Quarterly Report

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Investidor Profissional
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Index

We begin with a comment on the PIPA, a pioneering initiative of IP in partnership with the MAM-RJ (Rio de Janeiro Modern Art Museum) which created the largest art award in Brazil (as mentioned in the 1st quarter 2010 report).

PIPA 2010 Winners

The winners of the PIPA 2010 award were Renata Lucas, chosen by the official jury; Marcelo Moscheta, selected by the votes given by visitors to the MAM; and Ana Paula Oliveira, through PIPA Online. The video showing Gilberto Chateaubriand, the president of the Award Jury, announcing the winners can be seen on the website http://www.pipaprize.com /?p=2307 (with English subtitles).

Another highlight is that Cinthia Marcelle, one of the 4 finalists who took part in the MAM exhibition, also won the "Future Generation Art Prize", another recently created award for emerging artists, in this case with a global focus.

Shortly, reproductions of the works that the finalists donated to the MAM collection will be posted on the PIPA website, as well as those donated to the Investidor Profissional Institute by the winners chosen by both the Popular Jury and the Official Jury.

Art and Research & Development

A recent article in the "*EU&Fim de semana*" section of Valor (which we consider one of the best Brazilian publications at the present time) discusses investments in R&D in Brazil. We have some fundamental doubts in relation to the figures for the segment, given that tax and media incentives tend to reduce their credibility. But one of the points raised was that in Brazil there was a considerable imbalance between research and development. Most of the investments in the category are thought to be dedicated to development and/or adaptation of technologies and products, with little being done in terms of pure research. The article, like every good text, gave rise to a critical reflection on the subject:

Works of art are capable of stimulating and communicating ideas in ways that formal language cannot. Just like reading, music and dance, the plastic arts "stretch and tease the mind", often leading to the creation of reasoning and frameworks we would not reach (or would take longer to reach) without them. We are convinced, to a very high degree, that many ideas originating from the arts in their purest forms are developed into technologies, products and services.

The PIPA is an investment in R&D that certainly does not appear as such in the statistics.

Highlights from the artists' interviews

If, on the one hand, it is impossible by definition to convey in words a visual work of art, we can learn and be stimulated by the words of the artists. In this respect, it has been a great pleasure for us to watch the video-interviews with these artists. In the short period of 3 minutes (each) we frequently find brain-teasers, remarks that crystallize and synthesize many of our sensations in relation to the way in which we look upon life, processes, etc. The videos with the interviews and the respective transcripts may be found in the PIPA website, starting from the page with the list of artists participating in the PIPA 2010: http://www.pipaprize.com/?p=1066

"... the idea of doing a work is to "de-catalogue", if such a word exists, it is to disqualify what exists already... I don't create this separation – oh, that's right, this work speaks of "A", the other speaks of "B"... You will absorb it in the end, you reflect... I think that in the end everyone matures, every day, every hour, depending on each of us. What you can't do is to lock yourself up in a block."

Andre Komatsu

"My work may happen anywhere. I have an atelier, I work in an atelier, but I may be in the middle of driving a car and be formulating some work... I don't know, being stimulated by something I see along the street, you know? ... to me, art is a way in which we reinvent the worlds."

Cinthia Marcelle - PIPA 2010 Finalist

"In order to be an artist you have to be reasonably passionate, or rather, not reasonably, you have to be passionate, delete the word reasonably. We have fun, at least... Working with art has a lot to do with that, there's a lot of pleasure in it. It's also very difficult, that's for sure ..."

Joana Traub Csekö

"I dedicate myself 24 hours a day to my work. I think and think and draw 24 hours a day, I dream of a drawing, get up and see the drawing, my whole time is dedicated to these wanderings."

Marcelo Solá

"When I was little I loved to keep apart from other people, to keep awake at night, and at that time when the world was quiet, I could touch the things that were around me and reorganize them... even now I try to maintain these moments of emptiness and silence, and moments when you ignore things and that you don't know things, and they will then tell you what they are... It's not so much the formal education that you receive, but the other... stimuli and opportunities that you receive to create knowledge."

Renata Lucas | PIPA 2010 Winner chosen by the Official Jury

These are only examples of what we received from the artists. It would not make sense to give the whole transcript here, but the whole content (video-interviews, photos of works, CVs) may be visited at http://www.pipaprize.com/?p=1066

PIPA 2010 – Summary of the experience

Among the many joys that the PIPA 2010 brought us, one that was very special to us had to do with the execution of the project. Of course, not everything was perfect. It never is. But the deadlines were met, videos and catalogues were produced with a quality we consider good, and the online dissemination and participation were very satisfactory.

PIPA 2010 in numbers:

- 7 members of the PIPA Board formed a Selection Jury, with 30 members
- 30 members of the Selection Jury, composed of art critics and curators, collectors, gallery owners and renowned artists, indicated 101 artists
- The 4 who received the most votes were declared finalists and had an exhibition at the MAM
- Visitors to the websites (different "unique visitors")
  - Over 16,000 in Portuguese (www.pipa.org.br)
  - almost 1,000 to the website in English (www.pipaprize.com)
- Over 20,000 online viewings of the artists' video-interviews
- Active community of over 6,000 members on Facebook (www.facebook.com/premioPIPA)
- Almost 1,000 valid votes for the Popular Jury award from people present at the exhibition, and 4,000 valid votes for PIPA Online
- More than 1,000 post-its in the exhibition mural at the MAM, with comments, drawings, etc., a selection of which is being posted on Facebook (http://www.facebook.com/PremioPIPA?v=photos#!/album.php?aid=40161&id=110110845680625). Some are very good!

The artists' pages continue to be fed with material sent in by the artists themselves, forming a repository (not exhaustive) of their respective careers. The following are also available: the videos showing the setting up of the exhibition and the announcement of the finalists made by Luis Camillo Osório (curator of the MAM and board member). Soon to come are interviews with some members of the Award Jury, such as Catalina Lousano, a member of the jury from

Gasworks, and PIPA Board Members such as Marcelo Araújo, of the *Pinacoteca de São Paulo*.

One of the contributions we sought to achieve with the PIPA is to prove that it is possible to do something significant, in a structured and reliable manner, in the so-called 3*rd* sector in general and in the arts especially – even with limited resources. The teams from the MAM, the Investidor Profissional Institute, Matrioska Filmes and others who participated as volunteers, board members, members of the jury and artists are to be congratulated. We all learned a lot and hope to improve every year. Discussions about further developments and planning for the PIPA 2011 are already well advanced.

"In business, I look for economic castles protected by unbreachable 'moats'." – **Warren Buffett**

"Most people are other people. Their thoughts are someone else's opinions, their lives a mimicry, their passions a quotation" – **Oscar Wilde**

Sand castles, concrete walls – Part II

Revisiting the idea of an "economic moat" and sustainable competitive advantages

In the last report we used as a backdrop the "Maginot Line", the huge French fortification system skillfully bypassed by the German army in the Second World War, to start a discussion on three questions that we consider important for the decision taking process regarding value-oriented investments: the identification of sustainable competitive advantages ("economic moat"), the sense of security embedded in our convictions and risk perception (our behavioral "Maginot Lines"), and finally, the partial antidote for our ignorance – the requirement of a "margin of safety" (quantitative and qualitative).

In this edition, we try to reflect a little on the concept of an "economic moat", the metaphor immortalized by Buffett to designate a "sustainable competitive advantage", one of the sacred cows both for the strategy/competition theories and for classical methods for valuing companies.

Roughly speaking, an "economic moat" is a competitive advantage that is difficult to replicate, working as a formidable shield, a barrier against the entry of competition. Among the sources of competitive advantage most frequently mentioned we can highlight cost leadership (scale, processes, cheap access to resources and transport); intangible assets (brands, licenses, contracts, patents, etc.); positive external network factors (the usefulness of a product or service increases according to the number of users); and switching costs (the degree of client captivity).

To put it simply, from an investor's point of view, if this competitive advantage or set of advantages is sustainable in the medium to long term, the companies that have them will tend (even if not necessarily) to obtain extraordinary profits, and returns on capital employed above the opportunity cost (creating economic value) – until market forces (through competition, innovation, replacement, regulation) eliminate this distortion.

One of the great challenges for the long-term investor is to assess the sustainability and potential durability of these excess returns, usually by identifying one or more advantages that are said to be "structural, inherent to the business", as well as their magnitude and level of sustainability.

One of the ways most frequently used is very simple in theory: checking the company's accounting documents diligently. If, after all the applicable adjustments are made, a company has proved historically to be capable of maintaining a high level of return on capital employed, recurrently and consistently, above its opportunity cost, and its profits above the industry average, one **postulates** (instead of the more obvious and conservative path of conjecture) that the company has some structural competitive advantage – especially when the industry's level of competitiveness is perceived as relatively low. If we assume that companies and industries are usually complex bodies and ecosystems that operate with reaction speeds closer to transatlantic cruise-ships than to sailboats, it seems reasonable to assume that the performance record is a good indicator of what lies ahead.

But it's not that simple…

The extraordinary results of "winning companies" end up strongly influencing the analysis of their supposed "structural" competitive advantages from the start. It's amazing how we have an incredible capacity to build simple causal relationships in order to justify results, proficiently playing the role of prophets of the past. Spectacular financial performances inspire us to build almost epic narratives to justify them retrospectively and – more importantly – prospectively, though founded on vague, generic concepts, endorsed by the common sense, such as "brand", "distribution", "intellectual property", "innovation capacity", etc.

It is our understanding that the ideas of "economic moat" and "sustainable competitive advantage", semantically close, should be used with greater zeal and moderation, so as to avoid a type of error that costs us a great deal: their posing as concrete tools to serve as a basis for taking investment decisions, as if they were true. There is nothing more lethal for an investor than to act based on deep convictions which are, in turn, backed by precarious "fundamentals" that are not expressed as precarious.

"Economic moat"

To us, as long-term investors, it is undoubtedly a challenging exercise to seek to visualize which companies and business models will be standing, firm and strong, in 5, 10, (20?) years, and will be capable of creating and returning significant value without incurring great operational, market, regulatory, agency and capital allocation risks.

