(A free translation of the original in Portuguese)

JARDIM BOTÂNICO INVESTIMENTOS

TRIANNUAL LETTER

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Second Letter

INDEX

SECTION 1 THEMATIC ANALYSIS

I. OUR INVESTMENT PHILOSOPHY

As discussed in the first edition (August 2009) of our four-monthly report, two specific topics, value investing and corporate governance, are currently in vogue. For the JBI team, these are two key concepts, since the guiding investment philosophy for managing our funds is value-oriented, and we define our universe of investable companies by first screening their corporate governance practices through our proprietary *Governance Scorecard*.

The aim of this letter is to spell out JBI's understanding of these concepts and, via this analysis, to explain our investment process. Our intention is to firmly imprint in our investors' minds the key attributes of our "brand" of investing since, for reasons we discuss further on herein, these two concepts have become so generalized in our asset management industry that, nowadays, it is well nigh impossible to differentiate managers at first glance. To understand these differences, their pros and cons, an investor seeking to select an asset manager, must probe ever deeper in order to clearly comprehend the rationale on which each decision is based. This task demands significant time and patience. We trust that the content of this letter will provide the necessary impetus (and save time) for investors to correctly slot us into their fund management environment.

Let us begin with the concept of value investing, aka value oriented investments. Wikipedia has a most intriguing definition (visit http://en.wikipedia.org/wiki/Value_investing): "*Value investing is an investment paradigm that derives from the ideas on investment and speculation that Ben Graham & David Dodd began teaching at Columbia Business School in 1928 and subsequently developed in their 1934 text Security Analysis. Although value investing has taken many forms since its inception, it generally involves buying securities whose shares appear underpriced by some form(s) of fundamental analysis……High-profile proponents of value investing, including Warren Buffett, have argued that the essence of value investing is buying stocks at less than their intrinsic value. The discount of the market price to the intrinsic value is what Benjamin Graham called the "margin of safety". The intrinsic value is the discounted value of all future distributions. However, the future distributions and the appropriate discount rate can only be assumptions.*"

Here at JBI, our understanding of value investing does not differ from the definition above. But our particular take on this philosophy lies not in this definition *per se*, but in the inherent concept of the margin of safety.

Thanks to the manner in which we have built our portfolio, we have remained more faithful than most managers to the concept of safety margin discussed in Chapter 20 of Ben Graham's[1] "The Intelligent Investor".

In this chapter, the author states: "*...margin of safety is a favorable difference between price and value. It is available for absorbing the effect of miscalculations…..the function of the margin of*

[1] The Portuguese language edition was sponsored by JBI and *Bovespa* (São Paulo Stock Exchange).

safety is, in essence, that of rendering unnecessary an accurate estimate of the future...the margin guarantees only that one has a better chance for profit than loss – not that loss is impossible."

However, in JBI's view, this is not the only message to be drawn from this chapter. In many passages of the book, the author clearly wishes us to recognize the concept of preservation of capital which is the basis for the safety margin. In other words, since the margin is conditional upon the price discount in relation to the value and this value calculation could contain significant errors, it is vital to consider a scenario that produces a value that could come to be **lower** than the price and to check the volume of this "fat"', i.e., the size of the potential loss.

At JBI, we have opted to focus more closely on the aspect of the risk of loss of a given investment than on its potential gain. The reason for this is that we reached the conclusion that, regardless of how carefully we select the basis that will give us the value of a company, there will still be a significant degree of uncertainty in this process, or, at least, a greater uncertainty inherent to the scenarios that produce a permanent loss of value for such company.

Accordingly, a crucial stage of our analysis process is to draw up pessimistic scenarios that produce permanent value loss for the companies. As a rule, we refrain from investing in companies that, in such pessimistic scenarios, produce a **value** of 30% below market price. In the event of a potential **value loss** above this 30% threshold, even if in a catastrophic scenario, we would not buy such assets for our portfolio[2]. This is the major reason behind our decision not to invest in state companies or in start-up projects, even if they are in businesses consolidated by other players.

