Fund Report

VBF Class A and VBF Class C

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Index

Summary

For most of us, the financial and economic crisis that overtook the world in 2008 has been qualifying as the most serious we have ever experienced in our lifetimes. Subjects like the "1929 Crisis", the "Great Depression" and the "New Deal" had always been distant, abstract references. Chapters in history books, but not newspaper headlines. If current fears will prove themselves well founded, no one really knows. It's a story to be written a few years down the road.

A great deal of time has been invested in summing up or explaining the present crisis, whose specter promises to haunt us for some time yet. In our view, to curtail our interpretation of the recent events to the failure of the free-market model, to the ailments of savage capitalism, or even to human greed, aggravated by the incentive systems that govern Wall Street, is an enticing and convenient proposal. It places us in the comfortable position of pointing to the "culprits" among Them, the Others.

We chose to follow a different path: to reflect a little bit, in the light of the crisis and its circumstances, on the importance of all of us perfecting our use of the best risk-control tool that we know: **moral diligence**.

It is the "by design" fragility of incentive systems, and the importance of raising our moral critical standards, which are addressed in the introductory texts "Own Goal" and "Dolus Bonus", followed by the text that subsumes the core of our reflection: "Moral Diligence".

In the investments section, we present an analysis of the performance of VBF in 2008. In addition to a retrospective look at the year, we comment on some of the main changes in the fund's portfolio and present some of the new positions that were put together during the last months of 2008, already taking advantage of the opportunities resulting from the crisis. Further in this section we present a brief investment case on the company Anheuser-Busch Inbev (ABI), one of the top holdings of the portfolio.

We conclude the report with the transcript of an address by José Galló, Lojas Renner's CEO. On the occasion, Galló had just received the award "Sales Personality of the Year" from the ADVB[1]. In his acknowledgement speech, he chose to "sell" the audience scarce goods, real luxury articles: "principles", "ethics" and "values". Although it took place three years ago, it is worth reading and reflecting on what he said.

[1] Brazilian Association of Sales and Marketing Managers

"The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design."

Friedrich Hayek

Own goal

During the Shell Caribbean Football Cup in 1994, two countries were fighting for classification for the second phase of the competition: Barbados and Grenada. Barbados needed to win by a difference of two goals. If it won by only one goal or if it lost, Grenada would be classified. But if there was a draw, the story could be different.

A new rule adopted by the organizing committee introduced a novelty. So as to make the spectacle more exciting, incentivizing the teams to be more aggressive in "tough", close matches, the organizing committee came up with the following formula: if a game ended in a draw, there would be extra time. What is more, any goal scored during extra time (and while the "*golden goal*" was in force there could only be one per game) would be worth two when the balance of goals was counted; the key criterion for the decision, if the teams had reached the same number of points.

Because of this rule, the game became very interesting. Barbados was winning by two-nil up to the final minutes. But at the 38th minute of the second half: Grenada scored a goal, making it 2 x 1.

Now under the gun, Barbados tried to strike a third goal for a few minutes, but soon realized that it was not going to be easy. After scoring the goal, the Grenada team fell back, closed in and was firmly on the defensive. The pressure on Barbados was high. With the game almost over, its players were visibly tense. But after weighting their options, they acted rationally: thanks to the new rule, it would be much safer to score an own-goal and force the game to be extended (when one goal would be worth two), rather than try to score against the Grenada team, which were in heroic defense.

And that's exactly what happened. After exchanging a few passes with his goalkeeper, Sealy, full-back of the Barbados team, kicked the ball into his own goal, causing the game to be drawn at two-all.

But that is not yet the strangest part of this game.

On kick-off, at the 40th minute of the second half, the Grenada players went on the attack, but were visibly downcast. After 2 minutes of a desperate attack, they reckoned the alternatives: if they scored an unlikely goal against Barbados during the last few minutes, they would be classified. But if they scored a goal against themselves, they would lose by a difference of one goal, a result that would also place them automatically in the next phase. Therefore, they launched themselves full steam ahead in pursuit of the saving own-goal.

What was seen after that was a true slapstick episode: the Barbados players anticipated the Grenada team's move and divided themselves in the field between defending both their own goal and that of their opponents (from themselves). Sealy, the Barbados goal-scoring full-back, placed himself beside the Grenada goalkeeper in order to defend their goal from their own team!

The game ended in a draw, and at the fourth minute of extra time Barbados scored the golden goal and was classified. The players were not punished, because "both teams were genuinely trying to advance to the next phase, following the rules of the competition".

The moral of the story: designing incentive systems laden with good intentions and believing in our ability to foresee the consequences (direct, indirect, and those that will arise way ahead, as the result of the autonomous interaction of the "agents" of the system in question), seems much easier than it really is.

In the present context, in which governments and regulating bodies appear as a lifeguard to restrain and remedy the limitations and disorder in the free market, it is good to have examples such as this as a reference, in order to recall the tremendous iatrogenic potential of regulations: the "remedy" very often kills rather than cures.

The list of curious examples of measures that backfired, though "carefully designed" by the most diverse entities and organizations, is rather long. In Brazil, the taxation of commercial flows between jurisdictions in accordance with the principle of origin, one of the main factors of the tax war that has overtaken our federalist system, feeds a well-known perverse incentive: the transport of goods between States follows a tax-efficient route, making our already precarious logistics system even more unproductive and inefficient.

In the United States, the institution of the Prohibition in 1920 to eliminate crime in the country proved to be a resounding failure: it was expensive to implement and enforce, generating, as collateral effects, a rise in violent crimes, an explosion in consumption of stronger, home-made alcoholic drinks (the number of deaths due to cirrhosis in the period remained stable) and a huge drop in tax collection.

In French Hanoi, a law created to end a plague of rats paid the "hunters" for each rat carcass. It ended up stimulating gigantic rat-breeding operations.

In China, in the 19th century, peasants received a reward from foreign paleontologists for each fragment of dinosaur bone found. In order to maximize their remuneration, the peasants used to break the bones into several small pieces.

Finally, a more current and universal example: the medical reimbursement system for insured patients which remunerates the treatment of illness, rather than its prevention, is one of the simplest and most harmful misalignments of interests that we know of.

Frédéric Bastiat, acclaimed by Schumpeter as "the best economics journalist the world has known", called our attention to "the difference between a bad economist and a good one". "The first only sees the direct, short-term consequences of actions, while the second observes the indirect consequences in the longer term." According to Bastiat, "To understand the immediate consequences of a law is not enough to judge its efficacy. It is necessary to try to uncover, *a priori*, all its long-term consequences for society as a whole. The more politicians concentrate on solving specific problems, the greater the disaster becomes on a broad scale. An economic policy consisting of immediate measures, with its simple, miraculous promises, causes a much greater impression than an invitation to intellectual exercise."

But the problem of incentive design is even more serious. Because the market is dynamic and operates as a complex adaptive system, it goes on "learning", "evolving" and becoming "autonomous" over time, as its agents interact, cooperate and compete among themselves. Therefore, some of the consequences of new schemes and regulations, positive or negative, are by definition unknown at the time they are formulated.

What is more, it does not help, as we say in Brazil, "to hide the sun with a sieve": any incentive scheme or system, tacit or explicit, can be bypassed. As Andy Grove says: "For every goal you put in front of someone, you should also put in place a counter-goal to restrict gaming of the first goal". If you pay your programmers to solve bugs, do pay them also for quality and new features, or several of them will create real "bug factories".

That is why it is important for us to use high moral criteria when selecting our business partners, associates, and even our clients, in order to restrain one-dimensional and undesired behavior.

Although Academia and the media focus mostly on financial incentives, we can roughly divide the types of incentives into three groups: material/financial, moral/social and punitive/coercive.

The punitive incentive is simple: going off the tracks implies being dismissed, imprisoned, sued, etc. Monetary incentives are old acquaintances: powerful motivators, they encourage people to wish… for more financial incentives. The problem is not that they don't work. They work too well, encouraging people to focus their attention on a behavior that is directly associated with compensation. When money becomes more obvious, vivid, people find it much more difficult to see long-term dysfunctions or ethical dilemmas involved in the process of obtaining their results. People will tend to focus only on doing what matters in order to capture the incentive.

Finally, we have moral interests (doing the "right" thing because it is "right", and full stop), as well as social and personal interests. No matter how much some theorists may lead us to think the opposite, people are not mere economic agents, acting with a view to maximizing their material interests. They have other aspirations and goals. They are moved by passion and ideals. They want to be inspired. To dream. To accomplish. They have interests that are sometimes ambiguous and conflicting. Competing motivations. They give in to peer pressure. Their ambitions and preferences varies over time and are subject to interference.

To believe that people only act because they want to retain or accumulate wealth is to suffer from extreme short sight in relation to what we are and do.

Curiously, exceptional performance, in several domains – including the financial market itself – does not necessarily originate from extrinsic rewards, but from intrinsic motivation. In the words of the serial entrepreneur Richard Branson: "I never, ever thought of myself as a businessman. I was interested in creating things I would be proud of." Buffett himself refers to Berkshire Hathaway as his "canvas", and likes to say that he feels like a Michelangelo.

Moreover, sometimes transactional incentives are in fact clearly subordinated to moral incentives. A recent example: six nursery schools in Israel imposed a fine in cash in order to encourage parents who used to be late collecting their children to arrive on time. The result of the measure was somewhat unexpected: instead of decreasing, the delays doubled in number. And they remained high even after the fine was removed. **The relationship had changed from the social, personal sphere ("if I delay, the teachers will suffer, they will take longer to get home"), to the transactional realm. The moral cost of the offense became low.**

Thus, the design of an incentive system is only successful – that is, when the resultant between the explicit incentives vectors and the different variables that influence the behavior of the agents that are the scheme's target, points in the desired direction – if it is permeated by a clear set of solid principles and values.

