

RIO BRAVO STRATEGIES



A BLAZING START FOR 2017

JANUARY 2017

Copom's decision on January 11 to reduce the Selic rate to 13% was the highlight of the month, also due to the disclosed facts regarding the low cycle that has just started. The Monetary Authority brought back a long forgotten sense of discipline and commitment to the developed target system. It patiently waited – while struggling

to fend off some faultfinders – until the 2017 and 2018 IPCA expectations were adjusted to the target, ultimately leading the events unfolded on January 11 to be praised as a sort of resurgence in credibility or, more precisely, the reinstatement of the system's integrity and consistency of the administration's macroeconomic policy.→



A BLAZING START FOR 2017

→ Evidently, it is still too soon to even consider a full-blown recovery of the “triad”, with the tax scenario still gloomy and not a single word on the touchy social security reform subject since the recess, except for recent developments in state negotiations. The media reports tough negotiations ahead, but also encouraging signs coming from the government, especially after some reports indicating that CEDAE and BANRISUL will have to line up for the privatization queue.

The steps taken by the Central Bank of Brazil were surprisingly reassuring, considering its clear intention to lower the Selic rate even faster than anticipated, as well as the list of scheduled activities published on December 20 (listing all of the entity’s actions, similarly to a strategic planning report), and rumors regarding a possible lower target set for 2019, which will soon be confirmed by the CMN [National Monetary Council].

The winds have changed and the transatlantic ship seems to have found its bearings, adjusting its course towards economic recovery. Activity indicators related to November, disclosed in January, still depict a rocky scenario ahead, with some growth despite a few unexpected setbacks. The main upside was the strong “Black Friday” sales figures recorded by the retail segment.

Analysts are quite optimistic about the seasonably favorable data from December, which should come out in February. There has been an improvement in the confidence level, the first index to capture a snapshot of the recovery.

On the other hand, the last rate to be impacted is unemployment, which will continue rising for some time. The 12% unemployment rate recorded in the last quarter of 2016 in PNAD is a reminder of how much we still have to overcome.



Copom’s decision was welcomed as a way to regain credibility.

However, just when the dust appeared to be settling down at the pace of the relatively bold moves by the Brazilian Central Bank, attention was diverted by the news and uncertainties aroused in the Operation Car Wash, including the tragic death of Minister Teori Zavascki and by the Trump hurricane. The approval of Odebrecht executives’ plea bargain statements was a breakthrough, and the replacement of Minister Zavascki, possibly through a draw, may represent both a new



A BLAZING START FOR 2017

phase and a challenge to the proceedings.

In the US, before the President's inauguration, all signs seemed to confirm the theory that hurricanes usually lose strength as they move over dry land. The market outlook was positive and well expressed by the behavior of the American Stock Exchange, which expected a more expansionary macroeconomic mix, since the new Republican-controlled Congress should facilitate the tax cut policies, deregulation and increase in infrastructure investments Obama failed to pass.



The first actions taken by the new American President were surprising, both by their form as by their bold intentions

The market reading was pragmatic: implementing more tax policies and interest standardization, with some protectionist ingredient (which will never be as intense as in Brazil, of course), is a positive and sensible combination. Hence the rush.

The first actions taken by the new American President were surprising, both by their form as by their bold intentions, which were until then considered to be unthinkable, or at least improbable. No other American President has started his term amidst so much controversy and so many passionate ideas. His contentious and antagonistic style is unprecedented in the U.S. presidency. Protests and resistance have erupted everywhere, whose consequences are hard to predict.



The markets seemed convinced of the theory that the economic policy would be isolated from Donald Trump's media agendas

Opinion polls indicate negative perceptions of the new President - the worst for the first few days of any other White House occupant. It is important to remember that Trump won the American Electoral College despite losing the popular vote, as **effectively predicted by the polls**. It is interesting to bear in mind that the polls failed to predict the results by district in an indirect vote, which



A BLAZING START FOR 2017

was historically different from the popular vote. This “error” in the polls has been widely explored by Donald Trump, who seems to come into an open conflict with the conventional media, greatly multiplying the controversies and tension around the new President.