The decision to not invest in state organizations is straightforward: it is based on Article 238 of Brazilian Corporation Legislation, which asserts that the controlling shareholder *"may guide the company's activities in such a way as to serve the public interests that justified its creation".* Despite, possibly, appearing somewhat subjective, our reading is that this orientation in favor of public interests could all too easily take precedent over the company's economic objectives. In our opinion, it is impossible to estimate the loss in value of a company when its controlling shareholder, the State, is quite legitimately (as established in Article 238) entitled to take positions that do not necessarily maximize or protect the company's economic results. In other words, it is impossible to measure the possible margin of an investment in a government company.

In respect of start-ups, let us take as an example the exploration of oil fields, gold deposits, and similar projects. We know that the concession of the areas to be explored assumes the existence of a pre-determined volume of the product that is the *raison d'être* of such exploration. This is a quite reasonable estimate but, depending on the product price conditions and on long-term exploration costs, a lower than expected volume or more complex access than originally foreseen, could cause the value of the project to become negative (or very much lower than projected). In other words, it would not be so unreasonable to imagine that such projects could produce zero value in certain adverse circumstances. And here, we would have extinguished our much prized safety margin.

[2] Note the emphasis on "value". The intent here is to avoid confusing loss or value with a drop in price. Catastrophic market scenarios lead to significant drops in price. However, we are not referring to what occurs in the stock market or to asset prices, but to the business environment scenarios that we draw up in our analyses and to the drop in value that a pessimistic scenario such as this could produce.

Please note that there is nothing intrinsically wrong in investing in state-owned or start-up companies. Countless investors have a highly successful record in this type of investment. Not for a moment, do we believe that nobody should invest in such organizations. We merely state that such investments are incompatible with JBI's Public Equities Team basic investment philosophy. Our reading is that investing in such companies is well outside the mandate that we proposed to follow for the Focus family of funds.

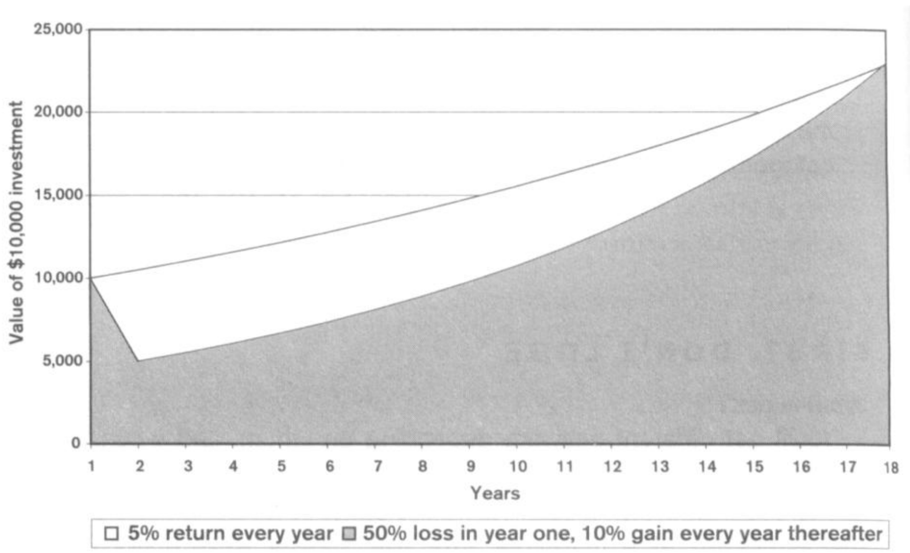
This is how we interpret the safety margin concept. We see an exaggerated focus on the price-value ratio and little importance attributed to the preservation of capital. In our opinion, this is a given in Graham's discourse on the topic of margin of safety.

