

PIPA Global

PIPA Global Report

4th QUARTER
2017



Ana Luisa Santos, "Crisálida", 2012, performance.
Conception and performance: Ana Luisa Santos.
Photo: Guto Muniz.

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Research and Analysis

Research and Analysis

On an introductory note, we always try to select the image of our cover among pieces by artists that have participated in at least one of PIPA Art Prize editions and that we think somehow reflects our views for that point in time. This work by Ana Luisa Santos is a good example: the regulatory, geopolitical and technological issues are all conspiring into a situation where governments, the general investor and most companies are getting more and more entangled in a way that will be very hard (as in costly and time-consuming) to revert.

ON EXPERIENCE

“The only source of knowledge is experience.” - Albert Einstein.

Maybe it’s a bit self-serving as we get into the second half of the 50s, but the more time passes, the more value we attribute to experience. We know that correlation is not causality, but as we go through life and quite diverse experiences, we can clearly reaffirm that the “algorithms for time compression” have their inexorable limits.

We see it in many walks of life, from parents trying to keep their babies from sticking their fingers into electrical sockets to the young crowd in the market adopting a know-it-all attitude.

Not being a philologist per se, but true to our hard sciences background, we have the habit of poking quite a lot for what people mean by each word (more so for data).

Oddly enough, we find it easier to find examples of extraordinary analysts out of the capital markets. We tend to think of science people like Charles Darwin, Michael

Faraday, Einstein and Richard Feynman, to name a few, known to all as the ultimate analysts, as in they gathered the facts, imagined narratives that could fit them all and never compromised. They were always trying to find failures in their theories and only rested (a bit) when many others validated their ideas through carefully controlled experiences.

Another obvious example that comes to mind is Leonardo da Vinci. The way he tirelessly studied the human body, to the point of dissecting bodies in order to understand which muscles were responsible for each movement. How he observed the differences in the final result of “building” colours by from patiently adding thin layer upon thin layer over a white background. Many are the examples of an extremely curious mind, that pursued the understanding of how things “work”, digging ever deeper in order to be able to attain extraordinary results that stood the test of time to the tune of 500 years.

Specifically in the investment arena, Warren Buffett is without par, at least to our knowledge. Others might have even had better results for sometime, but nobody lived a whole long life just thinking, making and getting better at analysing investment opportunities both from the upside and risk perspectives so well. The proof of his competence is the fact that he single-handedly built a USD 500 billion company, only by deciding what to do and what not to do, understanding that managing your “liabilities” is as important as your assets and in the process creating and proving a mental framework of how to do it. And as Munger likes to say, the key is both in his

personality and in the fact that he built a mental lattice work of concepts that never stopped to grow and improve.

The common thread is that they weren't motivated by money. Curiosity, passion for learning and understanding drove them. And they all did it for a long, long time. As in their whole adult lives.

A useful analysis, beyond being based on wide scope facts and developed in a logic form, usually has some creativity and certainly some independent thinking involved, otherwise it will tend to lead to the conclusion that market prices are right. Not that we're victims of the "not invented here syndrome". Actually, most of the good ideas come from somewhere else. We just make it a point to validate (and, just as we do with ours, invalidate) them before committing. And when speaking on creativity, we always like to check what the late Steve Jobs had to say. Here's an example:

"Creativity is just connecting things. When you ask creative people how they did something, they feel a little guilty, because they didn't really do it, they just saw something. It seemed obvious to them after a while. That's because they were able to connect **experiences** they've had and synthesize new things"

A column by the brilliant FT writer Simon Kuper published this last December called "Brexit, Trump and a generation of incompetents"² also touches the "experience" subject in another interesting (if not scientific) way:

"I didn't want Brexit, but I assumed the Brexiters had a plan. I didn't think Donald

² <https://www.ft.com/content/3a31862c-df91-11e7-a8a4-0a1e63a52f9c>

Trump had a plan, but I assumed the Republicans did. They didn't. Whether you like these people or not, the question is: why are they incompetent? It seems that the Brexiters really thought the EU would just bow to their demands.

In the US, when Republicans finally got their chance to abolish Obamacare, it turned out they had spent seven years not preparing an alternative. Much of their tax bill got handwritten overnight by lobbyists. And Russiagate's key characteristic is amateurism.

From the 1940s until the 1990s, most politicians in both countries were men who had fought a world war. That experience shaped them.

You could tell similar stories about Clement Attlee (badly wounded in Iraq in the first world war, prime minister 1945-1951), John F Kennedy and George HW Bush. In 1975, 81 percent of US senators were military veterans, says the Pew Research Center. Experience of war doesn't guarantee seriousness (see Flynn) but it helps.

(...)

But both countries have now fallen into the hands of well-off baby boomers, born between 1946 and 1964 — the luckiest members of the luckiest generation in history. These people had no formative experiences, only TV shows. They never expected anything awful or unknown to happen. They went into politics mostly for kicks. The paradigmatic shift was from George HW Bush (born 1924) to his son (born 1946). Like Trump, Bush Jr spent much of his early presidency on vacation.”

Indeed, whenever we see people whining about how hard things are, we remember the experiences and scars of both XX century World Wars (every tragedy is terrible for those who lived through it, but those two are much more wide scale and vivid in most minds).

In the end, we think the best quote on experience we know is the final scene in the original Blade Runner movie where the Android represented by Rutger Hauer saves the life of the Blade Runner (Decker, the special police force in charge of retiring/killing Harrison Ford) and says:

“I’ve seen things you people wouldn’t believe, Attack ships on fire off the shoulder of Orion. I watched C-beams glitter in the dark near the Tannhauser Gate. All those moments will be lost in time. All those moments will be lost in time, like tears in the rain”³

Just like these examples show, it seems impossible to transmit experience. The best one can do is to provide those coming up with the opportunities to have the most formative ones (and survive them), avoid the ones that could be a “game over” and try to provide analogies to the ones they have experienced. But it has proved wise to accept that when it comes to experience, there are clear (and low) limits to any time compression algorithm. Inasmuch we might try, “all those moments will be lost in time, like tears in the rain.”

ON READING

As a natural sequel to the previous topic, we found it interesting to return to the topic of reading. We shall start by noting that even Da Vinci, who lived when books were

³ <https://www.youtube.com/watch?v=HU7Ga7qILDU>

still quite rare (Gutenberg's press was invented about the same decade Leonardo was born), was an avid book reader and collector.

Over the years, we have been constantly pounding that, in order to increase dramatically one's chances of a fulfilled and successful life, one must study, reflect and learn a lot. But in an age where information is free and ubiquitous, we end up constantly surrounded by masters of saying a tremendous amount when nothing needs to be said. For this reason, we pose an important personal question that few people know the answer well enough: *How do I Learn?*

As Peter Drucker points out in *Managing Oneself*, people can often be divided between readers and listeners. Readers, like Leonardo, relish at written information and in engaging in a silent discussion with the writer. When ideas are written, they make sense and flow with them far better than they would with vocal cues. Listeners, on the other hand, need verbal interactions in order to fully grasp concepts. When reading, listeners tend to skip over important details and miss the overall message.

Failing to recognize which field you fall into can have damaging results. Take the case of President Lyndon Johnson. As a gifted parliamentarian, he was undoubtedly an excellent listener. However, when put in the shoes of a presidency built around a reader (JFK), where a brilliant group of writers communicated with him in memos before discussing them, he never seemed to understand a word of what they wrote.

Here at PIPA, and this is part of the reason we work in this field, we tend to consider ourselves readers. Luckily for us, it is only through reading that one can sit at the

table with the world's most accomplished thinkers and doers, regardless of their language, era or our prior knowledge. Nonetheless, we recognize that in order to extract “nuggets of knowledge” from what we read — the type that can be readily available when we need them and form the foundation of new discoveries and connections — we must first master the skill of reading.

Having a deliberate strategy for anything we spend a lot of time on is a sensible approach. But most people don't consciously try to get the most out of the time they invest in reading. Most people think that consuming information is the same as learning information and end up becoming passive readers that forget things almost as quickly as they read them.⁴

To get the most out of everything we read, we must become active readers. This enables us to further increase retention and learn to differentiate good arguments from bad ones. To explain, we borrow the words from Shane Parrish in a post on Farnam Street blog which we think nicely summarizes the key points on becoming an active reader:

Before Reading:

- **Choose your books wisely.** There are no rules when it comes to choosing books. We don't have to read bestsellers, or classics, or books everyone else raves about. This isn't school.
- Nevertheless, place an emphasis on reading what will stand the test of time,

⁴ www.farnamstreetblog.com/...how-to-remember-what-you-read

pique your interest and resonate with your current situation. This means reading things you disagree with and reading more than just finance.

- **Quality matters more than quantity.** If you read just one book a week but fully appreciate and absorb it, you'll be far better off than someone who skims through half the library without paying much attention.
- **Skim the Index, Contents, and Preface.** Before starting to read a book (particularly non-fiction), skim through the index, contents page, preface, and inside jacket to get an idea of the subject matter, context and the author.
 - Remember: When it comes to non-fiction, you don't need to read the book. You need to *understand* them.

While Reading

- **Making notes** is perhaps the single most important part of remembering what you read. Most of us were taught as children to treat books as something sacred – no folding the page corners, and no writing in the margins, ever. However, if you want to remember what you read, forget about keeping books pristine. In fact, go crazy with marginalia. The more you write, the more active your mind will be while reading, the more you will remember.
 - *“Marking a book is literally an experience of your differences or agreements with the author. It is the highest respect you can pay him.” - Edgar Allen Poe*

- **Speed-reading is bullshit.** The only way to read faster is to actually read more. The point of reading is not to read faster. It's to read better.
- **Stay Focused.** Decide that for the time you will be reading, you will focus on the book and nothing else. Active reading requires focus and the ability to engage with the author.
- **Make Mental Links,** books do not exist in a vacuum. Every concept or fact can be linked to countless others. Making an effort to form our own links is a fruitful way to better remember what we read. Mental models enable us to better understand and synthesize books.
 - Like Munger says: "If you get into the mental habit of relating what you're reading to the basic structure of the underlying ideas being demonstrated, you gradually accumulate some wisdom."
- **Put It Down If You Get Bored.** As a general rule, people who love reading never, ever finish a crappy book. The need to read a book cover-to-cover is something we are taught when young and often continue to do as adults. Life is much too short to finish a bad book.
 - Nassim Taleb emphasizes this: "The minute I was bored with a book or a subject, I moved to another one, instead of giving up on reading altogether. (...) The trick is to be bored with a specific book, rather than with the act of reading."

