Report
DYNAMO 89
1/4 2016

Heading *North*

"All of the actions in my government have been guided by the commitment to the strengthening of state **institutions**, respecting individual rights, combating corruption, and defending the principles governing the Democratic State." **President Rousseff**, March 3, 2016.

"The peaceful nature of the protests that took place on Sunday show the maturity of a country that knows how to live amidst divergent opinions and knows how to respect its laws and **institutions**." **President Rousseff**, March 13, 2016.

"Serious people are the preconditions of strong **institutions**. There can be no brats, there can be no brats, there must be serious people." **Ex-president Lula**, in testimony to the Federal Police, March 4, 2016.

"I believe in democratic **institutions**, in the independent and harmonic relations between the Three Powers, as established in the Federal Constitution." **Ex-president Lula**, March 17, 2016.

"The immediate effect resulting from these allegedly criminal behaviors seems to justify the recognition that illegal practices perpetrated by the referred agents had a sole objective: to enable the capture of government **institutions** by said criminal organization ..." **Celso de Mello**, Supreme Court minister, March 3, 2016.

"What we cannot do in a time like this is to use as a defense an attack on our **institutions**." **Aécio Neves**, Senator and former presidential candidate, March 10, 2016.

"It is important that the elected authorities and parties hear the voices in the streets and equally commit themselves to the combat of corruption, strengthening our **institutions**..." Judge **Sérgio Moro**, March 13, 2016.

"Our country's **institutions** are functioning regularly: the Executive, Legislative, and Judiciary are fulfilling their tasks." **Interim President Michel Temer**, March 29, 2016.

"The country is going through an extremely delicate situation where the **institutions** are being insistently tested and are so far responding appropriately." **Eduardo Cunha**, March 30, 2016.

In a country divided by the constant dueling of rival political positions, one word emerges as an unlikely consensus, moving freely through the speeches of all actors. Hailed in the streets, "institutions" suddenly became celebrities. Institutions matter. Institutions are fundamental. If attacked, they must be defended. If preserved, we are in anomie. A deserved fame or merely a common opinion during uncommon times? There is no doubt that institutions deserve to be investigated – in the best sense, of course. It seemed to us a good opportunity to address such a fertile and current theme.

The concept crosses many disciplines and may be approached through different angles. We choose a more "institutional" route, accepting a ride from the person we judge to have offered the best analysis for its comprehension: Douglass North (1920-2015). An American economist, author of several important works, North was awarded the Nobel Prize in economics in 1993 precisely for his original contribution in bringing the theme of institutions to the center of economic theory and history. If in our two previous Reports we have followed those intrepid explorers of the South Pole, in this Report we suggest following the compass, trailing the safe route of Mr. North.

It is an incursion with equally challenging obstacles. With the Pole, we avoided a full and detailed description of each journey, preferring to select and highlight a few aspects of particular interest to us. Here, we will repeat the method. North's work is of such scope and depth that we do not have the pretension, the space, nor the competency to describe it. It is true that the context of the citations above led us to revisit it. It was a most enjoyable as well as useful experience, since it helped us establish parameters to interpret today's world, and especially the complex moment Brazil is going through[1].

1 *For those more curious ones, we enthusiastically recommend North´s books. We took the opportunity to post in our website a few bibliographical references, texts by and about North, as well as a quick summary of relevant aspects of his work, where we even venture a few parallels with Brazil´s current reality.*

As a purpose for this Report, we opted for drawing a more modest script. In the first part, we situate in passing the intellectual context that gave rise to North's classical definition of "institution", which will give us hints about the superior importance of this notion, so commonplace in the quotes above. Next, we go straight to the Report's focal point. Borrowing an insight from his last book, a comparative study on the stages of development of several countries, we attempt to build a bridge to our investing day-to-day, bringing the argument (or analysis) to the scope of corporations.

From early on, Douglass North felt a restlessness that followed him through his entire career. He wanted to understand and explain why some nations become developed and others do not. His entire academic production can be understood as a continuous evolution of the elements that would take him in the direction of this overarching purpose.

