an unremarkable conference call, the stock started to lose its momentum. In the afternoon it was already clear that despite the impressive result, the stock would finish the day without most of the morning's gains.

All in all, Pinduoduo finished March 20th only 3.50% higher despite the fantastic results.

But that was only the beginning: the following day, Pinduoduo fell 7.47%, again without any news. It is now trading some 10% lower than before the release of its remarkable fourth-quarter results.



What is happening?

To answer the question, we first need to dig deeper into the fascinating Pinduoduo story, one of our FCL Opportunities largest positions for the past couple of years.

Pinduoduo was founded in 2015 in the Chinese province of Shanghai by a man named Collin Huang, a former Google engineer.

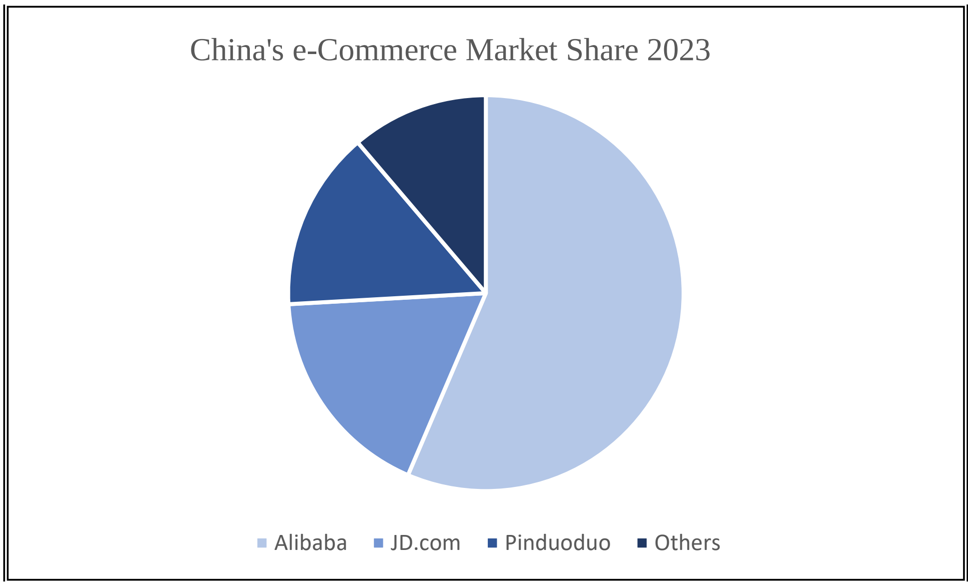
Huang, and by extension, Temu, certainly have always been secretive. The company pioneered a new model of e-commerce, that it decided to call "social commerce".

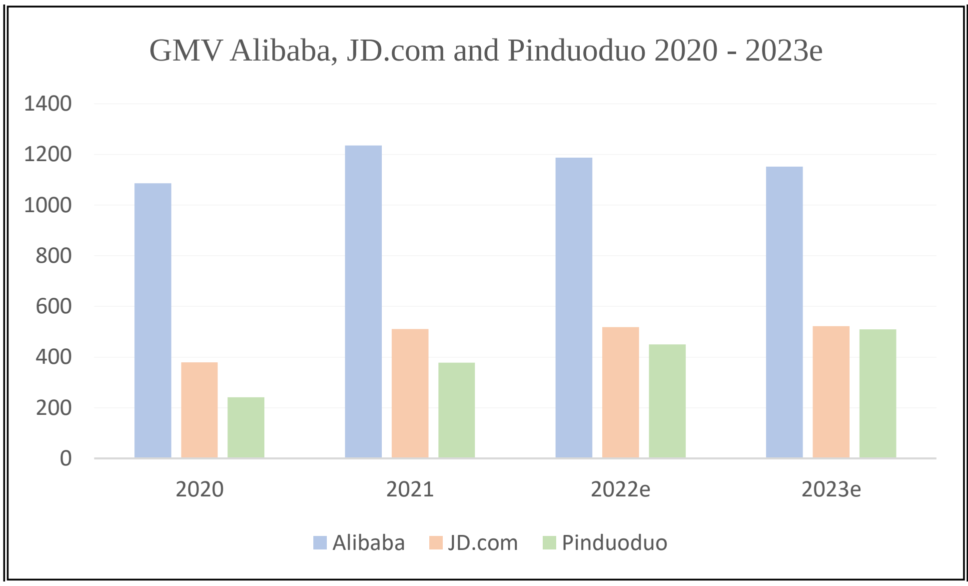
Basically, it tried to bring together elements of entertainment and social networking to e-commerce. It made it possible for friends to connect and interact while shopping, and friends could invite friends to buy agricultural products together. The transaction would only proceed if a predetermined number of friends agreed to buy together, resulting in cost savings for both producers, who could sell in bulk, and consumers.

In short, it brought e-commerce to the era of interactivity and social networking and combined to e-commerce[12].

Since its founding, while the model encountered many sceptics, including its Chinese rivals that bet the model would find its limit, the fact is that gradually, Pinduoduo grabbed market share from its Chinese rivals.

[12] https://www.youtube.com/watch?v=F24Qd_sCMEk





Needless to say, many people tried to bring the model to western audiences and replicate it, but the huge cultural differences made this a hard task.