After Reading

- **Think About What You Can Apply.** So, you've finished the book. Now what? How can you use what you have learned? Don't just go away with a vague sense of "oh yeah, I should totally do what that author says." Take the time to make a plan and decide how to implement key lessons from the book.
- **Reread (If Necessary).** Great books should be read more than once. While rereading them can seem like a waste of time because there are so many other books to read, this is a misunderstanding of the learning process. The goal is not to read as many books as possible. The goal is to gain as much wisdom as you can.
- **Teach What You Have Learned.** Teaching others is a powerful way to embed information in your mind. This is part of the Feynman technique. (...) It was Schopenhauer who said, "When we read, another person thinks for us: we merely repeat his mental process." To escape this, you need to reflect on your views and see how they stand up to feedback.

We find it helpful when we force ourselves to organize internal discussions as we do via this report. And think about what we have learned, review it and identify its gaps, organize it and simplify in order to finally teach it to others (i.e. to follow Feynman technique⁵) is a powerful way to consolidate and create knowledge. Receiving your feedback just makes it even more powerful.

⁵ www.farnamstreetblog.com/2012/04/learn-anything-faster-with-the-feynman-technique/

To conclude, here are a few quotes from the great Albert Einstein that are somewhat related to this topic:

“I have no special talent. I am only passionately curious.”

“Learn from yesterday, live for today, hope for tomorrow. The important thing is not to stop questioning.”

WESTERN UNION

In our last report, we laid out what we see as the investment case for Western Union. In this one, we'd like to focus on the company's recent performance and on westernunion.com.

As of the third quarter of 2017, the company has been posting positive low single digit revenue growth for the year, which is a decent improvement on the results of 2015 and 2016, when revenue declined by low single digits. Also, so far this year they've allocated USD 475M to buybacks and USD 245M to dividends.

During this last quarter, pricing remained stable contrary to the bear consensus that competitive pressure would make Western Union lose on pricing. Granted that there's still time for that to happen, but one has to recognize their resilience so far.

Finally, their digital platform continues to perform consistently well with over 20% yoy growth. Although this is still only 8% of the company's revenue, it is a key component of their strategy.

This resilience as well as the bright spots in their performance however, are not reflected on the stock price. Quite the contrary actually, the surrounding sentiment remains very pessimistic, as accurately represented in the stock's 11% short interest.

It's fair to say that, given its size and market share, WU's C2C retail business won't grow substantially, or at all, in the coming years. So, when thinking about what will propel the company, and thus its EPS and stock forward, digital will likely be their main driver.

Many are pessimistic about the actual impact the platform will have for the overall company, arguing that, as it grows, it will cannibalise their retail business. However, the data shows that over 80% of wu.com's transactions are incremental volume as opposed to regular C2C retail customers. Plus, it's a different demographic target they're reaching, a more tech savvy and banked group of people.

On this note, it's important to highlight WU Connect, part of their digital strategy. It gives online business the opportunity to offer digital money transfer by plugging into WU's platform. WeChat, Facebook and Viber have already partnered with them, further strengthening WU's brand and adding to the potential of widening their moat.

Also noteworthy is that, combined with the positive outlook that mobile and online bring to WU's future, the company carries a light balance sheet and is currently leveraged at around 2x net debt/EBITDA, which means they can comfortably take on an additional USD 2Bi in debt should they find an attractive acquisition target.

We know that the way one sees Western Union depends a lot on how one frames their business and their competitive position. Some see “WU is a cigar butt company doomed to be disrupted by money transfer apps” while we see it as an essential part of life for the hundreds of millions of migrants who don’t have a bank account. Once we include the brand trust, the compliance complexity and costs over all channels, it looks a much more compelling alternative. We do agree that the way it works will eventually have to change, but that has been the song since early PayPal days. Eventually paper money will go obsolete, but if we frame the company as a compliance agent willing and capable of dealing with people banks don’t care, it might still have some puffs left. We elaborate more on framing further down on this report.

BEST BUY

This is one company that’s been constantly challenging our conviction over both 2016 and 2017, closing the year up 60% and reaching its all time high in December when most retailers suffered from the “A” wave. And Best Buy, while it didn’t collapse itself, continued to post mediocre numbers.

Annual sales remain around USD 40 billion as they have been since 2008, having peaked just below USD 50 billion in 2011. Most of the bottom line growth came from both from an aggressive (and in our view not sustainable) cost-cutting program and large share buybacks.

BEST BUY SHARE PRICE IN 2017



Whenever we're confronted with a situation like that, our instinct is to double-down on our ongoing paranoia. What are we missing?

On the M&A front, could Amazon itself buy the company to accelerate its expansion into brick-and-mortar retailing and implement the mother-of-all-omni-channels, converting some stores to dark stores and using the best located as Go concept stores? The bigger BBY's market cap gets, the least likely this scenario becomes. Amazon is known for its strict adherence to fiscal discipline. Also, contrary to Whole Foods and Zappos, Best Buy doesn't bring a great brand to the fold, nor any special

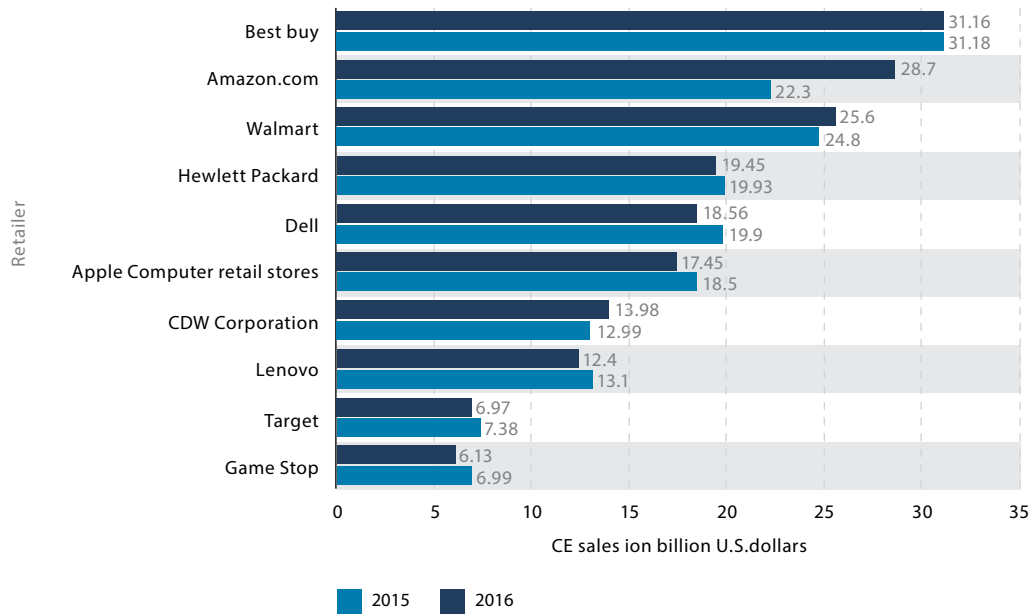
relationships neither up or down stream. We know that with Amazon “you never know for sure”, but it seems they have their focus elsewhere(s).

Another alternative would be the Chinese. Both Tencent and Alibaba recently made investments in traditional retailers in Asia, stating clearly that they want/need to breach out. In terms of fiscal discipline we'd be far less sanguine in these cases and they could position themselves as Asian hardware beachhead. Nice on paper, but doing that with a company that has more than its fair share of problems, in a different country with a different culture would be bold. USD 20 billion still is a lot of money for a lacklustre company with no growth and serious competitive challenges. There would be no evident synergies and overhead costs could even get higher.

At the end of the day, we tend to get stuck with more prosaic alternatives.

The first one is that as it was the biggest in the category and the pure play, it possibly has been able to extract better terms from suppliers.

SALES OF THE LEADING 10 CONSUMER ELECTRONICS RETAILERS OF THE UNITED STATES IN 2015 AND 2016 (IN BILLION U.S. DOLLARS)*



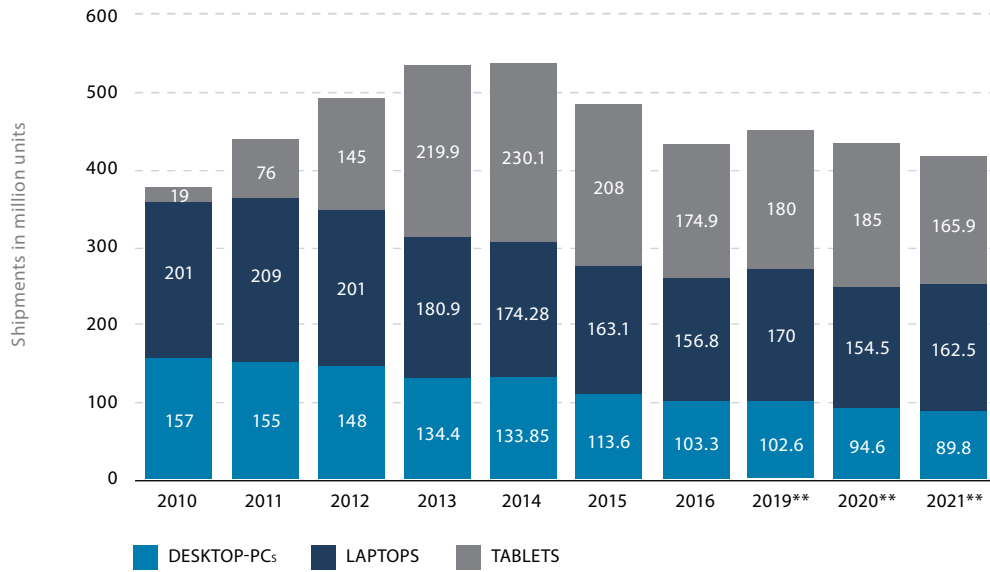
Source: Dealerscope
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Additional Information: United States; Dealerscope; 2015 and 2016

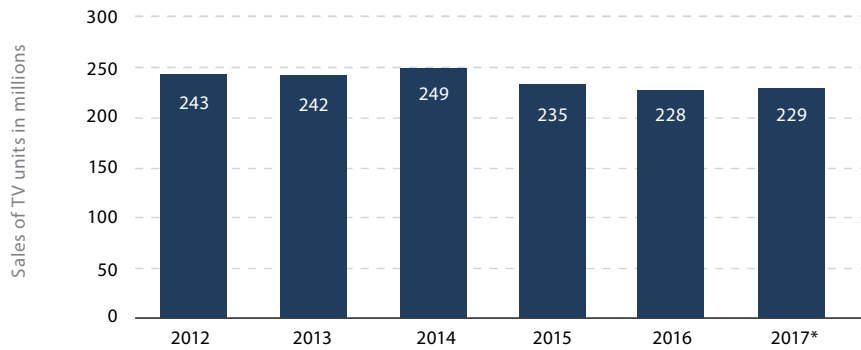
But looking at what’s happening in terms of growth, we think it’s quite likely that this condition won’t last, as consumer electronics has been the fastest growing category at Amazon.

