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RIO BRAVO
STRATEGIES

HELP FROM THE ECONOMY IS NEEDED

FEBRUARY 2017

There was a lot of political commotion in February, despite how easy it appeared to be for Brazilian Congress to elect the Presidents of both Houses, hand-picked by the President. The political ramifications of the plea bargain made by Odebrecht executives were predictable, especially to the so-called "hard core" of the Government, as well as the inevitable strain generated over time (or due to the delay in the economy's recovery) and the onset of debate surrounding the Social Security reform. Nonetheless, a general sense of anxiety took over the political arena in the last few weeks. →

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→ This year's Carnaval season was marked by the ongoing tension and occasional protests. The festive mood and lighter environment were somewhat tarnished by an undertone of cynicism. It's about time the economy helped politics.

Fortunately, the main indicators show that the economic transatlantic ship is adjusting its course.

Economic activity forecasts indicate that last year's fourth quarter GDP (whose estimates should be released March 7) will once again be lower than the previous quarter. A slight retraction would represent an annual GDP drop of nearly 3.5% in 2016. Although this comes as no surprise, it is imperative not to underestimate the impact of such news and the record confirmation in terms of recession, seeing as accountability will come under debate. The inherent lag between the actions of authorities and impacts on the economy make it look like President Temer's administration is more responsible for the economic recession than it actually is. But what matters is popular perception, and apparently there is a growing sense that nothing has changed dramatically in the economy after the impeachment. The fact that former president Lula was mentioned in the polls and news, weaving his own comments on the economy, adds even more to this overall sense of discomfort.

Recently published figures for 1Q17, however, along with previous indicators, point towards a slight growth – the first increase after seven consecutive quarters of a downward spiral. This trend appears while the inflation rate continues to fall and the Central Bank of Brazil considers the possibility of speeding up interest rate drops.

> *"A general sense of anxiety took over the political arena in the last few weeks.*

February came with a silver lining for the markets: Ibovespa rose 2.82% and the Brazilian Real grew 0.6%, closing at BRL 3.11 and seeking to experience lower levels. Sovereign risk premiums (in CDS) dropped from 246bps to 223bps, as well as pre and post-fixed interest rates.

What was new about the cogitations and comments made by the Central Bank on monetary policy had to do with the reference to "estimates for the which the Committee will continue to reassess over time". When

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speaking to the "structural interest rate", the Monetary Authority may be referring to the idea of "neutral interest rate". This rate pertains to the logical portion of the targets system and matches inflation rate to goal and product to potential. On the other hand, the comment seems aligned to recent debates on whether the "neutral rate" or "structural interest rate" is too high compared to those of similar countries. Fiscal problems such as primary deficit and even excessive debt have been indicated as causes by the President of the Central Bank of Brazil, as well as regulatory distortions such as credit direction and excessive compulsory deposits. This concern is healthy, and one more reason to fuel the fire for reforms.

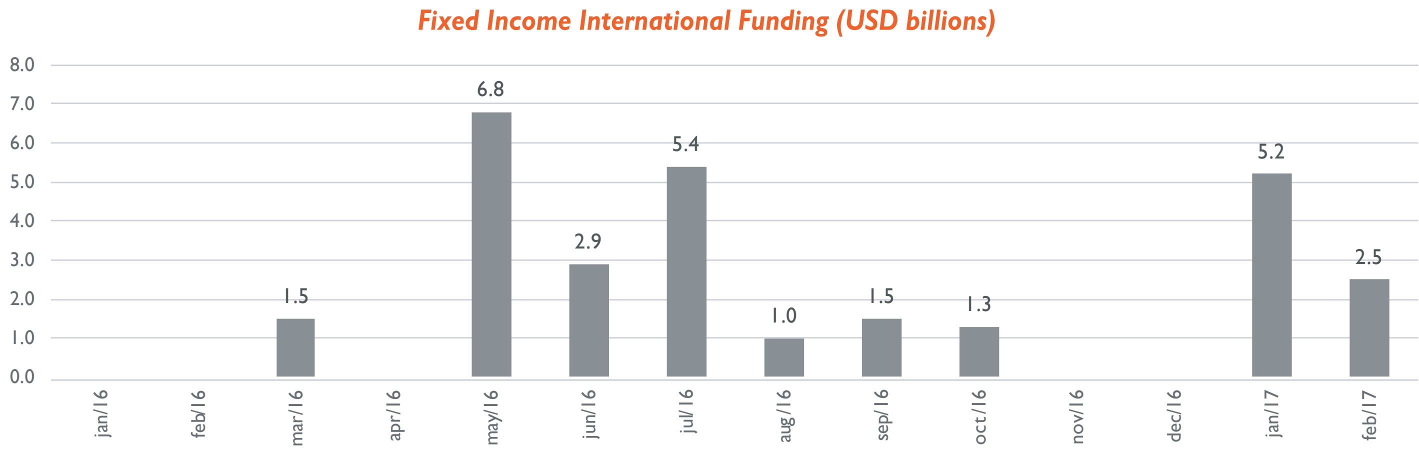
> *February saw positive market results*