Initially, the markets seemed convinced of the theory that the economic policy would be isolated from the President’s media agendas, and that protectionist measures, including those unfavorable to treaties and offshoring by multinational companies, would not have major effects. However, the new style may not be only a political marketing option, but simply a combination of voluntarism with amateurism, whose consequences could be more severe in matters of greater relevance to the economy.

Many analysts have stated that the American democracy is well equipped with checks and balances that protect it from an excess of any of its powers. However, it is true that the system has never been subject to the risks brought by strong personal leadership, as pointed out by Daron Acemoglu¹. Populism has always been an influence foreign to the political system, rarely reaching electoral expression, as in the 1896 election².

Will American institutions be able to restrain a President with such characteristics? Is the system designed by the founding fathers equipped to handle this possibility?

Only time will tell.

¹ “We Are the Last Defense Against Trump: America’s institutions weren’t designed to resist a modern strongman. That leaves civil society”. Foreign Policy, January 18, 2017.

² Regarding this matter, please refer to “*Trump na terra de Oz*” [Trump in the Land of Oz] O Globo and O Estado de São Paulo, 1/29/2017.



The economic activity's poor performance and the more favorable inflation scenario have led Copom to expand the cut in interest rates during its first meeting of 2017, from 25 base-points to 75 base-points. This domestic scenario increases the chances of the Selic rate closing the year at single digits. This is a positive sign for the domestic capital market, which reported strong contraction during the past few years.

Throughout 2015 and 2016, the local interest rate above 14% p.a. secured real returns close to 6% in government securities (before tax). The deep recession during this period generated greater aversion to risk, reducing the credit offer and practically doubling the corporate credit spreads when compared to the 2010-14 period.

Cases of debt restructuring also presented a significant increase, together with judicial recovery requests and bankruptcy filings.

This reduction in interest rate is good news especially for sectors such as real estate enterprising, shopping malls and infrastructure. A recovery of the capital market can be expected with this gradual recovery of the economic activity.

The expectation that banks and public institutions will present at a slower pace than seen until mid-2014 also favors the capital market. This impact is quite relevant: based on BNDES alone, its disbursements in 2016 totaled BRL 88.3 billion - even with a 35% p.a. drop, representing approximately half of the disbursements made in 2014.

This figure is close to the BRL 98.6 billion in primary issuance in the local fixed income market (debentures, FIDCs, NPs CRIs and CRAs) in 2016. Therefore, there is room for the domestic capital market.