In order to understand the relevance of this author's contributions, we must first take a step back and situate the context of the economic discussion at the time. The established theory, known as the neoclassical paradigm, proposed that economic growth depends fundamentally on the accumulation of production factors – mainly labor and capital – and technological conditions. The system self-adjusts automatically – supply and demand, production and consumption – based on the incentives emanating from the price mechanisms and competition. Individuals are perfectly rational and have complete information. Decisions are made strictly based on wealth maximization process, and exchanges occur without transaction costs or noise. Institutions are ignored – they simply do not matter. Price and competition incentives, together with the assumptions on behavior and the cognitive abilities of individuals are enough to take the economy to its efficiency frontier.

North was a prolific author. His books show a progressive perfecting of his theoretical thinking, which was always accompanied by the descriptive analysis of historical facts. Concerned with explaining reality and with giving a practical sense to his conceptual model, North began to notice the limitations of the neoclassical outfit. An illustration of this progressive evolution of his work is the 1968 paper, *Sources of Productivity Changes in Ocean Shipping, 1600-1850*, a perhaps less well-known, but very important text. North, who had worked in the American merchant marine during WWII, dissected the available industry data, combining knowledge of history, aptitude for statistical analysis, acuteness of observation, and personal experience. A kind of microeconomic sector analysis that we here at Dynamo find especially valuable. North concludes that the rise in the marine transport industry's productivity was due to the decline in piracy combined with an expansion of the international commerce, without the effect of any technological change. With the reduction in piracy activities, ships had more room – earlier occupied with armaments – for merchandise, and the necessity for labor per ship diminished. The opening of commercial frontiers and the strong wave of immigration contributed to the rise in utilization rate (turnover) of the fleet, also reducing the total docked time per ship. As such, the tonnage of merchandise per man-hour fell significantly. In this same period, there was no registered technological advance in the industry. The ships used in the main trade routes remained with the same design of the Dutch fleets of the seventeenth century, and their average speeds almost did not increase. That is, the rise in productivity arose from reasons alien to the technological momentum or the substitution of production factors, something unthinkable until then. Other elements of the social gear arise as protagonists. A safer and more peaceful commercial environment inhibited piracy and allowed the expansion of transoceanic trade bringing wealth to nations. It is the rise of the "institutions", germinating in North's mental models, on the way to notoriety.

Starting from the basic notion that uncertainty permeates the human condition, and that individuals possess obvious limitations in cognitive capacities, North understood that trades do not occur in a frictionless environment, on the contrary, they involve transaction costs: and they are substantially relevant[2]. As a society grows more complex, a great number of individuals start interacting among themselves, enjoying the benefits of larger specialization and division of labor. For such an environment to prosper, the conditions through which individuals may overcome the uncertainties surrounding transactions must be established. Property rights must be well grounded, tradable goods must be appropriately measured, contracts must be defined with accuracy, and adequately executed. Institutions are precisely the structures designed by individuals to produce order and reduce uncertainty[3]. In the words of North himself, in a now classic definition: "Institutions are the rules of the

2 *Ronald Coase was who first called attention to the importance of transaction costs in his seminal paper* The Nature of the Firm *(1937). According to Coase, companies exist precisely to internalize the several transaction costs involved in trades: prospection, negotiation, hiring, inspection, among others. It is interesting to note that, with the advent of the internet, and the consequent brutal reduction in certain transaction costs, there is a reversion of this tendency: an expressive growth in autonomous labor, and the one-man company. It is the other side of Coase's theorem, functioning at full throttle, or, better yet, mega bps.*

3 *The Political Science literature has already anticipated this path since Hobbes' Leviathan and Rousseau's Social Contract. However, both only indicate the necessity of what needs to be done for a functioning human society to be viable. The theme of institutions may be considered a significant corollary of this founding theorem of social life for this line of thought.*

game in society, or, more formally, are the humanly devised constraints that shape human interactions" (North 1990)[4].