As our oldest readers well know, from White Martins (Praxair) to Itaúsa, from Elevadores Atlas (Schindler) and Lojas Renner to Totvs, Ambev, Inbev or Berkshire Hathaway, the evaluation of a company's capacity to maintain, perpetuate and even consistently expand its value creation process is crucial for our asset selection process and, to a great extent, our risk management.

But what characterizes a "sustainable competitive advantage" or an "economic moat"? Are we, investors, entrepreneurs or executives, really capable of identifying them, understanding them and judging them prospectively with the precision and conviction we desire?

Is it possible that, for a start, these concepts do not even have a life of their own – independent, for example, from people (shareholders, board members, managers) with powers to influence and/or decide, and their motivations and incentives, from their *savoir faire*, their processes and methods; from the organization's culture (which sometimes varies among a company's departments); from the business and regulatory environment itself; from the evolving trajectory of its business model; and finally, from the experimental dynamics and micro-schemes that in real life orientate a company's discrete and intermittent path of development toward its ideal of perpetuation and expansion?

Curiously, Buffett himself crystallizes, reifies and isolates the "moat" concept much less than his biographers, fans and devoted followers: "*We seek to invest in economic fortresses protected by unsurmountable moats." (…) "I don't want a business that is easy for the competitors. I want a business with a "moat" around it. I want an extremely valuable castle in the middle,* ***and I want the duke responsible for it to be honest, hard working and capable.*** *" (…) "I have a message for the* ***managers of our businesses****: do seek to* ***broaden*** *these "moats". We want to throw crocodiles, sharks and alligators in the "moat" so as to keep competitors away.*"

In short, although the "economic moat" concept reverberated in the investment world and gained huge prominence, we should point out this "little detail": at carefully chosen occasions, Buffett himself took the trouble to mention, together with the defensive metaphor, the "valuable castle" to be protected and – perhaps even more important – "honest leaders ("dukes"), capable of increasing the size of the moat".

More than that, when we observe Buffett's discourse together with his practices, we get the clear impression that the weight that he himself attributes, in his investment process, to the "duke's" capacity, honesty, commitment and alignment may be much greater than appears at first sight.

And in our perception, **"the castle", "the duke" and "the moat", besides being difficult to define and discern clearly as individual elements, are interdependent and inseparable concepts.**

An entrepreneur, board member, executive (a "duke") who is fully "capable" but not aligned or inadequately advised can destroy solid franchises, built in the course of a lifetime. Cases like that of the Bucksbaum family, then controlling shareholders of General Growth Properties, a shopping-mall administrator – and so many other empires that tumbled during the 2008 crisis, not because of operational problems, lack of financial sophistication or erosion of competitive advantages, but because of an "aggressive" incentive and capital structure (in hindsight easily called "irresponsible") – well illustrate this phenomenon.

In Brazil, the great value destruction that left deep scars in shareholders of companies such as Sadia and Aracruz, companies with colossal "economic moats", was the result of strategic, operational and/or capital allocation decisions, made by flesh-and-blood people, which proved "not to be quite right" – to put it courteously.

One may argue that these are distinct concepts: competitive advantage, "people", with their incentives, ambitions, capacity for execution and capital allocation, strategy. But are they really? One wonders if it makes sense to evaluate a company's perpetuation and value creation capacity, from the viewpoint of its shareholders, using as a prime reference the idea of a supposedly superior and unshakable positioning in a market or industry structure.

In his 1986 Letter to Shareholders, Buffett spoke about the economic moat of the subsidiary GEICO (insurance) in the following way:

"*The difference between GEICO's costs and those of its competitors is a kind of moat that protects a valuable and much-sought-after business castle. No-one understands this moat-around-the-castle concept better than* ***Bill Snyder, Chairman*** *of GEICO.* ***He continually widens the moat*** *by driving down costs still more, thereby defending and strengthening the economic franchise. Between 1985 and 1986, GEICO's total expense ratio dropped from 24.1% to the 23.5% mentioned earlier and,* ***under Bill's leadership****, the ratio is almost certain to drop further. If it does – and* ***if GEICO maintains its service and underwriting standards*** *– the company's future will be brilliant indeed.*"

Please note that, in this paragraph, Buffett highlights 1) the direct relationship between Bill Snyder's strategic view and leadership, GEICO's economic moat and its expansion; and 2) the importance of GEICO maintaining its level of services and underwriting standards (in our opinion, fundamental in the value creation process, although they are implicitly perceived as "execution"). Curiously, an aspect that is not mentioned, but is absolutely crucial, is that part of the competitive advantage that translates into GEICO's "cost leadership" comes from a particular innovative business model (the direct sale of insurance), carried out with discipline and efficiency. In our view, GEICO's business model is one of the main drivers of the company's "competitive advantages".

To bring up another question: why, when we evaluate the existence of potential "economic moats" as foundations for the generation of extraordinary profits and returns, is the idea of the degree of competition in an industry implicitly more important than the quality and sustainability of the company's business model, embedded in increasingly modular, flexible and global supply chains? Why is the profit pool commonly evaluated vertically (by industry or sector) and not horizontally (from the viewpoint of supply chains)? Within a network or ecosystem? According to the total (out-of-pocket) expense of potential clients (who says that clothes do not compete with refrigerators)? According to the total profit contribution per square foot of its clients' sales areas? Does it make sense to be a preferential supplier of apparel to Wal-Mart and to be more concerned about your direct competitor than about ways to extract more value from your own giant client (or visualizing ways to avoid being squeezed "to death" by it), or avoid being bypassed by a procurement meta-outsourcing business model, without its own factories, such as the powerful Li & Fung?

Our viewpoint is as follows: perhaps the "economic moat" is more useful as a vague concept than as a powerful trait or concrete characteristic, with almost magical analytical properties, to be "found" and "weighed" by analysts and investors. It may be less tangible, discernible, independent and instrumental than the literature and the "specialized" communication media repeatedly proclaim.

Many articles and books take the "economic moat" concept as given. There are checklists to help identifying it and there is even an institution – Morningstar – that classifies companies as "without a moat", "with a narrow moat" and "wide moat" (taking due "care" to reclassify the companies over time, as moats come and go).

We are pleased to see that companies like Itaú are classified as having a "narrow moat" – perhaps because they operate in what is seen as the banking sector of an "emerging" country. Music to our ears.

In fact, some years ago, Dell – with its innovative business model and overwhelming results – was classified by the institution as a company with clear sustainable competitive advantages, a "wide moat". Over time (and with the company's, and its shares', negative performance), it was "duly" reclassified as having a "narrow moat".

One might counter-argue that competitive advantages do not last forever, that they have expiry dates that vary from case to case, that the exceptions do not invalidate the rule. But we have the impression that sometimes, anxious to build shortcuts for our decisions, we ascribe to vague concepts, understood in isolation, explanatory properties which, instead of bringing us closer to our ideals of prediction and control, only support and crystallize unfounded convictions – or worse, base convictions on muddy slime that aspires to be concrete.

If, instead of embracing deep-rooted concepts such as competitive advantage as if they were given, blindly rushing to use them as "working tools", we reflect a little on their potentialities and limitations, our impression is that we may achieve an important degree of freedom in evaluating potential investments.

We agree with Buffett: investing (in its narrow sense) is simple. But it is not easy. It is much more an art than a science, and less susceptible to little rules and checklists than it seems.

Considering that very often a good part of the value of a business is in its future, the challenge of evaluating the potential for perpetuation, expansion and self-diffusion of the value-creation process of a business is as important as it is difficult.

In this report, we call attention to the Buffettian medieval troika, composed of the "castle", the "duke" and the "economic moat". These are concepts that, besides being difficult to define and see clearly as individual elements, seem to work better, from the instrumental viewpoint, when understood as interdependent and inseparable. In the next report, we will explore the dynamics of this troika and will later return to our ideas regarding sense of security and margin of safety, which, for our purposes, intertwine with it.

Finally, instead of proposing rules of thumb of the type "the 5 killer shortcuts to identify sustainable competitive advantages", we leave the reader with a kind of anti-checklist, i.e., a set of open questions, using as ingredients some of the concepts addressed in the text, with the mere objective of encouraging reflection on a subject that, despite its relevance and appearance of being concrete, has the consistency of sand.

Medieval anti-checklist

1) About the "Castle": Are shareholders and investors really capable of defining clearly and lucidly what the crown jewels of their Castle consists of? When they are not, what sense does it make to invest in walls and moats to protect what is not necessary or what cannot be defended? Let's take, for example, a retail company. What are the most important "assets": Location? Brands? Channels? Relations with consumers? A well-oiled supply chain that is optimized in order to increase productivity and to grow along with the business? The organization's key people? The method of extracting value from its supply chains? Its relative "positioning" in the supply chains? The method of extracting value from its customers? A pervasive meritocratic culture with a strong analytical and process bias that permeates the company as a whole (and not the more common case of feuds of excellence)? A sales force that is spectacularly well trained and motivated? It's a long list…

2) About the Moat: Isn't it possible that some well positioned companies, "entrenched" in their forts, are inflating the value of their moats and cannot stop investing in models and ways of doing business that have an expiry date? Is it possible that most fortresses said to be inexpugnable are, in the long term, doomed to become obsolete, to be bypassed, to be circumvented? Is the moat metaphor too defensive? Agility, flexibility, intellectual capital, productivity: these do not fit in well with the defined circumscription of castles, walls and moats. Although Porter clearly disagrees with this hypothesis: up to what point can operational efficiency and corporate culture be dissociated from "competitive advantage"? Up to what point is a particular organizational culture not a competitive meta-advantage? If the castle and the moat are always changing over time, one of the solutions might be to select castles in which changes occur more slowly and the future seems more predictable. But in a context of globalized markets, intangible assets, rapid gains in productivity and technology, innovations and constant redesigning of the supply chains, how can one commit to a rigid business format and model? On the other hand, how can one maintain the commitment and the focus that are crucial in obtaining operational efficiency? This is an important and increasingly common dilemma. Experimenting has a cost. Failing to experiment, ditto.