Average Spreads (DI +) for Brazilian Issuers - by Credit Rating

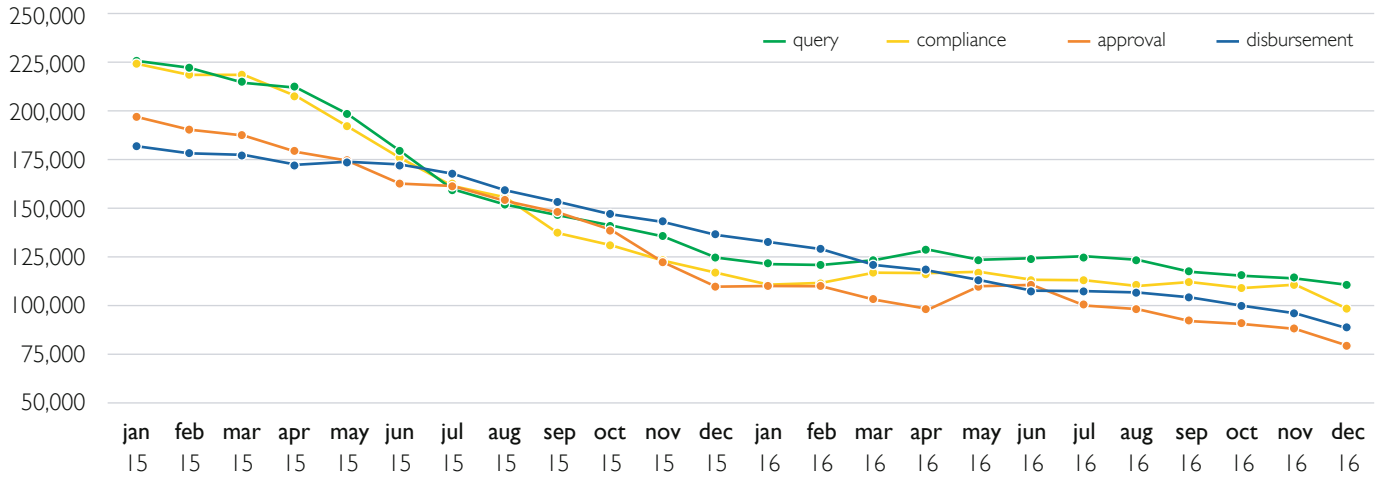
Spread (DI +)	2009	2010	2011	2012	2013	2014	2015	2016
AAA / AA+	1.4%	1.0%	0.9%	0.9%	0.8%	1.2%	1.7%	2.0%
AA / AA-	1.2%	1.5%	1.4%	1.3%	1.2%	1.1%	2.3%	2.6%
A+ / A	1.8%	1.9%	1.6%	1.5%	1.8%	2.2%	n.a	3.0%

Source: BTG Pactual and Anbima Estimate



FIXED INCOME

BNDES – Change in the 12-month accrual, per operation phase (BRL million)





BRF

Since the last letter on BRF, about six months ago, several variables have developed as we expected, while other less predictable variables have emerged.

Starting with the category with less predictability, over the past few months we have seen a spread of avian influenza outbreak, especially in Asia and Europe. Some countries were deeply impacted, such as South Korea, where the number of sacrificed birds has reached approximately 30 million. In addition to experiencing a drop in poultry offer, affected countries have also suffered restrictions to their export.

Brazil occupies a privileged geographic position on this matter: there has been no avian flu cases registered. Due to its position in the beef and poultry trade worldwide, added by its good poultry sanitation history, Brazil is considered the clear option to supply the global market at times like this. The United States, one of the largest poultry exporters, as is Brazil, went through a severe crisis a few years ago, with drastic impacts. There have been no relevant records of avian flu cases in the United States this winter (Northern hemisphere). On the other

hand, Chile has recorded a recent case of low pathogenicity, already under control – representing the closest case to Brazil. We are monitoring how this issue develops, which, although not desirable under any circumstances, is nonetheless an opportunity for BRF.

Within the scope of the variables that are somewhat predictable, there has been a drop on the prices of soybeans and corn over the past few months, – both important cost components for BRF. Despite a quite challenging macro environment and a negative seasonal effect at the beginning of this year, the poultry price spread over the grain price improved, as expected.

Such more favorable spread should translate into a significant margin recovery throughout the year. Although we expect better times over the next quarters, the company is not immune to the situation our country has been experiencing.

We still expect a difficult result for Q4, reflecting high grain prices and a scenario where demand is still limited. The year of 2016 will surely be remembered as one of



EQUITY

the most difficult for BRF and for the sector as a whole. Anticipating the obstacles in Q4 2016 and possibly in the first quarter of this year, the market has been punishing the company shares, which have reached a plateau close to the one at the beginning of our acquisitions.

Not only do we believe this adversity to be temporary, but we also view some evidence of recovery, whether through slightly better spreads or by lower production in the sector.

Another important point, also mentioned in the last letter and that has shown positive progress, is the expansion in international markets. BRF is strongly committed to its plan to recreate the characteristics of the Brazilian market in different locations worldwide, focusing especially on the Halal market (Islamic law).