Institutions exist to reduce transaction costs and many times to make transactions possible. In allowing the potential gains from commerce and specialization to materialize, they become critical determinants of the economy's performance. In establishing the rules through which individuals interact, they direct incentives, calibrate opportunities, and end up formatting society's own way of being. Protagonists of a nation's destiny, institutions require special care. Hence, as we saw at the start, its ubiquitous presence in the speeches of those with governing missions in the country. The collective fascination with the more and more frequent claim that "institutions are working" also becomes clear.

According to North, institutions possess three dimensions. The informal dimension is composed of the behaviors, traditions, conventions and codes of conduct in a society. They are based on the cultural beliefs and values. The formal dimension, on the other hand, represents the contracted set of rules and norms. The formal rules are not necessarily perfect, or efficient. They reflect the interests and bargaining power of the groups participating in their construction and of those intending to alter them. The third dimension of institutions is its ability to enforce the commitments agreed on and contracted by its parts. A few examples of institutions include: the Constitution, the Rule of Law, the Three Powers, the Civil Code, the Capital Markets.

It is easy to see that institutions only work when the three parameters – the customary, the legal, and the legitimate execution – are present. Let us visit an example that is practical, close to us, and brief: the Brazilian capital markets. Our *Lei das S.A.* (our set of corporate laws) from 1976 is recognized for having a high quality for the time, and was inspired in what was most modern in the field of corporate law. Thus, the formal dimension was already well designed from the start. But the country lacked a culture of stock-market investing. As we know, it was the fiscal incentives that drew corporations and investors to the stock exchange at the time. In other words, the informal dimension was not present. Nor was the third dimension of enforcement. Only more recently, when companies needed to attract shareholders for their equity base and investors became really interested on participating in corporate ventures, at the same time when the rules of enforcement and governance practice improved, did the capital markets in Brazil prosper, or, in current language, were institutionalized. Said another way, only when the three dimensions aligned, did the capital markets become an institution.

At this point, North introduces a new element in the model: the organizations. Organizations are groups of individuals bounded by common purposes and motivated to pursue certain objectives. A few examples: political parties, universities, churches, unions, industry associations, NGOs, companies, etc. If institutions are the rule of the game, organizations are the teams competing in the championship, they are the main social agents. The institutions create opportunities, and the organizations attempt to capture them. The institutional context establishes the incentives that format the organizational profiles, the kinds of knowledge and skills required.

To North, societies that remain stagnated are the ones that cannot update their organizational designs. That is, they do not achieve an adequate incentive structure to induce organizations to act in a way that creates sustainable economic growth. In a few words, they are the ones lacking the incentives for individuals to pursue higher productivity.

As we mentioned above, North's work is immensely rich and an appropriate exposition of its main elements surpasses the scope of our Reports. In his last book, *Violence and Social Order: A Conceptual Framework for Interpreting Recorded Human History* (2009), coauthored by John Wallis and Barry Weingast, North set out after an ambitious task: to describe the operational logic of the so-called "social orders", the way in which humanity get organized into societies. North

4 *And so we see that the traditional theory functions under a very particular hypothesis: when there are no transactional costs. Under a more realist world view, when such costs are present, institutions matter and can no longer be ignored.*

Dynamo Cougar x IBX x Ibovespa Performance up to May 2016 (in R$)

Period	Dynamo Cougar	IBX	Ibovespa
60 months	85,6%	-4,8%	-25,0%
36 months	40,4%	-6,8%	-9,4%
24 months	34,7%	-5,3%	-5,4%
12 months	10,9%	-8,3%	-8,1%
Year to date	12,9%	10,6%	11,8%

NAV/Share on May 31 = R$ 581,643466

and his colleagues developed a conceptual apparatus that explains the reasons why certain societies can achieve higher levels of material wellbeing, and others cannot.

The description of the dynamics of these social orders, classified as "limited access orders" and "open access orders", reveals the analytical acuity of a more mature North. An original contribution to the comprehension of social phenomena. It is a very interesting reading in of itself, in addition to improving the understanding of the social, political, and economic situation in Brazil today. However, as we mentioned above, we prefer to detain ourselves for now and address an aspect that drew particular attention to us and that was in fact what motivated us to write this Report. We therefore depart from North's line of reasoning to concentrate on this particular insight.