3) About the Duke: Who is the real Duke – the shareholders, the controlling shareholders, the Board, the Chairman, the CEO? Our impression is that the "right" answer varies considerably, and directly influences both the economic moat and the castle. Is it possible that, especially in corporations, the company managers take for granted (and as "given") the capital to be allocated? It seems that the way in which the agents that lead the company see their own assets influences the way in which they see the wealth to be safeguarded by the castle, which, in turn, influences their perception of the nature and the dimension of the economic moat and the need to expand and deepen it.

"While we don't like having excess cash, we like doing dumb things even less." – **Warren Buffett**

"We don't get paid for activity, just for being right. As to how long we'll wait, we'll wait indefinitely." – **Warren Buffett**

"Investments do not provide information about their risks the way food packages provide nutritional data." – **Seth Klarman**

Cash Position and Margin of Safety: Cushion and Weapon

In the preceding text, we considered the idea that the metaphor "economic moat" has an apparently "defensive" connotation, not only creating a false sense of security, but also placing us in a passive position, indexed to the past. Now, while we discuss the Fund's portfolio and performance in 2010, when our "excess cash" position was one of the main factors, we introduce the idea that cash and margin of safety (surely two different concepts) have a connotation and practical use that are much more "offensive" than it seems. We also affirm that fairies and goblins do not exist. On the other hand, Alphas and Betas do (in the "make-sense" world). In our view, they may even exist, but are as relevant as fairies and goblins.

The risks of permanent loss of capital, absolutely relevant in a continuous investment decision-making process, are, on the other hand, absolutely invisible to most investors – as long as "performance" is achieved. They are like fairies and goblins; but unlike the latter, they do exist and are infinitely more important than Alphas and Betas. Investors look ex post at the funds' returns (a "synthesis" number and absolutely comparable), but usually do not try to get to know well and to qualify the risks incurred in obtaining these returns.

The variation in the market prices of VBF Class A in the year 2010 was 27.7%, VBF Class C 22.9% and IP-Value Brazil, which holds positions in international companies up to 10% of its NAV, was 39.5%. This difference is mostly a result of the Mills IPO in April 2010. Differently from IP-Value Brazil, in VBF the investment in Mills was structured through a side-pocket class and had its performance disclosed separately. If we consolidate the side-pockets' performance on both VBF Classes, the appreciation in the market prices of VBF Class A in the same period was 52.1% and VBF Class C was 30%.

The variation in the market prices of VBF Class A in the fourth quarter of 2010 was 10.9%, VBF Class C 9.5% and IP-Value Brazil was 9.7%.

The main positive contributions to the portfolio in 2010 (excluding Mills in the case of IP-Value Brazil) came from four companies: Dimed/Panvel, Odontoprev, Saraiva and Totvs. During the last quarter, the story was similar excluding Odontoprev, which we had been reducing as described in previous reports. The main detractors in the year were Pão de Açucar (excluding IP-Value Brazil) and Redecard; in the last quarter, Redecard and Cielo.

At the beginning of the year our main positions were "cash", Itaúsa, Lojas Renner, Odontoprev, Saraiva and Totvs. At the end of the year they were "cash", Aliansce, Dimed, Itaúsa, Saraiva and Totvs.

In the course of the year we had to exchange, or at least partially sell, positions that represented great convictions on our part, put together in the last 1-2 years, such as Lojas Renner, Totvs (still a core holding) and Odontoprev, replacing them with others of smaller sizing – because of relative prices: Aliansce, Porto Seguro, Redecard/Cielo and Cyrela.Three themes deserve special mention in this report: Management, Research and Collaboration/"Activism", and Global Investments (important to understand our research process, yet only directly applicable for the IP-Value Brazil Fund).

Management

As most of our readers know, our mandate is to obtain absolute returns that are consistently and significantly above our opportunity cost in five-year windows, duly calibrated by our risk perception.

In order to achieve this long-term objective, our zeal with regard to capital preservation is incomparably more important than maximizing returns – especially in the short term. We prefer to miss "opportunities" than lose money.

We have learnt this lesson in different ways: first, paying attention to how experienced investors get it right; second, from the mistakes of others; third, seeking to "walk our talk" for over a decade, through crisis after crisis; and finally, learning from our mistakes.

Given that our fund is long only, we could be seen as a mere "enlightened Beta play" disguised as "pure Alpha", as we are long, by definition, in the so-called market risk. But we do not see ourselves, position ourselves or act – and much less are we – a subset of a class of assets. We do not believe in alphas and betas. Neither are we stock pickers, but rather asset managers. More than half the net assets of the company's partners is invested in IP's funds.

We do not compare ourselves to the market or to our peers when taking investment decisions. We believe that the best way to achieve our goals is to purchase assets that are priced significantly below our value perception. According to our investment philosophy, significant absolute performance is obtained by purchasing "undervalued" assets and selling those that are "overvalued".

In the course of the year, we were forced gradually to sell some shares that had appreciated rapidly and significantly, reducing /exchanging them for assets that were already present in the portfolio, with better risk-return prospects, and other investment opportunities which, because of price movements, fundamentals or some research insight, had entered (or returned to) our radar.

In the last report we explained that:

"*In the course of the quarter, we significantly reduced our position in a set of stocks linked to domestic consumer goods, which, due to the segment's sharp and almost indiscriminate rise in prices, no longer offered us a wide enough margin of safety to justify the investment* ***(at least in that "sizing") – comment added now****. The momentum and the potential operational leverage of some of these assets tend to be favorable this semester (and duly powered up by the effect of the presidential election year on incomes), but our reading is that their prices already reflect very optimistic scenarios for sales growth and expanding margins, for which we prefer not to "pay in advance" – especially because it is possible to list clear execution and capital allocation risks, to which we attribute a considerable probability of occurring in the medium term, and which are far from being recognized and duly discounted by the market.*"

We continue to think that way.

At several times in the course of 2010, sales took place much faster than the new purchases, leading to a temporary incremental accumulation of cash. Considering that the cornerstone of our investment philosophy is capital preservation, having cash is not synonymous with "idleness". Like Seth Klarman, we believe that "*cash offers a positive carry (even more so in Brazil), safety for the principal, and total, instantaneous liquidity*". It is an insurance, a cushion, but at the same time has an interesting embedded optionality, especially in stock markets like the Brazilian one (with little liquidity, and historically unstable). In fact, if we invert our reasoning, NOT to have cash at the right time, when expectations change from one moment to the next, creates an "opportunity cost" that is not often taken into account by the average investor.

Cash

We do not have a crystal ball or privileged vision of the future. We do not have today, nor do we seek to have, a top-down opinion on the general level of market prices. First because our approach in selecting assets is bottom-up. Second because the "market", understood here in the narrow sense as the universe of investments that may be addressed, is defined for our purposes by the companies, people, shareholder arrangements and business models that interest us – whether in Brazil or worldwide.

If the prices of the assets in the portfolio rise beyond the level we think they should, we sell the positions either partially or totally. While we don't find something better that satisfies our "filters" and presents a significant margin of safety, we accumulate cash.

From this viewpoint, our exposure level is defined "bottom-up", and the cash position is a residue.

On the other hand, after two decades managing assets in an emerging country, having cash available to absorb possible micro and macro mishaps helps a lot in long-term performance.

Cash is not just a weapon of a defensive nature: it is a kind of tank that protects you when there's a deluge of difficulties (and believe us: like Borges, "*I don't believe in witches, but that they exist, they exist*"), but it becomes a large-caliber weapon when despair descends on the vast majority of investors. We love buying when everyone has to sell. Even more so when there is a concentration of capital in less liquid companies, or huge institutional investors building concentrated positions that are not very important to them, in assets they don't know well and that have liquidity restrictions.

No matter how "bottom-up" we are, managing assets in a country like Brazil involves thinking about liquidity, inflation, politics, currency, flows and contagion. We do not have, nor do we think it necessary or useful to build, a "master view" to protect ourselves from sudden changes in these variables.

If we are 100% invested and the market plummets or takes a "jolt", the value of the portfolio falls, and consequently so would our fire power to take advantage of opportunities (sometimes real bargains) offered by anxious – or, in specific circumstances, panicking – sellers.

It can be alleged that this is 'market timing' or simply the availability bias. In our perception, it is not. Capital preservation is one of the cornerstones of our investment philosophy. Considering our relative size, in which the level of mobility navigating through mid/small caps does not allow us to enter and exit positions instantaneously, having cash in hand allows us to seize golden opportunities – those in which an investor needs to get rid of a position rapidly and at any price. And better still, if the investment community tends to act as a herd in rising movements, its cohesion is even greater when they all need to escape through the same hole.

"If" we had been more exposed to the same assets (a "heroic" premise), we would certainly have achieved an even better performance in the year. What if we had applied the 75% invested in the "wrong" assets? We like to think in the conditional (the "ifs") *ex ante*. *Ex post*, we only live with and deal with our decisions. To have high cash levels is more a consequence than a decision. To have more cash than the average investor thinks appropriate or comfortable is conviction. It is part of our perception of the margin of safety concept (cushion and weapon).

This brings us to an interesting point: in our brazilian equity funds, before seeking to maximize returns, we are obsessively concerned with capital preservation. If we look around us and what we like seems too expensive, we wait.

Research and Collaboration/"Activism"

In the course of 2010, we advanced a bit more in relation to our longstanding ideal of forming an increasingly qualified and integrated – and at the same time small – management and research team.

Today there are eight of us (including three managers), and we do not intend to increase the group – unless we find someone exceptional. In our experience, the coordination cost increases out of proportion with the entry of each additional team member, consuming absolutely precious time and attention, distracting us from our core activity, our reason to exist and greatest motivation: reflecting and investing.

IP is a 22-year-old institution and, we believe, a company with well established processes – with its burdens and benefits. Years have passed since we were just a group of people who "ran a fund". Even so, although we have a whole work dynamic that is established and reasonably well organized, we have reached the conclusion that our productivity and the quality of our team work increases when we work in small, qualified groups.