Also, the product mix is shifting. Big TVs are a no-growth business (to be polite), just as PCs and notebooks as we can see in the following charts.

SHIPMENT FORECAST OF TABLETS, LAPTOPS AND DESKTOP PCs WORLDWIDE FROM 2010 TO 2021 (IN MILLION UNITS)*



GLOBAL TV UNIT SALES FROM 2012 TO 2017 (IN MILLIONS)



© Statista 2017

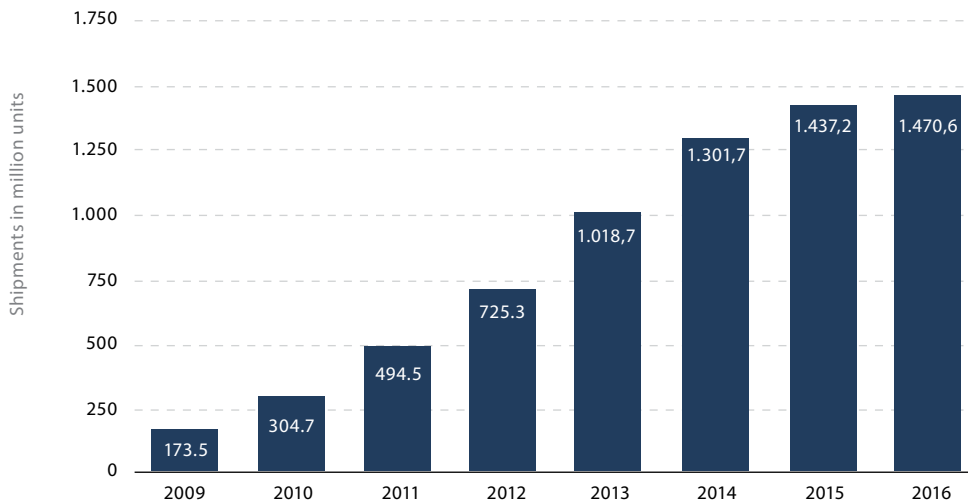
Source: Consumer Technology Association

Additional Information: Worldwide; Consumer Technology Association; 2012 to 2016

Even though those charts are for the world as a whole, we think it's fair to assume this should be even worse in developed markets, especially in the US.

This leaves accessories (printers, etc) and smartphones. Besides the fact that their biggest growth phase is behind them, we also have the trend of operators driving the move to SIM-less phones, which is the final step of the long process of eliminating one element of the distribution chain for mobiles (just look at what happened to Carphone Warehouse and Dixon's).

GLOBAL SMARTPHONE SHIPMENTS FROM 2009 TO 2016 (IN MILLION UNITS)



All those facts combine to pose the following question: why a sector that was so vibrant with players like CompUSA, Radio Shack, HHGregg, Circuit City (of Jim Collins' Good to Great⁶ fame) and many smaller retailers has collapsed into a single pure player? Obviously it might have to do with some special competency.

⁶ Those interested in the final stages of Circuit City saga might find it useful to read "From Good to Great to Gone" by Alan Wurtzel, the company's VEO at <https://www.amazon.com/Good-Great-Gone-Year-Circuit/dp/1682302431/>

But when we look at the cost structure, habits and industry structure, it's hard to think that even the last of the Mohicans will stand long. From Apple to Google, all are going direct to consumers. In Apple's case, both on and off-line for quite some time. At the same time Amazon and Walmart are able to spread the logistic and technological costs over a much wider base of sales.

The second reason has little to do with BBY's business and much more with the indexation phenomena. As more and more capital is indexed, there's an "automatic" flow of money for the companies in these indexes.

Last but not least, the company has been doing huge share buybacks over the last few years (which look even worse in light of the insider selling wave we show further down).

BEST BUY SHARE BUYBACK*

	FY 2016	FY 2017	FY 2018**
Buyback Value	USD 1 billion	USD 751 million	USD 1.1 billion
Buyback Quantity	32.8 million	21.1 million	21.9 million

* Approved an increase of USD 3 billion to its plan on March 1, 2017, superseding the existing share repurchase authorization dated June 2011, which had USD 2.2 billion in purchases remaining, for a total of USD 5 billion. Declared in 3Q18 earnings that intent is to repurchase USD 2 billion this fiscal year, up from USD 1.5 billion.

** Data up to 3Q18.

While Amazon uses all of its cash flow to increase and optimize operations and Walmart throws truckloads of money at its online efforts, it's hard to believe that BBY will manage to be that much more efficient... And if sales numbers are any guide...

The proof is in the pudding

We like to base our analysis on three things: people, incentives and business model. And always keeping in mind that the worst scenario is when you have smart people with interests against yours.

In terms of people, BBY has been a mixed bag. In one hand, they have been effectively reducing their lease obligations over time, a sure killer for retailers.

They also have been cutting staff aggressively in order to preserve margins. But there's a limit to what one can do it, specially if you "sell" yourself based on service and depend a lot on extended warranty sales, which so far has proven to be absolutely people intensive.

There have also been quite a few negatives in the "people" side of the company.

Best Buy's former Chief Marketing Officer Greg Revelle and Mary Lou Kelley, president of e-commerce, have both left the company in April 2017 (Revelle was appointed CMO of department store chain Kohl's). Tom Nowak, the former head of Peterson Milla Hooks agency was hired by Best Buy less than two years ago as the electronic brand's first-ever chief creative officer and has also left.

Sharon McCollam, Best Buy Co.’s Chief Financial and Chief Administrative Officer, left the company in May 2016, a bit more than three years after coming aboard the electronics retailer to help reverse its then-dismal prospects.

And to top it all off, there’s been a steady flow of insider selling:

	2015	2016	2017
Nominal Value*	USD 297.1 million	USD 129.6 million	USD 230.4 million
As % of Shares Outstanding	2.2%	1.0%	1.3%

* Considers closing price for each trade date.

It seems they might be seeing the same thing as us: a company with no sales growth over the last 10 years, stuck around USD 40 billion sales (or a 20% decrease, if you base your analysis on 2011), 0 to 3% net margins and 2/3 of that depend on the sales of extended warranties.

Even if we consider the 3% net margin, with eventual tax gains compensating for lower operational margins, that would lead to a USD 1.2Bi in profits and a P/E at current levels of about 16x. Meanwhile, they’d be trying to accomplish 3 hard things at the same time: implement the omni-channel concept, reduce its physical footprint and face the Amazon/Walmart competition.

To sum it all up, this reminds us of the famous Samuel Goldwyn quote: “Include me out”.

FRAMING

We always try to evaluate how the market is framing an issue and how could things change if it was framed differently. For instance, if voters had been given at the time of vote the USD 96 Bi figure the UK is reportedly offering to exit EU, we doubt the result would have been to Leave. The question would cease to be framed based on an immigration issue but rather focused on the financial one. And as we learned from the Bush election campaign, “it’s the economy, stupid!”.

We find this concept to be of utmost importance and a relevant part of many businesses. Actually, the most successful businesses are the ones that frame their products in the most favourable way to increase sales. If the product actually fulfils its promises, it’s a blockbuster. Otherwise, the backlash could be terrible.

Let’s take the airline business as an example. The way companies frame these offerings is always with images of happy people getting to know wonderful new places and executives sleeping with relaxed smiles in business classes. All that and a highly courteous and always smiling team of flight attendants. So the framing is all about freedom, happiness and comfort.

But in our experience, the user is more likely to face a website full of misleading promotions, with a dynamic process that turns buying a careful selection of air transportation into a true nightmare. Huge queues at airports, immigration and customs are the norm.

High expectations and poor results beget the worst possible scenario: high expectations and low quality services, which over time leads to reciprocal cynicism.

A more honest way of putting it would be: “Our services are highly unreliable due to technological and weather situations. We’re constantly fighting with our crew and their unions. We really understand that you’d like a stress-free and more straightforward service, but given our constraints, we can’t do it. So be prepared for a likely less-than-perfect experience.”

Why all this digression? Because we believe most of our most successful cases have been those we could reframe the issue. We tend to think that successful investing is all about being able to build consistent narratives and implement them with discipline.

Take Amazon, a.k.a “the bookseller with no profits”. If you reframe it as an unheard-of execution machine capable of re-investing its free cash flow in ways that keep increasing its moat and margins, it makes about a USD 500 Billion dollars difference, so far.

Berkshire is an immense hedge fund with permanent capital, part of it with negative cost over time (insurance float) and a very disciplined, honest, and aligned management.

