

FUND MANAGER LETTER – September 2016

1. AZ QUEST LUCE

1.1 Overview:

In September, our **AZ Quest Luce** fund returned 105.6% of the CDI, above its long-term targeted return. The main drivers of these gains were the same as in the last 3 months, especially our debentures portfolio. We maintained the same conservative portfolio position (54.9% of our NAV allocated in Cash and LFTs).

We flag that the entire political-macroeconomic scenario in place in the last 2 months has been important in companies' decision to start issuing again in the capital market. As another potential catalyst, we saw some offers in August and September, symbolizing that now may be the appropriate timing for primary offers. There will be nine offers taking place in October and November (that we are analyzing) that accurately illustrate the current moment. So far, we believe most of these offers match the mandates of our funds.

In September, we also liquidated new operations in the fund, coming from primary offers in which we participated at the start of the month. We also added, via the secondary market, names that we already had in the fund in order to allocate our available cash.

We can see the same supply/demand dynamics for credit assets as commented on in previous letters. Investors are still under-allocated in credit and there is a need to buy assets to ensure an appropriate portfolio composition. However, investors are demanding prices at the levels of a market in crisis (i.e. as if we were still experiencing the same conditions of 1H16). We believe these high premiums, a good credit analysis and a responsible management enable us to build a portfolio with a very interesting volume of premiums!

1.2. Returns (note: optional reading)

This month, we highlight the returns of our LFS and LFS-N portfolios, since one of them slightly underperformed the CDI and the other slightly outperformed the CDI. We believe it is important

to explain this phenomenon and educate our readers-investors in this asset class. In fact, we saw two completely different events (see below):

- (i) Breakdown of credit spreads.
 - a. We believe credit spreads narrowed excessively and too quickly, making assets expensive. This mainly occurred in the LFS-N portfolio. During August (mainly) and September, we sold almost 70% of the assets what we deemed expensive in the portfolio of LFS-N, allowing us to make a sizable gain
 - b. At a specific moment, the credit spreads of these sold assets started to widen. This impacted the result of the portion of the assets that had yet to be sold (*this basically occurred in the LFS-N portfolio*).
 - c. The opening of this credit spread didn't reflect deterioration in the credit quality of the issuer, but instead because a specific issuer will make a new issuance at better prices than those on view in the secondary market, thereby equalizing the secondary and primary markets.

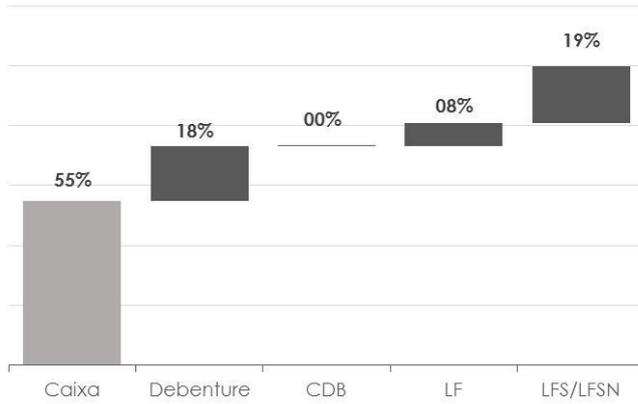
- (ii) Narrowing of yield curve
 - a. The narrowing of the yield curve has a negative result on assets pegged to the CDI rate (*when their MTM is above par*), an effect that is even more evident in long-term positions. This is a secondary effect on the marking-to-market, only visible when there are major movements in the yield curve. A similar rationale (and with opposite effects) occurs when the yield curve widens.

RETURN ATTRIBUTION

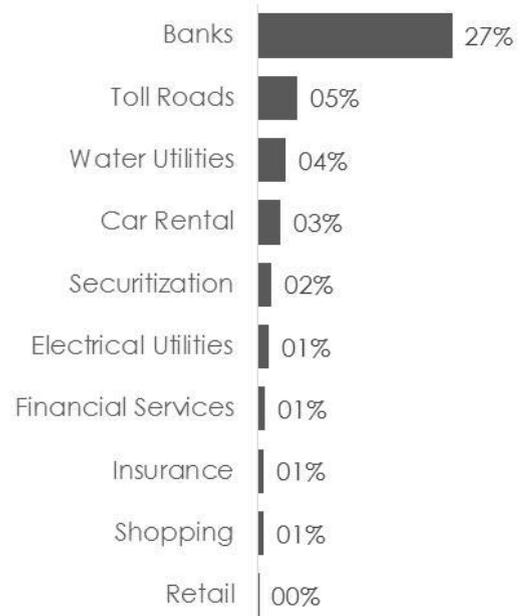
AZQUES LUCE	%PL médio	Long	Short	%CDI	Value Added	Value Added Breakdown				
						Carrego	Ganho de capital	Trade		
CDB	0.8%	0.8%	0.0%	105.5%	0.0%	-0.35%	0.40%	0.00%		
LF	6.7%	6.7%	0.0%	112.9%	1.0%	0.51%	0.45%	0.03%		
LFS	7.4%	7.4%	0.0%	107.0%	0.6%	0.50%	0.10%	0.01%		
LFSN	12.4%	12.4%	0.0%	137.0%	5.3%	1.78%	3.45%	0.07%		
DEB	19.5%	19.5%	0.0%	127.6%	6.2%	3.31%	2.01%	0.89%		
CAIXA	53.3%	53.3%	0.0%	99.7%	-0.2%	-0.21%	0.00%	0.00%		
TOTAL	100.0%	100.0%	0.0%	112.9%	12.9%	5.5%	6.4%	1.0%		
Custos MT						-0.6%				
LUCE MT						112.3%	12.3%			
Custos FIC						-3.6%				
LUCE FIC						108.7%	8.7%			