In the course of the year we adjusted our discussion forums and internal incentives in order to bring the "research" and the "management" even closer together – a delicate, difficult process, but one that is fundamental for the team's maturity and integration.

In order to free up even more time for the management area, we have been investing in the support areas, further aligning the administrative and operational areas, with a view to increasing our productivity in generating ideas, convictions and "refutations".

As commented on in the previous quarter, in 2010 we invested a lot of time in enhancing our knowledge and building closer relationships with companies and regulatory bodies in various sectors. Some of them, like those in the financial services segment, required exhaustive field work.

In the portfolio's less liquid positions, for which we adopt a more active/collaborative posture (in Mills, Panvel and Saraiva we have a seat on the Board or appoint a member), the year was very productive. Because of the sharp rise in prices, we made some tactical sales of shares of companies that we still consider long-term holdings.

Global Investments and International Research

Just as in the previous quarter, the management team made some trips abroad to continue bringing to the Funds managed by IP a broader and more differentiated perspective on risks and investment opportunities, both local and international – in several sectors. In this quarter, we highlight the trip of the whole management team to Asia, with emphasis on China, which is a theme we will explore in the next report. The trip had multiple objectives: 1) To evaluate, from the "micro" viewpoint (talking to several relevant agents, from lawyers' and accountant's offices to municipal governments, exchanges and private equity funds), some of the tacit "macro" hypotheses we had built, even subconsciously, on "China". Translating: we carried out field work in tier 1, 2 and 3 cities, seeking a better understanding of the risks (real estate, bank credit dynamic, the health of SOEs and private companies, urbanization process, social tensions, the governmental/regulatory dynamic) and opportunities for our local and international investments; 2) To visit factories and talk to the managers of several Brazilian companies, such as WEG, Randon and Fras-le, in order to better understand risks and opportunities; 3) To have a broader perspective on several sectors in which: a) the marginal demand and/or supply come from Asia (from consumer goods to steel), b) there are companies with business models that are comparable/similar to companies that we study either locally or globally (ports, exchanges, real estate, consumer goods, shopping malls); 4) To revisit financial hubs and, more and more, service hubs, such as Hong Kong and Singapore, which have an impact on and are strongly impacted by the dynamics of the "Dragon" and the Dollar/Yuan Renminbi dilemma.

Finally, we would stress the contribution of the global investments to the IP-Value Brazil fund's results and point out that our allocation to international assets today remains very close to the regulatory ceiling of ten percentage points (not applicable for the VBF Class A and VBF Class C).

Prospects

Today, our portfolios have a concentration level in line with our track record. The 5 largest positions represent approx. 36% of the exposure, and there is no top-down concern about sectorial exposure, and much less about indices of any kind. Judging from the portfolio positions, one might infer that we are, once again, long in "domestic consumer goods", but the truth is that each investment case has absolutely specific and bottom-up drivers. For example, to define Dimed as a "regional drugstore chain with a liquidity discount" would be to ignore important assets that are peculiar to the company, which are not known to nor priced by the market – from real assets to own brands, from online to 'store-in-store' operations, in addition to its own distribution operations (which makes understanding it difficult).

In a more general sense, the portfolio today suggests the following: on the one hand, a good dose of conviction expressed by a set of concentrated investment ideas; and on the other, prudence, in the form of a cash cushion. Although it is an effect of our research activity, reflecting the fact that, at the moment, we are unable to find more bargains that will pass through our qualitative and quantitative "filters", we attribute to this residual cash position an attractive tactical value.

The foreign capital flow which is *par excellence* the great marginal buyer of Brazilian shares (investing directly or via funds) comes in hordes in search of the strong growth of the "New Brazil" (or the expectation that it will be sustained). As good Brazilians, we are rooting for this to happen. However, we do not like the idea of paying for it.

We prefer to be positioned so as to indeed reap, in part, the results of what the "New Brazil" has recently planted, like the few companies (10, 15, 20 at most?) with good business models, good management and governance, as well as dominant competitive positions, which the approximately 120 IPOs effected from 2004 on have brought us – provided the prices are attractive. And is there anyone who does not want to surf on the benefits brought by the demographic bonus, formalization of the economy, increased employment, credit, and income, some important micro/regulatory reforms, the organization of supply chains, etc.?

But paradoxically, on the other hand, as investors, we are interested in reaping what the "Old Brazil" planted years ago, with its ailments, inconsistencies, bureaucracy, protectionism, unorganized urbanization process and unpredictability, creating abyssal inequalities between the winner-survivors and the defeated, and historic barriers between leading, dominant companies, very often forced to integrate vertically (to survive the chaos of decades of totally unreliable supply chains), and the second tier, as well as between local players and potential international competitors, or between listed and privately-owned companies. There are entire sectors in the country in which one or two companies earn money and the others sink. And the fact that some sectors hardly operate or are obsolescent (for example: let's combine the country's port/highway system with its Byzantine tax system...) jeopardizes the competitiveness of several sub-sectors that interest us. These market inefficiencies due to the country's "historical incompetence" (and regional/sector incentives) help dominant companies to perpetuate themselves at the top, and not exclusively thanks to their own strategic/operational merit. Established players have a huge advantage over newcomers, and have been benefiting today from the operational leverage of the "boom in demand" in a country where supply is structurally compressed ..... One of the great risks is to assume that this leverage will be perpetuated. The other is to get carried away with the phase the country is going through and the investor's appetite to take strides longer than one's own legs.

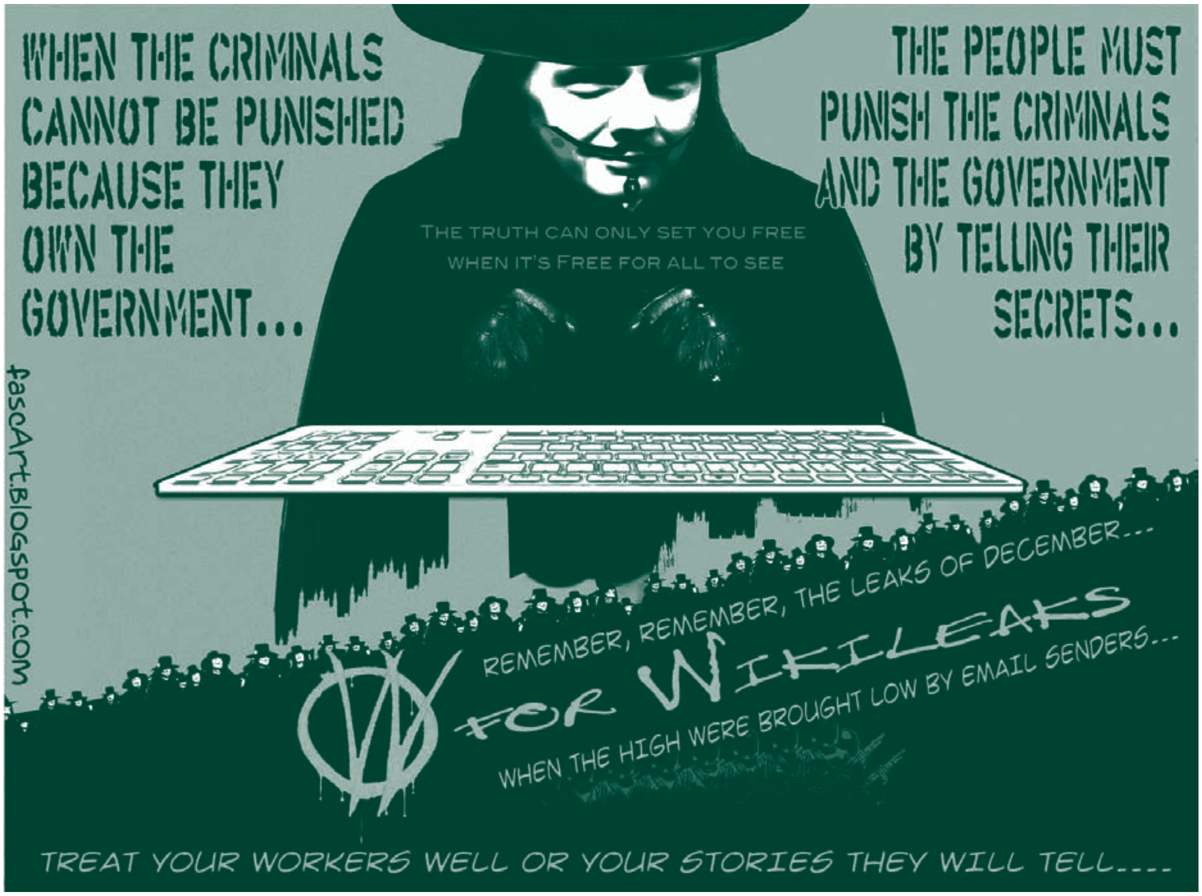
During some particular periods of the short history of the so-called capitalist regime, free access to money (cheap money) to finance capital-intensive projects, added to the sense of security given by the periods of calm and to words of encouragement from partners, bankers, and board members, besides the backing given by the media and the similar behavior of peers and neighbors, create a kind of "courage" that usually brings harmful effects, after a certain interval, that can sometimes be devastating.

In our experience, excessive liquidity (or the perception of liquidity, capital that is cheaper and recurrently accessible) tends to catalyze decisions and actions on the part of shareholders, directors and executives that are inefficient and even foolhardy (to grow very rapidly and in an unorganized way; to diversify betting on sub-sectors or geographies that are less profitable, defendable, or compatible with the company's culture; to assume that bottlenecks in infrastructure will be solved in good time, etc.).

With inflated growth expectations, margins of safety are compressed – or even eliminated.

In Brazil, the limited number of listed shares and their low liquidity increase the potential negative effect on prices of a possible "mass flight". Especially in small/mid-cap stocks where there is a big concentration of non-specialized foreign investors, which may give us interesting opportunities when there is an increased perception of market risk – for any reason (we could list several). In this context, putting our cash to work would be much easier.