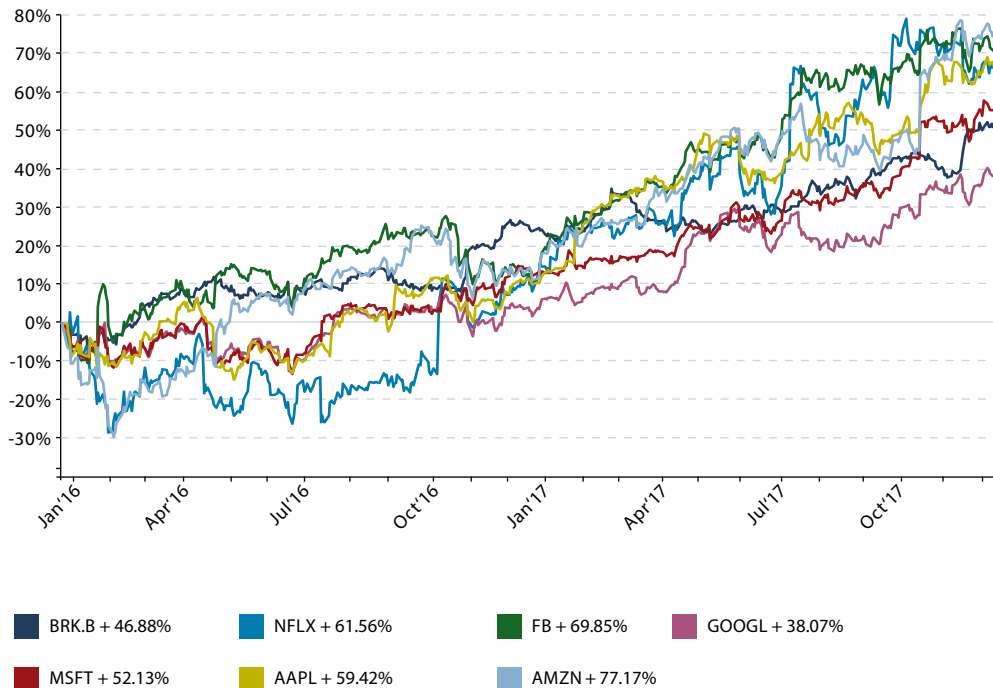
The trillion dollar question and the power of compounding interest

About a year ago we made a small, completely unscientific survey among friends from different walks of life about who would be the first USD 1 trillion dollar

company per market cap. Well, so far none have got there. Of course, this is a very simplistic way of looking of things, for we hadn't specified any of the many variables like dividends, share issuance, divestitures etc. The whole idea was to get a feeling of what people we respect thought about these big companies.

Since “a rising tide raises all yachts”, they all got closer.

THE TRILLION DOLLAR QUESTION



So in this time horizon, there's not much to be taken from here, except:

One of the reasons AAPL hasn't got there yet is because they distributed a lot of cash to its shareholders. On the other hand, Amazon, "the company with no profits", had the biggest market cap increase, and we thought the contrast of the two is quite interesting.

While Apple generates truckloads of free cash flow, it clearly can't find a way to invest it. Granted, having the discipline of not doing dumb things⁷ deserves some credit. But when we compare it with Amazon, a different "driving force becomes clear. While in the "big new ideas arena" Apple only managed to launch an uninspiring upgrade of the iPhone, Amazon came up with so many "big new things" that it's pointless to repeat here.

Instead of distributing cash when BMV⁸ "matured" in the US, Amazon launched Prime, which reduces current profits while building an ever-increasing moat that led it to approximately 50% of ALL US e-commerce. That happened in parallel with creating and nurturing AWS, a business that if was to be spun-off, would be worth about USD 100 Billion dollars. Prime TV and the advertising business are already registering significantly in their respective industries radars. That could only happen because Bezos was around. One can only guess what would have happened to Apple if Jobs was still around to use the cash torrent he started...

Our point is: it's not everyday that we have the opportunity to invest in a company that not only manages well a great business, but also manages to find great ways to invest its profits. We can count in our hands those opportunities over decades. Being

⁷ other than the "The Spaceship"

⁸ Books, Music and Video

it Berkshire when Buffett bought it, Itaú when Olavo Setúbal took over, Brahma/Ambev/InBev/ABI when Jorge Paulo bought Brahma and Marcel went to run it, Lojas Renner when José Galló became its CEO, Danaher when Larry Culp stepped up or Apple when Jobs went back.

At least we now know a few more things, such as what Jim Collins wrote in “Good to Great: Why Some Companies Make the Leap... And Others Don’t”: **“if you have the wrong people, it doesn’t matter whether you discover the right direction; you still won’t have a great company. Great vision without great people is irrelevant.”**

GOOGLE

We found it relevant to give the new Google Pixel 2 Phone a try. Why are we interested? Because it can affect not only Apple (which we see as the intended main target), but also Amazon, Microsoft and even the Chinese players. There are quite a few relevant positive points and a few challenges.

The product

Although as consumers we’d prefer otherwise, we can understand why Google opted to follow the iPhone’s path of not having an expansion slot for MicroSD Card, and not allowing battery changes. Also, it broke with the micro USB connector tradition and opted for the USB “C” version, meaning a new cable/adaptor. Last but not least, the headphone connector is gone as well. Either you migrate to Bluetooth headphone⁹ or use an adaptor that plugs into the USB “C” connector that can be purchased for about USD 2 and seems to be becoming the standard.

⁹ Positive = not a lot of twisted wires, negative = one more device to keep charged.

The USB C also supports a much faster charge of a much bigger battery, which comes in handy as screens get bigger and the amount of high power consumption apps, specially video, continues to increase at high rates: from 40% p.a. in more “mature” markets to hundreds of % p.a. in markets like India. It’s data throughput is also much higher, allowing faster uploads and downloads through a physical connection.

We imagine that on top of cost and space factors, the MicroSD option was related to the idea of forcing users into Google cloud services. Indeed, photos taken with the phone are granted unlimited storage without compression for free “forever”, videos up to 2021 and the integration with all other Google services is quite good. At the end of the day, if there’s bandwidth and nice cloud providers, local storage becomes less and less relevant.

Format change is always a hassle but at least the Micro USB withstood many improvements over the years with the same form factor. In the same time frame, we lost count of how many new connectors consumers were forced to buy from Apple.

Our last comment product-wise is that when you hold a top of the line Samsung or Apple, the build quality of both feel much better than the Pixel 2.

The marketing strategy

The site promoting and explaining the extra feature is great. Pricing strategy seems to be aimed at positioning the product as premium (and in tech terms it is) but might be also a function of supply conditions.

However, all of this can be compromised by the terrible online checkout experience. We had to try three times to buy it. We only did it because our intention was to evaluate the product and service. Were we on a “regular consumer mode” we’d certainly given up and gone to a Samsung or Apple.

First, the BUY button wouldn’t get “clickable”. We tried and tried different configurations and reloads, to no avail. The only message we got was that we have to fill all the options. Which we think we did (screen size and memory). After sleeping over it, we understood that what was missing was the colour option. But they didn’t point it and the first option was “just Black”. Which seemed quite ok for us.

The next day we retook the challenge and returned to the site, and as soon as we clicked the “just black” the buy button magically went “clickable”. Hurray!

But we celebrated too soon. Despite being a Google active client, both via Google Drive storage and via their Play Store, we were prompted to re-enter our address - which the site didn’t recognize as valid. We had to play with the number and building name (a much relevant data in the UK than IN many other places) until “the organizers of all information of the world” got it. Hurray!

Again, hold your bottles. We were prompted to select our payment method, which didn’t include the one we use monthly to pay for Google Drive. So, we took a deep breath, made ourselves a chamomile tea and entered our card details. You’d be forgiven to think that this would be the end of it, but it wasn’t. We were then asked

for our billing address, without being given the option of “the same”. That’s one level below “E-commerce for Dummies”, 1999 edition...

After all was said and done, we placed our heroic order and were informed to expect to receive it in about 10 days. TEN DAYS!!! To deliver to London. Which planet are those guys from? If I was buying something from Amazon, it would be 1-Click Order to receive in 2 days. Or for thousands of items I’d be given the option of 2 hours delivery.

To add insult to injury, at least in the UK they came up with a misleading promotion offering a “Google Echo” for those who buy before December 31:

“Buy a Pixel 2, get a Google Home Mini on us. When you purchase a Pixel 2 from Google Store before 31 December 2017, you’ll get a promo code to redeem for a Mini from Google Store by 28 February 2018. Terms Apply.”

The “terms apply” is where things go terribly wrong. We would expect something in the line of offer limited to one per person or other reasonable conditions. But on top of the long usual terms, there’s the indescribably awful, immoral, goodwill destructing “chalk colour only”.

Do they want to enhance the penetration of their Echo me-too device or not? In our humble view, they managed to get the worst of both worlds. They sacrificed whatever goodwill they might have had and didn’t increase penetration of their device.

But the “*grand finale*” is... there is no Chalk colour option in their site!

“Colour: Just Black, Clearly White, Kinda Blue, Black & White”

It's becoming clearer by the day that each of the giants are in an all-out mission to make life more difficult to their competitors. Look for Pixel 2 in Amazon UK web store and you'll find lots of ancillary products like covers, adapters, cradles etc. The only way to get to the phone itself is at the marketplace section. And there's not a single one of them Fulfilled by Amazon.

On the other hand, as we were setting up a new Echo at home, a process that had been ultra-straightforward with our previous phone (a Samsung running Android), wouldn't go through using the Google Pixel 2. The Alexa App installed but would freeze during the setup.

We will never be sure if that was a bug or “evilness”, but the fact is that someone aimed for a big market share should have made sure the process was seamless, even more considering Echo's penetration. It seems clear to us that in many cases AAPL, AMZN, GOOG and FB see more value in making life more difficult for each other than benefiting the client.

Conclusion

The Pixel 2 is a great product and certainly could give Apple a run for its money if sales execution and marketing strategy were better. However, the shopping experience on Google Store shows the lack of a vocation for retail, as well as an unclear strategy and goal. That seems to be just the “tip of the iceberg”, a signal of

a much greater leadership issue that has always manifested itself, as in the recent Eric Schmidt resignation.

As it is, the jury is still out, but we aren't holding our breath. Apple will probably have more time to skim the cream from the mobile market's cappuccino and Google has shown the way to all its competitors on how to create a great product in many aspects. If anything, it showed us one more time the advantage from Amazon to all others when it comes to selling something online.

MEDIA WARS TMT 2.0

The media space is a specially tricky one. One is trying to evaluate companies that used to make and now at very least control how (some) information flows. There's little doubt that we're going through a "special moment" in the industry.

There's been rampant M&A activity among legacy players to try to face the challenge presented by the newcomers, both in content and distribution. With the seemingly close end of Net Neutrality in the US, connectivity companies are trying to build an oligopoly where they could exert a much bigger pricing power. We've been following this issue for more than a decade. Legislation has swung back and forth, and this month we saw a very divided FCC revert the Net Neutrality rules in a 3/2 vote that is still generating a lot of backlash.