Before we advance one last caveat. Borrowing concepts and narratives from other contexts and trying to bring them to our reality as investors is always a risky task. Even more so in this case where the argument to be transported is from the work of a thinker of the stature of Douglass North. What we will do henceforth is a kind of free exercise in flexibility, where we try to build an improbable bridge from the well-paved expressway of the performance of nations to the much more sinuous neighboring path of the performance of corporations. Since we have been reflecting on the theme of resilience for quite some time, as soon as we saw North's argument, we could not resist making the approximation. The illustration we will propose also cannot compare to the reach of the long series of countries' statistical data that North collected. Our intention in this case is again more modest, reflected in a much smaller sample of a few indicators from companies we follow more closely (and which we prefer not to name to avoid sensitivities that may arise when comparing). Adjusted by the admitted distance between the quality of our examples, we still believe the venture is justified.

Let us get to the argument. North concludes that the wealthier nations, which successfully made the transition to open access order, and thus to higher levels of consistent development, were not those who could achieve longer periods of accelerated growth, but those characterized by being able to reduce the intensity of the periods of negative growth. Indeed, rather counterintuitively, the evidence shows that the group of wealthier countries shows the smallest average growth rates in the periods of income growth. On the other hand, when income shrinks, it is the poorer nations that post the more drastic falls in domestic product. These latter groups present both more years of negative income growth as well as a sharper average decline during these periods, as shown in table below (Table 1), extracted from the introductory chapter (North 2009).

Naturally, North is able to explain this performance pattern under the lens of his analytical apparatus, from the basic assertion that wealthier countries present much higher relative numbers of organizations than their poorer counterparts.

*Table 1 – Growth rates in good and bad years for countries ranked by per capita income (from 1950 to 2004)**

Countries Per capita income in US$ in 2000	Number of countries	% of world population	% of years of positive growth	Average positive growth rate	Average negative growth rate
Over $20.000**	27	13%	81%	3,88%	-2,33%
$15.000 to $20.000	12	2%	76%	5,59%	-4,25%
$10.000 to $15.000	14	2%	71%	5,27%	-4,07%
$5.000 to $10.000	37	16%	73%	5,25%	-4,59%
$2.000 to $5.000	46	53%	66%	5,39%	-4,75%
$300 to $2.000	44	14%	56%	5,37%	-5,38%

** Penn World´s series*

*** No oil countries - Qatar, United Arab Emirates, Kuwait, and Brunei excluded*

The data on organizations is presented in the table below (Table 2), extracted from the same text[5].

The higher relative volume of institutions in wealthier countries precisely reflects a more mature institutional environment, which permitted civil society to develop with more dynamism and autonomy, and which was capable of imposing a system of brakes and counterbalances to the State. They are societies where competition predominates in the political and economic environment – the Schumpeterian creative destruction in the business world and the alternation of powers so dear to the democratic game; where the rules of conduct and the cultural values drastically shorten the space for income expropriation, distribution of privileges, and for the proliferation of personal relationships in the management of public affairs. And thus arises the profound understanding that capitalism and democracy are eminently institutional constructions. This explains, at least in part, the glamour of institutions, commented on in the beginning of this Report.

The insight that more developed nations show more robustness during periods of recession naturally led us to think of companies. Although we do not immediately dispose of a quantitative 'demonstration' with numbers as well organized as in the table above, our feeling and experience – besides the support of more scattered data – is that the argument, valid in the context of nations, also applies to the corporate level. The companies that show the best compounded performance across many years are those that do relatively well in times of crises, suffering in less magnitude those impacts of low business cycles than their peers do. They are less volatile, in a broad sense.

The performance indicator proposed by North would reflect, in the corporate environment, a measure of business quality and managerial competence. What makes good companies perform relatively better in moments of difficulty is the consistency of prudent decisions, mainly the ones taken during cycle highs. Warren Buffett's exhaustively repeated quote is already a classic: "Only when the tide goes out that you learn who has been swimming naked". With his masterly permission, and applying a 180-degree shift to the aphorism, we propose that it is in fact the high tides that have attracted a bunch unwary individuals, who, feeling sheltered by the bonanza, dived naked into the water. The low tide only exposes a previous lack of prudence. Generally, the origin of the crises of the bad times rests in the equivocal decisions taken during the periods perceived as more benign.