AZQUES LUCE	%PL médio	Long	Short	%CDI	Value Added	Value Added Breakdown				
						Carrego	Ganho de capital	Trade		
CDB	0.3%	0.3%	0.0%	103.3%	0.01%	0.01%	0.00%	0.00%		
LF	7.4%	7.4%	0.0%	131.7%	2.44%	0.57%	1.87%	0.00%		
LFS	6.4%	6.4%	0.0%	90.4%	-0.66%	0.33%	-0.98%	0.00%		
LFSN	14.3%	14.3%	0.0%	113.4%	2.05%	1.82%	0.11%	0.12%		
DEBENTURES	18.7%	18.7%	0.0%	128.5%	5.61%	2.61%	3.00%	0.00%		
CAIXA	53.0%	53.0%	0.0%	99.6%	-0.24%	-0.24%	0.00%	0.00%		
TOTAL	100.0%	100.0%	0.0%	109.2%	9.21%	5.09%	4.00%	0.12%		
Custos MT						-0.36%				
LUCE MT						108.8%	8.8%			
Custos FIC						-3.3%				
LUCE FIC						105.6%	5.6%			

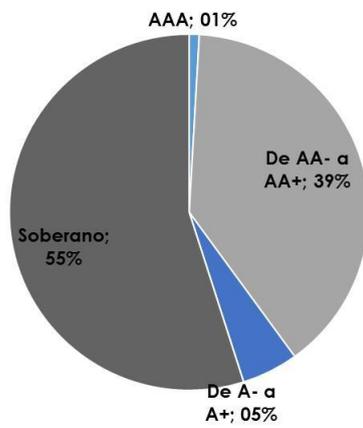
Portfolio Breakdown



Sector Breakdown



Rating Breakdown



2. AZ QUEST ALTRO

2.1 Overlook:

In September, the **AZ Quest Altro** fund returned 115.3% of the CDI rate, in line with the ceiling of the fund's long-term return target. The main drivers of these gains were the same as in the last 3 months, especially the portfolio of debentures, hedged securities and senior LFs. We maintained the same conservative profile in our portfolio (32.7% of NAV allocated in Cash and LFTs)

We flag that the entire political-macroeconomic scenario in place in the last 2 months has been important in companies' decision to start issuing again in the capital market. As another potential catalyst, we saw some offers in August and September, symbolizing that now may be the appropriate timing for primary offers. There will be nine offers taking place in October and November (that we are analyzing) that accurately illustrate the current moment. So far, we believe seven of these offers match the mandates of our Altro fund.

In September, we liquidated three new operations in the fund, resulting from primary offers in which we participated at the start of the month. We also added, via the secondary market, names that we already had in the fund in order to allocate the available cash.

We can see the same supply/demand dynamics for credit assets as commented on in previous letters. Investors are still under-allocated in credit and there is a need to buy assets to ensure an appropriate portfolio composition. However, investors are demanding prices at the levels of a market in crisis (i.e. as if we were still experiencing the same conditions of 1H16). We believe these high premiums, a good credit analysis and a responsible management enable us to build a portfolio with a very interesting volume of premiums!

2.2 Returns:

In relation to the result of our portfolios of LFs and junior LFs, please see the text dedicated to the AZ Quest Luce fund. In our portfolio of hedged securities, our gains mainly came from a relevant narrowing of credit spreads in almost all the assets of this strategy. We also took the opportunity to marginally reduce the gross exposure of our allocation in hedged securities during the month.

In September, we also opted to maintain our small position in real interest rates (always via credit assets) and in line with the view of our fixed income/macro team. At the end of the month, this strategy produced:

- (i) Gains from our real interest rate position, and
- (ii) The bulk of gains from a narrowing of credit spreads.