That seems to be the best strategy left to the connectivity providers. Per a recent article at "The Information"¹⁰:

¹⁰ www.theinformation.com/ble-is-disappearing-tv-profits

“... once they aren’t making money on video, cable operators may well decide to throw in the towel on selling their own TV service, which includes everything from hundreds of TV channels to video-on-demand. They will still be profitable thanks to broadband: the profit margin for Comcast and Charter in that business averaged about 63% in the second quarter, S&P estimated. And because they are so identified among consumers with TV, they may decide to keep offering a product, perhaps by bundling streaming TV services, like YouTube TV or Hulu’s new Hulu Live service, with their broadband offering. How long this would last is uncertain.

Alternatively, cable operators might just let entertainment companies fend for themselves by going directly to consumers with streaming versions of their channels. Think HBO Now, but for every TV network.”

Indeed, some operators are so optimistic about that legal strategy that they’ve already given up at offering any type of content. They simply assume that given new rules, they’ll be able to offer and charge for connectivity, as per a Bernstein report:

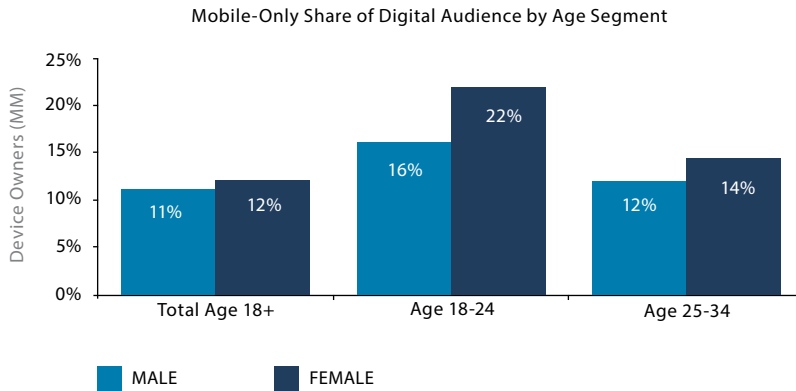
- Cable One, for instance, which operates in 21 states and was once the cable arm of the Washington Post Co., has retreated from the television business. Unlike most other cable operators, it doesn’t aggressively try to sell packages of video, phone and broadband with big discounts. Instead, it charges higher prices for video than other cable firms. For instance, Cable One’s website shows TV service with up to 100 channels a month costs \$80. Comcast, in contrast, offers 140 channels plus internet for \$70 a month.

- Cable One is unapologetic about this approach: “We have declined to cross-subsidize our video business with cash flow from our higher growth, higher margin” businesses (a reference to broadband), it regularly says in regulatory filings. While that strategy “runs contrary to conventional wisdom in the cable industry, which puts heavy emphasis on video customer counts...we believe it best positions us for long-term success.”
- The result is that Cable One’s video business is declining faster than the industry average: the number of video customers dropped 12.4% last year and revenue dropped 11.4%. It has far more broadband customers than video: 637,000 vs. 371,000. But Cable One’s net income rose 11% last year and is up 25% so far this year.

Others are still in the old mindset of finding ways to differentiate through exclusive content. Examples go from Comcast having bought CNBC to AT&T bidding for Time Warner to Verizon buying Yahoo and AOL. The FTC’s questioning of AT&T Time Warner acquisition will be a good test. Even though these seem like sensible actions in the short term, data consumption numbers suggest that it might be too late.

The percentage of millennials that are mobile-only consumers should give us a pause.

NEARLY ONE IN EIGHT U.S. INTERNET USERS ARE NOW MOBILE-ONLY, WITH 18-24 YEAR-OLD WOMEN THE HIGHEST SKEWING FOR THIS BEHAVIOR

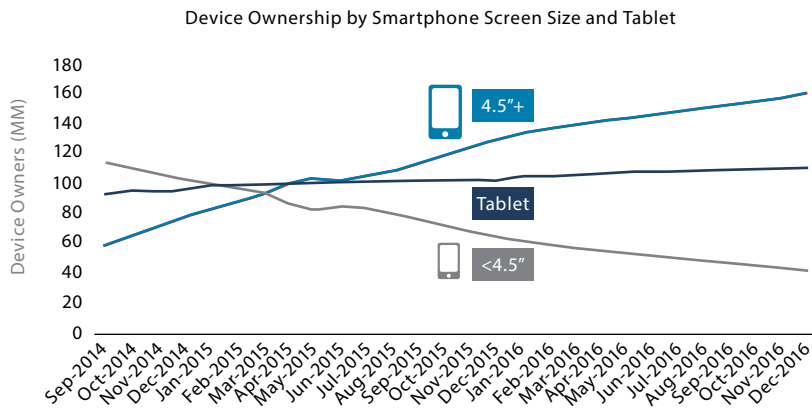


INSIGHT

The mobile-one internet user is an emerging group within the digital media ecosystem. Millennials are more likely to rely exclusively on their mobile devices, with the heaviest skews occurring among college-aged adults and females.

Source: comScore Media Metrix Multi-Platform, U.S., Age 18+, Dec 2016

THE SMARTPHONE MARKET HAS TRANSITIONED HEAVILY TO LARGE SCREEN MODELS, WHICH NOW OUTNUMBER SMALL SCREEN DEVICES BY 4X



INSIGHT

More consumers are adopting smartphones with a 4.5" display or greater, while tablet ownership growth has pulled back in recent years. This correlation could be due to tablets and larger screen smartphones sharing many of the same use cases.

Source: comScore MobiLens, U.S., Age 13+, 3 Mo. Avg. Ending Sep 2014 - 3 Mo. Avg. Ending Dec 2016

We don't see that trend being reverted. Quite the opposite: the combination of demographics with ever faster wireless network connections and the increase in mobile screen size seem to lead inexorably to a continuing loss of relevance for everything we've got used to. Plus, that is before anyone gets Virtual Reality or Google Glasses technology right.

To complicate matters a bit more, while all (occidental) eyes are on the “usual suspects”, Tencent announced plans to invest USD 3 Bi to ramp up its YouTube-style content. The move follows a period of unrestrained professional content acquisition, spanning from US National Basketball Association streaming rights to music from major record labels. Content is a key tool for keeping users within Tencent's platforms. It will invest RMB 10Bn a year in revenue sharing with content creators and devote a further RMB 10Bn to resources as start-up spaces and providing intellectual property protection. “The mobile ecosystem in China is quite mature, so the products are all kind of similar. What differentiates them now is content, so that's the way to attract customers from your competitors.”¹¹

While we agree that connectivity is more important by the day, we've been around long enough to see coaxial cables disrupt twisted pairs and fibre disrupt coaxial. Each round costs hundreds of USD Billions in the US alone and when it comes down to it, the only sure thing is that each round increased the value of premium content.

It might take time and there might be some bumps on the road, but if we're talking about long term (and we always are), we'd rather be on the content side. Leonardo,

¹¹ Quote from Matthew Brennan, analyst and co-founder of China Channel site, they train companies to use WeChat. <https://www.ft.com/content/0ac6504e-c901-11e7-ab18-7a9fb7d6163e>

Vermeer, Giotto & Co proved much harder to be disrupted or “upgraded”. A reflection on all those facts led us to a quite exciting “dream”.

Disney

Given our belief that top content is one of the best assets to have, Disney has always been a company we’ve kept an eye on. It certainly owns some of the most valuable content in the world and Bob Iger is a great manager. On the other hand, despite some improvements from Eisner years, cost and expenses controls are still quite lax for our standards as is their governance. But we’ve always thought it to be in a state of unsteady equilibrium, despite being a company with a USD 150 Bi market cap, as it was earlier this quarter.

Disney faces a few key relevant issues:

- Leadership/Iger succession with a Board we think is not up to the task. The issue might have been postponed as Iger vowed to stay until 2021 to see the implementation of the Fox deal.
- Challenges for the all-important Media Business that’s suffering from a secular transition from cable operators (cord cutting) to Over The Top “OTT” distribution (the likes AMZN’s Prime Video, NFLX, Apple TV, Hulu). Disney appears inclined to try a third alternative: Direct to Consumer, which implies relevant IT investments, manage a phase-out of many long term deals and a learning curve.
- There’s also a traditional issue related to tax control and administrative costs.

For those reasons, the expectation has been that DIS would either be acquired or would acquire a smaller peer. We've been hearing about AAPL buying DIS for a while now. But we couldn't help thinking that AMZN + DIS would be a much more value-generating deal.

Daydreaming on AMZN + DIS

We started playing with that idea a few months before Disney announcing the Fox deal, which is still pending shareholder approval from both sides and countless regulatory hurdles, and the unfurling of also pending Fox offer to buyout other shareholders at Sky. Since both the transaction and Disney's strategy may fumble, we think it's worth to continue to keep an eye on it.

The FOX acquisition and the inevitable antitrust issues this scenario would bring keeps our feet very firmly on the ground while we walk you through our daydream.

Why it could make sense for AMZN:

It would open an ultra wide autobahn for growth overlaid on most of their assets. AMZN has the penetration, IT infrastructure (AWS), screen control via Prime Interface and Alexa, billing and e-commerce capabilities to drive the move of content from distribution via Multi Channel Television Networks like Comcast or Carter to streaming before they can utter "OMG"!

Amazon's capacity to leverage its "everything store" would likely generate unfathomable synergies, selling not only movies but all the ancillary Lego, Mickey

Mouse, princess costumes, special editions, tickets, you name it. No other company comes close in terms of being able to generate this much value. We think it could easily double those revenue streams while letting go most of their existing physical stores.

It also goes very much in line with the trend Amazon has been establishing of buying only “admired companies and/or beloved brands”. Think Zappos, Kiva, and Whole Foods.

To top it all off, it would not only solve Iger’s succession issue, but also provide a nice cultural shock to DIS, that despite having seen some progress over the years, can still be significantly improved.

Why it could make sense for DIS:

1. Solves Eiger succession, specially if Bezos and/or Buffet offer him a Board seat. A decent offer opens the door for a friendly deal with a nice break-up fee could be feasible.
2. Solves the IT challenge Disney faces. So far, only Netflix and Amazon TV have “cracked the code” of packaging and selling streaming content direct to consumers. Disney has just start investing on it, this year with the acquisition of BAMTech, and projects to do so at a run rate of more than USD 1Bi/year in a way many experienced operators think the odds of success are low and slow (witness Hulu). Switching them to Amazon Prime Video would be almost plug & play.