Moral behavior is not exercised by creating ethics committees and drawing up codes of conduct. Hanging the mission, principles and noble values on the wall is also far from enough. Companies need a code of conduct, but one that is tacit, anchored by the reputation and behavior of their leaders.

The environment in which incentives are (re)created and propagated is absolutely crucial for the net result of behaviors not to point in the wrong direction. Very often some explicit incentives are subsumed by tacit incentives, which are undeclared but embedded in a company's culture.

Social relationships are marked by the uncertainty regarding future reciprocity. The obligations of the parties involved are diffuse and uncertain – they bear risks of defection or exploitation/opportunism. It is our understanding that in any relationship, and especially in long-term ones, the material and financial incentives should be clearly subordinated to broader personal and social interests, and simple moral principles and values, such as honesty, integrity and respect, as long as they are genuinely experienced in everyday life. The logic of the transaction should be subordinated, as a matter of principle, to long-term relations. Always. And this must be unquestionable, not negotiable.

In our view, the best possible system of alignment is for us to select our associates and business partners with great zeal. They should be few and competent, well educated, ethical, and genuinely aligned and committed to our way of seeing things, to our long-term vision. This is far more efficient than trying to "sew up" incentive systems that are real strait jackets and that, at the end of the day, can be escaped from if the alignment between the parties is not genuine, legitimate.

"The iron rule of nature is you get what you reward for. If you want ants to come, you put sugar on the floor."

Charlie Munger

Dolus Bonus

In the first half of the last century, some of the wealthiest university professors in the whole world were art historians, who earned their living less by their teaching gifts, and more by the strength of their opinions. As experts, they attested to the authenticity of works of art by the great masters, especially the old, classical painters. Their job: to certify that a painting was in fact a Rembrandt, a Rubens or a Titian.

At that time, documental study and technical laboratory analyses were still very incipient, and the attribution of authorship of a work of art was done with the naked eye, based merely on connoisseurship[1], a very subjective process which required sensitivity and experience. Some specialists went so far as to smell and even lick the paintings – let's agree, it worked at least to identify the "Botticellis" produced that same week – but the appraisal of works by means of photos was common practice, especially in intercontinental transactions.

The experts were true authorities. For the appraisal of a work of art, they would receive a commission, a percentage of the sales price that could range from 5% to 25%. Obviously, if they confirmed it as genuine, they would earn astronomical figures. If they belittled it as false or as a work by some other, "lesser" painter, their earnings were much more modest.

Great collectors such as J. Pierpoint Morgan, Andrew Mellon and Henry Clay Frick entrusted the selection of these experts to their dealers. Competition was intense, and frauds common. Little by little, the tycoons were learning to protect themselves, selecting only the more reliable and experienced as business partners.

Among the dealers of that time, Joseph Duveen was undoubtedly the most famous in the intermediation of works of the great masters in the New York-London- Paris circuit. Through his company, Duveen Brothers, he was one of the protagonists and a great beneficiary of one of the largest transfers of cultural assets of all times: from 1890 to 1929, fast-rising American entrepreneurs, industrialists and bankers took possession, on a large scale, of European cultural treasures. And for the first time in History, not by force of sword or cannon, but by the "invisible hand" of capitalism.

Duveen's internal intelligence service could be the envy of many contemporary organizations, capable of advising him of the first signs of any fatal illness in the Great Houses of Europe, or of imminent insolvency in the English or French aristocracy, besides always keeping him informed of the secret preferences of American tycoons. The "dealer king" recommended butlers, chamber-maids and chauffeurs to his clients, taking care to keep them on his own payroll.

Duveen had a spectacular eye for art objects (evidenced by the clearly positive outcome of countless legal battles about the authenticity of art objects in which he was involved), but in order to countersign the authorship in transactions involving works of art of the Renaissance period, he counted on the advice of the eminent professor of the history of art, Bernard Berenson, who endorsed *pro homine* the authenticity of the works in his collection.

Berenson was, in fact, the greatest authority on Renaissance painting at the time, and used all his connoisseurship and reputation as a historian and "independent" critic to validate the authorship of dozens of works of art in support of Duveen. A secret contract with the dealer guaranteed him the payment of a fat percentage for each work sold in the course of 27 years.

[1]Knowledge of techniques and concepts of art that qualify an individual to play the role of appraiser of the authenticity of works of art.

One of them, the "Madonna and Child", was first appraised by Berenson as "in bad condition, without defined origin", when Duveen acquired it in 1895, and a few years later it was re-classified by Berenson himself as an authentic "Bellini", allowing Duveen to multiply tenfold the price paid for the work.

The majestic Villa i Tatti[2], Berenson's property in Florence, is a most beautiful witness to the degree of wealth he attained through his agreement with Duveen and others. It is important to observe that, in the course of time, several of his ascriptions eventually proved to be wrong, though most of them were correct.

In short, during the formidable "bull market" in the art sector at the beginning of the last century, a real virtuous circle of incentives was closed: the favorable opinion that made the professor rich also endorsed the dealer and the seller. What is more, the buyer was not left out either: with the expert's guarantee, he became the owner of a certified work of art. To have a "Raphael" certified by the seal of Berenson was worth much more than just a "simple Raphael". Finally, if we add to all that the tax benefits granted at that time for donations to public collections, we have a true "heavenly feast".

It was not by chance that the period prior to the First World War was a Golden Era for art dealers, when the prices of some works of art reached levels that would only be seen again in the eighties. Not only was demand high, but also Duveen and his team were always trying to keep the market up by nourishing the rivalry between the legendary Fricks, Altmans and Huntington family with information and intrigue, using the contemporary press with great skill (especially the New York Times).

The similarity between this "virtuous" circle of fees and commissions and the merry-go-round led by brokers, investment banks, rating agencies, investors and companies of the modern world is evident. So is the vast range of misalignments and conflicts of interest inlaid in the model. And if Duveen went so far as to sell the work "Aristotle contemplating Homer's bust" four times, always pushing the price up, Avis, the car rental firm, has been bought and sold no less than 18 times since it was founded in 1946 – probably handing to lawyers and banks, in fees and commissions, a good deal more than the value of the whole company at today's price.

With regard to the chain of US sub-prime loans, consumed from Oslo to Bangkok in their re-securitized clothing, or the IPO feast here in Brazil, they are very similar in general lines. With an aggravating factor: the relationships, and the processes of placing, packaging and selling securities, have been "industrialized". There was a loss in art and romantic style, but a gain in scale and productivity. And simple but powerful ideas, such as "Europe has art, America has money", may be exploited and geared up today in a much more efficient way – at least for some time.

Systems such as the financial markets, which depend on cooperation and exchange, are founded on a framework of reciprocal trust. Whether working for institutions or for their own account, people must trust their counterparts.

At the heart of the natural credit system, in particular, lie two fundamental aspects: personal reputation and the community. The crucial decision in granting credit is "will this guy pay me?". It is not just a matter of cash generation capacity, but of character and reputation. The roles played by those who grant the loan and those who take it are important, very important, in the local social network. The purpose of the credit is key.

In today's financial system, relations between the agents exist more and more on a strictly transactional basis. Technology, interconnection between markets, de-regulation, securitization, and with them the profusion of new, increasingly complex products, which nobody has the time to decipher but everybody wants to consume, have created a gigantic efficiency machine. If on the one hand this efficiency has permitted huge scale "gains", on the other, it has reduced relationships and credit to their transactional dimension, multiplying the moral hazard exponentially, changing social and local links into pasteurized transactions that are global

[2]http://www.itatti.it/

in their reach but without anyone socially responsible for them. The system's gears gave us the right to act physically, without doing so politically or morally. There is no "personal" responsibility, reputation cost, when promoting a credit that is going to be re-packed, priced, ratified and consumed very far from where it originated.

Innovations such as mortgage pools extinguish the social element in transactions. Derivatives and swaps too. The direct relation between the person who lends and the person who takes the loan is dissolved. Social pressure disappears. And the result is that, adding the markets' transactional steamroller to the greed of the agents, geared up by incentive systems where conflicts of interest are obvious and the vigilance of regulating bodies is insufficient and inoperative, Alabama sub-primes end up being thrown outspread out, together with their tranche fellows, reaching remote beaches on the other side of the world, in the hands of investors hungry for higher but guaranteed returns. Credit scores and agencies' ratings have shown themselves to be very bad proxies, not only for payment capacity (cash-flow), but also for "reputation".

After being reduced to one dimension alone, limited to its transactional component, credit had its real risk disguised for creditors and borrowers. This, added to the opacity and high leverage of financial institutions with laughable risk controls, and the excessive complacency and credulity of agents throughout the consumption chain, instead of efficiently promoting the much-celebrated transfer, re-distribution and dispersion of risk, ended up contributing, as a catalytic agent, to a real metastasis of the system's liquidity.

"What aren't you able to bring men to do, miserable hunger for gold!"

Seneca

On Moral Diligence

2008 was a long, hard and troubled year, during which the world financial system had its governance and compliance structures questioned, and the markets went completely off the rails; they were severely destabilized and shaken by a crisis of confidence that was unprecedented in complexity and scale.

It is no exaggeration to say that, from September on, the generalized uncertainty and mistrust severely dried up the liquidity of a system that had already been staggering for over a year, locking its financial and transactional gears.