The Social Security reform is the next major challenge for the President and majority rule so carefully managed by the strategists from the President's office. Controversial reforms always carry heavy objections, and this time is no different, many of which come from allies seeking to enhance their buy-in. The promises to be made inside and outside the context of the reform to accommodate these

> *The Social Security reform is the next major challenge for the President of the Republic*

In the international arena, things start settling down in the USA, while the next major hurdle for Europe is the French elections in the coming months. Marine Le Pen leads the first round, but falls short in all likely scenarios for the second round. Le Pen stands at 25-27%, Macron at 23-24% and Fillon at 19-21% in the latest polls taken between 02/26 and 03/02. For the second round, research puts Fillon at 58-60% and Le Pen at 40-42% in one scenario; and Macron at 62-63% and Le Pen at 37-38% in the other. The first round is scheduled for April 23 and the second for May 7. Fasten your seat belts.

Bonds issue gave way to a favorable start for 2017 as resource funding on the international market for Brazilian companies. A seasonal increase in foreign funding normally occurs at the beginning of the year, more specifically during January and February. This historical pattern was broken in 2015 and 2016, both due to negative forecasts for Brazil at that time, and also as a result of the Operação Lava Jato investigations, since Petrobras issues the majority of Brazilian bonds on the foreign market. The first Brazilian bonds issued on the foreign market in 2016 only occurred in March (sovereign bonds). Only two months into 2017, the volume of Brazilian bonds issued totaled USD 7.7 billion, about 40% of all the entire volume issued last year (USD 20.25 billion).



Petrobras realized the first operation of 2017 in January, in the amount of 4 billion USD. It was followed by Fibria (USD 700 million), Raízen (USD 500 million), Embraer and Rumo (both at USD 750 million), in addition to Vale (USD 1 billion).

With intentions to return to the market, Suzano and Marfrig hired banks in March to coordinate investment meetings both in the U.S. and Europe: both had already secured funding throughout 2016.

FIXED INCOME

Funding on the domestic market, however, saw a weaker beginning to 2017 than the previous year. January's fixed income funding totaled BRL 3.4 billion, concentrated in the BRL 1.6 billion issued by Andrade Gutierrez, which was not distributed to the market. This volume represents a 52.5% drop compared to January of 2016.

Even though ANBIMA [Brazilian Financial and Capital Markets Association] has not released the official February figures yet, two large events occurred - Telefônica issued BRL 2 billion and Lojas Renner issued BRL 300 million - neither of which had market distribution. At the month's closing, a distribution process also occurred with restricted efforts of MRV's 9th Issuance, which will liquidate in March/17. The initial estimate for this issuance was BRL 500 million, but preliminary information reports a BRL 1.1 billion demand. It was later increased to BRL 750 million. MRV issuance success also stands out regarding funding over a longer series (BRL 497 million will be issued in the five-year series).

The Central Bank indicated a possibility for accelerating reduction of the basic interest rate, which should encourage some issuers to return to the market in the coming months, leading to potentially higher domestic issuance volumes this year than those recorded in 2016.

ITAÚ UNIBANCO

We last discussed the Itaú Unibanco case in our newsletters a year ago. Its stocks were extremely low at that time, while Brazil made leaps and bounds toward bankruptcy.

Despite these huge questions about the magnitude of losses due to default, we saw a very safe valuation for a long-term investment at just over 1x the equity value. Furthermore, the market consensus was already very pessimistic and the urgent need for moderation of the public banks should have given way for quality market share gain by the private banks.