How the deal could be structured:

As the divisions that would interest Amazon would be the Studio, Consumer Products and ESPN, that leaves the Media Networks without ESPN and the Parks and Resorts division. Here, we imagine what could be done with those two divisions left outside the supposed AMZN + DIS combo.

In our view, the Parks and Resorts Division could be spun-off/remain as the Disney listed company, maybe in a REIT form, or sold to Park operator/private equities groups. Since Disney already licenses the operation of foreign parks (Tokyo, Shanghai, Hong-Kong, Paris), that shouldn't be much of an issue. Bob Chapek, who runs the Parks/Resorts division, which has been performing quite well, is considered the most likely to succeed Iger so this part could be considered "solved".

The networks division "sans" ESPN, which is the smallest segment could be sold to a connectivity provider or new media in need of content, like Verizon, Charter/Time Cable, AT&T- if the Time Warner deal doesn't go through - or even Softbank, Google, or Facebook.

We did think of another buyer that would make sense and has the cash to do so. Given Warren Buffett's previous ownership of Cap-Cities ABC and Bezos' Washington Post any or both could eventually have interest in those assets.

Why the interest in content:

We know that total number of US subscribers for Netflix is 53M, Hulu 17M¹² and Amazon Prime are estimated at 90M. If you're Prime you have access to Amazon

¹² But 54M unique viewers in 2017.

Video on PC, tablet, mobile or if you buy a USD 40 dongle to stream directly to your TV in up to 4k resolution (it comes with a remote with voice recognition that works).

HBO has 49 million subscribers in the United States and around 130 million worldwide via Cable, but its direct to consumer offer is struggling (less than 3 million subscribers) for obvious reasons: no direct experience in IT, nor on direct to consumer.

Netflix is at USD 11Bi in terms of global revenue but it's still FCF negative, being financed by successive equity and debt issuances.

By incorporating Disney's Studios, Library and ESPN into Amazon Video, they would "finish" the competition for who will be the absolute leader in digital entertainment distribution AND they could achieve that by reducing consolidated investments in content creation.

Where would the upside come from?

- Revenue synergies: It goes from selling Disney and ESPN merchandise and tickets through Amazon, to short-cutting Disney migration to digital Streaming of Disney content.
- Lots of low hanging costs to be cut from DIS.
- The combination of the two companies should allow significant tax gains, even without any new US tax legislation as Disney's effective tax rate has been in the low 30's.

Conclusion

On the governance side of Disney, it's clear that its board is not stellar in terms of commitment or driving change. It has 11 members plus Bob Iger. Apparently, most relevant to the case is the presence of Sheryl Sandberg (former Google and current Facebook COO), who would/should abstain in most situations. Nobody has more than 0.01% of shares outstanding.

There are no poison pills currently on DIS' by-laws. However, it allows the Board to create dilutive provisions effective to shareholders on register before the offer is made. Such an action requires more than 50% of the Board (including independent shareholder) and can be reverted anytime, again by half of the Board.

The deal is big and Disney doesn't fit neatly in any other company, necessarily needing other parties (except perhaps, Apple). Plus, based on our scuttlebutting, as we mentioned, cost disciplined has improved from Eisner days (couldn't be worse!) but there seems to be a lot more room for improvement on their cost structure.



A few months ago, a poll for the BBC World Services by Global Scan, a consultancy, found that for the first time in 15 years of tracking, more people around the world saw themselves as global citizens than citizens of their own country

- Notebook by Roula Khalaf.



The UN's International Labour Organization estimates about 56 per cent of employment in Cambodia, Indonesia, the Philippines, Thailand and Vietnam is at a high risk of being automated over the next decade or two, with clothing and footwear manufacturing jobs among the hardest hit. More than 75% of footwear line workers for Nike work in Vietnam, Indonesia and China.

- FT

2017 felt like a terrible year for many close to us. Despite the fact that not only is 2017 a prime number, it's actually special even among primes. 2017π (rounds to the nearest integer) is a prime. $2017e$ (rounds to the nearest integer) is a prime. The sum of all odd primes up to 2017 is a prime number, i.e. $3+5+7+11+\dots+2017$ is a prime number. Key takeaway: despite all empathy for prime numbers in general, never trust them blindly.

Miscellaneous

“The less prudence with which others conduct their affairs, the greater the prudence with which we should conduct our own affairs”

- *Warren Buffett*

“To buy when others are selling and to sell when others are euphorically buying takes the greatest courage, but provides the greatest profit.”

- *Sir John Templeton*

“Education is what remains after one has forgotten what one has learned in school.”

- *Albert Einstein*

“The flame that burns twice as bright, burns twice as fast”

- *Blade Runner*

Michael Bloomberg’s comment on working with Sir Norman Foster when he inaugurated new Bloomberg’s London ultra-green headquarters: “Some people say that the reason it took us almost a decade to build this was that we had a billionaire who wanted to be an architect working with an architect who wanted to be a billionaire.”

“When a man is tired of London, he is tired of life; for there is in London all that life can afford.”

- *Samuel Johnson.*

“Perhaps we know more about the world than we used to, and insofar as knowledge is prerequisite to understanding, that is all to the good. But knowledge is not as much a prerequisite to understanding as is commonly supposed. We do not have to know everything about something in order to understand it; too many facts are often as much of an obstacle to understanding as too few. There is a sense in which we moderns are inundated with facts to the detriment of understanding.”

- *From “How to Read a Book” by Charles Van Doren & Mortimer J. Adler*

“What do You Care What Other People Think”, Richard Feynman.

- “Miracles were stories made up to help people understand things ‘more vividly’, made up to help people understand things “more vividly”, even if they conflict with natural phenomena.
- Arlene was studying Descartes, when he starts with “Cogito, ergo, Sum” and ends up proving the existence of God. “Impossible!”

I said, without stopping to think that I was doubting the great Descartes. (It was a reaction I learned from my father: have no respect whatsoever for authority; forget who said it and instead look at what he starts with, where he ends up, and ask yourself, “Is it reasonable?”) I said, “How can you deduce one from the other?”

“The banks that were deemed ‘too big to fail’ are now even bigger... [in the next crisis regulators] “would still not know what is owed and by whom and to whom” [because of the way assets have shifted out of banks into the more lightly regulated “shadow banking” system.] “2009 has proved to be the turning point at which history has failed to turn”

- *Gordon Brown, former Prime Minister of the United Kingdom.*

“Because mobile phones in the early 80s were bulky and expensive to use, renowned consulting firm McKinsey & Company advised AT&T not to enter the mobile telephone business, predicting there would be fewer than one million cellular phones in use by 2000. In fact, by 2000, there were one hundred million mobile phones.”

- *from “Exponential Organizations: Why new organizations are ten times better, faster, and cheaper than yours (and what to do about it)” by Salim Ismail, Michael S. Malone, Yuri van Geest, Peter H. Diamandis*

“At its inception, the internet was a beautifully idealistic and equal place. But the world sucks, and we’ve continuously made it more and more centralized, taking power away from users and handing it over to big companies. And the worst thing is that we can’t fix it. Everything has gone wrong. That’s the thing, it’s not about what will happen in the future it’s about what’s going on right now. We’ve centralized all of our data to a guy called Mark Zuckerberg, who’s basically the biggest dictator in the world as he wasn’t elected by anyone. Trump is basically in control over this data that Zuckerberg has, so I think we’re already there. Everything that could go wrong has gone wrong and I don’t think there’s a way for us to stop it... The internet was made to be decentralized, but we keep centralizing everything on top of the internet.”

- *Peter Sunde, Pirate Bay co-founder.*

From the brilliant (and short) book “Rules from a Knight”, by Ethan Hawke. Many passages are quite applicable to many walks of life and specifically for investments:

- “Do you know why King Arthur’s knights could not see the mountain peak of Scafell? Because that’s where they were standing.”

- “Create time alone with yourself. When seeking the wisdom and clarity of your mind, silence is a helpful tool. The voice of the spirit is gentle and cannot be heard when it has to compete with others.”
- “Humility is an essential element to a magnificent life. Humility is the ability to see yourself in a much larger context. Aspire to be like the soil after the March rains, wet, open and receptive. Be humble or be humbled.”
- “When people speak, listen. As much as you like to be heard and understood, so does everyone.”

From the not less brilliant “Managing Oneself”, by the venerable Peter Drucker:

- “Many brilliant people believe that ideas move mountains. But bulldozers move mountains. Ideas show where the bulldozers should go to work.”
- “The only way to discover your strengths is through feedback analysis. Whenever you make a key decision or take a key action,

write down what you expect will happen. Nine or 12 months later, compare the actual results with your expectations. I have been practising this method for 15 to 20 years now, and every time I do it, I am surprised”

From “Seeing What Others Don’t: The Remarkable Ways We Gain Insights” by Gary Klein:

- “The most lasting contribution of *The Art of Thought* is contained in a chapter called “Stages of Control,” in which Wallas presents a four-stage model of insight: preparation, incubation, illumination, and verification. During the preparation stage we investigate a problem, applying ourselves to an analysis that is hard, conscious, systematic, but fruitless. Then we shift to the incubation stage, in which we stop consciously thinking about the problem and let our unconscious mind take over. Wallas quoted the German physicist Hermann von Helmholtz, who in 1891 at the end of his career offered some reflections on how this incubation stage feels. After working hard on a project, Helmholtz explained that “happy ideas come unexpectedly without effort, like an inspiration. So far as I am concerned, they have never come to me when my mind was fatigued, or when I was at my working table. They came

particularly readily during the slow ascent of wooded hills on a sunny day.” Wallas advised his readers to take this incubation stage seriously. We should seek out mental relaxation and stop thinking about the problem. We should avoid anything that might interfere with the free working of the unconscious mind, such as reading serious materials.”

From FT article “Could ETFs survive a sudden downturn in the market?”:

- The market making activity behind ETFs (see graphic) is intended to make sure that the fund rarely trades at a discount or premium to its net asset value: in other words, it mirrors the value of the stocks or bonds held within it. But this relies on the market makers, so-called “authorised participants” — commonly an investment bank — buying when units are at a discount to the underlying assets, and selling at a premium. The suspicion is that those players are happy making a margin by providing liquidity in calm markets, but that they will disappear if things get choppy.
- The ETF is clearly here to stay, and there are reasons to believe an accident is no more likely to befall this type of fund than any other. But the era of net inflows will end at some point, and if it

occurs during a market sell off, the fund and its market making infrastructure will be sorely tested. In the meantime, as with all investment decisions, it is worth reading the fine print.

