MONTHLY LETTER– DECEMBER 2016

Dear Investor,

In contrast to what was published in newspapers and even in the reports of several fund managers and financial institutions, we believe that 2016 was a very positive year, marking an inflection point in the modern history of Brazil.

Despite all the events, and amid the biggest recession in our history and a problematic political environment, we witnessed the strengthening of institutions and the dismantling of a secular structure that was draining efficiency from the public sector and weakening democratic mechanisms. Operation Car Wash will bring inestimable long-term gains for society.

If a few months ago there were no minimum political conditions to take measures to revert the scenario of strong deterioration in the public accounts and put Brazil back on track, the new government needs to approve the reforms to make it through to the 2018 elections. Important measures were taken, especially the spending cap amendment, the DRU revenue de-linking mechanism, the waiving of Petrobrás' obligation to participate in all the pre-salt operations and the new regulatory framework for the electricity sector. Major obstacles were removed, some of which had been dragging on for decades.

Finally, we enter 2017 with the expectation of approval of the pension and labor reforms. If approved, they will be historical achievements, enabling Brazil to converge to lower interest rates and grow in sustained fashion with greater productivity.

In relation to AZ QUEST, 2016 was also a very positive year. We posted strong growth in assets under management, with highly diversified exposure and an even more diversified product offering of consistent funds with different strategies, meeting the various needs and risk profiles of our investors.

It was the inaugural year of our private credit funds, which were highly successful. We launched new pension products and incentivized debentures, in response to strong demand from our partners and investors.

Our multi-market funds in the Long Short and Macro strategies posted excellent results in 2016. Both the AZ QUEST Total Return and AZ QUEST Multi funds ended 2016 at the top of the 1st quartile of their respective industries.

Our equities funds (long only and long biased) also ranked in the 1st quartile of the industry in the second half of 2016.

We received, for the second consecutive year, the TOP GESTÃO award – Specialized Equities Fund Manager, awarded by Valor Investe/ S&P.

We are in the phase of concluding the incorporation of AZ Legan, which will add a team of high-quality professionals and funds with a long and consistent track record.

We left 2016 as an even bigger and more solid company. We thank everyone for the confidence deposited in us by all our investors and partners, and we hereby reiterate our commitment to work hard to continue providing superior returns and quality service to our clients.

We wish everyone a 2017 full of joy and achievements!

MACRO SCENARIO

After a period of turbulence in November, resulting from the US election and the political scenario in Brazil, December can be considered a month of market respite.

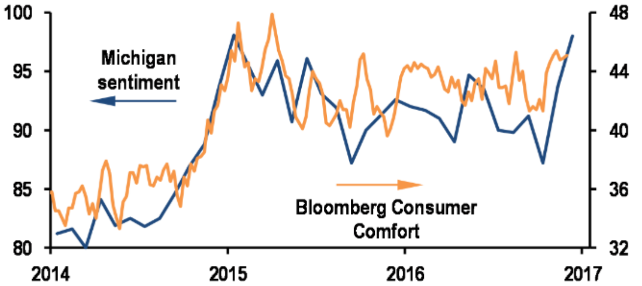
In the international scenario, after a brief period of incredulity and major volatility in markets, market agents analyzed the discourses, citations and nominations of Donald Trump, in order to map out a new political-economic scenario in the US and its impacts on global economies.

The mandate of defending jobs in the US indicates a new cycle of economic deregulation, of protectionist policies and fiscal expansion via tax cuts and increased public spending, generating uncertainty on inflation and higher interest rates (previously stable at historically low levels).

The first nominations of key members of his administration also signal a pragmatic government, with a special focus on defending the economic interests of the country and of its corporations, as in the case of Rex Tillerson, an executive linked to the oil industry and who was appointed Chief-of-Staff. The appointment of James Mattis, an ex-army general with a hard-line profile, to Secretary of Defense, also suggests a more active US stance in matters of security of its interest and less participation in matters where its interests are less explicit, which will probably lead to a more problematic geopolitical environment.

The lingering doubt is on the limit of involvement of Trump and the real impact of these measures on the confidence of households and businessmen, with a consequent rise in investment rates and internal consumption, which in turn would take the US to a new level of sustainable growth, above the current mere 1.5%-2.0%. The first batch of data show an improvement in confidence, but we need to await fresh numbers to confirm if this is really a trend.