Things took a turn when the impeachment process quickly sped up and Brazil was suddenly faced with a new reality. Today we are faced with an opposing scenario. Although the public finances are still riddled with difficulty, we have concrete growth prospects for the GDP, inflation is fully controlled and interest rates are on an undeniable downward trend. As an obvious result, Itau's stock prices practically doubled in this short period of time.

The recently released 4Q16 results reinforce our optimism. The big question from a year ago was easily answered. The year closed with net losses due to default at BRL 22.4 billion, below the range indicated by management and "only" 18% higher than 2015. We say "only" because a year ago we indicated that those losses would have to be 2.5 times higher to cut earnings in half – and it didn't even come close. The earnings multiple would still have been quite reasonable, even if this extremely far-fetched scenario had materialized.

The 2017 indication was even better, anticipating a 30% drop in these losses. We are confident that this company's responsible administration would not make such an impressive indication without high levels of conviction. Although credit and revenue growth recovery is not on the horizon, loss reductions and the already customary expenditure control should allow for two-digit earnings expansion in 2017 and an equally strong or stronger expansion rate in 2018.

EQUITY

Such good news is quickly perceived by the market and today's earnings multiples are above recent averages as a natural result. None the less, we believe that this executive team took advantage of the favorable competitive macroeconomic scenario, which will still allow for increased earnings revisions. We believe that the market consensus in 2018 will still be conservative and the earnings multiple will therefore remain attractive even after strong stock appreciation. Since Itaú's size is dynamically calibrated according to price behavior and expectations, it continues to be one of our major Fund positions in this context. The bank continues to build a history of good results, good adaptability to macro conditions, high profitability and competent decisions regarding capital allocation.

FII Rio Bravo Renda Corporativa conducts its first assets sale: New Century building

Over the past eight years, we implemented an investment cycle in FII Rio Bravo Renda Corporativa, issuing several shares and purchasing new assets. From our point of view, diversification of buildings, areas and lessees was essential to reduce the Fund's exposure to the JK Financial Center building. The Fund's last acquisition was made in August 2016 and we conducted the first sale within the real estate portfolio in February, which was the third floor of the New Century building, negotiated at BRL 16,100.00/sqm, after commissions.

It is expected that an actively managed Fund will recycle its portfolio over time, but we thought it appropriate to detail our acquisition strategy and asset management up to the asset's effective sale, which occurred six years after its acquisition, as well as contextualize our perception of the Fund's portfolio.

The property was purchased for BRL 14,200.00/sqm in December of 2011, reducing the Fund's expos which represented 71% of the lease revenue at the time. Upon acquisition, the floor was 100% leased to Droga Raia. The property was vacated in December/2012, when the real estate market started showing signs of a surplus of offers and reduced demand. Suite 31 was quickly leased to Contour Global in May 2013, due to an activist strategy.

Despite all the commercial efforts made by Rio Bravo following that lease, suite 32 remained vacant for another 17 months, when a new contract was signed with the same occupant of suite 31, which ended up becoming the lessee of the entire floor. Since the property is a Class A asset, with optimal technical specifications, in a premium location and at a competitive rental price, we often questioned the unexpected difficulties in leasing this suite while searching for lessees. We then came to the conclusion that one of the factors explaining this difficulty was the great diversification of property owners within the development, which ended