RETURN ATTRIBUTION

AZQUEST ALTRO	%PL médio	Long	Short	%CDI	Value Added	Value Added Breakdown		
						Carrego	Ganho de capital	Trade
CDB	0.7%	0.7%	0.0%	106.4%	0.05%	0.04%	0.01%	0.00%
LF	5.9%	5.9%	0.0%	116.4%	1.06%	0.53%	0.49%	0.04%
LFS	6.5%	6.5%	0.0%	109.2%	0.66%	0.46%	0.15%	0.05%
LFSN	13.5%	13.5%	0.0%	135.6%	5.29%	1.89%	3.47%	-0.07%
Debentures	42.0%	42.0%	0.0%	131.3%	14.47%	7.38%	5.67%	1.42%
Debentures hedge	0.3%	5.5%	-5.2%	2177.5%	6.47%	1.13%	5.22%	0.12%
Inflação Livre	0.4%	0.4%	0.0%	207.9%	0.49%	0.08%	0.54%	-0.13%
FIDC	0.3%	0.3%	0.0%	120.1%	0.08%	0.08%	0.00%	0.00%
Caixa	24.6%	24.6%	0.0%	99.5%	-0.13%	-0.13%	0.00%	0.00%
Outros ¹	5.8%	5.8%	0.0%	96.7%	-0.21%	-0.21%	0.00%	0.00%
TOTAL Ativos	100.0%	105.2%	-5.2%	128.2%	28.23%	11.25%	15.55%	1.44%
Custos MT								-1.1%
ALTRO MT								27.1%
Custos FIC								-10.4%
ALTRO FIC								16.7%

¹ Inclui compromissadas com lastro em títulos públicos

AZQUES ALTRO	%PL médio	Long	Short	%CDI	Value Added	Value Added Breakdown		
						Carrego	Ganho de capital	Trade
CDB	0.4%	0.4%	0.0%	106.7%	0.03%	0.02%	0.01%	0.00%
LF	8.2%	8.2%	0.0%	130.3%	2.50%	0.73%	1.78%	0.00%
LFS	4.0%	4.0%	0.0%	97.5%	-0.10%	0.25%	-0.35%	0.00%
LFSN	15.6%	15.6%	0.0%	113.7%	2.21%	0.85%	2.01%	-0.66%
DEBENTURES	40.8%	40.8%	0.0%	129.7%	12.34%	5.95%	6.94%	-0.55%
DEBENTURES HEDGE	0.6%	8.5%	-7.9%	1227.3%	7.23%	1.46%	5.77%	0.00%
Inflação Livre	0.8%	0.8%	0.0%	245.2%	1.26%	0.13%	1.13%	0.00%
FIDC	0.1%	0.1%	0.0%	119.2%	0.01%	0.01%	0.00%	0.00%
CAIXA	20.9%	20.9%	0.0%	99.5%	-0.11%	-0.11%	0.00%	0.00%
Outros	8.5%	8.5%	0.0%	96.4%	-0.32%	-0.32%	0.00%	0.00%
TOTAL	100.0%	107.9%	-7.9%	125.1%	25.06%	8.98%	17.28%	-1.21%
Custos MT								-0.4%
ALTRO MT								24.7%
Custos FIC								-9.4%
ALTRO FIC								15.3%

¹ Inclui compromissadas com lastro em títulos públicos

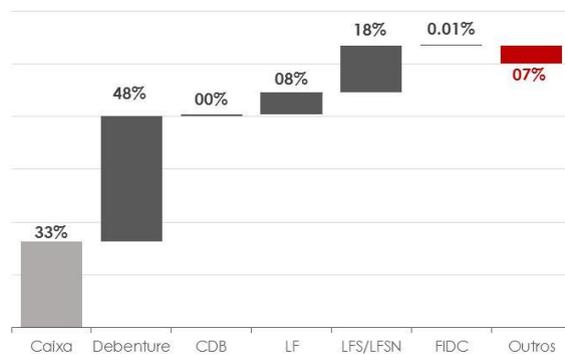
Estratégia de hedge consolidado

Debentures hedge	0.3%	5.5%	-5.2%	2177.5%	6.5%	1.1%	5.2%	0.1%
Outros ¹	5.8%	5.8%	0.0%	96.7%	-0.2%	-0.2%	0.0%	0.0%
Hedge Consolidado	6.1%	11.2%	-5.2%	203.0%	6.3%	0.9%	5.2%	0.1%
Inflação Livre	0.4%	0.4%	0.0%	207.9%	0.5%	0.1%	0.5%	-0.1%
TOTAL	6.5%	11.7%	-5.2%	203.9%	6.8%	1.0%	5.8%	0.0%

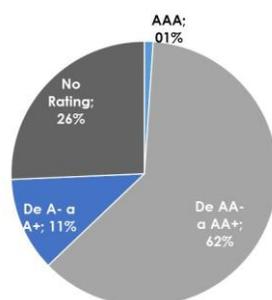
Estratégia de hedge consolidado

DEBENTURES HEDGE	0.6%	8.5%	-7.9%	1227.3%	7.2%	1.5%	5.8%	0.0%
Outros	8.5%	8.5%	0.0%	96.4%	-0.3%	-0.3%	0.0%	0.0%
Hedge Consolidado	9.1%	17.0%	-7.9%	176.0%	6.9%	1.1%	5.8%	0.0%
Inflação Livre	0.8%	0.8%	0.0%	245.2%	1.3%	0.1%	1.1%	0.0%
TOTAL	9.9%	17.8%	-7.9%	182.2%	8.2%	1.3%	6.9%	0.0%

Portifólio Breakdown



Rating Breakdown



Sector Breakdown