Figure 1: Measures of consumer sentiment: Michigan and Bloomberg
Index, both scales



Source: University of Michigan, Bloomberg

We believe Trump will have less room than expected by the market to implement the policies he wants. In this sense, we highlight the slender advantage of Republicans in the Senate and Congressional elections in 2018 as a potential buffer against for more radical alterations in current fiscal and external policies.

In the realm of monetary policy, as expected, the Fed raised US interest rates by 25bps, paving the way for three more interest rate hikes in 2017. Recent comments by Janet Yellen signal uncertainty on the scenario. On the other hand, they reinforce the fact that the slow pace of economic growth and US productivity justifies their conservativeness in the process of interest rate hikes. It also keeps open the FED's room for action, since we see risks of inflationary pressure, reflecting the outlook of expansionist fiscal policy and the rise in energy prices, especially oil, which is up almost 45% YTD.

Elsewhere, Japan and Europe, still dealing with an environment of low growth and deflation risks, continue betting on expansionist monetary policy. This month, the ECB and BoJ maintained their interest rates and announced the extension of their QE asset buying programs. The increased interest rate differential between the US and these regions reinforces the vector of USD appreciation against hard currencies.

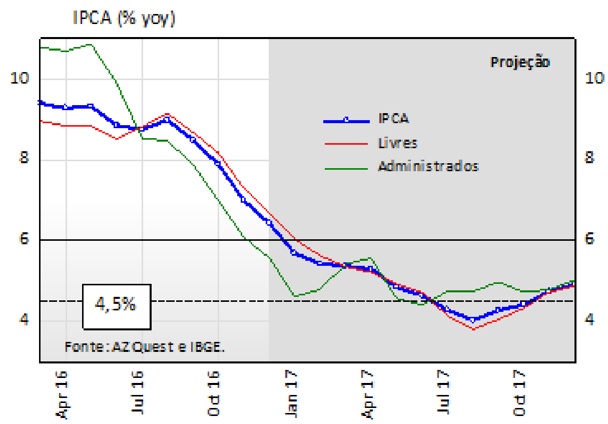
In Italy, the proposal of Constitutional changes to reduce Senate powers, in order to facilitate the approval of laws that could lead to the modernization of the country, was rejected in a referendum, leading to the downfall of Prime Minister Matteo Renzi. The result is another signal of the population's rejection of the European Union, increasing market fears on elections in France and Holland in 2017. We believe this will be a key source of risk throughout next year.

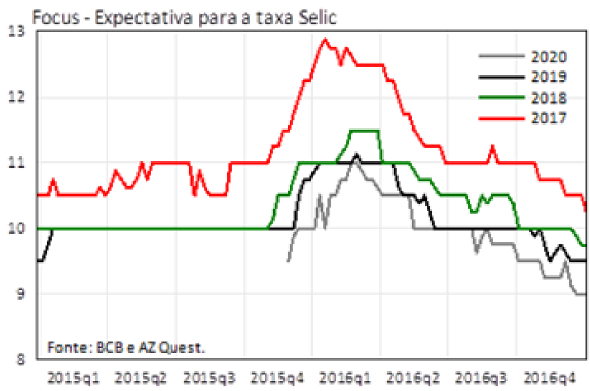
We continue mapping out a positive external scenario, since we still see a scenario of abundant liquidity, and global interest rates and inflation at relatively low levels, guaranteeing access to financing sources – crucial to a rebound in investments in Brazil.

In Brazil, the political-economic scenario continues to be influenced by three interdependent processes, with parallel dynamics, but with a clear mutual influence: the economic rebound, Operation Car Wash and the approval of the reforms.

The latest batch of economic data leads us to believe that the cyclical reversal of economic activity should occur in a longer period than we previously thought. GDP continues to decline, especially private investment and industrial production. Unemployment is already affecting over 12 million workers, pressuring household income. The brief rebound in confidence, shortly after confirmation of the presidential impeachment process, weakened with the deterioration in the political environment following the Operation Car Wash accusations and the clash between Brazil's Judiciary and Legislative.