The banks, whose very existence is founded on the most basic form of "credit", their reputation, stopped believing in each other's balance sheets and capacity to survive. They discredited their own auditors, as well as their compliance mechanisms and risk gauging and control systems. They started to doubt the payment capacity of those they finance. Insurers stopped trusting those they insure, and vice-versa.

All over the world today, producers suspect suppliers, and salesmen their customers. Contracts were and are being questioned, suspended and canceled. Voters are skeptical about the capacity of their governments to resuscitate the markets and the economy in a fair and efficient manner. And governments do not believe in the autonomy of the markets. The market, in turn, trusts neither the government nor the regulators. Investors question their advisors, who in turn question their managers, who no longer believe their economists and analysts, who do not trust their models any more. It is a long list. Bonds of trust, once broken, take time to rebuild. And many of the consequences and effects of these ruptures are yet to come.

In this context of worldwide broken trust, we would like to share with our clients, business partners and friends a reflection of a moral nature. But one that is not moralistic.

In our opinion, which differs from the consensus, to reduce the recent events to human "greed", to deposit them in the account of the "irresponsible behavior of a few" or, at the opposite end, to interpret them as a direct, exclusive and inexorable consequence of a framework of incentive systems and the conflicts of interest associated with same – for which, at the end of the day, no-one feels responsible or accountable – is to ignore an issue that we consider crucial: it seems to us more interesting to look at the situation from a "micro" point of view, where we can in fact take action, than from a "macro" angle, where searching for culprits and definitive explanations, or even postulating solutions, is beyond our scope and competence.

In the sky-high "macro" sphere, realm of Them, the Others, we all think ourselves creditors and victims. But it is in the streets and alleys of the "micro" sphere that **We** are (or should be) accountable.

It seems more productive to use the crisis as a backdrop for us to reflect on potential forms of protection against our own recurrent fallibility (greed, imprudence) and the fluctuations in the alignments of interest that are intrinsic to each and every relationship.

We could hastily reach the conclusion that the design of the incentive systems that govern the relationship of agents in markets and organizations "perverts character", instigating agents to "act". And conclude, like Shakespeare's Cassius trying to persuade Brutus to murder Caesar: "For who so firm that cannot be seduced?"

And how can we apply this premise on a "macro" scale? Re-designing the explicit and tacit incentive systems that govern exchanges among the agents? Establishing more and better surveillance, reinforcing regulations, imposing more controls? Frankly, we haven't the faintest idea. It is outside our circle of competence and, honestly, we are somewhat skeptical about it.

But with regard to our own "circle of trust", emphasizing the importance of all of us acting in a morally diligent fashion – especially in selecting our business partners, employees and investments – is definitely in the order of the day. And there is no doubt: this is an extremely important subject that generally goes unnoticed while the world moves full steam ahead, and only becomes evident and haunts us at times of crisis.

We wonder whether to ponder such a question is the quintessence of naiveness on our part. But naive and foolish is to think that only the "market's" incentive systems are misaligned or corrupted.

Yes, in the financial sphere, there are very clear points of unbalance, which, as became evident in this and in several of the latest crises, instigate behavior that crosses, without shame or remorse, the frontier between simple "misalignment" and moral issues. As we have seen, the huge machine of transactional efficiency of the global markets intensifies this effect.

But it is worth looking at this issue very closely: to well-trained eyes, conflicts of interest are easy to see. In many cases, like the Wall Street bonuses, they are explicit.

But "misalignments" – that is, the imperfect convergence of interests among agents - are much more difficult to see. Primarily, they belong to the sphere of the tacit. They are multi-dimensional and fluctuate over time. They are much more difficult to pick out in contracts or schemes. Preferences change over time. They are volatile, ambiguous and conflicting. Anyone who has had friends or partners knows exactly what we are talking about. By definition, there is no "perfect" alignment of interests. Or do you think that this malady is exclusive to the financial market?

Yes, structurally, we live under the aegis of a generalized misalignment of incentives – from our government systems to mechanisms for remuneration and promotions in companies, which, given time, could even be corrected, improved, or at least better watched over, controlled, punished.

But the other side of the coin, what demands our attention a great deal is that, despite the "structures", "systems", "markets", the social pressure to follow tacit rules and behavioral consensuses, the struggle to deliver significant results, to be better than the competitors, there is ALWAYS the option, as a matter of principle and discipline, to use from the very beginning a high moral filter for everything we do.

The option to say "I will not take part in this", "No, I will not invest in this fund with the best Sharpe Ratio without fully understanding the process that generates this irreproachable performance", "No, I will not manage this company or investment fund aiming at short-term results", or "I will not do business with these people of questionable reputation" DOES EXIST. Always.

This posture is valid with regard to managing our own business – as usual, it is always easier said than done – but it also extends to the people close to us, and is especially critical with respect to the business partners we select – in relation to whom our degree of control is clearly lower.

It is not by chance that, as long-term investors, one of the aspects that we most consider in filtering our potential investments are the people involved and their motivations. What type of partner do we want? Has the company in fact an owner or owners? Who are they? Where do they come from? What are their aims, their ambitions for themselves, for their families and for the company? What do they value and despise? How are they called to account? How do they measure their progress, their success? How do they act in relation to their associates (business partners, clients, suppliers, etc.)? What are the values that are really adopted and practiced by the company: how are they reflected in the behavior of the owners and employees? How do the explicit and tacit incentive systems of the different areas of the company interact among themselves?

Fully understanding how the organization chart of a potential investment really works in real life (in greater or lesser harmony with the company's explicit incentives) should be covered in a special chapter in each and every book on valuation.

It is astonishing how powerful an analysis based on people and their motivations can be. What is more, this "social auditing" should also be extended to the company's "neighbors", the key points in its value chain.

For example, when we "analyze" a company that sells products and services to another, it is crucial also to know: WHO is really responsible for the purchase of the company's product? How is HE compensated? How is HE, the buyer, profiting from the purchase? What is HE placing at stake?

In short, if the misalignment of interests among "agents" (always flesh-and-blood people) is a fact of life, there is only one reasonably effective way to deal with this: to make use of a high moral/reputational filter and to keep within our circle of trust just a few business partners/associates, but good ones: competent, ethical and genuinely aligned.

A good example of moral diligence to be followed is that of Warren Buffett, whose control and governance system for the companies in which he invests is, at first sight, rather "loose". And even so, he gets it right much more often than not.

In the words of Charlie Munger, his partner at Berkshire Hathaway: "it's wonderful to be trusted. Some think if we just had more compliance checks and process, virtue would be maximized. At Berkshire, we have subnormal process. We try to operate in a web of seamless trust – deserved trust – and try to be careful whom we let in."

Part of their secret: a very good eye for evaluating a person's character (and the ability to audit their reputation with a couple of phone calls). But obviously the two men only developed this sharp perception because, at a given moment in their careers, they gave this filter a **disproportionally high weight** in evaluating potential investments. This makes all the difference.

If on a scale from one to ten, traditional investors give a weighting of 3 or 4 to traits such as integrity, character and values, in Buffett's case, where the horizon for carrying an investment is "forever", there is no other way: the weighting must be close to 10, and in the hierarchy of desirable attributes of a good investment, precede all others.

Buffett applies a high moral filter, he says, always seeking three characteristics in his potential business partners: integrity, energy and intelligence. In this order. And in his own words: "if your candidate does not have the first, the other two will kill you".

On the other hand, it is important to stress that, sometimes, basing a good part of the process of selecting business partners on an apparently robust moral filter, but without due diligence, has the opposite effect. In cases such as that of Madoff, the exaggerated trust that many of his victims placed in the investor's most obvious traits (former Nasdaq chairman, a link with charity and the Jewish community, several of his investors had an irreproachable reputation, his intermediaries were renowned companies, the fund always delivered good, consistent results, though not extraordinary, and for years on end) created an aura of "integrity" around him that made his scheme very convincing for a long time. In this case, the "moral" trait took part in the selection process, but diligence was insufficient. The golden rule is "Trust. But verify".

Well, taking all that into account, what should be done from the practical point of view to safeguard ourselves, at the "micro" level, from our own mistakes?

Firstly, having a very clear notion of our suggestibility and susceptibility (recurrent fallibilities and biases), and controlling it with principles, values, discipline, systems, internal processes, and a competent, aligned team; demanding a significant margin of safety; and knowing that, even though well-meaning and alert, we can be (and are) fooled by our senses, judgment and evaluations of information and – even more important – people.

Secondly, building an environment that will clearly promote incentives other than just material ones (starting with the selection of people using an ever higher "moral filter"), in harmony with the principles and values practiced in the company (selection of associates/counterparties – few, competent, honest and aligned – who share these principles).

Thirdly, being morally diligent – with ourselves and our business partners. This applies to the evaluation of the companies in which we invest, to the people we hire and keep in our team, to the people who render us services, to our business partners, and to our clients as well.

Conclusion

We used as a backdrop reflections on "incentive systems", like those that marked the present financial crisis – and, along with several other factors, helped to gear it up – in order to throw a somewhat solitary light on another place: the importance of raising our standards, our **moral filter**, ever higher when making our choices, less as agents of a transactional system, but more as responsible members of a community.

When we reflect on last year, one of the most important things we have learned is that there is no better risk control than to be surrounded by good business partners and few, both in-house and outside: competent, well educated, ethical, and genuinely aligned with and committed to us for the long term.

In this respect, we seek always to be on the alert – and even so, now and then we err in evaluations and judgments.

To elect a high moral filter as a crucial instrument for risk control has a high "visible cost". The universe of investments that we can consider is drastically reduced (it is not for nothing that we seek to invest in companies on a global scale, so as to expand our reach without having to lower our governance and management-quality benchmark). The universe of employees that can be hired and eligible partners, ditto. In short, as a rule, our number of potential business partners falls a lot.