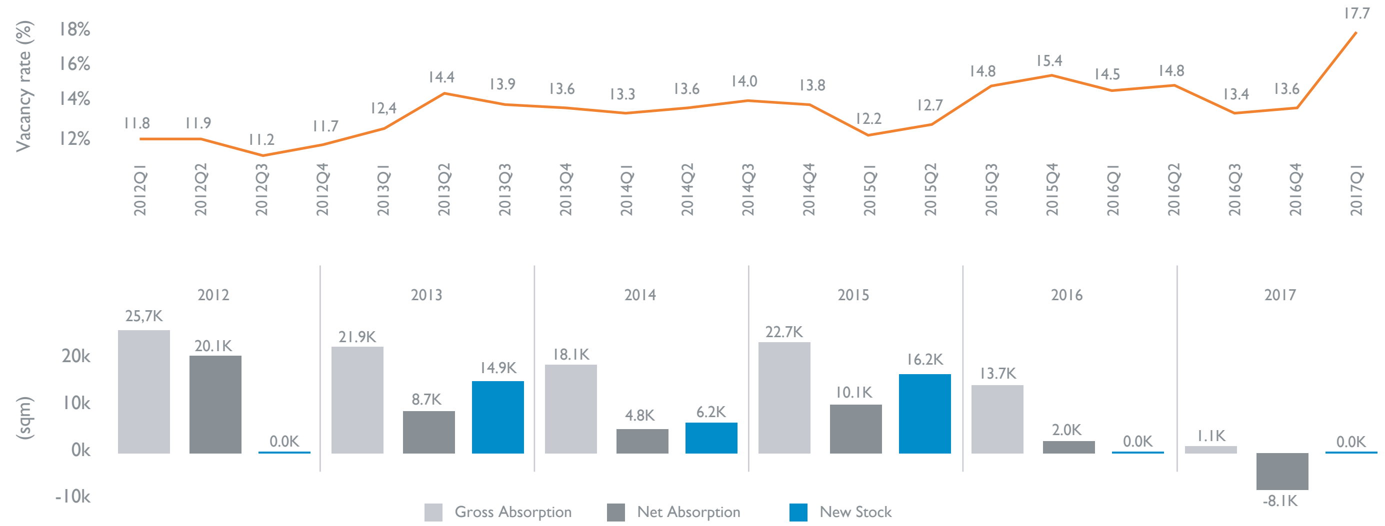
REAL ESTATE INVESTMENTS

up causing internal competition within the building. Even though we had a small stake in the building, we were very active throughout the entire ownership period regarding the development's preservation and modernization and we managed to approve several jobs and improvements in the condominium association's Ordinary General Meetings, which maintained our building highly competitive when compared to similar buildings in the area, thus keeping the lease values above the average market value.

Then, at a moment in December 2016 when the vacancy rate of the Itaim Bibi offices reached a peak of 17.7%, according to data from Cushman & Wakefield consulting, the lessee requested a renegotiation of the lease. Internal and external competition in the building gives considerable bargaining power to the occupants in the current real estate market, so although the agreement was outside the revision period, we understood the importance of maintaining the lessee.

Therefore, we conceded a reduction to an amount closer to the other leases in the Building, reducing the lease from BRL 145/sqm to a nominal amount of BRL 120/sqm. On a macro scale, the increased vacancy rate in the area reinforced that the timing for sale could be right, as shown on the graph below.

Vacancy rate (%) x Gross Absorption (sqm) x Net Absorption (sqm) x New Stock (sqm)
Class A and B Commercial Offices in the Itaim Bibi area



source: Cushman & Wakefield

REAL ESTATE INVESTMENTS

We also noticed that the property underwent a tenant repositioning process, during the time period when we were property owners. The occupants were big investment banks and brokerage firms at the time of our purchase. Although we consider Global Contour an excellent lessee, the Building has less prestigious, more fragmented tenants today, coming from various sectors. We can't justify the possibility of increasing our participation in the development, which would give us more power to achieve operational improvements and cost reduction in the condominium, resulting in long-term appreciation of the asset, in addition to reducing internal competition.