The company continues implementing its acquisition strategy in this market, with the

recent acquisition of the largest poultry producer in Turkey - Banvit. BRF has also segregated the Muslim market operations into a new company called One Foods, and will continue capitalizing this new unit, whether by public offering or private placement.

Despite a few short-term uncertainties, we are confident in our investment in BRF. We should see a good recovery in the results throughout this year, probably accompanied by a re-composition of multiples negotiated by this company.

Furthermore, the possible capitalization of One Foods can represent yet another key to unlock the value of our investment. Therefore, for the coming quarters, we visualize a healthy combination of favorable cyclic moment, successful funding decisions and allocation of resources, and the gradual recovery of the Brazilian economy.



On January 17, in the column entitled 'Palavra do Gestor', the newspaper "Valor Econômico" published the following article by Augusto Martins, Partner at the Real Estate Investment Sector at Rio Bravo:

Outlook for real estate investment funds in 2017

When you think of investment, the first question that probably comes to mind is: "where should I invest my money?". If this is not the first question, it is sure to be the second.

Answers vary and are probably assertive only after many questions have been made. Profile? Horizon? Goals? Risk tolerance? Sectorial preference? After all, each investor has his/her own idiosyncrasies. In the world of real estate investment funds, this is no different. However, the question is usually even more direct: "what investment fund should I buy?". Far from having a single answer, it is interesting to look back and understand the behavior year over year, observing which funds presented good performances and which have not.

Currently, Ifix, the real estate investment funds index, has 70 funds in its composition setting - compared to 17 when it was first established, back in 2011. This data alone is already an indicator of how much the industry has been transformed during this period. It was only in 2014 that Ifix adopted

a composition similar to today's, since several new funds were created and many shares issued in 2012 and 2013. With this scenario in mind, it makes sense to analyze what happened not only in 2016 but also in the three-year period (2014 to 2016).

First, let's look at 2016. The ten best performances of the year do not have much in common; they are from several different segments and present different characteristics. Funds that had their "problems solved" - whether a relevant vacancy rates or management issues - represent a strong presence. On the downside, there was a common factor among the ten worst performances: above average vacancy rates.

The fact is that the real estate investment fund asset class presented a very good performance in 2016, with only four negative funds and, even better, 89% of the funds exceeded CDI, and 62% exceeded IMAB. Thus, it was more important for the investor to choose to invest in the asset class than to choose between fund A or fund B.



REAL ESTATE INVESTMENTS

How about from 2014 to 2016? The three-year period presents a quite different story, since less than half of the funds outperformed CDI and IMAB. However, unlike the one-year short-term period, the good performances have a lot in common and can easily be explained. The good performances were concentrated in four types of funds: Real Estate Investment Funds (FII) related to Shopping Malls, FII with AAA Offices in SP, FII with “atypical” agreements (long-term, without re-pricing or possibility of early termination) and FII carrying CRIs (fixed income securities with real estate collateral).

There is an intuitive explanation for this. Since retail was the last sector to be affected by the issues experienced by the economy, the crisis had not yet been felt in this three-year period. Buildings in São Paulo are not at their prime time, but the quality of AAA assets (and the scarcity of these funds) is rapidly noticed during recovery actions. Atypical agreements, in turn, are more resilient. Finally, all fixed-income asset funds presented a good performance at a time when the Selic rate remained mostly at 14.25%.

Hard to believe, but the worst performances during the three-year period are also easy to explain. Office funds in Rio de Janeiro

or funds with relevant (and persistent) vacancy rates had a bad performance during that period. The two other groups were the industrial/logistics funds and those with guaranteed income. Logistic real estate assets have a shorter cycle. Therefore, the crisis started earlier for them. Most guaranteed-income funds presented a relevant drop in income after the guaranteed period, which resulted in losses to the investor.