Economic cycles tend to provoke greater impact on companies than they do on countries. This is because companies rely more frequently on leverage without, of course, having

5 *The numbers reflect the distribution of only specific kinds of organizations, those related to commerce and to business in general. Of course, in a broader concept, the total number of existing organizations in a given country is much higher. Just as illustration, in the United States alone, in 1997 there were 23.6 million for-profit organizations, as well as 1.1 million of private tax-exempt institutions, not to mention the 87.5 thousand organizations in the public sector.*

*Table 2 – Number of Organizations for countries ranked by income per capita**

Countries Income per capita in US$ in 2000	Number of countries in income range	Number of organizations total in income range	N. of organizations per country average per country	N. of organizations per million residents average per country
$300 to $2.000	41	1.238	30,2	2,8
$2.000 to $5.000	38	1.430	37,6	4,5
$5.000 to $10.000	34	2.338	68,8	16,7
$10.000 to $15.000	15	714	47,6	21,2
$15.000 to $20.000	8	708	88,5	26,9
Over $20.000	28	30.976	1.106,3	63,6
All	164	37.404	228,1	19,3

* *Formal trade and business organizations. Dated published by K. G. Company, supporting the analysis of Coates, Heckelman e Wilson (2007)*

the prerogative of printing money. The higher capacity to take on leverage boosts corporate results in boom cycles, but can be fatal when the tide goes out. One of the characteristic traits of lasting companies is that they maintain sobriety in euphoric periods, when the others seem to believe that "this time it is different" and act as if the phase of prosperity was there to stay. This tacit intelligence of the executive or entrepreneur, of knowing when to speed up and when not to do, is an ability that is hard to evaluate *ex-ante* since, by definition, it is only verified *ex-post*. Hence the permanent challenge to the long term investor who pursues selective stock picking as a strategy. From that fact too, lies the comparative advantage from having a long acquaintance with several companies.

Besides the aspect of management aptitude, North's indicator, when applied to the corporate world, also points to the quality of businesses. Companies that offer products or services deemed essential, critical, mandatory, differentiated, or having high value/cost relation to clients, and that are inserted in an industry arrangement where this value does not flow to consumers, usually fare better during periods of crisis. Typically, this differentiated position translates in a few common characteristics in the layout of commercial relations: long and well-defined contracts, of difficult termination, high contracted switching costs to customers, recurring-revenue model (such as services charged as monthly fees). They are businesses where, at the end of the day the client has limited options as to how they can interrupt or even delay the consumption of the good or service. Said another way, where he has low discretion over the bill that inevitably arrives at the end of every month. A few examples are: elevators, airplane turbines or software maintenance, credit card fees, trading platform fees, distribution of essential products such as fuels and medicine. In common, all of these businesses post high returns on invested capital.

The 'northean' elements that explain the performance among countries also seem adequate to justify the relative performance of companies. First, the quality of 'informal limitations': the codes of conduct, the beliefs, the cultural values. Good companies typically have well defined principles and values, establishing the basis which may be called a healthy corporate culture. People are moved by belief and good companies are those that can transmit a message of purpose that inspires the desired behaviors, establishing a more profound connection with its collaborators and other stakeholders, which goes beyond performance targets, remuneration packages, or the characteristics of their products. Processes are much more consuetudinary than coercive.