The long period of recession plus contractionary monetary policy led to a strong decline in inflation rates, which will likely end 2016 below the ceiling interval, converging to the 4.5% target in 2017. Despite the rise in US interest rates, the decline in inflation indices and the outlook for approval of the fiscal reforms pave the way for the Copom (Brazil´s monetary policy committee) to accelerate the cycle of Selic rate cuts beyond the 25bps pace of the last two meetings. We thus maintain a constructive view on the recovery of economic activity in the long term, with lower interest rates.





Despite the more problematic political scenario due to various plea bargains, the economic reforms have moved ahead nicely. The government proposed important economic measures to improve the business environment in Brazil (labor reform, tender/bidding law, oil regulatory framework), to control public spending (spending cap amendment, limits on super-salaries) and to unlock and cheapen credit (´positive credit bureau´ and authorization to draw down workers´ FGTS funds). We also had a positive surprise with the sending and passage of the pension reform in the Lower House legal committee, which will certainly be the government's most important battle in 2017.

Thus, and despite the turbulence, the government has intervened and we clearly ended the year with better foundations than when we started 2016. Inflation is under control, without the manipulations of past years, paving the way for a structural reduction in interest rates. The FX rate, stabilized at a realistic level, makes our products competitive again and reduces external vulnerability.

After a long time, we no longer have a tough relationship between Congress and government, favoring the approval of reforms. PEC #241 is key (though not sufficient) to stabilize spending and public debt levels, Brazil's main source of risk. The microeconomic reforms create a more favorable environment for companies. Operation Car Wash imposes a new ethical standard on the State and its governors.

However, since the effects of these positive measures are not immediately perceived, the approval ratings of the President are in decline, weakening the government in its herculean task of reorganizing the country. We believe, however, that the government now has broad congressional and economic support, guaranteeing stability despite its low popularity ratings.

The economic recovery should be accompanied by the population's support of the government, reducing speculation on an unlikely interruption of the presidential mandate and increasing the chances of approval of this reformist liberal agenda in the 2018 elections. Temer is in a race against time. Economic growth will be his main obsession in 2017 and 2018.

EQUITIES STRATEGY

Our equities funds posted good results in December, with most funds beating their benchmarks, reflecting the adjustments made in November in response to the new international scenario, when we decided to increase our exposure to global cyclical sectors.

We highlight our Long Short strategy (AZ QUEST Total Return: 3.23% and AZ QUEST Equity Hedge: 2.30%), which helped us to easily recoup the previous month's losses. The main contribution came from the Toll Road Concessions and Sanitation sector, via which we explored the theme of the structural decline in interest rates in Brazil. We also obtained large gains from our long position in the Petrochemical sector, which benefits from prospects of higher global inflation.

We also highlight gains from our short position in Banks and Financial Services, reflecting high valuations and the outlook for disappointing results in the credit sector and changes in the business/operating rules of acquirers.

Our funds posted strong gains on the year, but 2016 was a year that demanded that we adopt a very active stance in our portfolio management.

Brazilian stocks posted strong gains, reflecting the reduction in the risk premium required by the market, in response to the government changeover and a highly favorable global interest rate scenario.

In a period of numerous scenario changes, we had to make major adjustments in our portfolios during the year. The defensive and "dollarized" nature of our portfolios ended up affecting first quarter results, mainly due to the stock exchange rally and strong BRL gains in February and March.

As the scenario of a change of government became ever clearer, we took the decision to reposition our portfolios to increase exposure to sectors more linked to local dynamics, which would benefit from a lower risk premium in Brazil. As a result, our funds posted a strong performance, especially the AZ QUEST Total Return, which posted its best six-month result in the second and third quarters, ending the year for a 21.70% gain (155% of CDI).

At the end of the year, we made another adjustment to our portfolios, increasing our position in sectors linked to commodities, which should benefit from the new international scenario of higher inflation and more investments in infrastructure.

For 2017, we expect the dynamics of structural reforms in Brazil to drive up the confidence levels of market agents, crucial to a rebound in economic activity starting in the second half of 2017.

As a result, the outlook for a decline in risk premiums and an improvement in companies' results should lead to a second cycle of gains in Brazilian stock prices.

This positive scenario is contingent on a continued favorable political environment for the approval of reforms and a stable international scenario, with no major liquidity reduction and rising interest rates. We will pay attention to these two risk factors.

MACRO STRATEGY

Our funds posted a positive performance in the month, recovering from their November losses. AZ QUEST Multi posted a return of 2.95% (263% of CDI), while the AZ QUEST Yield gained 1.38% (123% of CDI) in December.