From “Good to Great”, by Jim Collins:

- He could not stand mediocrity in any form and was utterly intolerant of anyone who would accept the idea that good is good enough.
- If you have the wrong people, it doesn't matter whether you discover the right direction; you still won't have a great company. Great vision without great people is irrelevant.
- The purpose of a compensation system should not be to get the right behaviours from the wrong people, but to get the right people on the bus in the first place, and to keep them there.
- In determining “the right people” the good-to-great companies placed greater weight on character attributes than on specific educational background, practical skills, specialized knowledge, or work experience. Not that specific knowledge or skills are

unimportant, but they viewed these traits as more teachable (or at least learnable), whereas they believed dimensions like character, work ethic, basic intelligence, dedication to fulfilling commitments, and values are more ingrained.

- The only way to deliver to the people who are achieving is to not burden them with the people who are not achieving.

PIPA Prize

PIPA Prize

PIPA INSTITUTE

Our mission is to support, help document and promote the development of Brazilian Contemporary Art and Artists. Our tagline is “The Window into Brazilian Contemporary Art”.

Why Brazilian Contemporary Art?

We should start with the obvious. PIPA Institute Founders were born and raised in Brazil. Although that has been a quite relevant factor, it is evidently not sufficient reason.

Despite its size (fifth biggest Country on Earth in terms of area) and vast natural richness, Brazil is much behind in terms of having developed (and much less preserved) a relevant cultural heritage. There are many possible reasons for that.

It is a relatively new civilization, having been “discovered” by Western civilization about 500 years ago, millennia after groups in Africa, Asia and Europe started to create and develop through a rich exchange most of what constitutes current civilization. Whatever culture and civilization existed was mostly erased by the “*Conquistadores*”.

Distance, although not necessarily an impediment, didn't help further integration and exchange of ideas. Even in terms of its neighbours, it's been kept quite isolated by the “Cordilheira dos Andes”, a mountain range that runs from North to South of Latin America, and by language: all other countries, having been colonized by Spain, speak Spanish, while Brazil, having been colonized by Portugal, speak Portuguese.

We believe that Art has many important “roles”. It serves as open space to discuss and experiment new ideas and concepts. It brings people together. It registers the most relevant discussions and innovations over time.

The combination of the factors listed above, widely differences in population concentration, income and backgrounds (Brazil has received many relevant immigration groups, like Japanese, Italian, Portuguese, German and from many African countries during slavery period) has led to a diverse but less mediated society. Voluntary isolation, heavy-handed censorship during the military Government during most part of the second half 20th century and successive economic crises also relegated art and its register to a lower priority.

The result is that Brazil lags in terms of discussion, artistic register and institutional organizations focused on the sector taken for granted in many other countries. While most developed countries have plenty of public and private institutional collections, Brazil has few, most poorly supported.

That’s why we chose our Mission to support the development of Brazilian Artists and build a historical reference of contemporary Art starting in 2010. It includes not only keeping a website and publishing annual catalogues but also building a collection with works from relevant Artists.

And last but not least, on top of the above mentioned factor, because we’re passionate about Art.

Being far in the Liberal side, we believe that Brazil's Government has many more short term pressing issues, modern and 19th century Art inclusive, to take care of. We like to think that the private sector can and should support contemporary art. That's why we don't look for or accept public incentives or tax breaks. We see it not only as part of our civic responsibilities, but also as something that benefits us a lot.

So we keep working hard in order to increase the chances of fulfilling our Mission, and for a long life for the Institute.

2017 was a year of acquisitions for the Institute's collection, to be continued in 2018.

For the next year, we are also preparing exhibitions with works from the Institute's permanent collection.

At the end of the year we got a very nice surprise. **Ana Paula Oliveira**, PIPA Online 2010 winner and a nominee in 2014, donated an artwork to the Institute.

The work, entitled "Vouindo", is an artist book resulting from the Proac Edital Prize 2016 which she was awarded. It is a book-object which intends to transform the traditionally two-dimensional book, into a set of spaces. Those are situations/ acrylic plates sculptures, with birds modelled in lead, that are disassembled in a box, to be opened and assembled. They are small sculptures that point to internal spaces, creating architectures, models of sculptures, where movement and pause are combined, where the immaterial of the flight path of the bird assumes the geometric design of the acrylic. "My production deals constantly with sculptural issues. They

mix diverse subjects, which don't seem to go together at first, but do, even if forced, thanks to my action as an artist, thus creating a relationship of instability and ephemerality”, says Oliveira.



Ana Paula Oliveira - “Vonindo”, 2016, acrylic, leather and lead, 22x28x3cm. Photo by Edu Barcellos

PIPA PRIZE

In 2017, a storm over artistic freedom and censorship has erupted in Brazil. But the Brazilian art world is not easily intimidated. Artists, curators and other players of the art scene joined their forces to fight against censorship.

PIPA Prize has been supporting artistic freedom of expression since its first edition in 2010. Most of its exhibitions have prompted, through artworks, discussions about politics, economic inequality, racism and other social themes.

Its eighth edition was one more step towards fulfilling its mission: to stimulate and promote the production of Brazilian contemporary art, giving visibility to artists and helping them establish their careers. We're glad to see PIPA Prize consolidating itself, year by year, as an important research platform on the present art scene in Brazil, currently featuring 367 artists with profile pages on PIPA's websites, receiving about 20,000 visitors per month. The artists' pages, which we try to keep constantly updated (always inviting artists and their galleries to send us recent material), including biographies, critical texts, images of works and exclusive video interviews, where the artists discuss their creative processes, trajectories, desires and paths. PIPA's website also features a daily agenda of cultural events related to artists who have participated in the award and other collaborators, and a monthly critical text by Luiz Camillo Osorio (one of them – "Where does art belong?" – reproduced later in this report).

Throughout the years, we have been noticing that most of the participating artists are men, on the 31-40 age range, based in the Brazilian Southeast, represented by galleries, and that the majority of the galleries are located in São Paulo. This year, amongst the 56 participating artists, 48 of them were nominated for the first time.

Always seeking improvement, some changes were made. For the first time, PIPA catalogue was not released during the opening of the exhibition. Instead, it was launched one week before the end of the show, along with the winner's announcement.

The change was implemented in order to reunite, in one publication, the information (such as the names of the three categories winners) and images (photographs of the exhibition, for instance) pertaining to the current edition. Until last year, this information would only be published in the catalogue of the upcoming edition. The 2017 catalogue¹³ includes images of works and biographical information on all 56 participating artists. The publication also presents a series of new additions, the most important of them being the inclusion of four critical texts about the 2017 finalists, **Antonio Obá**, **Carla Guagliardi** and **Éder Oliveira**, and the 2017 PIPA Prize winner **Bárbara Wagner**.

Another change introduced in 2017 was to have each finalist invite a critic/curator of their own choice to write about their work/trajectory. This change represents the consolidation of the catalogue as an important research tool when it comes to Brazilian contemporary art, the recognition of the relevance of critic's review for the artists' works, and also an incentive for new critics.

Bárbara invited the curator, researcher and art critic Julia Rebouças, co-curator of the 32nd São Paulo Biennial (2016) and former curator at Inhotim, to write about her work.

“Photography was widespread in Brazil for many decades; in the first half of the 19th century, it was used to record landscapes, urban views and particularly characters from an ethnographic and documentary perspective. Portraits of the imperial court in Brazil come from the same period; Dom Pedro II was a pioneering enthusiast of photography in the country. Bárbara Wagner’s A Corte (The Cortege) suggests a return to the memory of such images by accessing an iconography that

¹³ PIPA Prize catalogues can be downloaded for free in PDF (approx. 8.5Mb) directly at <http://www.pipaprizo.com/> or <http://www.premiopia.com/>.

refers to the construction of the country's imagery. Here, the queen and the king, vassals, princesses and ambassadors have dark skin and wear costumes that do not match their existence, blending wigs, brocades, stones and cetin to objects of consumption which characterized the social mobility experienced in the first decade of the 2000s in Brazil.” - excerpt from the text written by Julia Rebouças for PIPA Prize 2017 catalogue.



Bárbara Wagner- “The Cortege”, 2013, mineral pigment on cotton paper, 75 x 50 cm

This was a year of many highlights for Bárbara Wagner. She was chosen by the Award Jury, composed by Consuelo Bassanesi, Fernando Cocchiarale, Leda Catunda, Luiz Camillo Osorio and Marcelo Campos, as the winner of PIPA Prize 2017. The Award Jury selects the winner based on the works showcased in the exhibition at MAM-Rio and on the examination of the artist's trajectory and portfolio.

She was also awarded at the 20th Contemporary Art Festival Sesc_Videobrasil. Her works, developed with Benjamin de Burca, were praised at Munster, Germany, and at the opening exhibition of Instituto Moreira Salles in São Paulo.

As part of winning PIPA Prize 2017, Bárbara will participate in a three-month residency programme at Residency Unlimited in New York in 2018.

Éder Oliveira won the PIPA Popular Vote award, having received a total of 643 votes out of 1,807, from the audience during the exhibition at MAM-Rio.

A huge face in red of a young man painted on the museum's wall caught the attention of the audience. In 2014, his mural painting was also an icon at the São Paulo Biennial.

“The invitation that Éder Oliveira makes us is very strong and serious. A continuous process of otherness and critical reflection about our place. These are images, image-words that shake us, as if saying: See! Wake up! Take a stand.” - Orlando Maneschy, curator of Amazoniana Collection of Art in UFPA.



Éder Oliveira, site-specific at MAM-Rio for the “Arquivamento” [Filing] series, 2017. Photo by Jaime Acioli.

The winner of the third category of the Prize, PIPA Online, chosen by the public through an online voting at the PIPA Prize website, was Jorge Fonseca, who received 4,101 votes.

In a time in which everything becomes merchandise and the artistic practice is more and more institutionalized – take, for example, the proliferation of art fairs across the world –, where does art belong? The question guides the PIPA Institute curator Luiz Camillo Osorio in yet one more exclusive text for PIPA Prize.

Where does art belong?