Meanwhile, we continue doing research, reflecting and exercising our patience and discipline. We assess old friends and some novelties, but without the least pressure to invest if our quality and price criteria are not met.



"The quadrillion (10^{15}) dollar question – or its equivalent in a "strong currency", whichever that may be – is the following: "how long will it take for the great nations to face reality and to adjust unsustainable benefits, reduce inefficient bureaucracies and end nonsensical and painful wars? There is a clue, a glimpse of something that may bring changes in this scenario when one studies initiatives such as WikiLeaks (www.wikileaks.org) and Propublica (www.propublica.org), which are very specific examples of how technology can and will enable change by introducing transparency." – **IP Global Report of June 30, 2010**

"Governments of the Industrial World, you weary giants of flesh and steel, I come from Cyberspace, the new home of Mind. On behalf of the future, I ask you of the past to leave us alone … You have no sovereignty where we gather." – **John Perry Barlow**

"On résiste à l'invasion des armées; on ne résiste pas à l'invasion des idées." – **Victor Hugo**

"Jailing Thomas Edison in 1890 would not have darkened the night." – **The Economist**

"In gold we trust." – **Anonymous**

The variation in the market price of IP-Global's positions in the 4th quarter of 2010 was 4.8% in dollars. As a result, the yield in 2010 amounted to 11.8%. Since IP started managing the Fund, on August 1, 2001, it has accumulated a return of 80.5% (details on page 28).

We reduced the gold basket position by 30% (further details in the 2nd and 3rd quarter/2010 reports). The case is becoming more mainstream day by day, which, if on the one hand it rewards us with the appreciation of the position, certainly brings us closer to the moment when the "supply" of new buyers, which is essential for prices to continue rising ("greater fool theory"), will come to an end. The position is still very significant (approx. 9% on Dec. 31).

On the other hand, we increased the positions in the "unloved giants of the Internet infrastructure" – at the moment, Microsoft and Cisco. In both cases we took advantage of moments of more negative feelings, when prices fell and the implicit volatilities of the options (in this case, puts) rose, to buy shares and sell puts, which would result in automatic increases in the positions in the event of a drop in prices.

We continue to be intrigued by the apparent opportunity offered by Microsoft shares. The search for reasons to explain the recent prices continues. We have not found any other important negative point in addition to those already mentioned in our last report. On the other hand, while in the latter we focused more on exploring the valuation in absolute terms, in this report we will address some additional positive points which, in our opinion, support the thesis that, apart from the low price in terms of present multiples, the situation may be even better in terms of the future (growth).

The first would be the successful launching of the Kinect (an interesting demo can be seen at http://www.youtube.com/watch?v=LUsiFjeRWjw), a device that allows users of the Xbox (Microsoft's Trojan Horse in the battle for the TV room, disguised as a videogame console) to interact with the system entirely by gestures, making mouse and joystick dispensable in many cases.

"*According to information supplied to retailers, the Kinect is capable of simultaneously tracking up to six people, including two active players for motion analysis with a feature extraction of 20 joints per player. The software technology enables advanced gesture recognition, facial recognition and voice recognition.*"

From one moment to the next, the brilliant Wii interface (Nintendo's, launched in 2006), which captures the user's movements but requires the use of one or two wireless joysticks, has become obsolete. From what we were able to verify, the Kinect has been selling at a speed of 1 million units every 10 days. This number takes on greater significance when we take into account the fact that, up to now, the device only works when connected to the Xbox 360, which had an installed base of around 40 million consoles up to November (in the same range as Sony's Playstation 3 and still below Wii's 70 million). Obviously there is no technological limitation for the same device to be used as an interface for any other device or software, as was seen, for example, in the film "Minority Report". This led us to think about the reasons for Microsoft having limited the interface of the device to the Xbox. The best explanation we have found is that, because of production and distribution restrictions, the company is opening it up to other systems in stages, like the PC itself.

A possible positive scenario in this case would be the adoption of the gestural interface on a large scale, with Microsoft having the pioneer's advantage, both in relation to the operating system and to the applications.

Another positive potential would be for the XBox to have a significant gain in penetration. Being able to control an "intelligent" set-top box in an innovative and intuitive way – despite all the craze over tablets – is extremely powerful, especially if such set-top box is integrated to one's online games (Halo?), messenger (MSN?), or search engine (BING?), and if it is infinitely lighter than the tablet, as indeed it is – the user only makes natural gestures and the "TV" responds to them.

Here, the greatest risk is that once again the idea may be better marketed by third parties (Apple?), but with sales running at the present rates, that risk will diminish quickly.

Another interesting consideration is the comparison of Microsoft's "Business Division" unit, which supplies software and services to corporate clients, with other corporate software companies such as Oracle and SAP. Like all comparisons, it should be used as a reference and not as absolute truth:

	Oracle	**SAP**	**Microsoft** (Business Division)
Revenues last FY	27 (US$ Bi)	10.5 (US$ Bi)	18 (US$ Bi)
Operating margin – last 3 years	34.8%	24.6%	50% (IP est. for 2010)
Market Cap	158 (US$ Bi)	62 (US$ Bi)	NA

Another point of reference is Nintendo, the above-mentioned leader in the electronic game sector, with sales of over US$ 15 billion in the last fiscal year (March 31), made a US$ 2.4 billion profit, and whose market cap amounts to US$ 41 billion; while Microsoft's "Entertainment and Devices" division sold a little over US$ 8 billion in the last fiscal year (June 30), with a profit estimated by us at around US$ 600 million.

In the "icing on the cake" category, we have some elements that are known and others probably not. One of them is the operating system for telephones, with regard to which we tend to agree with the market that the chances of success are lower.

On the negative side, we understand that there are many risks, both known and unthinkable; but it is difficult for us to share the belief of those who characterize Facebook and Twitter as Microsoft/Google killers, ignoring the fact that many companies don't even permit access to Facebook and Twitter through their corporate networks. Both Facebook and Twitter are important, but one can't say yet that they are killers in a time horizon that would justify the present valuations...

In fact, what concerns us the most would be a possible "clumsy" acquisition. There is no lack of alternatives. In the mobile telephony segment alone, two alternatives would be Nokia and Research in Motion. Another would be Netflix, whose business may have great synergies with the XBox platform and whose founder is a member of Microsoft's Board; but the integration challenges and cultural and motivational differences would be immense, not to mention valuation. At this time, we do not have the capacity to evaluate the potential of these alternatives; they certainly may even be positive, but the history of large acquisitions recommends caution.

A clear conclusion we have reached is that, considering the difficulty for analysts to cover the diversity of Microsoft's activities/sectors, the company is currently trading with a "holding company discount". The clamor for the company to be broken up is an old one. It was even ordered at the first court level at the time of the company's anti-trust trial in the USA (later reversed). We don't have a strong opinion about this alternative, but we are quite convinced that it would be well received by the market, leading to a significant rise in the stock price.

We believe that the "right question" in relation to Microsoft is whether the organization has values/culture we believe in and whether it is functional. Though we do not believe that it is comparable to the extreme examples that immediately come to mind and that historically have had a significant participation in IP-Global (such as Berkshire Hathaway and Anheuser-Busch InBev), our view is that it is much better than the present stock prices indicate.

In the case of Cisco, several points converged to persuade us to make a significant increase in the long exposure to the company.

Three of them are related to the potential of the mobile Internet, which becomes clearer to us every day:

- The impact of iPhones – especially when analyzed in a relatively "purer" way, as in more connected cities, such as in the Silicon Valley or San Francisco – indicates what is to come with the increased penetration of smart phones.

• On the other hand, as the installation of 4G (faster) networks begins, this will increase the usage capacity of each user (and the operators' capex...)

• As a consequence of the increase in penetration, "main-streaming" at the user end, and capacity, history shows that new, unexpected uses arise.

The combination of the above factors leads us to believe in exponential growth in demand for connectivity (Cisco's product, in the most varied forms: switches, routers, set-top boxes, software).

Another factor at the demand end, which does not seem to us to be adequately reflected in the models of many analysts/investors, is the issue of security in the Internet, reinforced by points such as the "WikiLeaks event", stuxnet[1] and the creation of the "United States Cyber Command[2]" – a "fourth armed force" in the USA[3], specifically dedicated to "online war".

The obvious counterpoints to these positive aspects would be a fall in prices, driven by competition and a drop in demand from government entities – important clients of Cisco – due to public deficits and debts. The latter immediately leads us to the fact that the "defense" businesses of companies such as Boeing, General Dynamics, United Technologies, and others that are less "popular", historically do quite well...

When all is said and done, we believe that the positive factors will outweigh the negative ones that seem to be reflected in the price of Cisco's shares, leading us to the final driver of our position increase: the fall in Cisco's stock price, which took the paper to very inviting multiples. There is obviously a series of other factors to consider, such as the corporate culture, governance, business model, balance sheet, competition and competitiveness, regulatory environment, etc. But this is a company that, in greater or lesser depth, we have been following for over a decade, which made us comfortable to take a considerable leap. We shall see...

In the opposite direction to the increases in the Microsoft and Cisco positions, in October we sold the small position (approximately 2%) that we had in Nokia (with a loss of 36bps in the year, after a gain of 3 bps in 2009). The reason for that was the combination of a peak in the stock price and the inexorable increase in the probability of what we consider the greatest risk: the growth of the Android platform (developed and offered free by Google to handset manufacturers, including Asia's ultra-low-cost producers).

In what may seem a paradoxical move, we also reduced our position in Google by approximately 20%. The main reasons here were the increased risk because of the negative development of the anti-trust issue in Europe, and the rise in the stock price. Once again, a matter of combination of the increase in our risk perception together with a rise in the stock price. But in this case, Google remains as a "medium size" position (approximately 5%).