In a month of strong narrowing of the onshore yield curve, our flattening position in the belly of the DI curve posted strong gains. The strong decline in inflation indices and the outlook for approval of fiscal reforms pave the way for the Central Bank to accelerate the cycle of interest rate cuts, starting at the January 2017 meeting.

The international FX market enjoyed a period of stability, after the election of Donald Trump in November. The prospects of Trump's room for maneuver being limited by Congress and by the balancing system of the US political model led the US yield curve to end the month below the recent peak of 2.60%.

The USD continued strengthening against the Euro and the Yen, after the Central Banks of Europe and Japan confirmed the maintenance of their expansionist monetary policies. In Brazil, the Real gained 4.05% due to the decline in Treasuries and strong USD inflow from some corporate operations. Despite the outlook for Real appreciation, we need to monitor any Central Bank interventions to curb over-appreciation of the currency.

The relative value strategy produced strong gains, mainly reflecting our long positions in global cyclical sectors (Petrochemicals and Mining) and Utilities (Sanitation and Electricity), as well as short exposure in Banks.

For the second consecutive year, the AZ QUEST Multi fund beat its long-term targeted return (170% of CDI in 2016), as reflected in growth in its NAV to R$138mn at year-end.

The fund received a positive contribution from all strategies, especially for the interest rate strategy, mainly via positions in the belly of the real and nominal yield curves, which benefited from the structural decline in yields during the year.

We remain positioned in the belly of the curve via a flattening position in DIs and a long position in NTN-Bs, reflecting expectations of a decline in inflation and the outlook of approval of fiscal measures, paving the way for a significant decline in interest rates in Brazil.

We also still believe in USD appreciation, and are exploring this theme via purchases of USD against Yen and Euro. We maintained our long BRL position against a basket of cyclical currencies in the expectation of an improvement in the domestic sector, whilst seeking to neutralize the vector of a potential structural appreciation of the USD against the main currencies.

We kept our long equities position, in the expectation of a recovery in confidence levels and a better business environment in Brazil.

We are aware of the risks that the international and local scenarios impose on us, mainly stemming from the political scene in Brazil, elections in Europe and the US economy. But beyond surprises not foreseen in our base-case scenario, we foresee an inflection point in the Brazilian economy starting in mid-2017, mainly grounded on economic reforms and the return of private investment.

CREDIT STRATEGY

In the month in which our funds celebrated their 1-year anniversary, we celebrate the end of this fruitful and tough year by thanking you for your trust in our work, and for the opportunity you have given us to show what we can do.

We sought, via a major commitment, to make money for our fund shareholders as per the previously established investment policy. For all these reasons, we believe we were successful in 2016.

In December, the AZ QUEST Luce fund posted a return of 106% of the CDI, again above its long-term return benchmark. Although we have a very conservative portfolio (cash and LFTs of 55.0% of our fund NAV), we obtained good results from our debentures portfolio. However, this month we also highlight the result of our portfolio of LFs, mainly junior LFs.

The AZ QUEST Altro fund posted a return of 110% of the CDI in the month. Although we have a conservative portfolio (cash + LFTs of 26%), we obtained good results in almost all the sub-portfolios of the fund, especially the portfolios of LFS-Ns, hedged and inflation debentures.

We saw a strong narrowing of the yield curve (real and nominal) in the period, which added a gain that practically offset our November losses, due to the contrasting movement of the curve in that month. We trimmed the gross exposure of our hedged bonds strategy via the sale of some assets whose credit spreads no longer offered major narrowing potential.

In the month, we analyzed ten primary offers for AZ QUEST Luce and twelve for AZ QUEST Altro, allocated into six and ten offers, respectively. Some of the primary offers for AZ QUEST Altro will only be settled in January. We weren't very active in the secondary market for both funds, since we didn't see any major opportunities.

For the start of 2017, we will stick to the view described in our last letter: caution! In the internal scenario, Brazil still needs to approve some important measures (mainly the pension reform), whilst Operation Car Wash remains alive and kicking. On the international front, there are still uncertainties on the economic and geopolitical environments – the latter clearly has the potential to produce the most negative surprises.

Although we believe the year-end situation should be better than it is currently, we are aware that negative news will definitely impact asset prices over the period.