On the other hand, the "invisible benefits" generated by this more conservative conduct are extremely valuable to us. And in our assessment, they more than compensate the visible costs.

A good way to think about moral diligence is to make use of an old friend: the margin of safety concept. Just as we must invest in companies whose price offers a significant margin of safety in relation to our perception of their value, we must also require a "margin of safety" when we assess the moral contours of an opportunity for an investment or partnership.

The fact that we seek to be always on the alert does not mean that we always get it right, whether internally or externally. Last year is a good example of that.

But the simple fact that we pay attention to the importance of being increasingly morally diligent with ourselves and with our associates helped us to minimize some of the mistakes made and to correct them relatively quickly. Our portfolio today is, to a large degree, a positive result of these changes.

Finally, in order to exemplify the type of partnerships that we greatly enjoy cultivating, we have selected a very interesting text: the transcript of an address given some years ago by José Galló, the president of Lojas Renner. On that occasion, Galló had received the award "Sales Personality of the Year" from the ADVB[1]. And in his thanking speech, he chose to "sell" to the audience scarce assets, true luxury goods: "principles", "ethics" and "values" (the address is in an Attachment at the end of the report). It is especially interesting to the shareholders of our funds, since we took the opportunity provided by the market to put together again a significant position in the company, our old acquaintance, at extremely attractive prices.

As a final message, a very simple observation: properly exercising what we call moral diligence implies doing more with less. The universe of investments, counter-parties and partners that can be considered is reduced. And that is precisely the direction we're following. We want few but good business partners with whom we can cultivate and nourish relationships that transcend the transactional.

To have a select group of clients and business partners who admire and trust you is immeasurably more valuable than an infinite number of clients and

[1] Brazilian Association of Sales and Marketing Managers

business partners that maintain a merely transactional relationship with your company. In this respect, we feel privileged.

We agree once more with Buffett and Munger: "we try to operate in a transparent web of seamless trust – deserved trust – and try to be careful whom we let in."

All funds managed by IP presented significantly negative performance in 2008, including VBF Classes A and C. The fact that our performance was similar to that of the Ibovespa is a reason for great disappointment to us. After all, over the years, one of our funds' most distinguishing features was their conservative approach, which caused the funds to book relative results that were consistently satisfactory in bear markets.

Despite all the talk about how exceptional the biggest crisis in the last 70 years was, etc., we expected a better relative performance in a scenario such as this. We think it is fundamental to analyze what happened. Obviously, there is a series of components, but two points stand out very clearly: the Globex (Ponto Frio) position and the position formed by Coteminas and Springs Global shares (Coteminas/Springs) that we had at the end of 2007. Together they were responsible for a loss of over 35% in VBF Class A (of the total 57%) and 20% in VBF Class C (of the total 41%) in the year.

Both positions proved to be wrong in the size/risk ratio. In the case of Globex (mostly in Class A), we were close to making a public stock offering at the beginning of 2008, but in the end the deal had to be aborted. In the case of Coteminas/Springs (in both Classes A and C), in addition to a combination of macro-economic factors that greatly harmed the company's results, we had a much larger position than we should have had, given the companies' prices and attributes. To end this story, the capital increase proposed by Springs and the consequent dilution of shareholders at the peak of the crisis helped to crystallize the transformation of what could have been a temporary depreciation (at least in part) into a loss.

Another way to break down the problem is according to the relevant periods. In this way, we see that in the first semester VBF Class A fell by 5% while the Ibovespa was up 13%. The sum of the losses from Globex and Coteminas/Springs corresponded to 12% in VBF Class A. This was clearly the critical period in defining the year's performance. In the same period VBF Class C rose by 9%.

The degree to which our posture is aggressive or conservative is always an important subject and a source of concern at IP. Since the beginning of 2008 we had started a "back to the origins" movement in our internal processes (we tried to illustrate this in our quarterly reports), which culminated in June with significant changes in the management team and the strengthening of the founders' "final word" regarding risk.

From July to September, we went through a period of considerable adjustments in the portfolios, especially at the selling end. The relative performance still suffered more than it should, reflecting the way problems were addressed and the assumption of losses: VBF Class A fell by 37% and VBF Class C by 31%, as against the Ibovespa's 39% decline.

In the last quarter, as the market approached its nadir, we had already been through ours. The funds' long positions were greatly reduced: in VBF Class A from 99% on June 30 to 76% on September 30 and in VBF Class C from 89% on June 30 to 69% on September 30. Also, in this process all positions were adjusted to a much more conservative view.

Thanks to the crisis, which was the catalyst for a price movement in line with our restored, extremely conservative approach, the results started to appear more rapidly than it was reasonable to expect. While the Ibovespa fell by 36% in the last quarter of the year, the VBF Class A was down 29% and VBF Class C 22%, resuming its historic standard (it is important to note that in order to recover from a negative fluctuation of 29%, a 41% rise is necessary, while for one of 36%, over 56% is necessary).

We closed the year with approximately 80% invested in shares and a portfolio that leaves us much more comfortable, considering that our large positions are in companies of the highest quality and soundness – and even so, smaller than those we held in Globex in VBF Class A and Coteminas/Springs in both VBF Classes A and C.

Some of these companies deserve to be highlighted.

One is Saraiva, which we have known for so long. Although its stock price suffered (causing a negative impact of 6.7% in VBF Class A and 7.2% in VBF Class C), the company continued its apparently inexorable march along the path of profitable growth. The publishing firm (Editora Saraiva) continued to present a good performance. The bookstore chain (Livraria Saraiva) recorded a large increase in results, based not only on favorable winds but also on tangible operating improvements. The "dot.com" segment is expected to have closed the year with sales above R$ 300 million, and the acquisition of its main competitor, Livraria Siciliano, was concluded. We consider the company's capital structure to be very comfortable. Our expectation is that the integration of Livraria Siciliano's operations and improvements in logistics will absorb everyone's attention in the next few months. We also believe that, despite all the success already achieved, the "dot.com" operations still present great potential for growth and value creation. Saraiva's shares represented approximately 10% of the funds on December 31, 2008.

Other old friends that have returned in full force to the portfolio are Lojas Renner, Itaúsa and Ambev. In our opinion, an important characteristic is common to the three of them: they are companies with "top global standard" management quality. And we don't say that based on third-party impressions. We have followed all of them for at least 15 years, a period during which we have always sought to take them as benchmarks, studying their peers at a global level. Within a context such as today's, we see this aspect as significant and rare.

Lojas Renner continues to display the qualities we have known since 1994: exceptional management, even by global standards, focus and high quality execution. Since the company returned to the market (in June 2005), we had been waiting for an opportunity to build up a significant position again. This is one of the advantages of the retail segment for the long-term investor: one weaker quarter, and the best companies are priced based on the perpetuation of that specific quarter's results. With the global crisis coinciding with the risks of an acquisition process and atypical weather, the company's shares suffered a sharp fall, together with the availability of substantial blocks of shares for sale – a rare combination for a good quality company. The issue of the acquisition of Leader Magazine was resolved without any cost for Lojas Renner – the deal was abandoned in agreement between the parties. The crisis is real, but companies such as Lojas Renner have an advantage. The same team of executives was there during the crises of 94, 98, 99, and 2000. We were present at a conference at the beginning of November where the company made a transparent and candid presentation, as might be expected of it. It is interesting to note that, while the market had a negative reaction, knocking down prices even further, we left feeling more comfortable because we had realistic, experienced and pro-active executives managing the company. We took the opportunity to increase our position. Finally, we would like to stress the matter of the weather. Obviously, it is impossible to determine precisely how big its negative effect on the 2008 results was, but contrary to many who give little weight to the significance of this matter, we tend to believe in the 15 years that we have followed the company, which indicate the opposite. This tends to be, therefore, a temporary issue. What is important is that the company reacted rapidly once again, based on its culture, competence and systems. Lojas Renner's shares already corresponded to 3.4% of VBF Class A and 6.3% of VBF Class C on December 31, 2008.

Itaúsa (Banco Itaú's controlling shareholder) was one of the great opportunities presented by the crisis. During the "black" weeks of October, we had the chance to buy significant lots of shares at prices that implied the definitive loss of the pattern of results that the company had presented for decades (assuming that similar results would continue, we managed to buy paying a P/E ratio which, depending on certain assumptions, was between 5 and 6, approximately). And during this time, the company has improved not only in absolute terms but also in its relative position; has given solid proof of governance quality; and has prepared to become a global top player. In fact, soon afterwards, the company gave another proof of its qualities, absorbing Unibanco in a lightning-quick operation. As a result, it attained an even more enviable size. We consider the combination of an absolutely superior soundness, modern and aligned management (the Setúbal family has been proving to be the dream controller - competent, aligned, flexible and dynamic), and systems of the highest quality, very attractive. On December 31, 2008, Itaúsa's shares represented approximately 10% of both VBF Classes A and C portfolios.

And last but not least, Ambev/Anheuser-Busch Inbev, the top holding of our funds, which represented approximately 11% of both VBF Classes A and C. Anheuser-Busch Inbev is the world's largest brewer, and controller of Ambev in Brazil. It is wonderful to be able to stop worrying about shareholder risks and "be closer to God". A detailed description of this investment case is presented in the next section.

Anheuser-Busch Inbev (ABI)

We have closely followed Inbev's stock since its creation. In fact, for over 10 years we had studied Brahma, the company from which Ambev, and later Inbev, originated.

