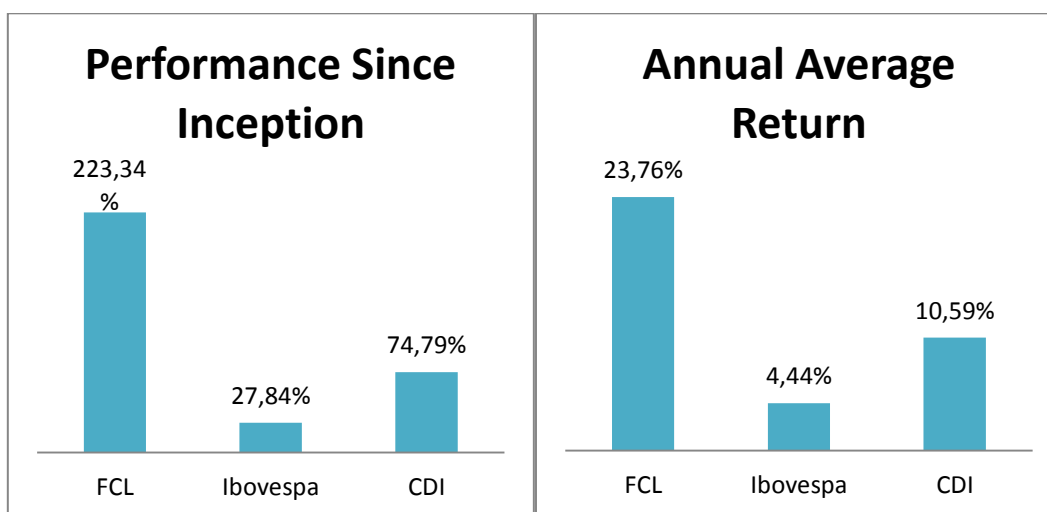


## Tables and Graphics:

Quota Value in 28/09/2012: 3.23345322		
Net Worth: R\$ 12,805,413.32		
Performance	In R\$	In US\$
September 2012	3.50%	3.84 %
Last 12 months	45.59%	23.60%
Since Inception	223.34%	224.16%
Annual Average	23.76% a.a.	23.93% a.a.



### Highlights

-FCL Capital investment club's net asset value per share increases 3.84% in US dollars (3.50% in Brazilian reais) during the month of September 2012;

-Our compounded annual performance is of 23.71% in US dollars (23.76% in reais);

-Over the past 12 months our performance was of 32.96% in US dollars versus 3.28% of the Ibovespa index. In reais our 12 month performance was of 45.59% against 13.09% of the Ibovespa and 9.45% from the Brazilian CDI

FCL Team:

Fernando Araujo  
Gustavo Prado  
Felipe Marcondes  
Besmar Lino

Phone:  
(55) (21) 3268-7918

E-mail:  
[fcl@fclcapital.com](mailto:fcl@fclcapital.com)

1) Investment outlook:

*Four horsemen are waiting. Why we love emerging markets. And why we learned to love a crisis.*

There are many parallels between financial markets and our personal lives. One of them is how we, as investors and as living creatures, hate uncertainty. In fact, there are many stances where the fear of a certain bad outcome is way worse than the outcome itself. We face this paradox in our personal lives, in our love lives, with our families, dealing with other people, and we certainly face it when we invest in the financial markets. There is not a more relevant reason why “sell the rumor, buy the fact” has been one of the longest-lasting sayings in finance.

With that said, we can come back to the facts of when we are writing this letter (October 2012). Four years ago, with justified reasons or not, we had the greatest financial stress of the past eight decades. Then we, as investors, became excited as soon as we realized we were not in some sort of Depression 2.0. We realized that the healing process was going to be painful, slow (buy the rumor, sell the fact, in this case!). And that’s what we are living right now.

But there’s more: as anyone who reads the financial press knows, there are four main risks wandering around in the global economy, waiting to ruin the recovery if we let them: you probably know them by heart but here they are anyway:

- The Euro crisis;
- The US “fiscal cliff”;
- The question of if and when Israel will attack Iran;
- The question of how serious is the China slowdown.

So, if a naturally painful and fragile recovery was not enough, four horsemen are waiting. Let’s talk about each of them. Starting with the Euro Crisis, it should have been clear from the start that the Euro project was “stuck in the middle”. Each member state ceded enough sovereignty to not have control of its own currency and financial matters when they signed up for it, but not enough to be part of a “real federation”, therefore, the architecture was unbalanced. Europe is the equivalent of an aero plane with all its weight on one of its sides.

We don’t envision a terrible scenario for the Euro; of course it is possible that one or more of its members will leave the project, for different reasons. Europe will most likely experience very slow growth in the next decade or so (and not only because of the single currency but due to other factors such as demographics, high taxes, low competitiveness in most of its countries, etc.).