In general, we think the market capitailzation of companies in a "hot" sector such as technology, which should experience strong relative growth, exceeds the reasonable value of those that will eventually win. In this case, though not all obvious potential winners are listed (some may not even exist yet...), a "back of the envelope" calculation (usually the best) indicates that there is a good opportunity. As in most cases, there are "darlings" and "dogs". The practical consequence has been a gradual increase in exposure to the technology sector, both in gross and net terms. As a way to try to maximize the risk-return ratio, we are replacing some more systemic hedges with some companies in the sector that are in the "darling" phase.

Along the lines of helping our investors to monitor our mental framework, here are some generic considerations on the "tech" segment that have significant implications in our investment decisions:

I – In certain situations we disagree with the market regarding the impact curve of competition/new technologies. It is a fact that, over time, most technologies become obsolete. But in terms of investment, what is important is to get right, in general terms, the speed at which each process occurs, and the efficacy and costs of the incumbent's efforts to take advantage of the changes or to resist them.

II - Some products and services seen as substitutes end up proving to be additions, complements, and sometimes even "enhancers" of established products.

Examples of both cases are abundant and many are very well known, so we will spare our readers' patience.

Additionally, and paradoxically, in some cases new products are discounted excessively. The most extreme case, of course, was Windows (in its first versions). Recently, significant cases of which we believe we took some advantage were PayPal (via eBay) and YouTube (Google).

Our work and pleasure is to seek opportunities in these occasional distortions and transform them into profits for IP-Global.

Thermo-Fisher (TMO)

In December, Thermo-Fisher announced the acquisition of Dionex for approximately US$ 2 billion. This amount represents approximately 10% of Thermo's recent market capitalization. Contrary to what happens in most cases, the stock price of TMO, the acquiring party, rose after the announcement. In our opinion, the exception here is justified by the fact that the acquisition of companies to be "plugged in" to its global distribution network for technical / scientific equipment and supplies has proved to be very profitable (see further details on the company in our 3rd quarter/2010 report).

Dionex fits like a glove into Thermo-Fisher, not only in respect of its business but also its economic and financial profile. The company habitually generates cash, which has been used over the years to repurchase its shares, clearly showing an internal perception of respect for the limits of organic growth. The company's expectation that the acquisition will rapidly generate value through cuts in common costs and sales gains due to integration under the TMO umbrella seems reasonable to us. On the other hand, the increased frequency of M&A operations in the sector causes us some concern. In December, the sale process of Beckman Coulter, a company in the laboratory equipment sector with a market capitalization of US$5 billion, was announced. No matter how much sense many acquisitions may make, especially for Thermo-Fisher, which is a machine for acquisitions and freeing up synergy and sales in the sector, there are risks created by the quantity[4] and especially by the prices that may be paid. Historically, low interest rates and excess liquidity lead to a lot of "easy money" for acquisitions, both by strategic players and financial investors[5]. TMO's new CEO must be very disciplined. With the big rise in the stock price, we effected a covered sale of call options equivalent to approximately one third of the position.

The negative point here was that we failed to purchase Dionex shares earlier. This failure was compounded by the fact that the strategy of seeking opportunities among TMO's potential targets is something we had already made explicit. It's not possible to get them all right, considering the day has only 24 hours, but this was a sad case. Our apologies.

In terms of general and finer adjustments, we reassembled part of the position in Berkshire Hathaway that had been "taken from us" by the exercise of covered calls, when the price subsequently fell back to more attractive levels. Berkshire continues to be a significant position (approx. 9% on Dec. 31). We also increased our position in Johnson & Johnson (more details on the company in the 3rd quarter/2010 report), which remains in the "medium size" category, with approximately 6%.

Along the lines of year-end soul cleansing, we cannot fail to express our frustration regarding our difficulty in implementing some positions in the long-term US fixed-income segment, where we dedicated a lot of effort to identification, but failed in the execution. We erred in the speed of reconstruction of operating channels that had been drastically reduced because of fears regarding credit risks in 2008. We estimate that, considering only the gain we could have made if we had implemented the strategy, we "left behind" about 200bps. The point has not been lost on us and we hope to make progress in this respect.

Last but not least, one in the "are you nuts?" category: we put together a small position (approx. 2% on Dec. 31) in Petrobrás. Perhaps the main reason here, more than anything else, was to reaffirm that we can speculate. We do not consider the company's shares as something that can be fitted into the "pieces of a business" category, because we estimate that the chance of the company's terminal value being close to zero is quite high. But today, as it happens with gold, this view is very popular and we believe that these things are cyclical and that the prices are very depressed. In addition, it fits into the "if we are very wrong this could help" category, a.k.a. hedge.

Prospects

The Wikileaks imbroglio shows clearly and indelibly, once again, the inflection point we are going through in terms of governance. The present model is irreparably obsolete. No matter how hard the establishment tries to curb the new initiatives[6], "the Genie (it is up to each of us to decide whether it is "good" or "bad") is out of the bottle". In mid-December, a search for "Wikileaks" in Google showed approximately 440,000,000 hits in 0.18 seconds. Assange has not created his "personal" page in Facebook, but he had over 30,000 friends "queuing" with explicit interest on a when-and-if basis. During December, because of the attention generated by the Wikileaks event, several other similar sites started being noticed and launched, such as rospil.info (which focuses specifically on Russian companies), tradeleaks.com, etc…

In our opinion, the discussion about whether Wikileaks is a "good thing" or a "bad thing" is ineffective in practical terms. Our opinion is of little importance (it is, in fact, non-qualified, because we don't think it's worth investing our scarcest and most valuable resource – time – in qualifying it, given that it would be irrelevant both because of the inexorability of the phenomenon and because of the conditionality it would certainly have). We wonder if yesterday's governments did not feel threatened by the first investigative newspapers? Were there no abuses? What, and how many, will the unintended consequences of such a profound, all-embracing event be?

An approach that is little used but that called our attention, paradoxically to the approach of most of the coverage, was the fact that, in so many documents, so few absurdities appeared. Score a point for the US State Department[7]. Because, honestly, the "novelty" that US Embassies are instruments for obtaining information for the US State Department, and that a lot of people consider Carla Bruni attractive and the French State Department uses this fact ... this is a left-over from the "old world".

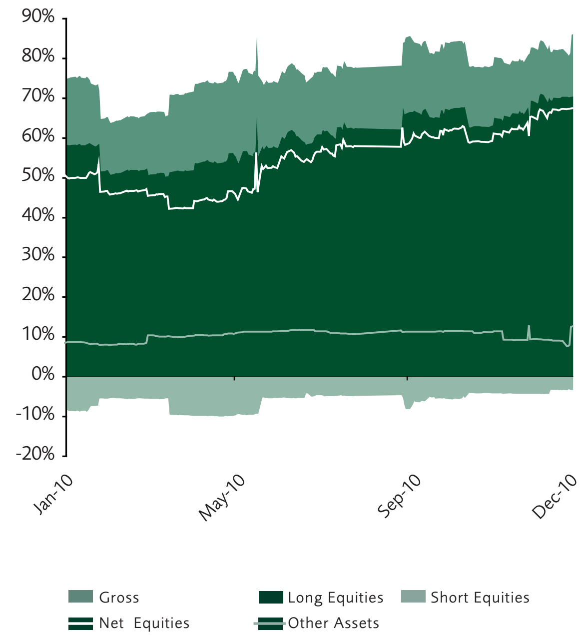
The evolution of communication technologies and their derivatives and consequences no longer leaves room for so much hypocrisy, "hidden agendas" and "spin" (is the culprit the one who divulges the errors, blunders, or massacres, rather than those who commit them?!?! Have a heart…).[8] For an interesting exploration of possible consequences, we recommend reading "The Truth Machine", by James Halperin.

So we continue following the popular saying, "a problem without a solution is already solved"… From the investment viewpoint, on the one hand we will have a further increase in security efforts (a positive trend, in principle, for Microsoft and Cisco). On the other hand, the increased transparency may benefit companies that can position themselves accordingly, such as Facebook and Google.

We still hold the opinion that the USA is thoroughly stuck in the mud. The moral damage is huge and increases day by day. Apparently Obama was talking seriously when he said that "Lula was the man". He now follows in his footsteps (and Chavez's) and has moved toward censorship[9]. The result is that the probability that we're seeing the end of the era with the USA as the dominant power is increasing day by day. That in itself is nothing much, because it may be good or bad, depending on the situation we're moving to, on one's viewpoint, and the fact that everything will be resolved in time[10].

We feel optimistic in relation to the long-term impacts of these changes, but there will be costs, traumas, as there are in all of them ... From the investment point of view, we believe that many opportunities will continue to arise. Gold was/is[11] one of them; Treasury shorts and 30-year spread swaps are others; and the difference in perception in relation to what an "American" company is, is another. The valuations of some companies that are considered "American" for historical reasons – but that compete globally – are attractive, and this is a theme we have been focusing on. In addition, losing one's dominant position is different from being unsuccessful. Even this hypothesis, from the investment viewpoint, should be seen taking prices into account. It is a complex scenario, which requires constant monitoring of the obstacles and possible sudden adjustments, in which, as always, it is also fundamental not to lose the long-term perspective.

The most objective way we can find to present our summary of this "opera" is by using the Fund's exposure data. The evolution of the exposure during 2010 can be seen in the graph below:



What cannot be seen above is that, considering the risks coming from a stronger rally in the US economy and an increase in interest rates in that country, we are putting together a position of long, out-of-the money puts in gold. The amount invested is very low for the Fund and will probably be lost. But insurance is like that.