One of Graham's most legendary disciples, Warren Buffett, once said: *"Rule Number One: Never lose money. Rule Number Two: Never forget Rule Number One."*

Distinguished financial columnist, Jason Zweig, who commented on the chapters of the updated edition of "The Intelligent Investor", made the following remark on chapter 20 (the chapter entitled "Margin of Safety"): *"In the first place, don't lose it"*. Right there on the following page, it becomes quite clear why Buffett, Zweig, and we at JBI have become so obsessive about this topic. As we said in our last letter: *"The key concept here is preservation of capital, i.e., making investments that minimize loss and don't necessarily maximize gains. Experience has shown us that, in the long-term, the magic of compound rates enable investments of this type, that devalue little in crises and only* *partially* *follow increases resulting, in earnings greater than the other options."*

Zweig very clearly demonstrates this point in the following graph and text:

Table 1: The cost of loss



Imagine that you find a stock that you think can grow at 10% a year even if the market only grows 5% annually. Unfortunately, you are so enthusiastic that you pay too high a price, and the stock loses 50% of its value the first year. Even if the stock then generates double the market's return, it will take you more than 16 years to overtake the market–simply because you paid too much, and lost too much, at the outset.

Source: The Intelligent Investor

We focus on preventing losses and not necessarily on maximizing gains. This is what steers our overall inclination to invest in companies negotiating at levels close to their value rather than investing in organizations with a high gain potential, but also dangerously at risk of loss because the quality of their business shows little resilience in the face of adverse scenarios.

Buffett also clearly expressed his focus on buying exceptional companies negotiated for a reasonable price rather than mediocre companies available at bargain prices.

As we said earlier, despite our biased take on value investing, we have witnessed a positively feverish adherence to this philosophy by an ever growing group of Brazilian fund managers. For those of us who embarked on our Brazilian money market careers in the early nineteen-nineties, as in the case of most of the JBI partners, this movement appears to reflect a dynamic degree of maturity in our stock market. At that time, the prevailing opinion was that the stock market was no more than an exotic casino, where, to gain wealth, it was essential to be “wired”, privy to hot tips on which companies would gain and which would lose. This was a mindset that had been in place since the nineteen-sixties and seventies, when the volume of our market grew strongly based on artificial incentives that generated the “right demand” for shares. And, of course, the companies, aware that they could successfully sell their shares, hastened to obtain funds from the “new buyers” in the market. This led to a curious situation: instead of having investors, we merely had buyers. In other words, people were pushed in the direction of the stock market rather than being attracted thereto through a study of the quality of the product they were buying (holding investments in these companies).

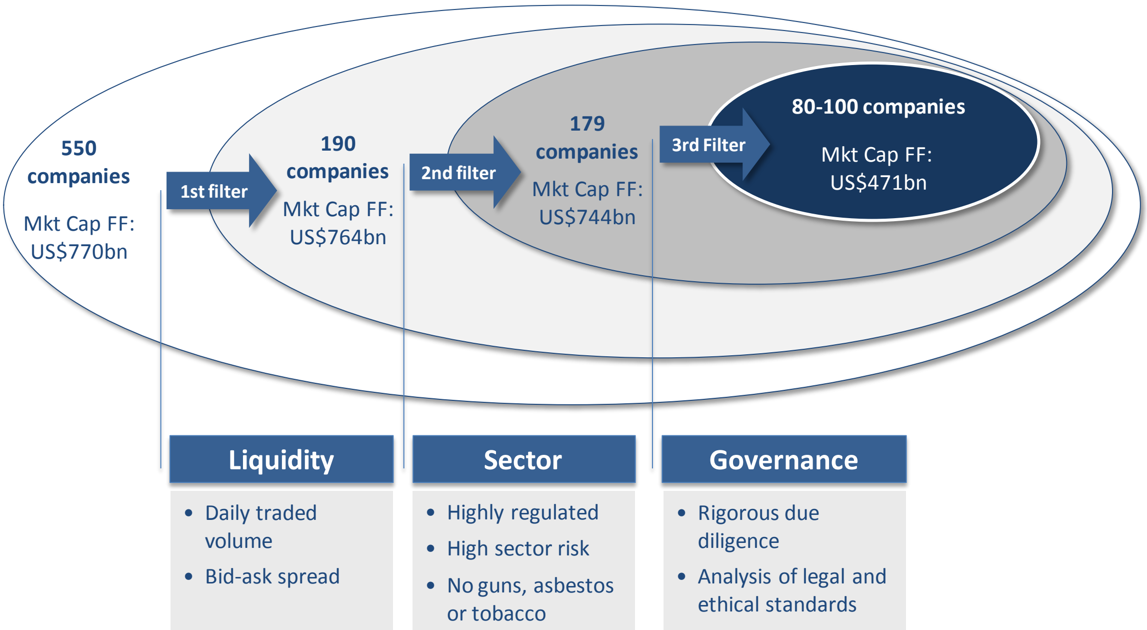
We are still unable to fully comprehend the reasons for this “value investing fever”, but surmise that it occurs because: (i) over the last twenty years, this proved to be a winning strategy and, overseas, countless academic studies showed that value stocks consistently surpassed the return on “growth stocks”; (ii) possibly, the influence exerted by Warren Buffett’s indisputable record of success for over fifty years and, specifically, after the last occasion in the nineteen-nineties, when so many doubted him (the Internet bubble), and his standing has soared exponentially ever since.