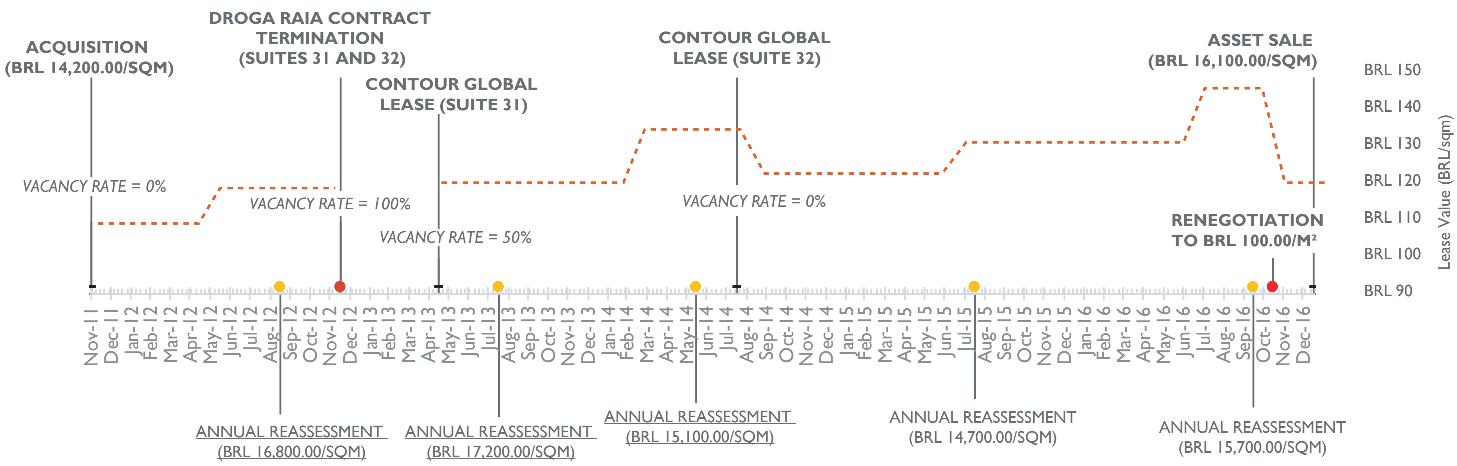
We believe it especially important to explain why this building differs from the rest, since the Fund has no majority participation (>50%) in any building owned. In short, we can´t see three important characteristics to keep our investment in New Century, even though we managed to keep a positive agenda in the building:

- Owner profile is very heterogeneous, with differing views related to investment term, requirements for short-term funds, business strategy and willingness to invest;
- Even though the building is well located, low agreement among the owners hinders the building from assuming a better position at a higher level;
- We can't envision any possibility for increasing our participation in the building.

Since the Fund's investment strategy is to increase its stake in Buildings we consider strategic and that can appreciate in the long term and reduce its stake in buildings where gaining relevance through participation to attain operational improvements and decrease internal competition is not possible, Rio Bravo realized that this sale was needed in order to continue with this strategy, based on this scenario.

Financially and prospectively speaking, we know that the proposal's price already included potential improvements over the next two years, in addition to generating a return of 11.1% p.a. after income tax. This return represents 102% of the CDI in the period. As such, we believed the selling price to be quite attractive and provided positive gains for the shareholders. Just as a reference, internal and external assessments indicated values well below the sale price, in a range of net brokerage prices between BRL 14,000.00 - 14,800.00/sqm. Consequently, we considered this proposal as an opportunity to sell the property above the amount we considered fair, gain a more relevant cash on hand that may be used in greater acquisitions with better return prospects and, finally, better align the Fund's strategy to reduce participation in property without prospects to gain operational improvements.