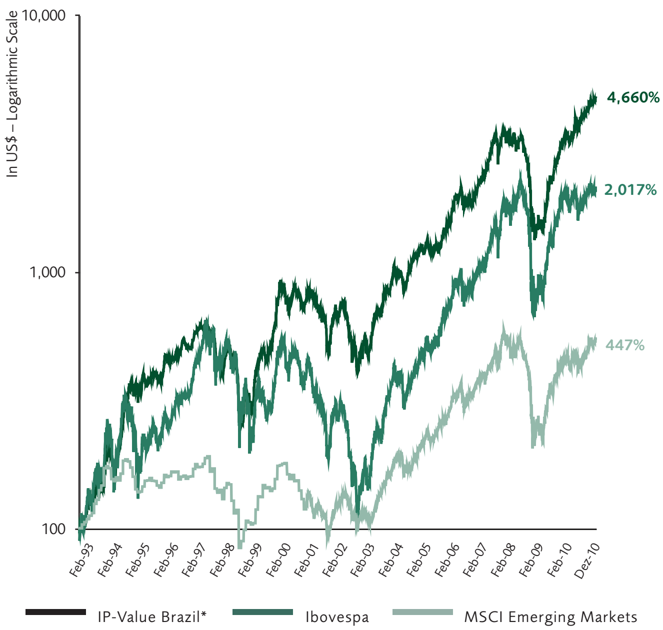
Working for good returns and rooting for a more balanced and transparent world, we wish everyone a happy 2011 and beyond.

Notes

1. http://en.wikipedia.org/wiki/Stuxnet
2. http://en.wikipedia.org/wiki/United_States_Cyber_Command
3. http://www.infosecurity-us.com/view/14826/cyberspace-the-fourth-arm-of-the-military/
4. "Many more companies die of indigestion than of hunger." Charlie Munger
5. A recent interview with David Rubenstein, of Carlyle, leaves little doubt regarding the global private equities scenario: http://dealbook.nytimes.com/2010/12/20/carlyle-keeping-eyes-on-the-dragon/
6. "I think he needs to be prosecuted to the fullest extent of the law, and if that becomes a problem we need to change the law." - said Mitch McConnell, Republican leader, in the Senate on December 5th 2010.
7. A point well raised in the excellent article by Timothy Garton Ash in The Guardian, November 28 (http://www.guardian.co.uk/commentisfree/2010/nov/28/wikileaks-diplomacy-us-media-war/print)
8. "President Obama says the latest deal will help "parents and students and other folks manage their bills". Indeed. Ordinary people find it easier to keep their financial houses in order when the federal government shows no sign of doing the same." FT's Lex on Dec 7th 2010.
9. Let's hope that he continues on the track of our great politician and changes his mind and defends Wikileaks and Assange.
10. On this issue, the reaction observed in the mid-term elections, commented on in the last report, may be considered a "positive" point for American society.
11. If we get to the point that the market applies to US securities the same rigor as it applied to countries in similar fiscal situations – most recently, Greece, Ireland, Portugal and Spain, just to mention the best known – there is still a good upside/downside ahead, as always depending on the "long" or "short" viewpoint of each investor...

PERFORMANCE – IP-VALUE BRAZIL CLASS

PERFORMANCE



* IP-Value Brazil is an offshore mirror of IP-Participações, a long-only equities fund based in Brazil and managed by Investidor Profissional. Both funds hold the same positions, the only difference being cash, held in dollars for IP-Value Brazil and in reals for IP-Participações. Although IP-Participações had its inception on 02/26/1993, its offshore mirror was not created until 12/29/1995. For reference, we show IP-Participações performance in dollar terms for the period between 02/26/1993 and 12/29/1995. To make it easy to differentiate, every time we show an IP-Value Brazil performance number affected by IP-Participações' performance, it will be in italics.

Performance (US$)	IP-Value Brazil (2)	Ibovespa	MSCI EM
December 10	4.91%	5.41%	7.15%
November 10	0.19%	-4.85%	-2.64%
October 10	4.41%	1.39%	2.91%
September 10	5.28%	10.62%	11.13%
August 10	1.00%	-3.35%	-1.91%
July 10	5.26%	10.92%	8.40%
June 10	5.49%	0.38%	-0.72%
May 10	-7.32%	-12.10%	-8.75%
April 10	14.56%	-0.56%	1.23%
March 10	3.35%	7.54%	8.08%
February 10	4.93%	3.87%	0.37%
January 10	-6.48%	-10.14%	-4.71%
2010	39.52%	6.21%	20.27%
2009	127.67%	143.95%	77.42%
2008	-57.06%	-55.52%	-53.18%
2007	54.10%	73.43%	39.78%
2006	45.32%	46.41%	32.59%
2005	23.13%	44.09%	34.76%
2004	28.11%	28.16%	26.28%
2003	87.65%	141.04%	56.36%
2002	-26.36%	-45.44%	-6.05%
2001	-7.58%	-25.00%	-2.37%
Last 60 months	205.46%	192.66%	85.15%
Since 02/26/1993 (1)	*4660.46%*	2016.59%	446.76%
Annualized Return (1)	*24.62%*	18.99%	10.16%

(1) Inception of IP-Participações
(2) Performance numbers of IP-Value Brazil and IP- articipações are ne of all fees
(3) Sharpe Ratio is: (Annualized Return minus the a nual 3-month T-b return)/Annual V latility

EQUITY HOLDING CHARACTERISTICS

	% In Equities
International Assets	10%
Ibovespa	31%
Small Caps (smaller than US$ 1bi)	18%
Mid Caps (between US$ 1bi and US$ 3bi)	9%
Large Caps (larger than US$ 3bi)	73%

PORTFOLIO CONCENTRATION

	%	Monthly Attribution
Top 5	35.3%	2.54%
Next 5	17.7%	1.10%
Other	22.4%	1.20%
Cash	24.6%	0.07%

THE FUND

IP-Value Brazil is a Class of IP Investment Fund Ltd, which is an open-ended investment fund organized as a limited liability exempted company, incorporated under the provisions of the Companies Law (2001 revision) of the Cayman Islands.

Objective

Obtain significant long-term absolute returns by investing long only in the Brazilian and international equity market.

Strategy

- **We follow a disciplined, value oriented long-term approach.** We do thorough fundamental analysis to identify companies that are trading at far less than their intrinsic value.
- Our aim is to find Brazilian companies with the best combinations of:

- Perfectly understandable business;
- Above average long-term prospects;
- Managed by people that are competent , honest and aligned with minority investors ;
- Trading at attractive prices.

- We do not associate risk with the inevitable short-term fluctuations in the market quotes of our positions.
- **We believe our main competitive advantage is having a different investment horizon than that of the market as whole, and sticking to it with discipline.** By focusing on the long-term and having a deep knowledge of the companies we invest in, we are able to take advantage of short-term market overreactions.

TERMS AND CONDITIONS

Subscription: Daily
Minimum Initial Investment: US$ 100,000.00
Minimum Additional: US$ 100,000.00
Minimum Redemption: US$ 100,000.00
Minimum Balance Left: US$ 100,000.00

Redemption: Last business day of each calendar quarter, subject to a previous notice of 30 business days. Payment of redemption proceeds shall generally be made within 10 business days following the Redemption Day.

Performance Fee: 15% of the increase of the Net Asset Value per Share, accrued daily and paid monthly or on redemption, subject to a high-water mark

Management Fees: 2% per year of the Net Asset Value per Share, accrued daily and paid monthly

ADDITIONAL INFORMATION

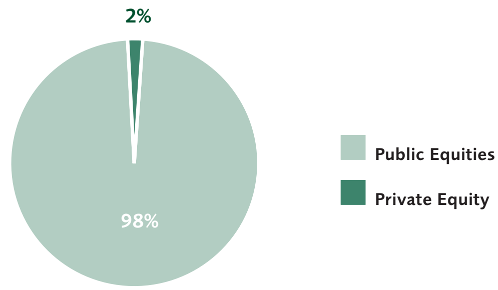
For additional information regarding of IP-Value Brazil Class, please contact us by phone at (55 21) 2104-0506 or by e-mail at contactus@investidorprofissional.com

VBF CLASS A

Performance (US$)(1)	Class A	Class S (Mills)(5)	Class S (Casa Show)	Classes A + S + S
December 10	5.03%	-	2.99%	5.00%
November 10	0.90%	-	-0.98%	0.87%
October 10	4.66%	9.53%	-0.53%	5.22%
September 10	4.88%	7.59%	3.68%	5.14%
August 10	0.81%	8.09%	-0.03%	1.19%
July 10	5.49%	9.39%	2.64%	5.81%
June 10	4.35%	19.29%	1.08%	5.54%
May 10	-6.26%	-6.80%	-4.89%	-6.52%
April 10	3.70%	307.41%	3.01%	23.79%
March 10	3.06%	1.45%	1.81%	2.93%
February 10	5.77%	3.33%	3.39%	5.56%
January 10	-6.63%	-7.32%	-17.93%	-8.96%
2010	27.70%	515.08%	-7.68%	52.09%
2009	127.84%	36.80%	35.07%	115.43%
2008	-57.28%	-25.46%	-22.64%(4)	-54.54%
2007 (1)	30.59%(2)	4.03%(3)	-	30.51%
Since inception (1)	62.33%(2)	552.52%(3)	-3.53%(4)	91.49%

(1) Net of all fees
(2) Inception VBF Class S Mills 2007. July 06
(3) Inception VBF Class S Casa Show 2008. February 29
(4) Inception VBF Class A 2007. March 06
(5) Total realization at 2010. October 25

BREAK-DOWN PUBLIC EQUITIES X PRIVATE EQUITY

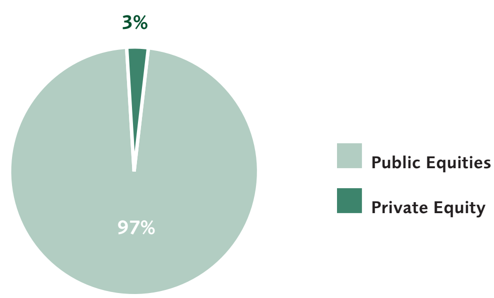


VBF CLASS C

Performance (US$)(1)	Class C	Class S (Mills)(5)	Class S (Casa Show)	Classes C + S + S
December 10	4.37%	-	2.96%	4.32%
November 10	0.83%	-	-0.97%	0.83%
October 10	4.01%	9.14%	-0.54%	4.24%
September 10	2.18%	7.49%	3.67%	2.55%
August 10	0.81%	8.09%	-0.03%	1.19%
July 10	5.50%	9.15%	2.64%	5.60%
June 10	4.35%	18.65%	1.23%	4.91%
May 10	-6.40%	-7.46%	-4.88%	-6.54%
April 10	3.75%	294.75%	3.00%	14.35%
March 10	3.01%	1.43%	1.81%	2.91%
February 10	5.69%	3.25%	3.44%	5.51%
January 10	-6.40%	-6.03%	-19.13%	-10.24%
2010	22.93%	490.32%	-8.88%	30.02%
2009	129.18%	34.36%	37.42%	109.62%
2008	-41.12%	1.80%(3)	-29.90%(4)	-40.92%
2007 (1)	-3.15%(2)	-	-	-3.15%
Since inception (1)	60.66%(2)	707.47%(3)	-12.22%(4)	57.46%