The 'formal rules' are also fundamental. And here we are talking about a vast set of norms, laws, and contracts that govern the lives of companies: *Lei das S.A.* (our set of corporate laws), civil code, norms and directives from our securities and exchange commission (CVM), shareholders agreement, corporate bylaws, commercial contracts, that is, a collection of documents that order, regulate, and legitimize relationships in the corporate framework. Among good companies rights are clear, consistent and, of course, respected. More than that. As we said in a previous occasion, ethics reach where the law cannot. The companies we look for are those governed by ethical standards that resolves the controversies arising between the lines of the written contracts. There is no mentality of expropriation in any of the relationship fringes: suppliers, collaborators, clients, minority shareholders. Good companies pursue competitive advantage and, if possible,

Table 3 – Same Store Sales – Apparel Retail
Group of more mature Companies

	2T14	3T14	4T14	1T15	2T15	3T15	4T15
Co A	10,0%	7,5%	17,3%	16,5%	14,5%	12,6%	4,5%
Co X	2,4%	-2,7%	1,0%	5,8%	0,2%	-2,1%	-3,1%
Co Y	2,3%	-1,5%	-0,5%	-4,8%	-4,2%	-2,4%	-8,6%
Co Z	-9,9%	-6,0%	-3,8%	-1,9%	-1,7%	-4,3%	-5,1%

target a monopoly position, but within the rules of the game, respecting the market environment.

The companies we admire have an open and inclusive internal environment, following the example of North's open access orders. Relations are frank and to the point, with no room for free-rider or rentier behaviors. Even with present and experienced leaders, knowledge is decentralized and ideas are encouraged to compete with each other under a design of production and process of decision-making where creative destruction prevails. By example of open societies, experimentation is encouraged, good ideas are incorporated, and bad ones, eliminated. The result is more innovation and productivity, more flexibility and adaptability towards permanent changes in the business environment.

The current recession in Brazil reaches unprecedented levels of intensity, with repercussions amplified in corporate earnings, and may be seen as a particular laboratory where the long term investor, armed with the 'northean' toolkit, can test his convictions and find opportunities. Times of crisis tend to reveal acute bifurcations in business performance. Companies caught off-guard in the investment cycle, or operating in more competitive businesses, suffer the most in this period. Margins compress, cash runs out, accounts payable accumulate, the market for credit evaporates, shareholders´ equity flips to negative territory, in brief, a hard-to-reverse swirl which can lead to the shut-down of businesses. In another axis are the companies that operate in more stable businesses, or who build their balance sheet solidly enough for the times of drought, and can thus transpose the hardships with few adjustments or even gain market share, given the frailty of competitors[6].

The environment becomes especially inviting for the more disciplined long-term investor. Therein lies the fact that while a somber and lamenting atmosphere predominates the market's general mood, here at Dynamo we see it as the moment to double down our research efforts and diligently scan companies both in and outside our portfolio. Beyond the renewed motivation, we face the challenge armed with all the analytical weaponry we dispose, of both traditional and novel tools more recently incorporated. "North's indicator" is certainly an example of the latter.

As the current proposal seems too abstract, and knowing the seduction of well-intended general purposes, we tend to use empirical verification as a monitoring tool. In other words, we enjoy practical examples that shine light on and illustrated arguments. In this case of North's 'indicator', data abounds both in Brazil and abroad showing this bifurcation in the relative performance of companies during business cycles. We therefore decided to show a familiar case for us. Once again, for illustrative purposes only.

The examples are from two companies we invest in. Both operate in the same industry, apparel retail, which makes the exercise more reasonable. One is a large company, with a long history, and established position (Company A). The other has a younger corporate lifespan, and is in an accelerated expansion phase (Company B). A performance indicator commonly used in this industry is the so-called same store sales (SSS), which measures the selling performance of comparable stores, in this case, every quarter. With it, we eliminate the

6 *As would be expected, this superior financial and operational performance will reflect in a higher relative valuation for good companies. And a portfolio manager's reflex would be to reduce his exposure to such high-performing names. On the other hand, the 'northean' lesson seems to suggest less reflex and more reflection at this moment. Counterintuitively (or in a contrarian fashion) perhaps the best long term payoff is still to be found in the group of best relative performers. A dilemma that is hard to solve. Tough life for investors!*

Table 4 – Same Store Sales – Apparel Retail
Group of younger Companies

	2014	1T15	2T15	3T15	4T15
Co B	25,1%	16,4%	5,7%	14,0%	16,1%
Co U	1,1%	-11,6%	n.d.	-10,5%	-2,0%
Co V	16,4%	7,6%	11,0%	5,0%	-10,9%
Co W	-22,7%	-15,6%	-6,1%	0,1%	0,9%