Taking the crown of Chinese e-commerce, the world's largest market, from Alibaba and Jack Ma would be an amazing feat by itself.

In fact, after disappointing results and a lagging share price at least in part due to the severe new challenge brought by Pinduoduo, Jack Ma himself, after practically disappearing from public view in recent years made a rare reappearance and sent an internal memo to Alibaba top employees, recognizing the challenge ahead, calling its troops for battle and praising Pinduoduo´ direction and leadership[13]. But that was only the beginning of the story.

[13] https://www.businessinsider.com/jack-ma-criticize-alibaba-performance-rare-message-congratulated-pinduoduo-2023-11

In an even more ambitious move, Pinduoduo launched an app called Temu, trying to replicate a few of its elements but tailoring them to western audiences. Temu was born with a drastically audacious idea: to challenge Amazon and western local online retailers by offering dirt cheap prices by selling goods straight from factory producers in China and shipping them to US and western audiences.

Imbedded in it there is a bet that the western public would be willing to accept slower delivery times (since the goods take a couple of weeks to be shipped from China) in return from unbelievable cheap prices)

During the Superbowl in 2023 Temu, presented itself to the world in a new advertising campaign entitled ‘’Shop Like a billionaire’’.

The results surpassed anyone´s expectations: since its launching in late 2022(around the time of this house´s investment in Pinduoduo), Temu has basically been almost nonstop the most downloaded app in virtually every major global market it was launched, including the USA, the UK, Australia, Germany, Canada and more.

To its sceptics, the whole thing is unsustainable since Temu is being subsidized by its parent company in China and according to some estimates, loses $30 on average in every order it sent the to the US. On the other hand, according to the bulls, the same model originated in the parent company Pinduoduo in China and after a few years it reached critical mass and it is widely profitable now.

In Millions of CNY 12 Months Ending	FY 2023 12/31/2023	FY 2022 12/31/2022	FY 2021 12/31/2021	FY 2020 12/31/2020	FY 2019 12/31/2019	FY 2018 12/31/2018	FY 2017 12/31/2017
Market Capitalization	**1.380.400,0**	**742.374,4**	**468.531,5**	**1.436.500,0**	**306.153,0**	**171.937,8**	**—**
- Cash & Equivalents	217.209,8	149.438,7	92.943,3	86.972,3	41.057,0	21.791,0	3.108,2
+ Preferred & Other	0,0	0,0	0,0	0,0	0,0	0,0	2.196,9
+ Total Debt	10.165,9	16.934,3	12.760,3	16.967,1	6.649,8	0,0	0,0
Enterprise Value	**1.173.300,0**	**609.869,9**	**388.348,5**	**1.366.500,0**	**271.745,8**	**150.146,8**	**—**
Revenue, Adj	**247.639,2**	**130.557,6**	**93.949,9**	**59.491,9**	**30.141,9**	**13.120,0**	**1.744,1**
Gross Profit, Adj	**155.915,6**	**99.095,3**	**62.231,8**	**40.213,2**	**23.803,1**	**10.214,7**	**1.021,2**
EBITDA, Adj	**—**	**33.194,3**	**8.777,3**	**-8.550,8**	**-7.805,3**	**-10.302,7**	**-583,5**
Net Income, Adj	**60.776,5**	**31.767,7**	**7.832,8**	**-7.179,7**	**-6.967,5**	**-10.297,6**	**-491,2**
EPS, Adj	**41,66**	**22,08**	**5,48**	**-6,04**	**-6,04**	**-13,88**	**-1,11**
Cash from Operations	**94.162,5**	**48.507,9**	**28.783,0**	**28.196,6**	**14.821,0**	**7.767,9**	**9.686,3**
Capital Expenditures	**—**	**-635,7**	**-3.287,2**	**-43,0**	**-27,4**	**-27,3**	**-8,9**
Free Cash Flow	**—**	**47.872,1**	**25.495,8**	**28.153,6**	**14.793,5**	**7.740,6**	**9.677,4**

One huge point of contention: there is probably no other company that is as big and relevant as Pinduoduo (or Temu) that is also so secretive.

Pinduoduo is worth some $ 160 billion dollars, but its financials are really opaque and somewhat of a mystery. This house spent countless hours trying to understand the financials and even after some interactions with management we are still left with a few unanswered questions. Judging by our interactions with fellow Pinduoduo investors and believers we are certainly not alone.

The company functions more like eBay, in the sense that it is at its most basic level a marketplace, than as Amazon with its inventory and heavy structure of warehouses[14].

The number of its employees its likewise small to a company of its size, certainly many times smaller than Alibaba, not to mention Amazon. Its press conferences feel scripted with generic answers.

Pinduoduo also doesn´t disclose its Temu sales, lumping it together in its ‘’transaction services’’ line. The only other line Pinduoduo discloses in its Income Statement is called “marketing services” where merchants bid for their products to appear in searches linked to keywords in the Pinduoduo website.

This secretive temperament came since the early days: in a long investigative report, the Financial Times found out that since before Pinduoduo was incorporated, Coling Huang, its founder, had a diverse array of businesses that basically had the central theme of shipping goods to the US, and most of them would list other people as owners and beneficiaries. This only changed when Pinduoduo grew and the company had to report its finances and shareholding structure in its prospect to list in the New York Stock Exchange[15].