How about 2017? It would not make sense to look back and not attempt to make a projection for this year. It is likely that the best performances of 2017 are filled with “problems solved” funds, the best being those with significant vacancy rates. The million-dollar question is to find out which funds are those, since choosing an investment fund without the “problem solved” could result in the worse performance of the year.

Showing the best performance of the year is excellent, but it makes more sense to analyze a longer period - up to 2019 at least -, thus mitigating the performance risk with more consistent investment theories and greater chances of achievement in a longer period, since investing and gambling are actually two very different things.



REAL ESTATE INVESTMENTS

Therefore, funds with atypical agreements should be good options for the same reasons they were in the past, and fixed-income securities, even with the decreasing interest rate, should continue presenting a good return. FIs of class-A offices in São Paulo could also show good performance, probably with a cycle slightly longer than three years.

The scenario of other segments may change, with opposite results to those found in the past. Shopping mall funds, unlike the 2014-2016 period, may be slower in the 2017-2019 period, since consumers will continue in debt, with low confidence and high unemployment rates, signs indicating that retail could still take a while to recover.

On the opposite end, it seems that logistics assets may present better results ahead due to their shorter cycle. With their belts tightened, all industries and trade reduced their storage space to the maximum. Therefore, any improvement in the economic activity might increase the demand for such spaces very quickly.