From the beginning, the combination of a strong, stable cash-flow with a business that is not very capital-intensive and has significant entry barriers was already the basis for an attractive long-term investment opportunity.

In addition to the quality of the business, we always admired the way in which the company was managed. After it was acquired at the end of the eighties, Brahma underwent a thorough transformation, becoming a pioneer in adapting to its culture some corporate management principles that were still uncommon in Brazil: focus on results, meritocracy, in-house formation of leaders, transformation of employees into partners, and administrative simplicity. This model, which was later copied by many other companies in the country, broke away definitively from the traditional Brazilian style of corporate management.

This simple and pragmatic management generated exceptional results and caused productivity gains to be repeated year after year. In addition, the strong culture, capable of attracting and retaining talents and making them able to take on new challenges, worked as a catalyst for bigger strides: mergers and acquisitions quickly became an important instrument to create value.

The idea was more and more to use the business' strong cash-flow to purchase new assets or to join up with existing companies, and later to use the great number of executives that had been formed in-house and the corporate culture focused on results in order to extract value from these operations.

The first great step was the "merger" between Brahma and Antarctica (1999) – the latter, at that time, was the vice-leader in the Brazilian beer market – and the consequent creation of Ambev. This operation was opportune not only because of the fact that the Brahma management could lift Antarctica's results to a new level of profitability, but also because of the strategic value of dominating the important Brazilian beer market. In the following years, Ambev strengthened its competitive position in Latin America, substantially increasing the efficiency of its operations and booking high growth rates.

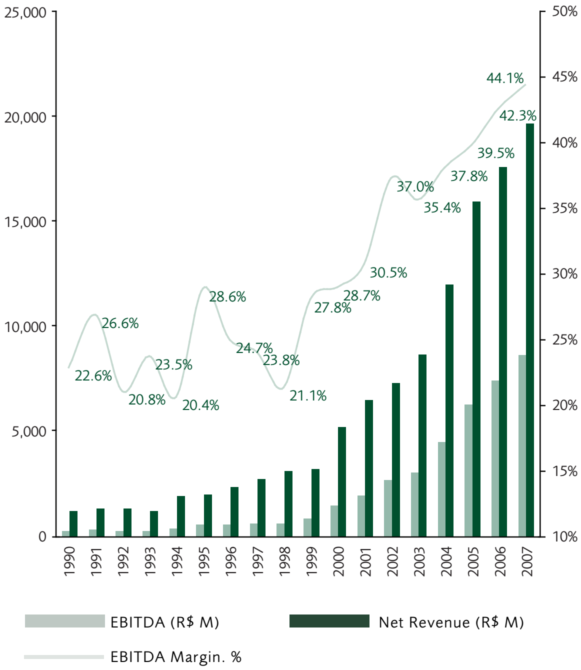
When most of its synergy gains had been achieved, Ambev started preparing for an even more ambitious movement that would raise the company to a global scale.

Inbev was created after the merger between Ambev and Interbrew in 2004.

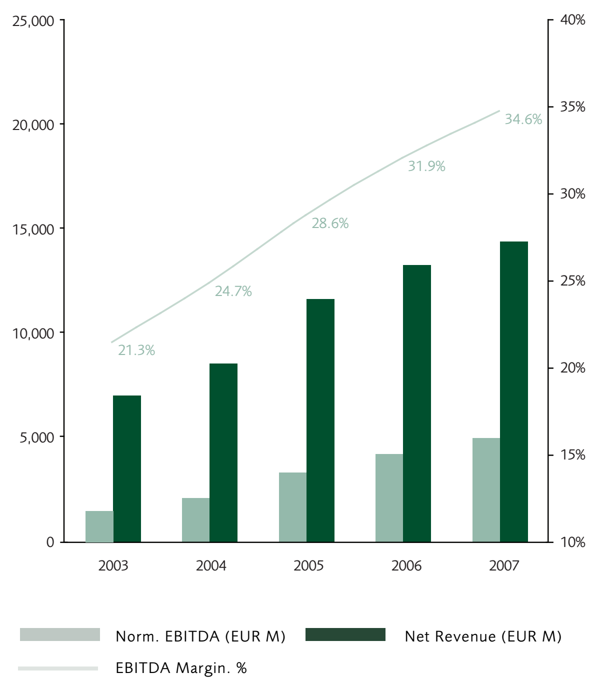
From the beginning of the nineties up to the time of the merger with Ambev, Interbrew grew from a small Belgian brewer with sales of 17 million hectoliters of beer per year into a multinational company with operations in over 120 countries and sales of over 90 million hectoliters per year; in 2003, it reached the third position in the world ranking. This strong growth was the result of distribution agreements and the acquisition of a series of small/medium local brewers, which ended up increasing the degree of complexity of the operation, thus leading to big inefficiencies. Execution – a capacity that Interbrew did not possess – is a determining factor within a sector in a constant process of consolidation.

This operation represented the union of two companies that complemented each other well: while Interbrew, which had just been through an intense period of acquisitions, proved to have little skill in capturing synergies, Ambev showed an incredible execution capacity ingrained in its culture, already proven after the merger between Brahma and Antarctica. It was a perfect marriage. Since then, Inbev has dedicated itself to extracting the maximum value possible from this merger, generating exceptional returns for its shareholders.

AMBEV – MARGIN EVOLUTION



INBEV – MARGIN EVOLUTION



In the middle of 2008, a new opportunity appeared, this time on an even higher scale: the appreciation of the Euro and the Real vis-à-vis the Dollar helped to create a situation that was favorable for Inbev to acquire the total control of Anheuser-Busch (AB), the century-old brewer which, through its traditional brand Budweiser, holds 50% of the US beer market. Thus, AB Inbev was born.

The rationale for this acquisition was similar to the previous ones: to take advantage of Inbev's strong cash-flow and the quality of its team of executives in order to purchase larger assets, with a big cost-cutting potential, extracting value over the years from gains in efficiency and synergies. One particular point was that AB is a very strategic business, given its great presence in the US market, a crucial factor for Inbev to became a truly global company.

However, AB's fragmented control and the executives' initial refusal of the proposal meant that the purchase could only be concluded through a hostile offer, which, in the end, raised the price of the deal. The final valuation was not low, but could be justified by the business's quality and strategic value, as well as the proven capacity of Inbev's management to extract synergies from acquired companies.

In order to make the operation feasible, a complex debt structure was built, guaranteed by a bank syndicate that was irrevocably committed to providing the loans, even before the worst phase of the financial crisis, between August and October 2008. The amount of the loan would be US$ 54.8 billion and, as demanded by the creditors, the company would have to pay US$ 9.8 billion within 6 months after the transaction was formalized, and US$ 7.0 billion within 12 months. The money for the first payment would be raised by means of a primary public stock offering, while the second installment would be paid from the sale of assets.

Between the conclusion and the settlement of the transaction, the worsening of the macro-economic environment caused the market's risk perception to deteriorate drastically. In a highly unfavorable credit scenario, the company would not only be highly indebted, but would also need to raise US$ 16.8 billion in the short term.

In addition, for the first payment, the controllers ended up being forced to effect the primary public offering at a very low price in order to ensure the success of the transaction, putting pressure on all the investors to take part in the capital increase so as not to suffer dilution from the new share issue. This took place at a time of strong global de-leveraging, when most investors had no capital available for a transaction of this kind.

Our confidence in AB Inbev's capacity to generate value from acquisitions, together with the sharp depreciation of the company's stock, had already been sufficient for us to put together a small position in the portfolio, as the stock price fell in mid-October. However, the urgency in carrying out the public offering, together with an adverse financial scenario, resulted in an even sharper drop in the shares, which we saw as an attractive investment opportunity. We took the chance to significantly increase our exposure to the company, in addition to subscribing all of our share in the capital increase.

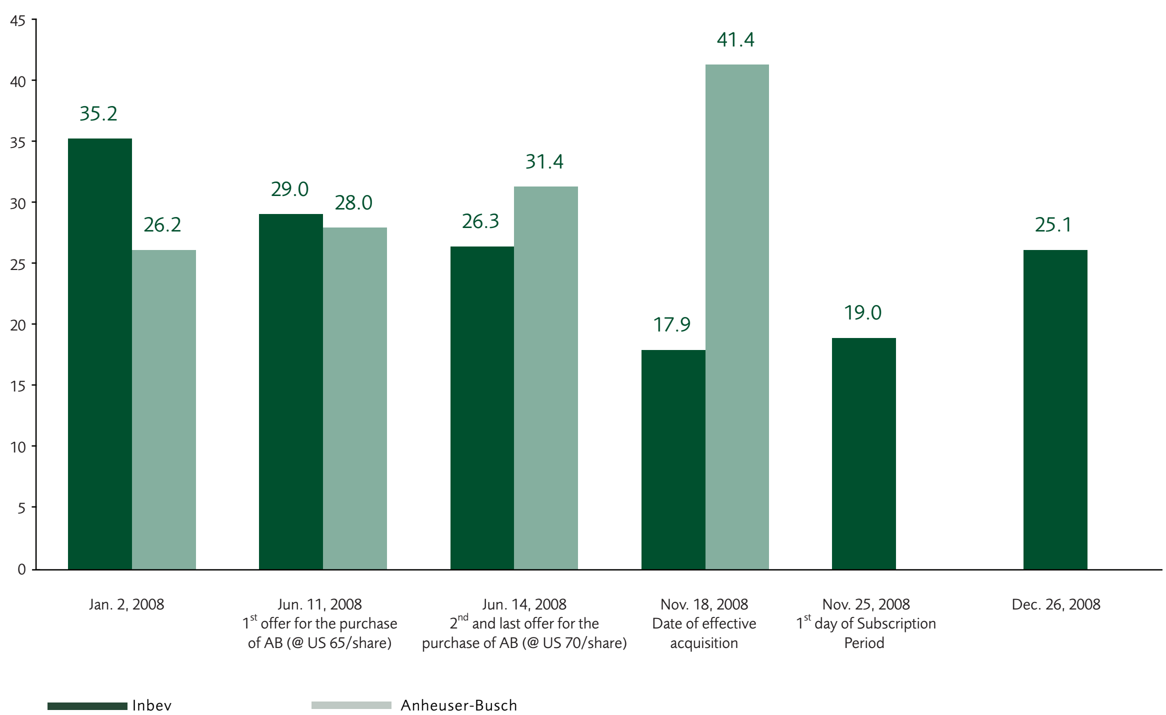
This investment was effected through a partial exchange of our position in Ambev for AB Inbev, placing us closer to the controllers, and thus leaving us in a more comfortable situation as shareholders.