But let´s stick to the undisputed facts: we do know that Pinduoduo changed the e-commerce market in China and turned it to its head. Every independent estimate puts Pinduoduo number of monthly users in the hundreds of millions, and fastly approaching Alibaba´s.

[14] Although there are rumors and reports that this might change in the future.
[15] https://www.ft.com/video/bb65dbf9-cfa7-4723-a412-a88af9285383

It is also undisputed that Temu is shaking the world of e-commerce in the west like no other app has done in the past few years. It is a thorn in the side of dozens of companies from Amazon to Etsy to eBay and analysts frequently mention it during conference calls ("is Temu a threat?").

Its finances might be opaque and the company doesn´t have much concern with western sensitivities when it comes to corporate governance. It doesn´t like to give anything away.

But according to our best assessment its finances are sound and its opportunity to change e-commerce both in China as in the west, is real and unprecedent.

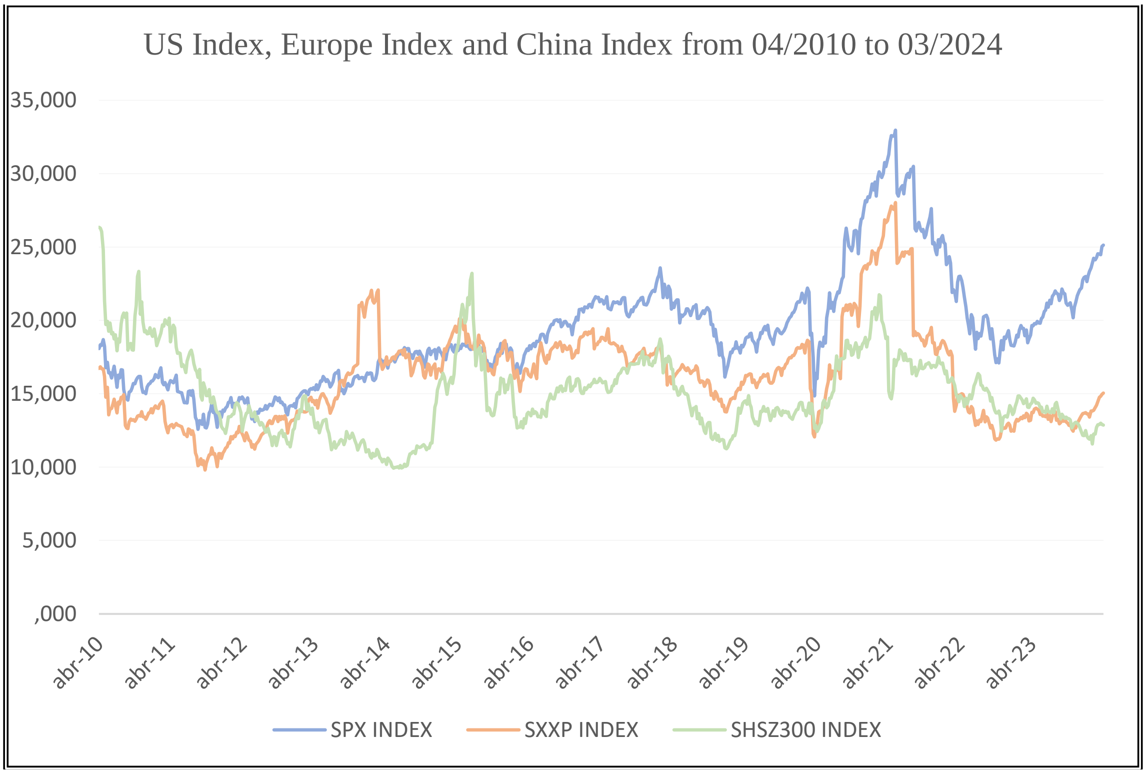
So why the huge discount?

The first hypothesis, as expected since it relates to anything that deals with the US and China nowadays, is related to geopolitics.

Temu benefits from a 1938 ''de minimis'' provision in US law that exempts from taxes any package that is sent to America that is below the $800 dollar value. This way Temu can send its packages from China tax free to the USA.