(1) Net of all fees
(2) Inception VBF Class S Mills 2007. July 06
(3) Inception VBF Class S Casa Show 2008. February 29
(4) Inception VBF Class A 2007. March 06
(5) Total realization at 2010. October 25

BREAK-DOWN PUBLIC EQUITIES X PRIVATE EQUITY



VBF PORTFOLIO

EQUITY HOLDING CHARACTERISTICS

	% VBF Class A	% VBF Class C
Ibovespa	32%	33%
Small Caps (smaller than US$ 1bi)	24%	21%
Mid Caps (between US$ 1bi and US$ 3bi)	11%	11%
Large Caps (larger than US$ 3bi)	65%	68%

PORTFOLIO CONCENTRATION

	VBF Class A	Monthly Attribution	VBF Class C	Monthly Attribution
Top 5	36%	3.08%	35%	2.67%
Next 5	18%	0.60%	18%	1.09%
Other	14%	1.22%	14%	0.53%
Cash	32%	0.13%	33%	0.08%

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 Class A: March 06, 2007
Inception Date of Class C: November 09, 2007
Inception Date of Class IP Brazilian Equities: April 01, 2010
VBF Classes A and C are closed.

INVESTMENT OBJECTIVE

The investment objective of the VBF Segregated Portfolio is to provide sophisticated investors with substantial long-term returns comprised of capital appreciation (capital gains, dividends and interest income) by investing principally in companies listed on the São Paulo Stock Exchange ("BOVESPA"), which in the Investment Manager's opinion are trading at a substantial discount to their intrinsic value.

INVESTMENT STRATEGY

The strategy of the VBF Segregated Portfolio is to identify and invest in companies whose prevailing share prices, in the Investment Manager's judgment, do not reflect their intrinsic values, and to hold such investments until such fair value is reflected in their market prices. While the VBF Segregated Portfolio may invest in any securities that in the

INVESTMENT STRATEGY (CONT.)

Investment Manager's judgment meets the underlying objective of long-term capital appreciation. In addition, up to 20% of aggregate assets of the VBF Segregated Portfolio Class C and 15% in Class A may participate in Designated Investments (Class S). These may include unlisted equities.

No Designated Investments will be made in respect of the VBF Segregated Portfolio – IP Brazilian Equities Class Shares.

TERMS AND CONDITIONS FOR IP BRAZILIAN EQUITIES CLASS

Subscription: Daily

Minimum Initial Investment: USD 1,000,000.00

Minimum Redemption Value: USD 100,000.00

Minimum Holding: USD 1,000,000.00

Redemption Day: the last Business Day of the third subsequent month following receipt by the Registrar and Transfer Agent of the Redemption Form.

Management Fees: 2.0% per annum of the Net Asset Value of the VBF Segregated Portfolio.

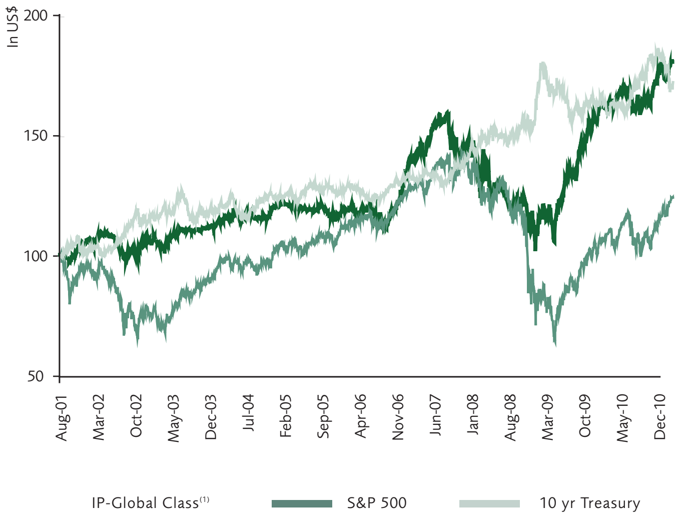
Incentive Fees:

- 20% computed on returns in excess of Libor+6%
- 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

IP-Global Class of IP Investment Fund is the master fund for all IP's global strategy portfolios including IP-Fund Class of IP Brazil Fund SPC.

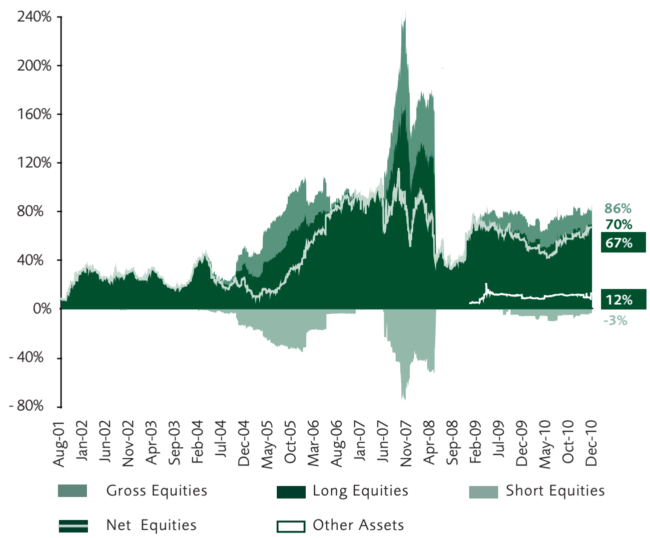


(1) Net of all costs since inception until November, 2003, since then gross of performance fees and since July, 2008 also gross of management fees.

Performance (US$)	IP-Global Class[1]	S&P500	10Y Treasury	3-month Libor
December 10	4.79%	6.70%	-4.56%	0.00%
November 10	-2.87%	0.01%	-1.80%	0.02%
October 10	2.92%	3.80%	-0.68%	0.02%
September 10	6.43%	8.92%	-0.14%	0.02%
August 10	-0.83%	-4.51%	4.58%	0.03%
July 10	1.30%	7.01%	0.29%	0.04%
June 10	-0.50%	-5.23%	3.48%	0.05%
May 10	-3.91%	-7.99%	3.55%	0.04%
April 10	-0.09%	1.58%	1.79%	0.03%
March 10	1.90%	6.03%	-1.68%	0.02%
February 10	0.83%	3.10%	-0.17%	0.02%
January 10	1.72%	-4.57%	2.97%	0.02%
2010	11.82%	13.93%	7.48%	0.32%
2009	38.31%	29.56%	-11.91%	0.69%
2008	-17.93%	-38.30%	25.31%	3.05%
2007	1.83%	6.22%	9.60%	5.30%
2006	18.46%	15.23%	2.05%	5.21%
2005	-2.89%	5.43%	3.47%	3.65%
2004	7.24%	11.11%	4.89%	1.64%
2003	8.12%	28.50%	0.92%	1.22%
2002	-1.29%	-22.11%	15.58%	1.79%
2001	6.04%	-5.05%	1.88%	1.11%
Since Inception	80.46%	24.08%	71.14%	26.29%

(1) Net of all costs since inception until November. 2003. since then gross of performance fees and since July. 2008 also gross of management fees.
(2) Inception of IP-Global Class 08/01/2001

EXPOSURE



PORTFOLIO CONCENTRATION

	% Portfolio	Monthly Attribution
Top 5	45%	3.04%
Next 5	24%	1.68%
Other Investments	10%	0.02%
Fixed Income	20%	0.00%
Total	**100%**	**4.74%**

PORTFOLIO BREAKDOWN

	% Portfolio	Monthly Attribution
Long Equities	70%	4.84%
Short Equities	-3%	-0.26%
Fixed Income	20%	0.00%
Other Assets	12%	0.20%
Total	**100%**	**4.79%**

The following information refers to IP Fund Class of IP Brazil Fund SPC.

TERMS AND CONDITIONS

Subscription: Daily

Minimum Initial: US$ 1,000,000

Minimum Additional: US$ 100,000

Redemption: If the Redemption Form is received by the Registrar and Transfer Agent on or before the 15th day of each calendar month the Redemption Day is the 15th day of the second subsequent calendar month. If the Redemption Form is received after the 15th day of each calendar month the Redemption Day is postponed by one month.

Minimum: US$ 100,000

Minimum Balance Left: US$ 1,000,000

FEES

Management Fee: Up to 1.5% p.a. on the Net Asset Value per Share, accrued daily and paid monthly.

Performance Fee: 15% of the increase of the Net Asset Value per Share, accrued daily and paid semi-annually or on redemption, subject to a high-water mark. The Incentive Fee will be paid through the automatic redemption of a number of Shares of each subscription in respect of which an Incentive Fee is payable, corresponding to the value of the accrued and unpaid Incentive Fee.

ADDITIONAL INFORMATION

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

Miscellaneous

"Airplane travel is nature's way of making you look like your passport photo." – Anonymous

"Every drunken skipper trusts to Providence. But one of the ways of Providence with drunken skippers is to run them on the rocks." – George Bernard Shaw

"If you pick up a starving dog and make him prosperous, he will not bite you. This is the principal difference between a dog and a man." – Mark Twain

"Bad artists always admire each others work." – George Bernard Shaw

"Education is an admirable thing, but it is well to remember from time to time that nothing that is worth knowing can be taught." – Oscar Wilde

"Any fool can make a rule, and every fool will mind it." – Henry David Thoreau

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