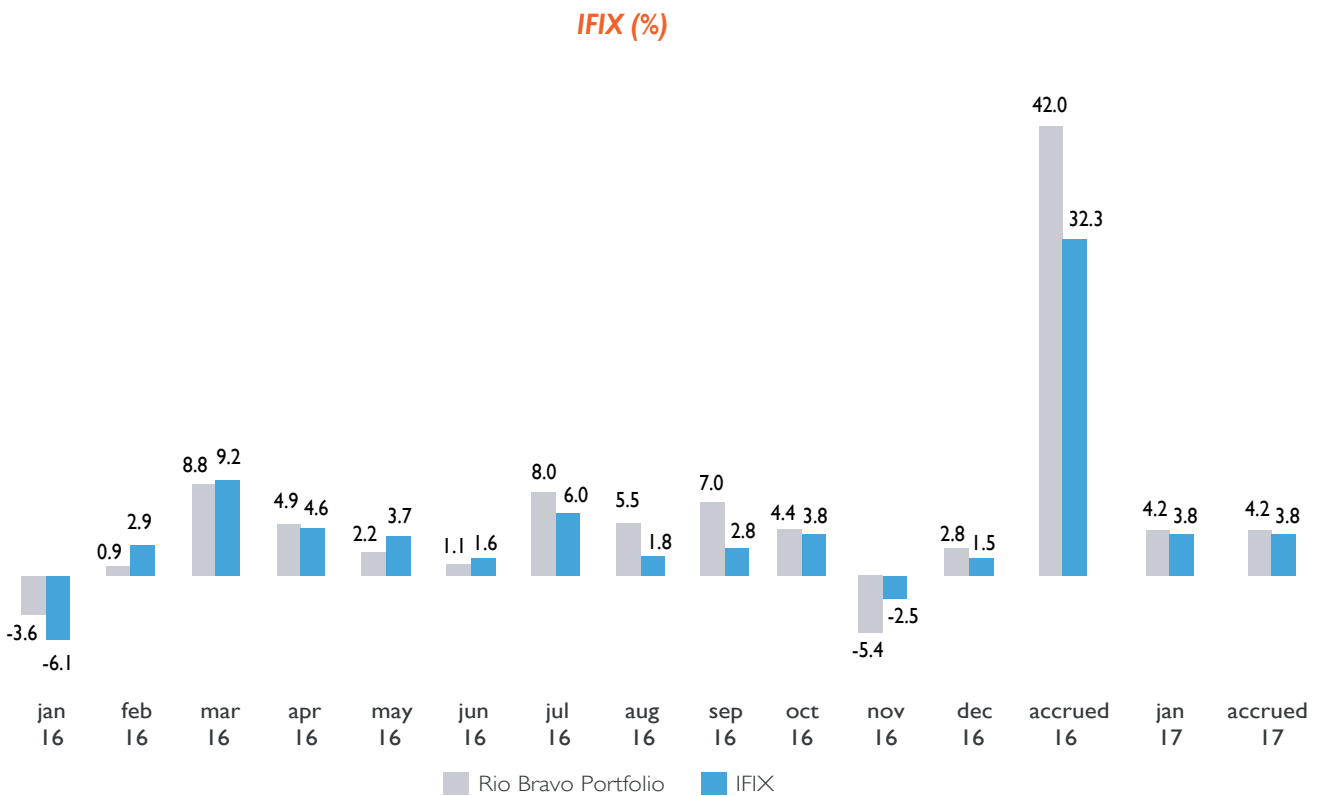
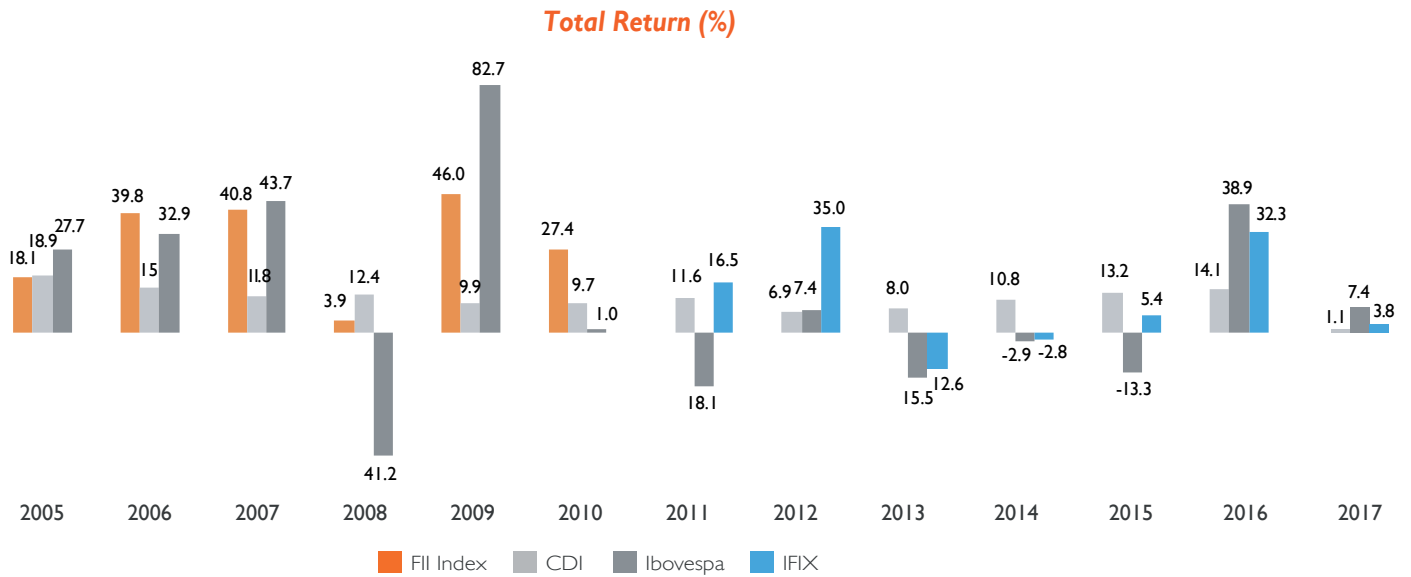
How about the FI industry? Without a doubt, we will see an expansion and consolidation of portfolios and product benefits. On the other hand, I dare to say that on average, returns will remain above CDI in three years. Only time will tell.

IFIX

The first chart below shows the total return of IFIX month by month, as well as an elaborate theoretical portfolio with the FIs managed by Rio Bravo, which can be traded at BM&FBovespa. The second graph shows a comparison of the total return each year, from 2005 until January 2017, among CDI, Ibovespa, IFIX and IFI index - elaborated by Rio Bravo and used for series prior to the creation of IFIX.