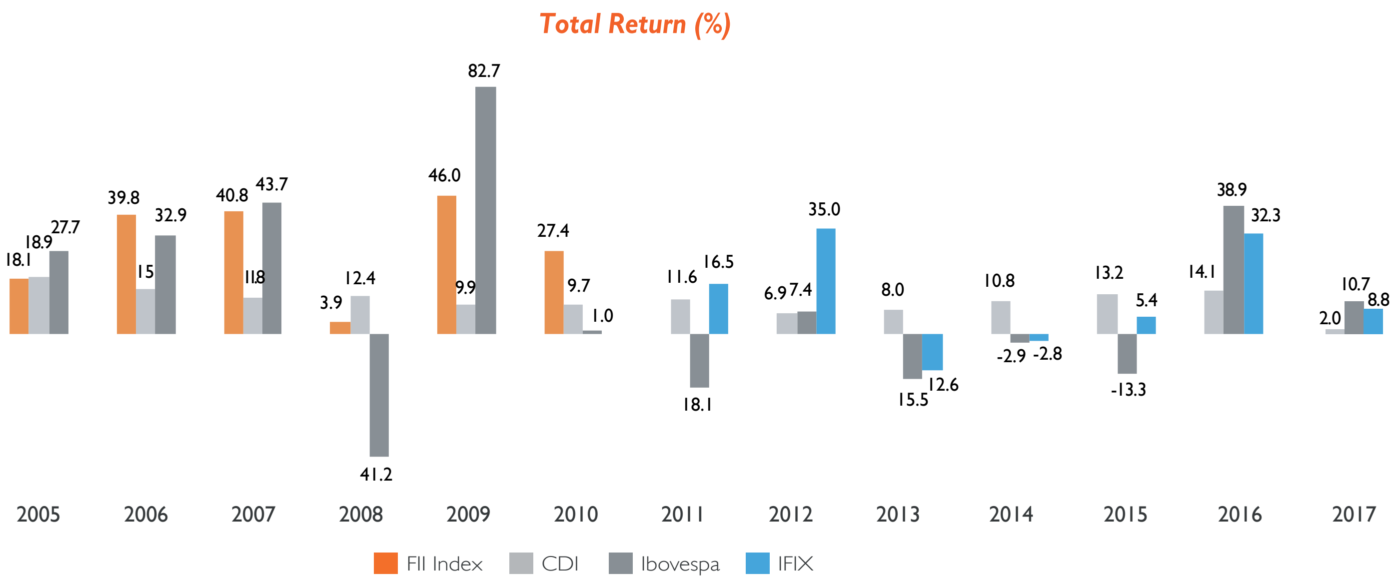
New Century Timeline

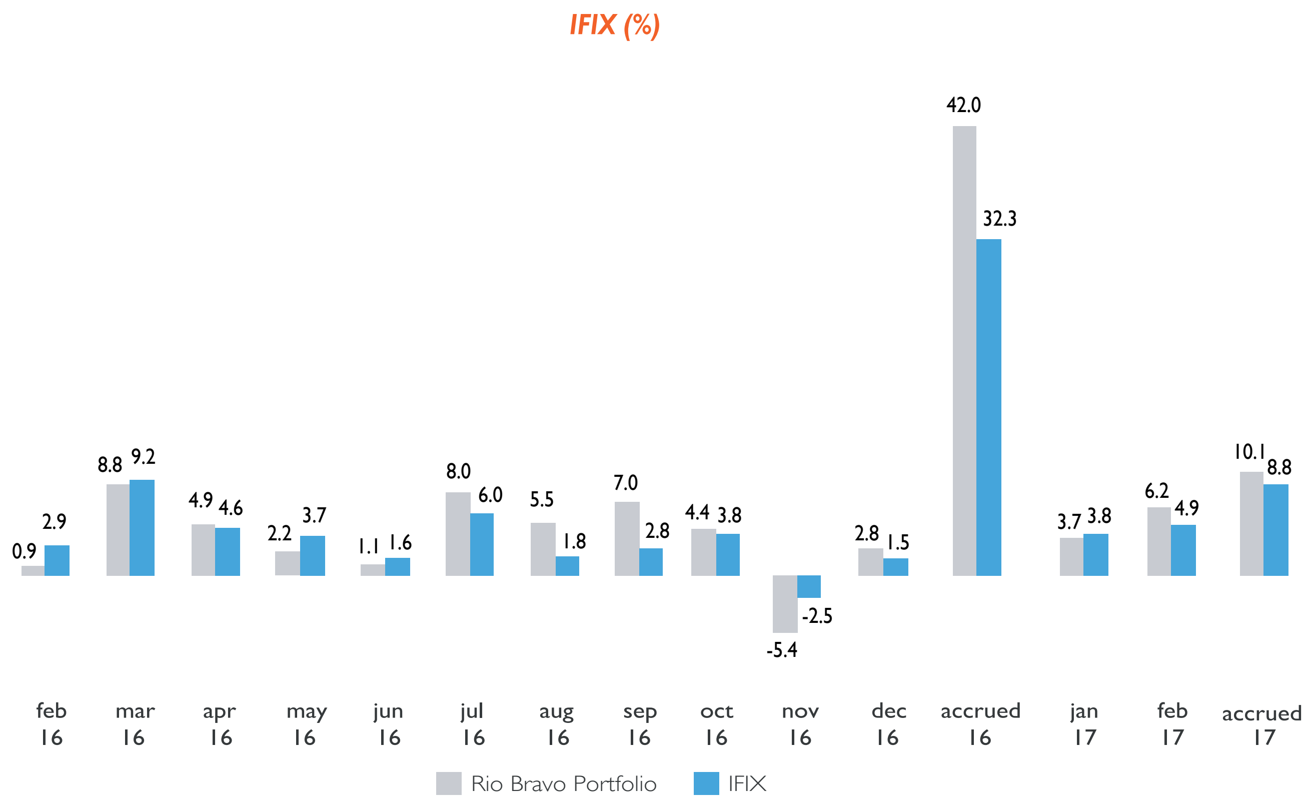


IFIX

The first graph shows the month-by-month IFIX total return, as well as a theoretical portfolio comprising the FIIs managed by Rio Bravo and available for trading at BM&FBovespa. The second graph shows a comparison of the annual total return, from 2005 to February 2017, among CDI, Ibovespa, IFIX and the FII index - developed by Rio Bravo and used for series prior to the creation of IFIX.