It should be mentioned that soon after the announcement of Inbev's first offer for AB (June 2008), Ambev's stock fell considerably. The market acted in anticipation of the fact that the Brazilian subsidiary (AB Inbev holds about 62% of Ambev) could be used in some way to pay part of the bill for acquiring AB. Because we believed that the drop had been exaggerated, we then put together a significant position in Ambev.

From that moment up to the conclusion of the above-mentioned public stock offering, this investment appreciated marginally, while Inbev's shares (which would become AB Inbev) depreciated, so much so that its market cap. reached € 19 billion, while the value of its participation in Ambev was worth € 12 billion. This means that all the other AB Inbev operations (including AB) were worth only the remaining € 7 billion, representing a huge value distortion.

With regard to the sale of assets in order to pay the second short-term debt installment, we believe that AB Inbev has a series of unique businesses with high strategic value for possible buyers. In addition, the sale of only a few of these businesses would be sufficient to reach the value agreed upon with the banks. The market's greatest concern is whether there will be buyers in fact and how they would be able to

Market Capitalization (Euro Bn)



obtain finance in an adverse credit scenario. We recognize the risk of this transaction, but wish to stress our confidence in the capacity of the team of executives to overcome adversities and to find alternative solutions to the challenges they face.

In addition, there is a high degree of alignment both of the executives and the controllers for the transaction to be carried out, given the proportion of their assets allocated to AB Inbev's shares, especially after the recent capital increase.

The remaining debt has a longer term and should be paid with the company's own cash-flow.

AB has an above-average execution track-record in marketing and distribution. In the nineties, it managed to close exclusivity agreements with the largest beer distributors in the US market. The alcoholic beverage distribution sector is highly regulated in the USA, and these relationships turned out to be great entry barriers. Enjoying a privileged position in the distribution of its products, together with its famous marketing campaigns, AB had built a stable and profitable leading position. One of the consequences of its solid competitive position was that the company did not have in its culture an obstinate focus on seeking greater operational efficiency.

AB represents a new, huge platform for cost cutting, which was never the main focus of the American company, but a specialty of Inbev's team of executives. In our opinion, this strengthens the chances for the synergies announced not only to be realized, but also to be augmented in the course of time.

As in all other acquisitions, AB Inbev will focus its initial efforts on obtaining synergies on three main fronts: (i) a reduction in expenses and general costs; (ii) the use of the new structure in order to re-negotiate prices and terms with all suppliers; and (iii) the implementation of its culture and best practices throughout the company. It should be borne in mind that the executives appointed to command the AB operation received a large quantity of stock options that can only be exercised in the long term and that are subject to a reduction in the company's indebtedness to a much lower level than the current one. This strengthens the alignment between the executives and the company, in addition to increasing significantly the operation's chances of success.

No doubt there are risks. Even believing in the sale of assets and in the strong cash-flow to pay the debt maturing in the next few years, we are investing in a company with a high leverage level in a world in which credit lines are scarce. Another point that makes us worried is the risk of an increase in taxes on the beer sector, especially in developed countries that now need funds to pay their growing deficits. This sector, at times like these, is always vulnerable, given the low political cost of such a decision. In the USA, for example, taxes on the sector are among the lowest in the world and are relatively lower than those on other alcoholic drinks.

But these risks seem to be excessively priced in to the shares. AB Inbev is trading at a P/E09e ratio of 9.6x (@ EUR 16.58/share). In addition, there should be a significant increase in its profit line in the coming years, as a consequence of the expansion in margins resulting from the synergies. Considering all these factors, we reach an intrinsic value that is much higher than the market cap., and consequently what we believe to be an excellent investment opportunity.

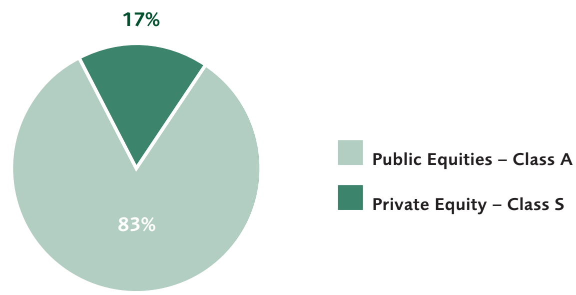
PS: At the beginning of January, there was a further event in relation to AB Inbev that we think it is important to mention. A private issue of the company's debt securities amounting to US$ 5 billion was successfully carried out; it was divided into three maturities (5, 10 and 30 years). The rates – though higher than those for the debt incurred previously – were attractive, given the current market conditions. We are starting to see the debt market opening for new issues once again. That is positive for our investment case, both with regard to the rolling over of AB Inbev's present debt, and to the funding necessary for the potential buyers of the assets put up for sale. The capital raised will be used to pay a part of the short-term debt that previously would have been paid through the sale of assets. Now the company can carry out the sale process in a more rational way and without any time pressure which would reduce the value of the assets.

Performance – VBF Class A Portfolio

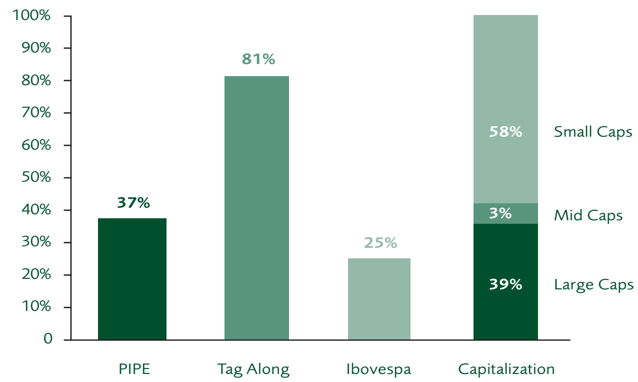
VBF Class A		Performance (US$)[3]			
	% Invested Equities	VBF Class A	VBF Class S (Mills)	VBF Class S (Casa Show)	Classes A+S+S[2]
December 08	78.45%	1.23%	-0.36%	0.22%	0.99%
November 08	76.43%	-6.53%	-9.62%	-7.91%	-6.96%
October 08	72.07%	-25.33%	-9.77%	-1.05%	-22.64%
September 08	76.09%	-22.50%	-14.90%	-14.08%	-21.69%
August 08	76.97%	-11.22%	-3.97%	-4.10%	-10.52%
July 08	84.68%	-7.93%	1.33%	1.32%	-7.13%
June 08	98.73%	-6.30%	3.17%	1.92%	-5.74%
May 08	98.93%	12.61%	3.24%	0.73%	12.18%
April 08	95.78%	5.63%	3.50%	2.46%	5.53%
March 08	98.25%	-11.97%	-3.98%	-3.53%	-11.66%
February 08	98.58%	6.82%	4.31%	-	6.75%
January 08	97.15%	-8.91%	0.35%	-	-8.68%
2008 (YTD)	-	-57.28%	-25.46%	-22.64%	-54.54%
2007 [1]	-	30.59%	4.03%	-	30.51%
Since inception [1]	-	-44.21%	-4.56%	-22.64%	-40.67%

(1) Inception VBF Class A 2007, Mar 06
(2) Inception VBF Class S 2007, July 06
(3) Net of all fees

Break-down Public Equities x Private Equity

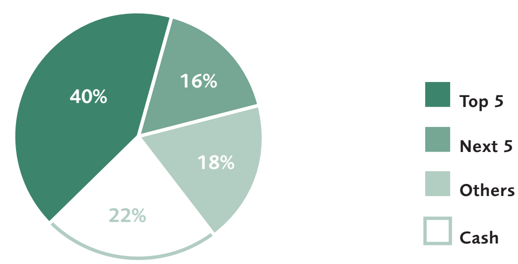


VBF Class A – Equity holding characteristics*



* PIPE: Private Investment in Public Equity/Tag Along: % with tag along rights/Ibovespa: % in the index/ Capitalization: small (smaller than US$1b), Mid (between US$1b and US$3b), Large (larger than US$3b)

VBF Class A – Portfolio Concentration



Structure

IP Brazil Fund SPC, VBF Segregated Portfolio is an exempted company registered as a segregated portfolio company, incorporated under the provisions of the Companies Law of August 3, 2006 of the Cayman Islands.

Investment Manager: Investidor Profissional Gestão de Recursos Ltda.
Net Asset Value Calculator: Mellon Serviços Financeiros DTVM S.A.
Brazilian Custodian: Banco Bradesco S.A
Bank: UBS AG, Stamford Branch, CT (USA)
Registrar and Transfer Agent: UBS Fund Services (Cayman) Ltd.
Auditor: KPMG
Inception Date of Classs A: March 06, 2007

Terms and Conditions

Subscription: On scheduled rounds. Closing day of the first round was March, 2007.
Minimum Initial Investment: US$ 1,000,000.00
Redemption: Lock-up Period of 18 months. Redemption dates on the last Business Day of each calendar quarter, with a three months prior notice
Maximum Redemption: Limit of 10% of the issued shares of the class in each quarter of the first five years after the lock-up period and 15% thereafter.

