SPECTRA INVESTMENTS

Investment Letter

October 2016

When describing the business model of raising capital from third parties in order to invest in a multitude of assets, people use interchangeably the terms Investor and Asset Manager. However, our view is that those two are fundamentally different endeavors that happen to have a similar structures.

The Asset Management's business model is client-centered. It consists in developing interesting investment products that cater to investors' needs. Once an investor's demand is identified, a product that fits this investment demand is crafted and then sold to those demanding investors.

On the other hand, Investment businesses are product-centered. Managers identify investment strategies/opportunities that they find compelling and then go after investors that might be interested in those investments.

Both business models add value to society and, therefore, there is not an obvious preference of one versus the other. Some would say that combining both is the ideal outcome, but our view is that perfection is seldom possible and, thus, compromises are necessary.

Asset Managers' strengths lie in the fact that their products tend tail to client's allocation desires, have great investor relations divisions and thus provide good degrees of transparency, and have well-functioning compliance divisions. In sum, attributes perceived as necessary for a manager to be "Institutional". Their brand names provide comfort to investors that their money will not be recklessly spent, reducing the chances of very poor outcomes even if at the cost of extreme superior performance. This institutionality helps reduce the perceived risk of the investment, which is an obviously desired attribute to any investment allocation process.

However, it is often perceived that Asset Manager's main goal is to grow their business rather than to producing outsized returns to their investors, in what is called Asset Gathering. This means they could focus more on management rather than performance fees. The lesser focus on the investment side, could lead to Asset Managers' products to producing lower returns to their LPs.

Investors, on their turn, spend great efforts on developing a product they think will provide a great risk-return profile. In many cases the investment idea is linked to their personal histories and, thus, managers tend to be passionate about the product they are working with, leading to their superior knowledge on the subject.

The downside is that they are often less institutional, could get stuck managing a product that is not scalable and thus could create issues as they are not able to grow the business, promote and compensate well their teams, and therefore be stuck with sub-par personnel. Also, their products might not be trendy nor fit the "boxes" many LPs have, creating issues getting them approved at LPs' investment committees. Investors also don't present as well their business ideas, have a tendency to treat their LPs poorly with insufficient information on their quarterly reports.

To sum it up, Investors need LPs so that they can invest whereas Asset Managers need to produce returns so that people want to keep on investing with them. Investors have a hard time scaling up and Asset Managers in producing alpha.

At Spectra, by being on both sides of the spectrum (forgive us for the poor joke) both raising money from LPs and looking for mangers to invest our capital, we get a unique perspective on this issue.

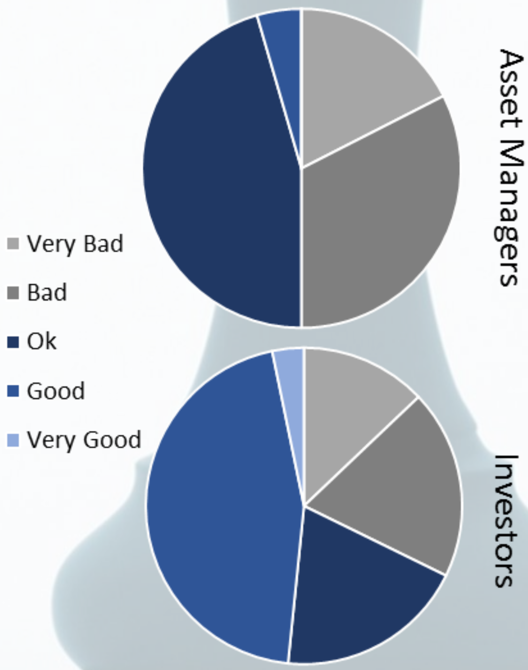
We often hear prospective LPs saying they definitely prefer to allocate with Investors, but more often than not give their money to Asset Managers. It is much easier. As they say: you never lose your job by investing with X, Y or Z.