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(55) (21) 3268-7918

E-mail:  
[fcl@fclcapital.com](mailto:fcl@fclcapital.com)

All in all Europe is still almost a third of the world's GDP, has some of its best companies, some of its best workers, and is just too rich and too well placed to face total ruin. The region should probably have the slowest growth in the world, but in 10 or 20 years it will still be one of the richest regions, with some of the best companies and people tend to lose sight of that fact.

As for the fiscal cliff, we still believe that in the end some kind of solution is almost inevitable. It is hard to sell America short, in every possible meaning. And we think the whole political process indeed has the potential to hurt the US economic recovery, but not for too long and not too much. As for the Middle East possible war, it is not the scope of this letter to judge which side is right or wrong, but to realize the possible implication for the financial markets.

It is very hard to know how to put an accurate price on a future event, let alone a possible future war because we never know its duration or intensity. It is one of the reasons why investors hate uncertainty and almost always discount future events with too much intensity. Certainly the oil market would be affected and there's an old and inexact rule of thumb that a 10% increase in the price of oil leads, with a six month delay, to a 0.1% fall in global GDP.

In any case, the world has faced two great world wars in the twentieth century and that turned out to be a century of explosive economic growth. We don't think this war, if it happens, would make the 21st century any different. And this leads us to our last and, in our opinion, potentially most dangerous horseman: China. If we look back to the last few decades, the rise of Asia, and China in a very particular way, was the single biggest social transformation in human history.

Never before two billion people entered the world economy and lived in a way that the generation before couldn't even dream. The rise of China is so relevant because in the end, the Chinese have the numbers on their side: a sixth of the humans in this planet are Chinese. So like it or not it is almost an anomaly that countries with four or five times less people were able for so long to have a bigger economy than China.

Just the fact alone that suddenly Chinese left Marxist dogmas behind and started, albeit timidly and with caveats, to embrace some form of capitalism, had the power to turn the world upside down. Commodities exporters were back on business. A different century and a different world order begun. Brazilian politicians started to believe in their own geniality and thought (actually they still think) that their country growth was of their making and not due to a new world where commodities were now in a huge sellers' market due to unprecedented demand.

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E-mail:  
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And since we invest primarily in Brazilian companies, it is important to realize that possibly no other country is more exposed to a possible China slowdown than Brazil. This is without a doubt one of the reasons behind the Ibovespa index underperformance if compared to world equity markets in the past few months.

Commodity	China % of World
Cement	53.2%
Iron Ore	47.7%
Coal	46.9%
Pigs	46.4%
Steel	45.4%
Lead	44.6%
Zinc	41.3%
Aluminum	40.6%
Copper	38.9%
Eggs	37.2%
Nickel	36.3%
Rice	28.1%
Soybeans	24.6%
Wheat	16.6%
Chickens	15.6%
PPP GDP	13.6%
Oil	10.3%
Cattle	9.5%
GDP	9.4%

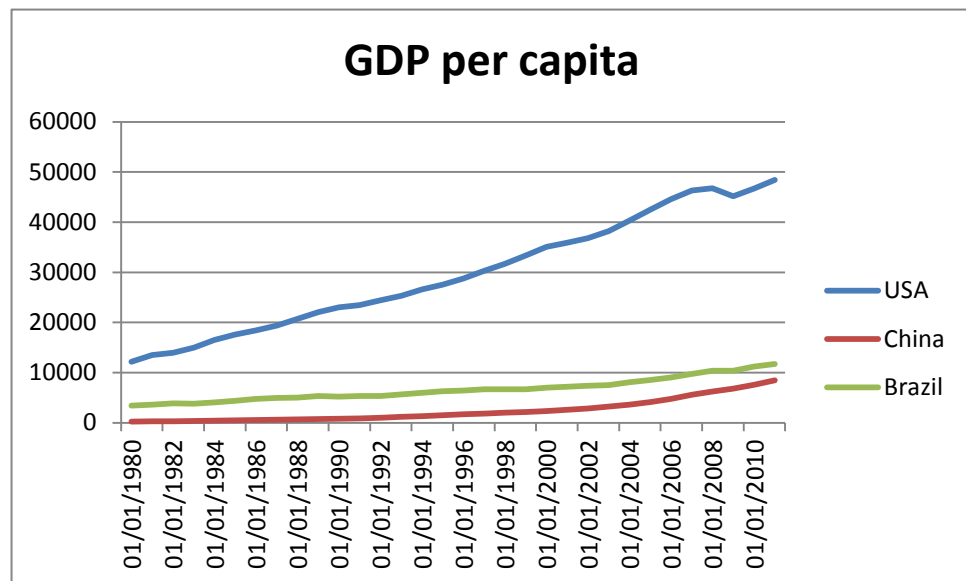
So what is our take on China? Somewhere in the middle, considering the most extreme scenarios. We do agree that there is huge inefficiency in the system. A series of politically connected enterprises dictates a large part of China's economy and not necessarily makes decisions in a profit maximizing way. To understand China, you have to understand the logic and the motivation of the people in charge of China. And the more we look into it, the more we realize that the logic of their economy is to a large extent (still) not the logic of rational profit maximizing agents. That being said, many people miss the big picture when they point to China's problems. We are talking about an economy that has a GDP per capita still less than one eighth of US levels, less than half Brazilian levels.