REAL ESTATE INVESTMENTS





Central Bank indications show a sharper fall in interest rates and assist the recovery of the other asset classes.

The Central Bank not only proved its ability for quick action by cutting rates by another 75bps in the Copom meeting last February, but also opened the door to acceleration, as long as internal reforms and the external scenario continue to help. As we expected, the discussion on long-term structural interest rates began at a time when inflation expectations are anchored for the first time in seven years.

Our strongest structural position was based on a real interest rate drop through NTNs-B 202 and 2050, and was responsible for the positive outcome in the Rio Bravo Apollo FIC FIM fund. We maintained our currency position due to continued concerns with profit-taking and changes in the external scenario, which slightly reduced the monthly result, while keeping its volatility low. The final monthly profitability was 113.3% CDI (+0.98%) with only 1.48% volatility, below the goal of 3-4% p.a.. The period's returns were even more striking for the positions in which we allow a greater concentration on interest rates, equity and multi markets, with Rio Bravo Juros and Rio Bravo Portfólio Diversificado I respectively yielding 167.4% CDI and 140.5% CDI.

What next? Our vision remains consistent: structurally, we continue to focus on a downward trend for real interest rates (NTN-B). With the actions observed in the Ibovespa in the first days of March, we marginally increased allocations in equity. The rise of the US Dollar from BRL 3.04 to BRL 3.11 during the month authorized us to decrease the portfolio's protection, but concerns with high U.S. volatility continue to contain the overall risk. We're almost to the ideal point for developing hedging structures against S&P500, which will therefore allow Brazil to increase its position in the medium term.

PERFORMANCE (%)