Another concept frequently applied in the selection of investee companies has been to analyze their corporate governance policies. With all due modesty, we cannot but take personal pride in this particular policy since, over the last fifteen years, JBI founding partner, José Luiz Osorio was (and still is) one of the most forceful advocates of corporate governance in Brazil. It is highly satisfying to see corporate governance evolve from being thought of as having purely academic, idealistic, and dreamer status, to becoming an inevitable reality for any company seeking to protect itself from pricing discounts and to leverage the creation of value for its business.

However, the concept of applying good governance practices is still recent in Brazil. Few companies have been put to the test and some were even disqualified when they found themselves in unexpected conflict situations. Thus, to include an analysis of corporate governance in organizations as being a basic investment selection prerequisite is no mean achievement.

The governance analysis standards we apply are comparatively restrictive. Let us examine how this works based on the description shown in the table below, demonstrating how we select the companies which will make up our investment universe:

Table 2: Investment Filters



Before reaching the governance filter stage, we apply our first liquidity filter: There are many outstanding companies reporting liquidity below this level, but we keep this rule in place for three reasons: (i) good companies can report unsatisfactory returns if we are unable to divest at the precise time of when price is converging to its intrinsic value; (ii) predictably, with a liquidity level significantly below this threshold, we could easily become "price makers" of a particular share, a position we strive to avoid; (iii) since the inception of the fund, we have run it to ensure a substantial growth in the assets under our management, without having to alter our portfolio construction – obviously, the purchase of less liquid shares would seriously limit the size of our strategy.

Our second industry segment filter currently eliminates eleven companies. Here we do not even consider sectors we regard as risky, such as aviation, a segment subject to severe competition and highly regulated. We do not invest in the tobacco, asbestos, or weapons segments, since we have no wish to promote any of these businesses.

Our third filter, corporate governance, is one of JBI's unique features. This is a relatively simple process but consists of a meticulous evaluation of certain governance criteria, such as: related parties, true board of director independence, and the company's record at the *CVM* (Brazilian Securities Commission). At the end of this analysis, we then answer the question, "do we want to be partners of this company or not?" Here we benefit greatly from the experience of the JBI team, who has worked in investment banks, regulatory bodies, and other companies. We were at the CVM when corporate governance was at its most vigorous: the redrafting of Brazilian Corporation Legislation and the foundation of the *Bovespa* (São Paulo Stock Exchange) New Market. This invaluable JBI asset, a living memory that enables us to interpret the true agenda of controlling shareholders and directors, cannot be replicated elsewhere in the fund management market.