Enough about theory. Having gone through a tough period in Brazil, we looked at Asset Managers and Investors we know and made an assessment on how well they have performed during this period. Needless to say, it’s a very subjective definition both on performance and on their categorization.

Our hypothesis was that Asset Managers would have a lower volatility of performance with few extreme losers, but few extreme winners, whereas Investors would have a greater discrepancy of returns.

Out of the universe of 200+ managers, we felt comfortable including 53 (31 Investors and 22 Asset Managers) in this analysis given the degree of our conviction both on their category and the status of their portfolio/performance.

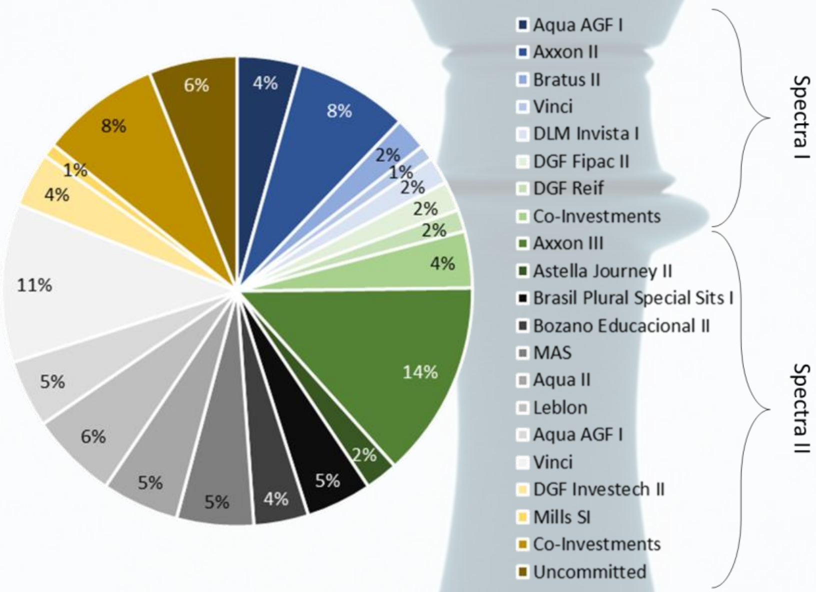
To our surprise, Investors have performed considerably better than Asset Managers. Only a third had bad performances, and about half have been performing well. Asset Managers had 50% of the cases with bad performance and only 5% of good performers.



One potential explanation is our own bias on assigning a category to them, framing as Asset Managers the ones that had bad performance. The only counter argument to this is that we tried our best not to do it.

A more plausible explanation is that Asset Managers tended to engage in investment fads in a greater degree than Investors. In Brazilian case, those were looking for deals that were linked to the "growth of the middle-class" and Oil & Gas given local pre-salt investments. A great percentage of the Asset Managers were heavily invested in companies linked to those theses, whereas Investors were much more balanced.

This follows the trend we observed with Spectra's own portfolio. On a combined basis, our 52 companies have been growing on Revenue and EBITDA CAGRs of 15% and 18% since 2011. This compares with Brazilian GDP growth of 0,94% a.a. for the same period. This outperformance is in part explained by the under investment in the fad trends of middle class growth and O&G.



The increased focus on what LPs want to invest rather on what they think is good is what, in our view, creates their underperformance. Our view is that there is an asymmetry in information in which the manager has a much closer and precise view on a particular investment thesis than LPs can have and, thus, should have the driving seat in their selection.

With this, we get to the difficult question of the day: how do we make sure that we at Spectra behave as Investors to manage your money as we grow our business?

We have been ruminating this question in our minds for the last few months, but could not find a satisfying answer that goes much deeper than: this is what gives us pleasure. Motivation is the key driving force behind the way one structures their businesses. You make it to look after your own image. We want to make an Investment enterprise out of Spectra and we hope this is what we will achieve of it.

Thank You

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