	Fixed Income			Equity		Multi-Assets							
	Rio Bravo Crédito Privado FIRF	Rio Bravo Liquidez DI FI Referenciado	Rio Bravo Inflação FIRF	Rio Bravo Fundamental FIA	Rio Bravo Pandas FIC FIM	Rio Bravo Portfólio Diversificado I FIC	Rio Bravo Portfolio Diversificado II FIC	Rio Bravo Portfolio Diversificado Internacional	Rio Bravo Portfolio Diversificado Equities FIC FIA	Rio Bravo Juros FIC FIM	Rio Bravo Previdencia FIM	Rio Bravo Absolute Yield FIC DE FIM CRED PRIV IE	Rio Bravo Columbia Threadneedle FIM IE
February 2017	0.91	0.83	2.41	3.54	0.14	1.09	1.19	0.32	2.97	1.45	3.64	0.89	-0.32
January 2017	1.15	1.04	2.01	2.99	1.27	1.42	1.28	-1.83	5.96	1.65	2.28	1.34	-1.48
December 2016	1.18	1.07	2.21	-1.22	0.09	1.46	1.57	-2.80	-0.49	2.27	1.36	1.14	-0.95
November 2016	1.09	1.00	-0.30	-8.44	-1.57	-0.50	0.25	2.19	-6.24	-0.62	-3.79	0.64	3.51
October 2016	1.08	1.01	0.74	2.82	3.68	1.64	2.08	-3.03	7.05	0.72	1.62	1.08	-6.79
September 2016	1.15	1.06	1.39	-0.39	0.00	1.58	1.26	0.60	-0.10	1.52	0.86	1.07	0.27
August 2016	1.24	1.17	1.26	-1.37	0.91	2.08	1.42	1.30	-0.08	1.13	1.26	1.47	-0.10
July 2016	1.14	1.06	1.89	3.92	3.37	2.55	0.96	1.69	7.51	1.23	3.51	1.25	5.23
June 2016	1.23	1.10	1.46	2.09	1.37	1.28	0.55	-8.60	4.32	1.26	1.41	0.91	-14.11
May 2016	1.18	1.07	0.51	3.43	2.38	0.28	0.66	4.62	-1.52	0.99	0.81	1.31	3.31
April 2016	1.13	1.01	2.45	6.04	0.02	1.47	2.18	-2.15	5.26	2.35	2.76	0.77	-1.84
March 2016	1.23	1.09	3.99	10.07	-3.54	0.70	0.55	-6.23	7.78	2.83	6.60	1.67	-3.24
February 2016	1.04	0.95	1.86	-5.59	0.94	1.43	0.44	0.79	3.45	1.61	0.97	0.86	-4.57
Year	2.08	1.87	4.47	6.64	1.41	2.53	2.49	-1.52	9.11	3.12	6.00	2.24	-1.80
12 months	14.55	13.18	21.56	22.16	8.59	15.98	14.72	-13.19	34.69	17.77	23.51	14.32	-18.30
24 months	30.19	28.04	38.55	2.19	-	29.64	29.37	13.89	26.10	29.31	24.55	29.33	-
36 months	44.85	41.35	56.75	2.58	-	-	41.64	37.32	26.63	44.76	31.17	-	-
48 months	56.74	52.83	55.60	-8.52	-	-	46.83	-	6.78	39.34	-	-	-
Since its inception	146.86	147.83	56.60	433.93	15.20	33.41	153.53	38.72	20.74	84.91	26.25	45.32	-21.11
Current NW (in BRL thousands)	298.182	22.892	17.045	18.870	9.424	61.031	6.951	4.169	7.466	30.840	17.002	8.984	38.761
Inception date	8/14/2008	12/27/2007	2/27/2013	9/8/2004	8/17/2015	10/9/2014	11/3/2008	12/11/2013	4/16/2012	6/10/2013	3/12/2013	3/18/2014	9/27/2015
Management rate (p.a.)	0.45%	0.35% [1]	0.65%	2.00%	0.90% [2]	0.04%	0.60%	1.75%	0.70%	0.70% [3]	1.10%	0.50% [4]	0.08%
Performance rate (p.a.)	-	-	20% over 100% of the IMA-B	20% over the IBOVESPA	25% over the CDI	-	-	-	-	10% over the CDI	-	10% over the CDI	-

	Indexes						
	CDI	Ibovespa	SMLL	Euro	U.S. Dollar	IMA - B	IFIX
February 2017	0.86	3.08	5.73	-3.40	-1.21	3.85	4.86
January 2017	1.09	7.38	11.42	-0.81	-3.27	1.87	3.76
December 2016	1.12	-2.71	-0.54	-4.46	-3.86	2.91	1.47
November 2016	1.04	-4.65	-8.44	2.42	6.02	-1.22	-2.55
October 2016	1.05	11.23	7.01	-4.46	-2.11	0.64	3.80
September 2016	1.11	0.80	0.09	1.86	1.11	1.57	2.77
August 2016	1.21	1.03	0.18	-0.82	-0.68	0.89	1.84
July 2016	1.11	11.22	14.60	1.70	1.12	2.51	5.92
June 2016	1.16	6.30	9.12	-11.21	-11.04	1.93	1.61
May 2016	1.11	-10.09	-4.21	2.20	5.12	-0.10	3.73
April 2016	1.05	7.70	5.56	-3.79	-4.35	3.93	4.65
March 2016	1.16	16.97	11.39	-6.42	-10.55	5.31	9.11
February 2016	1.00	5.91	4.66	0.88	0.42	2.26	2.95
Year	1.96	10.68	17.81	-4.19	-4.45	5.79	8.80
12 months	13.82	51.09	58.79	-23.16	-20.94	26.22	49.12
24 months	29.41	28.79	27.31	0.98	7.04	40.74	48.20
36 months	43.51	41.55	10.46	1.50	32.68	61.80	52.43
48 months	55.78	15.05	-15.32	28.34	57.86	47.24	26.35

[1] Maximum management fee. including the management fee of the invested funds: 0.50% p.a.
[2] Maximum management fee. including the management fee of the invested funds: 1.10% p.a.
[3] Maximum management fee. including the management fee of the invested funds: 1.10% p.a.
[4] Maximum management fee. including the management fee of the invested funds: 2.04% p.a.

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