Joining the *Bovespa's* New Market is an important step. Having been strong supporters and proponents of this initiative, we could not but support every company that voluntarily joins the New Market. However, it is a fact that, in no way does full compliance with a list of governance prerequisites guarantee that a company will have a permanently effective governance policy in place. Familiarity with what motivates controlling shareholders and company directors is infinitely more revealing, since the New Market follows a traditional rules-based policy rather than being principles-based. Since it is quite impossible to draw up rules covering every type of potential misalignment of interest, it is vital to interpret the behavior of the agents in such situations. This is because the list of rules will not necessarily clarify what is right or wrong on a case-by-case basis. Accordingly, familiarity with the background of such conduct, usually not in the public domain, is extremely valuable.

Due to our concentrated focus on governance, it is our policy not to invest in government organizations. This investment restriction arises, not only from the fact that it is impossible the measure the safety margin of these companies, but also due to something incompatible with corporate governance principles: alignment of interests. It is not hard to imagine any number of circumstances in which the interests of the controlling shareholder (the government) is at variance with those of the other partners. This is quite simply intrinsic to the nature of state companies; it is unavoidable.

We will not restrict our investments only to companies with an impeccable corporate governance record. Our investment environment includes companies that, undeniably, could upgrade their governance policies. The embargo only occurs when a genuine and incontrovertible motive is revealed.

As stated in our previous letter, please note that this analysis filter aids us in selecting the organizations with the highest chances of success in the context of returns on investment. It is vital to understand that, no matter how high they are, governance policies alone will not transform an economically weak company into a robust generator of value. However, we believe that, in terms of business objectives and management policies of two very similar companies, the trend is for the one with more satisfactory corporate governance practices in place to perform better in the long-term and, consequently generate a higher return for its shareholders.

II. JBI'S DIFFERENTIALS

In summary and to aid potential investors to correctly position JBI in their manager ranking, we list below the qualities that we believe set us apart in the market:

1. Restriction to invest in state-owned companies
2. Use of a proprieatary corporate governance filter
3. Disciplined application of Graham's margin of safety concept
4. Emphasis on liquidity
5. A team with a longstanding history of working together

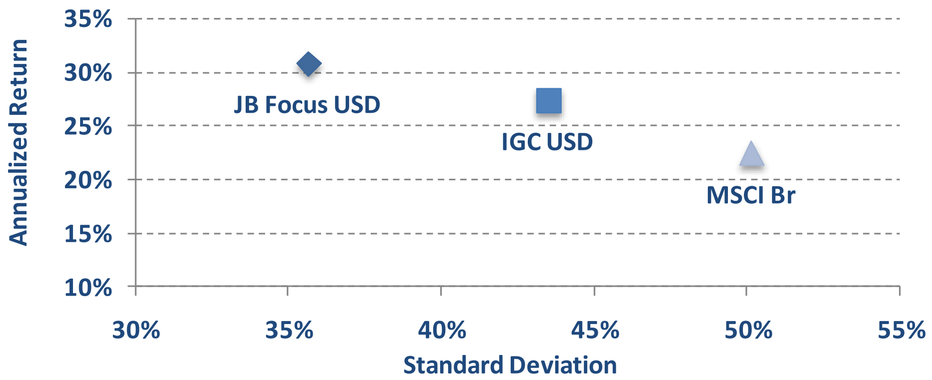
SECTION 2 PORTFOLIO RISK-RETURN

I. FLAGSHIP FUND: JB FOCUS FIA in USD

Since its inception on September 16, 2005, the fund's performance has been 222.9% or 30.9% *p.a.*

As shown below, during the same period, the disciplined application of our investment philosophy has resulted in a more encouraging risk-return ratio than those of the options shown in market indices.