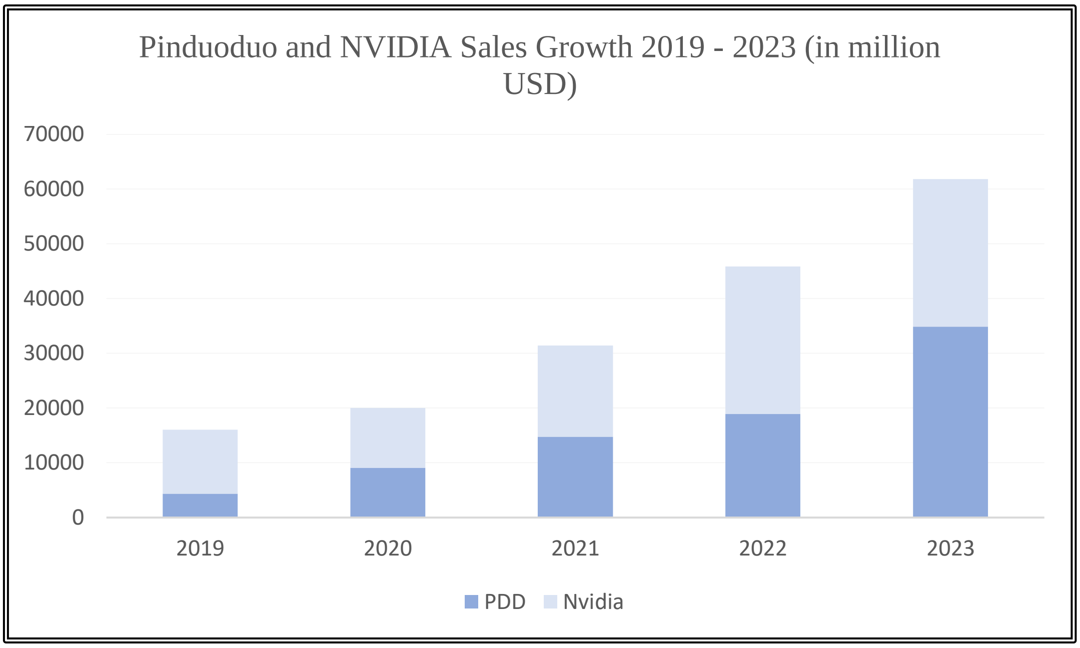
As bashing and trying to look tough on China is now one of the favorite ways for US politicians to promote themselves, some US senators are talking about changing or scrapping the "de minimis"[16] provision.

Add to that, the whole China discount which has never been bigger and might have reached almost insane levels.



[16] https://www.forbes.com/sites/laurendebter/2023/12/27/temus-blazing-run-could-falter-in-2024-with-changes-to-unpopular-tax-break/?sh=1fb8fac2343f

That geopolitical explanation is certainly part of the equation, but it is not the whole story. Pinduoduo numbers are so impressive, the company is growing so much that there might be something specific to it. Indeed, Pinduoduo in the past three years is growing faster than Nvidia!



Even more important, the company realized this threat and swiftly acted on it: the western expansion started in the US, obviously the most important market, but Temu seems eager to diversify. Although it doesn't disclose specific geographic Temu sales (or total Temu sales for that matter) some sources say that from 100%, the US is now around 60% of its (rapidly growing sales) and Pinduoduo has plans for it to comprise less than half of total Temu sales in the near future. So that would mitigate the risk to some extent.

Finally, one interesting and not discussed point that was noticed by this house: Pinduoduo is very interestingly a beneficiary of "China bashing": since Trump imposed its 25% tariffs on most China goods and those were maintained by Biden, every company that imports and sells Chinese goods in the US, including Amazon, has to pay tariffs on these goods. But not Pinduoduo with the "de minimis" exemption. So paradoxically, tariffs might even explain part of its cost advantage against some US rivals.

So, if not for geopolitics why is Pinduoduo so cheap when it is growing so much? That leads us to a second possible explanation: Pinduoduo´s numbers are almost too good to be true.

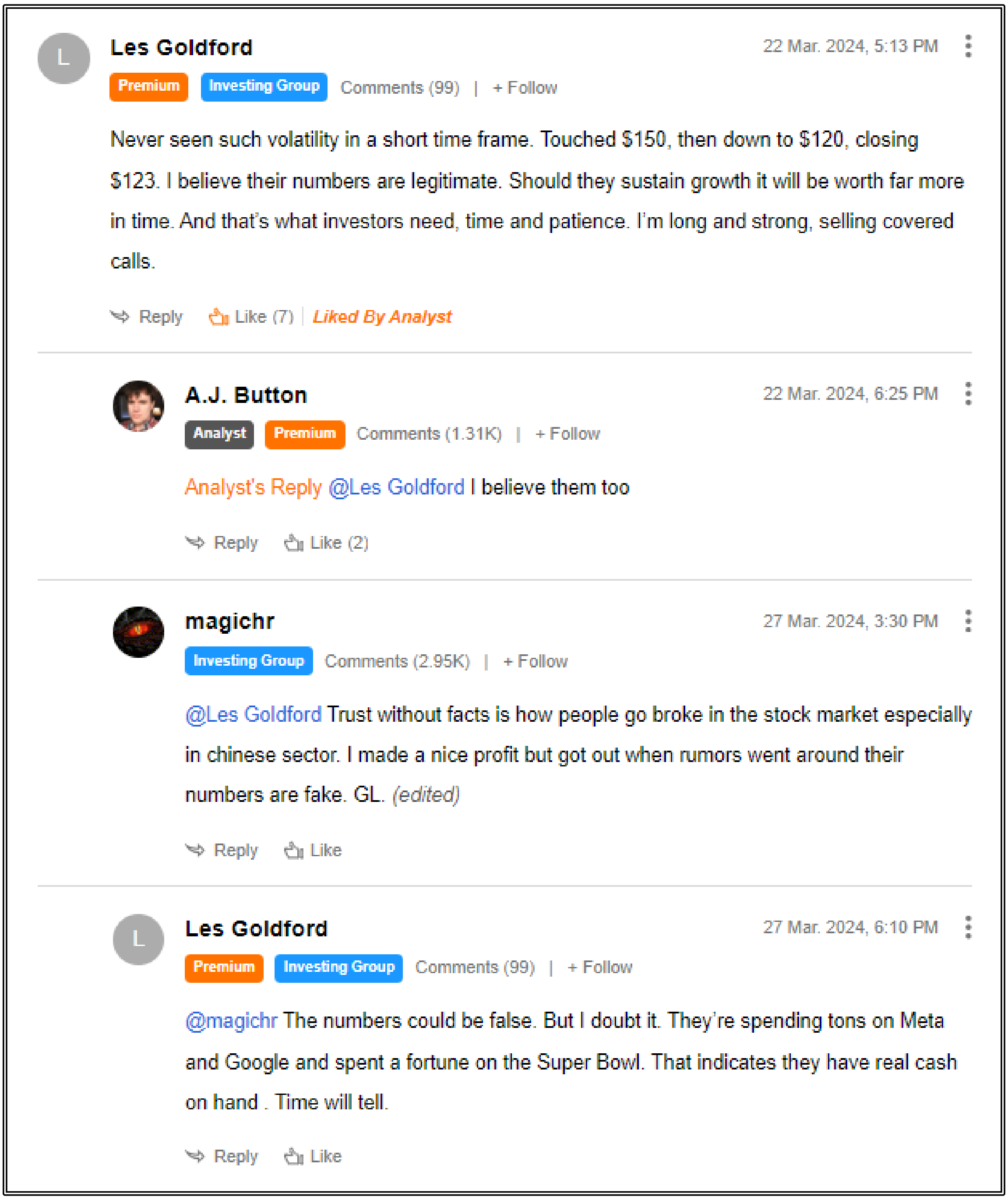
Are they true?