REAL ESTATE INVESTMENTS





The strong beginning of the year for local markets hides the feeling of future volatility in the foreign scenario. This is the context in which we are launching Rio Bravo Apollo FIC FIM, a low volatility macro investment fund.

In this area of the Strategies Letter, we will monitor its managers' position and the behavior of the fund, which completes a 12-month track record at home and for clients included in our portfolio, now opened to several investors and allocators.

Let's talk about the market. After much speculation, the Brazilian Central Bank has finally accelerated the drop in the prime interest rate with 75bps in the last Copom. With inflation under control, the activity now has a weight in the decision-making process. The cut started a trend for the period in several asset classes. With the interest curve now stable below 11% for the first time in about two years, IFIX and Ibovespa have also presented strong appreciation.

The greatest confidence for our structural position was precisely the interest curve. Once the gain was achieved, we decided to decrease the portfolio risk in order to protect the results. Consistency in the returns and in volatility is essential for the Brazilian investor. Therefore, Rio Bravo Apollo FIC FIM fund

closes the month with final profitability of 133% CDI (+1.24%) for the shareholder, with an even lower volatility than its target of between 3% and 4% p.a.

What next? The new U.S. President was sworn into office on January 20 throwing trade agreements into the air, together with inter-country relations, shaking the already tense and intense geopolitical scenario. Caution is now the name of the game. Structurally, we bet on the fall of real interest rates (NTN-B), protecting the yet small position, selling the Brazilian currency at a stronger level in the past 18 months. Occasionally, we allocate structured operations in the real estate market, which offer high return with low correlation to the other strategies. We will continue monitoring the protection options (hedging) in foreign markets in order to increase the local medium- and long-term allocation.



	Fixed Income			Equity		Multi-Assets							Indexes							
	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 Portfólio Diversificado II FIC	Rio Bravo Portfólio Diversificado Internacional	Rio Bravo Portfólio Diversificado Equities FIC FIA	Rio Bravo Juros FIC FIM	Rio Bravo Previdência FIM	Rio Bravo Absolute Yield FIC DE FIM CRED PRIV IE	Rio Bravo Columbia Threadneedle FIM IE	CDI	Ibovespa	SMLL	Euro	U.S. Dollar	IMA - B	IFIX
January 2017	1.15	1.04	2.01	2.99	1.27	1.27	1.26	-2.97	5.27	1.65	2.28	1.28	-1.48	1.09	7.38	11.42	-0.81	-3.27	1.87	3.76
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	1.12	-2.71	-0.54	-4.46	-3.86	2.91	1.47
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	1.04	-4.65	-8.44	2.42	6.02	-1.22	-2.55
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	1.05	11.23	7.01	-4.46	-2.11	0.64	3.80
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	1.11	0.80	0.09	1.86	1.11	1.57	2.77
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	1.21	1.03	0.18	-0.82	-0.68	0.89	1.84
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	1.11	11.22	14.60	1.70	1.12	2.51	5.92
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	1.16	6.30	9.12	-11.21	-11.04	1.93	1.61
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	1.11	-10.09	-4.21	2.20	5.12	-0.10	3.73
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	1.05	7.70	5.56	-3.79	-4.35	3.93	4.65
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	1.16	16.97	11.39	-6.42	-10.55	5.31	9.11
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	1.00	5.91	4.66	0.88	0.42	2.26	2.95
January 2016	1.06	1.01	1.34	-5.42	1.79	1.04	1.63	0.48	-2.54	2.06	-0.51	1.25	-3.56	1.05	-6.79	-8.53	0.70	0.97	1.91	-6.17
Year	1.15	1.04	2.01	2.99	1.27	1.27	1.26	-2.97	5.27	1.65	2.28	1.28	-1.48	1.09	7.38	11.42	-0.81	-3.27	1.87	3.76
12 months	14.64	13.26	21.27	16.78	9.66	16.60	14.12	-13.75	39.14	18.15	19.57	14.20	-20.22	13.91	67.56	61.12	-21.92	-21.09	24.79	45.85
24 months	30.03	27.99	35.91	1.33	-	30.52	29.51	25.38	26.93	27.43	21.29	29.03	-	29.35	35.40	27.08	15.42	20.90	33.76	40.87
36 months	44.73	41.13	56.34	-1.94	-	-	40.84	34.10	24.04	45.32	29.10	-	-	43.29	37.70	5.18	4.56	30.89	62.35	53.88
48 months	56.11	52.31	-	-13.30	-	-	45.91	-	3.57	38.71	-	-	-	55.19	9.70	-20.17	26.31	58.13	43.90	20.04
Since its inception	144.62	145.80	52.91	415.68	15.04	31.78	150.49	36.67	16.48	82.27	21.82	43.95	-20.86							
Current NW (in BRL thousands)	276,842	29,036	16,645	18,798	9,369	59,310	6,870	4,107	8,404	29,612	16,405	10,884	39,704							
Inception date	Aug-14-08	Dec-27-07	Feb-27-13	Sep-08-04	Aug-17-15	Oct-09-14	Nov-03-08	Dec-11-13	Apr-16-12	Jun-10-13	Mar-12-13	Mar-18-14	Sep-27-15							
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	-							