Table 3: Risk-Return Ratio

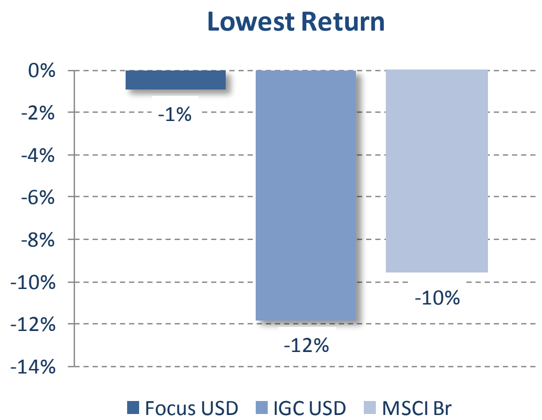


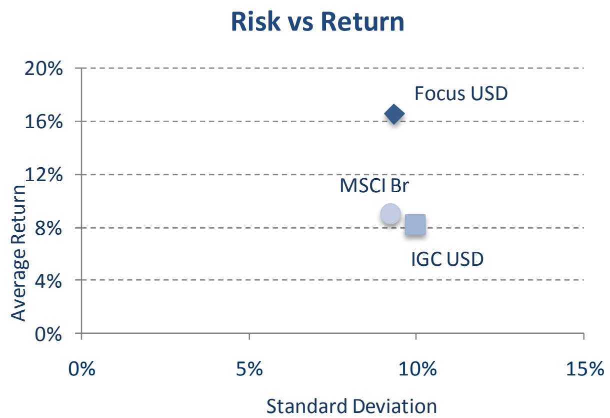
	JB Focus USD	IGC USD	MSCI Br
Annualized Return	30.9%	27.4%	22.5%
Annual St. Dev.	35.7%	43.5%	50.1%

Source: Economática and BNY Mellon.

However, in the context of quantitative standards for checking compliance with our mandate, we believe that a joint analysis of the tables below is more revealing.

Table 4: 3 Year Investment Windows Analysis





Source: Economática and BTG Pactual DTVM; (1) the above statistics derive from the JP Focus FIA moving windows. A one-year moving window is equivalent to an interval of 365 successive days. All data are annualized.

An analysis of the three-year moving windows more faithfully reflects our target of obtaining good risk-return ratio levels over time.

The table that interests us is the one that more clearly reflects our interpretation of the capital preservation concept. The Lowest Return Window table shows that the Fund's most "ill-fated" investor, which entered with high quotas in the past and withdrew without being able to give itself the luxury of waiting to overcome the opportunity cost, descreased by only 1% in nominal terms over this three-year period. However, if this same wave of bad luck had been applied to an alternative market index, this investor would have lost between 10% and 12%.

Throughout the close to four years of JB Focus FIA in USD, the companies that most contributed to our results were: Itaúsa (37.5%), Vale (at 34.9%), and Marcopolo (31.0%). The lowest contributors were: Login (at - 2.2%) and Klabin (-0.7%).

In 2009, the Fund in dollar terms earned 130.4% as compared with 146.1% of the *IGC* and 40.0% of the *IGPM* (General Price Index) plus 6% *p.a*. The first section of this letter describing our investment philosophy clearly upholds the Fund's trend to perform at below market indices in periods of rapid recovery. In our opinion, the results obtained for that year are wholly in line with the principles of our mandate. They focus permanently on the risk-return ratio, on emphasizing the preservation of capital, and on a value-guided philosophy which tends to produce superior results over periods in excess of a single year.

The positive portfolio highlights for 2009 were: *Itaúsa* (15.8%) and *Odontoprev* (14.5% contribution in a performance of 71.7%). We had no negative contributions during that year. Among the shares that least contributed to the portfolio were Fosfértil PN (0.7%), Bematech (5.3%), and Tractebel (5.8%).

II. QUOTES

Our view of the risk:return ratio of an investment in the shares of some of the more highly respected companies in the market reminds us of one of Buffett's unforgettable comments criticizing managers that take high risks: "*If you risk something that is important to you for something that is unimportant to you it just doesn't make sense. I don't care if the odds to succeed are 100 to 1 or 1000 to 1. If you hand me a gun with a thousand chambers, a million chambers in it, and there's a bullet in one chamber and you said: Put it up your temple, how much do you want to be paid to pull it once? I'm not going to pull it. You can name any sum you want. Because it doesn't do anything for me on the upside, and I think the downside is fairly clear. Yet people do it financially everyday very much without thinking.*"

"If management is about running the business, governance is about seeing that it is run properly."
– Robert Tricker

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