Among the countless hours this house spent on Pinduoduo, its finances, its conference calls, its attempts to reach management, its attempts to contact users and merchants in China, a significant amount was used in a very non-orthodox fashion: in obscure investment forums.

In Seeking Alpha, one of the most prominent communities where individual and professional investors exchange their views, some of them amateurs, some of them pros using pseudonyms, some impossible to identify, opinions about Pinduoduo are discussed with such passion that it might seem people are talking about their favorite sports teams or politicians they despise.

For example, is a recent post made just days after the now infamous 4Q2023 results called ''*PDD Holdings' Post Earnings Plunge: A Buy Opportunity (Rating Upgrade)'' by user A.J Button*[17], the author stresses that since revenues grew 123% and profits grew 146%, ''Pinduoduo bizarre post-earnings reaction is a buying opportunity''.

In the space a few hours, more than forty other forum users chipped in with their opinions, some showing facts and opinions about the uniqueness of this opportunity while some others disparaged insults and expressed doubts about the veracity of the results.



Les Goldford 22 Mar. 2024, 5:13 PM

Premium | Investing Group | Comments (99) | + Follow

Never seen such volatility in a short time frame. Touched $150, then down to $120, closing $123. I believe their numbers are legitimate. Should they sustain growth it will be worth far more in time. And that's what investors need, time and patience. I'm long and strong, selling covered calls.

Reply | Like (7) | *Liked By Analyst*

A.J. Button 22 Mar. 2024, 6:25 PM

Analyst | Premium | Comments (1.31K) | + Follow

Analyst's Reply @Les Goldford I believe them too

Reply | Like (2)

magichr 27 Mar. 2024, 3:30 PM

Investing Group | Comments (2.95K) | + Follow

@Les Goldford Trust without facts is how people go broke in the stock market especially in chinese sector. I made a nice profit but got out when rumors went around their numbers are fake. GL. *(edited)*

Reply | Like

Les Goldford 27 Mar. 2024, 6:10 PM

Premium | Investing Group | Comments (99) | + Follow

@magichr The numbers could be false. But I doubt it. They're spending tons on Meta and Google and spent a fortune on the Super Bowl. That indicates they have real cash on hand . Time will tell.

Reply | Like

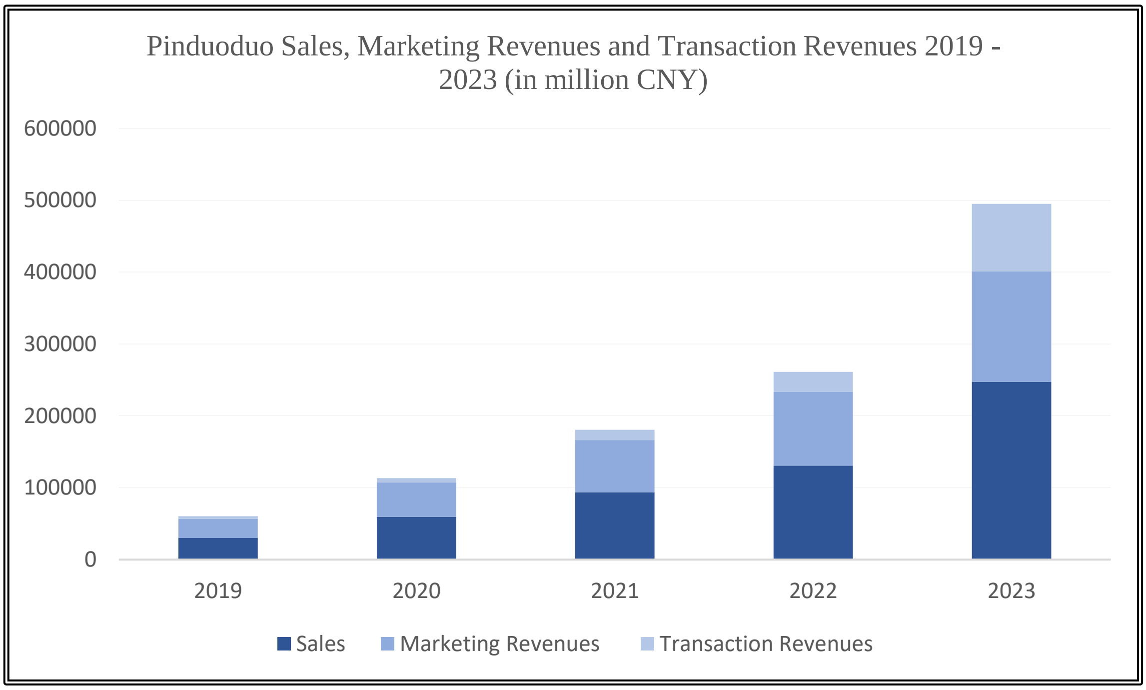
[17] https://seekingalpha.com/article/4679885-pdd-holdings-post-earnings-plunge-a-buy-opportunity-rating-upgrade