Terms and Conditions (cont.)

Management Fees: (i) 1.0% per annum of the Net Asset Value of the VBF Segregated Portfolio allocated to fixed income investments, including but not limited to cash, and (ii) 2.0% per annum of the Net Asset Value of the VBF Segregated Portfolio allocated to the remaining Investments.
Any Management Fee and Incentive Fee payable in respect of any Class S Shares representing Designated Investments will not be paid until the realization or deemed realization of the Designated Investments.
Incentive Fees:

- 20% computed on returns in excess of IPCA+9%, with catch-up mechanism:
  – between IPCA+9% and IPCA+10% p.a.: 100%
  – above IPCA+10% p.a.: 20%
  note: IPCA is the Brazilian Broad Consumer Price Index
- High-water-mark mechanism avoiding double charging for same performance
- Accrued daily and paid semi-annually

Additional Information

For additional information regarding of VBF, please contact us by phone at (55 21) 2104-0506 or by e-mail at contactus@investidorprofissional.com

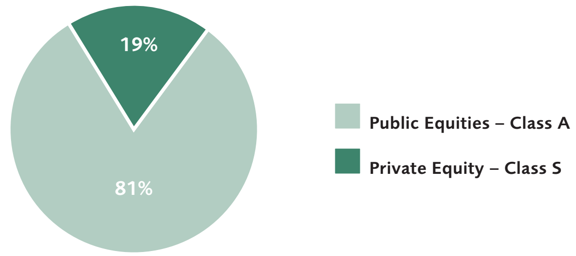
Performance – VBF Class C Portfolio

VBF Class C		Performance (US$)			
	% Invested Equities	VBF Class C	VBF Class S (Casa Show)	VBF Class S (Mills)	Classes C+S+S (2)
December 08	80.75%	2.23%	0.30%	0.52%	1.88%
November 08	81.29%	-6.06%	7.43%	-8.02%	-6.36%
October 08	76.52%	-18.50%	-10.94%	10.11%	-17.86%
September 08	68.67%	-19.47%	-14.07%	-	-19.38%
August 08	66.02%	-8.04%	4.10%	-	-7.98%
July 08	73.84%	-6.84%	1.31%	-	-6.73%
June 08	89.13%	-3.06%	1.92%	-	-3.00%
May 08	90.20%	15.78%	0.73%	-	15.59%
April 08	83.53%	5.07%	2.54%	-	5.04%
March 08	83.90%	-8.67%	3.53%	-	-8.60%
February 08	83.14%	8.71%	-	-	8.71%
January 08	77.38%	-6.89%	-	-	-6.89%
2008 (YTD)	-	-41.12%	-29.90%	1.30%	-40.92%
2007 (1)	-	-3.15%	-	-	-3.15%
Since inception (1)	-	-42.97%	-29.90%	1.30%	-42.78%

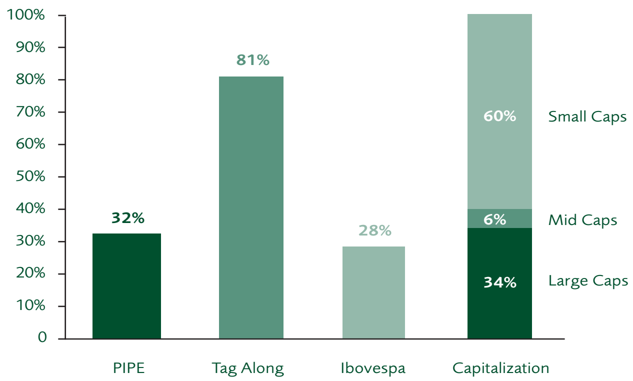
(1) Inception VBF Class C 2007, Nov 09

(2) Inception VBF Class S 2008, Mar

Break-down Public Equities x Private Equity

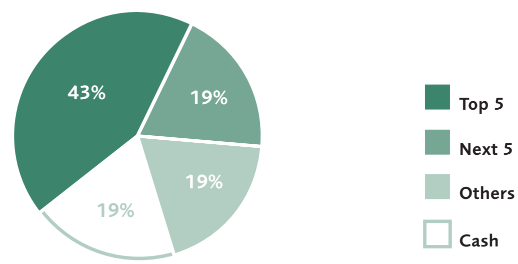


VBF Class C – Equity holding characteristics*



* PIPE: Private Investment in Public Equity/Tag Along: % with tag along rights/Ibovespa: % in the index/ Capitalization: small (smaller than US$1b), Mid (between US$1b and US$3b), Large (larger than US$3b)

VBF Class C – Portfolio Concentration



Structure

IP Brazil Fund SPC, VBF Segregated Portfolio is an exempted company registered as a segregated portfolio company, incorporated under the provisions of the Companies Law of August 3, 2006 of the Cayman Islands.

Investment Manager: Investidor Profissional Gestão de Recursos Ltda.

Net Asset Value Calculator: Mellon Serviços Financeiros DTVM S.A.

Brazilian Custodian: Banco Bradesco S.A

Bank: UBS AG, Stamford Branch, CT (USA)

Registrar and Transfer Agent: UBS Fund Services (Cayman) Ltd.

Auditor: KPMG

Inception Date of Classs C: November 09, 2007

Terms and Conditions

Subscription: On scheduled rounds. Closing day of the first round was March, 2007.

Minimum Initial Investment: US$ 1,000,000.00

Redemption: Lock-up Period of 18 months. Redemption dates on the last Business Day of each calendar quarter, with a three months prior notice

Maximum Redemption: Limit of 10% of the issued shares of the class in each quarter of the first five years after the lock-up period and 15% thereafter.

Terms and Conditions (cont.)

Management Fees: (i) 1.0% per annum of the Net Asset Value of the VBF Segregated Portfolio allocated to fixed income investments, including but not limited to cash, and (ii) 2.0% per annum of the Net Asset Value of the VBF Segregated Portfolio allocated to the remaining Investments.

Any Management Fee and Incentive Fee payable in respect of any Class S Shares representing Designated Investments will not be paid until the realization or deemed realization of the Designated Investments.

Incentive Fees:

- 20% computed on returns in excess of IPCA+9%, with catch-up mechanism:
  - between IPCA+9% and IPCA+10% p.a.: 100%
  - above IPCA+10% p.a.: 20%

  note: IPCA is the Brazilian Broad Consumer Price Index
- High-water-mark mechanism avoiding double charging for same performance
- Accrued daily and paid semi-annually

Additional Information

For additional information regarding of VBF, please contact us by phone at (55 21) 2104-0506 or by e-mail at contactus@investidorprofissional.com

Miscellaneous

"Men are more moral than they think and far more immoral than they can imagine." - Sigmund Freud

"The greater danger for most of us is not that our aim is too high and we miss it, but that it is too low and we reach it." - Michelangelo Buonarroti

"For want of a nail, the shoe was lost,

For want of the shoe, the horse was lost,

For want of the horse, the rider was lost,

For want of the rider, the battle was lost,

For want of the battle, the kingdom was lost,

And all for the want of a nail!"

George Herbert

"The only thing necessary for the triumph of evil is for good men to do nothing." - Edmund Burke

"Capitalism is the outstanding belief that the wickedest of men will do the most wickedest things for the greatest good of everyone." – Keynes

"Why people approve risky loans? They are rewarded for it. From their frame of reference they act logically based on how they are rewarded. The system pays them to do the wrong thing. You get rewarded every year while the net consequences of the bad loans won't be realized for a long time." - Warren Buffett

"To say derivatives accounting in America is a sewer is an insult to sewage." – Charlie Munger

"Moral excellence comes about as a result of habit. We become just by doing just acts, temperate by doing temperate acts, brave by doing brave acts." – Aristotle

"A people that values its privileges above its principles soon loses both." – Eisenhower

Ladies and gentlemen, friends, good evening!

I would like to congratulate the companies that have won the ADVB 2005 Top Marketing Award, and entrepreneur Jorge Gerdau Johannpeter for the Peter Drucker trophy.

I am flattered by the award the ADVB is conferring on me – Sales Personality of the Year. I must confess that this honor makes me very proud and has made me think a lot.

As a sales personality, what would I like to sell to you?

In view of the worrying scenario in Brazil – the huge lack of values, poverty, violence, indecency in politics – I see just one possible – and urgent – reaction: to bet on the principles and values on which our personal and professional lives are based, overtaken today by distorted attitudes and practices.

We do not accept this situation. A change is needed and must be made. That is what I want to sell here today: an article that has been scarce in Brazilian everyday life lately, a fundamental value that we miss, because it gives support to true democracy.

As we live in an immense country and there are many "Brazils", we need to have a minimum of common values – such as ethics, decency, truth, honesty, justice – in order to stabilize our present day and build a dignified future for all. What are the values of the society in which we live? How are they distinguished? It seems that we no longer know the difference between value and counter-value in today's permissive and passive society.

The debasing of ethical standards, the lack of legitimacy and growing deterioration of institutions, and the lack of punishment for those who legitimate counter-values, undermine and paralyze our capacity to react.

We are all anesthetized. But if we wish – and we certainly do – to live in a just and serious country, we need to impose our views and restore our values. Freedom, justice, honesty, ethics, respect, transparency, dignity, and social well-being – these are values. Injustice, dishonesty, disloyalty, opportunism, corruption, cunning – these are counter-values.