DYNAMO COUGAR x IBOVESPA
(Performance – Percentage Change in US$ dollars)

	DYNAMOCOUGAR*		IBOVESPA***	
Period	Year	Since Sep1,1993	Year	Since Sep1,1993
1993	38,8%	38,8%	7,7%	7,7%
1994	245,6%	379,5%	62,6%	75,1%
1995	-3,6%	362,2%	-14,0%	50,5%
1996	53,6%	609,8%	53,2%	130,6%
1997	-6,2%	565,5%	34,7%	210,6%
1998	-19,1%	438,1%	-38,5%	91,0%
1999	104,6%	1.001,2%	70,2%	224,9%
2000	3,0%	1.034,5%	-18,3%	165,4%
2001	-6,4%	962,4%	-25,0%	99,0%
2002	-7,9%	878,9%	-45,5%	8,5%
2003	93,9%	1.798,5%	141,3%	161,8%
2004	64,4%	3.020,2%	28,2%	235,7%
2005	41,2%	4.305,5%	44,8%	386,1%
2006	49,8%	6.498,3%	45,5%	607,5%
2007	59,7%	10.436,6%	73,4%	1.126,8%
2008	-47,1%	5.470,1%	-55,4%	446,5%
2009	143,7%	13.472,6%	145,2%	1.239,9%
2010	28,1%	17.282,0%	5,6%	1.331,8%
2011	-4,4%	16.514,5%	-27,3%	929,1%
2012	14,0%	18.844,6%	-1,4%	914,5%
2013	-7,3%	17.456,8%	-26,3%	647,9%
2014	-6,0%	16.401,5%	-14,4%	540,4%
2015	-23,3%	12.560,8%	-41,0%	277,6%

	DYNAMOCOUGAR*		IBOVESPA***	
2016	Month	Year	Month	Year
JAN	-5,8%	-5,8%	-10,0%	-10,0%
FEV	4,9%	-1,2%	7,6%	-3,1%
MAR	22,1%	20,7%	30,8%	26,7%
ABR	8,3%	30,7%	11,1%	40,7%
MAI	-6,2%	22,6%	-13,7%	21,4%

AverageNetAssetValueforDynamoCougar
(Last12months):R$ 2.388.338.245

(*) The Dynamo Cougar Fund figures are audited by Price Waterhouse and Coopers and returns net of all costs and fees, except for Adjustment of Performance Fee, if due. (**) Index that includes 100 companies, but excludes banks and state-owned companies. (***) Ibovespa closing.

distortions in comparison brought about by the different growth realities – such as store openings – between companies. In the tables in the previous pages (Table 3 and Table 4), we show the recent SSS performance for each of these two companies, and a few of its respective competitors.

We are in a moment of hardship in Brazil, and the apparel retail industry has been especially affected by the strong contraction in consumer credit concurrent with the fall in families' disposable income. The disparity of the relative performance between the two companies and their competitors in this recessive period is staggering. The sample is small, over a short timeframe, and specific to this industry, but knowing the characters and their roots, we have conviction that their results are not ephemeral. Moreover, an X-ray of their fundamental gears shows, in each case, a complete collection of the qualities we herein defined as desirable.

Our investment in both companies illustrates the opportunity that moments like these can bring to long-term investors. We live in a particularly complicated period, with a vacuum of lack of definition in public policies, exposing companies to high levels of uncertainty and disorientation in their decision processes. In such environment, the probability that investors infer inaccurate judgments concerning the future of companies rises, leading to the heightened difficulty in adequately pricing assets. Resorting to the elements that would explain "North's indicator", that is, clues that could signal a higher resilience of certain companies during this trial period, arises as an interesting and useful analytical tool.

By the way, the theme of resilience is of great interest to us. Who knows, we may have the chance to address it in the future.

Rio de Janeiro, June 15, 2016.

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Dynamo funds to other indices:

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