So where does this leave us in the debate? There are certainly some accounting yellow flags. To this house in particular the lack of discloses around Temu is particularly annoying. But Coling Huang is a product of its environment. Over the past three years China went through a crackdown on its online entrepreneurs. He, while remaining the largest shareholder and, according to Forbes magazine, being now Chinas richest online titan, is no longer chairman, deciding to relinquish this title possibly to avoid unwanted attention and being replaced by Chen Lei, a trusted insider.

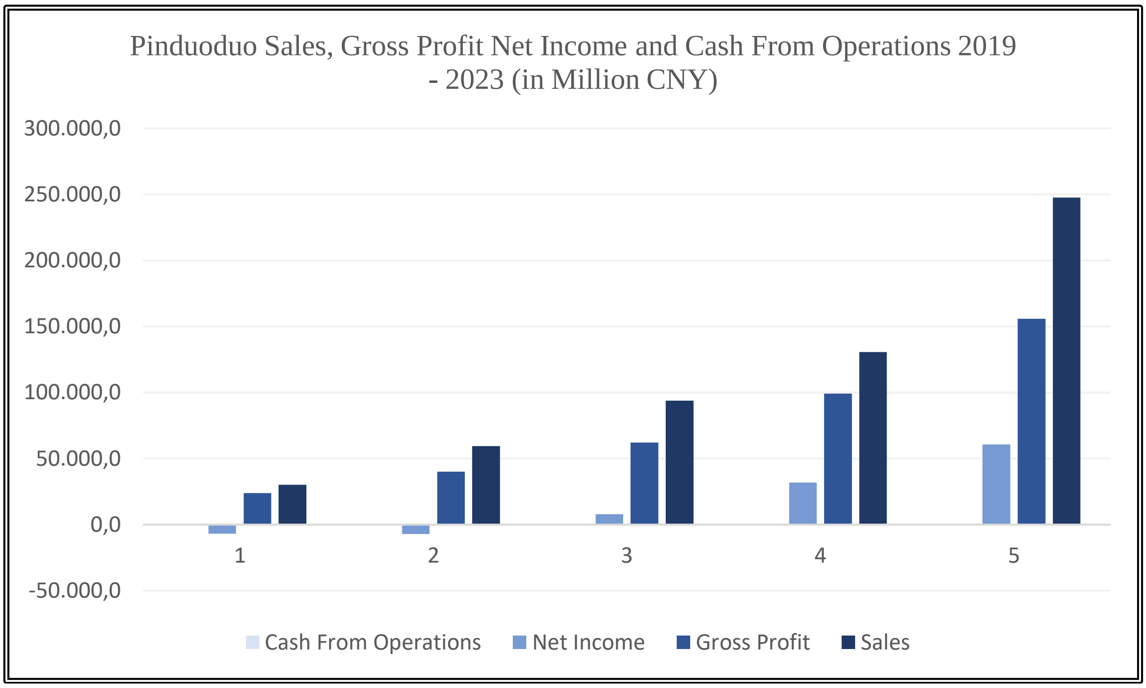
Not only that, but China's online competition is ferocious. While we write this letter, Pinduoduo is once again in financial headlines in the west for being the most aggressive company in China to enforce "non-compete" agreements, sometimes even with mid and lower level managers[18].

All in all, we honestly don´t think we would act too differently. We would try to avoid publicity and scrutiny, especially if we had a trillion-dollar potential opportunity that few people deeply understand in our hands and if we were operating in a country that is suspicious of extravagant wealth.

In fact, in every single call in the past two years, Pinduodo goes out of its way to religiously stress that it is still in "early mode", as if to apologize in advance to any possible complaints and critiques.



[18] https://www.ft.com/content/d40cd7a9-24c7-4bae-91b6-ae74b54e5978



To this house it just seems that the worst-case scenario is already priced in: analysts decided that Pinduoduo´s numbers aren´t true (which they very likely are) Even if there are some cockroaches in the closet, we think there might be upside: the company is growing too much and too profitably to allow for downside at current stock prices in almost no scenario.