Who is going to win this battle?

The Brazilian political crisis of the last few months is the greatest proof that we are experiencing a huge privation of values. Recent facts are evidence that we have lost common sense and the notion of justice and ethics.

Scandals, corruption, misuse of money and the behavior of many office holders generate even more uncertainties.

On October 22, Dora Kramer, who writes in the newspaper O Estado de São Paulo, commented on the decision of the Federal Supreme Court to release Paulo and Flávio Maluf. What was most intriguing to her was the declaration of Justice Minister Carlos Velloso that "he was moved by the unsatisfactory conditions in which father and son were imprisoned".

Police stations and prisons are crowded with men and women serving their sentences in extremely bad conditions. Why is the Malufs' suffering more moving? It's a good thing to remind the Justice that this father, Paulo Maluf, is being investigated for the misappropriation of one billion dollars, or 2.5 billion realsreais, sent out of the country – public money that would be enough to build over 150 hospitals and save thousands of lives.

If each of these hospitals attended 200 people a day, 10 million people would benefit, every year.

In its editorial of October 21, O Estado de São Paulo commented on the behavior of the president of the Federal Supreme Court during the vote on the request for a preliminary injunction to suspend the process against the deputy and former minister José Dirceu, by which his mandate would be canceled, in the Council of Ethics of the Chamber of Deputies.

According to the editorial, the president of the Supreme Court conducted the session "as if he were conducting a small-town council, forcing its members to vote in accordance with the interests that, for some reason, he wanted to preserve". He was arrogant, sharp and prejudiced towards the other Justices, "evading any considerations of a legal nature".

What strange values these are! Where do men's justice, discernment and respect for others' rights lie?

The routine of scandals that culminated in the discovery of the mensalão (a scheme of monthly payments to congressmen, with a view to buying their loyalty), blew wide open the countless shady transactions between governments, parties, public and private companies.

Deputies and Senators whom we have elected, our representatives in Congress, have exchanged their dignity and the voters' trust for the commercialization of their political position – favors, protégés, posts. All with a view to ensuring their perpetuation in power. What is most astonishing is that they are not ill at ease to admit the purchase of votes and the existence of caixa dois (illegal, off-the-records funds). They even declare that they could have paid off past debts or could generate cash for future campaigns with the help of suppliers to the Ministry in which they worked, but that they preferred to contact their party's treasurer. That was what the former Minister of Transport, Anderson Adauto, did. He admitted his "wrongdoings" and made it clear that this type of crime is recurrent, it is part of the customs and practices. It is practically a prerogative of the holder of the post of Minister.

In the face of this abundance of illicit acts, we have come to accept absurdities as ordinary facts. We are indeed anesthetized! Where did the millions come from to fund the mensalão – the money that circulated among government offices, inside suitcases and underpants throughout the country? From tax evasion, smuggling, piracy, abuse of power, collusion, embezzlement, impunity, from the "let it be" attitude. From the absence of values!

While we fight the irregular practices that defy the country's laws, how can we explain that a pirate product – a DVD film – reached the plane of the President of the Republic? The fact that we are at ease with piracy shows our flexibility in relation to crime. The fight against the informal market and the criminal vices that interfere in the economy is not taken seriously.

Ethics is lacking in competition, efficiency in managing the public accounts, in controlling expenses, in administering revenues and expenses. These practices do not match the democratic advances we have won. Democracy implies functional laws, without legal formalism, without any make-believe, without our well-known Brazilian jeitinho (way of getting things done).

We cannot agree with the idea that "it has always been like that". We cannot minimize the seriousness of the facts and accusations.

Where do the record amounts collected in federal taxes go? The State, created to administer and serve, collects millions in taxes and does not return anything to the people. The State itself consumes the 40% of the GDP.

We can no longer permit the small offenses that lead to the big ones. When we do not demand a trade bill, we become accomplices of the unlawfulness that has been established in the country. And if we evade taxes, we cannot demand health, education, employment, production, safety – the citizen's basic rights. .

What is left for the million of young Brazilians who follow the political scandals through the media every day? What values do our representatives in Congress pass on to these young people, still in their formative years, students or those who have just entered the labor market? What values do they pass on to the country's population? The absence of austerity in relation to public expenditure is astonishing. A survey carried out by the newspaper O Estado de São Paulo showed that the Federal Government has already spent over one billion reals on daily travel allowances alone. In the last two years, there have been cases of civil servants who received up to 168,000 reals. Can anyone explain to me the reason for so much travel? Well, this money spent on the "travel allowance spree" is five times higher than the Ministry of Culture's budget for the current year. 44 times greater than the total invested in the "First Job" program. Not to mention the budget money that is embezzled and never reaches its destination.

Respect has been lost for public money, collected through the countless, expensive taxes paid by the population and by companies, fruit of the hard work of millions of Brazilians. Not only do we pay taxes, we also pay the expenses for the payment of these taxes, and we do not know precisely how much we pay. There is a great void of principle in the way we are governed, in the way companies and entities are managed, and in the attitudes of many of the people who hold political and economic power in this country.

A government, just like a company or entity, needs to have clear values and projects. What is one to think when two Senators of the Republic and a Federal Deputy threaten to "beat up" the president of the country?

How far we've gone, gentlemen! Where are parliamentary decorum and the dignity of those who were elected to defend the interests of the nation? What is to be done when the former marketing director of Banco do Brasil – after receiving 326,000 reals from the "valerioduto" (a scheme set up by Marcos Valério to distribute illegal monies to politicians) and spending 70,000 reals to buy tickets for a show – becomes involved in another scandal: the use of the Bank's corporate credit card to pay for expenses on pornographic websites? This same director received an envelope containing over 300,000 reals and said that he did not check the amount! Meanwhile, the president of Banco Popular, an institution to render banking services to people in the low-income bracket, managed to spend more on advertising – 24 million reals – than on loans to the people – 20 million reals. According to the October 26 issue of the magazine "Veja", we have no lack of police. We have 322 policemen per group of 100,000 inhabitants, while in the USA there are 283. We have no lack of judges. We have 7.73 judges per group of 100,000 inhabitants, while Chile has 3.22 judges for the same number of inhabitants. What are we lacking, then?

Fewer laws and more correct enforcement, instead of thousands of laws which overlap and confuse everyone, leading to decisions being put off, postponements, lapse of time.

In Brazil, the statute of limitations is applied to penalties and people are declared innocent because they are not judged in good time. In Brazil, the law of impunity is in force. There is no efficiency in investigations, in judging lawsuits, in managing public policies.

The Brazilian government machinery suffers from managerial incapability: the managers do not succeed in efficiently spending the little money left over for investments.

In three years of the Lula administration, the Legislature's payroll has grown by 53.6%; that of the Judiciary, 35.5%; that of the Federal Public Attorney's Office, 45.2%; and that of the Executive, 27.8% – all above the cumulative inflation of 24.5% that was recorded in these three years.

A lot is said about reducing interest rates, but little about reducing government expenditure. Minister Dilma should know that the way in which the government increases its expenses is also "rudimentary and indecent", which makes interest rates even higher.

Investments in infrastructure and economic and social projects focused on the people were below 1% of the GDP between 2003 and 2005. Just another of so many symptoms that make the absence of VALUES evident.

And how do we, citizens and entrepreneurs here present, stand in the face of all this?

Have we asked ourselves what kind of Brazil we want?

We are responsible and have to abandon this passivity urgently. We – entrepreneurs, leaders, men and women of good will, law-abiding politicians, workers – who wish to live in a dignified country, need to take a position. It is time to wake up from this lazy omission and take on our responsibilities. WE are Brazil.

It is necessary to overcome comfortable old habits that lead us along the same old track, and to say what has not yet been said and needs to be said. When we stop dreaming or being hopeful, we succumb both in our personal and in our professional or collective lives. It is up to us to say "enough" to corruption and inefficiency, which are practices that only spread in weak, precarious societies.

Utopia is both in the large social movements history has known, and in the small acts each of us performs, which can change our Brazil.

I propose a deep reflection and incessant work to recover the values we learnt from our families. We will show our anger, and become true agents that can redeem this country. We cannot allow counter-values to win this war. The country that we want for our children and grandchildren is not this one.

We want a country that spends less and where everyone pays less tax; a country that invests well the funds it collects; that invests in health, safety, education, job creation and in the well-being of the people.

A country that no longer occupies the 71st position in Unesco's ranking for education. A country that respects its people!

Let's raise the flag of the values that we have learnt, do away with counter-values, be proud again, disseminate good deeds, good practices, the true values, and turn Brazil into a just and dignified country that brings a future to each of us. We have had enough of tolerance, a Brazilian virtue that is so permissive today. Let us not accept the small crimes, small offenses, small thefts, small corruption and small embezzlements that feed the big ones and are themselves fed by the traditional "jeitinho", which finds a solution for everything.

There is no half way when it is a matter of ethics. Either you are honest or you are not honest at all.

In our role as citizens, we are the agents of change. And the change lies in saying NO to the agents of counter-values.

Confident in my sales capacity, with the conviction that I have sold the product VALUE and found an echo in each one of you, I conclude by quoting from an article by the writer João Ubaldo Ribeiro, from Bahia.

"We are the raw material of this country and have a lot of good things, but there is still a lot wanting for us to become the men and women that our Brazil is in need of. These defects, this congenital BRAZILIAN CUNNING, this small-scale dishonesty that later grows and evolves until it becomes a scandal, this lack of human quality, real and bad – that must end".

It is the responsibility of all of us! Good night! "

José Galló, CEO of Lojas Renner

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