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E-mail:  
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Of course China's economy has huge misallocations and distorted incentives. At this level, if it isn't, it would be almost an outlier. But the "long march" of their economy, to use a very Chinese reference, is still in the beginning and it is almost certain that the huge GDP per capita difference between China and its trading partners will narrow significantly in the next decades. We are not claiming it will reach US levels. We don't think it will in the foreseeable future. But China will grow enough to be a larger economy than the US, not because its leaders remade economic concepts but because as we said before China has the numbers on its side. So when China reaches Brazilian levels of GDP per capita it will already have a bigger economy than the US.

But if we look back at these four risks, the four horsemen of the financial world, we see two obvious truths:

- Politicians don't like to make unpopular reforms;
- Politicians only do unpopular (economic enhancing) reforms when they have no other option.

So if we look back at these risks we see how crisis are useful to the system. A lot of blame for Europe's (and in consequence to the world's) troubles has been put on Germany but we have to give some credit to the Germans: they always believed that the debtor countries in Europe's periphery would only act when they faced the abyss. For no other reason Silvio Berlusconi abandoned his pursuit for reforms in 2011 hours later the ECB started buying Italian bonds. Now they've learnt their lesson and are demanding more before they write more checks.

A sense of crisis was also necessary to make American politicians act on the 25th hour last year and avoid a US default at the last possible minute. A sense of crisis and danger may very well

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prevent the Iran-Israel war from happening (we think this is almost a probability). And last but not least a sense of crisis or at least a sense of “all is not well” is pushing china’s leaders to reform their economy away from its previous export driven model to a more consumer driven economy. So there are three main tasks for the next few years:

- To allow the renminbi to be a freely float currency;
- To rise Chinese household earnings;
- To liberalize and reform the country’s interest rate system.

If China can be successful in the three above mentioned tasks without a big growth slowdown, nothing will stop it from assuming the place of the world’s biggest economy, at least until India put its act together.

And where does FCL stand in this panorama? First and foremost we try to visualize investment opportunities and theses prior to other investors. And we are emerging market investors. But when you talk about stock markets, “emerging markets” is a misused and oversold concept. We don’t have a problem with the term, which means countries of lower level of development and less sophisticated financial markets. We do, however, have a problem with the reasons behind investors thinking they should buy shares in emerging markets and not in development ones.

As value investors we like to have a scientific approach to investing. By looking at the historical evidence, we found out that higher economic growth does not have any positive correlation with higher stock returns. In fact, differently than everyone tends to believe, it is a (slightly) negative one. In other words, usually markets that have high economic growth have worse subsequent performance than low growth markets. That makes the fact that investors attempt to time their stock exposure to the economic cycle even funnier. And the reason is simple: stock markets are discounting machines. If everyone knows that, let’s say, Indonesia will have high economic growth in the future, there’s no reason its market won’t have a higher price/earnings multiple right now.

But this is not the end of the story. And we still believe in emerging markets. Because there’s one more thing: emerging markets are not exclusively countries with lower GDP per capita, higher economic growth, but also, have less developed financial markets as we said. And if a market is less developed it means it either has less participants or is less efficient than its developed peers. And investors put a higher discount on its (in this case lack of) transparency, liquidity or safety. In other words, it has more valuable investment opportunities and less competition in searching for them. The Brazilian market, just to give an example,

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E-mail:  
[fcl@fclcapital.com](mailto:fcl@fclcapital.com)

is full of mispricings, so obvious and huge that they probably wouldn't happen in Europe or the US.

And this way, the theory holds true. Investing in emerging markets makes a lot of sense. We should not after all look for the treasures everyone is looking for. We should look for the forgotten ones. It will be easier to find and the reward will be bigger. And that's what we try to do at FCL. And emerging markets are the place to be if you have this framework.

As Robert Frost said a century ago:

"Two roads diverged in a wood and I –  
I took the one less traveled by  
and that has made all the difference."

## 2) Performance

The net increase in book value per share of FCL Capital's investment club was of 3.84% in US dollars (3.50% in Brazilian reais) during the month of September 2012. Since our inception, April 3rd 2007, our net increase in book value per share was of 224.16% in US dollars (223.34% in reais). This performance translates itself in a compounded annual return (our most important internal metric) of 23.71% in dollars.

## About FCL Capital

FCL Capital is an independent investment company, focused on portfolio management, free from conflicts of interest and multiple objectives that has for a mission the preservation and multiplication of its investors' capital, through a thorough financial analysis. Our goal is to generate absolute returns, staying solid and consistent through good and bad periods of the economic cycle.