Pinduoduo is indeed a complicated company to research and analyze, probably exactly like this house likes it. What is unique is that it is so complicated while at the same time being so big, so consequential, and indeed so fascinating.

Performance

FCL Opportunities	
Returns	%
Year To Date (BRL)	-4,66%
Year To Date (USD)	-7,54%
12 Months (BRL)	-5,30%
12 Months (USD)	-4,21%
Since Inception (BRL)	91,72%
Since Inception (USD)	15,83%
Annualized Rate of return (BRL)	8,67%
Annualized Rate of return (USD)	2,07%

FCL Opportunities		
Top 5 Concentration	% AUM	Country
Uber	15,91%	US
Pinduoduo	13,21%	China
Anta	12,28%	China
Moncler	10,02%	Europe
BYD	6,64%	China

FCL Opportunities	
Geographic Distribution	% AUM
China	32,13%
US	21,79%
Europe	14,42%
Brazil	12,40%
Others	9,08%

FCL Opportunities	
Exchange Exposure	% AUM
USD	52,03%
HKD	18,92%
BRL	14,62%
EUR	14,42%

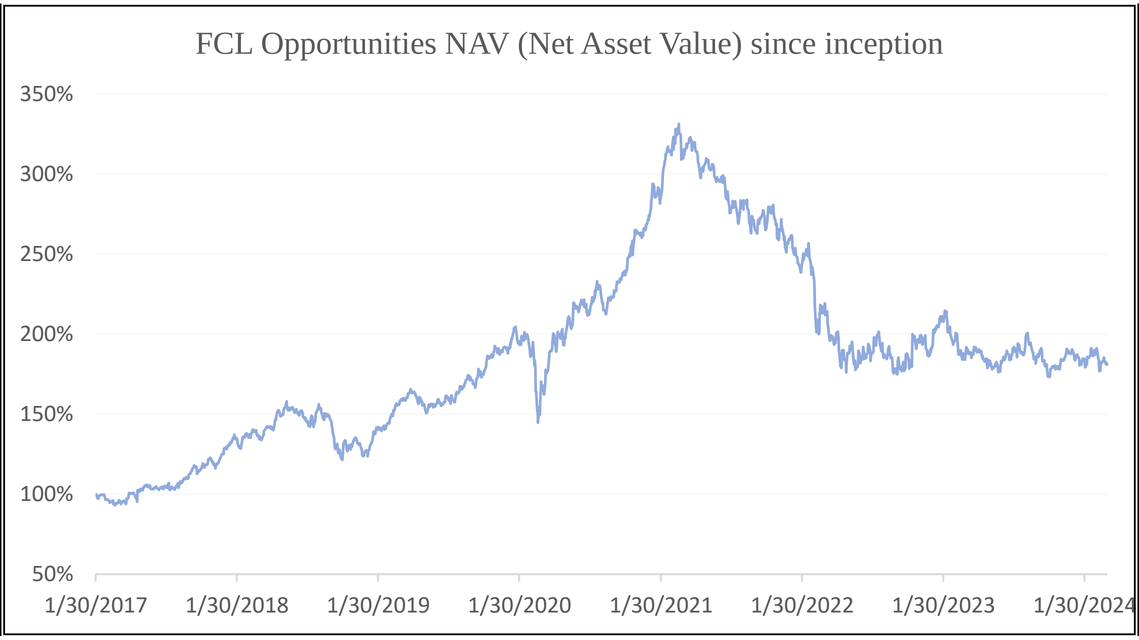
FCL Opportunities	
Sector Distribution	% AUM
Consumer Discretionary	39,91%
Technology	15,91%
Healthcare	11,58%
Financials	9,60%
Industrials	6,64%
Communication Services	5,88%
ETFS:	0,31%

FCL Opportunities	
Portfolio Concentration	% AUM
Top 5	58,06%
Top 10	81,29%
Top 15	89,75%

FCL Opportunities ended the first quarter down 4,66% in Brazilian real and 7,54% in US Dollars. Over the past 12 months, performance has been similar, down 5,3% in Brazilian real and 4,2% in US Dollars.

In truth, FCL Opportunities shares have been fluctuating in a tight range over the past two years, never falling below the 1.75 mark and never reaching higher than 2,15.

In the previous three years however, from 2018 to March 2021, FCL Opportunities shares more than doubled.



We know that the past three years were a challenging journey for our investors, when they saw their shares basically move nowhere. To make matters worse, we know many investors joined our partnership in 2021 when FCL Opportunities shares were at all-time highs and they are still some 20%-30% underwater.

What explains this unsatisfactory performance?

To sum it up, FCL Opportunities maintains a globally diversified portfolio of stocks. While this protects our downside and avoids that we ever face the risk of ruin (especially since we don´t leverage our portfolio[19]) the unfortunate fact is that while our stock picking worked and our portfolio positions outperformed their respective national stock indexes, especially in China, our global allocation framework stopped working: the thing that really carried global stocks higher was the US market and crucially, large cap US stocks represented by the so called ‘’magnificent seven (Meta, Alphabet, Amazon, Apple, Microsoft, Nvidia and Tesla. And we had practically no exposure to these.