Luiz Camillo Osorio

This article's title refers to the name of a book by writer and theorist Chris Kraus – *Where art belongs*. Posed as a question, it matches the spirit of the book and compels us to pay attention to the risk of conceptual determination. The goal is definitely not to establish art's place, namely to define what is art and then exclude everything else that does not fit the concept. Formulating the question and looking for an answer is to try to find a kind of relationship, always contingent, between creation processes, forms of sentiment, and institutional territories. The channels through which art circulates are often unexpected, moving around institutional boundaries and putting in motion thought and imagination. The connection between surprise and intensity makes the place of art, where it bursts and presents itself, a place where we want to be, even though we know that it is ephemeral.

Life's growing commercialization tends to reduce the expectations of poetic events, levelling everything by their monetary value and restricting the circulation of what does not fit in it. Art fairs are the perfect space for such levelling. Everything is excessive and predictable – which minimizes the surprise and intensity mentioned above. Well, I have nothing against art fairs, they have a role to play. The problem is when they start to become a paradigm, that is, when they want to go beyond commerce and become an art space. Excess and predictability end up spreading institutionally. The problem is not new. "Instituting" has always been synonymous with being predictable; excess, on the other hand, is typical of the neurotic spirit of

our times. Therefore, we are forced to look outside artistic institutions when we wish to seek poetry (surprise) and the aesthetic strength (intensity) that tend to settle in. Of course, looking out and looking inside are not mutually exclusive; after all, we are all in, looking for a breathing space.

I received Chris Kraus's book by mail and I met photographer and DJ Maurício Valladares on the same day. The coincidence is relevant to this article only. We sat down, had a beer, and he said: "Don't miss my show on Rádio Globo tonight. I interviewed Adelzon Alves!" I must confess I didn't know who Adelzon was. However, if Maurício interviewed him and was so enthusiastic about it, it should be good. For nearly 35 years now, since the Smiths, in 1982, in the memorable Rádio Fluminense, Maurício has only introduced me to what matters. Since the 1960s, this guy, Adelzon – so Maurício tells me – spends his nights playing music and presenting on the radio what's new in samba and entertaining people who live in the outskirts of the city. Stories over stories were wittily told.

The guy who introduced Paulinho da Viola, Martinho da Vila, Clara Nunes, among many others, keeps on mining music, acting as a "late-night musical curator", taking the bus to go to work at Rádio Nacional, and living peacefully in the outskirts of the city. His show, previously on Rádio Globo, was open to anyone; the musicians left the studio on Lapa and ended up playing somewhere at Rua do Russell. Each one of them had their 15 minutes of fame, but fame was not what they were interested in. Making music and performing it was, and still is, the reason for Adelzon's show. Its existence is decisive for developing an audience, a space of exchange, of conversation, i.e., a home, among others, for popular music. Adelzon's show and

ear have a generosity that does not belong in the current world. He wants to get musicians together and turn the radio show into a place to be, in his time and in other times simultaneously, to hear what you don't normally hear and to get us out of the logic of musical consumption.

Despite all the differences, something similar appears in the first chapter of *Where art belongs*. It is a presentation of an alternative art space called Tiny Creatures, in Los Angeles, which operated from 2006 to 2009. Conceived by the artist and musician Janet Kim, the idea was to have a place where people could hang out and show their work. After moving to a warehouse in the Echo Park area, in Los Angeles, she settled in the back of the place and left the rest of the space open for the events. At first, only friends from the local underground scene would attend. Mostly musicians and artists, all just coming out of the university, jumping from one job to another, trying to keep going.

What caught my eye in the description provided by Chris Kraus was attention to detail, to the spirit that mobilized the creation of Tiny Creatures and how (not) to deal with the eventual success. In the first presentations, just friends, lots of improvisation and passion – all of which showed in the desire to make something happen. “Tiny Creatures is a desire to find a way to live our own way, to have a sense of community, to see each other while on earth, to share our lives, our pains, our talents, our thoughts, to capture a moment in time that will be lost or forgotten, and to package it with beauty, love, pain, and all that we can feel as humans”, wrote Janet Kim in her 2007 *Manifesto*.

Disagreements and unprofessionalism characterized the place in those brief three years. So did success. Already at the end of the first year, there was a sort of frenzy, much like at Warhol's Factory parties in the 60s. Junkies, the jet set, curators and idlers crowded the place. Tiny got big. I mean, it was time to stop. In 2009, at the peak of success, a manifest for closure and a *finissage* were launched. The original idea was no longer there – the friends no longer met, music and exhibition became an obligation, and art, as an event that opens up a space for surprise and intensity, settled and became a marketable object.

Asked in an interview what would become of Tiny Creatures after the closure, Janet Kim was sharp: “Being a Tiny Creature as a tiny creature is. Ears and eyes. Surfing. Getting back into John Cage, Xenakis. Details. Concocting some sort of new drug. Embracing”. Embracing open forms of poetic production is increasingly necessary in a world where everything is pre-established and needs to follow rules. Such openness is uninterested in the genuine sense of a search for something we do not know and cannot determine beforehand, but that comes unexpectedly whenever there are attention and availability. Without it, there is a desire for art, but no art. Bottom line is: We don't know exactly where art lives, but we do understand when it is no longer present. Let's hope individuals like Adelzon Alves and Janet Kim, as diverse as they may be, keep on trying to shelter it: in the middle of the night, or in the details.

PIPA PRIZE MISCELLANEOUS

Now in our 9th edition, we can see that the prize is getting recognition and building

a reputation in the Brazilian art industry. Here, we select a few quotes from artists and members of this community that have spoken about our work:

“PIPA art prize is Brazil’s equivalent to the Turner Prize.”

- *Henri Neuendorf, November 30, 2017, Artnet News*

“It has been a fantastic experience to participate in PIPA Prize. It has been really great to see all the repercussion the Prize has, to see people talking about my work and cheering for it. I believe PIPA Prize is maybe the most important platform nowadays. If you get to know artists and Brazilian contemporary art, I believe the best place for research is PIPA Prize. And the award and everything that surrounds it, helps to reinforce it, and to motivate artists to produce art.”

- *Éder Oliveira, PIPA Prize 2017 finalist and winner of PIPA Popular Vote Exhibition 2017 award*

“I have observed a growing scenario of huge impact, which is indeed fascinating. I must confess it is even hard for me, to know in depth what is going on in Brazil today. And PIPA Prize has the merit of showing us the panorama of Brazilian contemporary art today.”

- *Carla Guagliardi, PIPA Prize 2017 finalist, based in Germany for more than 20 years*

“It’s really amazing to see your work being acknowledged. Artists work for a long time, mostly just chasing a theme or developing a language. For me, participating in this exhibition alongside with the other selected artists, gives me great satisfaction, because it’s not only a recognition of my work, my particular practice, but also a

whole way to think about art, connected to thinking and reflecting about reality. I think that is the way I connect with the other artists who participate in this edition, and it brings me great joy, because that is how I see my own artistic practice: a way to contribute with a reflection about the world around us.”

- *Bárbara Wagner, PIPA Prize 2017 winner*

“The importance I see in PIPA Prize is the fact that it promotes artistic production and the artists themselves, once the Prize has a lot exposure in the media and mobilizes so many people, not only in the artistic community, but also the public in general, so it has this reinvigorating character. I think this matter is really important, and has become even more vital nowadays, especially in the sense of everyone joining forces to stimulate Brazilian artistic production.”

- *Antonio Obá, PIPA 2017 finalist*

“Congratulations on the excellent work in widely promoting both the artists and the arts in Brazil.”

- *Ivani Pedrosa, Dec. 2017, PIPA 2010 nominated artist*

“I am very happy to be able to be part of your constellation of ways and gestures for the PIPA 2017.”

- *Ana Vaz, PIPA 2017 nominated artist*

“I am happy to be nominated, as I know how important PIPA is to artists, primarily as a research platform on Brazilian Contemporary Art.”

- *Alexandre Moreira, PIPA 2016 nominated artist*

“This nomination for PIPA will certainly bring me new opportunities, which makes me very happy!”

- *Dalton Paula, PIPA 2017 nominated artist*

“Congratulations on the excellent platform for the dissemination of contemporary Brazilian art.”

- *Christus Nóbrega, PIPA 2017 nominated artist*

“I’m always researching on PIPA catalogues. They are a good source for finding Brazilian artists.”

- *Marc Pottier, French curator and art advisor based in Brazil*

The following quotes come from the book Josef Albers: To open eyes. Albers has been one of, if not THE most influential art teacher of the XX century. Many of his alumni went on to have brilliant careers. Much of what underlies his teachings seem to us very similar to how we see critical for the development of an investment professional.

- “We’re learning how to play the notes, like music students’, he cautioned his students. “The music will come later. Even the great masters, before they went on stage, practised the scales. We’re learning to play the scales”.
- “Clear thinking and seeing won’t spoil emotions, just gets them in the right place.”

- “Developing art depends upon developing one-self... This means a most intensive work based on self-criticism, for years, for many more years, for a lifetime...”
- “You can’t be an artist,... unless and until you’ve devoted considerable time to mindfully exploring the visual field through its elements - line, shape, colour, texture, the components that make up what is generally termed form... For Albers, the fundamental building block of an art education was simplicity (and complexity) learning to see more acutely”.

“If Duchamp missed attending the Governors Ball or some such other event he would make up for it by creating something equally or more elegant in his studio. This leads to the assumption of time well spent in his life. Some of his friends commented that he lived every second wisely. The simple act of smoking a cigar, his mind racing faster than the clock ticks, shows us a smile on his face as he exhales, a job well done.”

- *Ed Ruscha*

The following is a debate by Marcel Duchamp and the famous architect Frank Lloyd Wright at the The San Francisco Museum of Art back in 1949:

FLW: I regard Marcel Duchamp as an honest man; and I am glad that he still swears by his original mistakes.

MD: On the other hand, forty years have gone by, and **time, after all, is an**

important factor in the decision whether a thing is good or bad. (the highlight is ours)

FLW: That's what I imagined you felt when you did the so-called 'Nude Descending the Staircase' [sic - he was referring to the famous Nude Descending the Staircase', No 2].

MD: Now, when you made your first architecture, did you know whether it was going to be a good thing?

FLW: No, my first was "kindergartenish", and I was learning to walk.

MD: So was I.

FLW: That's what I assume... now that you walk, do you still regard it as a great picture?

MD: More so.

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