¹ Maximum management fee, including the management fee of the invested funds: 0.50% p.a.²

² Maximum management fee, including the management fee of the invested funds: 1.10% p.a.³

³ Maximum management fee, including the management fee of the invested funds: 1.10% p.a.⁴

⁴ Maximum management fee, including the management fee of the invested funds: 2.04% p.a.



RIO BRAVO INVESTIMENTOS

Mario Fleck

Chief Executive Officer
mario.fleck@riobravo.com.br

Gustavo Franco

Chief Strategist
gustavo.franco@riobravo.com.br

Paulo Bilyk

Chief Investment Officer
paulo.bilyk@riobravo.com.br

Rafael Alves Rodrigues, CFA

Equity Director
rafael.rodrigues@riobravo.com.br

Alexandre Fernandes e Souza

Fixed Income Director
alexandre.fernandes@riobravo.com.br

Anita Spichler Scal

Head of Real Estate Investments
anita.spichler@riobravo.com.br

Augusto Martins

Head of Real Estate Investments
augusto.martins@riobravo.com.br

Eduardo Levy

Multi-Assets & Portfolios Director
eduardo.levy@riobravo.com.br

Charles Putz

Net Assets
charles.putz@riobravo.com.br

Eros Dalhe

Operations Director
eros.dalhe@riobravo.com.br

Rodrigo Gatti

Compliance Manager
rodrigo.gatti@riobravo.com.br

Fabio Cardoso

Content Editor

INSTITUTIONAL INVESTORS

Scheila Lofrano, CFP

Director
+55 11-3509-6687
scheila.lofrano@riobravo.com.br

Rafael Conrado

+55 11-3509-6689
rafael.conrado@riobravo.com.br

Sarah Reis

+55-11-3509-6646
sarah.reis@riobravo.com.br

Henrique Rios

+55-11-3509-6688
henrique.rios@riobravo.com.br

PERSONAL ADVISORY

Felipe Vaz Magalhães

Director
+55 11-3509-6622
felipe.guimaraes@riobravo.com.br

Julio Ortiz Neto

Director
+55 11-3509-6618
julio.ortiz@riobravo.com.br

Rio Bravo Investimentos S.A.
Av. Chedid Jafet, 222, Bloco B, 3.º andar
04551-065 São Paulo SP Brazil
Phone: (55 11) 3509-6600 / 2107-6600
Fax (55 11) 3509-6699 / 2107-6699
www.riobravo.com.br

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