To sum it up, FCL Opportunities underperformed because of 3 crucial characteristics:

- It holds a more globally diversified stock portfolio, usually comprising a 20%-30% weight in US stocks against 60% in some global benchmarks and 100% for investors in the S&P500

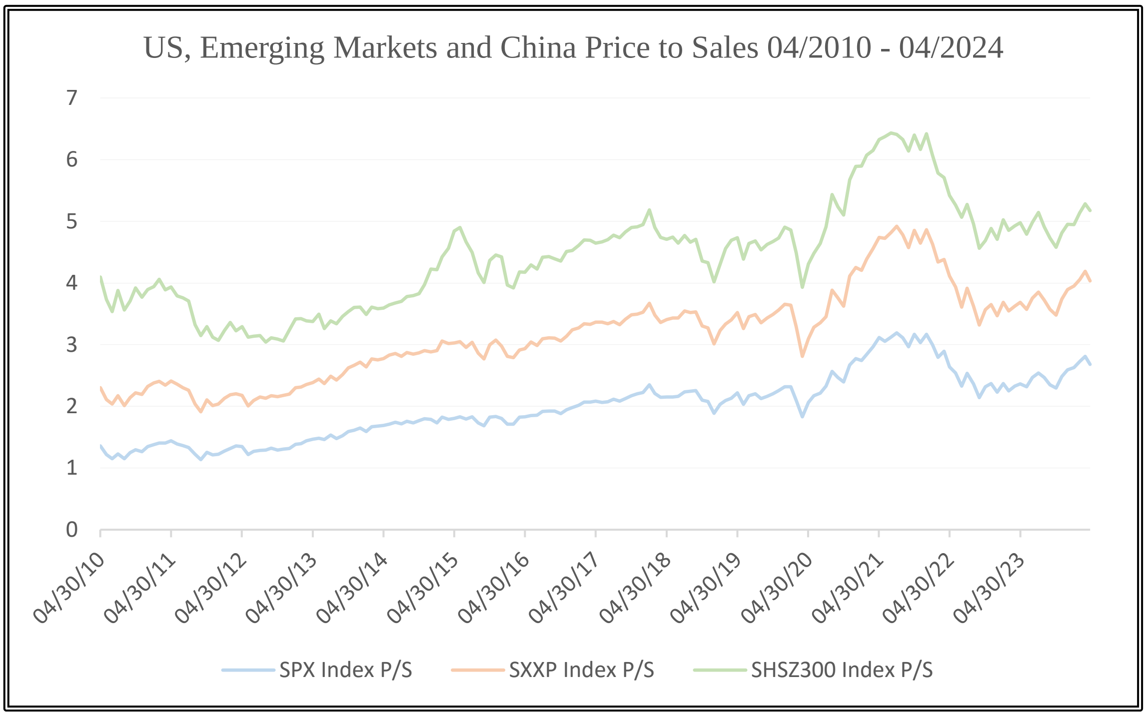
- It is more heavily weighted in emerging markets, around 50%-50%, against some 80% in developed markets (which outperformed) in the All-Country Index

- It puts more emphasis in smaller capitalization companies (which underperformed in the past few years) because we like to search in more inefficient markets.

This house still believes that over the long term this strategy will be vindicated, and our portfolio will show a higher return while incurring significantly less risk than the Nasdaq, the S&P500 or the All-Country Index. But meanwhile, these factors were out of favor in the past three years and the underperformance was certainly painful for us.

[19] Our relative outperformance against US tech stocks in the chaotic year of 2022 was a partial vindication of our style.

Gradually, investors realize that the best days for US large tech companies may be behind, with an increasing number of financial commentators puzzled by the fact that even if we discount by firm size, growth and quality, some European and UK companies appear significantly cheaper than US ones even if in both cases revenues are globally diversified[20]. Certainly, an anomaly that lacks any rational explanation.



[20] A bizarre case might be CRH, an Irish company that always had 75% of its revenues in the US and decided to delist from the Irish Stock Exchange and relist in the US, which instantly gave the company a higher multiple. Neuberger Bergman analyst Steve Eisman, in a recent podcast, called this "sell side analyst arbitrage".

The easiest thing for us would be to completely change strategy, buy Nvidia or whatever worked in the past three years while our performance suffered. But we want to do the best job we can for the long term and across the cycles. We simply don´t believe these anomalies, with cheap stocks getting cheaper and whatever is in vogue getting more expensive will continue forever. As the famous saying goes, if something can’t go on forever, it won’t go.

The news flow has been positive this quarter, with the Chinese economy in an increasingly firmer[21] footing and the ECB in Europe getting ready to start cutting rates in June[22]. In Brazil, inflation expectations are as expected showing some resistance in converging to the Central Bank´s goals but overall, the fiscal and monetary picture seems at least manageable.

We feel very confident about the long-term prospects of our portfolio companies. As Charlie Munger once famously said: “Active investing is the art of deciding where not to be diversified”.

Since everyone can buy a stock index cheaply these days, is there somewhere or some hidden places in global financial markets where it is still worth it to take a closer look, spend a few (or countless) hours in exchange for potentially huge long-term rewards? We look at our portfolio in the first half of 2024 and can confidently answer with a resounding yes.

As always, we thank you for the trust you put in us,

FCL Team.

[21] https://www.cnbc.com/2024/04/01/china-april-2024-caixin-manufacturing-pmi.html

[22] https://youtu.be/32NyJLzGTq0?si=pXqxk26uTXwtNcnw